

# LONGEVITY AND RETIREMENT INCOME

If it feels like this problem has snuck up on us very quickly, that's because it has.

**W**hy would we tinker with the retirement income system at this moment—why now? The recent Intergenerational Report tells us very clearly that age-related expenditures in the budget are an ever increasing problem going out to 2055.

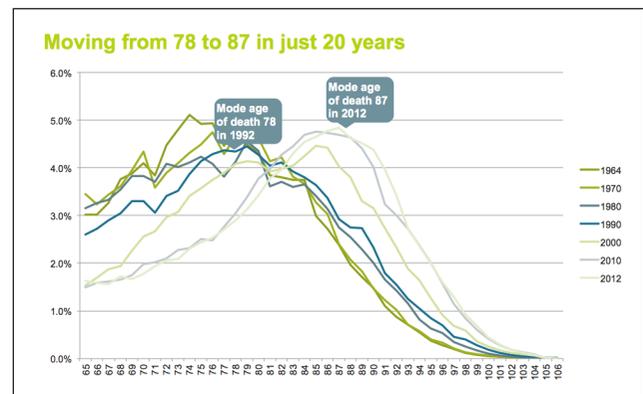
We've had baby boomers retiring at the rate of about 700 a day since 2011. We now have larger retirement balances. The superannuation system is sufficiently old that the median male is retiring with something like \$225,000. Unfortunately, his female counterpart is retiring with about half that. These amounts are not amounts to go off and buy a sheep station with, but they are amounts that you can do something sensible with in the retirement years and something that can also ameliorate to age pension costs.

We've got increasing life expectancy with averages of 88 for males and 90 for females for today's 65-year-olds — and that's ever increasing. The adjacent charts demonstrate how quickly those numbers have shot up to those levels, and please remember they're only averages, since the peak of a bell curve goes just as much in the right direction as it does the left.

We know that as people age they become less able to deal with the complex issues that surround retirement. And we've got a large financial system inquiry report still on the table that's recommending for the very first time that we really quite sharply define what the principal and secondary objectives of the superannuation system are.

I have to say that after talking about these sorts of issues for a number of years now, I think the industry is actually ready to get a much sharper product going in retirement and to look after retirees

Figure 1: Life expectancy – mode age of death



Source: Australian Bureau of Statistics

a little bit better than is being done at the moment.

What figure 1 is showing us is that in 1992 the most frequent age of death for older Australians was 78. Twenty years later, that number had gone up by nine years to 87. Over two decades, the most common age of death of Australians went up by a year roughly every two years. That gives you an idea of the pace of change. It is little wonder that this extra longevity problem feels like it snuck up on us very quickly, because in actual fact it has.

The important thing about this chart is that these are not forward projections, as you often get in the life expectancy game. These rates are looking backwards. This is the

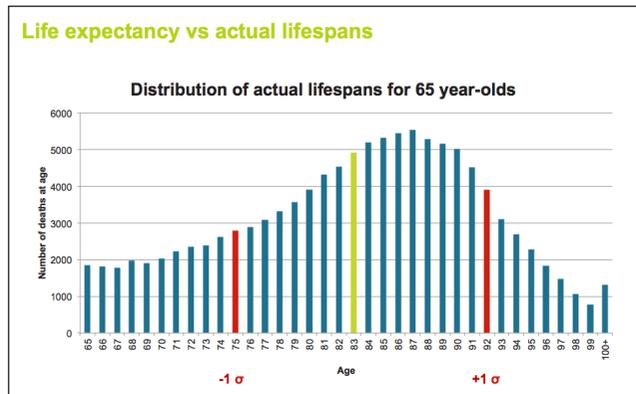


**Jeremy Cooper** is chairman of retirement income at Challenger Limited.

These remarks were originally delivered at a CIS event in Sydney in July 2015.

Bureau of Statistics saying in these years how many Australians died and what age were they. So that's the life expectancy problem illustrated for you in one particular way.

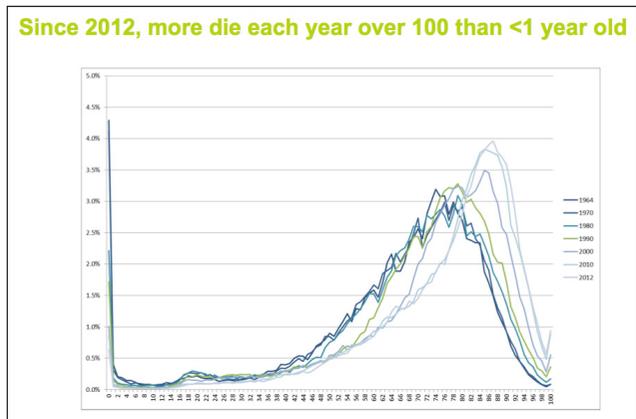
**Figure 2: Life expectancy – variability**



Source: Australian Bureau of Statistics

Another way is presented in figure 2, which looks at the variability. We all talk about these averages of life and the olive green bar in the middle is showing that in 2012 the average life expectancy was 83 and the mode is consistent with what I said before: the tallest bar there is at age 87, so that's the most common age at which people died. The red bars are what statisticians call one standard deviation either side of the average. So in two thirds of cases you'll be somewhere along that rather wide degree of variations of lifespan. Though we talk about averages, the actual challenge in retirement is that we have really no idea within this very broad range of possibilities how long we are actually going to live for.

**Figure 3: Life expectancy: generational changes**

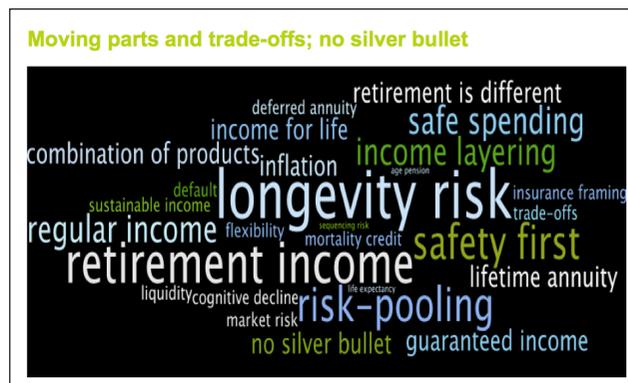


Source: Australian Bureau of Statistics

Figure 3 is a dreadfully complicated graph, but also a very happy one, because in Australia for the first time in 2012 (and it's happening every year now) we have more people dying each year who are over 100 than in the first year of life. You'll see that the peak of the very faint line is the most current data and that's showing that more and more people are dying over the age 100 because we now have four or five thousand Australians who are in that happy territory of being over 100 and we've really solved infant mortality shown on the left-hand side. A large part of that will be the indigenous population but nonetheless a very low infant mortality. These longevity stories are not all negative.

Let's think about getting better retirement income products, and this goes right to the heart of the Murray Financial System Inquiry that is on the table at the moment. Recommendation 11 went to coming up with a thing called a comprehensive income product for retirement that was meant to solve many different problems in retirement.

**Figure 4:**



Source: Australian Bureau of Statistics

The word cloud in figure 4 illustrates the number of different moving parts that are going on in a product like that, seeking to solve longevity risk, the risk of living too long and running out of money. In other words, the need to be able to spend money safely in retirement rather than taking risks. I've put words in there like 'deferred annuity,' which is a product that we're hoping will be available in Australia soon which will enable you to effectively insure against living a very, very long time. The product might provide income to you at the age of 85 and beyond, should you live that long. The

idea of the word cloud is really just to show how complex some of the issues are. But if we get them right — and we’re hoping that the government will support the recommendation for these products — they certainly will go towards helping people have more efficient retirements economically; and this will indeed reduce the burden of the age pension on the budget.

Another challenge we have at the moment is our ultralow interest rate environment. In April I wrote an opinion piece for the *Financial Review* that simply pointed out that with the ultralow long-term bond rates we have at the moment (at that point the 10 year bond rate was 2.2%), what this does is effectively increases the future cost burden of retirement.

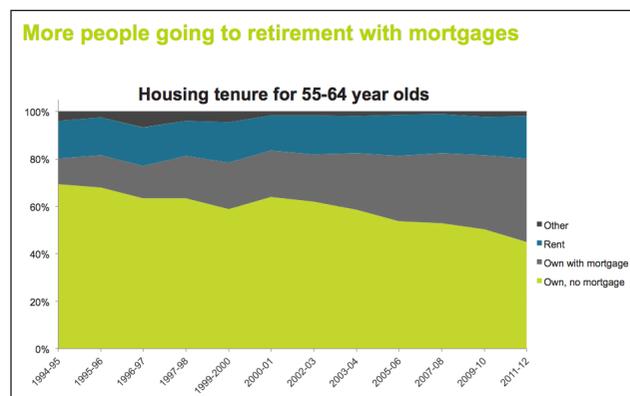
If the government was sitting down thinking how much the age pension is going to cost over the next 30 or 35 years using a very low discount rate like we currently have at the moment, what that does is it just keeps pushing those liabilities up. I pointed out if you wanted to buy the age pension from the government — which of course you can’t do but just hypothetically — if you wanted to buy a guaranteed stream of income for the rest of your life as a couple from the government, it would cost you more than a million dollars at today’s interest rates.

I was trying to stimulate some discussion about the effect of ultralow interest rates on retirement, which essentially put the cost of retirement up.

Anyway, there was a firestorm of commentary and people were very surprised at just how little \$1 million could buy. But the trick was that it was all about the interest rate. At a normal bond rate of say 6%, that cost would come down to four or five hundred thousand dollars, which we’re all relatively comfortable with. So that’s just another variable I suppose that makes retirement more complex. And indeed, if people are exhausting their retirement savings because they can’t get sufficient returns, that’s going to put additional pressure on the age pension.

Another issue is the extent to which people are carrying debt into retirement. In figure 5, the brown line is effectively showing that over a 20-year period it’s been fairly constant that about 80% of people in the 55-to-64-year-old age group own their homes. The brown sections are the proportion

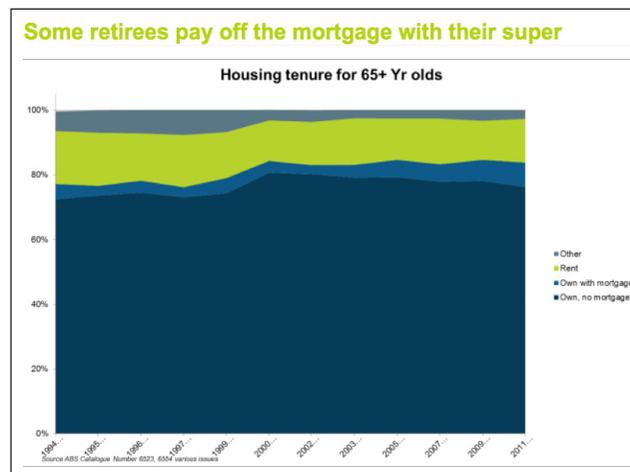
Figure 5: Debt in retirement



Source: ABS Catalogue Number 6523, 6554 various issues

of those homeowners who still have a mortgage in that age group. Twenty-odd years ago in 1994–95 it was only 10% of the cohort who owned a home and actually had a mortgage. Now over on the right-hand side, in 2010 and 2012 — which is the latest data that we’ve been able to get on this — we see that 35% of the people in that age bracket are carrying mortgages at that point.

Figure 6: Debt post retirement



Source: ABS Catalogue Number 6523, 6554 various issues

That’s a significant increase and what we think is happening, which figure 6 demonstrates, is that they are effectively pre-consuming some of their retirement savings and pouring it into the house. This is 65-year-olds plus, and what we see is that the mortgage is effectively being extinguished by the super balance. The blue line in the middle of figure 6 is showing the number of people who owned a home over 65 and still had a mortgage was 4.7%

twenty-odd years ago and is 7.5% now. So what people are doing is using their superannuation to pay off their mortgages quite late in life. There are some quite strong incentives for them to do this, which I'm sure we'll touch on later in the discussion.

The Productivity Commission has just put out a very useful report on superannuation policy post-retirement. They were looking at two things. Are people still taking lump sums out of superannuation and buying a caravan and using it for things that don't really relate to retirement; or are they tending towards investing the money in income streams and so on? They found a very strong trend towards people keeping the money in superannuation, putting it into income streams and not taking out lump sums.

We can afford old age, but we need a more efficient retirement income system.

Then they asked what would happen if we were increase the age at which you can access super — what is called the superannuation preservation age — from the current levels up to 65. What that's doing is locking off superannuation to people until much closer to the increased ages at which you can access the age pension, which is being increased to 67. In the budget it was announced that in 2035 the age pension access age would be increased to 70.

So you can see the need to keep those ages much in alignment. Because of the way that preservation age works this change would take some time to have an impact. The Productivity Commission says that if this were implemented it would save about \$7 billion annually in the budget because people

would be in the workforce longer, paying tax and building up their super. This would mean higher super balances going into retirement, which would tend to once again take pressure off the age pension.

Another interesting lever in terms of the cost of old age is how many people stay in the workforce. And it's very interesting that the OECD very recently put out a study looking at the 33 or 34 countries in the OECD and ranking them in terms of mature age workforce participation — and sadly New Zealand was ranked second and Australia ranked fifteenth. PricewaterhouseCoopers pointed out what it would look like if we could get Australia to where New Zealand is in the rankings, and some quite interesting numbers fell out of that calculation. It would add about \$24 billion to our GDP and take pressure off the budget as you would expect.

Other things have been done. Susan Ryan has been appointed as an ambassador for mature age employment. There is now a \$10,000 grant to employers who take on mature age employees and other measures recommended by the Law Reform Commission.

My conclusion is that we *can* afford old age, but we need a more efficient retirement income system. The ideas behind that are sitting behind recommendation 11 in the Financial System Inquiry. A lot of thought has gone into that, so that's something that we can implement.

There have been age pension changes announced, the entitlement age going up progressively from 67 to 70, assets test changes, and lastly the examination of the issues by the Productivity Commission in increasing the age at which we can actually access superannuation that has flow-on impacts on the age pension.