Why Your Financial Planner Should Be a Robot

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Retirement planning requires more data and less human involvement to nudge customers to a more comfortable future.

In 2015 the Singapore-based bank, DBS, surveyed 600 local mothers in their 30s about retirement. The results were revealing. Three-quarters had not started planning for their retirement. Only 25 percent thought they would have sufficient funds to retire on. The average Singaporean household, headed by a 45-year-old, spends US$3,800 per month. However, 69 percent believe they would be able to retire on less than US$2,200 a month, while 38 percent believe it would be less than US$1,500.

It is unlikely that the average person is willing to settle for such a sharp drop in their lifestyle. Based on current spending levels, the reality is that Singaporeans' monthly retirement stipend will need to be closer to US$3,300 to maintain their current living standards. Most Singaporeans will draw US$550 per month from the Singaporean retirement income scheme for the elderly, the Central Provident Fund (CPF) LIFE. Contrary to popular wisdom, household spending does not decline significantly during retirement. This is often referred to as the retirement income puzzle.

According to a **2015 Nielsen survey**, six out of 10 Singaporeans only start saving for their retirement once they reach 45. They believe they will just need to double their current savings to retire comfortably with peace of mind.

In China, the social pension is the primary source of retirement income. However, 43 percent of respondents in a **survey** conducted by the Society of Actuaries in 2016 believe the government or their company will cut their benefits in the future. With an estimated 329 million Chinese turning 65 by 2050, it is projected there will be a **US$118 trillion** pension deficit.

Why is retirement planning so difficult?

For behavioural, judgement and decision-making reasons, planning for an uncertain future is extremely difficult – especially when the trade-offs are known. For example, putting more money into an investment or savings plan is considered a loss in the short term, as it decreases spending power and consumption. The exact future gain is uncertain.

What makes retirement so difficult is that it is not only numerically complicated but also inexact. Think of your retirement as a liability (much like an insurance company would). That liability needs to be at least matched (on the asset side) for you to be able to retire in comfort. The difficulty lies in how to model the liability and how to think about the structure of the asset.

The liability has two key components – both of which are difficult to assess:

1. The longevity of the liability (i.e. the life expectancy of the youngest member of your household)
2. The annual negative cash flow stream (i.e. the kind of lifestyle you want in retirement)

The composition of the asset has also two parts:

1. Regular cash flow contributions (forced and unforced savings)
2. The asset mix (including housing and all financial assets)

The average 55-year-old male has a life expectancy of 82 but he has a 22 percent chance of living past 85. If we assume a realistic retirement age of 67, that means, on average, the individual will live 15 years in retirement –

but there is a one-fifth chance it could be more than 18 years. Based on our calculations at OnTrack Retirement, adding an extra three years of life reduces the probability of funding the entire retirement from 41 percent to slightly over 1 percent.

Reality of the problem

By all measures, Singapore is a rich country – the net worth of Singaporeans is around US$275,000 per adult. Of that, housing is the dominant asset representing 55 percent of personal net worth. This is followed by cash at 24 percent and CPF retirement savings at just under 20 percent.

Retirement savings is a large financial asset for the household, but when we break the data up by gender and age, the numbers become more sobering. The average balance in CPF for a 45-year-old male is US$95,000. For a woman of the same age, it is only US$87,500. If we assume they are married, then household retirement assets are around US$180,000. At 45, with 22 years to go until retirement, surely you can still save enough, right?

Unfortunately data do not support this. At 55, the average male has US$98,000 and female has US$85,000, bringing the total household retirement assets at around US$183,000. However the couple now has only 12 years until retirement.

Of these balances, for a household, approximately US$87,000 is in cash instruments granting a low return. Only about US$94,000 is available for higher risk investment options which will mostly be relied on to grow the asset pool.

Most people have not been properly educated about the need to plan for retirement. Fewer than a quarter of Singaporeans have prepared a proper retirement plan with a financial professional. In China, 68 percent of respondents to the aforementioned study had prepared their retirement plan without help from a financial advisor. Their primary sources of information were family, friends and co-workers. As a result, most portfolios gravitate towards low-risk cash instruments.

The often praised CPF limits what people can invest in. As a result, many stick with what they know – their own house and cash. Presently CPF only allows four exchange-traded funds (ETFs) to be used. Among academics, ETFs are typically seen as a cost-effective investment advice.

Cost of advice

People tend to be unprepared for retirement due to a lack of financial planning and associated costs.

Good financial advice does not take five minutes. Frequently costs are estimated based on the client’s situation but we find that looking at it from the financial planner's perspective is just as revealing. The average retirement plan takes between two and three hours to prepare – being conservative we estimate that it could cost the financial planner around US$300 per client. Assuming he or she wants to make a profit – and most do – they might need to generate US$435 in revenue per client plan.

The average 55-year-old male with a CPF balance of approximately US$98,000, after allowing for the minimum balance, has about US$41,000 to invest. If all that money is invested based on the advisor’s recommendations, that US$435 plan represents a total upfront cost to the 55-year-old of over 1 percent every time a plan is undertaken. That is just the cost for the advice. Then the client needs to pay the asset manager, custodian, trustee, etc. – roughly another 1 percent per year. Add inflation and the investment solution needs to make 4 percent per year just to keep up with today’s purchasing power. So, while the typical solution – more investment advice – is well meant, the end result at a macro level is unlikely to be economical for the average client.

Is there a better solution?

As an option, the human touch in retirement planning needs to be reduced with the help of fintech to make it affordable for the average person. A hybrid model blending a mix of technology for most people and face-to-face advice at pivotal moments is an obvious solution. It cuts cost for end users, but still gives them the flexibility to receive face-to-face advice when making important decisions that require a human touch to provide reassurance. At the same time, it enables financial advisors to provide more profitable outcomes for their clients. We will expand on how this can work in practice in the next article.

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