Retirees' Needs and Their (In)Tolerance for Risk

A report by

National Seniors Australia and Challenger

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Executive Summary

The most important financial needs for Australian retirees are:

- meeting their medical expenses;
- having their income last for their lifetime; and
- making sure their purchasing power keeps pace with inflation.

Addressing these three goals provides peace of mind to senior Australians, particularly when their essential living expenses are covered by regular income.

Senior Australians have a conservative attitude towards financial risk which becomes even more conservative at retirement. Indeed, 77% of seniors surveyed said they would prefer an income stream that lasted for their whole life over an investment which had a 1% higher return, but carried the risk of not lasting for their whole life time. Only 5% of those surveyed chose the higher return, higher risk, option.

Retirees focus on income to meet living expenses and they see financial risk as being not having the money when it is needed. There is not a strong alignment with the commonly used measure of volatility of returns. This highlights the need for advisers to keep discussions about risk with retirees on simple terms such as how likely it is that they will run out of money, rather than measures like "one bad year out of seven".

The Financial Needs of Retirees

Investment professionals and product providers often make claims about what retirees need. This survey asked senior Australians what was important to them. The responses highlighted a core set of concerns people in retirement or approaching retirement have about their finances. Over 90% of all seniors said that the following factors are somewhat or very important:

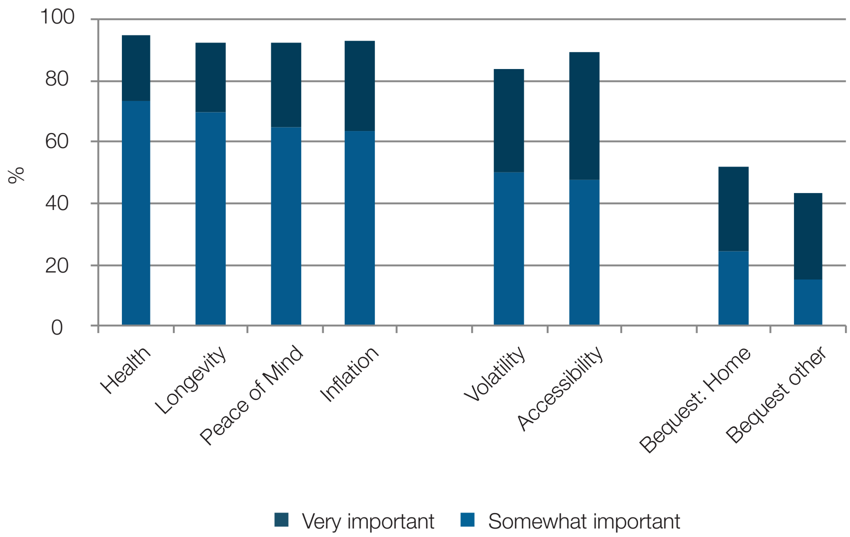
- **Health:** Being able to afford aged care and medical expenses (73.3% very important);
- **Longevity:** Money that lasts a lifetime (69.9% very important);
- **Peace of mind:** Regular income to cover the bare essentials (65.1% very important); and
- **Inflation:** Income that adjusts for inflation (63.9% very important).

There were two other objectives outside the 'top four' that were still important for Australian seniors, being:

- **Volatility:** Savings not adversely affected by market falls (50.3% very important); and
- **Accessibility:** Savings can be withdrawn instantly when needed (47.5% very important).

The other financial objective surveyed was the 'bequest motive': a desire to leave an inheritance. Interestingly, less than half those surveyed attached any importance to leaving anything beyond the family home, and almost 27% thought that leaving the family home was either not very important or not at all important.

Figure 1: *Key needs of retirees*



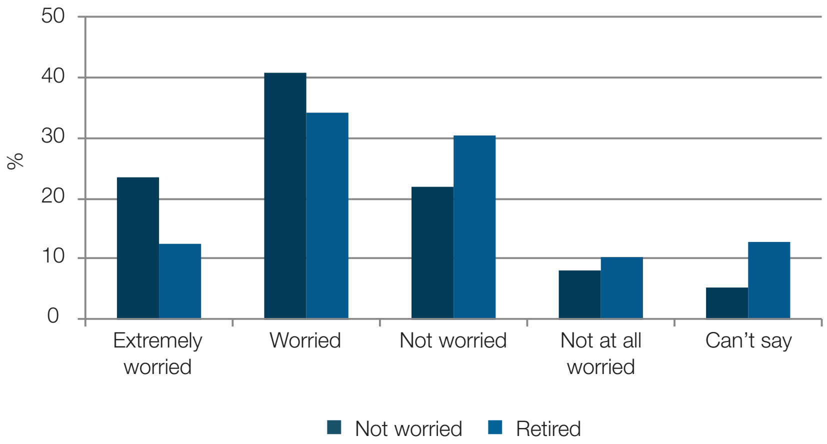
Longevity was also highlighted as an important consideration when seniors were asked (Q24) to indicate a preference for income that will be certain of lasting for life on the one hand or an investment that is expected to provide a higher return, but might not last for life, on the other. While some were undecided, a large majority, 77%, would prefer an investment with lifetime income (ie mitigating longevity risk), with only 5% opting for the higher returning investment that might not last for life. The higher 6% return is in line with the projections in the MoneySmart website for post-fee returns for a balanced pension fund, while 5% was the rate available at the time of the survey for a CPI-indexed lifetime income product.[1]

There was very little difference in the retirement objectives between those who had already retired and those who hadn't. People over 50 have a good idea about what they want in retirement and what they will need financially in order to achieve it.

Overall objectives do not vary a lot with different levels of current income (as a proxy for wealth). There is a small bias for those on low incomes (<$20k pa) to desire greater accessibility (53% of people earning less than $20k pa v 44% of people earning over $60k pa rate accessibility as very important). Some 10% of higher earners have a slightly greater preference for a higher expected return rather than having income that lasts for life, compared to 4% of lower income earners.

The survey also indicated a relatively high level of concern among seniors regarding outliving savings (Q20). 56% of seniors are either worried or extremely worried about outliving their savings. Interestingly, the level of worry for pre-retirees was higher (64%) than retirees. It may be that retirees have saved enough to be able to retire or they may have accepted a standard of living that would be more likely to last their lifetime.

Figure 2: *Percentage of seniors who worry about outliving their savings*



Length of retirement

Many people appear to underestimate how long they are likely to be retired. This is notable for those who have not yet retired. Only 17% of seniors not yet retired expected to support themselves for 25 years or more in retirement. As people continue to live longer, with improvements in health and medicine, a retirement of at least 25 years is increasingly likely for a majority of Australians. People who have been retired for some time have more realistic expectations about the total length of their own retirement. Of those retired for more than 10 years, 43% now expect a total retirement of at least 25 years. On the other hand, there is evidence that uncertainty around the length of retirement increases over time. The longer people have been retired, the more some of them have been unable to say how much longer they will have to support themselves. For those already retired 20 years or more almost half could not say how long they think they will need to support themselves.

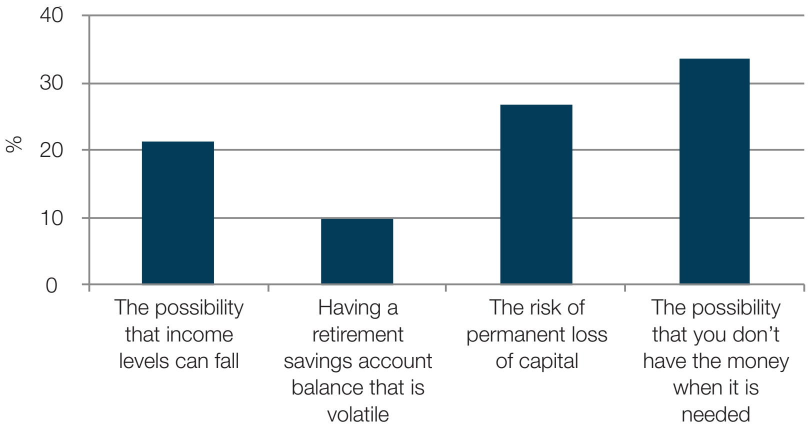
[1] *Australian Securities and Investments Commission, (2013) MoneySmart, www.moneysmart.gov.au.*

Attitudes to Risk

Understanding Risk

Understanding retirees' attitudes toward risk was the main objective of this survey. To be clear about these attitudes, it is important to understand exactly what risk means to retirees. From a limited range of options, more seniors considered risk in direct terms, with the least preferred response being one that is commonly used in the wealth management industry, the volatility of investment capital.

Figure 3: *What is risk in retirement?*



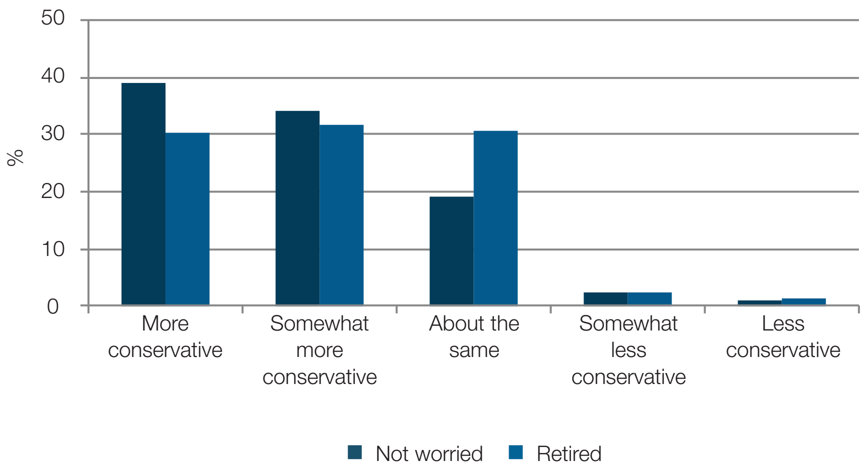
There was a difference in responses from those who had already retired. Retirees have a greater concern over a potential fall in income (25% of retirees v 18% of non-retirees) and place less emphasis on the possibility that they don't have the money when it is needed. Those on lower incomes also preferred to think of risk as money not being available when needed (42%) while a larger proportion of those with the highest income levels (14%) thought about risk in terms of volatility.

The responses highlight the need for financial advisers and superannuation funds to be clear when talking about risk. The statement that a retiree won't have the money when it is needed would be a better description of risk than a reference to volatility. Another common volatility measure, which was not surveyed here, is the number of losses in 20 years as per the Standard Risk Measure produced by the Association of Superannuation Funds of Australia and the Financial Services Council. Research from Australian universities has highlighted that frequency of losses are not easily understood as risk measures.[2] This survey supports those findings, suggesting that simple descriptions might be better.

Change in Risk Appetite at Retirement

There is a shift to a more conservative approach to managing finances once people retire. As the responses to Q25 highlight, a majority of retirees take a more conservative approach with their finances compared with before they were retired, and an even larger majority of pre-retirees expect to be more conservative after they retire.

Figure 4: *How did/will your investment strategy change at retirement?*



[2] *See Bateman, H, C Eckert, J Geweke, J Louviere, S Satchell and S Thorp (2011), `Financial Competence, Risk Presentation and Retirement Portfolio Preferences', Australian School of Business Research Paper No. 2011ACTL03. Available at SSRN: http://ssrn.com/abstract=1776528.*

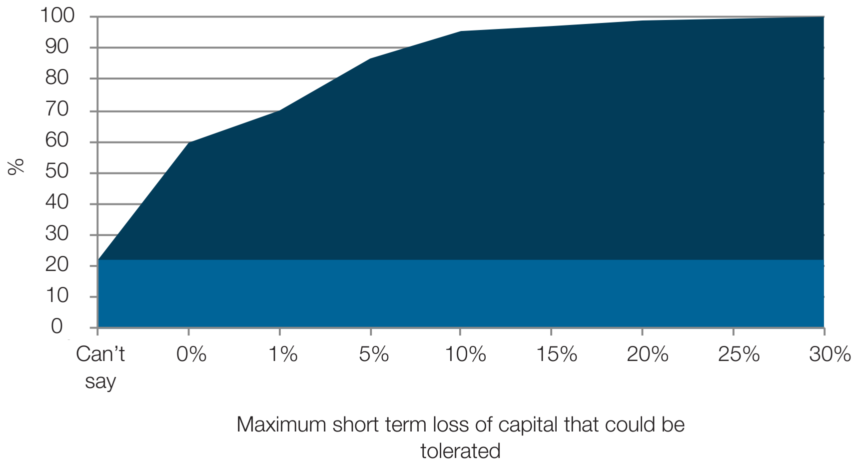
While almost a third of retirees reported maintaining a similar risk appetite in retirement, it was evident that this was correlated with income. That is, retirees with higher incomes were more likely to have reported a similar level of conservatism (48% for retirees earning over $60k pa) after retirement. For those not yet retired, the pattern was not repeated. The data indicate that higher earners still expect to be more conservative, but that they may only be somewhat more conservative after they retire.

There is clear evidence here that moving into retirement is a time when people want to be more conservative with their finances. Several questions in the survey attempted to determine just how strong risk aversion is for retirees.

Measures of Risk Aversion

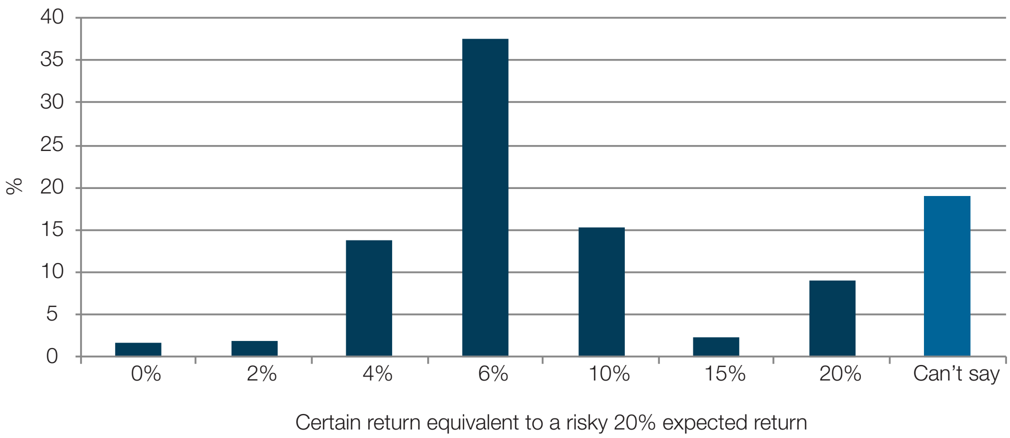
A striking result was that nearly 38% of seniors responded (Q29) that they would not tolerate any loss in their retirement savings over a one-year period. While some did not quantify a response, only 13% would tolerate a loss more than 5% in any one year. Interestingly, there was not much difference in the responses between those people already retired (39%) and those still working (37%). There was, however, a much larger difference in attitude for different levels of income. Lower income earners were much more likely (47%) to say that they would not tolerate any loss than higher income earners (30%).

Figure 5: *Proportion of respondents who can't tolerate losses higher than…*



Risk aversion was also measured by asking for a preference between a simple risky outcome and a guaranteed outcome. Two different approaches produced different results in the survey. In the first approach, respondents were asked about investment preferences for a $10,000 investment. One risky outcome had a potential loss of 10% or a 50% gain, with an expected return of 20%. For the guaranteed return, only 9% opted for a risk neutral 20% return, with 55% seeking only a 6% return or less. 19% did not quantify a response. The weighted average of those who provided answers was that an 8% guaranteed return was seen as having the same value as a risky expected 20% return.

Figure 6: *Certain return equivalent to a risky, 20% expected return*



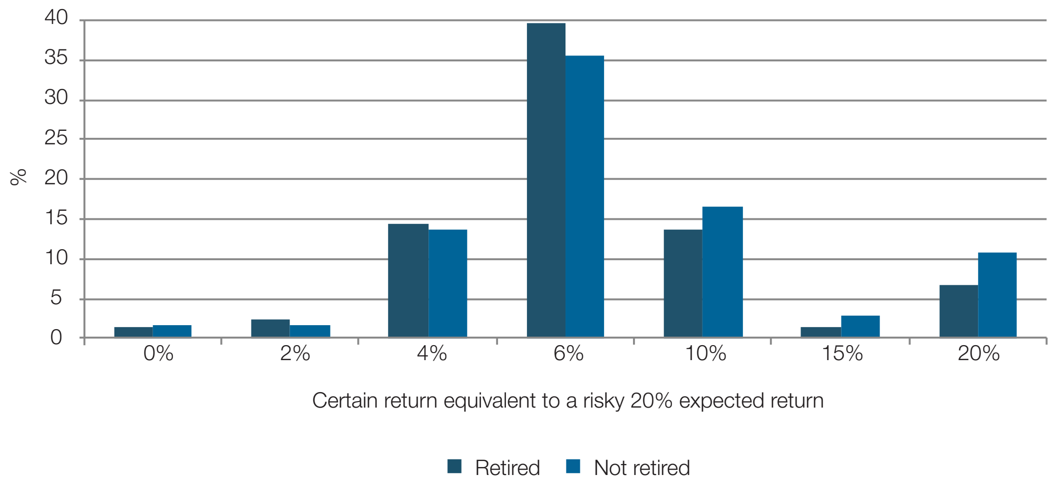
For the second approach, the risky investment had a 50% chance of losing all its capital and a 50% chance of having a return; the respondent was asked how high the return would have to be for them to invest. Two different investment amounts were used. $1,000 was used as a match to the potential loss in the first example, and a $10,000 investment was used to assess if having a larger amount of capital at stake affected people's risk appetite. Most people said they would not want to make such a risky investment: 52% in the case of the $1,000 investment and 64% for the $10,000 investment said they would not invest.

An interesting outcome with this approach was the relatively high number of risk-seeking responses. 14% of the responses indicated that an even chance of a 75% return was enough to cover the risk of losing all of the $1,000. A further 11% were prepared to take the double-or-nothing option of an even chance of win or lose the $1,000. The responses were slightly lower with $10,000 at risk at 10% and 7%, respectively.[3]

Retirees are More Risk Averse

Retirees indicated a higher level of risk aversion than their non-retired counterparts. They were willing to accept a lower certain return (7.4% v 8.4%) as equivalent to a risky 20% return and a greater number of retirees did not wish to take on any investment if all the investment capital could be lost (56% v 48%).

Figure 7: *Different risk aversion for retirees*



Summary

Australian seniors have some very important financial objectives for their retirement savings. The most important objectives relate to having an income stream that is maintained, and being able to cover the required health and medical expenses when necessary. Participants saw some benefit to being able to access capital, but this was not as important as the income factors. The survey also highlighted that the majority of respondents do not rate leaving any estate, and almost half leaving the family home, as important financial objectives.

Seniors in Australia are also relatively risk averse in their financial attitudes, and this risk aversion typically increases once a person retires. Retirees perceive risk in terms of potential impact to their income and whether or not money will be there when it is needed. The concept of volatility as risk is not something that resonates well with many seniors, regardless of whether or not they are retired.

[3] *The risk-seeking behaviour was out of line with other results, so it may also be the case that the question was mis-understood, and some did not realise that the expected return was negative.*

Appendix 1: Survey Design and Responses

The data in this report are taken from the National Seniors Social Survey Wave 2. This survey was conducted in August 2012 among members of National Seniors Australia aged 50 years and over, and results weighted to make them representative of the total Australian population aged 50 years and over.

A total of 10,000 members were selected to complete the survey. The sample was stratified by age (50-64, 65-84, 80+ years), sex and state/territory. The number of respondents allocated to each of the strata was calculated proportionally to reflect the Estimated Resident Population in Australia aged 50 years and over in June 2010. The respondents within each stratum were selected randomly from the database of over 200,000 National Seniors Australia members, ensuring two members from the same family were not chosen.

A paper survey questionnaire was mailed to each of the 10,000 selected members, and respondents could complete the paper questionnaire and return by mail or complete the questionnaire online. A total of 1,976 surveys with sufficient information were completed and returned (overall response rate of 20%). Survey weights were applied to each combination of age, sex and state/territory, to adjust for differences in response rates by these population groups and to make the results representative of the Australian population aged 50 years and over.

The National Seniors Social Survey Wave 2 comprised a financial, health and social module, as well as a range of demographic and socio-economic measures. Information from the financial module, together with demographic and socio-economic data, was used in this report.

Appendix 2: Questions and Responses

Q18: *Importance of each attribute in terms of importance for your savings and finances in retirement (% of all respondents)*

	Not at all important	Not very important	Neutral	Somewhat important	Very important	Total
Regular constant income that covers my bare essentials	1.0	1.5	5.2	27.2	65.1	100.0
Income that adjusts to rising prices (or inflation) over time	1.0	0.9	5.1	29.2	63.9	100.0
Accessible savings/ capital that can be withdrawn instantly or when needed	0.6	1.1	8.9	41.8	47.5	100.0
Money that lasts my lifetime	1.1	0.6	5.7	22.6	69.9	100.0
Leaving the family home to the children/ estate	12.7	14.2	21.5	27.2	24.5	100.0
Something that I can leave for my children, estate, etc., other than my family home	14.1	16.5	26.1	28.1	15.2	100.0
Being able to afford aged care and medical costs	0.8	1.0	3.5	21.5	73.3	100.0
Savings not adversely affected by short term falls in financial markets	2.0	2.2	12.1	33.4	50.3	100.0

Q19: *How long plan to support yourself in retirement (% of retired/ not retired)*

	Not retired	Retired
Less than 5 years	15.6	5.3
5-9 years	9.4	9.2
10-14 years	9.2	13.4
15-19 years	7.4	10.4
20-24 years	19.0	13.1
25-29 years	8.8	7.9
30 years or more	8.6	8.4
Will not support myself (non-ret.)/ don't have means to support myself anymore (ret.)	3.1	6.7
Can't say	18.9	25.7
Total	100.0	100.0

Q20: *Worried may outlive savings and investments (% of all respondents)*

	%
Extremely worried	18.3
Worried	37.8
Not worried	25.8
Not at all worried	9.3
Can't say	8.8
Total	100.0

Q21: *Expectations, on average, of spending compared with income earned on capital in retirement (% of all respondents)*

	%
Spend a lot more than the income (ie, spend a lot of your capital each year)	6.8
Spend a little more than the income (ie, spend a little of your capital each year)	42.1
Spend only your income (ie, spend none of your capital each year)	26.6
Spend less than your income (ie, continue to grow your capital)	12.8
Can't say	11.8
Total	100.0

Q22: *Which of the following statement explains risk in retirement (% of all respondents)*

	%
The possibility that income levels can fall	21.3
Having a retirement savings account balance that is volatile	9.7
The risk of permanent loss of capital	26.7
The possibility that you don't have the money when it is needed	33.7
Can't say	8.6
Total	100.0

Q23a: *Impact of availability of Age Pension on comfort in taking on greater risk (for a greater return) for investment of some or all of retirement savings (% of all respondents)*

	%
Very comfortable	2.4
Somewhat comfortable	17.3
Has no impact	41.5
Somewhat uncomfortable	15.1
Very uncomfortable	11.0
Can't say	12.6
Total	100.0

Q23b: *Likelihood of taking on more risk with investment of remainder of retirement savings if could buy another pension for life that paid more than Age Pension (% of all respondents)*

	%
Very likely	3.8
Somewhat likely	15.0
Neither likely nor unlikely	20.7
Somewhat unlikely	29.6
Very unlikely	17.7
Can't say	13.2
Total	100.0

Q24: *Preference of the following investment options (% of all respondents)*

	%
Investment that generates 6% per annum in long run, but on average will not last your whole lifetime	5.2
Investment that generates 5% per annum in long run, but guaranteed to last your whole lifetime	77.2
Can't say	17.6
Total	100.0

Q25: *How conservative expect to be with your finances (ie trying to avoid losses) after you retire compared with now (% of not retired), how conservative have you been with your finances (ie trying to avoid losses) since you retired compared with before you were retired (% of retired)*

	Not retired	Retired
More conservative	39.1	30.2
Somewhat more conservative	34.3	31.6
About the same	19.2	30.6
Somewhat less conservative	2.3	2.4
Less conservative	0.8	1.2
Can't say	4.4	4.0
Total	100.0	100.0

Q26: *Lowest amount of certain return from $10,000 preferred after one year if also have option for investment that, after one year, has 50% likelihood of growing to $15,000 and 50% likelihood of falling to $9,000 (% of all respondents)*

	%
$10,000 return (0% gain)	1.6
$10,200 return (2% gain)	1.9
$10,400 return (4% gain)	13.8
$10,600 return (6% gain)	37.5
$10,000 return (10% gain)	15.2
$11,500 return (15% gain)	2.2
$12,000 return (20% gain)	9.0
Can't say	18.9
Total	100.0

Q27: *Minimum return wanted from investment of $1,000 that, after one year, has 50% likelihood of losing the $1,000 and 50% likelihood of making a return (% of all respondents)*

	%
$1,750 return (75% gain)	13.8
$2,000 return (100% gain)	11.2
$2,500 return (150% gain)	2.6
$3,000 return (200% gain)	2.5
$4,000 return (300% gain)	2.2
I would not make an investment this risky	52.0
Can't say	15.7
Total	100.0

Q28: *Minimum return wanted from investment of $10,000 that, after one year, has 50% likelihood of losing the $10,000 and 50% likelihood of making a return (% of all respondents)*

	%
$17,500 return (75% gain)	9.7
$20,000 return (100% gain)	6.9
$25,000 return (150% gain)	2.0
$30,000 return (200% gain)	1.5
I would not make an investment this risky	63.9
Can't say	16.0
Total	100.0

Q29: *Largest loss in retirement savings that would tolerate over one year, thinking about long-term goals for retirement savings (% of all respondents)*

	%
Cannot tolerate any loss	37.6
1% loss	10.3
5% loss	16.7
10% loss	8.8
15% loss	1.6
20% loss	1.8
25% loss	0.6
30% loss or more	0.6
Can't say	22.1
Total	**100.0**

Q30a: *How long would expect for capital to grow back to recover this loss (% of all who can tolerate some loss in retirement savings)*

	%
Less than 1 year	6.3
1-2 years	39.2
3-4 years	32.6
5-7 years	11.6
8-10 years	2.9
11 years or more	0.4
Can't say	7.1
Total	**100.0**

Q30b: *During period that capital is growing back, how likely to spend some of the capital to meet living needs (% of all who can tolerate some loss in retirement savings and state a period that they expect capital to grow back)*

	%
Very likely	20.1
Somewhat likely	42.9
Somewhat unlikely	22.4
Very unlikely	10.3
Can't say	4.4
Total	**100.0**

ABOUT NATIONAL SENIORS AUSTRALIA

National Seniors Australia is the leading independent voice of over 50s in Australia. As the nation's largest not-for-profit organisation for over 50s, we represent the views of older Australians and their families to governments of all levels, on issues ranging from age discrimination and mature age employment to the age pension and health and aged care. Founded in 1976 and now with more than 200,000 members, we provide unrivalled access to policy makers, Innovative and practical research and a raft of commercial benefits to our members. Every day, National Seniors Australia seeks to improve the quality of life for mature age Australians.

For more information about National Seniors Australia visit **www.nationalseniors.com.au** or call **1300 76 50 50**.

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