FinancialServicesCouncil
growing and protecting the wealth of New Zealanders

Financial Services Council
of New Zealand
Level 12, City Chambers
Cnr. Johnston & Featherston Streets
PO Box 1514, Wellington 6140
New Zealand
Ph: +64 4 473 8730
Fax: +64 4 471 1881
Email: fsc@fsc.org.nz
www.fsc.org.nz
www.yourwealth.org.nz

8 November 2013

Submission by: Financial Services Council

Contact:	Peter Neilson	Deborah Keating
	Chief Executive	Executive Officer
	peter@fsc.org.nz	deborah@fsc.org.nz
	04 831 0306	04 831 0308

Total pages: 9

2013 Review of Retirement Income Policies

Introduction

The Financial Services Council (FSC) appreciates the opportunity to comment on the discussion document: *Focusing on the Future,* released by the Commission for Financial Literacy and Retirement Income following the 2013 Review of Retirement Income Policies.

The FSC made a submission to the Review. We share many views with the Commission and we are keenly interested to see positive change in retirement income policies come out of the 2013 Review.

General Comments

FSC fully supports the aims, outlined by the Retirement Commissioner in the Foreword to the Report, to:

- Tackle the hard challenges that don't have immediate answers; and
- Bring a comfortable retirement within reach for future generations

The key proposals made in the FSC submission to the Review were all in line with those aims:

- Having a comfortable retirement income for all New Zealand employees as an objective.
- Indexing the age of eligibility for NZ Superannuation ("NZS") to our improving longevity after age 65 so that each generation on average gets the same number of years of NZS as the current generation does, based on the NZ Statistics VLM scenario unless evidence emerges that the trend of improvement over the last 30 years is not continuing.
- Matching contributions by employers and employees.
- Having an option for new entrants to start contributing only at 1%, split between employee and employer to gradually build up to 10% over 10 years.

- Gradually stepping up contributions of existing KiwiSavers to 10% at a young age or to a higher level in the case of people closer to retirement who are currently saving less than 10% of their income.
- Top ups for KiwiSaver balances at retirement if you have been unable to save enough to fund a comfortable retirement after say 30 years or more of contributions.
- Removing the imbalance in tax treatment between investments in rental property and financial products with compound returns (such as KiwiSaver) to fund retirement.
- Reviewing the bureaucratic hardship withdrawal provisions to see if they could be better dealt with by insurance.
- Possibly allowing withdrawals for either funding the deposit to purchase a business, tertiary education or as at present, a deposit on a first home.

We have made specific comments below in response to the recommendations on pages 9 and 10 of the draft Report.

In general, the draft Report agrees that the optimum provision of retirement income would come from maintaining NZS as a universal entitlement and topping that up to a level sufficient for a comfortable standard of living by increasing private provision through savings.

However, since the date of our submission to the Review we have received the reports and recommendations from independent consumer polling, expert tax modelling and financial analysis, commissioned by the FSC. We used this material to prepare our proposals for consideration on how New Zealanders could achieve a comfortable retirement with an income double NZS by making KiwiSaver, as the preferred retirement savings vehicle, fairer, more accessible, affordable and harder working.

This substantial body of work, plus benchmarking our proposals against international best practice, including OECD experiences of contribution based pension schemes, form the basis of the FSC proposals which were presented at the FSC-hosted Future of Super conference in October 2013. We have continued discussing our ideas for providing a comfortable retirement for all New Zealand employees with politicians, officials and advisors and are encouraging public debate to highlight the predicament that many New Zealanders may face if they do not start saving sufficiently now for their eventual retirement. The shortfall in retirement saving as longevity increases, the population of pensioners expands and the cost to the national economy grows is an urgent issue requiring action by our policymakers to come to a cross party accord on retirement income savings.

At the time of our submission to the Review we noted that responses to polling had found a majority of people considered they would need twice the level of NZS in order to have a comfortable retirement. Our 2012 research indicated that a KiwiSaver scheme contribution rate of 10% net of tax (combined employee + employer) over a 40 year working life would be needed to achieve a nest-egg of sufficient size to provide an income in retirement of at least twice NZS, based on current tax and default investment style settings.

The research and modelling FSC commissioned from Infometrics, available on our web site (http://fsc.org.nz/SuperSizeRetirementIncome.html), has since revealed that the contribution rate could be reduced to around 7%. This rate would provide a comfortable retirement in conjunction with fairer tax rates applied to retirement savings along with a move to an investment portfolio better aligned with life stages. We would also envisage an eventual reduction in fees as the savings pool accumulates and competition among providers increases

The FSC 2013 recommendation, supported by the research available on our web site, is now to:

- Keep NZS as is with the level linked to wage and with the age of eligibility moved out 2 years
- Gradually increase the contribution rate to KiwiSaver schemes by 1% a year, split between employee and employer, until it reaches 7%. That will to enable people to buy a pension equal to the twice the amount of NZS from the age of eligibility.

This proposal also addresses the concern expressed in the draft Report that there is no requirement for KiwiSaver to be used for retirement purposes.

To get the required KiwiSaver contribution rate down to 7% four things need to happen:

- move default KiwiSaver savings into higher earning funds depending on life stage
- offset the additional risk with insurance to guarantee a level of savings at retirement
- level the tax playing field for KiwiSaver investments with other forms of retirement savings
- re-target the $740 million that the government spends on KiwiSaver incentives to fund the lower tax rates on savings and make the new policy fiscally neutral (Horizon Research 2013: 7.8% of KiwiSavers say they only put in the minimum $1024 contribution p.a. so they can get the $521 tax credit)

While we support the retention of NZS as the Tier 1 universal retirement scheme, we have concerns at the likely impact on contribution levels of the recommendation in the draft Report that the indexation of NZS should be changed from 2023 to be based on the average of percentage change in consumer prices and earnings but no less than price inflation in any year. That indexation change would have the effect over time of reducing NZS in comparison with the average wage and would require more private savings to compensate in order to reach a comfortable retirement. New calculations from Infometrics indicate that in order to build up sufficient savings to compensate for the reduction in NZS, the contribution rate needed over 40 years would increase to 16.5% per annum which we consider would be unachievable for most people.

In order to implement the changes recommended in the FSC proposal, all parties represented in Parliament need to agree and commit to providing a retirement savings policy that will:

- continue to support KiwiSaver to help New Zealand employees save for a comfortable retirement over their working lives
- progressively step up KiwiSaver contributions and coverage
- not put New Zealanders who save for retirement in KiwiSaver at a tax disadvantage compared with other savers
- reduce taxes on KiwiSaver fund earnings over time to level the playing field so KiwiSaver members are not at a tax disadvantage

A key feature of our proposal is that the investment portfolios of KiwiSaver default funds should move from conservative to balanced or growth portfolios, based on life stage, so investors would hold more growth assets when younger, in place of the current cap of 25% in growth assets.

We are also concerned that the recent government decision to retain the conservative default funds approach to KiwiSaver means New Zealanders will have to save a lot more for a lot longer and pay a lot more tax on those savings as they try and build their retirement nest egg. We recommend that this is addressed in the final Report.

Many people who have enrolled into KiwiSaver have defaulted into conservative funds without making an active choice to be there. The effect of that is that someone on the average wage contributing 6% p.a. and staying in a conservative fund for the next 40 years will end up with a nest egg at least $150,000 smaller than if they had invested in a balanced portfolio and $250,000 less than if they had invested in a growth fund. In addition, the savings of investors in conservative funds suffer the highest effective tax rates, which increases the savings they need to achieve a comfortable retirement.

This impact can be supported by calculations done for our submission to the Review of KiwiSaver Default Providers:

Nest Egg for Someone on Average Wage Contributing 6% to KiwiSaver over 40 Years

KiwiSaver Fund	*Interest Rate Return After tax and Fees*	*Nest Egg at 65*	*Difference*
Conservative	4.0%	$328,772	-
Balanced	6.0%	$514,521	$185,749
Growth	6.6%	$596,543	$267,771

Although the government considers retaining the conservative, risk- averse investment approach is the most appropriate choice in taking decisions about other people's private savings, there are other ways to mitigate risk and volatility of higher-earning funds.

The OECD recommends a life stages approach to default investment so younger people invest in more growth assets and then move into conservative funds close to retirement. The OECD has also provided advice on how to provide guarantees to manage the risk of retirement savers.

FSC recognises that, with more growth assets, there is more volatility in the returns year by year so we have suggested providing a form of insurance, or a top-up, to guarantee a level of funds in savers' accounts when they reach 65. One way of doing that would be to guarantee that anyone who saved over 30 years, for example, would get enough in their retirement nest egg to purchase a second pension, equivalent to NZS, and double their retirement income.

An independent assessment shows that a top-up would cost KiwiSaver scheme members about 0.31-0.35 of 1% each year in additional contributions which is a bargain if returns are to be 2.0-2.6% higher per year. This would be of particular value to people who spend more time out of the paid workforce, such as women looking after family members, or for those whose date of retirement coincided with poor financial markets.

Another reason to move people into balanced and growth funds to better match their life stage is the hostile tax environment in New Zealand for long term savings in financial products with compound returns, such as typical KiwiSaver conservative assets. On the basis that the amount someone needs to save each year under current settings is 10% of income for 40 years for a comfortable retirement, the impact of the effective tax rate on investment returns over 40 years reduces the retirement nest egg by more than 50%. More detail can be found in the report *The Tax Barrier to Retirement Prosperity in New Zealand* which can be found here: http://fsc.org.nz/site/fsc/files/SuperSize%20Conference%202013/FSC-Taxation%20and%20Savings%20Paper-Final%20copy.pdf

As well as supporting 'life stage' investment strategies for retirement savings, the OECD Roadmap (available on line at http://fsc.org.nz/SuperSizeRetirementIncome.html) to encourage greater saving and expand coverage endorses automatic enrolment with an opt-out (where mandatory enrolment is not opportune), along with appropriate incentives. New Zealand relies heavily on automatic enrolment and incentives. However, in the absence of universal KiwiSaver scheme membership, the draft Report needs to recommend some other way of ensuring that people on modest incomes will be able to achieve a comfortable retirement. This should address the issues relating to the taxation of savings and the investment portfolios KiwiSaver members default into.

Evidence from the international literature indicates that women, low income earners and people with a low level of financial literacy are more likely to end up holding conservative portfolios that will considerably reduce their retirement nest egg or considerably increase the contribution rate required to fund a comfortable retirement. In its 2013 report on NZ, the OECD recommended that the government consider defaulting KiwiSaver members into portfolios with more growth assets.

Another general concern we have is the proposed timetable in the draft Report. We fully endorse the need to signal changes well in advance in order to allow people to prepare themselves. However, we recommend that decisions on the necessary changes should be made as soon as possible to allow an adequate notice period. For instance, an allowance of four years to complete work on the proposed Schedule and Review process seems too long when the need to provide a policy framework to both encourage and enable greater savings at all working ages is critical now. This subject should be one of the matters covered in a new cross party agreement in retirement incomes policy with a timetable for completion in calendar year 2015.

Comments on Recommendations

Keeping New Zealand Superannuation fair and affordable

1. ***That the proportion of life over the age of 20 in receipt of New Zealand Superannuation be kept at a minimum of 32 per cent (see pages 35 to 40)***.

   A "set and forget" formula for setting the age of eligibility for NZS has merit as part of a coherent, sustainable and fair retirement income policy as it would avoid the need for regular decisions to set the age of eligibility for NZS.

   The FSC would like to see the age of eligibility formula as one of the matters covered in a new cross party agreement on retirement income policy, updating the last Accord agreed back in 1993.

   To aid transparency and individuals' retirement planning it would be helpful to express the NZS eligibility age formula as increasing by, say, 1, 2 or 3 years per decade rather than a harder to understand percentage.

Official longevity projections have consistently underestimated the trend in cohort life expectancy in New Zealand.

A formula based on such projections therefore risks being misleading if it is used to predict the number of years that retirement income savings are expected to cover.

2. ***That the Government establish, by 30 June 2017, a schedule and review process for New Zealand Superannuation, guided by the principles outlined in this document (see pages 37 to 40).***

   The FSC considers that this timetable "kicks this issue too far down the road" and will induce inertia in the political process when action is required on the policy front now.

   This should be one of the matters covered in a new cross party agreement along with measures to encourage greater coverage and contributions into KiwiSaver, fairer taxation of long term savings in New Zealand and removal of barriers to creating a market for decumulation products in New Zealand. This discussion should be concluded in the 2015 calendar year.

3. ***That a new method of indexation of New Zealand Superannuation, based on the average of percentage change in consumer prices and earnings but no less than price inflation in any year, be introduced from 2023 (see pages 44 to 45), subject to an adequate proportion of fiscal savings being applied to:***

   a. ***Measuring the impacts of the change on the living standards and wellbeing of older New Zealanders, and***

   b. ***Maintaining the real living standards of less-well-off older New Zealanders at the same levels as provided by the current system of indexation***

Any coherent plan to address NZ's retirement issues will have features that do not please some people.

The FSC has expressed support for keeping NZS on the current basis including its link to wages. Over time wages tend to increase in line with labour productivity and can be expected to grow faster than wages most years.

The formula proposed by the Retirement Commission will therefore likely see the incomes of those in retirement relying on NZS steadily decrease relative to the wider community's incomes. Surveys commissioned by the FSC and also by ANZ have shown that most New Zealanders believe they need close to 2 times NZS in retirement to be comfortable. Any relative reduction in the level of NZS to wages will increase the savings required to achieve a comfortable retirement.

If wages increase by 1.1% a year above inflation of around 2% then the average increase in NZS will be around 0.6% each year on average under the formula the Retirement Commission proposes. Based on this proposal and using the current settings, New Zealanders seeking a comfortable retirement would have to save 16.5% of their net income each year over 40 years to achieve the desired target of an income 2 times NZS. It is unlikely that many New Zealanders could fund a comfortable retirement if the proposed policy was put in place.

KiwiSaver

4. ***That the age of access to KiwiSaver balances be kept at 65 (see pages 39 and 76)***.

   The FSC agrees with this proposal.

5. ***That as soon as fiscally prudent, an auto-enrolment day be held for employees who are not currently members of KiwiSaver, with retention of the right to opt out (see page 66).***

   The FSC would welcome a regular day of automatic enrolment for those employees not yet in KiwiSaver. Our most recent survey commissioned with Horizon Research indicated that around 18.9% of adult New Zealanders have not yet enrolled in KiwiSaver and would be interested in doing so.

6. ***That the Government establish a joint working party, chaired by the Retirement Commissioner or her nominee and comprising public and private sector representatives, to identify gaps in the available data on KiwiSaver such as on the savings paths of different segments of the population, and to report by 1 December 2014 on ways in which those gaps can be filled (see pages 75 to 76).***

   The FSC agrees with the recommendation but suggests that the work include all forms of saving for retirement including real estate, equities, bank term deposits as well as KiwiSaver.

7. ***That the Government agree to the Retirement Commissioner convening a broadly representative review to determine the viability of different approaches to the voluntary annuitisation of savings including KiwiSaver balances on retirement (see pages 74 to 75).***

   The FSC agrees with the recommendation but would suggest that the viability of compulsory annuity options be considered as well, given the rage of opinions held by the political parties in the New Zealand Parliament.

8. ***That the Ministry of Business, Innovation and Employment report to the Government by 30 June 2014 on means to fairly maintain the employee contributions of KiwiSaver members while they are on parental leave (see pages 59 and 65).***

   The FSC agrees with the recommendation but suggests that other mechanisms to achieve gender fairness be investigated including sharing contributions between partners in a relationship and a top-up guarantee on savings at retirement as proposed as an option by the FSC.

Financial Literacy

9. ***That the Government provide the Commission for Financial Literacy and Retirement Income with an explicit mandate to lead the provision of financial education for New Zealanders (see pages 84 to 87)***

   The FSC would like a discussion on the most effective means to promote practical financial literacy in New Zealand and what role the Commission for Financial Literacy and Retirement Income, the Financial Markets Authority, the financial sector, the education sector and industry organisations would play in improving practical financial literacy. Such a conversation would also include how these activities should be funded.

Taxation

10. That in line with a recommendation of the Savings Working Group, the Government remove tax on the inflation component of interest on simple savings products such as bank deposits and bonds (see pages 51 to 52)

The FSC strongly supports this recommendation but also believes other tax related issues need to be addressed to establish a level tax playing field for retirement and other savings. Those issues include not having the inflation component of interest as a deductible cost, the over taxation of compound interest earning financial products and the absence of an accruals capital gains tax on rental property investments.

These issues are well canvassed in the FSC commissioned report *The Tax Barrier to Retirement Prosperity in New Zealand* published in October 2013, which became available after the Focussing on the Future discussion document was published.

Age-friendly housing

11. That the Ministry of Business, Innovation and Employment report by 1 December 2014 on ways to increase the supply of age-friendly housing (see pages 76 to 79).

The FSC agrees with the recommendation.

Age-friendly Workplaces

12. That the Ministry of Business, Innovation and Employment work with employers, industry associations and unions to implement ways to encourage the recruitment, retention, retraining and mobility between jobs of older workers, and report back on progress by 1 December 2014 (see pages 79 to 83).

The FSC agrees with the recommendation.

International pensions

(See Appendix One)

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

The FSC agrees with the recommendation.

14. That the Ministry of Social Development improve information and advice for recent and prospective migrants and returning New Zealanders on the implications of the direct deductions policy for their future retirement income.

The FSC agrees with the recommendation.

15. That the Ministry of Social Development improve the public availability of decisions on the classification of overseas pension schemes whose pension payouts are subject to the direct deduction policy.

The FSC agrees with the recommendation.

16. ***That the Ministry of Social Development explain the rationale behind each international pension scheme classification.***

The FSC agrees with the recommendation.

We are happy to discuss these comments if that would be helpful.