2010 Review of Retirement Income Policy

Retirement Commission
Whiriwhiria!

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This review of retirement income policies is released as the first of the baby boomers reach pension age in New Zealand. With more people aged 65 and over, and people living longer, it is inevitable that retirement policy settings will come under increasing scrutiny. The challenge is tough, but it is not yet a crisis and there are solutions (or 'ways forward'). Furthermore since the 2007 Review the data are more reliable to support the decision-making process.

The ageing population brings with it many social and economic challenges for New Zealanders and our government. The cost of retirement income is but one of these and there is a limited set of options for successfully meeting the challenge.

This Review suggests a practical, fair way to resolve the fiscal challenge associated with retirement income costs. The report proposes changes to the policy settings of the retirement income framework so that, in future, New Zealanders can enjoy the best value for money while the standard of living of future pensioners remains at a satisfactory or better level. The proposal presented in this Review preserves the essential design features of our excellent pension system – in particular its simplicity and low cost of administration. The Review also suggests some adjustments to improve fairness and equity. It will be up to the politicians to either embrace this approach or provide the public with their alternative ways of managing the future costs of retirement income.

The issues are clear. Now it's time for decisions. The population needs time to prepare for any changes in retirement income policy. The sooner these decisions are discussed, debated and agreed the better it will be for all New Zealanders.

Diana Crossan

RETIREMENT COMMISSIONER

Acknowledgements

The terms of reference for this review were set by the Minister of Social Development in December 2009. This review addresses all of the requirements of the terms of reference. I have also taken the opportunity, with this review, to address other aspects to do with retirement income policy that were not specifically included in the terms of reference. These subjects include the competing objectives for retirement income policy, the individual rates of NZS, the affordability of NZS, and the evaluation of KiwiSaver. Appendix D maps the terms of reference to the content of this Review and also identifies where I have addressed topics outside of this terms of reference.

Completing this Review would not have been possible without the support and input from a great many people (Appendix E). This has included:

» 25 public submissions.

» Regular meetings with an Officials Group, Finance Sector Reference Group and Non-Government Organisation Reference Group.

» Two finance sector focus groups.

» 12 research projects that we commissioned as part of this review, all of which are available on the Retirement Commission's website, www.retirement.org.nz.

I have particularly valued the contribution of the members of the Advisory Group (Jonathan Boston, Keith Taylor, Pip Dunphy and Sue Bradford) who, from their various perspectives, have discussed, debated and challenged issues raised during the course of this review. This Review covers a lot of ground. Some is fairly straight-forward descriptive, technical and interpretive material while other sections have entailed thorough analysis, judgment and advocacy. However, the views expressed in this review are mine alone.

Finally I would like to thank key members of the review project team for their expertise and commitment throughout the course of this review: Anna McMahon, Katherine Meerman and Roger Hurnard.

Executive summary

This 2010 Review is the second three-yearly review of New Zealand's retirement income policies to be carried out by the Retirement Commissioner. It comes at a time of significant change in economic and financial conditions.

Changes in the savings environment

Since the 2007 Review, New Zealand has been through a recession that saw the economy shrink by 2.7%. Growth has resumed, but real GDP, on a per capita basis, is not expected to recover to the 2007 level until some time in 2012.

The long period of expansion in the early to mid-2000s finally ended with a drought in the summer of 2007/08 that was quickly followed by the impact of a global financial crisis that had started in the US with dramatic increases in loan defaults and the collapse of several of their major financial institutions.

The onset of the inevitable adjustments brought to light how fragile and risky many finance companies' investments were. Since 2006 more than 50 finance companies have either failed or had to seek a moratorium from their investors. The governance, regulatory and supervision arrangements of finance companies were insufficient for their type of business. Many private investors or their advisers did not adequately assess the risks, partly because these were not adequately disclosed.

The initial direct impact on New Zealand of the global financial crisis and the failure of finance companies was an estimated fall of 9% in household net worth. However, the overall effect was modest in comparison with the harder-hit economies in the northern hemisphere, largely because the New Zealand banking system and corporate balance sheets did not have the same degree of exposure to subprime lending.

Monetary and fiscal policy has absorbed much of the recession's impact on households. The Reserve Bank made a rapid series of reductions in the Official Cash Rate and a series of income tax cuts have been introduced. Currently the government is spending more than its current income, and having to borrow the difference, and this higher level of public sector debt effectively transfers some of the adjustment burden onto future taxpayers.

In response to these developments many people are taking a much more cautious approach to borrowing and debt. New Zealand households appear to be increasing their saving. At the same time there appears to have been a decline in general consumer confidence and trust in the financial system.

A number of reforms are being developed or have been implemented. Some seek to improve business practices and the training and monitoring of product issuers and financial advisers. Other reforms are aimed at improving savers' understanding of financial matters and consumers' ability to compare financial products and understand risk.

The design of retirement income policies

The main instruments of retirement income policy in New Zealand are:

» New Zealand Superannuation (NZS), the universal public pension scheme.

» The New Zealand Superannuation Fund, a way to smooth the projected rise in the future cost of NZS.

» KiwiSaver, the voluntary, government-subsidised scheme for private saving.

» A range of information and education programmes under the National Strategy for Financial Literacy.

» Financial market regulations as they apply to the way people finance their retirement.

Maintaining fair, efficient, effective and sustainable retirement income policies has been a challenge for successive New Zealand administrations. It requires that all stakeholders recognise the pressures of multiple and sometimes competing objectives, the historical background to some of today's policy settings and likely reactions to any significant change in the balance of policies.

Eight policy objectives, or areas of concern, that can influence how public policy on retirement income provision is designed, are identified in this Review. These, together with their underlying policy model, are:

» Personal responsibility, individual choice and control (voluntary saving).

» Alleviation of old age poverty and hardship (income support).

» Social cohesion and national identity (citizenship dividend).

» Positive and active ageing (wellbeing).

» Maintenance of living standards in retirement (lifetime consumption smoothing).

» Each generation paying its own way (cohort self-funding).

» Protection against longevity risk (risk pooling).

» Economic growth and efficiency (fiscal restraint and investment).

The search for financial and political sustainability and a broad public consensus on the overall fairness of the system requires that the tensions and the trade-offs that have been made among these objectives be recognised, since that is often why particular aspects of a policy's design are the way they are.

Many countries of the Organisation for Economic Co-operation and Development (OECD) have, for a variety of reasons, undertaken pension reform initiatives in recent years. Some reforms seek to extend pension coverage or improve the adequacy of benefits, while others address the financial affordability, high administrative costs or economic distortions of their pension systems. In this respect New Zealand is today better placed than many other OECD countries. NZS has very low administration costs and no artificial incentives to take early retirement.

Older New Zealanders

The wellbeing of older New Zealanders is largely influenced by NZS, the universal public pension, which, together with a mortgage-free home, underpins the living standards of many retired people. Today, half the population aged 65 and over receive less than $100 per week each in income from sources other than NZS or other government transfers. At the other end of the scale, around one in three older people receive more than half their income from sources other than NZS. This proportion is likely to increase over time as the 'baby boom' generation starts to qualify for NZS, starting from 2011.

Older people as a group have the highest average economic living standards index score, 47 (out of 60), compared with 40 for the whole population and 36 for children. After housing costs are taken into account, only 9% of people aged 65 and over live in a low-income household.

Despite this generally positive picture, there are situations where a public pension on its own cannot prevent hardship. Typically these are where an older person's expenses are particularly high and/or difficult to manage. Examples are expenses for rent, healthcare, disability, meeting family obligations and debt servicing. In addition, people may struggle due to a lack of financial knowledge, budgeting skills, or as a result of behaviours such as addictions or financial exploitation by others.

Increasing the rate of NZS would be a very blunt and costly way to reduce poverty among vulnerable groups of older people, since it would entail additional payments to everyone regardless of their income and circumstances, when the problem is restricted to a small proportion of older people. Measures targeted at the risk factors themselves are more likely to succeed. The way in which such measures are designed, linked and delivered by government agencies and other private and community sector players is a key factor to their success.

Strengthening NZS as a universal, individual entitlement

The universal character of NZS and the fact that it is an individual, not a family, entitlement makes it almost unique among the basic, tax-funded pillar components of retirement income systems around the world. The broad principle that NZS is a non-income-tested individual entitlement is worth defending and preserving. It supports gender equality, taking personal responsibility for one's own financial future and it does not distort paid employment decisions. In addition, its universality makes it simple and cost-effective to administer.

There are currently, however, three areas where the principle of non-income-tested individual entitlement is stretched, if not broken, and should be changed. They each relate to the different treatment of partnered and non-partnered superannuitants. These areas are:

» The optional, income-tested rate of NZS for a superannuitant with a partner who is not qualified for NZS in his or her own right.

» The two different NZS rates that apply to people who are sharing accommodation; one applies to those who are partnered and a different rate for those who are not.

» The way in which a person's own NZS entitlement can sometimes be affected by the amount of his or her partner's pension, if it is an overseas state pension.

These three situations, each of which infringes the principle of universal individual entitlement, are recommended for change.

Private retirement saving by younger generations

There are indications that households' rates of saving are not as poor as the overall official flow-based measure of national saving might suggest. The official measure of national saving is known to have some serious deficiencies and attempts are being made to improve it and the associated aggregate measure of household saving.

Some recent research suggests that many New Zealanders are making adequate provision for their retirement, but some middle-income earners are not yet doing so and would need to increase their savings if they were to smooth their consumption between working life and retirement.

Working age people do not appear to share a clear view of how much they need to save in order to enjoy a comfortable retirement. This may be due to a combination of genuine uncertainty, scepticism about the future policy environment, promotional messages from financial product providers and a lack of financial information or skill to interpret what achieving this goal might entail, for instance home ownership. The picture is complicated because NZS provides the first tier of retirement income. Unless younger people believe that the longer-term survival of NZS will continue to be managed responsibly, they are likely to feel uncertain about their own savings decisions.

The level and pattern of saving is expected to change as KiwiSaver balances build up and new regulations of financial products and advisory services come into effect, together with recent changes in the taxation of superannuation products. Patterns of first home purchase are changing and this will also affect the timing and composition of saving.

KiwiSaver and compulsory saving

The KiwiSaver scheme introduced in 2007 represented a change in the retirement saving policy framework as, although it is a voluntary scheme, it contains generous incentives. Since its inception, more than $5.8 billion in funds have been passed to scheme providers for investment, of which $2.4 billion is accounted for by government subsidies.

One-third of current members were automatically enrolled in KiwiSaver, while most members opted-in to the scheme. There is some evidence suggesting that there may have been some redirection of contributions into KiwiSaver that might otherwise have been made to other superannuation funds.

The assessment of KiwiSaver in this Review covers several aspects of the scheme, such as the cost and effectiveness of the incentives, membership of children, the default fund arrangements, the reporting of investment performance and fees, and some issues of equity. These aspects should be revisited at the next Review in 2013 when a more complete evaluation of KiwiSaver will be available. That will also be a good time to examine the issue of how post-retirement withdrawals from KiwiSaver might be managed.

This Review has also considered the issue of whether making retirement saving compulsory might be a better option than a voluntary saving regime. The evidence on the effectiveness of compulsory retirement saving schemes is mixed. A compulsory scheme might reduce government costs if savings incentives were removed at the same time, but some incentives might need to be retained to achieve support for the compulsory system. Administration and compliance costs would be higher. Compulsory saving would alter the composition of saving, but not necessarily the overall amount.

In addition a compulsory scheme would direct and limit the choices of individuals to save through a particular means. It would not allow for differences in circumstances, preferences or stages of life. It might also open the door to undermining the universality of NZS.

This Review does not support changes to make KiwiSaver compulsory or to introduce another form of compulsory retirement saving scheme.

Keeping NZS affordable

New Zealand's public pension system today is better placed, from an affordability point of view, than many other countries in the OECD. New Zealand now has one of the lowest cost pension systems, while still ranking highly in terms of preventing old age poverty.

But this is not a permanent state of affairs and the advantage should not be frittered away. The long-term sustainability of NZS needs to be assured by taking a responsible view of the way the major cost pressures that will come onto the public pension system in the 2020s should be handled. The proposed future modifications to NZS in this Review are not focused on helping to correct fiscal imbalances over the next several years. Instead, they anticipate the longer-term structural, particularly demographic, pressures that will arise in the following decade.

There are a number of approaches that could be considered for dealing with the retirement income policy challenges for the 2020s and beyond, ranging from placing all the onus for adjustment onto other parts of the government's budget, through to a fundamental reform of the pension system. The approach recommended here is to modify some of the entitlement rules for NZS, while accepting some continuing rise in its cost due to demographic pressures. Within this general approach, it is recommended that a combination of three changes be made, all starting in the year 2020.

» A modification of the annual NZS rate adjustment system.

» A gradual increase in the age of eligibility for NZS.

» A transitional, means-tested benefit for people aged 65 and over who will be affected by the higher age of eligibility to NZS.

A great strength of New Zealand's universal flat-rate public pension system is that it is simple and transparent. The changes proposed have been selected in part because they do not result in new complexities or the emergence of multiple rates of payment across different age groups or cohorts. Even-handedness is the key to preserving the system.

Although the proposals recommended in this report may seem modest and do not need to be implemented immediately, the public debate has already started and decisions will need to be announced and legislated well in advance. If there is no commitment within the next 10 years, the total cost of NZS will continue to trend upwards and more severe changes might need to be taken later, putting the long term future of NZS itself at risk. Provided these changes can be agreed soon and implemented from 2020, the retirement income system should remain affordable for at least the next 30 years.

Summary of recommendations

The savings environment

Recommendation 2.1

That the Ministry of Social Development and the Ministry of Economic Development develop quality standards for the provision of budget advice and that government funding to non-government organisations for the provision of budget advice (primarily via the Ministry of Social Development) be contingent on these providers meeting established quality standards.

Recommendation 2.2

That, in the development of any regulation of the financial services sector, government agencies establish processes to ensure that the consumer voice is given sufficient weight.

Vulnerable groups

Recommendation 4.1

That the Retirement Commission works with the Ministry of Women's Affairs, Te Puni Kōkiri, the Ministry for Social Development and Statistics New Zealand to develop a clearer picture of factors affecting the wellbeing and living circumstances of non-partnered older New Zealanders, particularly women living alone.

Recommendation 4.2

That the Ministry of Health and Ministry of Social Development develop additional and co-ordinated information resources on the likely costs of health and residential care to assist those planning for, and in, retirement.

Strengthening NZS as a universal, individual entitlement

Recommendation 4.3

That the non-qualified partner rate of NZS should be removed as an option for new applicants and that existing recipients should be allowed to continue to receive it for a maximum of five years. Beyond that they would be entitled to claim any applicable benefit through the welfare system.

Recommendation 4.4

That the partnership distinction in the NZS rate structure be removed, by gradually merging the individual sharing and individual partnered rates of NZS over time.

Recommendation 4.5

That an individual's overseas state pension entitlements should be directly deducted against their own individual entitlement to NZS and that any excess should not then be offset against the individual NZS entitlement of their partner.

Recommendation 4.6

That the Ministry of Social Development implement programmes to:

» Provide information and advice for recent and prospective migrants and returning New Zealanders on the implications of the direct deduction policy for their future retirement income.

» Improve the public availability of decisions on the classification of overseas pension schemes whose pension payouts are subject to the direct deduction policy.

» Explain the rationale behind each pension scheme classification decision.

KiwiSaver

Recommendation 5.1

That KiwiSaver default funds should continue to be based on products with a conservative risk profile and that KiwiSaver default fund providers be encouraged to provide members with information to help them to make a more active choice of investment, even if this means that they choose to stay where they are.

Recommendation 5.2

That, for the sake of transparency and ease of understanding, and to allow comparisons by consumers, a standardised approach to the calculation of KiwiSaver fees and performance, as well as fees and performance on other investment products, be adopted.

Recommendation 5.3

That the evaluation of KiwiSaver continues as planned until 2012/13, when the main findings will be available.

Recommendation 5.4

That the Retirement Commissioner's 2013 Review of Retirement Income Policy should include a thorough assessment of KiwiSaver, including the emerging pattern of withdrawals and reinvestments by people aged over 65.

Recommendation 5.5

That the recommendations relating to saving and wealth statistics from Statistics New Zealand's review of economic living standards be actioned in a timely way and in conjunction with key data users.

Recommendation 5.6

That Statistics New Zealand include KiwiSaver questions in the most appropriate household surveys of assets and liabilities in order that the impact and effectiveness of KiwiSaver can be assessed and informed decisions made about adjustments to the scheme beyond 2012/13.

Keeping NZS affordable

Recommendation 6.1

That, with effect from 2020, NZS rates should be adjusted each year by the average of the percentage change in consumer prices and earnings, subject to no less than price inflation in any year.

Recommendation 6.2

That a future rise in the age of eligibility for NZS should be announced. The age would be gradually increased from 65 years starting in 2020 and would rise by two months per year until it reached 67 years in 2033.

Recommendation 6.3

That, as the age of eligibility for NZS is increased above 65 years, a transitional, means-tested benefit should be introduced to address the particular situation of people who are aged 65 and at risk of hardship because of their inability to continue to financially support themselves over an extended period.

Chapter 1: What's been happening – trends and developments

The purpose of this chapter is to set the scene for the Review, discussing the national and global events that have influenced retirement income prospects since the last review in 2007.

It has been an eventful period dominated by the global financial crisis (GFC) potentially the biggest shock to the international financial system since the demise of the Bretton Woods system[1] in the early 1970s. A fuller discussion of the GFC is presented in chapter 2.

This chapter focuses on the consequences of the crisis (and other events) on the performance of the New Zealand economy, the environment for saving, and how this has influenced the saving patterns of New Zealand households.

The global financial crisis

The financial crisis of 2007 was essentially the result of credit failures that threatened to undermine the entire US banking system. It has resulted in the collapse of large financial institutions, the bailout of banks by national governments, and downturns in stock markets around the world.

The immediate cause or trigger of the crisis was the bursting of the US housing bubble which peaked around 2005–2006. The housing bubble was fed by a spike in 'subprime loans' (lending to people with weakened credit histories) and the bundling of subprime mortgages into new securities for sale to other investors.

When interest rates began to rise and housing prices started to drop moderately in many parts of the US in 2006, this led to dramatic increases in loan defaults and foreclosure activity (forced sale of property by the lender) as easy initial terms expired and as house prices failed to go up as anticipated. The crisis intensified when exposure to these mortgage-backed securities caused the collapse or takeover of several key firms, beginning first with Lehman Brothers in September 2008, but quickly extending to other financial heavyweights such as AIG, Merrill Lynch, and HBOS.

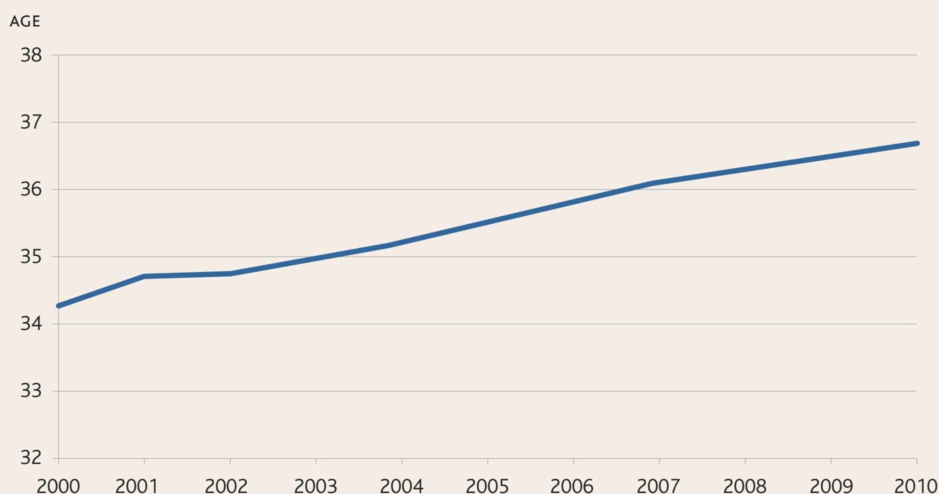
In the wake of this crisis, the US Federal Reserve and central banks around the world took steps to expand money supplies to avoid the risk of a deflationary spiral, in which lower wages and higher unemployment lead to a self-reinforcing decline in global consumption. In addition, governments have enacted large fiscal stimulus packages, by borrowing and spending to offset the reduction in private sector demand caused by the crisis. It is difficult to know what the consequences might have been had authorities not taken these actions, but it has not prevented unemployment rates of around 10% becoming the norm in the US in recent years.

1. The Bretton Woods system of international monetary management involved each country being responsible for maintaining the exchange rate of its currency at a fixed value in relation to gold.

Demographic context

Statistics New Zealand population estimates indicate that the New Zealand population increased by 139,400 over the last three years – reaching 4.368 million at the end of June 2010. The majority of this population growth (105,600) resulted from natural increase (the extent that births have exceeded deaths during this period), but there was also a net increase to the population of 33,800 due to migration flows.

Chart 1.1: Median age of New Zealanders



Source: Statistics New Zealand.

The median age of the New Zealand population continued to climb during the last three years, from 36.1 in 2007 to 36.7 in 2010. The proportion of New Zealanders aged 40 and over has increased from 44% in 2007 to 45% in 2010. From 2011 the population of New Zealanders aged 40 and over will exceed 2 million.

The proportion aged 65 and over has also increased, from 12.5% of the population in 2007 to 13% in 2010. Men are making up an increasing proportion of the elderly, up from 45% of those 65 and over in 2007 to 45.5% in 2010.

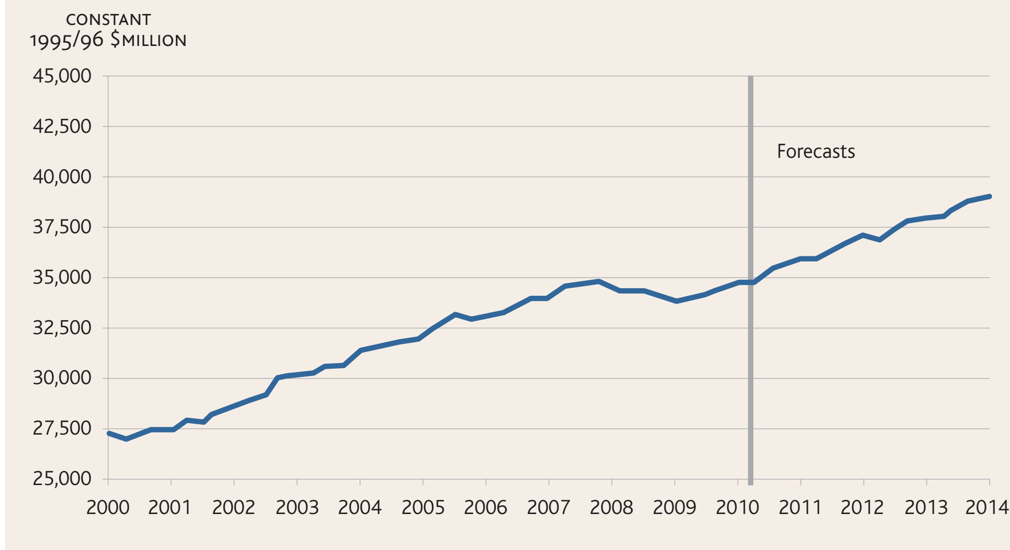
From expansion to recession

In New Zealand a long economic expansion turned into a prolonged recession from which the recovery has been mixed. Internationally the worst financial crisis for more than a generation came to a head in 2008. As in other countries, a boom then bust in the housing market has been a critical factor underpinning changing fortunes in New Zealand.

The Reserve Bank has eased monetary conditions and the Government has adjusted spending and tax settings in order to stimulate economic activity. The net result is that the New Zealand economy is well on the way to recovery, but the resulting deterioration in the government accounts will constrain the options available to future governments.

In 2007, where this Review starts, New Zealand was in the final stages of a long period of economic expansion. With economic growth averaging 3.5% per year, the New Zealand economy had expanded by 40% in the decade following the 1997 Asian economic crisis. A drought in the summer of 2007/08, quickly followed by the impacts of the GFC, ended this growth sequence as the New Zealand economy shrunk by 2.7% in the five quarters from December 2007 to March 2009. A resumption in economic growth since then has meant that the economy regained its 2007 level by mid-2010 (see chart 1.2).

Chart 1.2: Expenditure on Gross Domestic Product (GDP)



Source: Statistics New Zealand and 2010 Budget Economic and Fiscal Update.

However, given that the population also expanded by 3.3% between 2007 and 2010, the typical New Zealander is still worse off than they were in 2007 (i.e. in mid 2010 we were dividing the same amount of production as in 2007 but among a population that was 3.3% larger).

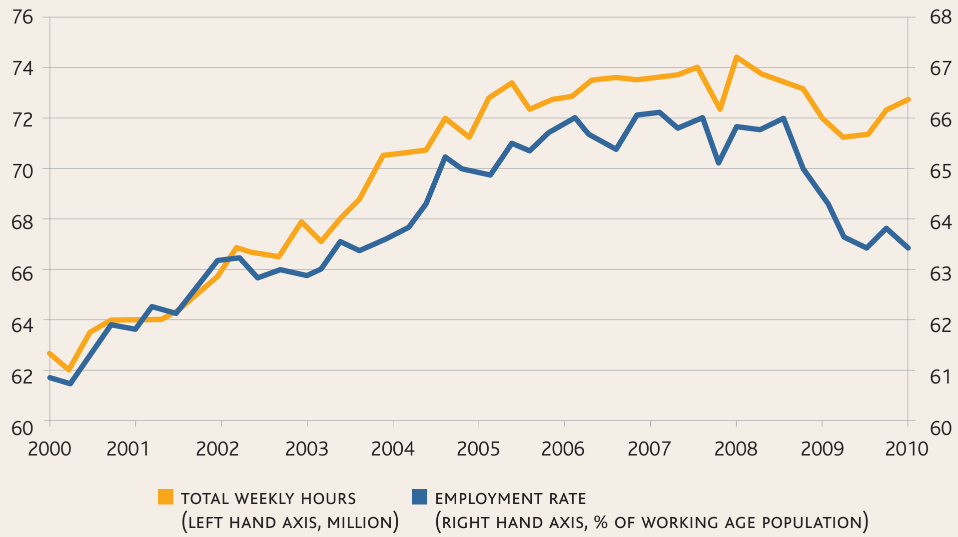
The economic forecasts prepared by Treasury to accompany the 2010 Budget suggest that the economic recovery since 2009 will continue and that the New Zealand economy will grow by roughly 3% per year in coming years. But, with the population continuing to grow by about 1% per year, this effectively means that it will still not be until sometime in 2012 that we can expect our average level of economic wellbeing to once again match where we were in 2007.

To put the current recession in context; it effectively took five quarters from September 1997 to December 1998 for average incomes to recover from the aftermath of the Asian crisis in the late 1990s, this time it is expected to take close to five years (i.e. four times longer).

Although the recession in New Zealand was precipitated by the 2007/08 drought and the GFC there are a number of factors that indicate the economy was naturally hitting a number of growth constraints in 2007. Economic growth during the growth phase could perhaps be described as being 'job rich', with roughly two-thirds of the economic growth resulting from increases in hours worked.

On the positive side, this type of growth meant that the fruits of growth were widely shared. But it also meant that labour increasingly became a binding constraint to further growth. Between 2000 and 2006 employment in New Zealand expanded from 61% to 66% of the working age population, but it seems that this proved to be an effective upper limit to employment intensity in New Zealand (see chart 1.3).

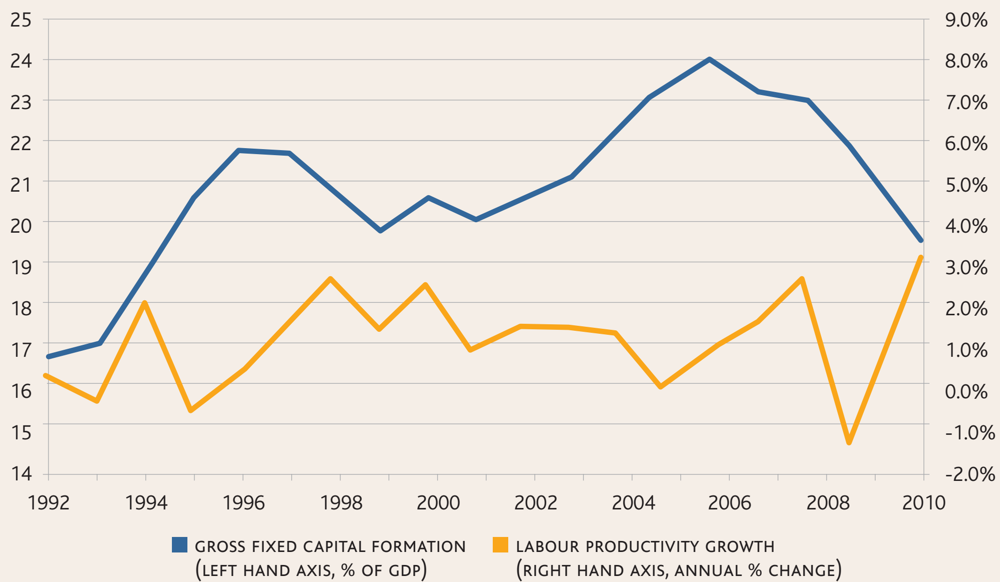
Chart 1.3: Labour market outcomes



Source: Statistics New Zealand.

A natural response to labour constraints is to improve the productivity of workers by using better equipment. A surge in investment activity as gross fixed capital formation increased from 20% of GDP in 2001 to 24% in 2006 is suggestive of this type of response, but it failed to produce any significant improvement in the pace of labour productivity growth (see chart 1.4).

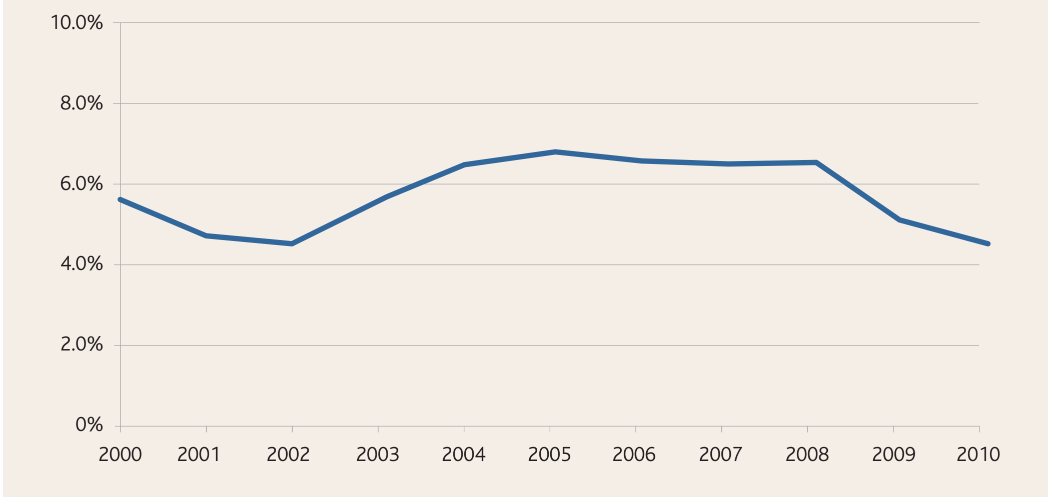
Chart 1.4: Investment and labour productivity



Source: Statistics New Zealand.

A reason for this result seems to be that little of the surge in investment was related to the purchase of new equipment. Instead housing investment appears to have been the key driver behind the mid-2000s investment surge, particularly between 2002 and 2005 when increases in house building were behind 80% of the growth in investment (see chart 1.5).

Chart 1.5: Investment in residential housing (% of GDP)



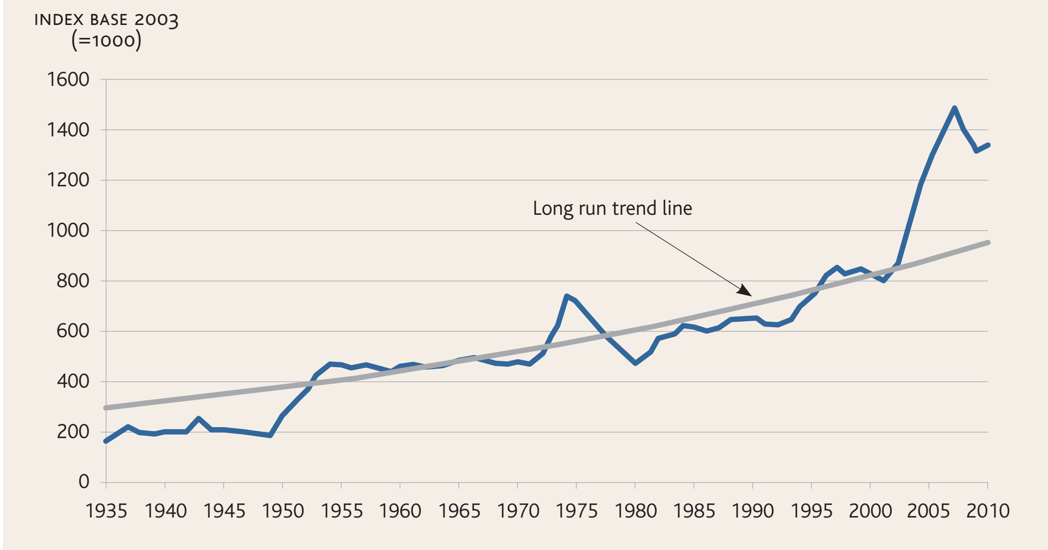
Source: Statistics New Zealand.

A booming house market played a crucial role behind the surge in house building and, indeed, to the economic expansion in general. Since the 1930s house prices in New Zealand have on average increased at a pace 1.6% ahead of inflation. However, as is illustrated in chart 1.6, house prices can vary away from the long run trend line for considerable periods of time. The chart also clearly illustrates the abnormal nature of the recent housing boom.

House prices effectively doubled between 2002 and 2007. The sharp rise in house prices had the impact of greatly increasing home owners' perception of wealth. Home owners responded by increasing spending – the level of private consumption spending in 2007 was 46% higher than five years earlier.

But the pace of growth in house prices achieved over this period was not sustainable. By 2007 house prices were 60% above what the trend line would suggest was sustainable. Although the gap has closed since then, house prices still appear to be 40% above the long run trend in 2010. A key implication is that increases in house prices are unlikely to fund an expansion in consumer spending in the foreseeable future.

Chart 1.6: Real house prices

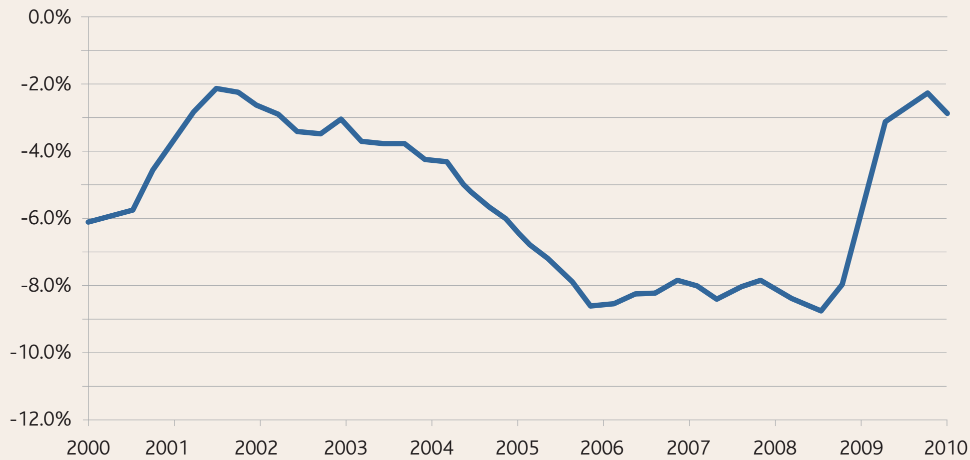


Source: Infometrics Ltd.

The balance of payments

The surge in investment coincided with a large deterioration in the current account deficit of New Zealand's balance of payments (see chart 1.7). This statistic neatly sums up the net impact of actions taken during the housing boom – New Zealand borrowed heavily from the rest of the world, but because borrowed money was used to fund house building and consumption, the type of economic growth that would have justified the extent of the overseas borrowing was not generated. The net result was that the current account deficit blew out from 2% of GDP in 2001 to over 8% of GDP in 2006.

Chart 1.7: Annual balance of payments current account (% of GDP)



Source: Statistics New Zealand.

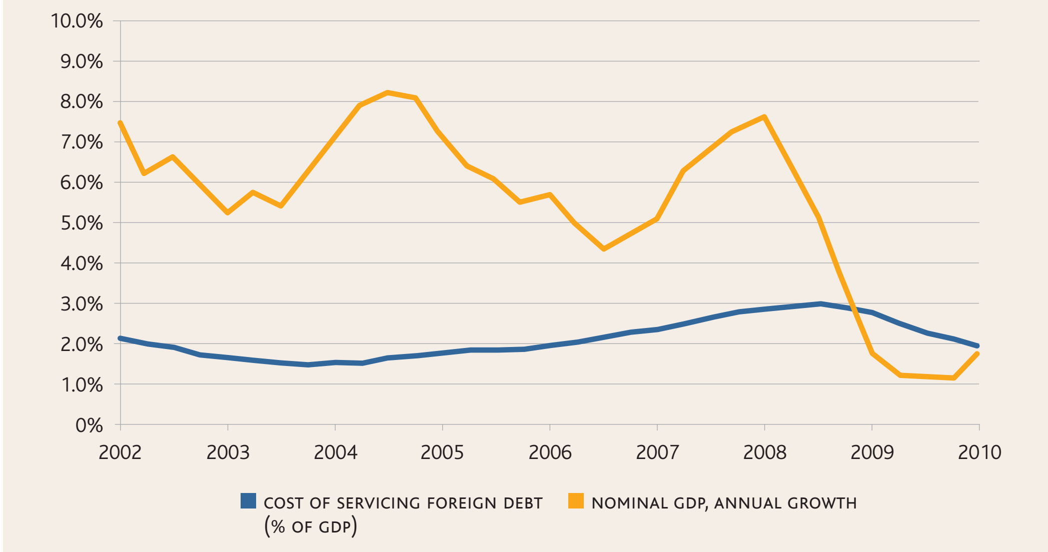
The recession has resulted in a big correction in the balance of payments deficit. Just before the start of the review period the current account deficit for the year to March 2006 had reached $14.5 billion, or 8.7% of GDP.

By March 2009, despite imports beginning to fall, the deficit was still running at 8.0% of GDP. Yet in the space of a year the current account deficit was back to levels last seen in 2002, with the current account deficit for the year to June 2010 at 3.0% of GDP.

New Zealand sustained high deficits for the best part of five years due to the fact that New Zealand debtors have proven reliable in servicing individual debt obligations. While the prudence of borrowing from others to fund so much of our activities could be questioned, the fact is that New Zealand's pace of growth was sufficient to allow ever increasing amounts of borrowing from the rest of the world. To illustrate, chart 1.8 compares national income growth (as indicated by nominal GDP growth) with the costs of servicing international debt (as measured in the balance of payments).

The increasing debt position resulted in a steady increase in debt servicing costs, peaking at 3% of GDP during 2008. However with nominal GDP growing on average by 6% per year, prior to 2008 there were no serious constraints on borrowing. The recent crunch in economic activity, however, highlights the riskiness of the extent of overseas borrowing. Despite a large reduction in debt levels and large falls in interest rates, throughout 2009 combined debt servicing costs exceeded the pace of income growth.

Chart 1.8: GDP growth and debt servicing



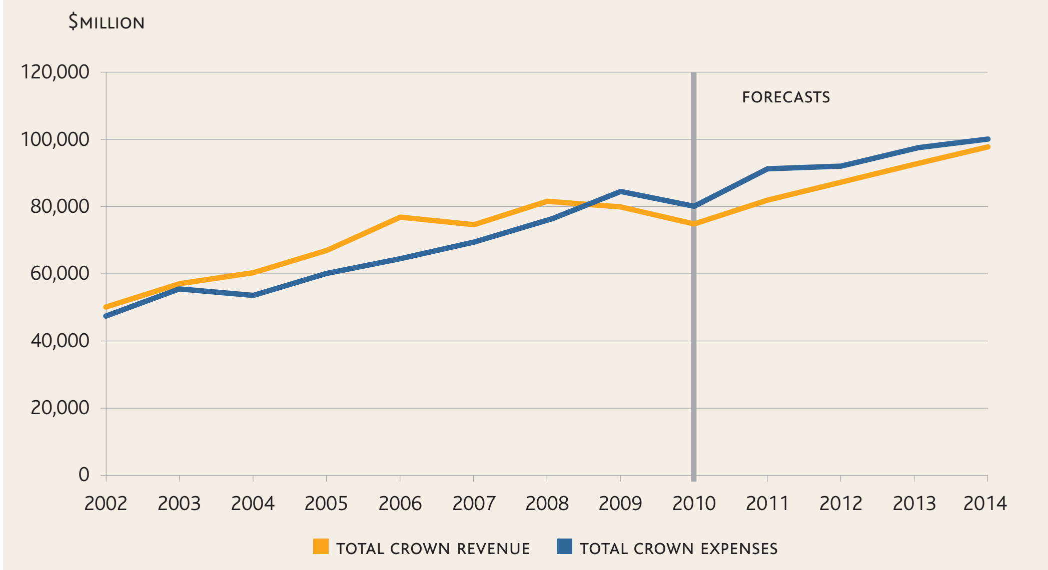
Source: Statistics New Zealand.

Government accounts

There has been a steady rise in government spending levels since 2004 (see chart 1.9). As well as growth in the traditional high spending policy areas, new programmes such as Working for Families and KiwiSaver came on line during the review period. Despite the strong growth in spending, the government accounts remained in surplus prior to 2009 as the increases in spending were typically matched by similar increases in revenue.

The recession's effect in shrinking tax receipts and increasing the expenditure on unemployment benefits created extra fiscal pressure. This and a series of income tax cuts in 2008 and 2009 quickly shifted the government accounts from surplus to deficit.

Chart 1.9: Government revenue and expenses



Source: Crown Accounts and 2010 Budget Economic and Fiscal Update.

For 2010/11 the core Crown operating deficit is expected to climb to $10.4 billion (approximately 5.2% of projected GDP) before beginning to fall again. The income and company tax cuts in October 2010 and the offsetting GST rise to 15% and other tax changes (including abolition of depreciation on investor housing and other long life assets) were estimated to add around $0.46 billion to the annual deficit in the first year. Treasury is forecasting the government deficits to continue to at least 2014.

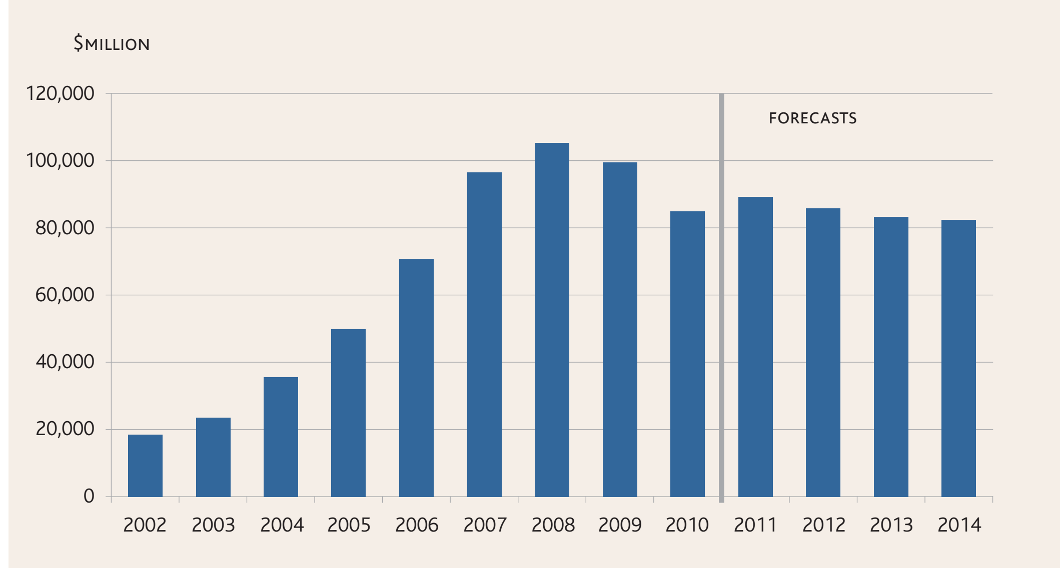
Chart 1.10 presents the recent history of Crown net worth, a useful summary statistic of the government's financial position. The chart illustrates that, despite the increases in government spending in recent years, the financial position of the Crown improved markedly in each of the six years until 2008.

The strength of the government financial position has probably been part of the reason why global financial markets have generally tolerated the deterioration in New Zealand's balance of payments in the middle of the decade. The chart also illustrates that although the fiscal deficits since 2008 have resulted in a marked decline in Crown net worth (equivalent to 13% of GDP between 2008 and 2010), the financial position of the government remains robust, with net worth still as high as 45% of GDP in 2010.

Although in dollar terms, Treasury forecasts suggest that Crown net worth will change little over the next three years, the outlook actually implies a further decline in the financial position of the government.

Treasury forecasts imply that Crown net worth declines from around 58% of GDP in 2008 to 45% of GDP in 2010, and to less than 35% of GDP by 2014. Even at this point, few would argue that this constitutes a weak financial position for the government. Many would also argue that it is entirely appropriate for the government to use fiscal policy to support economic activity at this time. However, the key consequence is that use of government assets at this time must necessarily constrain the options available to future governments.

Chart 1.10: Crown net worth



Source: Crown Accounts and 2010 Budget Economic and Fiscal Update.

The changing environment for saving

With the onset of the recession, housing, shares and other asset prices followed a boom and bust scenario. The Official Cash Rate (OCR) in New Zealand was reduced rapidly to the lowest level for many years and has only just begun to be increased. The banking sector's access to global markets reduced significantly and this impacted the supply of credit in the New Zealand economy.

The Reserve Bank responded by offering to purchase a greater range of financial assets. The government also intervened to mitigate potential systemic risk to the finance sector through offering a deposit guarantee scheme. There has been a policy shift away from a 'light regulation' approach towards measures designed to increase public confidence in the financial system.

Both household disposable incomes and their overall wealth position have shrunk since the onset of the recession in 2008. Until wealth recovers, households are being forced into some combination of reducing spending and/or accepting lower net savings. Adjustments at the individual household level will of course depend on the particular income and asset circumstances and life stage of each household.

However, a net increase in household saving is likely to be a legacy of the recent recession. Savings typically pick up in the aftermath of a recession, if for no other reason that the risk of unemployment encourages people to act in a more precautionary way.

In the current situation, the volatile nature of the housing market has produced large swings in perceptions of wealth for house owners. The picture has been complicated by large changes in asset prices, the loss of public confidence in some sectors of the market and the steps that have been taken to respond to these changes.

The rapid rise in house prices in the middle of the decade probably resulted in many households developing an exaggerated view of their true wealth, which would also have reduced their perceptions about the need for saving. Declines in house prices since 2007 will have changed perceptions in many households. As discussed above (see chart 1.6) New Zealand house prices still look to be on the high side when compared with long run historical trends, thus a resurgence in house prices is probably not a likely source of wealth growth in the foreseeable future.

In 2010 house prices have fluctuated with no clear trend. An upward creep in interest rates seems to be offsetting other improvements in the economic situation. Investors may also be more cautious about the prices they are prepared to pay for investment housing now that depreciation allowances are to be scrapped on assets with an expected life of more than 50 years, a category which includes most investor housing purchases. Some rental investors may also lose the ability to claim rental losses to lower taxable income.

Monetary conditions

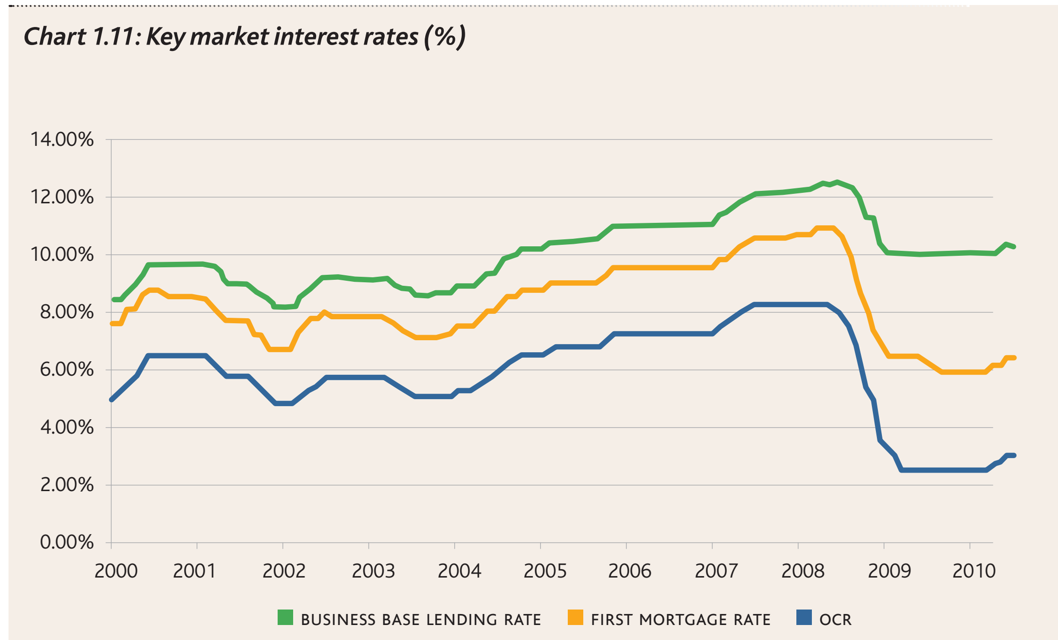
During the economic expansion period the Reserve Bank progressively raised the Official Cash Rate (OCR) to help drive up domestic interest rates in order to ease inflationary pressures. From 5% in December 2003 the OCR progressively rose to 8.25% by March 2008. Interest rates offered by trading banks rose in a similar way (see chart 1.11).

The impact of higher interest rates had mixed effects on the economy. High New Zealand interest rates encouraged an inflow of overseas monetary capital into New Zealand, funding an ongoing expansion of bank lending. The inflow also helped to drive up the real exchange rate, which impacted negatively on the export sector while reducing import prices.

At the same time the rising cost of funds and emerging difficulties in new construction developments impacted the finance company sector. Between 2006 and 2010 more than 50 finance companies either failed or had to seek moratoria from investors. In other cases of finance company failure, investors are being reimbursed by the government under the Retail Deposit Guarantee Scheme that was established in October 2008.

The economic recession of 2008 saw house price inflation slow and turn negative. Share prices also experienced a dramatic downturn, falling 42% between the June quarters of 2007 and 2009. However, as overseas capital was still flowing into the economy, bank lending continued to expand up until the third quarter of 2008.

Chart 1.11: Key market interest rates (%)



Source: Reserve Bank of New Zealand.

The onset of the GFC in October 2008 produced major consequences locally. Despite the Reserve Bank cutting the OCR down to 2.5% by April 2009, the commercial banks stopped expanding their lending. Total lending remained static for the next 18 months, and lending to the business sector (from banks and other institutional lenders) actually fell by 10%.

In June 2010 the Reserve Bank raised the OCR to 2.75%, and in July the OCR was further raised to 3%. This has flowed through into higher interest rates on lending. However, the OCR change was preceded by increases in term deposit rates offered by the banks as they competed for shares of domestic deposits. This was caused by the change in prudential requirements, where the Reserve Bank imposed a requirement for banks to hold a higher percentage of their deposits in retail term deposits or term wholesale debt. The net effect of this was a significant (up to 2.5%) increase in the banks' funding costs.

The commercial banks were affected by a number of factors which led to them instituting what amounted to a credit freeze from late 2008 onwards:

» The supply of foreign capital froze for a time and subsequently became very difficult to obtain for a period after the onset of the global financial crisis.

» Many corporate clients had become more indebted to the banking system during the boom and some were in breach of their loan covenants or at risk of doing so. The new climate of financial prudence which followed the crisis and reduced investment plans led to a lowering of the corporate sector bank loan gearing.

» The banks now had to meet stricter criteria for capital, funding sources, and reserves in relation to lending and funding as a result of Reserve Bank prudential requirements.
» The four big Australian-owned banks had to find funds to meet the extra tax bill flowing from a court case won by the Inland Revenue Department.
» Lending expansion had become less profitable in New Zealand than in Australia, where the economic recovery was faster.

One consequence of the shortage of new bank lending for the business sector was a shift into the issue of securities by a number of larger companies seeking to raise capital.

The global financial crisis also generated a policy shift from the New Zealand Government in respect of the financial services sector with the establishment of the Retail Deposit Guarantee Scheme and the Wholesale Funding Guarantee. These were designed to avoid financial panic and prevent runs on financial institutions.

Financial regulation

The Capital Market Development Taskforce noted in its December 2009 report that:

> "Our capital markets have not served retail investors well. A number of major failures – most recently of finance companies since 2006 – have resulted in large investor losses and justifiably dented trust and confidence in financial assets. Some issuers and financial advisors have behaved poorly, useful information is lacking, and some capital markets products have performed poorly."

The taskforce concluded that New Zealand had thin public capital markets, patchy private markets, significant gaps in the derivatives markets, and weak investment to grow businesses through their lives. It highlighted six areas where improvements were required in order to improve the market for retail investors:

» Improve product and services disclosure.
» Improve financial advisory services.
» Improve investment literacy.
» Improve managed funds products.
» Increase the stock of publicly listed companies.
» Create and facilitate new or missing products such as annuities.

The taskforce developed a number of recommendations designed to make New Zealand capital markets work more efficiently. Many of these recommendations have been accepted by Government.

The current situation regarding financial regulation is as follows:

» The Securities Act is being rewritten, and may come before parliament in 2011.
» A single Financial Markets Authority, often referred to as the 'Super Regulator' is to take over enforcing securities reporting and financial law as they apply to financial services, including the KiwiSaver providers.
» Changes have been introduced with stricter rules covering financial advisers, including registration and licensing requirements for some categories of advisors.

- Changes are also proposed regarding the regulation of KiwiSaver schemes, including requiring KiwiSaver managers to have direct duties to investors rather than this obligation applying only to trustees, and improving ongoing disclosure of KiwiSaver schemes.
- The Reserve Bank has reviewed prudential requirements for the banks and is establishing prudential requirements for some other financial organisations.

Taxation changes

New tax rules for savings came into force during 2007. These rules consist of the new portfolio investment entity (PIE) rules for managed funds and the fair dividend rate (FDR) rules for offshore portfolio share investments.

The PIE rules were introduced to address the issue of investors in managed funds having their investment income taxed at a higher rate than their marginal tax rate. The tax rate on investment income of higher income savers in PIEs was lowered to 28% from 1 October 2010.

The main changes in the taxation of offshore portfolio share investments are the removal of the previous 'grey list' exemption in the foreign investment fund (FIF) rules and the new fair dividend rate (FDR) method. The FDR method broadly taxes 5% of a share portfolio's opening value each year. If the total return on the share portfolio is less than 5%, individuals and family trusts pay tax on the lower amount, with no tax being paid if the shares make a loss.

Dividend only taxation is not feasible for taxing investments in companies resident in countries whose tax systems do not encourage the payment of dividends (such as the United States). The FDR method seeks to collect a reasonable level of tax each year from such investments.

Investments in Australian listed companies are generally exempt from the FDR rules. This exemption reflects the fact that Australian dividend yields, like those in New Zealand, are relatively high. Consequently, dividend-only taxation is a reasonable approach for these investments because the Australian tax system encourages distributions, as the New Zealand tax system does. (Both countries operate imputation-type company tax systems which remove double taxation.)

Under the new FDR rules, offshore portfolio share investments are taxed more consistently, regardless of the country where the investment is located and whether the investment is made by an individual directly or through a managed fund.

Starting from 1 October 2008 there has been a series of personal tax cuts. The latest round of tax cuts took effect from 1 October 2010.

Households' response to the changing environment

There has been a 'flight to security' back to bank deposits and a much more cautious approach to borrowing and debt on the part of many households and businesses, matched by more caution in lending by the major financial institutions. The number of KiwiSaver retirement saving accounts is expanding rapidly. Home ownership rates are dropping among younger age groups. More recently New Zealand households appear to have increased their savings and the Reserve Bank forecast this trend to continue, though it is too early to draw any firm conclusions.

Asset losses

For a substantial group of savers the loss of savings from the finance company failures, and losses in share market values and in structured credit portfolios, was traumatic. Confidence and trust in the financial sector generally has been damaged. For many older people there is little hope of ever replacing these savings, which had formed an important part of their retirement income planning. These events have influenced the Retirement Commission in its advocacy of better consumer protection and clearer disclosure by issuers of financial products, in order to mitigate the risk of future catastrophic losses.

Changing patterns of saving and asset holding

The financial turmoil of recent years has understandably encouraged a change in household financial behaviour.

» **A flight of deposits back to the banks.** Between December 2006 and December 2009 household deposits with registered banks rose 33%. Over the same period household deposits with non-bank lenders fell 27%. The flight slowed but did not stop once the government extended the Retail Deposit Guarantee Scheme to most continuing non-bank deposit takers. Finance companies were the most heavily affected by the outflow of funds.

» **A retreat into fixed interest securities.** Between December 2006 and December 2009 the value of fixed interest securities held by households rose by 65% to $26 billion. These included contributory mortgages, syndicated investments and, later in the period, direct purchase of fixed interest securities issued by major companies substituting bank debt. For local investors these investments offered better yields than bank deposits, and were typically issued by strong brand names that investors trusted.

» **KiwiSaver.** Only introduced in 2007, KiwiSaver has since grown to become the most commonly held financial form of retirement saving. As of June 2010, 1.46 million people had KiwiSaver accounts (or 38% of the population aged under 65). Most KiwiSaver balances are still relatively small, but growing.

The total value of KiwiSaver account balances as at March 2009 of $5.8 billion was still less than the amount of growth in fixed interest securities held by households over the same period. However, the sources of these amounts are different. KiwiSaver is now widely held in the population, with the potential for rapid future growth in the aggregate size of KiwiSaver balances. Conversely, fixed interest securities appear to be mainly held by a small group of wealthy households.

Some other changes in the financial asset portfolios of savers reflected medium and longer term trends. The proportion of the labour force that belongs to superannuation funds (other than KiwiSaver) continued to decline. In 1993 Government Actuary calculations indicated that 23% of the labour force belonged to such schemes. By 2009 it had fallen further to 12%. Life insurance assets have also declined in relative importance among the assets held by households.

Home ownership

As house prices rose faster than incomes, the proportion of New Zealand households that own their own home has declined. According to census data, the home ownership ratio, including ownership by family trusts, fell from 74% in 1991 to 67% in 2006.

Table 1.1: Rates of home ownership

1981	1986	1991	1996	2001	2006
71.4%	73.7%	73.8%	70.7%	67.8%	66.9%

Source: Department of Prime Minister and Cabinet; House Prices Unit Final Report, March 2008.

Reliance on census data means that this information is now quite dated. However, indications are that the trend away from home ownership has continued. The number of active tenancy bonds held by the Department of Building and Housing rose 17% to 450,540 in the four years to March 2010. Given that population growth over the same period was 3.4% this suggests that the proportion of renters has continued to rise, and consequently owner occupation proportions have probably continued to decline since the 2006 Census.

Financial education

The call for better public financial education has gained momentum since the GFC. This has occurred in many countries including New Zealand, Australia, the United Kingdom, Canada, and the United States. In New Zealand the collapse of finance companies has intensified interest in extending financial education. Since 2007 considerable progress in extending financial education has been made:

- The National Strategy for Financial Literacy was released in June 2008 and updated in 2010 to include a five-year action plan.
- There is now considerable government interest in financial education issues. The Minister of Commerce now plays a leadership and policy coordination role for financial literacy in New Zealand.
- The Ministry of Education has taken responsibility for ensuring the successful implementation of financial education in schools. Both the national curriculums – New Zealand Curriculum (NZC) and Te Marautanga o Aotearoa – recognise the importance of developing financially capable citizens who contribute effectively to New Zealand's economy. The NZC clearly states that schools should be including financial capability in their teaching and learning programmes. Students can gain worthwhile qualifications in personal financial management through unit standards available at Levels 1, 2 and 3 on the national qualifications framework.
- The Sorted information programme has continued to be developed by the Retirement Commission; 28% of New Zealanders have used sorted.org.nz or Sorted resources.
- The ANZ-Retirement Commission Survey of Financial Knowledge has been undertaken twice (2006 and 2009) and provides an indication of both the level and trends in financial knowledge for the general population. The survey results are discussed throughout this Review where appropriate.

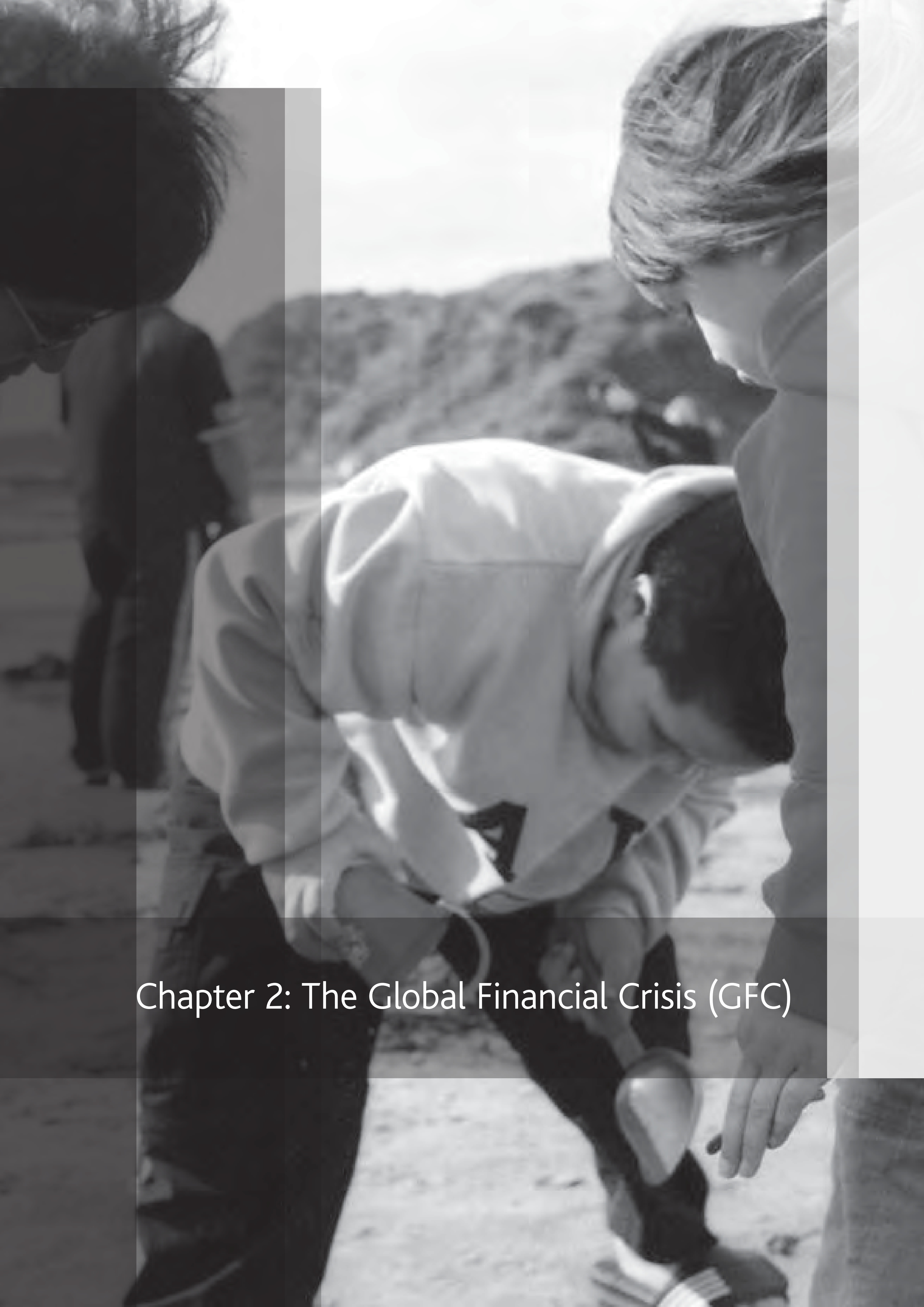
Conclusion

The last three years have been an eventful period dominated by the global financial crisis that is potentially the biggest shock to the international financial system since the demise of the Bretton Woods system in the early 1970s. The crisis compounded and extended New Zealand's drought-induced recession of 2008 and a series of finance company failures.

As in other countries, a boom then bust in the housing market has been a critical factor underpinning changing fortunes in New Zealand. Also as in other countries, the Reserve Bank has eased monetary conditions and the Government has adjusted spending and tax settings in order to stimulate economic activity.

The net result is that the New Zealand economy is well on the way to recovery, but it may take until the middle of 2012 before our income levels return to their pre-recession highs.

Potential longer-term ramifications of the recession relate to the time it may take for the housing market to fully correct the excessive price movements of the last decade, and to the extent that fiscal stimulus will constrain the options available to future governments.



Chapter 2: The Global Financial Crisis (GFC)

This chapter describes the impact on New Zealand households of what has become known as the global financial crisis (GFC). It also discusses the important policy issues that arise as a result of New Zealand's response to the GFC.

The impact of the GFC on household savings and net worth

Together with the failure of New Zealand finance companies, the initial direct impact of the GFC on household aggregate net worth was significant (-9% in 2008). But recoveries in bond, equity and house prices in 2009 (with some reversal in the first half of 2010) offset a good part of that initial impact.

Overall the impact to date has been moderate compared with harder-hit economies in the northern hemisphere, and probably less than that following the 1987 share market crash.

New Zealand has weathered the GFC comparatively well for a number of reasons including:

» Going into the crisis, the core domestic banking system and corporate balance sheets were sound overall. In particular, they had little exposure to subprime lending and to complex structured credits of the kind that caused major problems for their offshore counterparts.

» Strong financial sector links to Australia (including through Australian ownership of much of New Zealand's banking system) which has equally strong banks and corporations.

» The New Zealand and Australian economies are tied to the Asian economies which have rebounded from the crisis more strongly than any other region.

» The government went into the crisis period in a good financial position, which helped to underpin financial market confidence, and meant there was some room to ease fiscal policy to boost the economy overall.

However, that moderate aggregate impact masks a wide dispersion of outcomes across individual households. These include not only financial outcomes but also the disruption and stress of losing a job, or having to relocate to find a new job.

Some households will have incurred permanent losses on a scale that will be devastating for their future wellbeing, a few will have augmented their wealth, while the majority will not have been impacted substantially, although on average will have experienced something of a setback.

Most prominent among those who have experienced losses have been investors in finance companies, and in some fixed interest managed funds. There is no official data on losses. Unofficial estimates based on information collected on finance industry failures suggest that, excluding those whose failures were covered by the Crown Retail Deposit Guarantee Scheme, there have been more than 50 finance company failures affecting 195,000 deposits and that investors face incurring losses of around $3.8 billion out of around $6.7 billion invested[2]. The percentage losses vary widely, with some of the failed finance companies having returned over 90% of debenture holders' funds, and others (depending on the class of security held) experienced total loss. Since the

2. Source: Interest.co.nz website. The total number of investors affected is unknown, but will be less than the 195,000 deposits because some investors will have investments spread across a number of finance companies.

Retail Deposit Guarantee Scheme commenced, further finance companies have failed, most notably South Canterbury Finance. But in these cases, investors have been, or are in the process of being, reimbursed by the Government.

Other investors will have incurred losses on equity investments (both directly held and via managed funds). These losses can persist long-term, or even be permanent (in those cases where a company fails). Some commentators note, for example, that the loss in Telecom's market value of about $5.5 billion since the start of 2007, is a multiple of the losses from finance company failures. However, so far during the GFC, no company in the NZX top 15 index (by market capitalisation) has failed.

While the beneficiaries from the crisis will be few in number, there will have been some. A few will have been astute enough early in, or ahead of, the crisis to have sold equities and bought prime fixed interest bonds which, (with falling interest rates) will have increased in value. A few others may have benefited in ways that are more questionable.

While in New Zealand bankers' 'bonuses' have not been as much of an issue as they have in North Atlantic markets, there still have been suggestions that the shareholders of some finance companies extracted dividends that (at least with the benefit of hindsight) were excessive. That is, dividends were paid even though subsequent events provide evidence that the company was actually facing a need for capital to be injected, not withdrawn, and as a result losses to investors have been greater than otherwise would have occurred.

Fiscal and monetary policy has absorbed much of the impact that otherwise would have been felt by household incomes and saving. In other words, much of the impact has been absorbed by government 'dis-saving'.

Household saving (if anything) has increased, with the rate of household debt accumulation having slowed quite sharply. The projected deterioration in Crown net worth over the five years to 2013, at nearly 20% of GDP, is three times the fall in household net worth over 2008-09. This is, in effect, a transfer of the impact to future taxpayers (today's younger to middle-aged cohorts).

The government also responded with guarantee schemes covering both retail deposits and wholesale borrowing by banks. In these ways, the government stepped in to absorb risk that financial markets were retreating from during the height of the crisis, and provided an underpinning for financial confidence.

Impact on different age cohorts

A full assessment of the impact of the GFC across different age cohorts is complicated by a need to trace through effects felt via a number of different channels and data limitations, but broadly:

» Losses on financial assets will disproportionately have impacted older cohorts, given that they account for a disproportionate share of aggregate financial assets (having been accumulating for longer, and given that a larger share of the saving by younger cohorts typically is channelled into servicing a mortgage). This older cohort appears to have been worst affected by the finance company failures and generally has less opportunity to recover from investment losses than younger cohorts.

» Older cohorts will, however, have benefited disproportionately from the sustained increase (to date) in the real value of houses in the years running up to the crisis. Middle-aged cohorts also will have benefited, but will also be carrying more debt, while younger cohorts aspiring to home ownership face larger borrowing requirements and uncertain prospects for house values (but for a period at least, lower mortgage interest rates than have prevailed for some time).

» Today's older cohorts are also benefiting from the government's commitment to maintain the terms of New Zealand Superannuation (NZS). At the same time, the GFC has increased uncertainty about those terms being able to be sustained in the longer term. The significant deterioration in the Government's fiscal position and its decision to suspend contributions to the New Zealand Superannuation Fund may reduce the level of certainty that future retirees have in NZS remaining in its present form (whether in terms of eligibility criteria or the rate at which superannuation is paid).

Causes of finance company failure

Four specific factors have contributed to the large number of finance company failures since 2006 but, taken together, they boil down to finance companies having been able to represent the investments they offered to the public as something different from the assets that backed them. In many countries, the investments offered would have been referred to as 'high yield' or 'junk' bonds, and could not have been referred to as 'deposits'.

Firstly, the finance companies that failed were predominantly property development financiers. These institutions typically lent on terms that provided little protection in the event that the development failed to meet the developer's expectations. The lending terms often did not require servicing payments (interest and/or principal) to be made for the first two or three years of the loan (with interest being added to the loan amount).

Finance companies also often held second-tier security (ranking behind another lender, who held the first mortgage). In some cases the loan portfolio was highly concentrated, rather than diversified, or had related-party exposures. All this is the antithesis of the prudent lending one normally would expect of a 'deposit-taker'.

Secondly, the applicable governance, regulatory, and supervisory arrangements were not of a standard commensurate with being in the business of taking 'deposits'.

A third factor is that investors, and/or their advisers, did not themselves adequately assess the risks. In part this might be because they did not perceive a need to do so, in part because the risks were not adequately disclosed, and, in part, because they did not have the capability required to understand what was disclosed or the commission structure dominated the decision. Others, of course, may have correctly read the warning signs or received prudent advice, and shifted away from these investments.

Finally, the investment mantra that 'high return = high risk' may have been (mistakenly) extrapolated by the investing public to also mean 'moderate return = moderate risk', and facilitated finance companies pitching their interest rates for what were actually high risk investments just a few percentage points above bank deposit rates.

This will have left finance companies with ample interest margin to cover the cost of high-profile brand advertising (that reinforced a no more than moderate risk profile) and commission payments to induce advisers to recommend their investment products.

To the extent these are explanatory factors, they point to professional standards and the regulatory regime as having not been sufficiently effective in ensuring that risks were adequately disclosed to (and understood by) the investing public.

Important lessons for the management of individual savings and retirement income

The GFC has 'stress-tested' most aspects of financial sector policy and practice, including some established principles relating to individual saving and investing for, and in, retirement. Broadly speaking, the crisis has provided a powerful reminder that risk is always present. More specifically, it has pointed to:

» A need for realistic assessment of the level of investment returns that can be expected in a low-inflation environment.

» A need to reassess the limits of do-it-yourself investing (by non-experts).

» The need for those holding themselves out as advisers to comply with professional standards.

» The desirability of those offering investment products to have a greater role in, and responsibility for, providing guidance on the nature and level of risk embedded in their products.

The years running up to the GFC have been widely described, globally, as a period during which investors were 'searching for yield'.

Interest rates, but more particularly credit-risk margins, were relatively low by historical standards, and investors had to move into riskier assets to achieve yield. Examples include the global appetite for high yielding currencies (including the NZD and AUD); for asset-backed securities and, in New Zealand, for finance company deposits.

What was not so much appreciated at the time, but is hardly surprising, is that the search for yield was accompanied with increased risk.

Investors need to understand risk and their capacity to withstand losses. For those seeking to accumulate a nest egg for retirement, expectations of what is an appropriate return on savings need to be aligned with the level of commitment they are willing to make to managing risk (or paying for professional management), as well as their capacity to withstand losses. In some cases, these considerations might point to lower risk (and lower return) investments as being appropriate, and a corresponding need to save more than previously thought.

There are implications also for retired people relying on their investment nest egg to provide a regular and reliable cash flow to substitute for previous employment income. The lesson here is that they may need to be more willing to run down their capital, given that the alternative (taking greater investment risk in an attempt to generate more investment income) can result in outright loss of capital.

Many investors were enticed into new, and in some cases complex, areas of investment, where risks were lurking below the surface and were under-appreciated. This suggests a need for a re-assessment of the limits of do-it-yourself investing (by non-experts), which has implications for:

» Policymakers, specifically a need to reassess the extent to which a regulatory regime that assumes investment capabilities on the part of 'non-expert' investors can be effective.

» Savers/investors, who may need to be more willing to seek (and to be prepared to pay for) advice, or confine themselves to relatively 'vanilla' products.

» The financial services industry, in which the public may have higher expectations than before regarding its responsibilities for providing trustworthy and value-for-money advice.

Trust and confidence in the finance sector

The financial losses arising from the failure of finance companies have been felt by many New Zealanders, both directly and indirectly. It is not surprising then that this has affected people's trust and confidence in the sector.

The results of a nationwide survey of consumers released in September 2009 by RaboDirect prompted its General Manager to report that "New Zealanders are wary, and trust and confidence in the financial sector has taken a battering"[3]. The more recent survey, released in September 2010, indicates that confidence in the financial sector overall remains weak.

The results reported from the September 2010 survey included the following:

» While there was a high level of confidence in banks, consumers were a bit less sure of credit unions and building societies and had a particularly grim view of finance companies.

» Relative to banks and insurance companies, fund managers, financial advisers and sharebrokers are still poorly perceived.

It is inevitable that, with more New Zealanders opening KiwiSaver accounts, more of the population will become exposed to the quality of service of fund managers.

If a KiwiSaver scheme fails there may be scheme-wide confidence problems, especially given the (wrong) impression some people appear to have of a government guarantee on these funds.

Sloppy fund management may be hidden to a degree while members' accounts are still growing quickly due to contributions being made to a small balance. As the balances get larger, and contributions become a smaller proportion of the increase in value, management success or otherwise will become more obvious.

Policy responses

A number of reforms to improve consumer confidence are currently under development or in the process of implementation. A number of the policy measures listed below were initiated prior to, but have been accelerated by, the outbreak of the GFC.

The aim of the current raft of policy initiatives is to achieve a two-fold effect:

» To deliver improved capital adequacy (among non-bank deposit takers in particular), business practices, training, competence and ongoing monitoring of product issuers and advisers.

» To improve the quality of information given to consumers of financial services which in turn will help increase their financial literacy (if they get better information, they will be inclined to use it, and if they use it, they will in the process become more financially literate), their ability to compare products and their understanding of risk.

Reform of existing securities law

One area of the current comprehensive reform of securities law involves substantially revamping existing prospectus and investment statement disclosure requirements. Substantial changes to the regulation of the securities market were proposed in a discussion document released by the Ministry of Economic Development in June 2010.

3. RaboDirect media release, September 2009.

One proposal is that the information required to be provided to investors at the 'point of sale', at least for some investment products, should include (a) a risk rating, not just the information needed to enable investors themselves to make their own assessment; and (b) in the case of complex products, warnings that the product is highly complex and more likely to be suitable for an experienced investor.

These approaches are well-aligned with the points made above in relation to 'do-it-yourself' investing and, if implemented, could make for a substantially more effective disclosure regime than was in place previously.

Product prescriptions

One way to protect consumers, which has been looked at in other countries, is introducing prescribed features for investment products. There does not appear to have been much debate of this issue in New Zealand but it may emerge as an issue as discussions take place around the new Securities Act.

Under this approach the regulator would go one step further than is currently proposed – to not just vetting the documents for clarity and accuracy, but vetting the suitability of the products themselves. An example where product limitations might be potentially useful is banning the use of leverage in products advertised as cash trusts. Similarly, prescribing minimum or maximum exposures could have significant benefits.

The concept of excluding products with high leverage, low liquidity and high derivative content from being sold to retail investors is now used in the UK, after highly geared closed end funds were mis-sold with disastrous consequences for investors.

At the heart of the matter is the question of what might be the appropriate balance for the responsibilities among:

a. Investors (to read and understand the information available to them).

b. Issuers (to provide appropriate information to investors, which includes what this means in practice – ranging from giving investors all the detail they need to make their own risk assessments, to actually themselves providing a risk assessment).

c. The regulator (to determine what investors would and would not invest in if only they could work it out).

Incorporating the perspectives of all of these key stakeholders will be critical to getting the balance of product prescription right.

New Financial Markets Authority

In April 2010 the Minister of Commerce announced the establishment of a new financial market conduct regulator, the Financial Markets Authority (FMA).

The FMA will combine the functions of the Securities Commission, with some of the financial regulatory roles of the Ministry of Economic Development (including the Government Actuary) and of the New Zealand Stock Exchange (NZX) to create a single regulator focused on proactively monitoring and enforcing securities law. The FMA will enforce the laws that govern the issuing of securities, financial reporting and company law (as it applies to financial services). It will regulate and oversee trustees, auditors, financial advisers and financial service providers.

Legislation establishing the FMA is expected to be passed in early 2011 and the FMA is due to start operating shortly thereafter. This has progressed very quickly and it is likely the FMA will be up and running before key decisions about the new Securities Act, which the FMA will enforce, have been made. The board tasked with designing the structure of the FMA was announced in May 2010.

Creating a new regulator was one of the recommendations of the Capital Market Development Taskforce which reported to government in December 2009.

There appears to be widespread agreement that a fundamentally new approach to market supervision is needed.

The inability of the Securities Commission to prevent catastrophic losses from finance companies and failed collective investment schemes, along with difficulties in securing high profile convictions afterwards, has undoubtedly eroded consumers' confidence in the finance sector. To be successful the new regulator will need stronger powers and more resources (and some would say a more pro-active and pro-consumer culture) than the Securities Commission.

Reducing fragmentation of regulatory roles should make for more effective regulation. It is not clear, however, whether current proposals go as far as they could. For example, whether it would be beneficial also to incorporate the current financial regulatory role of the Commerce Commission under the Fair Trading Act, and the Takeovers Panel, into the FMA.

There is also a question concerning whether the multi-layered structure (fund manager, trustee, and administrator) for collective investment funds, such as KiwiSaver funds, is the most cost-effective approach. Does splitting roles and responsibilities strengthen or weaken scrutiny and accountabilities? Then there is the question of cost, against the backdrop of a widely held view that the all-up costs (fees) for managed investment fund products are high relative to the value added.

Prudential regulation

In September 2008 the Reserve Bank Amendment Act was passed. This made the Reserve Bank the sole regulator of the New Zealand deposit-taking sector, including of non-bank deposit takers (NBDT) such as finance companies and building societies.

The new regime is expected to bring about a strengthening of the capital base of the NBDT sector and an improvement in business practices as these bank-like institutions will be required to maintain minimum prudential standards, similar to those applied to banks.

Ideally a further step would be to simplify and further clarify the bank/non-bank boundary by restricting use of the term 'deposit' and 'deposit-taker' to institutions that are banks, with all other institutions then being described as issuers of risk investments.

An area of policy development that is at a more preliminary stage is macro-prudential policy. There is an emerging global consensus that central banking during the last decade or two became somewhat divided, with monetary policy focused on Consumer Price Index inflation, and prudential supervision focused on individual institutions taken in isolation. As a result, the potential for monetary instability originating in system-wide financial booms and busts – which individual investors have very limited capacity to diversify against – was underplayed.

In these respects the Reserve Bank arguably maintained a more integrated approach than most, as evident, for example, in the weight it appears to have attached to housing market developments in its monetary policy settings. Like other central banks, however, the Reserve Bank has identified a possible need for prudential policy to play a greater role in maintaining macro-financial stability.

This should be a priority area for policy development in the future, and has been listed as such in the Reserve Bank's 2010 Statement of Intent.

Regulation of financial advisers

The objective of the Financial Advisers Act 2008 is to "promote the sound and efficient delivery of financial adviser and broking services, and to encourage public confidence in the professionalism and integrity of financial advisers and brokers".

The Code of Professional Conduct should see a floor being put under standards when there has been none previously. Whether that, by itself, will result in standards lifting to a more consistently adequate level may depend as much on the extent to which existing industry bodies take up the mantle of developing a more fully-fledged profession, say, along the lines of the accounting and legal professions.

Adviser licensing regime

A new occupational licensing regime for financial advisers is due to be fully in force on 1 July 2011, but is somewhat contentious as the scheme has been subject to rapid and recent changes.

The purpose of the regime is to restrict entry only to advisers who meet set criteria. If the required standard is above current practice, standards in the regulated industry will rise as the less able exit and the more able up-skill. However, because there is no record of who was acting as an adviser and what their skill level was, there is no way of knowing whether the new rules will raise standards in practice.

The new regime requires a relatively low level of competency which may or may not provide better protection for consumers beyond what was already available to consumers via disputes schemes and other options available to enforce their rights (under the Consumers Guarantees Act and Fair Trading Act).

Potential benefits of the regime include the prevention of poor adviser behaviour (by proactive monitoring) and lifting standards of advice over time. However the regime is complex and there is a risk consumers may not see any value in using authorised advisers. If this eventuates the potential benefits of the regime will not be realised. There is also a risk that the proposal to define some consumers as 'wholesale clients' will reduce the access of the wealthy or the financially literate to the protection afforded to other consumers.

The Code of Professional Conduct for Authorised Advisers (the Code) was approved by the Minister of Commerce in September 2010 after a number of changes. In the details accompanying Standard 8 the proposed Code allows authorised financial advisers to contract out of their obligations to clients where the client has asked for a non-personalised service or the client refuses to provide sufficient information to enable the adviser to provide a personalised service. However, the duties of care, skill and diligence still apply. It is not yet known whether this will, in practice, provide adequate protection for these consumers.

The adviser licensing regime applies to any financial adviser service provided to a client in the course of a business. It does not apply to free services provided by the not-for-profit sector. There are some other forms of financial advice that are provided to particularly vulnerable segments of the community who could well do with being protected from receiving poor quality advice.

One example is the provision of budget advice by some non-government organisations. Budget advice quality standards should be used more widely across the sector and government funding to such organisations should be provided only on the basis that such standards are complied with. The continued good work undertaken by such organisations needs to be endorsed and supported.

New adviser disclosure rules

Proposals for new adviser disclosure rules were released in February 2010 and are expected to be passed as legislation before the end of 2010.

The draft regulations include a new brief disclosure statement for advisers. This aims to ensure that clients receive comparable and key information that is easy to understand and should be an improvement on the current situation. However, it seems no information about commissions and other opaque payments will be required of advisers who are not authorised (including mortgage brokers and insurance brokers).

Registered advisers only need to disclose basic information (contact details, an explanation of the type of adviser they are, details about the disputes scheme that is available to the consumer, contact details for the Securities Commission).

While authorised financial advisers (AFAs) will be required to disclose additional information (how they get remunerated, potential conflicts of interest, limitations to their services, previous bankruptcies and disciplinary actions) this appears to mirror current practice in many respects. AFAs will be required to disclose criminal convictions but not their previous employment history.

Consumer law

A review of all consumer law is currently underway. One of the proposals is to include oppressive clauses as unfair trading practices (in other words, make them a breach of the Fair Trading Act). This would potentially address excessive interest charges and fees charged on 'loan shark' type credit contracts, for example, and other oppressive clauses which might be used in contracts with vulnerable consumers (for example, disreputable equity release schemes or retirement village contracts).

There are a number of organisations concerned about the impacts that 'loan sharks' are having on some consumers. Fortunately there are indications that some mainstream banks are exploring the provision of micro-financing services, which should put stronger competitive pressure on these third tier lenders.

Consumer voice

Consumers are at a disadvantage when dealing with the financial sector. Almost universally, consumers have less knowledge of financial products, including their fees and incentives, than the adviser, broker or sales representative. This imbalance creates the environment for the sale of products that are more in the interests of the seller than the buyer.

Consequently it is important that legislation and regulation of the financial sector is formed with consumer protection being a guiding principle. Strong representation from consumers or their representatives in the legislation and regulation development process would assist this process.

Unfortunately there are few financial consumer organisations in New Zealand; even fewer that have the knowledge to contribute to financial regulation development. Consumer NZ, some unions and the Shareholders' Association have all worked to keep the consumer perspective in either regulation development or through helping inform the consumer through media.

Those responsible for producing regulation need to give at least equal weight to the consumer voice as is given to the finance sector voice.

Conclusion and recommendations

The GFC has served as a timely reminder of the need for consumers to understand where and how their savings are invested.

In many ways New Zealand as a whole has weathered the financial crisis better than many other countries because of structures and processes already in place. This has included the regulation of the Australian and New Zealand banking system. It will be important to ensure that this sound foundation is maintained or improved so that New Zealand comes through any future crisis reasonably well.

Fortunately some good work is already under way to improve the overall quality, transparency, service provision and consumer focus of the financial services sector which will, in turn, improve consumer confidence in the sector. The intent is that these changes will make a difference to both the products and services offered by the sector and consumer confidence. Work in this area will continue to be monitored as part of these three-yearly retirement income policy reviews.

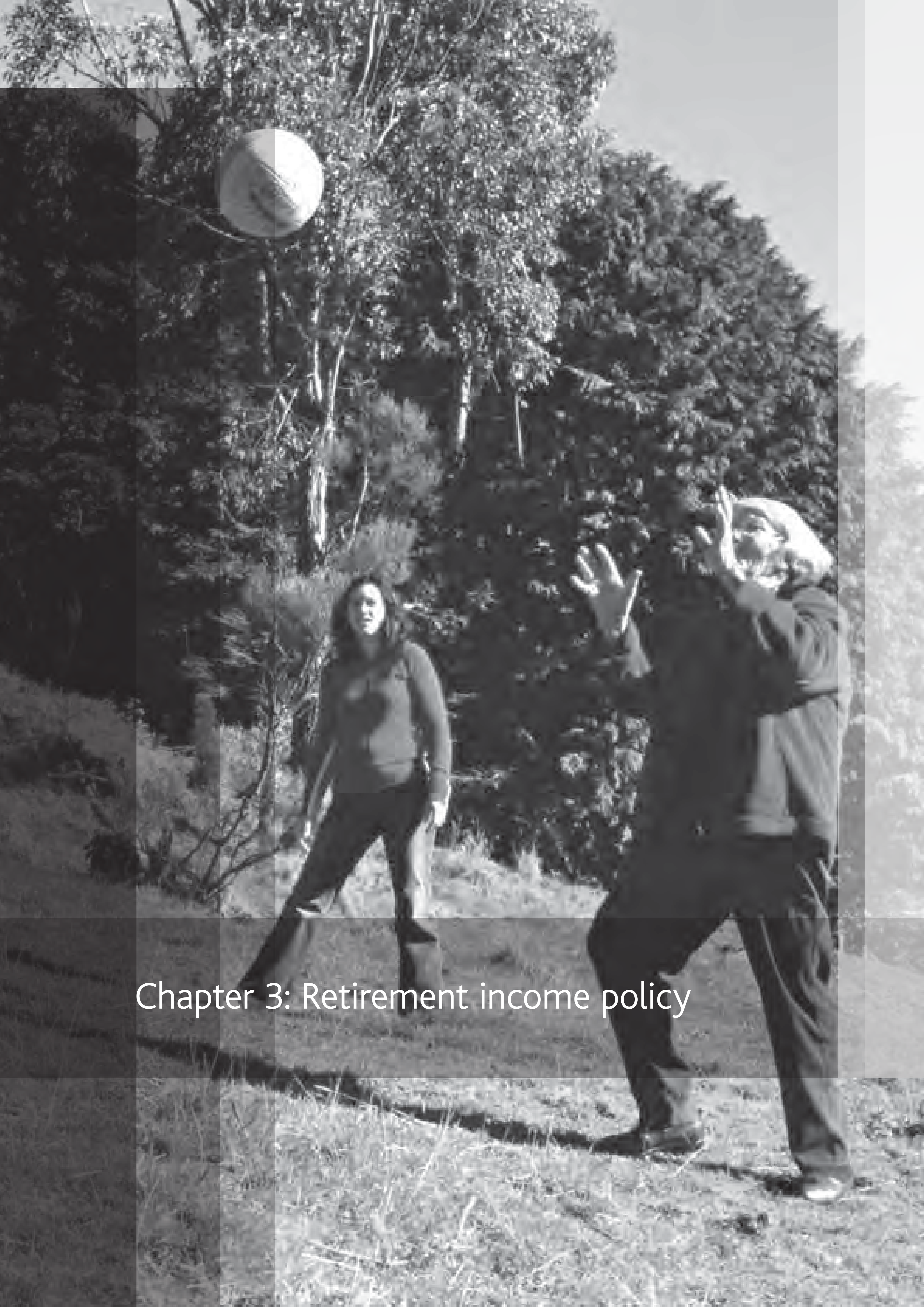
Ongoing consultation should ensure that regulation improvements will deliver the best possible outcomes for all interested stakeholders. Understanding and representing the consumer perspective is critical to the success of this.

Recommendation 2.1

That the Ministry of Social Development and the Ministry of Economic Development develop quality standards for the provision of budget advice and that government funding to non-government organisations for the provision of budget advice (primarily via the Ministry of Social Development) be contingent on these providers meeting established quality standards.

Recommendation 2.2

That, in the development of any regulation of the financial services sector, government agencies establish processes to ensure that the consumer voice is given sufficient weight.



Chapter 3: Retirement income policy

This chapter briefly describes the major components of New Zealand's retirement income policy. It then looks at how each of these components is administered and goes on to point out that, when other policies that relate to retirement incomes are taken into account, there is a large, complex network of agency responsibilities that poses challenges for the effective coordination of policies and services.

The next section explores how New Zealand's retirement income policies have evolved and what they reveal about the underlying objectives, values and tensions behind this critical area of public policy and the debates that arise from time to time.

The final section notes that several overseas countries have adjusted their pension policies in recent years. It also compares the Australian and New Zealand pension systems.

Elements of retirement income policy

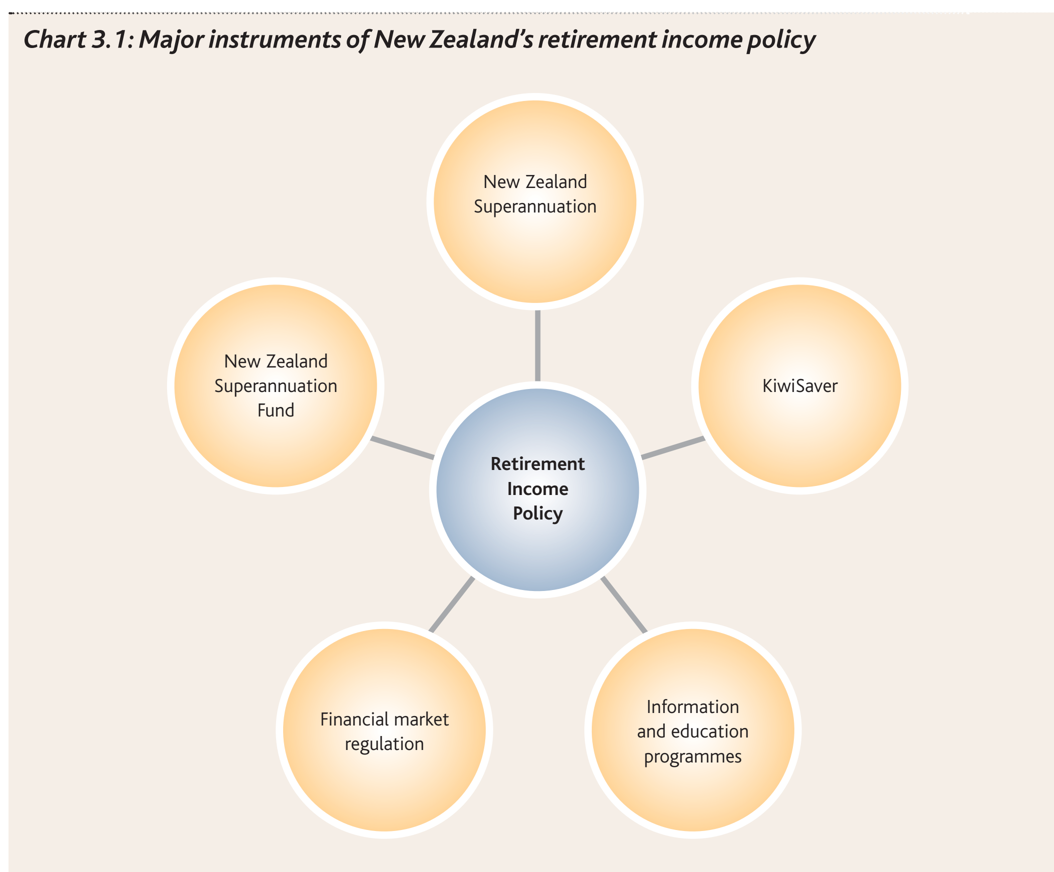
Retirement income policy is about more than old age pensions. It encompasses policies that affect the environment for savings and investment (including the management of debt), the ways people build up assets during their working lives and how these assets are used to preserve and promote a good standard of living in retirement. Mortgage-free home ownership is an important means by which many people achieve financial security in their retirement, although there is no official policy on home ownership.

Retirement income policy is also concerned with how government fiscal and monetary policies achieve various social protection goals for today's generation of older New Zealanders, as well as the prospects for future generations of older New Zealanders.

Internationally, retirement income policy frameworks are based around a mix of public and private provision. Public provision can be universal, means-tested or something in between. Private provision is either compulsory or voluntary, although incentives commonly exist to encourage particular private savings behaviour.

The five major policy instruments that comprise retirement income policy in New Zealand are shown in chart 3.1 and are briefly described below.

Chart 3.1: Major instruments of New Zealand's retirement income policy



New Zealand Superannuation

New Zealand Superannuation (NZS) is the flagship retirement income policy. The detailed rules around NZS are specified in the New Zealand Superannuation and Retirement Income Act 2001, but essentially:

» NZS is a universal, flat-rate public pension.

» It is paid to all New Zealanders aged 65 and over who have resided in the country for more than ten years since age 20, at least five of which are since age 50 (except for some people from countries with which New Zealand has a social security exchange agreement).

» NZS is funded on a pay-as-you-go basis from general taxation, not from individual contributions.

» The pension is paid at one of three standard rates according to each person's living arrangements. The amount received does not depend on a person's income or employment status.

» The standard rates are increased each year in line with general price or wage movements.

» Veteran's Pension (VP) is an alternative pension paid at the same rate as NZS but with some additional advantages, paid to qualifying persons.

People aged 65 and over who do not meet the New Zealand residency test for NZS may qualify for an income-tested social welfare benefit, usually the Emergency Benefit, instead.

In addition to NZS, several types of supplementary assistance are also available on the basis of need and about one quarter of people over 65 receive such supplementary assistance. The most common forms are Disability Allowance and the Accommodation Supplement.

The New Zealand Superannuation Fund (NZSF)

The NZSF is a 'buffer fund' created in 2001 to help smooth the projected future rise in the cost of NZS. The government can choose to allocate a portion of its current budget into the NZSF with the intention that the accumulated balance will eventually be drawn down in future years to help meet the cost of NZS payments. In effect, today's taxpayers help to fund a small part of their own future NZS entitlements through these budget allocations.

The fund, run at arm's length from government, has to invest the money in a way that maximises returns without undue risk.

KiwiSaver

KiwiSaver, introduced in 2007, is a voluntary retirement saving scheme with a government subsidy component.

» Employees aged 18-65 are automatically enrolled in KiwiSaver when they start a new job, but they can opt out. Children, non-employees and the self-employed can join.

» Compulsory employer contributions and government incentives add to individual contributions.

» Funds are invested with a private KiwiSaver fund provider, chosen by the member, or to a default provider if no choice is made.

» Funds are normally locked in until age 65. There is no requirement that the balance be converted into an annuity at that stage.

» Early withdrawals are permitted in cases of demonstrated hardship or permanent emigration. Further subsidies and a partial withdrawal of savings are also available for first home purchase.

Information and education programmes

The National Strategy for Financial Literacy sets the framework for the development and coordination of financial literacy programmes throughout New Zealand. The Strategy aims to "ensure New Zealanders are financially literate and educated to make informed financial decisions throughout their lives". It recognises that financial education is one of a number of components that contribute to achieving financial wellbeing; others include appropriate financial regulation, consumer protection legislation, and a trustworthy financial sector. An action plan for the period 2010 to 2015 is included in the strategy. An advisory group monitors and reviews progress and reports to the government on this.

The Retirement Commission has a mandate to inform and educate New Zealanders about financial management and retirement planning. Other agencies also provide financial education.

Financial market regulation

A number of changes are currently in train for reforming and extending parts of the regulatory system. These include prudential standards for non-bank deposit-takers, the regulation of financial advisers and reform of the existing law relating to securities. These changes were discussed more fully in chapter 2.

The administration of retirement income policy

Each of the five main components of policy has its own separate administrative structure:

» **New Zealand Superannuation** is administered by the Ministry of Social Development (MSD). Responsibility for service delivery is within the Students, Seniors and Integrity Services business group of MSD. MSD's Specialised Processing unit operates the interface with social security pensions from other countries.

MSD and the Treasury are jointly responsible for developing and providing NZS policy advice.

» Although **KiwiSaver** contributions are invested by private scheme providers, the Inland Revenue Department (IRD) collects employer and employee contributions through the pay-as-you-earn (PAYE) system and passes them on to the private scheme providers. The IRD reconciles payments through the PAYE system, pays the kick-start and member contribution subsidies and administers contribution holiday arrangements. Responsibility for regulating private KiwiSaver fund providers is currently within the Ministry for Economic Development (MED), but it is intended to be transferred to a new body, the Financial Markets Authority, which is expected to be established in 2011. Housing New Zealand Corporation (HNZC) administers the first home deposit subsidy aspect of KiwiSaver.

KiwiSaver policy advice is another area of overlapping responsibilities, in this case among IRD, the Treasury and MED.

» **Financial education** is promoted by the Retirement Commissioner, an autonomous crown entity, with funding via MSD. However, the Commissioner does not have a legislated role for policy development in this area. The Minister of Commerce is responsible for integrating the government's oversight of financial literacy.
» **Financial market regulation** policy is largely the responsibility of the Investment Law team within the Competition, Trade and Investment Branch of MED. MED also monitors the Securities Commission, which is the market conduct regulator for financial markets, including investment offers of various kinds. This function will be moved to the new Financial Markets Authority.
» Operation of the **New Zealand Superannuation Fund** is at arm's length under the Guardians of the New Zealand Superannuation Fund. The Treasury advises the Minister of Finance on determination of the amount of contributions from current revenue and drawings from the Fund. The Minister of Finance may give directions to the Guardians regarding the Government's expectations as to the Fund's performance, but must not give any direction that is inconsistent with the duty to invest the Fund on a prudent, commercial basis. The Guardians must have regard to any direction from the Minister.

Beyond these particular administrative and policy advice roles lie an extensive network of government agency roles and responsibilities that relate importantly to retirement income. These areas may directly affect the adequacy of retirement income, or they may look to invest money now to save greater costs arising from an ageing population later. There are also policies that support growing the tax base and the economy's ability to meet age-sensitive pay-as-you-go costs, such as NZS and health.

The sheer number and complexity of these roles (including the core functions described above) is illustrated in table 3.1. It creates challenges for the development and integration of policies across areas that are closely concerned with working-age people's retirement saving capabilities and the wellbeing of older people.

Many departments are involved in private savings and public provision policy. There is no single 'owner'. This diffusion of responsibility is an opportunity for key agencies to work together for improved communication including the sharing of information and discussing issues. Several agencies have commented during the course of this Review on the value of meeting regularly with other officials and the opportunity this offers to consider the broader context of their own areas of responsibility.

Inter-agency co-ordination has been seen to work successfully in the context of major retirement income policy projects. For example, at the initial stage of designing KiwiSaver, officials were seconded from Inland Revenue and the Ministry of Economic Development to work with Treasury officials on policy development. A KiwiSaver Savings Steering Group was established at the same time to implement and co-ordinate the operational and policy activity. Treasury, IRD and MED officials led the project, with participation by Housing New Zealand Corporation, the Ministry of Social Development, the State Services Commission, the Government Actuary and the Retirement Commission. This process was valuable as a way of airing and sorting out operational issues and getting policy attention to those issues by the responsible agency. It also ensured that everyone was kept abreast of other people's activities.

A need for sound evaluation of KiwiSaver was identified early on, given its experimental aspects, and funding was found for a programme to continue to 2013 that is being run by Inland Revenue. The evaluation project is being directed by the KiwiSaver Evaluation Steering Group, comprising officials from the same agencies, along with the Retirement Commission and an external expert.

Outside of such project-specific collaborations, attempts to maintain regular inter-agency contact on ongoing retirement income policy work have been less successful. A Retirement Income Steering Committee, co-chaired by the Treasury and MSD, was established several years ago for this purpose but appears to be in abeyance.

The Retirement Commission intends to explore with other agencies how best to reinstate a system of regular meetings to monitor retirement income policy developments, share information and discuss upcoming issues. As well as facilitating information-sharing among government agencies, it is important that there are effective links to the market players, communities and individual savers and retired people to help agencies identify practical issues, problems and potential behavioural responses to policy settings.

One example of a discussion and information-sharing group that involves finance sector, business and union representatives is a Retirement Income Interest Group (RIIG) that is convened from time to time by the Retirement Commission.

Table 3.1: Government agencies: who does what?

	Administering laws or delivering services	**Providing policy advice**	**Monitoring developments or providing data and research**
Adequacy Policies that directly affect the adequacy of retirement income	MSD/ WI – NZS, supplementary assistance, funds social services HNZC – state rental housing DBH – tenancy, dispute resolution services, housing quality MoH – public health services, residential care subsidy, home help DIA – rates postponement and rates rebate schemes Veteran's Affairs – Veteran's Pension	MSD – superannuation policy, ageing issues Treasury – fiscal policy, including impacts of population ageing HNZC – housing provision policy DBH – general housing quality policy MoH – health policy, especially aged care provision DoL – older workers DIA – local government MFAT – pension portability outside NZ	MSD – costs, living standards, social conditions, policy evaluations Statistics NZ – price and wage movements, household surveys HNZC – housing affordability DBH – housing research (CHRANZ) MoH – health status of population sub-groups MWA – position of older women Retirement Commission – three yearly policy review TPK – position of older Māori MPIA – position of older pacifica people
Savings Working age and family policies that look to invest money now to save greater costs later	MED – financial regulations, Government Actuary MoE MoH – preventative health services MSD – working age income support IRD – family tax credits DoL – immigration, employment, training HNZC – first home deposit subsidy Reserve Bank – actions affecting housing market	Treasury – fiscal, savings and capital markets policies, KiwiSaver IRD – taxation of entities, KiwiSaver MED – financial and commercial regulation, including KiwiSaver, consumer protection Retirement Commission – financial education MSD – social policy advice Reserve Bank – prudential regulation of banks MoE – educated public MoH – preventative health expenditure	MED – economic and commercial monitoring, Securities Commission Statistics NZ – national and sector accounts, household surveys Treasury – economic and fiscal monitoring Reserve Bank – economic, monetary and banking sector monitoring Retirement Commission – three yearly review MWA- position of women TPK- position of Māori Families Commission- impact of debt
Affordability Policies that support growth to help the future affordability of population-sensitive costs		Treasury – macroeconomic and fiscal policy settings Retirement Commission – three yearly review MoH – preventative health DBH – home ownership MED – economic development DoL – future workforce and skills IRD – tax policy MoE – improvements in productivity per worker	Treasury – long term fiscal projections, economic and household modeling, NZSF Statistics NZ – demographic projections and data for modeling MSD – medium term strategy and research DoL MoH MoE

Abbreviations:

CHRANZ = Centre for Housing Research Aotearoa NZ
DBH = Department of Building and Housing
DIA = Department of Internal Affairs
DoL = Department of Labour
HNZC = Housing New Zealand Corporation
IRD = Inland Revenue Department
MED = Ministry of Economic Development
MFAT = Ministry of Foreign Affairs and Trade
MoE = Ministry of Education
MoH = Ministry of Health
MPIA = Ministry of Pacific Island Affairs
MSD = Ministry of Social Development
MWA = Ministry of Women's Affairs
TPK = Te Puni Kōkiri
WI = Work and Income

Local government and communities

Local government is made up of regional councils and territorial councils (district and city councils) The purpose of local government is defined in the Local Government Act 2002 section 10 as being to enable democratic decision-making and action by, and on behalf of, communities; and to promote the social, economic, environmental, and cultural wellbeing of communities, in the present and in the future.

The role of local government and communities is to respond to the needs of its people. Therefore the level of services delivered for the older population should, and does, vary with the population mix in each geographical area.

An example It is to be expected that the Kapiti Coast District Council will provide more services for people aged 65 and over, where this older population makes up 23% of the total population in this area. And they do. Their 2009 Community Outcomes vision states that:

"Older people have a high level of control and influence over those things that ensure their access to services and enjoyment of life including:

- ongoing advocacy for older people's needs;
- opportunities to use their skills and experience through employment and volunteering;
- opportunities to contribute to community wellbeing through connection with young people;
- a sense of safety for themselves, their family and their community and feel secure in their homes and in the community;
- increased opportunities for 'door to door' transport, especially where this enables access to services;
- appropriate access to local and district centres and to beach areas;
- where possible, walkways, footpaths, cycleways, and public spaces designed and made safe for use by older people and people with physical disabilities;
- an affordable and accessible range of community activities and recreation for the varying interests of older people;
- more seating at bus stops, stations, key beach areas and along main pedestrian/street routes;
- recognising the importance of libraries for older people."

Other local councils and communities will choose to respond appropriately for the population they represent. For example, Christchurch City (where only 14% of the population is aged 65 or over) should be expected to have a different range of relevant services and policies. Even as the number of older people in the population increases there will likely still be a lot of regional variation as the level of service is influenced, not only by age breakdown, but also be socio-demographic makeup.

Whether or not there are any current inequities in the quality of services delivered to the older population is not known, as each district council, as an autonomous entity, develops its own annual plan. Unfortunately with different report content, services being delivered cannot be readily compared.

However, it seems reasonable to expect and trust that, as the population ages, local government and communities will respond to their population needs accordingly. This is supported by reforms that are contained in the Local Government Act 2002 Amendment Bill and are currently underway. These reforms "are designed to improve local authorities' ability to set their

direction and to improve the ability of ratepayers and residents to influence and assess councils[4]". The Minister of Local Government also intends to produce in 2011 a 'first principles' discussion document of the proper constitutional status of local government in New Zealand, how its proper function and structure should be evaluated and assessed, and how central and local government can better mesh both their decision-making and their work programmes to improve the service provided in communities.

Policy objectives and design

Why are our policies the way they are?

Each country's pension policies have their own historical background and social and economic context. New Zealand is no exception. What is perhaps unusual is that the pension system here is so different, in many respects, from those operating in the countries we often compare ourselves with.

These differences can make New Zealand appear to be an 'outlier' and this has sometimes led to calls for reform to make our system more like the 'mainstream' of advanced countries or to conform to a standard or ideal model of how pension schemes should operate.

For example, in its seminal research report published in 1994 'Averting the Old Age Crisis' the World Bank recommended that countries adopt a particular three-pillar system to provide income security in old age:

1. A publicly managed, tax-funded pillar for income redistribution.
2. A compulsory, privately managed, fully funded pillar for savings.
3. A voluntary pillar for people who want more protection in their old age.

Countries such as New Zealand whose retirement income systems did not completely conform to that ideal system were urged to reconsider their policies.

More recently, in the light of many years' experience of various countries' attempts to reform their public pension systems, the World Bank has modified its original view[5]. Among the additional perspectives brought to the World Bank's original concept that are particularly relevant to New Zealand's situation are:

- » A better understanding of the limits and other consequences of making pension schemes compulsory, particularly for low-income groups, for which risks other than old age may be more immediate and much stronger.
- » Recognition that a number of different approaches to structuring pension systems can be effective. "Some pension systems function effectively with only a zero pillar (in the form of a universal social pension) and a third pillar of voluntary savings[6]".
- » Greater awareness of the extent to which a country's inherited pension system as well as its economic, institutional, financial and political environment dictates the options available for reform. It also dictates the scope and the pace of any viable reforms.
- » Innovative reforms that work well in one country setting cannot be assumed to be successfully transferred to other country settings.

An example The United Kingdom reviewed its own, complex system of public and private pensions and concluded that New Zealand's much simpler, universal flat-rate public pension (NZS) had a number of clear advantages. However, the UK authorities decided that changing to the New Zealand model in one step would be too difficult from where they started and instead made a partial change towards universality in a way that more easily sits with the existing UK system.

4. Extract from Smart Government – *Strong Communities* Address to the Local Government New Zealand Annual Conference by the Minister of Local Government, 26 July 2010.
5. See for example Holzmann R and Hinz R (2005) "Old-Age Income Support in the Twenty-first Century: An International Perspective on Pension Systems and Reform".
6. Op cit page 13.

It is inevitable that retirement income policy should contain several different objectives. The sheer amount of income that is redistributed and the number of citizens affected in different ways means that the selection and design of policies has far reaching social, economic and political implications.

Chart 3.2 illustrates this point. It shows eight policy objectives, or concerns, that frequently arise when retirement income policy is being considered. All are valid concerns, but it is not possible to fully satisfy all of them together.

It is important, therefore, for all stakeholders to recognise the pressures of competing objectives, the historical background to some of the current policy settings and the likely reactions to any significant change in the balance of policies.

Chart 3.2: Multiple objectives influencing retirement income policy

Each objective shown in chart 3.2 has been given a short-hand name (bold). The name encapsulates the underlying 'policy model' influencing the way each objective is usually approached. These names have been adopted here to help simplify the following discussion.

Overarching all the specific policy objectives is the realisation that, whatever mix of policy instruments is used, the system itself needs to be accepted as both fair and sustainable over an extended period of time. This requires a process for keeping the future costs manageable and a broad public consensus on the overall effectiveness and fairness of the system for all the stakeholders, including vulnerable groups and future generations of children, workers and retirees, whose voices are sometimes not easily heard. This important point is illustrated in the centre of chart 3.2.

There is an important international dimension to retirement income policy that is not shown explicitly in chart 3.2 but is part of achieving consensus and sustainability. Effective international connectedness concerns both the technical interface with other countries' pensions systems (via international agreements, reciprocal arrangements and so on) and the need to ensure that the treatment of those who migrate into or out of New Zealand is fair and coherent. This aspect of retirement income policy is taken up in chapter 4.

The remainder of this section provides a discussion on each of the eight objectives or concerns.

The voluntary saving model

The **voluntary saving** model aims to improve the overall welfare of New Zealanders by encouraging and enabling them to take greater responsibility for managing their own finances in a way that best suits their long-term interests. The basic guaranteed level of income in retirement provided by NZS supports this approach because it removes the risk that a poor investment outcome could drive a saver into absolute poverty in old age. People should have a real choice of when and how much to save, given their working life circumstances and other priorities.

Key requirements for achieving this objective would include:

» Opportunities for families to earn sufficient income to permit meaningful saving choices to be made.

» A good level of financial literacy among the population generally and access to sound financial advice to support these choices.

» A well functioning and regulated financial market that offers sensible risk/return choices to savers and annuities to those who need them. People should find the system transparent and trustworthy.

» A generally tax-neutral saving and investment environment to avoid distorting decisions.

History This model of voluntary saving owes much to the 1992 Task Force on Private Provision for Retirement (the so-called Todd task force), which advocated a non-subsidised, voluntary saving option for New Zealand in preference to an incentive option based on tax concessions or a funded compulsory saving scheme.

This recommended approach was later incorporated as a principle in the 1993 multi-party Accord on Retirement Income Policies: "People should be encouraged to save for their retirement through the availability of appropriate savings products, supported by education and the provision of information about retirement matters, but should not be compelled by law, or given tax incentives, to do so."

This approach has been endorsed in each of the 1997, 2003 and 2007 reviews of retirement income policies.

The income support model

The **income support** model focuses on the objective of alleviating poverty and hardship in old age. People with little or no savings, who cannot earn an income or who face particularly high and unavoidable costs, are unable to support themselves financially. The social welfare system exists to help in such situations by providing a basic level of income support funded out of general government revenue. It also provides a range of supplementary income support programmes.

Note that, while NZS is very effective in keeping poverty rates low among older people, it has several features that are not normally associated with a programme focused exclusively on alleviating poverty. In particular, NZS is not targeted solely at those on low incomes.

A programme that focused more single-mindedly on alleviating poverty among older New Zealanders might:

» Phase down the universal component of NZS and place greater emphasis on targeting income support, including supplementary assistance, towards those in greatest need.

» Select forms of assistance that are likely to be associated with situations of hardship, such as rental housing, health care, home help, insulation or transport. This could reduce reliance on income testing, which carries incentive and administrative risks.

» Provide options for people to transfer on to means-tested old age income support at an earlier age where the circumstances justify this, for example where a person is an invalid or caring for dependent family members.

» Restrict the ability for benefits to be received off-shore.

History The income-tested Age Benefit introduced in 1938 for people aged 60 and over is the classic example of a policy focused on poverty alleviation. However, the Age Benefit was also accompanied by a separate universal benefit for people aged over 65 years.

The 1972 Royal Commission of Inquiry into Social Security in New Zealand first spelled out that an adequate benefit should allow people to belong and participate in the community. It proposed setting all benefit rates, including the Age Benefit, at a percentage of the ruling rate of wages paid to building and engineering labourers, or of the lower quartile of adult male earnings.

The citizenship dividend model

This model aims at achieving social inclusion and cohesion by recognising, in a general way, the productive efforts and contributions made by citizens from all walks of life. Each generation is promised the same recognition and entitlement when they reach qualifying age and this is believed to promote solidarity.

By providing every citizen with a standard pension from a standard age, it could be argued that the government is removing any stigma that might be attached to applying for a targeted benefit. At the same time it avoids any suggestion that wealthier people might receive a larger public pension than poorer, when all are equally valued citizens.

The **citizenship dividend** model carries a number of implications:

» The pension 'dividend' is unfunded because the payment comes out of current revenue, rather than accumulated savings. Since each working generation is paying the taxes to support their parents' generation in its retirement, this makes the costs very susceptible to fluctuations in the age structure of the population.

- Recognition of citizenship is a different matter from providing income support for the purpose of poverty prevention. It does not require a payment to be set at any particular level. In fact the SuperGold card, introduced in 2007, could be seen as an example of a citizenship dividend on a much smaller scale.
- In the case of a large pension dividend, the arbitrary qualification point, for example age 65, can assume great significance and trigger early retirement from the workforce.
- On the other hand, the absence of any means testing has a beneficial effect on incentives to earn and save.

History The 1972 Royal Commission of Inquiry into Social Security in New Zealand saw universal superannuation as a way of rewarding those who had worked and served in the community for a long time. It also removed any sense of indignity associated with a selective benefit and positively encouraged other forms of saving. Because of its cost and different justification, the Commission saw no reason for it to necessarily be paid from the same age or at the same rate as the Age Benefit, whose purpose was to relieve need.

In 1977 the Age Benefit and Universal Superannuation were merged into National Superannuation establishing the single, universal flat-rate structure that continues to this day. Its provisions reflect an emphasis on merit and general contribution. Those rationales were frequently appealed to in the arguments supporting the universal nature of its provisions, and the level of payment. Self-reliance and need were not given weight.

The wellbeing model

The objective behind the **wellbeing** model is to enable older people to enjoy more successful and fulfilling lives than might occur when the policy focus is simply on the provision of a basic income in retirement. The emphasis here is on positive and active ageing, with opportunities for paid work and voluntary service, lifelong education, maintaining family, whānau and community networks, a safe and healthy living environment and access to a range of other valued services. Promoting 'ageing in place' initiatives such as home care services is another example.

Achieving this goal requires a more holistic approach to policy, with better integration of services across departmental silos, between central and local government and among private sector enterprises and the voluntary and community sector.

Income remains an important factor enabling older people to remain engaged in a full life:

- Since the early days of social security the goal of *subsistence*, simply maintaining life and health, has been supplanted by the goal of *belonging and participating* in the life of the community.
- But belonging and participating need not entail relying on the public pension alone. Improving access to re-training, employment and self-employment opportunities can significantly expand an older person's earnings.
- Investing in improving the overall wellbeing of younger adults can also create spill-over benefits both for themselves in later life and for others.

History Active ageing as a policy approach has attracted increasing attention in recent years. Following the 1999 International Year of Older Persons, the government produced its first Positive Ageing Strategy in 2001. The strategy aimed to improve opportunities for older people to participate in the community in the ways they choose.

The current priority areas for positive ageing are promoting flexible work options and opportunities for mature workers, inter-generational programmes and raising awareness of elder abuse and preventing neglect.

The lifetime consumption smoothing model

The **lifetime consumption smoothing** model describes the process by which people seek to save out of their earnings enough to yield a future income that will help them to maintain a similar standard of living after they retire to the one they enjoyed when they were working.

Borrowing to buy a home can be seen as one form of consumption smoothing. A portion of a home-buyer's income is diverted away from current consumption into saving for a deposit and then, later, repaying the mortgage. The payoff in retirement is that someone living mortgage free in their own home can spend their retirement income on other things.

The idea of consumption smoothing lies behind many superannuation saving schemes where the objective is to convert an individual's regular savings into an annuity at retirement that is a fairly high proportion of the original earnings.

In this context, saving for the purposes of consumption smoothing is seen as something that should be of value to all citizens, although it would need to be complemented by a social safety net for people whose lifetime incomes are low and so have been unable to save enough to support themselves in old age.

Focusing on the earnings replacement objective would likely entail:

» Reducing or replacing the current flat-rate public pension with a compulsory, broad-based superannuation scheme to which all earners would contribute.

» Compulsory annuitisation of at least a proportion of the accumulated savings balance at the time of retirement, to ensure that the annuities market is able to deal with the problem of adverse selection.

» Individual pensions received would be able to be taken off-shore when someone retires overseas, since the pension would be seen to be owned by each contributor.

Another possible approach that could allow individuals to more closely match their retirement incomes to their own levels of earnings would be to adapt the current NZS scheme to allow each person to decide when to start receiving NZS. A larger payment could then be offered to those who choose to delay and higher income earners might then select this option.

History The short-lived 1975 New Zealand Superannuation Scheme was a compulsory contributory saving scheme that was intended as a top-up arrangement on the universal superannuation benefit, which was to be retained in its present form.

A proposal to introduce a new compulsory retirement saving scheme was put to the New Zealand public in a referendum in 1997, but was defeated by a large majority.

The cohort self-funding model

The **cohort self-funding** model seeks to address the problem of unequal cost sharing across different generations. The objective is to maintain equity across generations by developing systems whereby the government services received by each generation throughout its lifetime matches in some way the amount of taxes it has paid. The idea is to avoid a situation where, because it makes more claims than it created, one generation bequeaths debt to the next generation.

Although in theory this concept refers to all the government's budget outlays, it is often invoked more narrowly when considering public pension entitlements. Pay-as-you-go systems for funding pensions work on the idea that the taxes paid by people of working age are used to pay the pensions of those who are retired. In turn, when they retire, these workers' pensions will be funded

by their children's generation of workers. If however, one generation is larger than the next, or succeeds in voting itself too large a pension, then the funding burden for the following generation will start to increase. A projected rise in the tax rates required to fund the pension promises is a signal that the funding burden is being unfairly shifted on to future generations.

Changing to a fully self-funded contributory pension system is one way of addressing the problem. Another way that has been tried in some countries is to control the rising cost of pensions due to longer life expectancy. The age at which a particular birth cohort can start to receive the public pension is adjusted so that each cohort is covered for the same expected number of years of remaining life.

The New Zealand Superannuation Fund can be thought of as a way to help shift some of the cost of NZS payments to the 'baby boom' generation back onto themselves instead of their children. Government contributions into the NZSF are financed by today's taxpayers, including many high-earning baby boomers. In around 15 years time, when most of this group has retired, the drawdown of the NZSF will start to offset part of the tax burden placed on the upcoming generation to pay the baby boomer's NZS entitlements.

History The New Zealand Superannuation Fund was established in 2001 with the intention of smoothing the projected future rise in NZS costs. It was also seen to have advantages from a cross-generation fairness point of view as it eases the NZS financing burden on future taxpayers relative to today's generation of earners.

In 1989 and 1990 an attempt was made to publish pension cost projections (using a notional 'retirement income tax rate' indicator) to signal when in the future NZS entitlements might need to be trimmed back to keep the tax burden fair for future taxpayers. This mechanism was overtaken in 1991 by a series of budget initiatives that directly reduced the cost of NZS ahead of the timetable suggested by demographic pressures alone.

Many older New Zealanders can recall the social security contribution of 'one and six in the pound' that used to be paid up until it was fully incorporated into income tax rates in 1969. Many believed that their contribution was pre-funding their future old age pension entitlements, but this was never the case. The revenue was used by the governments of the day to help finance social security and health spending at the time. In fact, today's NZS entitlements are much greater than could have been financed by placing all the social security contributions in a fund and investing it.

The risk pooling model

The objective of the **risk pooling** model is to ensure that people who survive to a longer than expected age have sufficient income protection. NZS provides good, inflation protected cover against this so-called longevity risk because it continues to be paid for as long as a person lives. However it can only provide income protection up to the level of the standard pension. For any guaranteed ongoing regular income above NZS, people require some type of additional annuity.

Not knowing how long we will live complicates financial planning. Even if annuities were readily available in New Zealand some people would resist the idea of buying them because they are expensive or they would prefer to retain their capital for possible bequest.

Issues that arise when considering longevity risk from an annuity provider's point of view include how to improve the functioning of the annuities market, the pricing of risk and the availability of suitable matching assets. In a small market like New Zealand the government might need to become directly involved in supplying annuities.

A focus on reducing the risk that older people's living standards might fall if they live longer than they had expected and planned for might suggest a policy that paid a higher rate of NZS (or some type of other income supplement) to people above some benchmark age, say 85 or 90 years. The benchmark might be set at a margin above each cohort's estimated life expectancy and adjusted from time to time.

History Since their inception in 1898, age benefits have provided some measure of protection against the risk of outliving one's own income. The original Age Benefit, payable at 65 years, was tightly means tested. Eligibility was confined to persons of 'good character' who had lived in New Zealand for more than 25 years, but over time the population coverage and level of protection provided has been increased.

In the private pension area the demand for annuities has tended to shrink with the phasing out of defined benefit schemes. The management of longevity risk is perhaps a greater issue for countries that rely more heavily than New Zealand on comprehensive private contributory pension schemes.

The model of fiscal restraint and investment

The strategy behind the **fiscal restraint and investment** model is to use economic growth and productivity improvements as the way to raise living standards for New Zealanders generally. The way to achieve growth is seen to be through prudent fiscal and monetary management, well functioning, efficient markets and access to investment capital and a skilled, well managed labour force.

In order to facilitate growth in this way and to prevent the public sector crowding out the private sector, the government's budget needs to be restrained. One of the greatest pressures on the future fiscal position is forecast to come from higher health and pension costs related to the ageing of the population. The main elements of this approach are therefore:

» Adjustments to health and pension spending to help counter the projected rising trend of these components as a percentage of GDP.

» De-connecting the present linkage between NZS rates and average earnings would enable real wage growth to occur without this gain being automatically passed onto people who have left the labour force.

» Progressively increasing the age of eligibility for NZS would generate fiscal savings directly. At the same time it would increase the incentive on older people to stay in the labour force for longer, thereby boosting the supply of labour.

History The steps announced in 1991 to temporarily freeze NZS inflation adjustments and to raise the age of NZS eligibility from 60 to 65 years over an eight year transition period had a major effect on reducing the cost of NZS, which fell as a percentage of GDP from 7% in 1990 to 4% in 2007. However, another policy initiative to introduce tight income testing of NZS failed because of public resistance.

Recent developments overseas

One notable development in recent years has been the number of pension reform initiatives attempted by many OECD countries. These initiatives are aimed at a range of different policy objectives:

» Increasing the coverage of the pension system, mainly through voluntary, private pensions.

» Improving the adequacy of retirement benefits, generally targeting low income earners.

» Addressing the financial sustainability and affordability of pensions to taxpayers and contributors.

» Improving economic efficiency, by minimising behavioural distortion to individuals' labour supply and savings allocation decisions.

» Achieving administrative efficiencies.

» Improving the security of benefits in the face of various risks and uncertainties.

Each country faces its own challenges and trade-offs and these are reflected in the variety of pension systems and approaches taken to pension reform. Despite this, a common theme to reforms has been to address concerns about the long-term financial affordability of current pension entitlements in the face of demographic and economic pressures. A number of countries have announced higher levies or reduced pension benefits through lower formula entitlements, changed indexation rules or have increased the statutory pension age.

Raising the normal pension age (table 3.2), tightening the rules for early retirement and reducing disincentives for people to work beyond normal pension age are all methods being used to improve economic efficiency by reducing distortions in the labour market.

Table 3.2: Announced increases in the normal pension age

Effective in the decade	Age 65	Age 66	Age 67	Age 68
2000-2009	Australia men Austria men Belgium Canada Denmark Germany Ireland Italy men Japan Netherlands **New Zealand** Portugal Spain Sweden Switzerland men UK men	USA	Iceland Norway	
2010-2019	Australia women (2014) UK women (2018)	Ireland (2014) Australia (2019)		
2020-2029		UK (2020) Netherlands (2020) Denmark (2025)	Ireland (2021) Australia (2023) Netherlands (2025) Denmark (2027) USA (2027) Germany (2029)	Ireland (2028)
2030-2039	Austria women (2033)		UK (2036*)	
2040-2049				UK (2046*)

* The UK has announced that this timetable is likely to be accelerated.
Source: OECD "Pensions at a Glance 2009" and later announcements.

One change which may have local consequences in New Zealand, because of the degree of integration of the two labour markets, was the Australian decision to increase compulsory employer contributions to employee retirement savings accounts. The 2010 Commonwealth budget announced that the required employer contribution to the Australian 'Superannuation Guarantee' scheme funds for employees is to be phased up over seven years from 9% to 12% of ordinary-time wages.

Comparing the Australian and New Zealand pension systems

Both Australia and New Zealand have a publicly funded pension scheme and a privately funded superannuation scheme. The main differences are:

» The New Zealand public pension scheme (NZS) is a universal scheme whereas the Australian scheme is both assets tested and means tested.

» The New Zealand private superannuation scheme (KiwiSaver) is voluntary on an opt out basis whereas the Australian scheme has both a compulsory and a voluntary component.

» The tax/subsidy arrangements applying to the private schemes differ in many respects. Notable examples are the higher taxation in New Zealand on the investment earnings of superannuation funds, and the age at which tax-free withdrawals can be taken (age 65 for KiwiSaver in New Zealand and 60 for Super in Australia).

The Australian retirement income scheme consists of three pillars:

1. A public pension which is subject to an income and assets test.
2. The Superannuation Guarantee Levy (SGL) which is a compulsory levy on employers of 9% of employees' gross ordinary earnings, and progressively increasing to 12% commencing in 2013/14. It applies to employees aged up to 70 (75 as from July 2013)[7].
3. Voluntary superannuation contributions, with substantial tax subsidies.

Table 3.3 gives the percentage of Australians covered by superannuation in 2007.

Table 3.3: Superannuation coverage in Australia in 2007, by gender and age group (%)

Age group	Males	Females	All
15-24	58.3	56.5	57.4
25-34	91.4	74.2	87.8
35-44	90.1	84.0	87.0
45-54	87.8	83.6	85.7
55-64	82.0	67.7	74.8
65-69	57.1	35.8	46.3
70 and over	31.2	12.7	21.0

Note: Superannuation coverage is defined by the Australian Bureau of Statistics as people who have superannuation accounts in the accumulation phase and/or are drawing on superannuation.

Source: Australian Bureau of Statistics Catalogue 6361.0.

Table 3.4 gives the median superannuation account balances.

Table 3.4: Australian median superannuation account balances in 2007 (A$)

Males	31,252
Females	18,489
By age group:	
15-24	1,672
25-34	14,793
35-44	32,283
45-54	45,525
55-64	71,731
65-69	80,000
70 and over	66,521

Source: Australian Bureau of Statistics.

7. These changes have been announced in the Budget but have not yet been passed into law.

Females have lower median account balances due to their lower wage rates and lower labour force participation rates including breaks from the workforce due to childbirth and caring responsibilities.

Australians currently at pre-retirement age (55-64 year olds) do not typically save enough to finance a modest retirement lifestyle, even with the public pension. In 2007 the median superannuation balance of 55-64 year olds was $71,731. This figure takes account only of the 75% of 55-64 year olds who had superannuation. The median accumulated saving (all forms including superannuation) of all 55-64 year olds was only $51,500 excluding their home.

The compulsory superannuation scheme is expected to add significantly to average retirement incomes once the system is fully mature (around 2040), but there are substantial administrative and compliance costs associated with the scheme and it distorts savings choices.

The compulsory component of private superannuation in Australia is a double-edged sword from a public policy perspective:

» On the positive side, it may increase national saving, reduce age pension costs, reduce the call on foreign saving and probably increase the capital stock.
» On the other hand it tends to disadvantage low income earners and those who do not earn for significant periods of their lives by constraining their consumption during their working years. Income earners more generally are disadvantaged by the distortion of their saving and/or debt repayment choices.
» Finally, it is a tax on labour because, although the SGL is paid by employers, the economic incidence is eventually on the worker.

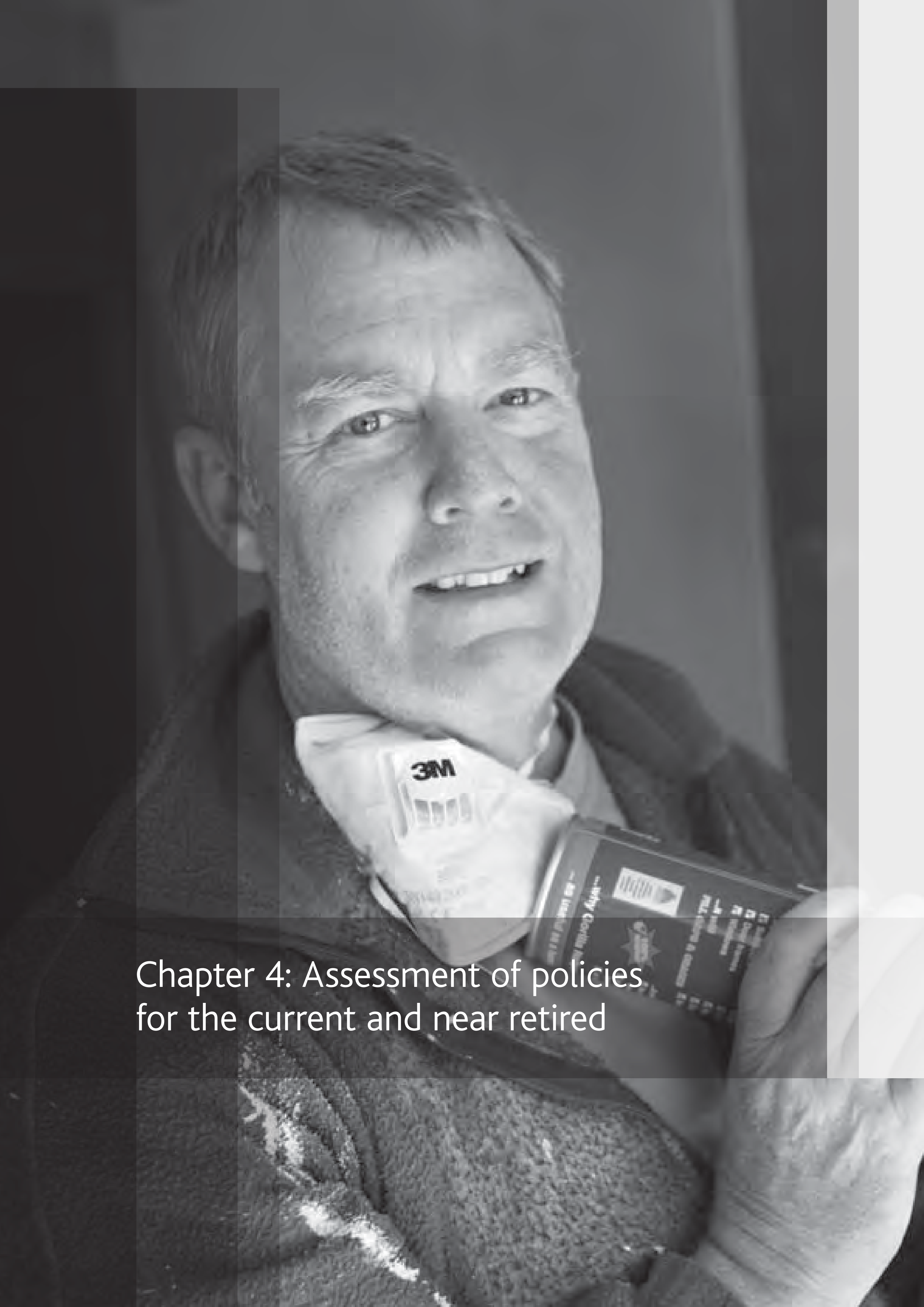
Conclusion

The government is responsible for managing a wide range of policies that can affect how people prepare for their older years and what sort of incomes and living standards they are then likely to enjoy. As well as the design and operation of NZS and other forms of income support for older people these policies address the savings environment, promoting effective long-term savings products, financial literacy, information and advice. They also seek to promote various social and economic outcomes that will enhance the wellbeing of future generations of New Zealanders.

Many policies having implications for wealth accumulation, retirement income provision and general social wellbeing are aimed at different objectives and pose co-ordination challenges. The eight retirement income policy objectives described earlier in this chapter will be referred to throughout this Review because they offer a useful insight into the many debates, concerns and approaches that come into play when considering retirement income policy.

The search for financial affordability, political sustainability and a broad public consensus on the overall fairness of the system requires that the tensions and trade-offs among these objectives be recognised, since that is often why particular aspects of a policy's design are the way they are.

At the same time, New Zealand's retirement income policies cannot be seen in isolation from the rest of the world. How our system interfaces with the policies and practices of other countries needs to be carefully evaluated, both from the perspective of citizens who move across our borders and from the point of view of negotiating government to government agreements.



Chapter 4: Assessment of policies for the current and near retired

This chapter focuses on people aged 55 and over, particularly those over the age of 65. Some are still in paid work but may be starting to evaluate their financial position and life-style choices when they scale down their involvement or leave the paid workforce. Many others, particularly those over the age of 70 will have been out of the paid workforce for several years, but still enjoying an active life and participating in a wide range of unpaid activities. Still others will be struggling to cope with a range of personal, family, health or financial challenges.

The first section of this chapter describes the economic situation of older New Zealanders. It covers the composition of older people's incomes, their employment and housing patterns and their financial knowledge and skills. This section also assesses how the wellbeing, or material standard of living, of older people compares with that of the New Zealand population overall.

The second section presents a number of issues affecting particular groups of vulnerable people who are currently retired or approaching retirement.

A final section examines retirement income policies from the perspective of the current retired generation, focusing on the three areas where current policy is inconsistent with the principle of personal entitlement to New Zealand Superannuation (NZS) and recommends changes to make the system fairer from this perspective.

The economic situation of older people

There are currently 570,000 people aged 65 and over who make up 13% of New Zealand's total population. In 20 years' time these numbers will have almost doubled when one out of every five New Zealanders will be aged 65 or over.

Population age structure

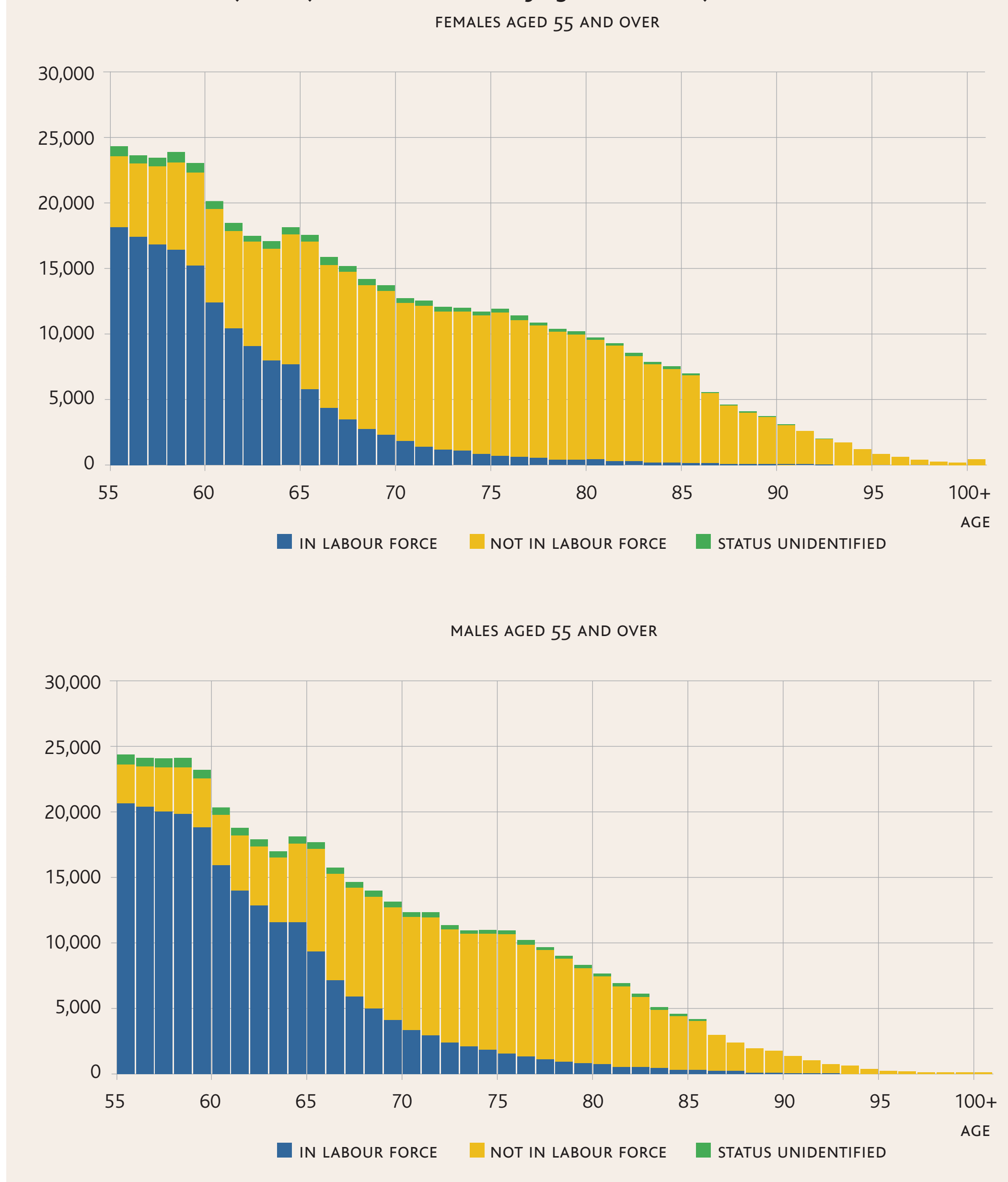
Chart 4.1 illustrates the age/sex structure of the population aged 55 and over in 2006, together with the number of people at each age who were attached to the paid labour force. This shows:

» A large cohort of people who were aged 55 to 60 in 2006. This is the first wave of the post-World War 2 'baby boom' generation. The oldest of these will qualify for NZS in 2011.

» There are more females than males, particularly at higher ages, because of the longer average life expectancy of women.

» A higher proportion of men than women remain in the paid labour force beyond age 65.

Chart 4.1: Number of older females and males, by age and labour force status in 2006



Source: Statistics New Zealand, Census 2006.

Sources of personal income

The great majority of the current generation of older New Zealanders are very dependent on NZS and other government support for their income. Two-fifths of those aged 65 and over have little or no other income, while a further fifth have on average around 20% of their income from other sources. Overall, half of older New Zealanders report receiving less than $100 per week (per person) from sources other than government transfers. This degree of dependence has not changed greatly in the last two decades.

At the other end of the scale, around one in three older New Zealanders receive more than half their income from sources other than NZS (or Veteran's Pension). For this group, the proportion of income from other sources has grown a little over recent years, mainly due to increasing non-government income for those in 'younger' couple households (aged 66 to 75).

Table 4.1 shows the proportion of people aged 65 and over who receive income from various sources. Nearly all receive NZS (or some other government transfer income) with an average weekly amount per person of $294.

Just over half of this group receives some income from investments, with an average gross weekly amount of $143. However, because the distribution of investment income is very uneven, most people with this income source are receiving less than this amount.

Table 4.1 also shows that the amount of income earned from wages, salaries or self-employment can be a very significant supplement for those with those sources.

Table 4.1: Number of people aged 65 and over who receive income from various sources, June quarter 2010

Income source	Number receiving this source (thousands)	Percent of all people aged 65+	Average weekly amount for those receiving that source
Government transfers (mainly NZS)	517.8	96.8%	$294
Investment income	280.9	52.5%	$143
Wage or salary income	61.0	11.4%	$641
Of which:			
Full-time employment	31.6	5.9%	$955
Part-time employment	29.0	5.4%	$299
Other transfers	53.0	9.9%	$272
Self-employment income	28.4	5.3%	$448

Note: People may receive income from more than one source.

Source: Statistics New Zealand *New Zealand Income Survey*, June quarter 2010, Supplementary tables 4 and 5.

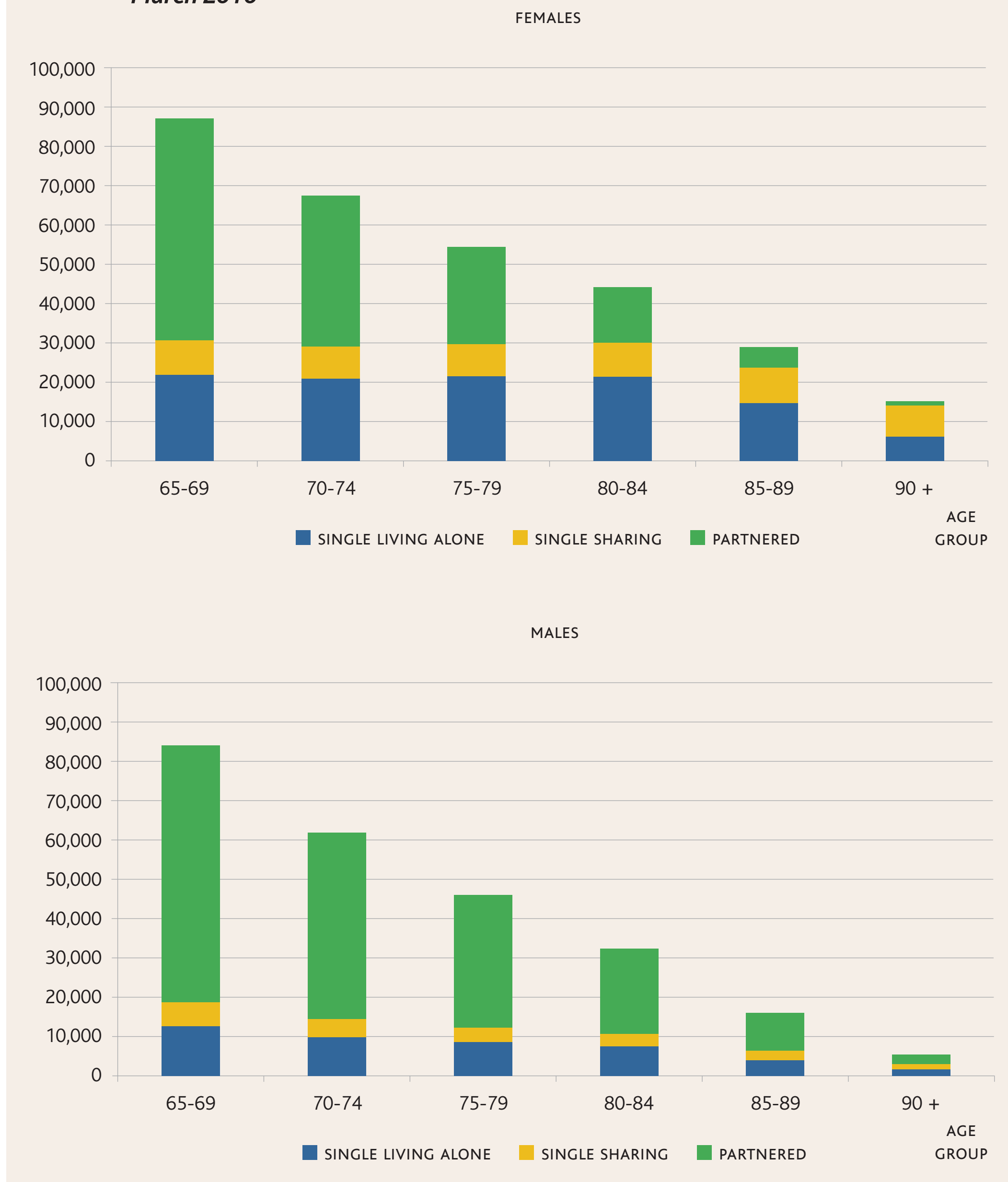
Income received from NZS and Veteran's Pension

As at March 2010 there were 555,646 people receiving NZS or Veteran's Pension (VP). For 2010/11 the cost of NZS alone is expected to be $8.822 billion, before any income tax is deducted.

There are three standard rates of payment for NZS and VP, depending on the partnership status and living situation of the recipient. The numbers receiving each rate of payment is shown in chart 4.2.

Women are less likely than men at the same age to be receiving the partnered rate, because their male partners tend to be older than them and die at a younger age.

Chart 4.2: Number of females and males receiving NZS or VP, by age group and rate type, March 2010



Note: The married rate category includes people aged 65 and over whose partners receive the non-qualified partner rate of NZS or VP.

Source: Ministry of Social Development administrative data.

Investment income

An assessment of the global financial crisis (GFC) presented in chapter 2 concludes that it has had a moderate impact overall on New Zealand households. However, households experiencing unemployment as a result of the downturn will certainly have suffered. Also some households with investments comprised primarily of fixed interest, particularly finance company investments, have suffered substantial losses. These losses may have impacted on public confidence more than the actual amounts involved might indicate.

Losses on financial assets will have affected older people disproportionately more than other groups. On the other hand, older people will have benefited disproportionately from the sustained increase (to date) in the real value of houses. Today's older group are also benefiting from the government's commitment to maintain the terms of NZS.

IRD data for the income tax year ended 31 March 2009 show that the number of people aged 65 and over earning income in the form of interest has increased, together with the total amount of interest earned by this group. Patterns revealed in the data for those aged 65 and over include:

» The amount of interest earned is highly skewed. The top 10% of interest earners earned 64% of the interest.

» Female interest earners earn slightly less interest on average than males.

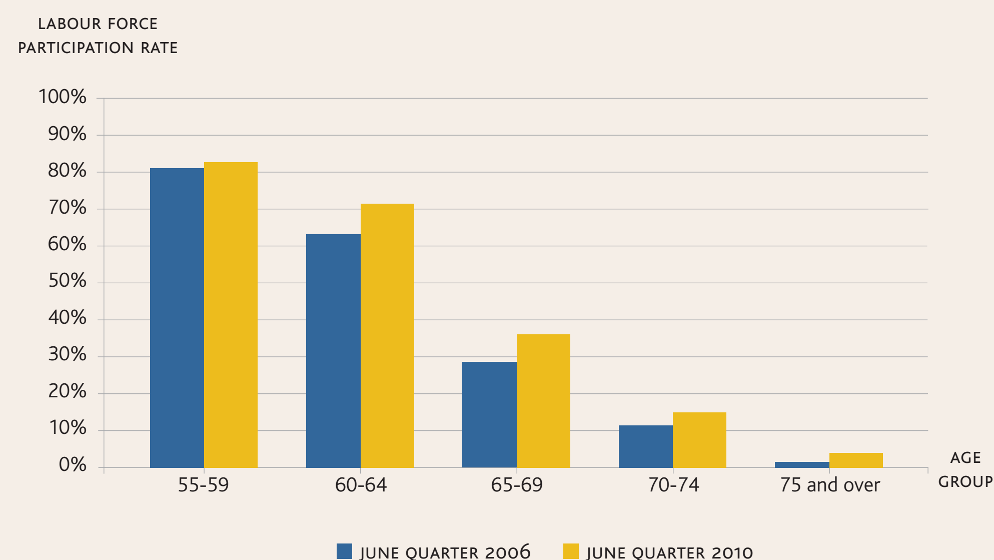
» People with joint bank accounts tend to earn slightly more interest than those without. This may give an indication of a different pattern for partnered and non-partnered people.

» Somewhat surprisingly, the average amount of interest earned is higher amongst the oldest age group, people aged 80 and over (both male and female). One reason is likely to be that people with higher lifetime incomes and investments are more likely to live longer on average than those with low lifetime incomes and fewer investments. Therefore, the older age groups will contain a greater proportion of people with significant interest income than seen in younger age groups, which raises the average dollar amount per person within that higher age group. Another reason may be changing asset portfolios or asset allocations as people age; for example, a switch to income producing assets.

Employment and earnings

A small but growing proportion of older people remain in the labour market beyond age 65 (chart 4.3). This rise is not confined to those near age 65 but can be seen across higher age groups as well.

Chart 4.3: The change in labour force participation of older people between 2006 and 2010



Source: Commissioned analysis from Statistics New Zealand's Household Labour Force Survey.

There are indications that this labour force participation could be a continuing trend. The reasons for this could include:

1. People are remaining healthier for longer.

2. Some people want to work; they want to make a contribution, use their expertise, enjoy the social aspects of working.

3. Social values to do with expectations of labour force participation have been changing.

4. Some people need to continue to work and earn money (e.g. they are still repaying a mortgage).

For most of the past decade New Zealand has had a higher rate of employment of older workers than many other countries. This is likely to have occurred as a result of several factors specific to the New Zealand situation:

» There is no compulsory or standard age of retirement in New Zealand, so people may continue in paid work if they choose. This is supported by anti-age discrimination legislation.
» There is no requirement to be retired in order to receive NZS.
» The amount of NZS received is unaffected by any other earnings one may have and those earnings attract only a slightly higher rate of income tax as a result of receiving NZS.
» There is no option to take a public pension before the standard age of eligibility.
» Some low income workers, expecting NZS to be adequate for their retirement needs, chose not to save additional amounts, so when the age of eligibility for NZS increased to 65 years, they had little in the way of private savings that could be used to finance an earlier retirement.

Retirement is now more of a process than an event. For an increasing number of people, reaching 65 years is no longer a marker for exiting from the labour market completely. By remaining in work for longer, older New Zealanders have been big contributors to the overall growth in the labour force. For example, over the three years between June 2007 and 2010, the New Zealand labour force grew by 4.3% overall. However, the number of people aged 65 and over in the labour force increased by 28% over the same period and this expansion was responsible for fully one-fifth of the overall increase.

Earnings have also been rising. Table 4.1 shows that, for those people aged 65 and over who are in paid employment (full-time or part-time), their average weekly earnings in 2010 were around $640. This compares with $526 three years earlier.

The New Zealand Income Survey indicates that, in the June quarter of 2010, the median weekly income (including NZS and other sources) among people aged 65 and over who remained in the paid labour force was $778. This compares with a median income among those not in the labour force of $331 per week.

With the number of older workers growing rapidly, the transition to retirement will become a more significant human resources issue for both the employee and employer. Policies that support constructive conversations between employer and employee are to be encouraged. The Department of Labour and other organisations, such as the Council of Trade Unions and EEO Trust, are currently doing work in this area.

Health and aged care costs

As people age the likelihood of being disabled increases. 45% of adults aged 65 and over report being disabled[8]. Of adults living in households, 29% of those aged 65 to 69 report being disabled compared with 38% of those aged 70 to 74 and 52% of those aged 75 and over.

Just over half of these disabled older people receive help from formal or informal caregivers for everyday activities such as personal care, meal preparation, shopping, housework or personal finances. While family and friends provide much of this care, often voluntarily and on a daily basis, formal care is also commonly provided, funded either by the relevant District Health Board (DHB) or paid for by family members or the disabled person themselves.

8. Statistics New Zealand, 2006 Disability Survey.

Unplanned costs can be very difficult for older New Zealanders to deal with because the great majority are dependent on NZS and other government support for their income. Some of the costs that people may only become aware of when faced with a health issue can include in-home support, other healthcare costs and residential care costs if these must be paid for personally.

Residential care costs

The amount a person assessed as requiring rest home level care has to pay for residential care depends on their assets and income and whether or not they have a partner. If their assets preclude a residential care subsidy, then they pay for their contracted care services up to a maximum weekly contribution amount (currently between $785 and $865 per week, depending on region). These rates are set from time to time by the Director-General of Health to reflect the price paid to residential care providers.

Of the approximately 30,000 people currently in residential care about a third pay the maximum rate themselves. For the remaining two-thirds a portion or all of the costs of care are paid for by the state (by way of the residential care subsidy).

There has been a trend, over recent years, for residential care providers to charge extra fees for services and facilities that are over and above the required service level specified by the Ministry of Health in the standard age related residential care services agreement contract with providers. 43% of the providers that responded to the 2010 Aged Residential Care Service Review, and 58% of facilities built in the last decade, charge some of their residents extra fees for additional services. 14% of all residents in the surveyed facilities were charged an extra fee, on average around $20 per day.

The number of facilities charging extra fees has more than doubled since 2006. Based on projected residential care demand it is expected that additional aged care capacity be developed from 2014 onwards. With actual costs of establishing new aged care facilities, and allowing for a fair rate of return for the provider, likely to be well in excess of the current established maximum contributions rates the "who pays?" question will need to be answered.

Healthcare costs

Particular health problems that can have a detrimental impact on the wellbeing of older people, if their treatment cannot be afforded, relate to problems with ears, eyes and teeth. Unfortunately little data is available on the effects of the deterioration of these things. Some of these costs are borne by the health system and some must be paid for personally. A number of financial assistance programmes, such as Disability Allowance, hearing aid subsidy and the community services card, help to alleviate some of the cost pressures on the individual.

It is to be expected that health and welfare policy will continue to change the boundaries around what the government (effectively the taxpayer) pays for and what the individual is personally liable for. However, it is important that up-to-date local information is readily available to people so that they are aware of, and can plan for, future possible costs.

Living standards

Individual incomes provide only a partial indication of people's ability to buy a comfortable lifestyle in retirement. Some people are able to pool their incomes and share living expenses, while for many the cost of their housing arrangements affects how much they can afford to spend on other items.

Household income and living costs

One way to assess how well older people are doing is to combine the after-tax incomes of all the members of the household, deduct housing costs, and adjust for the number of household members.

This approach recognises that someone who has low housing costs, because they live mortgage-free in their own home, has more money available for other expenses than a person earning the same income but who has to pay a significant amount in rent. It also allows comparisons of incomes to be made across families of different size and composition and is one of the indicators used by the Ministry of Social Development in analysing patterns of hardship, or poverty, among different groups[9].

On this basis (see table 4.2), older people as a group appear to be doing reasonably well. Using this low income benchmark the latest MSD analysis indicates that 9% of those aged 65 and over are in low-income households. This compares with 15% of the total population and 22% of children who are classified as living in low income households.

However, there can be quite large wellbeing differences between different groups of older people.

Table 4.2: Poverty rates among people aged 65 and over according to the tenure of their household, 2009

Tenure of household	Share of each tenure type (%)	Proportion of individuals living in low income households (%)
Owned or in family trust, no mortgage payment	79%	3%
Owned or in family trust, with mortgage payment	11%	20%
Paying rent (private, HNZC or local authority)	10%	47%
Total aged 65 and over	100%	9%

Note: The benchmark for low income or poverty used in this table is where household disposable income, adjusted for the size of the household, less housing costs, is 60% of the 2007 median household disposable income, adjusted for inflation. The median income (before housing costs are counted) is adjusted to an after housing costs basis by deducting a notional 25% to represent housing costs. This is known as the AHC CV07 60% threshold.

Source: Table 2 of Perry B (2010b).

Clearly, the high rate of debt-free home ownership (79%) among older people is an important factor in helping their income to stretch further. Only 3% of those who own their own home live in low-income households. On the other hand the 10% who are paying rent show up as having a much higher incidence of low income (47%) on this measure.

Another point of difference that affects the proportion of older people in low-income households is their living arrangements. Older single people who are living alone in a single-person household have a higher rate of poverty (15%) compared with those living in two-person households (5%). This most likely reflects differences in tenure and other sources of income between couples and single people living alone.

9. See for example:
Perry B (2010a) "Household Incomes in New Zealand: trends in the indicators of inequality and hardship 1982 to 2009", Ministry of Social Development;
Perry B (2010b) "The Material Wellbeing of Older New Zealanders: background paper prepared for the Retirement Commission's 2010 Review", Ministry of Social Development.

Non-monetary indicators of living standards

The amount of income flowing into a household gives an indication of the living standards of the people living in that household. However, it cannot capture some of the factors that also influence individual wellbeing, such as whether people are able to access a range of essential goods and transport services, feel safe and are participating in community activities and have the support of family and friends.

In order to assess how well people are doing in terms of outcomes, rather than income, an alternative approach is to ask people to describe their own lives through a series of survey questions focused on access, capability and subjective assessment of their living standards.

Results from using this approach indicate that, despite having quite low incomes compared with today's working-age New Zealanders, the majority of older people report that their income is enough to meet their daily needs (table 4.3). Furthermore, they report a higher level of satisfaction with the amount of social contact they have with family and friends than do other age groups. Many are involved with voluntary work for a group or organisation.

Table 4.3: Measures of the wellbeing of older people compared with the total adult population

	Older people (aged 65 and over)	**Total adult population**
Personal income $30,000 or less	78.2%	51.6%
Not enough income to meet everyday needs	7.8%	14.5%
Fair or poor self-assessed general health status	21.1%	12.5%
Have a major problem with house or neighbourhood	32.3%	51.2%
Feel unsafe when walking alone in the neighbourhood at night	42.2%	32.0%
Have experienced discrimination in the last 12 months	2.7%	10.1%
Not enough contact with non-resident family	17.6%	25.4%
Not enough contact with non-resident friends	11.2%	21.2%
Undertook voluntary work in the last 4 weeks	35.6%	32.6%
Overall dissatisfied or very dissatisfied with life	4.3%	6.5%

Source: Table 3.01, General Social Survey: 2008, Statistics New Zealand.

Material living standards

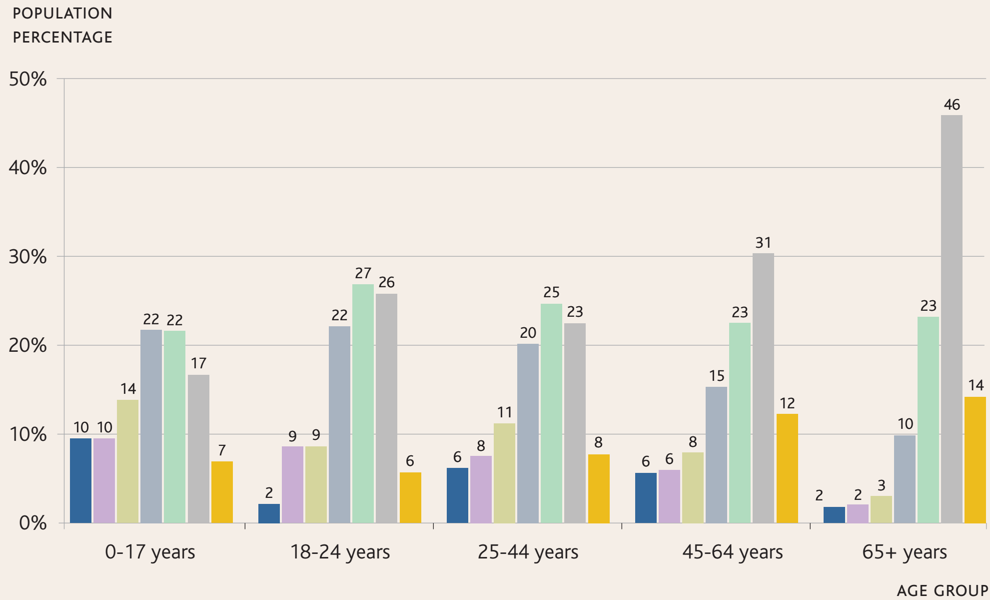
The Economic Living Standards Index (ELSI) is how New Zealand seeks to measure material living standards more directly rather than use income as a proxy measure for wellbeing. Based on household survey information ELSI uses a range of non-monetary indicators relating to what items and services people can access and use and how they rate their own living standards. Each individual/household receives a score within the possible range of 0 to 60 and on the basis of that score is placed into one of seven levels of living standards.

Older New Zealanders have the highest average ELSI score of all groups: 47 compared with 40 for the whole population and 36 for children aged under 18 years. Furthermore, the statistics for those aged 65 and over had actually improved slightly since the 2004 survey.

There are some indicators of wellbeing where the proportion of older people with poor outcomes is worse than for the population as a whole, for example on general health status and feeling unsafe. However, only a small proportion of older New Zealanders report being dissatisfied with their lives overall.

The most recent comprehensive survey of the living conditions of older New Zealanders is the Ministry of Social Development's 2008 NZ Living Standards Survey. This found that most people aged 65 and over were in adequate or good economic circumstances, with the lowest proportion of any age group experiencing economic hardship.

Chart 4.4: Material living standards (2008), by age group



Notes: The numbers above the bars in the chart are percentages.
The left-hand bar in each age group is Level 1 (very low living standards), and the right-hand bar is Level 7 (high living standards).

Source: Ministry of Social Development 2008.

These relatively good outcomes for older New Zealanders are due to the mix of current public provision (mainly NZS) and the private provision built up by most of the current cohort over their lifetime. A key component of the private provision is home ownership which is relatively high among the current cohort.

In spite of this general level of financial security and stability among older people, there are several recent examples of people suffering large financial losses during the GFC. For many of them it is likely to be too late for them to rebuild their savings, and resulting income, which may impact on their standard of living for the rest of their lives.

A number of lessons are to be learned from these experiences and these are reflected elsewhere in this Review. They emphasise the importance of financial education, the need for protection of small-scale investors and the importance of regulation of financial products.

If these lessons can be translated into better performing capital markets and some recovery in investor confidence, then people approaching retirement should feel more confident about the wisdom of accumulating wealth and the preservation of capital.

Financial knowledge and skills

Information on how older people approach financial management in retirement is scarce. Older people, even those with above average incomes, practice a wide range of economising behaviours. This may be an attribute of today's older people who were raised during times of depression or war and may help to explain why most find their incomes adequate for their needs.

The challenge of making investment choices and monitoring and managing asset portfolios has not, and does not, arise for many people. For the majority of older people their interest and dividend income is relatively small and stable and the only significant asset is the equity in their homes, which they may not recognise as a form of wealth which can be mobilised.

The 2009 ANZ-Retirement Commission Financial Knowledge Survey found that 44% of people aged 65 and over were in the 'low' financial knowledge group.

There are clear gender differences. While 49% of women aged 65 and over were in the low knowledge group, only 37% of men aged 65 and over were in this group. Although more women are in paid employment today, their opportunities are often limited by education, culture and family circumstances. In some sectors of the community it is considered culturally inappropriate for women to concern themselves with financial matters. Yet women live longer than men and need support through a longer period of retirement.

Where do people go for advice on managing their income and assets? According to the 2009 Financial Knowledge Survey older people in the low knowledge group depend mainly on friends and family, while the high knowledge group uses a wider variety of sources. Banks are a major source of advice, used by 37% of people aged 65 and over. Older people are less likely to use websites for financial information and one in five of those aged 65 and over received no help in their financial transactions.

The risk of financial exploitation

Financial exploitation (the illegal or improper exploitation or use of funds or other resources of an older person) is one of the most common types of elder abuse. Its impact may lead to permanent loss of financial security and may even be life-threatening. It can result in higher levels of dependence and an increased need for care services. Older people living alone, especially women and those in poor physical and mental health are especially susceptible.

Most of the perpetrators are family members, but financial exploitation may also be carried out by sales and tradespeople, by financial advisers and by paid carers in the home or in residential care. It is, however, much more difficult to detect and regulate when it happens within families.

Enduring Powers of Attorney (EPA), which give one person the power to act for another in financial matters, are intended to protect older people whose ability to manage their own affairs has been compromised by ill-health. Concerns about financial exploitation led to the tightening of EPA rules in 2008. The new rules require people to seek independent legal advice before making an EPA. This is intended to make attorneys more accountable and requires them to keep clear financial records.

These issues will become increasingly significant and widespread as KiwiSaver matures, as this will require careful financial management and possibly difficult decisions right through old age. Trusted financial products will need to be available.

Vulnerable groups

Pockets of serious hardship or deprivation exist throughout the country and across a range of age groups and family settings.

Hardship among older people is probably related less to a lack of a basic income and more to situations where expenses are high and it is difficult for them to be managed. Examples are:

- The cost of rent particularly when living alone (although the majority of older people are not renting).
- Costs related to healthcare over and above those normally covered under the public health system.
- Costs related to a disability.
- Costs arising from obligations to family, whānau or friends.
- Excessive debt servicing costs.
- Costs arising from a lack of financial knowledge, budgeting skills or from behaviours, such as addictions or financial exploitation by others.

Increasing the rate of NZS would be a very blunt and costly way to reduce poverty among vulnerable groups of older people, since it would entail additional payments to everyone regardless of their income and circumstances, when the problem is restricted to a small proportion of older people.

Measures targeted at the risk factors themselves are more likely to succeed. The way in which such measures are designed, linked and delivered by government agencies and other private and community sector players is a key factor to their success.

Women alone

Partnered individuals have, on average, higher living standards and lower hardship rates than non-partnered individuals. There are also slightly higher hardship rates for non-partnered women who are aged 65 or over than for non-partnered men[10].

Unfortunately available data does not enable us to understand why it is that some non-partnered women appear to be relatively worse off. What we do know is that while most men (70%) over the age of 65 are partnered, only 42% of women are.

With women on average living longer it is not surprising that they are more likely to be non-partnered and this even holds true at younger ages with women aged 65-74 almost twice as likely (36%) to be non-partnered than men (19%). As expected, most men and women aged 65 and over become non-partnered as a result of bereavement (46% and 74% respectively).

Given the lack of data we cannot be certain why it is that women, generally, appear to be disadvantaged in retirement. Some possible explanations are:

- Women are living alone at older ages and for longer, and the costs of living alone for so long constrain lifestyle and therefore, also, wellbeing.
- Women are less able to save for retirement as they take time out of the workforce to raise children and later, to care for family.
- Women, when in the workforce, have lower incomes than men.
- Women who are divorced or separated are not easily able to access a fair share of marital assets and future income.

10. MSD's 2008 Living Standards Survey.

» Women generally outlive their male partners and the costs associated with the care of their partner draw on shared income and assets thus impacting the wellbeing of the partner left behind.

Older Māori

Māori are a youthful population, but more Māori are living to older ages than ever before. Māori currently make up around 5% of the total population aged 65 and over. By 2026, using medium projections, Māori are expected to make up over 7% of this group. This change will place demands on whānau to provide support for elderly parents and grandparents.

Many older Māori are net contributors to whānau who are able to care for the children of workers and students and provide financial support. Yet this situation can change rapidly with older Māori requiring care themselves and needing to call on whānau resources.

Most older Māori live alone or in couple-only situations[11]. While whānau relationships are highly valued by older Māori, circumstances and choices determine that living with whānau members is not the experience of the majority of older Māori. The practical realities of policies that encourage continuing to live in your own home will increasingly be of concern for older Māori.

There are also expectations that many older Māori fulfill the role of kaumatua in older age. Functioning in this role may place additional demands on retired Māori, yet this cultural role is vital to the maintenance of Te Ao Māori – the Māori World.

Māori are less likely to have saved for retirement, and are also less likely to have large assets to call on (such as a freehold home). Older Māori widows, in particular, are more likely to live in circumstances of relative economic deprivation (many below the poverty line).

On average, Māori live shorter lives and are therefore less likely to live to claim superannuation and receive it for a shorter period. The implication for retirement income policy is that those who die before age 65 will not qualify for NZS nor, for that matter, will they be able to access any KiwiSaver balances they might have accumulated (unless an early withdrawal under hardship provisions can be approved), although KiwiSaver balances will pass to their heirs.

As already discussed, many of the current retired are reliant on NZS to ensure they have a reasonable standard of wellbeing in retirement. NZS, as a universal individual entitlement, has many attractive features, but it cannot compensate or correct for a shorter life expectancy. Any inequity in retirement income is swamped by the broader inequity of persistent differences in life expectancy, which is primarily a health issue.

The issues for Pacifica peoples are very similar to those for Māori. Both groups may become increasingly reliant on publicly provided aged care.

People with health and aged care issues

The rules surrounding health and aged care services, subsidies and entitlements can be confusing and daunting for older people and their families. A complicating factor is the shared responsibilities of the Ministry of Health and the Ministry of Social Development in this area, although both ministries maintain helpful websites.

The greater challenge perhaps is how to encourage families to consider the implications of a possible change in living arrangements or aged care needs well ahead of the event. There is a need for clear information.

11. Prof. C Cunningham, Massey University "Retirement income policy, intergenerational equity and Māori development".

Strengthening the NZS principle of universal individual entitlement

Two notable features of NZS are its generally universal character and the fact that it is an individual, not a family, entitlement. This makes NZS almost unique among the basic, tax-funded pillar components of retirement income systems around the world.

Subject only to tests for age and length of New Zealand residency, each person is eligible to receive NZS irrespective of (most) other personal circumstances. Unlike the usual working age benefits aimed at social protection and based on the income support model, getting NZS does not depend on whether a person is employed or partnered. Nor is it based on 'need' as indicated by the amount of their income or their partner's income.

This is an essential feature of the **citizenship dividend** model, as distinct from the **income support** model. In some respects, focusing on the circumstances of the individual puts NZS on a similar basis to the income tax system that uses the individual as the unit of assessment (although family tax credits require joint assessment of a couple to determine entitlement).

The broad principle that NZS is a non-income-tested personal entitlement is worth defending and preserving. It supports gender equality, taking personal responsibility for one's own financial future and it does not distort paid employment decisions. In addition, its universality makes it simple and cost-effective to administer.

There are currently, however, three areas where the principle of non-income-tested personal entitlement is stretched, if not broken, and should be changed. They each relate to the different treatment of partnered and non-partnered superannuitants:

- The optional, income-tested rate of NZS for a superannuitant with a partner who is not qualified for NZS in his or her own right.
- The two different NZS rates that can apply to people who are sharing accommodation; one applies to those who are partnered and a different rate for those who are not.
- The way in which a person's own NZS entitlement is affected by the amount of his or her partner's pension if it is a certain country's overseas state pension.

These three situations, each of which infringes the principle of universal individual entitlement, are discussed in turn, with recommendations for change.

The non-qualified partner rate of NZS

There is a special optional rate of NZS available for low-income, partnered couples in situations where one partner is qualified for NZS, but the other partner (by virtue of age or residence) is not qualified. This situation arises most commonly where a husband is aged 65 or over and retired with little income (apart from NZS), while his wife is under 65 years and has little income, or may wish to retire at the same time as her husband.

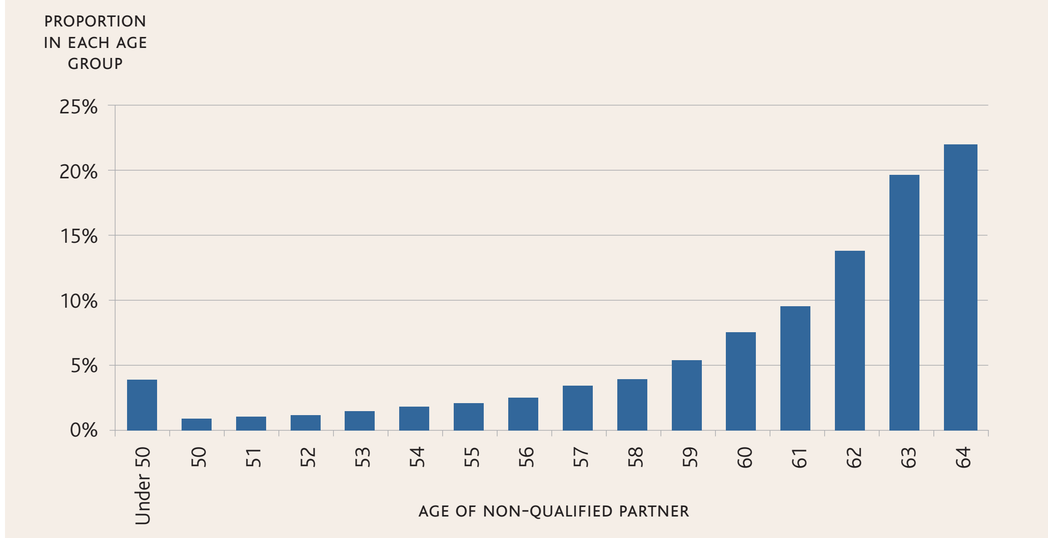
The couple (non-qualified partner) rate of NZS is slightly less than the amount two partnered and qualified people would receive, but it is noticeably higher than any of the 'partnered couple' rates of benefit normally available to somebody under the age of 65[12].

This non-qualified partner (NQP) option offers a partnered person under the age of 65 income support at a higher rate than a partnered unemployment, sickness or invalid beneficiary (and with no work search, compliance or reporting conditions), merely because their partner is old enough to be eligible for NZS. This is unfair.

12. It is also subject to a slightly different, and less severe joint income test, than applies to other categories of benefits.

While the non-qualifying partner is often close to the age of 65 (when they will qualify for NZS in their own right) this is not always the case (see chart 4.5). Some partners are considerably younger, so some couples could remain unemployed and on the NQP rate for many years.

Chart 4.5: Age distribution of the partners of superannuitants claiming the non-qualified partner rate of NZS or VP



Source: Ministry of Social Development administrative data as at September 2010.

The pension system is designed to be a universal entitlement for those aged 65 and over and the income support/benefit system is designed to provide support and a safety net for those of working age. There is therefore no need for NZS resources to be drawn on to support people of working age. A non-qualifying partner on low income should be required to access the social welfare system and meet the usual categorical tests and conditions to receive income support.

The single sharing and partnered rates of NZS

There are currently two different NZS rates that can apply to individuals who are sharing accommodation. People who are partnered receive a lower individual entitlement than those who are not partnered but are sharing accommodation. From 1 October 2010 the weekly rate of NZS for a partnered person is $255.53, compared with $307.67 for a non-partnered person who is sharing accommodation with at least one other person[13].

The standard justification for this distinction is that partnered couples face lower expenses (per head) than two or more non-partnered people who are sharing accommodation. This is based on a belief that partners have a greater ability to economise on some of their living expenses, for example by sharing bedroom space, facilities and consumer durables.

Evidence for those aged 65 and over does indicate that couples do, on average, have a higher material standard of living than single people. However, this does not justify using partnership status as a way of setting payment rates within a system of individual entitlement such as NZS. Living standards are much more likely to be related to the private income and assets of each household and, while being partnered may partially explain why income and assets are high, in general partnership status is an unfair basis for assessing entitlement.

As discussed earlier in this chapter, there are circumstances where some older people face high expenses that are difficult to manage and as a result they are at a higher risk of hardship than

13. These amounts are after deduction of income tax at the M rate.

the rest of the older population. From the point of view of alleviating hardship, people in such circumstances may need to have a source of supplementary income assistance to help them meet these cost pressures.

There is a case for retaining the NZS living alone payment to help tailor the standard individual entitlement for the many people who live in a one-person household who might otherwise be in financial difficulty. The rates of NZS should not however be distinguished by the partnership status of the person receiving it. There are other forms of financial assistance, including Accommodation Supplement, Disability Allowance and so on that are available for this purpose.

The way in which the sharing and partnered person rates of NZS might gradually be brought together over time would be a matter for policy decision. It could be done without eroding the purchasing power of any payment by adjusting each rate gradually using the margin between price and earnings movements.

The residence test for NZS and the overseas pension direct deduction policy

A final area where distinctions based on a person's partnership status are inequitable is when dealing with the treatment of overseas state pensions when determining how much NZS is payable.

The direct deduction policy is an important way of dealing with the difficulty of interfacing New Zealand's approach to entitlement with those of many other countries. It provides some fiscal offset for the fact that residents who have spent time abroad and accumulated social protection entitlements can also receive income support on the same terms as life-long New Zealand residents.

As already discussed, NZS is an individual entitlement. However, when it comes to overseas pensions, any overseas public pension payments (from a country with which New Zealand has no reciprocal social security agreement) are taken into account in assessing both partners' entitlement to NZS. If one partner's NZS is fully reduced to zero because the overseas public pension amount is greater than the rate of NZS, the excess amount is then applied to directly reducing the other partner's NZS. In some cases it can mean that a New Zealand citizen who has lived and worked all their lives in this country receives no NZS because their partner receives a public pension from overseas. This is an inconsistent piece of policy that goes against the principle of universal individual entitlement and needs to be changed.

This Review does not deal with other overseas-related NZS eligibility issues. These have been the subject of a number of past policy reviews. Further background and analysis of this policy area is set out in appendix A.

Overseas pensions – information and communication

A number of other policy and operational issues affecting the potential pension entitlements of people moving to New Zealand have been identified by people who have been through the NZS application process. These issues include:

- The difficulty of knowing in advance whether a particular overseas pension scheme will be treated as a 'state pension' for the purposes of applying the direct deduction policy.
- A perceived lack of transparency and the time taken to reach decisions with regard to specific overseas pension schemes.
- The difficulty of obtaining accurate information and advice about the direct deduction system ahead of a decision to emigrate to New Zealand.
- The multi-layered appeal process.

There is a need to improve information and communications in this area. The issues that need to be sorted may seem to be small and technical, but they can be very significant to the individuals who are affected, often after they have made the decision to move to New Zealand. This can impact both returning New Zealanders and new migrants.

Conclusion and recommendations

This chapter has reviewed the economic circumstances of older New Zealanders and also raised a number of issues where it is considered that the retirement income system and its interface with the income-tested benefit system could be improved.

The existing older population appears to have remained in a generally adequate financial situation through the Review period, despite investment losses, because of the income protection from NZS, increased ongoing participation in paid employment, and high levels of debt-free home ownership. As a group, older people have the highest average score on the Economic Living Standards Index (ELSI) of any age group, and a smaller proportion who report being in hardship.

Strategies for addressing the particular problems of vulnerable groups require careful consideration, since NZS is not designed for the purpose of targeting assistance directly to those in hardship. It is a simple, broad-based standard pension instrument. Rather, a suite of budgeting skills education, supplementary assistance and special support services is likely to be required and tailored to different age groups within the vulnerable population.

Finally, three changes to NZS policy are suggested which would help buttress the principle of universal individual entitlement that underlies the design of NZS.

Recommendation 4.1

That the Retirement Commission works with the Ministry of Women's Affairs, Te Puni Kōkiri, the Ministry for Social Development and Statistics New Zealand to develop a clearer picture of factors affecting the wellbeing and living circumstances of non-partnered older New Zealanders, particularly women living alone.

Recommendation 4.2

That the Ministry of Health and Ministry of Social Development develop additional and co-ordinated information resources on the likely costs of health and residential care to assist those planning for, and in, retirement.

Recommendation 4.3

That the non-qualified partner rate of NZS should be removed as an option for new applicants and that existing recipients should be allowed to continue to receive it for a maximum of five years. Beyond that they would be entitled to claim any applicable benefit through the welfare system.

Recommendation 4.4

That the partnership distinction in the NZS rate structure be removed, by gradually merging the individual sharing and individual partnered rates of NZS over time.

Recommendation 4.5

That an individual's overseas state pension entitlements should be directly deducted against their own individual entitlement to NZS and that any excess should not then be offset against the individual NZS entitlement of their partner.

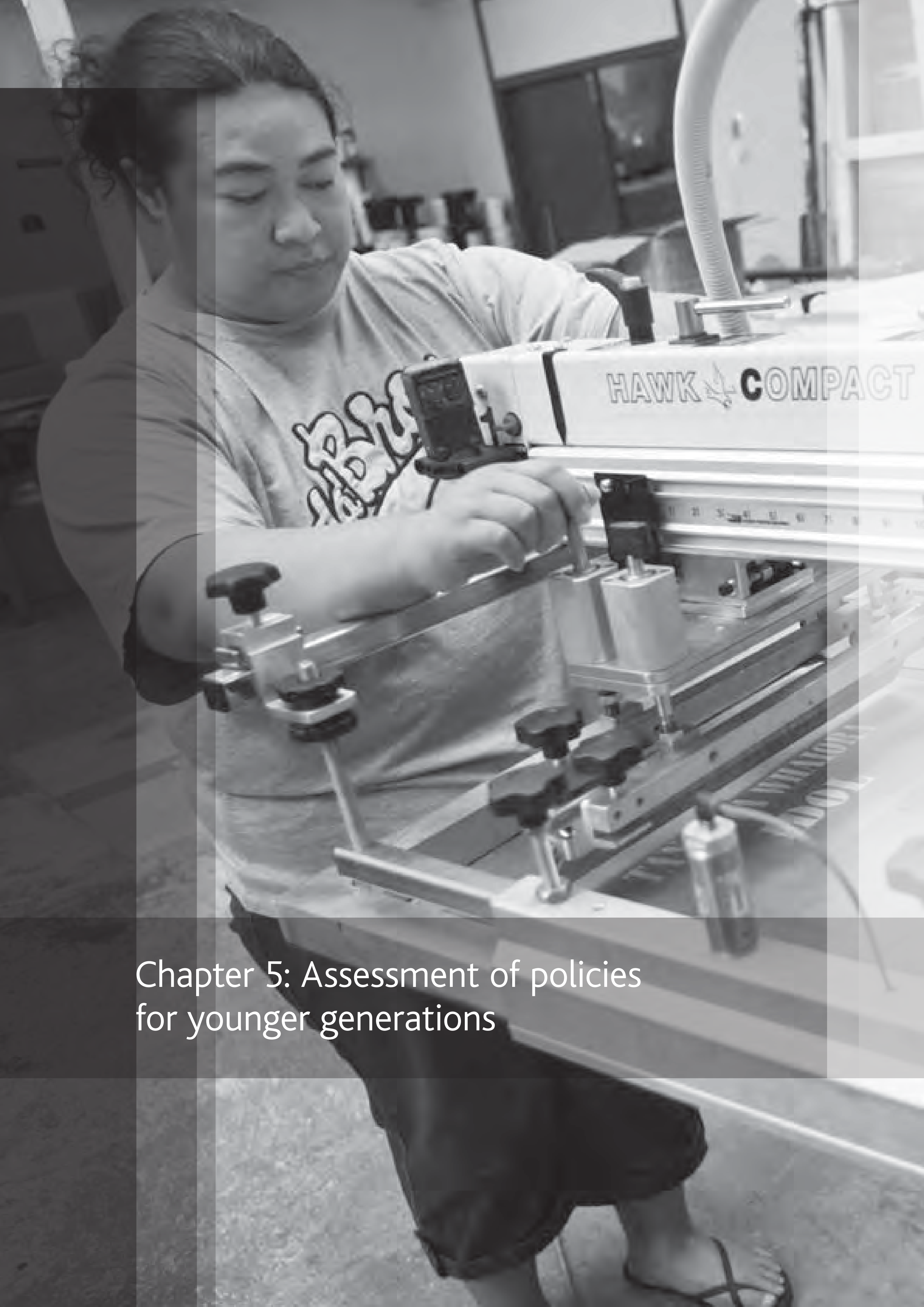
Recommendation 4.6

That the Ministry of Social Development implement programmes to:

» Provide information and advice for recent and prospective migrants and returning New Zealanders on the implications of the direct deduction policy for their future retirement income.

» Improve the public availability of decisions on the classification of overseas pension schemes whose pension payouts are subject to the direct deduction policy.

» Explain the rationale behind each pension scheme classification decision.



Chapter 5: Assessment of policies for younger generations

This chapter considers the younger generations of working-age New Zealanders, broadly those aged 18 to 55, who are still some way from retirement. The first section presents some features of their financial situation and research into whether people at this stage of their lives are saving adequately for retirement. Recent developments in retirement savings policies that are important for this group are also described, in particular the savings environment and the growth in KiwiSaver.

The second section assesses current retirement savings policies as they affect younger generations of New Zealanders. It considers the messages that are signalled to this age group about the need for retirement saving. A number of KiwiSaver policy features are analysed, with recommendations for the future, but it is too early to judge the likely overall, long-term effectiveness of KiwiSaver. This section also looks at the adequacy and availability of other financial retirement products and discusses whether or not the introduction of compulsory private saving to New Zealand's retirement income policy framework would be appropriate.

A final section discusses the complexities of measuring New Zealanders' saving rates and the implications and limitations of the data available for policy making.

Developments affecting working-age people

Most of today's labour force was born between the mid-1950s and the start of the 1990s. Older members of this generation will have grown up in a period of peace, relative post-war affluence and high employment. The 1970s and 1980s were, however, a relatively more turbulent economic period.

Chart 5.1: Number of males and females by age and labour force status 2006

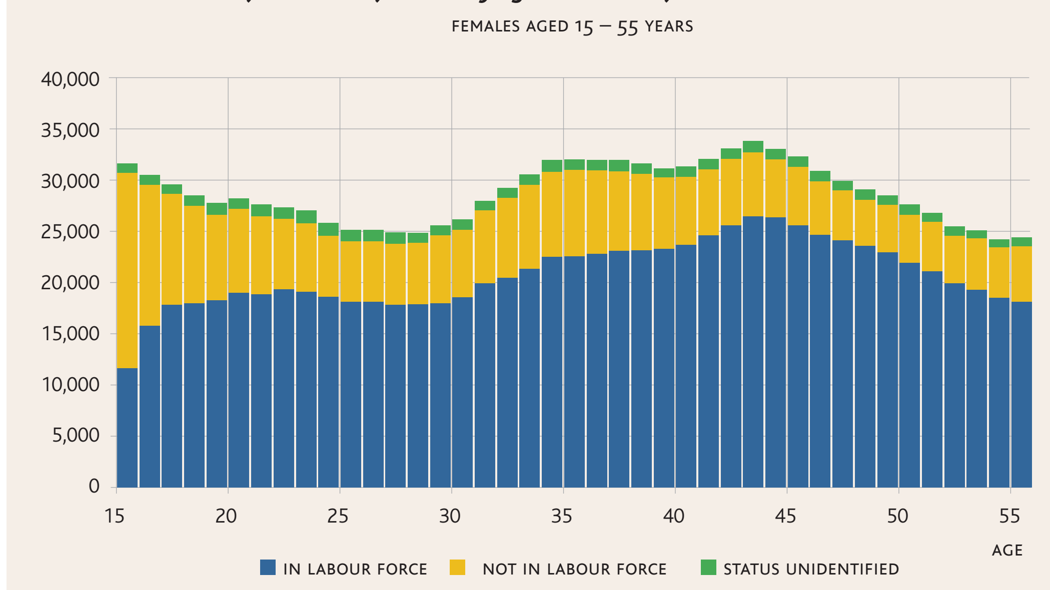


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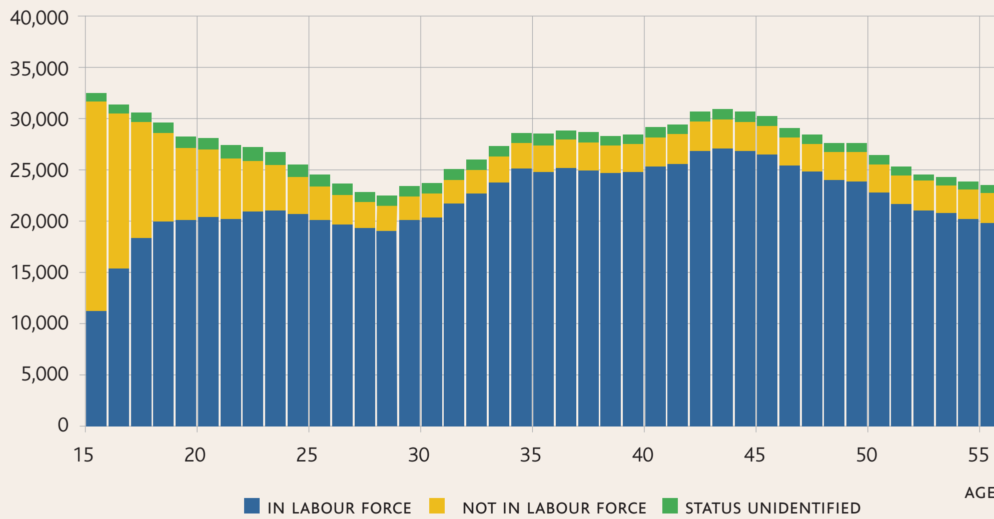
Chart 5.1: Number of males and females by age and labour force status 2006 (Continued)

MALES AGED 15 – 55 YEARS



Source: Statistics New Zealand: Census 2006.

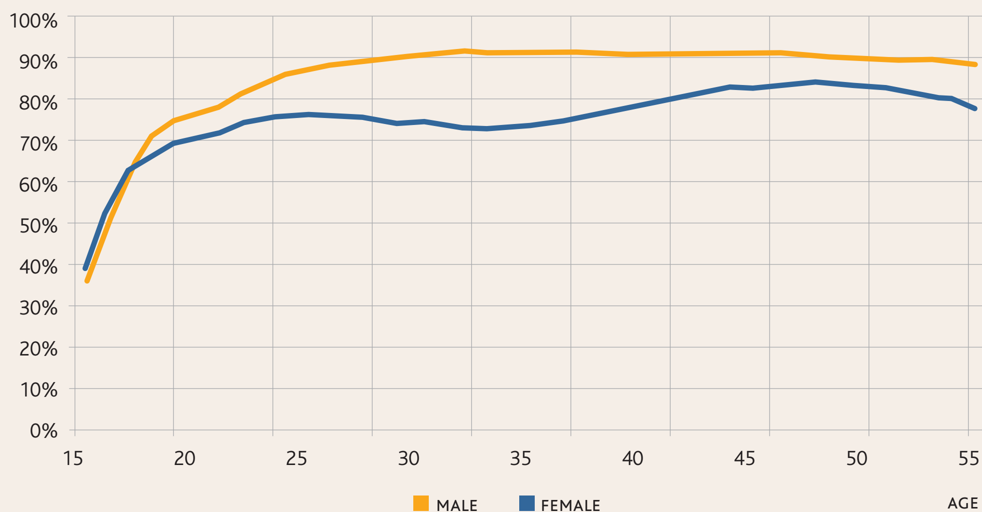
Within this broad age range, the size of the different age groups varies substantially (chart 5.1). For example, in 2006 there were about 20% fewer 25 to 30 year olds than 35 to 40 year olds resident in New Zealand. Some, but not all, of this difference may represent young people temporarily away overseas.

This variability in cohort size will mean that younger, smaller cohorts will be required to finance New Zealand Superannuation (NZS) for the older, larger cohorts ahead of them.

Employment and income

The labour force participation rate gives a partial indication of the potential for working-age people to save for their retirement by putting aside some of their earnings. Chart 5.2 illustrates that, once they have completed their formal education, men are most likely to undertake paid work, with up to 90% of them participating in the labour market. The participation rate of women has been increasing over time but is lower than the male rate and also shows some decline during the early 30s, likely the result of taking time out of the workforce to raise children.

Chart 5.2: Percentage of people aged 15 to 55 in the labour force 2006

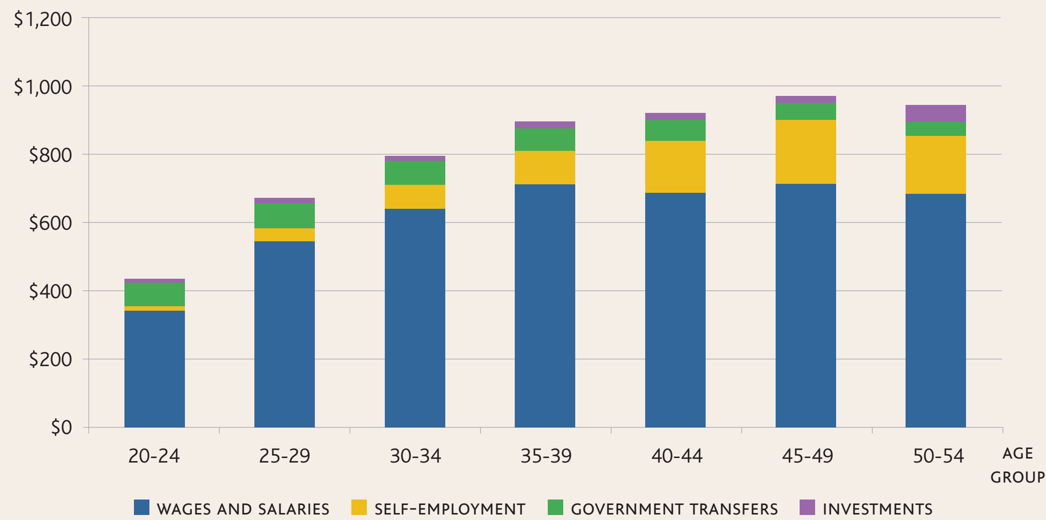


Source: Statistics New Zealand Census 2006.

Incomes for this working-age population are primarily from salary and wages, with a growing share coming from self-employment among older age groups (chart 5.3). The average amount of income per person from investments is very low among younger age groups, largely because only about one quarter of them have any investment income.

Total income from all sources rises with age, with average gross weekly income reaching approximately $900 for those in their 40s and 50s.

Chart 5.3: Average gross weekly income per person from each major source by age group, June quarter 2010



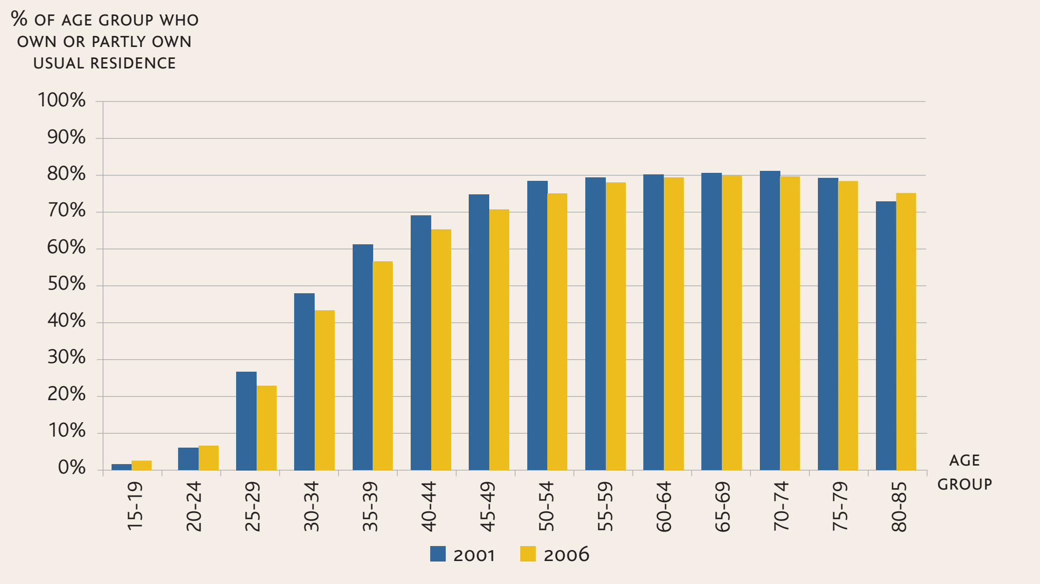
Source: Statistics New Zealand: New Zealand Income Survey June 2010.

Home ownership

Over the last 10 years or so, it appears that people have delayed the purchase of their first house. A comparison between the 2001 and 2006 Census (chart 5.4) shows that, while the rate of home ownership among older cohorts has remained steady, younger age groups contain a lower proportion of home owners in 2006 than five years earlier.

Some of this may reflect delays in family formation, which should eventually stabilise, but the increasing difficulty of saving a deposit and servicing a mortgage when house prices were rapidly increasing will have also restricted first home ownership options for younger people. The percentage deposit requirements have also been increasing as lenders take a more precautionary view. These changes have the potential to alter the timing and the composition of saving for retirement, since paying off a mortgage is one of the major forms of wealth accumulation in middle age.

Chart 5.4: Proportion of adults in each age group who are home owners



Note: People living in a house owned by a family trust are not counted as home owners.

Source: Statistics New Zealand Census data on age of tenure holder.

Home ownership is an important component of most New Zealanders' retirement planning. Even where the capital value of a house is disregarded when looking at the accumulated balance of retirement savings, living debt-free in one's own home represents a significant reduction in future living costs compared with having to pay rent. People aged over 65 who live mortgage-free in their own homes are much less likely to score low on a living standards scale than those who are renting (refer chapter 4, table 4.2).

Given the important role home ownership plays in retirement wellbeing, it is important that home ownership rates be carefully monitored with the aim of addressing any serious impediments to home ownership.

Household saving patterns and adequacy

Depending on the approach taken to measuring saving, different pictures emerge about the savings of New Zealand households. Some sources present a relatively positive overall picture while others present a rather bleak one. Each approach has its own problems of coverage and measurement and sometimes adopts somewhat different concepts of saving[14]. The reasons for these differences are discussed in the final section of this chapter, along with the difficulties in obtaining comparable data on saving from different sources.

Despite these difficulties, the approach that holds the most promise in helping to inform retirement savings policy is to measure saving using a longitudinal estimate of the change in individuals' net wealth as they age. Currently this kind of information is collected through Statistics New Zealand's Survey of Family Income and Employment (SoFIE)[15].

Unfortunately there is no reliable up-to-date information on the overall saving behaviour of individuals in response to the recent recession, the GFC and the introduction of KiwiSaver. The data and research results reported here all refer to the period up to 2007.

14. For example, measuring saving by comparing the stock of wealth at two points in time incorporates changes in asset values that are not normally picked up when saving is measured as the difference between flows of income and consumption spending.
15. SoFIE is a longitudinal survey running over an eight-year period from 2002 to 2010. Every second wave (even numbered waves) the survey collects detailed information on assets and liabilities. Wave 2 was in the field over the period October 2003 to September 2004 and wave 4 was in the field for October 2005 to September 2006. Wave 8 (the final wave) is currently in the field and will collect data on assets and liabilities.

Data from the first two waves of SoFIE that collected assets and liabilities information, 2003/04 (wave 2) and 2005/06 (wave 4), show that:

» The estimated overall median annual saving rate over the period between the two waves was 16% of gross income.

» There are positive saving rates for the period for people in all income deciles. The median saving rate generally rises with income.

» Median saving rates increase with age and peak in the 45 to 55 age group.

» The estimated median saving rate for people who held owner-occupied housing in wave 2 and 4 was 42%. When owner-occupied property is excluded the estimate falls to 5%. The reason for excluding owner-occupied housing is that, when thinking about saving for retirement, people have to live somewhere. Even where people 'downsize' their home, they may (or may not) purchase a smaller property of equivalent value and therefore don't release considerable equity for income. Further, to date the use of home equity release products has not been significant, so excluding the primary residence from the saving calculation is reasonable when considering retirement income.

» Considering the effect of property prices, the overall median saving rate falls from 16% to 5% when house price effects are excluded and, for those individuals with property in both waves, the estimated median saving rate falls from 41% to 6%. This means the majority of the estimated saving rate is generated by increasing house prices, although estimated saving rates remain positive when house prices are excluded[16].

More recently published research into the wealth and saving patterns of New Zealanders using the same SoFIE data indicates that the average net worth of adults was $223,000 in 2006, one third of which was in owner-occupied homes. Wealth varied across age groups, gender, partnering status and ethnicity.

By comparing the change in net assets reported by individuals, the authors calculated average saving to be $29,900 per adult over the two-year period 2004 to 2006. When housing capital gains (passive saving) are excluded, average saving was $12,600, or a rate of 18% of gross income per year.

Active saving (i.e. the change in individuals' wealth excluding real capital gains and losses) was found to be related to age and income, but there was no evidence that passive saving from the property boom had crowded out other forms of saving. People with higher passive saving between 2004 and 2006 also had higher active saving and active, non-property saving[17].

Private provision: are those of working age saving enough for their retirement?

People will have different ideas about the standard of living they would like to have in retirement and this will imply different levels of required saving. Additionally, some individuals will seek to leave bequests to family members, which will mean that not all their saving will be available for consumption through the retirement period. The most commonly used approaches to considering the adequacy of post-retirement income are:

» Post-retirement income should be a certain proportion (e.g. 70%) of a person's pre-retirement income, both measured pre-tax (the earnings replacement rate approach).

» Post-retirement income should sustain pre-retirement consumption and avoid a drop in living standards ('pure' consumption smoothing); or should support some maximum acceptable change in the level of consumption (e.g. post-retirement consumption should be at least 80% of pre-retirement consumption).

16. Scobie, G. and Henderson, K., *Savings Rates of New Zealanders: A Net Wealth Approach*, Treasury Working Paper 09/04, December 2009.

17. Trinh Le, John Gibson and Steven Stillman *Household Wealth and Saving in New Zealand: Evidence from the Longitudinal Survey of Family, Income and Employment*, MOTU Working Paper, 10-09, Motu Economic and Public Policy Research, September 2010.

- Income in retirement should be at least at a level deemed necessary to attain an acceptable minimum standard of living (an absolute poverty line approach).
- Income for retirees should be some fraction of the average incomes of the current working-age population (a relative poverty line measure), or a fraction of the income of some reference group of retirees (a variant of the relative poverty line approach).
- Income in retirement should enable an individual to have the same marginal utility of consumption over time (i.e. the last unit of consumption has the same value to the individual before and after retirement)[18].

Because each of these approaches yields different answers, there is no official view or assessment of whether the amount of private provision that people make to supplement their NZS is 'adequate'.

However, the objective of KiwiSaver, set out in the KiwiSaver Act 2006, is to encourage asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement. This implies that KiwiSaver is intended to help people meet a consumption smoothing objective.

Research using SoFIE and the Household Saving Survey (HSS) has explored the implications of adopting a consumption smoothing approach to determine whether people are saving adequately. Under this approach, individuals need to accumulate a stock of wealth at the point of retirement that will, when combined with any regular income earned in retirement, generate an income stream (that may or may not include capital run down) that is equivalent to pre-retirement levels. This approach does not however make any judgements about the 'adequacy' of the individual's pre-retirement income.

This research, using information prior to the recession and the introduction of KiwiSaver, indicates:

- Many New Zealanders are making adequate provision for their retirement. In particular those on low incomes are likely to be able to smooth their consumption between working life and retirement provided they own a mortgage-free house at retirement, largely due to the role played by NZS. Some in the top income deciles may be able to smooth their consumption, but even if they can't, many will have sufficient income to provide a reasonable standard of living.
- While some in the middle income deciles are making adequate preparation, many in these deciles are not yet doing so and will need to increase their savings if they are to smooth their consumption between working life and retirement.

Given the numerous definition of savings adequacy and the data challenges, drawing definitive conclusions on this issue is difficult. Taking a cautious approach might suggest a need for greater saving by most New Zealanders, but there is also evidence suggesting that New Zealanders can make and are making sensible saving decisions based on their own personal circumstances.

Introduction and growth of KiwiSaver

KiwiSaver's introduction in 2007 represented a significant change in saving policy for working-age New Zealanders and a departure from New Zealand's long-maintained approach (universal public provision and strictly voluntary, non-subsidised private provision) to retirement saving. An early assessment of aspects of KiwiSaver's effectiveness follows later in the policy assessment section of this chapter.

By June 2010, KiwiSaver membership reached 1.46 million and growth remains steady at approximately 30,000 members per month for the last two years. More than $5.8 billion in funds have been passed to scheme providers for investment, of which $2.4 billion is accounted for by government subsidies. Most members have opted-in and one-third of current members have been automatically enrolled (table 5.1).

18. Scobie, G., Gibson, J., Le, T., 2005, Household Wealth in New Zealand, Institute of Policy Studies, Wellington, 2005.

Table 5.1: KiwiSaver membership by enrolment method

Enrolment method	Members	Percent
Opt-in via provider	706,290	48%
Automatically enrolled	541,769	37%
Opt-in via employer	211,883	15%
Total	**1,459,942**	**100%**

Source: Inland Revenue administrative data.

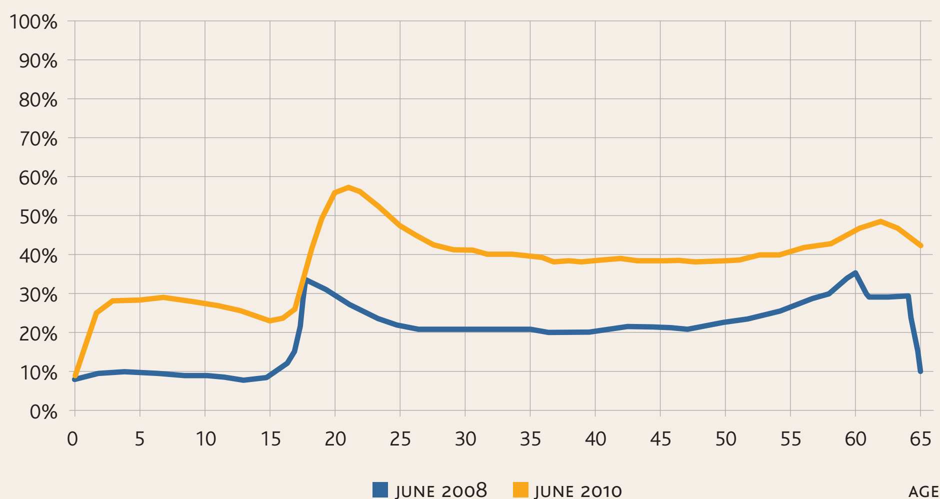
KiwiSaver's coverage continues to grow. Currently 38% of the eligible population is enrolled and an estimated half of households have at least one KiwiSaver member. Chart 5.5 shows differences in coverage by age and the growth in the number of account holders between 2008 and 2010. Particular points to note are:

» There has been a rapid rise in new KiwiSaver accounts for younger children.

» 18-year olds who constituted the peak age group of new members in 2008 are now aged 20 and the coverage of this age group has been further boosted by additional enrolments since then so that their coverage now exceeds 50%.

» The initial coverage of young people was relatively high as was the coverage of older people due to a high level of early opt-ins amongst those in their late 50s and early 60s.

Chart 5.5: Coverage of KiwiSaver by age, 2008 and 2010



Source: Inland Revenue administrative data and Treasury long-term fiscal model for eligible population.

Research done as part of the evaluation of KiwiSaver shows that the desire to save for retirement and to have more than NZS in retirement is a significant membership motivator. KiwiSaver's financial incentives, its flexibility, as well as the fact that members are not required to make choices if they do not wish to are also considered to be attractive reasons to join.

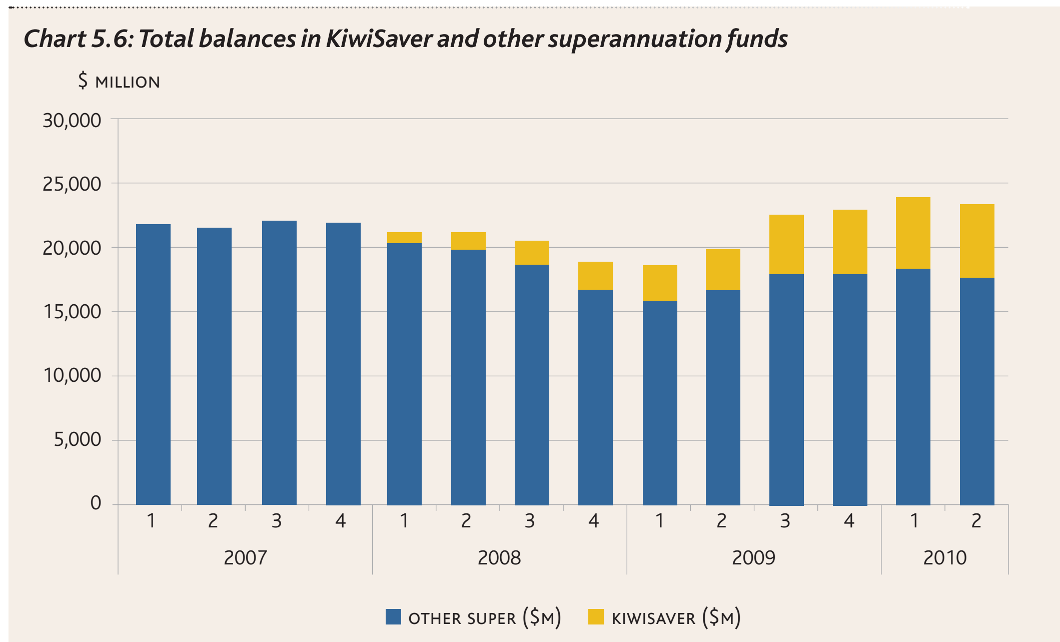
There are a few key reasons behind decisions to stay out of KiwiSaver; affordability, concern about the future security and sustainability of the scheme, and a belief that, for individuals' circumstances, there are better financial priorities. There are also a reasonable number of people who say they simply 'have not got around to it'[19].

As at 30 June 2010, over $5.8 billion in contributions from individual members, employers and the Crown had been passed from Inland Revenue to scheme providers for investment. About 60% of that has been contributed by members and employers and the remaining 40% has been contributed by the Crown through subsidy payments.

Information available relating to inflows of funds (as opposed to funds under management) to KiwiSaver and other managed funds products indicate that total inflows have declined since the year ended March 2009. Inflows to KiwiSaver have increased, while inflows to other investment types (particularly superannuation funds) have declined. Substitution of saving is a possible explanation; that is, that KiwiSaver contributions are being 'funded', at least partially, by money that would otherwise have gone to other superannuation or managed funds investments[20].

Chart 5.6 suggests that there may have been some redirection of contributions to KiwiSaver which may have otherwise been made to other superannuation funds, but the picture is complicated by the generally depressing effect on fund values of the recession.

Chart 5.6: Total balances in KiwiSaver and other superannuation funds



Source: Reserve Bank of New Zealand Managed Funds Survey.

Several aspects of the KiwiSaver scheme are assessed in the next section, with recommendations. However, the key longer-term question for KiwiSaver is whether or not it delivers on its legislative purpose of establishing saving habits and assisting the target group to smooth their pre and post-retirement standard of living. Determining this is the objective of the multi-agency evaluation of KiwiSaver underway and running until 2013.

19. Colmar Brunton (2010), KiwiSaver evaluation: survey of individuals.
    Available at http://www.ird.govt.nz/aboutir/reports/research/report-ks/research-ks-evaluation-report.html
20. Eriksen and Plan for Life New Zealand Retail Managed Funds media releases.

Taxation of superannuation

The current taxation framework for superannuation has its genesis in the tax reforms of the late 1980s. Prior to this, New Zealand offered incentives to save for retirement through tax exemptions on contributions to certain superannuation products. The tax treatment of most superannuation was 'EET' i.e. contributions were exempt (E), fund earnings were exempt (E), and withdrawals from the fund were generally taxed (T). Between 1988 and 1990 the tax scale was flattened and all tax incentives for savings were removed. The focus of the reforms was to ensure tax neutrality between different savings vehicles.

The new regime that developed, and which still largely applies today, was 'TTE' i.e. contributions are made from after-tax income (T), fund earnings are taxed (T), and withdrawals from the fund are exempt (E). There is, therefore, largely no distinction between the tax treatment of retirement savings and any other types of savings.

The tax treatment of employer contributions to KiwiSaver schemes and complying superannuation funds is an exception to the general rule that contributions to superannuation funds are taxed. The 2% compulsory contribution employers are required to make for their employees who are members is exempt from employer's superannuation contribution tax (ESCT). Any contributions over 2% are subject to ESCT.

Before 2007, the tax rules generally favoured direct investment over investment through managed funds such as superannuation funds. The introduction in 2007 of portfolio investment entity (PIE) rules for managed funds and fair dividend rate (FDR) rules for offshore shares resulted in a more equal tax treatment of direct investors and those who invest through managed funds and removed some distortions arising for those who invested offshore. The changes in tax rates for PIEs and the introduction of the FDR regime have tried to address some of the previous anomalies in tax treatment. But differences will remain (refer table 5.2).

Table 5.2: Taxation of different fund entities

Investment type	Widely held superannuation fund*	Closely held superannuation fund	PIE	Direct investment (withholding at source)
Tax rate 2011/12	28%	33%	Capped at 28%	Four rates up to 33%

* A widely held superannuation fund is one that has 20 or more members.

A more detailed overview of key, recent changes to taxation of saving and investment are outlined in appendix B.

Financial knowledge and skills

A financially educated population is one that has the necessary information and skills to make sound decisions about planning and managing their personal finances throughout their lives. Financial education helps people become more aware of financial issues and their significance, to equip individuals with the ability to assess their personal financial situation, and to make quality decisions about their involvement in KiwiSaver or other savings options.

The ANZ-Retirement Commission Financial Knowledge Survey is the primary way New Zealanders' financial knowledge is regularly assessed. The survey was last carried out in 2009 (and is planned to be repeated approximately every four years)[21]. Some care needs to be taken in comparing the results across the two cross-sectional surveys as the respondents differ in each case.

The context within which the survey is carried out is also important. The 2009 survey was carried out in the midst of the GFC, whereas the 2006 survey was completed during the period of expansion and asset price growth. Some key results from the 2009 survey are:

» There has been a significant improvement in New Zealanders' overall financial knowledge since the survey was first carried out in 2006. Close to half (43%) of New Zealanders are considered to have high levels of financial knowledge according to the survey's measures and the number of individuals who are considered to have advanced financial knowledge has significantly increased from 15% in 2006 to 20% in 2009. However, while there are positive signs, the numbers of New Zealanders with low financial knowledge have not changed significantly.

» In the 2006 study, disparities in financial knowledge were identified. The communities whose financial knowledge was significantly lower (such as females and low income households) in 2006 are among the groups that have had the most significant improvements in their financial knowledge for 2009.

» There is no significant change in the number of New Zealanders saying that they are saving between the two surveys. However, this study does not measure the amount being saved, which with the introduction of KiwiSaver might have increased.

» There have been no major changes in knowledge around retirement planning. Two out of three New Zealanders still do not know the approximate amount that a single person living alone will receive from NZS. And while there have been significant improvements in knowledge around whether or not NZS is either income tested or asset tested, there are still New Zealanders approaching retirement (10 years out) who are unaware of the basic conditions applying to the public pension[22].

Assessment of retirement saving policies

The importance of clear signals

The next generation to enter retirement, over the next 20 years, will be both numerically larger and wealthier on average than the generation of currently retired people. Many in this age group express doubts about whether NZS on its own will be able to provide them with the sort of standard of living they would like to have in their retirement and expect to have income additional to NZS for this purpose. In the 2009 Financial Knowledge Survey, only 7% of respondents agreed with the statement "because of NZS I don't need to save for retirement", while 75% disagreed. Research done for the KiwiSaver evaluation shows that a key motivator in individuals' decisions to join KiwiSaver was a desire to secure their retirement income and to have more than the basic pension.

It is commendable that the next generation of people have high aspirations for their retirement income, but there is a lot of uncertainty over how this will actually be achieved. When Financial Knowledge Survey respondents were asked to respond to the statement "people with KiwiSaver will have an adequate retirement income" there was a clear split of opinion, with 21% agreeing, 32% disagreeing, 36% neutral and 11% unsure.

21. The survey measures knowledge and understanding, behavior and attitudes in relation to mathematical and standard literacy, financial understanding, financial competence, and financial responsibility. The survey tested the following areas of personal financial knowledge – money management, budgeting, goal setting, financial planning, debt management, home loans and mortgages, managing risk, saving, planning for retirement and investing.

22. ANZ-Retirement Commission Financial Knowledge Survey 2009.

Media reports frequently claim that New Zealanders are poor savers. The promotional activities of the financial services sector may also be adding to the general uncertainty over what level and type of individual saving is needed to achieve personal retirement goals.

The message for younger people that KiwiSaver will give extra income in retirement is reassuring but unless it is backed up by good financial education and advice, it risks confusion and complacency. Some may believe that contributing the minimum 2% of their earnings is all they will need to do to guarantee a comfortable lifestyle in their retirement.

Once they are enrolled in KiwiSaver no particular effort is required on the part of the individual, since all the funding (subsidies and automatic contributions) happens before the pay packet is received and investment settings may be left unchanged. It is tempting, therefore, for a young person to believe that someone else (i.e. the government or their KiwiSaver provider) is taking responsibility for their long-term financial security for them.

The picture is complicated by the central role played by NZS in providing the first tier of retirement income. Without the universal public pension the need for a personal retirement saving plan and the rate of saving would be much greater, so assurance about the long-term affordability of NZS and its future shape is a critically important consideration.

Public statements regarding the future of NZS risk sending mixed messages because they are aimed at two distinct audiences: those who are at or near retirement age who seek reassurance that their entitlements are safe, and younger people who wish to know how much they need to save for their retirement.

Both the major political parties have stated that they support the continuation of NZS in its current form, with no income testing or change in the payment formula or age of eligibility, for the foreseeable future.

Despite this assurance, or perhaps because of doubts about the long-term affordability of such a commitment, there are indications that younger people are sceptical that NZS will still be available under the current conditions when they retire. The introduction of KiwiSaver and recent public debate on the merits of compulsory saving may be adding to this public scepticism, since the widespread accumulation of savings in individual accounts opens up the possibility of a future phasing back of NZS. The decision to suspend contributions to the New Zealand Superannuation Fund may also have raised doubts.

It is important to reiterate that NZS is an excellent public pension scheme from the perspective of both the present and future retired populations. Unless younger people believe that the longer–term survival of NZS will continue to be managed responsibly, they are likely to feel uncertain about their own savings decisions.

There are other uncertainties to be taken into account by people starting to plan for their future retirement. Local and global issues (e.g. earthquake recovery and climate change) suggest that GDP growth might not necessarily translate into higher living standards and wellbeing. Future changes to KiwiSaver, the emergence of other new financial products and changes in the regulation of the finance industry could all affect the future environment for retirement savings.

KiwiSaver

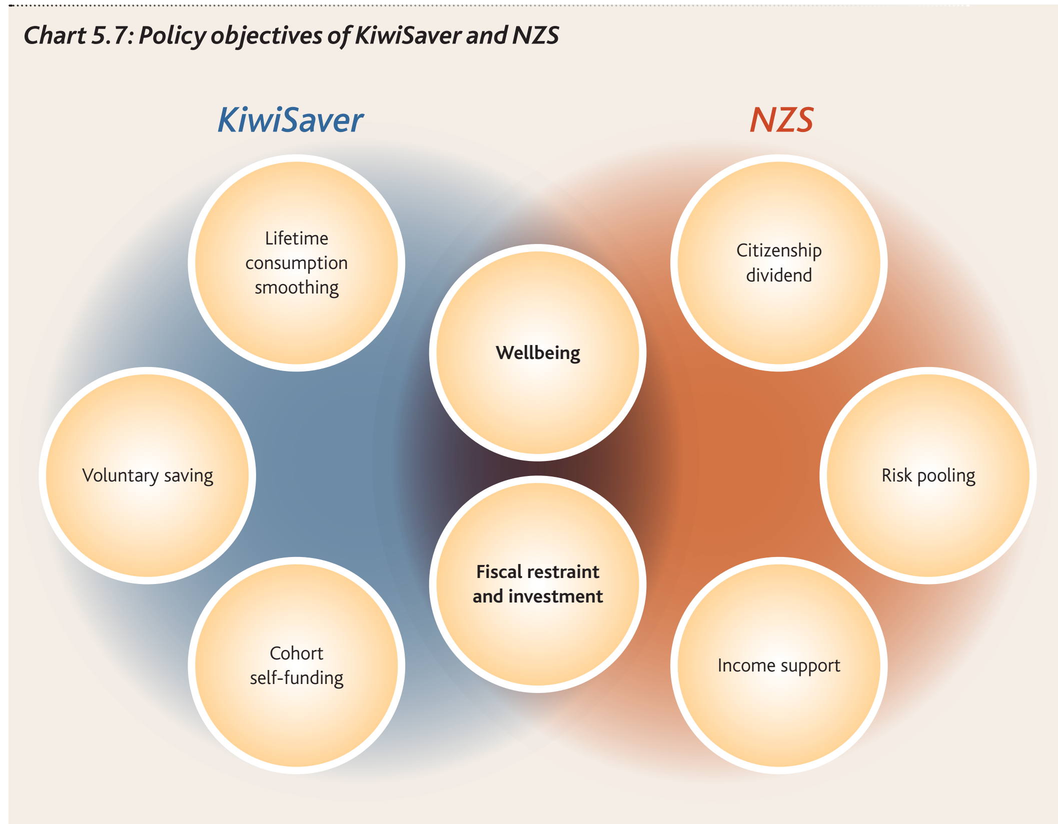
KiwiSaver in combination with NZS

In chapter 3, eight objectives, or concerns, for retirement income policy were introduced (see chart 3.2). NZS, as the flagship retirement income policy, addresses many, but not all, of those objectives.

The introduction of KiwiSaver in 2007 addresses a number of the objectives that are beyond the primary focus of NZS. For this reason, KiwiSaver can be seen as a useful complement to NZS since, in combination, they help address all eight policy objectives (chart 5.7).

NZS offers a **citizenship dividend**, covers longevity **risk pooling** and, in conjunction with the rest of the social welfare system, provides **income support**, while KiwiSaver focuses on the policy concerns of **lifetime consumption smoothing**, **voluntary saving** and **cohort self-funding**. Arguably, both schemes promote **wellbeing** and have some limited **fiscal restraint and investment** promoting characteristics[23].

Chart 5.7: Policy objectives of KiwiSaver and NZS



The objectives of KiwiSaver are set out in the KiwiSaver Act 2006:

> *To encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement. The Act aims to increase individuals' wellbeing and financial independence, particularly in retirement, and to provide retirement benefits.*

These statements encapsulate the voluntary saving, consumption smoothing and wellbeing objectives listed in chart 5.7 above. The cohort self-funding objective is implicit in the use of individual accounts where each person's future benefits are based on their own contributions. However, the use of general taxpayer funded incentives to promote KiwiSaver does mean that some cross-subsidisation remains in the system.

KiwiSaver was first announced in the 2005 Budget. It was to be a voluntary, largely unsubsidised, portable, retirement savings scheme to sit alongside NZS. However, in Budget 2007 (two months before KiwiSaver was due to be launched), significant incentives were announced to encourage membership. Following the change of government in late 2008, further changes were made to KiwiSaver that served to trim some of the costs of the scheme.

23. For example, NZS has very low administrative costs compared with income-tested or contributory schemes and also has beneficial labour market characteristics, while KiwiSaver funds are available for capital investment.

KiwiSaver and NZS are complementary policies in terms of meeting a diverse range of policy objectives, so offer a simple solution to the overall policy design challenge. Unfortunately they are also both serious competitors for funding and public support from a range of stakeholders. For this reason, in combination they add to the overall pressure on financial affordability and political sustainability of the retirement income system.

Effect and cost of KiwiSaver tax incentives

When individuals join KiwiSaver the government contributes an initial $1,000 kick-start payment and each year pays a matched contribution of up to $1,042.86 (referred to as the Member Tax Credit) for members over the age of 18, based on the member's level of contribution over the year. These cost the government $970 million in the year ended June 2010 and they are projected to cost about 0.5% of GDP per annum in future years. Crown costs by way of contributions to members' accounts are forecast to stabilise at approximately $1 billion per annum over the next four financial years.

These incentives have had an impact on membership uptake – three-quarters of members cite government and/or employer contributions as a factor in their membership decision and one-quarter of members say these incentives were the most important factor in their decision.

Although influential, the incentives are likely to have diverted some saving away from other forms. There is some indication from research done as part of the KiwiSaver evaluation that, while some KiwiSaver saving could be considered additional or new saving (i.e. saving made by reducing consumption) a good portion of KiwiSaver contributions may represent substitution from other non-subsidised forms of saving[24].

Future analysis of SoFIE data should be able to quantify the extent of substitution over new saving.

In considering the value of any net gain in overall savings (and who gains as a result), it is important to remember both who receives the subsidy and who pays. Those with greater ability to join and contribute to KiwiSaver can easily access the subsidy payments whereas those on lower incomes or those who take time out of the workforce (e.g. those with caring responsibilities for children) cannot so easily access the full subsidy entitlement.

This raises the question whether it is appropriate for taxpayer funds to be used to subsidise the saving of those who can most afford to save anyway. With regard to the issue of those taking time out of the workforce to raise children (typically women, whose lifetime incomes tend to be less than men's), one way to acknowledge the issue would be for the government to make KiwiSaver contributions on behalf of people during any period of paid parental leave.

Membership by children

Children (those under 18) are eligible to join KiwiSaver and currently this group makes up approximately 18% of all members. It was never completely clear why children were originally allowed to join KiwiSaver. Subsequently, the reasons given were to help build a savings habit early. To date the government has paid $273 million in kick-start contributions to children. It was hoped that parents and grandparents would make contributions but at this stage it appears that very few children's accounts are receiving contributions.

The extent to which KiwiSaver has been effective in establishing savings habits amongst children (or when these children become young adults) is not an area being specifically addressed as part of the KiwiSaver evaluation. But given the large fiscal cost and uncertain benefit, it is an area of work that should be undertaken. If the purposes are not being met or look likely not to be met in future, then the goals for children's participation should be made clearer or the inclusion of children in the scheme reconsidered.

24. Colmar Brunton (2010), *KiwiSaver evaluation: survey of individuals*.

Default investment funds

As at March 2010, there were more than 370,000 KiwiSaver members of default funds, or approximately one-third of members aged over 18 years[25]. An individual's decision to invest in a default or non-default fund will be influenced by a range of factors (e.g. risk appetite, income, age etc.), some observable and others non-observable.

With such a significant proportion of members belonging to a default fund it is important that the appropriateness of the default fund investment settings be considered. Current default fund investment settings are conservative (i.e. they provide a relatively low investment return with a relatively low investment risk). The government has specified that 75-85% of the default investment funds be invested in income assets (e.g. cash and fixed interest) and 15-25% in growth assets (e.g. shares and property). In practice, this will mean that balances will tend to grow, albeit slowly, year on year.

Investment theory suggests that, in order to maximise the value of the investment at retirement, those who are young should invest relatively more heavily in growth assets as these can be expected to generate better returns over the long-term (despite significant swings in value in the short and medium term) and those nearing retirement should invest relatively more conservatively. Although, with increased longevity, the investment horizons of those retiring in their early to mid-60s are long, making investments favouring riskier, higher-returning assets potentially desirable for some investors.

On this basis, those individuals invested in KiwiSaver default funds may not be investing optimally to maximize long-term savings, given the length of time until retirement. In other words, according to theory, the default setting is nudging these investors towards the 'wrong' investment option. However, the 'right' option requires a much greater level of investment risk to be taken on the part of individuals and, in some ways, by the government, on individuals' behalf.

One option to address this theoretically non-ideal outcome for default investors would be to change the KiwiSaver default fund to one that changes its asset mix according to the life stage of the member. This would mean that younger members would be primarily invested in growth assets (given their long-term investment timeframe), middle-aged KiwiSaver members in more balanced options (since they invest for the medium term) and older members in more conservative funds (since they invest for the short term).

While it is reasonable to assume that KiwiSaver members would wish to maximise the value of their retirement savings there are a number of reasons why a life stage investment approach is problematic:

» First and foremost, life stage funds ignore an individual's risk appetite and investment decisions are based solely on an individual's age and life stage. Risk preferences should be a primary consideration in the investment decision. Additionally, an individual's KiwiSaver investment could be part of a broader portfolio of retirement saving and the risk preference and asset allocation should be considered by the individual at the portfolio level.

» KiwiSaver lump sums can be withdrawn for first home purchase. Younger people (aged 18 to 25) are the largest group of members in the default funds and many of this group may intend to use KiwiSaver to help fund their first home purchase. By implication, therefore, they are invested for the short term, at least for now.

25. Report of the Government Actuary (in respect of the KiwiSaver Act 2006) for the year ended 30 June 2010.

» A move towards more risky default investment settings will mean that KiwiSaver balances can be expected to rise and fall in value over time. Consider the implications of the GFC if default KiwiSaver members had been invested in less conservative funds for say, 10 years, when the crisis hit. The balances would have been significantly impacted and it is difficult to know whether default members would have accepted the decline in the value of their investment or whether they would they have rushed to transfer to another KiwiSaver product or ceased their KiwiSaver contributions altogether. Perhaps most significantly, they may have expected the government to compensate them for the loss, since many perceive that there is implicit government endorsement of the default options as adequate, or even preferable[26].

There are also a number of reasons why conservative default investment settings continue to make sense. People generally see the value of their funds increase over time, the rate of return on equity investment has not always (in the long run) outperformed fixed interest investments, and, most recently during the GFC, default KiwiSaver funds have generally outperformed other funds.

The government's role is to consider the interests of both passive and active savers. In the context of passive savings, the government should seek to protect members' contributions and to encourage individuals to make their own choices based on their personal preferences and saving goals. On this basis, the current conservative default fund should be retained.

This is not to say however that all current default fund members are in the 'right' place, particularly if they wish to maximize their retirement nest egg. This underscores the importance of educating members not only on the basics of KiwiSaver, which has been the focus of communications activity to date, but also on the different types of KiwiSaver investments and the reasons why they might choose one over another.

Both the private and public sectors have a role in this education. The public sector can provide information on general issues to consider in choosing a KiwiSaver investment and the principles of diversification and risk. New material need not be developed, as there is already information on spreading investments across different asset classes and product types available on the Sorted website.

The private sector should be encouraged to assist default members to consider their options even if these members ultimately decide to remain in the default funds.

Default fund providers

There are currently six KiwiSaver default providers that were selected through a tender process conducted by the Ministry of Economic Development in 2006. Re-tendering will be undertaken in 2014. The rationale for having six default providers was never particularly obvious, although in the early days of KiwiSaver it might have been appropriate to limit them to major institutions.

Some non-default providers consider it unfair that the number be limited to six on the grounds that these providers receive a competitive advantage by being allocated one-sixth of the automatically enrolled members. This could be reviewed as part of the next selection process. As public knowledge of KiwiSaver has grown and the requirements of fund providers become better understood there is perhaps less justification for an arbitrary limit on the number. However it remains important to set minimum standards for potential default providers.

It is interesting to note that a key recommendation in the recently released review of Australia's superannuation system is the establishment of a low-cost default super fund called MySuper. This would be similar to many existing default funds but with a number of additional regulations, including a ban on trailing commissions (ongoing fees paid to advisors in years after the employee joins the fund), a default post-retirement product, no contribution fees, and member annual statements required to show projected annual income at retirement.

26. A recent UMR survey (March 2010) of KiwiSaver members showed that 48% thought KiwiSaver was government guaranteed and a further third were unsure.

MySuper is designed for the roughly 80% of Australian employees who are in the existing default fund and who would prefer to delegate their investment strategy. The Australian Treasury estimates that MySuper would result in fee reductions of around 40% for the average member, which would raise their superannuation balance by around $40,000 after 37 years in the workforce.

Reporting investment performance and fees

In August 2010 the Ministry of Economic Development released a scoping paper seeking feedback from KiwiSaver fund providers on proposals for the disclosure of fees, asset allocations and investments, performance and related party transactions. Consultation on the draft regulations is expected by the end of 2010, with draft regulations released in early 2011 and implementation scheduled for 2012.

A standardised and correct approach to calculating returns is required to ensure individual investors can make valid comparisons. Reported returns should be based on the amounts credited to members' accounts, after local and overseas taxes and all fees and expenses have been deducted[27]. Consideration should also be given to reporting returns adjusted for inflation.

As well as this, identifying and producing clear information on KiwiSaver fees has proved difficult. The Sorted website has a fees calculator that attempts to make fees transparent, comparable and easy to understand, but it is not perfect. There are differing views on how the fees ought to be calculated.

There remains a risk that performance data will encourage unnecessary and ill-informed 'churn'; that is, savers changing providers on the basis of past performance combined with assertive sales and marketing policies. The provision of independent information and education on issues to consider before changing provider would be a helpful way of addressing this issue.

Information regarding fees and performance for all KiwiSaver schemes should be available in a format that ensures they can be readily compared. It would also be good to see such a comparison rate applied more broadly to disclosure of a standard rate of return on investments. One option might be to adapt the comparison rate established in Australia's Consumer Credit Code.

Post-retirement withdrawals

Lump sum withdrawals from KiwiSaver by contributors aged over 65 are due to start from July 2012, five years after the scheme commenced. There is no indication at this stage how many of these contributors will choose to withdraw at their earliest opportunity, nor what their accumulated balances will be at the time.

There is no policy concerning how such balances may be used. Some KiwiSaver fund providers may develop tailored products to assist people in managing decumulation decisions but it is too early at this stage to assess the likely behaviour of both savers and fund providers. This is a matter that will need to be examined more closely in the next Review since it could have an important bearing on future strategies for managing income flows in retirement.

Ongoing evaluation and assessment of KiwiSaver

Work is underway to evaluate the effectiveness of KiwiSaver (including its various features and incentives) in terms of its impact on individuals' savings, including looking at whether individuals are saving more as a result of KiwiSaver and whether KiwiSaver contributes to improved financial preparedness for retirement.

27. Because there are three different tax rates (PIRs) that can apply where a scheme is a Portfolio Investment Entity (PIE), three different "after tax and fees" returns may have to be published.

This work is being undertaken jointly by Inland Revenue, the Ministry of Economic Development, the Treasury, Retirement Commission, Housing New Zealand Corporation and the Ministry of Social Development and is due to be completed in June 2013. Conclusions will be available to inform the next review of retirement income policy due to be completed by December 2013. Should governments in future years wish to alter KiwiSaver, evaluation results will be important to inform decisions.

Adequacy and availability of financial products

New savings schemes

The financial sector has a role in providing investment options to assist New Zealanders both to save for their retirement and to manage their income and assets in retirement. Alongside KiwiSaver, there are savings products being developed to meet the needs of particular groups of New Zealanders. Whai Rawa, Ngāi Tahu's savings scheme, is one of these.

Whai Rawa was established in 2006 and includes matched contributions and distributions from Ngāi Tahu to members. Features of the scheme, including the ability to withdraw savings for tertiary study and a first home and to withdraw for retirement from age 55 have proved important in attracting members even though the scheme does not benefit from KiwiSaver's incentives (e.g. the kick-start payment and tax credits).

However, it is worth considering whether some of KiwiSaver's features, particularly the first home deposit subsidy given the critical role home ownership plays in the wellbeing of older New Zealanders, could be extended to non-KiwiSaver, long-term savings schemes. As iwi and other groups continue to develop similar bespoke savings schemes greater consideration will need to be given to how these schemes fit with KiwiSaver.

Products to assist with decumulation in retirement

While there are many ways that individuals can save for retirement, currently there is little available in the New Zealand market in the way of decumulation products[28], especially for small investors, who need simple and safe options. Currently banks and other financial institutions have shown little interest in providing bespoke services to individual investors with assets of less than $300,000, as the cost of service is high and the returns are low. Assisting individuals to manage their income and assets in retirement will become more important over time as KiwiSaver members retire with increasingly large balances.

The evidence suggests that substantial state involvement may be required for an annuities market to thrive. The government could work with the private sector to facilitate this. Compulsory annuitisation (or partial annuitisation) of KiwiSaver could be considered along with tax reform, subsidisation, inflation and longevity underwriting, regulation or even state provision.

There may be a role for government in providing long term bonds to assist in the annuities market, along the lines of the US Treasury Inflation-Protected Securities. Additionally, to combat the small size of the New Zealand market, joint ventures and harmonisation of rules with Australia may be beneficial, for example in the development of annuities, longevity and long term care insurance products.

For some, it is likely that investment for returns in the form of interest and dividends may be a better option than outright decumulation (in which capital is divided by years of expected longevity and drawn down to exhaust the capital by the expected date of death).

28. These are products that convert assets into income.

For people with small sums to invest (under $100,000), term deposits and government bonds are appropriate and comparatively safe. Term deposits may be 'laddered' over a range of maturities to spread the rate risk. There is also a range of multi- and single-sector managed funds and bonds.

Investment portfolios may be self-managed or managed by a professional. In particular, the sector could look at developing cost-effective products and services that meet consumers' needs when, at the point of retirement, they are faced with the prospect of investing lump sums released from their KiwiSaver schemes.

KiwiSaver providers may be in a position to provide different types of products, information and advice when lump sums mature. The component products and services exist to support this kind of self-management, but, as greater numbers of people retire with financial assets to manage, it may simply be a case of packaging up options for retired people with accompanying information, education and advice.

It is possible that a wider variety of providers and equity release products is likely to emerge when credit eases. Increased longevity, higher aspirations for retirement living and fiscal constraints on NZS are likely to make home equity release more attractive and change attitudes towards decumulation and inheritance.

As a relatively new product category in New Zealand, knowledge about home equity release remains low, suggesting that the public need education on its benefits, drawbacks and appropriate use. Drawing down equity in a property may feel more of a momentous decision than adjusting the size of composition of an investment portfolio or bank deposits. In the interests of providing clarity and fair treatment, it would be helpful to clarify the tax treatment of withdrawal of capital in the form of home equity release and how income derived from equity release affects eligibility for various forms of state support.

Should New Zealand have compulsory retirement saving?

As discussed earlier in chapter 3, a number of other jurisdictions have either introduced or considered introducing compulsory private provision for retirement alongside their public, tax-funded provision. Compulsory saving has also been previously considered on a number of occasions in New Zealand – in 1992 by the Task Force on Private Provision for Retirement (and in subsequent public reviews held in 1997, 2000, 2003 and 2007), and in the late 1990s a referendum was held on the issue.

In 2010, the government has appointed a Savings Working Group (due to report by January 2011) to examine ways to improve national savings. Included in the Group's terms of reference is a requirement to weigh the case for and against compulsory savings. The Group's assessment will need to be undertaken within a broader context than retirement income policy, however this Review has considered the issue of compulsory saving in relation to retirement income.

The current voluntary KiwiSaver scheme costs the government approximately $1 billion per year in subsidies to members' accounts. Turning KiwiSaver into a compulsory scheme could be seen as a way of reducing this cost burden – under a compulsory environment there would arguably be no need to maintain costly incentives to encourage participation or to administer an automatic enrolment and opt-out system.

On the other hand the cost issue may not be so clear cut. There would also be costs associated with the administration and compliance of a compulsory scheme, which could be at least as expensive as the current arrangements, and maintaining some form of incentive may be necessary to achieve support for a compulsory system.

It could also be argued for on the basis that such a scheme, where each person's future retirement entitlement depends on his or her own savings, could address the cost pressures on the current pay-as-you-go public system. However, in order to realise this benefit, some form of means testing would be required for NZS. Means testing is not supported by this Review as it would undermine the principle of universal entitlement and other desirable features of NZS (discussed further in chapter 6).

The other key argument discussed in relation to compulsion is whether or not compulsory saving would increase the extent to which individuals save for their retirement. Despite its generous incentives and automatic enrolment of new employees, KiwiSaver has currently achieved less than 40% coverage among the eligible population. While introducing compulsion would raise participation, would it increase the amount saved?

The Australian example

Proponents of compulsion typically point to the Australian example as a success story given the total size of the assets under management and the high rates of compulsory contribution (currently 9%, possibly rising to 12% subject to passing legislation).

The evidence on the effectiveness of compulsory schemes however is mixed (as too is the evidence on tax-favoured schemes such as KiwiSaver). While Australians hold more superannuation assets than New Zealanders, comparisons show that, as a proportion of net assets, households in both countries hold similar proportions of assets that can be realised as income for retirement, e.g. property (excluding the primary residence), superannuation, businesses, directly-owned investments and other financial assets.

This suggests that the different policy settings between the two countries have affected the composition of saving but not necessarily the overall amount[29]. The experience of Latin American countries also seems to show that, while compulsory schemes result in considerable capital accumulation in individual accounts, the effect on national saving is uncertain.[30]

Recognising individual circumstances

The reasons why people are not currently members of KiwiSaver in its voluntary form also need to be considered. The main reasons why individuals have not joined KiwiSaver are affordability (despite the recent lowering of the minimum contribution rate), having other, competing financial priorities including paying down mortgage and other debt, and having concerns about the financial security of the scheme and that current or future governments may make changes to it. These are issues that would remain in a compulsory environment.

Compulsory saving would require those on low incomes or non-standard workers (e.g. those in part-time work, low paid jobs or those who move in and out of the workforce for a range of reasons, including to care for children) to reduce their current consumption in order to save, potentially reducing their welfare. In some cases, pre and post-retirement standards of living could be smoothed with little private saving due to presence of NZS.

Additionally, running counter to the **voluntary saving** model (discussed in chapter 3) which seeks to encourage individuals to make provision for their retirement in a way that best suits their long-term interests, compulsion directs and limits the choices of individuals to save through a particular means – it does not allow for differences in circumstances, preferences or stages in life.

29. RPRC Pension Briefing 2010-5 *Household wealth in Australia and New Zealand*. And Infometrics, *Assessing the Australian retirement income system, with comparisons to New Zealand*, paper prepared for the 2007 Review of Retirement Income Policies.

30. Mesa-Lago (2002), Reassessing pension reform in Chile and other countries in Latin America. Sourced from www.pensionreforms.com

For example, saving for education or the purchase of a house are forms of preparation for retirement and compulsory savings would lock away income in a particular asset that may be better used to pay down mortgage or other debt. Equally individuals may choose to invest in their own businesses and use the sale of these assets to fund their retirement.

In summary

The five official reviews of retirement income policies (1992, 1997, 2000, 2003 and 2007) have rejected the introduction of compulsory saving and instead have favoured voluntary provision to supplement NZS, accompanied by education initiatives and appropriate financial regulation to support consumers' decision-making. Similarly, this Review does not support changes to make KiwiSaver compulsory or to introduce another form of compulsory retirement saving scheme. The reasons have been covered in the preceding discussion, in particular:

» Mixed evidence on the current state of New Zealanders' saving.

» Mixed evidence on whether compulsory schemes are effective in raising saving and ensuring income adequacy in retirement.

» Uncertainty over whether fiscal savings from the removal of incentive payments would in practice be realised.

» The equity issues associated with compulsion.

» Concern that compulsion would risk undermining the universality of NZS.

Data issues affecting the assessment of saving

Good information on household saving and wealth is a critical input to retirement income policy. There is much debate on whether or not New Zealand households are good or bad savers and the conclusions drawn will vary depending on the source of information being used. The information presented throughout this chapter on saving rates and adequacy of New Zealand households is based on currently available data but there is scope for improving what is available for future policy development and decision making.

There are two core ways to measure saving – the stock approach and the flow approach. Both these approaches can be used to assess savings at the individual (or household) level and at the aggregate, macroeconomic level. The flow approach broadly speaking calculates income minus consumption and the stock approach measures the change in net worth (assets minus liabilities) over time.

A major distinction between the two approaches is that the stock approach incorporates the change in asset prices (essentially passive saving) whereas the flow approach does not. While in principle these two approaches can be reconciled, in practice this has proved difficult. Table 5.3 sets out the sources of saving data used for each approach.

Table 5.3: Data sources and approaches to measuring saving

	Flow approach (income less expenditure)	Stock approach (change in net wealth)
Microeconomic data	Household Economic Survey[31]	Survey of Family, Income and Employment (SoFIE)
Macroeconomic data	System of National Accounts: Institutional Sector Accounts Household Income and Outlay Account (experimental)	RBNZ Household financial assets and liabilities and housing values

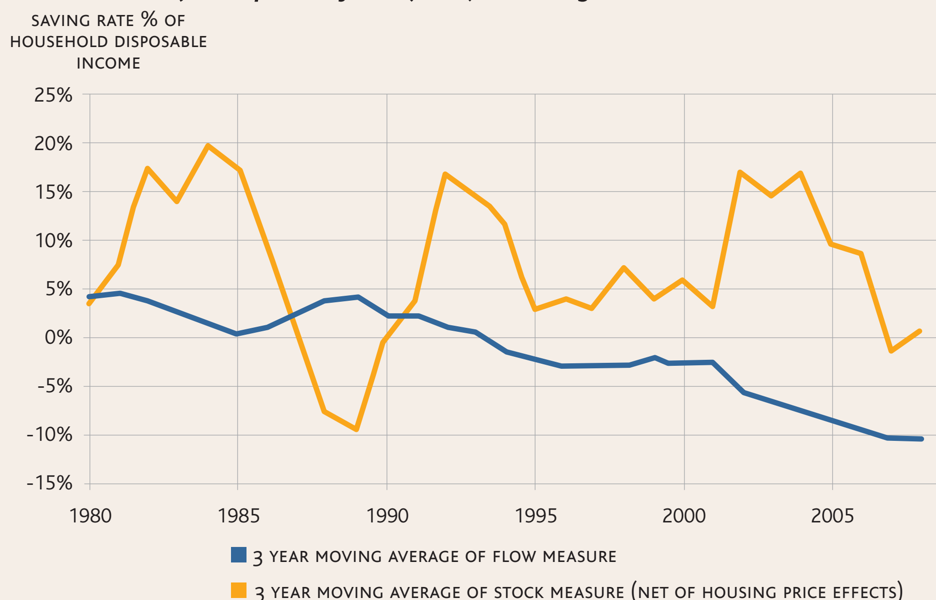
Source: Treasury Working Paper 09/04.

Chart 5.8 shows the different pictures provided by stock and flow measurement approaches. New Zealand's official measure of national saving uses a flow approach at the macroeconomic level (national disposable income less private and government consumption expenditure) but it is known to have some serious deficiencies that make New Zealand's household sector saving rate appear to be a negative outlier among OECD countries.

The official measure of New Zealand household saving shows that the household saving rate has been declining since 1978 and negative since the early 1990s, suggesting New Zealanders have been living well beyond their means. The persistent and growing negative rate of household saving since 1992 according to the national accounts is simply not credible.

The alternative (stock) measure presents a relatively more volatile picture but no long-term upward or downward trend – it has a positive average rate for the 1978 to 2008 period of 6% (after adjusting for house price effects) or 16% unadjusted.

Chart 5.8: Stock (house price adjusted) and flow saving measures 1980 – 2009



Source: Treasury Working Paper 09/04.

31. Note that while it has been used extensively to measure savings, HES was not designed for this purpose and Statistics New Zealand advise against using it for this purpose.

In thinking about retirement income policy, longitudinal information (i.e. information on the same individuals collected over a period of time) at the individual or household level (as opposed to the aggregate household sector level) is important. SoFIE is a longitudinal survey running over an eight-year period from 2002 to 2010. Every second year the survey collects detailed information on assets and liabilities which enables changes in individuals' net wealth over time and saving rates to be estimated. A data source such as SoFIE is valuable because:

» Aggregate data such as the national accounts provide no insight into the distribution of wealth and saving. Looking at data at the individual level is more meaningful in understanding different saving behaviours amongst various subgroups of the population.

» The use of a personal interview is likely to capture a more accurate record of a particular household's assets and liabilities.

» Recording changes in an individual's net worth along with their changing economic and social situation over an extended period of time makes it possible to build and statistically test more realistic models of saving behaviour at the individual or household level.

» Analysis of savings rates using SoFIE data generates similar estimates to those using aggregate Reserve Bank of New Zealand (RBNZ) stock data.

While SoFIE is an extremely valuable data source, the final wave of data is currently being collected (due to be completed by December 2010) and as yet no decision has been made about a replacement, longitudinal data source. Additionally, there are long lead times between data collection and availability for analysis.

The economic situation of the past couple of years highlights the consequences of out-dated information. Now coming out of the recession it is difficult to ascertain the impact the recession had on individuals' saving and wealth and how any impact was distributed across the population. Further, the Household Savings Survey (HSS) that was carried out by Statistics New Zealand in 2001 also collected data on assets and liabilities but this survey was a one-off and a rerun has been deferred.

Statistics New Zealand has recently reviewed their economic standard of living statistics, which include statistics on income, wealth, and saving. The purpose of the review was to identify the enduring information needs and to recommend actions required to address any significant shortcomings or gaps in current statistics. The review made a number of recommendations which are important for future understanding of the dynamics and trends in saving, wealth and retirement preparation (table 5.4).

Table 5.4: Statistics New Zealand Economic Standard of Living review – relevant conclusions and recommendations

Conclusion	Recommendation
There are currently differences in definitions of some income and wealth measures at micro and macro levels. These differences complicate policy making.	Statistics New Zealand to undertake a comparison of micro and macro measures of income and wealth with a view to better integrating these and a goal to work towards a full set of national accounts.
The Household Savings Survey is out of date and the current SoFIE panel is ending. Future options for producing net worth statistics at the household level require investigation.	Statistics New Zealand to confirm information need in relation to household net worth and investigate options for producing regular statistics.
Longitudinal data sources are valuable for policy making but current surveys with income, wealth and consumption data are ending. Options for future surveys and utilising existing data sources (e.g. administrative data) need to be considered.	Statistics New Zealand to work with users to prioritise needs for longitudinal data and investigate options for meeting these needs, including the potential role for future longitudinal surveys.

Source: Statistics New Zealand Review of Economic Living Standards.

It is important that these recommendations are acted on, in a timely way, and that retirement income policy makers and researchers are involved in influencing future data development for two reasons.

First, the current difficulty in reconciling available stock and flow saving data makes it challenging to draw firm conclusions about whether New Zealanders have a saving problem or in fact are saving adequately for their retirement. Greater reliability in this data is essential for future policy making.

Secondly, the outdated nature of current sources means it is not possible to assess recent trends and changes in saving behaviour. Since the previous review of retirement income policy was undertaken in 2007 much has changed that is likely to have had an impact on individuals' attitudes and approach to saving. But this Review and other policy processes are drawing on outdated data in developing a response. Policy makers will require more timely data in the future.

Conclusion and recommendations

This chapter has described the key aspects of working life today that influence people's ability and willingness to save for their future retirement, including demographic, employment, earnings and home ownership patterns. The confidence of consumers in financial products and institutions has been coloured by the experience of the recession and the GFC. This, together with new tax rules and the introduction of KiwiSaver can be expected to be changing attitudes towards saving.

KiwiSaver is still in its infancy. While early growth in membership has been strong, there are a number of matters that require ongoing monitoring and work. Additionally, it is still too early to conclude whether or not KiwiSaver is a cost-effective way to encourage saving and whether, alongside NZS, it will effectively prepare New Zealanders for retirement. The current evaluation of KiwiSaver is due to be completed in 2013 and will be an important input to the next review of retirement income policy.

In light of the recently announced Savings Working Group, this Review has considered the issue of compulsory private saving for retirement. With the effectiveness of the voluntary KiwiSaver scheme still largely unknown it is premature to consider a compulsory scheme. Further there are important equity issues created by compulsion and this approach has not been widely proven to be effective. But most importantly, the New Zealand retirement income system of a universal, individual entitlement to a public pension supplemented by voluntary saving has many desirable features and has proved to be effective. Moving towards compulsory private provision opens up the way to undermine the universality of NZS and is therefore not supported by this Review.

Despite the fact that much has happened that could be expected to impact savings attitudes and behaviours since the last review in 2007, it remains difficult to accurately measure the level of saving across households, let alone track recent changes, due to data discrepancies and complexities. The need for improved and ongoing data on saving and wealth, including KiwiSaver, is a critical one. Further work to develop data sources is required and it is essential that this work is done in time to inform the next review. Without good data, evidence-based policy making is hampered.

Recommendation 5.1

That KiwiSaver default funds should continue to be based on products with a conservative risk profile and that KiwiSaver default fund providers be encouraged to provide members with information to help them to make a more active choice of investment, even if this means that they choose to stay where they are.

Recommendation 5.2

That, for the sake of transparency and ease of understanding, and to allow comparisons by consumers, a standardised approach to the calculation of KiwiSaver fees and performance, as well as fees and performance on other investment products, be adopted.

Recommendation 5.3

That the evaluation of KiwiSaver be continued as planned until 2012/13, when the main findings will be available.

Recommendation 5.4

That the Retirement Commissioner's 2013 review of retirement income policies should include a thorough assessment of KiwiSaver, including the emerging pattern of withdrawals and reinvestments by people aged over 65.

Recommendation 5.5

That the recommendations relating to saving and wealth statistics from Statistics New Zealand's review of economic living standards be actioned in a timely way and in conjunction with key data users.

Recommendation 5.6

That Statistics New Zealand include KiwiSaver questions in the most appropriate household surveys of assets and liabilities in order that the impact and effectiveness of KiwiSaver can be assessed and informed decisions made about adjustments to the scheme beyond 2012/13.

Chapter 6: Keeping New Zealand Superannuation affordable

Previously this Review has outlined New Zealand's current retirement income policy settings and assessed these for both the current and future retired populations. This chapter considers the public provision dimension of current policy.

There is much to like about the current system. This Review supports retaining the current New Zealand Superannuation (NZS) with as many of its desirable features as possible, particularly universal entitlement. In order to ensure entitlements for future generations of retirees, changes are needed to improve long-term affordability.

Scoring the system

In a small, unscientific, experiment run during a recent workshop, some international and local pension system experts were asked how they would score the performance of New Zealand's retirement income support system.

They were asked to 'grade' a number of aspects of the system, first taking the perspective of people who are retired (or close to retirement), and second taking the perspective of younger generations looking to the future.

The responses showed a reasonable consensus of view among the experts:

- New Zealand's retirement income system tended to be scored well, from the perspective of currently retired people, in areas such as poverty prevention, encouraging work beyond age 65, supporting gender equity and administrative cost and effectiveness.
- Lower ratings were given for exposure to political risk (undefined) and uncertainty about the total amount of expected retirement income, but there was no aspect of the current system that was awarded a failing grade.
- When it came to assessing how well New Zealand's retirement income system performs from the perspective of future generations, the system still scored well on poverty prevention and administrative cost and effectiveness.
- Several other aspects of the system continued to receive quite good grades: encouraging work beyond age 65, supporting gender equity, exposure to market risk and the administrative cost and effectiveness of the KiwiSaver scheme.

However, some aspects of the system were awarded a failing grade. The areas of greatest concern for the future were judged to be:

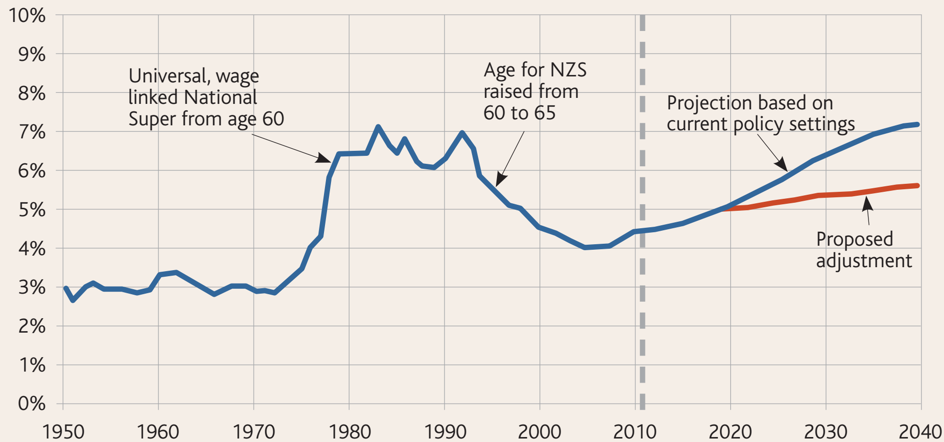
- Long-term affordability of the system.
- Clarity to New Zealanders of the amount of retirement income (both with respect to NZS and overall) they can expect to have.
- Exposure to political risk.

The concern expressed by the experts in this small, qualitative survey, was not about any inherent structural weaknesses in the system's components. Rather, the concern was about how well any future specific adjustments that might be needed to protect the long-term sustainability of the system would be signalled, debated, agreed, managed and communicated.

Facing the future

Despite maintaining a broad and basically simple public pension system, New Zealand has a history of volatility in its policy settings. Chart 6.1 illustrates the size and speed of the swings in the fiscal cost of public pensions that occurred in the 25-year period between 1976 (when National Superannuation was introduced) and 2001 (when the phased increase in NZS eligibility age from 60 to 65 was completed).

Chart 6.1: Public pension expenditure: 1950 to 2010 and projected to 2040 (before tax, as a % of GDP)



Source: The Treasury.

Looking ahead, the cost of NZS as a percentage of New Zealand's Gross Domestic Product (GDP) is about to start rising steadily under the effect of the wave of 'baby boomers' who, from 2011, will start to receive NZS in increasing numbers. Beyond 2020, the cost is projected to start increasing at a faster rate.

The projections suggest that, in 20 years' time, the economy will be devoting roughly the same share of resources to NZS as it was in the 1980s and early 1990s when governments were struggling to correct some major imbalances in the economy. This is clearly not a situation to be repeated.

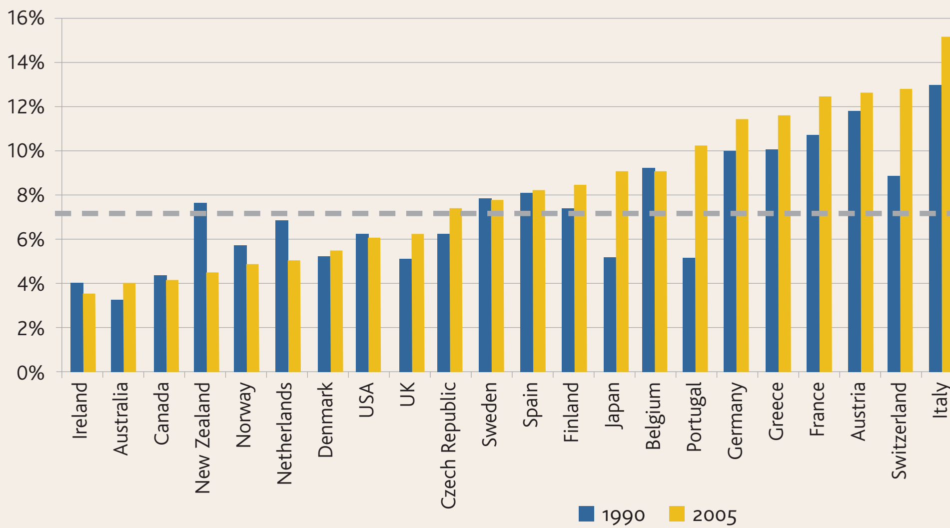
Even further out, there is the prospect that the cost of NZS will continue to rise, as a percentage of GDP, through to 2060 at least, although at a slowing rate as smaller sized cohorts reach retirement age and start to replace the baby boomers.

Also shown on chart 6.1 is the projected path of NZS expenditure as a percentage of GDP if the policy adjustments that are explained later in this chapter were to be introduced.

New Zealand's strengths and advantages

While future prospects are challenging, it is important to recognise that today New Zealand is better placed than many other countries in the OECD (chart 6.2). Superannuation adjustment measures taken since 1990 have resulted in New Zealand now having one of the lowest cost pension systems. A number of other countries have seen their pension costs escalate since 1990 and are now facing the sort of pension cost burdens and economic adjustment pressures that we want to avoid in 20 years' time.

Chart 6.2: Government expenditure on old age benefits, including compulsory private pension schemes (as a % of GDP)



Source: OECD Pensions at a Glance 2009.

This Review has documented the effects the global financial crisis (GFC) and the associated recession have had on the New Zealand economy. It has also reported on the responses of individuals, households, financial institutions and the government to the difficult times. Adjustments and new priorities are being brought to personal budgets, the property market, the regulatory environment, credit markets, and the central government's budget in particular.

This general adjustment and reorientation is likely to produce a reassessment of what is important for securing our living standards, our national values and prospects for the future of our children. Hopefully, an important feature of this reassessment process for younger people will be a greater awareness of the value of making responsible saving and consumption choices.

As personal saving, assisted by KiwiSaver, assumes a greater profile, some of the reliance that has been placed on NZS to be the major source of retirement income for most people may start to ease. People who phase out of the paid workforce over the coming 20 years will increasingly bring other forms of wealth into retirement, and the average level of income in retirement over and above NZS can be expected to rise.

Longer term economic pressures and policy choices

Over the past two years the focus of government fiscal and economic management has been on getting New Zealand through the recession and the GFC in reasonable shape but without losing financial control. The worsening of the operating balance between 2007 and 2010 has meant that borrowing has been required, not just to finance future capital investment but to cover operating deficits that are forecast to continue until 2015/16. In addition the Government has suspended the normal annual contributions to the New Zealand Superannuation Fund.

Commenting on the future prospects in this year's Budget, the Minister of Finance noted:

> *"Each year of deficit means an increase in public debt and higher debt servicing costs and increases in the vulnerability of the Crown and the economy to further shocks…*
>
> *Balancing the books and lowering debt provides choices around future fiscal policy and better prepares the country for future shocks, the ongoing pressures on spending and revenue and with the impacts of demographic change"*[32].

The timeframe and the means by which the government books are brought into better balance are of course matters of policy and political judgement. The fiscal and economic strategy set out in the Budget 2010 documents envisages using expenditure control as a key tool to improve the fiscal position and return to an operating surplus by 2015/16. This adjustment is proposed to be achieved without the need to make any changes to NZS policy settings.

The suggestions made in this chapter are fully consistent with this position. The proposed future changes to NZS are not focused on helping to correct fiscal imbalances over the next several years. Instead, they anticipate the longer term structural, particularly demographic, pressures that will arise in the following decade. It is for this reason that changes are not recommended for implementation until 2020. Ten years' advance notice also has the important benefit of giving everyone sufficient time to plan and adapt.

As described in the previous section, New Zealand has taken a responsible position to correcting past imbalances and in comparison with some other countries we are in a relatively enviable position today. Unlike some other countries, New Zealand does not need to take severe or precipitate action on pensions. But this is not a permanent state of affairs and the advantage of having room to carefully prepare to address the longer term pressures should not be frittered away.

Even if policy is not altered overnight, the need for some future adjustment should be publicly acknowledged and the adjustments prepared for gradual introduction to help offset the rising future pension cost burden. Without such adjustment, the pressure on other parts of the government budget such as education and health spending or debt servicing will simply become even greater.

Making NZS affordable for the future

The long-term sustainability of NZS needs to be assured by taking a responsible view of the way the major cost pressures that will come onto the public pension system in the 2020s should be handled. This can help protect, not just the affordability of NZS itself, but a host of other government programmes and services that might indirectly come under stress if future pension cost growth starts to absorb more and more of the budget.

There are a number of broad approaches that could be considered and have been canvassed for dealing with the challenges for retirement income policy of the 2020s and beyond. These approaches, in order of increasing degree of shift away from the status quo, are:

1. Fully preserve NZS entitlements out into the future and offset the growing cost through general tax increases or a higher level of public debt as needed, or expenditure savings in other social or pension programmes, including KiwiSaver subsidies.
2. Modify some of the entitlement rules for NZS, while accepting some continuing rise in its cost due to demographic pressures, and rely to a lesser degree on fiscal adjustment from elsewhere in the budget.

32. NZ Government *Fiscal Strategy Report*, May 2010, p35.

3. Reintroduce a gradual or partial income test on NZS, along the lines of the Australian Age Pension, the NZ Superannuitant Surcharge, or the dual age benefit universal superannuation structure advocated by the 1975 Royal Commission on Social Security.

4. Fundamentally change the New Zealand pension system and its components to shift more of the cost of pension provision away from general taxation. For example, universal NZS could be replaced by a tightly targeted safety-net benefit focused on poverty alleviation and KiwiSaver replaced by a more extensive second-tier compulsory saving scheme with greater employer contributions and reduced government subsidies.

It is important to note that pre-funding some of the future cost of NZS as done via the New Zealand Superannuation Fund (NZSF) helps to alter the pattern and timing of the financing of future NZS entitlements, but by itself does not affect the underlying cost of the entitlements. The changes discussed here are concerned with the drivers of the underlying costs.

This Review has considered each of these general approaches in terms of how effectively they might balance all the competing policy objectives and concerns that were presented in chapter 3 and illustrated in chart 3.2. It has also considered the ability of each approach to achieve a broad public consensus on the overall effectiveness and fairness of the resulting system for all the stakeholders.

The conclusion of this Review is that Approach 2 is clearly the preferred approach to adopt. The reasons are:

» **Approach 1** places an unrealistically high burden on other stakeholders to do all the adaptation to the demographic, environmental, economic and social issues that will face New Zealand in coming decades. Children, young workers, high income earners and those with a short life expectancy or special support needs could all stand to be adversely affected by the pressure to raise taxes or trim other government programmes. The cost of NZS alone, currently 10% of all government spending and set to rise, is too significant an item to be completely ring-fenced away from any future consideration of priorities.

» **Approach 2** requires some give and take among different age groups and a willingness to accept the fairness of real future entitlements increasing less rapidly than some might have expected. However, the strength of this approach is that it preserves the important feature of NZS as a universal individual entitlement. Without this at the centre of New Zealand's pension system, the prospect of reaching consensus on any change is much worse.

» **Approach 3** has been recommended and tried several times in the past and was a component of the 1993 multi-party accord on retirement income policies. Income-testing NZS targets any cost reductions in a way that affects those who are more able to bear a reduction in entitlement, while protecting and preserving the position of those who enter retirement with little or no income or savings. However, experience with the 'super surcharge' 20 years ago highlighted how easily it can distort saving and earning behaviour and create confusion and discord.

» **Approach 4** also risks breaking the current broad consensus in favour of universal NZS. It involves a lengthy and significant transition from the current, administratively simple system. This, plus the possible efficiency costs of mandating savings for retirement, requiring additional employer contributions and managing a targeted benefit system for older people, suggests that the pension system would have to be critically flawed and quite unaffordable to justify such a comprehensive and disruptive reform.

Options for slowing the future rapid expansion of NZS costs

Concluding that there should be some modifications to the current system to preserve its affordability, based on Approach 2, is the first step. There remains the task of suggesting how this should best be done.

A number of specific options were evaluated and, where feasible, their effects on the projected path of NZS costs were modelled. One criterion for proceeding has been that an option should have the potential to lower the future annual cost growth in NZS enough to help avoid serious economic, fiscal and debt problems emerging over the 2020s and 2030s. No specific target has been set for where the ratio of NZS cost to GDP should track for this to occur, because projections are often revised in the light of new economic data and improvements in methodology and are sensitive to projection assumptions. Furthermore, it will be the combined effect of many policy and external elements in addition to NZS that will in the end decide what happens in 20 years' time.

Essentially the point of this criterion is that, if an option is expected to have little or no overall impact on the cost of NZS, there is no point in proposing it unless, like the policy reforms recommended in chapter 4, it is aimed at other policy objectives.

A final and more important test for recommending an option is that it should have a clear rationale and justification in terms of consistency with the underlying values of New Zealand's public pension policy and that achieving broad public agreement that the amended system is still fair and reasonable. Unless this test can be met, policy changes are unlikely to occur or, if they do, they are more likely to be overturned some time in the future.

Table 6.1 describes the main options that were considered and comments on them.

Table 6.1: Options for modifying NZS

Aspect	Option	Evaluation
Qualification rules	Tighten the NZ residency test to require a longer period than 10 years of adult residency before someone can receive NZS.	Cost reduction would be small, affecting one group.
	Change to a proportional system where people would receive a partial NZS entitlement based on the proportion of their adult life spent in NZ.	Cost reduction would be small. Paying non-standard amounts of NZS to different New Zealanders based on their life history could infringe the universal principle.
	Increase the age of eligibility for NZS above its current level of 65 years.	Significant cost reduction possible. Could be justified because of increasing average life expectancy. Would require plenty of advance notice so people could review their saving and retirement plans.
Level of NZS	Introduce different rates of NZS depending on age.	Significant cost reduction possible. Difficult to justify the case for age-based discrimination when living standards vary for many other reasons.
	Retain the current NZS rate for people currently above a certain age, but set new, lower rate of NZS for younger people who will qualify in the future.	Significant cost reduction possible. A two-tier payment system would remain in place for many years. Different payments to different generations could test social cohesion.

Aspect	Option	Evaluation
	Allow people to choose to defer NZS take-up in return for receiving a higher rate of payment later.	Cost reduction possible initially through deferrals, but could be offset in the longer run. Would complicate the payment system, alter the basic justification for NZS and could test social cohesion.
Annual adjustment of NZS rates	Change the annual NZS rate adjustment formula to pure Consumers Price Index (CPI) indexation, as with benefits.	Significant cost reduction possible. Targeted supplementary assistance programmes would need to be expanded. Future living standards of older people relative to working age families would need to be re-evaluated periodically. Difficult to achieve consensus.
	Retain the present adjustment formula for those currently receiving NZS and introduce pure CPI indexation for those qualifying in the future.	Significant cost reduction possible over the longer term. A two-tier payment structure would remain in place for many years. Different payments to different generations could test social cohesion.
	Change the annual NZS rate adjustment formula to the average of CPI and earnings.	Significant cost reduction possible, but less than under pure CPI indexation. Fairness may be justified because older people would continue to share some growth dividend and in future are more likely to have additional sources of income from earnings, KiwiSaver and other investments.
Work test	Restrict NZS to people who are not in employment, or alternatively abate the amount of NZS against earnings.	Some cost reduction possible in the short term. In the longer term this would discourage people from staying in paid employment beyond 65. Would represent a significant change to the structure and rationale of NZS.
Combination of changes	Increase the age of eligibility for universal NZS but provide NZS on an income-tested basis up until the new age.	Some cost reduction possible. Income testing, even for a time-limited period, risks distorting earnings and investment decisions. An income test for NZS that included a partner's income would infringe the principle of individual entitlement.
	Increase the age of eligibility for NZS and also change the annual NZS rate adjustment formula to the average of CPI and earnings.	Significant cost reduction possible. Retains the key features of NZS as a universal individual entitlement. Changes need be less rapid or severe than changing a single component. Package is less likely to be seen as aimed exclusively at one generation.

Proposed modifications to NZS

This Review recommends a combination package along the lines of that shown in the last row of table 6.1. Specifically the proposal comprises three parts:

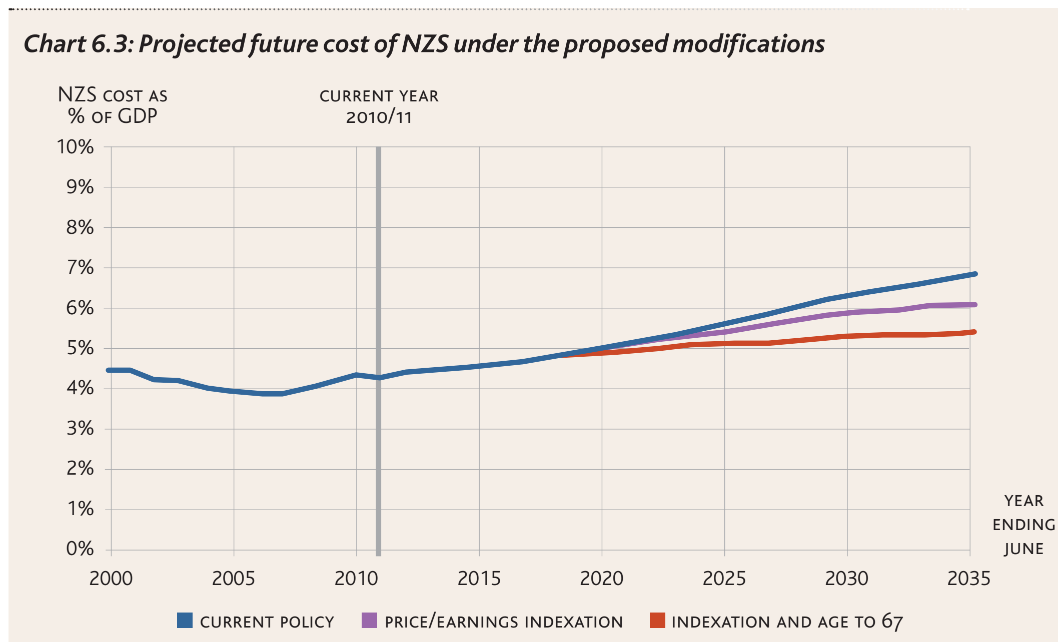
1. With effect from 2020, NZS rates would be adjusted each year by the average of the percentage change in consumer prices and earnings, subject to no less than price inflation in any year.
2. Announce a future rise in the age of eligibility to NZS. The age would be gradually increased from 65 years starting in 2020 and would rise by two months per year until it reached 67 years in 2033.
3. As the age of eligibility to NZS is increased above 65 years, a transitional, means-tested benefit would be introduced to address the particular situation of people who are aged 65 and at risk of hardship because of their inability to continue to financially support themselves over an extended period.

What is proposed for NZS in this Review might be seen by some as modest. For others, any modification of NZS entitlements is a step too far. This latter attitude simply cannot stand scrutiny. NZS is a very good mechanism for recognising the social and economic contributions of citizens, for old age poverty protection, longevity risk management and the promotion of wellbeing. But, unless some modifications are made by the next decade, its rising cost is going to threaten the ongoing achievement of these goals.

Recommending three policy adjustments in combination, rather than relying on one alone, is a deliberate decision. It allows the inevitable adjustment burden to be shared more broadly and with less difficulty. It also takes advantage of the different characteristics of each change to promote adjustments that in combination are fair and will help improve New Zealand's growth prospects and ensure the future sustainability of our system of retirement income provision.

If this proposal is adopted then the projected track of NZS costs as a percentage of GDP would be significantly eased, as illustrated in chart 6.3, without generating undue hardship.

Chart 6.3: Projected future cost of NZS under the proposed modifications



Source: Treasury projections, using Retirement Commission selected options.

The following sections describe each component of the proposal and explain the case for the change.

Annual adjustment of NZS rates

The present adjustment formula

The present formula for adjusting the rates of NZS is set out in legislation. Essentially it provides that the after-tax rates of NZS should be adjusted each year for changes in the cost of living, as measured by the Consumers Price Index (CPI).

However the adjustment formula contains another distinctive feature. If NZS rates (adjusted by the CPI) drift too far out of line as a percentage of the average (ordinary time, after-tax) weekly earnings of a full-time employee, then they are required to be further adjusted up or down so that they remain within a specified percentage band of those earnings.

The original idea behind this additional provision was to address situations of both high and low growth performance in the economy and what it might mean for living standards among different sections of the community[33].

Over the past 10 years with rare exceptions, NZS rates have been adjusted for the effect of CPI inflation alone, because the earnings-linkage test did not trigger any additional payment. In coming years, however, the formula is expected to require increases of more than the CPI on a regular basis, assuming that a return to economic growth following the recent recession can be translated into a more steady long-term growth in real average earnings.

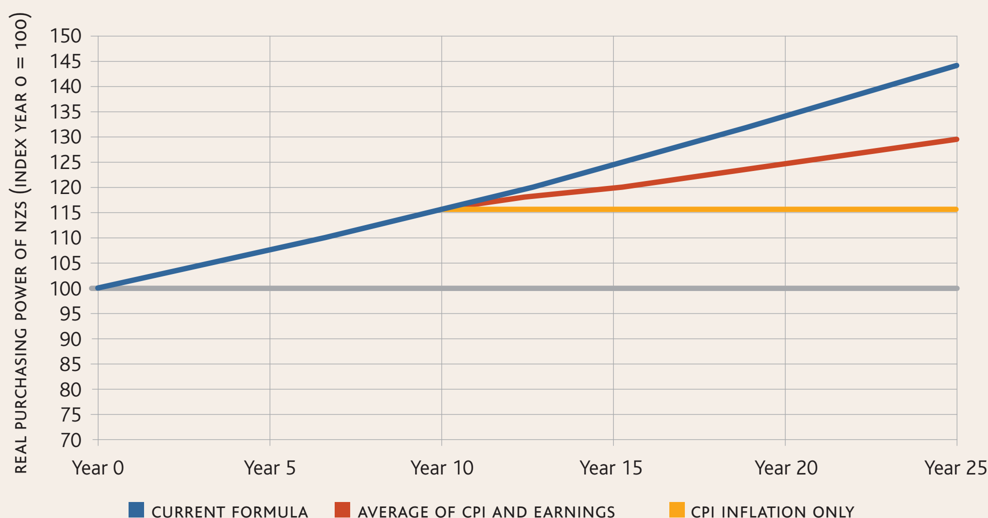
A revised annual adjustment system for NZS rates

The proposed change does not involve any decrease in the purchasing power of NZS compared with today's level. It does not require a return to simple CPI indexation alone, with no prospect of sharing in the benefits of future growth. Rather, from 2020 it simply involves a slower rise in the real purchasing power of NZS as real earnings grow, compared with the increase that is implied by the current formula.

Chart 6.4 is a simplified illustration of how the purchasing power of NZS payments would evolve over time under the proposed new adjustment system. This future track is compared with the alternative options beyond 2020 of continuing the current formula or with changing to pure CPI indexation, as is the current policy for adjusting income-tested benefits.

33. It is interesting to note that the design of today's NZS adjustment formula can be traced back to a policy initiative announced in 1989, where it was to be the method of adjusting the payment rates of a proposed new 'universal benefit' to which superannuation would eventually be brought into line. "The rate of payment for a couple will be set at the same level as the present Sickness and Invalids Benefits. It will be adjusted so that it remains within the range of 65 percent to 72.5 percent of the net average ordinary time weekly wage." *Summary of Social Policy Announcements* July 27 1989, David Caygill, Minister of Finance. The argument for the original design was therefore based around consideration of the living standards of beneficiary families, rather than superannuitant families.
In the event, a change of government in 1990 meant that the universal benefit did not proceed. Instead, a lower, revised structure of inflation-adjusted, categorical benefits was introduced. However, as part of the 1993 multi-party Accord on Retirement Income Policies the originally proposed earnings-linkage test formula for adjusting payment rates started to be applied to NZS (alone) from 1994.

Chart 6.4: Illustration of the future purchasing power of NZS payments under different adjustment formulas. Index based on today's NZS (=100)



Note:

1. The projections assume a steady rate of CPI inflation of 2% per annum and a steady growth in average earnings of 3.5% per annum. These are the 'trend' assumptions used in the Treasury's latest long term fiscal projection modelling.
2. For ease of illustration the current indexation formula triggers an earnings-linked adjustment of NZS rates in year 1. The current formula is assumed to continue to be used up until year 10 before changing to the new system.
3. There are three separate payment rates of NZS depending on individual circumstances. In this chart they are all set to a common starting index of 100 and, because they are fixed relative to each other, they all follow the same trajectory.

Source: Retirement Commission calculations using Treasury's growth projection assumptions.

Chart 6.4 illustrates the projected increase in the purchasing power of an NZS pension over the next 25 years that could result from the current adjustment formula, under these assumptions about the growth in average earnings and consumer prices. By year 10, NZS could be worth an extra 15% in purchasing power (i.e. after adjusting for higher consumer prices). By year 25 if the current adjustment formula continues to apply, NZS is projected to have 44% more purchasing power than today.

If, on the other hand, there were to be a return to simple CPI indexation from year 10, the purchasing power of NZS would remain steady from there on at a level 15% higher than it is today.

The proposed adjustment formula represents a mid-point between the other two approaches. Assuming that real earnings continued to grow at the projected rate, the purchasing power of NZS rates would continue to rise, but at a slower rate. This would alleviate some of the fiscal pressure while still offering older people a share of the overall rise in average living standards. By year 25, the projected purchasing power of NZS would be 29% higher than it is today.

Protection against poverty in old age

Both the present and the proposed adjustment formulas provide for the protection of the purchasing power of NZS as a standard minimum requirement. Older people are therefore protected against poverty in a fixed-income sense and will continue to be protected. Indeed, the evidence presented in chapter 4 suggests that older people, as a group, have higher material living standards than many other New Zealanders, particularly those receiving social welfare benefit incomes.

However, while the overall rate of poverty is low (9%) among people aged 65 plus there is a wide variation within this. In particular the 10% of older people who live in rental accommodation have a much higher probability of being in poverty (47%).

This implies that increasing the purchasing power of universal NZS is a very expensive and inefficient policy instrument for relieving absolute poverty. It means, for example, that if $100 million of tax revenue is spent on topping up NZS payments above the level required to protect its purchasing power, only $9 million of this amount would go to older people in relative poverty, while the remaining $91 million is received by other superannuitants.

There must be a range of better targeted programmes of financial assistance for those experiencing serious hardship that could be implemented for a fraction of the amount that would be incurred under the current NZS adjustment formula.

The main concern of the present NZS adjustment formula is more to do with maintaining relative living standards than avoiding severe hardship. The rationale behind the formula places a heavy emphasis on the risk that superannuitants' living standards could fall below those of the rest of the community, requiring them to receive an income boost. But is this the situation facing older people today?

The picture of material living standards of different age groups that was shown in chart 4.4 suggests strongly that most of those aged over 65 years appear to be doing better than many others. Table 4.3 suggests that people over 65 tend to score better on a number of wellbeing measures than the adult population as a whole.

Part of the reason for this relatively positive picture is that many older people have accumulated financial, housing and personal assets over their lifetimes and most also have at least some other income in addition to NZS. Their material standard of living and their ability to participate in the community is not limited solely by the amount of NZS they receive.

The NZS adjustment formula takes no account of these broader aspects of what influences wellbeing for people receiving NZS. Nor does it reveal how the pay packet of the 'average full-time earner' is converted into a living standard for his or her family.

Sharing in the proceeds of future economic growth

One of the values underlying the **citizenship dividend** model of retirement income policy is to promote social inclusion and cohesion by recognising, in a general way, the productive efforts and contributions made by citizens from all walks of life. From this perspective, it is important that older people, along with other citizens, should be able to share some of the benefits of any future improvements in living standards that may occur, for example through access to rising standards of health care.

It is also important, however, that not all the proceeds from a growing economy are diverted. Rising real earnings and investment returns should go hand in hand with strong economic performance and improving productivity. This is where the NZS adjustment formula could create a problem for the future. By perpetuating a fixed link between the growth in real earnings and the rates of NZS, the formula effectively rules out the possibility of 'growing our way out' of the fiscal pressure posed by the ageing population. A share of any extra tax revenue that would come from an increase in real earnings is earmarked to meet the same percentage increase in NZS payment rates.

Changing the way that NZS rates are adjusted in the longer term would make it easier to divert more of the dividend from a growing economy into achieving fiscal balance and stability. All New Zealanders stand to gain from this sort of sound economic management.

Intergenerational fairness

If the only policy change proposed was to increase the age of NZS eligibility, this would place all the future adjustment cost on those who are currently still in the workforce, leaving all those 65 and over completely unaffected. It is not unreasonable to suggest that those aged 65 and over, who can expect to continue receiving NZS at an enhanced rate for up to 20 more years, should accept a slightly lower rate of enhancement in future purchasing power of their public pension.

This proposal for shared restraint is fully consistent with the citizenship dividend model's objective of facilitating social cohesion and national identity. Changing the NZS adjustment formula seeks to avoid a situation where taxpayers start to resent additional real income transfers to older people, many of whom already have income and assets greater than those paying the taxes.

Details of the proposed formula would need to be worked through

The focus of this discussion of proposed change has been on the problems for fairness and structural adjustment that are expected to eventually arise under the present formula. The future implications of different possible adjustment formulas have been illustrated in a simplified way in chart 6.4. It is not appropriate in this Review to attempt to specify all the details of the adjustment formula, since there are a number of issues that require further analysis and development.

» The actual economic outturn from year to year will deviate from the simple, steady track projected here. There could, for example, be some years of negative real earnings growth and other years of very high growth. This means that the protection of purchasing power in years of low earnings growth could result in cost reductions being smaller than those projected in chart 6.1.

» There may also be a more suitable and convenient measure of earnings growth than the statistic that is used in the current formula[34].

» The way that income tax changes work their way through the present adjustment formula can lead to some unintended results. For example the after-tax positions of a superannuitant and a worker on the same gross income are likely to change relative to each other as a result of most tax reforms.

» Whether the all-groups CPI reflects the average expenditure patterns of older people to sufficient degree is another issue that might need to be explored.

These and other aspects of the proposal would need to be evaluated more fully as part of any policy decision-making and legislative process, along with considerations on the exact timing of the change.

NZS eligibility age

The age at which a New Zealander could receive a universal (non-means tested) pension was first set at 65 years in 1940, seventy years ago. It remained at that level until being cut to 60 years with the introduction of National Superannuation in 1977. The eligibility age was raised back up to 65 in a rapid series of steps in the 1990s and has been set at 65 years since 2001.

The majority of OECD countries presently set their standard pension age at 65, although several have announced increases to be introduced (table 3.2).

34. The case for using an average, rather than a median earnings statistic should be tested. Statistics New Zealand has noted: "Data from the NZ Income Survey for the June 2009 quarter showed that 63.0 percent of wage and salary earners had hourly earnings lower than the overall average for wage and salary earners. This confirms that the distribution of earnings is asymmetrical, with a bulge at the low end and a tail at the high end." Quarterly Employment Survey Technical Notes.

The proposed change to NZS eligibility

The proposed schedule for increasing the age of eligibility for NZS is set out in table 6.2. Unlike the increase in the 1990s, which formed part of a major fiscal consolidation and economic adjustment package, this change would be notified many years in advance. It would also involve a smaller and much more gradual increase – two years in age spread over 13 years, rather than five years of age spread over 12 years.

Table 6.2: Proposed schedule for introducing a higher age of eligibility for NZS

Year born	Age in 2010	Become eligible for NZS at age
Before 1955		65 years
1955	55	65 years 2 months
1956	54	65 years 4 months
1957	53	65 years 6 months
1958	52	65 years 8 months
1959	51	65 years 10 months
1960	50	66 years
1961	49	66 years 2 months
1962	48	66 years 4 months
1963	47	66 years 6 months
1964	46	66 years 8 months
1965	45	66 years 10 months
1966 or later		67 years

The case for making a change is based on considerations of need, cost and fairness.

» A greater proportion of older people will be willing and able to keep their attachment to paid and voluntary work for longer and will have their own additional resources.

» Cost increases will be driven by demographic developments over the coming decades.

» Finally, issues for disadvantaged people need to be recognised and allowed for.

Labour force participation of older workers is increasing

Alongside the fact that average life expectancy is increasing, people are continuing to work for longer. Chapter 4 discussed the increasing levels of labour force participation for those over 65, particularly the 65 to 69 age group.

Over the four-year period 2006 to 2010, the percentage of those aged 65 to 69 in the labour force has increased from approximately 28% to 35%. Further, the view towards retirement is changing over time. Rather than being seen as a one-off event when individuals leave the labour force completely, individuals are increasingly taking more of a transitional approach to retirement, reducing the number of hours work or the type of work done, before finally exiting the paid workforce. The fact that NZS entitlements are independent of work status also promotes participation by those 65 plus in paid work.

Despite this trend towards longer workforce participation, experience from the 1990s suggests that the prospect of receiving NZS at a given age does act as a marker and an inducement for people to retire. The increase in age of eligibility in the 1990s from 60 to 65 was accompanied by an increase

in participation in work of those aged 60 to 64. If the eligibility age were to be raised further (to 67 as under this proposal), particularly with plenty of advanced notice, then more people could be expected to delay their retirement and remain in paid work for longer, as they are increasingly already doing.

Provided the economy is capable of creating new jobs to fully absorb the regular inflow of young entrants into the labour market, the resulting rise in labour force participation among older age groups would be helpful in improving the overall growth prospects for the economy.

The demographic drivers of NZS costs

The projected future rise in the cost of NZS is driven primarily by two key factors: a large cohort of 'baby boomers' about to qualify for NZS and the continuing upward trend in life expectancy. In other words, over the next 20 to 30 years taxpayers will have to fund a greater number of new pensioners and they will also have to continue funding them for a longer period of time.

This year (2010), about 38,000 New Zealanders will turn 65. Official population projections indicate that in 2011 the number turning 65 will be close to 40,000. Ten years later in 2021, more than 52,000 people will turn 65, an increase of about 37% from 2010. Another ten years later in 2031, more than 57,000 people will turn 65, a 10% further increase in the flow of people expected to start to receive NZS.

The saving in government expenditure throughout the 2020s, by delaying the start of NZS payments to the baby boom generation by one or two years, is therefore an important consideration.

Also, it is essential that the financial risk for individuals of living longer than average should continue to be covered by NZS, but in order that New Zealand can continue to afford this protection as average life expectancy lengthens, the age at which NZS starts to be paid needs to be gradually raised.

Average life expectancy has been steadily rising for many years. Age cohorts born later are expected to live a greater number of years beyond a given age than cohorts born earlier (table 6.3).

Table 6.3: Expected years of remaining life

Expected years of life remaining at age	Women born in			Men born in		
	1915	**1925**	**1935**	**1915**	**1925**	**1935**
60 years	22.5	23.9	25.0	17.7	19.8	22.7
65 years	18.7	20.1	21.0	14.6	16.4	19.2
70 years	15.3	16.4	17.3	11.9	13.4	15.7

Source: Statistics New Zealand: Cohort life tables, September 2010.

The table shows that women born in 1935 are expected, on average, to live a further 21 years upon reaching age 65 whereas those born 20 years earlier in 1915 were only expected, on average, to live for a further 18.7 years at the point that they reached 65. The same increasing trend can be seen for men but in this case the increase is more rapid. Those born in 1935, upon reaching age 65, could be expected, on average, to live almost five years longer than men born in 1915.

Table 6.3 can also be used to illustrate how policy changes in the age of eligibility for superannuation have affected the average expected number of years of payment each age cohort would receive, which in turn has influenced the fiscal cost of the programme. For example:

» **Women born in 1915** would normally have been expecting to receive 18.7 years of Universal Superannuation when they turned 65 (in 1980), but the announcement in 1975 of National Superannuation paid from age 60, meant that they received a 'windfall' of a pension covering an average 22.5 years of remaining life (17.7 years in the case of men).

» **Women born in 1925** who survived to age 60 (in 1985) would have received National Superannuation covering them for an average 23.9 years of remaining life (men born in this same year would have expected to receive superannuation for 19.8 years).

» **Women born in 1935** faced a delay in receiving NZS, because the age of eligibility was being progressive increased to 65 in the 1990s. This particular cohort qualified for NZS at age 65 (in 1999), which gave them a pension for an average 21.8 years of remaining life (19.9 years in the case of men).

It is too early to calculate reliable life expectancies for cohorts born later, but the trends suggest that the cohort of women born in 1945, who qualify for NZS this year, are likely to receive it for at least 22 years, and that men, whose life expectancy has been rising faster than women's, might also receive NZS for 22 years on average.

Twenty years from now, given the rising trend in life expectancy, we might expect the baby boom generation to receive NZS for 24 or more years. Although this can be only a rough forecast, it does suggest that under the proposed increase in NZS eligibility age there might well be no reduction in the number of years of pension coverage for baby boomers compared with today's retirees.

Fairness considerations

It is important to remember that discussion of expected average years of remaining life masks important, persistent differences across different population subgroups. For example, based on the New Zealand Life Tables for 2005-07 the expected number of years of life remaining at age 65 is 16.1 for Māori women, compared with 20.9 years for non-Māori women. For men the comparable figures are 13.8 years for Māori and 18.2 years for non-Māori.

This source uses a different estimation methodology from the cohort life tables quoted in table 6.3 and are an unreliable indicator of the future mortality of today's younger people. However, the significant gap between Māori and non-Māori age-specific mortality rates is proving difficult to close and it is likely that Māori who survive to age 65 over the next 20 years can expect to receive NZS for fewer years, on average, than their non-Māori counterparts.

A challenge for retirement income policy is how to maintain a fair pension system when it uses an eligibility criterion (age) which itself is distributed unequally. From both the **income support** and the **citizenship dividend** perspectives, it is inequitable that persistent differences in life expectancy can, for some disadvantaged groups, limit access to NZS. This is especially a concern when the present gap between NZS entitlements and the level of income support available for people not eligible for NZS is set to widen because of their different adjustment mechanisms.

While there is a strong case on fiscal sustainability grounds to lift the age of eligibility for NZS in line with growing average life expectancy, doing so without considering the impact on particular groups is unreasonable. This is one of the reasons why the eligibility age rise proposal is relatively modest, includes a transitional means-tested benefit proposal and is accompanied by a proposal to restrain the future growth in the real value of NZS entitlements.

Protection of those who need to retire earlier

There is a danger that policy designed for the majority will impact unfairly on a minority. While many people will be able to extend their working lives, there will always be a proportion of people for whom continuing paid work beyond 65 is not realistic (e.g. as a result of health reasons or because they work in manual jobs that are increasingly difficult with age). For this reason it is recommended that, as the age of eligibility is increased beyond 65, some form of transitional, means-tested benefit should be considered to address the situation of people who are aged 65 and are at risk of hardship because of their inability to continue to financially support themselves over an extended period.

The rate of the benefit could be set somewhere between the current levels of the Invalids Benefit and NZS but should not be subject to the same degree of work test as the current unemployment benefit. This would need to be carefully designed and administered to ensure that they did not create unintended incentives for deliberate early retirement.

Conclusion and recommendations

New Zealand's public pension, NZS, scores very well against most commonly used criteria. It is simple and cost effective to administer, it does not discourage ongoing labour force participation by older workers, and most significantly it is effective in maintaining living standards and alleviating poverty amongst older New Zealanders and addressing inequities.

As far as is possible, the current system can, and should be, maintained into the future. However, the cost of the public pension will rise over the next two decades as a result of rising life expectancy, an increasing number of people becoming eligible to receive NZS and expected increases in payment rates above the rate of price inflation. Some adjustment will become necessary to manage costs and preserve the integrity of the system over the long-term. Fortunately, New Zealand is relatively well placed compared with many OECD countries that are struggling to cut back their future pension commitments.

The changes recommended in this Review anticipate the longer term structural, particularly demographic, pressures that will arise in the 2020s and beyond. They are not intended to form part of any fiscal package to correct any economic imbalances over the next several years. It is for this reason that changes are not proposed for implementation before 2020.

Major reforms of the current system, such as income testing or introducing a compulsory saving scheme to replace NZS, are not required. Instead, this Review has evaluated a number of possible options for modifying the current system and has selected a package that will preserve the essential universal character of NZS. It recommends some important but relatively modest changes to NZS eligibility and entitlement rules to be phased in starting in 2020.

A great strength of New Zealand's universal flat-rate public pension system is that it is simple and transparent. The proposals presented in this chapter were selected in part because they do not result in new complexities or the emergence of multiple rates of payment across different age groups or cohorts. They are broad-based and involve relatively little inconvenience to any group. Even-handedness is the key to preserving the system.

This package has been specified in some detail rather than in just general terms so that it is clear to everyone exactly what is being recommended and its cost implications can be modelled. It is recognised, however, that there would need to be consultation and a thorough and more detailed assessment of the package by operational and policy advisers and Ministers before it could be proposed for legislation.

Although the proposals recommended in this Review may seem modest and do not need to be implemented immediately, the public debate has already started and decisions need to be taken shortly. If there is no commitment within the next 10 years, the total cost of NZS will continue to trend upwards and more severe changes might need to be taken later, putting the long term future of NZS itself at risk. Provided these changes can be agreed and implemented from 2020, the retirement income system should remain affordable for at least the next 30 years.

Recommendation 6.1

That, with effect from 2020, NZS rates should be adjusted each year by the average of the percentage change in consumer prices and earnings, subject to no less than price inflation in any year.

Recommendation 6.2

That a future rise in the age of eligibility for NZS should be announced. The age would be gradually increased from 65 years starting in 2020 and would rise by two months per year until it reached 67 years in 2033.

Recommendation 6.3

That as the age of eligibility for NZS is increased above 65 years, a transitional, means-tested benefit should be introduced to address the particular situation of people who are aged 65 and at risk of hardship because of their inability to continue to financially support themselves over an extended period.

Appendices

Appendix A: The residence test for New Zealand Superannuation and the direct deduction policy

This appendix does not attempt to cover all the areas and policy issues to do with the interface between New Zealand's social welfare system and other countries' pension arrangements. It sets out to describe, as simply as possible, the part of New Zealand's system that is a particular matter of concern for this Review and the reasoning behind it.

Residence test

When someone moves to reside in New Zealand having spent some of their adult life living abroad (including people who were born in New Zealand), an issue arises regarding their possible eligibility to NZS. New Zealand operates a basically simple 'all or nothing' eligibility test. To be eligible for NZS a person must:

» be aged over 65, and

» be ordinarily resident in New Zealand at the time they apply for NZS, and

» have been legally resident and present for at least 10 years since age 20 including five years since age 50. (Time spent living in certain countries outside New Zealand, and with which New Zealand has a reciprocal social security agreement, can count as NZ residence for this purpose, which is an added complication).

Many countries operate a quite different sort of test when determining whether, and how much of, a state pension[35] should be paid to their residents. State pension entitlements are paid as a proportion of the amount of time someone has resided and contributed in that country. This can mean that people who have contributed to state pension schemes in several countries over the course of their working lives can accrue several 'mini-pensions', which together may add up to close to a full equivalent pension. In effect, each country's state pension system contributes its own share of the cost.

In New Zealand's case, as long as someone meets the 10/5 year residence condition they can receive a full state pension (i.e. NZS) rather than a 'mini-NZS' adjusted for the proportion of their adult life they spent in New Zealand. If someone arrives here with a state mini-pension entitlement from a country (which has no reciprocal social security agreement with New Zealand) and meets the 10/5 rule, then this, combined with a full NZS entitlement would result in a state pension of more than NZS alone.

From New Zealand's point of view this would be unfair in two ways. First, a person who worked in several countries would receive more state pension than someone who had spent all their working life in New Zealand. Second, New Zealand taxpayers would be funding a more than proportionate share of the combined pension, simply because of its 'all or nothing' system.

The direct deduction policy

There are two possible approaches to dealing with this problem that have been considered.

1. **Proportionality** – abandon the 'all or nothing' residency test for NZS and change to a system where NZS entitlements were proportional to the amount of time a person's adult life had been spent in New Zealand. Such mini-NZS pensions could then be combined with state mini-pensions earned in other countries. Mini-NZS pensions could also be treated as fully portable entitlements for New Zealanders who wished to retire overseas and combine them with other state mini-pensions they may have accumulated elsewhere during their working lives.

35. The term 'state pension' here refers to an overseas pension that is administered by or on behalf of the government of the country paying the overseas benefit or pension. A more complete definition is in s70(1) of the Social Security Act 1964. Purely private or non-state sponsored occupational pension schemes are not part of this discussion.

2. **Direct deduction** – retain the current approach to residence testing for NZS and keep paying full standard amounts of NZS to all those who qualify. However, to ensure that New Zealand does not pay more than its proportional share of the total state pension entitlements accumulated from people's working life spent in different countries, the combined value of NZS plus any state mini-pensions is scaled back, by offsetting the amount of these mini-pensions against the cost of NZS.

The direct deduction approach has been part of the New Zealand benefit and pension system since 1938. Its merits in comparison with a proportionality system have been the subject of a number of policy reviews over the years, the latest in 2007, but it remains current policy. Following the 2007 review the government has concluded that the direct deduction policy is reasonably sound, given the difficulties of interfacing the New Zealand system with those of other countries. It also does not favour a proportionality approach because it could lead to inequitable payment rates, require new hardship payments and makes NZS more complex.

How do these approaches fit with the retirement income objectives and models from chapter 3?

The primary concern of the ***income support*** *model is to prevent old age poverty and hardship among New Zealand residents. Currently, NZS is seen as the major policy instrument for achieving this and the direct deduction approach is a way of keeping the overall cost of the income support system fair and more manageable. A proportionality approach to NZS eligibility and the calculation of entitlements might signal that, for those who have spent time living overseas but have not accumulated state mini-pensions and have no other source of income, a proportional mini-NZS pension may not be sufficient to prevent financial hardship in old age and they may need to access the benefit system.*

The ***citizenship dividend*** *model might see NZS as an entitlement that is earned, at least partially, by virtue of the accumulation of 'contributions' both to the economy (via taxes paid during working life in New Zealand) and to the community (through participation and raising families). The proportionality approach to NZS entitlement probably sits more comfortably with this view, since those who have spent time abroad may not have been in a position to contribute to New Zealand to the same extent as a life-long resident, though this claim might be debated for some situations.*

The treatment of partnered couples under the direct deduction policy

People receiving NZS are the largest group of people affected by the policy of direct deduction of overseas state pensions. However this approach also applies to people entitled to overseas state pensions who apply for New Zealand benefits; the amount of an income-tested benefit is reduced by the value of such pension incomes.

This is where different views of the functions of NZS and income-tested benefits have created problems and perceptions of unfair treatment of partnered people under the direct deduction policy.

Direct deduction applied to benefits

The benefit system sits clearly in the category of support based on the income needs of the 'economic family unit'. This implies that the combined income of the applicant and his/her partner should be used to abate the standard benefit amount and that the resulting entitlement is paid to help support the couple (and any dependent children in the family).

In the case of the direct deduction policy (where one or more overseas state pensions belonging to either partner form part of the couple's income support) it follows by analogy that all these pensions should be used to reduce the New Zealand benefit amount, thereby effectively sharing the cost of providing income support with the other countries that the applicant or their partner have lived in.

Direct deduction applied to NZS

By contrast, NZS is an entitlement of each qualifying individual and is not centrally based on the concept of an economic family unit[36]. Furthermore, entitlement is not targeted at need based on low family income[37] so, in the standard case of a person applying to receive NZS, the financial circumstances of their partner are quite irrelevant.

Despite these features, the direct deduction policy is applied to NZS in a very similar way as it is to benefits. Any overseas state pension payments (from a country with which New Zealand has no reciprocal social security agreement) are taken into account in assessing both partners' entitlement to NZS. If one partner's NZS is fully reduced to zero because the overseas pension amount is greater than the rate of NZS, then the excess amount is then applied to directly reducing the other partner's NZS.

In some situations a person can lose complete entitlement to NZS in their own right as a result of their partner's personal overseas state pension offsetting the entitlement of both of them.

36. Partnership status is taken into account to a minor degree in respect of the difference between the single person and partnered person rates of payment of NZS. This is the subject of another recommendation in this Review.

37. The optional special income-tested rate of NZS available to a superannuitant with a non-qualifying partner is an exception to this general principle.

Appendix B: Chronology of key saving and investment tax announcements

Date	Announcement	Key features
15 September 2004	Report of the Savings Product Working Group – *A future for work based savings in New Zealand*	The report outlined the generic design and a how-to-guide to get workers into saving for their retirement.
16 November 2004	Stobo report on taxing investment income: *Towards Consensus on the Taxation of Investment Income*	Key issues identified: » Direct investment in NZ shares does not attract a tax on the capital gains but that indirect investment via a managed fund does. » The different treatment of income from offshore investments and income from New Zealand investments. » The tax preference given to 'grey list' countries (Australia, Britain, Canada, Norway, the United States, Germany and Japan). » The difference between an individual's marginal tax rate and the tax charged on income derived from collective investment vehicles, notably superannuation schemes which are taxed at 33% even if the individuals covered only attract the 19.5% rate on their income.
19 May 2005	Securing your future: budget savings package	KiwiSaver, a government-sponsored work-based savings scheme with the following features: » New employees automatically enrolled with the ability to opt-out. » Others able to opt into the scheme. » Contributions deducted from pay and channelled via Inland Revenue to employee's scheme. » Withdrawal of savings to contribute towards first home purchase. » Government contributions: kick-start of $1000 and an annual contribution towards fees.
28 June 2005	Government discussion document: *Taxation of investment income*	Key proposals include: *Domestic investment through collective investment vehicles (CIVs)* » CIVs – widely held unit trusts, registered superannuation schemes, group investment funds and other pooled investment vehicles - can choose to use the new tax rules. » Investors' taxable income earned through a CIV will generally exclude realised domestic share gains. » Under the new rules, investors will generally be taxed at their correct rate, instead of a flat 33%. CIVs will deduct tax at rates notified to them by individual investors. » Tax loses can be carried forward and used to offset assessable income in future years or allocated to investors accounts. » Tax credits such as imputation credits will be available to offset tax on assessable income derived via the CIV. *Portfolio investment into foreign shares* » The 'grey list', which allows concessionary tax treatment of investments into seven countries, will be removed for portfolio investment – offshore investment in shares where the investor owns 10% or less of the foreign entity. » CIVs and other investors that are not individuals will use the change in an asset's value over the tax year to calculate assessable income. » Individual investors will also base their assessable income on an asset's change in value over the tax year, but tax paid will generally be spread over several years to reflect cash flow. » Assessable income on assets that do not have a readily verifiable market value will be calculated under a simplified deemed rate of return method. » The new rules will not apply to individuals' investments under $50,000 into foreign companies that are listed in a country with which New Zealand has a double tax agreement.

Date	Announcement	Key features
1 February 2006	Issues paper: *Countering extreme salary sacrifice*	The paper suggested changes to the tax rules on employer superannuation contributions to counter the practice of extreme 'salary sacrifice', including amending the progressive scale for calculating tax on employer contributions.
6 September 2006	KiwiSaver Act 2006 enacted	The Act gives effect to the KiwiSaver scheme announced in Budget 2005. In addition, the Act allowed employer contributions to a KiwiSaver scheme to be exempt from income tax up to 4% of the employee's gross salary or wages.
19 December 2006	Taxation (Savings Investment and Miscellaneous Provisions) Act 2006 enacted	The key legislative changes were to: » Introduce the new portfolio investment entity (PIE) rules. » Tax low rate investors in PIEs at their correct income tax rate. » Make a PIE's capital gains on NZ and Australian resident listed shares tax-free. » Apply the 5% fair dividend rate method to non-Australasian portfolio share investments. » Ensure employer contributions are taxed at the correct marginal tax rate for each employee and to minimise the potential for taxpayers to use excessive 'salary sacrifice' as a means of paying less tax. » Extend the KiwiSaver tax exemption for employer contributions to complying superannuation funds.
17 May 2007	Budget 2007 tax changes: » Reduction in company tax from 33% to 30% » KiwiSaver enhancements	*Company tax reduction* The tax rate for managed funds such as unit trusts and most superannuation and group investment funds reduced to 30%. As a complementary measure, the top tax rate on investment income earned on behalf of individuals who invest in managed funds that choose to use the new portfolio investment entity tax rules also reduced from 33% to 30%. *KiwiSaver enhancements* » Government contribution up to $20 a week to match a member's contribution. » Phasing in compulsory employer contributions over 4 years (1% increasing to 4%). » Government contribution to employers of up to $20 a week per employee to reimburse for compulsory employer contributions.
22 May 2008	Budget 2008 tax changes – personal tax reductions	The bottom personal tax rate was reduced from 15% to 12.5%, and the thresholds at which personal rates apply are to be raised over a period of three-and-a-half years.
15 December 2008	Taxation (Urgent Measures and Annual Rates) Act 2008	The Act enacted the following: » A three-year programme of changes to personal income tax rates and thresholds from 1 April 2009. (Replaced the second and third tranches of the Budget 2008 tax reductions.) » Introduction of an independent earner tax credit of $10 a week from 1 April 2009, increasing to $15 a week from 1 April 2010. » Changes to KiwiSaver from 1 April 2009, including a reduced employee contribution rate of 2%, capping of compulsory employer contributions at 2%, and discontinuing the employer tax credit and the fee subsidy.
16 December 2009	Capital Market Development Taskforce report	The Taskforce made 11 recommendations relating to tax. The key ones relating to savings and investment were: » Reduce any tax biases between different investments – including PIE (reference was made to the work of the Tax Working Group). » Consider options that would tax annuities in a similar manner to other substitutable investments to remove a tax distortion that may encourage the development of a domestic annuities market.
20 January 2010	Tax Working Group Report – *A Tax System for New Zealand's Future*	The report identified a number of issues with the structure, coherence and sustainability of the current tax system and made a number of recommendations relating to broadening the tax bases, changing the tax mix and reducing and aligning of tax rates.

Date	Announcement	Key features
20 May 2010	Budget 2010 – personal and company rate reductions and GST increase	» All personal tax rates (including resident withholding rates) reduced from 1 October 2010. » GST rates increases from 12.5% to 15% from 1 October 2010. » Company tax reduced from 30% to 28% from 2011/12 tax year. » Top tax rate for portfolio investment entities (PIEs) reduced from 30% to 28%. » Tax rate for investment vehicles such as unit trusts and widely-held superannuation funds reduced to 28%.
30 August 2010	Officials' issue paper released – *Social assistance integrity: defining family income*	The paper discusses possible changes to the definition of income for working for family tax credit and student allowance purposes. The paper proposes including income from non-locked portfolio investment entities such as cash PIEs in the definition for such purposes.
24 August 2010	Savings Working Group established	The Savings Working Group has been tasked to consider how New Zealand can improve its national savings. In relation to taxation, the Savings Working Group is expected to consider the impact of the tax system, particularly taxation of capital income, on the level and composition of national saving and investment decisions, and options for improvement. These will include, but are not limited to: » The case for moving to a dual income tax system, whereby labour and capital income might be taxed at separate rates. » Indexation or partial-indexation of the tax system so that real, rather than nominal, income is taxed. The Savings Working Group is scheduled to report to the Government in January 2011.

Appendix C: Terms of reference for this Review

Introduction

The New Zealand Superannuation and Retirement Income Act 2001 (the Act) requires the Retirement Commissioner to conduct a review of retirement income policies before the end of 2010. In accordance with the Act, the Government has provided these terms of reference which set out aspects of retirement income policy and topics for the Commissioner to discuss. The Commissioner may exercise her power under the Act to identify and discuss matters relating to retirement income policies that go beyond these terms of reference.

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 and Veteran's Pension, supported by the operation of the New Zealand Superannuation Fund to smooth the cost over time.

» 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 their retirement; and

  – through the KiwiSaver scheme.

Topics for the 2010 Review

In the 2010 Review, the Government expects a brief commentary on the developments and emerging trends in the retirement income provision area since the 2007 review.

The Government then seeks analysis of the impact and relevance of policy settings that impact on retirement income under a broad framework of three key standpoints:

1. The way that government agencies work together and contribute to effective retirement income policy.

2. The role of New Zealand's financial services sector in relation to retirement income provision.

3. The future wellbeing of New Zealanders in their retirement years, and what this may mean for their communities, and for local and central government.

The first standpoint should include consideration of the interaction of retirement income policy with policies on housing, long term care and health, as well as data requirements for reliable forecasting and modelling.

The second standpoint should include a discussion of the products financial services are or could be providing, including KiwiSaver, and an analysis of what further might be done to enhance markets and consumer trust in this sector. The appropriateness of the conservative investment allocation settings for the six default KiwiSaver schemes is an example of a matter that should be discussed.

The third standpoint should address the wellbeing of the current and future retired population, including particular population groups such as women, and discuss the role that communities and government can play. It should include investigation of how the global financial crisis may affect the adequacy of retirement income provision for individuals at various life stages.

Appendix D: Mapping of terms of reference to content of this Review

Terms of reference	Report content	Report reference
Trends and developments in retirement income provision since the 2007 review.	Discussion on changing macroeconomic environment since last review e.g. employment trends, government accounts, and recessionary environment.	Chapter 1
	Discussion on changing environment for saving e.g. house prices, interest rates, financial regulation, taxation.	Chapter 1
	Discussion of ways that households have responded to the changing environment e.g. approach to saving, home ownership, financial education.	Chapter 1
The way that government agencies work together and contribute to effective retirement income policy including: » Interaction of housing, long-term care and health. » Data requirements for reliable forecasting and modelling.	Description of current retirement income policies, responsibilities and administration, including roles that local councils play.	Chapter 3
	Discussion of costs of residential care and how costs are borne.	Chapter 4
	Discussion of saving measurement issues and gaps in data for policy making.	Chapter 5
The role of the financial services sector in relation to retirement income provision including: » The products that financial services are, or could be providing, including KiwiSaver. » What further might be done to enhance markets and consumer trust in the sector. » The appropriateness of the conservative investment allocation settings for the default KiwiSaver schemes.	Discussion on current levels of consumer confidence in the finance sector.	Chapter 2
	Policy reforms underway intended to address trust and confidence issues and identification of further response where appropriate.	Chapter 2
	Discussion of KiwiSaver's conservative default funds and alternatives.	Chapter 5
	Availability of decumulation products for retirees and also alternative savings products for specific groups.	Chapter 5
Future wellbeing of New Zealanders in retirement years and what this may mean for their communities and local and central government including: » Wellbeing of current and future retired population. » Consideration of particular population groups such as women. » The role that communities and government can play. » Investigation of how the global financial crisis may affect adequacy of retirement income at various life stages.	Impact of the global financial crisis and finance company failure on saving and wealth, including discussion of affects on different age groups and lessons learned.	Chapter 2
	Description of roles local councils take in the retirement income area.	Chapter 3
	Description of wellbeing of current retired e.g. income, employment, home ownership, living standards, financial knowledge, including assessment of vulnerable groups.	Chapter 4
	Description of wellbeing issues for working age people including employment, income, home ownership, savings patterns and adequacy, how KiwiSaver impacts current working age, impact of tax changes for investment, financial education.	Chapter 5
	Discussion of importance of signaling private provision requirements for planning by working age people.	Chapter 5
	Assessment of the importance of New Zealand Superannuation (NZS) for current and future retirees and benefits of the current system.	Chapter 6

Other topics discussed (outside scope of terms of reference)	Report reference
Discussion of how current policies came to be and how they compare with other countries, particularly Australia, including recent changes made in other countries.	Chapter 3
Discussion of different policy models and objectives for retirement income policy.	Chapter 3
Discussion on aspects of NZS related to strengthening the principle of universal individual entitlement, including the two sharing rates of NZS, treatment of non-qualified spouses, residence test and direct deduction policy.	Chapter 4
Initial assessment of KiwiSaver, including key issues and implications for longer-term effectiveness.	Chapter 5
Consideration of compulsory saving.	Chapter 5
Discussion of the prospective rising cost of paying NZS to a growing number of older people, and proposed future adjustments to the system in order to preserve universal entitlement, fairness across generations and overall affordability of the system.	Chapter 6

Appendix E: Structure of the Review

Project Team	Anna McMahon – Project Manager David Feslier – Executive Director, Retirement Commission Katherine Meerman – Researcher Peter Johnston – Editor Roger Hurnard – Writer/Researcher
Reviewers	Alison O'Connell Angela MacRae Bill Rosenberg Peter Harris
Advisory and Reference Groups	
2010 Review Advisory Group	Jonathan Boston Keith Taylor Philippa Dunphy Sue Bradford
Officials Reference Group	Bryan Chapple, Ministry of Economic Development David Benison, Government Actuary Hillmare Schulz, Department of Labour Judy Edwards, Ministry of Women's Affairs Patsie Karauria, Te Puni Kōkiri Peter Frawley, Inland Revenue Department Simon MacPherson, The Treasury Tom Berthold, Ministry of Social Development

Finance Sector Reference Group	Bill Rosenberg, New Zealand Council of Trade Unions Bruce Kerr, Workplace Savings NZ Kirk Hope, Financial Services Federation Lyn McMorran, Institute of Financial Advisers Sarah Mehrtens, New Zealand Bankers' Association Stephen Summers, Business New Zealand Vance Arkinstall/Deborah Keating – Investment Savings and Insurance Association
Non-Government Organisation Reference Group	Andrew Hubbard, Citizens Advice Bureau Jacqui Te Kani, Māori Women's Welfare League Jean Fuller, National Council of Women Kim Aiomanu, Pacifica Lisbeth Gronbaek, Age Concern Philippa Read, EEO Trust Raewyn Fox, New Zealand Federation of Family Budgeting Services Ros Rice, New Zealand Council of Social Services Roy Reid, Grey Power Sue Chetwin, Consumer NZ Tina Reid, Federation of Voluntary Welfare Organisations Trevor McGlinchy, New Zealand Christian Council of Social Services Wendi Wicks, Disabled Persons Assembly

Appendix F: Research papers for this Review

A number of research papers were prepared as part of this Review. The papers are available on **www.retirement.org.nz**

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

Davey J (2010) *Income streams in retirement – Managing income and assets*.

Frawley P Inland Revenue Department (2010) *Recent developments in the taxation of retirement savings*.

Guest R Griffith University (2010) *Australian retirement income policy: Implications for New Zealand*.

Guthrie S Consumer NZ (2010) *Consumer confidence, policy initiatives and remaining issues*.

Heathrose Research Ltd (2009) *Retirement income issues for women – A stocktake of current research*.

Ministry of Social Development (2010) *Description of New Zealand's current retirement income policies*.

Perry B Ministry of Social Development (2010) *The material wellbeing of older New Zealanders*.

Preston D (2010) *Background papers for trends and developments affecting retirement income policy*.

Rashbrooke G and Stevens B Institute of Policy Studies (2010) *Government agencies working together: The development and oversight of retirement income policy*.

Rodway P The Treasury (2010) *New Zealand superannuation scenarios for the Retirement Commission*.

Te Puni Kōkiri (2010) *Key issues for Māori retirement*.

White B (2010) *The impact of and issues arising from the global financial crisis*.

Research paper reviewers included: Angela MacRae, Ben Forbes, Bill Rosenberg, David Mayes, Geoff Lewis, Grant Scobie, Kirk Hope, Melody Guy, Michael Littlewood, Paul Newfield, Peter Whiteford, Rebecca Thomas, Roger Hurnard, and Tore Hayward.

Additional research assistance was provided by David Grimmond and Adolf Stroombergen, Infometrics and Maire Dwyer.

In conjunction with the Institute of Policy Studies, the Retirement Commission ran a conference *Retirement Income Policy and Inter-generational Equity* and a post-conference workshop to help inform the Review. The papers presented at the conference are available on **www.retirement.org.nz** and **www.ips.ac.nz**

Appendix G: Progress on recommendations from the 2007 Review of Retirement Income Policy

Recommendation	Assessment as at December 2010
1. That these independent Reviews of Retirement Income Policy continue on a three-yearly basis, because retirement income policy is complex and involves many agencies.	Achieved. The requirement for three-yearly reviews continues in the legislation.
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.	Achieved.
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.	It is important to have excellent surveys and analysis in order to develop and evaluate informed policies. The Review of Economic Statistics by Statistics NZ is assessing direction for the future of these surveys. The Commission will continue to monitor progress. ANZ has committed to continue their sponsorship of the Financial Knowledge Survey in 2012/13.
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.	Since 2007, the Ministry of Social Development has carried out the following research related to how the costs of health, residential and in home care for older people impact on their personal finances: » Turning 65 Project. » Ageing in the Community.
5. That the basic structure of NZS be maintained.	Achieved.
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.	Although there is no formal political consensus, there have not been any major changes to the parameters of NZS, nor suggested changes by major political parties.
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.	Achieved. Treasury released the Long Term Fiscal Statement in October 2009 and have continued to develop options for future financing of NZS in 2010. Several new scenarios have been developed for the 2010 Review.

Recommendation	Assessment as at December 2010
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.	The review has been completed. Information on MSD's website has been improved although further enhancements are still required.
9. That the Retirement Commission, in 2008, develops financial education initiatives targeted for those on low incomes, including Māori and Pacific groups.	More Sorted booklets have been produced and made much more accessible and seminars are available for community groups. The Commission: » Is working with the Ministry of Pacific Island Affairs and other community groups to target Pacific and other low income groups. » Is putting together an evaluation for the ANZ/Ngāi Tahu financial education programme. » Has developed a five-year Māori financial education strategy that will be implemented from early 2011.
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.	Achieved.
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 evaluation has been adjusted to take account of the changes in KiwiSaver. There have been some cut backs in the evaluation owing to fiscal constraints, but the key parts of the evaluation continue, subject to SoFIE data being available. The Retirement Commission will, as far as possible using available data, monitor the impact of KiwiSaver beyond 2013.
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.	As for Recommendation 7.

Recommendation	Assessment as at December 2010
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.	This recommendation was not accepted. The Ministry of Economic Development will review the appropriateness of the default funds as part of their already programmed review of these in 2014.
14. That the government instructs the Ministry of Economic Development to fast-track the intended regulation of financial advisers.	Achieved. Financial Advisers Act was passed in 2008. Development of regulation is in progress.
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.	Achieved. The 2010 Review of Retirement Income Policy has addressed this.
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.	Achieved.
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.	The Commission understands that this work has been subsumed into other workstreams. Consumer Information on fees for savings products, including KiwiSaver, is being considered in the Periodic Reporting Regulations for KiwiSaver schemes.
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 school curriculum.	Achieved. The Commission will monitor progress in terms of coverage, quality and timeliness but is concerned that the Ministry has insufficient funds to achieve the goal of embedding financial literacy in schools.
19. That the Retirement Commission maintains and enhances its workplace-based information and education programme.	Achieved.
20. That the Retirement Commission reports annually on progress on the National Strategy for Financial Literacy.	Achieved. This is done through the Commission's annual report to Parliament, media releases and financial literacy seminars.

Recommendation	Assessment as at December 2010
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.	Achieved.
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.	The Commission understands that the Review of Economic Statistics will be assessing which data is required to enable the required monitoring.
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 booklet 'Your Money in Retirement' was published and widely distributed. Qualitative research was undertaken to understand how to assist older people make sound financial decisions following which two nationwide communication campaigns were released in 2009 and 2010. There is much ongoing work with older people interest groups.
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.	This work is positioned in Family Violence Task force. Age Concern and the Office for Senior Citizens are closely involved. It is part of the General Elder Abuse project. Age Concern produced a useful brochure sponsored by the BNZ on elder abuse.
25. That Inland Revenue, by end 2008, reports on the feasibility and implications of achieving tax neutrality in the treatment of annuity products.	Not achieved. This continues to be an item on IRD's work programme.
26. That the Ministry of Economic Development, by end 2008, put the code of practice for home equity release providers, being developed by the Office for Senior Citizens, into legislation.	In September 2008 a voluntary Code of Practice for home equity release providers was agreed on. Some aspects of the Code have been addressed by regulatory reforms. The Office for Senior Citizens continues to keep a watching brief regarding the adequacy of protection to consumers.
27. That the Ministries of Economic Development, Social Development and Inland Revenue together, by end 2008, look at all 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.	The government has reviewed this and is satisfied that the treatment of home equity release products is consistent.

Appendix H: Submissions received

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

- Age Concern
- AMP Financial Services
- Anya Vhemer
- Banking Ombudsman
- Bank of New Zealand
- Barrie Grant
- Boyd Klap
- Business NZ
- Consumer NZ
- Disabled Persons Assembly
- EEO Trust
- Eriksen and Associates
- Investment Savings and Insurance Association
- Jim Anderton
- Len Bayliss
- Mary Holm
- Mercer
- National Council of Women of New Zealand
- Paul Dell
- Paul Matthews
- Reserve Bank of New Zealand
- Robert Stevens
- Safe Home Equity Release Plans Association (SHERPA)
- University of Auckland Retirement Policy and Research Centre
- Workplace Savings NZ

In addition, two workshops were held with finance sector organisations (New Zealand Superannuation Fund, ASB, Tower, First NZ Capital, Superlife, Sovereign, BNZ, ANZ, Gareth Morgan Investments, and AXA).

Retirement Commission
Whiriwhiria!

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