

Working Paper 2015-2

Options for Dis-saving 'Safely'

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The Retirement Policy and Research Centre

The Retirement Policy and Research Centre is pleased to publish this Working Paper, *Options for 'Dis-saving' Safely*, which draws in particular on the Forum, *Decumulating retirement savings: making the options work*, co-hosted by the RPRC and the (then) Commission for Financial Literacy and Retirement Incomes on 21 November 2014 at the University of Auckland.

'Decumulation' is a formal term for spending down some or all of the assets accumulated prior to retirement, or dis-saving. Since the late 1980s' reforms to the taxation of saving, New Zealand has paid little or no attention to the decumulation phase of retirement saving, and opportunities for realistic annuitisation of accumulated wealth have all but disappeared.

While the living standards of the poorest in New Zealand are protected by social security and means-tested social assistance programmes, middle-income groups face under-appreciated risks, such as outliving their capital. Many middle-income retirees, confronted for the first time with management of large lump-sums, for example from KiwiSaver or other retirement savings, are ill-prepared for the task, and unable or unwilling to acquire the skills and knowledge necessary for safe financial management of their asset or to seek expert assistance.

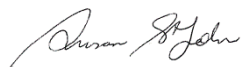
The RPRC's 2014 Forum brought together consumer and sector representatives, actuaries, academics and other experts to develop a report to the Government on the viability of various approaches to the decumulation of savings. The keynote speaker was Jeremy Cooper, Chairman of Retirement Income at ASX-listed Challenger Limited, a major annuity provider in Australia.

This Paper is primarily descriptive. It updates further developments since the forum to provide a snapshot of New Zealand's situation in early 2015.

We look forward to your comments.

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Working Paper 2015-2 Dis-saving Safely

Contents

Introduction	4
New Zealand's retirement income framework	5
New Zealand Superannuation	5
KiwiSaver and other savings	6
Other support	7
The Ageing Dilemmas	8
Decumulation options	9
Self-management	9
The role of the Financial Advisor	10
Decumulation products	13
Product 1: Managed income drawdown	13
Product 2: Home equity release or reverse mortgage	14
Product 3: Annuities	16
New Zealand Income Guarantee	19
A state option	20
A note on gender	22
Conclusion	22
Bibliography	24

Introduction

In New Zealand, the population aged 65+ is projected to almost double from 635,200 in 2013 to 1,100,000 before 2030. Demographic change exerts pressure on pension and retirement policies, labour markets, and health policies and programmes. The current system funds the provision of services and support for those aged 65+ out of taxation – a pay-as-you-go system. As the population ages over the next 20 years, this system will be under considerable stress.

While social security and means-tested social assistance programmes for long-term care (LTC) protect the living standards of the poorest in New Zealand, middle-income groups face under-appreciated risks, such as outliving their capital or needing expensive long-term care (St John, Dale and Ashton 2012). Many middle-income retirees, confronted with management of large lump-sums, for example from KiwiSaver or other retirement savings, or from the sale of the over-large family home, are ill-prepared for the task, and unable or unwilling to acquire the skills and knowledge necessary for safe financial management of their asset.

As reported by the Savings Working Group (2011, p. 102):

As it stands, most investors receiving large lump sums early in their retirement (as will increasingly be the case for members of KiwiSaver) will face investment decisions involving larger sums than they have ever seen in their lives. These are complicated decisions on how to best manage their retirement nest-eggs. The SWG is not only concerned with the limited options but also the consequent risk that many will not be able to manage their retirement nest-eggs in their best interests, let alone recognise their vulnerability to bad advice, and the temptation to partly solve the problem by going on a spending spree.

'Decumulation' is a formal term for dis-saving or spending down some or all of the assets accumulated prior to retirement. New Zealand has paid almost no attention to the decumulation phase of retirement saving since the late 1980s saw the reforms to the taxation of saving. And as is to be expected in a country where there has been no direct government intervention of any kind in the annuities market, the opportunity for realistic annuitisation of accumulated wealth has all but disappeared.

In addition to the complexities of accumulation, preservation and dis-saving, there is the uncertainty associated with ageing. "Central to the modern-day concept of retirement is the need for a regular income that covers the expenses of the active, passive, and frail stages of a retiree's life." (Cooper 2014, p. 516). The problem is uncertainty about how long any of the stages or phases will last, and what the total duration of all three phases will be for a given individual. While the averages may be known, individual longevity and morbidity are unknown. This uncertainty adds to the complexity around decumulation decisions.

In recognition of the lack of information and the need for suitable products for middle-income consumers, the Retirement Policy and Research Centre (RPRC), with the (then) Commission for Financial Literacy and Retirement Income (now the Commission for Financial Capability), held a symposium in November 2012: [*Spending the Savings: Decumulation & Middle-income Retirement*](#).² This provided the basis for the Forum in November 2014: [*Decumulating retirement savings: making the options work*](#).

² See Dale (2012).

This Working Paper draws on the presentations delivered by industry experts and academics at those events, and on subsequent research. The decumulation options discussed here include self-management, home equity release products or reverse mortgages, and a variety of annuity products. Some of these products are available in New Zealand, some are only available overseas, and some are still in the design phase.

In the final session of the RPRC's 2014 Forum, attendees were divided into workshops to discuss the following statement:

There is a current and future problem of income insecurity for middle income New Zealanders with modest lump-sums on retirement and uncertain life spans. Some form of annuity or income product would be a welcome addition to existing choices of drawdown products.

The consensus from the workshops was that there is a need for some form of annuity or income product in New Zealand. This paper contributes to that on-going discussion.

New Zealand's retirement income framework

New Zealand Superannuation (NZS) and KiwiSaver are the foundations of New Zealand's retirement income system.

New Zealand Superannuation

NZS is a non-means-tested, universal Tier 1³ pension, paid out of current taxation⁴ at a rate determined by marital status and living arrangements⁵ (see Table 1).

Table 1. New Zealand Superannuation & Veterans Pension rates (tax at "M"), 1 April 2015⁶

Category	Weekly rate		Fortnightly payment (net)
	Gross	Net	
Single, living alone	\$431.10	\$374.53	\$749.06
Single, sharing accommodation	\$396.17	\$345.72	\$691.44
Married person or partner in a civil union or de facto relationship	\$326.30	\$288.10	\$576.20
Married or in a civil union or de facto relationship, both qualify	Total	\$652.60	\$576.20
	Each	\$326.30	\$288.10
Married or in a civil union or de facto relationship, non-qualified partner included on or after 1 October 1991	Total	\$618.08	\$547.64
	Each	\$309.04	\$273.82
Married, non-qualified partner included before 1 October 1991	Total	\$652.60	\$576.20
	Each	\$326.30	\$288.10
Qualified partner in rest home with non-qualified partner in the community	\$295.41	\$262.64	\$525.28
Hospital rate	\$48.49	\$43.45	\$86.90

³ Tier 1: basic state pension. Tier 2: earnings-related scheme, with mandatory contributions by employees, employers or both, and can be complicated by the addition of state subsidies and tax concessions. Tier 3: all other voluntary workplace or individual savings or wealth accumulation.

⁴ Often referred to as a pay-as-you-go or PAYGO scheme.

⁵ The three basic NZS rates are "married", "single sharing", and "single living alone".

⁶ See <http://www.workandincome.govt.nz/map/deskfile/nz-superannuation-and-veterans-pension-tables/new-zealand-superannuation-and-veterans-pension-ra.html>.

In the context of decumulation, it is important to note that the majority of older New Zealanders are heavily dependent on NZS for their income, as reported in *Household incomes in New Zealand: Trends in indicators of inequality and hardship 1982 to 2013*:

- 40% have next to no other income, and the next 20%, those in the middle income quintile for older New Zealanders, receive 80% of their income from NZS
- around half of older New Zealanders receive less than \$100 pw from non-government sources (eg employment, private superannuation, other investment returns). (Perry 2014, p. 41)

Eligibility and entitlement to NZS are set out in the New Zealand Superannuation and Retirement Income Act, 2001 (NZSRI Act 2001). As with government-administered basic pension arrangements in many other countries, eligibility is by age and residency. Entitlement to NZS is conditional on reaching age 65, plus a minimum residence requirement of at least 10 years lived in New Zealand over the age of 20, with at least five of these after the age of 50 ("the 10(5) requirement"). The recipient must also be resident in New Zealand at the time of application. The residency or contributory requirement in some countries is as much as 45 years for the full pension. The qualifying age also varies and is increasing in many countries from 65 years to at least 67 years.⁷

Unlike the situation in most other countries, there are no specific contribution or work-related requirements for NZS. Universal entitlement to NZS may be viewed as a recognition of the paid and unpaid contributions of older citizens (TeAra.govt.nz 2006). It is not intended to be a poverty-alleviation device, though it serves this purpose well: the over 65s have the best living standards profile of any age group in New Zealand with low rates of significant hardship (Perry 2014). Other major advantages of NZS are administrative simplicity, transparency, and adequacy: 60% of those aged 65+ receive between 80% and 100% of their income from NZS and/or other government transfers (Perry 2014, p. 173).

Although NZS is termed "universal" not everyone who is eligible prima facie is entitled to receive it. The NZS Act 2001 provides for the NZS "entitlement" to be reduced against benefits received under the Injury Prevention, Rehabilitation and Compensation Act 2001 (ACC), and in accordance with the direct deduction policy (DDP) set out in section 70 of the Social Security Act 1964.⁸

KiwiSaver and other savings

NZS is supplemented by KiwiSaver, an auto-enrolment, voluntary, government-subsidised saving scheme,⁹ implemented in 2007, with matching compulsory employer contributions, now up to 3% of member's gross pay. There is no doubt about KiwiSaver's popularity with the general public. In December 2014, out of the 4.6 million population, almost 2.5 million are KiwiSavers.¹⁰ However, KiwiSaver is often criticised by industry and academic commentators, for example a report from the RPRC suggested:

⁷ For example, from July 2017, the qualifying age in Australia starts increasing from 65 years to reach 67 years by 1 July 2023. See <https://www.dss.gov.au/our-responsibilities/seniors/benefits-payments/age-pension>.

⁸ More than 10% of the approximately 620,000 New Zealanders over age 65 are entitled to NZS and at least one other public pension from abroad. Numerous complaints received annually by the HRC, the MSD, the Minister of Finance, and the RPRC, or published on www.pensionabuse.co.nz, indicate that the DDP has produced a sense of injustice in many of the affected pensioners.

⁹ While membership is not compulsory, if an employee does not opt out contributions to KiwiSaver are 3%, 4% or 8%. The employer must match that to 3%. After 12 months, a contributions holiday may be taken.

¹⁰ See <https://www.kiwisaver.govt.nz/statistics/monthly/>.

One key lesson from New Zealand is the importance of clarity about the problem to be addressed.... Another crucial lesson from the New Zealand experience is that competition among many providers, and a system of default providers, may not improve consumer outcomes and subsequent rationalisation with mergers and takeovers may be costly. The time-frames around KiwiSaver's introduction were unreasonably short and New Zealand continues to pay the price with poor quality regulation and constant change.... Opening the scheme to children has little justification, and most young adults need help today to pay debts and mortgages before they save for tomorrow. Compensating them by offering housing subsidies only muddies the waters and adds complexity. (St John, Littlewood and Dale 2015, p. 25-28)

Despite these weaknesses, KiwiSaver's features, particularly soft compulsion, and remarkable growth in membership, have generated considerable international interest (St John, Littlewood and Dale 2010; St John 2014) as countries such as the UK and Ireland develop their own auto-enrolment schemes.

However, a criticism of the design of KiwiSaver is the shallow consideration given to decumulation. There appears to be a general understanding that accumulated savings are available as a lump sum when the member becomes eligible, although there is no requirement to withdraw and arrangements can be made with most providers or with a bank for regular capital draw-downs. However, as a recent paper from the Retirement Income Interest Group of the New Zealand Society of Actuaries states: "Retirees relying on assets to provide income during retirement are exposed to investment risks" (O'Connell, Edgar, Ormrod, Mussett, Shirley, Benbow, Eriksen and Channon 2015, p. 16). That paper also notes:

The existence of KiwiSaver will increase demand for ways of converting assets into retirement income. More and more New Zealanders will reach age 65 with a KiwiSaver balance, and the size of the funds available will grow. We estimate about half of the KiwiSaver members reaching age 65 in twenty-five years' time will have a KiwiSaver balance of \$100,000 or more in real terms. (O'Connell, Edgar et al. 2015, p. 2)

New Zealand also has voluntary and varied Tier 3 superannuation schemes. Some are workplace-based, and subsidised by employers; others are individually directed, through formal saving plans, or by investment. Apart from KiwiSaver, saving arrangements receive no direct tax breaks, although some members are taxed at a lower top rate of 28% instead of 33% in portfolio investment entity (PIE) arrangements.

Accumulated assets may also be in the form of a mortgage-free home, rental property, shares, government bonds and other savings vehicles. A critical factor in preparing for retirement is reduction of debt. Paying off mortgage debt in particular is a highly desirable form of saving as mortgage interest payments are not tax deductible in New Zealand. Home-owners have multiple options for releasing some of their capital during retirement, including down-sizing, subdividing the section, installing a rental unit, and taking in a tenant or a boarder.

Other support

Other state assistance is also available, including needs-based in-home care and support; the public health system including subsidised GP visits¹¹ and some hospital care; the

¹¹ This subsidy applies if the GP is part of a Primary Health Care (PHO) organisation working with the District Health Board to improve access to primary health care. See <http://www.health.govt.nz/our-work/primary-health-care/about-primary-health-organisations>.

Residential Care Subsidy,¹² the income-tested Accommodation Supplement and Work & Income grants (not repayable); and the SuperGold Card discounts on travel and other services (Dale 2014).

Access to information regarding the available support and assistance is easy, whether online, at public libraries or at local and national government agencies. Grey Power and Age Concern organisations that offer nationwide support.

The Ageing Dilemmas

In spite of a sound framework as outlined above, there are risks and uncertainties associated with resourcing one's retirement. For everyone, whatever their wealth, decisions as to how to 'run down' accumulated savings operate in an environment of uncertainty. 'Average' lifetimes can be estimated using period life tables, but individual lifetimes are uncertain. Average life expectancy at age 65 for Kiwis born in 1950 is currently 21.3 years for females and 18.9 years for males, an increase of 1 and 2 years respectively since 2000.¹³ Cohort measures may give more realistic (and higher) lifespans. Leaving paid employment at age 65 is likely to mean around 20 years of 'retirement'.

The duration of each of the three phases of retirement: active, passive, and frail, cannot be predicted for any individual. Each phase involves different opportunities and costs.

In phase one, the active phase, the person is likely to be healthy and may still be in the paid work force. In 2011, New Zealand had the fourth highest employment rate of 34 OECD countries in the age group 65-69, and the second highest in age groups 50-64 years (Jackson, Cochrane and McMillan 2013). Factors affecting the timing of retirement include one's health and/or that of a family member; expectations based on social norms and individual feelings; and the availability of flexible work arrangements (Gorman, Scobie and Towers 2012).

In phase 2, the passive phase, the person is likely to require some level of regular in-home support or care, and continued workforce participation is unlikely.

In phase 3, the frail person is likely to require support with daily living tasks and residential care. In the final stages of this phase, hospital-level care may be required.

Individuals want to manage their retirement to achieve the best possible quality and outcomes. However, all the decisions need to be made in the reality of vast uncertainty and some significant risks, in particular, running out of funds while still healthy and active.

How much annual income is required?

One of the reasons to save or 'accumulate' is to draw on those assets in later years for 'income smoothing'. While NZS is a valuable base income, at \$19,475.56 a year after tax for an individual living alone (see Table 1), and may prevent poverty, many find it is not enough to support a modest participatory lifestyle.

Day to day expenses and expectations are different for those in work and those retired, for example, work may add the costs of appropriate clothing, transport costs, and perhaps the additional expenses of fastfood or a housekeeper. However, significant expenses apply

¹² See <http://www.workandincome.govt.nz/individuals/a-z-benefits/residential-care-subsidy.html>.

¹³ See <http://www.stats.govt.nz/Census/2013-census/profile-and-summary-reports/quickstats-65-plus/population-overview.aspx>.

whether or not one is in paid employment, including food, power, phone, doctor, rent or mortgage and rates, insurance, and leisure. Particularly for those retirees in rental accommodation, NZS alone may be insufficient although there is a higher living alone rate and a means-tested accommodation supplement is also available.

Research from the University of Auckland suggests \$6,000 to \$8,000 per individual is needed annually in addition to NZS for healthy living (O'Sullivan and Ashton 2012).¹⁴ The RPRC has updated this estimate to around \$10,000 annually (St John, Dale et al. 2012).

Accumulation of wealth during the 'earning' years can provide resources during the later years to fund a healthier and more comfortable retirement. However, risk and uncertainty remain the enemies, particularly inflation risk (that particularly affects low-return investments); investment risk (investments can be volatile, fund managers can be unskilled and/or unreliable, and businesses fail); longevity risk (living longer than expected and running out of supplementary funds); and mortality risk (living fewer years than expected and leaving unintended bequests). On the other hand there is also the risk of not spending enough, enduring a sub-optimal lifestyle and again leaving unintended bequests.

Decumulation options

The Australian Productivity Commission (2015, p. 76) reported:

The degree of flexibility that people have in drawing down their superannuation assets has advantages and limitations. A flexible system may be appropriate given the wide variety of needs and circumstances people face in retirement.... However, this flexibility may increase the risk that people outlive their superannuation savings (longevity risk), and potentially allow for some to structure their affairs to maximise access to welfare and taxation benefits.

A recent survey for the Inland Revenue Department found that while over 57% of those surveyed reported not having withdrawn any of their KiwiSaver funds, more than a third had withdrawn their money. However, caution is required in using the results of this survey to predict future behaviour of KiwiSavers as over time, balances will be greater. The survey was conducted in 2012, when KiwiSaver had been available for only 5 years.

Self-management

A principal concern for people managing their wealth during retirement is a lack of capability (comprising opportunity, knowledge and skills) including cognitive decline, which can lead to vulnerability. The current tools to manage the risks of decumulation capital over an uncertain length of life and with risks of ill health are currently few. Many people self-manage, with or without advice.

To self-manage retirement savings, for some people, is a bit like having a pile of car parts and a technical manual dumped in your driveway when you wanted to buy a new car (Merton 2014). Even with promotion of financial literacy, and online budget tools, it is an unrealistic task for most people to acquire sufficient financial expertise to manage all the

¹⁴ These figures compare with the latest Association of Superannuation Funds of Australia (ASFA) Retirement Standard: a single person looking to achieve a comfortable retirement needs to spend \$42,597 a year, while an individual seeking a 'modest' retirement lifestyle need to spend \$23,489 a year. See <http://www.superannuation.asn.au/resources/retirement-standard>.

investment steps needed to get to their pension goals, and then to manage the distribution of their assets or decumulation over the three phases of retirement.

Decumulation may involve drawdowns over as many as 30 years, so self-management requires careful consideration of assets, aspirations, risk tolerance and time. "Practical and relevant financial guidance will become ever more critical." (O'Connell, Edgar et al. 2015, p. 3) It may include a managed drawdown organised with a bank, insurance company or KiwiSaver provider.

In Australia, self-managed super funds (SMSFs) provide a tax-favoured way of saving for retirement, regulated by the Australian Taxation Office (ATO).¹⁵ Generally a SMSF can only pay out a member's super when the member reaches their 'preservation age'¹⁶ and meets one of the conditions of release, such as retirement. The payment can be an income stream or a lump sum. The ATO statistical report for the SMSF market shows its increasing significance, contributing 28% to the overall growth of the \$1.9 trillion Australian superannuation industry,¹⁷ with approximately 530,000 SMSFs in 2014 representing over 1 million members.¹⁸

Yet the Australian Treasury's *Financial System Inquiry* (2014, p. xvii) was critical of their superannuation system for the following reasons:

the superannuation system is not operationally efficient due to a lack of strong price-based competition. Superannuation assets are not being efficiently converted into retirement incomes due to a lack of risk pooling and over-reliance on individual account-based pensions.

There is no such tax-favoured, self-managed option in New Zealand. The nearest equivalent would be a PIE, for example a managed fund with multiple types of investments for the contributions from investors, and offering a concessional top rate of tax with no restrictions on access.

Some banks and the 'Sorted' website provide online software to assist the savings calculations and organising personal finances prior to retirement, but currently calculators are not available to assist with the dis-saving calculations.¹⁹ Difficulties are likely to emerge when retirees who have no experience in such matters, have to manage the drawdown of this lump sum over an uncertain number of years with uncertainty around possible events such as the need for expensive healthcare or residential care.

The role of the Financial Advisor

The Financial Advisers Act 2008, part of the Government's response to the finance company failures and the global financial crisis, requires qualification and registration of

¹⁵ Correctly established SMSFs can receive contributions and are eligible for significant tax concessions. SMSF members are usually also the trustees who run the trust for the beneficiaries' benefit and are responsible for complying with the superannuation and tax laws. Trustees' administrative obligations include arranging an annual audit, keeping appropriate records, and lodging an annual return with the ATO. See <http://www.superannuation.asn.au/resources/retirement-standard>.

¹⁶ Australians can have a preservation age ranging from 55 years to 60 years, depending on date of birth. See <http://www.australiansuper.com/tools-and-resources/questions-and-answers/superannuation-faqs/withdraw/what-is-the-preservation-age.aspx>.

¹⁷ See https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Annual-reports/Self-managed-superannuation-funds--A-statistical-overview-2012-2013/?page=4#Growth_of_SMSF_assets.

¹⁸ See <https://www.ato.gov.au/Super/Self-managed-super-funds/In-detail/Statistics/Quarterly-reports/Self-managed-super-fund-statistical-report---June-2014/?page=2>.

¹⁹ See Sorted at <https://www.sorted.org.nz/>; for the ANZ KiwiSaver account calculator, see <https://comms.anz.co.nz/kiwisaver-calculator/index.html>.

financial advisors, and imposes restrictions on the services they can provide. Financial advisers, regulated by the Financial Markets Authority (FMA):²⁰

... give advice about investing and other financial services and products as part of their job or business. They include financial planners, mortgage and insurance brokers and people working for insurance companies, banks and building societies that provide advice about money, financial products and investing.

Registered Financial Advisers (RFAs) can give advice or provide investment management services for products such as bank term deposits, bonus bonds, a share in a co-operative company, a unit in a cash or term portfolio investment entity, a consumer credit contract, an insurance contract (other than an investment-linked contract of insurance), and any other category 2 product²¹ specified by the regulations. They can also provide class services and services to wholesale clients.

Authorised Financial Advisers (AFAs) can provide the same services as an RFA, but can also provide an investment planning service, and services in relation to category 1 products,²² such as securities, land investment products, futures contracts, investment-linked contracts of insurance and regulation-specified other products.²³

Financial Advisors are required by law to belong to a financial complaints dispute resolution scheme, and must clearly display information about the scheme they belong to. Another element of consumer protection is that the dispute resolution schemes are free to consumers.

Financial advice on decumulation comes at a cost. The Retirement Incomes Interest Group (2015, p. 45) surveyed advice providers to find an average cost of less than \$1,000 for a one-off advice session. An online advertisement from a large company shows the establishment fee for ongoing management of a portfolio could be around \$500, and for portfolios valued between \$100,000 and \$500,000, annual management fees can range from 1.53% on \$100,000 to 1% on \$500,000. There is not yet a culture in New Zealand for advice purely on decumulation, perhaps reflecting the lack of available products.

The preferred system of self-management remains investment in property, including rental property, as the absence of a capital gains tax makes this a tax-favoured investment. However, while it enables accumulation, it does not answer the problems of decumulation.

The Retirement Incomes Interest Group (2015, p. 43) suggest a guidance focus to the complex decumulation problem is more appropriate than a product focus:

We suggest two approaches are worth developing in order to help guide people to ways to use their resources in retirement to meet their individual needs:

- *Simple approved "rules of thumb" freely available, for example on the Sorted website and used on product literature.*

²⁰ See <http://www.fma.govt.nz/help-me-comply/financial-advisers/who-needs-to-comply/>.

²¹ See <http://www.fma.govt.nz/assets/media/375829/173844-do-i-deal-with-category-1-or-category-2-products-2.pdf>.

²² Ibid.

²³ Financial adviser services can also be provided by Qualifying Financial Entities (QFEs), businesses that provide and take responsibility for the conduct of the Financial Advisers and any nominated representatives they employ. Other non-QFE businesses providing financial adviser services have to register as a Financial Service Provider, and can provide services to retail clients through an appropriately authorised or registered individual. Brokers (individuals or companies) act as an intermediary for the client and must be registered and comply with the brokers' conduct and disclosure obligations in the Financial Advisers Act. The Act exempts specific groups of people, including Budgeting Advisors, who only provide financial adviser services in the ordinary course of their jobs or as incidental to their jobs. See <http://www.fma.govt.nz/help-me-comply/financial-advisers/who-needs-to-comply/>.

- *Access to a simple form of approved independent financial guidance at suitable moments during retirement, with consideration to be given to whether this should be a default setting (that is, auto-enrolled but can opt-out) for KiwiSavers with significant balances.*

In addition, the Group argues that:

Developing rules of thumb, other tools and guidance in New Zealand would need input from a range of experts, including actuaries. We are concerned, in particular, to ensure that individuals are informed about longevity, mortality, credit, inflation and investment risks and uncertainties around costs including medical and long-term care needs. (O'Connell et al., 2015, p. 5)

The 'free advice' regime, introduced in the UK to coincide with the abolition of compulsory annuitisation may provide some information on the likely success or failure of this approach. The UK's 2014 Budget announced:

And we're going to introduce a new guarantee, enforced by law, that everyone who retires on these defined contribution pensions will be offered free, impartial, face-to-face advice on how to get the most from the choices they will now have. (Casey 2015)

At a colloquium of superannuation researchers in Sydney, Casey (2015) raised some serious questions about how the 'free advice' regime could possibly work: who needs advice, will it be web-based, phone-based, or face-to-face delivery, and who is qualified to deliver it?

The Ministry of Business Innovation and Employment's review of the Financial Advisers Act 2008 set 3 broad goals (2015, p. 7):

Goal 1: Consumers have the information they need to find and choose a financial adviser.	Do consumers understand the regulatory framework? Should there be a clearer distinction between advice and sales? How should we regulate commissions and other conflicts of interest?
Goal 2: Financial advice is accessible for consumers.	Does the FA Act unduly restrict access to financial advice? How can compliance costs be reduced under the current regime without limiting access to quality financial advice? How can we facilitate access to advice in the future?
Goal 3: Public confidence in the professionalism of financial advisers is promoted.	Should we lift the professional, ethical and education standards for financial advisers? Should the individual adviser or the business hold obligations?

After seeking submissions, a financial industry panel has been assembled to study the submissions and complete the review. The desired outcome of the review would be for the issue of commissions, and the issues raised above by Casey (2015) and the Group (2015), to be resolved. An options paper for public consultation is due to be released in November 2015,²⁴ with the final report to the Minister due 1 July 2016.

²⁴ See <http://www.mbie.govt.nz/info-services/business/business-law/financial-advisers/review-of-financial-advisers-act-2008/faa-review-tor.pdf>, p. 5.

Decumulation products

The three main products for dis-saving are managed income drawdowns; home equity release products or reverse mortgages; and annuities, as offered by various providers, including insurance companies. Of these options, the life annuities market has disappeared in New Zealand and when life annuities were available they were rarely purchased in recent years. This is predictable as this market is subject to market failure and requires some form of state intervention to be viable (St John, Dale et al. 2012). While that assessment is reiterated by the Retirement Income Interest Group (2015, p. 42): "Government provision may be the only practical way in which all KiwiSavers could have the option to turn their savings into guaranteed lifetime income", they add: "However, we do not see it as a straightforward or quick solution."

Product 1: Managed income drawdown

Managed income drawdowns are offered by financial service providers, KiwiSaver providers and banks, including AMP, ANZ, ASB, BNZ, Fisher, KiwiBank, Mercer, Milford, SuperLife and Westpac.

For example, UDC Finance, wholly owned by ANZ Bank, offers the UDC Secured Term Investment that enables a regular payment amount, pays competitive longer term rates on the principal, and charges no identified fees although costs are no doubt hidden in the interest rate.²⁵ The minimum principal is \$5,000, and the term is for 1 to 5 years.

SuperLife enables a regular monthly drawdown from the SuperLife savings account to a bank account at the level the member decides.²⁶ The balance of the savings account continues to be invested with all the standard investment options and flexibility. The managed income can be changed or stopped at any time, and lump sums can be added or withdrawn at any time and for any reason.

Other options include 'capital assured' funds, offered by life insurance companies or fund managers, which aim to provide a stable stream of returns over a relatively long investment period. Term deposits issued by banks typically mature in less than five years. With both these products, the investment can be structured to allow the investor to access a regular income stream.

New Zealand Government Bonds generally extend over terms longer than one year, and currently offer gross annual yields of 3.3% - 4.1%. A combination of semi-annual interest payments, and a return of capital on maturity, can provide income on lump sum investments. The minimum amount for purchase by a member of the public is \$10,000 and multiples of \$1,000 thereafter.²⁷

With all of these products, while the interest on investments is taxed, the managed drawdown from a PIE or similar vehicle is not taxed as it is a return of tax-paid capital. Each product also provides a level of flexibility. Different fees apply to different products and providers. New Zealand information on costs associated with managed drawdowns proved elusive. Indications of UK costs, albeit in a different tax environment, are provided below:

²⁵ See <http://www.bayfinancialpartners.co.nz/fixed-interest-and-bonds/udc-finance-capital-drawdown-facility>.

²⁶ See <http://www.superlife.co.nz/managed-incomes.html>.

²⁷ See <http://www.nzdm.govt.nz/securities/govtbonds/>.

Over the life of an income drawdown arrangement ... costs have been estimated at approximately 5% of the initial fund value although large funds will have a lower percentage Where drawdown is for a short period of time ..., it is possible to set-up a plan in a cash or sterling liquidity fund with lower costs. This could include a one-off drawdown fee of £100-£200, an ongoing plan charge for administration of 0.25% and fund charge of 0.15%. .. In addition both annuities and income drawdown have a one-off advice and administration charge to establish the plan. For a smaller fund with one provider of say £50,000 this could be about 1% to 1.5% of the fund value after tax free cash is taken. For larger funds of £150,000 this could be under 1%²⁸

It is noted that 5 years ago, New Zealand's investment advisors were calling on the industry to develop suitable generic products to provide a retirement income stream, and calling on the Government to make changes to ensure such features as tax-free status of investment returns, enforcement of low management fees, and minimum percentage drawdown.²⁹

Product 2: Home equity release or reverse mortgage

The Treasury estimates that home owners aged 65+ have over 85% of their wealth in property (Scobie, Le and Gibson 2007), and as already noted, over 60% of those aged 65+ rely on NZS for 80% to 100% of their income (Perry 2014, p. 41). According to the 2013 Census,³⁰ almost 75% of people aged over 65 own their home, and of those, over 90% are mortgage-free.³¹ Home ownership was highest for those aged 70–74 years, at 77.5%.³²

A Home Equity Loan, Home Equity Release, or a Reverse Mortgage is a home loan designed specifically for seniors who are asset-rich and cash-poor: no regular repayments, and only repayable when the owners sell or otherwise move permanently from the residence. Its uses include contributing to available income, home improvements, travel, upgrading the motor vehicle, and supporting the next generation.

Independent legal advice is mandatory before signing up for a reverse mortgage,³³ and independent financial advice and discussions with family are encouraged. The 'Code of standards for home equity release products', developed by the Office for Senior Citizens, and published on their website, is voluntary and thus is not binding.

Introduced in New Zealand from about 2003, reverse mortgages were primarily funded by insurance company Dorchester Life, finance companies, and Sentinel (Davey 2007). The global financial crisis (GFC) beginning in 2007 had a strong negative impact on confidence and borrowing. The combination of the finance company failures (New Zealand Herald 2008) and the GFC impacted on New Zealand's Home Equity Loan market: 6,613 loans

²⁸ See https://www.sharingpensions.co.uk/income_drawdown.htm.

²⁹ See <http://www.goodreturns.co.nz/article/976497124/investment-products-for-retirees-need-to-be-developed.html>.

³⁰ The Census questions on housing were ambiguous, and the resulting statistics are debated, for example, see <https://cdn.auckland.ac.nz/assets/business/about/our-research/research-institutes-and-centres/RPRC/PensionBriefing/2010-2%20What%20do%20New%20Zealanders%20own%20and%20owe%20-%20News%20from%20SoFIE%202004-2006.pdf>.

³¹ See http://www.stats.govt.nz/browse_for_stats/income-and-work/Income/SOFIE_HOTPSep04/Commentary.aspx, Table 10.

³² See <http://www.stats.govt.nz/Census/2013-census/profile-and-summary-reports/quickstats-about-housing/home-ownership-individuals.aspx>.

³³ The Credit Contracts and Consumer Finance Act 2003 applies. See <http://www.comcom.govt.nz/consumer-credit/consumer-credit-fact-sheets/buy-back-transactions/buy-back-transactions-overview/>.

were valued at \$447 million in 2009, but by December 2013, this had fallen to an estimated 5,300 loans, with a total book of \$444 million (Deloitte 2014).

In 2010 ASB announced it would be the first major New Zealand bank to offer reverse equity mortgages, and these would comply with the code of the Office of Senior Citizens.

... We are introducing HomePlus in response to demand from our senior customers. .. We will also set new ethical standards, particularly around ensuring borrowers seek independent legal advice so they fully understand the arrangement into which they are entering, and that the debt will increase over time due to compounding interest. We are introducing a 90 day cooling off period, and providing guarantees around lifetime occupancy and promising people never have to repay more than the value of their property. (Catherine McGrath, 2010, ASB's CEO of Customers, Markets and Products)³⁴

The ASB's equity release could be taken as a lump sum or as regular automatic payments. In 2010, the interest rate for HomePlus was variable, starting at 7.75% (while ASB's regular variable rate was 6.25%), which included the cost of funding the loans, the risk factor, the guarantees provided and the length of time the money would be tied up. The percentage of the home's value that can be borrowed is determined by the age of the youngest applicant, and increases from 15% at age 65, to 30% at age 80+ (see Table 2).³⁵ On 3 August 2015, ASB closed its HomePlus reverse equity product to new business, "at this time" (Edmunds 2015).

Reverse mortgages were also offered by SBS Bank,³⁶ TSB Bank, and ANZ Bank.³⁷ Terms and conditions vary around a 90 day cooling off period, ongoing fees, and interest rates 1% or 2% higher than their standard floating mortgage rate.

The most recent provider is Heartland New Zealand Limited (HNZ), the parent of Heartland Bank. In 2014 Heartland Bank purchased the home equity release businesses of Sentinel and Seniors Money International, and predicted the home equity market would enjoy significant growth through greater product awareness and credibility, demographic changes, and increased retirement funding needs.

Heartland's guarantees for home equity release include: lifetime occupancy, the amount required to repay the loan will never exceed the net sale proceeds of the property, and no requirement to make any loan repayment until the end of the loan.³⁸ Heartland offers a cooling-off period of only 30 days after taking out the loan, but if a client changes their mind, they can pay off the loan and the application fee is refunded in full.

Terms and conditions vary, although similar fees apply across all providers. Heartland's initial valuation fee is \$550 to \$805, plus an 'Arrangement Fee' of around \$895, can be deducted from the initial drawdown. There may be an 'Equity Protection Option Fee' (insurance charge) of around \$295, and legal costs are likely to be around \$1,000. Other fees for service may include an 'Express Top Up Fee' of \$125 or a 'Further Advance Fee' of \$295 (which can also be deducted from drawdown), a 'Loan Variation Fee' of \$295 (can

³⁴ See http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10668939.

³⁵ See <https://www.asb.co.nz/homeplus>.

³⁶ See <https://www.sbsbank.co.nz/borrow/for-retirement/advance>.

³⁷ No online information available for either TSB or ANZ home equity release mortgages.

³⁸ See <http://homeequityrelease.co.nz/about-home-equity-release/the-heartland-bank-promises/>.

be added to loan balance), and a 'Discharge Fee' of \$395 is collected on full repayment of the loan.

As shown in Table 2 below comparing ASB and Heartland, there is variation in the home equity release loan to value ratios based on the age of the youngest borrower.

Table 2. Two examples of home equity release Loan to Value Ratio

Youngest borrower	Age 65	Age 70	Age 75	Age 80	Age 85+
Heartland Maximum %	20%	25%	30%	35%	40%
ASB Maximum %	15%	20%	25%	30%	30%

Advantageous features of home equity release include: few reverse mortgages have fixed interest rates, so usually there is no cost for paying the loan back early; cash is freed up, and rising property prices can partially offset the cost of the accumulating interest. Disadvantages include interest rates 1% -2% higher than the standard floating mortgage rate to account for longer-term funding costs, quite high fees, and compounding interest without repayments so that even a modest loan can snowball. For example a \$40,000 loan may be \$77,000 in a decade and reach \$150,000 in 20 years (Meadows 2012).

Heartland provides the example of a customer aged 71, beginning with an asset worth \$400,000 15 years ago, borrowing \$75,000 over those 15 years, no repayments, and still having an asset worth almost the original value of \$400,000.³⁹ Of course, in a falling market, the outcome would be very different.

In Australia, the federal government offers a type of annuity product through the "Pension Loan Scheme" that works in the same way as a reverse mortgage but charges a lower interest rate than the banks. Fortnightly instalments are paid to the borrower, creating a secure income stream.

At present, it's restricted to people who don't qualify for the pension, the debt is secured against the house, and repaid on death. Introduced by the Hawke government at the same time as the assets test for the pension, it has been dogged by very low take-up rates, perhaps because it only allows access to an income stream equal to the full pension, which isn't enough for the baby boomer generation to maintain their lifestyles. Any suggestion that retirees will need to draw on the equity in their homes needs to involve the government either running the scheme or heavily regulating it. Banks should be kept well away and the recent financial advice scandals underscore that. (Thieberger 2015)⁴⁰

Product 3: Annuities

Existing annuities are of two main types: a 'lifetime annuity' is a lifetime guarantee of income; a 'fixed term' annuity guarantees payments over some set number of years. The principal risk that the annuity can offer protection from is out-living one's savings.⁴¹ Inflation risk is usually not covered by annuities, yet its effects, particularly given increasing longevity, can be devastating. For example, using the Reserve Bank's 'inflation calculator', a basket of goods and services that cost \$200 in 1985 would cost \$549.62 in 2015, 30 years later.⁴² Thus an indexed annuity such as the Government Superannuation Fund has provided for public sector employee would have risen over 175% over the same

³⁹ See the Heartland calculator at <http://www.heartland.co.nz/calculators/home-equity-loan/>.

⁴⁰ See http://www.businessspectator.com.au/article/2015/4/30/national-affairs/reverse-mortgage-risky-business?utm_source=exact.

⁴¹ Individuals may also be concerned about provider failure or fraud.

⁴² See http://www.rbnz.govt.nz/monetary_policy/inflation_calculator/.

30 years. In the 2000s, when inflation risk is low, the bigger risk may be the failure of a fixed annuity to reflect growth in real living standards.

In the UK, until 2014, compulsory purchase of an annuity at age 75 could be justified by the tax concessions given to retirement savings. However, the compulsory framework raised a different set of problems and disadvantages for consumers. High fees for service, and low value meant that in the four years from 2008 to 2012, despite the legal compulsion, almost 1 million retirees refused to buy annuities as they watched the annual income available from purchasing an annuity fall by almost 20%, from about £7,300 to £5,900 for a £100,000 purchase.⁴³ Annuities were also condemned because they die with the pensioner and do not form part of their estate.⁴⁴ A guaranteed period, say ten years, for the payment of the annuity would result in a smaller annuity.

From April 2015, as part of a comprehensive suite of changes to the pension system, including increasing the basic pension, the UK government has given pensioners complete freedom to draw down as much or as little as they want from their 'pension pots', any time they want. In the 3 months from April to June, payments worth £2.5 billion were made to customers from pension pots, £2.3 billion was put into buying nearly 37,500 pension annuities or income drawdown products, and £990 million was invested in around 17,800 annuities, making the average fund invested just over £55,600.⁴⁵

The existing ability for pensioners to take 25% of their pension pot tax-free at the point of retirement will remain, but the 55% tax rate for most on drawdown of the remainder will be cut to 20%. At the same time, the UK Government is introducing (and setting aside funding for) a new law-enforced guarantee that everyone who retires on these defined contribution pensions will be offered free, impartial, face-to-face advice on how to get the most from their available choices.⁴⁶ Existing annuitants may have the opportunity to sell their contracts for a taxable lump sum.⁴⁷

In contrast to the decline of interest in annuities in the UK, interest in Australia seems to be increasing. Australia's *Financial System Inquiry, Final Report, 2014*, made recommendations on five specific themes, including "Lift the value of the superannuation system and retirement incomes". They reported:

The superannuation system is not operationally efficient due to a lack of strong price-based competition. Superannuation assets are not being efficiently converted into retirement incomes due to a lack of risk pooling and over-reliance on individual account-based pensions.

The Inquiry's recommendations to strengthen the superannuation system aim to:

- *Set a clear objective for the superannuation system to provide income in retirement.*
- *Improve long-term net returns for members by introducing a formal competitive process to allocate new workforce entrants to high-performing superannuation funds, unless the Stronger Super reforms prove effective.*

⁴³ The global financial crisis and increasing longevity contributed to insurers' difficulties in providing desirable annuity products. Also see <http://www.telegraph.co.uk/finance/personalfinance/pensions/9605121/Are-you-one-of-a-million-annuity-rebels.html>.

⁴⁴ See <http://www.theguardian.com/uk-news/2014/mar/19/chancellor-scrap-compulsory-annuities-pension-overhaul>.

⁴⁵ See <http://citywire.co.uk/new-model-adviser/news/pension-freedoms-savers-withdraw-2-5bn-from-pots/a835424?re=35826>.

⁴⁶ See <http://www.theguardian.com/uk-news/2014/mar/19/chancellor-scrap-compulsory-annuities-pension-overhaul>.

⁴⁷ See *The Guardian*: <http://www.theguardian.com/money/2015/mar/21/selling-annuity-good-cash-deal>.

- *Meet the needs of retirees better by requiring superannuation trustees to pre-select a comprehensive income product in retirement for members to receive their benefits, unless members choose to take their benefits in another way.* (Murray, Davis, Hewson and McNamee 2014)

Australia's *Financial System Inquiry Final Report* made the following recommendation: "Require superannuation trustees to pre-select a comprehensive income product for members' retirement." (The Treasury Australia 2014, p. 117).

This recommendation seeks to: Better meet the needs of retirees, including those who are disengaged or less financially sophisticated, and provide a more seamless transition to the retirement phase of superannuation; Achieve the objectives of the superannuation system... by strengthening the focus on providing retirement incomes; [and] Improve Australians' standard of living during their working lives and retirement through greater risk pooling. (The Treasury Australia 2014, p. 118)

Perhaps the name change from 'annuity' to 'retirement income product' will help to overcome the negative history associated with such products.

In November 2014 at the RPRC's forum on decumulation, Jeremy Cooper, Chairman of Retirement Income at Challenger Limited, Australia, was invited to share their recent experiences with annuities.⁴⁸ In 2010, Challenger undertook research to develop and offer a new, simple annuity product. The result was an annuity that guaranteed income for life, access to capital, and low product fees.

Challenger's 2013 survey of 3,500 members of National Seniors Australia revealed that the highest priorities for Australia's retirees are: health considerations; outliving their savings or longevity risk; peace of mind that emerges from a regular, dependable income in retirement; and protection against inflation. In Australia's favourable tax environment, Challenger's annuity products have proved popular: annuity sales have increased by 560% over the last six years from \$500 million to \$2.8 billion.⁴⁹ The tax concessions seem an important driver for that change.

In New Zealand, of around 640,000 people aged 65+, only one in 10 has an additional income stream from an occupational pension or annuity-type product. "There are around 22,000 company scheme pensions and 46,000 pensions paid to retired civil servants." (St John 2014). In 2012, only three private life annuities were purchased (Neilson 2012) and that market is now best described as non-existent. Like reverse mortgages, many negative experiences, including high costs, low implicit returns and a loss of flexibility, have discouraged potential purchasers.

In 2011, New Zealand's Savings Working Group recommended that planning commence immediately to address the "acute" issue of the lack of a material annuities market in New Zealand for anyone receiving lump sum retirements payments from their superannuation schemes:

The SWG also recommends that consideration be given to whether members of KiwiSaver should, in time, be required to take some portion of their withdrawal in the form of such an annuity/NZ Superannuation increase (rather than as a lump sum)... [T]he SWG would like to see the government consider facilitating long-term

⁴⁸ See <https://cdn.auckland.ac.nz/assets/business/about/our-research/research-institutes-and-centres/RPRC/Decumulating-the-savings/2%20JCooper%20Decumulation%20Challenger.pdf>.

⁴⁹ See <http://www.fool.com.au/2014/10/10/heres-why-challenger-ltd-is-well-priced-for-long-term-gains/>.

investment by issuing inflation-indexed bonds as well as annuities,.. (Savings Working Group 2011, p. 103)

New Zealand Income Guarantee

Former AXA NZ CEO, Ralph Stewart, has formed New Zealand Income Guarantee (NZIG) to develop a variable annuity product that allows investors to retain their capital, withdraw it when they choose, and have any balance paid to their estate when they die.⁵⁰ A separate insurance business owned by NZIG will receive an individual premium from each investor to cover the potential cost of them outliving their retirement capital. NZIG is waiting for the new insurance solvency standard to be issued by the Reserve Bank, setting out the minimum capital and risk management processes a provider must have if it is to offer products to help manage financial risks in retirement.⁵¹

The NZIG proponents argue that traditional annuities have relied on insurers taking a client's capital and their longevity or mortality risk and guaranteeing the client an annual payment. Rather than pooling investor's funds together and paying tax and holding cash reserves for the whole liability for all annuitants, NZIG will keep every investor's funds separate and individual, and is working with the Reserve Bank to determine the appropriate level of reserving. NZIG plans to hold a 50/50 mix of bonds and equities which will be set up in PIE funds, allowing most investors to pay tax at around 18%. The assets would be split into an earnings account and a capital account, payments from which would be tax free. In their earnings account are the returns they get from investing in the balanced fund, less fees and taxes.

NZIG suggests that this new product will fix the problem that retirees don't currently know how much money they're going to get or how long it will last. The product is nearly a \$2 trillion business in the US, about \$600 billion in Japan and there are at least 15 providers operating in Europe. It's still technically an annuity because it pays a regular income, but NZIG suggests it's completely different. "It's something they can have whenever they want it," Stewart said. "Under the old annuity, they would never ever get their capital back." Someone who puts \$100,000 into the proposed product is essentially topping up their NZS by 25%. Stewart says:

*Traditional annuities ... require investors to surrender their capital, receive fixed interest returns, pay relatively high fees, suffer tax imposts and in most cases have no future liquidity. For providers the capital requirements are high and the margins low. Lifetime Income products are completely different always leaving the capital under the ownership of the investor, earning returns based on the performance of an underlying portfolio of balanced passive funds, offering liquidity for the investor or the estate at any times and paying regular income for life free of tax.*⁵²

NZIG is proposing two different types of product, colloquially: "naked" and "dressed". With a naked drawdown, if someone puts in \$100,000 at age 65, they can expect a return of around 3.7% in a PIE fund, after fees and taxes. This would provide them with the certainty of \$5,000 a year in capital drawdowns from age 70 until around 96 years of age. That's 26 years. If a client wanted the capital payments guaranteed until they died they could use the "dressed" fund, charged at 1.5% for a lifetime guarantee of \$5,000 per year. The return on \$100,000 invested would fall to 2.2% meaning the funds would technically 'run

⁵⁰ See <https://cdn.auckland.ac.nz/assets/business/about/our-research/research-institutes-and-centres/RPRC/Decumulating-the-savings/4%20RStewart%20NZIG%20Decumulation.pdf>.

⁵¹ See <http://www.goodreturns.co.nz/article/976502107/stewart-aiming-to-launch-nzig-in-october.html>.

⁵² Ibid.

out' when the client reached age 90 rather than 96. But the guarantee would then kick in and keep paying.

NZIG's proposal entails an annual tax free capital drawdown. That capital earns interest on the balanced fund that they're invested in and it's completely liquid and individual, and clients can draw money out as they wish. By combining the naked and dressed types, clients could be paid more sooner. Retirees could also defer their drawdown. A 65-year-old who deferred payments till he reached 67 could be guaranteed a 5.4% per annum return, and a 6% per annum return if they deferred till they were 70. Since 2007, people have been able to accumulate with KiwiSaver, but people also need a way of decumulating, so this possible product is timely.⁵³

The key hurdles NZIG face are getting a binding ruling from Inland Revenue, becoming a licensed life insurance company and finding the capital to get to market. Stewart says IRD has agreed that the withdrawals from this product should not be taxable, however will not issue the final ruling until they have reviewed the final offer documents. Currently the Reserve Bank is developing a set of appropriate solvency provisions for these products, which it plans to release to the market.⁵⁴

A state option

The RPRC has also theorised for some years on the development of a social insurance scheme to cover the risks of ageing, combining a gender-neutral life-time annuity with long-term care insurance (LTCI). Recent discussions in other countries including Australia have focused on developing the private LTCI market as an important supplement for public funding sources (Productivity Commission of Australia 2011; Productivity Commission of Australia 2013). "Because of the 1980s' reforms, New Zealand may be in a unique position to design new policies and products of this type which better share the costs of an ageing population." (St John, Dale and Ashton 2012)

Middle income retirees in particular face four main risks:

- longevity risk - living longer than expected and running out of money, or dying with unintended bequests
- unanticipated inflation
- investment risk
 - failure to earn the required after-tax return
 - fraud and mismanagement of retirement assets
- ill health and requiring long term care; uncertain costs.

The working title of the product is *KiwiSpend*.⁵⁵ The funding approach is designed so that the babyboom generation meets more of its own costs within that cohort. The target group is the middle 40% to 60% of those aged 65-74, with relatively modest financial savings of \$150,000 to \$200,000. A KiwiSpend lifetime annuity plus a long-term care add-on would provide an inflation adjusted maximum of \$10,000 net annually.

The School of Population Health research that suggests NZS plus \$6,000 to \$8,000 (2012) was needed annually to maintain a healthy lifestyle and KiwiSpend suggests that aiming for an annuity of a maximum of \$10,000 in 2015 is appropriate. The setting of a maximum is important to confine the implicit subsidies to the target group of middle income modestly

⁵³ See <http://portfolioconstruction.com.au/nz/guaranteed-income-for-life>.

⁵⁴ See <http://www.goodreturns.co.nz/article/976502107/stewart-aiming-to-launch-nzig-in-october.html>.

⁵⁵ See <https://cdn.auckland.ac.nz/assets/business/about/our-research/research-institutes-and-centres/RPRC/Decumulating-the-savings/5%20StJohn%20State%20option%20Decumulation.pdf>.

well off retirees. In addition to taking a role to ensure appropriate regulation and adequate security, the Government could be the provider, and carry the inflation and longevity risks.

There is a high probability that a person will need LTC at some stage before death, although the duration and level of that need will vary across a wide range. Also, average life expectancy at age 60 or 65 is a poor guide to the years an individual may actually live: some will live more than twice as long as the average (Wadsworth, Findlater and Boardman 2001), and some will live a commensurately shorter number of years.

An additional feature of KiwiSpend is the LTCI add-on: if long term residential care is required, the annuity of \$10,000 trebles to \$30,000 annually. That add-on plus NZS would come close to meeting the annual costs of residential LTC of around \$50,000 in 2014. Instead of that extra cost being born by taxpayers or by the individual and their families through a stringent income and assets test, as it is now, the cost would be shared by the purchasers of annuities. This social insurance approach would relieve some of the burden of the costs of the ageing population, without creating hardship or unfair asset stripping.

The July 2015 asset threshold for qualifying for the state-funded Residential Care Subsidy (RCS)⁵⁶ to meet the cost of residential LTC for a single person was \$218,598, and for a married couple with one in care \$218,598 or \$119,709 + house + car.⁵⁷ Although the cost of hospital-level care can exceed \$1,500 a week, the cap on personal contributions for residential care in 2014 was \$873.04 to \$955.29 a week, depending on the Territorial Local Authority Region.⁵⁸ As estate duties were abolished in New Zealand in 1992, any remaining assets can then be bequeathed in full at death.

Under KiwiSpend, more of the costs of care would be carried by the retired cohort of annuitants. Individuals would also enjoy the peace of mind of the guaranteed income stream in addition to NZS. A ball-park price for the KiwiSpend \$10,000 inflation-adjusted gender-neutral life-annuity purchased at age 65, without the long term care insurance (LTCI) add-on would be \$144,000 and if guaranteed for 10 years, it would be \$154,200. These figures do not factor in adverse selection or overheads which can add about 20% to the cost of private annuities. With the LTCI KiwiSpend would cost \$157,700, and with the 10 year guarantee it would be \$167,900. Note that KiwiSpend trebles on going into LTC. The estimated prices rely on state provision not having to conform to the pure actuarial standards of private insurance, with the state bearing some of the risks as social insurance.⁵⁹

Actuarially-based insurance cannot address uncertainties associated with LTCI, including the information problems facing both providers and potential purchasers. Although there are potential welfare gains if people can purchase LTCI, Barr (2010, p. 359) concludes that such supply-side and demand-side problems mean "social insurance is a better fit". (Dale, St John and Hanna 2012, p. 6)

The RPRC's 2014 decumulation forum posed these questions: What would it take to get appropriate decumulation products to the New Zealand market? What are the critical characteristics of decumulation products? Would there be a role for the state? What is the

⁵⁶ The RCS is funded through the Health budget.

⁵⁷ See <http://www.workandincome.govt.nz/individuals/brochures/residential-care-subsidy.html#Assets5>.

⁵⁸ See <http://www.health.govt.nz/our-work/life-stages/health-older-people/long-term-residential-care/maximum-contribution>.

⁵⁹ See St John (2014) *Life annuity proposal with Long term care insurance "KiwiSpend"*, at: <https://cdn.auckland.ac.nz/assets/business/about/our-research/research-institutes-and-centres/RPRC/Decumulating-the-savings/5%20StJohn%20State%20option%20Decumulation.pdf>.

role of consumer education? To get appropriate decumulation products to the New Zealand market, the forum found it would take some or all of:

- State mandating or compulsion of some kind, and/or
- Some form of tax break, and/or
- Some form of regulation, and
- A state guarantee.

There was strong support at the forum for this statement: “the only feasible provider is the state, as long as what is offered is not tax subsidised, not compulsory and broadly fiscally neutral, that is, taking into account the costs of health care attributable to the ageing population”.

Long-term care insurance is difficult to price, and adverse selection and overheads could add another 20% to a purchase price, so there would be a fundamental role for the state in provision as well as regulation. The New Zealand market is too small to encourage competition among multiple private providers. The role of consumer education and financial education is important, but is secondary to access to appropriate decumulation products. And financial education is of little value in an environment that lacks consumer protection, and lacks access to functional, fair and affordable consumer products.

A note on gender

The universal age pension in New Zealand provides a base level of protection against old age poverty for women, while the means tested Age Pension in Australia results in many older women being asset rich, but income poor.

In New Zealand and in Australia the data shows women accumulating smaller superannuation ‘pots’ for retirement, as a result of a combination of factors, including the gender wage gap. The World Economic Forum’s 2014 report on the gender gap index ranks New Zealand 13th out of 142 countries, and ranks Australia 24th.⁶⁰ Lower pay for women provides less opportunity for saving.

In addition, the choice to have children and spend some time out of the workforce as primary caregiver results in contribution gaps to any retirement savings plan. Both KiwiSaver⁶¹ and Superannuation Guarantee⁶² data reveal on average lower individual savings for women than men, and reveal the gender gap in savings widening as the lifetime of contribution to the fund increases.

These factors and the greater average female longevity suggest that safe dis-saving options for women are particularly critical.

Conclusion

The development of decumulation products in New Zealand is slow and fragmented. Drawdown products of various kinds, including home equity release products, are becoming more readily available, but they do not provide protection against the risk of

⁶⁰ See <http://reports.weforum.org/global-gender-gap-report-2014/>.

⁶¹ See, for example <http://www.goodreturns.co.nz/article/976502747/kiwisaver-gender-gap-widens.html>, and <http://www.ird.govt.nz/resources/a/5/a5426d39-ecc1-40da-aa59-ec2ff3fbc28f/ks-evaluation-final-summary-report.pdf>.

⁶² See, for example <http://www.canstar.com.au/superannuation/the-92000-gender-gap/>; and <http://www.tai.org.au/node/2131>.

outliving savings. The need for safe, fair, affordable decumulation products is clear, perhaps particularly for women, with smaller accumulations of retirement savings.

There is widespread if reluctant acceptance that to offer a life annuity product requires a strong role for the state that may also include provision.⁶³ A public education campaign for KiwiSpend similar to the KiwiSaver promotion could enable a similar adoptive and adaptive response.

Another alternative is to encourage participation by successful Australian providers of life annuities. Challenger's success there could perhaps be replicated here.

What is more urgent is to begin the conversation, grounded in intergenerational equity, about the needs of those aged 65+ and the costs of meeting those needs. This conversation also requires acknowledgement of the vastly increasing numbers of those aged 65+.

The risk is that, rather than engaging with the complexities of decumulation, the Government will sidestep the issues with reliance on advice or guidance, further individualising the problem of decumulation. As Casey and Bateman (2014, p. 6) argue in their response to Australia's *Financial System Inquiry Final Report*:

merely advocating better help for financial consumers – and, in particular, for those who have built up superannuation assets and are trying to work out how to use these to maximise their wellbeing in retirement – is not sufficient.

There is a need:

a) to make clear what is meant by assistance, and to make sure that consumers understand what is being provided and what is not; and

b) to appreciate that the provision of appropriate assistance is costly and that a way be found whereby the necessary resources are made available such that those who need assistance can and do obtain it.

More fundamentally, the Government needs to take an active role in encouraging rational decumulation products including a consideration of subsidisation and/or direct provision and underwriting.

⁶³ For example: "the only feasible provider is the state". See <https://cdn.auckland.ac.nz/assets/business/about/our-research/research-institutes-and-centres/RPRC/Decumulating-the-savings/decumulation-group-1-workshop-notes.pdf>.

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