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She has over 25 years' experience in the financial services industry. Prior to establishing Aged Care Steps, she was Executive General Manager, Financial Services at Trust Company, where she was responsible for financial planning, estates, trusts, estate planning, philanthropy, personal injury and funds management.
Previous roles have included consulting at Challenger/CPH, Head of Shared Services at ING, Head of Research and Technical at RetireInvest and a portfolio manager at Optimix

PLANNING FOR THE THIRD PHASE OF RETIREMENT

Assyat David

Introduction

Retirement planning for baby boomers has provided the foundation for significant growth in the financial services industry. It has underpinned service models, product solutions and growth outcomes. But as baby boomers age, new models and strategies need to be considered. The fundamentals of retirement planning advice must be reviewed against current issues arising from a population facing increasing longevity and issues of frailty, in combination with a regulatory environment increasingly focused on fee for service advice and value adding.

Advisers need to consider how well traditional financial planning strategies are positioned to address these issues and rethink the real-world needs of their clients. Ultimately, they may need new thinking and a fresh approach to retirement planning, which incorporates aged care needs associated with the frailty years[1].

The shifting landscape of financial advice

At a time when many have described the financial advice sector as reeling, and some advisers are saying they feel afraid about the future, there's a good news story emerging from the wreckage – aged care advice.

The white knight of the financial advice industry may not be overtly sexy, but it's steady, reliable and growing – both in consumer demand and profitability.

Over the last few decades, the focus has been on the wealth accumulation of the baby boomers and Generation X, while intergenerational wealth transfer and aged care advice have largely been forgotten.

Over the next two decades, we are likely to see a funds outflow from baby boomer clients, with a projected $3 trillion of wealth to be passed on to the next generation. This will necessitate a shift in focus as advice professionals adapt services and business models to participate in this 'great wealth transfer' wave with value-add services that protect funds under advice and capture opportunities to grow businesses.

The shifting landscape makes it imperative that advisers take time to develop their business plan to focus on areas of growth and the competitiveness and relevance of their client services.

Advice professionals will need to incorporate an aged care solution in their business to be equipped to manage the 'whole of life' client experience and provide the support that clients yearn for when they are going through a life transition.

Rethinking retirement planning

Financial planners focus on the beginning and end of retirement but potentially fall short in adequately addressing the journey through retirement and all its life stage transitions. Historically, advice has tended to concentrate on helping clients grow and manage their superannuation so that they are 'retirement ready' to fund the post work period, the length of which has been defined by life expectancy tables.

The quote

Ongoing advice is paramount to building trust and creating an ongoing relationship with clients.

Aged Care Steps has identified the three phases of retirement which are linked to a person's health. These phases are not defined by age, but rather by levels of independence and frailty. Each client's experience is unique, but as a client transitions through the phases they may need to adjust their goals and objectives, lifestyle decisions, living arrangements, income needs and priorities. But whatever the phase, quality of life, control and access to choices are key ambitions.

From a planning perspective, these three phases should be treated as distinct periods that require tailored planning considerations and outcomes.

The 'great wealth transfer'[2] wave

Baby boomers, those born between 1946 and 1964 (aged 55 to 73), represent a quarter of our population and are the wealthiest generation in our history. They own more than half (53%) of national wealth, according to McCrindle Research[3].

According to this research, Australians aged 55+ currently own a combined $2.8 trillion of wealth. And over the next two decades, most of this wealth will transfer to the next generation and over this time, it is expected to have grown to over $3 trillion.

Advice industry growth has been underpinned by the provision of pre-retirement advice to the baby boomers and helping them build this wealth. Advice businesses have generally measured success in terms of the value of funds under advice, rather than the provision of strategic advice or other client-centric measurements.

The 'great wealth transfer' wave will bring new challenges. The more progressive advisers are already starting to shift their service model and fee for service approach to ensure a more active participation in this unprecedented transfer of wealth. This requires establishing stronger connections with the next generation for the continuation of advice through the family line as the wealth transfers.

Without a doubt, advisers will need to expand their services to include advice on estate planning and aged care and actively engage with the next generation to be involved in the great wealth transfer wave.

Developing competitive advice services

Holistic service advisers deliver services that address the client's broad financial and strategic life needs, with ongoing advice to maintain currency and adapt to changes in the client's circumstances, economy or other external factors. Ongoing advice is paramount to building trust and creating an ongoing relationship with clients.

Offering an ongoing advice service that incorporates aged care and estate planning considerations can differentiate an adviser's client proposition as a relevant, all-encompassing and competitive offering.

Clients are also more likely to renew their ongoing advice fee arrangements if it incorporates reviews of the client's changing life transitions.

Clients particularly appreciate this ongoing advice service during major life transitions such as the death or separation of a partner, disability or health concerns and transition of living arrangements. Advisers can add substantial value to retiree clients by monitoring the transitions between life phases, which may be slow to unfold, and then revisiting the relevance of the assumptions in the financial plan.

Advisers who include ongoing services that address the 'frailty years' are likely to provide better value, better quality and better tailored services that can enhance the competitive advantage of their client service offering.

Benefits of discussing frailty years - adviser revenue

Aged care advice services provide clients with strategic advice to plan ahead for their frailty years, navigate the aged care options and payment choices, facilitate discussions to help families make effective decisions, and avoid the pitfalls, particularly with estate planning.

Incorporating services relating to the 'frailty' years can help advisers enhance revenue sources and reduce negative impacts on revenue in the following ways:

- **Help advisers transition to a true fee-for-service model.** Aged care advice fees are often a flat fee structure for specified aged care advice services. This represents a true fee-for -service arrangement because the advice is predominantly strategic and less reliant on investment portfolios and product placement. Delivering aged care advice services can help advisers position and deliver fee-for-service structures for other advice services.
- **Diversify revenue sources.** Aged care advice has helped many advisers boost business activity and profits, and diversify their revenue sources.
- **Reduce the impact of fluctuating investment markets on revenue.** The strategic nature of aged care advice means that the advice is less reliant on investment portfolios and product placement. Therefore, the quantum of aged care advice revenue tends to be less impacted by investment and product outcomes particularly compared to asset-based fee arrangements.

The above demonstrates only some of the benefits to advice businesses of growing and enhancing their advice services by incorporating aged care advice.

Phases of health in retirement

There are three distinct phases in retirement, which are defined by the client's health and capacity:

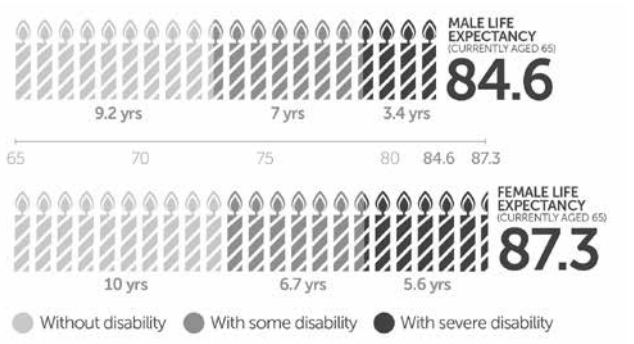
- The care-free (active) years – good health and higher levels of independence allow the client to follow their preferred activities and live independently. This is estimated to represent on average 45-47% of retirement years.
- The quiet years – where a disability or levels of frailty increase in intensity and while independence can still

be maintained, this may require an increasing reliance on external supports. This is estimated to represent on average 30-36% of retirement years.

- The frailty years – where higher levels of support are required on a day-to-day basis to maintain quality of life within the restrictions of the incapacity or frailty. This is estimated to represent on average 17-25% of retirement years.

These phases and average durations (separated for men and women) are shown in the diagram below.

Figure 1. The duration of the three retirement phases



Source: Developed by Aged Care Steps, using source information from Australian Institute of Health and Welfare.

Historically, the approach to retirement planning has been to determine how much a client needs to save to meet a given and constant level of income throughout an expected retirement period.

This has used a straight-line approach to income needs (with indexation for inflation) but a closer look at the issues of longevity and frailty, uncovers the need to develop this model further to take a different approach to portfolio construction and retirement planning.

Rising costs of care and the frailty years

Retirees can reasonably expect to need increasing levels of support over the last 10-12 years of their life, with many experiencing high levels of care dependency in the last 4-5 years. This may require:

- Additional and increasing income to fund care costs, including in the home
- Capital expenditure to make the home suitable for the ageing person (e.g. widening doorways to enable wheelchairs and ramps) or to move to more suitable accommodation.

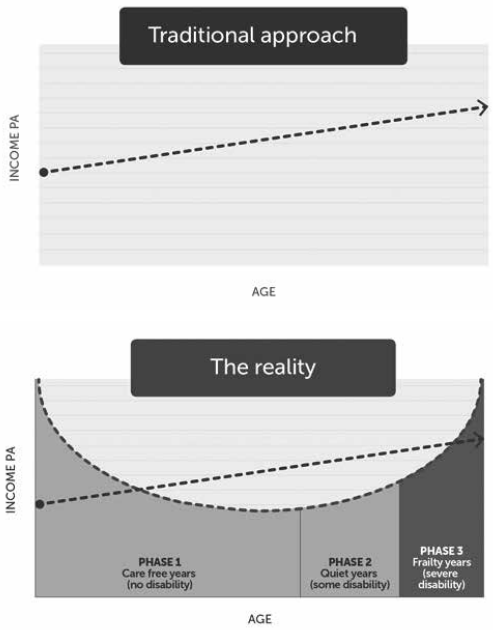
The costs of aged care have been accelerating and are likely to continue to increase at a rate higher than inflation. The current *Royal Commission into Aged Care Quality and Safety* has identified gaps in the standard of care in current funding models against community expectations for the standard of care. This is likely to result in higher costs to ensure quality staffing and a higher quality of care services with greater levels of consumer discretion. But if the costs increase, it is to be expected that higher costs will need to be passed on to consumers through higher fees.

The reality is that older Australians prefer to age at home rather than move into residential care, but accessing adequate and subsidised care in the home is likely to be more difficult than accessing residential care, which means a financial strategy is key.

Aged care costs can be difficult to predict and can vary from $100 a week to $5,000 a week depending on care needs and family circumstances. Access to government subsidies helps to drastically reduce the cost payable by the user, but having adequate savings opens up the choices and ability to control the level and type of care received.

The three-phase approach to retirement matched to income needs shows that income throughout retirement is more likely to follow a u-shape than a straight line. This is illustrated in the diagram below.

Figure 2. The three retirement phases and income expectation



Source: Aged Care Steps Lty Ltd 2018.

When taking into account the costs of aged care, the current retirement planning approach taken by many advisers may fall short of predicting the real retirement income needs and leave clients with significant shortfalls. Clients' savings could run out earlier than anticipated, exacerbating the longevity risk.

Advisers should start having conversations with all clients to discuss:

- How clients expect to fund their aged care costs – highlighting that legislation has been shifting towards a greater user-pays basis.
- The role of the home in meeting aged care costs – including the client's willingness to access the equity in their home or preference to maintain the equity in their home as an inheritance for their family. This includes consideration of the Pension Loan Scheme which is essentially a limited reverse mortgage from the government.
- Consideration of strategies such as downsizing the home and investing part of the proceeds into superannuation.
- Ability to rely on family and friends to provide care and financial support.
- Options for funding the accommodation deposit and ongoing costs if moving into residential care.

The provision of tailored advice is key to supporting clients with

guidance to understand their options, the interdependent variables affecting the outcomes of each option and the cashflow, estate planning and other considerations needed to make informed decisions.

What is certain is that advisers who do not start to address the issues of aged care and adequacy of retirement funding are increasing the risks for clients and placing greater potential burdens on the families of those clients.

Starting the conversation

Aged care can be a difficult and emotionally loaded conversation for family members. Many parents and their adult children avoid talking about it until a crisis occurs, by which time it is often too late for any effective planning.

The same emotions (anxiety, distress, avoidance) may also prevent clients from raising the topic with their adviser. So, as the objective and independent professional, it may be up to the adviser to initiate the conversation.

Advisers should review their advice processes to incorporate a practical framework to introduce the aged care conversation with clients of all ages. The initial client meeting for new clients or the review meeting for existing clients, is an ideal place to explore opportunities for aged care advice.

Advisers can start with simple process changes, such as including aged care and the frailty years in the agenda of review meetings with existing clients and drawing the family tree that branches upwards to include information about the client's parents, thereby providing the trigger to expand on the aged care conversation.

FASEA code of ethics and best interest duty

The FASEA code of ethics will drive behaviours and developments in the financial planning industry. Financial advisers need to incorporate aged care considerations and discussions in their advice processes to satisfy the FASEA Code of Ethics. To ignore aged care considerations puts advisers at risk of failing the FASEA code of ethics.

The code includes the need for advisers to:

- Act in the best interest of clients (which is also a requirement written within the Corporations Act)
- "Actively consider the broader long-term interests and likely circumstances of the client" according to Standard 6.

Acting in the best interest of clients requires advisers to ensure that advice, product recommendations and services are appropriate to meet the client's specific objectives and needs including their likely longer-term interests and circumstances. This means advisers are required to consider the phases of a client's retirement including the frailty years and the impact of changes to their health and circumstances to their financial plan including their income requirements and aged care needs.

Specifically, FASEA Standard 6 requires advisers to consider the longer term and broader effects of the advice provided to clients.

As the FPA[4] explains to advisers: "This standard expressly requires you to take into account the broader, long-term interests and likely circumstances of your client (reflecting section 961B of the Act). For example, any potential need for the client or one of the client's family members to move into aged care accommodation in the near future would need to be factored into any financial advice you give the client."

Advisers and licensees need to address aged care urgently and provide education, support and tools to help advisers adhere to the FASEA code of ethics.

Conclusion

Addressing the three phases of retirement, particularly the frailty years, offers real value and choice to clients by providing them with greater control and independence.

Financial advisers need to adapt their approach to retirement planning to ensure their service meets the real-world needs of their clients. Otherwise advisers face becoming less relevant and less competitive as a business, which will impact commercial viability. They also risk failing to meet the FASEA code of ethics as well as failing to satisfy the needs of the client.

Although all advisers need an aged care solution for their business, they can choose how involved they want to be in the advice process. They can choose to outsource to an aged care expert, use paraplanning services or become an accredited aged care adviser.

To get started in delivering aged care services, advisers need to understand how aged care works and what options clients have, so they can be confident to start client conversations.

They can then decide to build on this knowledge and undertake accreditation aged care training to develop the skills and knowledge to provide personal aged care advise to clients. Soft skills also need to be developed to build capability in dealing with families facing difficult and emotional times.

When implementing the aged care service regardless of the chosen business model, it is important that advisers access practical tools to support each stage of their advice process to enable them to implement efficient processes and maximise opportunities.

Advisers can no longer delay gaining the required knowledge and skills to incorporate discussions about the frailty years with clients or to rethink their business model and financial planning strategies in context of the current regulatory system for advice. FS

Notes

1. *Aged Care Steps 'The three phases of retirement'.*
2. *'Great Wealth Transfer' is a term used by economists and others to refer to the global transfer of wealth from the baby boomer generation.*
3. *McCrindle Research, Australia's generation by wealth and income.*
4. *Financial Planning Association of Australia: 'Helping you understand the FASEA code of ethics" April 2019 – page 29.*