Submission from Professor David Mayes

A problem with Kiwisaver

1. A major objective of Kiwisaver is to help people manage their savings in such a way as to provide a standard of living in retirement that is nearer to what they would like. This is achieved by encouraging them to save regularly in a fund that cannot be accessed until retirement except in a number of special circumstances.
2. Traditional routes to achieving this goal result in pensions, where sometimes there is the option to take out a lump up to some limit, perhaps 10-20% of the funds value on retirement. That way people are ensured of an increased income in retirement. With Kiwisaver that is not true. The entire fund can be withdrawn on retirement. This provides a strong incentive to have a splurge using both the newly realised wealth and the new opportunity for leisure. There may be relatively little left afterwards to achieve the original objective.
3. This is not a hypothetical outcome. The finding in Australia in the early days of their compulsory superannuation has been that much of the payout has been spent rather than reinvested.
4. The problem is exacerbated by the lack of annuity products in New Zealand so that people can turn their savings into a pension, with a choice of whether to receive it up to a fixed date or take out a life insurance element.
5. Knowing how to handle this wealth on retirement is a serious problem given levels of financial literacy, as this is now a much more major decision than the initial decision to save. Unless there is a serious focus on this in improving literacy much of the gain from the saving may be lost.
6. My solution is simple. On retirement all funds should offer a pension with a few standard variants. As people receive their statement each year it should say what their expected pension has reached, firstly from the fund's current value and secondly if they keep continuing at the current rate up to retirement. Then the information does not come as news and people can plan gradually as to what they will do when they retire.
7. I suggest they are offered three indicative options
   a. A pension for the rest of their lives
   b. A 25 year annuity, where their estate receives any undrawn portion
   c. A pension plus a lump sum equal to, say, 20% of the capital
8. If this is not done there needs to be a major investment in improving financial literacy so that people can work out what to do with their lump sum in the absence of the most relevant financial products
9. Clearly the relevant annuity and related products need to be developed along with reverse mortgages and other routes to running down capital to provide a better income in retirement.

The specific examples are only to illustrate the point and a proper scheme would require considerable research.