THE UNIVERSITY OF AUCKLAND
BUSINESS SCHOOL

Retirement Policy and Research Centre

Life annuity proposal with Long term care insurance

“KiwiSpend”

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Target group (middle 40-60% of those aged 65-74)

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

The 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**

How large does an income supplement have to be?


Food


Physical activity


Housing


Social connectedness


Healthcare

Needs an extra $6-8,000 of income
Per person


Hygiene

Using updates of estimates from the School of Population Health

RPRC suggests that an extra $10,000 is a good ball park figure

BUT, the elephant in the room is long-term care

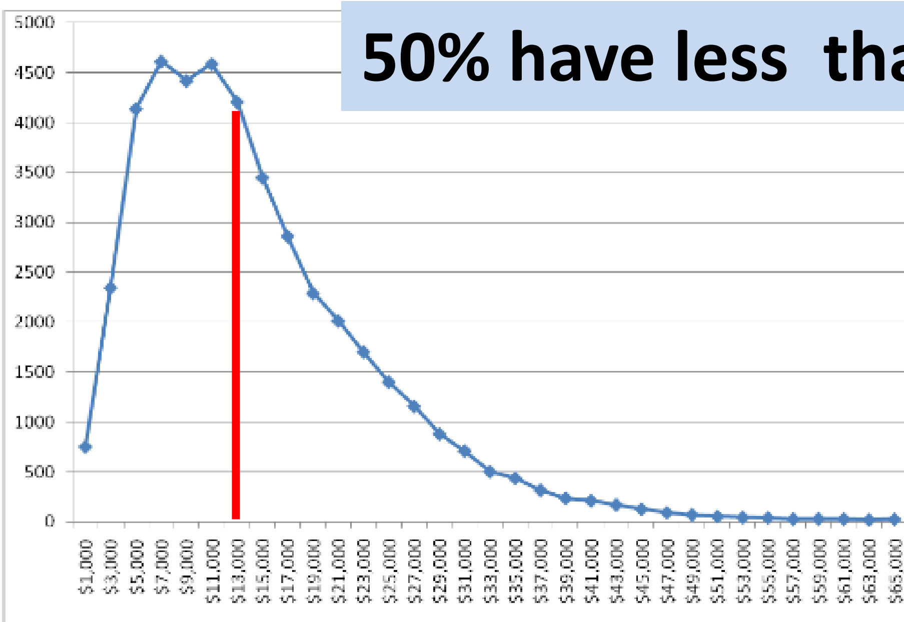
What is the average annual cost?

At least $50,000

The lucky generation

- **One in ten over 65 have a private pension**
- **22,000 private pensions 46,000 GSF**

GSF annuities in payment 30 June 2013



50% have less than $14,444

Annuities help healthy ageing

- *Retired at 58, now 100+, GSF pension*
- *Benefits of*
  - *longevity protection*
  - *inflation protection*
  - *peace of mind*
  - *End of life care*

Good for family and individual to have income stream for LTC

The value of inflation protection

A basket of goods and services
that cost $3,000.00
in quarter 1 of 1972
would have cost

$38,590.28

in quarter 3 of 2014

Total percentage change	1,186.3%
Number of years difference	42.50
Compound average annual rate	6.2%
Decline in purchasing power	92.2%
Index value for 1972 quarter 1 is	93.2
Index value for 2014 quarter 3 is	1199.0

Statement Last Updated: 19/11/2014 12:55:44 p.m.

Clear

We could wait for the private sector to develop annuity products, and Long-Term care insurance but…

- History shows they are a lottery
- Risk of inflation/longevity/ future cost projections
  - Annuitants are likely to be longer lived than general population
- Adverse selection and overheads may add another 20% to purchase price
- Long-term care insurance is fiendishly difficult to price

Or we can grasp the issue with urgency as a public policy issue

A generic **KiwiSpend product**

- **Paid for with KiwiSaver plus other saving**
- Mimic the clever advantages of KiwiSaver- branding, oversight, management

Question

Should there be a state agency to manage these income streams or should KiwiSaver providers manage KiwiSpend?

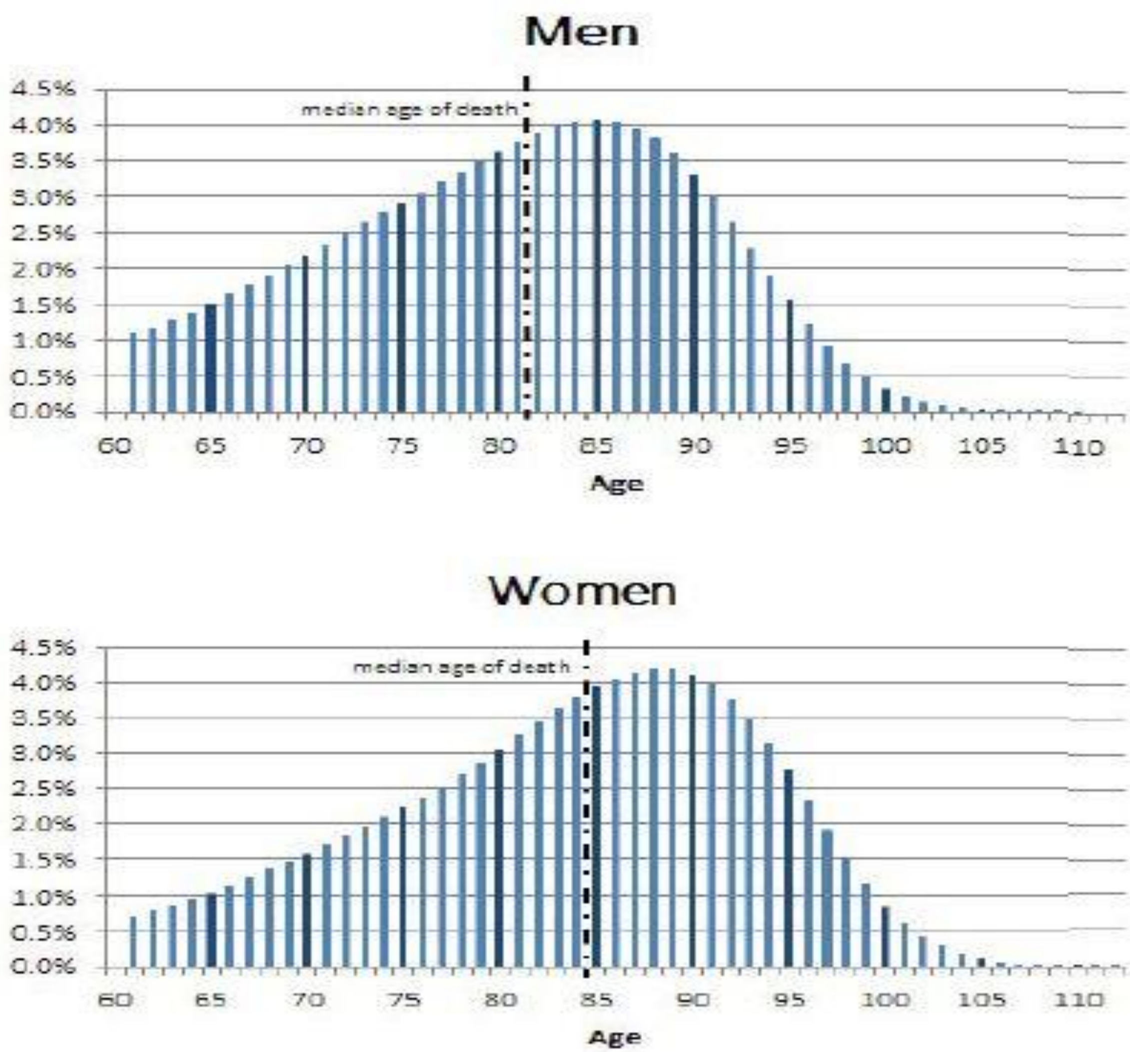
KiwiSpend: A state initiative

- One Crown agency called *KiwiSpend* (arms length)
- May offer choice but aim for max of $10,000 at age 65
- State carries inflation and longevity risk Justifications:
  - Best position to
  - Social advantages from annuitisation and better sharing costs of long-term care
  - NZ has not greatly subsidised accumulation
- Saves on overheads
- Gender neutrality

Fig 1.

Distribution of Projected Age of Death for Men and Women

Age 60 as of 2010



Source: Social Security Administration Period Life Tables 2010, authors' calculations.

Insurers differentiate on gender because they can

Other factors better…

(Brookings 2014)

Not life style, not exercise, not giving up wine, BUT

http://www.oecd.org/daf/fin/private-pensions/oecdseminaronannuitiesandpensions.htm

Shape of KiwiSpend?

- Inflation-adjusted gender-neutral Life annuity
  - Age 65-74
  - Limited to $10,000 pa to limit subsidy
  - May or may not appeal to higher income people

- Paid for at age 65 with cash and if suitable, equity share in housing

"an individual sells a portion of their home to the state in return for a guaranteed lifetime income. On death the property would be sold, the debt to the state paid and any remaining value passed to the person's estate" Mayhew & Smith (2014) Cass Business School

Currently: Asset limits for Long term care subsidy

Years	Single person	Married couple with one in care	Married couple, both in care
July 2014 **CPI adjusted**	**$218,423**	**$119,614 + house +car** ***or*** **$218,423 total**	**$218,423**

Annual capped payment for standard rest home care-

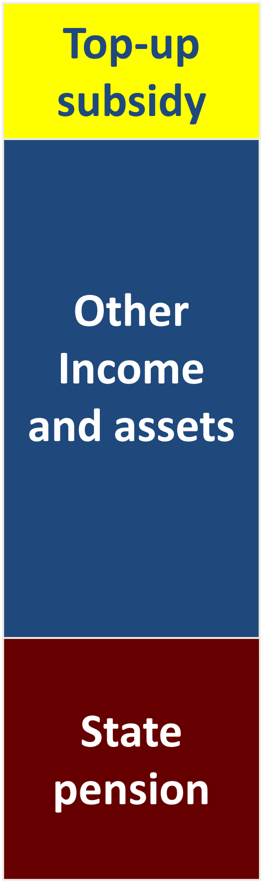
Govt carries risk of- TOP UP for **high level of care**

Individual contribution
Capped **<u>$45 - 50,000</u>**

If net NZS= **$16,600**

Basic **Kiwispend** = **$10,000**

Enhanced **KiwiSpend =** $30,000 to meet LTC costs



Failing means test

Ball park price for $10,000 inflation-adjusted life-annuity, averaged M&F- at age 65, 2% real interest rate. KiwiSpend trebles on going into LTC

KiwiSpend Without LTC	10 years certain	KiwiSpend With LTC rider	10 years certain
$144,400	**$154,200**	$157,700	**$167,900**

KiwiSpend

- State does not have to be actuarially pure
- Bears some of the risks as social insurance
- All of KiwiSpend to count as income for LTC
- **Single premium** Ages 65-74 or deferred annuity say 85+?
- Keep separate from NZS?

Could it be PAYGO?

New Ponzi scheme?

Some reserves build up as scheme matures