Challenger **Tech**

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February 2020

Part two: How should I structure a lifetime income stream for a client?

By Michael McLean, Technical Services Manager

A lifetime income stream including a lifetime annuity, can provide secure, regular income for life, providing clients with peace of mind in retirement regardless of how long they live or how investment markets perform. Once a decision has been made to invest into a lifetime income stream, advisers can consider who owns the income stream for partnered clients and how much to allocate to it.

We have approached this issue in two parts. In this article, part two, we address some of the considerations relating to how much a client should invest in a lifetime income stream. Part one further explored how to structure a lifetime income stream by discussing which spouse should own the lifetime income stream.

In part one, we explained the Challenger Guaranteed Annuity (Liquid Lifetime), including the three Liquid Lifetime options available for clients to choose from, and the Centrelink/ Department of Veterans Affairs (DVA) assessment of each option. We continue part two of this article with assumed knowledge from part one and continue with Liquid Lifetime Flexible Income (Immediate) as the focus. More information regarding Liquid Lifetime can be found in the Product Disclosure Statement, and Centrelink/DVA and tax information in the Challenger lifetime annuity Technical Guide.

How much should my client invest in a lifetime income stream?

Ultimately an appropriate amount will depend on a client's situation and the strategy implemented to achieve their goals. In this article we discuss three strategies and how much clients can consider investing for each.

Rates and thresholds used in this article are as at 24 January 2019 unless otherwise stated, and couples are considered non-illness separated for Age Pension purposes.

1. Layering – securing a guaranteed level of income above the maximum Age Pension

For many clients the full Age Pension is not enough to meet all their essentials. The Association of Super Funds of Australia (ASFA) provides modest retirement standards for singles and couples, $27,913 p.a. and $40,194 p.a. respectively for the September 2019 quarter, which are both higher than the respective maximum Age Pension amounts.

Table 1: Maximum Age Pension rates

	Single	Couple
Maximum annual Age Pension rate	$24,268.40	$36,582.00

For those who do not want to live on the full Age Pension alone, a strategy to consider is using a lifetime annuity as a layer of guaranteed income on top of the Age Pension. This means if a client was to ever run out of assets, they would continue to receive two sources of income, the Age Pension plus their lifetime annuity income.

The amount to invest in a lifetime income stream depends on the level of minimum income a client wants. The lifetime income stream payment should equal at least the difference between the client's minimum income target and the full Age Pension rate. For example, if a single client wants $30,000 p.a. minimum income for the rest of their life, then a lifetime income stream which provides $5,732 ($30,000 – $24,268) could achieve this.

However, there are a few issues to consider:

- Whilst the Age Pension basic rate and Pension Supplement increase with at least CPI each year, the Energy Supplement ($14.10 p.f. for singles and $10.60 p.f. for members of a couple) does not index. This means that over time the full Age Pension rate may not keep up with inflation.
- Will your client wish to add a buffer into their minimum income level in case they have underestimated their needs?
- If 60% of the first-year annual payment from the lifetime annuity is greater than the first-year Age Pension income test thresholds (currently $4,524 for singles and $8,008 for couples) and CPI-indexation is selected, then clients might always have assessable income greater than the income test threshold.

Based on these considerations, a slightly higher investment amount into the annuity may help clients maintain their minimum target income for longer.

Ali and Yasemin

Ali and Yasemin, both age 66, are couple homeowners with $200,000 each in deemed account-based pensions. After speaking with their adviser, they realise the full couple Age Pension is not enough to meet their essentials. They are currently spending $55,000 p.a. but would like a minimum $40,000 p.a. for the rest of their life, an extra $3,418 above the full couple Age Pension.

> For those who do not want to live on the full Age Pension alone, a strategy to consider is using a lifetime annuity as a layer of guaranteed income on top of the Age Pension.

> For a layering strategy, the lifetime income stream payment should equal at least the difference between the client's minimum income target and the full Age Pension rate.

Ali and Yasemin's adviser recommends they invest $100,000 (25% of their assessable assets) in a Liquid Lifetime Flexible Income (Immediate) with $4,034 p.a.[1] payments indexed to inflation. This means they will receive at least $40,616 p.a. (full Age Pension $36,582 plus lifetime annuity $4,034). This is slightly higher than their $40,000 p.a. goal because their adviser considers planning for the non-indexed Energy Supplement and adding in a buffer.

Ali and Yasemin's adviser recommends they invest in Ali's name with Yasemin as reversionary because:

- The surviving spouse will receive minimum income of $28,302 p.a. (full Age Pension $24,268 plus lifetime annuity $4,034), enabling them to maximise their guaranteed income for life.
- They receive slightly higher payments compared to investing in Yasemin's name with Ali as reversionary, which is more important to them than a slightly longer withdrawal period from investing in Yasemin's name.

2. Helping non-pensioners get some Age Pension and the Pensioner Concession Card

Those not receiving Age Pension due to being above their Age Pension assets test cut-out threshold can invest in a Liquid Lifetime Flexible Income (Immediate) to help reduce their assessable assets.

Table 2: Age Pension disqualifying asset limits

Disqualifying asset limits	Single	Couple
Homeowner	$574,500	$863,500
Non-homeowner	$785,000	$1,074,000

A simple guide for how much to invest in a lifetime income stream where only the assets test is considered:

(Total assessable assets less Disqualifying asset limit) divided by 40%

Advisers can use the following formula as a simple guide for how much to invest in a lifetime income stream for clients where only the assets test is considered:

(Total assessable assets – Disqualifying asset limit) / 40%

Note, if a person has assessable assets exactly equal to the disqualifying asset limit, they will not receive any Age Pension. Furthermore, assessable asset amounts can increase or decrease over time as markets change or clients spend/save. Therefore, it could be prudent to invest slightly more to ensure clients receive Age Pension and the Pensioner Concession Card immediately and continue to in the future. Challenger Tech are currently writing an article on the value of the Pensioner Concession Card for March 2020 Tech News.

Raj and Isha

Homeowner couple Raj, age 68, and Isha, age 67, each have $475,000 in deemed account-based pensions, or $950,000 combined assessable assets. The investment amount in a Liquid Lifetime Flexible Income (Immediate) to reduce their assessable assets to the $863,500 threshold is:

($950,000 – $863,500) / 40% = $216,250

1 Challenger quote 24/01/2020, Liquid Lifetime Flexible Income (Immediate), 66 year old male owner with 66 year old female reversionary, CPI indexed payments, no adviser fees.

Raj and Isha's adviser recommends a $250,000 investment (26.3% of their assessable assets), which will reduce their assessable assets to $850,000. Raj and Isha are comfortable with a guaranteed lifetime income stream and that being $13,500 under their $863,500 disqualifying asset threshold is sufficient for them. This provides them with $2,002 Age Pension combined in year one and the Pensioner Concession Card.

Raj and Isha are both in their second marriage and would prefer to keep their assets separate. Their adviser also notes that there are no material Centrelink/DVA benefits from investing in just one of their names. They choose to invest $125,000 each into a Liquid Lifetime Flexible Income (Immediate), with no reversionary, which allows Raj and Isha to choose their own beneficiaries. This strategy provides them with $20,721[2] more Age Pension over five years if they spend $60,000 p.a. in today's dollars, and provides them with the Pensioner Concession Card three years earlier compared with leaving all their funds in account-based pensions.

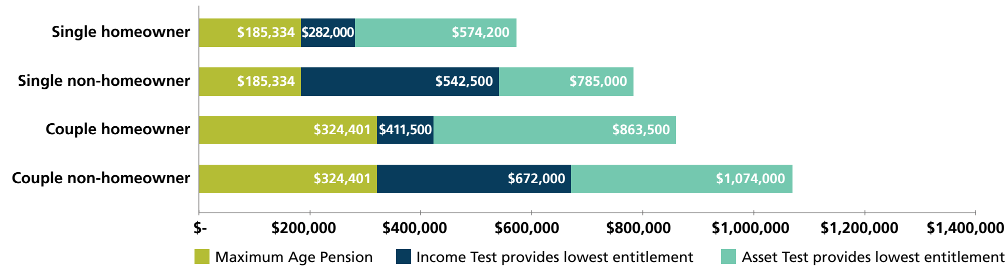
3. Helping asset-tested pensioners get more Age Pension

Generally, the more that an asset-tested pensioner invests in a Liquid Lifetime Flexible Income (Immediate), the more Age Pension they will receive. They can increase their Age Pension by $3,120 in the first year per $100,000 Liquid Lifetime Flexible Income (Immediate) investment. However, a client's risk profile and diversification needs should be considered, as well as the point at which a pensioner becomes income-tested, as the Age Pension benefit of investing in a lifetime income stream reduces at that point.

Clients can increase their Age Pension by $3,120 in the first year per $100,000 Liquid Lifetime Flexible Income (Immediate) investment.

Figure 1 provides a guide for these crossover points, showing the points for clients who just have deemed financial assets. For example, couple homeowners are full pensioners up to $324,401, at which point they become income tested and remain so up to $411,500, then they are asset-tested up to $863,500 where they lose Age Pension.

Figure 1: Income and asset strategy zones



The Challenger Age Pension Illustrator (the Illustrator) can be used to determine where the income and asset crossover points are for each specific client case.

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2 Challenger Age Pension Illustrator 24/01/2020, $60,000 p.a. target income, 50/50 defensive/growth risk profile, account-based pension 3.7% defensive returns before 0.6% defensive investment fee and 7.7% growth return before 0.8% growth investment fee, both before 0.5% platform fee, CPI 2.5%. Liquid Lifetime full CPI payments with no adviser fees.

Alex and Alina

Alex and Alina, both age 66, are couple homeowners with $250,000 each in deemed account-based pensions (50/50 risk profile) and want $58,000 p.a. retirement income.

Their adviser realises that their $500,000 assessable assets are just above the crossover guide for couple homeowners ($411,500). Alex and Alina's adviser feels that a lifetime income stream could be a good option for them, to both help them receive more Age Pension today and provide them with a guaranteed income source for life.

By using the Illustrator, Alex and Alina's adviser models their retirement income scenario to see how a Liquid Lifetime Flexible Income (Immediate) might help with their Age Pension. Their adviser changes the investment percentage of the lifetime annuity on the Illustrator to see where Alex and Alina become income-tested.

Alex and Alina's adviser tests this strategy with half the annuity investment in each spouse's name with the other as reversionary, so both income streams continue for the rest of the surviving spouse's life.

Table 3: Alex and Alina's Age Pension increase in year one for different lifetime income stream investment amounts

Lifetime income stream % investment	Lifetime income stream $ amount	Age Pension increase in year one	Applicable Age Pension test
20%	$100,000	$3,120	Assets
30%	$150,000	$4,680	Assets
35%	$175,000	$5,460	Assets
39%	$195,000	$6,084	Assets
40%	$200,000	$6,179	Income
45%	$225,000	$6,252	Income

By using some trial and error with the lifetime annuity allocation on the Illustrator, Alex and Alina's adviser finds that a 40% investment, or $200,000, in a lifetime income stream, is the point at which they become income-tested. Any higher investment does not significantly improve their Age Pension, as Table 3 shows. Their adviser discusses the findings with Alex and Alina, and they decide that a 35% investment would be best for them. This does not give them the highest Age Pension today, but Alex and Alina understand that they are drawing down their assets over time, so expect to become income-tested soon enough.

If they invest $87,500 each in their individual names with each other as reversionary, then over five years they are projected to receive $16,075[3] more in Age Pension compared with leaving their money in account-based pensions.

3 Challenger Age Pension Illustrator 24/01/2020, $58,000 p.a. target income, 50/50 defensive/growth risk profile, account-based pension 3.7% defensive returns before 0.6% defensive investment fee and 7.7% growth return before 0.8% growth investment fee, both before 0.5% platform fee, CPI 2.5%. Liquid Lifetime full CPI payments with no adviser fees.

4. Other strategies

Advisers may also use a lifetime income stream for other reasons, including:

- Managing tax outcomes – The deductible amount of a non-super lifetime income stream's regular payment is not assessable for tax purposes. Competitive payments as part of a client's defensive portfolio – Some advisers simply use a lifetime income stream as an alternative to cash, term deposits and other defensive assets.
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- Estate planning considerations – Nominating an individual beneficiary, either for super or non-super lifetime income streams, does not form part of the estate so can help with estate goals.

The deductible amount of a non-super lifetime income stream's regular payment is not assessable for tax purposes.

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