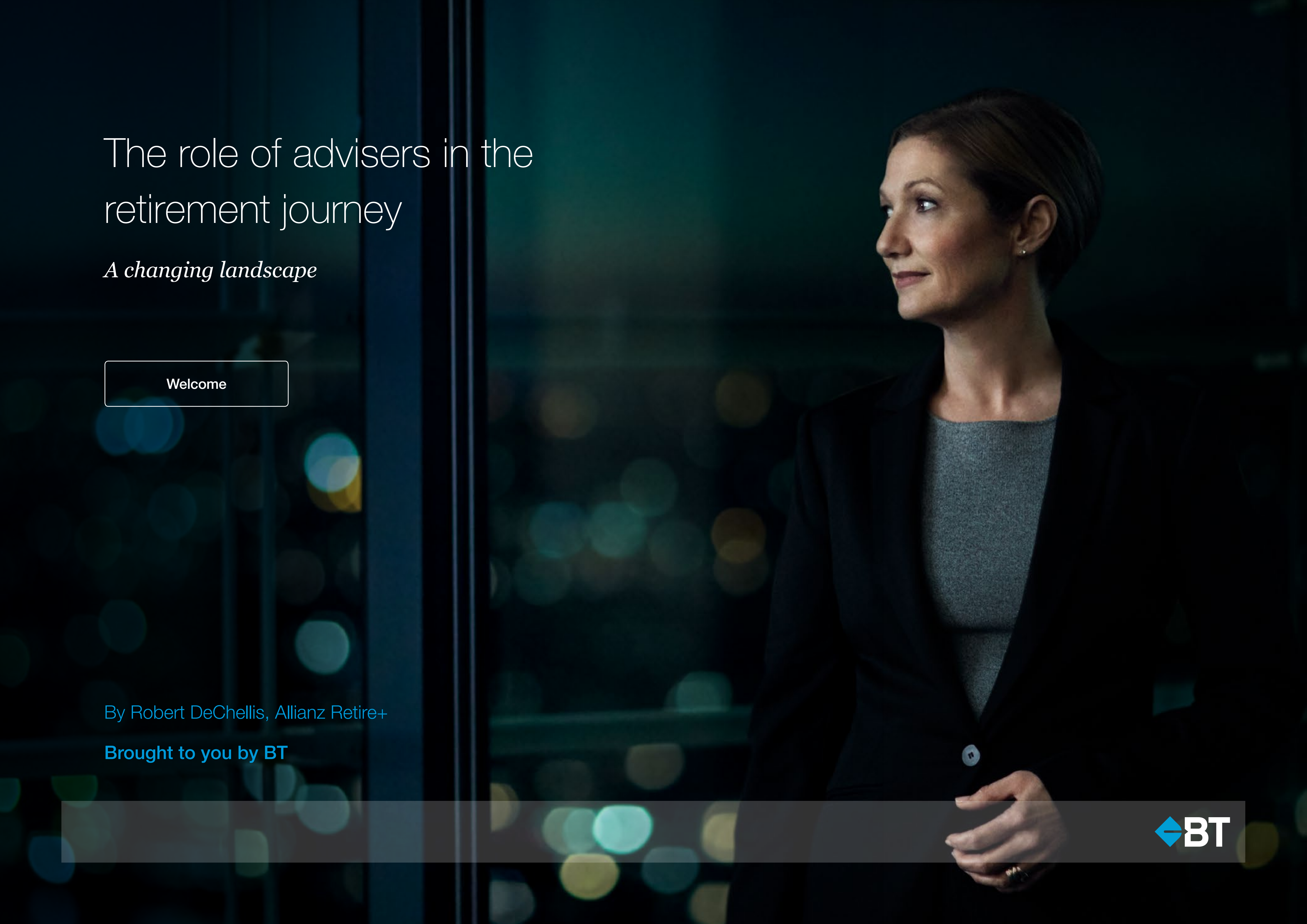

The role of advisers in the retirement journey

A changing landscape

Welcome

By Robert DeChellis, Allianz Retire+

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About Robert DeChellis

Robert is a Consulting Retirement Strategist for Allianz Retire+. He is also the Past Chairman of the Insured Retirement Institute and also sits on the board of the Invest in Others Charitable Foundation.

Most recently he was President and Chief Strategist for the Allianz Exchange, a division of Allianz Life Insurance Company of North America (Allianz Life®). In this role, DeChellis was responsible for uniting strategic relationships, technology and intellectual capital to identify opportunities to deliver better financial solutions and thought leadership.

Prior to this, DeChellis was President and CEO of Allianz Life Financial Services, LLC. He has also held senior executive roles with Travelers Life and Annuities, Jackson National Life Distributors Inc. and Goldman Sachs. DeChellis earned a BS in Finance from the University of Colorado, Boulder and holds an MBA from the Kellogg School of Management.

The race to zero

Without doubt, we are in the midst of the greatest disruption we've ever seen in financial services. New technologies, increased regulation and a cost epidemic is slowly eroding away at profit margins and business models, and significantly changing the competitive landscape for financial advisers in Australia.

Many things consumers used to pay for in financial services are now free. We've seen tremendous price compression across all areas of our industry – from asset allocation, to securities selection, trading and money management. In my view, there are two key drivers of this:

1. **The rise of cost-conscious investing** – financially savvy investors are looking to have greater control of their money, moving away from high to low cost investing and increasing their focus on investment performance[1]. This shift will only become more prevalent among younger generations. According to a study by KPMG[2], Gen X & Y held about 36% of financial assets in 2010 and are estimated to hold around 70% by 2030.

2. **The adoption of algorithms and 'robo advice' for digital platforms** – technologies that can match a client's risk profile to a model portfolio at a fraction of the cost of traditional channels are cutting out middlemen and passing on cost savings to the investor. More and more of the services that advisers and finance brokers have traditionally delivered are being automated.

Zero account fees

Zero minimums to open an account

Zero minimum investment Fidelity mutual funds

Zero expense ratio index mutual funds

Many previous 'value-adds' are now being given to clients for free

1. https://australiancentre.com.au/wp-content/uploads/2017/07/2017-D1P7.pdf
2. https://assets.kpmg/content/dam/kpmg/au/pdf/2017/banking-on-the-future-2015-report.pdf

If competing on price was the only determining factor of success, an adviser's only option would be to do more for less. However, as we've seen from other industries, price is only important in the absence of value. People are willing to pay in some cases 2, 3 or even 4 times more for a product, if that product is providing value they can't get from cheaper alternatives.

The coffee pod industry is a good example of this. Coffee pods are priced at a significantly higher price point than ground coffee, yet Australians consume around three million single-serve coffee pods every single day[3]. The lesson here for advisers, is that there's much more to the equation than price.

Embracing innovation is key

In my view, the key to a sustainable financial advice business, is to embrace technology, rather than be afraid of it. The financial services industry up until now has been hugely underserved by innovation in my view. Whilst change is almost always uncomfortable, there is a huge opportunity for advisers to embed new technologies into their business and use it to reduce costs, increase efficiency and ultimately focus on higher value services for clients.

> *"There is a huge opportunity for advisers to embed new technologies into their business and use it to reduce costs."*

In parallel to this, there is an undeniable opportunity for advisers to service the growing number of baby boomers in the retirement phase. To seize this opportunity, advisers need to tap into their core value, revisit the value proposition, and re-focus financial strategies to support clients in a very complex decumulation phase. There is no room for complacency in the future, just a challenge for those willing to take it on.

But what does this opportunity look like exactly? We'll explore some ideas in this paper.

Australians consume three million single serve coffee pods every day

3. https://sustainablecampus.unimelb.edu.au/a-z/c/coffee-pods

The retirement challenge

Solving the maths complexities of a generation

I heard someone say last year that the single biggest maths problem we currently face today, is the decumulation of assets saved by the baby boomers over the last 30-40 years.

By contrast, the accumulation phase is almost a 'set and forget' system where the variables are more or less known, and the formula is less complex. The decumulation phase presents a much more complex problem that requires strategies that are far more intentional.

In decumulation, the focus transfers away from the simpler problems of fees or tax, to the more complicated task of forecasting a person's current and forecasted liabilities against their assets and ensure the assets are drawn down in a sensible and timely way. In decumulation, there is no luxury of a regular income. The assets become the income and the challenge for the adviser here, is to ensure the client has enough income to sustain them through every phase of retirement.

Timing is everything

Most of us have been taught that when it comes to investing, 'time in the market, not timing the market' is one of the biggest factors that impact the success of a portfolio. In, or nearing retirement, this philosophy no longer applies. As we've sadly seen, a global financial crisis can have significant ramifications on the income stream of an investor nearing retirement. In the lead up to retirement (often called the retirement risk zone), timing takes on a new set of risks:

Sequencing risk – as shown in *Figure 1*, when in the accumulation phase and staying invested, sequence has little to no bearing on performance, providing two investments are in the exact same rate of return[4]. In decumulation, you don't have the luxury of staying invested over the long term. When you look at sequence of returns and the various

4. Macquarie Technical Advice Services

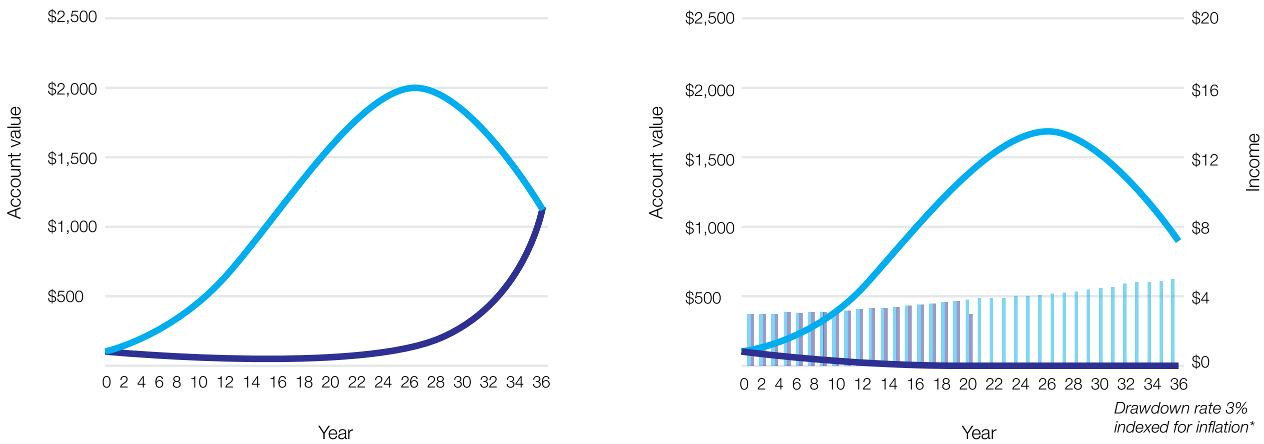
inputs that impact performance, sequencing risk is the number one factor that impacts performance over and above asset allocation, stock selection and diversification.

Inflation risk – When it comes to inflation, timing starts to take on a different issue as assets are drawn down. As a retiree, there's a real risk of inflation eroding away retirement savings if those savings are not working hard in retirement. Whilst inflation rates in Australia have been low for a long time now, inflation is unpredictable and should always be viewed as a threat.

Longevity risk – the risk of running out of money is probably the most common fear held by retirees. A recent survey by Allianz[5] discovered that 63% of respondents across all generations fear running out of money more than they fear dying. But longevity risk is not just about running out of money, it's also about how hard your money is working for you, given how long you're going to live.

Many people believe they can close the retirement income gap by continuing to work in the early stages of retirement. But in my experience, that's not always possible – health issues arise, redundancies happen or caring for a loved one can become the priority.

Figure 1 Sequencing: a unique risk faced by retirees



Source: Macquarie Technical Advice Services

*Drawdown rate is 3% of beginning value of $100, indexed to inflation at a rate of 1.50% p.a.

5. https://www.allianzlife.com/-/media/files/allianz/pdfs/newsroom/2017-allianz-generations-ahead-fact-sheet.pdf?la=en&hash=6170191A3CE1B96BF96EA4E9F6E52B1FC00724DC

Understanding retiree behavioural bias

Cash is not king

In my view, the infatuation with liquidity is possibly the single most expensive and detrimental risk factor to an investment portfolio. We've seen this manifest at times of significant volatility, such as the GFC. At the time of the GFC, cash holdings started peaking in summer of 2009, which proved to be the worst time to hold cash.

For those nearing retirement, or already in retirement, holding cash out of fear would have meant significant negative impact on the retirement nest egg. Of course, by this stage, the damage has been done and there is little time to recoup losses. In the decumulation phase, focusing on liquidity and holding too much cash can be financially devastating. It is therefore critical that the focus shifts away from liquidity, to creating a sustainable, long-term income.

Holding liquidity out of fear is not the only behaviour that can be detrimental to the retirement portfolio and hinder quality of life in retirement. A shift in demographics and a challenging market environment have brought about other behaviours that advisers need to be aware of:

Underspending in retirement – A 2017 paper by BlackRock Research[6] showed that in many cases retirees are vastly underspending, out of fear of running out of money and a desire to pass on wealth to the next generation. The paper reported that across all wealth levels, most existing retirees still had 80% of their pre-retirement savings remaining after almost two decades of retirement. This statistic indicates to me that many retirees are uninformed about how to effectively decumulate their assets and enjoy a standard of living they can afford.

Fear of judgement – As humans, most of us live with a fear of being judged by other people. Interestingly, a study into robot-human trust showed that this fear of judgement is particularly strong when the topic is illegal, unethical or culturally stigmatised[7]. In such cases, an honest response to a question is much less likely. Topics

"Retirees are vastly underspending, out of fear of running out of money."

6. https://www.blackrock.com/us/individual/literature/whitepaper/retirement-spending-whitepaper-final-stamped.pdf pdf?la=en&hash=6170191A3CE1B96BF96EA4E9F6E52B1FC00724DC
7. http://www.bbc.com/capital/story/20160412-truth-be-told-were-more-honest-with-robots

such as debt have a negative connotation attached to them, so it's not a stretch to assume that a client may sometimes massage the truth they tell their adviser.

By contrast, robots are free of judgement and in most cases programmed to simply look at the facts. The challenge for the adviser, is to make the client feel as comfortable as possible and to build a trusted relationship where the client can be open and honest about their finances.

Protect me from myself – As humans, we are often governed by emotion and when it comes to taking risk, studies have shown that the pain of losing is psychologically about twice as powerful as the pleasure of giving[8]. In my view, this goes a long way in explaining the infatuation with liquidity I mentioned earlier. The mind is a powerful force, and the opportunity for the adviser is to provide clients with a pragmatic plan that is grounded in expertise, experience and rational thinking, instead of emotion.

"...it's not a stretch to assume that a client may sometimes massage the truth they tell their adviser."

8. https://www.allianzlife.com/-/media/files/allianz/pdfs/newsroom/2017-allianz-generations-ahead-fact-sheet.pdf?la=en&hash=6170191A3CE1B96BF96EA4E9F6E52B1FC00724DC

Evolving the adviser value proposition

"Australians aged 55+ own a combined $2.8 trillion and over the next two decades, they will pass on much of this wealth on to the next generation."

The growing need for retirement advice

When looking at the retiree landscape in Australia, I see two compelling forces at play. Firstly, the seismic amount of wealth shifting from accumulation to decumulation as baby boomers move into retirement. According to McCrindle Research[9], Australians aged 55+ own a combined $2.8 trillion and over the next two decades, they will pass on much of this wealth on to the next generation.

The second, is the significant change in Australia's demographic pool where the population is ageing, and more people will be in decumulation than ever before. The number of Australians aged 65 and over is projected to more than double by 2054-55[10].

Australia

Over $4.5tn in Super, including $1.4tn in retirement, by 2033*

US

10,000 people turn 65 every day#

US

Baby Boomers to have over $53 trillion by 2030^

Source:
*Rice Warner – Superannuation Market Projections Report, 2018
#Pew Research Center – Baby Boomers Retire, 2010
^Deloitte University Press – The future of wealth in the United States, 2015

9. https://mccrindle.com.au/insights/blog/australias-generations-wealth-income/
10. https://treasury.gov.au/publication/2015-igr/chapter-1-how-will-australia-change-over-the-next-40-years

The case for retirement advice could not be clearer. Never before has there been an environment where retirees will need a trusted financial adviser to help them solve the complex maths problem of decumulation and help them live out retirement in a sustainable and satisfying way. In my view, the opportunity for advisers who are willing to re-tool and take on the retirement challenge is very real.

Be technically savvy and behaviourally sensitive

I often talk about the role of an adviser in two parts; quantitative (technology and numbers) and qualitative (relationships). In my view, the advisers who can master the art of technology, whilst creating deeply connected client interactions, are the advisers who will prosper the most.

From a quantitative perspective, how are you going to systematically solve the complex maths formula for clients, and enlist the insurance companies and asset managers to help them manage their decumulation in the most effective way? From a technology perspective, how are you going to embrace technology, as a more cost-effective way of managing assets?

From a qualitative perspective, are you establishing a level of trust and transparency with clients, so that they can be 100% open and honest about their goals and challenges? In future, how will you make sure you're adding priceless value to your clients, so that the relationship remains rock solid over the long term?

Leveraging new technologies

Probably one of the biggest fears about technology, is that technology will eventually replace the role of the adviser. In my view, the opposite is true. If advisers view technology as an enabler, rather than a threat, technology could be the thing that frees up advisers from administration and repetitive tasks and puts more emphasis on the client relationship. Viewed this way, technology suddenly becomes something to embrace, rather than be afraid of.

"If advisers view technology as an enabler, rather than a threat, technology could be the thing that frees up advisers from administration and repetitive tasks."

There are of course plenty of technology options, and without a framework to follow, it can easily become overwhelming. Below are some key areas to think about:

1

The approach to risk – investment risk can be handled in three ways: You can avoid it by holding cash. You can assume it, by investing in markets and planning for both the good and bad. Or, you can transfer some of that risk by leveraging new technologies or innovative retirement products designed specifically for the needs of retirees. Deciding how you want to approach risk will inform many of your decisions.

2

Process automation – how are you taking advantage of automation to reduce the time spent having to be hands on, so that you can free yourself up to add more value to clients? What are the tasks that you repeat day in, day out, that can be automated and won't impact client outcomes?

3

Communication process – are you using a robust financial planning platform to help you document and manage your onboarding and ongoing communications with clients? The software on the market today can help significantly with the CRM process and ensure the ongoing client experience is a positive one.

Decide where your value lies

Start to think about what aspects of the financial planning process you are going to outsource – and what aspects you will continue doing yourself.

Deciding where your highest value lies will help you decide which areas are best outsourced to technology or product solutions, and which areas need a more hands-on approach.

It's about quality, not quantity

A challenge for advisers in this new technological era, is to step up quality dialogue, and build even deeper connections with clients. I often say it's the quality of the time you spend with clients, and the intensity of the interaction that really matters. When clients share highly personal information with an adviser, understandably they may feel vulnerable. In my view, what an adviser can do here is lead by example and dare to be vulnerable too.

What that means, is sharing personal stories, talking about the things that matter to you and show your client that you too are human. It's these meaningful interactions that will trump robots every time and push the relationship beyond a transaction, and into the territory of trusted friend.

A strategic solution for retirees

Transitioning to an outcome-driven model

In this new world where technology is rapidly advancing, and consumers are taking more control of their finances, the role of the adviser I believe must shift from accumulation planning and portfolio management, to a model that focuses on broader client outcomes.

To effectively service the retiree segment, advisers will need to holistically manage the needs and wishes of clients, take in to account their goals and objectives, and to a high degree of certainty, balance the entirety of their current and future wealth with their current and future liabilities. In other words, solve the complex maths equation of decumulation. Advisers that stay stuck in accumulation planning, and focus on returns and not outcomes, I believe will struggle in the new landscape we find ourselves in.

From a value proposition perspective, advisers will need to answer the 'What's in it for me?' question in a way that promises specific and tangible outcomes. By this, I mean being incredibly specific about what retirement income streams you can create for clients – and putting in place a plan to systematically and strategically decumulate assets in a way that takes in to account market risk, inflation, health care risk, and a myriad of episodic events such as downsizing, estate planning, selling a business or leaving work.

Focus on the balance sheet, not the balanced fund

Another way of looking at this approach, is to focus on the balance sheet, not the balanced fund.

The strategic focus of advisers has typically been on the balanced fund. The accumulation of wealth up until the point of retirement has been the holy grail, and not too much attention has been placed on life beyond that. But in today's world where managing the balance fund has been in many cases commoditised and automated, focusing on this alone is unlikely to be sustainable or profitable in future.

"To effectively service the retiree segment, advisers will need to holistically manage the needs and wishes of clients."

Income streams over liquidity

As outlined earlier in this paper, what a retiree really needs in the decumulation phase, is an income. My advice for advisers looking to service the retiree market, is to focus less on liquidity and more on income streams. As an adviser, if you can put in a strategic and methodical process to turn your client's assets into a steady income for the duration of their retirement, in a way that protects them from a unique set of risks in retirement, right there you have delivered priceless value.

"What a retiree really needs in the decumulation phase, is an income."

Total wealth management

The final idea I wanted to cover in this paper, is the idea of total wealth management. Looking through the lens of total wealth management, an adviser could in some ways become the CFO of a family. As CFO, an adviser's role might be to manage the entire balance sheet and ensure that the assets and liabilities continue to work in harmony throughout every stage of life. When it's time to pass on wealth to the next generation, the family will hopefully turn to the CFO who has been a long-term trusted adviser, and knows the family's finances intimately.

"... an adviser could in some ways become the CFO of a family."

A 'total wealth management approach' would involve the management of four key asset groups:

Financial assets – including super and investments

Real assets – including the family home and any rental properties they may have

Pension assets – including Centrelink entitlements they are eligible for and any account-based (allocated) pensions they may receive

Human capital – the ability to go out to work and generate an income

From what I've seen, human capital is typically the least talked about and most misunderstood asset. As humans, our human capital peaks in our 20s, and slowly depletes over time. A client's ability to go out an earn an income has significant impact on the balance sheet, and therefore the human capital reserve should be considered a key input in to the equation.

By evolving the business model to a total wealth management approach, the client has the entirety of their financial affairs looked after, and the peace of mind that comes with that. As a result, the relationship will inevitably become stronger and more sustainable because the value the adviser is adding to the client – and their family – far transcends the management of money.

Disclaimer

The content for this paper is prepared by Robert DeChellis, Consulting Retirement Strategist for Allianz Retire+. Information is current as at 1 May 2019. The views expressed in this presentation are those of Robert DeChellis alone unless otherwise quoted, and do not reflect the views or policy of any company in the Westpac Group. This paper is for adviser use only and is not intended for and is not suitable to be delivered to retail clients (as that term is defined in the Corporations Act and related regulations). It does not take into account any personal objectives, financial situation or needs. You should consider its appropriateness having regard to these factors before acting on it. Any graph, case study or example contained in this publication is for illustrative purposes only, and is not to be construed as an indication or prediction of future performance or results. While the information contained in this publication may contain or be based on information obtained from sources believed to be reliable, it may not have been independently verified. Where information contained in this publication contains material provided directly by third parties it is given in good faith and has been derived from sources believed to be accurate at its issue date. While such material is published with necessary permission, no company in the Westpac Group accepts any responsibility for the accuracy or completeness of, or endorses any such material. Except where contrary to law, we intend by this notice to exclude liability for this material.

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