

NZ needs to stop the retirement lotto

By Ian Perera, President of the NZ Society of Actuaries

To save for retirement or not to save for retirement? That's the question.

Well, actually it's only part of the question. The more Kiwis save, the less we have to borrow from overseas.

And thanks to the ongoing debate about our relatively poor savings habits, there are now around 1.6 million Kiwis involved in KiwiSaver and other retirement savings schemes.

While the numbers could obviously be better, the message is starting to get through.

However, there is a potentially bigger problem than just how many of us are saving for our retirement. And that relates to what we are doing with our savings dollars and how we are using them.

At the moment, retirees who have saved for their twilight years generally get a lump sum when they stop working.

This lotto-esque retirement windfall might not actually be the best approach to helping retirees manage their finances for the remainder of their lives.

The fact is that many Kiwis might end up outliving their retirement nest-egg and have little else to fall back on.

It's not just that we are not saving enough. It's also a result of the combination of longer life expectancies, the ever-present impact of inflation and, of course, how we choose to manage our super when we get it.

A 65 year old female retiring now can expect to live for another 20 years. But don't bet the house on that. She could live for another 40. And this is where it becomes difficult to manage your retirement savings when on the one hand you want quality of life and on the other you don't want to burn through all the cash too quickly.

Uncertainty about inflation adds to the problem. New Zealand's recent history has been of relatively mild inflation and the policy target between the government and the Reserve Bank is to keep future inflation between 1% and 3%.

However, rising demand for food and other commodities from China and other rapidly developing nations may make inflation a more significant problem.

Although there is commitment from the major political parties to maintain the real value of New Zealand Superannuation, retired people's savings are often poorly protected from inflation. And they are most at risk.

This situation is exacerbated because very few New Zealanders are in the privileged position of having substantial retirement savings.

For most of us, our retirement pot will be modest, meaning that balancing quality with quantity is particularly difficult.

The problems would be mitigated to some extent if New Zealanders had easier access to retirement savings products, like inflation linked bonds and annuities, that help them manage these risks. Unfortunately we don't.

It makes sense that those planning wisely for their retirement years would want to have access to products that guarantee to protect them from inflation, at least.

The New Zealand Debt Management Office recently announced that it is considering an issue of inflation linked bonds. The downside is that investors with relatively small savings would be unlikely to be able to access such a product, and this is the sector with the biggest headache when it comes to a comfortable retirement. The government should consider how it could create or encourage inflation linked products for retail investors.

The other challenge that retired people face is that we don't know how many years our savings will need to last. Other countries are way ahead of us in helping their retirees cope with this uncertainty. In many countries there is an active life annuity market that allows retired people to manage this risk.

Annuities are a form of insurance contract in which the saver makes a lump sum payment which the insurance provider then turns into a regular income stream, often for life. You get it paid to you in retirement much like a salary, no matter how long you live.

In some countries there has even been a requirement that some or all an individual's retirement savings be used to purchase an annuity and this is often incentivised through tax concessions.

The New Zealand annuity market is very undeveloped with only one active provider. However, recently, the Savings Working Group recommended that the government considers whether members of KiwiSaver should be required to take some portion of their withdrawal in the form of an annuity.

This would ensure that some element of their savings will match life expectancy, ensuring a steady, regular income throughout their retirement.

Although the purchase of an annuity may not be the best outcome for all retirees, Kiwis need the choice.

Some people may be in poor health while others may achieve a better financial outcome by using their retirement savings to pay off debt.

Expanding the annuity market here would require the government to address distortions that over-tax annuities. It could also encourage the New Zealand Debt Management Office to consider the needs of annuity providers when planning its debt programme.

2011 is the year in which the first of the baby boomer generation reach retirement. Let's make sure that they have access to the best financial products for a long and happy retirement.

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