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“NEW ZEALANDERS ARE WORRIED - SHOULD THEY BE?”

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There's a range of views about the current economic downturn:

From being “swept away in the financial vortex” as we read in the *NZ Listener*, to a Sunday newspaper columnist asking “is the recession simply another case of Y2K?” .

Much of what is happening started on Wall Street.

We cannot lose sleep over what bankers in New York, Japan and Europe do next, or how the government of China will react, but there is no doubt that many New Zealanders are feeling a real impact, as they lose their jobs or their savings.

There are also many New Zealanders who feel they have not been directly affected so far, but are anxious about what might happen next.

I've even heard a new term being used: “recession depression”.

New Zealanders are worried

So what are New Zealanders worried about, and are they right to be worried?

The comments I've been hearing from people I meet or people who have contacted the Retirement Commission include concerns such as:

“Lots of people are losing their jobs”

“The kids will never be able to buy a house”

“Credit card debt is out of control”

I want to look at whether these concerns are realistic.

Employment

It is true that people are losing jobs.

The unemployment rate measured by the Household Labour Force Survey is increasing. It was up to 4.6 percent in December 2008 - the highest since 2003.

The number of people getting the unemployment benefit is also up - Work and Income report 35,000 people are on the benefit, up from 23,000 last July.

This is still far short of the worst unemployment figures; some of us remember unemployment peaking at 10.9 percent in 1991.

We can't predict how many jobs will be lost.

But we know that for every individual who's been made redundant, it's a personal crisis.

Housing

If we look at the cost of servicing a standard mortgage for the median house, as a proportion of the mean gross income, we can see it's harder to afford a house than it was 10 years ago.

In 1998, it cost 40.5 percent of the mean gross income to service a standard mortgage for the median house.

By 2001, this figure had dropped to 30.9 percent.

By 2004, it was back over 40 percent, peaking at over 60 percent in 2007. It's currently 48.7 percent.

Generally, government agencies start to worry about affordability problems if people are spending more than 30 percent of their income on housing costs.

A year ago (March 2008) the Department of Prime Minister and Cabinet (DPMC) reported that house prices had increased by 80 percent since 2002. <https://www.dpmc.govt.nz/dpmc/publications/hpr-report/hpr-4.html>

That report identified a growing group that could not afford a mortgage.

Since then, house prices have fallen and mortgage interest rates have fallen. However, saying that, Kiwibank, Westpac, ASB, BNZ, ANZ-National all increased their fixed rates last week.

We can just see the start of a downward trend towards houses becoming more affordable.

It's hard to predict how far this trend will go. It's hard to predict anything - because the world has changed so much.

Banks have become more cautious and are requiring bigger deposits - up to 25 percent.

So people are right to worry that it's not easy for the younger generation to buy a house.

One option for some families may be that parents who can afford it could help the kids get the deposit together.

Home ownership

The DPMC report also mapped a decline in home ownership over the past couple of decades.

In 1981, 71.4 percent of New Zealand homes were owner-occupied. In 1991, this was 73.8 percent. Since then it's declined, to 66.9 percent in 2006.

Owning your own home is one of the most important factors in maintaining good living standards in old age.

The Ministry of Social Development's Living Standards Report (2004)
<http://www.msd.govt.nz/about-msd-and-our-work/publications-resources/monitoring/living-standards/living-standards-2004.html>

shows that for people aged 65 or over:

58 percent of those who owned their own home were recorded as having a good standard of living ... with 37 percent having a comfortable living standard.

That compares to 19 percent of those renting having a good standard of living, and 13 percent of those who are Housing New Zealand Corporation (HNZC) tenants having a good standard of living.

Currently, 80 percent of people over 65 own their own home.

But if we don't see an ongoing improvement in housing affordability, then in future that ownership rate won't be as high, and we should be worried about the long term impact of that.

While it is sensible to invest in owning your own home, that doesn't mean putting all your retirement savings into the one property you're going to live in.

I've seen and heard of many people who upgrade their house in their 40's, thinking they will sell down and get some money out when they retire. But then when it comes to the crunch, they say they can't face moving out of the family home or away from their community.

Or the children don't want them to sell.

Or a new house in a desirable retirement location costs the same as the old.

So they find themselves asset rich and income poor. That then drives the market for home equity release products.

We've provided advice on the Sorted website to people considering that option.

For the 15 percent of households who own an investment property, the fall in prices is a concern - just as the reduction in interest rates is a problem for those with their retirement savings in short term deposits.

How much of a problem this is for individuals, depends on how far away from retirement they are.

Debt

Credit card debt is currently \$5.3 billion.

Many New Zealanders have been "maxing out" their credit cards.

Credit card debt is easy to get in to, hard to get out of, and expensive, with high interest rates.

People are starting to take the sensible step of putting the card "on ice" - not taking on more debt and paying off as much as they can. Credit card debt is down \$0.1 billion from the December 2008 figure; although we still hear of people getting another credit card to pay off their credit card debt.

But credit card debt is just the tip of the iceberg.

What we should be worrying about is the net wealth of a person or a household.

The outstanding consolidated student loan balance as at 30 June 2008 (latest official data) is \$9.6 billion.

Total household debt at December 2008 was \$174 billion - equivalent to 158 percent of disposable income.

I'm concerned at this level of debt.

More than 90 percent of this is housing debt, the rest is personal loans, such as for travel or a new car, and credit cards.

Another impact of falling house prices is that some people who borrowed against the house now have more debt than equity.

Family Budgeting Advisory Services are reporting more middle-income people coming to them with problems. For example, a professional couple, both made redundant in the same week, with a half a million-dollar house and hefty mortgage, recently sought help.

One budget advisory office in Auckland has had to deal with 24 requests for mortgagee sales assistance already this year.

And I'm particularly worried when I hear of people borrowing from a loan shark to pay the mortgage.

The economic downturn is making it harder for some people to manage their debt. That has the potential to cause problems for them further down the track as it will be harder to build up the net wealth to support their preferred lifestyle in retirement.

Retirement concerns

People are also worried about retirement. And the closer you are to retiring, the grimmer the picture looks.

I hear from people who are scared they'll be poor when they're old.

Standard of living in retirement

The Ministry of Social Development's Living Standards report (2004) shows on average people over 65 have higher living standards than the working age population.

Fifty-four percent of those over 65 were recorded as having a good or very good standard of living ... with 27 percent having a comfortable living standard. Eight percent of those over 65 were experiencing hardship.

In comparison, 37 percent of the working age population were recorded as having a good or very good standard of living ... with 26 percent having a comfortable living standard. Twenty-one percent of those of working age were experiencing hardship.

Note that living standards is calculated on more than just income.

But even if you just look at income levels, older New Zealanders are still less likely to be living in poverty than other age groups (*MSD Household incomes monitoring report*).

With the safety net of universal New Zealand Super, New Zealanders will not be plunged into poverty in old age.

However, we also know that feeling poor is subjective and very much depends on your experience and your expectations.

We have research underway to develop a standard budget for people aged over 65 - so we can more accurately put a figure on what's needed for a comfortable retirement.

Currently, we say you need 70 percent of your pre- retirement income to be comfortable, but this research will test whether that's still appropriate.

NZ Super

I also hear from older people concerned that the Government's going to cut their Super.

There is no basis for this concern.

One of my roles as Retirement Commissioner is to regularly review Retirement Income Policy. In my most recent review I recommended "no change" to NZ Super.

There is no appetite to change the level of New Zealand Super from any of the political parties I have spoken to.

The Prime Minister has made his position clear, stating he would resign as Prime Minister and as a Member of Parliament if superannuation were to be cut.

But I do remind all the politicians that I'll be watching closely.

The next review of Retirement Income Policy is due next year.

Decisions on contributions to the NZ Superannuation Fund are a completely separate issue.

The grass is greener...

Then there are the older people who tell me think they'd be better off to move to Australia.

This depends on how you decide what being "better off" means.

It's naive to try to compare well-being on the basis of one factor alone.

If you're making comparisons to the situation of older people in Australia, or any other country in the world, there are a range of factors to consider, including:

- Universal super safety net - the New Zealand safety net is broadly comparable to other countries.
- Housing - we have a culture of home ownership. Others have a culture of renting.
- Health care - New Zealand offers significant subsidies on health care, but this is not the case everywhere.
- Tax - there are different and complex tax rates in different countries, funding different levels of services
- Social networks - are there family and friends nearby?

There's a lot of debate about how to measure well-being, because it's about more than just income.

In New Zealand, the Living Standards report takes a wider view of "material well-being" including other factors as well as income. As I've discussed, this report shows that older New Zealanders on average are doing OK.

I'm pleased to hear that the next Living Standards report will include international comparisons, so that we can see more clearly how we measure up. The Ministry of Social Development is due to complete that by the end of this year.

But even that won't look at the intangible social aspects that go into making us feel better off.

So I don't think it's worth individual New Zealanders worrying about whether Australians - or anyone else around the world - has a few dollars more or less when they retire.

Retirement income

We know from the 2006 Census that there were over 420,000 people receiving New Zealand Super.

Forty-six percent of them also had some income from sources such as rents, dividends or interest. There were also 15 percent with other pensions, 11 percent earning some wages or salary, and 8 percent with income from self-employment.

These figures can't simply be added up as some people will have more than one source of income.

But what I take from this is that currently about half of New Zealanders over 65 do not have any additional income in retirement. They live on New Zealand Super alone.

There are indications that New Zealanders are paying off debt rather than spending, which is a positive development for their personal financial management.

This may mean the number of people who have extra income in retirement may change over time, as people are able to manage their finances to that end.

But, like everything else, it is difficult to predict what will happen because we don't know how long the current downturn will last, or whether we've seen the worst of it yet.

Financial services sector

I've said it before - people don't trust what they don't understand.

I'm hearing from many concerned New Zealanders - asking where the money has gone.

I hear comments like:

"The great majority of my finance company investments have failed and I'm left wondering if a lifetime of saving was worth it."

"I can't understand how 'X' products can leave people without money when Company X still makes a profit" - you can insert one of several company names in this sentence.

Finance companies

So where has the money gone?

There are 24 finance companies that have lost or frozen funds amounting to about \$2.8 billion. There are 109,000 investors affected who might on average get back 55 percent of their money.

By comparison, there are 1.65 million houses in New Zealand, with a median value of \$325,000. The fall in house prices in the year to February 09 was 8.9 percent, a total impact of \$52.5 billion.

For those who have lost money through finance companies, there is an immediate and serious impact.

For those who have lost value on their properties, the impact is only as serious if they are forced to sell now. Some people will have the opportunity to recover that value.

“Shonky” is one of the more polite words I’ve heard from people talking about finance companies that have lost or frozen their clients’ money.

It is a huge problem for those tens of thousands of New Zealanders who have been affected.

We need to ask why it happened. Whose fault is it? Was it the regulator, the trustee companies, the management or the investor taking too much risk?

Of course, I am not the only one asking these questions. Neville Harris, the Registrar of Companies, made similar observations in the MED’s 2007/08 Financial Review to the Commerce Select Committee.

No matter who is to blame, it is a huge problem. I wonder if this isn’t the “leaky homes” scenario for the financial services sector.

These are reputational issues for the whole sector. Many people don’t know the difference between a finance company and a financial services company. We need to work together to build much needed trust in the sector after all of the collapses and now the international downturn

Who’s watching the sector and who’s watching the watchers?

Trusted financial services sector

New Zealanders’ perception and experience of the financial services sector is poor and the sector can do much to improve.

You can move from complexity and confusing documents to simple, straightforward explanations in clear language. You can move from being inward-looking and pushing products on to captive customers, to acting with greater professionalism, focusing on customers who are diverse and more informed.

You might think, “that doesn’t apply to me” but most New Zealanders don’t differentiate between companies - the fact is, the sector is currently seen as the “bad guys”.

There are five principles I’ve identified with the sector that are needed to build trust and confidence - you need to be: open, fair, accessible, expert, and relevant.

Information and education

Clear communication is essential.

It's easy for those in the sector to over-estimate the understanding of the public.

It's also easy to over-estimate the understanding of the general news media. While there are some specialist journalists doing a good job, we need to make sure the right messages are getting through.

For example, last year Alan Bollard urged New Zealanders to stop investing in housing as investment properties. People thought he was saying they should not own the home they live in.

As another example, the debate over whether the Government contributes to the NZ Superannuation Fund has got people worried their fortnightly Super payment is at risk - which it's not.

Communication with individuals is just as important. I spoke at the ASFONZ Communication Awards last year and had a chance to look at some of the entries. I was amazed at what some organisations submitted, thinking it was clear communication.

As you read your material, put yourselves in the shoes of your aunt, nephew or neighbour, and then decide if you're being clear.

I also want to touch on the important issue of New Zealand building the capability of good financial advice. We are all awaiting the legislation - we all hope it will make a big difference.

And we also as a sector need to talk about at what point we recommend someone getting financial advice? Is it \$100,000 or is it \$300,000. And if it's the latter, what do the people with less than \$300k do? My answer would be that they use Sorted.org.nz.

Conclusion

We are in a crisis like few of us have known before.

Currently, job losses, falling house prices and increases in required deposits, and finance company losses are impacting on individuals' ability to manage their finances and prepare for retirement - especially those closer to giving up work.

In the longer term, the biggest potential impact on New Zealand's retirement income framework is from falling levels of home ownership if housing affordability continues to be a problem.

On the positive side, most people over 65 are faring reasonably well and there is no indication that NZ Super will change.

There are some areas to watch.

We need to be cautious about the many predictions being made, because we are in new territory.

We need to improve our communication.

And we all need to work together to improve trust in the financial services sector.

We always need better statistics.

Despite all this, I think New Zealand's the best place to be.

As I said, we cannot worry over what bankers, regulators and investors will do in Japan, US and Europe and what the government will do in China.

We can help New Zealanders manage their own money, reduce their own debt and prepare better for their own future.

What's next

The Retirement Commission is moving ahead in a number of areas.

The ANZ/Retirement Commission Financial Knowledge Survey 2009 is now underway.

We are planning a Financial Literacy 09 summit in June to bring together the latest knowledge and expertise.

We are looking ahead to the Retirement Income Policy Review in 2010.

We are continuing to work with the financial services sector.

And of course we are continuing to make sure New Zealanders have the best free independent financial website in the world!

Thank you.