2007 Review of Retirement Income Policy

Retirement Commission
Whiriwhiria!

CONTENTS

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As Retirement Commissioner, my work contributes towards three key elements which together help New Zealanders to prepare financially for their retirement:

1 Stable, effective government policy.

2 A trusted financial services sector.

3 A financially educated population.

One of my statutory duties is to regularly prepare an independent assessment on the first item above: how effective and stable our government's retirement income policies are. This Review is important as it brings a non-political, fact-based assessment to a long-term issue that can be too easily driven off course by political, emotive or short-term expediencies.

I, and the independent experts who have worked with me on this report, have been mindful of all three elements above as we have undertaken this Review.

A huge amount of work is already in progress by the Ministry of Economic Development on potential regulation of financial products, services and advisers to help develop a trusted financial services sector. The second item of the framework is therefore not a focus for this Review, and should be addressed in greater detail in the next Review, in 2010.

This Review is a summary of a number of complex issues. Several background papers were commissioned for it. To keep it accessible, many of the details have not been repeated; but I urge interested readers to read these papers for the full picture. They are available on the Retirement Commission's website www.retirement.org.nz.

I established an Advisory Group to assist me with this Review. The feedback from the members of this Group has been invaluable to me as I have undertaken the Review, and I thank them for it. I would also like to acknowledge and thank many others for their assistance with this Review:

» All of those who sent submissions, with especial appreciation for the high standard of these.

» The many other people who met to discuss the content and progress of the Review, particularly the Reference Groups.

» The members of the Project Team, particularly Anna McMahon and Alison O'Connell, who made sure this review drew on all relevant information and delivered within the required timeframes.

» All of those in the Retirement Commission who provided varied support throughout the course of this project.

The views expressed in this report are those of myself as the Retirement Commissioner.

We hope that this Review helps to deepen our shared understanding of current retirement policy and where it is heading.

Diana Crossan

RETIREMENT COMMISSIONER

Executive Summary

New Zealand has had, whether by luck or good management, a straightforward and stable retirement income framework for some time.

New Zealand Superannuation (NZS) is a remarkably effective, simple and secure foundation for retirement income. It means that New Zealanders – and especially women – are less at risk of hardship in later life than people in many other developed countries. The current structure of NZS – a benefit defined as a proportion of the average wage, paid to people eligible on the basis of residency and age – should be maintained.

More people are reaching the age at which they can receive NZS, and living longer thereafter. Decisions will need to be faced on how and when to react to this trend. More work is needed to understand better the likely future longevity of New Zealanders, and to assess possible policy options. That work should start now, so that decisions can be made in time for a long notice period to be given to those affected by any adjustment.

The question of whether New Zealanders collectively are saving 'enough' for retirement is important, but unanswerable. We cannot know how saving behaviour will change in future, or whether savings will meet expectations at retirement. Now that we have an accessible, portable and highly incentivised savings scheme in KiwiSaver, this Review finds no reason to financially incentivise saving for retirement further, or to make it compulsory.

Savings policy encourages the aspiration to have more than NZS in retirement. Not everyone will be able to save for retirement at all times, especially if on a low income. NZS may meet the retirement income expectations of some people on the lowest incomes. The savings debate needs to reflect the variety of individual financial circumstances and choices. The debate should also reflect that for many people, buying a home to live in is a crucially important part of preparing for retirement.

KiwiSaver has brought additional complexity and new fiscal risks, because of the high cost of the generous new incentives. Government will need to evaluate the outcomes and cost of KiwiSaver fully. Will New Zealanders' retirement finances improve overall? Will those who find it hard to save unfairly miss out on the incentives? Can New Zealand continue to afford the current level of KiwiSaver incentives?

Having a savings plan in the workplace should make it easier to save, and possible to save without making many active decisions. However, many New Zealanders are now facing complex investment decisions for the first time. More should be done to give consumers clear and helpful product information, for example, to enable comparisons of the cost of KiwiSaver products. To improve financial decision-making skills, financial education should be enhanced as an integral part of government policy.

Paid employment at older ages is likely to be an important source of income for many people. Although there are now no legal barriers to working at older ages, negative attitudes still exist. This Review supports efforts to make it easier for those older people who want to remain in employment to do so.

More needs to be done to help people manage their money throughout retirement. Government may be able to ease some barriers to the provision of annuity and home equity release products. So that people can choose between all the options with confidence, the Retirement Commission's information role can be stepped up.

Merits of New Zealand's current retirement income policy

In general, this Review agrees with the assessment of the 2003 Periodic Report of retirement income policies that New Zealand retirement income policy is working reasonably well for the currently retired and those approaching retirement.

NZS has been remarkably successful in providing retirement income adequacy for most older residents, at a cost level which is lower than that of the public pension systems of most other developed economies. It scores well on the traditional criteria for assessing retirement income policy in New Zealand: adequacy, simplicity, flexibility, certainty, fiscal affordability, equity and fairness. NZS is much admired because:

» It is virtually universal, keeping the basic income of nearly all older New Zealanders above the hardship level.

» The living standards of older people relative to others are maintained by generally increasing NZS in line with average wages.

» It gives older people a regular basic income regardless of how long they live, so is a protection against longevity risk.

» It treats men and women equally, independent of marital status or income history.

» It does not discourage saving, or employment at older ages.

» It is simple to explain and run.

» It operates at a low administrative cost.

» Its long-term sustainability as the population ages is helped by the NZS Fund.

To complement the state provision of NZS, KiwiSaver provides a private savings vehicle designed to enable people to build up some financial assets for use primarily in retirement. KiwiSaver should make the biggest difference to young people: the longer people have to save, the more they will be able to accumulate. The introduction of KiwiSaver into retirement income policy has some key advantages:

» KiwiSaver is simple to join and stay in. Employees are auto-enrolled and others can opt in. The KiwiSaver account is portable on changing jobs.

» KiwiSaver saving is made from pay before there is a chance to spend the money, and most is generally locked-in until age 65. It is an easy way to make retirement savings for those that can afford to do so, but need some discipline to start and keep saving.

» There are generous incentives for saving in KiwiSaver and for first house purchase. This will help savers to build up financial assets alongside buying a home.

» Because KiwiSaver is voluntary, individuals have to make decisions about their own account. This may help to improve consumers' understanding of saving.

» KiwiSaver, it is hoped, will stimulate New Zealand's capital markets and strengthen the economy.

» The voluntary rather than compulsory nature of KiwiSaver means that government avoids an open-ended guarantee on the value of future retirement benefits.

KiwiSaver is consistent in outline (although not in design detail) with the proposals of the Savings Product Working Group, which was set up following the 2003 Periodic Report.

Concerns and risks identified by this Review

While the basic principles and structure of New Zealand's retirement income policy are sound, this Review identifies some concerns about the direction of policy, and risks to its long-term sustainability. The major issues are outlined below. These and others are discussed in later sections.

New Zealand Superannuation (NZS)

» Given the effectiveness of NZS, it is important to know that it can continue as the number of recipients increases. There is great uncertainty in how fast life expectancy will increase. It seems likely that people will live longer than current policy planning expects. This would lead to NZS costing more than currently envisaged.

» There is some confusion in the way in which NZS works for some people who migrate in or out of New Zealand. This is because eligibility for NZS is on the basis of residency, and generally entitlement is 'all or nothing'. This works well for the majority of New Zealanders, but differs from the way eligibility is determined in other countries.

The savings debate

» Assessment of the adequacy of current levels of saving for retirement is hampered by insufficient data and by the complexity of the analysis needed. Interpretation of findings on saving is not straightforward. Indications are that most over-45 year olds are saving 'enough' to smooth their pre-retirement spending into retirement, although a minority of 45-54 year olds may not be. However, it is not clear how much of a problem this is, or will be in future.

» Younger people have always had lower net worth and have saved less than older people. The available data does not conclusively prove that successive younger age cohorts are saving less than previous cohorts of the same age. However, there are some signals that the retirement income of today's under-45s may be of more concern than that of today's over-45s.

» Low earners, those who earn irregularly or take career breaks, and those who take on caring or cultural commitments are not well placed to save consistently for retirement. The savings debate tends not to reflect the difficulties of low-income savers.

» Home ownership is falling in all age groups. House prices have increased markedly, and buying a home through a mortgage takes more income than it used to. The standard of living in retirement is better for those who own the home they live in mortgage-free. But as more income during working life is needed to pay the mortgage, additional saving for retirement becomes more difficult.

KiwiSaver

» KiwiSaver's generous incentives will compound the gap in retirement income between those who have saved and those who have not, threatening the equity and fairness of current retirement income policy.

» The introduction of KiwiSaver has made retirement income policy more complicated, and more likely to be subject to change. Stability of policy is important so that New Zealanders can have confidence in the future of KiwiSaver.

» KiwiSaver has made retirement income policy more expensive. Treasury has estimated that the cost of KiwiSaver incentives will exceed $2 billion a year by 2016, but has not estimated how the cost may grow beyond then.

» Fee levels and asset mixes in default KiwiSaver funds are different, so that savers risk lower retirement funds purely as a result of the random assignment process.

The financial markets, information and education

» New Zealand needs high standards in product information, investment management, selling practices and consumer protection. It also needs an efficient capital market. The Ministry of Economic Development's review of the financial sector is vital. However, implementation will not start before 2010.

» High standards in investment product cost disclosure will become more important. In particular, choosing a KiwiSaver fund is more difficult than it needs to be, as product costs are disclosed in different ways, making consistent comparisons near-impossible.

» Given the more complex financial decisions active consumers now face, there is scope to extend and improve financial education. But current initiatives are uncoordinated, and not easily accessible to all, in particular in schools. What works best in financial education is not well understood.

Employment of older people

» Employment at older ages can make a significant difference to individuals' financial and general well-being in later life, and also to the nation. New Zealand has one of the highest labour participation rates for older people among OECD countries, and it is growing. However, barriers to older people working if they want to still exist. There are initiatives aimed at helping older workers to find and stay in employment. These initiatives may not be learning enough from each other.

Managing assets and income in retirement

» The decisions on how to manage money through retirement are individual, often complicated, and may present challenges to many older people. Further, there are anecdotal cases of older people suffering financial abuse.

» There are virtually no annuities sold in New Zealand. They may become more popular as people retire with accumulated KiwiSaver savings. There are some major barriers to the development of annuities, not least the uncertainties of longevity risk, and the taxation of annuities, which makes them poor value for money.

» Home equity release can provide modest amounts of capital in retirement for some older people, but would not be right for everyone. There has so far been limited demand for such products. Given the vulnerability of the potential customers, good regulation needs to be assured. There is some confusion on the interaction of home equity release products with state benefits.

Taxation issues

» Tax neutrality between asset classes has generally improved, with a bias now towards retirement saving through the KiwiSaver incentives. The complexity of personal taxation has increased. As older people's income reduces, those who are no longer required to fill in a tax return may be left paying tax at a higher level than they should.

This Review discusses actions to address each of these concerns. The next section summarises the main recommendations of the Retirement Commissioner.

Summary of recommendations

To address the concerns and risks in retirement income policy identified in this Review, the Retirement Commissioner recommends:

General

1. That these independent Reviews of Retirement Income Policy continue on a 3-yearly basis, because retirement income policy is complex and involves many agencies (page 23).

2. That the Retirement Commissioner, by mid-2009, reports on progress made on the recommendations set out in this Review to the Minister of Social Development and the Minister of Finance (page 23).

3. That, in the interests of having a comprehensive fact base for evaluating retirement income policy, special surveys, notably the Living Standards Survey, the Survey of Family Income and Employment (SoFIE), the Household Savings Survey (HSS), and the Financial Knowledge Survey, are continued and enhanced where necessary (page 24).

4. That the Retirement Commission works with Treasury and the Ministries of Social Development and Health to ensure that there is an appropriate research programme in place to assess how the costs of health, residential and in-home care for older people will impact on their personal finances (page 25).

New Zealand Superannuation (NZS)

5. That the basic structure of NZS be maintained (page 29).

6. That political consensus is sought for any future changes to the parameters of NZS, and such changes are made with long lead times in order to allow individuals to adjust their retirement planning (page 29).

7. That Treasury, by end 2008, reports on the necessity, feasibility and implications of options for the future financing of NZS, because there are likely to be more recipients of NZS in future, with longer life expectancies (page 34).

8. That, by mid-2008, the Government completes its review of the 'portability' aspects of NZS for people who migrate to or from New Zealand, and announces its decisions, and that the Ministry of Social Development takes steps to clarify the decision and appeals process for unusual NZS cases (page 36).

The savings debate

9. That the Retirement Commission, in 2008, develops financial education initiatives targeted for those on low incomes, including Māori and Pacific groups (page 43).

10. That the messages of government and other public bodies on the concern that New Zealanders tend to over-invest in residential property are referenced to multiple housing investment, and that such messages reflect that investing in a mortgage to buy a home to live in is an important part of preparing for a good retirement (page 45).

KiwiSaver

11. That Inland Revenue fulfils and extends its plans beyond 2013 to evaluate KiwiSaver on the *outcomes* from the policy, in particular, whether KiwiSaver has improved retirement wealth overall for households, and what its distributional impact has been. That these outcomes are examined by analysing the spread of take-up and the value of incentives received by different households: by income level, gender, ethnicity, age, whether disabled, and employment status (page 52).

12. That Treasury, by mid-2008, publishes the likely future fiscal cost of KiwiSaver on different demographic and economic scenarios, with commentary on its sustainability in its current form over short-, medium- and long-term time periods (page 55).

13. That the Ministry of Economic Development, by mid-2008, reports on whether KiwiSaver default funds should have the same level of fees, on the prescription of asset mix, and on any other changes to default fund legislation in order for passive KiwiSaver members to stand a fair chance of even outcomes (page 56).

The financial markets, information and education

14. That the government instructs the Ministry of Economic Development to fast-track the intended regulation of financial advisers (page 60).

15. That the 2010 Review of Retirement Income Policy considers the progress in implementation of the Ministry of Economic Development's widely-supported initiatives to develop high standard consumer protection and market conduct regulation in the financial sector (page 60).

16. That the Retirement Commission, working with the savings industry, keeps its comparison information on the cost of KiwiSaver products up to date and accessible to the general public (page 62).

17. That the Ministry of Economic Development considers, as part of its ongoing review of the financial sector, whether the number of fee types for savings products, including KiwiSaver, should be restricted, and whether disclosure of fees on a 'one figure' comparable basis should be mandatory (page 62).

18. That the Ministry of Education, from 1 July 2009, takes responsibility for the schools project currently within the Retirement Commission, to ensure that financial education is embedded in the schools curriculum (page 64).

19. That the Retirement Commission maintains and enhances its workplace-based information and education programme (page 64).

20. That the Retirement Commission reports annually on progress on the National Strategy for Financial Literacy (page 64).

Employment of older people

21. That the Department of Labour, by mid-2008, develops a plan outlining how co-ordination could be improved among the agencies involved in initiatives – research, practical support and advice, public information and policy changes – that support older New Zealanders to find and stay in paid work, and the benefits of doing so (page 68).

Managing assets and income in retirement

22. That the Ministry of Social Development monitors trends over time in the size and distribution of financial assets held by older people, in order to give some indications of the issues facing older people in managing assets in retirement, including the potential demand for annuity and home equity release products (page 70).

23. That the Retirement Commission, by end 2008, updates and extends its information about options for managing assets throughout retirement, and provides that information to older people in ways other than the internet, including liaising with other providers of information to older people (page 71).

24. That the Ministry of Social Development, by end 2008, considers how the issue of financial abuse of the oldest people can be addressed within current social services (page 71).

25. That Inland Revenue, by end 2008, reports on the feasibility and implications of achieving tax neutrality in the treatment of annuity products (page 74).

26. That the Ministry of Economic Development, by end 2008, puts the code of practice for home equity release providers, being developed by the Office for Senior Citizens, into legislation (page 78).

27. That the Ministries of Economic Development, Social Development and Inland Revenue together, by end 2008, look at all of the interfaces of home equity release products with state benefits to confirm a consistent policy that can be communicated to consumers in a straightforward way (page 78).

The Retirement Commissioner expects that all of the above recommendation reports will be made publicly available via departmental websites.

Introduction

The Retirement Commissioner is required, under the New Zealand Superannuation and Retirement Income Act 2001, 'to review the retirement income policies being implemented by the Government and to report to the Minister by 31 December 2007…'

Previous reviews of retirement income policy were conducted by independent review teams every six years. The last one was undertaken by the Periodic Report Group in 2003.

In 2005, amendments to the Act gave future responsibility for the reviews to the Retirement Commissioner, and changed the frequency of the reviews to every three years. This 2007 Review of Retirement Income Policy is the first such review under this new regime.

Terms of reference

As required by section 84 of the Act, the terms of reference for this Review were set by the Minister of Social Development and Employment. This Review has focused on the following issues from the terms of reference:

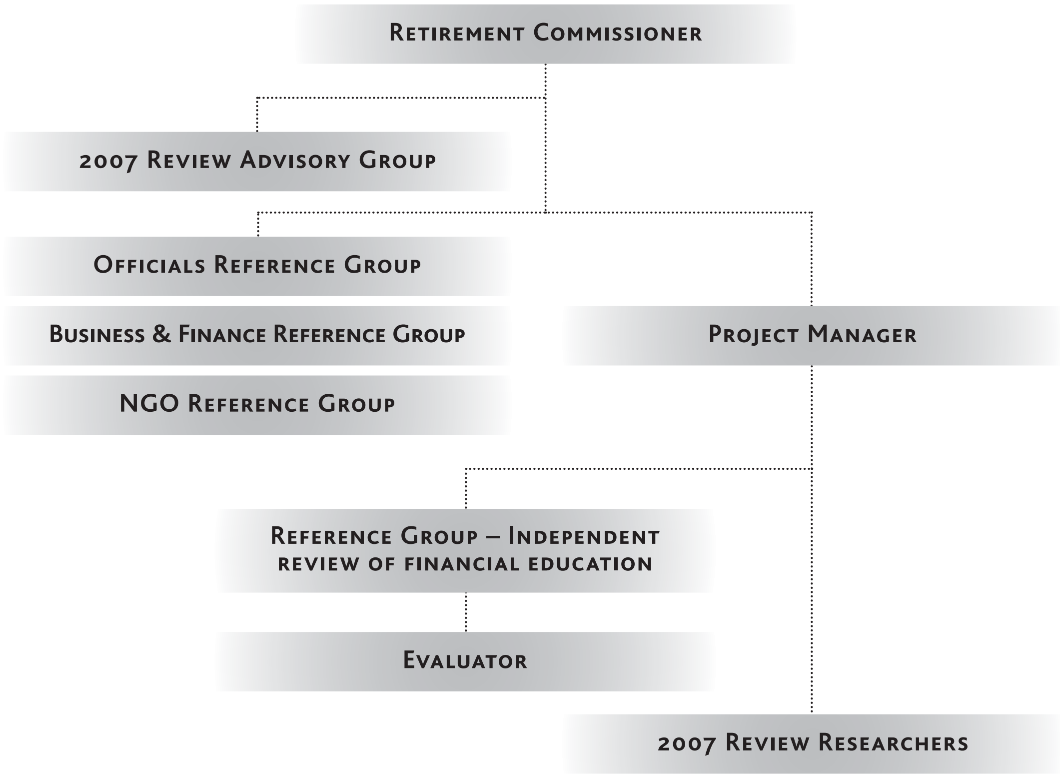
- » Trends and developments, since the 2003 Review, affecting the provision of retirement income, and any areas of risk, including:
  - Owner occupied housing.
  - Level and composition of personal assets.
  - Social attitudes of younger people in relation to consumption and savings.
- » Employment opportunities for older people, and people with a disability, who want to work.
- » Issues and opportunities relating to the use of annuities.
- » Issues and opportunities relating to the use of home equity products.
- » Commissioning an independent assessment of the effectiveness of financial education available to, and used by, New Zealanders.

Because the Review is responding to these terms of reference, it may appear to give more emphasis to some issues (e.g., annuities, home equity release) than would otherwise have been the case.

The complete terms of reference appear as Appendix A.

Structure of the Review

Figure 1: 2007 Review Structure



Review Advisory Group: This was established to provide the Retirement Commissioner with both individual and collective advice in relation to the 2007 Review.

Reference Groups: Three reference groups, of officials, business and finance industry representatives, and non-governmental organisation representatives, were established to facilitate sharing of ideas and information relating to the Review. To ensure the independence of the assessment of the effectiveness of financial education, an external evaluator was used and a separate specialist Reference Group was established to oversee this aspect of the Review.

The work programme for the Review was undertaken by a Project Team consisting of various specialists and researchers. This programme included the preparation of a number of background papers that provided further understanding and analysis of retirement income issues.

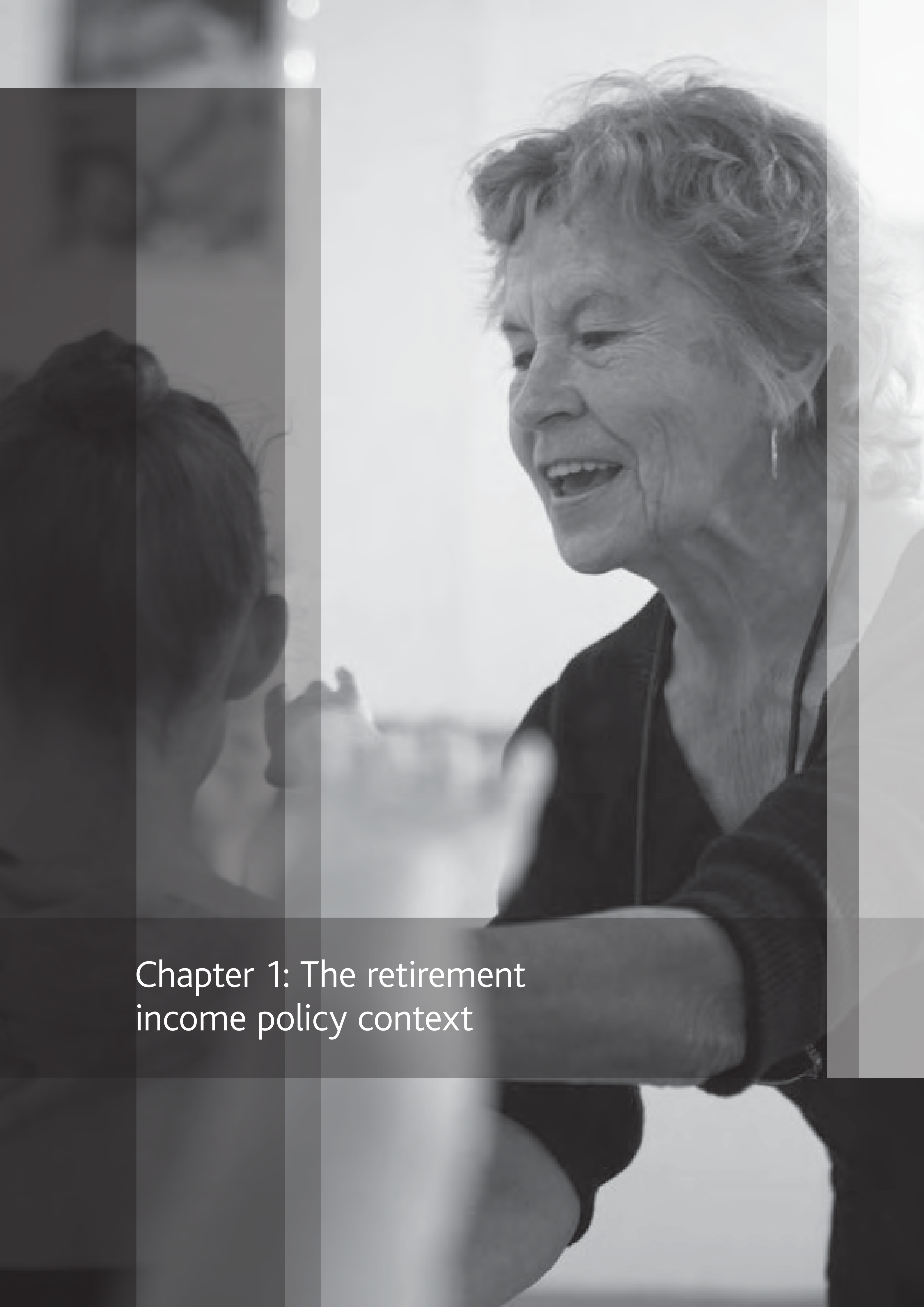
Further detail about the structure of the Review is given in Appendix B. The background papers are listed in Appendix C.

Submissions

The Retirement Commissioner was keen to receive input to this Review. In addition to the establishment of the Reference Groups, interested parties were given the opportunity to make submissions.

The Commissioner sought submissions by writing directly to key individuals and organisations, and by placing a public notice in major newspapers seeking public submissions. In all, 23 submissions were received. The deadline set for the receipt of these submissions was prior to the 2007 Budget announcements. Given the significance of the Budget announcements for retirement income provision, those that initially sent submissions were offered the opportunity to amend their submission, should they wish to do so. Two subsequent submissions were received.

These submissions are all listed in Appendix E.



Chapter 1: The retirement income policy context

This chapter briefly outlines the current context for retirement income policy in New Zealand, highlighting important changes since the 2003 Periodic Report. The chapter first describes the 'retired' population and covers some key points of economic context. It then briefly explains current retirement income policy, lists those involved, and summarises the most important data sources referred to throughout this Review. The chapter concludes with a brief note on topics requiring further work.

The 'retired' population

Many policy analyses focus on the problems that New Zealand will face as a result of increasing numbers of older people. This Review takes the opposite view: that more New Zealanders living to older ages, with their retirement income expectations met, can only be good.

Statistics tend to measure the population aged 65 and over. This is relevant for analysing the income and living standards of people eligible by age for New Zealand Superannuation, but it is not the 'retired' population. 'Retirement' will mean different things to different people. It could mean a sudden change from full-time work to full-time leisure, or a gradual transition involving some part-time work, caregiving commitments, or voluntary work. This diversity of work transitions is considered later in this Review.

Box 1 summarises some key facts about New Zealanders aged 65 and over.

The economic context

The general economic environment is critical to both saving for retirement and living standards during retirement. The growth and general health of the economy helps everyone. In particular, the security of New Zealand Superannuation (paid as it is from general taxation) depends on a growing economy. As the 2003 Periodic Report said:

> *The simple fact is that the stronger the economic growth the greater will be the quantity of goods and services available for all, whether retired or working. Overall living standards will largely be determined by economic growth rather than the details of financial arrangements*[1].

A review of the New Zealand economy since the 2003 Periodic Report can be found in a paper by David Preston commissioned for this Review[2]. In summary, economic activity has been growing since 2003, with spending and employment levels rising. Investment has boomed, and the majority of the population have enjoyed rising consumption standards.

1. 2003 Periodic Report p. 8.
2. See Appendix C for access details.

Box 1: Some key facts about New Zealanders aged 65 and over[3]

- » 527,000 people – one in eight of all New Zealanders – were aged 65 or over at 30 June 2007.
- » Over the last 50 years, the number of people aged 65+ has consistently grown faster than the total New Zealand population.
- » The number of people aged 65+ is expected to more than double between now and 2051. By then they will make up one-quarter or more of all New Zealand residents.
- » The number of New Zealanders aged 85+ is expected to more than quintuple, from 61,000 in 2007 to 335,000 in 2051.
- » For every 100 men aged 65+ there are 122 women in the same age group, compared with 104 women for every 100 men in the total New Zealand population.
- » Over the last 50 years, the proportion of New Zealand male newborns living to age 65 climbed from 68% to 86%; of female newborns, 90% are now likely to live to age 65.
- » On average, a New Zealand man aged 65 is expected to live for a further 18 years, and a woman for a further 21 years.
- » Official population projections suggest that by 2051, these average life expectancies will have increased to over 22 years for men and around 25 years for women (but see chapter 2 for why it may be even longer).
- » Over 81,600 people aged 65+ are in full-time or part-time employment. This is 17% of the age group, a proportion which has steadily risen from 6% ten years ago.
- » About three-quarters of men aged 60-64 years are in the labour force, as are more than half of New Zealand women of the same age.
- » In 2004, 8% of New Zealanders aged 65+ were living in 'severe, significant or some' hardship, compared to 21% of New Zealanders aged 18–64 years.
- » In 2004, 6% of the population aged 65+ had disposable income below the often used low-income threshold of 60% of the national median income.

However, at the same time a number of structural weaknesses have developed in the economy, notably:

- » A very large balance of payments current account deficit.
- » A high exchange rate for the New Zealand dollar.
- » Poor productivity growth.
- » Relatively low average incomes.
- » Negative aggregate savings in the household sector (but see chapter 3).
- » A historically high ratio of house prices to incomes (see also chapter 3).

At the same time some positive trends have developed in the economy, for example:

- » Rising labour force participation by older workers (see chapter 6).
- » A trend to upskilling of the workforce.
- » Ongoing government fiscal surpluses.

Specific structural issues in the current economic context are particularly pertinent for retirement income policy. As indicated, these are considered later in this Review.

3. From Statistics NZ (2007) *New Zealand's 65+ Population: A statistical volume*, 2006-base national population projections, abridged period life tables 2004-2006 (life expectancies quoted in the above are based on death rates in 2004-2006) and Ministry of Social Development (2007) *Positive Ageing Indicators*.

Retirement income policy

New Zealand's current retirement income policy can be considered to have five elements: New Zealand Superannuation (NZS), the New Zealand Superannuation Fund (NZSF), financial education, encouraging private saving, and social safety nets. These are outlined in Box 2.

Since the 2003 Periodic Report, the following changes to retirement income policy have been noteworthy:

- The benefit level of NZS for couples was increased to be 66% of national average earnings, from 65%, as at 1 April 2007.
- The State Sector Retirement Savings Scheme (SSRSS) was launched on 1 July 2004 for public service employees. A number of agencies in the wider state sector have since joined as participating employers.
- KiwiSaver was launched on 1 July 2007. Budget 2005 and the KiwiSaver Act 2006 laid most of the framework for it. Budget 2007 introduced major changes, including compulsory employer contributions and additional incentives, which make saving in KiwiSaver more attractive than other forms of saving. KiwiSaver is outlined in Box 2 and considered in more detail in chapter 4.
- In May 2007, Treasury announced that it believed a more interventionist policy to encourage private saving for retirement was justified, marking a significant change from its previously long-held view. This is considered further in chapter 3.
- The taxation landscape for saving has undergone a number of changes. The broad thrust has been to improve neutrality between saving in financial assets through collective investment schemes, and saving through direct investment; and to remove biases towards investing in certain countries. Taxation is further considered in chapter 8.
- In 2004, the Retirement Commission (with the Ministry of Education and others) set up a project to embed financial education in the school curriculum.
- The SuperGold Card, a discounts and concessions card issued free to all eligible seniors and veterans, was introduced in August 2007.

Box 2: The five key elements of New Zealand's retirement income policy

1. **New Zealand Superannuation (NZS)**

   NZS has provided a universal, flat-rate, individual pension since 1977. Eligibility is determined by age (65) and residence. For most people, entitlement is independent of other income, so there is no abatement or income test. NZS is subject only to income tax.

   Currently, the combined pension rate for a married couple cannot fall below 65% or rise above 72.5% of the net average earnings of employed New Zealanders. Within these limits, the level of benefit is adjusted every year with the consumer price index. Benefits for single people living alone or sharing accommodation are calculated as adjustments to the level for couples. The level of NZS is not intended as a generous replacement for earnings, nor is it just to alleviate poverty; rather it is set at a level intended to allow older people to belong to and participate in their community.

2. **New Zealand Superannuation Fund (NZSF)**

   The NZSF is a 'buffer fund' created in 2001 to help pay for the future cost of NZS. NZS will cost the country more in future as more people reach the age of eligibility and receive NZS for longer. Currently, the Crown allocates around $2 billion a year to the NZSF, and contributions are expected to continue for around 20 years. Thereafter, withdrawals from the NZSF will contribute towards the cost of NZS payments. The fund, run at arm's length from government, has to invest the money in a way that maximises returns, without undue risk, and avoids prejudice to New Zealand's reputation as a responsible member of the world community.

3. **Financial education**

   The Retirement Commission, an autonomous Crown entity, has had since 1993 a mandate to inform and educate New Zealanders about financial management and retirement planning. A wide variety of other agencies also provide financial education. A National Strategy for Financial Literacy is currently being developed, led by the Retirement Commission.

4. **Encouraging private saving**

   Private sector products, services and advice are a vital component of New Zealand's retirement income framework. There is an expectation that the private sector will accelerate their innovation of products, services and advice to meet the requirements of the changing natures of people's lives.

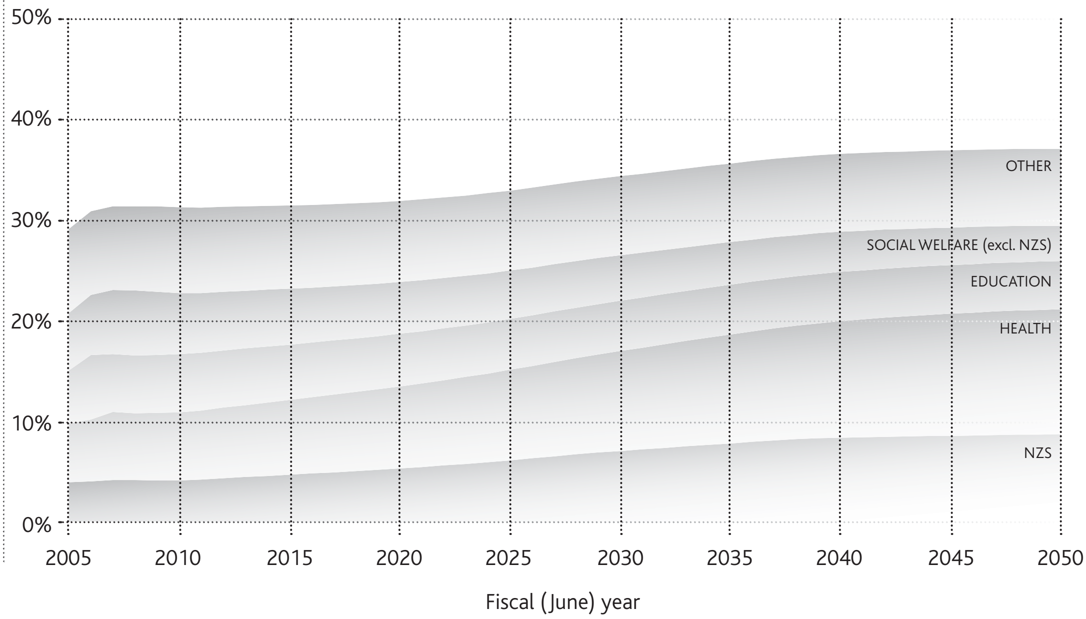
   KiwiSaver, introduced in 2007, is a collective investment scheme in which savers get special incentives in return for locking-in funds until (usually) age 65. Employees (with some exceptions) are automatically enrolled into KiwiSaver as they start a new job. They can opt out, and non-employees and the self-employed can join. Compulsory employer contributions (to be confirmed in legislation) and government incentives add to individual saving. Further subsidies, and a partial withdrawal, are available for first home purchase. Funds are invested with a private KiwiSaver provider, chosen by either the member or the employer, or randomly assigned if no choice is made.

5. **Social safety nets**

   A variety of targeted benefits give extra assistance to people over 65 in specific circumstances where NZS is not adequate. These include: help with housing costs, including accommodation supplement and rates rebates; reduced health care costs; disability support, including subsidised taxi fares; and long term residential care cost subsidies.

It is useful to set the costs of retirement income policy in the context of other policy demands. Chart 1 shows the cost of NZS alongside other fiscal costs, as percentages of GDP.

Chart 1: Core Crown operating expenses as % of GDP[4]



The net cost of NZS, including capital contribution to the NZSF, is currently (2006/07 fiscal year) around $7.6 billion a year, or 4.6% of GDP. The cost of the social safety nets for older people is included in the total social welfare costs in the chart. The cost of KiwiSaver is discussed in chapter 4. The cost of financial education is comparatively small: the annual budget of the Retirement Commission is around $5 million.

Who is involved with retirement income policy?

The Retirement Commission provides information and education to New Zealanders about financial management and retirement planning. The Commission also carries out research on retirement planning behaviour and attitudes. The Retirement Commissioner is called upon to monitor and advise government on retirement income issues, and review the effects of retirement income policies every three years. The Retirement Commissioner is appointed by the Minister for Social Development and Employment.

Many other government departments and agencies have an interest in retirement income policy, and view it from different policy perspectives. For example:

- The Ministry of Social Development (MSD) provides social policy advice to the government on issues that affect older people through the Older People's Policy Unit.
- The Office for Senior Citizens, part of MSD, promotes the rights and interests of older people, and leads, monitors and promotes the New Zealand Positive Ageing Strategy.
- MSD, through Work and Income, administers NZS, Veteran's and War Pensions, special benefits, and financial means testing for long-term care subsidies.
- The Ministry of Economic Development (MED) leads the regulation of financial services companies offering retirement savings products and financial advisers.
- The Ministry of Consumer Affairs, part of MED, covers the consumer protection issues of retirement savings products.

4. Estimates from Treasury. Figures are gross of tax, excluding debt servicing costs.

» MED, with the involvement of the Government Actuary, appoints KiwiSaver default providers and maintains a registry of KiwiSaver schemes.

» The Government Actuary, who sits within MED, has further supervisory duties for KiwiSaver and registered superannuation schemes.

» Statistics New Zealand provides demographic projections and other data which are key inputs to retirement income forecasting and policy.

» Treasury is the government's lead advisor on economic and financial policy. Among its budgeting and planning roles, for example, it prepares long-term forecasts of expenditure on items such as NZS. Short-term forecasts of benefit expenditure, including NZS, are provided to Treasury by MSD.

» Inland Revenue advises government, with the Treasury, on tax policy and certain social policy measures. It also collects tax payments. Inland Revenue plays a strong role in KiwiSaver policy, administration and evaluation.

» Te Puni Kōkiri, the Ministry of Māori Development, is concerned with retirement income policy as it affects Māori.

» The Ministry of Women's Affairs is concerned with retirement income policy as it affects women.

» The Department of Labour has an interest in older workers, in relation to labour market participation, skill levels and productivity.

» The Retirement Commission has been working with the Ministry of Education to place financial education into the schools curriculum.

This broad range of inputs should help ensure that all relevant points of view are taken into account, but it also requires some careful managing of cross-sector responsibilities.

Every three years, independent Reviews of Retirement Income Policy, such as this one, under the mandate of the Retirement Commissioner, are important opportunities to:

» Look across key aspects of retirement policy;

» Bring together the issues; and

» Set out a recommended work programme that goes beyond the boundaries of any one agency.

Recommendation 1

That these independent Reviews of Retirement Income Policy continue on a 3-yearly basis, because retirement income policy is complex and involves many agencies.

Recommendation 2

That the Retirement Commissioner, by mid-2009, reports on progress made on the recommendations set out in this Review to the Minister of Social Development and the Minister of Finance.

Important data sources

As is evident, making retirement income policy requires long-term planning. Stability in policy is important for New Zealanders preparing over 30 or more years for a retirement which may last for 20 or more years. Making policy robust for the long term depends on having a good fact base. These Reviews have been and should continue to be a stimulus to developing good data sources and using them wisely.

Some particularly valuable surveys and data sources are vital to retirement policy planning and evaluation. Throughout this Review, there is comment on the benefits of repeating or extending four surveys in particular:

» The **New Zealand Living Standards** survey, from the Ministry of Social Development, updated in 2004 the information in the series' first report, in 2000, and expanded it by looking at a wider range of factors that can affect people's wellbeing and living standards, such as life history and personal health, as well as income. As all age groups are surveyed, the living standards of older people can be set in the context of the population as a whole. The data on older people could be enhanced by including people in residential care.

» The **Survey of Family Income and Employment** (SoFIE) is an invaluable resource from Statistics NZ. It is a longitudinal survey, tracking the flow of household wealth and asset accumulation by age cohorts over time. As discussed in chapter 3, it can help us to understand how people save as they grow older. It can also help to identify the groups most at risk of significantly reduced income in retirement, and issues around saving for people on low incomes. In chapter 7, the use of SoFIE to track the assets people have through retirement is discussed. The first phase of SoFIE started in 2002 and will run for 8 years. A second phase should then be started to build up a long-term picture of savings behaviour.

» The **Household Savings Survey** (HSS) was a one-off survey in 2001 to measure the value of people's personal assets and debts at that time. It complements the longitudinal SoFIE. A repeat of HSS would give another snapshot to review trends since 2001, and could be particularly helpful for information on the assets held by older people, as discussed in chapter 7.

» The **Financial Knowledge Survey**, commissioned by the Retirement Commission and funded by ANZ, with the support of the Ministry of Economic Development, was first carried out in 2006 to measure adult New Zealanders' level of financial literacy. The survey results set a benchmark against which future surveys can measure knowledge trends.

Recommendation 3

That, in the interests of having a comprehensive fact base for evaluating retirement income policy, special surveys, notably the Living Standards Survey, the Survey of Family Income and Employment (SoFIE), the Household Savings Survey (HSS), and the Financial Knowledge Survey, are continued and enhanced where necessary.

Topics requiring further work

Retirement income and other issues for those aged 65 are very different from the issues for those who are aged 85 or more – the 'old old'. For example, how to provide for the cost of residential care is a more acute issue for the oldest people. The potential for financial abuse also increases for the oldest.

The Retirement Commissioner has concerns about the services and support being provided to the 'old old'. While some groups of the oldest people on the lowest income thresholds receive comprehensive services, others do not have easy access to services. This Review has not been able to consider all the implications of how financial issues may change during what may be a long retirement period, but notes that further work should be done.

As Chart 1 shows, health care is another major part of government policy. The provision and funding of health care naturally affects older people significantly, as does the funding of long-term residential and in-home care.

As will be discussed in the next chapter, there is significant uncertainty around the future life expectancy of older New Zealanders. The prospects for healthy life expectancy, and the need for care in later life, are further uncertainties. In retirement provision, a greater understanding of changing life courses, and of how productivity is changing through a longer working life, have increased our confidence in what is needed to sustain policy going into the future. For health policy, changing life courses and productivity are doubtless of comparable significance. This Review has not been able to address the retirement income policy issues around the health of older people, but they should be considered in the next Review.

Recommendation 4

That the Retirement Commission works with Treasury and the Ministries of Social Development and Health to ensure that there is an appropriate research programme in place to assess how the costs of health, residential and in-home care for older people will impact on their personal finances.

Chapter 2: New Zealand Superannuation (NZS)

This chapter considers the foundation of retirement income for nearly all New Zealand residents over age 65: New Zealand Superannuation (NZS).

The general consensus from submissions to this Review, from previous Reviews, and from overseas experts is that, broadly, the structure of NZS is sound, and it should continue to work well. Concerns arise over the fiscal cost in the longer term, because of demographic changes, and over confusions of entitlement for a small minority of people.

Further analysis of NZS, its impact, and options for change can be found in a paper commissioned for this Review from David Preston[5].

Merits of NZS

NZS has been remarkably successful in providing retirement income adequacy for older New Zealanders at a cost level which is lower than that of the public pension systems of most other developed economies. It scores well on the traditional criteria for assessing retirement income policy in New Zealand: adequacy, simplicity, flexibility, certainty, fiscal affordability, equity and fairness[6]. NZS is much admired, because:

» It is virtually universal, with over 90% of people aged 65 and over usually resident in New Zealand receiving it[7].

» The benefit level is above the hardship level[8] and, because it is kept within a band defined by a percentage of the average wage, NZS broadly keeps the basic income of older people rising in line with the incomes of working age people.

» It gives older people a regular basic income regardless of how long they live, so is a protection against longevity risk. This is an important benefit, as longevity is improving, so people are living longer than they may expect to do.

» It has a residency criterion for eligibility, not a contributory one. This means that it provides independent retirement incomes regardless of recipients' gender, marital status or income history. This is important to many of those in groups more at risk of low or irregular earnings, including many women, disabled people, Māori and Pacific peoples, and casual workers.

» It does not discourage saving, because it is not means-tested.

» It does not discourage employment at older ages, as it is paid whether the recipient works or not.

» It is simple to explain and run.

» It operates at a low administrative cost.

» Its long-term sustainability is helped by the NZS Fund. The Fund invests a contribution each year until amounts are withdrawn to help pay the higher cost of NZS caused by population ageing.

5. See Appendix C for access details.
6. See Cook (2006) *Questions for our times about retirement saving and pensions*, Retirement Commission, p. 14.
7. Ministry of Social Development (2003) *Briefing to the incoming Minister for Senior Citizens*, p. 11.
8. Ministry of Social Development (2007) *Positive Ageing Indicators*.

NZS is the main source of retirement income for over 70% of people aged 65 and over living in New Zealand[9]. NZS is the main reason why the living standards of older New Zealanders compare well against those of older people in other countries.

The cost of paying NZS in future will increase as the number of eligible recipients increases. Treasury estimates that the net of tax cost of NZS could more than double between 2010 and 2050, from 3.4% of GDP to 7.1% of GDP[10].

The New Zealand Superannuation Fund (NZSF) is designed to help with this increasing cost to some extent. By 2050, Treasury estimates that NZSF could be drawn upon to provide over 1% of GDP, reducing the net cost of NZS to 6.0% of GDP.

The 2003 Periodic Report stated that in addition to NZSF, some adjustment to NZS would be needed to address the increasing fiscal pressures. The OECD has suggested that, 'without undermining the basic design of New Zealand Superannuation, two measures could diminish its long-term cost: using a lower indexation formula for pension payments and/or lifting the eligibility age'[11]. The International Monetary Fund has also suggested that, 'some consideration might be given to a gradual decline in the replacement rate and a gradual increase in the eligibility age as life expectancy rises'[12]. Treasury has warned that, 'if trends do not change… NZS may have to become less generous in future'[13].

Any way of reducing the generosity of NZS is likely to prove unpopular, as would raising taxes to pay for NZS to continue at its current level. In practice, a combination of different approaches could be used. Some possible options are considered in the next section.

Given the general policy advantages of NZS, and its importance to most New Zealanders, especially those with little other income in later life, it should continue broadly unchanged. This can be achieved by retaining the basic structure of NZS as a benefit defined as a proportion of the average wage, paid to people eligible on the basis of residency and age.

If the structure of NZS is to continue, then changes to its parameters may be necessary in order to meet the increasing cost. These are discussed further below. Political consensus should be a pre-requisite for any such changes, so that the likelihood of future changes is reduced. Stability in policy is important so that New Zealanders can plan ahead for their retirement with confidence. This also means that any adjustment to NZS should be implemented with as long a lead time as possible.

Recommendation 5

That the basic structure of NZS be maintained.

Recommendation 6

That political consensus is sought for any future changes to the parameters of NZS, and such changes are made with long lead times in order to allow individuals to adjust their retirement planning.

9. Statistics NZ, Household Economic Survey, Year ended 30 June 2004, Table 24.
10. Information provided by Treasury for this Review.
11. OECD *Economic Survey of New Zealand*, April 2007.
12. IMF *Country Report No. 07/150*, May 2007.
13. Treasury (May 2007) A *Synopsis of Theory, Evidence and Recent Treasury Analysis on Saving*.

Fiscal pressure on NZS

Given the effectiveness and reach of NZS, it is important to know that it can continue to be paid for. This will depend either on taxpayers accepting the rising cost as people live longer or, more likely, adjusting NZS so that the cost stays at a level taxpayers will consider reasonable. Looking ahead to get the best possible forecast of the future cost is therefore critical.

There is great uncertainty in how the demographic trends affecting the future cost of NZS will turn out, but of particular importance is how fast life expectancy will increase. A risk identified by this Review is that current policy planning is not reflecting this uncertainty, and may be underestimating how long people may live. This would lead to the cost of NZS being higher in future than currently envisaged.

Demographic factors

The future cost of NZS is calculated making some assumptions about how demographic factors will change over time. If these factors turn out differently from the assumptions made, then the cost of NZS will be different from that expected. Considering each demographic factor in isolation, then broadly speaking:

» Changes in the birth rate affect the ability to fund NZS in the short to medium term. More children than expected would increase fiscal costs in the short term, but then as they reach the workforce they would become net fiscal contributors. But they would increase the cost of NZS in the long term, when they eventually claim NZS.

» Changes in the migration rate have a similar impact. More migrants would help to pay for NZS in the short term, but would claim NZS in the long term.

» Changes in life expectancy have a direct impact on the cost of NZS. If each generation of superannuitants is larger than expected and receives NZS for longer than expected, then the cost of NZS will rise more than expected.

Both the fertility rate and migration rate tend to fluctuate year on year. Throughout the developed world, however, life expectancy has steadily increased over time. Greater longevity has a direct impact on the cost of public pension systems such as NZS, especially as longevity is improving more among the over-65s than in younger age groups. There is fierce debate among demographers about how far life expectancy can improve in future, and uncertainty as to what actually will happen, but it seems more likely that improvement will continue, rather than stop or reverse.

Statistics NZ publish a range of scenarios for future life expectancy from age 65. These are shown in Table 1. The Technical Note below Table 1 explains the importance of understanding the basis used to measure life expectancy.

Table 1: Number of years the New Zealand population is expected to live on average after reaching age 65 in each year, using different Statistics NZ scenarios of life expectancy [14]

Males

Scenario	2011	2021	2031	2041	2051	2061
Very high	18.8	21.1	23.6	26.2	28.9	31.7
High	18.9	20.9	22.5	23.7	24.4	24.7
Medium	18.6	20.0	21.1	22.0	22.5	22.7
Low	18.3	19.1	19.8	20.3	20.6	20.7

Females

Scenario	2011	2021	2031	2041	2051	2061
Very high	21.3	23.1	25.1	27.1	29.2	31.4
High	21.5	23.3	24.9	26.0	26.7	26.9
Medium	21.2	22.6	23.7	24.5	25.0	25.2
Low	20.9	21.8	22.6	23.1	23.5	23.6

Technical Note

The life expectancies in Table 1 are 'period' life expectancies. These assume that a person experiences the age-specific mortality rates (probability of dying within the year for someone of that age) of a given time period from the given age onwards. So a life expectancy on this basis for someone aged 65 in 2011, say, assumes he or she experiences the 2011 mortality rate at age 65, the 2011 rate at age 66, the 2011 rate at age 67, and so on. This is, for demographers, a convenient snapshot indicator, but it does not give us the most useful picture of the future.

In real life, people aged 65 in 2011 experience the 2011 mortality rate at 65, the 2012 rate at age 66, the 2013 rate at age 67 and so on. Life expectancies on this basis are 'cohort' life expectancies. They are calculated by tracking a group of people of the same age (a 'cohort') over their lifetime. A complete cohort life expectancy cannot be known until the lifespan of that cohort is complete, but analysis of past cohort data can help to make assumptions about the future life expectancy of cohorts still living.

We know that generally people are living longer (that is, mortality rates are decreasing). In a time of generally improving longevity, the cohort measure of the life expectancy of a 65 year old in 2011 would be higher than the period measure of the life expectancy of a 65 year old in 2011. A common mistake is to interpret a period life expectancy as if it is a cohort measure, but this is likely to under-estimate life expectancy.

This can be illustrated by an example. The Statistics NZ latest life expectancy at age 65 for women on a *period* basis is 20.5 years. On a *cohort* basis, Statistics NZ estimates that the cohort of women who reached age 65 in 1997 had a further life expectancy of 21.2 years[15]. Given generally increasing life expectancy, the cohorts of women reaching age 65 now are likely to live longer than the 1997 cohort on average. So the period measure understates the likely life expectancy actually experienced by today's 65-year-olds.

14. From Statistics NZ 2006-base national population projections released October 2007. These scenarios have been renamed, to describe, for example, 'high life expectancy' instead of Statistics NZ's 'low mortality'. Note that the 'very high' scenario is produced on a different basis from that used for the other three scenarios.
15. Statistics NZ cohort life table for the 1932 birth cohort and abridged period life tables 2004-6.

The impact on NZS costs

That people are living longer is great news, which should not be forgotten in analyses of the impact on fiscal costs. But it is worth taking a closer look at how much the future cost of NZS could change on plausible scenarios for future life expectancy.

In order to provide the best possible estimates of the future cost of NZS, New Zealand has further work to do:

» New Zealand has a good analysis of the life expectancy of birth cohorts[16] up to those born in 1932 (therefore reaching age 65 in 1997). However, more could be done to forecast how the longevity of later cohorts (current and future superannuitants) may change in future. In the UK, this extra cohort-based analysis led to increasing the forecasts for life expectancy. If similar work led to the same conclusions for New Zealand, then the cost of NZS is currently underestimated.

» Treasury has published one set of illustrative forecasts for the cost of NZS (and other fiscal costs such as health) with different scenarios for life expectancy[17]. But policy planning in New Zealand has not yet reflected a full analysis of the implications of the uncertainty around future life expectancy, and the likely effect on other factors, such as the proportion of people working at older ages.

For this Review, we asked Treasury to calculate the future costs of NZS on the different Statistics NZ scenarios that indicate possible future life expectancy. The results are summarised in Table 2.

Table 2: Treasury projections of the future net cost of NZS, including capital contribution to or from NZSF, as % GDP, on different scenarios of life expectancy [18]

Scenario	2011	2021	2031	2041	2051
Very high	4.9%	5.4%	5.8%	6.0%	6.2%
High	4.8%	5.3%	5.6%	5.8%	6.0%
Medium	4.7%	5.1%	5.4%	5.6%	5.9%
Low	4.5%	4.9%	5.3%	5.5%	5.8%

The 'medium' line in Table 2 is the principal projection of Statistics NZ in terms of life expectancy. Under that projection, the cost of NZS in 2031 is expected to be 0.8% of GDP above the current cost of 4.6% of GDP (2006/07 fiscal year). If life expectancy turned out to be 'very high' instead of 'medium', the 2031 cost of NZS would rise by another 0.4% of GDP. By 2051, the cost of NZS is expected to be somewhere between 1.2% and 1.6% of GDP above the current cost. Cost increases of this magnitude are unlikely to be able to be absorbed without some adjustment to the financing of NZS, or to the parameters defining NZS.

16. Statistics NZ (2006) *A History of Survival in New Zealand: Cohort life tables 1876-2004* and cohort life tables up to the 1932 birth cohort.
17. Treasury (2006) *New Zealand's Long-Term Fiscal Position* p. 106.
18. Estimates from Treasury. The life expectancy scenarios are those prepared by Statistics NZ for the 2006-base projections. These scenarios have been renamed, to describe, for example, 'high' life expectancy instead of Statistics NZ's 'low mortality'.

Future options

Paying for the increasing cost of NZS will require new money to be found, at the expense of either the taxpayer or some other tax-funded service. Alternatively, options for adjusting the parameters of NZS in future could be considered, so that the cost levels off or grows more slowly than expected with no change. Such options include:

» Introducing some form of income targeting.

» Lengthening the required period of residence in New Zealand.

» Reducing the ratio of the benefit level of NZS to that of the average wage (the 'replacement rate'), by, for example, indexing it to something less than the average wage over a period.

» Phasing up the age of entitlement.

The advantages and disadvantages of each of these options are discussed more fully in David Preston's paper for this Review[19]. In summary:

» Both income targeting and increasing the required residence period would fundamentally, and negatively, change the universal nature of NZS.

» Reducing the benefit level would require some justification as to what the 'right' level of benefit should be, and would adversely affect current superannuitants.

» Putting up the age of eligibility by one or two years would not affect current superannuitants. It fits with likely trends in life expectancy (see Table 1), and with the increasing number of people working at older ages (see chapter 6). Other countries are planning to put up the age of public pension entitlement, or already have ages higher than 65 (see Box 3).

Further work

Making any decision on whether and how to adjust NZS requires fairly significant advance work. This work programme should include:

» More analysis to forecast the possible scenarios of the future life expectancy of New Zealand's older people, and how this varies across the population.

» Developing a more detailed understanding of the implications of life expectancy improvements. For example, one scenario could be that health improves with longer lives and the proportion of people working at older ages continues to increase. This should mean greater economic growth, which should feed back into a higher tax base from which to afford NZS.

» Developing the full range of implications from policy options, including interfaces of retirement income policy with health policy and housing affordability policy. For example, an increase in age of eligibility will make a cost saving in NZS, but will increase the costs of the assistance benefits and KiwiSaver incentives that are available until NZS eligibility age.

» Forecasting the future cost and financing of NZS, including the appropriate contribution to NZSF, on a range of potential scenarios, with and without policy change options.

» Considering the social implications of policy options, and how to resolve issues for any groups who may be most harshly affected.

» Informing the public about future life expectancy forecasts. This may help public acceptance of any adjustments to NZS, and would also help individuals with their own retirement planning.

19. See Appendix C for access details.

Any adjustment to NZS should be made with long lead times for anyone affected (see **Recommendation 6**). If, for instance, the adjustment was like that in other countries to put up the age of eligibility, there could be a notice period of at least 20 years. Given that the fiscal strains will already be evident by then, and that a significant programme of work is required, it is the right time now to start the work.

Recommendation 7

That Treasury, by end 2008, reports on the necessity, feasibility and implications of options for the future financing of NZS, because there are likely to be more recipients of NZS in future, with longer life expectancies.

Box 3: Increasing the age of entitlement: what other countries are doing

Some countries already have an age of eligibility greater than 65. One of Ireland's two public pensions cannot be taken before 66; in Norway the public pension cannot be taken before age 67; and in Iceland, one of its two public pensions can be taken in full only at age 67, with a reduction if payment starts between ages 65 and 67.

Other countries looking at forecasts of improving life expectancy have decided to increase the age at which people become eligible for the public pension (see below), at some date in the future. Most have given around 20 years' notice, so that the changes affect only those aged in their early 40s and younger at the time of legislation.

Other countries' plans to increase the age of eligibility for the public pension are set out below.

Country	Plans
Denmark	Legislated in 2006 to increase pension age from 65 to 67 between 2024 and 2027, and, from 2025, to index the age to average life expectancy.
Germany	Announced in 2006 an increase in pension age from 65 to 67 by 2029.
UK	Legislated in 2007 to increase pension age from 65 to 68 in phases between 2024 and 2046.
US	Legislated in 1983 to phase in an increase in the minimum age of receiving full Social Security retirement benefits from 65 to 67 over a 22-year period, ending in 2027.

Equalising rates

A further adjustment to NZS could be considered more for equity reasons, although it may also make a small cost saving. Currently two single people living together receive NZS at higher rates than a married couple or partners who live together. Equalising the rates for any two people living together has some justification, as it is inappropriate today to differentiate among superannuitants sharing accommodation according to whether they are married, partnered or single. Rather than making cuts, the single sharing rate could be held constant until indexation brings half the couple's rate up to the same level.

Confusions in entitlement

This section considers apparent confusion in the way in which NZS works for some people who migrate in or out of New Zealand.

Eligibility for public pension schemes in most other countries is by a contributory criterion: the amount of pension depends on how many contributions a person has made over a working life. When people live in more than one country with a contributory criterion through their working life, they accrue contributions to more than one public pension, so it is easy to 'add up' the total pension accrued.

In contrast, NZS is generally paid in full to a resident with 10 years' residency since age 20 (with 5 of those years since age 50). This allows NZS to be almost universal, and so works well for the vast majority of New Zealanders.

In general, when an NZS recipient also receives a public pension from another country, New Zealand's policy is to deduct the amount of that other pension from NZS. This is referred to as the 'direct deduction' policy. Specific agreements with some countries may add further rules. The overall approach is consistent with that used around the world for such cases: that policy is equitable between people who stay in one country and those who move around, and that no-one gets more pension than they would have done if they had lived for their whole life in any one of the countries they have lived in.

New Zealand's direct deduction policy applies to around 10% of superannuitants, and for many it works fairly. As a simple example, a person retiring to New Zealand from the UK would continue to receive his or her entitlement to the UK public (or 'state') pension, paid from the UK. Residence in the UK counts as residence in New Zealand under the terms of the agreement between the two countries. So he or she would probably be eligible to receive NZS, but, if claimed, the amount paid in New Zealand would be the full amount of NZS less the UK entitlement.

The precise outcome depends on individual circumstances, the rules of the particular pension systems involved, and how they interface with the direct deduction policy and the rules of any agreement between New Zealand and the other country involved. There are some cases, within the 10%, which may appear unfair, or at least inconsistent or anomalous. Although in total relatively few in number, these cases cover a variety of issues, and are often very complicated.

Some people in unusual circumstances report difficulties in getting a clear decision and accessing an appeals process. Previous Reviews back to 1997 have raised this as a concern. Migration is likely to increase in future, so these problems are not likely to go away.

There are also issues for people who work in New Zealand for a time and then retire in another country. Because NZS is paid to residents, working for a time in New Zealand does not 'earn' entitlement to NZS, unless the person remains resident after age 65, or there is an agreement with the other country. The limited NZS portability rules lead in most cases to NZ superannuitants who move to live overseas being entitled to less than the full NZS rate. Dissatisfaction with this may increase if entitlement to public pension is a factor for people considering working in New Zealand for a spell.

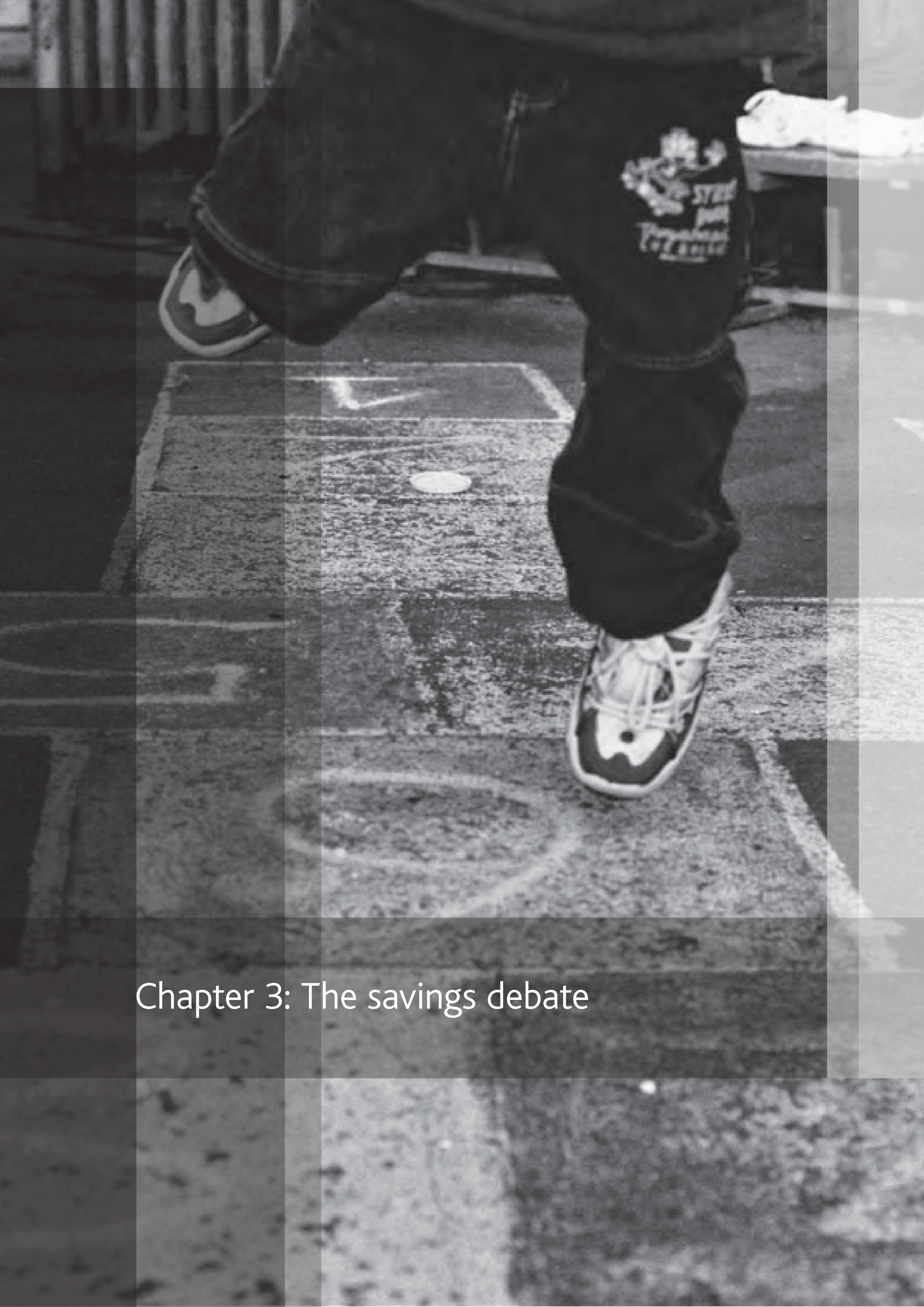
Equitable and simple solutions to valid concerns should be implemented where possible, recognising that some reported concerns may in fact reflect a fair and practical, but not well-understood, approach to cross-country pension entitlement issues.

It should be stressed that NZS works well and equitably for the majority of New Zealanders. Any solutions should not undermine the basic structure of NZS, or the general approach to cross-country equity.

It is understood that the Ministry of Social Development has been working on proposals which would maintain the structure and advantages of NZS but clarify the approach to apparent anomalies. Decisions on these should be made and any changes implemented as soon as possible. In addition, to make sure uncertainty is minimised for people in unusual entitlement circumstances, MSD should ensure that the entitlement rules and the decision and appeals process are made clear.

Recommendation 8

That, by mid-2008, the Government completes its review of the 'portability' aspects of NZS for people who migrate to or from New Zealand, and announces its decisions, and that the Ministry of Social Development takes steps to clarify the decision and appeals process for unusual NZS cases.



Chapter 3: The savings debate

Saving is done for many reasons, including for retirement – for example, as a precaution against life shocks; and in many ways, such as through buying a home, or training to get a better job in future. Financial assets earmarked for retirement income are only part of the picture. Saving is generally seen as a good thing both for individuals and for national reasons, such as helping to promote economic growth and macro-economic stability.

There has been concern for some time about how much New Zealand is saving. The picture is confused, with micro-level data on how much saving is being done by households apparently conflicting with national-level data. The latter indicates that the New Zealand household sector saves less than in other countries, and the household savings rate has been falling. The current account deficit is high, as is external indebtedness. Saving into workplace superannuation schemes has tended to be lower than in other countries, and has been declining. The assets of the New Zealand household sector appear to be poorly diversified, with a high and increasing proportion held in housing stock.

There may be different opinions on the degree to which each one of these indicators is a problem, but a view has prevailed that taken together, they show that New Zealand has a savings problem.

Specifically, Treasury has recently adopted a stronger stance on encouraging saving than it had prior to the 2007 Budget[20]. It cited the potential benefits of more household saving as including 'improved financial resilience for individuals, better macroeconomic outcomes under some circumstances (e.g. a lower structural current account deficit and equilibrium real exchange rate), and potential financial system development'[21].

Treasury's view is now that savings should be positively encouraged, as, to paraphrase, it would be better for the nation to have saved than to regret in the future that it has not done so.

Saving is therefore a wider policy issue than retirement. However, the concern about saving has led to a specific retirement policy: a form of KiwiSaver in Budget 2007 which is significantly enhanced beyond what had previously been planned.

This Review considers the savings debate from the perspective of personal retirement policy.

This chapter is concerned with clarifying the saving-for-retirement problem. It first defines the issue, then considers specific retirement saving issues for young people and for low earners. It also stresses the importance of home ownership as part of retirement preparation.

The next chapter focuses on KiwiSaver, and considers how effective it could be in enhancing retirement savings.

20. Treasury (May 2007) A *Synopsis of Theory, Evidence and Recent Treasury Analysis on Saving* and Treasury (August 2007) *Better saved than sorry: The Treasury's position on New Zealand's saving performance.*
21. Treasury (May 2007) *A Synopsis of Theory, Evidence and Recent Treasury Analysis on Saving* p. 3.

Defining the saving-for-retirement issue

In New Zealand and other countries, the issue of saving for retirement has tended to be simplified down to the question: Is the population saving 'enough' for retirement?

The calculations made to attempt to answer this question are similar. They assume a target retirement income; estimate what hypothetical households representative of the population will have in future from the public pension and from their current assets after appreciation; calculate how much additional saving will be required to reach the target; then compare that 'required' amount of saving with the rate of saving currently observed.

Opinion is polarised, and sometimes passionate, both on the question of whether New Zealanders are saving 'enough' for retirement, and on the analytical approach that should be used to determine this. In fact there is no right answer to the question.

First, saving 'enough' implies that there is a right amount to save, but there cannot be. Who can say whether a better lifetime standard of living is achieved by a low income family going without or getting into debt for some years, in order to put money into a retirement savings plan? How much of a drop in spending in retirement do people anticipate, or will accept if they have to, or will compensate for by delaying retirement? What proportion of the population can realistically be expected to save 'adequately' (presumably not 100%)?

Secondly, the interpretation of the calculations is necessarily very uncertain. The calculations require complicated analysis making multiple assumptions to hold true over many years. Conclusions necessarily have many caveats. The results are more like an answer to a multi-dimensional 'What if?' question. Small changes in assumptions will change the results. The answer should not be understood as 'this will be the case', although it can sometimes be reported as such.

Household savings data

Micro-level data on the savings patterns of households are provided by Statistics NZ's Survey of Family Income and Employment (SoFIE) and the Household Savings Survey (HSS). The most recent key results from this analysis are summarised in Table 3.

Table 3: Proportions of the population who may not be saving adequately for retirement[22]

	Baseline	Adjusted
Non-partnered individuals		
Ages 45-54	31%	18%
Ages 55-64	27%	8%
Overall	29%	13%
Couples		
Ages 45-54	40%	26%
Ages 55-64	39%	10%
Overall	40%	19%

The 'baseline' and 'adjusted' scenarios differ in the way they assume that spending changes after retirement, and therefore how much saving is needed to meet the retirement income target.

22. Le et al (2007) *The accumulation of retirement wealth: evidence for New Zealand*, Paper presented at USNW, Sydney, July 2007, Treasury and the Retirement Commission.

The baseline scenario assumes that pre-retirement consumption continues into retirement. The adjusted scenario appears to be more realistic, in that it reflects the observed pattern of consumption declining during retirement, and also eliminates the very highest levels of retirement consumption.

Although this analysis can give only an indication of the saving-for-retirement picture, the data in Table 3 is by no means bad news, but it is not all good news either. Based on this study, the scenarios suggest that most over-45 year olds are saving 'enough' for a reasonable transition to retirement, although a minority may not be doing so. There is even less of a savings issue with the over-55s.

However, the study suggests that around one-quarter of couples aged 45-54 and one-fifth of non-partnered individuals may not have a smooth transition to spending in retirement if they do not increase the rate at which they are currently saving.

We do not yet know whether those currently aged 45-54 will save more as they get older, so that they will reach the better position of those currently aged 55-64 by the time they get to that age. We will know this only if surveys continue to gather data on age cohort behaviour. Further, we do not know how the saving behaviour of younger generations will differ from that of the age cohorts studied.

In summary, therefore, the jury is still out. There can be no clear answer on the adequacy even of current levels of saving for retirement. Assessment of these levels is hampered by insufficient data and by the complexity of the analysis needed. Interpretation of the findings is not straightforward.

Now that KiwiSaver is in place, this evidence does not suggest that further initiatives are needed to address an urgent problem of under-saving for retirement. But it does suggest that efforts to improve our understanding of the savings issue should continue.

As part of **Recommendation 3**, it is crucial that work continues to develop more data on national and household saving and household net worth, with more analysis to understand the differences between different datasets. In particular, SoFIE is an invaluable resource to track the flow of household wealth and asset accumulation by age cohorts over time, and thus to help to identify the groups most at risk of significantly reduced income in retirement.

Younger people and saving

This Review was asked to look specifically at the savings attitudes of younger people. There is little data on this, so a fuller picture has been gleaned from the available data on younger people's actual spending and saving. More detail is given in NZIER (2007) and Preston (2007)[23].

Younger people have always had lower net worth and have saved less than older people. However, the available data does not prove that saving rates for younger New Zealanders are declining relative to those of older age groups. Financial planning is not a priority for many young people; but as far as it is possible to tell, young people are generally not averse to sensible financial actions, such as paying off debt when they can.

It also seems to be the case that in other countries (Australia, Canada and the United States), the share of total net worth held by younger age groups has remained about the same.

Calculations to analyse whether the under-45s are 'saving enough' would not be robust. This is because individuals in this age group have at least 20 years before receiving NZS in which to boost their saving, or for any of the other assumptions in the calculations to change.

However, there are some signals that the retirement income of today's under-45s may be of more concern than that of today's over-45s. Compared with older generations, many younger New Zealanders have easier access to credit (both credit cards and personal loans). They are leaving

23. See Appendix C for access details.

the education system later and are likely to have student debts to pay off. They are also later in starting employment, forming partnerships, having children and becoming homeowners. All these factors may delay the start of saving for retirement.

The retirement prospects of current and future younger people will depend on these and other long-term influences that are hard to predict, but are not all negative. For example, having to repay student debt may mean that starting to save is more challenging than it was for earlier generations; however, having a higher level of education may bring in a higher income once employment begins.

KiwiSaver will also make more of a difference to younger people. Clearly, the earlier in life people join KiwiSaver, and the longer they stay in it, the more savings they will accumulate.

These uncertainties add to the importance of improving data on savings patterns, assets and debts, as part of **Recommendation 3**. Both a new snapshot Household Savings Survey (HSS) and the continuation of SoFIE will be valuable. New waves of SoFIE can be enhanced without affecting comparability of past data. This facility should be exploited by adding selected questions to SoFIE to learn more about, for example, New Zealanders' attitudes to risk, debt and saving, and patterns of KiwiSaver behaviour.

Difficulties saving on low income

Under the savings adequacy analysis referred to earlier, using SoFIE analysis, some households already satisfy the savings 'adequacy' test of being able to smooth consumption into retirement[24]. Some of these households hold significant wealth, giving them enough to continue their lifestyle into retirement.

However, others are earning at low levels, so New Zealand Superannuation (NZS) will be sufficient to keep their retirement spending levels consistent with those before retirement.

People on low incomes are a particular policy concern. New Zealand's retirement income policy is rated highly on equity, because NZS provides an adequate basic retirement income for people who have not earned at high enough levels to enable them to save a lot over their lifetimes. This underlies the importance of sustaining NZS, as discussed in chapter 2. It is also recognised that there is a huge opportunity to improve financial literacy for this group.

People on lower incomes than average find it difficult to save, as they have little money left after living costs. There is little analysis of 'savings ability': how many households or individuals could, given their incomes and a reasonable budget for living costs, realistically have enough money to save – for example, the equivalent of 4% of pay for KiwiSaver.

This Review received submissions referring to the difficulties low income people may have in saving, and in particular in being able to save consistently at all times, because their income and/or expenses may fluctuate. Employees on low wages and casual workers may find it difficult to save at times, as may younger families with high living costs in relation to income.

Potential non-savers may include many women, disabled people, and Māori and Pacific peoples. These groups are more likely to be on incomes which are low, or irregular, or vary considerably over time. There may also be other factors affecting the general potential to save. Box 4 gives a brief summary of issues for groups who are at risk of lower incomes and/or higher costs than average, and so are more likely to find it difficult to save.

24. Le et al (2007) *The accumulation of retirement wealth: evidence for New Zealand*, Paper presented at USNW, Sydney, July 2007, Treasury and the Retirement Commission p. 10.

People on low incomes may want to save in order to have more than NZS (which may improve their standard of living in retirement relative to what it was at younger ages). They may also want to save for other reasons if they can, such as buying a house or having money put by for emergencies. They may want to take advantage of KiwiSaver's incentives to save. But finding the money to save, especially through KiwiSaver, which takes regular contributions[25] and locks in funds until age 65, may not be easy at all times.

Accessible help in making savings decisions, in the context of specific financial low-income situations, would be valuable.

Box 4: Saving difficulties for particular groups

Women on average still earn less than men, and are more likely to have career breaks because of caring responsibilities: for children, for ill or disabled family members, and later in life for grandchildren and/or the elderly. Currently, the living standards for women and men in retirement are similar, largely because of NZS. If retirement incomes shifted more to being provided by savings, then it is likely that average retirement living standards for women would fall behind those for men, because saving tends to be proportionate to incomes. This will continue for as long as there is not pay parity between men and women, and caring responsibilities are not equally shared.

Disabled people are less likely than the general population to be in the workforce. Many are seeking work and would need no special assistance at work. Many in work tend to be in less secure employment, and in occupations with lower pay than average. Disabled people on benefits face the prospect of benefit abatement if they seek to increase their income through work, and may fear benefit abatement if they save.

Many **Māori** have lower education and incomes, as well as more dependents and poorer health, than non-Māori. Improving education, skills and pay rates for Māori will have a greater impact on the ability to financially prepare for retirement than any direct retirement income policy. Many Māori also have cultural responsibilities which demand commitment of time and often of money. In future, the socio-economic factors may change through government intervention, and through the potential for growth in iwi asset bases to benefit members, for example, through savings schemes such as Ngāi Tahu's Whai Rawa. However, the impact of these factors is still unclear.

Similar issues arise for many **Pacific peoples**. Living standards surveys point to the low incomes of many Pacific people, who may also have cultural cost commitments, such as sending remittances to family members outside New Zealand, and tithing to churches.

For some years now, health sector policy has had as a key objective that health services and treatments be designed in ways that better engage Māori and Pacific peoples. This policy should have a positive impact on employment and earnings, and also on longevity.

Specific issues for Māori have been considered for this Review by Te Puni Kōkiri; for women by Prue Hyman; and for disabled people by Wendy Wicks[26].

25. Contributions holidays can be taken subject to specific rules.
26. See Appendix C for access details.

Initiatives for improvement

Many of the causes of low saving are related to the labour market, rather than retirement income policy. They are particularly intractable and are unable to be resolved from a retirement policy focus.

The 2003 Periodic Report considered many of these issues. Some of the initiatives recommended by the 2003 Periodic Report have been progressed: for example, a unit looking at the gender pay gap in the Department of Labour, and a joint Retirement Commission/Ministry of Women's Affairs effort on financial education for women. However, some of the recommendations made then need to be progressed (see Appendix D). In particular, specific initiatives to develop financial education support for Māori and Pacific peoples have started, but need more work.

Recommendation 9

That the Retirement Commission, in 2008, develops financial education initiatives targeted for those on low incomes, including Māori and Pacific groups.

Those low income people who do not join KiwiSaver will miss out on the incentives available. The next chapter considers the fairness issues this raises between savers and non-savers.

Home ownership

Home ownership is especially important to the savings debate in New Zealand, where housing contributes relatively more, and private superannuation assets less, to total net worth than in other OECD countries.

The Reserve Bank, for example, is concerned that New Zealanders rely too much on investment in housing. Some people own multiple properties as investments. The risk of this lack of diversification is that households become vulnerable to economic shocks affecting house prices, and to over-optimistic assessment of the potential capital gain[27]. However, this concern could be mis-interpreted as discouragement of investing in a house to live in.

The importance of home ownership in retirement

Around 80% of those aged 65 and over currently own their home[28]. Preserving a high proportion of people reaching retirement without a mortgage is a fundamentally important element of retirement policy. This is because investment in housing can contribute to a positive retirement in many ways:

» Net retirement income is boosted for a retired person living in a home which he or she owns mortgage-free, because living costs are lower compared with living in rented accommodation.

» The reported standard of living in retirement is better for those who own the home they live in mortgage-free than for those who do not (see Table 4).

» Enabling an older person to live in his or her own home is central to 'ageing in place', which is part of New Zealand's Positive Ageing Strategy, and the preferred option of many older people.

» Property investment can be a source of retirement funds. Properties that have been rented out can continue to be rented, or can be sold. The house that the retired person lives in can be sold in order to move to a less expensive one, or home equity can be released from it while it is still occupied[29].

27. See Reserve Bank submission to this Review.
28. Estimate including homes owned by Family Trusts, Preston (2007) report for this Review, Table 34. Note that the data in this paragraph has some issues, so the trend is indicative.
29. See chapter 7.

Table 4: Proportion of New Zealanders aged 65+, of each housing tenure, reporting different levels of hardship, 2004[30]

Living standard	Owning their home	Renting from a private landlord	Renting from Housing New Zealand
'Good' living standard	58%	19%	13%
'Comfortable' living standard	37%	57%	46%
'Some' hardship	3%	14%	9%
'Severe and significant' hardship	3%	10%	32%

The increasing difficulty of achieving home ownership

Home ownership is falling in all age groups[31]. In 1991, 84.4% of those aged 65 and over owned their home. By 2006, this had dropped to 79.5%. More concerning is the drop in the proportion of younger people buying a home. For example, in 1991, around 69% of those aged 30-34 owned their home; by 2006, this had dropped to around 53%.

One pressure making it difficult for younger people to buy a home is the increasing cost of servicing a mortgage. Some key figures illustrate this[32]:

» Average house prices increased by over 40% between 2003/04 and the first quarter of 2007.

» Over the same period, average interest rates on new mortgages increased from 7.4% a year to 9.6% a year.

» On average, 7.6% of all households' disposable income was used to repay mortgage debt in 2003/04, but this had risen to 11.6% by June 2007.

The overall effect of these trends is that buying a home through a mortgage takes a higher share of income than it used to.

One measure of the affordability of buying a house through a mortgage is the percentage of average earnings required to meet the cost of interest payments for a median house purchase. The higher this measure, the more unaffordable buying a house is.

Using this measure, the Reserve Bank[33] has calculated that home affordability has steadily deteriorated since 2001; at March 2007, this percentage was at a 20-year high, and was 45% higher than the average for the period 1992-2007. Using a slightly different measure that adjusts for the effects of inflation, home affordability deteriorated by less over this period. Nevertheless, by March 2007 the percentage of average income required was still 30% higher than the 1992-2007 average, with periods of only slightly worse affordability in 1991 and 1996-98.

For those who do have a mortgage, higher repayments mean that saving in other ways for retirement becomes more difficult. However, those who do not have a mortgage run the risk of reaching retirement without owning a home. People on lower net incomes, who find saving difficult, are likely to find buying a home difficult also. The affordability of housing is therefore a central issue in retirement planning, and for many New Zealanders, buying a home is a crucial part of personal retirement planning.

30. Ministry of Social Development (2006) *New Zealand Living Standards 2004*.
31. Estimate including homes owned by Family Trusts, Preston (2007) report for this Review, Table 34.
32. Figures from Brian Easton *Mortgage Stress: How much has it risen?* Note commissioned by the Sunday Star Times 5 August 2007, and Reserve Bank of New Zealand *Financial Stability Report*, November 2006, p. 11.
33. Reserve Bank Internal Memo, October 2007.

Recommendation 10

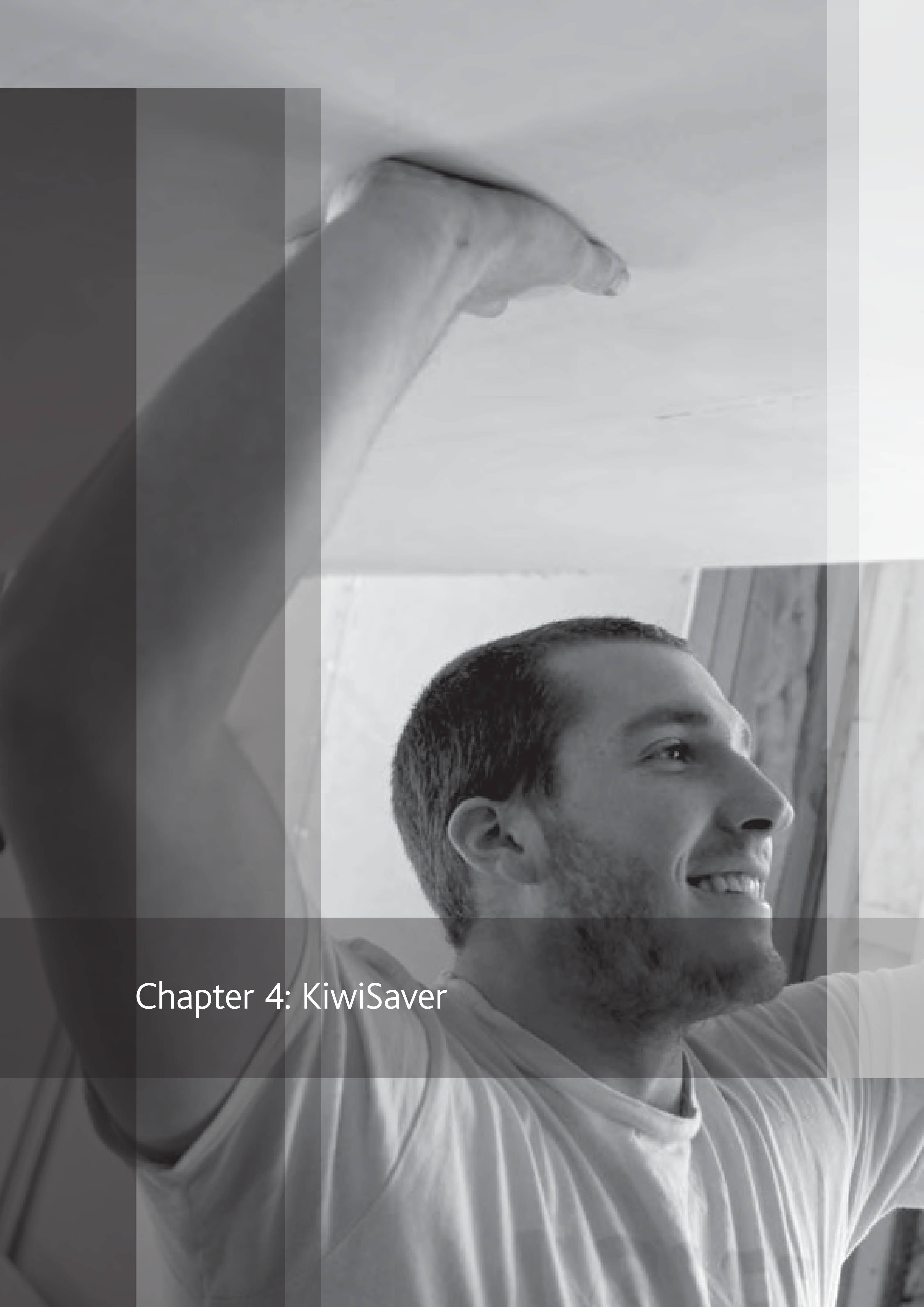
That the messages of government and other public bodies on the concern that New Zealanders tend to over-invest in residential property are referenced to multiple housing investment, and that such messages reflect that investing in a mortgage to buy a home to live in is an important part of preparing for a good retirement.

Further issues

The Department of the Prime Minister and Cabinet has begun a project to address the affordability difficulties caused by high house price inflation and volatility. This is welcomed by the Retirement Commission, because of the critical impact that owning a home has on preparation for retirement.

There are also signs that housing costs for older people have increased in the last couple of years. Accommodation Supplement is a means-tested benefit available to help with housing costs such as rent, board, rates, mortgage payments and essential repairs. The number of Accommodation Supplement claimants aged 65 and over has been steadily increasing for some years. Since the beginning of 2005, it has increased from 4.0% to 4.5% of NZS recipients. The increase has been most marked among people renting, but an increase is also evident among people who own their own home[34]. The Ministry of Social Development is monitoring this trend and investigating possible reasons for the increase.

34. From Ministry of Social Development administration data.



Chapter 4: KiwiSaver

As discussed in the previous chapter, KiwiSaver is a significant new way to save for retirement, although some of the reasons for its introduction go wider than retirement income policy alone. This chapter considers how effective KiwiSaver will be at increasing retirement savings.

Box 5 gives an overview of the design of KiwiSaver. Legislation, principally the KiwiSaver Act 2006, should be referred to for specific detailed rules[35].

Why include KiwiSaver in this Review?

The terms of reference of this Review suggested that KiwiSaver should not be a focus, as considerable debate had already led up to the original KiwiSaver proposal. Following a recommendation for the government to consider a work-based savings plan in the 2003 Periodic Report, a working group reported in 2004, public submissions were received, and KiwiSaver was announced in the Budget in May 2005.

Further scrutiny was then applied before the KiwiSaver Act 2006 was passed. During that time, a further incentive was announced: the exemption to Specified Superannuation Contribution Withholding Tax (SSCWT) for employer contributions to KiwiSaver.

In Budget 2007, major changes were announced to KiwiSaver: employer contributions were made compulsory for employees who join KiwiSaver, and tax credits paid by government were introduced for both member and employer. The incentives in KiwiSaver now more than triple the value of an employee contribution of $20 a week.

The revised 'KiwiSaver II' is significantly different from 'KiwiSaver I' as envisaged in Budget 2005. The sudden major enhancements will change what KiwiSaver may achieve, and introduce new risks to retirement income policy. As the later revisions were not part of the earlier debate, and are significant, it is appropriate that this Review consider KiwiSaver.

The chapter starts by considering the merits of KiwiSaver, although as it began in July 2007, it is too early to evaluate its effectiveness. Increased risks are then identified: that the distribution of retirement incomes may unfairly diverge; that KiwiSaver has made retirement income policy more complicated and unstable (including it becoming more likely that calls for fully compulsory saving will intensify); and that new fiscal risks have been introduced. The chapter concludes by considering specific issues to do with KiwiSaver's default funds.

35. See also www.kiwisaver.govt.nz.

Box 5: Key features of KiwiSaver

KiwiSaver is a voluntary, long-term savings initiative that for most people will be set up through the workplace. This means that they will receive information from their employer, and their KiwiSaver contributions will come straight out of pay.

The KiwiSaver account for any individual will be a savings plan run by a financial services provider. Organisations wanting to provide KiwiSaver schemes must meet specific criteria to obtain Inland Revenue certification and meet Government Actuary registration requirements. KiwiSaver schemes are governed by trust deeds and regulated like other superannuation schemes.

Most employees are automatically enrolled in a KiwiSaver scheme when they start a new job. They can opt out and others can join, subject to specific rules. An employee can choose a contribution level of either 4% or 8% of salary, and can choose a KiwiSaver fund from any registered provider. The employer may choose a KiwiSaver scheme for employees who do not do so themselves. The Government has appointed six 'default' KiwiSaver scheme providers for auto-enrolled members who do not make a choice, and whose employer has not chosen a preferred scheme.

The government provides a number of incentives to join KiwiSaver. It:

» Contributes $1,000 (tax-free) to each member's savings on first joining KiwiSaver.
» Pays a member tax credit by matching member contributions up to $20 a week for members aged between 18 and the age of fund withdrawal.
» Pays a fee subsidy of $20 into each member's account every six months.
» Offers a first home deposit subsidy of up to $5,000 to people who meet specified criteria.
» Exempts employer contributions to members' KiwiSaver accounts from SSCWT up to a maximum of 4% of the employee's gross pay.

In Budget 2007, the government proposed that from 1 April 2008, employers:

» Must match employee contributions for KiwiSaver, to be phased in over four years (starting at 1% of an employee's gross salary and rising to 4% by 1 April 2011).
» Will receive a tax credit from government of up to $20 a week per employee.

Legislation giving effect to these changes is currently before Parliament and is expected to be enacted late in 2007[36].

Funds are available, tax-free, to KiwiSaver members only at NZS eligibility age (currently 65), or after 5 years of membership, if later; or in case of permanent migration, significant financial hardship or severe illness; or, in part, to buy a first home.

There is no Crown guarantee of the performance of KiwiSaver schemes.

36. In the remainder of this chapter no further references to these features of KiwiSaver being 'subject to legislation' are made.

Merits of KiwiSaver

To complement the state provision of NZS, KiwiSaver provides a private savings vehicle designed to encourage and enable people to build up some financial assets for use primarily in retirement. The workplace provides good access to a savings vehicle for many potential savers.

KiwiSaver should make the biggest difference to young people: the longer people have to save, the more they will be able to accumulate. It therefore meets a concern identified in the previous chapter: that younger people may be more at risk than older people of reaching retirement with poor savings.

The introduction of KiwiSaver into retirement income policy has some key advantages:

For savers

- KiwiSaver is simple to join and stay in. Employees are auto-enrolled on changing jobs, using the psychology of inertia to make it more likely than not that an employee will join and stay saving in the scheme. Non-employees and the self-employed can opt in.
- The KiwiSaver account is portable on changing jobs. This should cost less than having one account per employer. It also removes the opportunity to take money out at job change.
- For employees who are KiwiSaver members, contributions are deducted from pay before there is a chance to spend the money. Subject to certain rules, a break in contributions can be made (a contributions holiday). This means people are less likely to feel difficulty in saving.
- Most saving is unable to be accessed until the age of eligibility for NZS (currently age 65), so it is earmarked for retirement. It is therefore an easy way to put money aside for those who can afford to save, but need some discipline to do so.
- KiwiSaver offers incentives for saving. The $1,000 kickstart lump sum on joining KiwiSaver, annual fee subsidy of $40, tax credits to match an individual's contributions up to $20 a week, exemption from SSCWT for employers' contributions, and tax credits to match employer contributions up to $20 a week add up to a very generous package by international standards.
- The generous incentives, and compulsory employer contributions, should help to overcome procrastination to start saving, by making it an easier decision. For example, the changes made for KiwiSaver II enabled the Retirement Commission to simplify the message about whether it would be in an individual's best interests to join KiwiSaver. Instead of needing to consider several factors, the decision now depends on just one: can you afford it?
- There are incentives for first home purchase of up to $5,000, depending on household income and the price of the home. This feature of KiwiSaver recognises that buying a home to live in is an important part of retirement planning.
- Because KiwiSaver is voluntary, individuals can make decisions about their own account. This may help to improve consumers' understanding of saving.

For the wider economy

- Potentially KiwiSaver will strengthen New Zealand's capital markets, as financial assets increasingly become part of the asset mix of typical households. It is also hoped that a stronger economy will emerge, with less pressure on inflation and current account deficit[37].
- The voluntary rather than compulsory nature of KiwiSaver means that government avoids an open-ended guarantee on the value of future retirement benefits. Moral pressure for government to mitigate investment losses is higher in a compulsory scheme than in one which is optional.

37. Memorandum to Cabinet 19 April 2007 *Budget 2007: KiwiSaver Plus*.

Evaluating KiwiSaver

KiwiSaver is the world's first national auto-enrolment retirement savings scheme. Only one other country, the UK, plans to develop such a scheme, which will differ in several design aspects. Given that KiwiSaver is a unique innovation, its significance for New Zealand's retirement income and wider policy, and the significant cost to taxpayers of funding its set-up and ongoing incentives, it is clearly vital to measure KiwiSaver's impact and understand its effectiveness. It will also be important to understand how other government policies, such as Working for Families, are impacting on KiwiSaver take-up.

The evaluation of KiwiSaver planned by Inland Revenue, with the other agencies involved in the scheme[38], indicates that there will be fairly rigorous assessment at least to 2013. Evaluation over a longer period will be needed to assess actual retirement benefits for long-term savers.

Most of the evaluation measures are not easily available from administrative data, but depend on interpretation of survey results. This will not be straightforward, and the temptation may be to rely on easy measures, such as total numbers enrolled or dollars invested, to indicate whether KiwiSaver is a success.

However, these easy measures will not tell us whether KiwiSaver has achieved better outcomes for members, compared with what would have happened if it had not been introduced. For example, will overall retirement wealth be improved, or will saving simply shift from one asset class to another?

The evaluation of KiwiSaver needs to be completed as planned, and to be continued beyond 2013, with an emphasis on outcomes rather than process.

The prospect of diverging retirement incomes

As long as NZS continues, there should be equity in basic retirement incomes. But the potential for retirement incomes to be higher than NZS differs between savers and non-savers. Any saving scheme will lead to a gap in retirement income between those who have saved and those who have not.

Such a gap is compounded by the current KiwiSaver design and level of incentives. The member and employer tax credits in KiwiSaver II will cause more of a gap than KiwiSaver I would have done, where the incentives were just the $1,000 kickstart and the fee subsidy.

Further, although the tax credits are capped at a dollar amount, the exemption to SSCWT is capped as a percentage of salary. Therefore higher earners will benefit more from this incentive than lower earners.

Some low income people, as the last chapter noted, may find that NZS provides adequate retirement income. Low paid workers may find it hard to go without the minimum proportion of salary required to join KiwiSaver. Low earners may be less likely to join KiwiSaver than high earners, and will therefore miss out disproportionately on the incentives.

This may be a particular problem if wage bargaining in a company keeps wages low, in order to enhance the employer contribution to KiwiSaver. Low wages affect all employees, while only those joining KiwiSaver benefit from the employer contribution. If proportionately more high earning than low earning employees join KiwiSaver, the gap in total remuneration and ultimate retirement benefits would widen.

38. Inland Revenue, Ministry of Economic Development, Housing New Zealand (2007) *KiwiSaver Joint Evaluation Strategy.*

The structure of KiwiSaver may also cause other distortions:

- KiwiSaver II is of more value to employees than to the self-employed and those who are not in paid work. Non-employees receive the member credit on their own contribution, but they do not have any employer contribution on which to receive the employer credit or SSCWT exemption.
- The cost of KiwiSaver's incentives may not all be 'spent' on encouraging new saving. KiwiSaver may be taken up by people who are saving already, as a substitute for all or some of their existing saving, because it offers better incentives. For example, people aged 60 or over with sufficient superannuation may divert some of their saving to KiwiSaver, because it provides them with enhanced benefits which they can access after only five years.

The incentives in KiwiSaver come out of general taxpayer funds. Whether the incentives are an *unfair* subsidy from non-savers to savers is a debatable point. But to start the debate, the facts on the distribution of these incentives will be needed. The evaluation of KiwiSaver should examine how much different groups actually receive from the scheme's incentives.

Recommendation 11

That Inland Revenue fulfils and extends its plans beyond 2013 to evaluate KiwiSaver on the *outcomes* from the policy, in particular, whether KiwiSaver has improved retirement wealth overall for households, and what its distributional impact has been. That these outcomes are examined by analysing the spread of take-up and the value of incentives received by different households: by income level, gender, ethnicity, age, whether disabled, and employment status.

The minimum contribution

One approach to making it easier for low earning employees to save would be to lower the minimum contribution to KiwiSaver to, say 2% of salary (rather than 4%). A majority of the Select Committee reporting on KiwiSaver and other amendments in late 2007 recommended transitional changes that would allow this temporarily from 1 April 2008 if the employer agreed, from that date, to contribute at least 2% to an employee's eventual 4% of contribution[39]. This would mean that employee and employer could agree on a contribution schedule of 2% of salary from employee plus 2% from employer for 2 years starting 1 April 2008; 3% plus 3% starting 2010; and 4% plus 4% from 2011.

A positive impact from this recommendation depends on an agreement being made between employer and employees. While it may help employees to get used to saving and to build up to a 4% contribution, it does not solve the problem of the low income worker who would not be able to afford to give up 4% of salary. If this option is pursued, the level of KiwiSaver participation for low income workers, in particular, should be carefully monitored throughout the transition period, to see if increasing the minimum contribution affects membership.

39. Report by the Finance and Expenditure Committee, Taxation (Annual Rates, Business Taxation, KiwiSaver, and Remedial Matters) Bill November 2007.

Retirement income policy more complicated and unstable

The introduction of KiwiSaver, and especially KiwiSaver II, has made retirement income policy more complicated. Compulsory employer contributions, and the different forms of incentives, add to the number of features that define KiwiSaver.

The impact of these complexities on the ability of prospective savers to make informed decisions is considered in the next chapter. Here the focus of concern is the impact on the stability of policy: how likely is it that KiwiSaver's features will be changed by future governments?

For example, a reduction or withdrawal of the KiwiSaver fee subsidy would be a retrospective charge: it would apply every year until KiwiSaver assets could be taken out at age 65. Such a change would be unpopular. By contrast, an increase in the member tax credit would be popular.

These features are relatively easy to change, as shown by the way in which changes were made at short notice for KiwiSaver II. Such changes may well become a point of difference between political parties, and lobbying points for interest groups. More popular (and expensive) changes are perhaps more likely than unpopular ones.

But stability in the design and detail of KiwiSaver is important for people trying to plan the contribution it will make to their retirement. Different political parties may have different intentions on KiwiSaver and its many features. These intentions should be transparent to New Zealanders, so that they can make decisions on savings taking into account the likely stability of KiwiSaver.

The compulsion argument

KiwiSaver may promote further debates about whether saving for retirement should be compulsory. KiwiSaver II means that there is now a vehicle with partial compulsion: employers must pay additional contributions for employees who choose to join and have contributions deducted from their pay; and auto-enrolled employees have to take action if they decide they want to opt out.

Making KiwiSaver fully compulsory for all employees or workers could seem an easy policy, so there might be increased calls for compulsory private saving to be introduced via KiwiSaver. Such calls are unhelpful to the stability of policy.

The progress of the Australian compulsory private superannuation accounts ('Superannuation Guarantee', SG) is often used to support compulsion for New Zealand. This Review commissioned Infometrics to prepare an assessment of the Australian retirement income system, with comparisons to New Zealand. It concluded that:

» SG is likely to provide a good portion of the total retirement income of Australian households.

» No evidence was found to suggest that SG has generated higher savings, stronger wealth accumulation or higher rates of economic growth in Australia than might have developed in the absence of SG.

» It is likely that any positive stimulus of SG on saving has been offset to some extent by reduced non-superannuation saving, gains in asset prices (especially housing), increased access to credit, and reduced precautionary motives for saving.

» Wealth accumulation in New Zealand has been similar to that in Australia, but has been more dependent on housing. It remains to be seen how the overall outcomes of these two different patterns compare. Much will depend on how asset values move.

As the 2003 Periodic Report also concluded, Australia and New Zealand are in fundamentally different situations. Each has evolved a retirement income policy for its own social contract: more self-reliance in Australia (with a means-tested public pension), compared with a more universal approach (based on NZS) in New Zealand. It is therefore not appropriate to think that the Australian model can simply be bolted into New Zealand policy.

This assessment therefore provides no evidence that compulsory private saving for retirement in New Zealand is necessary or desirable.

New Zealanders voted decisively against a compulsory savings plan in 1997. The 2003 Periodic Report continued the perspective of previous Reviews: that saving should be voluntary, supported by financial information and education. The Treasury does not support compulsory schemes, on the basis that 'they suffer the disadvantage of inflexibility that is likely to be costly in the face of varying individual circumstances. It is desirable to avoid such inflexibility[40].' A compulsory scheme may also carry with it a higher responsibility for government to compensate for poor investment performance. This would be an expensive burden for taxpayers.

The Retirement Commission's work in giving New Zealanders information and education on personal financial matters clearly points to the conclusion that saving in a prescribed way would not be the right thing for everyone at all times.

KiwiSaver was developed as a voluntary scheme. The first phase of evaluating KiwiSaver will not be completed until 2013. To consider compulsory saving before then would be premature, and would distract from important current issues. Even after 2013, the arguments set out above against compulsion are still likely to stand.

New fiscal risks

The fiscal cost of KiwiSaver arises from one-off implementation costs and the ongoing cost of the incentives (including the lost tax revenue from the SSCWT exemption). KiwiSaver II introduced new incentives, and therefore increased the cost of KiwiSaver.

Table 5 gives estimates of this cost for 2007/08 and 2016/17.

Table 5: Estimates of the fiscal cost of KiwiSaver in the years shown, $million[41]

	2007/08	2016/17
Implementation and ongoing costs (operating and capital)	86	68
KiwiSaver I incentives (kickstart, fee subsidy, housing deposit subsidy)	285	60
SSCWT exemption[42]	52	223
KiwiSaver II incentives (member tax credit, employer tax credit)	206	1,678
Total	629	2,029

Table 5 shows that the total annual cost of KiwiSaver is expected to be over $600 million in 2007/08, and to reach over $2 billion by 2016/17 (assuming that the same incentives still apply). To put this cost in context:

» Within ten years, the total cost of KiwiSaver will be the same order of magnitude as the capital contribution to the New Zealand Superannuation Fund. By 2016/17, it will be around one-fifth of the net cost of NZS.

40. Treasury (May 2007) *A Synopsis of Theory, Evidence and Recent Treasury Analysis on Saving* p. 4.
41. Provided by Treasury, based on Budget 2005 and 2007 allocations, using the assumption for take-up of KiwiSaver as at Budget 2007.
42. For KiwiSaver and other qualifying superannuation schemes (KiwiSaver accounts for the majority of cost).

» The Budget 2007 announcement of additional KiwiSaver II incentives increased the 2016/17 cost of the total incentive package to nearly 7 times the cost of the previous incentive package, including the SSCWT exemption, or to 32 times the cost of the incentives originally envisaged in Budget 2005.

The swift introduction of more generous and costly incentives in KiwiSaver II has made the fiscal cost of KiwiSaver a more significant issue. However, some critical cost questions are as yet unanswered:

1. **How much will KiwiSaver incentives cost long-term?** The costs of KiwiSaver beyond 2017 are not available. These costs can be expected to continue to increase for some time, as more people join than leave. The costs are uncertain. They depend on how many people join KiwiSaver, but as yet there is no experience on which to base future assumptions about take-up. The costs of KiwiSaver are highly sensitive to take-up rates. Table 5 assumes take-up of 50% by 2016/17. But Treasury estimates[43] that if take-up were to reach 65% of the workforce by 2016/17, then the incentives would cost around one-third more than the amounts shown in Table 5.

   The costs also depend on whether the dollar value of the incentives increases. In line with projections of this type, the cost estimates in Table 5 assume that this dollar value stays at today's level. However, it could be increased or decreased by future government policy decisions.

2. **Will the cost of the incentives be too high?** The incentives are now a significant cost that future governments will have to consider. The danger is that these costs become too high, and something has to change. If the KiwiSaver incentives are cut, not only will it be unpopular, but it may reduce the public's confidence in being able to rely on government savings policy. But cutting other costs to fund KiwiSaver incentives, either in retirement income policy or outside it, is also likely to be unpopular.

   The worst case, from a retirement income policy perspective, would be if New Zealand Superannuation were cut to fund KiwiSaver incentives. KiwiSaver has been designed to work on top of NZS, not instead of it. Reducing the advantages of NZS would hurt more people more seriously than cutting KiwiSaver would.

3. **Will the New Zealand taxpayer have value for money from paying for these incentives?** Evaluation of the effectiveness of KiwiSaver will partially answer this question. But we have lost the chance to see how well lower incentives (at lower fiscal cost) would have worked. If the original KiwiSaver had been left as planned to run for some years, then we would have gained some understanding of the effectiveness of the unique KiwiSaver design, including the major innovation of automatic enrolment, but without the generous incentives of KiwiSaver II. Given the probable disinclination of politicians to reduce incentives, New Zealand is likely to be locked into a high-incentive/high-cost system without ever knowing whether a lower-incentive/lower-cost system would have been just as effective.

Underlying all these concerns is the lack of information on how much KiwiSaver will cost long-term. This is a serious problem, given that KiwiSaver is an expensive policy, and that retirement income planning is a long-term issue. KiwiSaver is a new product, and there are, understandably, many unknowns about its future. But Treasury's cost forecasts to 2050, produced using its long-term fiscal model, should now include KiwiSaver. Best estimates of likely future costs should be published and discussed, with particular regard to the sustainability of KiwiSaver in its current form.

Recommendation 12

That Treasury, by mid-2008, publishes the likely future fiscal cost of KiwiSaver on different demographic and economic scenarios, with commentary on its sustainability in its current form over short-, medium- and long-term time periods.

43. Office of the Minister of Finance and Office of the Minister of Revenue, Memo to Cabinet, 19 April 2007, *Budget 2007: KiwiSaver Plus*, Table 8. This estimate does not include the impact of the SSCWT exemption. A take-up of 50% of the workforce by 2016/17 was Treasury's principal forecast assumption as at Budget 2007.

Potential unfairness of default funds

People who are auto-enrolled into KiwiSaver without making any active choices are randomly assigned to one of six default providers. These providers have been chosen by a tender process run by the Ministry of Economic Development.

Having a default position is important, as people cannot be forced to choose a fund. People assigned to one default fund can choose to switch to another fund if, for example, performance is poor, but default funds exist so that people do not have to be active investors if they choose not to be. Given the policy of having default funds, it seems reasonable for a default member to expect that he or she should not be worse or better off as a result of being randomly assigned to KiwiSaver Default A instead of KiwiSaver Default B.

The two main ways in which fund performance could vary are by having different investment returns over the period of investment, and by having different costs.

Returns: The scope for different investment results from default funds is limited by asset restrictions, so that default funds have to invest predominantly in cash. In practice, five of the six default funds have 20% of their funds in growth assets, and one has 24%.

Costs: KiwiSaver default funds are authorised only if their fees are 'reasonable'. In practice, the six default funds charge differently.

To illustrate the impact of cost (holding other factors constant)[44]: an employee earning $40,000 a year and contributing 4% of salary who is assigned to the highest cost default fund could have, after 15 years, a fund $600 lower than someone in the same position assigned to the lowest cost default fund, purely as a result of the fee differences. After 25 years, costs could have caused a difference of $1800.

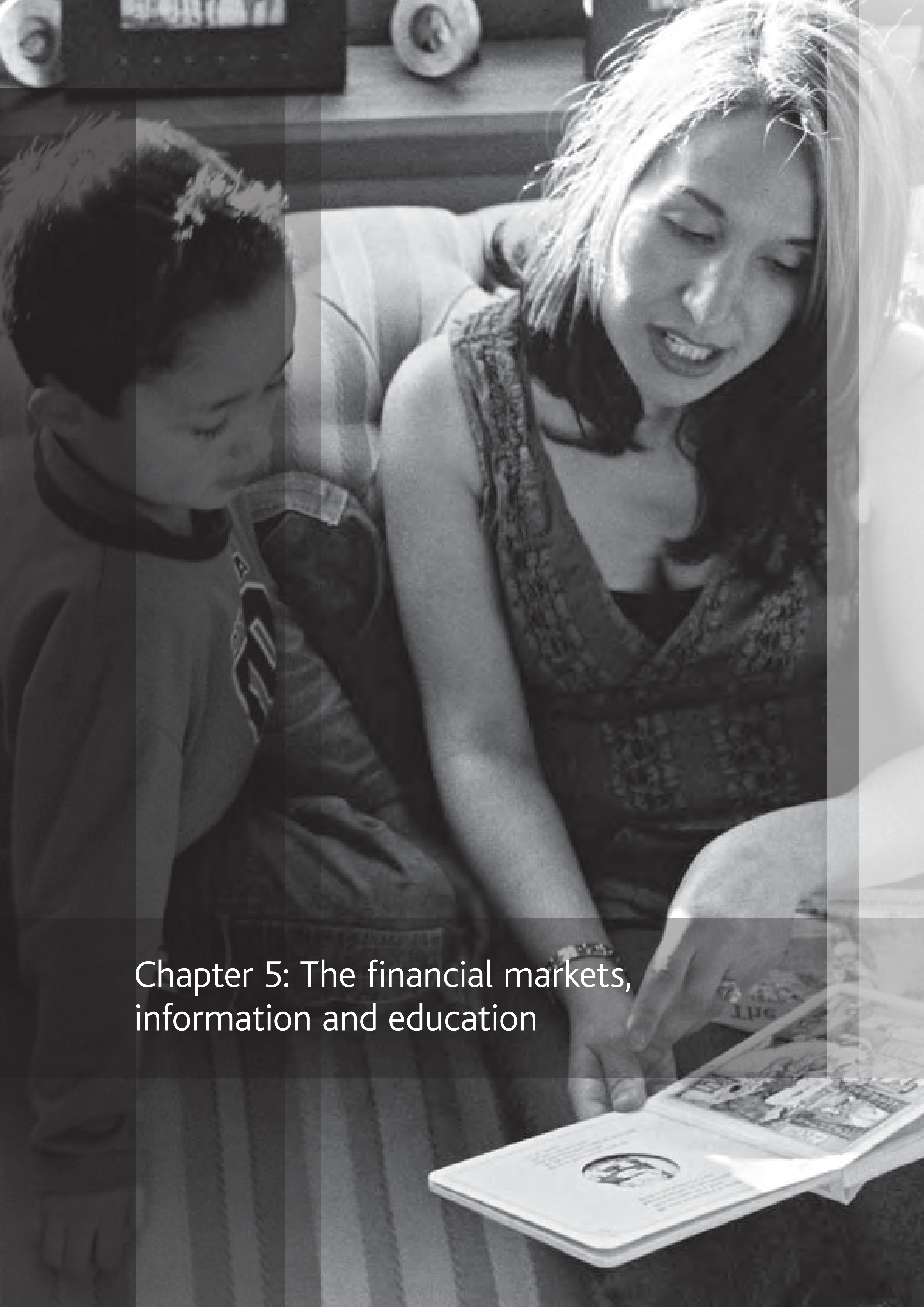
These differences are small in the context of the total KiwiSaver balance, which would be around $75,000 after 15 years and $146,000 after 25 years. Further, long-term performance of default funds would be expected to vary, so the actual differences between default funds could turn out to be smaller or larger than in this example.

However, it seems invidious that anyone auto-enrolled into KiwiSaver should lose out purely as a result of random assignment. There is a strong case that the fees levied by all default funds should be the same, and that the asset mix of default funds should also be prescribed more tightly. It is recommended that the Ministry of Economic Development consider whether such changes would be appropriate.

Recommendation 13

That the Ministry of Economic Development, by mid-2008, reports on whether KiwiSaver default funds should have the same level of fees, on the prescription of asset mix, and on any other changes to default fund legislation in order for passive KiwiSaver members to stand a fair chance of even outcomes.

44. Examples from the fees calculator developed for the Retirement Commission. Calculations assume 5.39% investment return for each default fund after tax and before fees and inflation (the consensus view of long-term investment returns for each asset class, consistent with the Retirement Commission's fees calculator, averaged for the asset mix of the six default funds). In practice returns would vary year by year and between funds, but this calculation isolates the impact of fees. Amounts are in today's dollars.



Chapter 5: The financial markets, information and education

Two core elements of New Zealand's retirement income policy framework should be a trusted financial services sector and a financially educated population. This chapter first considers the Ministry of Economic Development's Reviews of Financial Products and Providers and of Financial Advisers. Together, these reviews comprise a major initiative towards a trusted financial services sector. It then considers a specific issue of financial information disclosure for savings products. The final section considers financial education in New Zealand.

Improving financial markets, information and education is a world-wide trend. It is a response to:

» Increasing longevity, which means that people need to manage their personal finances over longer timeframes.

» Increasingly well-educated populations, able and willing to make demands of financial services providers.

» Greater policy emphasis on new insights into savings behaviour from behavioural economics, for example, the New Zealand government making auto-enrolment a feature of KiwiSaver.

» Increasing reliance on private savings as part of government policy for retirement planning. In some countries, this has meant a shift away from public pensions towards more individual private saving. This has often been accompanied by a shift in the type of private pension provision from 'defined benefit', where the individual knows what the benefit will be, to 'defined contribution', where the individual takes the risk of what the benefit will turn out to be. In New Zealand, where NZS has stayed in place and there has been relatively little defined benefit superannuation, the issue is more one of people being introduced to defined contribution retirement savings for the first time, through KiwiSaver.

MED's Reviews of Financial Products and Providers and Financial Advisers

The MED reviews are expected to bring in new regulations on the subjects outlined in Box 6. These regulations will cover products used for retirement savings, including KiwiSaver and superannuation schemes, and are therefore crucial to this Review.

Box 6: Subjects covered by MED's Reviews

Subjects for which decisions have been made, and legislation is being drafted:

» Development of a co-regulatory model for the regulation of financial advisers.

» Registration of all financial services.

» Improved supervision of corporate trustees.

» Improved prudential supervision of registered deposit takers (to be advised on and monitored by a single prudential regulator).

» Providing for a comprehensive approach to consumer dispute resolution and redress.

» Insurer prudential and market conduct regulation.

Subjects for which decisions are due to be taken at the end of 2008:

» Supervision by corporate trustees of collective investment schemes and debt issuers.

» Security offerings disclosure.

» Regulation of mutuals' governance.

» Platforms and portfolio management services.

While this initiative would have been important to improve consumers' confidence in the financial services sector at any time, the introduction of KiwiSaver has made the MED reviews particularly relevant to retirement income policy now, especially because of the issues outlined below.

New investors: For some people, KiwiSaver will be their first contact with investment or savings beyond a simple cheque or savings account. The amount of money in KiwiSaver accounts is expected to become a significant part of household assets, especially with the enhanced level of government incentives. KiwiSaver funds may well be invested in riskier assets than people have been used to. New investors need to know they can have confidence in the timeliness and effectiveness of the MED review implementation ensuring high standards in, for example, the information they are given, the careful management of their invested funds, selling practices, and consumer protection.

Auto-enrolment: By introducing the policy of auto-enrolment, because it believes people are more likely to join KiwiSaver if they do not need to take any action, government is directing individuals' funds into financial services companies. The MED reviews therefore have an obligation to ensure the highest standard of practice by the financial services sector where full choice may not be exercised by the consumer.

Complex decisions: Although auto-enrolled default savers do not need to make any decisions, people would be well advised to make active decisions on whether to join or opt out of KiwiSaver, and which fund provider and investment mix to choose. These decisions are not just one-offs, but should be reconsidered as individual circumstances and products change. However, there are 30 KiwiSaver providers, with around 180 different funds, varying by investment mix and cost. Decisions are therefore complicated, and some of the information is opaque. The MED reviews will consider what information disclosure is appropriate. The specific issue of cost disclosure is considered in the next section.

Market efficiency questions: New Zealand's capital market is not well developed by international standards; indeed, one rationale for the introduction of KiwiSaver is that it will help to develop the market. There is some evidence from Australia to suggest poor returns for investors there, relative to a more developed market such as the UK[45]. This raises the question of how efficient New Zealand's undeveloped capital market will be, and how its efficiency will affect returns. The timely implementation of MED initiatives that will improve the efficiency of the market are therefore critical.

Currently, specific regulations give the Government Actuary a supervisory role for KiwiSaver and superannuation schemes. It is appropriate that KiwiSaver and superannuation schemes are treated as special cases of collective investment schemes. The reasons for this include: the lock-in of funds; the tax incentives available; the involvement of an employer who contributes to members' retirement saving; and the defined benefit nature of some superannuation schemes. The MED reviews will need to carefully take into account the special cases of KiwiSaver and superannuation schemes, as part of the general review of collective investment scheme regulation.

Many of the recommendations of the MED reviews will not be implemented until after the next Retirement Income Policy Review in 2010. At this stage, many key detailed decisions have not been made. This Review has found that the finance sector is expecting these changes, and implementation, particularly relating to advice, should be brought forward. The 2010 Review will be an opportunity to consider progress.

Recommendation 14

That the government instructs the Ministry of Economic Development to fast-track the intended regulation of financial advisers.

Recommendation 15

That the 2010 Review of Retirement Income Policy considers the progress in implementation of the Ministry of Economic Development's widely-supported initiatives to develop high standard consumer protection and market conduct regulation in the financial sector.

Financial information disclosure

As the previous section noted, high standards in KiwiSaver and other investment product information disclosure will become more important. For KiwiSaver and for all other collective investment schemes, the goal should be to provide the consumer with transparent information on charges, in an understandable way, so that the consumer can use the information as easily as possible, as part of his or her decision on which fund to invest in.

Compared with some other countries, New Zealand has lighter regulation on cost disclosure, and on levels of allowable costs. As in other countries, consumer activism may mean that the costs of KiwiSaver products become a more important issue in New Zealand.

45. Infometrics (2007) Report for this Review p.32.

In the UK, for example, the costs of investment products are central to policy. Standard ways of disclosing costs in retirement savings products and other collective investment schemes have been in place for some years[46]. The UK government is planning an auto-enrolment private retirement savings plan with a target annual cost of 0.3% of funds under management, compared with current product fees of 1% to 1.5%[47]. In the Australian compulsory superannuation system, annual management charges are as low as 0.4% of funds under management for some accounts.

Comparable figures for KiwiSaver are not easily available, but default charges seem to be around 0.3% to 0.6% of funds under management. More actively managed growth funds appear to have fees around 1% to 1.2% of funds under management.

Costs are not the only issue to be considered; higher costs may imply more active management and better returns. But the overall cost impact of fees should be one important factor in a consumer's decision to invest. The UK government suggests that for an individual who saves regularly over a working life, a reduction in annual fees from 1.5% of funds under management to 0.5% can increase fund size at retirement by one-quarter[48].

Making fees transparent

The Retirement Commission has been working with actuaries and KiwiSaver providers to gather data on the fees levied on all the available KiwiSaver products, in order to show comparison of the overall cost impact. This initiative has had to overcome a number of difficulties:

» Not all fees are readily explained in the investment statement or other material.

» Around 10 different types of fees can be identified, including: those charged regularly as a percentage of funds under management (e.g., administration fee, trustee fee); a membership fee charged regularly as a dollar amount; fees charged in specific circumstances (e.g., switching funds, exiting, out-performance); and fees to cover specific costs as charged (e.g., legal, audit).

» The overall cost impact of fees charged cannot therefore simply be compared across companies. Calculations are needed to work out the 'one figure' that describes the overall cost impact on a consistent basis.

» This 'one figure' could be expressed as a dollar amount, or as a percentage of funds under management (as in the UK), or both. The Retirement Commission prefers a dollar amount, as consumers seem to understand this more easily.

» The 'one figure' overall cost impact of fees can be calculated only by making some assumptions, for example for investment return, and can be illustrated only for selected contribution amounts and investment terms. This means that the overall impact is illustrative rather than specific to an individual purchaser.

» Comparisons across different products are valid only if the funds being compared have similar investment mixes. Actively managing an equity portfolio is more expensive than keeping monies in a cash fund. Judgement is required to choose the most helpful comparison basis.

As the discussion above shows, it is currently difficult to obtain correct information on what fees are charged, and to compare them consistently. There is therefore a case for regulation to prescribe specific ways in which companies can levy fees, and to mandate a format for disclosure of the overall cost impact. Transparency on fees will also enable regular reviews of the levels of fees operating in the market, and this will show whether competition is working to keep fees low.

Regulation will have to be balanced with allowing providers to charge in a reasonable number of different ways for competitive advantage. A provider may charge higher fees than a competitor

46. See http://fsahandbook.info/FSA/html/handbook/COB/6/6.
47. Department for Work and Pensions (2006) *Personal Accounts: A New Way to Save* p. 94.
48. Department for Work and Pensions (2006) *Personal Accounts: A New Way to Save* p. 91.

because of higher service levels, or more active investment management. There will also need to be information and education on how to use comparison tables, making it clear that costs are only one factor in an investment purchase decision, alongside issues such as potential investment return and risk, and service from the provider.

The Retirement Commission and savings industry voluntary initiative to publish a consumer-friendly KiwiSaver fee comparison, as described above, will provide a good learning experience in the immediate future. Meanwhile, the MED review should consider the case to strengthen cost disclosure regulation for KiwiSaver and other collective investment schemes.

Recommendation 16

That the Retirement Commission, working with the savings industry, keeps its comparison information on the cost of KiwiSaver products up to date and accessible to the general public.

Recommendation 17

That the Ministry of Economic Development considers, as part of its ongoing review of the financial sector, whether the number of fee types for savings products, including KiwiSaver, should be restricted, and whether disclosure of fees on a 'one figure' comparable basis should be mandatory.

Financial education in New Zealand

Good financial information or education does not mean that everyone automatically makes the right financial decisions for retirement. But it is one element of a retirement income policy, alongside straightforward basic public superannuation and encouragement to save, that should help retirement income. Government has an interest in making good information and education about preparing for retirement easily available because[49]:

> *Much of what is important to working life choices made to increase living standards after retirement is not universally known,* and
>
> *Some people do not have enough understanding about how they can influence their personal situation.*

In many countries, financial education has been embraced as an integral part of policy to help people make the decisions that should improve their retirement incomes. It is clear that financial education needs to cover all lifetime financial issues, as these are all linked in any individual's personal planning for retirement.

As discussed, recent policy – most obviously KiwiSaver – has raised the importance of developing a trusted financial services sector, and high quality disclosure of product information. It has also made good financial education more important than ever. Further, the provision of good financial information or education is a relatively low cost policy option.

In many ways, New Zealand has been a world leader in the provision of financial information[50]. The Retirement Commission's *Sorted* website provides a model that many other countries are trying to emulate. New Zealand is also one of very few countries to carry out a national survey on levels of adult financial knowledge.

49. Cook (2006) *Questions for our times about retirement saving and pensions*, Retirement Commission p. 49.
50. O'Connell (2007) *How effective is financial education?* in *Policy Quarterly* Vol. 3 No. 3, Institute of Policy Studies, Victoria University of Wellington.

The 2006 ANZ-Retirement Commission Financial Knowledge Survey found that many New Zealanders feel confident about managing their financial affairs, and many actively plan for retirement. However, gaps in knowledge are evident.

Low financial literacy levels are found at all levels of income and education. For example, more education and knowledge would be of particular benefit to Pacific peoples, especially in South Auckland, to assist them in their dealings with 'loan sharks' and with their remittances to the Islands.

There seem to be good reasons and enough scope to extend and improve financial information and education, based on better understanding of where and how to target it effectively.

An independent assessment of the effectiveness of the financial information and education currently available to and used by New Zealanders was prepared for this Review by Roorda Research and Evaluation[51]. This made the first attempt at a stocktake of the initiatives available.

Over 40 initiatives were identified in primary and secondary schools, as well as adult education. Providers were national, regional, and local, and both not-for-profit and commercial. As well as the Retirement Commission, they included the Ministry of Education, Enterprise New Zealand Trust, He Oranga Pounamu/Te Runanga o Ngāi Tahu, Housing New Zealand, Plunket, the New Zealand Federation of Family Budgeting Services, and various banks, financial planners and colleges.

Schools and training schemes: The offer and take-up of financial education programmes in schools is patchy. Programmes are run by external agencies, including NGOs. Since 2004, the Retirement Commission has been working with the Ministry of Education to embed the teaching of financial education into the curriculum. But the New Zealand Curriculum is changing, so the provision of financial education is evolving. The programme is on track for introduction into schools by 2009/10, but will require a specific budget for the Ministry of Education to implement.

The Retirement Commission is working closely with the Industry Training Organisations to develop a financial education programme for trade and other training courses, to be delivered by polytechnics and private training establishments. NZQA is developing a series of unit standards for financial education, to be used in both senior secondary school and tertiary institutions.

Adult financial education: There is little financial education available for adults in New Zealand. Courses may cover a single subject, such as budgeting, or a range. There is a diversity of subjects, providers, media used, and target audiences. Evaluations of three programmes found some evidence for their effectiveness, but the evaluations all have limitations, and give little scope for drawing wider inferences.

Nevertheless, some useful indications of what works best were identified. For example, financial education that meets a financial need at the time the need exists helps to engage more active participation than learning about particular areas when they are not relevant. Ongoing programmes that reinforce learning over time work better than short courses.

The limitations of these evaluations, and of those carried out in other countries, reflect the difficulties of evaluating any financial education programme. New Zealand recognises the importance of evaluation and is attempting to build relevant skills.

The workplace: Some adults have access to financial education from their employer. The Retirement Commission supplies materials and support for such programmes. When KiwiSaver was introduced, the Retirement Commission was given additional funding, for a limited period, specifically to develop a workplace-based programme to help people make decisions about KiwiSaver.

Because people are auto-enrolled into KiwiSaver when changing jobs, every year some people will be facing KiwiSaver decisions for the first time. Once a person has joined KiwiSaver, the need for financial planning does not go away. For example, fund switches may be considered, or life shocks may prompt a decision to take a contribution holiday.

51. See Appendix C for access details.

The need for financial information and education in the workplace is therefore ongoing, and the Retirement Commission's role in workplace financial education should not be a 'one-off'. Evaluation of the effectiveness of the material may also lead to enhancements.

Key issues

To summarise the key issues in the provision of financial information and education:

» There is active interest and participation in financial education in New Zealand. Given the increasing complexity of consumer decisions, the known areas of low financial knowledge, and the relatively low cost of financial education, its provision should be enhanced as an integral part of government policy.

» Gaps in the provision of financial education should be addressed. In particular, financial education should be embedded into the schools curriculum, and workplace financial education should be continued.

» Co-ordination between financial education programmes could be improved. This would help to share learning between initiatives on what works best.

» There is scope to improve evaluation of the effectiveness of financial education. New Zealand could take a world lead in understanding how financial education works best. While evaluating all programmes is neither feasible nor appropriate, the major programmes that would be most valuable to evaluate should be identified.

To help fill the gaps in financial education, two recommendations tackle the embedding of financial education in schools and the continuation of workplace-based financial education.

Recommendation 18

That the Ministry of Education, from 1 July 2009, takes responsibility for the schools project currently within the Retirement Commission, to ensure that financial education is embedded in the schools curriculum.

Recommendation 19

That the Retirement Commission maintains and enhances its workplace-based information and education programme.

The Retirement Commission is currently developing a National Strategy for Financial Literacy, working with the other agencies who offer financial education or information. The National Strategy will tackle the key issues outlined above. Although the National Strategy is owned by all of the agencies involved, it will be convenient for the Retirement Commission to monitor progress as part of its statutory annual report.

Recommendation 20

That the Retirement Commission reports annually on progress on the National Strategy for Financial Literacy.

Further, as part of **Recommendation 3**, it was proposed that the Financial Knowledge Survey should be repeated regularly to track progress and to enable better targeting of adult education efforts.

Chapter 6: Employment of older people

As people live longer, it is likely that the extra time available will be split between paid employment and retirement. Employment can make a significant positive difference to New Zealanders' financial and general well-being in later life. It can also contribute to economic growth.

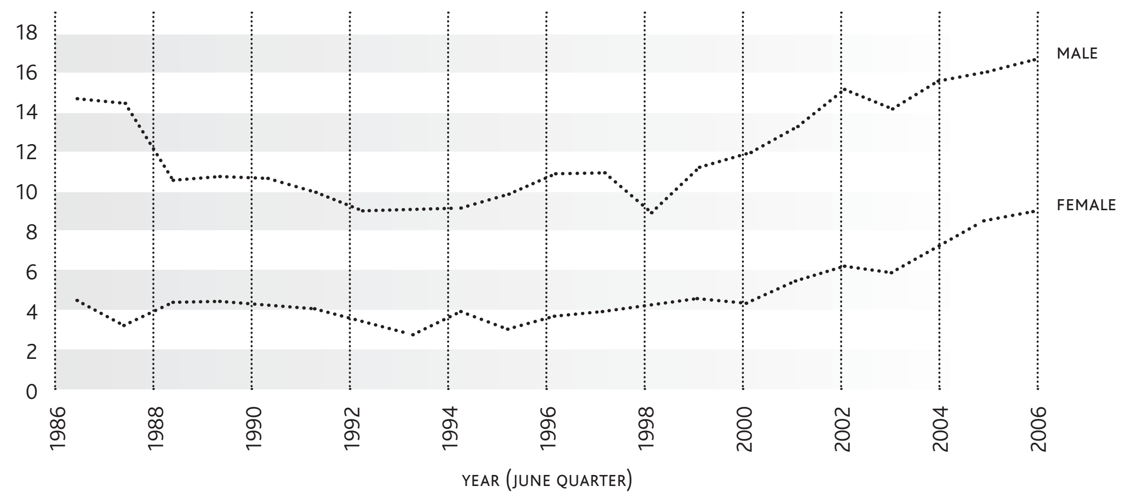
This chapter draws on a paper commissioned for this Review by the Equal Employment Opportunities Commissioner, Dr. Judy MacGregor[52]. It first considers what we mean by older workers, then considers the barriers to older people continuing with paid work if they want to, and concludes with some comments on how efforts should continue to overcome these barriers.

Retirement and older workers

Patterns of 'retirement' are changing and becoming more diverse as people live longer. Some people want to continue working full-time or part-time, in their current jobs or in different ones, as they grow older. Because of the diversity of older workers, there is unlikely to be a 'one size fits all' policy. Indeed, the phrase 'older worker' means different things to different people. The OECD defines an older worker as one who works in paid employment at age 55 and upwards. Here, we are concerned with policies and approaches that need to reflect the transition to partial or full retirement from paid employment.

New Zealand has one of the highest rates of workplace participation of older people in the OECD. Chart 2 shows the growth in New Zealand's employment rates over the last 20 years.

Chart 2: Proportion of the population aged 65 years and over in paid employment, by sex and year, June 1986 – June 2006[53]



The number of older New Zealanders in the workforce has increased dramatically in recent years. From June 1991 to June 2005, over half of labour force growth in New Zealand came from people aged 50 and over. This growth has therefore been a significant contributor to labour supply, and has helped to alleviate skill and labour shortages in a very tight labour market[54].

52. See Appendix C for access details.
53. Ministry of Social Development (2007) *Positive Ageing Indicators 2007*, fig. 54.
54. Department of Labour (2007) *Older People in Work: Key trends and Patterns 1991-2005* p. 3.

The labour force participation rate of people aged 65 and over has been rising since the early 1990s. In 2006 it was 23.9% for men and 11.6% for women. For people aged 65-69, the participation rate was 42.9% for men and 25.3% for women[55].

There are many reasons for New Zealand having a relatively high proportion of older people employed[56]. The age of eligibility for New Zealand Superannuation is likely to be a factor, especially since 1992, when a phased increase in age from 60 to 65 began. However, countries with fewer older people working have had the public pension age of eligibility age set at 65 for longer than New Zealand. The design of NZS, as New Zealand's state pension scheme, is not a disincentive to work, as is the case elsewhere. Most other state pension schemes are means-tested. A relative lack of private superannuation provision in New Zealand, compared with other countries, may be another factor. New Zealand also adopted legislation outlawing age discrimination in the workplace earlier than many other countries. Some older people may also have been more likely to work in New Zealand because of economic conditions, rather than as a result of any particular policy.

Growth in the number of older people working, therefore, may not necessarily continue at the same rate as in the recent past, nor may a more active and targeted policy result in greater rates of employment at older ages.

Barriers to remaining in the workforce at older ages

While people will want to make their own choices, policy should try to enable the widest possible range of options, and reduce any barriers to working at older ages. However, there are still significant barriers in the New Zealand work environment.

Negative attitudes against the older worker are still evident. Despite anti-age discrimination legislation, some employers demonstrate ageist attitudes, and some older workers themselves hold stereotypical views about ageing which can lower their own expectations with regard to employment, training and promotion.

Research has also suggested that there are issues around the availability of the flexible work options that many older people want, a lack of training opportunities for mature workers to improve or update skills, and the availability of suitable information about options that could help older people specifically. There may also be family, home or community commitments and circumstances – such as caring responsibilities, which may especially affect older women – that prevent older people who would like to undertake paid work from doing so.

Some employment-related structures, such as ACC, still use age 65 as a marker. This is often for the practical reason that they follow the age of eligibility for NZS. For example:

» Employed workers aged 65 and older who are covered by ACC are entitled to one year of compensation for lost earnings for injuries which remove them from employment. A second year is payable only if the person is not on New Zealand Superannuation.

» People aged 65 and over cannot join KiwiSaver, so would not be auto-enrolled on starting a new job at that age.

Despite the rationale for these markers being set at age 65, as more older people stay in or return to the workforce after that age, these rules may appear increasingly anomalous.

55. Statistics NZ (2007) *New Zealand's 65+ Population 2007: A statistical volume* Table 4.01.
56. See Hurnard (2005) *The effect of New Zealand Superannuation eligibility age on the labour force participation of older people*, Treasury Working Paper 05/09.

Benefit issues

People who have been on Work and Income benefits may have particular problems. For example, around 4.9% of the working age population receives either Invalid's Benefit, because their work capacity is restricted by a 'permanent and severe' incapacity, or Sickness Benefit, because their capacity for full-time employment is reduced through sickness or a medical condition[57]. One-third of Invalid's Benefit recipients and one-fifth of Sickness Benefit recipients are aged 55-64. Many of these have been receiving benefit for 10 years or more. Returning to or entering the workforce is difficult for this group, and the type of work that is appropriate depends on the person's individual circumstances. For many, part-time employment may be more achievable than full-time[58].

Overcoming the barriers

There are many initiatives aimed at helping older people to remain or go back to work, and to keep the issue of employment at older ages on the policy agenda. These include:

» Actions in government departments, including the Ministry of Social Development and the Ministry of Labour, and other authorities. The employment of older workers is part of the government's Positive Ageing Strategy. Specific recent policies which affect the labour market participation of older workers include an intensified jobs search service, with new specialist health and disability advisors, and the removal of the age-related work-test exemptions for Unemployment Benefit.

» The work of the Human Rights Commission and other bodies when a complaint is raised under the anti-age discrimination legislation.

» Research by government departments, NGOs, policy institutes, academics, and employer and employee interest groups on the barriers to employing older workers, and on effective management of older people at work. For example, the Ministry of Social Development's *Turning 65* research project will ask people currently around that age to describe their involvement in paid work over the past 10 years, and what has affected it.

» Community efforts involved with local older workers and other age-related issues, such as the Volunteer Community Co-ordinators network, organised by the Office for Senior Citizens.

» A joint initiative of the Retirement Commission and Human Rights Commission to develop a good practice guide for employers to tap into the talent of older workers in New Zealand's public and private sectors.

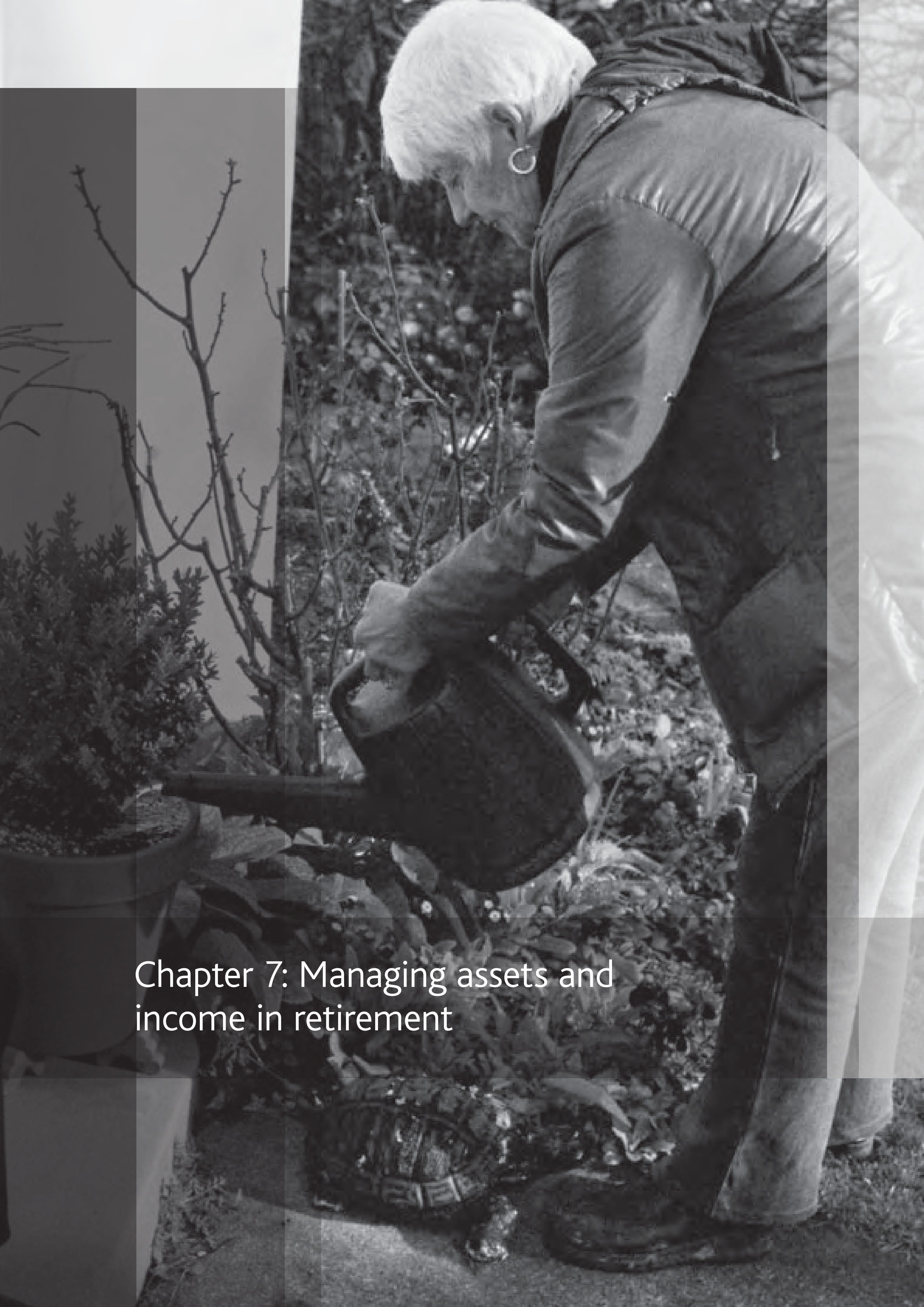
These initiatives by a variety of organisations reflect the diversity of the issue. Research or advice on employing an active 70-year-old is not necessarily relevant to a 55-year-old seeking employment after a spell on a benefit. This diversity is a barrier to agencies working together or learning from each other. An employer or employee seeking advice does not have one obvious place to go.

Better co-ordination between the various agencies involved in encouraging work at older ages may bring some benefits, although a large bureaucracy would not be good if it stifled individual initiatives.

Recommendation 21

That the Department of Labour, by mid-2008, develops a plan outlining how co-ordination could be improved among the agencies involved in initiatives – research, practical support and advice, public information and policy changes – that support older New Zealanders to find and stay in paid work, and the benefits of doing so.

57. Ministry of Social Development as at September 2007. Working age population is defined here as ages 18-64.
58. Beynon and Tucker (2006) *Ill-health, disability, benefit and work: A summary of recent research* in *Social Policy Journal of New Zealand* Issue 29.



Chapter 7: Managing assets and income in retirement

New Zealand Superannuation provides people over 65 with a regular income (as do the defined benefit type of employer-based superannuation schemes). However, other private savings, including KiwiSaver, are not designed to provide a regular income in retirement. Instead, funds can be accessed from age 65, so could be taken as one lump sum at that age if desired. The value of a house is similarly in one lump sum.

This chapter deals with ways in which assets accumulated during working life can be managed for use during retirement. After some general comments, it considers two specific issues noted in the terms of reference for this Review: annuity products and home equity release.

Although this chapter focuses on annuities and home equity products, it should be noted that it is not essential to use a product to manage assets in retirement for income. Many older people do not have sufficient financial assets to make buying an annuity good value for money.

There is a general paucity of up-to-date and accurate data to do with the financial assets of the older population. It is also possible that the available data does not include all of the financial support provided by the extended family. Nevertheless, the available data points to fairly low levels of financial assets, not broadly spread among the older population. In 2001, half of the men aged 65 and over had financial assets (excluding housing equity) of less than $31,200, while half of the women had less than $24,000[59]. Similarly, many older people will not have a house which is valuable enough to release a large amount of capital through a home equity product.

In terms of priorities, policies to help people manage their assets to meet their income requirements without necessarily purchasing a product therefore need to be considered alongside policies to encourage the availability of such products.

Better information on the amount of assets available to older people is necessary to help make such priority decisions. However, the latest available data dates from 2001. KiwiSaver may in the long-term lead to more people having financial assets available in retirement, and it will be useful to track the emergence of this as a factor. **Recommendation 3**, which called for the continuation of SoFIE and the repeat of HSS, is important here, as these surveys could provide the data from which the required analysis could be made.

Recommendation 22

That the Ministry of Social Development monitors trends over time in the size and distribution of financial assets held by older people, in order to give some indications of the issues facing older people in managing assets in retirement, including the potential demand for annuity and home equity release products.

As discussed in chapter 1, the 'retired' population is not a homogenous group. Retirement income and other issues for 65-year-olds will be very different for those in the oldest age group of 85 and above. The decisions on how to manage money through retirement are individual, often complicated, and may present challenges to many older people.

59. Household Savings Survey (2001). Note that annuity purchase may be more appropriate at later ages than 65, but this asset data is available only for people aged 65 and over.

For many people, retirement means a transition from regular employment income to a new mix of income from different sources. People who have some accumulated savings get closer on retirement to facing continuing decisions on how much to spend and how much to keep to cover large or unexpected expenses, or to leave as an inheritance.

These decisions are made more difficult by not knowing how long one has to live, how interest rates, asset prices and inflation may change, and whether there will be unforeseen special costs to deal with.

As people live longer in retirement, these uncertainties become more acute. Statistics NZ[60] indicates that, on average, life expectancy for the cohort of women reaching age 65 in 1997 was around 21 years, and for men nearly 19 years. But there is great variability in individual life expectancies. For example, of that cohort turning 65 in 1997, 38% of the women and 28% of the men are expected to reach their 90th birthday. As discussed earlier, these expectations are themselves uncertain, and may prove to be under-estimates.

Given current indications that older people have, on average, fairly low levels of financial assets in retirement, many older people will need to manage their money themselves. Quality information and education on a range of financial issues to help older people manage their personal finances at different times throughout retirement is therefore important. Such information should be available in a number of ways.

A related issue that also requires information to be freely available for older people is the treatment of property in the asset test for Residential Care subsidy. The net equity of an older person's interest in a property (house and/or land), is included as an asset in the means assessment of assets for the subsidy, subject to rules regarding partner's residence. However, if the property is owned by a trust, even if the older person has been living in the property, it is not included in the means assessment. The information to be made available to older people should include guidance on the implications of trust ownership as opposed to individual ownership of property.

Recommendation 23

That the Retirement Commission, by end 2008, updates and extends its information about options for managing assets throughout retirement, and provides that information to older people in ways other than the internet, including liaising with other providers of information to older people.

The Retirement Commissioner is especially concerned that the 'old old' find managing money particularly worrisome, and can be a target for financial abuse. There are several anecdotal cases of older people being financially exploited by others. While improved regulation of financial product providers and advisers should help to improve consumer protection generally, specific additional support for the oldest people most at risk may be appropriate.

Recommendation 24

That the Ministry of Social Development, by end 2008, considers how the issue of financial abuse of the oldest people can be addressed within current social services.

60. Figures calculated from Statistics NZ's life tables for the 1932 birth cohort.

Annuities

Some commentators believe that it is in the best interests of people to have a regular income in retirement. The product that can be purchased with a pot of savings to buy a regular income for the rest of life is called an annuity. There are virtually no annuities currently being sold in New Zealand. The lack of an annuity market in New Zealand will become more apparent as people start to retire with large pots of KiwiSaver savings.

This section considers the barriers to both the supply of and demand for annuities in New Zealand. It then considers the arguments for government intervening to enable annuities – or other products that convert savings to retirement income – to flourish, and concludes with some recommendations. This section has been informed by a detailed paper by Roger Hurnard[61].

Barriers to annuity supply and demand

The traditional annuity deals with the uncertainties of managing financial assets in retirement by providing a regular income for the rest of life, however long that turns out to be. This means that the insurance company, instead of the individual, takes the risks of unknown future longevity, interest rates, and asset prices, and also of inflation, if an inflation-linked annuity is purchased.

Given that annuities provide the benefit of a stable, certain income for the rest of life, why has the demand been low, not just in New Zealand, but also in other countries? There is a long list of possible reasons, relating to perception, cost, need and fear.

Perception

- Annuities are not easy products for a non-expert to understand and therefore trust.
- Most people would prefer not to think about an annuity purchase, as it requires thinking about their own mortality.
- People prefer to leave something as a bequest, rather than risk handing over their savings to an insurance company and then dying before they have had value from the annuity.
- People prefer to manage their assets themselves, taking money from their savings as they need it, rather than cede control to an insurance company.

Cost

- Annuities can appear poor value for money. The cost to the insurance company of taking the risks involved in an annuity is high (see supply issues, below). The price of an annuity can seem expensive to a customer who does not understand this.
- The taxation of annuities may imply a poor after-tax return. This is the case in New Zealand, as the income component of an annuity is likely to be effectively taxed (within the annuity provider) at the corporate tax rate (currently 33%), while many annuitants will be subject to income tax at a lower rate (19.5%).

No or little need

- The public pension provides enough certainty of basic income, so that securing further certainty from annuitising savings is not seen as necessary. This may well be the case in New Zealand for many people, because of NZS.
- Many people do not have retirement savings large enough to be annuitised efficiently. This has been the case in New Zealand, but may change as KiwiSaver assets build up.

61. See Appendix C for access details.

Fear of being worse off

- » The level of income that a traditional annuity provides for a given price depends very much on interest rates at the time. Buying an annuity at a bad time may lock in payments at a lower level than buying even a week earlier or later.
- » People may wish to buy an annuity only if there is a rock-solid guarantee for the continuation of annuity payments if the insurance company fails. No such guarantee or safety-net exists in New Zealand.

There are also barriers on the supply side, which make selling traditional annuities difficult. For example:

- » The risks that an insurance company takes on are unknown. Data on the expected future longevity of potential annuitants (which will differ from that of the general population) is not well defined in New Zealand's small market.
- » The insurance company pools the annuity products it sells to mitigate longevity risk. Because New Zealand will always be a relatively small market for annuities, longevity risk pooling is not as efficient here as in other, larger markets.
- » The longevity uncertainty works against the company's interest. While life expectancy is increasing faster than expectations, insurance companies stand to lose money from taking on longevity risk. They therefore build expensive contingency margins into annuity products.
- » Insurance companies have to have capital set aside to cover the cost of the annuity risks. Because the risks are high and uncertain, a substantial sum is needed. The cost of this is passed on in annuity pricing.
- » The insurance company seeks to invest in assets which match the liabilities of the annuity. But in New Zealand, there are no long-term bonds and few inflation-linked bonds available.
- » The costs of selling, including the costs of satisfying consumer protection regulation, cannot be spread thinly in a small market. A minimum size of annuity purchase is usually imposed, which may take annuities beyond the reach of those with small savings.

Many of the barriers to annuity supply and demand stem from two inescapable issues: the significant uncertainty of longevity risk, and the small size of the New Zealand market.

Should the government intervene?

One argument for government intervention could be that annuity purchase is good for people, and that there is market failure which government should correct.

Whether or not annuity purchase is good for people is a topic of fierce debate in countries such as the US and UK, which have had large numbers of potential purchasers with substantial savings for many years. The case is made that having saved ostensibly for their retirement, especially if that saving has been bolstered by government incentives, people should not take the money as soon as they can, spend it all on travel or other luxuries.

However, potential purchasers themselves do not seem to be convinced of the benefits of buying an annuity, for reasons which have little to do with wanting to spend large sums quickly.

In the US, 'While life annuities play an important role in the economics literature, the insurance features of life annuities appear to be poorly understood and/or 'undervalued' by the general public, as evidenced by the very small size of the market[62].'

In the UK, it is estimated that only around one-quarter of pensioners buy an annuity[63], even though more people have pension savings than in New Zealand and annuity purchase is compulsory by age 75. Compulsory annuitisation is unpopular.

62. Brown (October 2007) *Rational and Behavioural Perspectives on the Role of Annuities in Retirement Planning* Working paper 13537 National Bureau of Economic Research, Cambridge MA p. 2.
63. Pensions Policy Institute (2004) *An analysis of unisex annuity rates* p. 29.

The UK government has reinforced that compulsory annuitisation, and the subsequent taxation of the annuity income, is fair exchange for sizeable contributions to pensions being allowed out of untaxed income[64]. The UK case may seem to suggest compulsory annuitisation for KiwiSaver funds. However, currently the KiwiSaver tax credits are effectively a supplement to contributions, whereas the UK tax relief system aims to defer paying tax on pension contributions[65].

Possible government options

Three types of possible government options are outlined here, then discussed below.

1. The government, or more precisely the general taxpayer, takes on the longevity and perhaps other risks, to neutralise the problems which the private sector has in supplying annuities.
2. The government incentivises or strongly encourages the private market to sell annuity products as a way of stimulating demand.
3. The government leaves the private market to sell annuity products, to allow natural demand to emerge more easily.

1. **Government takes the risk**

   Ideas for how this would work include the government effectively becoming an annuity issuer, or a 'stop-loss' insurer for insurance companies; for example, the companies take the annuity up to age 90, and the government takes the risk thereafter.

   The New Zealand taxpayer already funds a large amount of longevity risk through NZS, which is highly cost-efficient and equitable. As long as NZS stays at a substantial level, it would be difficult to expect the general taxpayer to take on more of the same risk.

   If compulsory annuitisation is proposed, it is likely to be as unpopular as in the UK. New Zealanders strongly rejected the compulsory savings and annuitisation proposed in the 1997 referendum.

   If voluntary annuitisation is proposed, government is less likely to feel obligated. People for whom annuitisation is a real option (for example, they have reached 75 and have large savings) are more likely to have had higher incomes, and so may not be a priority for taxpayer subsidy. In the long term, KiwiSaver may lead to a broader distribution of financial assets available in retirement. However, currently, annuitisation would probably be efficient for only a minority of older people.

2. **Government incentivises or strongly encourages the private market**

   There could be an argument for tax incentives for annuity purchase, if government thought that this was in the best interests of society, and therefore worthy of taxpayer subsidy. However, given the large tax incentives already going into KiwiSaver accumulation, it seems hard to justify more incentives at the decumulation stage.

   However, the government could reduce the current tax disadvantage of annuities, compared with other financial assets. Action on this has been deferred while other life insurance tax reform has been progressed.

Recommendation 25

That Inland Revenue, by end 2008, reports on the feasibility and implications of achieving tax neutrality in the treatment of annuity products.

64. Annuities must be purchased for pension funds of more than GBP15,000 (NZ$40,000), and are then taxed as income. Thus compulsory annuitisation is not driven by the UK government being paternalistic in thinking that it is in the best interests for people to annuitise. HM Treasury (2006) *The Annuities Market* paragraph 1.9 (London).
65. Further, the UK system offers partial tax exemption on the investment of contributions. It is an imperfect 'EET' system.

3. **The private market is better enabled to sell annuity products**

   There are overseas examples of innovation in annuity products that have not yet been seen in New Zealand, such as:

   » Variable annuities, where risks are shared between company and individual.

   » 'Impaired life annuities', where people with some health conditions get a better purchase price.

   » 'Advanced life delayed annuities', where, for example, a customer aged 65 can buy an annuity that starts paying out at age 85.

   » Income drawdown plans, which allow continued control over invested funds.

   » The issue of longevity bonds.

   Although not all of these have yet proved successful, the international market is able to stimulate ideas. New Zealand could learn from these ideas, once the market here is ready for growth.

   As well as the asset data and tax issues mentioned above, the government could help enable growth by investing in better data on future longevity prospects. It was suggested above that to carry out **Recommendation 7** of this Review, New Zealand needs better estimates of the future longevity of the general population. This would be a first step to establishing better longevity data for potential annuitants.

In summary, because KiwiSaver is intended to boost the number of people with retirement savings, there is a case for government to remove some current barriers relating to products that offer options for converting savings to income in retirement. However, at this stage there is no emerging demand, nor is there a case for government incentivising annuity purchase, or taking any annuity risks on behalf of the taxpayer.

For now, therefore, the recommendations of this Review prepare the ground for a possible increase in demand for annuities. **Recommendation 23**, above, is important to ensure that older people are given enough information and education to help them think through the options for managing their assets for their income and capital requirements throughout retirement. These options may include buying an annuity at some stage, but also 'do it yourself' drawdown alternatives.

The case for any stronger government action in future should be reconsidered in the 2010 Review, in the light of take-up of KiwiSaver and trends in the New Zealand and international annuity markets.

Home equity release

Releasing equity from the home you live in is one way in which income or capital can be supplemented in retirement. Given the high levels of home ownership in New Zealand, home equity release products might be thought to appeal to retired people. But as with annuities, a strong market has yet to emerge.

This section describes home equity release products, considers why the market has been slow to grow in all countries, including New Zealand, and concludes with recommendations. It has been informed by a paper by Judith Davey on home equity release products, commissioned for this Review from the New Zealand Institute for Research on Ageing[66].

Home equity release products

Home equity release products have been available in New Zealand since the 1990s. Market innovation has led to several different types of home equity release products, with different features[67]. Most of these products are reverse mortgages.

With a reverse mortgage, the owner of the property takes out a loan with a financial company; but instead of making repayments, the loan and accumulated interest are repaid from the proceeds when the borrower dies or sells the property. The cash released may be taken in the form of a lump sum, or as a regular or irregular income. The regular income facility is not common.

Home equity release products differ in the detail of the terms and conditions. Broadly, they are available only to homeowners aged 60 and over, with a minimum house value ranging from $100,000 to $300,000. The ratio of the maximum loan available to the house value can be set (usually at 25%), or can increase with age at purchase (usually 10% or 15% at age 60, up to 45% at age 90). This restriction guards against interest accumulating to more than the amount the product provider can recoup on sale of the house.

In practice, the average age of people taking out home equity release plans has been around 72. The average value of the loans taken out has been around $40,000-$50,000. Typical product purchasers have had little income except for NZS, and only modest savings, if any. The main reasons for releasing home equity appear to be to pay for ‘living expenses’, home maintenance, buying a car, home improvement, or travel.

Reverse mortgages have so far appealed to only around 5,000 older people in New Zealand. As with annuities, the increasing number of older people is expected to lead to a growth in demand for home equity release products. Providers believe that the potential market in the next 15 years is around 200,000[68].

For some older people, home equity release can only provide modest amounts of money. Even for those in suitable circumstances, the loan-to-value ratio means that the amount available may easily be eaten up in capital requirements, such as a new car. This may avoid tapping into rainy day savings, getting into debt, or going without, but will not necessarily contribute significantly to income.

A different, non-commercial, form of home equity release is where a local council allows rates to be deferred and paid, with accumulated interest, on the sale of the property. Again, there are restrictions, and the few schemes in New Zealand seem not to have been well publicised. Take-up has been low.

Given the smaller role that rates deferral schemes play, the next section focuses on the commercial home equity release market, although some of the same issues may apply.

Why the market is slow to grow

Many of the barriers to supply of and demand for home equity release products are similar to those for annuity products:

» There is a perception that home equity release is difficult to understand and trust, and a reluctance to cede control of part of a major asset to a commercial provider (particularly for something that looks like getting into debt). Home equity release products have had some bad publicity, both here and overseas, and many older people are suspicious of them.

66. See Appendix C for access details.
67. The Retirement Commission website *www.sorted.org.nz* explains the various types.
68. Davey (2007) report for this Review, and Sentinel’s submission to this Review.

- The product provider is taking on risks on which there is limited information, so needs to set aside capital for a long time, with contingency margins. The cost of this is high, but is difficult for a customer to value, so home equity release can appear expensive.
- Many people may feel that they do not need or want to tap into their home equity, which they see as providing a 'last resort' cushion or an inheritance.
- Some potential customers for home equity release may fear being worse off, to the extent that their eligibility for state means-tested benefits may be affected. This issue is considered in more detail below.
- The costs of marketing and selling, including the costs of satisfying consumer protection regulation, add proportionately more to the cost of the product in a small market. Regulation is also considered below.

Benefit abatement issues and regulation

It has been suggested the interaction of home equity release products with means-tested state benefits, such as Disability Allowance, is a particular problem for the development of the home equity release market in New Zealand. The argument put forward is that money released from home equity is really capital; so the current Work and Income rules (which may abate income-tested benefits if the recipient takes home equity as periodic payments) are unfair.

Whether a potential home equity release customer would be hit by benefit abatement is not clear. Different individual circumstances mean that it is difficult to generalise about how the rules would apply. However, periodic payments received for 'an income-related purpose', and therefore taken into account for income-tested benefits, are defined in legislation[69].

A proposal has been made to treat home equity periodic payments in the same way as a lump sum. But they would then form an asset that would have to be taken into account for those benefits (such as Special Needs Grants) which are asset-tested.

Home equity release consumers generally have the choice of taking the funds as capital or periodic payments. The problem is not preventing home equity release itself, but restricting some consumer flexibility in how the funds are taken.

Regulation for home equity release products, providers and advisers is clearly important, given the need for potential customers to trust what is being offered. This is particularly necessary because there are some concerns about some operators who are working in what is a vulnerable market. However, unnecessarily heavy regulation would add to the costs of the product. Some providers, but not all, already adhere to a code of practice administered by an industry body[70]. A code of practice for home equity release providers is currently being developed by the Office for Senior Citizens (OSC).

The case for government action

One argument for home equity release being more likely to attract the attention of government than annuities is that it may help the older people of today who have no financial assets other than their home, and little income above NZS. In contrast, the market for annuities is focused on people with enough financial assets for annuitisation to be worthwhile.

However, as with annuities, it is still difficult to make the case that government should intervene in the commercial market, or take on risk itself, when more straightforward actions could remove barriers to the development of the home equity release market.

69. Section 3(1) and 3(4) of the Social Security Act 1964.
70. The Safe Home Equity Release Products Association (SHERPA).

In view of the likely market of older people for home equity release (especially if market predictions of growth in demand are correct), and the serious consequences of a loan rolling up to exceed the sale value of the property[71], the market conduct and security of product providers and advisers must be an urgent priority. This should be achieved by taking the code of practice into legislation, and therefore, making it mandatory for all providers.

Given that the regulation being introduced for the financial sector by the Ministry of Economic Development is focussed on providers, not products, home equity release regulation needs to be part of different legislation. Whatever legislation is used, the OSC should continue to be involved, to ensure that the necessary focus on the older market for this product is not lost.

Recommendation 26

That the Ministry of Economic Development, by end 2008, puts the code of practice for home equity release providers, being developed by the Office for Senior Citizens, into legislation.

There is also a case for government to clarify the interaction of released home equity with benefits. This is particularly important for potential home equity release product purchasers of limited means. Any decision to change the rules to favour home equity release by periodic payments will have implications in the rest of the benefit system and in the tax system, so will involve several government departments. Whatever the decision, a set of rules with as much clarity as possible should be easily available to consumers.

Recommendation 27

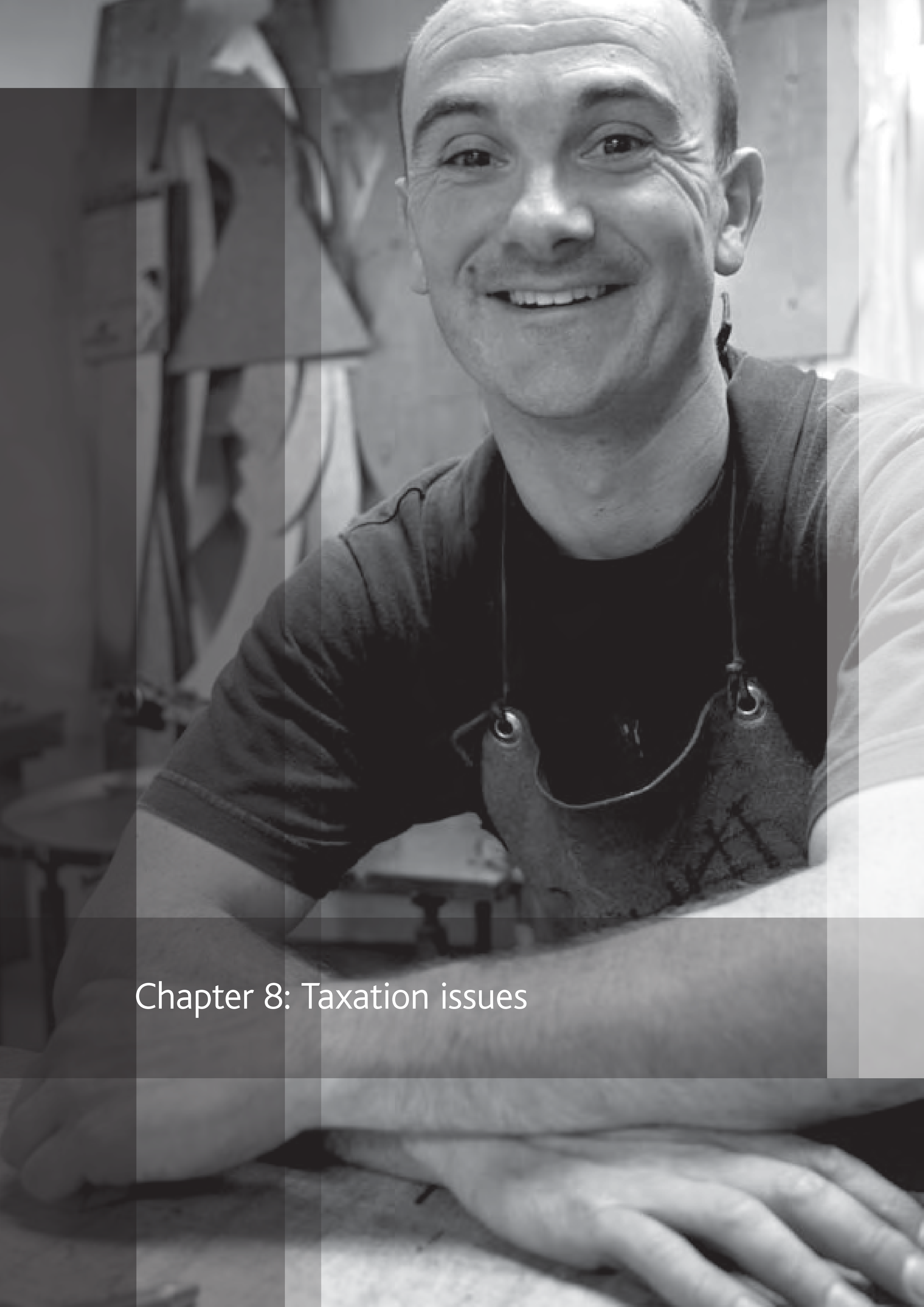
That the Ministries of Economic Development, Social Development and Inland Revenue together, by end 2008, look at all of the interfaces of home equity release products with state benefits to confirm a consistent policy that can be communicated to consumers in a straightforward way.

Given the difficult decisions around home equity release, independent information and education to help potential customers think through the options should be easily available. As part of **Recommendation 23**, the Retirement Commission will keep its material on home equity release options up to date and accessible to older people in a variety of ways. This information will include clear guidance on the potential risks, details of the protections available to consumers, and information on the interaction of home equity release with state benefits.

Monitoring the size and distribution of financial assets held by older people over time, noted above in relation to **Recommendation 22**, will give an early indication of the potential demand for home equity release products as it emerges. As with annuities, the 2010 Review should consider the progress of the home equity release market to see whether any stronger policy change is then warranted.

71. Some providers give 'no negative equity' guarantees, but not all.

Chapter 8: Taxation issues



This chapter considers taxation issues relevant to retirement policy. Taxation is an integral part of savings and investment. To consider tax separately is to risk taking issues out of context, but this chapter is intended as a brief accessible summary.

It begins by commenting on the general savings taxation landscape. It then reviews some taxation issues already considered in this report, and tackles a further specific issue to do with taxation in retirement. It has been informed by a paper prepared for this Review by Paul Mersi of PricewaterhouseCoopers[72].

The general saving taxation landscape

Since the 2003 Periodic Report, a number of significant legislative changes have been made to the New Zealand tax system, as it applies to saving for retirement in particular. The most significant changes relevant to saving are:

» Portfolio Investment Entities (PIEs) remove the distortion that previously meant direct investment in property or equity was taxed differently from the same investment made through intermediaries. Tax payable on PIE investments will now be at the investor's marginal rate (which could be 19.5%), but will be capped at 30% (from April 2008), instead of being levied at the fund's marginal rate of 33%. Overall, the PIE rules make direct and collective investment in the same underlying asset more tax-neutral, although the costs of investing in a managed fund would have to be compared with those of direct investment to see whether overall returns were affected.

» Foreign Investment Fund (FIF) reform removes biases towards investing in certain countries. A new Fair Dividend Rate (FDR) method of calculating taxable income from offshore portfolio share investments has also been introduced. FDR favours investment in higher yielding shares, as the taxable income is capped at 5% of the opening market value every year. Although controversial, FIF and FDR do give New Zealand savers a wider choice of non-tax-disadvantaged investments.

Any changes to the tax system need to continue to follow the principle of tax neutrality between asset classes. The effect of the above changes has been to remove many distortions which previously existed, and generally improve tax neutrality. Those distortions which remain are not necessarily detrimental for savers. As discussed below, new distortions have been deliberately introduced to make saving for retirement, especially in KiwiSaver, attractive. All these changes have made the tax system more complicated. For some savers, saving decisions will have to take into account a new and more complex set of tax issues.

KiwiSaver

KiwiSaver contributions are calculated as 4% or 8% of gross pay (for employees), but tax is paid on total gross pay. However, the kickstart incentive, fee subsidy, member tax credit, and SSCWT exemption for employer contributions all add to the member contribution in the KiwiSaver account. Investment earnings in KiwiSaver are taxed (as most KiwiSaver accounts are PIEs, the new rules noted above apply), but the funds can be taken tax-free.

72. See Appendix C for access details.

As chapter 4 explains, KiwiSaver is now more attractive than other collective investment schemes, and would be expected to distort savings behaviour. Chapter 4 also covers the extent to which this will cause gaps in retirement income between people with and without KiwiSaver accounts, and the risk to the stability of retirement policy from the structure and high cost of KiwiSaver incentives.

Recommendation 11 is that the evaluation of KiwiSaver should explicitly include an identification of where the money spent on incentives ends up, to highlight any distortions, and an assessment of the value for money the taxpayer will get from the incentives. **Recommendation 12** is to publish the likely long-term fiscal cost of KiwiSaver, so that the cost of the incentives can be part of long-term planning.

Annuities

The taxation disadvantage for annuity products is discussed in chapter 7. **Recommendation 25** encourages Inland Revenue to report on plans to tackle the issue.

Paying tax in retirement

Superannuitants with significant other income will often opt for a higher 'non standard' tax code on their NZS payment, in order to avoid being under-deducted on their total income. However, this tax code may later become too high if their income drops. This can then lead to a situation where the superannuitant is over-deducted for tax. The extent of this problem is not known, as such a situation is not proactively identified and rectified by Inland Revenue (nor is unpaid due tax collected). Therefore the individual taxpayer has to monitor the situation and take action when necessary.

The Retirement Commission will ensure that its information about managing assets in retirement, as described in **Recommendation 23**, includes up to date advice on managing IRD Personal Tax Summaries.

Appendices

Appendix A: Terms of reference for this Review

Terms of Reference for the Retirement Commissioner's 2007 Review of Retirement Income Policy

The New Zealand Superannuation and Retirement Income Act 2001 requires the Retirement Commissioner to conduct a review of retirement income policies before the end of 2007.

The Government has policies relating to both the public and private provision of retirement income.

Public provision of retirement income is provided through New Zealand Superannuation, Veteran's Pension and the operation of the New Zealand Superannuation Fund. The Government also has policies to encourage the private provision of retirement income to supplement public provision. This is currently being implemented in two major ways:

» Through programmes run by the Retirement Commissioner aimed at educating people about the need to save for retirement.

» By the introduction of the KiwiSaver scheme from 1 July 2007.

There is now a broad level of agreement on the parameters for New Zealand Superannuation. In addition, many of the issues surrounding the private provision of retirement income were subject to consideration and debate during the passage of the KiwiSaver Act 2006.

The 2007 Review is to focus on those aspects of retirement income policy that build on this foundation and should include:

» In relation to the government's retirement income policies, an update of and commentary on the trends, and the likely future developments, since the production of the 2003 Periodic Report, that will affect, or will be likely to affect, the provision of retirement income. The commentary should identify any areas of risk, and should include (but not be limited to) areas such as:
  - owner occupied housing
  - level and composition of personal assets and debts
  - social attitudes of younger people in relation to consumption and savings.

» Commentary on any current policy settings which may be acting as a barrier to the continued employment of older people.

» Identification of any areas of policy development needed to enhance employment opportunities for older people, and for people with disability who want to work.

» Identification of the problems facing efficient utilisation of assets accumulated pre-retirement to meet the need for regular and predictable income at different stages of ageing, and suggestions as to potential solutions.

» Commentary on the risks, opportunities and barriers relating to the use of home equity products and any suggestions for change.

» An independent assessment of the effectiveness of financial education available to and used by New Zealanders, utilising arms-length research.

Appendix B:
Structure of the Review

Project Team	David Feslier – Executive Director, Retirement Commission
	Anna McMahon – Project Manager
	Alison O'Connell – Writer/Researcher
	Anne Else – Editor
	Mathea Roorda – Evaluator – Effectiveness of Financial Education
Researchers:	Anne Geelen – Te Puni Kōkiri
	David Grimmond / Adolf Stroombergen – Infometrics Ltd
	David Preston
	Judith Davey – NZIRA
	Judy McGregor – Human Rights Commission
	Patrick Nolan – NZIER
	Paul Mersi – PricewaterhouseCoopers
	Prue Hyman
	Roger Hurnard
	Wendi Wicks
Peer Reviewers:	Peter Harris
	Roger Hurnard
	Sue Watson
	Suzanne Snively

Advisory and Reference Groups	
2007 Review Advisory Group	Paul Costello, General Manager, Future Fund, Australia Professor Gary Hawke, School of Government, Victoria University of Wellington Susan Guthrie, Consultant Economist Dr. Susan St John, Retirement Policy and Research Centre, University of Auckland
Officials Reference Group	Artemisia Kousis, Treasury Cathryn Ashley-Jones, Statistics New Zealand Justine Gilliland / Caroline Ramsey, Ministry of Economic Development Karen Threadwell, Department of Labour Leith Comer, Te Puni Kōkiri Michael Nutsford, Inland Revenue Department Nick Pole / Michael Papesch, Ministry of Social Development Shenagh Gleisner, Ministry of Women's Affairs
Retirement Income Interest Group (RIIG)	Alan Yates, NZ Bankers Association Bruce Kerr, ASFONZ David Hutton, Institute of Financial Advisers Peter Conway, NZ Council of Trade Unions Phil O'Reilly, Business NZ Vance Arkinstall, Investment Savings and Insurance Association
NGO Reference Group	Graham Stairmand, Grey Power Jacqui Te Kani, Māori Women's Welfare League Jean Fuller, National Council of Women Kerry Dalton, Citizens Advice Bureau Philippa Read, EEO Trust Raewyn Fox, NZ Federation of Family Budgeting Services Simon Laube, Age Concern Sue Chetwin, Consumers' Institute Wendi Wicks, Assembly of People with Disabilities
Reference Group, Independent Review of Financial Education	Sally Boyd, NZ Council for Educational Research Sharon Ellis, Education Review Office Suze Strowger, Ministry of Education

Appendix C: Background papers commissioned for this Review

The views expressed in the background papers are, in each case, those of the author and do not necessarily reflect the views of the Commissioner.

The papers are available on www.retirement.org.nz.

Davey J A (for the Institute for Research and Ageing) (2007) *Home equity release products in New Zealand: risks and opportunities*.

Hurnard R (2007) *Managing assets and income in retirement*.

Hyman P (2007) *Retirement Income – Issues for Women*.

Infometrics Ltd (2007) *Assessing the Australian retirement income system, with comparisons to New Zealand*.

McGregor Dr J (2007) *Employment of older workers*.

Mersi P (2007) *Tax issues relating to retirement income provision*.

NZIER (2007) *Younger people's attitudes towards consumption and saving*.

Preston D (2007) *Working papers for the 2007 retirement income report*.

Roorda Research and Evaluation Ltd (2007) *Independent assessment of the effectiveness of financial education available to and used by New Zealanders: A Snapshot*.

Te Puni Kōkiri (2007) *Key issues for Māori preparing for retirement*.

Wicks W (2007) *Disabled people and provision for retirement*.

Appendix D: Progress on 2003 Periodic Report recommendations

Previous reviews of retirement income policy were undertaken every six years. The last one was undertaken by the Periodic Report Group in 2003. In 2005 the New Zealand Superannuation and Retirement Income Act 2001 was amended to give future responsibility for reviews to the Retirement Commission, and for such reviews to be undertaken every three years, commencing in 2007. This 2007 Review therefore comes just four years after the previous review. In that time there has been progress on some of the 2003 recommendations. Others have been overtaken by events, such as the implementation of KiwiSaver and other legislative changes.

The following chart provides an update of progress on the recommendations of the 2003 Periodic Report Group.

2003 Recommendation	Current position
Private provision: The risks and opportunities The Periodic Report Group 2003 (PRG2003) recommends that:	
» The Retirement Commission take responsibility for co-ordinating the ongoing monitoring of risks and opportunities to private provision, initially focussing on: – the impact of increasing financial liabilities on private provision for retirement – the impact of student loans and home ownership on private provision for retirement – the impact of labour force participation by those aged 65 plus on net worth, retirement income and decisions to retire.	» The Retirement Income Steering Group (RISC), consisting of government agencies with an interest in retirement income policy, was established to co-ordinate inter-agency research related to retirement income, and to draw up and report to Ministers annually on the retirement income work programme. » The Retirement Commission monitors and reports on progress in relation to work on the ongoing monitoring of risks and opportunities to private provision. The Commission monitors research being undertaken and released, and includes this on their website as it becomes available.
» We need ongoing data and research to give estimates of net worth at different points in time. The Household Savings Survey has been an important step forward, but only a first step, and should be repeated. This would enable the analysis of cohort effects (such as the impact of household debt) and ongoing patterns of saving, and the testing of policy changes on savings behaviour.	» The Survey of Family Income and Employment (SoFIE), a longitudinal household survey, is being undertaken and reflects this recommendation. » The Household Savings Survey is planned to be repeated in 2011.
» A research fund, managed by the Retirement Commission with guidance from an independent panel of experts to be appointed by the Retirement Commissioner, is established to extend and develop research on household saving behaviour.	» Government announced it agreed in principle that a research fund be established. A budget bid was developed. However, research on and evaluation of the KiwiSaver initiative became a higher priority.

2003 Recommendation	Current position
Work-based savings PRG2003 recommends that:	
» The Government establish a Work-based Savings Group (WSG) to develop an agreed approach to promote work-based savings by the end of 2004. » The WSG membership should include employers, unions, academic experts, officials, the financial services industry, and be chaired by the Retirement Commissioner. » The WSG should focus its work programme on: – education through the workplace for employees – minimising regulatory and compliance costs – scheme design and best practice – training and resource support for employers and unions – sector or industry-wide approaches to facilitating work-based savings – reducing the costs for employers to provide access to work-based savings – assistance for small employers to encourage work-based savings – assistance for those on low incomes to access work-based savings – getting employees started saving for retirement.	» A Work-based Savings Group was established. » The WSG membership included an economist, lawyer, actuary, the Retirement Commissioner and representatives from the financial sector. Officials were in attendance. » The terms of reference for the WSG, and their subsequent work, addressed much of the recommended work programme. » An implementation timeframe was included in the report of the WSG. » A subsequent implementation group was established. » KiwiSaver has been the final result.
» The WSG should set milestones to assess changes in the membership of work-based savings schemes.	» It is expected that this will come out of Government Actuary monitoring of work-based schemes, including KiwiSaver.
» The Government consider the possibility of extending the new public service savings scheme beyond the core public service; in particular, providing for organisations in the wider state sector to opt into the new scheme.	» With the Budget 2007 enhancements to KiwiSaver, Ministers confirmed that they expect that KiwiSaver schemes will become the core savings vehicle in the State sector over time, with State sector employers and employees being treated on the same basis as their private sector equivalents.

2003 Recommendation	Current position
Personal financial education and information PRG2003 recommends that the Retirement Commission:	
» Promote workplace seminars and either provide them itself or contract providers to do so.	» Workplace seminars have been provided within the context of KiwiSaver.
» Extend the *Sorted* programme to include more information, targeted information and supplementary written materials. » Increase its promotional campaigns to encourage New Zealanders to use *Sorted* and other PFE programmes.	» Ongoing enhancements to *Sorted* and associated promotional campaigns have been made.
» Provide a face-to-face or telephone information service to supplement *Sorted*.	» A pilot programme in New Plymouth indicated a lack of demand for a telephone service. » 0800 SORT MONEY has been implemented, and evaluation is underway.
» Enhance and extend its provision of information about public provision.	» Further information on public provision has been provided on both retirement.org.nz and sorted.org.nz.
» Establish a methodology to make fees for savings products more transparent.	» Attempts to make fees transparent are being made with the KiwiSaver product offerings.
» Develop criteria for assessing the appropriateness of savings products and advice for retirement saving.	» sorted.org.nz includes information about types of savings products and an 'advice checklist'.
Issues for women, Māori and Pacific peoples: Women PRG2003 recommends that:	
» The Retirement Commission make it a key education priority to increase the knowledge of women about the need to save for retirement on their own behalf. We recommend a particular focus on the periods in women's lives when they have disposable income.	» The Retirement Commission is working alongside the Ministry of Women's Affairs in this area. » Some specific information for women is included on *Sorted*. » Seminars with women's groups have been held.
» The Retirement Commission develop criteria for a 'best-practice' vehicle for retirement savings that accommodates the needs of those people with periods of broken employment or reduced earnings during their working life.	» Recommendation overtaken by the development of KiwiSaver.
» Efforts continue to be made to close the gender pay gap in the state sector and recommend these efforts extend across the labour market.	» The Department of Labour set up a unit to work on the gender pay gap.

2003 Recommendation	Current position
Māori PRG2003 recommends that:	
» The Retirement Commission, in consultation with Te Puni Kōkiri, develop a research programme to address the information gaps regarding Māori experience and attitude to savings and to facilitate a better understanding of Māori attitudes to retirement saving.	» Some work has been undertaken, within the analysis of SoFIE, specifically on Māori.
» If it is successful, the financial education pilot programme for young Māori, developed in partnership between the Retirement Commission and Ngāi Tahu, is extended.	» The initial pilot was extended to a further five schools. It showed positive financial education gains for children. » The information gained is the basis for discussions with other iwi.
» The Retirement Commission and Te Puni Kōkiri work with interested Māori organizations to assess the feasibility of those organisations taking an active role in the provision of savings and insurance services for the organisations' beneficiaries.	» Ngāi Tahu has established their Whai Rawa Savings Scheme.
Pacific peoples PRG2003 recommends that:	
» The Retirement Commission work with Pacific communities to facilitate education programmes, tailored to the Pacific peoples, which highlight the benefits of preparing for retirement. These programmes should take into account the important characteristics of Pacific peoples we have identified, such as the existing commitments to the church, the extended family and the community. » The Retirement Commission, in consultation with the Ministry of Pacific Island Affairs, facilitate research to see whether the current arrangements in which extended family groups establish trusts for various events, such as weddings and funerals, could be involved in superannuation funds and insurance schemes.	» The KiwiSaver work-based education programme has included material targeted to Pacific peoples. » Further work in this area has still to be actioned.
Taxation of savings PRG2003 recommends that the Government:	
» Make it a priority in its tax work programme to resolve the tax non-neutralities arising from the indistinct capital/revenue boundary.	» The new portfolio investment entity (PIE) rules which came into force on 1 October 2007 remove the previous capital/revenue boundary by: – placing all Australasian share gains on capital account – introducing the fair dividend return (FDR) rule for all non-Australian portfolio share investment. These rules mean that people who invest via managed funds are treated similarly to direct investors.

2003 Recommendation	Current position
» Continue its work to resolve disparities in the treatment of international investments.	» See above re: the PIE rules and FDR changes.
» Revisit options, such as those developed by the Working Party on Taxation and Life Insurance and Superannuation Fund Savings (TOLIS), to address inequities in the taxation of superannuation funds and life insurance companies.	» The PIE rules allow investors in PIE to be taxed at their marginal tax rate, capped at 33% (30% from 1 April 2008).
» For equity reasons, either remove the tax advantage for employees earning over $60,000 on employer contributions to superannuation funds or make it available to all taxpayers irrespective of their marginal tax rate.	» The SSCWT rules were amended from 1 April 2007 to deal with excessive salary sacrifice arrangements by including the amount of the employer contribution in the income that is used to determine the applicable SSCWT rate. As part of the policy development the issue of increasing the top SSCWT rate to 39% was considered. The Government decided that the top SSCWT rate would remain at 33%.
» Review the fund withdrawal tax and remove it if there is no compelling evidence it is successfully acting as an anti-avoidance mechanism.	» Officials recommended to Ministers that fund withdrawal rules not be reviewed, as officials were monitoring the impact of salary sacrifice arrangements on the then recently enacted SSCWT rules to determine where there is any significant risk of tax avoidance. As a result of that monitoring, the SSCWT rules were modified.
Financial services market and regulation PRG2003 recommends that:	
» The Government remove the prospectus requirement from employer superannuation schemes, as proposed in the Business Law Reform Bill currently before Parliament.	» The prospectus requirement was removed.
» The Ministry of Economic Development and the Government Actuary review how much leakage is taking place from employer superannuation schemes because of written consent requirements for member transfers, and assess whether it is practical to better facilitate transfers in cases where transfer provides equivalent benefits.	» A new mechanism was introduced for all superannuation schemes to facilitate transfers without member consent, where the transfer provides equivalent benefits.
» The Retirement Commission promote best practice guidelines for dispute resolution for group and employer superannuation scheme members.	» The guidelines were completed and have been circulated.
» The financial services sector develop an agreed approach to self-regulation of financial advisers and report to Government with a comprehensive proposal by the end of 2004.	» The Ministry of Economic Development is establishing regulations around Adviser membership of Approved Professional Bodies, with legislation being prepared.
» The Government's proposed review of the tax rules applying to life insurance consider the tax barriers to the development of annuities; in particular, home equity reverse annuity mortgages.	» The Government has announced that it is reviewing the tax rules for life insurance. That review is expected to cover annuity related issues.

2003 Recommendation	Current position
Implementing PRG2003's proposed work programme PRG2003 recommends that:	
» An ongoing work programme, based on the Government's response to PRG2003's recommendations, is established to replace six-yearly reviews. » The Retirement Commissioner monitors the progress of the work programme.	» The RISC group, referred to above, was established and some funding has been provided to the Retirement Commissioner for her monitoring role.
» The Retirement Commission establishes an advisory group to provide a mechanism for stakeholders to provide input into the work programme.	» The Retirement Income Interest Group has been established. Membership includes representatives from: CTU, Business NZ, ASFONZ, Investment Savings and Insurance Association, Institute of Financial Advisers, NZ Bankers Association.
» By the end of 2007 the Retirement Commission, in consultation with the advisory group, review retirement income policy. The review should: – report on progress and change in retirement income policy – report on the risks and opportunities identified in the PRG2003 report – highlight the issues needing policy attention – assess the proposed work programme approach and whether it should be continued.	» New legislation has provided for the Retirement Commission to undertake reviews of retirement income policy every three years.

Appendix E: Submissions received

Written submissions are available on www.retirement.org.nz. Submissions were received from:

» Age Concern
» AMP Financial Services
» Bank of New Zealand
» Boyd Klap
» BT Funds Management (NZ) Ltd
» Business NZ
» Business Pacific Trust
» Disabled Persons Association
» Equal Employment Opportunities Trust
» Institute of Financial Advisers
» Investment Savings and Insurance Association (ISI)
» Len Bayliss
» National Council of Women
» NZ Council of Trade Unions
» NZ Society of Actuaries
» PMW van Bussell
» Reserve Bank of NZ
» Safe Home Equity Release Plans Association (SHERPA)
» Securities Industry Association
» Sentinel
» Tower Employee Benefits Limited
» University of Auckland Retirement Policy and Research Centre
» Westpac NZ Limited

Retirement Commission
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