8 February 2024


Retirement Advice and Investment Division
Treasury
Langton Cres
Parkes ACT 2600


Dear Secretariat

I have worked in the financial markets for 25 years until 2012 when I finished full time work.  I then undertook a range of part-time activities for a further 5 years including work relating to matters on retirement financial adequacy.  A CV is available upon request.

I will focus on one reporting and planning feature that I believe is required to enable superannuation fund members to simply understand and manage retirement income streams.

For background to some of my thinking, I have attached an article a colleague and I wrote for Cuffelinks.com.au[1] in September 2014 "Retirement myths doing more harm than good".


Yours sincerely


Peter Vann

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[1] https://www.firstlinks.com.au/five-retirement-myths-harm-good
Cuffelinks.com.au is now Firstlinks.com.au

## Understanding and Enhancing Financial Retirement Outcomes
## for Superannuation Fund Members

This submission is in response to the consultation questions in The Treasury's discussion paper "Retirement phase of superannuation", December 2023 ("Discussion Paper")

Introduction

My submission focuses on providing members key communications

- in everyday language they can understand
- that relate to the purpose of superannuation savings

- thus, empowering members to understand and, together with appropriate tools, manage their financial retirement outcomes.

My submission addresses aspects of numerous consultation questions in the Discussion Paper.

Background

"On average" the superannuation industry has complicated retirement without providing fund members simple and practical solutions.  This is reflected in a section of the Discussion Paper titled

- "*Members face complex decisions to plan their retirement income*"

  and in that section this sentence

- "*Planning for retirement income requires retirees to solve a "risky, long-horizon, multi-dimensional problem" – a problem that any individual retiree cannot be expected to solve on their own.*"[2]

Whilst working around the superannuation industry I have seen complexity being raised time and time again forming a barrier hindering provision of pragmatic solutions for retirees.  I have also observed that these barriers are used as excuses for lack of action by some industry participants.  There are many examples in other industries where complex systems are solved and can be presented in easy to understand language to non-experts, e.g. Google maps as a car navigation tool.

Why can't planning for outcomes in retirement be presented in language that most members can understand?  I note that this topic was discussed in the 2020 Retirement Income Review (e.g. see "Improving Outcomes" section).

**A small but big step forward.**  Both the retirement income covenant and the proposed objective for superannuation emphasize the importance of funding retirement income. Now the challenge is to frame superannuation in terms of this retirement objective and assist members to easily manage their retirement outcomes.

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[2] This point equally, or more importantly, applies to members in accumulation phase when they potentially have greater ability to improve retirement outcomes.  I note that superannuation funds also have not solved "the problem".

## Frame superannuation in terms of the retirement objective

If we understand that the purpose of superannuation is to *deliver Australians with income for a dignified retirement*[3], then we should be framing key member communications in terms of this outcome, namely their

### Retirement Paycheque.

This can be achieved by providing retirement income estimates (including age pension estimates when eligible) to all members based on the data that their superannuation fund has available.  For example, member's annual statement could commence with words, such as:

> ***Your superannuation has a good chance of providing***
> ***a fortnightly[4] retirement income of \$4,400.***

and these words could also be a headline banner when a member logs into their superannuation account.  Without wishing to state the obvious, members shouldn't need much financial literacy to understand a salary or wage.

Members would see their superannuation presented in terms of a key purpose of superannuation, their expected retirement paycheque; why have a purpose if individual members aren't informed of its expected outcome?

Provision of retirement income estimates applies to BOTH accumulators and retirees.  Accumulators have more time to act, potentially improving their retirement outcomes, and retirees will develop an understanding of their trade-offs to better manage retirement outcomes (see "A planning and review tool" below).

**"Good Chance"[5]** is a key phrase in the above member communication.  I believe there are two key uncertainties impacting a member's retirement income that should be factored into retirement income estimates, investment returns and longevity[6].  The current deterministic calculators that assume known investment return and life span provide a retirement income estimate that a member has a 50% chance, at best, of achieving.  The material failure rates from members using estimates from deterministic calculations is bound to deliver a fair amount of future disappointment[7].

Stochastic calculations[8] including investment and longevity uncertainty will reduce future member disappointment if using a pragmatic level of safety.  Discussions a colleague and I had with numerous superannuation funds around a decade ago steered us to using a probability of 2/3 as a good chance (i.e. 67%), There is nothing

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[3] Page 9 of the Discussion Paper
[4] Our whatever frequency is appropriate for the member.
[5] Whilst I use "good chance" to express the probability of being able to deliver the estimated paycheque, there are other verbal probability expressions that may be more suitable for members.
[6] There are other uncertainties such as changes to Age Pension rules, and tax rate changes in accumulation and retirement.  Whilst one can model these, this would enter the realm of being "accurately wrong" rather than "approximately right".
[7] Assuming members don't have regular monitoring/reviews through retirement (see later).
[8] Deterministic calculations such as MoneySmart's Retirement Planner use one invest return and life span whereas stochastic retirement income calculations provide a statistical distribution of outcomes that can be converted to a simple "good chance" retirement paycheque.

magical about a 2/3 success rate and I note that some proponents of stochastic calculations in the USA use a 90% chance of success.

**To summarise**, a well structured stochastic retirement income calculator is a necessary tool for all members (accumulators and retirees) to see where they are heading regarding the objective to fund retirement income.

## A planning and review tool

The mechanics behind a well structured retirement income estimation system can also be used as a planning tool[9].

Superannuation fund members have several "levers" they can control to manage their retirement outcomes from superannuation (and optionally including any external investments). Note the first two levers generally apply in accumulation:

- changes to contributions, e.g. salary sacrifice or break from work
- age to commence using superannuation to fund retirement
- investment strategy
- and for retirees with greater interest and understanding of retirement expenditure, analysis of the impact of different retirement expenditure patterns over the retirement years.

Superannuation funds can provide some simple push communications outlining "what-if" analysis for cohorts of members. For example, after providing a simple statement regarding their "good chance retirement income" (e.g. see previous page), a fund could report something like

> **Additional contributions:**
> **Asking your employer to increase your fortnightly contributions by $100 will**
>
> - **have a good chance to increase your fortnightly retirement income from $4,400 to $5,150**
>   **OR**
> - **allow you to retire almost two years earlier (age 65 instead of 67).**

or focusing an investment strategy

> **Change investment option:**
> **You have good chance that your superannuation can provide a higher fortnightly retirement income of $5,300 if you change your investments from your current balanced fund option to our growth fund option.**

**Review estimates:** Periodic reporting of estimated retirement income will provide a useful review to members hopefully prompting more action to improve their retirement outcomes. Members may also wish to undertake their own what if analysis using retirement income estimation tools necessitating simple useful interfaces.

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[9] See the "Manage with feedback" point in point 4 of the attached article "Retirement myths doing more harm than good".

## Challenges in Implementing Effective Retirement Income Planning Tools

While the need for retirement income planning tools should be evident, there are numerous hurdles that the superannuation industry must overcome to ensure their effectiveness.  These challenges include:

1. Calculation methodology: Developing accurate stochastic retirement income estimations requires calculations that consider various factors including market conditions, inflation, and life expectancy.  The industry needs to invest in advanced modelling techniques to generate reliable and meaningful projections that can be compared across funds.

2. Assumptions:  It is important that reasonable shared assumptions are used across the industry including, inter alia, return parameters, future age pension methodology, inflation and real wage growth.  This will, inter alia, allow comparisons across different fund retirement income calculators.

3. Data Accessibility: Some industry participants have said superannuation funds do not have sufficient data to provide retirement income estimates.  But starting with the member data[10] superfunds should have and making clear assumptions regarding "missing" data such as home ownership is a reasonable base to engage members.

    Engaged members should have the option to add to the data (e.g. homeowner status, has a partner, planned retirement age, expected employment breaks and external investments[11]) thereby increasing the relevance of the retirement income estimates.

4. Education and Communication: Introducing new retirement income planning tools requires effective education and communication strategies.  Fund members need to understand the purpose and benefits of these tools enabling informed decisions impacting their retirement paycheque.

5. Regulatory hurdles:  It would be remiss of me not to mention that regulatory challenges exist, but I leave comment to other industry participants more versed in this area.

All this work requires collaboration between Government, superannuation funds and other industry participants to overcome hurdles thereby, inter alia, allowing funds to be comfortable taking up this challenge so they can better assist members understand and manage financial retirement outcomes.

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[10] For example, account balance, contribution level, investment strategy and member age
[11] External investments introduce a range of issues regarding consistent return parameter assumptions.

Conclusions

1.  The industry should undertake a concerted effort to
    a.  implement relevant retirement income estimates in terms of "good chance" outcomes to accumulating and retired members, and
    b.  provide easy to use planning tools to undertake the what-ifs discussed above.

    This is essential to enable members to effectively understand and manage their financial outcomes through retirement.

2.  The industry should scrap the current deterministic retirement income estimation tools since they are misleading and bound to deliver a material level of future disappointment.

3.  However, implementing effective retirement income planning tools requires overcoming challenges related to complex calculations, data accessibility, and education.  With concerted efforts from industry stakeholders and support from the federal government, these challenges could be addressed, ultimately benefiting fund members and the broader community.

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