CV Solutions

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Financial System Inquiry
GPO Box 89
Sydney NSW 2001

Dear Panel Members

This letter and attachment contain CV Solutions' submission to the Financial Services Inquiry ("FSI").

CV Solutions is a partnership of two individuals, Peter Vann and Chris Condon, each with nearly decades experience in Australia's institutional investment industry.

Our mission is simple: to help individuals better understand how they are tracking to meet retirement aspirations, and how they can manage those aspirations in retirement.

To this end, we have used our industry experience, combined with our mathematical and actuarial training, to develop a stochastic engine for estimating retirement income.

While CV Solutions is not alone in providing such technology, our experience is that the superannuation and financial planning industry is extraordinary slow to apply stochastic asset/liability models to retirement planning for individuals. Appropriate use of quality stochastic models will solve many of the issues the FSI raises in the chapters on retirement and financial planning. Our submission focuses on this.

While our business imperatives are achieved by licensing our engine to superannuation funds and financial services groups, our passion is that all Australians working towards, and enjoying, retirement can have access to the type of information that stochastic asset/liability models such as ours can provide. For this reason, we would be delighted to provide the FSI access to our technology and our experience on a gratuitous basis.

We have already met with two members of the FSI secretariat, Geoff Atkins and Brad Parry, and welcome further involvement.

Yours faithfully

Chris Condon and Peter Vann

Submission to Financial Services Inquiry from CV Solutions

1 Summary

This submission primarily focuses on the section "Retirement Incomes" in the Interim Report. We also provide some comments relating to the "Financial Advice to Individuals" section.

The primary purpose of superannuation is to provide for retirement. But it seems that the obsession with account balances and rates of return means that most industry participants believe that superannuation's purpose is simply wealth accumulation. And many of the requirements by regulators amplify this misperception.

We believe that many issues that The Inquiry have raised in the sections on retirement and financial advice can be addressed and resolved if the industry simply **changes its focus from account balances to retirement incomes**.

Such a change in focus requires appropriate tools to analyse the impact of many decisions on retirement incomes. Currently the industry is slow to use such tools, hence it is essentially making decisions without assessing their impact on the end goal of superannuation. In banks and insurance companies, this is called "asset-liability" analysis, management and monitoring, and it is vital for a stable system. In the superannuation industry, this important step has been dropped in the move from defined benefit to defined contribution and one could well say that the **industry is running in the dark**. If the industry is running in the dark, then **so are members**.

Without describing what these tools do and deliver (refer to sections 2.1 and 2.5), the benefit to members is that they could simply monitor and manage many of the issues raised in the Interim Report in language they understand, including:

- Receive sustainable pensions that are reflective of, and robust to, the retiree's changing circumstances
- Receive higher pensions amounts than those emanating from investment products using low volatility assets
- Spend capital in retirement, without leaving excessive unintended bequests
- Manage personal longevity variability, without use of life time annuities
- Retain flexibility to adjust to life's changing circumstances
- Follow an appropriate, personalised investment "glide-path" that adapts to changing circumstances
- Have their drawdown amounts and investment strategy automatically reset in a manner suitable to meet the requirements of a default retirement option as canvassed in the report

We also note the important focus within the Interim Report on **default strategies** for the unengaged members. Design of sensible strategies for these defaults during the retirement phase must also use these tools to assess and compare the ability or otherwise of a range of possible default strategies to safely fund various levels of retirement incomes.

Additionally, these tools may also provide useful **"default" drawdowns** for the unengaged member, and thereafter provide a (push) monitoring service on issues such as financial longevity and the best investment strategy for a default case. Indeed, such a service could be fully implemented with a dynamically calculated account-based pension paid automatically to retirees' bank accounts.

If this captures the interest of an unengaged retiree, then they can become engaged and be more pro-active. At least then a retiree could see the impact of decisions such as drawing down a lump sum now on the likely longevity of their superannuation savings to fund a retirement income.

Furthermore, we do not understand how any **financial planner** can offer advice where the advice has not been based on an objective assessment of the client's **financial** ability to take risk by analysing the impact on the client's end goal (i.e. their retirement and bequest aspirations). Psychometric risk questionnaires do not do this; the tools we refer to above do.

We elaborate more of these issues in the body of our submission below with reference to specific questions and points raised in the Interim Report.

2 Retirement Income

In this section we respond to the request for comment made on page 4-25 of the report:

A spectrum of options to achieve the objectives of the retirement income system and position Australia to manage the challenges of having an ageing population:

- *Maintain the status quo with improved provision of financial advice and removal of impediments to product development.*
- *Provide policy incentives to encourage retirees to purchase retirement income products that help manage longevity and other risks.*
- *Introduce a default option for how individuals take their retirement benefits.*
- *Mandate the use of particular retirement income products (in full or in part, or for later stages of retirement).*

And on page 4-32:

The Inquiry seeks further information on the following areas:

- *Would deferred lifetime annuities or group self-annuitisation be useful products for Australian retirees? Are there examples of other potentially suitable products?*
- *If part of retirees' superannuation benefits were to default into an income stream product, which product(s) would be appropriate?*
- *Will the private sector be able to manage longevity risk if there is a large increase in the use of longevity-protected products? How could this be achieved?*
- *Should Government increase its provision of longevity insurance? How would institutional arrangements be established to ensure they were stable and not subject to political interference?*
- *What are some appropriate ways to assess and compare retirement income products? Is 'income efficiency' a useful measure?*

We approach these questions under the following headings:

1. Better information will probably result in account-based pensions being more efficient than annuities (Section 2.1)
2. Annuities are not popular for good reasons (Section 2.2)

3. What is the best investment strategy for the system? (Section 2.3)
4. The report confuses the concepts of personal longevity variability with the population mortality improvement risk (Section 2.4)
5. Simple and cheap ways to deal with personal longevity variability (Section 2.5)
6. Lump sums (Section 2.6)
7. Is the government a cheaper provider of annuities? (Section 2.7)
8. Improve understanding before retirement (Section 2.8)

We link these concepts to specific extracts from the interim report in the following table. The table is followed by our detailed comments.

Page	Extract from report re retirement	Brief CVS Comment
4-3	This chapter explores some of the weaknesses of the retirement income system and impediments to the development of new **products**. [Emphasis added] There are regulatory and other policy impediments to developing income **products** with risk management features that could benefit retirees.	We disagree with the report's focus on new products without first solving the impediment to delivering relevant retirement outcome information to members. Then the relevance, or irrelevance, of the new products can be put into perspective. We believe that the report largely overlooks real and perceived regulatory impediments to developing information services for superannuation members. See 2.1, 2.5 and 2.8 below.
4-9	Assessment of current products [section]	ditto
4-10	A lifetime annuity has an estimated income efficiency of 76 per cent for an average 65-year-old male (for reasons discussed later in this chapter). The income efficiency of an account-based pension that is drawn down at the minimum rate for a 65-year-old male is around 70 per cent. The remaining funds in an account-based pension will typically be left to beneficiaries.	We believe that the efficiency of account based pensions will be much higher with better information provided to retirees. Indeed, for many retirees they may be much higher than annuities. See 2.3 and 2.5.
4-10	Longevity risk [section]	We suggest that there may be simpler and cheaper ways of dealing with personal longevity variability risk. See 2.5.
4-12	Lump sums [section]	We agree that lump sums should be discouraged. But this does not require forced annuitisation. See 2.6.
4-13	Approximately 44 per cent of retirees who take a lump sum use it to pay off housing and other debts, to purchase a home, or make home improvements.	We view this as rational and consistent with supporting retirement as it is a form of pre-paid accommodation expense. See 2.6.

Page	Extract from report re retirement	Brief CVS Comment
4-14	Butler, Peijnenburg and Staubli concluded that a pension means-test can substantially reduce demand for longevity insurance products. The Age Pension in Australia is the primary source of longevity insurance and is contributing to the low demand for market-based products that provide such insurance.	So what? This seems to be a self-serving comment by the private annuity industry. Arguably the government can provide annuities at a cost much lower than private companies. See 2.7
4-14	Similarly, Hulley, McKibbin, Pedersen and Thorp found that means-tests for the public pension encourage eligible and near-eligible retirees to decumulate assets faster and choose riskier portfolios, especially early in retirement. This distorts the amount of risk eligible and near-eligible retirees expose themselves to and shifts longevity risk to the Government.	We agree with the comments on rapid decumulation and suggest that Age Pension design can be tweaked to handle this. We disagree with the concern regarding choosing riskier investments strategies. See 2.3.
4-15	Around one-quarter of people with a superannuation balance at age 55 have depleted their balance by age 70.	This is primarily due to inadequate saving, and is somewhat of a red herring in this section on retirement. It is not about the uncertainty of timing of death, but about level of saving combined with mortality improvements. (We do note that you recognise lack of savings as a primary issue on page 4-26.)
4-15	Retirees make once-in-a-lifetime critical decisions about how to manage their assets, ideally to deliver an income stream and to manage effectively the associated investment, inflation and longevity risks.	This is only an issue if retirees are encouraged or forced to purchases inflexible retirement products. For account based pensions, retirees can make rational and dynamic decisions over retirement, provided they receive appropriate information. See 2.1, 2.2 and 2.5.
4-15	A number of studies have reported that Australians are unprepared for the financial decisions they need to make as they approach retirement. They know neither how much to save for retirement nor how to create income from their accumulated balance	We strongly agree with this comment, and suggest that poor regulations have been a contributing factor to this situation. See 2.8. Once again, providing relevant information to members regarding their retirement outcomes in everyday "paycheque" language is a necessary step to solving this issue.
4-16	Academics have struggled to solve the 'annuity puzzle' — the fact that while annuities deliver desirable characteristics, demand for annuities is very low.	This is a naïve comment. There are very good reasons why Australian eschew private annuities. See 2.2

Page	Extract from report re retirement	Brief CVS Comment
4-19	Policy settings should ensure that retirees can manage their accumulated balances in a way that improves retirement income and risk management, without transferring an excessive amount of longevity risk to the Government.	This statement confuses personal longevity variability (i.e. the uncertainty of the date of death) with societal costs of improving mortality at an uncertain rate and deteriorating dependency ratios. The law of large numbers removes individual longevity uncertainty. See 2.4. Also note, it is virtually impossible for the private sector to hedge uncertain mortality improvement without holding huge capital reserves and/or purchasing prohibitive reinsurance. The private sector annuity industry, as a whole, will be under considerable stress and potentially fail if this risk is realised, and the cost will revert to the government in one form or another. The government has the best risk mitigants, being able to shape policy (e.g. encouraging working to later) and the power to tax. See 2.7.
4-20	Table 8.3	This table does not mention that promoting annuities is likely to be more expensive to the public purse, as (a) it will force a huge proportion of the community to invest too conservatively (see 2.3) and (b) it will involve a huge transfer of wealth to private annuity providers (see 2.2).
4-21	The taxation and social security systems could be used to create strong incentives for retirees to take superannuation benefits as income streams	We have no issues with removing the considerable barriers to the development of efficient retirement income products. But we question whether the taxation and social security systems should be used to promote them. Discussed in 2.1.
4-25	Defaults could be introduced to the retirement phase of the system … Default arrangements could differ based on the size of the account balance, or other individual circumstances.	We strongly agree with this, and indeed suggest that it is possible to achieve this with **individualised** settings applied to account-based pensions. This allows automatic drawdowns to provide a stable and sustainable retirement income together with an evolving investment strategy that reflects

Page	Extract from report re retirement	Brief CVS Comment
		changing circumstances. See 2.5.
4-27	A portfolio of products: … retirees with sufficient savings will typically best meet their objectives by using a combination of products and taking some of their benefits as a lump sum.	We agree. Ideally such an approach could be guided by providing the retiree with better information about the consequences of various strategy choices. See 2.5.
4-30	The Government could offer longevity insurance to individuals on a commercial basis, in addition to that provided by the Age Pension.	We agree that this is worthy of consideration. See 2.7.

2.1 Better information will probably result in account-based pensions being more efficient than annuities

In our view, the interim report pays excessive attention to facilitating, favouring and even mandating products (such as annuities) as the solution to the retirement issues it has been comprehensive in identifying.

We agree that such products should be facilitated. As has been identified by several contributors, there are many unnecessary policy impediments for private providers to offer such products. We agree that these should be removed so that they can be purchased by retirees if they offer good value.

But, as discussed in 2.2, we doubt whether most new products will offer good value in all but a minority of circumstances. We are therefore opposed to the notion on page 4-21 of the report that policy settings should be altered to promote such products. And we certainly believe that forced annuitisation will be expensive for both annuitants, and possibly also the public purse (see 2.3).

In our view, this focus on products as being the solution to the issues facing retirees seems to have swamped much simpler and cheaper notions surrounding the provision of better information to retirees (and also before retirement).

In particular, our work has shown that a retiree can be shown, on a regular basis, the rate of drawdown from an allocated pension that would result in a sustainable level of retirement income (including, if eligible, the Age Pension). This is achieved using stochastic modelling that incorporates investment volatility and the relevant information on personal longevity variability. It results in a stable level of retirement income, using investment strategies with appropriate volatility to achieve the best risk adjusted retirement income.

Most well diversified investment options that superannuation funds offer today provide reasonable investment efficiency. They do not impose the use of overly conservative low returning investment strategies, such as those that may be used to back annuities. And they avoid artificially imbalanced investment portfolios that accompany marketing-driven products such as those that invest excessively in high income yielding assets.

Moreover, retirees can be provided with frequent information about how their actions (e.g. the rate of actually drawdown) affects their future retirement income. This information is in the language that most people understand (normal household budgeting), so financial literacy is not an issue. And it provides prompt feedback, which is the best form of learning that leads to positive behavioural change.

Individual longevity uncertainty can be accommodated in a simple fashion that means that retirees do not suddenly run out of money. (Explained in 2.5.) At the same time, the rate of drawdown suggested to the retiree will permit the retiree to spend capital in a sustainable fashion throughout retirement.

The current dearth of such information for retiree is one reason for the claim that account-based pensions are less efficient than annuities. This may well be true, as retirees wishing to sustain a self-funded retirement do not know how much they can reliably draw, and thus will often live way below their means. The incidence of such behaviour will intensify as the maturing superannuation system generates higher account balances at retirement due to a higher average SGC over members' working lives.

This inefficiency is currently mitigated by investment strategies that are not overly conservative, which no doubt explains why the efficiency of annuities (reported on page 4-10) is not materially superior to account-based pensions. It seems evident that if retirees were provided better information about sustainable drawdowns, then they would spend more of their superannuation during retirement and leave smaller bequests. We would not be surprised if the efficiency of account-based pensions managed in such a fashion were to be materially higher than annuities, which suffer from excessively conservative investment strategies, high capital margins, high risk margins in response to uncertainty of future mortality improvement, and significant credit risk (to the annuitant). (See 2.2.)

We acknowledge that CV Solutions has built and sells a stochastic engine that provides this service to retirees. For this reason we have attempted to be generic as to how such a process could work. This wariness may have resulted in us providing insufficient explanation. We would welcome an invitation from the Inquiry to elaborate in writing or in person.

2.2 Annuities are not popular for good reasons

The report acknowledges "Life insurance companies impose various margins on annuities that increase their price for a given income stream. These companies must use significant capital to fund their assets and minimise the risk of failure. They must cover administrative costs and provide profits to shareholders." (Page 4-16)

It also recognises that the Age Pension already provides substantial longevity insurance for most retirees.

We would suggest that there are other reasons why annuities have not proved to be popular amongst Australians. Some include:

- The Age Pension in Australia has features that make it a particularly valuable and efficient alternative to privately purchased annuities:
    - It is a true safety net for the entire population, not those who happened to contribute to 'social security' during their working lives.
    - The income and assets tests mean that it provides a wonderful hedge to reduced drawdowns from pension accounts following realisation of investment risk
    - It is provided by the Government, which is in a better position to protect longevity than private providers (see 2.7)

- But even with conservative investment strategies, annuity providers can fail. Like banks, they are highly leveraged organisations, which is the reason why they must manage assets/liability risk carefully. In some cases this management will fail. In other cases, the annuity provider may deliberately mismatch assets and liabilities. It is our view that many Australians are implicitly concerned about such credit risk. Older Australians have seen many such failures over the decades and may rightly be more concerned that the annuity provider will have shorter longevity than their own.
- Option pricing theory demonstrates that options have real value. In the case of annuities, the retiree is giving up the option of changing financial arrangements to cater for changing personal needs. Many Australians rightly put a high value on this flexibility, which they prefer to the modest benefits of protecting personal longevity uncertainty that is offered by annuities. (See 2.5 for a discussion of a simple and cheap approach to personal longevity variability.)
- Private annuity providers must collect a premium sufficient to cater for all uncertainty decades in advance. One of the most difficult aspects of such pricing risk is that associated with systemic improvements in mortality. This is very difficult to hedge for affordable prices, and results in very high margins being required to mitigate. (If realised, mortality improvements may ruin some annuity providers who have insufficiently priced their annuities.) Arguably the Government, with the power to tax, is in a better position to deal with such long-run uncertainty. See 2.7.

We believe that Australia is in the vanguard of a DC-funded retirement system. Looking at the behaviours of other nations (e.g. noting that they have larger annuity markets) may well be looking backward. Those nations probably have a less financially engaged population as they have been paternalistically treated with generous private DB schemes and/or generous government-provided pensions.

2.3 What is the best investment strategy for the system?

An interesting modelling exercise would be to segment the Australian retired population by age, wealth and other attributes, and then determine the investment strategy for each segment that delivers the best risk-adjusted retirement income (including the Age Pension).

This exercise would not only indicate the levels of retirement income that would sustainably be available to retirees, but also the cost to the public purse of providing the Age Pension.

It is our hypothesis that such an exercise would show that investment strategies that many believe to be too volatile will deliver the highest levels of risk-adjusted retirement income for retirees **and** a lower cost to the public purse.

The reason for this hypothesis is that, with proper understanding, most retirees are able to financially withstand more investment volatility than many pundits claim. This is partly due to proper framing of risk expressed in terms of retirement income, not account balances. In addition, partially funded retirees also have the Age Pension as a virtual hedging asset. Accordingly, such retirees will enjoy higher expected returns, leading to higher likelihood of better incomes in retirement and lower reliance on the Age Pension.

If this is the case, then calls for forced annuitisation will likely be expensive to the public purse.

CV Solutions would be happy to discuss this concept further with the FSI and/or Treasury, possibly providing technology to assist with such modelling.

2.4 The report confuses the concepts of personal longevity variability with the population mortality improvement risk

In many places the report uses the term "longevity risk" to refer to two very different types of risk:

- The uncertainty of an individual's actual time of death. We refer to this as "personal longevity variability".
- The risk that mortality rates in the population will improve at a rate greater than anticipated. We call this "population mortality improvement risk".

While individuals are subject to population mortality improvement risk, the reality is that this risk is swamped by their personal longevity variability. Individuals buy annuities to primarily protect personal longevity variability.

But annuity providers are subject to population mortality improvement risk, and will need too price annuities at a level that compensates them for this risk. If the annuity provider's pricing turns out to be too fine and/or the risk larger than anticipated, then the provider may fail and its customers will have their annuity streams terminated or reduced.

In light of this it can be seen that annuities are a poor form of protection for population mortality improvement risk for individuals. If the risk is realised, then they may have defaulting annuity streams. If the risk is not realised, then they will have paid too much, and the annuity providers receive a windfall.

We urge the Inquiry to be careful to separate these issues.

2.5 Simple and cheap ways to deal with personal longevity variability

This section only deals with personal longevity variability, not systemic risk of unexpected mortality improvement. (Section 2.4 discusses why these are distinct issues.)

The report rightly indicates that it is difficult for an individual with limited resources to ensure that they do not outlive their wealth. The flipside of this risk is just as important… individuals with limited resources may experience an unnecessary frugal retirement and leave an unintended bequest, particularly if they die earlier than expected.

The report seems to be overly focused on lifetime annuities as the main solution to this risk[1]. But as we have discussed in 2.2, lifetime annuities have many real disadvantages that many retirees rightly believe materially outweigh the benefit of removing the risk of running out of money. Indeed, the costs of lifetime annuities can be so high, that it may be just as cheap for a retiree to invest in an inflation indexed risk free portfolio until a fixed old age.

We suggest that there may be a simpler and cheaper way of dealing with personal longevity variability for most Australians.

This notion requires retirees to be provided with an estimate of the level of retirement income that they have a "good chance"[2] of receiving until a specified old age. As discussed

[1] We acknowledge the report touches on group self-annuitisation on page 4-27, and encourage the further exploration of this concept.

[2] A "good chance" can be defined as, for example, 67%, 75% or 85% with the level depending on the member's risk tolerance.

elsewhere, CV Solutions sells a stochastic engine that makes this estimate. We wish to avoid promoting our own services so, at the risk of providing insufficient detail, we will attempt to make these comments as generic as possible.

The approach would work as follows:

- At, and before, retirement the individual is advised of that level of retirement income they have a good chance of receiving until an old age. The specific age selected need not be overly precise, it just needs to be a far way off and more or less exceed expectations of life.
- Then, as the retiree ages, this "old age" should be gradually increased, so that even in very old age there will remain several years over which retirement income remains to be drawn.

This approach may sound simplistic, but in fact any greater precision using actuarial tables is spurious, as individual variability in actual timing of death will swamp the precision of life tables, which are suited to populations, not individuals.

It is our contention that, using a simple monitoring and adjusting approach such as this, together with appropriate (i.e. not overly conservative) investment strategies will deliver to retirees a retirement income that is quite stable and materially higher than that of a lifetime annuity. For example, a standard balanced fund will have a good chance of providing a member with an indexed retirement income of 5.6% of their balance at retirement for about 30 years compared to a lifetime indexed annuity rate of 4%.

2.6 Lump sums

The report rightly recognises that the purpose of superannuation is to support an income over remaining life, not for funding a short period of living above means. But we suggest that such a policy objective could be achieved by imposing a maximum rate of drawdown from account-based pension balances. Lifetime annuities are not the only way to achieve this objective.

Having said this, it is worth remarking that some uses of lump sums at retirement are consistent with this policy objective. The most obvious is that of paying off the mortgage on the family home, as owning the family home can be considered as:

- prepayment of accommodation expenses for decades to come
- followed by a source of funding nursing homes and other forms of care in the retiree's frail years

The fact that the family home falls outside the superannuation system does not diminish its importance in supporting retirement funding.

2.7 Is the government a cheaper provider of annuities?

As indicated in 2.2 and 2.4, CV Solutions is of the view that lifetime annuities often do not necessarily provide good value, particularly as a retirement investment for all of a member's superannuation unless they are highly risk adverse. Furthermore, they are not the solution to population mortality improvement risk.

CV Solutions generally believes that private provision of services will generally deliver more innovation, keener prices and better service than the public sector. But the government's power to tax, and the population mortality improvement risk extant in the Age Pension, would seem to indicate that lifetime annuities may be an exception.

We are pleased to see that the Inquiry has postulated that the government may be a better provider of annuities (page 4-30). We suggest that this policy option be expanded by the government provision of a type of reinsurance to private annuity providers, which would no doubt considerably reduce risk margins and make privately provided annuities better value for money.

We also suggest that tweaks to the Age Pension design may obviate the need for annuities for much of the population.

2.8 Improve understanding before retirement

It will be evident in this submission that CV Solutions believes that information is the key to many of the issues facing retirees. If retirees are shown the level of a sustainable retirement income (taking into account investment and longevity risk) then they can make sensible personal budgeting decisions, without the need for additional "financial literacy" or expensive and imbalanced retirement products.

But this information should not commence at retirement. Superannuation members should be delivered information on prospective risk-adjusted retirement income levels during their working lives. With such information, members can make informed choices as to the appropriate level of saving and investment volatility.

Unfortunately, it appears that government actions have been viewed as impediments to providing such information. The most damaging is ASIC's Class Order 11-1227, which many trustees have interpreted as imposing artificial and deterministic assumptions for the provision of retirement income estimates. In April 2013 ASIC undertook a consultation process on this class order. In the covering letter to our submission[3] we stated:

> *We commend ASIC for attempting to encourage super funds to provide useful retirement income estimates to members. We agree that this is key to the critical policy objective of increasing engagement with members. However, we believe the class order, even as amended, **acts contrary to the policy objective** as funds we have spoken to universally hold the view that, inter alia, the prescribed method will often result in misleading estimates. This perverse outcome is evident in the lack of reliance on the existing class order. Also, they are unlikely to rely on the amended class order, regardless of the "no action" clause in draft RG229.14.*
>
> *The amendments do not address the class order's primary deficiencies, which we see as:*
>
> 1. *It is not necessary. RG229.22 states: "If a trustee does not provide personal advice in giving a member a retirement estimate, it is likely to be providing factual information and does not need to rely on the relief in [CO 11/1227]."*
> 2. *It will often lead to poor estimates of retirement income as they ignore investment risk.*
> 3. *By relieving trustees from liability the first layer of protection for members is destroyed.*
> 4. *It is likely to result in disengagement when a member receives conflicting information.*

[3] Available on our website: http://ccfs.net.au/cvs/content/Submission-to-ASIC-CP203.pdf

5. *Its prohibition on providing more information is both paternalist and limiting.*

In our view, ASIC would be better to scrap the class order and make clear the circumstances in which retirement income estimates do not constitute advice. Ideally ASIC should go further and clarify that a retirement estimates report demonstrating the outcome of saving more or investing differently does not constitute advice and can be provided along with retirement estimates. This is one area in which the promotion of innovation is likely to be beneficial and outweigh the unlikely risk that funds will use retirement estimates for inappropriate competitive purposes.

Interestingly ASIC is well over a year behind its own schedule for the consultant process for CP203. We are unaware of the reasons for this delay (or abandonment).

We would urge the Inquiry to consider this, and other, impediments to superannuation funds providing useful information to members both before and after retirement.

3 Financial advice to individuals

In this section we respond to the request for comment made on page 3-72 of the report:

- *What opportunities exist for enhancing consumer access to low-cost, effective advice?*
- *What opportunities are there for using technology to deliver advice services and what are the regulatory impediments, if any, to those being realised?*

We make brief comments on a number of extracts from the report:

Page	Extract from report re advice	Brief CVS Comment
3-71	Technology, including automation and 'mass customisation' techniques, provides an opportunity to offer consumers more cost-effective advice. It may also enable new business models, such as scaled or automated online advice. Although regulations do not impede the provision of online or automated advice, providing personal advice requires a sufficient process to allow the consumer's relevant circumstances to be taken into account. Otherwise, it may not lead to advice that adequately reflects the consumer's relevant circumstances.	We agree that mass automated technology can deliver valuable and inexpensive advice for many individuals. But there are many impediments to the delivery of such advice. No doubt some of these have been fostered by the financial planning industry.
3-63	The main issue with financial advice is variability in its quality. In addition, many consumers have difficulty … understanding the risks and rewards inherent in particular products. Access to affordable advice for consumers is also an issue…	Most financial planners have poor access to quality stochastic models that incorporate investment risk. This means that they are unable to ascertain a client's true financial tolerance for risk, and fall back on psychometric hocus-pocus to satisfy compliance. In many cases, psychometric analysis will generate perverse signals of risk tolerance (both too high and too low)

Page	Extract from report re advice	Brief CVS Comment
		because they focus on the wrong risk.
3-63	Observation: Affordable, quality financial advice can bring significant benefits for consumers. … Comprehensive financial advice can be costly, and there is consumer demand for lower-cost scaled advice.	Strongly agree
3-62	Improve the current disclosure requirements using mechanisms to enhance consumer understanding, including … risk profile disclosure and online comparators. Remove disclosure requirements that have proven ineffective and facilitate new ways of providing information to consumers, including using technology and electronic delivery.	Strongly agree
3-67	The quality of personal advice is an ongoing problem. Personal advice is a recommendation that takes into account personal circumstances. … This poor-quality advice mainly relates to … Relatively low minimum competence requirements that apply to advisers. [Also mentioned is conflicted advisor remuneration, but that is not our focus.]	Strongly agree. This could be resolved with a requirement, not only for higher competence, but for the use of well-designed stochastic analysis that incorporates investment volatility and allows advisers to assess a client's true financial tolerance for risk relating to poor retirement outcomes rather than investment volatility.
3-69	Access to quality financial advice helps consumers make informed financial decisions; however, the cost of personal financial advice may reduce its accessibility.	Agree. Simple advice generated using quality stochastic models with little, if any, human intervention, may provide the answer for many individuals with simple circumstances.
3-71	To make advice more accessible to consumers, one approach may be for advisers to provide more cost-effective scaled or limited personal advice. Scaled or limited advice is personal advice on a single topic or that is not intended to be comprehensive. This can be provided at lower cost. Many consumers only need personal advice at key stages in their life; in many cases, consumers may prefer scaled or limited advice that deals with particular issues.	ditto
3-62	What evidence is there on the effectiveness of financial literacy strategies in enhancing consumer confidence and decision making at particular points in time, and in achieving increasing literacy over the long term?	In most cases "financial literacy" is a red-herring. Individuals do not need to be literate in the jargon used by most of the investment and advice industry. Instead, if they are provided information in

Page	Extract from report re advice	Brief CVS Comment
		terms that they understand, such as their paycheque, then they would be able to make sensible decisions with existing skills. The most obvious example is to change the focus from superannuation account balances to estimated levels of retirement income that an individual has a good chance of receiving.

4 Who is CV Solutions?

CV Solutions is a partnership of Peter Vann and Chris Condon. CV Solutions is entirely owned by the two partners and has no connection with any financial services organisation[4].

Over the last three decades both Peter and Chris have researched and promoted solutions aiming for a closer link between superannuation assets and retirement liabilities for both defined benefit funds and defined contribution members. Our passion is that the superannuation industry should better address the needs of members. We are attempting to follow through by providing a service to superannuation funds so that they can provide a better service to their members.

CV Solutions has built a service that enables superannuation funds to report retirement income estimates for each member. This service explicitly incorporates investment risk. The way we display the results enables members to understand the three way trade-off between (a) investment risk, (b) quantum of retirement income and (c) longevity. In our view this is a key step to a member identifying that they should seek advice to improve their retirement outcomes and will serve as an effective catalyst for increased engagement across all ages, particularly the younger member.

More information about CV Solutions, its principals and services, can be found at http://ccfs.net.au/cvs.

[4] The partners do have other clients in the investment management and financial services industry. And they may hold positions on boards and investment committees. But none of these is related to the CV Solutions business of providing retirement estimates.