FinancialServicesCouncil.

growing and protecting the wealth of New Zealanders

Submission

to the

Commission for Financial Literacy

And Retirement Income

on the

2013 Review of Retirement Income

Policy

31 May 2013

Summary and Recommendations

It is now 20 years since the signing of the 1993 Accord on Retirement Income Policies. Over the past 20 years there have been a number of changes that suggest it would be desirable to renegotiate this agreement between the Parties represented in Parliament following the 2014 election, including:

- The rise in the 65 plus population and the growing length of our life after age 65 compared with what had been expected earlier. Our grandparents could look forward to 10-15 years in retirement, whereas our children can expect 20-30 years on average.

- The consequential cost to the taxpayer of more people receiving NZ Superannuation for longer which will increase the cost of superannuation from 4% to nearly 10% of GDP later this century.

- To restrain that cost going forward more New Zealanders would prefer the age of eligibility for New Zealand to move out with longevity rather than have the level of NZ Superannuation cut.

- Only 9% of us expect NZ Superannuation alone, ($357 per week after tax for a person on their own or $512 for a couple) will be an adequate income for us in retirement.

- Prefunding a second pension on top of NZ Superannuation, using KiwiSaver with compounding investment returns, could produce a pension for about half the economic cost of funding the same level of pension from taxation

- While 2 million New Zealanders have with encouragement enrolled in KiwiSaver, most of us are saving inadequately to fund a comfortable retirement at about 2 times the level of NZ Superannuation and many of us are not saving at all.

- Many default KiwiSavers are invested in conservative funds that are likely to give them much lower balances in their KiwiSaver account at retirement than if they had been invested in more growth assets.

- The current tax system strongly discourages longer term saving using the preferred vehicles of KiwiSaver and bank term deposits which feature compounding returns.

- New Zealanders want more flexibility in when and where they take their retirement.

In updating the Accord, it will be necessary to address the issues of the affordability of KiwiSaver for the low paid, women who on average spend more time out of paid employment and marginal employers by phasing in these changes over a decade or more.

A New Multi-Party Accord will need to Address the Following Questions

1. **What should be the objective of New Zealand's Retirement Income Policy?**
   Is it to achieve a just adequate retirement income, provide a comfortable level of income in retirement or to maintain pre-retirement consumption levels for all New Zealanders?

2. **How should we accommodate the rising cost of NZ Super as our population ages and the period of time we live past 65 steadily increases?**
   Do we want to increase tax rates to pay for the increased costs, cut the NZ Super benefits or move out the age of eligibility for NZ Super or some combination of these?

3. **If we want to have higher incomes in retirement should KiwiSaver be the vehicle to achieve this for employees?**
   If so, should it be voluntary as at present or universal (compulsory) as funding NZ Super out of taxation currently is?

4. **If we want to use KiwiSaver to supplement NZ Super, when do we need to start increasing contributions and coverage to achieve this?**
   If we leave this too long we won't be able to afford funding the already retired from taxation paid for by today's taxpayers while the same generation saves more to fund their own KiwiSaver based second pension.

5. **If we do decide to use KiwiSaver to help employees save for a more comfortable retirement, how do we make this affordable for the low paid, women who spend more time on average outside of the workforce and have lower incomes and savings and marginal employers?**
   We could top up KiwiSaver accounts for those who don't get to retirement with sufficient savings or we could, as taxpayers, pay the contributions of those on very low incomes or when they are on parental leave.

6. **If we want to achieve wider participation in KiwiSaver and higher contributions, how could we make it affordable?**
   Some New Zealanders cannot afford to immediately start contributing at 3% of salary backed up with the same amount from their employer. Allowing people to start off small at say 1% split between themselves and their employer and moving up 1% each year for 10 years may make it feasible to save more for retirement. Doing this as we come out of recession when incomes start increasing again will make it more affordable.

7. **If we want New Zealanders to use KiwiSaver as their prime means of retirement savings, do we need to remove the tax disadvantages KiwiSavers face in comparison with investors in rental property?**
   The FSC has work underway to address this issue of the over taxation of KiwiSaver and PIE financial products that was identified in the 2011 Savings Working Group Report.

The FSC has views on these issues that were outlined in the report we published last year entitled *"Pensions for the Twenty First Century: Retirement Income Security for Younger New Zealanders"* http://fsc.org.nz/site/fsc/files/reports//FSC_Pensions%20report%20%20FINAL%20Publication%2017%20June%202012%20copy.pdf

In summary our proposals were as follows:

- Keep NZ Super in its current form, but move out the age of eligibility as longevity increases. This reduces the need to have significant increases in taxes as longevity increases.
- Encourage New Zealanders to lift contributions to KiwiSaver to ten percent of income (five percent from the employer and five percent from the employee). This will enable New Zealanders to use the power of compounding returns to provide more resources to fund their retirement and for most to lift retirement incomes closer to twice the level of NZ Super.
- Phase in the increase in contributions over 10 years to make it affordable.
- Require KiwiSavers to use some of their funds to purchase a fixed term pension that gives them an income at least as high as NZ Super for the years between when they choose to retire and when they are eligible for NZ Super.

1. What Are The Current Features of the New Zealand Retirement Income Policy?

NZ Super (Pay As You Go, PAYGO)

Today's taxpayers pay for today's NZ Super recipients.

New Zealand Super is one of the most generous aged pensions in the world, paying a flat rate benefit to everyone who is aged 65 or over subject to a residency requirement. It is not subject to any income or asset test and is based on a set percentage, 65% of the average ordinary time weekly wage. As such it provides an income that moves in line with average income levels. It serves as an annuity so no matter how long you may live, it continues to be paid, you don't run out of money. For individuals over 65 it therefore provides a level of income funded by current tax payers that at the current level paid ensures that no one who owns their own home debt free will fall into absolute poverty.

KiwiSaver (Save As You Go, SAYGO)

KiwiSavers put money aside today for their future retirement.

In most other developed countries alongside the age pension is a compulsory contribution based pension where people in employment make regular contributions based on a percentage of their earnings to help fund their pension in retirement. These contributions are usually greater than 10% of salary. Typically, these arrangements mean someone on the average wage receives 60-80% of their previous income in retirement. Someone on the average wage in New Zealand receives less than 40% of their previous earnings in retirement if they live on NZ Super only.

New Zealand has had KiwiSaver, a voluntary second tier saving scheme for retirement, since 2008 and some two million New Zealanders have enrolled in it. Numbers are now growing slowly but the numbers enrolled have well exceeded the estimates made prior to its introduction.

KiwiSaver funds are locked in until the age of eligibility but earlier withdrawals are allowed for first home purchase, permanent emigration or in cases of severe hardship.

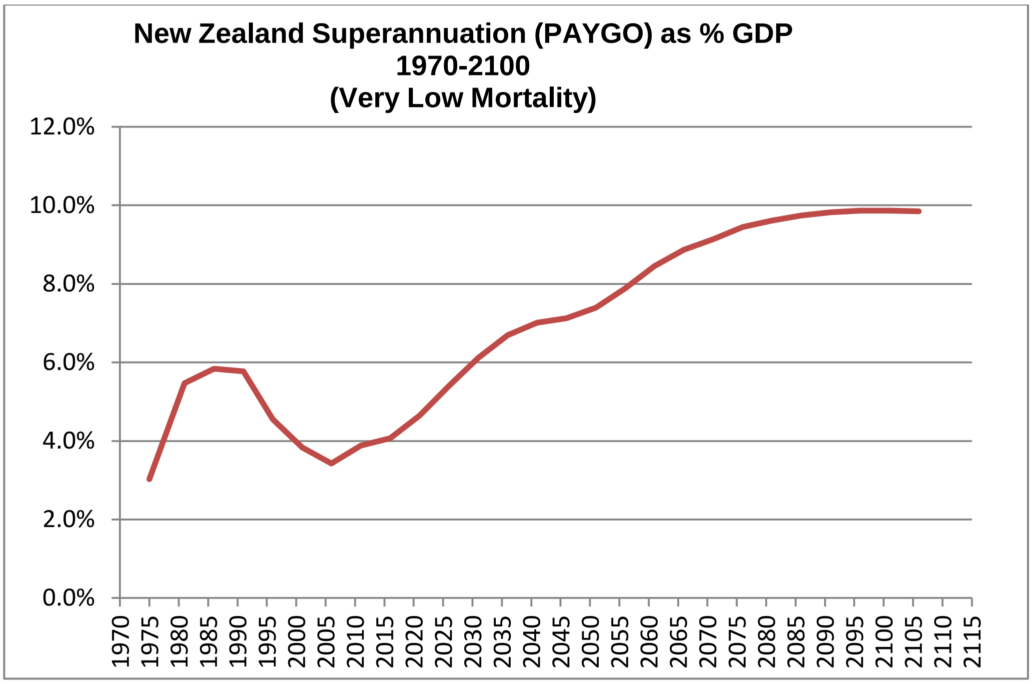
While KiwiSavers can contribute either 3, 4, or 8% of their incomes with their employers also making an at least 3% contribution, most people are currently contributing at the lower 3% level backed up with the same contribution by their employer. A 6% combined contribution rate is insufficient to fund a comfortable level of income in retirement, about 2 times the level of NZ Super. The KiwiSaver contribution rate to fund a second tier pension equivalent to NZ Super over a 40 year working life needs to be 10%.

Although some 2 million New Zealanders are enrolled in KiwiSaver, a significant minority of these are not currently making contributions having suspended contributions because of hardship, while currently being overseas or because they are children or adults where contributions were only made to the level to access the maximum level of incentive payments by the Government.

While NZ Super is a very good basic age pension it does not meet the requirements of most New Zealanders in retirement. With declining rates of home ownership for younger New Zealanders, it suggests higher levels of poverty in retirement for future generations unless there are policy changes.

2. How Sustainable is NZ Super without Change?

We are currently paying around 4% of GDP to fund NZ Super for those currently retired. If we take the Statistics New Zealand (SNZ) Very Low Mortality projections as our assumption, the cost will rise to nearly 10% of GDP later this century. (The VLM projections assume the trend improvement in longevity from age 65 observed over the last 40 years continues.) While we could decide to increase tax rates by over 20% to pay for this, on past experience if the cost has risen to close to 6% of GDP we have acted to reduce the cost by moving out the age of eligibility for NZ Super and looked at reducing the value of NZ Super.



Source: Infometrics

The table on the next page compares the situation that existed at the middle of the last century and what we can expect by the middle of this century.

Our longevity past 65 increases dramatically to reach 30 years for both men and women. Whereas last century there were 7 workers paying taxes to fund one pensioner, by mid century it will be 2 taxpayers only sharing the cost of each pensioner. Most New Zealanders consider we need to act. Acting early by agreeing to a gradual increase in the age of eligibility for NZ Super as longevity increases and stepping up contributions into and coverage of KiwiSaver will enable all future NZ retirees to have a comfortable retirement.

Retirement in the 20th Century	Retirement in the 21st Century
Funding retirement incomes in 1955 Over 65 population less than 300,000 Life expectancy at 65 - 12.8 years for males and 16.9 years for females. Seven working age people support one pensioner. Age pensions cost 3% of GDP when the universal pension was available from 65.	*Funding retirement incomes in 2055* Over 65 population reaches almost 1.7 million. Life expectancy at 65 – 30.9 years for males and 30.7 years for females. Two working age people support one pensioner. Age pensions will cost 9-10% of GDP if the age of eligibility for NZ Superannuation stays at 65.

Source: Updated version of table 35 p49 of Pensions for the Twenty First Century: Retirement Income Security for Younger New Zealanders Report 2012

3. What Has Changed Since the Last Retirement Income Policy Review in 2010?

Although it is only 3 years a number of significant changes have occurred in both our knowledge and expectations regarding our retirement income policy:

- Only 9% of the population now thinks they could live on NZ Super alone ($357 a week after tax for a person living alone or $549 for a couple).
- 2 million New Zealanders have now enrolled in KiwiSaver.
- We now know that longevity after 65 is increasing much faster than we had assumed earlier.
- We now know that most of us are likely to get to retirement with regrets about how much we have saved.
- We now know we are likely to underestimate how long we will live after 65 and therefore save less than we will need for retirement.
- We now know that saving for retirement pensions (SAYGO) is more efficient than funding retirement incomes out of taxation (PAYGO), provided the return on our investments is greater than the growth rate of the economy.
- From the 2011 Savings Working Group Report we know that the New Zealand tax system is strongly biased in favour of investing in real estate and strongly biased against intermediated financial products based on compound returns such as KiwiSaver.
- New Zealand is now believed to have a national savings problem that means we pay higher interest rates for our investment capital which probably helps keep our currency overvalued.
- New Zealanders want more choices in their retirement savings and their retirement options.
- There is majority support for making KiwiSaver universal (compulsory) for employees across all demographics and all party supporters.
- Some 15,000 New Zealanders have used KiwiSaver balances to purchase a first home and more than 400,000 plan to, if KiwiSaver is made universal.

- Australia's Superannuation Guarantee is maturing and Australians will soon be contributing 12% of their incomes and their total cost of funding retirement will start declining later this century as ours is rapidly increasing. Young people who move to Australia to take advantage of that emerging difference would no longer be here to fund NZ Super. Being able to double your retirement income by leaving for Australia is one more reason why we need to address our retirement income policy settings.

4. What Should Be the Objectives of Retirement Income Policy?

The overall objective for retirement income policy should be that people are able to live comfortably in retirement.

This requires not just an income but that most New Zealanders by retirement should have a debt free home and access to supporting social and health services on an affordable basis.

The objective for NZ Superannuation should be that no one in retirement lives in poverty.

The objective for KiwiSaver should be to fund a second tier pension on top of NZ Super for all New Zealand employees to achieve a comfortable retirement (2 times NZ Super approximately and the opportunity to maintain 40-60% of pre-retirement incomes and consumption) funded by a nest egg in KiwiSaver.

5. We have KiwiSaver, Isn't That Enough to Get Everyone a Comfortable Retirement?

While KiwiSaver has been a very successful innovation in long term savings for New Zealanders; for a number of reasons, the current policies in place will not see most employees achieve a comfortable retirement by saving 10% of their income over their working life to fund a total pension worth 2 times NZ Super. Those reasons include:

- Many employees are not yet enrolled in KiwiSaver and some of those enrolled are not currently contributing.
- Most people that are enrolled in KiwiSaver are contributing below the 10% of salary level necessary to fund a comfortable retirement.
- Many KiwiSavers who defaulted into a conservative investment account will likely arrive at retirement with a much smaller balance in their KiwiSaver accounts than if they had been invested in more growth assets.
- Many people underestimate their likely life expectancy after age 65 so are not likely to save sufficiently and are likely to outlive their savings.
- Many people who think KiwiSaver would be good for them have not got around to enrolling, most of us find it hard to save and procrastinate when it comes to taking the first steps.
- The tax advantages of owning your own home, paying off your mortgage or investing in rental property means many people do not start saving for retirement until they are in their 50s and then find the saving level necessary prohibitive.

The likely impact of all this is that most New Zealanders will end up at retirement with regrets about how much they saved. We therefore need a series of policy changes if we are to achieve a comfortable retirement for all New Zealander employees. The FSC would suggest these policy changes be the subject of the negotiation for a new Accord on Retirement Income Policy.

Saving for retirement is a very long term activity so it is desirable to have a fairly stable policy environment for retirement savings.

The FSC would recommend that this be achieved by having the parties represented in Parliament negotiate a new Retirement Income Policy Accord after the 2014 General Election to replace the one agreed to in 1993.

What would a sustainable retirement income policy package look like?

It might include:

- Having a comfortable retirement income for all New Zealand employees as an objective.
- Indexing the age of eligibility for NZ Super to our improving longevity after age 65 so that each generation on average gets the same number of years of NZ Super 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 to fund retirement like KiwiSaver.
- 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 business, tertiary education or as at present, a deposit on a first home.

6. How Do The Public Feel About These Issues?

The following summary is based on Horizon Research projects from 2010 to 2012 for the Financial Services Council. Similar questions when asked in other surveys have produced similar results.

Overall, New Zealanders aged 18+:

- Believe they are not saving enough for retirement and will not unless compelled to.
- Only 9% think that NZ Super alone will be enough for an adequate income in retirement.
- Only a third believe they will have enough income in retirement to cover basic costs for health, food and accommodation.
- 64% feel New Zealand Superannuation payments will be insufficient to live on in retirement.
- Individuals say they need around $630 per week and couples $845 per week to live comfortably in retirement. The shortfall between what they need and will receive from NZ Super for both individuals and couples is around $300 per week.
- Support for New Zealand having a retirement savings scheme where contributions are compulsory from both employees and employers is strong (59% to 24%).
- 73% – equivalent to around 2.4 million New Zealand adults – believe it was a mistake for New Zealand to abolish its compulsory super scheme in 1976. Only 4% disagree.
- 67.2% think making KiwiSaver compulsory would be good for New Zealand's future.
- 68% - equivalent to 2.22 million adult New Zealanders – agree that New Zealand needs a policy to keep NZ Super but also make a scheme like KiwiSaver compulsory for employees to provide an income in retirement higher than NZ Super alone.
- 48% of adults think increasing KiwiSaver contributions by 0.5% a year from each of the employee and employer until they reach 10% of earnings (5% from the employee, 5% employer) would be a good policy (17.6% oppose).

Retirement Commissioner's 2013 Review of Retirement Income Policy

Specific Responses to the Terms of Reference

1. An update of and commentary on the developments and emerging trends in the retirement income provision area since the 2010 review, both within New Zealand and internationally.

Within New Zealand there has been considerable change since the 2010 review, mainly attributable to KiwiSaver. As at 31 March 2012 there were 1,910,211 members in KiwiSaver schemes with a majority 1,051,820 making contributions.

There has been an increased recognition by the general population that NZ Superannuation on its own is unlikely to provide them with the lifestyle they want (and expect) in retirement. A poll conducted for the FSC by Horizon in December 2012 revealed that only 9% of the NZ population believed they would be able to live on NZS alone.

A Horizon Research survey conducted for the FSC in December 2011 revealed that most people expect to need at least an extra $300 per week on top of NZS in order to have a comfortable retirement.

In other countries the recognition that people are living longer has led to policy changes including moving out the age of eligibility for state pensions (Australia, UK, USA, Denmark, Spain and Germany have put plans in place to move in stages to age 67), reducing the value of pensions or increasing means tests (Australia, Germany, Ireland, Korea) and increasing the contribution rates (Australia moving from 9% to 12% by 2019).

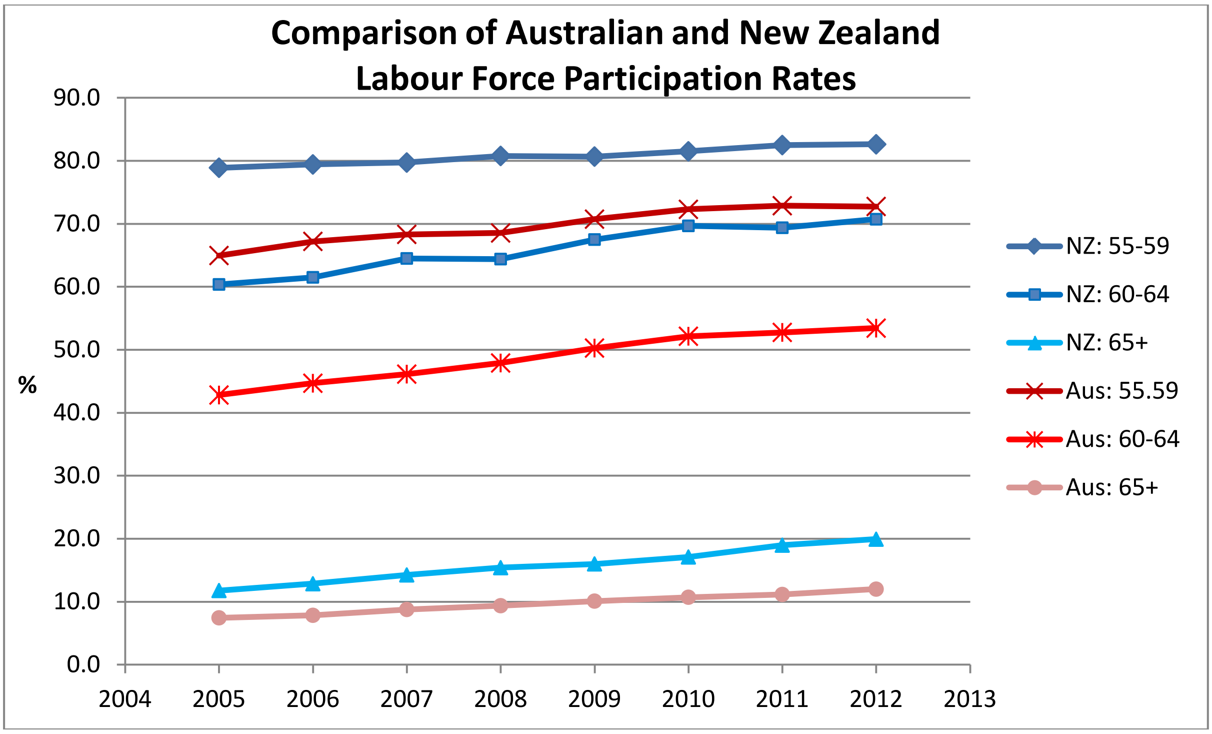
2. The intergenerational impacts of New Zealand's retirement income policy, with due consideration given to:

(a) The effects of increased longevity on present retirement savings schemes.
As noted above, the effects of increased longevity on retirement income schemes have been recognised worldwide and other countries have taken steps to limit the cost of providing state pensions.

The key effect of increased longevity in NZ will be that more people will be claiming NZS and they will be claiming it for a longer period. The long term trend has longevity increasing at approximately 2 years per decade but between 1996 and 2006 the increase in longevity in NZ was an extra 3 years after age 65. The 2006 Census results indicated that in 2051 there are likely to be 160,000 more people over the age of 65 than was previously expected based on the Statistics NZ Series 5 projections.

A 'no change' policy in NZ is expected to mean the cost of providing NZS would increase from 4% of GDP to 10% by 2100. Paying for this out of taxes would mean tax rates would need to increase by about 28% which is likely to make NZ a less attractive proposition for working age people able to relocate to Australia or elsewhere.

The proportion of over 65s still in employment is higher in NZ than many other countries, largely because receipt of NZS is not dependent on ceasing work and is not subject to income or asset testing.



Source: SNZ and ABS unweighted means of quarterly and monthly data respectively

Increased longevity and better health at later ages makes employment past age 65 a realistic option for many people but, unless the age of eligibility for NZS is moved out, does nothing to reduce the fiscal cost.

In personal terms the increased cost will put at risk the implied contract between the generations. That is, that working age people pay taxes and receive in return pensions and health care in their later years. If the cost of pensions forces taxes up to the extent that young workers leave, it may mean a New Zealand populated by grandparents who only see their grandchildren when they can afford to visit them in Australia.

The lack of decumulation products in NZ means those people retiring and withdrawing their lump sum savings from KiwiSaver are faced with the prospect of managing their own fund. This puts them at risk of running out of money before they run out of life. Tax policy changes would assist the development of annuities and other decumulation products by removing the disincentives that currently exist for product providers and purchasers.

(b) Alternative retirement savings approaches.

Previous retirement income policy reviews have mainly focused on those people who are soon to retire. What is needed from this review is a policy that addresses the issue of retirement income for young New Zealanders. They have the most to gain from getting retirement policy right as most of them are going to live longer after the age of entitlement to NZS than any generation before them.

The approach recommended by the Financial Services Council is to maintain NZS in its current form, as a universal Tier 1 pension funded on a pay-as-you-go (PAYGO") basis, but to recognize the likelihood that the age of eligibility will need to move out in order to limit the extra costs from increasing longevity.

The gap between the age that people may like to stop paid work and the age of entitlement to NZS could be funded relatively easily by extending take up and contributions into KiwiSaver to fund a save-as-you-go (SAYGO) second pension into the mix. We now know[1] that, provided the earning rate on savings is greater than the growth rate of the economy, contributing to an asset accumulating fund (SAYGO) is a more efficient way of saving for retirement than directly paying for pensions from taxation (PAYGO).

The relative size of SAYGO and PAYGO pensions when rates of returns and productivity change*

REAL RETURN	LABOUR PRODUCTIVITY GROWTH RATE	SAYGO PENSION ($)	PAYGO PENSION ($)	RATIO
UNFAVOURABLE CONDITIONS FOR SAYGO (LOW CAPITAL RETURNS, HIGH GROWTH)				
3.0%	2.0%	35,738	25,982	1.38
AVERAGE CONDITIONS FOR SAYGO				
3.0%	1.0%	32,072	16,678	1.92
3.0%	1.5%	33,804	20,828	1.62
3.5%	1.5%	39,921	20,828	1.92
4.0%	1.5%	47,252	20,828	2.27
4.0%	2.0%	49,638	25,982	1.91
FAVOURABLE CONDITIONS FOR SAYGO (HIGH CAPITAL RETURNS, LOW GROWTH)				
4.0%	1.0%	45,111	16,678	2.70

** The pensions assume the average wage begins at $45,000 and grows at the productivity growth rate. Each year a person contributes 10% of their income to either an accumulated SAYGO pension fund or to the Government to fund a PAYGO pension. Pensions increase at the productivity growth rate. The working life is 45 years and the retirement period is 19 years. When the working age population increases by 0.25% per year, the cost of providing a PAYGO pension reduces by 10%.*
Source: Andrew Coleman, Motu Research

In 2011 Horizon Research was commissioned by the FSC to ask New Zealanders what level of income would provide a comfortable income in retirement. The result was that most New Zealanders believed they would have a comfortable retirement if they were to receive about $300 above the then level of NZ Super. This is approximately twice the level of NZ Super.

With extension of KiwiSaver membership and higher contribution rates it is a realistic prospect for someone on the median or average wage, who contributes to KiwiSaver over a 40 year working life, to save enough to fund a pension that would double their income from NZS alone. Someone on minimum wage for 40 years could also achieve this if they delayed their retirement until age 67.

The FSC proposal is to introduce a combined approach which would see people accumulating sufficient savings to fund the gap before they become eligible for NZS and provide an additional top-up pension after that.

Pursuing that alternative approach needs a decision to be made on whether membership of KiwiSaver should be universal or optional. If membership continues to be voluntary it should be promoted actively by means such as ‘automatic enrolment days’ every 3 years or so.

Other means to help KiwiSaver members accumulate a substantial pot of savings include removing the tax distortions that penalize compounding savings products and introducing a lower initial contribution rate (say 1% split between employee and employer) with automatic increases of 1% on

[1] Diamond, Peter. 1997. “Macroeconomic aspects of Social Security Reform.” *Brookings Papers on Economic Activity* 1997 (2) 1 – 66

1 April of each year or when a pay increase occurs until a contribution rate of 10% of income was achieved.

The Savings Working Group report highlighted that while investment in rental property had an effective tax rate of 15-20%, the effective tax rate on KiwiSaver was close to 50%.

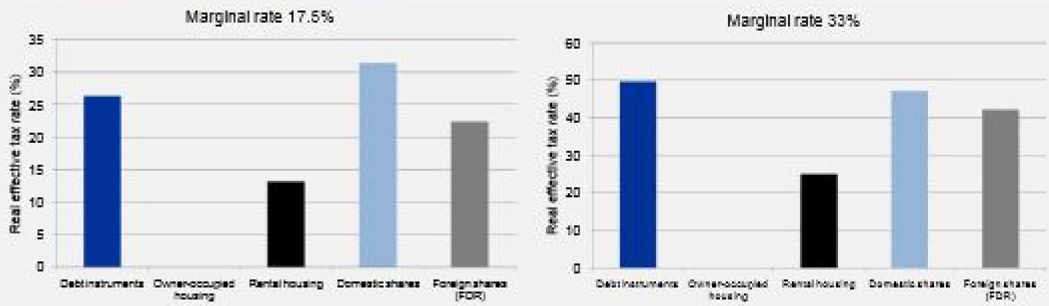
In the example below from the Savings Working Group 2011 Report the debt instruments shown have the same tax treatment as KiwiSaver and other PIE instruments.

Effective tax rates on different classes of investments

Box 6: Effective tax rates on different classes of investments

The following figure shows the effect of inflation and other factors on the effective real tax rates on different classes of assets for investors on 17.5% and 33% marginal tax rates, when the inflation rate is 2% and nominal interest rates are 6%. For rental housing, 50% of the return is assumed to be rent and 50% in non-taxable capital gains.

Figure 7.1: Real effective tax rates



Source: Treasury (2010b)

The large differences in effective rates distort the way people hold their savings and are likely to have played a part in New Zealanders' attraction to owner-occupied and rental housing since these asset classes are tax preferred over shares and debt instruments. The SWG's tax proposals, including broadening PIE and inflation indexation, would reduce these differences by lowering tax rates on the returns from non-property saving options. They would provide a higher after-tax return and thus a more attractive alternative to property investment and would be likely to raise the efficiency of investment and restrain house prices.

Source: p83 Savings Working Group 2011 Report

The FSC has work underway on the significance of the tax disadvantages that KiwiSaver and other PIE savings vehicles face compared with investments in rental property. This work is expected to be completed for release in October.

Financial education also needs to spell out the cost of delaying the start of saving:

The price of procrastination is higher cost later

CONTRIBUTION RATE NEEDED TO ACHIEVE SAME KIWISAVER PLUS ACCOUNT BALANCE AT AGE 65/70 FOR (COHORT TURNING 65 IN 2061) MEDIAN INCOME				
KiwiSaver Plus account balance if you start at age 25 on 10% contribution rate:	Account balance at 65		Account balance at 70	
	Male	Female	Male	Female
	$638,000	$420,000	$781,000	$515,000
Starting age	Required contribution rate (%)			
25	10.00	10.00	10.00	10.00
35	13.84	14.25	13.54	13.90
45	23.60	24.54	21.94	22.64
55	58.64	60.43	46.34	47.12

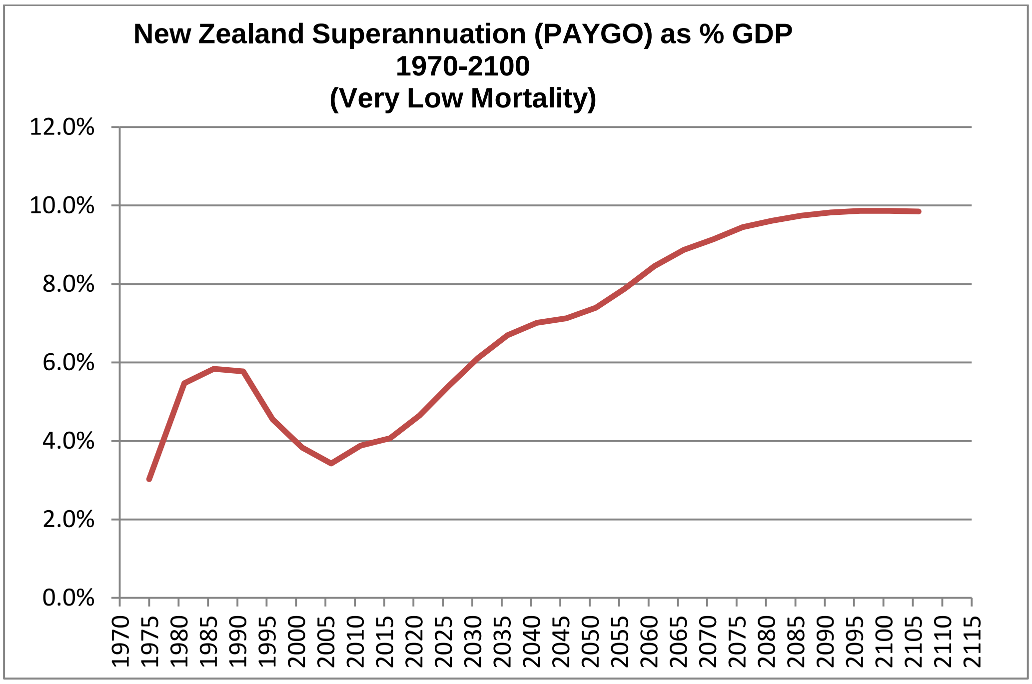
Source: Pensions for the Twenty First Century: Retirement Income Security for Younger New Zealanders p49

(c) The sustainability of New Zealand Superannuation.

When NZ's first old age pension was introduced in 1898 the average life expectancy at age 65 was 12.2 years for men and 13.3 years for women. NZS was never intended to provide a retirement income for every New Zealander for an average, 30 or more years in retirement. That is, however, what it will need to do on current longevity trends if no change is made to the age of eligibility.

The PAYGO design of NZS made sense in a period when each succeeding generation was larger and wealthier than the previous. It does not look sustainable in an environment where the proportion of elderly to young is increasing each year and the lifetime earnings of people now entering the workforce may possibly be less than the previous generation.

The impact of increased longevity on the cost of providing NZS can be seen in this graph.



Source: Infometrics

3. An assessment of the role of private savings for retirement. This assessment should cover:

(a) Trends in KiwiSaver, particularly withdrawal patterns of those retiring and the issues that these may raise.

Total membership of KiwiSaver at the end of April 2013 stood at 2,110,251 of which 1,042,116 had opted in directly via a provider, 253,823 had opted in through their employer and 814,312 had been automatically enrolled. Of the total membership 34% is in the 20 to 34 age band, likely because of the withdrawal and subsidy benefits for first home purchase.

As the first KiwiSaver members have only been eligible to withdraw their savings since 1 July 2012 it is too soon to draw conclusions about withdrawal patterns of those retiring. However, a key trend is the number of KiwiSaver members who are contributing and the rate at which they are contributing. The KiwiSaver Reports published by the FMA for the years ending 31 March include statistics on the number of KiwiSaver members who are contributing to their scheme. Figures available for the past 3 years show:

Year ending	**% of total membership contributing**
31/3/12	55%
31/3/11	55%
31/3/10	60%

The IRD KiwiSaver Evaluation Report for the year ending 30 June 2012 indicates that 59% of members were contributing at the 2% (now 3%) rate. Belonging to KiwiSaver without contributing, or contributing at the lowest rate possible, are not good strategies for building up a sizeable nest-egg for retirement.

Results of a survey conducted by Horizon Research for the FSC in December 2012 indicated most KiwiSavers enrolees were not contributing at all or at levels sufficient to fund a comfortable retirement

KiwiSaver member and employer contribution rates*	Total	KiwiSaver member	
		In paid workforce	Not in paid workforce
I currently contribute 2% and my employer contributes 2%	30.3%	38.2%	9.8%
I currently contribute 2% and my employer contributes 4%	3.3%	4.1%	1.6%
I currently contribute 2% and my employer contributes 8%	0.2%	0.0%	0.0%
I currently contribute 4% and my employer contributes 2%	11.9%	15.9%	0.0%
I currently contribute 4% and my employer contributes 4%	6.3%	8.6%	0.0%
I currently contribute 4% and my employer contributes 8%	0.5%	0.0%	0.0%
I currently contribute 8% and my employer contributes 2%	2.3%	3.0%	0.0%
I currently contribute 8% and my employer contributes 4%	0.5%	0.0%	0.0%
I currently contribute 8% and my employer contributes 8%	0.6%	0.0%	0.0%
I am not currently contributing to KiwiSaver	20.4%	10.8%	50.3%
Not sure	15.7%	14.0%	22.6%
Another contribution rate	7.9%	5.4%	15.7%

Source: Horizon Research 2012

*Note that from 1 April 2013 the 2% employee and 2% employer category will have moved to 3%+3%.

These contribution rates could potentially be improved by allowing more flexibility around rates or "stair casing" contributions into KiwiSaver. For example, one approach could be to provide a new default option for those who are not currently KiwiSaver members that would allow them to enter the scheme at a 1 per cent contribution level split between employee and employer but to step up the contributions by 1 per cent each year or as wages increase.

To achieve a comfortable retirement contributions need to lift to 10%. There would be merit in increasing the minimum 3% + 3% rates by 1% split between employer and employee until the combined total reaches 10%.

Another issue that needs to be taken into account is the number of KiwiSaver members who have been enrolled into a default fund and have remained there rather than moving to another fund that may better match their personal risk profile. According to the FMA KiwiSaver Report as at 31 March 2012, 447,274 of the total membership of 1,910,211 were in a default fund.

The MBIE discussion document for the 2012 Review of KiwiSaver Default Provider Arrangements identified that only 39% of entrants into the default option of their scheme had since moved. The balance may remain in the default fund for the duration of their membership. The implications of that include:

They are likely to accumulate less in investment earnings than if they were in a fund with more growth assets

They will in effect have paid more for each dollar of pension than their peers who take up a more aggressive option

They may in future conclude they were steered into a fund that was too conservative and hold the Government responsible for their lower earnings.

Research behind the FSC report *Pensions for the Twenty First Century: Retirement Income Security for Younger New Zealanders* calculated likely pensions from KiwiSaver fund balances at age 65 using relatively modest expected net return rates of 3% and 4%pa. Using the same base assumptions, further calculations using 3% and 5% rates of return (real, net of tax and fees) indicate that the additional 2% over a 45 year working life results in an extra 30% in available pension at age 65 for a male on the median wage and an extra 24% for a female on the median wage. This means that someone on the male median wage would receive $325,000 less in their retirement pot if they were to stay in a conservative default fund compared with a more aggressive fund that earns 2% more over 45 years. For a woman on the median wage, potentially $205,000 would be left on the table by sticking with the default option. For someone on the minimum wage throughout their working life, $179,000 would be left on the table. These are all significant sums that would make a major difference to a retiree's retirement life style.

(b) The role of the financial services sector in helping to ensure the adequacy of retirement income for New Zealanders.

The introduction of KiwiSaver has enabled the financial services sector to have a major impact on the level of personal saving in NZ. Since 2007:

- More than 2 million New Zealanders have engaged in long-term saving
- 15,000 people, with many more to come, have been able to make a deposit on a first home in a market requiring five times average earnings for a first home compared with three times for their parents' generation
- Increased long-term savings have enabled NZ-based fund managers to invest more in fast-growing New Zealand companies, some yet to be listed
- Despite the worst investment environment for 50 years no KiwiSaver has lost money
- KiwiSaver default fund investors are paying lower fees than they would in Australia or in other products, even given the low balances of many KiwiSaver accounts at this stage

KiwiSaver has proved to be an effective means for improving saving levels in NZ and increasing the pool of local capital for investment. The combination of low administrative costs, individual KiwiSaver accounts, where balances can easily be checked and where KiwiSavers have the option of changing provider has made it the most successful savings innovation in New Zealand's history.

With the brilliance of hindsight we can say that KiwiSaver, including the default arrangements, has been remarkably successful. However, we consider that the financial services sector could provide an even better service if the default provider rules around asset allocation in the default funds were revised to allow new entrants to default into an appropriate investment portfolio according to their stage of life, with a higher allocation of growth assets for the long term. Existing KiwiSavers who have defaulted into a conservative fund could also be allocated to a more appropriate portfolio mix.

The default fund is intended to provide an investment option for those savers who, for whatever reason, do not choose a specific investment option but a more aggressive investment strategy is likely to be more effective for younger savers with a long-term goal of building up a retirement fund.

As discuss earlier, the greatest barrier to enabling all New Zealanders to achieve a comfortable retirement is the current level of contributing membership of KiwiSaver and that contribution levels are at present insufficient to fund a comfortable level of retirement income. For people in their 20s this is 10% but it increases rapidly the longer the commencement of retirement saving is deferred.

4. The contributions made by other policies and programmes, such as in housing and health, to maintaining New Zealanders' retirement income.

Major drivers of the ability to achieve and maintain a desired standard of living after retirement are health and home ownership. Having debt-free accommodation at retirement is essential.

Current tax policies are contributing to pushing up the price of land and home ownership and making it increasingly unaffordable. If these tax policies are being maintained to encourage home ownership they are clearly not effective as home ownership levels for younger New Zealanders are declining steadily. The following extract is from the Savings Working Group in their 2011 report:

Taxes and house prices

A simple pricing model for property investment based on a required risk premium for after-tax returns relative to the after-tax returns on government bonds indicates that the favourable tax treatment of property investment relative to neutral treatment accounts for a good proportion, about 50%, of house price increases (Table 2).

Estimated impact of concessional tax treatment on real house prices, 2001-2007

	Marginal investor	
	Residential property investor	**Owner-occupier**
Actual gain in real house prices	88%	88%
Gain in house prices under neutral tax treatment	47%	41%
Gain in prices due to tax concession	42%	47%
% of price growth due to concessionary tax	47%	53%

Without a capital gains tax, the only way to reduce the tax distortion on property prices would be at the very least to reduce taxes on financial assets, the main investment alternative.

In short, a lower rate of tax on the returns from (especially) long-term savings would provide a higher after-tax return and thus a more attractive alternative to property investment. This would be likely to restrain house prices and therefore aggregate mortgage debt

Source: Savings Working Group Report 2011 p47

5. Women's future retirement income prospects.

Women continue to have lower incomes than men and longer periods out of the paid work-force due to family responsibilities. This means that a woman at age 65 is likely to have a lower level of financial assets than a man of the same age.

The FSC proposal for addressing retirement income needs supports maintaining NZS as a Tier 1 pension but recognises that the age of entitlement is likely to need to move out (in preference to increasing tax rates). It recommends encouraging increased membership of KiwiSaver, with provision for anyone not reaching a certain level of accumulated savings by age 65 to have their savings topped up to a level sufficient to purchase an annuity equivalent to NZS. That would ensure that women with periods out of the paid workforce would still be able to fund the gap between age 65 and a later age of entitlement to NZS and would be able to supplement their NZS pension by purchasing a fixed term pension with their KiwiSaver balance to reach a comfortable level of income in retirement.

6. The role of financial education and financial literacy in retirement income policy.

Retirement income policy must take account of the role of financial education in improving financial literacy which, along with adequate information, is essential to good decision-making. Ideally, savers should be aware of the trend to increased longevity and should understand financial concepts such as the benefit of compounding returns. However, research indicates that is not the case: people tend to under-estimate their likely longevity and most are unable to calculate the effect of compounding returns.

The 2 most important lessons to be built into financial education are the need to start saving early (to benefit from compounding) and the need to have an investment strategy suitable for the saver's risk profile.

As noted above, if the default provider rules were amended to allow default funds to have a more balance approach, either life style or target date funds would provide a better result in the long term than the current conservative investment option which risks savers reaching retirement with less than they could reasonably have accumulated.

A more neutral tax system for retirement savings would also assist KiwiSavers not to be disadvantaged by selecting KiwiSaver over an investment in rental property.

All New Zealanders need to understand the benefits of a lifelong strategy to build and protect their wealth.

The first step is to get the best education and training you can to build up your human capital and earn a good income.

The second step is to aim to own your own accommodation by retirement.

The third step is to insure your life and income and protect your health.

The fourth step is to save for your retirement with the earlier the start the better.

Some young people will learn this from their parents but we would all be better off if we all know this by the time we left school.

Objective information on these strategies should be available to all New Zealanders. The Sorted, FMA and financial sector industry websites should all be making this sort of information available to all.