Innovation in Retirement Investing

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MAGELLAN
EXPERTS IN GLOBAL INVESTING

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Technology advances
through a novel assemblage
of extant technologies and practices

- W. Brian Arthur

W. Brian Arthur. The Nature of Technology: What It Is and How It Evolves. Free Press, 2009.

e purpose of investing in retirement

eliver private income to enhance the living standards of retired Australians

The **Retirement Income Covenant** considers the goals of retirement investing:

- to maximise retirement income;
- to manage the risks to the sustainability of their income; and
- have some flexible access to savings during retirement.

Our perspective is that the goals consists of:

- an **effective salary replacement** to meet investors’ everyday costs of living;
- which is sustainable in order **manage sequencing and longevity risk**; and
- liquid to **retain access to their capital** for large or unexpected expenses and/or to meet a bequest wish.
- These goals must be met in a **low friction**, efficient package that investors and their advisers can easily use

Treasury Australian Government. Super System Review, Part One – Overview and Recommendations (2010)
The Australian Government Treasury. Retirement Income Covenant, Treasury Laws Amendment (Measures for a later sitting) Bill 2021. 2021. url: https://treasury.gov.au/consultation/c2021-209553

Pooling: investments and tax

To provide access to high quality investment management

Pooling of capital has been used for centuries to provide small investors access to high quality investment management. Investors share not only in investment returns, but the tax consequences

- Australian unit trusts almost always pass through the taxable income to investors
  - A trust may withhold taxable income, but this leads to taxation at the highest marginal rate
- Until recently, Australian unit trust almost always distribute cash equal to the taxable income
  - Distributing a lesser amount leads to double taxation
- Volatility of taxable income conflicts with the first goal of retirement investing: a predictable income
- It also forces the investment strategy to focus on dividend yield, which may bring additional risks
- Thus in 2015, Attributed Managed Investment Trusts (AMITs) were introduced to break the nexus between taxable income and distributed cash

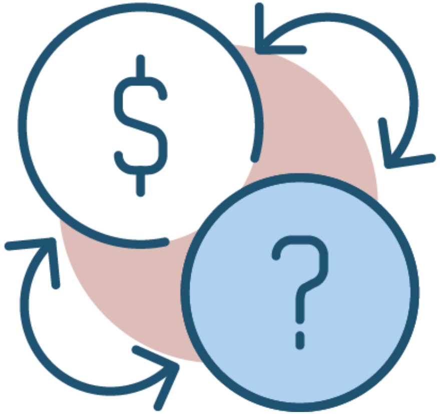
Future*Pay* is a Managed Investment Scheme that has elected to become an AMIT so that it may delivered a predictable regular income to investors

Bucketing

Managing the risks of a predictable income from risky assets

Investments in equity assets have inherent risk

- When a fixed income is provided from growth assets, an additional risk arises known as ***sequencing risk***, in which experiencing the same returns in a different order results in different outcomes
- This is a material risk that investors in retirement are exposed

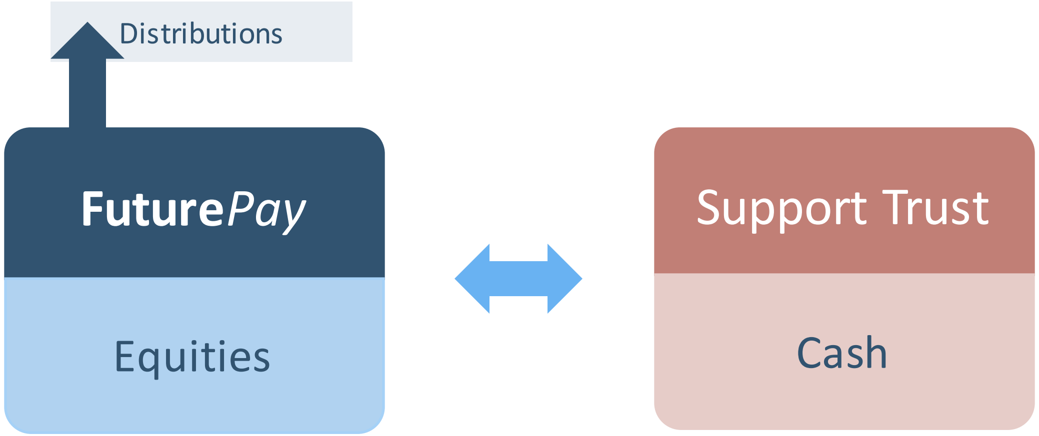


Many investors and advisers are using a *bucketing* approach where some amount of cash is provisioned (usually 1 to 3 years of income) to fund income in adverse markets

- Such an approach has several benefits, including a reduction in sequencing risk

Lisa Shalett et al. Building a Dynamic Retirement Plan: Time-Segmented Bucketing Revisited. 2013
Paddy McCrudden and Brett Cairns. The Utility of Reserving in Retirement Investing. 27th Colloquium on Pensions and Retirement Research, University of NSW 2019

Bucketing in **Future***Pay*



32

months of income stored*

Future*Pay* refined the bucketing process in a way that seeks to optimise the goals of the retirement investor

* As at 16 November. There is no guarantee that the Support Trust will provide income support to Magellan FuturePay or that the target monthly income will be met

...tualisation

profound and well-used means of sharing risk

Provisioning capital for potential adverse future events is costly

- Seeking to reduce this cost through risk sharing or mutualisation is an ancient and profound investment technology

The defined benefit scheme and life annuity mutualise two risks:

  - mortality risk: rather than expose investors to longevity risk
  - investment risk: rather than expose investors to the period they are beneficiaries

- This mutualisation of risk comes at the cost of limited or no access to capital
- A partial mutualisation of risk can ameliorate the limited access to capital

> To harness the benefits of mutualisation, **Future***Pay* mutualises its cash reserves, which are held in a separate trust for the benefit of current and future members

Active Exchange Traded Funds (ETFs)

ETFs are open-ended, traded continuously on exchange, providing investors with a high degree of liquidity

- The structure of ETFs requires market makers, known as Authorised Participants (AP) to continuously make markets and hedge their exposures with the underlying securities
- ETFs originally required complete transparency of holdings, meaning that active managers who wished to protect the intellectual property of their holdings were effectively precluded
- Active management is important in retirement, especially to manage downside risks

In 2015, Magellan pioneered actively managed ETFs in Australia when it launched the Magellan Global Equities Fund*

The key innovation was to enable the fund itself to act as market maker

*Now Magellan Global Fund (Open Class)

FuturePay as active ETF

Additional benefits of exchange trading include the ability for investors to sell units at a market price, thus obtaining value for the mutualised benefit of the Support Trust

Future*Pay* has been launched as an active ETF, which provides daily access for investors and to an active investment strategy, and the ability to trade the mutualisation benefit

2 "One unit"

Trading the same unit on-and off-exchange

Until very recently, pooled investment vehicles were available exclusively either on-exchange or off-exchange

- Thus, investors who purchased their investment via one venue could only exit their investment via that venue

In 2020, Magellan introduced the "single unit" structure, where a unit could be traded both on-or off-exchange

This structure has clear benefits to investors and their advisers as:

- they may choose their preferred venue for access without constraining future liquidity choices
- it enables a change of preferred trading venue without crystalising a taxable event
- it supports the continued use of sophisticated on-and off-market platforms for portfolio and tax analysis
- investors who purchase their unit off market may take advantage of an exit price on market

Future*Pay* was launched as a single unit active ETF enabling investors low friction access via their preferred venue, without limiting future modes of access

Magellan **Future***Pay*

A managed fund purpose-built for retirement investing that aims to deliver:

Predictable monthly income that grows with inflation

Returns and capital growth, focused on downside protection

Reserving strategy and income support

Daily access to your capital

There is no guarantee that the Support Trust will provide income support to Magellan **Future***Pay* or that the target monthly income will be met.

Magellan **Future***Pay*

Combining profound investment technologies to meet investment objectives

Pooling	To provide low-cost, high-quality investment management
AMIT	To provide regular predictable income not bound by taxable income
Bucketing	To manage the risks of delivering a predictable income from risky assets
Mutualisation	To efficiently manage risks inherent in retirement investing
Active ETF	To provide active management in a low-cost, low-friction manner and enable the trading of the benefits of mutualisation
One Unit	To provide flexible access independent of the initial mode of access

When used individually, these technologies provide significant benefit. When applied collectively they may provide an excellent building block for retirement investing

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