The product effect of implementing effective TTR strategy

In this article Midwinter Technical Analyst, Justin Labruna highlights the importance of investigating both the superannuation and pension product being utilised as part of Midwinter's Transition to Retirement Strategy.

Reasonable basis and product replacement advice

Where an adviser provides 'personal advice' to a retail client, the reasonable basis for advice rule must be adhered to (also known as the suitability rule). Additional requirements must also be satisfied where an adviser is recommending the replacement of product (refer to section 947D of the Corporations Act 2001).

Where implementing a Transition to Retirement strategy, the adviser is effectively recommending that the client commute (partially or wholly) their existing superannuation fund and rolling it into a Transition to Retirement Pension. Currently, this advice is not regarded as product replacement advice because it is not a replacement of product of the same type.

It should be.

The concurrent superannuation and pension products being recommended will have considerable effect on the final outcome (as our Case Study below reveals).

While such consideration may not necessarily be required when developing your TTR strategy, you may need to consider how this may affect your recommendation of a different superannuation product for the purposes of your strategy. You may be called upon to be able to demonstrate that your client's existing superannuation product is less suitable than your newly recommended product. It is not enough to recommend that your client switch superannuation products just because you are recommending an effective strategy.

It may be beneficial to also consider any costs associated with acquiring the Transition to Retirement Pension product, as well as any costs incurred within the existing or new superannuation platform. It is important to consider the impact of these costs on your projected strategy, as well as any net cost to your client. Implementing your strategy may also have adverse effects that are not immediately apparent, such as loss of any potential benefits or bonuses that may come with retaining the funds within an existing superannuation fund. A common example may be any fee aggregation or reduction in administration charges via rebates that may apply.

Care must be taken to fully disclose both the advantages and disadvantages of the Transition to Retirement strategy, including any product specific issues or consequences that may arise. Factors such as the asset allocation, fund costs, and potential benefits lost may have a detrimental effect on your client's ability to achieve their retirement aims.

The product effect on your TTR strategy

Since its introduction in 2005, the Transition to Retirement strategy has fast become the most effective way a financial adviser can add value to a client's available capital in retirement. However, unlike many other super strategies, the Transition to Retirement strategy carries with it a vital product component. Consideration of the effect of implementing the strategy, without simultaneous consideration of the effect the underlying fee structure the product is having on that strategy is not necessarily non-compliant, but is certainly not 'best advice'.

Consequences of not considering product when implementing a TTR strategy

When developing a Transition to retirement strategy for your client, you are in effect providing a product recommendation – the two are intrinsically linked. Yet it is common practice for advisers to consider the strategy independent of product, and provide a product recommendation separately. There are many ways that your choice of product can influence your strategy, so it is important to take into account the following factors when formulating your advice –

1. The cost of the fund on your projections. The impact of fees over the lifetime of your Transition to Retirement strategy can substantially affect the projected balances and income. The real cost of a fund can easily be as high as 2 or 3 percent per year – almost the equivalent of a minimum drawdown for one year. By not factoring in this discrepancy, the account balance may be much lower than anticipated, which might leave your client out of pocket when you are already attempting to draw the maximum allowable benefit of 10%.
2. The effect of investment allocation on returns. Without taking into account the asset allocation or fund selection, you will not be able to realistically demonstrate the value added as a result of your strategy. This will lead to a misrepresentation of available funds at retirement, and may impact your client's retirement aims.
3. The effect of the superannuation product on pension refresh strategies. By implementing a pension refresh strategy, minimum account balances may need to be maintained in the existing superannuation fund. This will need to be reflected in your advice in the interest of full disclosure, as well as demonstrating to your client the administrative procedure behind implementing the strategy.
4. Eligibility of fund platforms. There is a chance that your client may not be able to obtain a Transition to Retirement Pension product through their current superannuation product provider, or their current fund may not be able to accept salary sacrifice contributions. In addition, the recommended platform may not be able to implement a pension refresh strategy on your behalf, necessitating a regular review so you are able to implement this strategy manually. This will all need to be taken into account before you develop your recommendations, as this may drastically change the nature of the advice, as well as the fee you may charge your client for your services.
5. Self Managed Super Funds and Transition to Retirement strategies. While SMSFs may be allowed to offer a Transition to Retirement pension, this needs to be stipulated by the trustee, and provision must be made for the intricacies involved, such as establishing separate accounts for accepting contributions and paying benefits.

The effect of the recommended product on the Transition to Retirement strategy – Case Study

John, who is aged 56, has approached you to implement a Transition to Retirement strategy. He currently earns a salary of $90,000 per year, and receives Super Guarantee contributions of the standard 9%. He would like to retire at age 65.

His current superannuation balance is $250,000 (no tax free component), and has a Balanced risk profile.
John is unable to give up any of his net income, as his day to day expenses are quite high. However, he feels that the strategy is still able to offer some benefit to his retirement situation.

Depending on John's existing superannuation product, as well as the pension product recommended, his available retirement funds at age 65 will vary quite substantially.

The following table illustrates the difference the product recommendations will make on the final balance. For the purposes of the example, we have assumed a nil entry and contribution fee, as well as applied a 1% review fee on both products. Funds have been invested within the platform's multi manager balanced fund offering.

Table 1: Difference in optimised TTR outcomes using different public offer funds

Super Product	Pension Product	Pre strategy super Balance	Combined super & TTR balance	Difference	Investment option
AMP FLS	AMP FLP	$457,560	$518,421	$60,861	Future Dir Balanced
AXA Generations Super	AXA Generations Personal Pension	$467,087	$531,808	$64,721	Generations Balanced
BT Lifetime Personal Super	BT Lifetime Flexible Pension	$464,071	$529,372	$65,301	BT Multi Manager Balanced
ING One Answer Personal Super	ING One Answer Pension	$461,075	$526,694	$65,619	Optimix Balanced
MLC Masterkey Super	MLC Masterkey Pension	$462,434	$529,973	$67,539	Horizon 4 Balanced
Navigator Personal Retirement Plan	Navigator Personal Retirement Plan - ABP	$474,547	$541,118	$66,571	Pre Select Balanced

The table shows that even within such restrictive criteria as this case study, the effect of the product on your recommendation can vary the final account balance by as much as 4% between providers.

Clearly, considering which products to implement your strategy with should be an important consideration when formulating your advice.

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