smoothretirement

RETIREMENT INCOME DISCLOSURE CONSULTATION PAPER

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Smooth Retirement Submission

Retirement Income Disclosure Consultation Paper

Stage Two of the Retirement Income Framework

Introduction

Smooth Retirement Pty Ltd makes this submission to The Treasury in response to its Retirement Income Disclosure Consultation Paper, Stage Two of the development of its Retirement Income Framework.

Smooth Retirement Pty Ltd is a new offering to the Australian financial services market which enables retirees to increase their retirement income in a measured way while addressing issues of longevity and decumulation.

Smooth Retirement

Smooth Retirement was established in mid-2016 and is currently undertaking a pre-launch pilot with its new website and full financial services offering to be launched later in 2019.

The company was created by financial services professionals to assist the large number of Australian retirees who own their own homes but have little in savings and superannuation – or, certainly an amount of superannuation that may not see their whole retirement funded.

In summary, Smooth Retirement is a new website and platform for Australian retirees – specifically baby boomers – which provides self-serving retirement income management and advice plus access to increased funding via home equity release in a complete, all-in-one service.

We have created new smart technology to deliver individually tailored and affordable retirement income advice, including projections from age 60 through to 90, together with the online application for a reverse mortgage to increase retirement income (subject to lending criteria).

Our robo-adviser takes into account all of a client's income producing assets (savings, superannuation and family home) as well as their Age Pension entitlements when generating a complete, long-term retirement income plan.

Clients use our facility to turn equity in the family home into a measured 'line of credit', increasing their income in retirement with the added benefit of being able to monitor their situation on a regular basis through the online platform.

Our facility also has the capability to provide clients with access to lump sum withdrawals to pay down debt, finance expenses such as medical care and aged care, as well as enable one-off large purchases like a new car, caravan, home renovation or overseas travel (subject to lending criteria).

The company exceeds all current regulatory requirements and has been licensed and endorsed by ASIC to provide both retirement income stream and credit advice (AFSL and Australian Credit Licence), making it one of the only robo-advisers and fintechs in the country to have achieved this.

Comprehensive Income Products for Retirees (CIPR)

We believe the Smooth Retirement offering meets the objectives of a CIPR, namely:

A retirement income product which provides a complete solution that balances a number of competing objectives in retirement and is designed to provide:

- Efficient, broadly constant income, in expectation;
- Longevity risk management; and
- Some access to capital

Our model not only delivers a long-term retirement income plan from as early as age 60, based on a series of assumptions, it provides clients with the ability to access an increased income which is liveable, comfortable, reliable and most importantly, pre-determined, unchanging and constant, with lender review metrics 10 yearly.

Longevity risk is managed as part of a complete retirement income strategy, with all the client's income producing assets (superannuation, savings, Age Pension and family home) taken into account over the period of the loan facility, for example 30-years maximum, along with the added protection of a hard loan to value ratio (LVR) of 45% (when the youngest person in the couple turns age 90). Noting that this is based on the value of the property and the amount borrowed at the commencement of the ten-year loan period.

As mentioned previously, our model also allows clients to borrow against their home equity to access capital (dependent on the amount of equity they hold and the value of their home).

In line with other CIPRs currently under consideration, Smooth Retirement believes its new financial services offering has significant potential to serve as a new retirement income management option for superannuation fund members, particularly members with lower superannuation balances.

We also believe that equity release products, as they have done overseas, will most likely become commonplace in the Australian retirement market in the near future as demand for new income options for retiree grows and the population continues to age.

Smooth Retirement believes that equity release has a legitimate role in assisting people to manage their retirement and therefore should be included in the raft of measures under consideration in the development of the Retirement Income Framework.

Response to Retirement Income Disclosure Consultation Paper

While our concept is very different from the annuity / investment-based products under consideration, our platform has the inbuilt capacity to accurately model and clearly illustrate a client's monthly and annual income over the lifetime of a loan product (i.e. max 30 years from age 60), taking into account all their income producing assets including superannuation, savings, Age Pension entitlements home equity and lending criteria.

Our model uses the application of a reverse mortgage to release equity and increase income in a measured and strategic way, early in retirement and as part of a holistic 30-year retirement income plan.

Income

While we don't have the capacity to provide income figures based on an investment of $100,000, our platform and robo-adviser have the capacity to provide anticipated (based on a series of disclosed assumptions) estimates of expected real income on borrowings of $100,000 from age 60 to age 90 – the maximum period of the equity release facility.

If a couple were to borrow $100,000 from the equity in their home at age 60 (the earliest age a reverse mortgage facility can be taken) to boost their annual income to age 90 (the end of our loan facility), then their income would increase by $3,333 per annum. This figure excludes additional income from superannuation and Age Pension.

In this case, our facility could provide an increased total income over 30 years of $100,000, to be paid back to the lender in full plus compounded interest, when the house is sold or vacated.

These metrics however do not represent the full potential of Smooth Retirement in assisting retirees to independently live better, particularly those with no means to invest $100,000 and who probably have less than that amount in superannuation and savings combined as a couple.

For couples like this, who currently make up 20% of all retired Australians today, investment products to increase retirement income are simply not an option.

How much is enough for retirement?

The Association of Superannuation Funds of Australia (ASFA) currently describes a comfortable retirement as requiring an income of $60,977 for a couple and $43,317 for a single retiree.

A comfortable retirement is defined by ASFA as a lifestyle that "enables an older, healthy retiree to be involved in a broad range of leisure and recreational activities and to have a good standard of living through the purchase of such things as; household goods, private health insurance, a reasonable car, good clothes, a range of electronic equipment, and domestic and occasionally international holiday travel."

The Association describes a modest retirement as one which "is considered better than the Age Pension, but still only able to afford fairly basic activities."

Both the comfortable and modest budgets set by ASFA assume the retirees own their own home outright and are relatively healthy.

Taking into account the figures recommended to fund a comfortable retirement, if you deduct the current maximum Age Pension entitlements of $35,916.40 per couple and $23,823.80 for a single retiree, you are left with a clear shortfall of $19,493.20 for a single and $25,060.60 for a couple between them and the target.

Even looking at the modest retirement benchmarks, once the Age Pension is deducted singles still face a shortfall of $3,824.20 per annum and couples $3,858.60.

Both budget scenarios will require some sort of additional means of funding in order to deliver a quality of life greater than that provided by the Age Pension alone.

For too many retirees, their superannuation and savings are simply not enough to fund all their years of retirement and often last for less than 10 years, leaving them with only their Age Pension to live off.

Smooth Retirement Case Study

The majority of Australian retirees have more wealth in the family home than in superannuation or other savings. Our model assists retirees to access that equity in their home, to smooth out their long-term income, retain their full Age Pension entitlements and preserve their superannuation and savings for longer.

The case study below demonstrates how Smooth Retirement can be used effectively to increase income from age 60 to 90 for a couple with a home, and modest assets and savings.

John and Mary are turning 68 and have the following:

- A $825,000 home
- Modest additional assets of $17,000
- Joint superannuation balance of $235,000
- Existing debt of $20,000

The couple would like a retirement income of $59,000 per annum and receive the full Age Pension and supplement of $35,916.40 per annum.

Without Smooth Retirement:

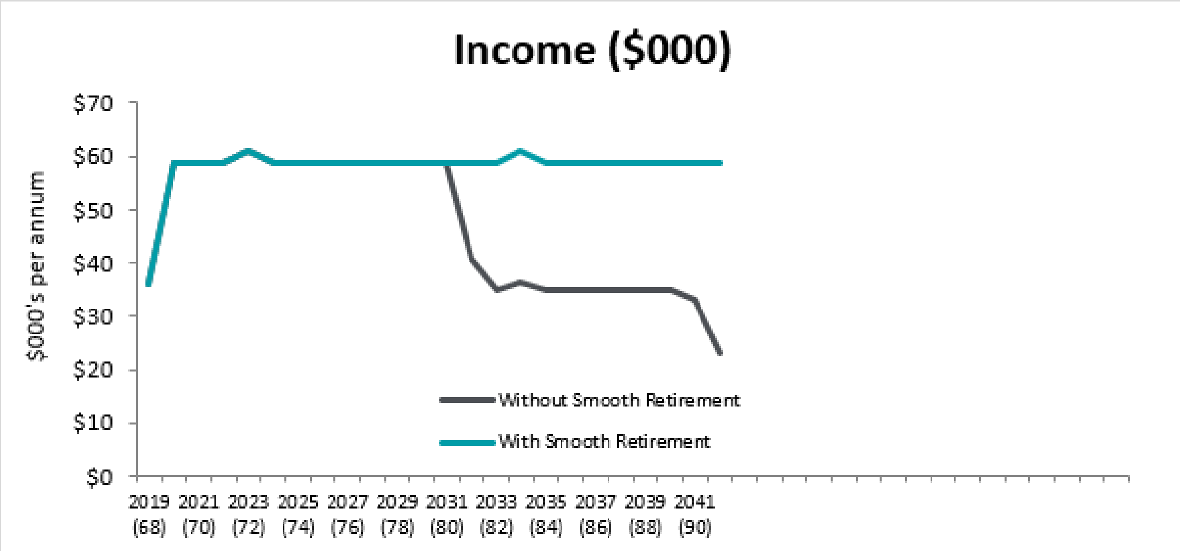
- Account-based pension is completely gone when John is 76 and Mary is 80
- At 90, their net assets would be worth $1,267,691
- Total combined income of $1,099,607

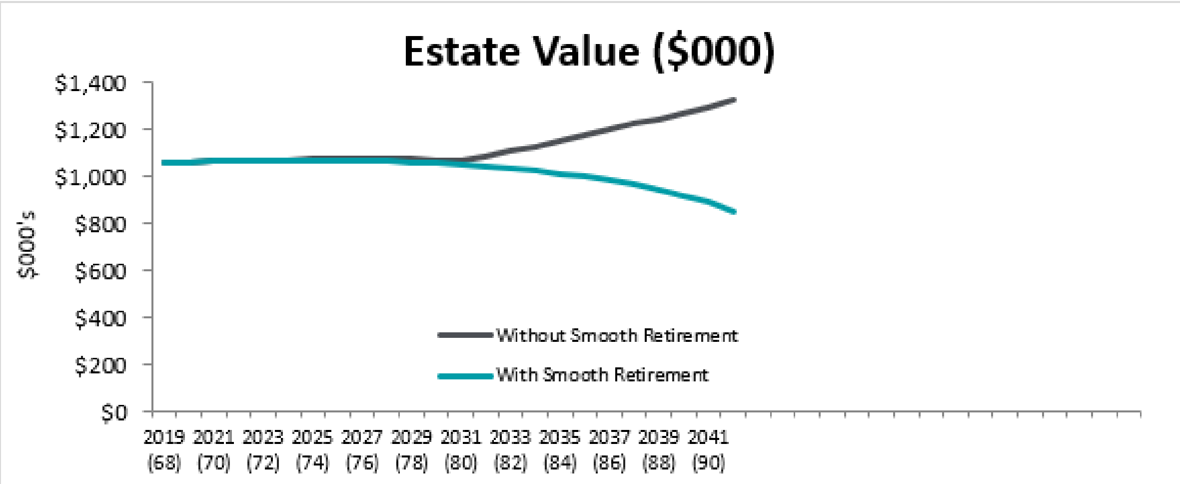
With Smooth Retirement:

- Account-based pension lasts until they are both 90
- At 90, their net assets would be worth $895,444
- Total combined income of $1,333,911

In summary, Smooth Retirement boosted John and Mary's income by $234,304 over the 22 years of their retirement and preserved their account-based pension for a further nine years.

The difference between total additional income received and reduction in net asset value totalled $167,943 over the lifetime of the facility.





These figures are based on a loan facility with an interest rate of 6.54%.

All income estimates are net of fees and taxes.

Variation in expected income – potential risks

One of the fundamental attributes of the Smooth Retirement solution is that there are more known factors with drawing equity from a home than there are with investing. The control factors working in our model are the hard loan to value ratios (LVRs), the interest rate on the loan and the value of the home.

While interest rates and property values are factors outside the control of individual consumers, it can legitimately be argued that if interest rates were to rise, it is a result of the Reserve Bank taking action to constrict the supply of money in order to reel in inflation. It would be hard to imagine an inflation event that would not include an increase in the value of residential real estate in Australia. On this basis, interest rates are less risk to our model because if they were to rise, it is likely that the consumer's home would also have increased in value.

Another common concern is, "what happens to a reverse mortgage if house properties reduce substantially?". If the house reduces in value due to an unforeseen localised event (i.e. a nuclear plant or freeway being built nearby), the value of that property would have reduced with or without Smooth Retirement. If a house was to halve in value ten years into the loan facility, regardless of whether the client has a reverse mortgage on the property, the client will be exposed to a reduction in their wealth. In such an event, our hard LVRs ensure there are inbuilt protection mechanisms along the way. If a client is 10% lent at the age of 75 and their home was to halve in value during that time, then it would effectively mean that the client is now exposed to a debt that is 20% the original value of the home and due to that decrease in value, the loan facility would not allow any further drawings on the home equity by the client. These inbuilt hard stops ensure the bank's position is safe and the client is not exposed to incurring any further debt against their home.

If there was to be an across-the-board reduction in house prices, then the responsibility of managing the supply of money would fall to the Reserve Bank. It is likely that interest rates would reduce, and it follows therefore that interest rates on reverse mortgages would also reduce, albeit they would be one of the last interest rates to reduce and they may reduce by less. A reduction in interest rates at a reverse mortgage level makes a substantial difference to the compounding impact of reverse mortgages.

Access to underlying capital

The Smooth Retirement model enables people to access capital to adapt or deal with changes to their circumstances. This includes lump sums for home improvements or accessing funds for large purchases. It also provides flexibility to access emergency funds to cope with large unexpected expenses.

All lump sum withdrawals are calculated based on current borrowings against the home and the amount of equity remaining in the home, noting that our model will not allow clients to borrow more than 45% of the value of their home (by age 90).

Our robo-adviser ANDREW can model in minutes whether or not a client has the capacity to borrow capital and what those maximum borrowings would be.

Lump sum payments can be used to pay down debt, including the refinancing of an outstanding traditional mortgage on the family home with a reverse mortgage, assisting retirees to use all their remaining income to fund their lifestyle without the need to continue servicing debt.

What happens on death?

A reverse mortgage facility ends when the youngest member of a couple turns 90 with the loan to be repaid back in full when the house is vacated by the last remaining borrower, either due to sale, move to aged care or death.

If the reverse mortgage loan facility is in the name of both members of a couple, then in the event of one member of that couple dying, the facility remains unchanged and in place for as long as the surviving member of the couple resides in the home.

If only one member of the couple is the only borrower and they die, then the surviving member of the couple will not be able to remain living in the home, unless they can pay down the debt in way that does not require the sale of the home. While the surviving spouse may not be able to prevent the sale of the home, and depending on the terms of the Will, they will likely receive the balance or a portion thereof the sale proceeds as part of their partner's deceased estate.

Attributes of the Smooth Retirement model

Equity release products such as the model delivered by Smooth Retirement, provide a high degree of protection against the risk of running out of money.

Our solution, with its inbuilt protections including a hard LVR, allows clients to utilise their entire wealth to support their capacity to not run out of money for the rest of their years and to use all of their income assets in retirement to produce a smooth income stream. This capacity is enhanced substantially the earlier equity release is adopted in retirement (i.e. the base model for Smooth Retirement from age 60 to 90).

A significant attribute of our solution is that at any given time the client can change their mind and choose to access all the equity in their house. They can choose to sell down their house at any time. There are no caveats, no restrictions and no break costs. Interest is calculated daily and debited to the account monthly.

With access to the equity in their home at any point, the client's degree of flexibility is quite large. It is significantly larger than other income product offerings (i.e. annuities).

It is most commonly the family home that is borrowed against and there are substantial tax treatment concessions for clients in this case, including the capacity to move cash reserves from a downsize into superannuation investments with no impact on Centrelink entitlements.

Our model is designed to deliver self-serving, ongoing, accessible and informative income advice that is value for money and readily available to the many retirees who would not be able to afford traditional forms of financial advice (i.e. financial planners).

Our platform also has the capacity to guide clients as their circumstances change to relevantly qualified experts to provide them with the right advice and drive better outcomes for retirees and the community overall.

Following the Royal Commission

Duty of Care

Greater focus is being placed on the duty of care obligations of financial advisers as a result of the Hayne Royal Commission.

This is certainly the case across the vast array of services that can be accessed by consumers from financial services providers.

Equity release is no different. Today, if a client presents to a financial adviser with little in savings or superannuation but with the majority of their wealth contained in the family home, it is the responsibility of the adviser to outline to that client all of their financial management options, including equity release.

In reality, few advisers know about equity release products. Of the few that do, most are unlicensed to provide advice on them.

As a result, clients in the financial situation outlined above present very little value to a financial adviser, and we contend that this situation will only become exacerbated once the Royal Commission recommendations are implemented and the cost of financial advice increases.

It is not possible for an adviser to commence a meaningful, helpful relationship with a client who has few resources to pay their fee?

Despite these factors, advisers have an increasing responsibility to act in the best interests of their clients and that includes in advising them of all their options in retirement.

It will no longer be acceptable for advisor to claim a lack of understanding or knowledge of a product as a reason for not presenting all available options to clients, particularly those that could be deemed in their best interests.

We contend that in a duty of care environment, when a client heading into retirement presents to a financial advice professional with the majority of their cash in their family home / investment property, and little in superannuation or savings, it is the responsibility of the adviser to present equity release as a possible option.

If the planner is not qualified to provide that advice, they should then refer the client to an advising professional who is (i.e. mortgage broker / credit adviser).

We believe there is an equal responsibility in relation to referring clients in need to a qualified professional (i.e. a lawyer) for the preparation of wills and estate planning.

Increasing cost of financial advice

As measures are implemented to clean up the industry, post the Royal Commission, it is likely that financial planners will have little choice but to pass on the increased costs for professional indemnity insurance and additional compliance to their clients.

The increased cost of providing advice will make it financially preclusive for lower tier clients – particularly retirees - to access these services in the future.

Our platform is well-placed to assist the growing retiree population with accessible, self-serving, affordable and easy to understand retirement income advice along with transparent and upfront onboarding and ongoing platform fees and costs.

Financial hardship

As credit providers, we have a really important role to play in the lives of our clients including ensuring that we are not enabling clients to live beyond their own financial resources.

It is the responsibility of the credit provider before any loan can be approved to determine whether a reverse mortgage is "not unsuitable" for that client and their retirement objectives. This includes considering factors such as the value of the home, level of equity in the home, health of the clients and need for aged care, along with their plans, if any, to set aside some of their wealth as legacy.

In addition, equity release has built-in safeguards. The lender is motivated by similar mechanisms to that of the borrower – ensuring under the loan facility there will be enough equity left in a property to pay down the debt if the client lives for a very long time and remains in the house well after they turn 90 years of age.

Further, residential real estate in Australian has demonstrated a long-term propensity to grow in value over time, and assuming this continues to be the case, this provides another safeguard for both borrower and lender.

The conservative age of the youngest borrower-derived LVR (age 90) is yet another safety feature.

We also ensure at the start of the loan that a client has sufficient income to pay the council rates and for their property to remain insured and in good repair – a further financial hardship safeguard.

Elder abuse

Smooth Retirement is extremely conscious of the need to protect clients wherever possible from being vulnerable to elder abuse.

Our platform has built in protections and hard-stops which are designed to prevent others from accessing client profiles and online facilities without consent.

Each client must submit to a 100-point identification check and will be given a secure password-protected log in, with the added security of Two Factor Authentication (2FA).

Despite the highest levels of security, it is an unfortunate fact that elder abuse still occurs, with relatives or carers able to use known client log in details, without permission and in some cases in unauthorised and illegal ways.

One of the most protective features of Smooth Retirement's model is its lender's hard LVR of 45% at age 90. This means that despite the best efforts of a wayward relative or carer, no more than 45% of the value of a property over the lifetime of the facility can be spent.

Further to this, our clients are protected by the age-derived LVR, meaning the 45% is an absolute worst-case scenario, giving the client a high degree of assurance – with a much lower LVR at the commencement of the facility, increasing over time.

Overseas experience

The US has the largest reverse mortgage market in the world. The reverse mortgage market also exists in the UK, Japan, South Korea, and Canada but the size of those markets is much smaller than in the United States.

Unique to the US is the substantial involvement of the public sector in the form of mortgage insurance by the Federal Housing Administration (FHA) and a guarantee on timely payment on mortgage-backed securities (MBS) by Ginnie Mae – both organisations function within the US Department of Housing and Urban Development (HUD).

Because the industry is government-insured, this means loans don't have to be financed by the reverse mortgage companies off their balance sheet.

Demand for reverse mortgages in Canada continues to grow. The elderly population of Canada is also growing rapidly. The largest provider is HomeEquity Bank which had outstanding reverse mortgage balances totally 1.58 billion CAD in 2015. This represented an annual growth rate of 16.04 percent since 2009.

In the UK the reverse mortgage market grew by 34 per cent in 2017. The market is relatively small at less than 2.2 billion pounds (the reverse mortgage market in the US is five times the size).

The take up of reverse mortgages in the UK has increased substantially since the compulsory purchase of annuities was abolished in 2017 – outselling annuities now by more than double.

It is likely to grow even more with an estimated 1.7 trillion pounds – or up to 340,000 pounds of equity per home – is tied up in property owned by people over 65.

Future considerations

Lifetime engagement

Not only do we support the early and ongoing engagement with people pre-retirement, our model is designed to work best for clients when implemented at the outset or early in retirement.

Our platform and ongoing self-serving retirement income advice and modelling is then available to them – with the ability to respond constantly to changing circumstances – throughout the lifetime of their facility – from as early as age 60 through to 90.

We are committed to providing clients with a full and complete understanding of their retirement income options and how our model can work for them – both in terms of boosting their income, accessing capital and the subsequent erosion of home equity over the lifetime of the loan.

Our model supports clients to retain and benefit from their maximum full or part Age Pension entitlements as well as to preserve their savings, superannuation and investments for longer. accessing vital funds at a time when no other loans would likely be available to them.

Post purchase engagement

The Smooth Retirement model has been designed to be responsive to a client's changing circumstances throughout the life of the facility.

Our clients have the ability to make changes and request new retirement income advice as many times as they choose via the 24-hour online access to the platform.

Any new inputs will result in a complete remodelling for their retirement income plan with new projections and income advice issued to the client at no additional cost.

We also have a responsibility to contact the client annually, regardless of any other interaction they may or may not have with us, to confirm that they are still living in their home, it remains insured and in good repair – as part of the conditions of their loan facility.

It is our commitment to our clients and their ongoing financial education to provide them with relevant, age appropriate information to assist them in meeting their retirement goals.

Reporting requirements

Our platform has superior reporting functionality and is able to provide individual reports for each of our clients on their annual and average expected income as delivered by our facility.

Again, as our product is equity release and not an investment-based income generating product, we are not able to provide the comparative information as outlined.

Consumer testing

Smooth Retirement would like Treasury to consider an additional fact sheet on equity release products when testing the effectiveness of fact sheets in assisting consumers to choose a retirement income product that aligns with their needs and preferences.

Conclusion

Smooth Retirement contends that equity release has significant potential to serve as a new retirement income management option and financial product offering for Australian retirees.

We also believe that the equity release market is going to increase substantially in Australia as more and more underfunded homeowners – particularly baby boomers – head into retirement.

On this basis, we submit that the Smooth Retirement platform and other equity release offerings like it, be included in the development of the Retirement Income Framework.

ENDS