AN ACTIVE RETREAT

The challenges involved in switching from saving for retirement to drawing an income stream to spend are similar no matter what type of assets investors hold. But those in self-managed superannuation funds face some extra complexities, Zoë Fielding writes.

There's no such thing as a typical retirement these days. As members of the Baby Boomer generation begin to leave the workforce, each person has a different take on what it means to retire. Some people are fearful of leaving behind stable employment or business income for the perceived uncertainties of drawing a pension from accumulated savings.

Others are excited about the prospects of having time to travel, engage in hobbies or charity work, or spend more time with family. Another group again is redefining that period of their lives, replacing a full-time job with part-time work, consulting or contract work, and weaving in other activities, too.

Michael Hutton, partner at HLB Mann Judd, Sydney, says it's a trend among his clients to gradually make a transition into retirement, cutting down the number of hours or days they work but staying employed for longer.

This is changing the way people think about their superannuation when they leave full-time work and the advice about whether to draw a pension from superannuation assets at that time.

"If they've still got plenty of income then they don't need the cash from their super fund and it becomes more of a tax and a retirement planning issue," Hutton says.

If the person has turned 60 and has a sizeable sum in their super fund that is generating a taxable income, it might be worthwhile to turn on a pension even if the person doesn't need the cash, as income is tax-free in the pension phase. The person might also be able to re-contribute amounts they don't need back into the fund, which can help reduce the tax that non-dependent children must pay on an inheritance.

In situations where the fund is generating a relatively low income, shifting to tax-free pension status won't achieve much of a saving. "In that case, if they didn't need cash from the fund it might be better to keep the fund accumulating," Hutton says.

Only 8 per cent of people aged 40 and over expect their superannuation to provide their sole source of income after retirement, according to an Investment Trends survey of almost 1000 Australians. The survey was conducted in December.

The researcher's *Retirement Income Report* showed people with more than $500,000 in their super fund expected those savings to account for only 52 per cent of their assets at retirement. Savings and investments outside super and investment properties account for a further 27 per cent of their expected savings.

How soon Hutton starts talking to clients about retirement depends on their level of accumulated assets, the type of investments they hold and their age.

"Typically we would be talking to them by the time they reach age 55 because by that stage they could have access to an income stream through a transition-to-retirement [pension]," Hutton says.

"But we often hold off on recommending they turn a pension on until they reach 60 because from 60 it's tax free whereas between 55 and 60 there's still tax on the payments."

Regardless of whether a person switches on a pension, their priorities for their savings typically change as they approach and enter retirement. The most important consideration for people aged 60 and over is keeping the value of their retirement savings, the *Retirement Incomes Report* found.

Wealth preservation was also important for people aged between 40 and 60, although that group was more likely to want to invest for good growth and was prepared to ignore short-term market movements.

The research showed people who have more than five years to go before retirement expect to change the way they invest after they have retired, but closer to that date most have already moved to a more defensive asset allocation.

The changing face of retirement, and the fact that most people will have income from multiple sources, means there are more options for advisers to consider when helping clients to ensure they have an adequate cash flow after they have left full-time work.

For people who have switched a pension on, the priority will be to make sure cash is available in the super fund to meet pension payments when needed.

Hutton often recommends his clients hold at least one year's worth of pension payments in a cash account earning a reasonable rate of interest. Some clients may hold as much as five-years' worth of cash in term deposits with varying maturity dates so that several years of cash flow can be met without having to sell growth assets.

Cash forms an integral part of the these clients' portfolios because high interest rates are available on term deposits at present. If interest rates fall, Hutton says the strategy

NIC WALKER

Michael Hutton, HLB Mann Judd: Clients are making a gradual move towards retirement, cutting down the number of hours or days at work but staying employed.

may change, although he does like retirees to hold a cash reserve.

"I really like the sleep-at-night factor of having a couple of years' pension payments in the bank ready to go so that a significant downturn can be ridden out without having to sell assets," he says.

David Kennedy, principal of Hillross-licensed Pacific Advisory, spends a lot of time with clients who are about to retire, helping them decide how much income they will need each year. "It's a really difficult thing," he says. "You get rules of thumb that say allow about two-thirds of what you take home from full-time work. It's important to be a bit more granular and go through the household budget and try to arrive at what is a realistic annual fixed living cost, and the client participates in building that with us."

The budget should account for one-off expenditure, such as travel, upgrading the car, renovating the house, and helping out children and grandchildren.

The figure that process comes up with is used in retirement projections and, being a concrete and considered amount, gives retirees greater certainty about what they will need for the future.

The conversation is different for each client but Kennedy asks people what they would like their retirement to "look like".

Like Hutton, he has seen a trend for people in their 60s to cease full-time work to take on consulting roles or move into small business rather than abandon employment altogether.

He sees it as his role to give his clients comfort that they have the capital reserves to generate the income they need to achieve the sort of lifestyle they want in retirement, or to reset their expectations if their goals are unrealistic.

Hewison Private Wealth director and private client adviser Chris Morcom goes through a similar exercise with clients. "We don't necessarily look at it as risk tolerance as the defining issue," Morcom says.

"We say, well how much money do you need and then we look to design an investment strategy to provide that cash flow.

"But we also tick off on the boxes of being able to provide enough growth to offset inflation, having due consideration to the funding of aged care costs in the future and also talking to the clients about the next generation and what their wishes are in relation to their estate."

Morcom deals with rich clients, many of whom have ample retirement savings to last through their lives.

"Sometimes we're not just investing for that generation but for the subsequent generations and so we have to think about what that means in terms of the asset mix within the super fund," he says.

Clients may have high investment incomes from assets held outside super so it might be more tax effective to keep the investments within the super fund (where earnings on assets in the accumulation phase are taxed at 15 per cent) for longer and spend money held in other structures such as a family trust first.

Clients should start to make decisions about their future income sources about five years out from retirement, says Mark Minchin, founding director of Minchin Moore Private Wealth, which is licensed by Securitor.

"It's important for the person to have a bit of a road map of this is where I am now, this is what needs to happen over the next five years or so and this is how it's likely to

Mark Minchin, Minchin Moore Private Wealth: It's natural for investors approaching retirement to have a lower appetite for risk but advisers should help clients maintain a longer-term investment focus.

LOUIE DOUVIS

look if things go according to plan by the time I retire," he says.

As clients approach retirement it is useful to go through a fresh risk profiling exercise. Minchin says it's natural for investors who are approaching retirement to have a lower appetite for risk but the adviser should help clients maintain a longer term focus.

"It's a fundamental shift, moving from working to retired and there's a tendency for people to change the way they look at their super, particularly when it forms their primary asset other than their home.

"There's a kind of fear that when they retire they're no longer going to be in a position to create more wealth and therefore they feel like they need to protect that super fund at all costs. Sometimes that can manifest in the investor becoming much more risk averse than they were when they were working and in accumulation phase and sometimes that can be to their detriment."

If the person plans to draw a pension from their super fund, the asset allocation within the fund may have to change. Increasing the income component of the portfolio naturally makes it more conservative.

But there is still a place for growth assets. Blue chip Australian shares, for example, can pay reasonable dividends and the franking credits can boost a retiree's after-tax income, with the added benefit that their capital value is expected to increase over time. Minchin also recommends good quality listed hybrids that provide high levels of yield and believes there is a place for cash and term deposits.

Bonds are incorporated, too. They play an important part of any properly constructed portfolio as they typically pay more income than equities, and tend to perform well when equities are struggling, he says.

Do-it-yourself retirement

There may be additional complications for clients who have a self-managed super fund and are making the transition from working and accumulating wealth to retirement and spending the savings.

"If the client has mainstream investments in their self-managed super fund the planning issues are fairly similar as to whether they were in a self-managed super fund or some sort of super wrap for example," Minchin says.

"But often people have started a SMSF because they've got an appetite for more exotic things that are not available through public offer funds. The common one is real property.

"Real property can be a bit of a problem when people start a pension. Often you come across people with self-managed super funds and they've put a large percentage of the fund's assets into a property and if it's a residential property, quite often the income yields on the property are relatively low. If that forms a large chunk of the fund, that can get you into a fair bit of strife when you're in pension phase."

Minchin says it's not hard to see how investors can end up in trouble if the rental income on the property is 4 per cent and at some point there's a requirement for a 6 per cent pension payment. "Property is such a lumpy asset and it's illiquid; you can't sell one of the four bedrooms," he says.

Clients who need to draw an income from their SMSF should think about whether it's appropriate to include lumpy assets like property in their funds as they approach the retirement stage. There may be sound reasons why they want to hold onto the property within the fund, but the adviser should then help them decide how to put other assets into the fund so that they are not so dependent on the property for income.

The same applies to exotic assets such as wine, art or other collectible items. If the client has bought the asset as just another investment, selling it to generate an income should not be a problem.

However, people are often more emotionally attached to these assets than they are to shares or managed funds, Minchin says.

"The reality is that quite often people haven't purchased those things for the sole purpose of generating a retirement income. They've often purchased an art work because they liked the art work and as an aside, it was a reasonable investment as well," he says.

Minchin actively discourages clients from putting such assets into a SMSF. If clients want to make that sort of investment, he suggests they do so outside super.

Overall, Minchin Moore Private Wealth has about 90 clients. Minchin personally advises about 30 investors and about 60 per cent of those people run their own superannuation fund.

Any changes that self-managed super funds make to their investment strategies must be formally documented, MLC head of technical services Gemma Dale says.

"That's one of the requirements under the law," Dale says. "You will sit down when you start the self-managed super fund, and you review on a regular basis what that investment strategy looks like."

SMSFs can have up to five members including the head trustee. Each person can have a different investment strategy within the fund. This can become complicated if the members are at different life stages and have varying risk profiles and requirements.

"If you've got one member who's 50 and one who's 75 and the one who's 50 is still working, you can have dramatically different needs," Dale says.

"But if you have two people who are relatively similar in age, and have similar risk profiles, it doesn't have to be hugely different. You can have the same investment strategy for everyone in the fund so long as that is appropriate for them."

Individuals within the fund may need two separate investment strategies for managing their own part of the assets if they have a transition-to-retirement pension because some of the assets will be in the accumulation phase and some will be funding a pension.

Dale says in most cases, it's recommended that the person has different investment strategies for each of those two parts of the fund as the requirements from each will be different.

If the fund must accommodate different investment strategies, its assets must be accounted for using a "segregated" method.

"That means each dollar earned by each of the assets in your name is credited to your account and each dollar that's earned by

> Retirement is a good time for advisers to talk to clients about exit strategies for the do-it-yourself super fund [in the event that] the fund member who takes primary responsibility is no longer able to perform that role.
>
> Gemma Dale, MLC

somebody else is credited to their account," Dale says.

The segregated method is more difficult to administer as each member of the fund needs to have a separate bank account, separately documented investment strategy and separate written reviews.

"Imagine if you've four people in the fund and each of those people has [assets in] accumulation and pension phase and they all have separate investment strategies," she says. "You have eight investment strategies and eight bank accounts, and that can be quite expensive and quite complicated to manage."

The alternative, unsegregated method lumps all of the fund's assets together and apportions them to members from the pool. That approach is generally preferred by accountants due to its comparative simplicity but Dale says it doesn't necessarily deliver the ideal outcome for clients if they have varying goals and risk profiles.

Hewison's Morcom avoids using the segregated method. He recommends people with different risk appetites and investment needs are not included in the same do-it-yourself super fund.

"We generally don't have the children in the same fund as mum and dad for the very reason that it's difficult to have an asset allocation that suits both," he says.

"Even between mum and dad investors there can be a difference between risk tolerance and that requires some fairly careful coaching and consultation and sometimes separate portfolios if you can't actually resolve the differences."

Deciding on how the investments will be split and the strategies documented is just one of the technical requirements that SMSF trustees need to consider when they're switching into pension phase that people with other sorts of funds don't need to think about. They must also ensure that the fund's trust deed is up to date and allows it to make pension payments.

The decision to convert from accumulation to pension phase must be appropriately documented and actuarial certificates may be needed. There are costs associated with each of these issues, Pacific Wealth's Kennedy says, particularly if the fund has to update the trust deed or engage an actuary to put together an actuarial certificate.

If the person converting their fund into pension phase is under 60 they will also have to register for PAYG withholding tax and withhold the appropriate amount from the pension payments that come out of their fund. There are plenty of organisations that can supply standardised pension minutes and assist with the documentation. Hewison's Morcom says it does not have to be overly difficult for the trustee.

"The important thing is making sure you've done the homework in terms of the investment strategy and the overall benefits of putting the fund into pension phase," he says. "The documentation side of things shouldn't be onerous."

Retirement is also a good time for advisers to talk to their clients about exit strategies for the do-it-yourself super fund if the fund member who takes primary responsibility for the investment decisions and fund's administration passes away or is no longer able to perform that role, MLC's Dale says.

"The classic example is where you have one person who is highly engaged and loves investing money and you have another member of the couple who is a natural delegator and has no interest," she says. "You've got estate planning issues to consider should one member become infirm or get dementia and no longer be capable of running the fund. You've got concerns about whether having a self-managed super fund is even appropriate for those clients."

To protect the fund, advisers should help clients decide on an exit strategy that maps out what the members would do, how they could get the money out of the super fund and who would make the decisions if the primary decision-maker is no longer able to. ⊠