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Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

By email: retirementincomereview@treasury.gov.au

Dear Panel,

Vanguard welcomes the opportunity to comment on the *Retirement Income Review Consultation Paper 2019,* and we commend the Panel and Treasury for the work done to date. In particular, we support the holistic view of retirement across the three pillars and not just assessing superannuation or the age pension in isolation.

Background

With more than AUD $8.4 trillion in assets under management as of 30 September 2019, including more than AUD $1.6 trillion in ETFs, Vanguard is one of the world's largest global investment management companies. In Australia, Vanguard has been serving financial advisers, retail clients and institutional investors for more than 20 years.

Vanguard has an unwavering focus on investor value. The Vanguard Group is owned by our US domiciled mutual funds, which in turn are owned by the investors in these funds. This means that the funds are managed at cost, which keeps expenses low, maximising investor returns. Vanguard in Australia operates with the same intention and focus which is reflected in our philosophy, policies and practices.

General comments

We were pleased to meet with the Secretariat in December to discuss Vanguard's retirement research which may assist the panel in their review. In particular, 'How Australia Saves', 'How America Saves' and 'How the UK Saves' (including gender supplement) provide useful insights into member level behaviour. Vanguard's other research including 'Assessing the Value of Advice' and 'Roadmap to Financial Security' may also assist the panel, and we discuss these in more detail below.

While we will refrain from dwelling too deeply on policy recommendations and aim to focus on data and other retirement system insights, there are a few policies which may assist and provide clarity on some of the Panel's focus areas. In particular, we would support the objective of superannuation being enshrined in legislation. This will assist in any adequacy assessment and modelling in the future. We also acknowledge that policy reforms may greatly impact some of the focus areas – including equity (e.g. gender, home ownership) and household level outcomes.

Specific comments

We outline four points below that we believe are important for the panel to explore further and may not have been fully fleshed out in the consultation paper. We also provide links to some papers which may be of assistance on each point.

Value of Advice

Firstly, financial advice can play a valuable role in preparing for and delivering successful retirement outcomes. Households typically only get one chance to make their retirement decisions, creating a behavioural challenge, since they have limited personal experience to call upon.

This role of advice is recognised in the consultation paper, however Vanguard wishes to provide two additional viewpoints. The first is on assessing the value of advice, both before and after retirement. Recently we published a paper to expressly measure the value of the advice being delivered to our US clients across three dimensions - portfolio, financial and emotional outcomes (Pagliaro & Utkus, 2019)[1].

In the US context we found that advice led to more appropriate portfolio outcomes relative to the experience of unadvised investors – such as through improved diversification – and that the improved emotional component was a significant driver of overall outcomes. A similar exercise in Australia, if possible, would provide insights into the cohesion of the system (ref questions 24 and 25 in the consultation paper).

The second viewpoint is on whether the current advice framework of general information, general advice, and personal advice; and corresponding restrictions of product and service providers to household and individual information, align with delivering the purpose of the retirement income system. Treasury, for example, in its Retirement Income Covenant Paper recognises in principle 7 that "the specific preferences and characteristics of an individual member may affect their optimal retirement income solution" and to meet these advice may be necessary. It raised that key factors, such as marital status and age pension eligibility could be brought into scaled advice provisions.

In Vanguard's experience, factors such as these can have a significant impact on strategy recommendations, and therefore it would be valuable for the review to consider ways to make such information more generally available to deliver strong outcomes.

Household Level Data

Secondly, there is a need for transparency into household level data in any assessment of the retirement income system. While superannuation is an individual product[2], retirement is a household issue and must be considered as such, both in the provision of appropriate strategies by financial service providers and the government; as well as in the assessment of the quality of aggregated outcomes.

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[1]Pagliaro, Cynthia, A. and Stephen P. Utkus, 2019. *Assessing the value of advice*. The Vanguard Group. Valley Forge, PA.
https://static.vgcontent.info/crp/intl/auw/docs/literature/research/assessing_the_value_of_advice_wp.pdf?20190930|173924

[2] Vanguard Investment Australia's publication, How Australia Saves, provides a detailed example of the quality of member level data for each super account, however the data transparency of the system does not allow for the easy aggregate of key data to the household level. The paper can be accessed from https://www.vanguardinvestments.com.au/retail/ret/campaign/how-australia-saves-2019.jsp

As discussed earlier, information on the household is needed for effective delivery of appropriate strategies, and would be a critical enabler of greater personalisation, an aspiration referred to by the Productivity Commission within the review into the efficiency and competitiveness of the Superannuation System. Given the complexity of the interaction between the pillars of the system, it would be appropriate to consider whether more can be done to improve the transparency into valuable household-level information – such as from different government departments and industry participants – required to deliver successful outcomes. Further on data, it would be relevant to consider whether the aggregate data collected at the system level is appropriate to measure outcomes now and into the future. It would be useful to begin analysing household level data now, and collecting additional required data, for comparative reasons as the system develops.

Aged Care and Health

Thirdly, the risks retirees are facing in the future will be expected to impact their spending patterns (or lack thereof) and therefore are integral to retirement planning decisions.

An example can be seen in the United States, where aged care costs are significant (15% of 65 year olds forecasted to spend more than $250,000 US) but are not incurred evenly across the population (48% of 65 year olds not being expected to incur any age care expenses)[3].

While differences in the design of government provided health and aged care support between the United States and Australia suggest that concerns over the costs of health care are less significant here, the presence of such risks can nevertheless strongly influence decision making[4]. We see value in the risks faced by retirees being quantified since retirement spending decisions cannot be assumed to occur independently of any thought of future uncertain costs that could arise.

Vanguard globally recognises five categories of risks retirees may face – market, longevity, health, event, and tax and policy risks[5] – but does not have a quantified model in Australia specifically at this time. We view this Review as an opportunity to examine how these risks are currently mitigated, whether there is an effective market to manage these risks and whether the government is comfortable with the level of self-insurance that current policy arrangements support.

Inter-Pillar Dependencies

Finally, on the topic of cohesion between the different pillars of the system, the influence of the interaction between superannuation withdrawals and the age pension should be considered. Much has been written on the most appropriate taper rate for the age pension means test, but it is also worth noting the impact this has on risk taking in a super fund member's investment strategy.

Using generally accepted academic representations of risk preferences over consumption, there is a stream of literature that has shown how to recursively solve for the optimal investment strategy and

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[3] Guyton et al., 2018. *Planning for health care costs in retirement*. The Vanguard Group. Valley Forge, PA. https://pressroom.vanguard.com/nonindexed/Research-Planning-for-healthcare-costs-in-retirement_061918.pdf

[4] Ameriks et al. (2019) demonstrate the impact this self-insurance decision to manage long term care risks has on wealth accumulation strategies in the US and the working paper can be found here: https://ebp-projects.isr.umich.edu/VRI/papers/VRI-LTC-U.pdf

[5] https://static.vgcontent.info/crp/intl/auw/australia/documents/retirement-centre/vanguard-research-retirement-roadmap-wp.pdf

consumption decisions so as to smooth spending over an individual's lifetime. Butt et al. (2018)[6] demonstrate that under these conditions in Australia, retirees are encouraged to take more investment risk where they are eligible or almost eligible for a part pension. Where the risk pays off, they reduce their eligibility for the age pension but have a larger investment portfolio to draw an income from, and where the risk does not pay off, their reduced investment portfolio is offset by higher age pension income received. A demonstration of these incentives by the review can allow the Government to make an informed decision on the most appropriate retirement behaviour to encourage.

We would be pleased to discuss these issues further with the Panel throughout the process of the Review.

Please do not hesitate to contact Sara Dix on (02) 8019 1131 if you have any further questions.

Yours faithfully,

Robin Bowerman
Head of Corporate Affairs and Market Strategy

[6] Butt, Adam, Gaurav Khemka and Luke Strictland, 2018. How academic research can inform default superannuation fund design and individual financial decision-making. *The Australasian Journal of Applied Finance.* 1: 40-49. https://www.finsia.com/docs/default-source/jassa-new/ajaf-2018/jassa-2018-issue-1/ajaf-2018-issue-1.pdf?sfvrsn=e84b9d93_6