Protecting Retirement Incomes

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Milliman

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Providing cutting-edge risk management and hedging solutions

- Milliman Financial Risk Management LLC (Milliman FRM) is a global leader in financial risk management to the retirement savings industry, providing investment advisory, hedging, and consulting services on $176 billion in global assets (as of December 31, 2021) and more than 80 investment products.

- The practice includes more than 200 professionals operating from trading platforms around the world (Chicago, London, Amsterdam, and Sydney).

The Retirement Income Covenant

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Introduction of the retirement income covenant

- **Takes effect from 1st July 2022, aims give retirees the confidence to spend more of their savings in retirement**

- **Requires superannuation trustees to have a 'retirement income strategy' that helps retiring members balance 3 key objectives:**

    1. Maximise expected retirement income over the period of retirement;
    2. Manage expected risks to the sustainability and stability of their expected retirement income, including longevity, investment and inflation risks; and
    3. Have flexible access to expected funds over the period of retirement

- **Difficulty lies in a two key definitions**

    – **"Period of retirement"** is different for each individual
    – **"Retirement income"** should include all sources of income, including Age Pension

What does it mean for the product landscape?

- **Market-linked annuities (Challenger, Optimum Pensions outsourced/white labelled solutions)**
  - ✓ Longevity risk protection
  - ✓ *Implied inflation risk protection*
- **Pooled annuities (QSuper, AMP, Aware's in-house solutions, TAL's offering)**
  - ✓ Idiosyncratic longevity risk protection
  - ✓ *Implied inflation risk protection*
- **Account-based pensions with smarter drawdown strategies**
  - ✓ Flexibility
  - ✓ *Implied inflation risk protection*

What’s missing, and why?

- **Market-linked guaranteed annuities**
  - ✓ Longevity risk protection
  - ✓ Inflation risk protection
  - ✓ Sequencing risk protection

Historically has been expensive, complex and lacked flexibility.

- **Investment solutions with explicit systematic risk management**
  - ✓ Sequencing risk protection
  - ✓ Flexibility

Investment teams within superannuation have been focused on accumulation and short-term peer relative performance. Appetite for managing dedicated investment strategies for retirees is limited.

Why manage risk for retirees?

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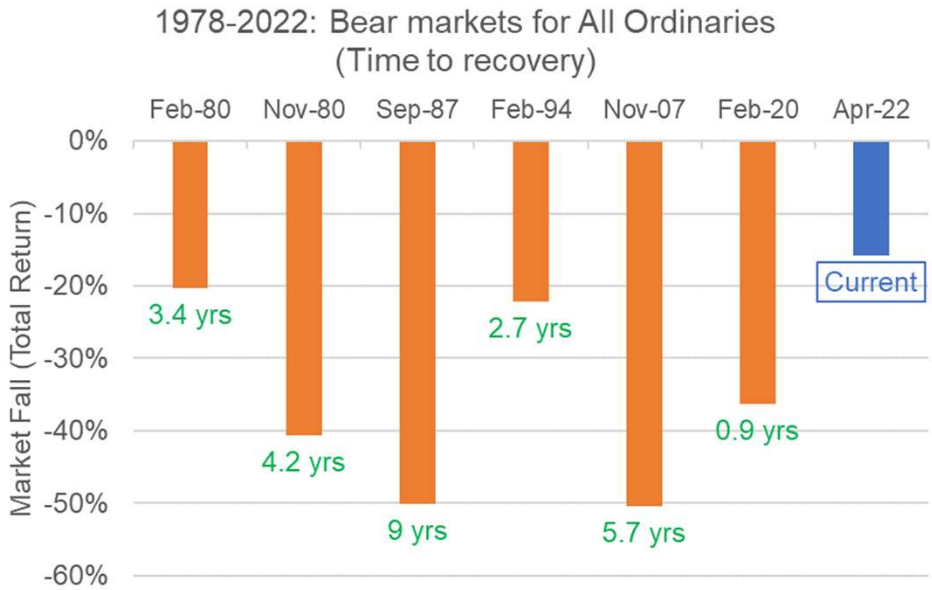
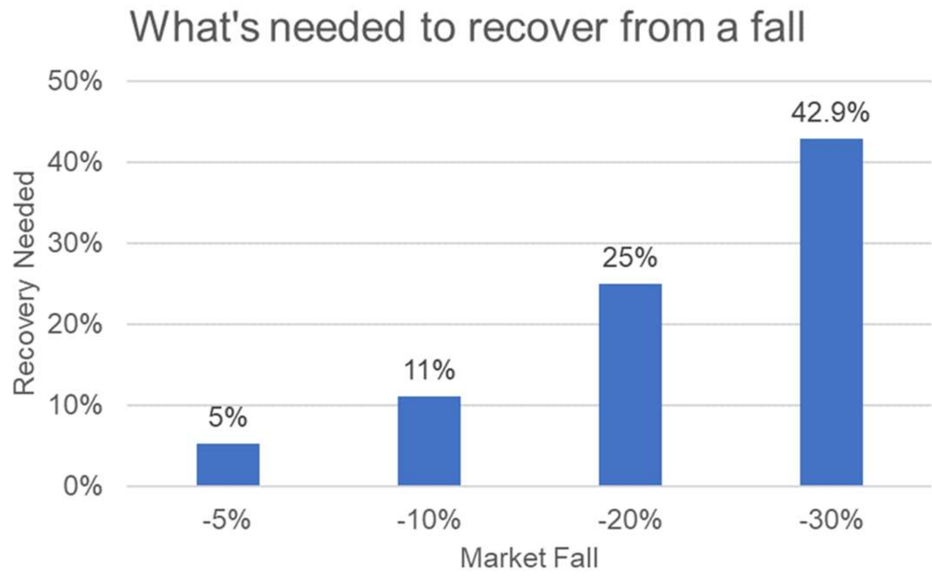
Manage investor behaviour in bear markets





Large corrections are likely

- All Ordinaries had six 20%+ falls in the past 50 years
- Fortunately, markets do recover.

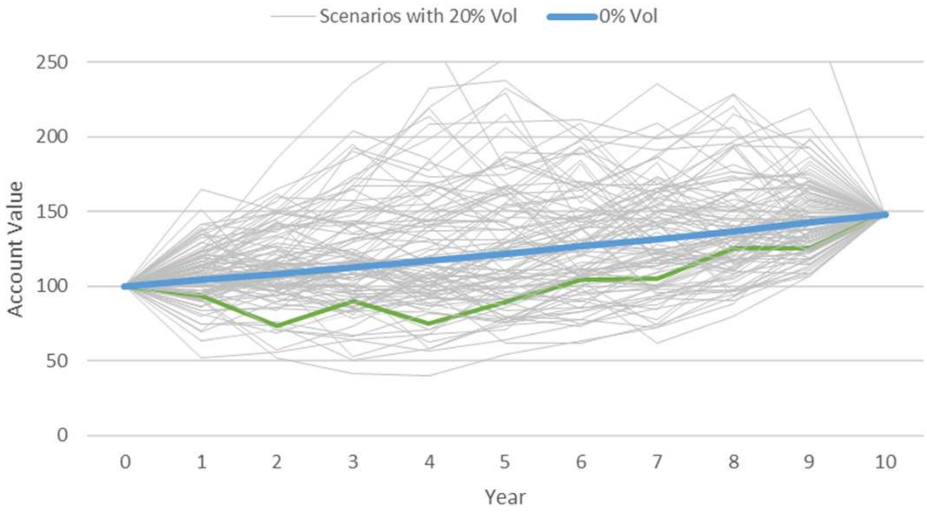
Recovery can seem difficult

- A 30% market correction needs +43% to recover
- Wisdom and literature suggest you ‘stay invested’, but risk aversion is strong factor driving behaviour for retirees

Source: Milliman & Bloomberg data

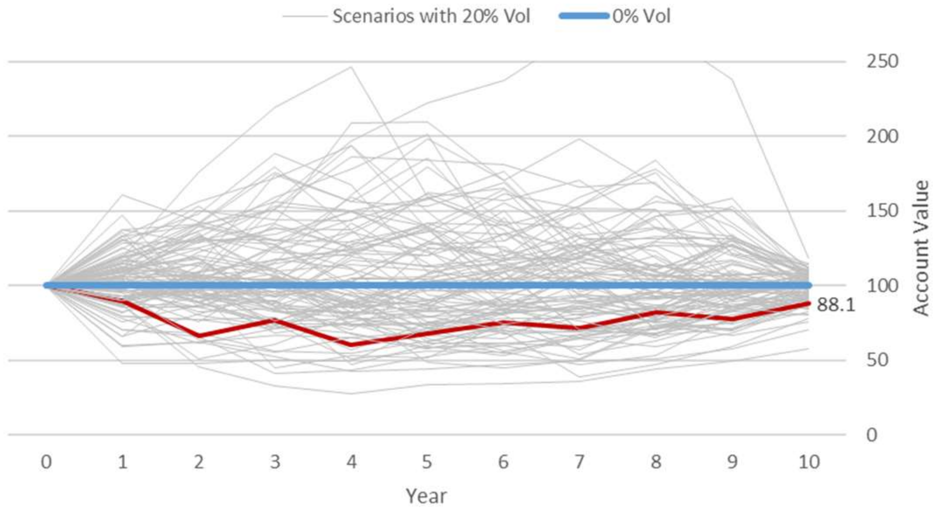
Sequencing risk impacts retirees

No withdrawals, 4% annualised returns



Without taking money out, the sequence of returns has no impact.

With withdrawal, 4% annualised returns



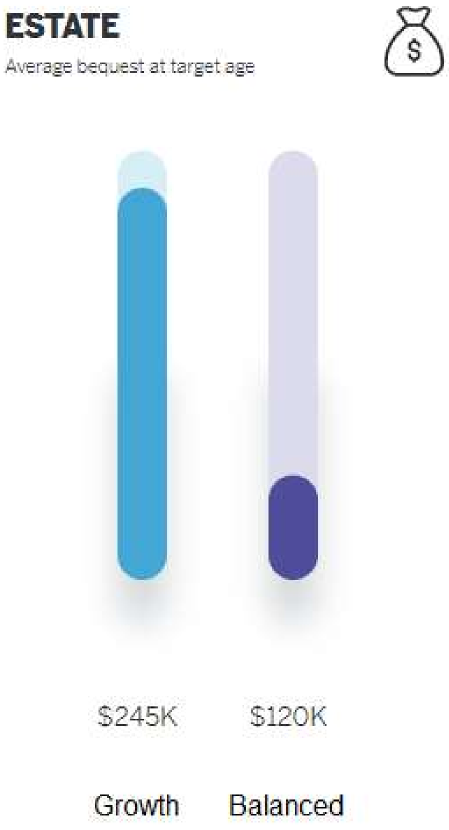
In retirement, the path impacts the outcome.

- With withdrawals, the outcome after 10 years is heavily dependent on the path of returns.
- The highlighted path returned almost 12% lower after 10 years despite the same average returns.

Source: https://us.milliman.com/en/insight/sequencing-risk-quantified

How to manage market risk

Derisking can be ineffective, and comes with hidden costs



Derisking from Growth to Balanced is expected to cost:

1.1% reduction in expected annual returns.

51% reduction in average bequest (from 245k to 120k) under the same withdrawal strategy.[1]

Derisking doesn’t always reduce risk

During Mar to May 2022, traditional lower risk portfolios performed worse than higher risk portfolios:

	Morningstar Australia Aggressive Target Allocation Index	Morningstar Australia Growth Target Allocation Index	Morningstar Australia Balanced Target Allocation Index	Morningstar Australia Moderate Target Allocation Index
Performance for Mar to May 2022	-1.65%	-2.20%	-3.09%	-3.59%

There is generally a cost to removing risk from a portfolio, whether it is explicit or implicit.

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[1]Bequest at age 90 for a person aged 67 with a starting balance of $500,000 and $25,000 per annum withdrawals indexed to inflation. Detailed assumptions can be found at https://smartshield.millimandigital.com/.

RESULTS BASED ON SIMULATED OR HYPOTHETICAL PERFORMANCE RESULTS HAVE CERTAIN INHERENT LIMITATIONS. MILLIMAN DOES NOT MANAGED THE UNDERLYING FUND.

Milliman's approach

SmartShield series of model portfolios with built-in risk management

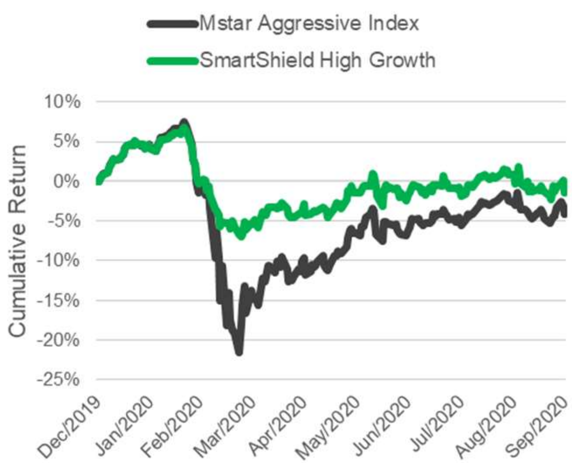
Instrument selection

- Australian Equities — Vanguard
- International Equities — iShares by BlackRock
- Cash — BetaShares Exchange Traded Funds
- Australian Fixed Income — Vanguard
- International Fixed Income — Vanguard

- Passive, low-cost ETFs
- Liquid
- All-in investment fees under 50bps

A simple & affordable core

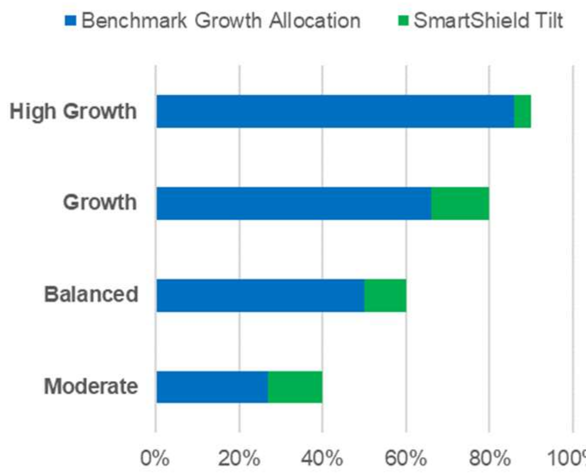
Managing sequencing risk



- Systematic strategy to explicitly manage risk
- Uses futures contracts to dynamically adjust exposure to equities in response to market volatility

In-built risk management strategy

Asset allocation tilt



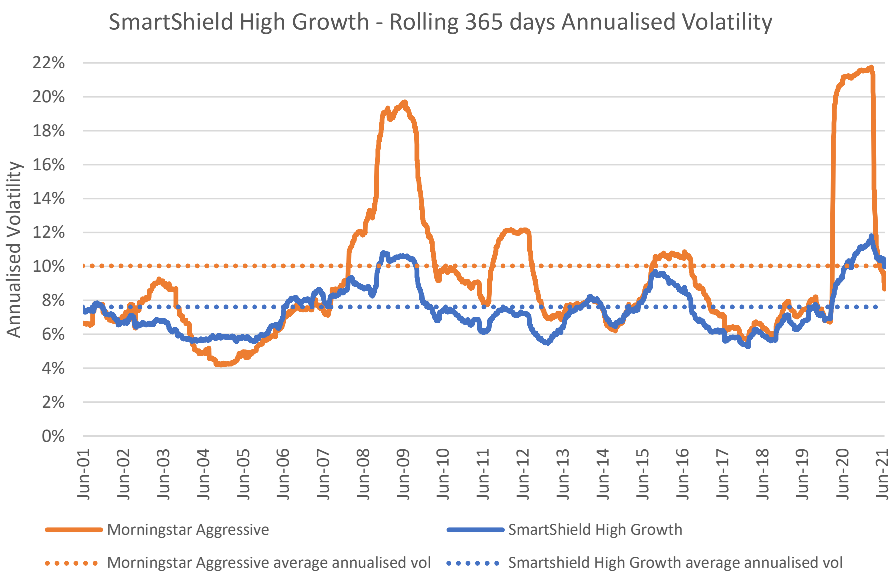
- Maximum allocation to growth assets in each risk profile
- Additional risk is managed by the in-built risk management strategy

Growth tilt participate in bull markets

Under the hood of SmartShield's risk management strategy

Component 1: Volatility Management

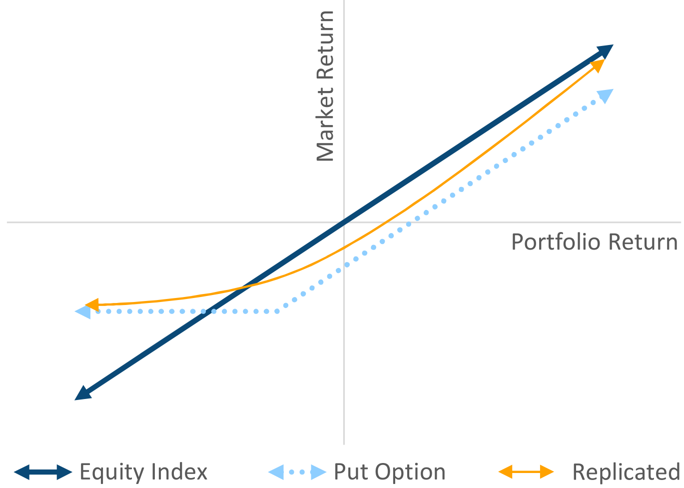
- Strategy seeks to **cap portfolio volatility** by dynamically adjusting the exposure to equities using futures
- Benefits from **higher exposure to equities during low volatility periods**,and vice versa, in stressed market environments.



Component 2: Put Option Replication

- Aims to **"manufacture" a long dated put-option payoff** by dynamically rebalancing a basket of futures contracts.

  This approach is expected to be more efficient than purchasing options in the long-term.
- Expected to **reduce losses** during periods of significant market downturn



SmartShield's performance

The environments we are built for.

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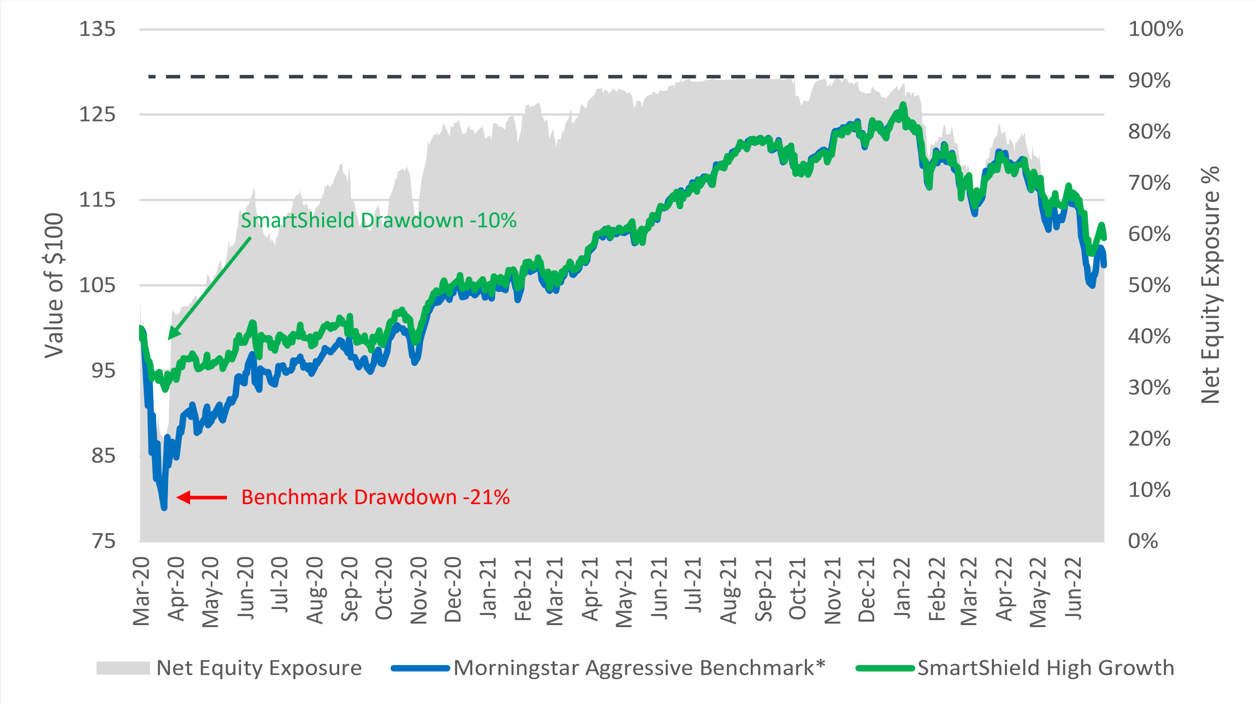
The impact of COVID-19 and the rebound that followed

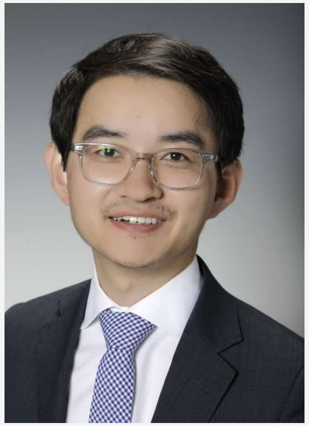
Using our High Growth portfolio

Since Inception Performance	SmartShield High Growth	Benchmark
Net Performance[1] p.a.	4.4%	3.1%
Volatility p.a.	9.4%	15%
Sharpe Ratio	0.47	0.21
Max Drawdown	-13.9%	-21.1%



[1]Performances are calculated net of underlying investment cost and management fee. Fees applied on the benchmark = 90bps, it represents the average management fee charged by investible multi-asset diversified portfolios as published by Morningstar research.

Our key local contacts



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Where we are looking for Growth in the year ahead Panel Discussion

Chris West, Context Capital Consulting

Anthony Golowenko, MLC Asset Management

Moderated by Andrew Kuruc, Redwood Wealth Alliance

Ethics for Advisers – Lessons from another profession

Andrew Bradley,Herbert Smith Freehills

Session Hosted by Jarrad Sundqvist, AMP

IMAP Portfolio Management Conference

Lessons from another profession: What does it really mean to be a professional?

28 July 2022

Andrew Bradley, Partner

What does it mean to be a Professional?

Professional vs ‘Professional’

- BBUS / LLB
- 20 years experience in the financial services industry, 14 in private practice
- Admitted by the NSW Supreme Court Feb 2005

- Once received a royalty cheque from APRA / AMCOS for $0.12

Characteristics of a professional

- Technical knowledge
- Integrity and trust
- Puts client's interests first
- Continuous learning & development
- Accountable
- Insight
- 'outside the box' thinking
- Perspective
- Communication skills
- Flexible
- Relationship driven
- Collaborative
- Respectful
- Committed to sustainable ways of working

A brief history of the legal profession…

Compare the timeline

High profile collapses
Allco Financial (2008), Storm Financial (2009)

FOFA commenced
1 July 2013

Professional Standards Act & ASIC Report 515
March 2017

CPD requirements (and FASEA exam for new advisers)
1 January 2019

Professional standards apply
1 July 2019

Code of Ethics applies
1 January 2020

Existing advisers must pass exam
1 January 2022

Professional accreditation for existing advisers
1 January 2026

The advice industry must do in 15 years what the legal industry did in about 800!

Financial Planners and Advisers Code of Ethics

You must always act in a way that demonstrates, realises and promotes the following values:

(a) trustworthiness;
(b) competence;
(c) honesty;
(d) fairness;
(e) diligence.

The challenges facing our industries are eerily similar

- New entrants
- Technology
- Pricing pressure
- Increasing regulation
- Community expectations
- War for talent
- Sustainability
- Globalisation

Just a little bit of law (I promise)…

Fiduciary obligations

- What is a fiduciary?
- *Proscriptive not prescriptive duties*
  - No profit rule – duty not to obtain an unauthorised benefit from the relationship
  - No conflict rule – duty not to be in a position of conflict

Best interest duty

- Test is about *inputs*, not *outcomes*
- … however, sometimes difficult to assess with hindsight
- Safe harbour for financial planners confuses the scope of the duty

Conflicts

- Two types:
- Conflicts of duty
- Conflicts of interest
- Conflicts of duty cannot be managed and must be avoided
- Conflicts of interest can potentially be managed, but you must seek to avoid conflicts where possible

Regulatory issues

- Enhanced breach reporting obligations
- Design & Distribution Obligations
- Anti-hawking

And more to come:

- Quality of advice review
- Financial Accountability Regime
- and more…

A word on the importance of culture

Culture drives behaviour

Behaviour drives action

Actions reinforce culture

The commercial success of any professional services business is dependent upon consistently delivering on the organisation's purpose and values

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