Milliman 2008 Survey

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Managing the needs of retirees

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THE BIG PICTURE

It is a pleasure to introduce the Milliman superannuation survey. Since we established our Australian practice, the landscape has changed immeasurably. The first new federal government in more than 11 years has seen the creation of a dedicated superannuation portfolio and reignited the debate on fees and advice. One of the final acts of the Howard government saw the largest series of one-off contributions into superannuation—which has been quickly eroded, along with other retirement savings and investments, by what is being called the biggest financial crisis since the depression of the 1930s.

What began overseas as a significant downturn in the US housing market has permeated global markets through the collapse of sophisticated and opaquely structured financial instruments. The effect has been widespread, triggering high-profile corporate failures, government bailouts and stimulus packages, and talk of a worldwide economic slowdown.

Australia's recent history of strong local investment returns, assisted by the strong demand for Australian resources, has insulated investors and superannuation funds from other recent market corrections, such as the deflation of the "tech bubble." Many individuals are experiencing negative returns for the first time; funds, the industry, and government have responded with a calm and coordinated message, focusing on educating the public and promoting the long-term nature of superannuation.

The impact and scale of the market downturn has been a surprise to many. Australia's recent history of strong local investment returns, assisted by the strong demand for Australian resources, has insulated investors and superannuation funds from other recent market corrections, such as the deflation of the "tech bubble." Many individuals are experiencing negative returns for the first time; funds, the industry, and government have responded with a calm and coordinated message, focusing on educating the public and promoting the long-term nature of superannuation.

The reassuring response on the part of leading institutions appears to have been successful, as large numbers of survey respondents have indicated that they are satisfied with their chosen fund despite worse-than-expected investment performance. This contradictory attitude serves to highlight an awareness among the public that the effects of the financial crisis have not discriminated—the crisis has left its mark on many. Nevertheless, there is evidence that events have resulted in investment decisions contrary to the long-term message. The group represented is currently small, but it will be interesting to see how this develops in light of continued market volatility.

As expected, the ramifications of risk have risen to the surface, and many of the survey respondents are concerned. Thus, market risk understandably dominates investors' current concerns; however, other major risks, including inflation, security, and longevity, are also high on the list of investor worries. Existing products tend to place the risk burden with the individual investor—a flaw that the current market climate has highlighted—and the growing awareness of this by investors will create sizeable opportunities for product providers who can successfully step in with attractive solutions that lessen or eliminate investor risk. The industry fund "compare the pair" ad campaign and the ongoing fee debate have clearly had significant success and found traction with fund members. With low fees the number one product feature in consumers' considerations, trade-offs between benefits and price will need to be carefully considered as the next generation of retirement savings products are developed.

Some of this work is already underway, with a new breed of risk-management products entering the market and the government's extension of the Henry Review to include retirement income reform. In the short term, multinational companies having expertise and experience with similar products overseas appear best placed to take advantage of the opportunities. Good examples are AXA Equitable, with its North product, released in November 2007, and ING, who announced the establishment of a dedicated "retirement and investment" business unit in 2008. Australian institutions, however, are among the most sophisticated in the world, and it is likely that a number of them will respond to the challenge and develop solutions, either independently or in conjunction with an experienced international partner.

As funds consider providing products to their members and potential outsourcing arrangements, they will need to pay close attention to market conditions, regulatory requirements, and the structures used to provide solutions. The complexity and long-term nature of many of these products create a need for transparency, along with a need to manage exposure to counterparty and reputational risk.

Needless to say, times such as these, although challenging, are exciting. Changes already in progress herald the next chapter of Australia's retirement savings system. We at Milliman look forward to continuing the journey with you.

Is retirement still valid?

With ever-increasing life expectancy and a flexible workforce, debate on the traditional notion of retirement is increasing. Calls for raising the pension age and other concepts, such as a disability-based pension system, are beginning to gather momentum. Whether or not such political decisions are reached, we may very well see more and more people continue working beyond the usual retirement age simply because they are healthy and want to stay active.

Some of this may be implicit in survey respondents' attitudes to work during retirement, with many indicating their desire to continue–in stark contrast to those already retired (see Figure 1).[1] Only time will tell whether this indicates changes in fundamental behaviour, a side effect of recent conditions in financial markets, or self-delusion on behalf of those yet to retire (i.e., they may not realize that as they get older they might not be able to continue working, or might no longer want to).

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FIGURE 1A: DO YOU PLAN ON WORKING IN RETIREMENT?

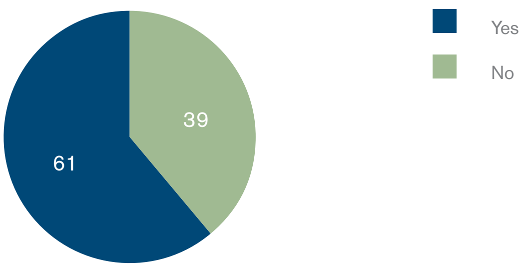
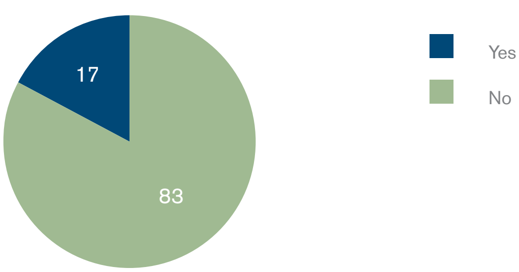


FIGURE 1B: HAVE YOU CONTINUED TO WORK DURING RETIREMENT?



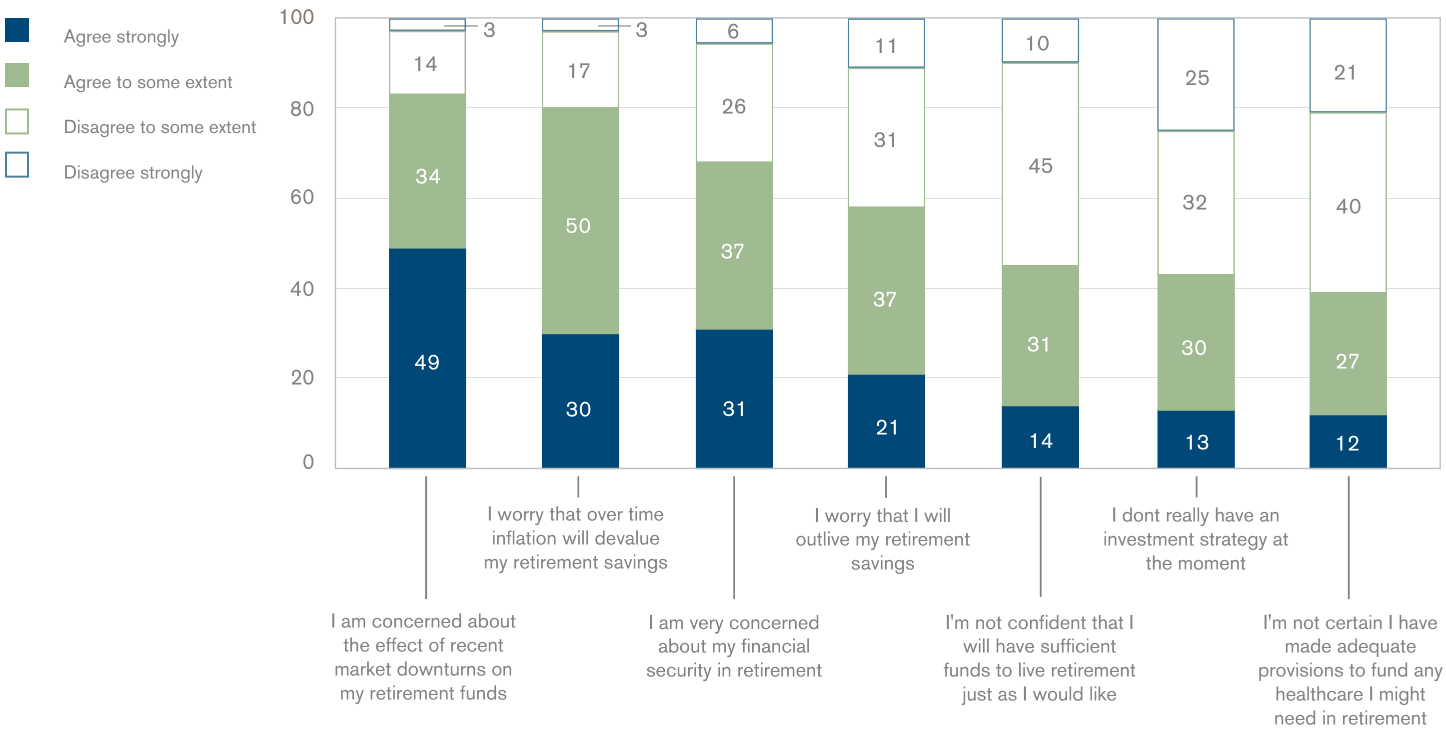
1 The exact question asked of those not yet retired was "Do you expect to work during your retirement in order to supplement your income?" The question asked of those already retired was "Have you continued to work during retirement in order to supplement your income?"

RISK CONCERNS

Much of the success and growth of superannuation funds has occurred during a relatively prosperous period, and current conditions clearly delineate some of the risks that exist within a DC system.

Since their inception in the late 1980s as defined contribution (DC) plans, superannuation funds (often referred to as "super") have become the dominant vehicle for the retirement savings of most Australians, currently totalling more than $1.1 trillion in assets.[2] Much of the success and growth of superannuation funds has occurred during a relatively prosperous period, and current conditions clearly delineate some of the risks that exist within a DC system. Although market risk has risen to the forefront in the minds of the public (Figure 2),[3] there is also a growing awareness of wider issues that can affect the sustainability of retirement savings.

FIGURE 2: RISK CONCERNS



2 Source: *ASFA Superannuation Statistics*, December 2008, available at http://www.superannuation.asn.au/Super-Statistics/default.aspx
3 The question posed to respondents was "Below is a set of statements focusing on retirement and retirement funds. Please indicate the extent to which you agree or disagree with each statement." Potential responses included agree strongly, agree to some extent, disagree to some extent, and disagree strongly. Two statements, together with the associated data, have been changed for comparison purposes in figure 3. They were:
"I am confident that I will have sufficient funds to live retirement just as I would like."
"I have made adequate provisions to fund any healthcare I might need in retirement."

The transfer of risk onto individuals, inherent in a DC system, represents a challenge for government and an opportunity for product providers to design innovative solutions that help investors manage the risks and obtain outcomes more aligned with individual preferences.

As industry focus shifts to the Baby Boomers' impending march to retirement, many providers are asking how to address longevity issues. It is clear that members are concerned about outlasting their savings, but they are also acutely aware of the risks that they are exposed to, namely:

- poor investment returns (market risk)
- increases in the cost of living (inflation risk)
- living longer than expected (longevity risk)
- inappropriate spending patterns or asset allocation (behavioural risk)
- inadequate provision for healthcare expenses (insurance risk)

The effect of recent market events on retirement savings dominates investors' concerns

Events over the last 12–18 months have clearly served to increase awareness of the inherent volatility of investment markets and the implications for Australia's superannuation funds. With global markets approximately 50% below their peaks at the time of the survey, many individuals have felt the impact, experiencing negative returns for the first time since the inception of superannuation.

Among those surveyed, concerns about the impact of the market downturn dominate. This is particularly true among those in the retirement "hot zone"–the years immediately before retirement. As retirement looms for these investors, time in the market is no longer a comforting message. Retirement plans already formulated have required modification or abandonment in the face of sizeable reductions in retirement savings assets.

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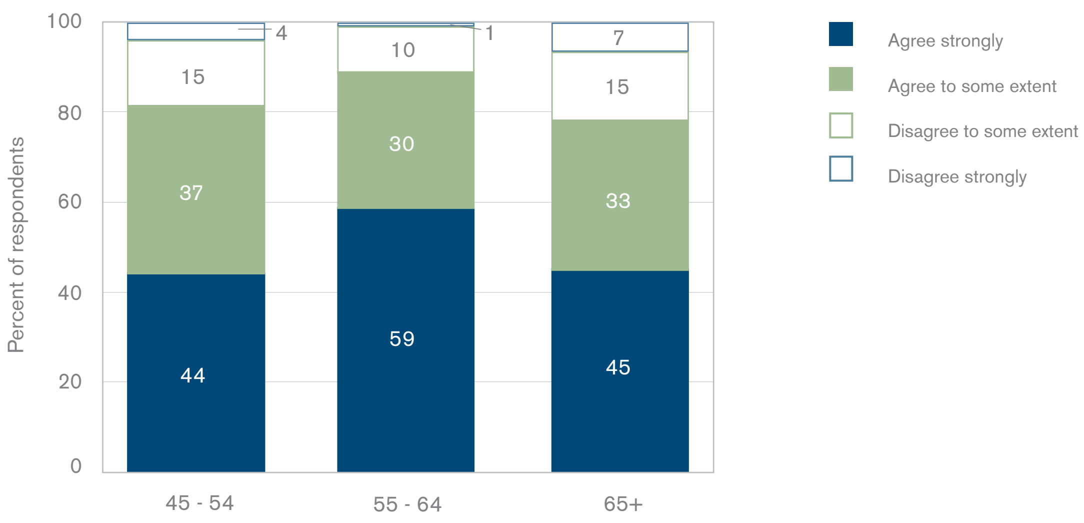
FIGURE 3: I AM CONCERNED ABOUT THE EFFECT OF RECENT MARKET DOWNTURNS ON MY RETIREMENT FUNDS[4]



4 Question: Please indicate the extent to which you agree or disagree with the following statement: I am concerned about the effect of recent market downturns on my retirement funds.

Inflation follows closely behind

The long-term devaluing effect of inflation ranked as the second most important concern behind recent market movements, according to those surveyed.

The public appears to have felt the recent increase in day-to-day expenses, as indicated by the fact that 80% of survey respondents expressed concern about the effect inflation will have on their retirement savings. The lack of inflation-linked investment products has caused many investors to opt instead for increased exposure to equity markets, which entail greater risk. This strategy was successful throughout the recent period of low inflation and strong investment returns, but the current compression in risk premiums resulting from lower market returns, higher inflation, or both may restore investors' interest in products that protect their retirement savings from inflation or negative market returns. The fact that average lifespans are increasing, which means that the length of retirement is increasing, only serves to heighten retirees' sensitivity to everyday prices.

Longevity and adequacy concerns trail, but are still significant

Of those surveyed, 58% agreed that they were concerned about outliving their retirement savings. This concern is a natural consequence of the two outlined above (market downturn and inflation); negative market returns, combined with anticipated inflation, make the prospects of a long retirement based on relatively meagre income-producing assets look dim. Indeed, one may be tempted to wonder if retirement as we have known it is even a realistic scenario. Will would-be retirees be forced to stay in the workforce longer–perhaps until the end of their life? (See "Is retirement still valid?" earlier in this report.)

As will be seen in the "Opportunity" section later in this report, there exists significant potential for product innovations that simultaneously provide protection to both market risk and longevity risk concerns.

The move to cash

The global financial crisis has prompted a significant shift from traditional growth asset classes into cash and other defensive options. This shift runs contrary to much of the well-established advice within industry and the financial planning community about staying with the long-term benefits of growth assets. However, the severity of the market correction has frightened investors, resulting in a degree of behavioural inefficiencies. We believe that there are opportunities to develop products that will encourage a return to equities and more stable investor behaviour through market volatility, as seen in other markets.

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Healthcare costs: Little concern or underestimated?

Interestingly, approximately 49% of the 45–54 age group indicated that they were confident that they have made "adequate provisions to fund any healthcare I might need in retirement." This percentage increases significantly among older age groups, with 69% of 55- to 64-year-olds and 70% of the 65+ age group indicating they were also confident in their provisions for healthcare through retirement. These results appear to diverge from other, more detailed surveys on healthcare issues, potentially highlighting respondents' inability to accurately judge the degree of future healthcare requirements and their costs. One might infer that most people probably have no clear concept of cost trends or the potential deterioration in health over time, and thus they have difficulty thinking beyond the here and now.

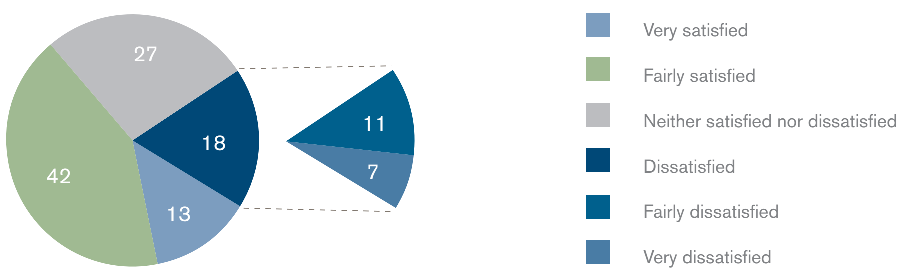
ARE WE SATISFIED?

The scale of Australia's superannuation industry and the introduction of fund choices have resulted in increasing competition for the retirement savings dollar. Much of the data to date suggests that investors have exercised their right to choose funds only sparingly, reflecting investor apathy and disengagement from their superannuation. It will be interesting to see whether a significant or continued deterioration in returns may create a level of dissatisfaction that prompts consumers to reassess their position.

Despite recent returns, we're largely satisfied

Even in the face of the largest negative returns since the inception of superannuation, it appears that fund members are, for the large part, satisfied, as only about 18% of our respondents indicated that they were dissatisfied with their funds' recent performance. When probed further, more than one-half of the respondents said their fund performance had met or exceeded their expectations; around 40% of respondents said fund performance was "as expected," 10% "a little better than expected," and 3% "much better than expected." (See Figure 4.)[5]

FIGURE 4: SATISFACTION WITH FUND PERFORMANCE



We believe that this response is a sign of a number of factors, key among them being:

- the coordinated response of industry and government and promotion of a clear, considered, and calm message
- the success of many funds' communication programmes
- the sheer scale of market events and a view that "everyone I know has been affected"
- the success of funds in developing a customer relationship and providing value to members beyond just the return of the fund
- understanding and accepting the long-term nature of investing in superannuation funds, combined with fund communications focusing on returns over longer time periods

The correlation between fund returns against expectations and satisfaction levels suggests that ultimately it is returns that matter. This highlights the benefits of policyholder communication in times of market turmoil. The changing needs of fund members as increasing numbers of them move into retirement will create opportunity for nimble funds to develop innovative services, increase member retention, and attract other members.

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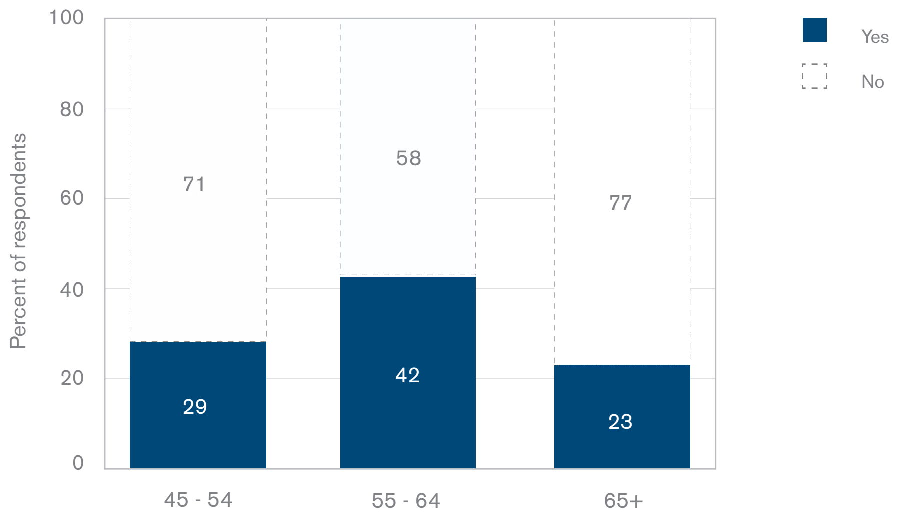
5 Question: "In general, how satisfied or dissatisfied are you with the performance of your superannuation fund?"

Changing plans?

Given the severity of the recent market downturn, it may come as no surprise that changes to some retirement plans are necessary.

Of those who stated that their fund performance was worse than they had expected (40%), a significant portion indicated further that they have changed their retirement plans as a result of this poor superannuation performance.

FIGURE 5: HAS POOR SUPERANNUATION PERFORMANCE CHANGED YOUR RETIREMENT PLANS?

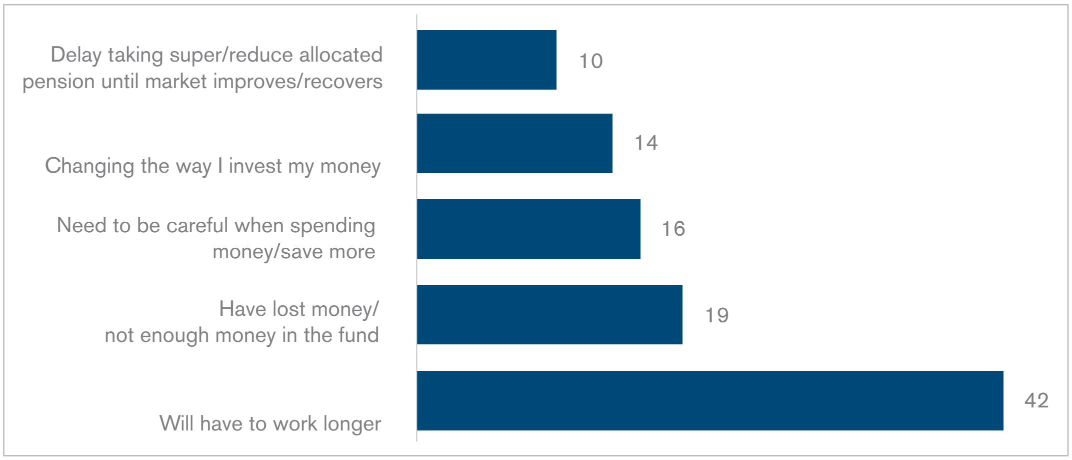


As might be expected, the response is strongest for those who are closest to retirement (ages 55–64), with 42% of those whose returns were worse than expected indicating that they have changed their retirement plans because of the poor performance. The responses of investors in this predicament varied, and some of the more common actions are outlined in the next section. Interestingly, those who were least likely to change their plans as a result of the recent market downturn were those that were already retired (Figure 5).[6]

6 Question: "You stated that your superannuation fund has performed worse than expected. Has this changed your retirement plans in any way?"

Of those who have altered their plans, the most common option applied to restore their savings appears to be returning to work rather than accepting a lower standard of living in retirement (Figure 6).[7] This begs the question of how many may cope in the face of a possible recession when work opportunities, particularly for those in or close to retirement, are limited.

FIGURE 6: MOST OF THOSE AFFECTED ARE RETURNING TO WORK



7 Question: "In what way has this changed your retirement plans?"

INVESTMENT CHOICES

Over the past 20 years, Australia's superannuation system has seen major reforms that have given investors more control and freedom over how their superannuation assets are invested.

The expansion of investment choices has created opportunities for professional advice and placed increased pressure on superannuation funds to differentiate themselves, among other ways, by providing innovative investment solutions. Until now, the numbers of members entering retirement have been relatively small, and therefore the current system has had an accumulation focus as the weight of funds have searched for a home. This is quickly beginning to change as the Baby Boomers move into their retirement years and begin to consume their retirement savings.

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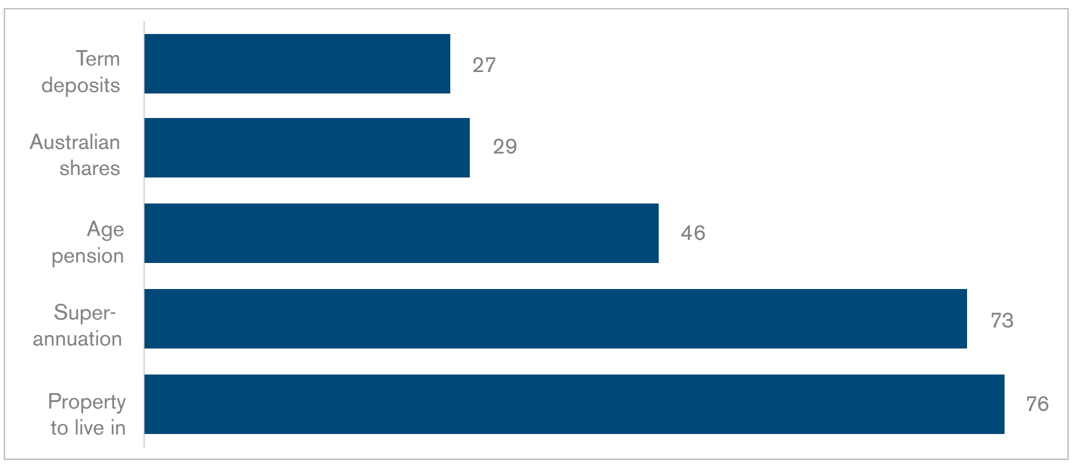
Bricks and mortar

When it comes to investments and their importance in retirement planning, again there are few surprises. With high levels of home ownership, particularly at the ages represented by this survey, the family home is viewed as the most important asset, followed closely by superannuation, with social security via the age pension coming in a distant third (Figure 7).[8]

FIGURE 7: TOP 5 INVESTMENTS BY PERCEIVED IMPORTANCE - RATED 8+



8 Question: "Using the following scale, where 1 is not at all important and 10 is very important, how important, if at all, [are/do you expect] each of the following investments to funding your retirement?"

Over time, this relationship will likely shift as a higher proportion of retirees' wealth is derived from the superannuation investments that they have accumulated throughout their working lives.

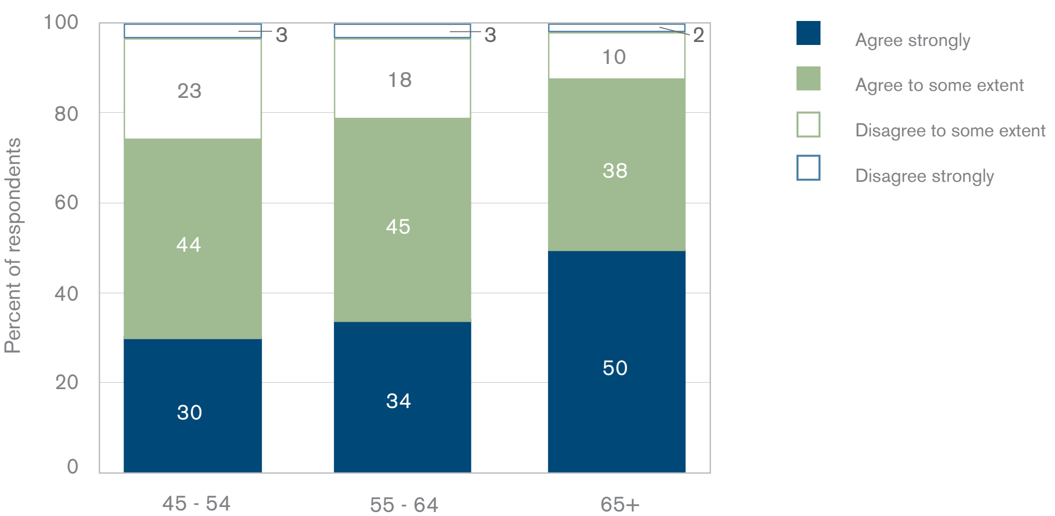
With significant value tied up in property through home ownership, we expect products that provide access to these assets, such as reverse mortgages, to play an increasing role in providing retirement income.

The older I get, the more cautious I become

Unsurprisingly, aversion to risk increases visibly with age as near-retirees and new retirees seek more certainty in the returns derived from their superannuation. When combined with increasing longevity, this trend presents a conundrum. As illustrated in Milliman's 2008 research report, *Risk in retirement*, higher allocations to conservative assets provide a more stable investment, but they also tend to lock in low rates of return.[9] When a person is facing a retirement of 20 years or more, this strategy guarantees that assets will not last longer than their owner's lifespan. On the other hand, a significant exposure to growth assets with sufficient risk management can ensure the sustainability of retirement funds. (See Figure 8.)[10]

As illustrated in Milliman's 2008 research report, *Risk in retirement*, higher allocations to conservative assets provide a more stable investment, but they also tend to lock in low rates of return.

FIGURE 8: I PREFER LOW-RISK OPTIONS THAT ARE STABLE



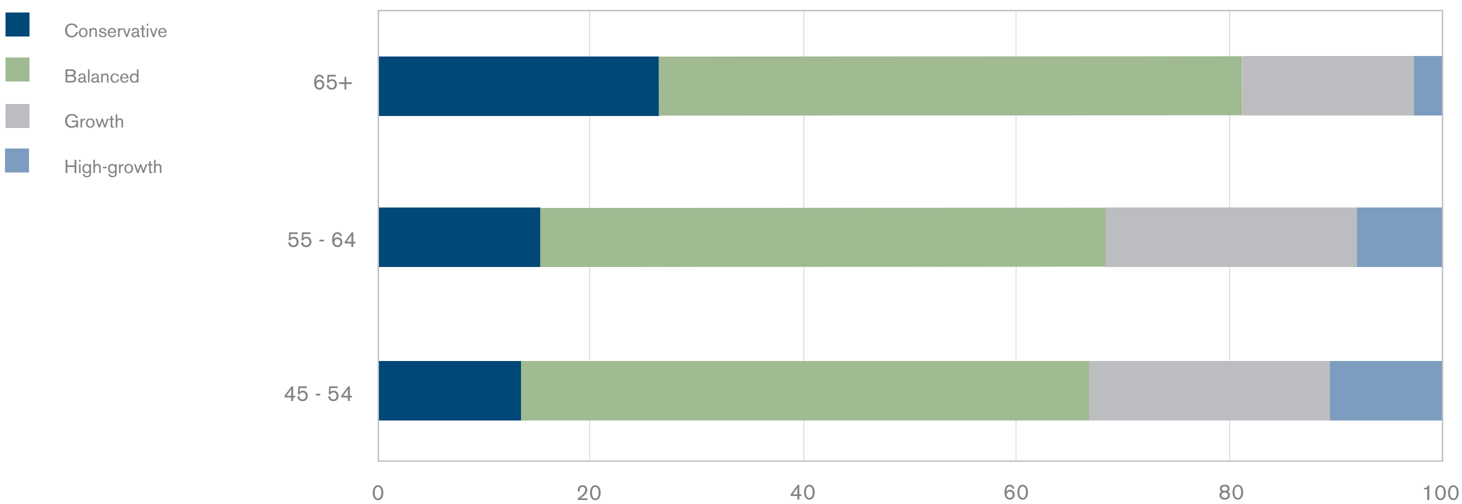
Move with the times

Different stages of a person's working life call for different approaches to managing the risks associated with these periods. In general, investors with a longer time horizon should allocate a higher proportion of their funds to riskier assets than they would as they approach and move into retirement.

9 Wade Matterson, *Risk in retirement*: *Impact of the market downturn and implications for retirees and product providers*, July 2008.
10 Question: "Below are some statements people have made about investments and financial management in general. Please indicate the extent to which you agree or disagree with each statement."

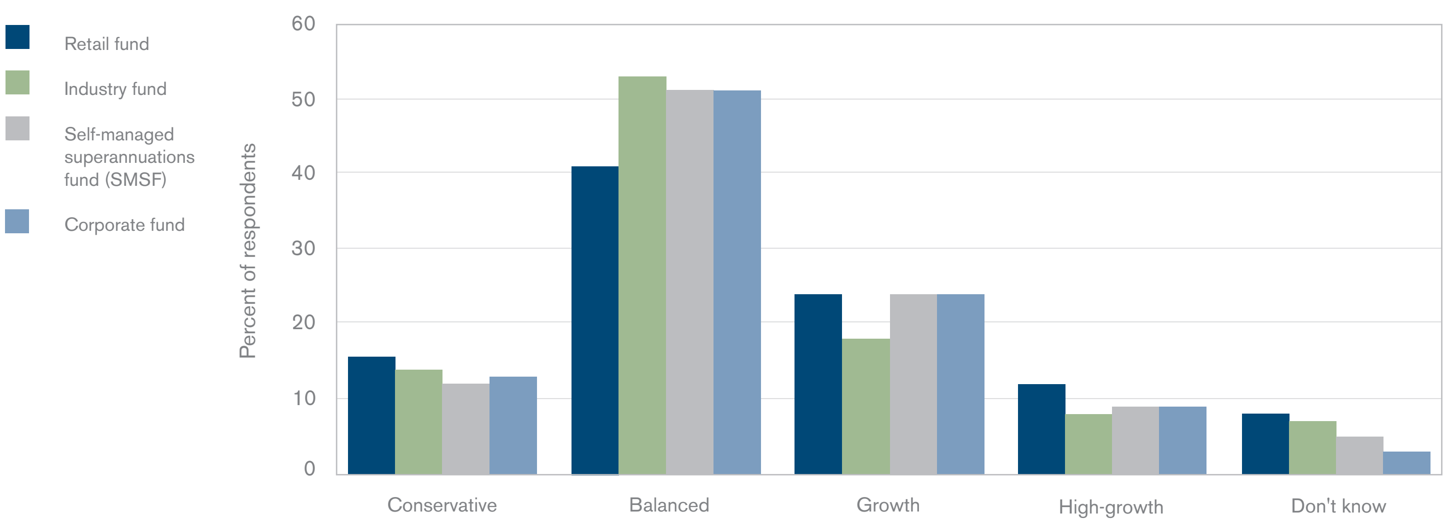
Through their behaviour, however, as represented by their selection of funds from the superannuation investment menu, investors show a difference in risk tolerances across age groups, consistent with the section above (Figure 9).[11]

FIGURE 9: ASSET ALLOCATIONS



Interestingly, retail fund investments appear to have different allocations compared with self-managed funds, industry funds, and corporate funds, possibly reflecting greater levels of advice (Figure 10).[12]

FIGURE 10: HOW IS YOUR SUPERANNUATION INVESTED?



Recent market events have shown how sensitive a worker's expected retirement income can be to market shocks that occur during this transition period. Younger members can take comfort in the long-term view with relation to their equity investments, but near-retirees do not have this luxury and may incur significant capital losses in order to access their funds before the equity markets have had an opportunity to recover.

11 Question: "Which of these best describes how your superannuation fund is invested?"
12 Question (to holders of retail fund investments): "Which of these best describes how your superannuation fund is invested?"

Fear and loathing in the US crisis

Because of recent market events, investors have naturally been switching to more conservative asset allocations at an increasing rate. Of those surveyed, 83% agreed that they were concerned about the impact of recent market downturns on their retirement funds.

Despite the fact that the vast majority of investors are relatively confident in their investment mix (85% are either very confident or fairly confident), nearly 40% have at one time or another changed their investment mix, and of this group, 35% have done so in the last six months to one year (Figure 11).[13] The widespread media coverage of the recent financial market turmoil may have influenced investors to make these changes in reaction to the endless predictions of doom and gloom on television and throughout the newspapers.

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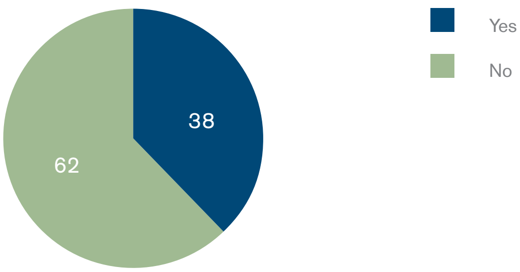
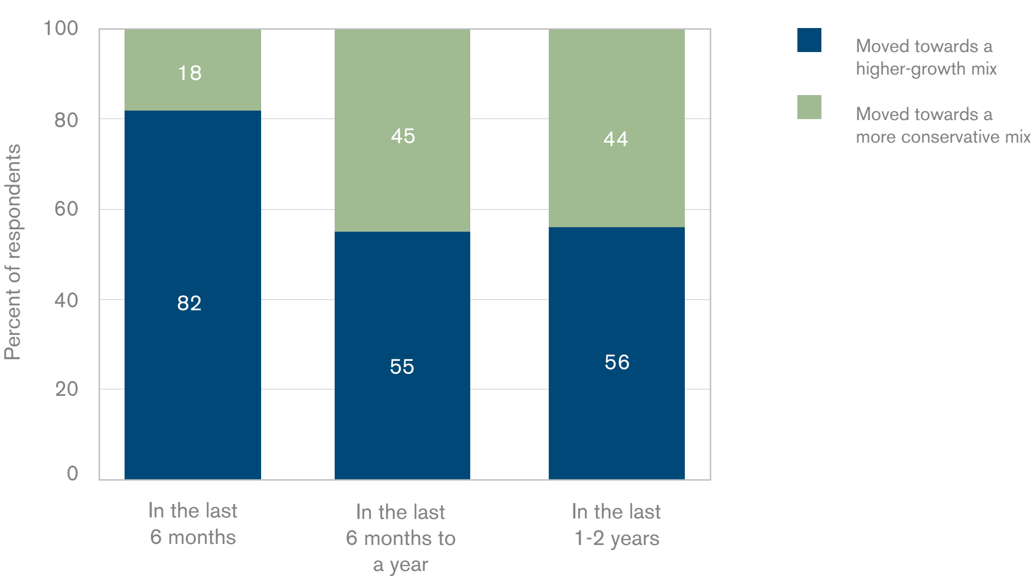
FIGURE 11: HAVE YOU EVER CHANGED HOW YOUR FUND IS INVESTED?



In particular, the six months just prior to the survey witnessed a flight to more conservative asset allocations, whereas during the preceding 18 months the movements towards more aggressive and more conservative asset allocations had been relatively similar (see Figure 12).[14] Arguably, this switching behaviour is reactionary and, because it lags behind the returns achieved from financial markets in more recent times, investors may have been moving to more conservative asset allocations at a time when equity markets had already suffered the worst of their fall, with the casualty being the loss of some potential future upside.

FIGURE 12: THE TREND HAS BEEN INCREASING AS MARKET CONDITIONS HAVE DETERIORATED

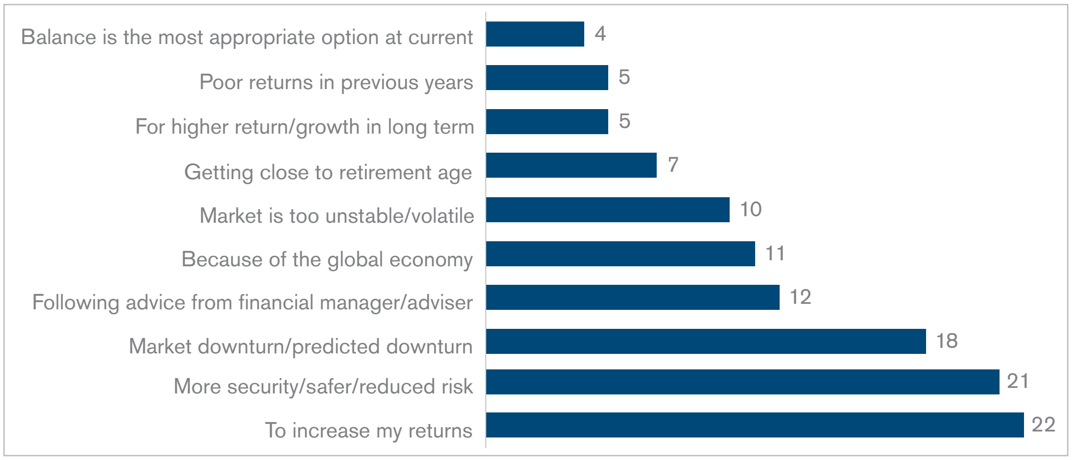


13 Question: "Have you ever changed the investment mix of your superannuation fund?"
14 Question: "How did you change the investment mix of your superannuation fund?"

Interestingly, the most prevalent reason individuals gave for changing their investment mix in the past two years was the desire to increase their expected returns–not explicitly as a response to the recent market turmoil and volatility, although hidden within that most prevalent reason may be some respondents' views that conservative assets offer greater returns given recent market conditions.

Importantly, switching because of recent market conditions, or in an attempt to manage risk, accounts for almost 65% of all respondents' reasons for switching (Figure 13).[15]

FIGURE 13: WHY ARE WE SWITCHING?



Confidence in asset allocation still positive

The largest number of survey respondents (46%) were invested in a balanced fund. Not surprisingly, the popularity of conservative funds increases with the age of respondents (11% for ages 45-54 compared with 21% for age 65+). The data, however, show a noticeable lack of confidence in the strategy investors have chosen. Also somewhat concerning is the finding that 15% do not know their investment allocation. Eighty-five percent of individuals are either very confident or fairly confident in their chosen investment mix.

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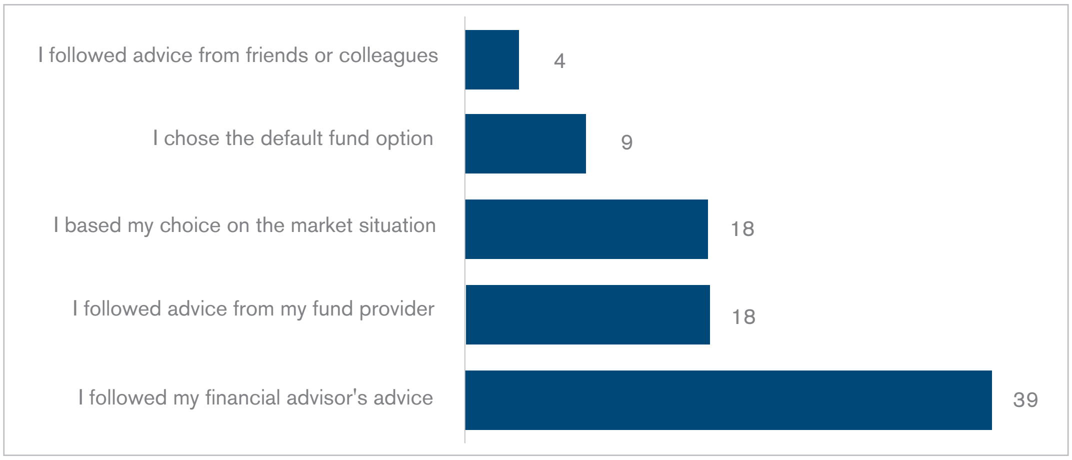
Confidence will naturally decrease in the event of a prolonged downturn, because there is a lag between the market events and the dissemination of investment-fund performance data for the corresponding period. If this lag is substantial, then investors could possibly be acting too late–and, in fact, acting in a way that will push them towards a more conservative asset allocation after the equity markets have already experienced the worst of their declines.

15 Question: "Why did you choose to change your mix of investments?" (open-ended response)

RETIREMENT PLANNING

Having a financial plan is not only the first, but also the most important, step in ensuring a comfortable standard of living during retirement. To get a picture of Australians' efforts at retirement planning, the survey asked respondents how they made their decisions about fund options (Figure 14a).[16]

FIGURE 14A: HOW DO WE DECIDE?



There is a notably weak response for the default fund option, with only 9% of respondents indicating that they invest their super as recommended by the default selection from their fund provider. One explanation may be that this response overlaps with others; some respondents may have confused "the default fund option" with "advice from my fund provider"—or perhaps the fund provider's advice was to choose the default. In any case, experience suggests that the actual proportion of investors who choose the default option is significantly higher than what these results indicate.

This may also be a reflection of the relative ages and superannuation balances represented by the survey, reflecting greater awareness and engagement among older respondents for whom superannuation becomes a significant asset in the face of a looming retirement.

One factor that the survey sought to determine was how many respondents had ever visited a financial planner for retirement planning. The results appear in the following table:

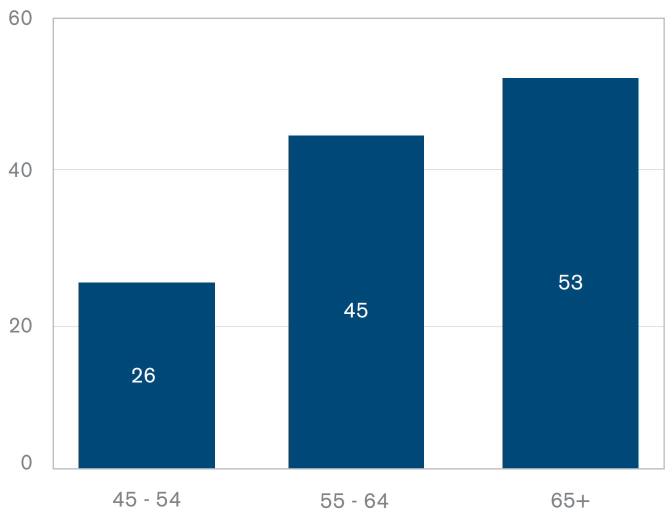
I VISITED A FINANCIAL PLANNER

AGE	45–54	55–64	65+
% WHO VISITED	46%	65%	68%

16 Question: "Which of the following best describes how you chose the investment mix of your superannuation fund?"

The trend is for investors to seek the counsel of a financial planner as they head into retirement age. As Figure 14b shows, however, visiting a financial counsellor is not the same as following his or her advice when selecting an investment strategy.[17]

FIGURE 14B: I FOLLOWED MY FINANCIAL ADVISOR'S ADVICE



So 46% of respondents in the 45–54 age group indicated that they had visited a financial planner as part of their retirement planning, but only 26% stated they had followed their financial advisor's advice when choosing their current investment mix. This is in contrast to the 65+ age group, of whom 68% of respondents said they had visited a financial planner and around 53% of all respondents indicated that they had followed their financial advisor's advice when selecting their investment strategy.

Not only are younger investors less likely to seek financial advice, but they are also less likely to follow such advice than those who are closer to, or already in, retirement.

This suggests that not only are younger investors less likely to seek financial advice, but they are also less likely to follow such advice than those who are closer to, or already in, retirement. Arguably, this indicates that younger investors place less value on the advice received or are overconfident in their own ability to understand financial concepts and develop a sound financial plan. This finding may also highlight opportunities for planners to restructure advice to more adequately meet the needs of this group.

We're leaving it until late

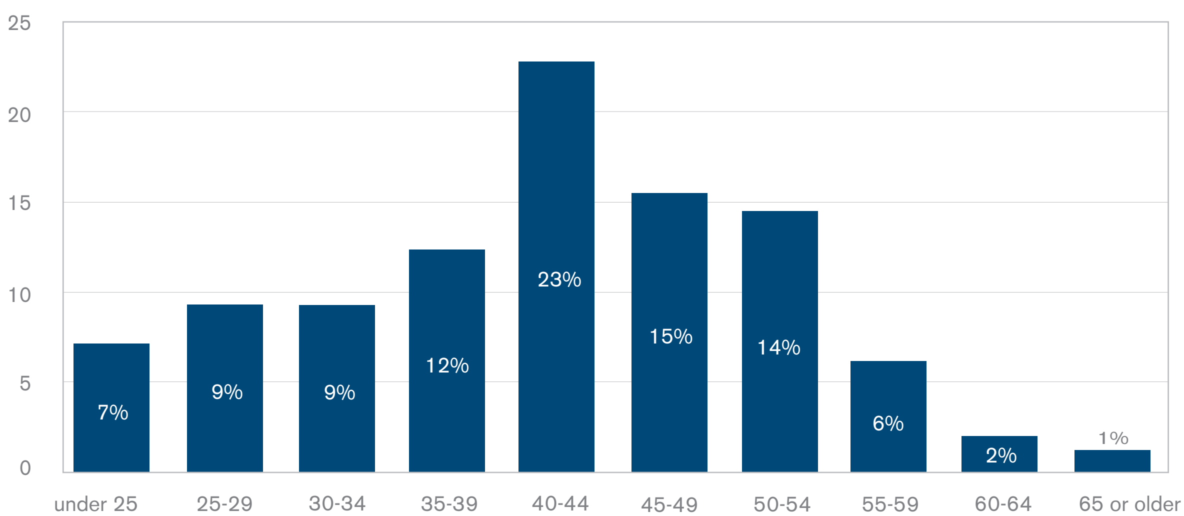
As the survey results suggest, many in the workforce seek financial advice for the first time as they prepare for retirement. Waiting until that moment often reduces the flexibility investors have in their asset allocations going forward. At this turning point, workers' greatest need is for advice about transitioning from an accumulation phase to what will predominantly become a drawdown phase into retirement.

17 Question: "Which of the following best describes how you chose the investment mix of your superannuation fund?" (By age)

The average age at which workers first begin planning for retirement shows that there is significant room for financial advisors to penetrate further into the under-40 age bracket, where almost 40% of respondents indicated that they have not begun planning for retirement.

Even among pre-retirees that have started planning for their retirement, 23% did not start the planning process until they were older than 50, a situation that leaves them with significantly less flexibility in how they implement their retirement plan and less time to meet their expectations of a particular standard of living in retirement (see Figure 15).[18]

FIGURE 15: AGE YOU STARTED PLANNING FOR RETIREMENT



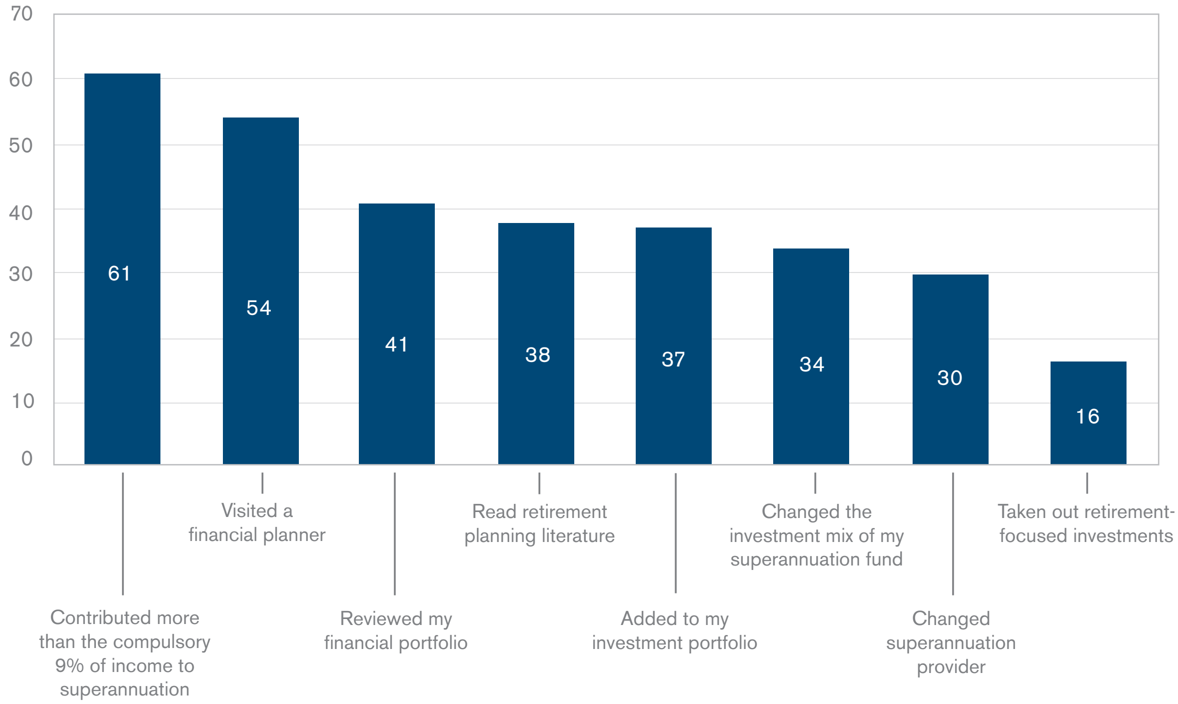
How we're planning

As workers begin actively planning for their retirement, many realize that they need to "beef up" the value of their retirement portfolios in order to reach their standard-of-living expectations in the future. The impending nature of retirement, combined with substantial tax incentives, creates a window of opportunity for those who can see an immediate financial windfall from increased contributions.

18 Question: "At what age did you start planning for your retirement?"

As Figure 16 shows, a majority of the pre-retirees said they have contributed more than the compulsory minimum (9% of their income) to their super.[19]

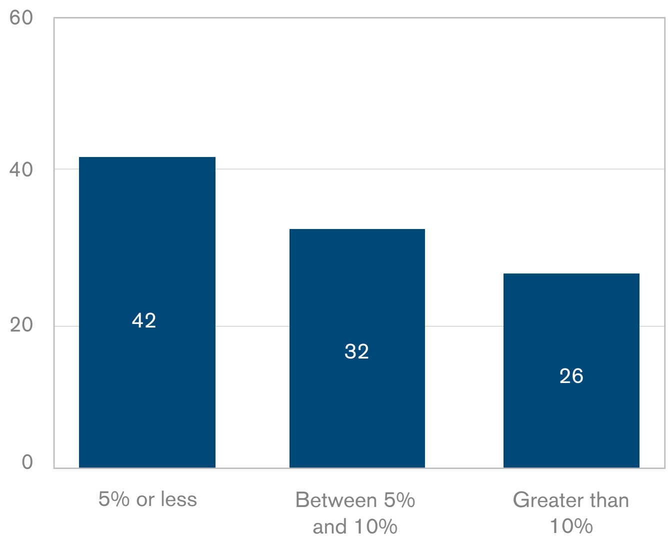
FIGURE 16: THINGS THAT HAVE BEEN DONE TO PLAN FOR RETIREMENT



19 Question: “What sort of things have you done to plan for your retirement funding?”

Twenty-six percent of the respondents who reacted by increasing their contributions did so by increasing them by more than 10% (Figure 17).[20] These results highlight the inadequacy of the current compulsory 9% employer contributions if Australians truly aim to achieve a generation of self-funded retirees.

FIGURE 17: ADDITIONAL CONTRIBUTIONS



There are notable differences between the ages at which individuals want to retire and the age that they actually expect to retire. To overcome this gap, changes in the way investors plan for their retirement will be necessary.

Retirement incomes need to get a move on

Australian workers have high expectations for the income they will derive during retirement. For pre-retirees to live in retirement as they would like to, they estimate they would need on average approximately $60,000 per annum[21] (in today's dollars), which is in stark contrast to the average retirement income of current retirees of around $37,000.[22]

Such expectations suggest that there will need to be significant increases in the average retirement income in the coming years if future retirees are to retire with their preferred lifestyle. If this is not achieved, then retirees will need to either alter their retirement plans (by perhaps working longer or contributing more than 9% of salary) or find other sources of funds to achieve their desired lifestyle during retirement.

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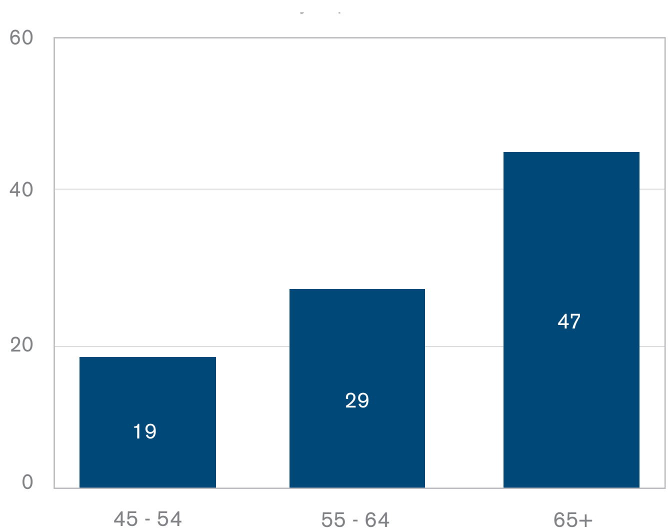
20 Question: "What proportion of your salary are you contributing over and above the contributions made by your employer?"
21 Question (to pre-retirees): "What would you realistically like your annual retirement income to be in order to live your retirement as you would like?"
22 Question (to retirees): "Which of the following best describes your personal income before tax?"

Retirees value the "safety net"

Australians place significant value on the age pension that forms the safety net in their country's retirement system. Around one-quarter of pre-retirees view the age pension as important in funding retirement, and the figure increases to more than one-half for those already in retirement (Figure 18).[23] This finding suggests that pre-retirees may tend to overestimate the adequacy of their funding in order to obtain their desired lifestyle in retirement.

Another factor contributing to this effect is the generational change that has occurred in recent years in attitudes towards the age pension. Younger workers now often see the age pension as a matter of last resort, whereas many older persons have a view that the pension is a natural right for those who have diligently paid their taxes throughout their working life.

FIGURE 18: IMPORTANCE OF THE AGE PENSION - PERCENTAGE RATING 10 (VERY IMPORTANT)



23 Question: "Using the following scale, where 1 is not at all important and 10 is very important, how important, if at all, [are/do you expect] each of the following investments to funding your retirement?" (By age)

OPPORTUNITY

The previous section of this report demonstrated that there is vast room for improvement in how the typical Australian worker plans for retirement. This fact creates a significant opportunity for advisors and product providers to add value by designing innovative solutions for new retirees and people facing retirement soon.

The silver lining

The opportunity is open for products that address both the market risks and the longevity risks that investors face as they move into, and through, the retirement phase—the most significant financial transition that they will likely experience in their lifetime. There is a noticeable lack of products in the Australian market for meeting the needs of these investors.

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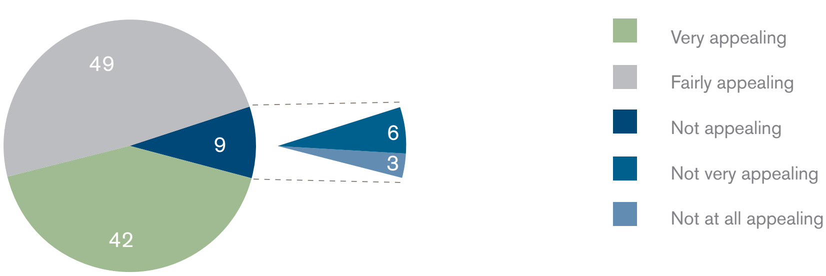
Overseas markets, such as the United States, Japan, and Europe, have embraced the introduction of products designed to help retirees manage risk, whether market risk, longevity, inflation, or a combination. The most popular product offered in these markets is an investment account that contains a guaranteed lifetime withdrawal benefit (GLWB).[24]

As part of the survey, respondents were presented with a simple description of a GLWB-style guarantee and asked a series of questions.

An attractive feature

The attractiveness of a GLWB-style feature is undeniable, as more than 90% of respondents indicated that they found the feature appealing (Figure 19).[25] This is not a surprising result given the current market conditions, in which the majority of investors place a premium on protection, particularly in relation to equity investments.

FIGURE 19: THE APPEAL OF GLWB OPTIONS GIVEN RECENT EVENTS IS SIGNIFICANT



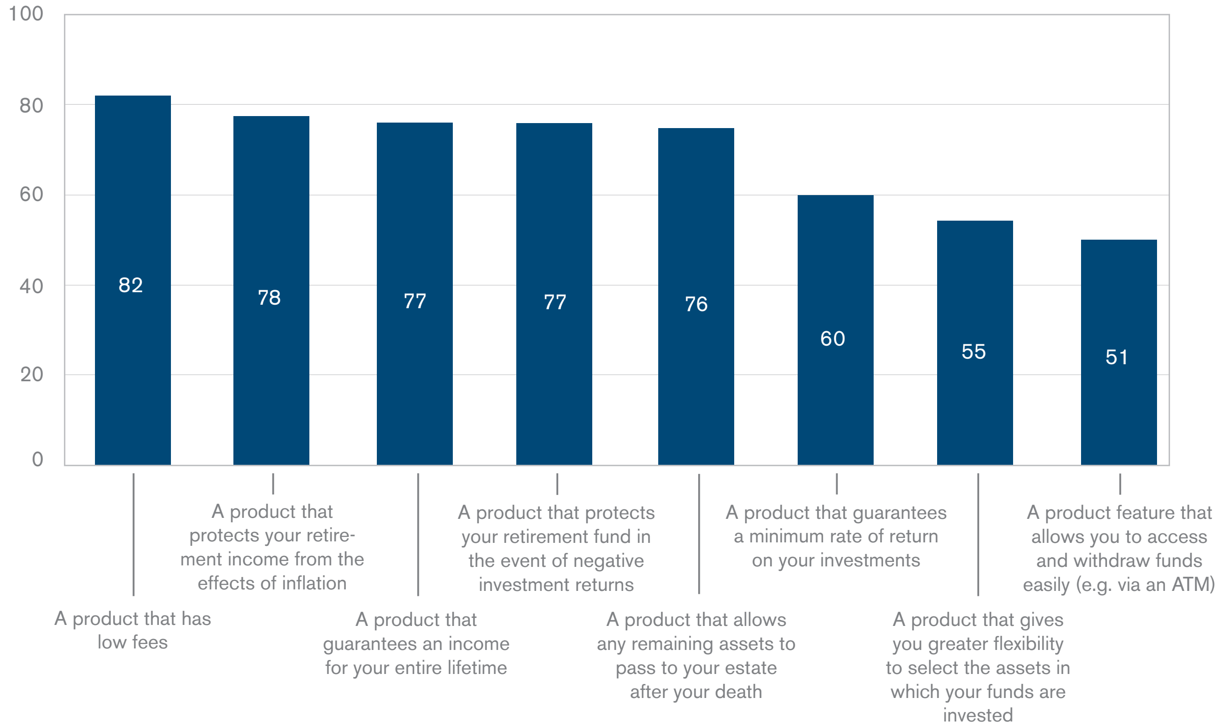
Thus, investors approaching retirement are searching for products that are capable of managing multiple risks. The GLWB's ability to manage market and longevity risk, while at the same time providing flexibility and control over the underlying assets, meets many of the key criteria.

Some want to have their cake and eat it, too!

Despite the fact that an overwhelming proportion of those surveyed found guarantee features appealing, significantly fewer indicated that they would expect to have to pay for such features. An analysis of the relative importance that investors place on individual product features shows that "low fees" ranks as the highest consideration (see Figure 20 on the following page).[26]

24 Sam Nandi, Tamara Burden, Gary Finkelstein, Rikiya Ino, Wade Matterson, and Peter Sun, "Cultivating confidence: The emerging global market for VA-style guaranteed benefits products," *Insight*, Issue No. 7 (Winter 2008), pp. 4–11. Available online at http://www.milliman.com/perspective/articles/cultivating-confidence-emerging-global-market12-01-08.php.
25 Question: "How appealing, or otherwise, would you say this feature in a superannuation fund would be to you?"
26 Question: "Below are a number of potential features of superannuation products. Please think about how important each feature would be to you in a superannuation product."

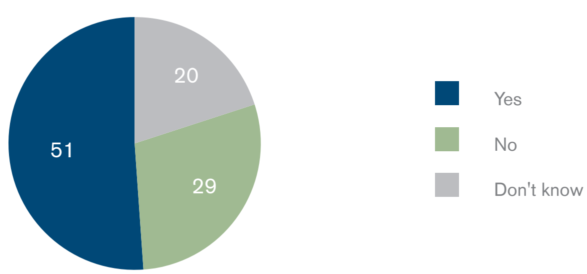
FIGURE 20: KEY PRODUCT FEATURES - RATED 8+



Thus, careful pricing will be critical to ensure sufficient take-up within the market. Providers will need to keep in mind the importance of the cost/benefit trade-off as far as Australian consumers are concerned.

As Figure 21 shows, approximately 29% of respondents said that they would not expect to have to pay for a feature such as the GLWB described earlier.[27] This is in contrast to the 9% of respondents who replied that the proposed feature is unappealing. These results imply a need for further education of both the client and the advisor so that the benefits of the product can be put into context and their intrinsic value realised.

FIGURE 21: COST / BENEFIT TRADE-OFF WILL BE IMPORTANT FOR PRODUCT PROVIDERS



Guarantees should increase aggressiveness

One of the benefits of having a guarantee attached to investors' superannuation funds is that it allows investors to be more aggressive in their asset allocations than they would otherwise be. Generally, this would involve dedicating a larger portion of the entire funds to equity investments.

27 Question: "Would you expect to have to pay for a feature such as this?"

When asked how the availability of a GLWB-type feature would influence their investment strategy, only 37% said they would move to a more aggressive investment mix. Ten percent said they would move to a more conservative mix, and 22% said they didn't know (Figure 22).[28] Once again, these results suggest that there is a need for further education so that the benefits of a product feature such as a GLWB are properly understood and the impacts on investors' asset allocations and risk tolerances are properly aligned. Financial advisors need to be aware of the implications of these types of investment guarantees and the flexibility that they afford retirees in terms of selecting their asset allocations.

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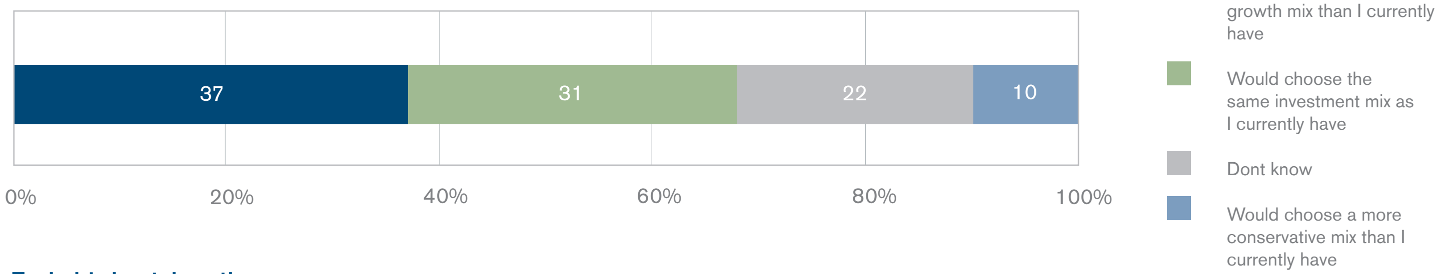
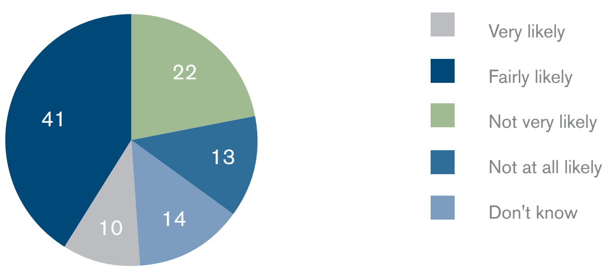
FIGURE 22: INVESTOR BEHAVIOUR WILL CHANGE



Early bird catches the worm

There are significant opportunities for those organisations that move early on the development of GLWB-style product offerings in the Australian market. More than 50% of respondents indicated that they would be likely to switch funds to gain a feature such as this (see Figure 23).[29]

FIGURE 23: OPPORTUNITIES MAY EXIST FOR FIRST MOVERS



Recent movements in both domestic and international equity markets have created an atmosphere in which investors now see the importance of protection against market downturns. Capitalising on current conditions may accentuate the marketing process and message so that providers will be able to penetrate the market more readily than would be true in more stable market conditions.

Challenges lurk

The current regulatory environment in Australia is uncertain in relation to products that contain features similar to the GLWB concept outlined above. In particular, the Australian life insurance regulatory framework will require adjustments and/or clarifications in order for product innovations such as this to find serious support among both investors and product providers.

Other challenges facing the development of guarantee-style products involve the integration of relevant systems to allow the administration of the product and the underlying platform to proceed seamlessly.

28 Question: "If this investment feature was available as part of your superannuation fund, in what way, if at all, would this influence your choice of investment strategy?"
29 Question: "How likely, if at all, do you think you would be to switch to a superannuation fund that offered this feature?"

ABOUT THE SURVEY

The results in this report are based on a total of 1,000 online interviews conducted nationally among respondents aged 45 years and over. All respondents met at least one of the following requirements:

- a current superannuation balance of at least $50,000
- an expected superannuation balance of at least $50,000
- a superannuation balance of at least $50,000 at the time of retirement

Interviewing was conducted between 29 September and 15 October 2008.

The sample was sourced from Research Now, a research-only online panel, with invitations sent to a nationally representative sample of respondents aged 45 years and over. Data is weighted by age to account for any bias in response rates by age group.

About Sweeney Research

Sweeney Research was founded in 1972 by Brian Sweeney. Over three decades, Sweeney Research has grown from a small office in South Melbourne to become one of Australia's most respected research companies. Sweeney is also now one of the largest Australian-owned research firms and one of the most significant overall, sitting inside the top 10 in terms of annual research revenue.

For further information, visit www.sweeneyresearch.com.au

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Milliman, whose corporate offices are in Seattle, serves the full spectrum of business, financial, government, and union organisations. Founded in 1947 as Milliman and Robertson, the company has 49 offices in principal cities in the United States and worldwide. Milliman employs more than 2,100 people, including a professional staff of more than 1,000 qualified consultants and actuaries. The firm has consulting practices in employee benefits, healthcare, life insurance/financial services, and property and casualty insurance. Milliman's global financial risk management practice is responsible for the management and execution of hedging programmes in excess of US$500 billion.

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