

**Submission to the Retirement
Commissioner**

on the 2010

**Review of New Zealand's Retirement Income
Policies**

by

AMP Financial Services



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Introduction

AMP is pleased to take the opportunity to make a submission on the Retirement Commissioner's 2010 Review of Retirement Income Policies.

AMP is one of New Zealand's oldest financial services companies having operated in New Zealand since 1854. AMP manages the savings of over 370,000 New Zealanders and is a provider of KiwiSaver, employer superannuation, personal superannuation, unit trusts and life insurance products.

Retirement savings products are a core part of AMP's financial services offering. AMP is one of six default KiwiSaver schemes and is presently the third largest KiwiSaver provider by funds under management. The New Zealand Retirement Trust is New Zealand's largest workplace superannuation master trust with assets of \$1.35bn, 33,000 members and 600 employers.

AMP operates an advice based distribution model through the AMP Adviser Business network - a nationwide group of 101 independently owned and operated businesses employing 367 financial advisers. In addition AMP has 9 employed financial advisers. AMP is presently preparing to apply for Qualifying Financial Entity status under the Financial Advisers Act.

AMP is a member of the Investment Savings and Insurance Association (ISI) and a participant in the Insurance and Savings Ombudsman Scheme (ISO).

From a political perspective we see the overall framework for state provided superannuation as broadly settled – universal entitlement to non-means tested New Zealand Superannuation (NZS) supported by the New Zealand Superannuation Fund. This view is supported by AMP's Superwatch survey¹ of August 2009 where nearly two thirds of respondents supported keeping the age of eligibility for NZS at 65. However, recognising the increasing costs to the state of an increasingly aged population, there may be political room to increase the age of eligibility as is happening in other developed countries. Perhaps in recognition of longer and healthier retirements, the greatest support in the Superwatch survey for increasing the eligibility age came from those closest to retirement. The February 2010 Superwatch survey also revealed a significant increase in those expecting to work beyond age 65, perhaps in response to the reduction in the value of their retirement savings.

An increase in the eligibility age for NZS will highlight the varied life circumstances that older people find themselves in. Private retirement savings, including KiwiSaver, are ideally placed to provide the necessary flexibility in retirement savings needs.

¹ AMP's Superwatch survey is a statistically robust survey of New Zealanders' responses to a number of retirement savings issues. Superwatch is conducted for AMP by Colmar Brunton and the latest results are from February this year.

In this submission we have confined our responses to those areas where overall retirement policy settings can be improved to support the financial sector in providing coherent retirement income products, including KiwiSaver.

Summary

1. While significant progress has been made on regulatory development since the 2007 review, particularly for financial advisers, we are, of course, still in the middle of both significant detailed implementation and policy development (e.g. securities regulation) that affects retirement planning directly. While AMP supports the broad direction of regulatory development as necessary to increase public confidence in retirement planning and financial services in general, the overall impact is only likely to emerge after the next triennial review.
2. The issues around the low-risk KiwiSaver investment option cannot be fully resolved when KiwiSaver has such divergent savings objectives as retirement and first home purchase. Without the opportunity for withdrawal for first home purchase, a default 'life-steps' investment option that invests in a fund with investment risk appropriate to the member's age would be a reasonable approach. However, the first home purchase option makes the low-risk default investment option the only safe alternative. Consideration should be given to removing the first home purchase option from KiwiSaver.
3. KiwiSaver has been an outstanding success in terms of public take-up. This success can only leave us optimistic that KiwiSaver members will reach retirement with significant savings. However, the generosity of up-front KiwiSaver incentives that have contributed to its success are unbalanced and, in particular, do not support the conversion of retirement savings into the income stream they are intended to provide.
4. At this early stage of KiwiSaver's life, the present level of government support for KiwiSaver could easily be remodelled to both encourage the saving phase and support the retirement income phase. For example, the present level of support is broadly comparable in cost to exempting contributions and investment income from tax and the basic 2%/2% KiwiSaver contribution level. Formally moving to a EET taxation model and taxing retirement withdrawals from KiwiSaver accounts as income, would support a coherent framework for both the savings and retirement income phases.

Submission

Developments since the 2007 Review

5. A number of the major developments affecting retirement income that were noted in the in the 2007 Review are both having a major impact on the retirement income framework or are still in the middle of development. These include:
 - The introduction of KiwiSaver.
 - The 2009 changes to KiwiSaver, including the reduction in the minimum contribution rate to 2% of salary and wages (and corresponding tax free employer contributions to the same rate) and the removal of the fee subsidy.
 - The overhaul of financial services regulation with the details of financial adviser regulation presently being finalised and the review of securities regulation about to commence.
 - 18 months of economic recession in New Zealand and the global financial crisis;
 - The paralysis of international credit markets that saw the introduction of a deposit guarantee scheme for banks and finance companies.
 - The almost complete collapse of the New Zealand finance company sector which will see around 100,000 household investors loose perhaps \$3bn.
 - Trans-Tasman portability of KiwiSaver and Australian SGC.
6. In addition, changes resulting from:
 - The Tax Working Group's work, with changes to be released in the May Budget, are expected to result in a realignment in tax impost that will impact on savings; and
 - Detailed development of the recommendations from the Capital Markets Development Taskforce;will continue to impact on the overall savings environment and particularly retirement savings.
7. As a major provider of KiwiSaver, workplace and retail retirement savings products, AMP recognises the negative impact on public confidence in the savings industry that finance company collapses, poor financial advice and fund governance has had. This is particularly true for long-term retirement savings where substantial retirement accumulations are exposed for decades to market and provider performance.
8. The significant 'incentives' to KiwiSaver contributions mean that, in general, it is not financially advisable to pay off debt in preference to saving through KiwiSaver. However, at this stage, and given the complicating effect of the global financial crisis, it is difficult to say what effect a commitment to long-term, locked-in savings will have on households' savings/debt situation.
9. We noted in our submission to the 2007 review that high household debt levels was an issue of national importance. The global financial crisis illustrated the national

risks of such a large exposure to, and reliance on international credit markets. Household savings remains an important issue and retirement savings is a significant part of that.

2010 Review Topics

Government Agencies

10. From a financial services perspective, the enormous amount of regulatory development that is presently underway highlights the potential for complex and inefficient overlap of regulatory functions both for the industry and consumers. While the final results will often only be known when the regulatory framework is finally in place, multiple anti-money laundering supervisors and consumer complaints resolution bodies are examples of policy decisions already taken that are needlessly complicated. From a retirement savings perspective, streamlined regulatory oversight needs to be a key objective of the review of securities regulation that is presently underway; e.g. the value of trustee and regulator oversight needs to be viewed critically.

Role of NZ Financial Services Sector

KiwiSaver

11. There is little doubt that the outstanding public success of KiwiSaver is due in large part to the nature of the incentives to join. An immediate kick-start of \$1,000, matching 'tax-credit' up to \$20 per week and employer contributions up to 2% of salary or wages mean that for each \$1 saved, a majority of members immediately have \$3 in their KiwiSaver account (at least when member tax credits are paid). This is clearly too great and immediate an incentive to ignore.
12. AMP has consistently argued, in response to the normative position that all savings should be treated equally, that retirement savings are a special and extreme form of savings and demand a different treatment – the typically pejorative 'incentives' in the language of the normative view. Retirement savers can reasonably expect to be compensated in some way for foregoing consumption until age 65.
13. However, while KiwiSaver incentives have clearly captured savers attention and some sort of retirement savings 'incentive' is justified, our view is that they are unbalanced and do not support an integrated approach to the accumulation and retirement income phases.
 - The encouragement is front-loaded in respect of contributions. Once the incentive is received there is only the statutory prohibition on withdrawal that encourages continuing membership and prevents savers immediately accessing the benefits.

- Once savers reach the age of eligibility for NZ Superannuation, they have immediate access to their accumulated KiwiSaver funds - there is no inbuilt or regulatory framework to support or encourage an income stream.
 - The large, up-front taxpayer support is not balanced by a contribution to the tax base by retirees once they receive their retirement income and make greater demands on public health and superannuation.
14. The appropriateness of the low risk investment option to retirement savings for default schemes generates a lot of market commentary. From an investment risk perspective, KiwiSaver design has two potentially widely different savings goals – first home purchase and retirement. After 3 years membership, the first KiwiSaver members will soon be able to withdraw funds for first home purchase whereas NZ Superannuation will typically be a number of decades away. A saver with a 3-year savings horizon should have low risk, fixed interest savings, not the higher return, higher risk equities suitable for retirement in 30 years. Without an understanding of the savers objective, a low risk default investment option is the only approach that will avoid an inappropriate choice, including short-term losses, for some savers; e.g. young members.
15. If first home purchase remains a withdrawal option, then delivery of needs based financial services demands that the member's saving objective is determined before the investment option is selected. KiwiSaver providers can, and do, provide information to help members make appropriate investment choices - but the challenge, particularly with default members, is to engage with them in a cost effective way. Of course, the Sorted website also provides information that can aid investment choice. However, the circumstances of default KiwiSaver membership imply a low level of member engagement that militates against passive advice and any interruption to the default membership process will compromise the enrolment success of this feature. The fees for default investment options are low and tightly controlled which makes personal advice from authorised advisers difficult for providers to justify financially. We would also expect explicit advice fees to be resisted by default members.
16. On the basis that any complication in financial services serves to disengage the public, the best way to resolve this fundamental mismatch in investment objective is to keep the savings purpose for KiwiSaver strictly for retirement income. In order to honour existing commitments, this could be introduced for new KiwiSaver members only.
17. The success of KiwiSaver with 1.37m members and over \$5bn saved highlights the need for the ongoing development of sound customer disclosure and fund governance within an efficient regulatory framework. In this context AMP supports ISI's development of:
- Standards of fee disclosure for investment products;
 - Investment performance reporting standards; and

- Replacement of commission with negotiated fee for service for financial advice on investment products including KiwiSaver.

Retirement income phase

18. As mentioned above, KiwiSaver is proving an effective scheme to provide a lump sum at retirement, but once eligibility age is attained, there is no framework to provide for or encourage the basic purpose – a retirement income. The factors that have led to the almost complete lack of sales of annuities in New Zealand and the resulting withdrawal of providers from the market are well covered in the 2007 report.
19. The basic retirement income needs and protection against longevity risk are met by the universal and non-means tested nature of on New Zealand Superannuation. Because of the variety of circumstances retired people face, particularly in health and physical ability, and that income needs often decrease with age as people are less active and spend less on leisure activities, a flexible approach to the generation of a retirement income from KiwiSaver savings is appropriate. If the age of eligibility for NZS was increased, the range of personal, particularly physical, circumstances people experience would be expected to be greater. Flexible access to personal retirement savings would aid the transition to NZS.
20. Turning KiwiSaver retirement lump sums into retirement income could be mandated on the grounds of the substantial government encouragement during the saving phase. However a rules based approach will be likely to be complex with a significant compliance burden to achieve the flexibility in retirement income arrangements needed by older people.

KiwiSaver and retirement income taxation

21. The unbalanced KiwiSaver incentives mentioned above (large and up-front), and the need to find a way to encourage an income in retirement, suggest that deferring tax on retirement savings until the retirement income phase is a viable option. Employer contributions up to 2% of salary or wages are already tax-free and the member tax credit is equivalent to tax-free member contributions of substantially more than that (three to four times). While the immediate fiscal cost of fully exempting the investment income of KiwiSaver investments would grow with time, moving to an EET tax regime for both the accumulation and retirement income phase for KiwiSaver (i.e. taxing retirement withdrawals from KiwiSaver accounts as income when it is received) would:
 - a) have a comparable immediate fiscal cost to government as the present 'incentives';
 - b) be a continuing encouragement to KiwiSaver savings;

- c) provide an inbuilt incentive to deferring spending of savings in retirement as large withdrawals would attract high income tax – i.e. encourage an income stream;
- d) provide flexibility in withdrawing KiwiSaver funds;
- e) broaden the tax base at the point where the elderly are making the greatest demands on public services, particularly health;
- f) and finally, provide a good reason to transfer Australian SGC contributions to New Zealand.

22. While this proposal may appear a radical change of direction and offend the policy stability criterion, given the short history of KiwiSaver and the level of government support applied to contributions up-front, such a change is justifiable given the benefits to a coherent overall retirement income framework.

23. Flexible withdrawal of retirement savings, whether supported by the tax system or not, will need competent financial advisers and financial service providers providing savings portfolios that meet the individual retirees income needs and timing. We are confident that portfolio construction advice and technology will be developed to meet customer needs in an efficient and effective way for even modest retirement sums.