Decumulation, Problems, policies and potentials?

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1. Population What does NZ look like in the future?
2. What are the implications
   – for society
   – For individuals
3. Decumulation policies- do we have any?
Is there an elephant in the room?
Aging population doesn’t matter: Bill English

Nathan Smith

Plenty of policy myths frustrate Finance Minister Bill English but none more so than “the aging population matters”.

Speaking at a recent New Zealand Initiative seminar, Mr English described the aging population problem as essentially a lot of “hand-wringing” without a real solution.

“Here’s some breaking news: there’s nothing you can do about it. Or to put it another way, suggesting there’s something you can do about it will be hazardous.

“It’s like the fact that we need to breathe oxygen, it just is what it is. I have no idea why we waste so much time talking about it.

New Zealand has had many demographic changes over the past 30 or 40 years. In the 1970s there were few single-parent families but now, according to NZ Statistics, about 30% of children are born to single-parent families.

“This is a massive demographic change, with enormous implications, and we almost never talk about it.”

His statements weren’t well received by the Commissioner for Financial Capability’s retirement commissioner Diane Maxwell, who questioned whether Mr English “actually meant that the aging population doesn’t matter.”

But Mr English says his point isn’t that the government shouldn’t prepare for the aging population. It’s that funding the previous government’s insistence on doing “stupid stuff” includes choosing problems today that can benefit from government action.

“People won’t vote themselves poor, they’re not stupid. If they know they’re going to be in retirement for 20 years, they know they need a productive working economy to feed that and they will act accordingly.

“So I am pleased that, in the past five or six years, because of a rational promise by the prime minister which almost nobody agreed with, we haven’t had to waste any time in retire-
1. Ageing: Coming ready or not

<table>
<thead>
<tr>
<th>Projected ratios of different age groups</th>
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<tbody>
<tr>
<td>15-64 years</td>
</tr>
<tr>
<td>2006</td>
</tr>
<tr>
<td>2020</td>
</tr>
<tr>
<td>2030</td>
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<td>2050</td>
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<table>
<thead>
<tr>
<th>Population aged 65+</th>
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<tr>
<td>2016</td>
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<td>2050</td>
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But the current population is growing

During the June 2016 year:
NZ population grew by 97,300 (2.1%).

Natural increase
(births-deaths) 28,200
Net migration gain 69,100.

New Zealand’s population is estimated to increase by one person every 5 minutes and 2 seconds.
Age structure changes dramatically
New Zealand of the future - what will it look like?
Today’s benign period of ageing?
Improvements in Life expectancy

‘Rectangularisation’ of the New Zealand survival curve

Life expectancy at birth for females born in these years:
- 1934-38 (68.5 Years)
- 1950-52 (71.3 years)
- 1970-72 (74.6 years)
- 1990-92 (78.7 years)
- 2005-07 (82.2 Years)
Cohort life expectancy

Cohort born 1951- reaching 65 today

At Birth
- Females  82.5  (72 using period LE)
- Males    77.5

Having survived to age 65 Life expectancy is
- Females  88.9
- Males    86.2
- a further 20-25 years to live on average
Huge variability in outcomes - who wants to be 100?

Figure 3

Chance of living from age 0 to age 100
Year of birth 1876–2014

Note: Shaded fan indicates an estimated 50 percent chance that survival will be within this range.
Source: Statistics New Zealand
2. Implications for society
Affording our futures - LTFS 2013

<table>
<thead>
<tr>
<th>% of nominal GDP</th>
<th>2010</th>
<th>2020</th>
<th>2030</th>
<th>2040</th>
<th>2050</th>
<th>2060</th>
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<tbody>
<tr>
<td>Healthcare</td>
<td>6.8</td>
<td>6.8</td>
<td>7.7</td>
<td>8.9</td>
<td>9.9</td>
<td>10.8</td>
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<tr>
<td>NZ Super</td>
<td>4.3</td>
<td>5.1</td>
<td>6.4</td>
<td>7.1</td>
<td>7.2</td>
<td>7.9</td>
</tr>
<tr>
<td>Education</td>
<td>6.1</td>
<td>5.3</td>
<td>5.2</td>
<td>5.2</td>
<td>5.1</td>
<td>5.2</td>
</tr>
<tr>
<td>Law and order</td>
<td>1.7</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Welfare (excluding NZ Super)</td>
<td>6.7</td>
<td>4.8</td>
<td>4.4</td>
<td>4.2</td>
<td>4.0</td>
<td>3.8</td>
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<tr>
<td>Other</td>
<td>6.5</td>
<td>5.6</td>
<td>5.7</td>
<td>5.8</td>
<td>5.9</td>
<td>6.1</td>
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<tr>
<td>Debt-financing costs</td>
<td>1.2</td>
<td>1.8</td>
<td>2.5</td>
<td>4.2</td>
<td>7.1</td>
<td>11.7</td>
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<tr>
<td>Total government expenses</td>
<td>33.4</td>
<td>30.8</td>
<td>33.4</td>
<td>36.9</td>
<td>40.6</td>
<td>46.8</td>
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<tr>
<td>Tax revenue</td>
<td>26.5</td>
<td>28.9</td>
<td>29.0</td>
<td>29.0</td>
<td>29.0</td>
<td>29.0</td>
</tr>
<tr>
<td>Other revenue</td>
<td>3.2</td>
<td>3.0</td>
<td>3.2</td>
<td>3.2</td>
<td>3.3</td>
<td>3.6</td>
</tr>
<tr>
<td>Total government revenue</td>
<td>29.7</td>
<td>31.9</td>
<td>32.2</td>
<td>32.2</td>
<td>32.3</td>
<td>32.6</td>
</tr>
<tr>
<td>Expenses less revenue</td>
<td>3.6</td>
<td>-1.1</td>
<td>1.2</td>
<td>4.6</td>
<td>8.3</td>
<td>14.3</td>
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<td>Net government debt</td>
<td>13.9</td>
<td>27.4</td>
<td>37.1</td>
<td>67.2</td>
<td>118.9</td>
<td>198.3</td>
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Health costs of ageing
Expensive chronic disease

E.g. Diabetes

Source: NZIER MoH 2004
Dementia

60,000 dementia sufferers today

By 2026, increase by more than 60%

Numbers expected to treble by mid century

Huge costs for society
Figure 1: Historic Deaths and Future Projections of Deaths in New Zealand by Age Band – palliative care implications
Probability of being in long-term care

Averaged for female and male

Expect 330,000-400,000 over 85 by mid century
One in four of those over 65

Census 1996
3. Implications for individuals

• New Zealand Superannuation provides basic longevity insurance

• Middle income groups are on their own
  – Lump sums may be used up too quickly
    • KiwiSaver
    • Other savings
  – Home equity illiquid
  – Risk of expensive healthcare-Long-term care costs
Distribution of net worth

By net worth bands
Year ended June 2015

Stats NZ 2016
How much has been accumulated?

Individual Net Worth Statistics: Yr June 2015

<table>
<thead>
<tr>
<th>Age</th>
<th>Median $</th>
<th>Mean $</th>
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</thead>
<tbody>
<tr>
<td>55-64</td>
<td>278,000</td>
<td>555,000</td>
</tr>
<tr>
<td>65+</td>
<td>288,000</td>
<td>534,000</td>
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65+ share of income from NZS, investment, employment

(MSD 2016)
Risks faced by individuals

1. Possible changes to NZ Super

- Raising the age (advocated by retirement Commissioner 2016)
- Reducing the level (dangerous)
  - Aligning single and married rates
- Introducing a means test (less likely)
The risks of ill health and long term care

Current Asset Test- allowed exempt assets

<table>
<thead>
<tr>
<th>Years</th>
<th>Single person</th>
<th>Married couple with one in care</th>
<th>Married couple, both in care</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2016 CPI adjusted</td>
<td>$218,432</td>
<td>$119,614 + house + car</td>
<td>$218,432</td>
</tr>
<tr>
<td></td>
<td></td>
<td>or $218,432 total</td>
<td></td>
</tr>
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Paying for old age care in New Zealand

- **State pension only**
  - **Subsidy**
  - **Other Income**
- **Low assets Some other income**
  - **Subsidy**
  - **State pension**
- **Failing means test**
  - **Top-up subsidy**
  - **State pension**

- Contract price
- Maximum Capped personal contribution
How are middle income people affected?

Annual capped payment-

Individual contribution
Capped $50,544

If net NZS = $18,500

Other income needed = $32,000+
(need for more for expenses)

Note additional Govt- TOP UP may be as high as $27,000- high level of care.
4. Decumulation policies- do we have any?

The burden of protecting nest eggs
What does utopian decumulation policy look like?

- Retired from teaching at 58, on GSF pension
- Benefits of
  - longevity protection
  - inflation protection
  - peace of mind
  - End of life/ dementia care

Good for family and individual to have income stream to help pay for care
Private pensions: a thing of the past

% Superannuation coverage in workplace schemes (excluding KiwiSaver)
<2% in DB schemes
How large does an income supplement have to be?

Using updates of estimates from the School of Population Health, RPRC suggests that an extra $10,000 is a good ballpark figure.

BUT, the elephant in the room is long-term care.
Why no annuities?

• Not lack of demand

• Research from Australia shows that people are interested in annuities
  
  “Pre-retirees do consider purchasing fairly priced annuities – when products described in terms of their features rather than commercial product names”- H Bateman
  
  – Products emerging eg Challenger
  – NZ has NZIG as a modest beginning
So what role for policy?

• We missed the boat with KiwiSaver
• BUT there are few tax favours for accumulation... therefore...
• Voluntary annuitisation of KiwiSaver and other savings could be subsidised
  – Say to max annuity of $10,000 pa annum
  – Use KiwiSaver infrastructure
    Maybe default option
  – Inflation adjusted, gender neutral, maybe 5-10 year guarantee?
  – Government may be provider in a Crown Entity
  – Long-term care rider
    • Facilitated by the capped fee
In the meantime ....what do you advise middle income retirees?

• 65+ year olds with modest lump-sum savings, with access to say $150,000-$200,000

They face risks of:

- living longer than expected
  - Or dying with unintended bequests

- unanticipated inflation

- investment risk
  - failure of investment to keep pace with growth
  - fraud and mismanagement of retirement assets.
  - Too much choice!!

- ill health and long term care; uncertain costs