

# 2010 review of retirement income policy

## Income Streams in Retirement – Managing Income and Assets

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### 1: The Income and Assets of Older people

The 65-plus age group includes more than one generation and there are significant variations in the circumstances of its members. The “young-old” may well still be in paid work, active and healthy and able to continue saving. In the transition to later life, beyond age 80 or 85, “retirement” from paid work becomes complete for most people and activities may become circumscribed by ill-health or disability. Bearing in mind the dangers of generalisation, the incomes of older people are, on average, low and, once they have left the paid workforce, they have few opportunities to augment them. Thus it is important for them to manage their income and assets well. Few have assets of any magnitude, over and above the equity in their homes and lump sums which they may have acquired on the maturity of a superannuation or insurance scheme. However, many retired people have income from savings, in various forms, which can be used to supplement superannuation and to provide a nest egg for large and unexpected expenditures. Older people may also wish to preserve assets for bequest, when they die.

#### *Sources of Income*

Over 90 percent of people aged 65 plus receive New Zealand Superannuation (NZS) and, according to the 2009 New Zealand Income Survey, 57.5 percent their incomes comes from government transfers, primarily NZS, with 5.8 percent from other superannuation, pensions or annuities<sup>1</sup>. Wages and salaries (12.9 percent), plus self employment (5.6 percent), accounted for 18.5 percent of income for people 65 plus.

It is estimated that 40 percent of people 65 plus have virtually no income source other than NZS and the next 20 percent receive 85 percent of their income from this source<sup>2</sup>.

Of particular interest is the proportion of older people who have income from savings and investments of various types. According to the June 2009 Income Survey, 296,000 people out of a total of 520,000 aged 65 plus (57 per cent of the total) had income from investments (interest, dividends, rent and other investments). This source, on average, accounted for 18.1 percent of older people’s income.

The main differences between the income pattern for older people and that for adults in general is a much lower proportion from paid work and a higher proportion from government transfers and investment. While 18 percent of older people’s income came from investment, the proportion was only 5.3 percent for all adults 15 plus. The components of income for people aged 65 plus, based on Income Survey data, are illustrated in Figure 1.

#### *Amount of Income*

The June 2009 Income Survey gave the median weekly income for people 65 plus as \$353 (average \$497). This compares to a median of \$538 for all people aged 15 plus ( average \$680). The lower

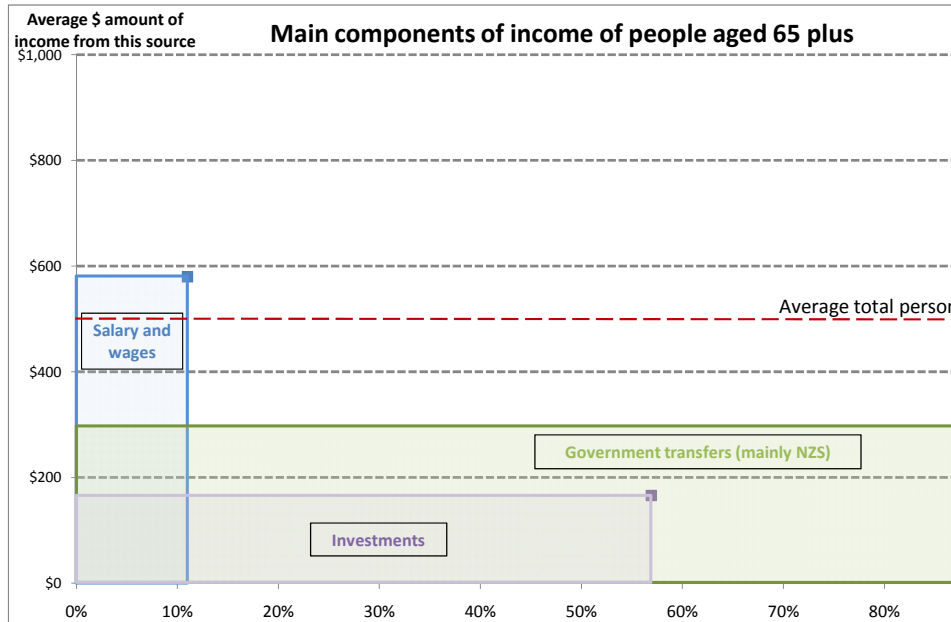
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<sup>1</sup> New Zealand Income Survey, June quarter 2009, Statistics New Zealand [http://www.stats.govt.nz/browse\\_for\\_stats/work\\_income\\_and\\_spending/Income/NZIncomeSurvey\\_HOTJun09qtr.aspx](http://www.stats.govt.nz/browse_for_stats/work_income_and_spending/Income/NZIncomeSurvey_HOTJun09qtr.aspx). Data from the 2010 survey may show changes in income patterns as a result of the recession.

<sup>2</sup> Perry, B. (December 2009) *Non-income measures of material wellbeing and hardship: first results from the 2008 New Zealand Living Standards Survey, with international comparisons*. Working Paper 01/09, Ministry of Social Development, Wellington.

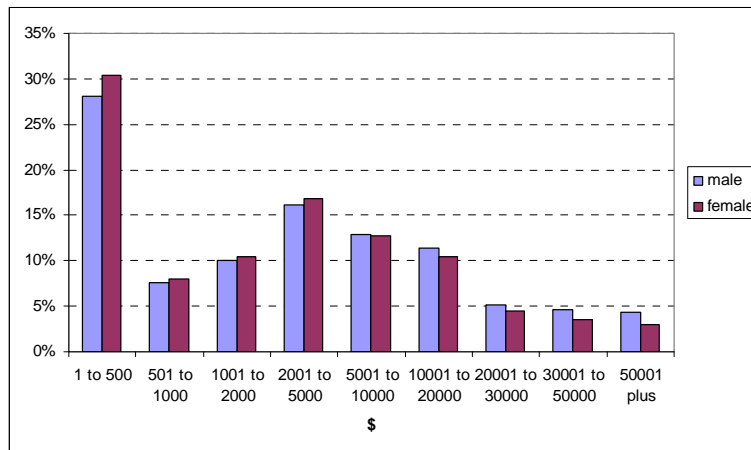
median suggests a concentration in the lower income groups. Personal incomes for women are lower than for men right up to the oldest age groups, mainly because men are more likely to have supplementary (occupational) pensions and higher incomes from investments. They are also more likely to be in paid work. The median income of people aged 65 plus who were in some form of paid employment was \$827 and for people not in paid employment was \$326 (total 15 plus \$788).

**Figure 1**



Despite the fact that over half of people aged 65 plus have some income from investments, the dollar values are generally low. According to the June 2009 Income Survey, half receive less than \$31 per week<sup>3</sup>. This is confirmed by Inland Revenue data on interest and residents' withholding tax<sup>4</sup>. Figure 2 shows that 64 percent of people aged 65 or over had \$5000 or less per annum in income from interest, according to 2009 tax year data. The patterns for men and women are fairly similar, although men predominate among people who have \$10,000 or more in interest income.

**Figure 2: 65 plus age group, income from interest (IRD data, 2009), by sex**



<sup>3</sup> The average weekly income from investments for the 65 plus age group as a whole was \$90. The figure for those who received income from investments was \$166. Average figures from Table 4, medians from Table 12 in the June 2009 Income Survey data.

<sup>4</sup> Information provided to the Retirement Commission by the Inland Revenue Department.

### *Adequacy of Income*

The majority of older New Zealanders appear to find their incomes adequate. The 2008 Living Standards Survey showed that people aged 65 plus have low hardship rates (4 percent) relative to the total population (13 percent) and especially to children aged 0-17 (19 percent)<sup>5</sup>. The 2008 Social Report<sup>6</sup> stated that 9 percent of people aged 65 plus were in low income households – a figure which has been stable in the last decade. Twenty percent of people aged 0-17 were in such households.

There are concerns, however, for older people with very low incomes. A recent study, commissioned by Age Concern New Zealand, concluded that superannuitants who had less than \$2,000 per annum in addition to NZS would not be able to meet minimal cost-of-living requirements<sup>7</sup>. Unexpected costs can arise, such as medical expenses, or when large household items have to be replaced. This emphasises the need for additional income to supplement NZS.

### *Assets*

The assets held by older people can be used to generate income, to be drawn down by various means or preserved to form estates after death. Income from assets, such as investments, is common, but the amount of capital held is difficult to assess. Home ownership is the most common form of significant asset holding. Three quarters of people aged 65 or over live in owner-occupied housing, the majority mortgage-free. A Treasury study found that 5.2 percent of people aged 65-74 owned rental property, and 1.8 percent of those aged 75 plus<sup>8</sup>. Net equity in property as a share of total net worth was 76 percent for people aged 65 to 74 and 82 percent for those aged 75 plus. New types of tenure – family trusts and retirement village arrangements - now complicate housing tenure patterns. The percentage renting increases from age 80 as some people move into supported living.

Although buying a house and paying off a mortgage has been a traditional means of wealth accumulation, continuing declines in home ownership may close off of this option for a growing proportion of the population. This is despite the fact that paying off a mortgage is one type of saving that has a regular and contractual element and households tend to be better at saving when this is the case<sup>9</sup>.

## **2: Current approaches to managing income and assets in retirement – expectations, problems**

### *Expectations and Attitudes*

Attitudes towards and expectations of retirement will vary over time, subject to a wide variety of influences. Should people expect the same standard of living in retirement as they have had in their working lives? Many people have accepted reduced living standards in old age and some still do. Now and in the future expectations may be higher, fuelled by a more materialistic ethos. What “retirement” means is changing, influenced especially by longer life expectancy. Older people are fitter and keener to maintain active lifestyles. Many New Zealanders have children and grand children in other countries, which encourages the desire to travel. This active stage of retirement may last to age 80 or beyond and is generating a demand for higher incomes.

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<sup>5</sup> Perry, op.cit.

<sup>6</sup> Ministry of Social Development (2008) *The Social Report 2008: Indicators of social wellbeing in New Zealand*, p.63. Data derived from Statistics New Zealand’s Household Economic Survey (1986–2008).

<sup>7</sup> Logan, J. (May 2010) *NZS – A Measure of its Adequacy*. Age Concern New Zealand, Wellington.

<sup>8</sup> Scobie, G., Le, T. and Gibson, J. (March 2007) *Housing in the Household Portfolio and Implications for Retirement Saving: Some initial findings from SOFIE*. NZ Treasury, Wellington.

<sup>9</sup> Burns, J. and Dwyer, M. (December 2007) Household’s attitudes to saving, investment and wealth. *Reserve Bank of New Zealand Bulletin*, Vol.70, No.4, p. 25-38.

### ***Planning for Retirement***

Although people still refer to 65 as “retirement age”, this represents only eligibility for NZS. When and how people leave, or expect to leave, paid work is much more variable. In the EWAS study of people aged 40-64 in 2008, the mean expected age of retirement was 64 for men and 63 for women<sup>10</sup>. The expected age rose with the age of the respondent, from 61.6 for people aged 40-44 to 66.4 for people aged 60-64. There may be a difference between the age at which people expect to retire and what they would consider the “ideal” age. In the EEO Trust’s 2006 survey, three-quarters had the ideal of retiring before age 65, but only one-third expected to do so<sup>11</sup>.

The expected length of retirement is a crucial factor for financial planning. Respondents to a survey on KiwiSaver were asked what age they expected to live to<sup>12</sup>. Most people said 80-90, with men and women giving similar answers. These replies were used to estimate length of retirement; 42 percent expect a retirement of 0 to 19 years and 58 percent of 20 years or longer.

For most people, planning for retirement means saving. Two-thirds of the EWAS respondents, aged 40 to 64, had some form of retirement savings, in the form of private superannuation, bank savings, investment property, shares and other investments. Men were slightly more likely to have retirement savings than women. The study also found significant inequality in asset-holding (other than equity in a home). Men were more likely to own assets than women.

It appears that KiwiSaver has encouraged savings. A 2008 Mercer survey showed an increase in the proportion of working New Zealanders who had thought about and started planning for retirement and this was true for 72 percent of those aged 50 plus<sup>13</sup>.

The AMP SuperWatch has been surveying retirement saving attitudes and behaviours since 2000<sup>14</sup>. In the most recent survey, three quarters of respondents said they will require income additional to NZS to realise their retirement aspirations. This is a theme that has been consistently reflected throughout the history of the survey. Information from the KiwiSaver Survey shows that there is a gap between what people expect as their income in retirement and what they feel they would require for a comfortable standard of living.

There are some positive signs in terms of planning for retirement, but many people still lack the information and means to meet their expectations. The widening distribution of incomes and assets, plus social/ethnic diversity may challenge existing policy settings<sup>15</sup>.

### ***Choices about workforce participation***

The number of people in the labour force aged 50 plus more than doubled between 1991 and 2005<sup>16</sup>. Older people represented half of labour force growth in New Zealand over this period. In 2006, 14 percent of people aged 65 plus were in the labourforce. This is projected to increase to 30 percent by 2031<sup>17</sup>.

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<sup>10</sup> Waldegrave, C. and Koopman Boyden, P. (March 2010) *Midlife New Zealanders Aged 40-64 in 2008: Enhancing Wellbeing in an Ageing Society*. Family Centre Social Policy Research Unit and Population Studies Centre, University of Waikato.

<sup>11</sup> Equal Employment Opportunities Trust (2006) *Work and Age Survey Report*, <http://www.eeotrust.org.nz/content/docs/reports/WorkandAgeReport%202006.doc>

<sup>12</sup> Colmar Brunton (May 2010) *KiwiSaver Evaluation: Survey of Individuals*, Draft Report

<sup>13</sup> Mercer (January 2008) *KiwiSaver Sentiment Report*. <http://www.mercer.com/referencecontent.htm?siteLanguage=100&idContent=1285840>

<sup>14</sup> Good Returns (April 2009) *Kiwis recognise need to save for retirement*. [http://www.kiwisaver.net.nz/Kiwis-recognise-need-to-save-for-retirement\\_20/10](http://www.kiwisaver.net.nz/Kiwis-recognise-need-to-save-for-retirement_20/10)

<sup>15</sup> Hurnard, R. (May 2007) *Managing assets and income in retirement - An issues paper prepared for the Retirement Commission*. NZ Retirement Commission, Wellington.

<sup>16</sup> Department of Labour (November 2007) *Skills in the Labour Market*. <http://www.dol.govt.nz/publications/lmr/lmr-Skills.asp>.

<sup>17</sup> Statistics New Zealand (May 2010) *National Labour Force Projections: 2006(base)–2061*.

The motivation to work beyond the age of eligibility for NZS may be driven by financial aspirations - the desire to have a comfortable retirement; to be able to travel and indulge in leisure activities. Adding to this is the desire to stay connected and involved or simply the enjoyment of working. Life events, such as marriage break-up, business failure or unemployment may upset plans and produce financial setbacks, which encourage people to stay in paid work. Level of debt, especially mortgage debt, will affect choices. All these influences were illustrated in the Ministry of Social Development's "Turning 65" project.<sup>18</sup>

As in many countries, the ageing population in New Zealand will drive employers to look to older workers to fulfill the labour needs of the future economy.

### **Using Income and Assets in Retirement**

Information on how older people approach financial management in retirement is scarce, although the majority have income in addition to NZS. Older people, even those with above average incomes, practise a wide range of economising behaviours.<sup>19</sup> This may be an attribute of the current cohort of older people and may help to explain why most find their incomes adequate for their needs. Whether economising behaviours are practiced by oncoming cohorts is another question. Family budgeting services report recent increases in numbers of people 65 plus seeking their services. These are not their traditional clientele, but may be linked to fears about income adequacy the face of rising prices and investment losses<sup>20</sup>.

Household savings rates in New Zealand have declined over the last two decades, even though household wealth has risen due to increasing house prices<sup>21</sup>. Universal superannuation may reduce the motivation to save for low or modest income people, especially as it can deliver a standard of living not much different from what they have had throughout their lives. Many people are working on the assumption, supported by rhetoric from the current government, that universal superannuation is here to stay. But, the long term affordability of such a policy remains in question.

Traditionally, any retirement lump sums, from maturity of superannuation or life insurance, have been used to pay off remaining mortgage debt, to replace household items and cars and to travel (formerly "home" for immigrants or to visit children and grand-children living overseas). Thus, the challenge of making choices between investments, monitoring and managing asset portfolios has not and does not arise for many people. For the majority of older people their only asset is the equity in their homes, which they may not recognise as a form of wealth which can be mobilised.

The trends suggest that more people may be entering retirement with outstanding debts. It has become easier to accumulate debt through credit cards, flexible mortgages and student loans, creating a culture where debt becomes a norm. This is important, because paying off debt will reduce the ability to save and, if debt is carried into retirement, this will make it more difficult to manage on a reduced income.<sup>22</sup>

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[http://www.stats.govt.nz/browse\\_for\\_stats/work\\_income\\_and\\_spending/Employment/NationalLabourForceProjections\\_MIR06-61update.aspx](http://www.stats.govt.nz/browse_for_stats/work_income_and_spending/Employment/NationalLabourForceProjections_MIR06-61update.aspx) (accessed 31/5/10)

<sup>18</sup> Ministry of Social Development (September 2009) *Maturity Matters: New Choices for Older People; Findings from the Focus Groups and Interviews of the Turning 65 Project*. Centre for Social Research and Evaluation, Wellington

<sup>19</sup> Davey, J. (May 2009) *Expenditure in Retirement*. NZ Retirement Commission, Wellington.

<sup>20</sup> Raewyn Fox, NZ Federation of Family Budgeting Services, Wellington. Personal communication.

<sup>21</sup> Burns and Dwyer, op.cit.

<sup>22</sup> The KiwiSaver survey, op.cit., has information about debt levels among the pre-retirement cohorts (p.103-105). Two thirds of households are paying off debt; 37 percent are paying mortgage related debt and 55 percent other types of debt.

### ***Financial Knowledge and Capability***

The management of income and assets in retirement will be strongly influenced by levels of financial knowledge and literacy. The 2009 Financial Knowledge Survey found that 44 percent of people 65 and over were in the “low” financial knowledge group (37 percent of men and 49 percent of women) as opposed to 31 percent of the total sample. Only 28 percent were in the “high” financial knowledge group (total sample 43 percent) although the proportion increased between 2006 and 2009<sup>23</sup>.

There are clear gender differences. Almost half of women aged 65 plus were in the low knowledge group. Although more women are in paid employment today, their opportunities are often limited by education, culture and family circumstances<sup>24</sup>. In some sectors of the community it is considered culturally inappropriate for women to concern themselves with financial matters. Yet women live longer than men and need support through a longer period of retirement. There are also couple effects. In the baby boom generation, two sets of expectations about retirement operate, as most women have had longer working lives than in previous generations. Nevertheless, gendered roles and gendered access to resources may persist.<sup>25</sup>

Lifetime experiences will clearly influence behaviour. People who have always had assets and income to invest will bring a lifetime experience of managing them. But others may have little experience beyond house purchase. Dealing with a cash lump sum on retirement may be a challenge.

### ***Access to financial education***

The Retirement Commission recognises that raising levels of financial literacy is a critical and challenging priority and some of its initiatives are gaining ground. But much remains to be done, not least in raising financial literacy among people already in retirement, despite helpful material provided by the commission through Sorted and the publication “Your Money in Retirement”. Retirement Commission financial seminars are aimed mainly at younger people and workplaces. There are very few opportunities for pre-retirement financial education at the community level<sup>26</sup>.

### ***Seeking advice and evaluating options***

Where do people go for advice on managing their income and assets? According to the financial knowledge surveys, older people in the low knowledge group depend mainly on friends and family, while the high knowledge group uses a wider variety of sources. Banks are a major source of advice, used by 37 percent of people 65 plus, as against 51 percent of the total sample. Older people are less likely to use web sites for financial information; only 12 percent had used Sorted, (males 21 percent, females 5 percent). One in five of the 65 plus age group received no help in their financial transactions.

Several of the submissions to the Retirement Commission’s current review pointed out the difficulty of obtaining reliable and independent advice on investment, especially for people whose savings/assets are small. Issues related to disclosure, ethics and redress are currently being addressed to some extent, but concerns about independence and industry standards still remain. In late 2009, the Consumer Institute conducted a “mystery shopper” survey of financial advisers and concluded that most were of little practical help<sup>27</sup>. “There is compelling evidence that the financial adviser market is

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<sup>23</sup> Colmar Brunton (June 2009) *2009 Financial Knowledge Survey*.

[http://www.financialliteracy.org.nz/sites/default/files/webfm/Research/Financial\\_Knowledge\\_Survey\\_2009\\_report.pdf](http://www.financialliteracy.org.nz/sites/default/files/webfm/Research/Financial_Knowledge_Survey_2009_report.pdf). People in the lowest knowledge group exhibited feelings of being out of control of money, being less confident and less likely to shop around. People in the advanced knowledge group were more likely to plan and more likely to feel in control of their money.

<sup>24</sup> National Council of Women (2010) Submission to the Retirement Commission’s review of retirement income policy.

<sup>25</sup> Keeling, S. (October 2009) *Retirement: his, hers and theirs?*, paper given at the NZAG/Age Concern Conference, Wellington. [http://www.gerontology.org.nz/conference\\_downloads\\_2009/4A-1-Keeling-MFC.pdf](http://www.gerontology.org.nz/conference_downloads_2009/4A-1-Keeling-MFC.pdf)

<sup>26</sup> Davey, J. and Fulton Bevers, S. (September 2009) *Preparing for Later Life – Pre-retirement Education and Planning*. Age Concern Wellington.

<sup>27</sup> Consumer magazine (November 2009) *Financial advisers*. <http://www.consumer.org.nz/reports/financial-advisers>.

not serving the needs of consumers and needs to be comprehensively restructured – either voluntarily or via regulation.” Recent changes to financial advisors legislation will assist here but may make professional advice more costly and out of reach for people who need it most.

### ***Attitudes to different asset and investment types***

Recent failures in the investment sector and subsequent financial losses have understandably increased older people’s apprehension about using such products. The Reserve Bank estimates that finance company failures led to over \$6 billion in savings being frozen, impacting nearly 200,000 people. People are tempted into risky investments by promises of high returns and they may not realise that term deposits may give better returns with greater security. Balancing security and risk may not be a well understood or appreciated consideration.

Only about 10 percent of New Zealanders purchase shares as against about 40 percent of Americans<sup>28</sup>. Among the reasons suggested for this is the availability of other attractive investment options, especially in real estate<sup>29</sup>. Investment in real estate has several attractions, including historically good returns and favourable tax treatment. People may feel that capital gains in the property market gives them the best protection against inflation. Property investment can be funded by borrowing using houses as collateral. The decline in occupational superannuation schemes and, until recently, the absence of an attractive and comprehensive retirement savings scheme has also favoured investment in property.

### ***The risk of financial abuse***

Financial abuse, defined as “the illegal or improper exploitation or use of funds or other resources of the older person”<sup>30</sup> is one of the most common types of elder abuse. Its impact may lead to permanent loss of financial security and may even be life-threatening. It can result in higher levels of dependence and an increased need for care services. Older people living alone, especially women and those in poor physical and mental health are especially susceptible<sup>31</sup>. Most of the perpetrators are family members. Risk factors include living with family members who have alcohol or drug problems or who are financially stretched. Older people whose levels of financial literacy are low are especially at risk. There may be a fine line between coercion and genuine willingness on the part of older people to help out family members. The belief that children and grand-children are “entitled” to family money, as they will eventually inherit it, may encourage abuse. “Financial exploitation” or “duress” are terms which help to distinguish such attitudes and practices from what is usually meant by family violence.

Financial abuse may also be carried out by unscrupulous sales and tradespeople, by financial advisers and by paid carers in the home or in residential care. It is, however, much more difficult to detect and regulate when it happens within families.

Enduring Powers of Attorney (EPA), which gives one person the power to act for another in financial matters, are intended to protect older people whose ability to manage their own affairs has been compromised by ill-health<sup>32</sup>. Concerns about financial abuse led to the tightening of EPA rules in 2008. The new rules require people to seek independent legal advice before making an EPA. This is intended to make attorneys more accountable and requires them to keep clear financial records

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<sup>28</sup> Mel C (March 2010) *Why are New Zealanders shy of the NZ Share Market?*

<http://www.grownups.co.nz/read/money/savings-investment/why-are-new-zealanders-shy-of-the-nz-share-market>

<sup>29</sup> Burns and Dwyer, op.cit.

<sup>30</sup> Darzins, P., Lowndes, G. and Wainer, J. (June 2009) *Financial Abuse of Elders: A review of the evidence*. Monash University, Faculty of Medicine, Nursing and Health Sciences, for State Trustees.

<sup>31</sup> Peri, K., Fanslow, J., Hand, J. and Parsons, J. (January 2008) *Elder abuse and neglect: Exploration of risk and protective factors*. Families Commission, Wellington.

<sup>32</sup> Age Concern New Zealand [http://www.agewell.org.nz/enduring\\_power\\_of\\_attorney.htm](http://www.agewell.org.nz/enduring_power_of_attorney.htm)

## **Decumulation**

The economists's model shows people accumulating assets throughout working life and then "decumulating" in retirement, to use up their wealth before they die. But actual behaviour does not follow this pattern. Why not? Impediments to "rational" financial planning include procrastination, time cost and hassle. Many people prefer not to contemplate eventualities such as the need for long-term care and death.

### ***Uncertainty about longevity***

People do not know how long they are going to live. Average life expectancy means little to individuals. How long must capital last and how much capital does an individual need to provide a pension or annuity which will be capable of providing an acceptable standard of living? These are questions which need to be considered.

### ***Uncertainty about needs***

How will needs change in retirement and what costs will increasing frailty bring? This question adds to uncertainty about longevity and encourages people to keep their resources for a "rainy day". Will children be willing and able to provide care? What will the state provide and at what cost to individual? The public health system may not respond in a timely manner and the cost of dental care, hearing and eye-sight aids can be very high.

### ***Uncertainty about the adequacy of NZS***

Fiscal pressures, increased life expectancy and lifestyle expectations mean that NZS is unlikely to be sufficient to finance desired standards of retirement living<sup>33</sup>.

### ***Wish to bequeath***

Although there is no hard evidence, attitudes to inheritance may be changing, reducing its importance and hence encouraging decumulation. Many older people agree that their children are comfortable and don't need to inherit; that it is better to use their assets to help them in their old age rather than to leave them to other people<sup>34 35</sup>. Even if savings are used up, capital tied up in houses will remain to be bequeathed and may also represent a source of security for older people against unexpected financial needs. If it is preserved in this way, home equity often becomes "accidental" bequests.

## **Current options for decumulation**

The mobilisation of assets to improve retirement incomes is clearly an option for older people. *Www.sorted.org.nz* provides options and advice on decumulation or "spending your nest egg".

### ***Releasing home equity***

Given high levels of mortgage-free home ownership, mobilising capital tied up in houses is an option open to the majority of people. There are various ways to do this:

- "Down-size" - move to a cheaper house to release cash;
- Rent out part of the home;
- Take in paying boarders;
- Subdivide the property or use it more intensively;
- Sell the home and move into rented accommodation;

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<sup>33</sup> Mercer (July 2009) *Securing Retirement Incomes: Time to Act – Risks, challenges and opportunities with New Zealand's retirement income system.*

<http://www.mercer.com/summary.htm?siteLanguage=100&idContent=1352835>

<sup>34</sup> Davey, J. (1998) Inheritance, Housing Wealth and Social Policy - Some Intergenerational Issues *Social Policy Journal of New Zealand*. June 1998, Vol. 10, p.16-27.

<sup>35</sup> Hancock, R., Katbamma, S., Martin, G., Clarke, H. and Stuchbury, R. (2002) *Attitudes to Inheritance: An exploratory study*. Joseph Rowntree Foundation, York. This UK study summarised the literature and found that the evidence for changes in attitudes to inheritance is mixed.

- Sell the home to family or whanau (possible through a loan repaid from the estate)
- Rent out the property and move into rented accommodation elsewhere.

The attractiveness of options involving renting will depend on how the amount of rent which is paid compares with the return on (re)-investing some or all of the capital from the sale of the house.

It is also possible to take out a standard loan secured against a house as a lump sum or access to credit, but this will incur repayments of interest and/or capital.

New Zealanders have access to reverse mortgages, where older people borrow an amount against their property either as a lump sum or by drawing down on the loan as and when the money is needed. In the meantime, the interest payments accumulate. When the client dies or the property is sold, the full loan plus interest has to be repaid. Equity release products usually charge a higher interest rate than normal loans on property because the provider does not receive repayment until the end of the term. Some councils offer rates-postponement schemes where the rates roll up until the older person dies or sells their house (at that point the rates *plus interest* must be repaid)<sup>36</sup>.

The Retirement Commission, Age Concern, the Consumer Institute and the Office for Senior Citizens all offer advice and caveats about commercial equity release schemes. These include advice not to use the schemes too soon, especially for lifestyle purposes, and to avoid schemes which involve investment in high-interest debentures or risky property developments. The recent financial crisis has made it difficult for providers to continue their operations, being dependent on international credit sources. Some left the market and some are not offering new loans<sup>37</sup>.

### ***Annuities***

Annuities are a way of turning retirement savings, or lump sums on maturity of superannuation or life insurance plans, into a regular income. In return for a large deposit, regular payments are made, which can be a fixed amount or variable and may continue for a set number of years, or until the annuitant dies. The amount payable depends on the remaining life expectancy of the annuitant at the start of the contract (estimated from mortality rates) and the amount of lump sum available. There may be indexing in line with the CPI or a similar measure and there may be some coverage for a spouse.

Annuities remove the need to manage and invest savings, which may be a source of anxiety for some older people. A lifetime annuity reduces the fear that money will run out, but regular payments may be smaller than for a fixed term annuity. These advantages must be set off against the risk that the annuitant may die early in retirement, before substantial benefit has been received, although some annuity plans offer a guaranteed payout period, with continuing payments to the estate. In addition to the longevity risk, annuities are typically priced with reference to interest rate on the day of purchase, locking in conditions for the life of the scheme. The consequences of an individual making the wrong decisions with respect to their life savings can be serious and irremediable.

Despite the advantages, the annuity market is in decline in New Zealand and in numerous other economies, including Australia. There are a range of barriers to its development<sup>38 39</sup> Some of these are attitudinal.

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<sup>36</sup> Davey, J. (2005) *The Prospects and Potential of Home Equity Release in New Zealand; Update to 2005*. Office of the Retirement Commissioner, Wellington. [www.retirement.org.nz](http://www.retirement.org.nz).

<sup>37</sup> Consumer Magazine (June 2009) *Reverse Mortgages*, <http://www.consumer.org.nz/reports/reverse-mortgages>. By December 2008, nearly 7000 borrowers had taken out equity release mortgages in New Zealand and \$430 million had been paid out in loans. The average loan was \$62,000.

<sup>38</sup> St.John, S. (October 2009) *The annuities market in New Zealand*. Report prepared for the Ministry of Economic Development. The author points out that, as of late 2009, there was only one medium sized life insurance company, Fidelity Life, providing annuities in New Zealand. All other providers had withdrawn from the market in the previous 10 years.

<sup>39</sup> Rashbrooke, G. (October 2008) Income in Retirement, *Policy Quarterly*, vol.4, number 1, p.26-35. Also Hurnard, op.cit.

- Lack of an annuity culture. People prefer lump sums and self-management of investments;
- People prefer not to hand over their assets to unknown or mistrusted financial service providers;
- The complexity of the products and lack of understanding of how annuities work;
- The wish to keep precautionary savings for unforeseen events, long-term care and medical costs;
- Lack of tax advantages or compulsion to purchase annuities;
- NZS is seen as reasonably generous and people may also expect also family support;
- It has been the norm to “leave something” for children as bequests.

There are also some barriers on the supply side<sup>40 41</sup>.

- It is difficult to price products, given the uncertainty of future mortality trends;
- The small size of the New Zealand market works against spreading risk and leads to adverse selection;
- Providers need to adopt high contingency margins and this increases the price of annuities;
- Lack of long term and inflation-proof bonds to hedge longevity risk;
- Capital requirements on providers – setting aside sufficient reserves to cope with risks;
- The high costs of updating prospectus and investment statements.

Further barriers arise from government action and policy settings. These remain despite numerous overtures by the finance industry and academic commentators.

- Applying a corporate tax rate makes annuities appear expensive when the individual tax rate of the purchaser may be lower;
- No government incentives to encourage the annuities market and no compulsion to use them;
- WINZ policy counts annuity payments as income when considering eligibility for means-tested benefits and, more particularly, supplementary assistance;
- The government does not guarantee the financial security of the annuity provider and does not provide any facility for reinsurance of investment or other risks.

### **3: Options for effective management of income and assets in retirement**

Planning to provide an adequate level of income for retirement requires an understanding of a number of relatively complex variables and their interactions. Some of these may be certain or controllable, such as retirement age, superannuation contribution rates or investment strategy. Others are uncertain and not directly controllable including lifespan, level of health and actual investment returns<sup>42</sup>.

Understanding these variables is only a first step. What follows is the search for products and/or services which could be used to manage income and assets in retirement. If NZS continues in its present form and with its current protections, then New Zealanders may feel more comfortable about adopting new investment and decumulation strategies, as their basic income stream is assured. There is a wide spectrum of options from improved education and advice to the introduction of new financial products.

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<sup>40</sup> New Zealand Society of Actuaries (May 2007) Annuity Market in New Zealand, submission to the Retirement Commission. <http://www.actuaries.org.nz/pdfs/Annuities%20May07.pdf> 20/4

<sup>41</sup> Mercer, op.cit.

<sup>42</sup> Blight, P. and Longden, D. (September 2007) *The next generation retirement income streams*. Paper presented at the Institute of Actuaries of Australia Biennial Conference, Christchurch, New Zealand.

### ***Improved financial information and education***

There are few opportunities for New Zealanders in retirement or approaching that stage of life to improve their financial literacy or to prepare in other ways for later life. Ideally, courses would be provided at community level through agencies such as WEA or college evening classes and would be free or low cost. Overseas examples (outlined in the Appendix) include the National Institute for Adult and Community Education's *Financial Literacy for Older People* programme and the Citizens Advice Bureau's *Financial Skills for Life* programme, both in the UK.

### ***Better advice on financial management***

In addition to the information provided on Sorted, the Consumer Institute has published articles for consumers on seeking financial advice<sup>43</sup> and Age Concern has hints on its web-site, under the heading "Keeping your money safe"<sup>44</sup>. Information backed by trusted community organisations and interest groups representing older people is likely to be more influential than information which could be seen as commercially slanted.

### ***Better consumer protection***

Older people may be vulnerable to "hard sell" and bemused by technical complexity. Their values, such as respect for "authority" may hold them back from asking questions and asserting their rights as consumers. Instances of financial abuse against older people show that many have been taken in by professional advisers. This emphasises the importance of moves to improve consumer protection.

### ***Protection against financial abuse***

A better knowledge base is needed to develop effective prevention and intervention in the field of financial elder abuse. An American report suggests that for every known case four or five may go unreported<sup>45</sup>. Older people often do not report abuse because they are embarrassed, especially if the perpetrator is a family member. Professionals who deal with older people may not want to get involved because of adverse publicity; because it may compromise relationships with fellow professionals or because they do not feel able to determine the mental capacity of their older clients. Justice and social services systems are often inadequately staffed to address the problem. New Zealand elder abuse services, contracted through Age Concern, have difficulty coping with demand and providing adequate coverage throughout the country<sup>46</sup>.

Few countries have legislation specifically on elder abuse, as many aspects of it are covered by civil, criminal or property law. Legislation developed specifically for older people risks perpetuating the stereotype that they are vulnerable, naïve and dependent. Criminalisation of elder abuse may deter reporting. Mandatory reporting of elder abuse (all types) is in place in some countries but its effectiveness remains contentious. Policy responses tend rather to be focused on intervention, education (including financial literacy), awareness and research (see Appendix).

### ***Making it easier to prolong income from work***

Incentives to prolong participation in paid work could come through changes in retirement income policy, in particular raising the age of eligibility for NZS. When this was done in the 1990s a significant rise in workforce participation followed. On the other hand, introducing a work or income test for NZS would probably have the opposite effect. The longer that older people remain in paid work the more they will be able to accumulate savings and decumulation decisions can be deferred until after earnings cease.

The attitudes of employers are crucial. Despite the ease with which myths and stereotypes about ageing and the abilities of older workers can be challenged, many employers still use age, perhaps

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<sup>43</sup> Consumer Institute (November 2009) op.cit.

<sup>44</sup> <http://www.ageconcern.org.nz/money/investing/keeping-your-money-safe>

<sup>45</sup> MetLife Mature Market Institute (March 2009) *Broken Trust: Elders, Family and Finances, A study on elder financial abuse prevention*. National Committee for the prevention of Elder Abuse and the Center for Gerontology of Virginia Polytechnic Institute and State University. Westport, CT.

<sup>46</sup> Peri et al., op.cit.

unthinkingly, as an indicator of performance and employability<sup>47</sup>. But, as smaller groups of younger workers follow the baby boom bulge through the population, there is likely to be an increasing scarcity of young workers, and international competition for skilled staff. Skills and labour shortages will have serious economic implications if measures are not taken to improve workforce participation rates.

Employers can make it easier for older workers to stay on by offering flexible working conditions and access to (re)training. Measures are needed to combat age discrimination in hiring, promotion and working conditions, which persist despite legal prohibition (see Appendix). There are many benefits of mixed age workforces<sup>48</sup>.

### ***Investment options***

Older people who have savings can use them in a great variety of ways to supplement retirement income. There are clearly risks inherent in long-term investments – risks of poor returns and early death – as well as uncertainties over health costs. One strategy is to set aside assets for precautionary reasons and for bequests before designating amounts to be released over a fixed period to provide regular payments. But the individual may die early before taking full advantage of his or her assets, or may die late and the money runs out.

Investment for returns in the form of interest and dividends may be a better option than outright decumulation (in which capital is divided by years of expected longevity and drawn down to exhaust the capital by the expected date of death). For people with small sums to invest (under \$100,000), term deposits and government bonds are appropriate and comparatively safe. Term deposits may be “laddered” over a range of maturities to spread the rate risk. There are also a range of multi- and single sector managed funds and bonds. Investment portfolios may be self-managed or managed by a professional. The availability of more sophisticated products may be restricted by the small size of the New Zealand market<sup>49</sup>.

### ***KiwiSaver***

As the scheme matures, KiwiSaver will deliver lump sums for participants at the age of eligibility for NZS (presently age 65, or 5 years after joining KiwiSaver, if later). This will produce “a new mass market” for investment products but there are questions about the adequacy and appropriateness of the response, unless levels of financial literacy can be significantly raised<sup>50</sup>. Are people able and willing to manage lump sums to best effect? As the AMP submission to the retirement income policy review pointed out, there is no inbuilt or regulatory framework to support or encourage investment in a retirement income stream as opposed to immediate consumption. The key feature in decumulation products must be certainty and security, for a product which can be “set and forget”, bearing in mind that many people will have only modest lump sums and this may well be their only cash asset<sup>51</sup>. Not everyone will all have access to lump sums. Many low income people cannot afford to contribute to KiwiSaver and many will have gaps in their working lives for caring responsibilities, study and unemployment.

### ***Inheritance as a retirement lump sum***

As people live longer, inheritances, mainly from sale of the family home, may provide retirement lump sums for “children” in their sixties. Comments on the use of KiwiSaver proceeds apply here also.

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<sup>47</sup> Davey, J. (2006) *Maximising the Potential of Older Workers*, New Zealand Institute for Research on Ageing, Wellington.

<sup>48</sup> Davey, Judith A. (2008) *Workforce Ageing – An Issue for Employers*. PS WP 08/04: Institute of Policy Studies, Wellington.

<sup>49</sup> Mercer, op.cit.

<sup>50</sup> Burns and Dwyer, op.cit. suggest that the immediate necessity to choose a KiwiSaver provider is leading people previously unfamiliar with the finance industry to investigate and discuss their options.

<sup>51</sup> Rashbrooke, op.cit.

### ***Encourage annuities and new types of annuities***

If annuities are to play a part in helping people to supplement NZS from their own financial resources, then barriers to the development of the market need to be addressed<sup>52,53</sup>. New ideas are needed to deliver benefits at the individual level, but also in wider economic terms. Susan St. John (2006, p.22) lists the attributes of an attractive annuity product:

- Good value for money;
- Inflation-proofing;
- Provide flexibility and be less of a lottery;
- Allow use of part of home equity for annuity purchase;
- Gender neutral;
- Include insurance for catastrophic care costs.

Compulsory annuitisation has been adopted in some countries, including the UK. This avoids problems of adverse selection, but is only acceptable where savings is compulsory or subsidised.

New forms of annuity, developed or being developed in other countries, have some of these attributes, including life, allocated, variable and deferred annuities (Appendix). NZS provides a “first tier” annuity which is inflation and longevity protected (and also has the desirable features of being universal, non-work-tested and gender neutral). Given this, people may be willing to use these new forms of annuity, which may not have the same degree of protections, provided that they are well regulated and fairly priced. The barriers to innovation in the annuities field are mainly consumer understanding and attitudes. The small size of the New Zealand population produces potential volatility in mortality rates and financial markets are subject to fluctuations in exchange rates and investment returns. These create challenges for the pricing of annuities (and also equity release schemes). Government policy settings may impede innovation and create disincentives and there are also technical issues relating to taxation and regulation.

### ***Equity release***

There is potential for innovative products in the equity release market to play a larger part in decumulation and in the provision of retirement income. Scobie, Le and Gibson concluded that by converting housing wealth into income in retirement households would be able to enjoy higher consumption in retirement<sup>54</sup>. The authors conclude that the effect of home equity withdrawal is modest until half of the equity is committed, and there are significant transaction costs. While equity release can play a precautionary role, representing a store of value what can be drawn on when facing uncertain income and unanticipated expenditure in retirement, it should not be viewed as a substitute for adequate levels of retirement saving.

A wider variety of providers and equity release products is likely to emerge when credit eases, possibly including annuity-linked options. Increased longevity, higher aspirations for retirement living and fiscal constraints on NZS are likely to make home equity release more attractive and change attitudes towards decumulation and inheritance. As a relatively new product category in New Zealand, knowledge about home equity release remains low, suggesting that the public need education on its benefits, drawbacks and appropriate use. Drawing down equity in a property may feel more of a momentous decision than adjusting the size of composition of an investment portfolio or bank deposits.

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<sup>52</sup> St. John, (2009) op.cit.

<sup>53</sup> St John, S. (July 2006) *The Policy Implications of Decumulation in Retirement in New Zealand: A background paper setting out the issues*, prepared for the Retirement Commission.  
<http://www.business.auckland.ac.nz/Portals/4/Research/General/DecumulationSSTJOHN.pdf> .

<sup>54</sup> Scobie, Le and Gibson, op.cit.

### ***Modifications to NZS***

Modifications to NZS have been suggested among policy options for the future. Raising the age of eligibility, on the basis of longer life expectancy and better health in later life, has become part of retirement income policy in many countries, including Australia.

Another option is to delay the receipt of NZS, possibly up to age 70, in return for higher payments once the pension begins<sup>55</sup>. This would save on the cost of NZS (if the higher payments were less than value of entitlements foregone) but might also encourage people to stay longer in the workforce. However, it would increase the longevity risk to taxpayers and moves away from a standard weekly entitlement for all recipients of NZS.

Several commentators have suggested that individuals could purchase additional NZS from the government for a lump sum and thus ensure an enhanced pension for life which would be protected from inflation (dubbed NZ Super Plus by Mercer)<sup>56</sup>. Details of this proposal, such as limits of purchase, any subsidies and long-term implications, remain to be worked out. The Mercer report suggests that it could be made compulsory to buy NZ Super Plus, using KiwiSaver lump sums.

### ***Long-term care insurance (LTCI)***

The costs of long-term care may be the reason why older people are preserving their assets and not using decumulation products. Long-term care insurance could ease such fears and allow for more efficient use of income and assets in retirement. It may also help to protect assets where residential care is subject to an asset test. Risk pooling is a logical move to achieve a more equal distribution of burdens in relation to unpredictable and potentially very expensive events, which include the need for long-term care.

Although it may be a useful addition to the array of financial schemes available for older people and their families, the concept of LTCI would need considerable public education to explain it and possibly incentives to make it attractive to both providers and purchasers (see Appendix). St.John suggests that subsidised annuities could include LTCI coverage. “Those whose health status makes them poor risks for LTCI are good risks for life annuities, so that linking the two risks is likely to increase long-term care coverage of the population at the same time as reducing adverse selection in the annuities market”<sup>57</sup>.

## **4: The role of different sectors in the management of income and assets in retirement**

### ***Individuals***

Individuals are responsible for their own retirement planning and for the management of income and assets in retirement. The extent to which they are able to do this effectively, however, depends on the actions and attitudes of many other players. Individuals themselves require assistance to achieve financial capability, knowledge and understanding. This may come through the educational system at all levels, but also through mass media, advertising and information on the internet. Achieving high levels of financial capability will make consumers of financial services more confident and assertive; better able to make good decisions and protect their interests. But this does not absolve the providers of financial services from adopting high standards of ethical behaviour. Nor does it mean that governments can relax, in terms of scrutiny and regulation.

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<sup>55</sup> Mercer, op.cit, Hurnard, op.cit. Submission by Boyd Klap to the Retirement Income Policy Review.

<sup>56</sup> Mercer, op.cit, St.John (2006) op.cit., Hurnard, op.cit. ISI Submission to Retirement Income Policy Review.

<sup>57</sup> St.John, S. (August 2003) *The role of annuities in the New Zealand retirement incomes policy mix*, A paper prepared for the Periodic Review Group.

A wide range of policies affect individuals' decisions about the management of income and assets in retirement, and decumulation choices.<sup>58</sup> They include health and residential care subsidies, taxation regimes for various investment choices and policies which influence price trends in the real estate sector. An in-depth review of these actual and potential interactions, influences and attitudes would help ensure that policy responses to population ageing are appropriate and effective.

### ***Employers***

As part of welfare and training policies, employers can play a part to improve financial literacy and capability among their staff. They can facilitate access to retirement saving schemes, with appropriate contributions on their part. Measures to make it easier for older people to remain longer in the workforce have the potential to benefit both employers and employees (see Appendix).

### ***Professional Organisations***

The HR profession, Industry Training Organisations and employers' associations all have roles in disseminating information on workforce ageing and in suggesting responses which would benefit business and maximise the potential of older workers.

The banking sector and other financial agencies, lawyers' organisations and health professionals could assist in preventing and dealing with financial elder abuse by educating their members and staff.

### ***Private and voluntary sector aged care providers***

Such providers have a responsibility to ensure that their clients are protected from financial abuse by their staff and to be vigilant where family members are suspected of abuse.

### ***Voluntary and Interest Groups***

In other countries, voluntary, self-help and older people's interest groups have become directly involved in providing ethical investment options and independent financial advice to older people<sup>59</sup>. These organisations are likely to be seen as trustworthy and also have educational objectives. Cooperatives and unions may have their own insurance schemes, death benefits etc. These initiatives could be explored in the New Zealand context. They would help people with low levels of assets, who fall below the purview of banks and commercial financial agencies.

Voluntary organisations have a role in assisting older people when they need to make complaints against financial institutions and advisers and in helping to raise awareness of financial abuse. Age Concern is contracted to provide elder abuse and neglect services. It has also made submissions on consumer protection. This and similar organisations could help in the provision of financial information and education, as shown by overseas examples (see Appendix).

Action on elder abuse by the voluntary sector may be carried out in partnership with the private sector. There is scope for extending this model and for further partnerships with financial institutions in the areas of research, education and information individuals, families and communities. With appropriate support, not-for-profit groups may be able to test innovative strategies to improve financial capability among older people and protect them from abuse.

### ***The Finance Industry***

Recent finance company failures have shown the need for higher standards of accountability and ethical behaviour by those involved in public investment offers, placing paramount importance on

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<sup>58</sup> Hurnard p. 21

<sup>59</sup> In the UK, Help the Aged (now merged with Age Concern as Age UK) offers home, motor, travel insurance, special gas and electricity tariffs. Age Concern Enterprises Limited as trading company of Age UK, and has offered equity release products. In the USA, AARP (<http://products.aarp.org>) also has insurance schemes as well as mutual investment funds. AARP Financial Inc. is an investment advisor and subsidiary of AARP. In New Zealand Grown-ups (<http://grownups.co.nz>) may be an appropriate comparator.

consumer protection<sup>60</sup>. This applies to managers, directors, trustees and auditors and requires cooperation with government initiatives in this area.

Self regulation by finance industry groups, using codes of practice, may help to bolster consumer confidence and provide avenues of redress.

The sector has a role in expanding investment options available in the New Zealand market, especially for small investors, who need simple and safe products. Currently banks and other financial institutions have shown little interest in clients with assets of less than \$300,000 as they do not generate sufficient profits. KiwiSaver providers may be in a position to provide information and advice when lump sums mature.

To combat the small size of the New Zealand market, joint ventures and harmonisation of rules between this country and Australia may be beneficial, for example in the development of annuities, longevity and long term care insurance products. New types of annuity could be explored and adopted for New Zealand conditions. An increase in the number of providers would encourage competition.

The finance sector has a role in promoting financial literacy and capability. The websites of banks and other agencies can help customers understand how their income needs change over their lifetimes and how to select appropriate investment vehicles and manage a decumulating investment portfolio.

### ***Government Agencies***

The government has adopted a range of legislative and regulatory measures to strengthen investigative and enforcement powers to monitor the conduct of private sector financial advisers and managers, some of which are listed in the Appendix<sup>61</sup>. These include measures to provide redress to investors where failure occurs. More work may be needed in the areas of the marketing and advertising of investments, advisers' commissions and sanctions on wrongdoing.

Public sector agencies, including the Securities Commission and the Ministry of Economic Development, have roles in educating the public about new legislation and regulations, ensuring that investors are well informed. This includes general encouragement of financial literacy and the dissemination of information on the advantages, disadvantages and risks of various types of investment, including annuities, investments and equity release schemes.

In the interests of providing clarity and fair treatment, it would be helpful to clarify the tax treatment of withdrawal of capital in the form of home equity release and how income derived from equity release affects eligibility for various forms of state support.

Ensuring income security in retirement for the future means that modifications to NZS should be considered, including raising the age of eligibility, deferred take-up and top-ups.

The evidence suggests that substantial state involvement may be required for an annuities market to thrive. Government could work with the private sector to facilitate this. Compulsory annuitisation of KiwiSaver could be considered along with tax reform, subsidisation, inflation and longevity underwriting, regulation or even state provision. There may be a role for government in providing long term bonds to assist in the annuities market, along the lines of the US Treasury Inflation-Protected Securities.

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<sup>60</sup> 2007/08 Financial Review of the Ministry of Economic Development. Report of the Commerce Committee. Appendix B Finance company failures – observations of the Registrar of Companies.

<sup>61</sup> The Financial Markets Authority (FMA), announced in April 2010 on the recommendation of the Capital Markets Development Taskforce, will incorporate a wide range of existing regulatory powers and functions and powers.

Through labour and employment policies and through directives to employers, government has a role in ensuring working conditions which will encourage older people to prolong workforce participation. This is likely to produce benefits not only to employers and workers but also at the economy-wide level<sup>62</sup>.

Partnerships between the public sector, the financial services industry and voluntary and community organisations could help to prevent and intervene in financial elder abuse. This might include a national register of financial powers of attorney (POAs) and random annual audits of activities carried out by attorneys and accountants.

An improvement in the statistical information on mortality, including projections, household saving and wealth would assist in the development of retirement savings policies.

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<sup>62</sup> Davey, J. and Davies, M. (2006) Work In Later Life – Opportunity or Threat? *Social Policy Journal of New Zealand*, Issue 27: 20-37.

## **Appendix – Further details on initiatives to improve the management of incomes and assets in retirement**

### ***Improving financial capability***

The Financial Literacy for Older People programme developed by the National Institute for Adult and Community Education (NIACE) in the UK has a curriculum specifically for older learners, which has operated since 2001 in partnership with community groups<sup>63</sup>. This covers financial planning, problem solving and decision-making; it encourages self development and confidence. The course is based on the principles of learning with peers, working at the pace of the learner, being non-judgemental, offering topics when people need them and providing materials relevant to real life.

The NIACE promoters point out that events in later life, such as bereavement, caring responsibilities, retirement or entering residential care, can require financial knowledge in new and unfamiliar areas or result in a sudden change of financial circumstances and responsibilities.

The British Citizens Advice Bureau is working to equip people of all ages with skills that enable them to budget, save and borrow with confidence through their *Financial Skills for Life programme*, in partnership with Prudential Plc.<sup>64</sup>. Programmes are aimed at specific groups, such as migrants and lone parents and involve a range of partnerships with financial services firms as well as community agencies such as housing providers and mental health groups. Courses appear to work best with smaller groups on an ongoing basis rather than one-off sessions for large groups. Lifesage events (or “teachable moments”), which could be retirement or loss of a partner, offer opportunities for educational input.

### ***Improving consumer protection***

Several initiatives would improve the quality of information provided to investors and their understanding of financial products and services.

- Addressing information asymmetries between financial advisers and their clients;
- Providing information which will allow consumers to compare financial advisers and the services they are offering;
- Checking that consumers understand the products and processes being offered;
- Ensuring that all information is presented in plain language which is easy for non-specialists to understand;
- Ensuring that consumers know how to make a complaint about financial advisers and are fully informed of their rights;
- Providing clear information on the credentials and “track record” of financial advisers and also on fee structures, remuneration and potential conflicts of interest;
- Partnerships between the public sector and the financial services industry<sup>65</sup>.

### ***Protection against financial abuse***

Policy responses across the world tend to be focused on intervention, education (including financial literacy), awareness and research. An Australian study outlines these, but points out that few have been rigorously evaluated<sup>66</sup>. Building professional knowledge and capability among case managers, GPs, police, residential care workers, solicitors, social workers, nurses and bank staff may be a

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<sup>63</sup> NIACE (March 2008) *Financial Literacy for Older People*. Briefing Sheet 82.  
<http://www.niace.org.uk/sites/default/files/Financial-Curriculum-OL.pdf> 12/5

<sup>64</sup> Citizens Advice Bureau (July 2006) *Financial Skills for Life: Building confidence through Citizens Advice Bureaux*.

<sup>65</sup> Ministry of Economic Development (June 2009) *Financial Advisers Act 2008: Disclosure Regulations Discussion Document*, Wellington.

<sup>66</sup> Darzins, P., Lowndes, G. and Wainer, J. (June 2009) *Financial Abuse of Elders: a review of the evidence*. For State Trustees, by Monash University Faculty of Medicine, Nursing and Health Services.

further preventive strategy. The Advocacy and Rights Centre in Victoria, Australia, reported on the challenges which the banking sector meet in relation to financial abuse<sup>67</sup>.

Older people can protect themselves against financial abuse by organising their financial affairs well, taking responsibility for them as much as possible; staying informed and knowing where to go for help. But this implies an adequate level of mental capacity. Families can keep watch for any signs of financial abuse, such as unexplained cash withdrawals, unusual signatures or missing belongings.

Financial services and other professionals are well placed to contribute to the prevention of financial abuse by educating their clients, training their personnel, seeking assistance from other disciplines such as social work and health services, and reporting suspected cases of abuse.

Other initiatives to combat financial elder abuse include:

- Multidisciplinary financial abuse specialist teams;
- Helplines;
- Use of Enduring Power of Attorney (EPA), with stringent safeguards against abuse. Studies in Australia found that older people had limited understanding of EPA and were more likely to allow family members to manage their affairs informally;
- Mandatory reporting of elder abuse (all types) is in place in the USA, Canada, Israel and South Africa, but its effectiveness remains contentious. There is no evidence that this is more effective than voluntary systems and denies the right of seniors to make their own decisions;
- Using the criminal justice system;
- Measures to tackle social isolation among older people and providing support and assistance, including access to legal services;
- Mandating of police checks for all people working with the elderly.

Other protective measures may be delivered through:

- Improved regulation of financial services;
- Banking - safeguards on withdrawal of large sums of money;
- Family law and inheritance.

### ***Measures to help older workers to continue labourforce participation***

Employers can help to facilitate this in a variety of ways.

- Offering flexible working conditions - hours of work, part-time, casual, relieving positions;
- Modifying work roles to accommodate the needs, capabilities and strengths of older workers;
- Ensuring that older workers have access to appropriate opportunities for education and (re)training;
- Building on the strengths of mixed age workforces, such as opportunities for complementary work, mentoring, etc.;
- Exploring ways in which transition out of the workforce can be managed so that it benefits both worker and employer;
- Examining attitudes and processes to avoid age discrimination.

### ***Regulation of Financial Markets and Service Providers***

A range of measures have been taken by government or are in train:

- Additional regulation of managed funds including KiwiSaver;
- Better supervision of finance companies and trustees;

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<sup>67</sup> Edmonds, J. and Noble, P. (November 2008) *Discrimination in the provision of banking and financial services to older people*. Advocacy and Rights Centre Ltd. Bendigo. Victoria.

- New rules on moratoria;
- Registration and licensing of financial advisors and product providers;
- Improvement and simplification of disclosure documents;
- Ensuring that financial service providers belong to a consumer dispute resolution service.

The provisions of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 will take a while to have their full effect. Measures related to means of redress and complaints resolution, disclosure of financial advisers' conflicts of interests, fees, accountability and competency, if fully implemented, will improve consumer protection<sup>68</sup>.

### *New forms of annuities*

#### **Life annuities**

Life annuities provide a regular income payable until death. These produce less income than annuities which last for a specified term, because of the longevity risk. Some are indexed to provide protection from inflation and some provide a spouse benefit on death, but these features again have costs in terms of the amounts paid out.

#### **Allocated pensions**

Allocated annuities from superannuation funds or life offices are increasing in popularity and common in Australia. They are linked to an investment account and provide regular annual payments made within limits prescribed by government which are tax free. They can be structured so as to exhaust the fund by age 80 and then linked with a deferred annuity<sup>69</sup>.

#### **Variable annuities**

Rather than receiving regular dollar amount, purchasers of variable annuities receive the value of a fixed number of units in a diversified portfolio. Payments fluctuate with fund returns, although there is often the possibility to switch between funds. Protection against inflation may not be guaranteed, although some have guaranteed minimum income and death benefits<sup>70</sup>.

#### **Deferred annuities**

In this option, there is an "establishment" phase, beginning at age 65, when members' contributions are invested in their choice of investment pools. At the "conversion age", chosen by the member, which may be 80 or 85, they begin to receive regular income for the rest of their lives. Annuity payment will vary with mortality - topped up by the funds of those who die - and with investment returns. Deferred annuities are mandated in the UK and German pension schemes. Income payments are delayed until owners opt to receive them. This option provides longevity insurance and gives government some relief.

#### **Hybrid products**

A gap exists for hybrid products to help manage longevity risk without having to pay for guarantees and to share risks between provider and individuals<sup>71</sup>. The use of pooled longevity risk has been criticised where schemes have no death benefits<sup>72</sup>. "Insurers offer longevity policies which can offer tantalizing payouts because they're certain many policyholders will never collect a dime." Investment-linked retirement products offer income comparable to conventional annuities with the potential for income increases to combat the effects of inflation, and provide opportunity for real growth in value of underlying pension funds. A conventional annuity locks in yields on the date it is taken out.

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<sup>68</sup> The Credit Reforms (Responsible Lending) Bill, to amend provisions in the Credit Contracts and Consumer Finance Act 2003, was introduced in August 2009.

<sup>69</sup> St.John (2006) op.cit., Mercer, op.cit.

<sup>70</sup> Mercer, op.cit., St.John (2009), op.cit.

<sup>71</sup> Blight and Longden, op.cit.

<sup>72</sup> Lankford, K. (July 2007) *Retirement income you'll never outlive*. Kilpinger's Personal Finance.

### ***Long Term Care Insurance (LTCI)***

LTCI may cover home care, adult daycare, respite care, hospice and rest home care, and dementia services. It is available in many countries and has become popular in the USA<sup>73</sup>. LTCI policies may be pre-funded by regular premiums through life; by a single large premium at time of requiring LTC (point of need) or linked to health insurance, life insurance or pension plans. In 1966, there was a proposal for “partnership schemes” in the UK, which offered additional protection of assets commensurate with LTCI coverage or government funding after a prescribed period of private payments through insurance. LTCI could be funded by lump sums taken out of home equity, using reverse mortgages. This did not go ahead as there was a change of government.

LTCI coverage can be expensive unless lump sums from assets are used<sup>74</sup>. But people may be willing to pay premiums for peace of mind, to preserve assets (including bequests), protect family members from financial responsibility, avoid dependence on the state or on family, and to be assured of high quality care.

On the supply side, moral hazard and adverse selection apply, as in other types of insurance. Would the availability of insurance lead to a greater demand for care and encourage families to “push” older people into residential care? The long-term nature of the product poses actuarial difficulties and makes it difficult to assess take-up and profitability.

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<sup>73</sup> Davey, J. (1998) Exploring shared options in funding long-term care for older people. *Health and Social Care in the Community*, Vol.6, No.2.

<sup>74</sup> Johnson and Uccello (2005) estimate that only 10-20 percent of Americans could afford LTCI, and its maintenance in the face of rate increases could be difficult. Trustee Executors offered a scheme New Zealand in 1996 which, to obtain \$1000 per week lifetime cover, would cost an annual premium of \$2,330 for a man and \$4,990 for a woman. This scheme was withdrawn for lack of interest.