RETIREMENT

Mass personalisation the key to improve retirement income adequacy

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Adopting a more personalised, goals-based investment approach to superannuation will help minimise pain in challenging economic climates such as the one we are facing, and vastly improve retirement adequacy for many Australians, writes JODIE HAMPSHIRE.

Retirement income adequacy has long endured as a topic of debate in the superannuation industry. As the debate has taken several twists and turns over the decades, many Australians have switched off.

However, the reality is retirement income adequacy is a real conundrum that affects the majority of working Australia, now and into the future. In fact, several variables are likely to exacerbate the problem for younger generations such as flat real-income growth and the movement towards the gig economy.

Our superannuation industry is recognised among the world's best pension systems; however, it is clear more needs to be done to meet the needs of retirees as we live longer.

According to the World Economic Forum, Australia had a US$1 trillion retirement savings gap as of June 2019. This expected to rise to US$9 trillion by 2050.

The primary drivers of this shortfall have been insufficient saving rates, misaligned asset allocations in superannuation investment portfolios—which have either been too aggressive or too conservative— and the increase in life expectancy.

Retirement income adequacy was again in the spotlight with the latest Retirement Income Review, announced by the Treasurer Josh Frydenberg in September 2019. The review has been exploring ways to improve the performance of Australia's retirement system for the future with the final report expected to be provided to the Government in the coming months.

Russell Investments believe a more personalised, goals-based approach will significantly improve overall retirement adequacy, through aligned investment outcomes and enhanced member engagement, and are vigorously working towards achieving this approach.

The world's largest investors start with outcomes in mind, so why aren't Australians saving for retirement doing the same?

As one of the largest investing outsourcing organisations in the world, Russell Investments work closely with some of the world's largest and most sophisticated investors. These investors have long understood the importance of matching their asset allocation to their unique goals and liabilities. They invest for outcomes.

Investing for outcomes always starts with a clear set of investment goals. Asset allocation is then specifically designed and updated as needed to provide the best chance of achieving said goals. It considers how they are tracking to that goal, otherwise known as funded status, which defines how well their projected assets match their expected liabilities.

For individuals saving for retirement, the desired outcome is the same: to have enough assets to cover their liabilities. Put simply, to have enough money to pay for the lifestyle they want in retirement.

Yet this approach, one propagated by the world's most sophisticated investors, is starkly different from the way most retirement savers invest.

In Australia, no pooled super fund offers an investment solution that considers an investor's desired retirement lifestyle. Instead, our default system sees super fund members pooled into strategies that don't consider their own unique set of circumstances, nor their funded status.

Under our existing system, a 25-year-old entering the workforce is invested in the same way as a 62-year-old person who potentially is a few years from retirement.

In what has been a step in the right direction, the superannuation industry has worked to address this issue with the development of lifestyle or target date funds that customise investment strategies based on age. However, age-only strategies are still a compromise as they are designed to be an approximation for a cohort of individuals, rather than optimal for each and every individual.

For instance, a 62-year-old well ahead of their goal can afford to invest more aggressively in contrast to a 62-year-old just on track to reach their goal. Within a lifecycle fund, these different individuals are invested in the exact same way.

Asset allocation: an understated determinant of personal retirement adequacy

Asset allocation is one of the primary controllable factors driving retirement adequacy alongside contributions. However, asset allocation often takes a backseat in industry discussion around retirement adequacy compared to other factors such as fees, which have a smaller influence on the ultimate outcome. This has also caused working Australians to underestimate its significance.

In fact, recent research conducted by Russell Investments into investment within super revealed many Australians don't realise asset allocation is one of the biggest determinants of having enough super for retirement.

Misaligned asset allocations have resulted in a vast majority of individuals missing out on potential asset growth or taking on unnecessary or inappropriate levels of investment risk.

While investors can choose their own asset allocation within their super, many don't know this is an option available to them or are ill-equipped to make an informed choice, and therefore, choose poorly. This is particularly the case in times of economic crisis such as the current environment, where strong emotions and behavioural biases have a heavy hand in decision-making.

Professional financial advice can help address this; however, current take up by Australians is low. Appropriate asset allocation advice also requires ongoing review as circumstances change which can be reliant on members to initiate and implement.

We have seen other industries overcome similar challenges by enabling a more personalised delivery of products and services to meet the unique needs of individuals. Not least has been the video streaming industry dominated by Netflix which reviews each user's behaviour to provide a personalised entertainment experience aligned to their preferences.

Russell Investments believe the same approach can, and should be, applied to superannuation.

Learning about member engagement from other industries

Advancements in technology have allowed for a range of products and services across many industries to be personalised to an individual's needs – without a premium price tag.

For example, the rise of fitness smart apps and devices has transformed the fitness industry, making it easier to set health and fitness goals and track progress. These tools have proved to be hugely beneficial, showing how tracking progress towards a personal goal can improve the chance of achieving that goal.

Part of this is achieved through the mere-measurement effect, that is, simply measuring activity output pushes an individual to move more. Furthermore, goal-tracking reinforces the positive impact of an individual's actions or alternatively, highlights lack of progress, helping them know when to course-correct.

The superannuation industry can draw on similar experiences to improve engagement and voluntary action (that is, making higher contributions) – issues, we all know, have challenged the industry for years. Leveraging the power of personalisation, goal setting, and tracking for super has the potential to materially improve engagement, and in turn, retirement adequacy.

In the next evolution of superannuation, each individual member will understand the retirement income goal they are likely to achieve and receive guidance on how to set a more meaningful goal. Alongside this, super funds will not only make it easier for individuals to measure progress but help them stay on track towards their goal.

This approach would simplify entry into the complex world of superannuation, making it easier for Australians to engage, take positive action and improve the likelihood of achieving the retirement lifestyle they choose.

Goal-based, mass personalised super is just around the corner

In summary, the optimal investment strategy and the right level of contributions are inherently personal and being poorly addressed by existing one-to-many solutions. Technology has sufficiently advanced to the point where super funds can deliver this level of personalisation at a competitive and accessible cost.

We are all experiencing investment uncertainty throughout this unprecedented crisis of the COVID-19 (Coronavirus) pandemic. However, the rise of individual, goals-based investment strategies and experiences is likely to help minimise this pain and improve retirement adequacy for many Australians.

The current crisis will also see retirement savers demand more of their super funds and we expect the pace of change to accelerate, with goals-based, mass personalisation in super funds coming sooner than you might think.

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investment operations