The value of financial advice for Australian retirees

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26th Colloquium of Pensions and Retirement Research
2 July 2018

Feel future ready

Agenda

- Introduction
- The method
- Results
- Conclusion

Introduction

Increasing burden for retirees to make complex financial decision

- Historically taking lump sums, in recent years more are converting to account-based pension

- Recent policy discussions/changes:
  - 40% discount on longevity products for means testing of the Age Pension
  - Development of Comprehensive Income Product for Retirement (CIPR)
    - Every superannuation trustee needs to offer a CIPR for members with account balance over $50,000 (Budget 2018-19 and Treasury position paper, 2018)
    - A CIPR needs to have longevity protection, which can be in various forms
    - A flagship CIPR as the starting point but also alternative CIPRs for choices

- Increasing complexity to make financial decisions in retirement
  - Complex products: CIPR is a mix of vanilla products
  - Consumption: most Australian retirees with an account-based pension making minimum withdrawals (Sneddon et al., 2016)
  - Asset allocation: could be too many choices, some of which have high fees

Introduction

…but low financial literacy and default probably does not work

- Low level of financial literacy among the general population (Bateman et al., 2011; Agnew et al., 2012)
  - Only 43% can answer all 3 questions on basic financial literacy correctly.
- Default may not work well in decumulation

Accumulation	Decumulation
Single objective	Multi-dimensional problem in retirement: income, risk, flexibility/liquidity etc.
Preference on risk	Preferences along each dimension
Similar financial position at start	Different financial circumstances
Disengaged	More engaged

- Increasing needs for financial advice in retirement.
- This paper studies the value of financial advice for Australian retirees.

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Method

The average retiree

- A retired couple at age 65
  - Own their family home and paid off mortgage; will not downsize
  - $500,000 total retirement savings
  - Modelling to age 95, no uncertainty on survival
  - Eligible for the Age Pension at age 65.5

- The “no advice” scenario
  - Purchase an account-based pension with a typical 60/40 growth-defensive investment option
  - Follow the minimum drawdown rules

Method

One-off advice at retirement

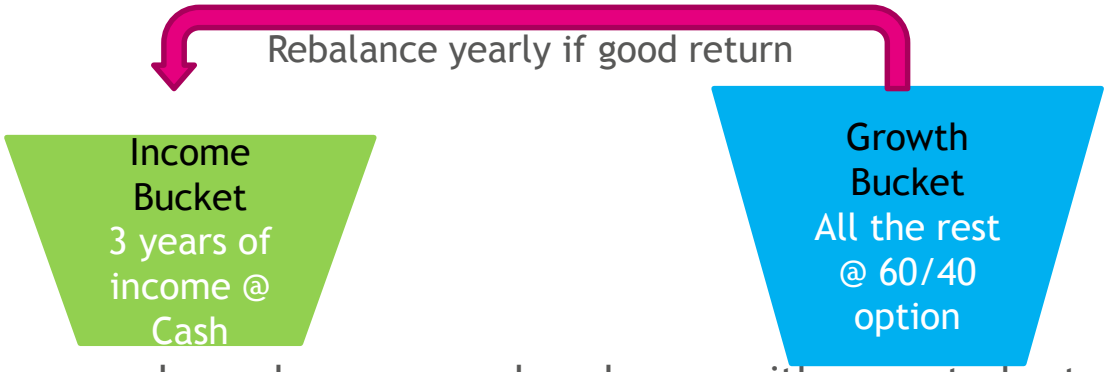
- Purchase an account based pension with a typical 60/40 growth-defensive investment option
- The retirement income level which gives 50% chance of running out of money before age 95, which is fixed in real terms for lifetime

Retirement income per year (including the Age Pension)	Balance at age 65 (retirement)
Couple	
$36,000 (ASFA modest)	$40,000
$40,000	$125,000
$50,000	$330,000
$60,000 (ASFA comfort)	$600,000
Single	
$24,500 (ASFA modest)	$40,000
$35,000	$250,000
$44,000 (ASFA comfort)	$550,000

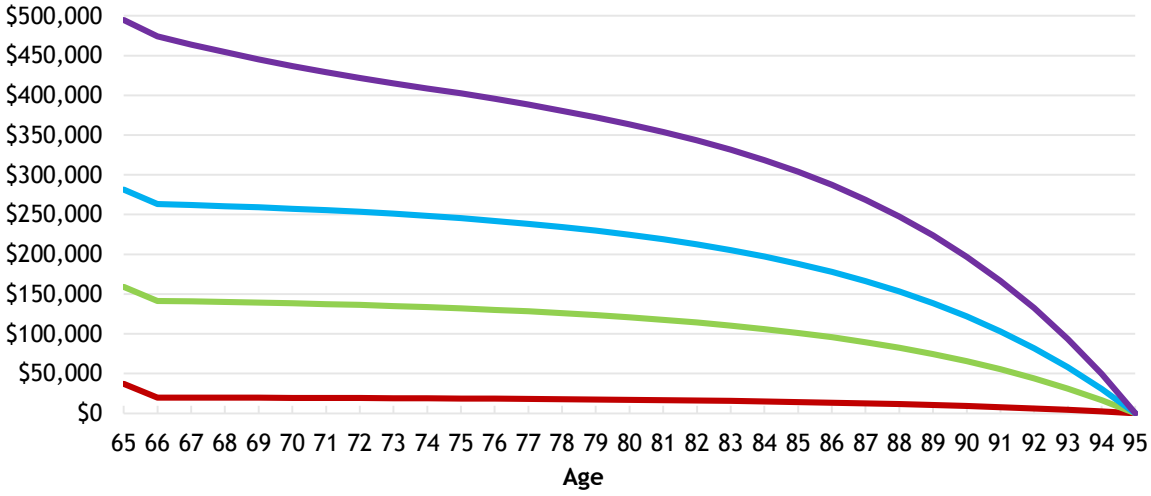
Method

On-going advice

- Bucketing investment approach: decreasing risk exposure over time



- Work out how much can be consumed each year with expected returns and pensions income



Method

The analytical approach

Conning: Simulate 1,000 future paths of asset returns, inflation, yield curves etc.

Project cashflows for each simulated path

- Investment returns and account balances
- Age pension benefits
- Amount of withdrawals needed to meet consumption

Calculate measures for retirement outcomes

- Utility measures (MDUF): risk aversion 5, time preference 0.96, bequest strength 0.927
- Probability measures

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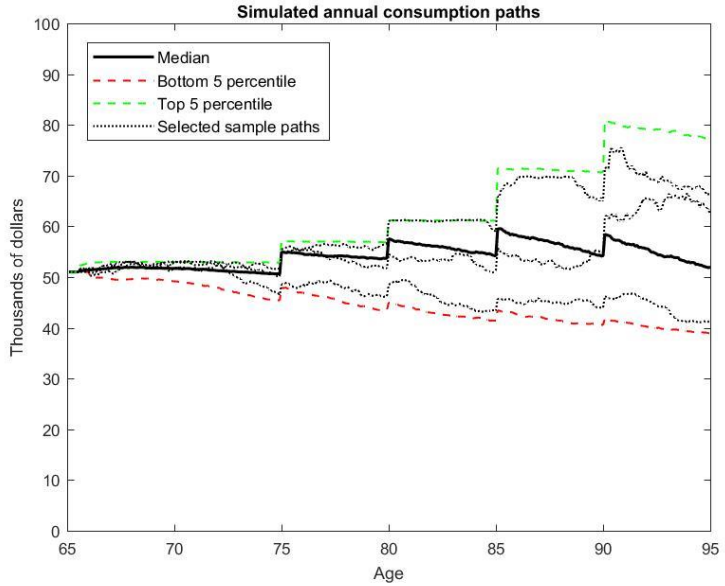
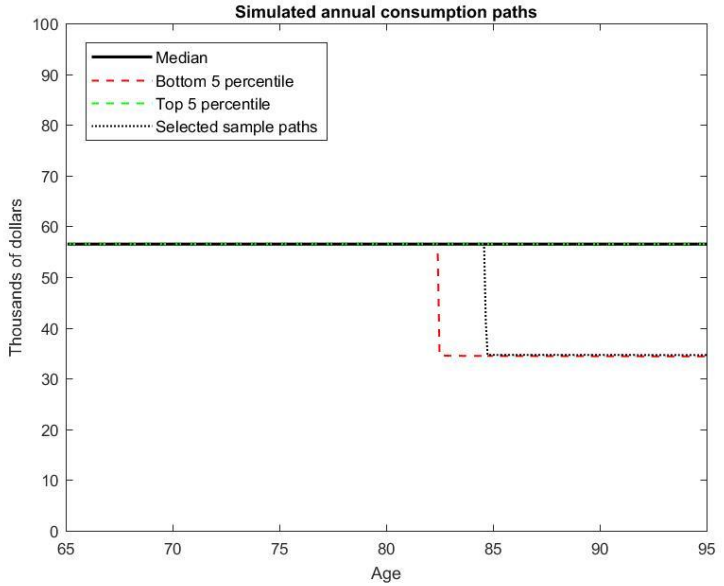
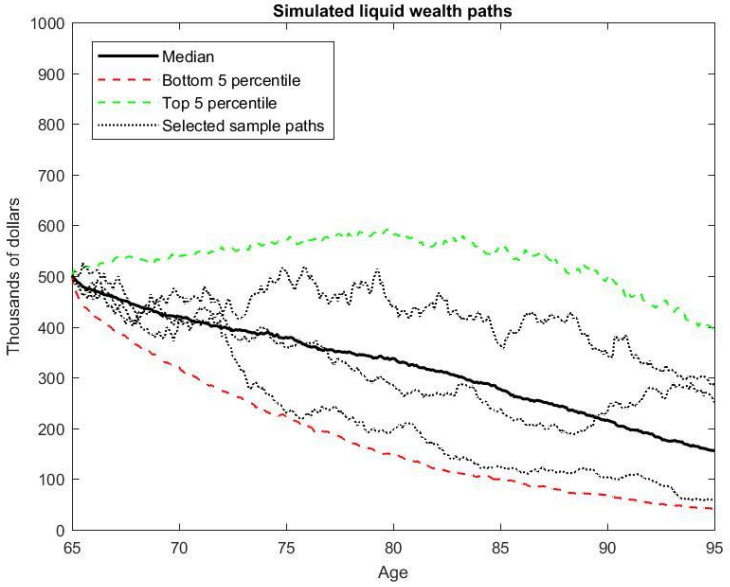
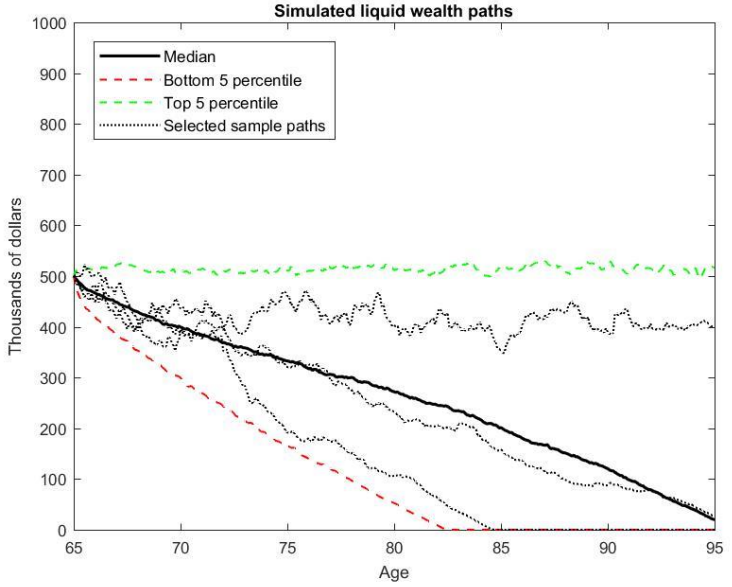
Results: no advice vs. one-off advice

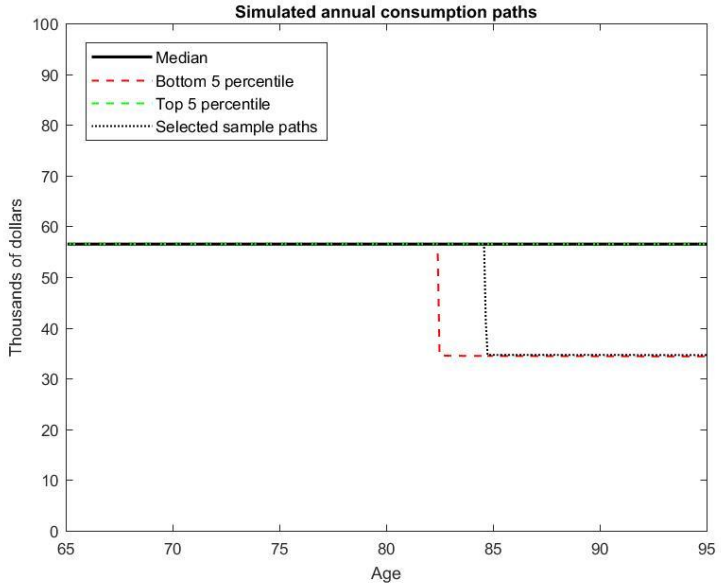


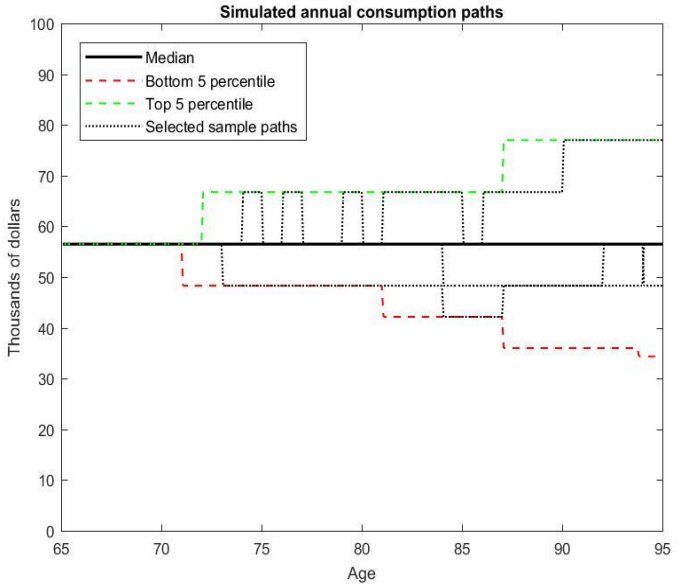


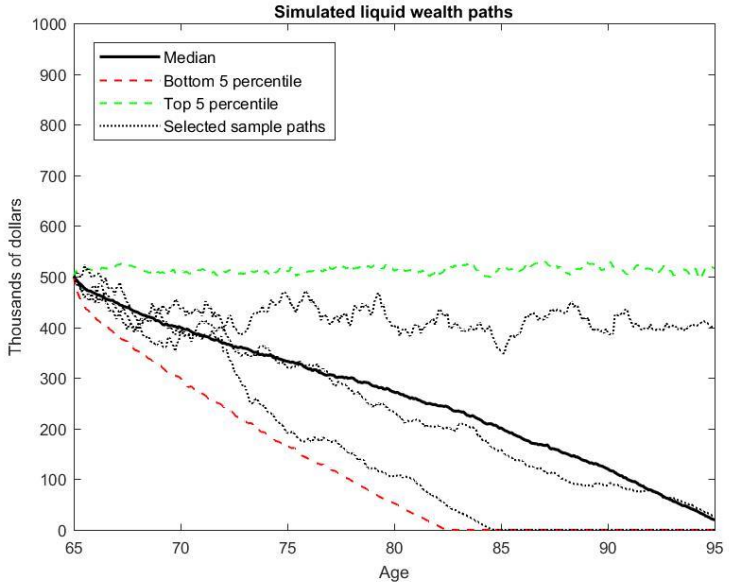


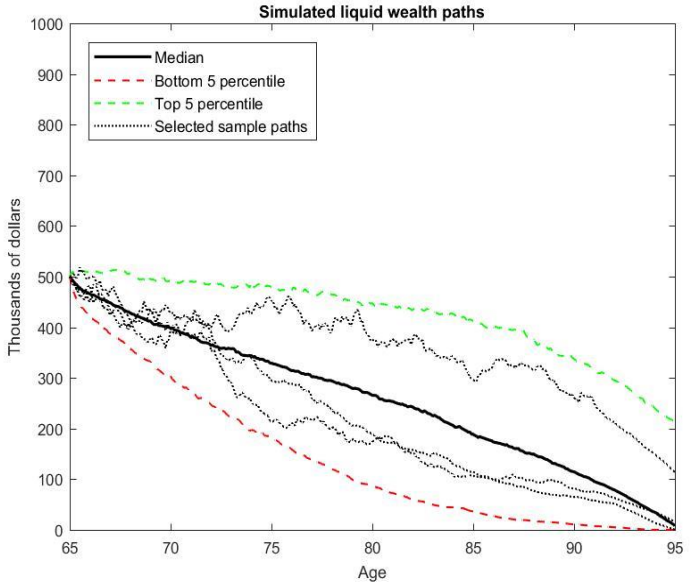


Results: one-off advice vs. on-going advice









Results

Retirement outcome measures

Measure of retirement outcomes	No Advice	One-off Advice	On-going Advice
Pr. of relying on the Age Pension	0%	47%	18%
Average age of reliance	-	88	89.8
Average shortfall when reliant on Age Pension	-	$154,443.6	$96,990.4
Pr. of selling pension assets at loss	91%	91%	50%
95th percentile of cumulative loss	-$56,015	-$65,007	-$58,411
Av. terminal liquid wealth	$156,000	$19,237	$7,867
Certainty equivalent consumption (lifetime utility)	$52,273	$52,900	$54,822
Additional return p.a. needed to match On-going Advice	1.7%	1.3%	-

- The value of on-going advice only diminishes marginally with review every two years.
- The value of financial advice increases with the balance of assets at age 65.

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Overview

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There is substantial value to retirees from receiving financial advice

- One-off advice at retirement can help retirees to deviate from taking minimum withdrawals to a constant level of 'sustainable' income
  - Delivers a welfare gain that is as much as can be achieved by additional 0.4% return p.a. over 30 years

- On-going advice further help retirees to
  - Reduce the chance of relying on the Age Pension and delay the time when it happens
  - Avoid selling assets in unfavourable market conditions and reduce losses
  - This is achieved by consumption smoothing and de-risking over time, which are closer to the optimal solutions implied by life-cycle theories.

- What we have not modelled…
  - Identifying personal preferences
  - Planning across the overall balance sheet than super
  - Irrational mistakes that could potentially happen
  - Uncomfortable with taking investment risks in retirement

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Questions?

Appendix: The implied optimal consumption and wealth path by MDUF

Retirement scenario

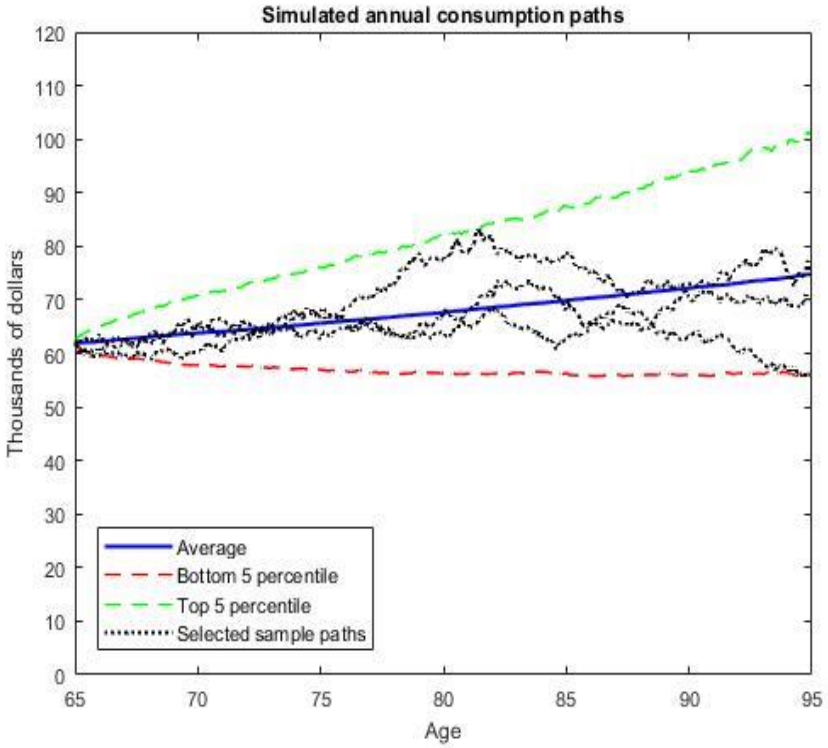
Items	Values
Wealth at retirement	$650,000
Retirement age	65
Family situation	Couple
Home-ownership	Non-homeowner
Real risk-free rate	0%
Fund return	Normal with mean = 3.75% Volatility = 5.8%
Risk aversion (how risk averse)	8
Bequest strength (between 0 and 1)	0.83
Utility discount rate (impatience of consumption)	1

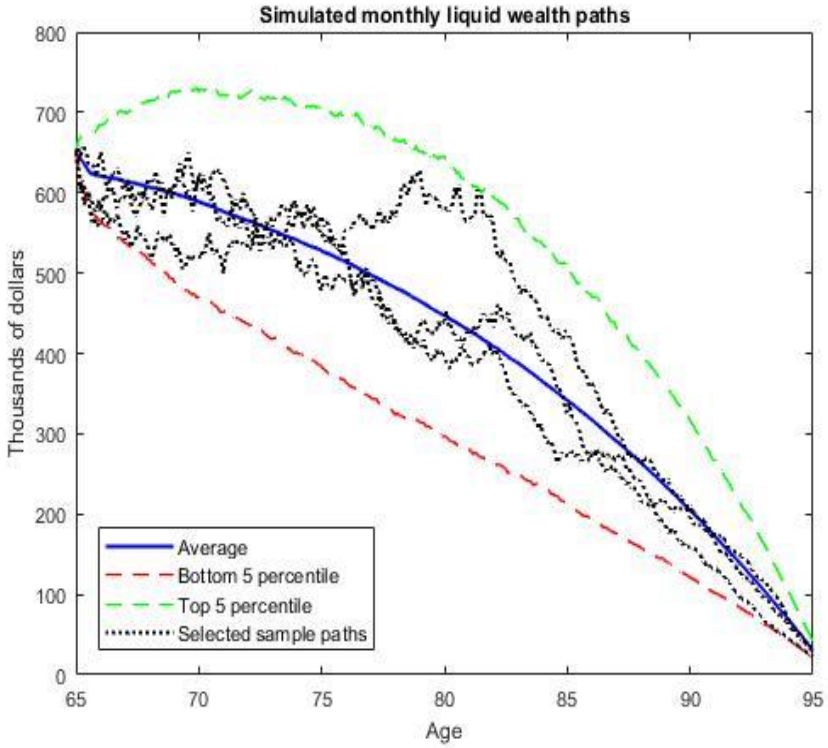
This couple optimise their consumption to maximise their lifetime utility

This slice is based on MDUF v1 static model calculator.

MDUF

Risk aversion = 8; Bequest motive = 0.83; Utility discount rate = 1;





What we changed to

Risk aversion = 5; Bequest motive = 0.927; Utility discount rate = 0.96;