

The critical question of **DECUMULATION** in the **KiwiSaver world**

Paul Newfield

Mercer

6 August 2009

Roadmap for today

- KiwiSaver – where have we come from?
- Decumulation – what does it mean and why is it so important?
- The 3 phases of retirement
- Risks retirees face
- The decumulation framework
- Annuities as a solution?
- Other possible solutions and global lessons

Decumulation

- What does it mean?

“the utilisation or draw down of a retiree’s accumulated capital once they permanently cease contributing to their retirement savings and access their retirement savings for the sole purpose of funding their retirement needs”
- Why is it important?

KiwiSaver

- Commenced 1 July 2007

1,100,540 members at 30 June 2009

- First savers can withdraw from 1 July 2012
- Risk around age at which eligible to exit?
- Decumulation end point is critical

KiwiSaver – Why have KiwiSaver?

- In a Statement released by Dr Cullen on 27 November 2006 in relation to the approval of the KiwiSaver regulations he said:

“We are making good progress in introducing KiwiSaver which aims to help New Zealanders develop long term savings habits so they can have greater financial security in their retirement years.”

- 7 December 2006 when announcing the 6 default providers under the KiwiSaver framework Dr Cullen said:

“KiwiSaver aims to make it easier for employees to save for their futures. It is essential New Zealanders develop better long-term savings habits so they can look forward with more confidence to a retirement that meets their aspirations.”

The Pre and Post retirement framework

	Pre-retirement	Post-retirement
Cash flow	In	Out
Objective	Wealth	Income
Time horizon	Generally fixed (to retirement)	Uncertain
Access (liquidity)	Very limited	Any time
Assets	Increasing	Reducing

There is NOT a one size fits all

- Income needs change during retirement
 - Active phase
 - Passive phase
 - Frail phase
- Need for one-off payments
- The costs of entering a nursing home can be material

Risks facing retirees...

- Longevity
- Investment/Market risk
- Flexibility
- Erosion of purchasing power
- Customisation
- Stable cash flow management
- Market risk at date of purchase
- Financial literacy
- Complexity

Possible Decumulation Options

- Life Annuities
- Deferred Annuities
- Variable Annuities
- Allocated Pensions
- Pooled Survival Payments
- NZ Super Plus
- Purchase long term bonds? Perhaps indexed linked?

Life Annuities...

- What is a life annuity? Benefits?

Demand Issues

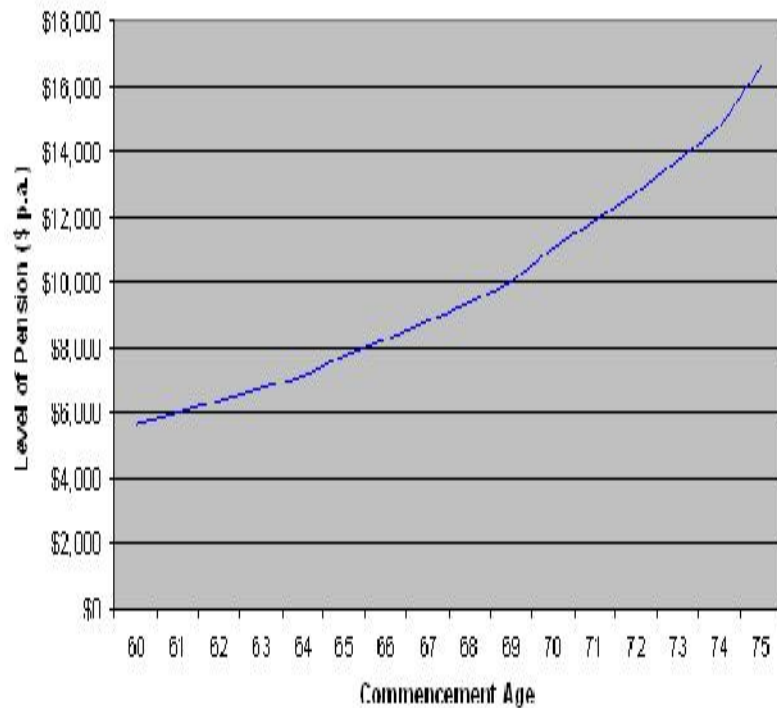
- Lack of annuity culture
- Lack of incentives
- Cost

Supply Issues

- Costs
- Spread of risk
- Capital requirements
- No suitable matched investments
- Tax impost

Other Annuity Options

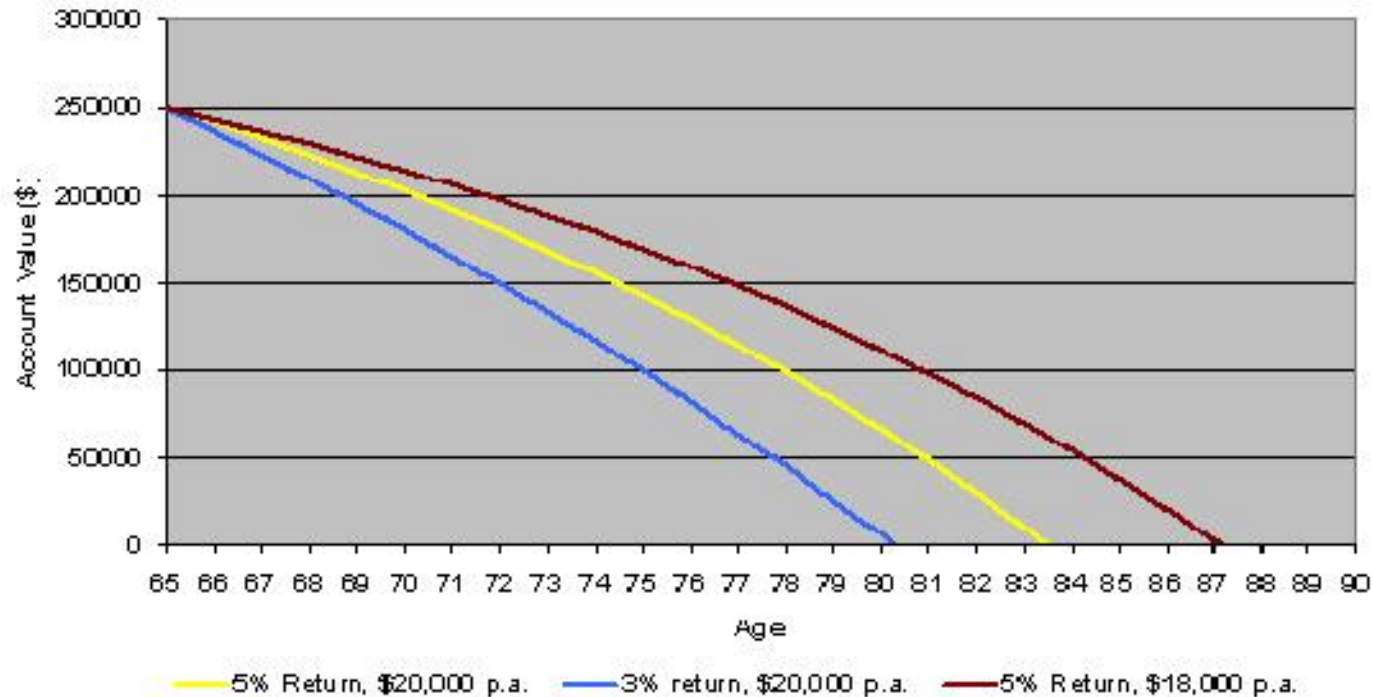
Deferred



Variable

An accumulated investment account is used to purchase an annuity but rather than receiving a regular dollar amount, the annuitant receives the value each pay period of a fixed number of units inside an investment fund. The regular annuity payments may fluctuate based on the investment fund's returns.

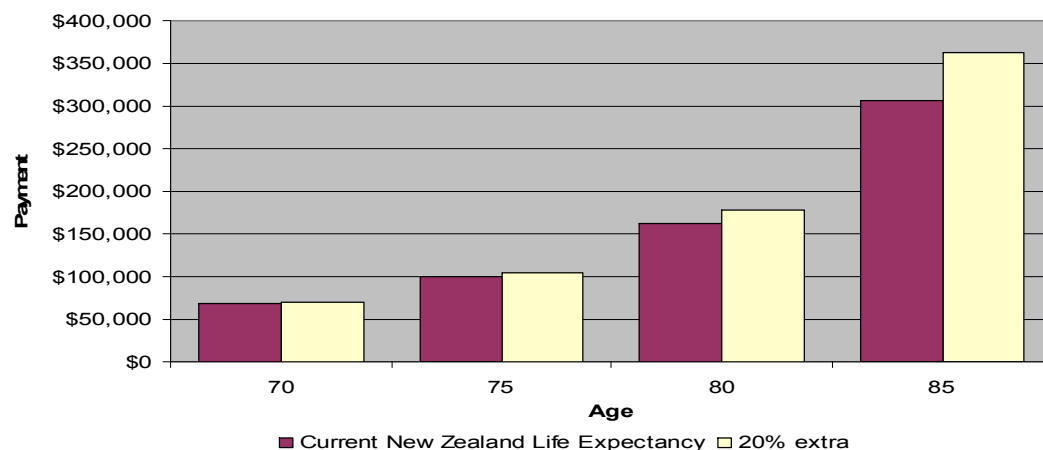
Allocated Pensions...



Prevalent in Australia

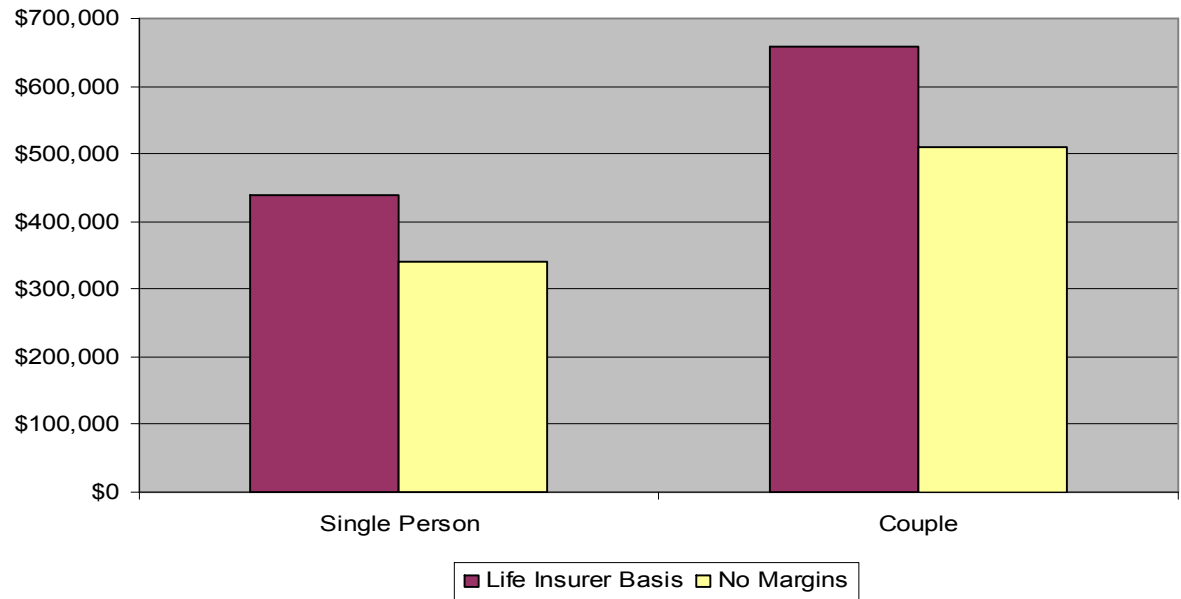
Pooled Survival Payments

- It's the story of insurance...
- Avoids some of the pitfalls...
- Customisation with pooling
- Moral hazard



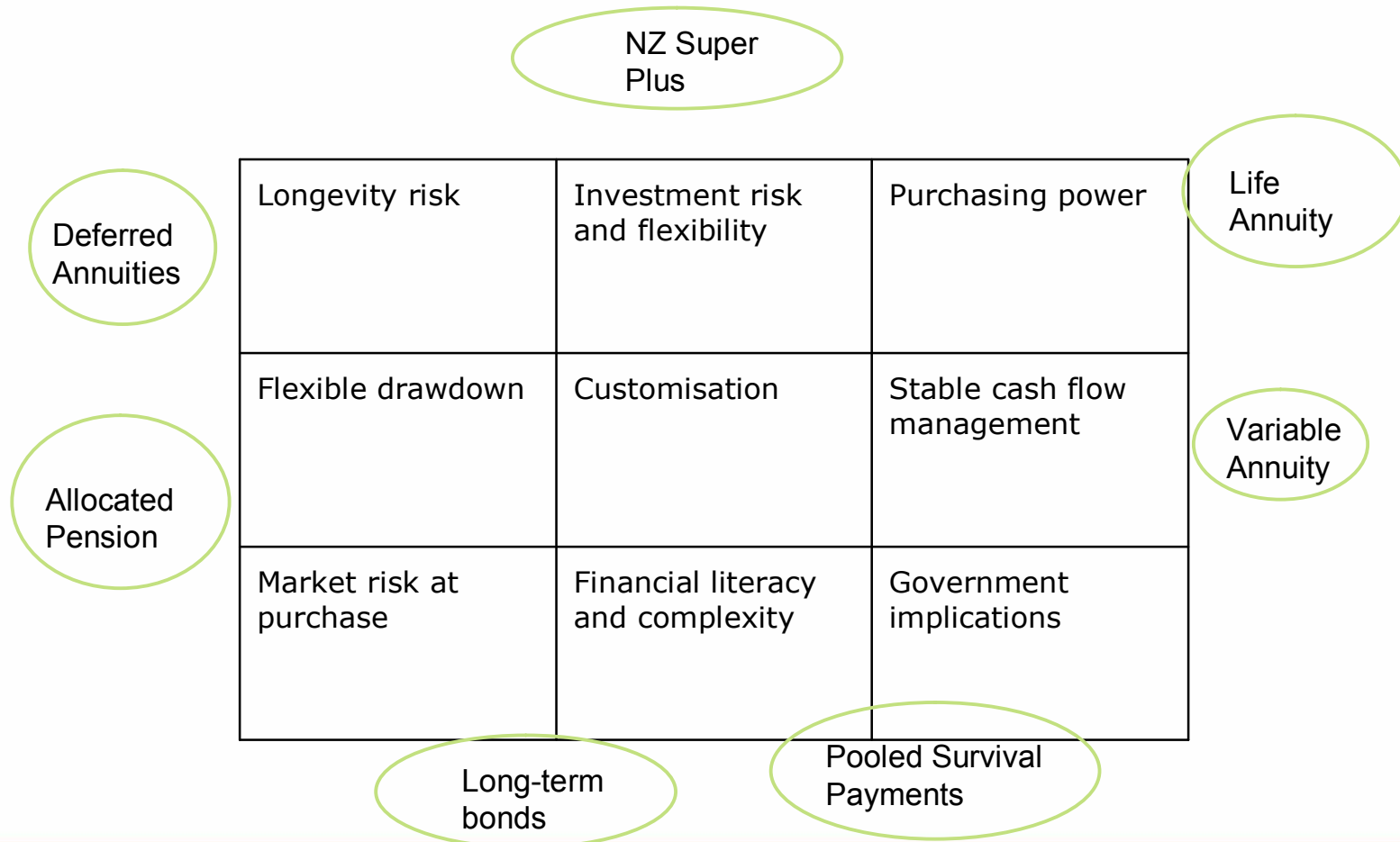
NZ Super Plus

- What is this?
- Why have this option?

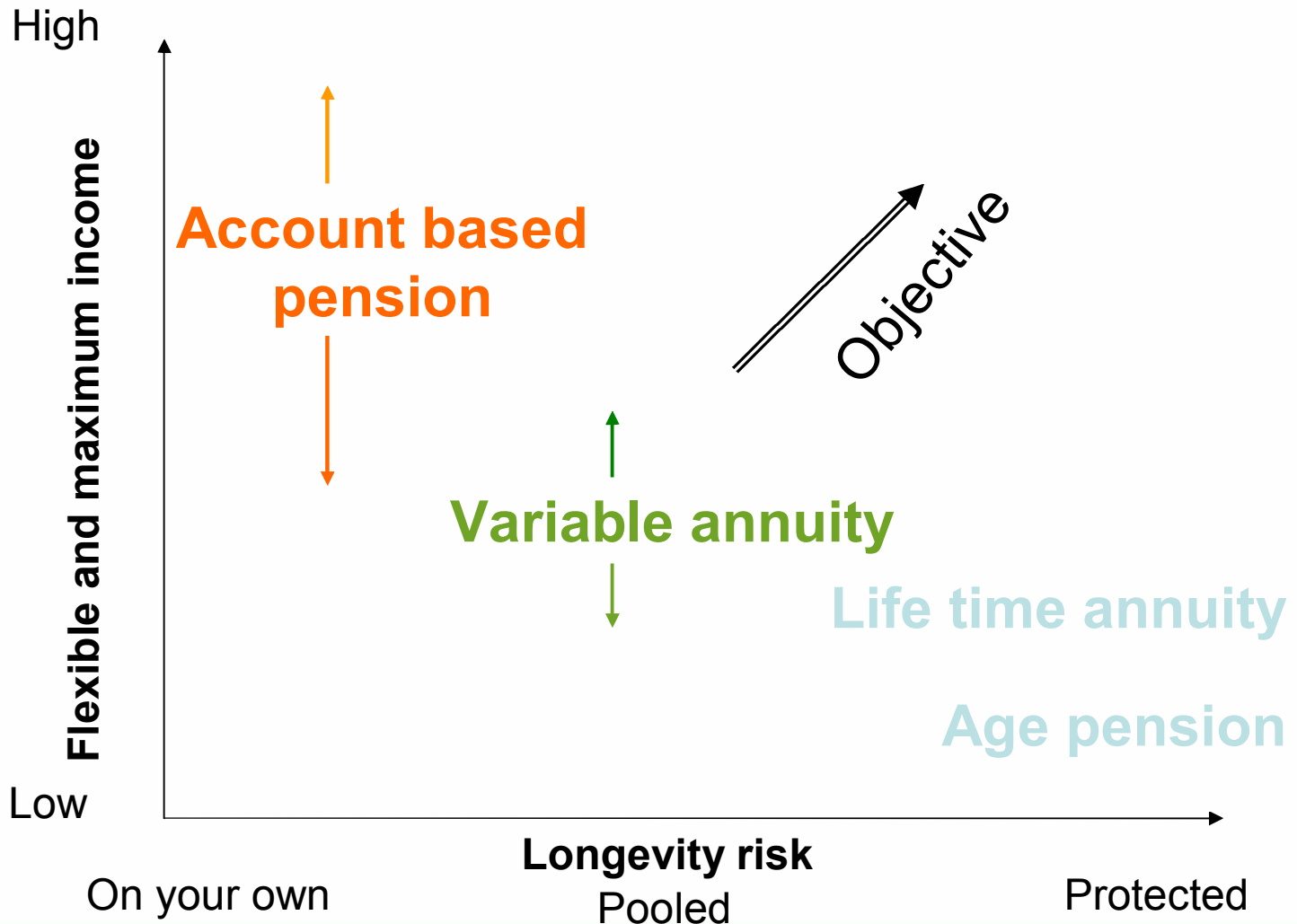


Grouping risks and options

Decumulation investment options

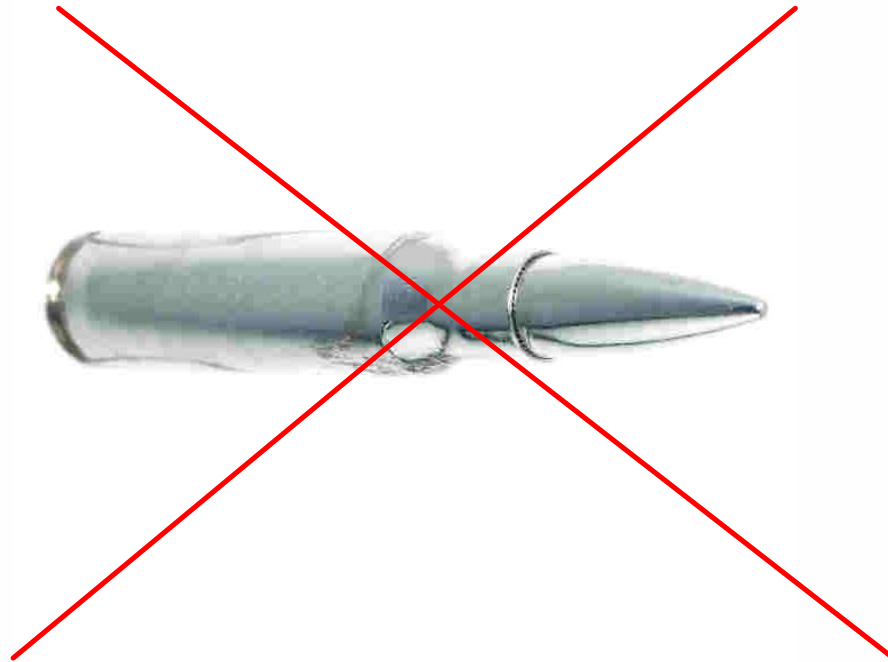


What are the retiree's needs?



The future solution!

- There is no silver bullet!



The future solution!

- Needs vary – we are not all the same
 - All generalisations are bad!
 - No-one is average!
 - Our risk profiles vary a lot!
- The system must support flexibility
 - Simple and understandable rules
 - Consistency

Summary

- Decumulation is critical in ensuring KiwiSaver lives up to its potential and that there is a clear retirement policy framework
- Currently there is a vacuum in respect of decumulation and Government Policy
- There is a range of options available
- There is not a one size fits all approach