



2007 Review of Retirement Income Policy
A summary



Retirement Commission
Whiriwhiria!

CONTENTS

02 FOREWORD

04 EXECUTIVE SUMMARY

12 SUMMARY OF
RECOMMENDATIONS

As Retirement Commissioner, my work contributes towards three key elements which together help New Zealanders to prepare financially for their retirement:

- 1 Stable, effective government policy.
- 2 A trusted financial services sector.
- 3 A financially educated population.

One of my statutory duties is to regularly prepare an independent assessment on the first item above: how effective and stable our government's retirement income policies are. This Review is important as it brings a non-political, fact-based assessment to a long-term issue that can be too easily driven off course by political, emotive or short-term expediencies.

I, and the independent experts who have worked with me on this report, have been mindful of all three elements above as we have undertaken this Review.

A huge amount of work is already in progress by the Ministry of Economic Development on potential regulation of financial products, services and advisers to help develop a trusted financial services sector. The second item of the framework is therefore not a focus for this Review, and should be addressed in greater detail in the next Review, in 2010.

This Review is a summary of a number of complex issues. Several background papers were commissioned for it. To keep it accessible, many of the details have not been repeated; but I urge interested readers to read these papers for the full picture. They are available on the Retirement Commission's website www.retirement.org.nz.

I established an Advisory Group to assist me with this Review. The feedback from the members of this Group has been invaluable to me as I have undertaken the Review, and I thank them for it. I would also like to acknowledge and thank many others for their assistance with this Review:

- » All of those who sent submissions, with especial appreciation for the high standard of these.
- » The many other people who met to discuss the content and progress of the Review, particularly the Reference Groups.
- » The members of the Project Team, particularly Anna McMahon and Alison O'Connell, who made sure this review drew on all relevant information and delivered within the required timeframes.
- » All of those in the Retirement Commission who provided varied support throughout the course of this project.

The views expressed in this report are those of myself as the Retirement Commissioner.

We hope that this Review helps to deepen our shared understanding of current retirement policy and where it is heading.



Diana Crossan

RETIREMENT COMMISSIONER

New Zealand has had, whether by luck or good management, a straightforward and stable retirement income framework for some time.

New Zealand Superannuation (NZS) is a remarkably effective, simple and secure foundation for retirement income. It means that New Zealanders – and especially women – are less at risk of hardship in later life than people in many other developed countries. The current structure of NZS – a benefit defined as a proportion of the average wage, paid to people eligible on the basis of residency and age – should be maintained.

More people are reaching the age at which they can receive NZS, and living longer thereafter. Decisions will need to be faced on how and when to react to this trend. More work is needed to understand better the likely future longevity of New Zealanders, and to assess possible policy options. That work should start now, so that decisions can be made in time for a long notice period to be given to those affected by any adjustment.

The question of whether New Zealanders collectively are saving 'enough' for retirement is important, but unanswerable. We cannot know how saving behaviour will change in future, or whether savings will meet expectations at retirement. Now that we have an accessible, portable and highly incentivised savings scheme in KiwiSaver, this Review finds no reason to financially incentivise saving for retirement further, or to make it compulsory.

Savings policy encourages the aspiration to have more than NZS in retirement. Not everyone will be able to save for retirement at all times, especially if on a low income. NZS may meet the retirement income expectations of some people on the lowest incomes. The savings debate needs to reflect the variety of individual financial circumstances and choices. The debate should also reflect that for many people, buying a home to live in is a crucially important part of preparing for retirement.

KiwiSaver has brought additional complexity and new fiscal risks, because of the high cost of the generous new incentives. Government will need to evaluate the outcomes and cost of KiwiSaver fully. Will New Zealanders' retirement finances improve overall? Will those who find it hard to save unfairly miss out on the incentives? Can New Zealand continue to afford the current level of KiwiSaver incentives?

Having a savings plan in the workplace should make it easier to save, and possible to save without making many active decisions. However, many New Zealanders are now facing complex investment decisions for the first time. More should be done to give consumers clear and helpful product information, for example, to enable comparisons of the cost of KiwiSaver products. To improve financial decision-making skills, financial education should be enhanced as an integral part of government policy.

Paid employment at older ages is likely to be an important source of income for many people. Although there are now no legal barriers to working at older ages, negative attitudes still exist. This Review supports efforts to make it easier for those older people who want to remain in employment to do so.

More needs to be done to help people manage their money throughout retirement. Government may be able to ease some barriers to the provision of annuity and home equity release products. So that people can choose between all the options with confidence, the Retirement Commission's information role can be stepped up.

Merits of New Zealand's current retirement income policy

In general, this Review agrees with the assessment of the 2003 Periodic Report of retirement income policies that New Zealand retirement income policy is working reasonably well for the currently retired and those approaching retirement.

NZS has been remarkably successful in providing retirement income adequacy for most older residents, at a cost level which is lower than that of the public pension systems of most other developed economies. It scores well on the traditional criteria for assessing retirement income policy in New Zealand: adequacy, simplicity, flexibility, certainty, fiscal affordability, equity and fairness. NZS is much admired because:

- » It is virtually universal, keeping the basic income of nearly all older New Zealanders above the hardship level.
- » The living standards of older people relative to others are maintained by generally increasing NZS in line with average wages.
- » It gives older people a regular basic income regardless of how long they live, so is a protection against longevity risk.
- » It treats men and women equally, independent of marital status or income history.
- » It does not discourage saving, or employment at older ages.
- » It is simple to explain and run.
- » It operates at a low administrative cost.
- » Its long-term sustainability as the population ages is helped by the NZS Fund.

To complement the state provision of NZS, KiwiSaver provides a private savings vehicle designed to enable people to build up some financial assets for use primarily in retirement. KiwiSaver should make the biggest difference to young people: the longer people have to save, the more they will be able to accumulate. The introduction of KiwiSaver into retirement income policy has some key advantages:

- » KiwiSaver is simple to join and stay in. Employees are auto-enrolled and others can opt in. The KiwiSaver account is portable on changing jobs.
- » KiwiSaver saving is made from pay before there is a chance to spend the money, and most is generally locked-in until age 65. It is an easy way to make retirement savings for those that can afford to do so, but need some discipline to start and keep saving.
- » There are generous incentives for saving in KiwiSaver and for first house purchase. This will help savers to build up financial assets alongside buying a home.
- » Because KiwiSaver is voluntary, individuals have to make decisions about their own account. This may help to improve consumers' understanding of saving.
- » KiwiSaver, it is hoped, will stimulate New Zealand's capital markets and strengthen the economy.
- » The voluntary rather than compulsory nature of KiwiSaver means that government avoids an open-ended guarantee on the value of future retirement benefits.

KiwiSaver is consistent in outline (although not in design detail) with the proposals of the Savings Product Working Group, which was set up following the 2003 Periodic Report.

Concerns and risks identified by this Review

While the basic principles and structure of New Zealand's retirement income policy are sound, this Review identifies some concerns about the direction of policy, and risks to its long-term sustainability. The major issues are outlined below.

New Zealand Superannuation (NZS)

- » Given the effectiveness of NZS, it is important to know that it can continue as the number of recipients increases. There is great uncertainty in how fast life expectancy will increase. It seems likely that people will live longer than current policy planning expects. This would lead to NZS costing more than currently envisaged.
- » There is some confusion in the way in which NZS works for some people who migrate in or out of New Zealand. This is because eligibility for NZS is on the basis of residency, and generally entitlement is 'all or nothing'. This works well for the majority of New Zealanders, but differs from the way eligibility is determined in other countries.

The savings debate

- » Assessment of the adequacy of current levels of saving for retirement is hampered by insufficient data and by the complexity of the analysis needed. Interpretation of findings on saving is not straightforward. Indications are that most over-45 year olds are saving 'enough' to smooth their pre-retirement spending into retirement, although a minority of 45-54 year olds may not be. However, it is not clear how much of a problem this is, or will be in future.
- » Younger people have always had lower net worth and have saved less than older people. The available data does not conclusively prove that successive younger age cohorts are saving less than previous cohorts of the same age. However, there are some signals that the retirement income of today's under-45s may be of more concern than that of today's over-45s.

- » Low earners, those who earn irregularly or take career breaks, and those who take on caring or cultural commitments are not well placed to save consistently for retirement. The savings debate tends not to reflect the difficulties of low-income savers.
- » Home ownership is falling in all age groups. House prices have increased markedly, and buying a home through a mortgage takes more income than it used to. The standard of living in retirement is better for those who own the home they live in mortgage-free. But as more income during working life is needed to pay the mortgage, additional saving for retirement becomes more difficult.

KiwiSaver

- » KiwiSaver's generous incentives will compound the gap in retirement income between those who have saved and those who have not, threatening the equity and fairness of current retirement income policy.
- » The introduction of KiwiSaver has made retirement income policy more complicated, and more likely to be subject to change. Stability of policy is important so that New Zealanders can have confidence in the future of KiwiSaver.
- » KiwiSaver has made retirement income policy more expensive. Treasury has estimated that the cost of KiwiSaver incentives will exceed \$2 billion a year by 2016, but has not estimated how the cost may grow beyond then.
- » Fee levels and asset mixes in default KiwiSaver funds are different, so that savers risk lower retirement funds purely as a result of the random assignment process.

The financial markets, information and education

- » New Zealand needs high standards in product information, investment management, selling practices and consumer protection. It also needs an efficient capital market. The Ministry of Economic Development's review of the financial sector is vital. However, implementation will not start before 2010.

- » High standards in investment product cost disclosure will become more important. In particular, choosing a KiwiSaver fund is more difficult than it needs to be, as product costs are disclosed in different ways, making consistent comparisons near-impossible.
- » Given the more complex financial decisions active consumers now face, there is scope to extend and improve financial education. But current initiatives are uncoordinated, and not easily accessible to all, in particular in schools. What works best in financial education is not well understood.

Employment of older people

- » Employment at older ages can make a significant difference to individuals' financial and general well-being in later life, and also to the nation. New Zealand has one of the highest labour participation rates for older people among OECD countries, and it is growing. However, barriers to older people working if they want to still exist. There are initiatives aimed at helping older workers to find and stay in employment. These initiatives may not be learning enough from each other.

Managing assets and income in retirement

- » The decisions on how to manage money through retirement are individual, often complicated, and may present challenges to many older people. Further, there are anecdotal cases of older people suffering financial abuse.
- » There are virtually no annuities sold in New Zealand. They may become more popular as people retire with accumulated KiwiSaver savings. There are some major barriers to the development of annuities, not least the uncertainties of longevity risk, and the taxation of annuities, which makes them poor value for money.
- » Home equity release can provide modest amounts of capital in retirement for some older people, but would not be right for everyone. There has so far been limited demand for such products. Given the vulnerability of the potential customers, good regulation needs to be assured. There is some confusion on the interaction of home equity release products with state benefits.

Taxation issues

- » Tax neutrality between asset classes has generally improved, with a bias now towards retirement saving through the KiwiSaver incentives. The complexity of personal taxation has increased. As older people's income reduces, those who are no longer required to fill in a tax return may be left paying tax at a higher level than they should.

This Review discusses actions to address each of these concerns. The next section summarises the main recommendations of the Retirement Commissioner.

SUMMARY OF RECOMMENDATIONS

To address the concerns and risks in retirement income policy identified in this Review, the Retirement Commissioner recommends:

General

1. That these independent Reviews of Retirement Income Policy continue on a 3-yearly basis, because retirement income policy is complex and involves many agencies.
2. That the Retirement Commissioner, by mid-2009, reports on progress made on the recommendations set out in this Review to the Minister of Social Development and the Minister of Finance.
3. That, in the interests of having a comprehensive fact base for evaluating retirement income policy, special surveys, notably the Living Standards Survey, the Survey of Family Income and Employment (SoFIE), the Household Savings Survey (HSS), and the Financial Knowledge Survey, are continued and enhanced where necessary.
4. That the Retirement Commission works with Treasury and the Ministries of Social Development and Health to ensure that there is an appropriate research programme in place to assess how the costs of health, residential and in-home care for older people will impact on their personal finances.

New Zealand Superannuation (NZS)

5. That the basic structure of NZS be maintained.
6. That political consensus is sought for any future changes to the parameters of NZS, and such changes are made with long lead times in order to allow individuals to adjust their retirement planning.

7. That Treasury, by end 2008, reports on the necessity, feasibility and implications of options for the future financing of NZS, because there are likely to be more recipients of NZS in future, with longer life expectancies.
8. That, by mid-2008, the Government completes its review of the 'portability' aspects of NZS for people who migrate to or from New Zealand, and announces its decisions, and that the Ministry of Social Development takes steps to clarify the decision and appeals process for unusual NZS cases.

The savings debate

9. That the Retirement Commission, in 2008, develops financial education initiatives targeted for those on low incomes, including Māori and Pacific groups.
10. That the messages of government and other public bodies on the concern that New Zealanders tend to over-invest in residential property are referenced to multiple housing investment, and that such messages reflect that investing in a mortgage to buy a home to live in is an important part of preparing for a good retirement.

KiwiSaver

11. That Inland Revenue fulfils and extends its plans beyond 2013 to evaluate KiwiSaver on the *outcomes* from the policy, in particular, whether KiwiSaver has improved retirement wealth overall for households, and what its distributional impact has been. That these outcomes are examined by analysing the spread of take-up and the value of incentives received by different households: by income level, gender, ethnicity, age, whether disabled, and employment status.
12. That Treasury, by mid-2008, publishes the likely future fiscal cost of KiwiSaver on different demographic and economic scenarios, with commentary on its sustainability in its current form over short-, medium- and long-term time periods.
13. That the Ministry of Economic Development, by mid-2008, reports on whether KiwiSaver default funds should have the same level of fees, on the prescription of asset mix, and on any other changes to default fund legislation in order for passive KiwiSaver members to stand a fair chance of even outcomes.

The financial markets, information and education

14. That the government instructs the Ministry of Economic Development to fast-track the intended regulation of financial advisers.
15. That the 2010 Review of Retirement Income Policy considers the progress in implementation of the Ministry of Economic Development's widely-supported initiatives to develop high standard consumer protection and market conduct regulation in the financial sector.
16. That the Retirement Commission, working with the savings industry, keeps its comparison information on the cost of KiwiSaver products up to date and accessible to the general public.
17. That the Ministry of Economic Development considers, as part of its ongoing review of the financial sector, whether the number of fee types for savings products, including KiwiSaver, should be restricted, and whether disclosure of fees on a 'one figure' comparable basis should be mandatory.
18. That the Ministry of Education, from 1 July 2009, takes responsibility for the schools project currently within the Retirement Commission, to ensure that financial education is embedded in the schools curriculum.
19. That the Retirement Commission maintains and enhances its workplace-based information and education programme.
20. That the Retirement Commission reports annually on progress on the National Strategy for Financial Literacy.

Employment of older people

21. That the Department of Labour, by mid-2008, develops a plan outlining how co-ordination could be improved among the agencies involved in initiatives – research, practical support and advice, public information and policy changes – that support older New Zealanders to find and stay in paid work, and the benefits of doing so.

Managing assets and income in retirement

22. That the Ministry of Social Development monitors trends over time in the size and distribution of financial assets held by older people, in order to give some indications of the issues facing older people in managing assets in retirement, including the potential demand for annuity and home equity release products.
23. That the Retirement Commission, by end 2008, updates and extends its information about options for managing assets throughout retirement, and provides that information to older people in ways other than the internet, including liaising with other providers of information to older people.
24. That the Ministry of Social Development, by end 2008, considers how the issue of financial abuse of the oldest people can be addressed within current social services.
25. That Inland Revenue, by end 2008, reports on the feasibility and implications of achieving tax neutrality in the treatment of annuity products.
26. That the Ministry of Economic Development, by end 2008, puts the code of practice for home equity release providers, being developed by the Office for Senior Citizens, into legislation.
27. That the Ministries of Economic Development, Social Development and Inland Revenue together, by end 2008, look at all of the interfaces of home equity release products with state benefits to confirm a consistent policy that can be communicated to consumers in a straightforward way.

The Retirement Commissioner expects that all of the above recommendation reports will be made publicly available via departmental websites.