BT Funds Management (NZ) Limited and Westpac New Zealand Limited

Submission to the Commission for Financial Literacy and Retirement Income on the 2013 Review of Retirement Income Policy

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1. INTRODUCTION

1.1. This submission on the Retirement Commissioner's *2013 Review of Retirement Income Policy* is made on behalf of BT Funds Management (NZ) Limited ("BTNZ") and Westpac New Zealand Limited ("WNZL").

1.2. Enquiries on this submission can be addressed to:

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2. EXECUTIVE SUMMARY

2.1. Westpac's key submissions are:

- New Zealand Superannuation is not sustainable in the long-term. It is unclear whether all New Zealanders appreciate this, and the impact this will have on their retirement;
- while New Zealanders are generally aware that alternative sources of income will be required in retirement they do not have a good understanding of how much they will require, and generally consider themselves under-prepared for retirement;
- before the first KiwiSavers with significant savings reach the age of eligibility it may be beneficial to consider developing a policy in relation to annuities; and
- the Commission for Financial Literacy and Retirement Income should continue its useful work in financial literacy to further raise awareness and promote saving for retirement.

3. SUBMISSIONS

3.1. Recent research by the Financial Education and Research Centre in conjunction with Workplace Savings New Zealand has provided some insight into the reality of retirement income in New Zealand[1]. That research showed that 27% of those surveyed did not believe they had adequate financial resources for retirement.

3.2. This aligns with research previously published in the *Health, Work and Retirement Survey*.[2] Although this report relates to data collected in 2006, many of its findings are relevant to a consideration of retirement income policy in 2013. In particular, the

[1] *The Retirement Expenditure Guidelines*, Financial Education and Research Centre and Workplace Savings NZ, August 2012

[2] *Health, Work and Retirement Survey: Summary report for the 2006 data wave*, Fiona Alpass, 2008. A research collaboration between the School of Psychology Massey University, The Health Research Council of New Zealand, The New Zealand Institute for Research on Aging, and The Centre for Māori Health Research and Development, School of Māori Studies Te Putahi-a-Toi, Massey University.

report states "*retirement finances is a consistent predictor of wellbeing in retirement*".

3.3. This survey also found that "*[p]lanning for retirement is not only likely to enhance the adequacy of individuals' wealth accumulation and retirement savings but there is evidence that planning also has positive psychological benefits…*".

3.4. New Zealand's retirement income policy needs to address both the shortcomings of retirement income as it currently stands, and the benefits of reshaping the policy to better address the needs of present and future retirees.

The impact of tax incentives

3.5. Annuity products are a useful tool for managing retirement income from withdrawals, but overseas experience indicates that they are most popular when they are structured so that they contain incentives to encourage appropriate investment behaviours in retirement. This would require Government intervention as at present all disbursements from an annuity are treated as taxable income (when in fact a portion will be liquidated capital). This compares unfavourably to the taxation of proceeds from investing in property.

3.6. The creation of tax incentives on savings is not straightforward, but other jurisdictions, including Australia, have recognised the use of tax as a way to modify investor behaviour in relation to saving for retirement. The tax treatment of retirement savings in New Zealand has previously been the subject of reform by the Government of the day, both in the 1980s and more recently with the advent of KiwiSaver.

Developments and emerging trends

3.7. While it is difficult to measure the degree to which New Zealanders' saving habits have changed[3], it appears that following the Global Financial Crisis there has been an increased focus on savings and deleveraging in New Zealand. KiwiSaver provides useful evidence of this. Since the inception of KiwiSaver in 2007 there has been an increase in retirement savings, and KiwiSaver has since grown to a total of $14.487 billion as at 31 March 2013. This information could be useful in raising public awareness of the impacts and benefits of long-term retirement saving.

3.8. However, a review of customer information as at December 2012 illustrates that even people who are currently 50 - 60 years old and who have paid off their own homes will be heavily dependent on New Zealand Superannuation:

- 50 – 60 year old customers have, on average, total savings of $26,000 (including KiwiSaver);
- around 40% of customers who have paid off their mortgage become "*savers*" and on average save $7-8k per person per annum; and
- if a customer has $26k in savings at age 50 and contributes $8k per annum into further savings and investments returning 3.5% after tax, then the accumulated balance would be $197k at 65 years old. This would produce an interest stream of approximately $130 per week (assuming 3.5% return after tax) or $220 per week if they ran the capital down to zero at age 90.

[3] *Save Us! How much are New Zealanders really saving?* Westpac Institutional Bank, 20 August 2012.

3.9. So far, WNZL and BTNZ's experience has been that the majority of KiwiSaver members are making full withdrawals once they reach the age of eligibility. This reflects the reality that after a maximum of six years, most KiwiSaver amounts are regarded by members as "*windfall*" amounts, rather than being sufficiently large to make a substantial and long-term contribution to their income in retirement. With the passage of time, it is a near certainty that KiwiSaver will become more central to retirement savings, and that there will be an increasingly large market for financial advice (and, to a lesser extent, for annuities) as a result. This is discussed in more detail below.

Intergenerational impacts

3.10. It has been widely reported over a period of many years that New Zealand Superannuation is not sustainable in the face of New Zealand's increasingly aging population. It is presently unclear whether New Zealanders appreciate the timeline within which this issue will crystallise, and the impact this will have on their lifestyle in retirement.

3.11. Workers were already concerned in 2006 about "*the Government's ability to support them financially in their retirement*".[4] More troublingly, the *Health, Work and Retirement Survey* also observed that despite these concerns, "*a significant percentage of [the] working participants had done little in the way of planning for retirement*".

3.12. Statistics NZ reports that: "*The 65+ dependency ratio (the number of people aged 65+ per 100 people aged 15–64 years) increased gradually from 14 per 100 in the mid-1960s to 20 per 100 in 2011. It is projected to increase significantly, with the ratio expected to be in the range 36–39 per 100 in 2036, and 39–51 per 100 in 2061. This means that for every person aged 65+, there will be about 2.6 people aged 15–64 in 2036 and 2.3 in 2061, compared with 5.0 people in 2011 and 7.1 in the mid-1960s*".[5]

3.13. The Government has a number of short term levers it can pull in response to increasing longevity in the population, including raising the retirement eligibility age, means-testing benefits, and implementing a transition to a defined contributions scheme. However, other meaningful action can be taken by the Commissioner even in the absence of direct Government intervention. This could build on the good work presently underway. It is critical to consider the long lead in times required for awareness raising and other education work in relation to changes to superannuation.

3.14. A clear message could be provided to New Zealanders that changes to New Zealand Superannuation to ensure its sustainability are likely, and consequently, other income sources may be required in retirement. It will also be important to provide information about the likely timeframe for any changes so that people are aware that they may be affected by them.

3.15. One change that has been raised, including in previous reviews of the Retirement Income Policy and more recently by the former Retirement Commissioner, is increasing the age of eligibility. New Zealand has done this previously by changing the age of eligibility from 60 years to 65 years over the period 1992 to 2001. In the

[4] *Health, Work and Retirement Survey,* ibid footnote 2.
[5] *National Population Projections: 2011(base)–2061,* Statistics New Zealand, 19 July 2012.

previous change to the age of eligibility, the Transitional Retirement Benefit was introduced to assist New Zealanders who had been close to retirement at the time the change in the age of eligibility was announced, but who did not have sufficient private savings to allow them to commence their retirement at age 60 as planned. If the age of eligibility were to be increased again as indicated above, the change will need to be signalled well in advance in order to allow people sufficient time to plan for it.

3.16. It also appears that many New Zealanders do not have a good understanding of the lifestyle restrictions they will face if relying solely on New Zealand Superannuation. Financial education and financial literacy are discussed further below at paragraph 3.32 and following.

The role of private savings

3.17. Private savings are likely to play an increasingly important role in ensuring people have adequate income for their retirement. In order to encourage these savings and maximise their benefit, it is important that the proper incentives and options are in place.

3.18. The current KiwiSaver withdrawals reflect the relatively short lifespan of the product to date. Accordingly most withdrawals have been in a lump sum. Furthermore, investors, such as first home buyers, are keenly aware of the other grounds for making withdrawals from KiwiSaver. This is reflected in the withdrawals being made at present. However, KiwiSaver numbers are increasing both at a participant level and funds under management level. Accordingly, it is anticipated that over time there will be a shift in the behaviour of investors at the age of eligibility when funds have increased from the levels they are at currently.

3.19. The New Zealand Government has an opportunity to develop a policy in relation to annuities before the first KiwiSavers with significant savings reach the age of eligibility. This would be a significant step towards assisting New Zealanders to manage their retirement, particularly as in the long term KiwiSaver will be a primary source of retirement income for many participants.

3.20. The involvement of the Government is crucial, as illustrated by the Australian experience. Despite substantially larger superannuation balances, Australia has a relatively small annuities market. In February 2012 Australia's professional body for actuaries, the Actuaries Institute, released a discussion paper titled *Exploring barriers to Australia's annuities market*. Barriers cited include:

- awareness of annuities;
- cost of annuities; and
- legislative, political and tax barriers.

3.21. The paper noted that in countries with developed annuities markets there is often some form of soft or hard compulsion to purchase annuities with superannuation funds.

3.22. The market for reverse equities is also small in Australia but grew 10% in 2011 to 42k loans and $3.3bn of lending.[6] John Thomas, the Chairman of SEQUAL

[6] *SEQUAL Deloitte Research Report to December 2011*, Deloitte, June 2012

observed in 2011 that "*Given our ageing demographic the Government's emphasis on ageing couples remaining at home for as long as possible is likely to support [releasing home equity to fund retirement]*".

3.23. In a progression of this policy, in September 2012 the Australian Government introduced statutory negative equity protection on all new reverse mortgage contracts. This ensures that consumers cannot owe the lender more than the value of the home when it is sold at the termination of the agreement. This is expected to further increase the use of reverse equities.

3.24. The most common alternative retirement savings approach in New Zealand is property investment. There is a perception that New Zealand's tax system currently favours investments in real property, as there is no capital gains tax on home ownership and low effective tax on investment in rental properties. New Zealanders aged 55+ have 70% of their gross wealth in their own home[7]. Property investment carries some risk for retirees, particularly in the event of a downturn in the economy. In a downturn, property prices would be expected to fall just as superannuation becomes less affordable for the Government.

3.25. Retirees may face unpalatable options once risks associated with property investment have crystallised, including reducing their lifestyle in retirement or, potentially, servicing mortgages that are unaffordable. Although it may be difficult to change New Zealanders' attitudes to property investment under the current tax regime, the Government could also provide education regarding products such as reverse mortgages as an alternative to liquidation of property investment in a lump sum. Accessing this equity could enable people to enjoy a higher quality of life by:

- allowing retirees to spend longer living at home; and
- improving their health through the provision of insurance and basics such as home heating.

3.26. The financial services sector, and particularly banks, is well placed to assist in ensuring the adequacy of retirement income for New Zealanders. WNZL encourages its customers to consider their long-term needs in retirement and other financial planning, and was a founder of the Financial Education and Research Centre. In addition, members in the Westpac KiwiSaver Scheme are able to make regular withdrawals once they are eligible. However, the Government and its agencies must provide the public with a clear and consistent message on the future of retirement in New Zealand in order for there to be a major shift in retirement planning.

Other policies and programmes

3.27. The Financial Advisers Act 2008 ("FAA") has created new standards for the provision of financial advice. While this is generally in the interests of investors, it does result in an increase in the cost of financial advice which may present a barrier for some, including low to middle income earners. These earners may benefit materially from financial advice and a broader view of what is required for retirement. The review of retirement policy, as well as the review of the FAA, presents an opportunity to explore any impact of the cost of financial advice on retirement saving behaviour.

[7] *State of the Nation*, Roy Morgan, 2012

3.28. Health spending also has a direct relationship to retirement income policy. Generally, an aging population places stress on Government spending in both of these areas. This is borne out by Treasury's *Long Term Fiscal Forecast*, which estimated that while superannuation payments amounted to 4% of GDP in 2010, by 2060 these will be 8%. Over the same period government expenditure on health will rise from 7% to 11% of GDP. It is unlikely that voters will tolerate a reduction in spending on health. The likely impact is that voters will choose to reduce government expenditure on superannuation, thereby further cementing the need for private retirement savings.

Women's future retirement income prospects

3.29. The BTNZ customer base illustrates that KiwiSaver balances for women are lower than for men from the age of 16 years. The greatest discrepancy of 25-30% appears in the mid thirties to mid forties age bracket.

3.30. It is widely reported that women experience disadvantages in saving for retirement. The *Health, Work and Retirement Survey* identified the following issues:

- intermittent workforce participation occasioned by child-bearing and child-raising;
- women are more likely to work in jobs with lower pay and have fewer opportunities for promotion;
- women are less likely to have access to or belong to superannuation schemes; and
- women spend more time in retirement than men due to increased life expectancy and therefore are more than twice as likely to live in poverty in old age.

3.31. Although some of these factors are the focus of significant work by various Governmental agencies and NGOs, the impact of the gender pay gap and increased life expectancy of women is likely to be felt for some time. At present, New Zealand Superannuation provides a minimum standard of living for women in retirement, regardless of their work history or life expectancy. This suggests that the development of retirement income policy will need to take into account the disproportionately severe impact that changes to New Zealand Superannuation may have on women.

Financial literacy

3.32. Financial education and literacy play a major role in ensuring that retirement income policy achieves its ends. Addressing New Zealanders' perception that New Zealand Superannuation will be available in their retirement and sufficient for their needs will increase the gains from working towards repositioning private retirement savings as a default accompaniment to New Zealand Superannuation in the future.

3.33. It is critical that people are prepared for the probability of changes to superannuation, so that they can start preparing early. It would be beneficial if this information was provided by the Commission, which is seen as an objective body.

3.34. A culture of adequate retirement savings relies on people having a good understanding of the future. The Retirement Expenditure Guidelines identify that a key question for a person planning for retirement is "*How much will I need in retirement*"?[8] New Zealanders do not yet seem to be able to answer this question; despite being able to identify that they are not planning for retirement and are not saving enough.[9] In Australia, the Association of Superannuation Funds of Australia ("ASFA") has published *The ASFA Retirement Standard*. This document sets out "*the annual budget needed by Australian to fund either a comfortable or modest standard of living in the post-work years*". It also provides a clear picture of the amount of retirement savings that would be required to support such a standard of living, and a high level view of how this can be achieved at different levels of income.

3.35. Once New Zealanders understand how much they will require in their retirement, it is important that they have sufficient financial literacy to manage their personal finances. This will enable them to manage their money so that they are able to save, and provide them with valuable knowledge so that they can more actively manage their investments. The need for this education is demonstrated by the significant number of New Zealanders who remain in default KiwiSaver schemes despite having investment needs or risk profiles that are divergent from their fund's profile.

3.36. While it may not be realistic to expect financial literacy endeavours to reach all investors or to have a galvanising effect on all investors that are reached, it is clear from the empirical and anecdotal evidence regarding retirement income in New Zealand that further information and education would be valuable.

3.37. The Commission has undertaken significant effort to get New Zealanders to consider their retirement income, in particular with the very useful retirement information set out on www.sorted.org.nz. However, alternative methods of communication are important to capture high risk groups, such as low income earners or those with limited literacy.

[8] *The Retirement Expenditure Guidelines*, ibid footnote 1.
[9] *Savings Survey*, Horizon Research Limited for the Financial Services Council, December 2011