Chapter 6: Employment of older people

As people live longer, it is likely that the extra time available will be split between paid employment and retirement. Employment can make a significant positive difference to New Zealanders' financial and general well-being in later life. It can also contribute to economic growth.

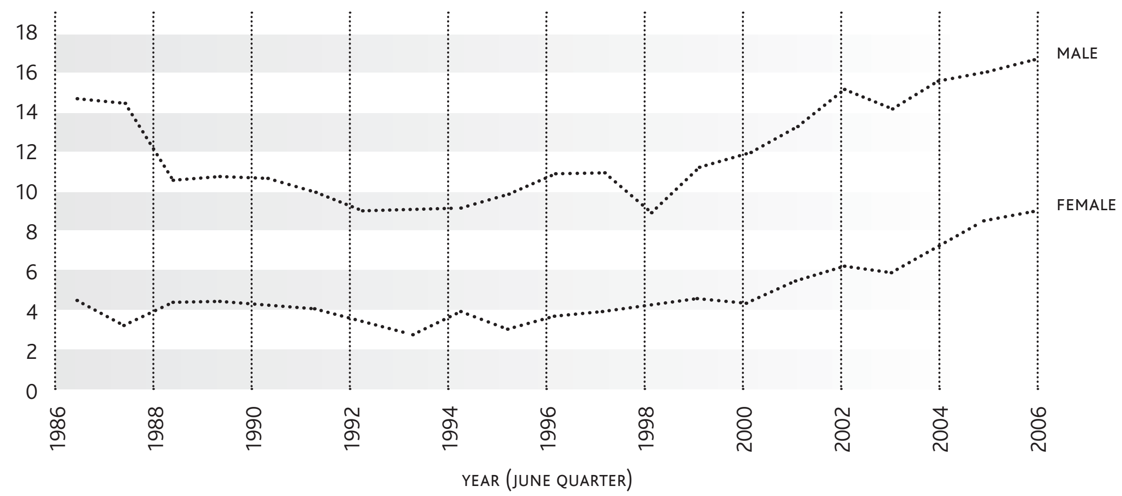
This chapter draws on a paper commissioned for this Review by the Equal Employment Opportunities Commissioner, Dr. Judy MacGregor[52]. It first considers what we mean by older workers, then considers the barriers to older people continuing with paid work if they want to, and concludes with some comments on how efforts should continue to overcome these barriers.

Retirement and older workers

Patterns of 'retirement' are changing and becoming more diverse as people live longer. Some people want to continue working full-time or part-time, in their current jobs or in different ones, as they grow older. Because of the diversity of older workers, there is unlikely to be a 'one size fits all' policy. Indeed, the phrase 'older worker' means different things to different people. The OECD defines an older worker as one who works in paid employment at age 55 and upwards. Here, we are concerned with policies and approaches that need to reflect the transition to partial or full retirement from paid employment.

New Zealand has one of the highest rates of workplace participation of older people in the OECD. Chart 2 shows the growth in New Zealand's employment rates over the last 20 years.

Chart 2: Proportion of the population aged 65 years and over in paid employment, by sex and year, June 1986 – June 2006[53]



The number of older New Zealanders in the workforce has increased dramatically in recent years. From June 1991 to June 2005, over half of labour force growth in New Zealand came from people aged 50 and over. This growth has therefore been a significant contributor to labour supply, and has helped to alleviate skill and labour shortages in a very tight labour market[54].

52. See Appendix C for access details.
53. Ministry of Social Development (2007) *Positive Ageing Indicators 2007*, fig. 54.
54. Department of Labour (2007) *Older People in Work: Key trends and Patterns 1991-2005* p. 3.

The labour force participation rate of people aged 65 and over has been rising since the early 1990s. In 2006 it was 23.9% for men and 11.6% for women. For people aged 65-69, the participation rate was 42.9% for men and 25.3% for women[55].

There are many reasons for New Zealand having a relatively high proportion of older people employed[56]. The age of eligibility for New Zealand Superannuation is likely to be a factor, especially since 1992, when a phased increase in age from 60 to 65 began. However, countries with fewer older people working have had the public pension age of eligibility age set at 65 for longer than New Zealand. The design of NZS, as New Zealand's state pension scheme, is not a disincentive to work, as is the case elsewhere. Most other state pension schemes are means-tested. A relative lack of private superannuation provision in New Zealand, compared with other countries, may be another factor. New Zealand also adopted legislation outlawing age discrimination in the workplace earlier than many other countries. Some older people may also have been more likely to work in New Zealand because of economic conditions, rather than as a result of any particular policy.

Growth in the number of older people working, therefore, may not necessarily continue at the same rate as in the recent past, nor may a more active and targeted policy result in greater rates of employment at older ages.

Barriers to remaining in the workforce at older ages

While people will want to make their own choices, policy should try to enable the widest possible range of options, and reduce any barriers to working at older ages. However, there are still significant barriers in the New Zealand work environment.

Negative attitudes against the older worker are still evident. Despite anti-age discrimination legislation, some employers demonstrate ageist attitudes, and some older workers themselves hold stereotypical views about ageing which can lower their own expectations with regard to employment, training and promotion.

Research has also suggested that there are issues around the availability of the flexible work options that many older people want, a lack of training opportunities for mature workers to improve or update skills, and the availability of suitable information about options that could help older people specifically. There may also be family, home or community commitments and circumstances – such as caring responsibilities, which may especially affect older women – that prevent older people who would like to undertake paid work from doing so.

Some employment-related structures, such as ACC, still use age 65 as a marker. This is often for the practical reason that they follow the age of eligibility for NZS. For example:

» Employed workers aged 65 and older who are covered by ACC are entitled to one year of compensation for lost earnings for injuries which remove them from employment. A second year is payable only if the person is not on New Zealand Superannuation.

» People aged 65 and over cannot join KiwiSaver, so would not be auto-enrolled on starting a new job at that age.

Despite the rationale for these markers being set at age 65, as more older people stay in or return to the workforce after that age, these rules may appear increasingly anomalous.

55. Statistics NZ (2007) *New Zealand's 65+ Population 2007: A statistical volume* Table 4.01.
56. See Hurnard (2005) *The effect of New Zealand Superannuation eligibility age on the labour force participation of older people*, Treasury Working Paper 05/09.

Benefit issues

People who have been on Work and Income benefits may have particular problems. For example, around 4.9% of the working age population receives either Invalid's Benefit, because their work capacity is restricted by a 'permanent and severe' incapacity, or Sickness Benefit, because their capacity for full-time employment is reduced through sickness or a medical condition[57]. One-third of Invalid's Benefit recipients and one-fifth of Sickness Benefit recipients are aged 55-64. Many of these have been receiving benefit for 10 years or more. Returning to or entering the workforce is difficult for this group, and the type of work that is appropriate depends on the person's individual circumstances. For many, part-time employment may be more achievable than full-time[58].

Overcoming the barriers

There are many initiatives aimed at helping older people to remain or go back to work, and to keep the issue of employment at older ages on the policy agenda. These include:

- Actions in government departments, including the Ministry of Social Development and the Ministry of Labour, and other authorities. The employment of older workers is part of the government's Positive Ageing Strategy. Specific recent policies which affect the labour market participation of older workers include an intensified jobs search service, with new specialist health and disability advisors, and the removal of the age-related work-test exemptions for Unemployment Benefit.
- The work of the Human Rights Commission and other bodies when a complaint is raised under the anti-age discrimination legislation.
- Research by government departments, NGOs, policy institutes, academics, and employer and employee interest groups on the barriers to employing older workers, and on effective management of older people at work. For example, the Ministry of Social Development's *Turning 65* research project will ask people currently around that age to describe their involvement in paid work over the past 10 years, and what has affected it.
- Community efforts involved with local older workers and other age-related issues, such as the Volunteer Community Co-ordinators network, organised by the Office for Senior Citizens.
- A joint initiative of the Retirement Commission and Human Rights Commission to develop a good practice guide for employers to tap into the talent of older workers in New Zealand's public and private sectors.

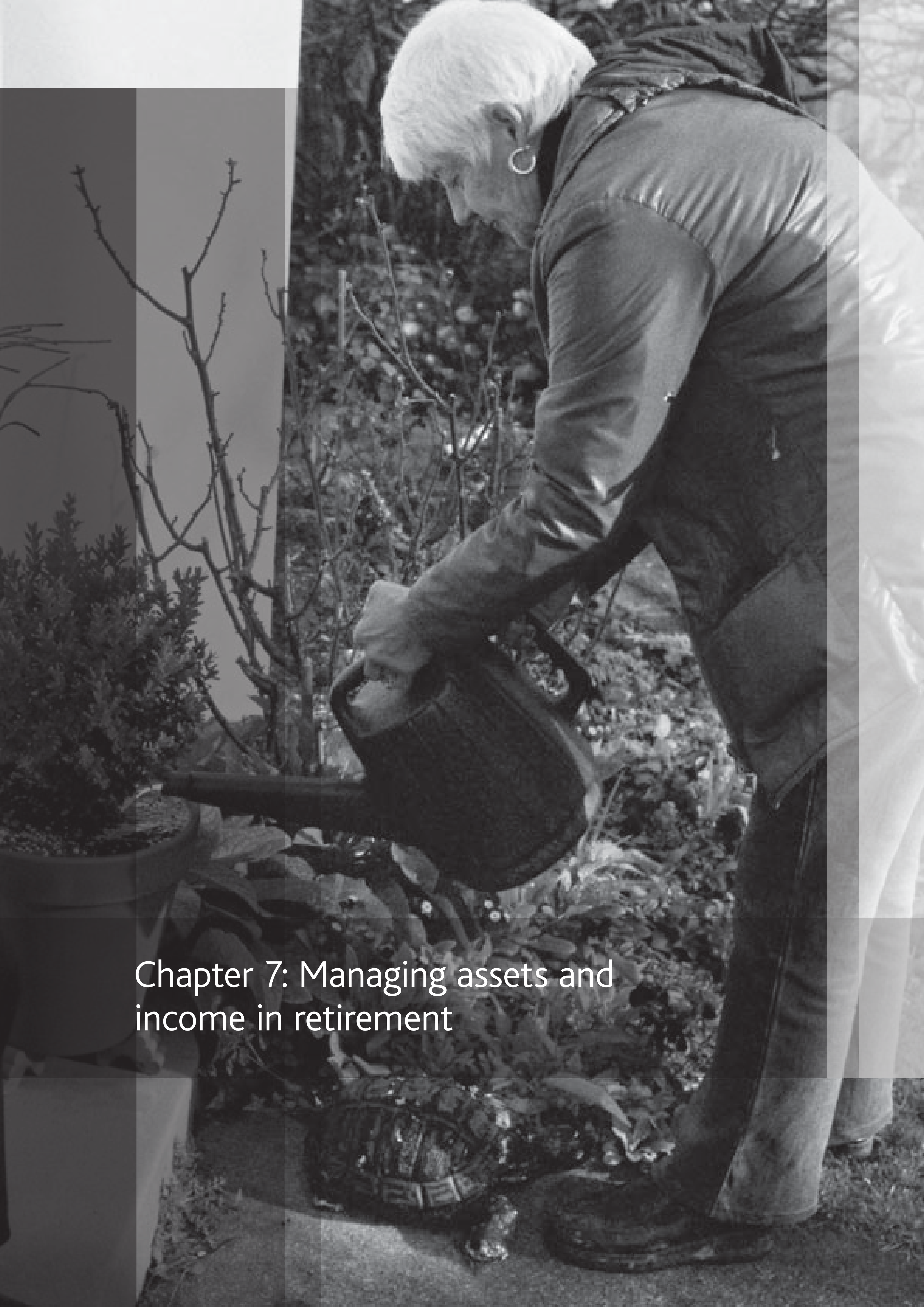
These initiatives by a variety of organisations reflect the diversity of the issue. Research or advice on employing an active 70-year-old is not necessarily relevant to a 55-year-old seeking employment after a spell on a benefit. This diversity is a barrier to agencies working together or learning from each other. An employer or employee seeking advice does not have one obvious place to go.

Better co-ordination between the various agencies involved in encouraging work at older ages may bring some benefits, although a large bureaucracy would not be good if it stifled individual initiatives.

Recommendation 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.

57. Ministry of Social Development as at September 2007. Working age population is defined here as ages 18-64.
58. Beynon and Tucker (2006) *Ill-health, disability, benefit and work: A summary of recent research* in *Social Policy Journal of New Zealand* Issue 29.



Chapter 7: Managing assets and income in retirement

New Zealand Superannuation provides people over 65 with a regular income (as do the defined benefit type of employer-based superannuation schemes). However, other private savings, including KiwiSaver, are not designed to provide a regular income in retirement. Instead, funds can be accessed from age 65, so could be taken as one lump sum at that age if desired. The value of a house is similarly in one lump sum.

This chapter deals with ways in which assets accumulated during working life can be managed for use during retirement. After some general comments, it considers two specific issues noted in the terms of reference for this Review: annuity products and home equity release.

Although this chapter focuses on annuities and home equity products, it should be noted that it is not essential to use a product to manage assets in retirement for income. Many older people do not have sufficient financial assets to make buying an annuity good value for money.

There is a general paucity of up-to-date and accurate data to do with the financial assets of the older population. It is also possible that the available data does not include all of the financial support provided by the extended family. Nevertheless, the available data points to fairly low levels of financial assets, not broadly spread among the older population. In 2001, half of the men aged 65 and over had financial assets (excluding housing equity) of less than $31,200, while half of the women had less than $24,000[59]. Similarly, many older people will not have a house which is valuable enough to release a large amount of capital through a home equity product.

In terms of priorities, policies to help people manage their assets to meet their income requirements without necessarily purchasing a product therefore need to be considered alongside policies to encourage the availability of such products.

Better information on the amount of assets available to older people is necessary to help make such priority decisions. However, the latest available data dates from 2001. KiwiSaver may in the long-term lead to more people having financial assets available in retirement, and it will be useful to track the emergence of this as a factor. **Recommendation 3**, which called for the continuation of SoFIE and the repeat of HSS, is important here, as these surveys could provide the data from which the required analysis could be made.

Recommendation 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.

As discussed in chapter 1, the 'retired' population is not a homogenous group. Retirement income and other issues for 65-year-olds will be very different for those in the oldest age group of 85 and above. The decisions on how to manage money through retirement are individual, often complicated, and may present challenges to many older people.

59. Household Savings Survey (2001). Note that annuity purchase may be more appropriate at later ages than 65, but this asset data is available only for people aged 65 and over.

For many people, retirement means a transition from regular employment income to a new mix of income from different sources. People who have some accumulated savings get closer on retirement to facing continuing decisions on how much to spend and how much to keep to cover large or unexpected expenses, or to leave as an inheritance.

These decisions are made more difficult by not knowing how long one has to live, how interest rates, asset prices and inflation may change, and whether there will be unforeseen special costs to deal with.

As people live longer in retirement, these uncertainties become more acute. Statistics NZ[60] indicates that, on average, life expectancy for the cohort of women reaching age 65 in 1997 was around 21 years, and for men nearly 19 years. But there is great variability in individual life expectancies. For example, of that cohort turning 65 in 1997, 38% of the women and 28% of the men are expected to reach their 90th birthday. As discussed earlier, these expectations are themselves uncertain, and may prove to be under-estimates.

Given current indications that older people have, on average, fairly low levels of financial assets in retirement, many older people will need to manage their money themselves. Quality information and education on a range of financial issues to help older people manage their personal finances at different times throughout retirement is therefore important. Such information should be available in a number of ways.

A related issue that also requires information to be freely available for older people is the treatment of property in the asset test for Residential Care subsidy. The net equity of an older person's interest in a property (house and/or land), is included as an asset in the means assessment of assets for the subsidy, subject to rules regarding partner's residence. However, if the property is owned by a trust, even if the older person has been living in the property, it is not included in the means assessment. The information to be made available to older people should include guidance on the implications of trust ownership as opposed to individual ownership of property.

Recommendation 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.

The Retirement Commissioner is especially concerned that the 'old old' find managing money particularly worrisome, and can be a target for financial abuse. There are several anecdotal cases of older people being financially exploited by others. While improved regulation of financial product providers and advisers should help to improve consumer protection generally, specific additional support for the oldest people most at risk may be appropriate.

Recommendation 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.

60. Figures calculated from Statistics NZ's life tables for the 1932 birth cohort.

Annuities

Some commentators believe that it is in the best interests of people to have a regular income in retirement. The product that can be purchased with a pot of savings to buy a regular income for the rest of life is called an annuity. There are virtually no annuities currently being sold in New Zealand. The lack of an annuity market in New Zealand will become more apparent as people start to retire with large pots of KiwiSaver savings.

This section considers the barriers to both the supply of and demand for annuities in New Zealand. It then considers the arguments for government intervening to enable annuities – or other products that convert savings to retirement income – to flourish, and concludes with some recommendations. This section has been informed by a detailed paper by Roger Hurnard[61].

Barriers to annuity supply and demand

The traditional annuity deals with the uncertainties of managing financial assets in retirement by providing a regular income for the rest of life, however long that turns out to be. This means that the insurance company, instead of the individual, takes the risks of unknown future longevity, interest rates, and asset prices, and also of inflation, if an inflation-linked annuity is purchased.

Given that annuities provide the benefit of a stable, certain income for the rest of life, why has the demand been low, not just in New Zealand, but also in other countries? There is a long list of possible reasons, relating to perception, cost, need and fear.

Perception

» Annuities are not easy products for a non-expert to understand and therefore trust.

» Most people would prefer not to think about an annuity purchase, as it requires thinking about their own mortality.

» People prefer to leave something as a bequest, rather than risk handing over their savings to an insurance company and then dying before they have had value from the annuity.

» People prefer to manage their assets themselves, taking money from their savings as they need it, rather than cede control to an insurance company.

Cost

» Annuities can appear poor value for money. The cost to the insurance company of taking the risks involved in an annuity is high (see supply issues, below). The price of an annuity can seem expensive to a customer who does not understand this.

» The taxation of annuities may imply a poor after-tax return. This is the case in New Zealand, as the income component of an annuity is likely to be effectively taxed (within the annuity provider) at the corporate tax rate (currently 33%), while many annuitants will be subject to income tax at a lower rate (19.5%).

No or little need

» The public pension provides enough certainty of basic income, so that securing further certainty from annuitising savings is not seen as necessary. This may well be the case in New Zealand for many people, because of NZS.

» Many people do not have retirement savings large enough to be annuitised efficiently. This has been the case in New Zealand, but may change as KiwiSaver assets build up.

61. See Appendix C for access details.

Fear of being worse off

» The level of income that a traditional annuity provides for a given price depends very much on interest rates at the time. Buying an annuity at a bad time may lock in payments at a lower level than buying even a week earlier or later.

» People may wish to buy an annuity only if there is a rock-solid guarantee for the continuation of annuity payments if the insurance company fails. No such guarantee or safety-net exists in New Zealand.

There are also barriers on the supply side, which make selling traditional annuities difficult. For example:

» The risks that an insurance company takes on are unknown. Data on the expected future longevity of potential annuitants (which will differ from that of the general population) is not well defined in New Zealand's small market.

» The insurance company pools the annuity products it sells to mitigate longevity risk. Because New Zealand will always be a relatively small market for annuities, longevity risk pooling is not as efficient here as in other, larger markets.

» The longevity uncertainty works against the company's interest. While life expectancy is increasing faster than expectations, insurance companies stand to lose money from taking on longevity risk. They therefore build expensive contingency margins into annuity products.

» Insurance companies have to have capital set aside to cover the cost of the annuity risks. Because the risks are high and uncertain, a substantial sum is needed. The cost of this is passed on in annuity pricing.

» The insurance company seeks to invest in assets which match the liabilities of the annuity. But in New Zealand, there are no long-term bonds and few inflation-linked bonds available.

» The costs of selling, including the costs of satisfying consumer protection regulation, cannot be spread thinly in a small market. A minimum size of annuity purchase is usually imposed, which may take annuities beyond the reach of those with small savings.

Many of the barriers to annuity supply and demand stem from two inescapable issues: the significant uncertainty of longevity risk, and the small size of the New Zealand market.

Should the government intervene?

One argument for government intervention could be that annuity purchase is good for people, and that there is market failure which government should correct.

Whether or not annuity purchase is good for people is a topic of fierce debate in countries such as the US and UK, which have had large numbers of potential purchasers with substantial savings for many years. The case is made that having saved ostensibly for their retirement, especially if that saving has been bolstered by government incentives, people should not take the money as soon as they can, spend it all on travel or other luxuries.

However, potential purchasers themselves do not seem to be convinced of the benefits of buying an annuity, for reasons which have little to do with wanting to spend large sums quickly.

In the US, 'While life annuities play an important role in the economics literature, the insurance features of life annuities appear to be poorly understood and/or 'undervalued' by the general public, as evidenced by the very small size of the market[62].'

In the UK, it is estimated that only around one-quarter of pensioners buy an annuity[63], even though more people have pension savings than in New Zealand and annuity purchase is compulsory by age 75. Compulsory annuitisation is unpopular.

62. Brown (October 2007) *Rational and Behavioural Perspectives on the Role of Annuities in Retirement Planning* Working paper 13537 National Bureau of Economic Research, Cambridge MA p. 2.
63. Pensions Policy Institute (2004) *An analysis of unisex annuity rates* p. 29.

The UK government has reinforced that compulsory annuitisation, and the subsequent taxation of the annuity income, is fair exchange for sizeable contributions to pensions being allowed out of untaxed income[64]. The UK case may seem to suggest compulsory annuitisation for KiwiSaver funds. However, currently the KiwiSaver tax credits are effectively a supplement to contributions, whereas the UK tax relief system aims to defer paying tax on pension contributions[65].

Possible government options

Three types of possible government options are outlined here, then discussed below.

1. The government, or more precisely the general taxpayer, takes on the longevity and perhaps other risks, to neutralise the problems which the private sector has in supplying annuities.
2. The government incentivises or strongly encourages the private market to sell annuity products as a way of stimulating demand.
3. The government leaves the private market to sell annuity products, to allow natural demand to emerge more easily.

1. Government takes the risk

Ideas for how this would work include the government effectively becoming an annuity issuer, or a 'stop-loss' insurer for insurance companies; for example, the companies take the annuity up to age 90, and the government takes the risk thereafter.

The New Zealand taxpayer already funds a large amount of longevity risk through NZS, which is highly cost-efficient and equitable. As long as NZS stays at a substantial level, it would be difficult to expect the general taxpayer to take on more of the same risk.

If compulsory annuitisation is proposed, it is likely to be as unpopular as in the UK. New Zealanders strongly rejected the compulsory savings and annuitisation proposed in the 1997 referendum.

If voluntary annuitisation is proposed, government is less likely to feel obligated. People for whom annuitisation is a real option (for example, they have reached 75 and have large savings) are more likely to have had higher incomes, and so may not be a priority for taxpayer subsidy. In the long term, KiwiSaver may lead to a broader distribution of financial assets available in retirement. However, currently, annuitisation would probably be efficient for only a minority of older people.

2. Government incentivises or strongly encourages the private market

There could be an argument for tax incentives for annuity purchase, if government thought that this was in the best interests of society, and therefore worthy of taxpayer subsidy. However, given the large tax incentives already going into KiwiSaver accumulation, it seems hard to justify more incentives at the decumulation stage.

However, the government could reduce the current tax disadvantage of annuities, compared with other financial assets. Action on this has been deferred while other life insurance tax reform has been progressed.

Recommendation 25

That Inland Revenue, by end 2008, reports on the feasibility and implications of achieving tax neutrality in the treatment of annuity products.

64. Annuities must be purchased for pension funds of more than GBP15,000 (NZ$40,000), and are then taxed as income. Thus compulsory annuitisation is not driven by the UK government being paternalistic in thinking that it is in the best interests for people to annuitise. HM Treasury (2006) *The Annuities Market* paragraph 1.9 (London).
65. Further, the UK system offers partial tax exemption on the investment of contributions. It is an imperfect 'EET' system.

3. **The private market is better enabled to sell annuity products**

   There are overseas examples of innovation in annuity products that have not yet been seen in New Zealand, such as:

   » Variable annuities, where risks are shared between company and individual.

   » 'Impaired life annuities', where people with some health conditions get a better purchase price.

   » 'Advanced life delayed annuities', where, for example, a customer aged 65 can buy an annuity that starts paying out at age 85.

   » Income drawdown plans, which allow continued control over invested funds.

   » The issue of longevity bonds.

   Although not all of these have yet proved successful, the international market is able to stimulate ideas. New Zealand could learn from these ideas, once the market here is ready for growth.

   As well as the asset data and tax issues mentioned above, the government could help enable growth by investing in better data on future longevity prospects. It was suggested above that to carry out **Recommendation 7** of this Review, New Zealand needs better estimates of the future longevity of the general population. This would be a first step to establishing better longevity data for potential annuitants.

In summary, because KiwiSaver is intended to boost the number of people with retirement savings, there is a case for government to remove some current barriers relating to products that offer options for converting savings to income in retirement. However, at this stage there is no emerging demand, nor is there a case for government incentivising annuity purchase, or taking any annuity risks on behalf of the taxpayer.

For now, therefore, the recommendations of this Review prepare the ground for a possible increase in demand for annuities. **Recommendation 23**, above, is important to ensure that older people are given enough information and education to help them think through the options for managing their assets for their income and capital requirements throughout retirement. These options may include buying an annuity at some stage, but also 'do it yourself' drawdown alternatives.

The case for any stronger government action in future should be reconsidered in the 2010 Review, in the light of take-up of KiwiSaver and trends in the New Zealand and international annuity markets.

Home equity release

Releasing equity from the home you live in is one way in which income or capital can be supplemented in retirement. Given the high levels of home ownership in New Zealand, home equity release products might be thought to appeal to retired people. But as with annuities, a strong market has yet to emerge.

This section describes home equity release products, considers why the market has been slow to grow in all countries, including New Zealand, and concludes with recommendations. It has been informed by a paper by Judith Davey on home equity release products, commissioned for this Review from the New Zealand Institute for Research on Ageing[66].

Home equity release products

Home equity release products have been available in New Zealand since the 1990s. Market innovation has led to several different types of home equity release products, with different features[67]. Most of these products are reverse mortgages.

With a reverse mortgage, the owner of the property takes out a loan with a financial company; but instead of making repayments, the loan and accumulated interest are repaid from the proceeds when the borrower dies or sells the property. The cash released may be taken in the form of a lump sum, or as a regular or irregular income. The regular income facility is not common.

Home equity release products differ in the detail of the terms and conditions. Broadly, they are available only to homeowners aged 60 and over, with a minimum house value ranging from $100,000 to $300,000. The ratio of the maximum loan available to the house value can be set (usually at 25%), or can increase with age at purchase (usually 10% or 15% at age 60, up to 45% at age 90). This restriction guards against interest accumulating to more than the amount the product provider can recoup on sale of the house.

In practice, the average age of people taking out home equity release plans has been around 72. The average value of the loans taken out has been around $40,000-$50,000. Typical product purchasers have had little income except for NZS, and only modest savings, if any. The main reasons for releasing home equity appear to be to pay for 'living expenses', home maintenance, buying a car, home improvement, or travel.

Reverse mortgages have so far appealed to only around 5,000 older people in New Zealand. As with annuities, the increasing number of older people is expected to lead to a growth in demand for home equity release products. Providers believe that the potential market in the next 15 years is around 200,000[68].

For some older people, home equity release can only provide modest amounts of money. Even for those in suitable circumstances, the loan-to-value ratio means that the amount available may easily be eaten up in capital requirements, such as a new car. This may avoid tapping into rainy day savings, getting into debt, or going without, but will not necessarily contribute significantly to income.

A different, non-commercial, form of home equity release is where a local council allows rates to be deferred and paid, with accumulated interest, on the sale of the property. Again, there are restrictions, and the few schemes in New Zealand seem not to have been well publicised. Take-up has been low.

Given the smaller role that rates deferral schemes play, the next section focuses on the commercial home equity release market, although some of the same issues may apply.

Why the market is slow to grow

Many of the barriers to supply of and demand for home equity release products are similar to those for annuity products:

» There is a perception that home equity release is difficult to understand and trust, and a reluctance to cede control of part of a major asset to a commercial provider (particularly for something that looks like getting into debt). Home equity release products have had some bad publicity, both here and overseas, and many older people are suspicious of them.

66. See Appendix C for access details.
67. The Retirement Commission website *www.sorted.org.nz* explains the various types.
68. Davey (2007) report for this Review, and Sentinel's submission to this Review.

» The product provider is taking on risks on which there is limited information, so needs to set aside capital for a long time, with contingency margins. The cost of this is high, but is difficult for a customer to value, so home equity release can appear expensive.

» Many people may feel that they do not need or want to tap into their home equity, which they see as providing a 'last resort' cushion or an inheritance.

» Some potential customers for home equity release may fear being worse off, to the extent that their eligibility for state means-tested benefits may be affected. This issue is considered in more detail below.

» The costs of marketing and selling, including the costs of satisfying consumer protection regulation, add proportionately more to the cost of the product in a small market. Regulation is also considered below.

Benefit abatement issues and regulation

It has been suggested the interaction of home equity release products with means-tested state benefits, such as Disability Allowance, is a particular problem for the development of the home equity release market in New Zealand. The argument put forward is that money released from home equity is really capital; so the current Work and Income rules (which may abate income-tested benefits if the recipient takes home equity as periodic payments) are unfair.

Whether a potential home equity release customer would be hit by benefit abatement is not clear. Different individual circumstances mean that it is difficult to generalise about how the rules would apply. However, periodic payments received for 'an income-related purpose', and therefore taken into account for income-tested benefits, are defined in legislation[69].

A proposal has been made to treat home equity periodic payments in the same way as a lump sum. But they would then form an asset that would have to be taken into account for those benefits (such as Special Needs Grants) which are asset-tested.

Home equity release consumers generally have the choice of taking the funds as capital or periodic payments. The problem is not preventing home equity release itself, but restricting some consumer flexibility in how the funds are taken.

Regulation for home equity release products, providers and advisers is clearly important, given the need for potential customers to trust what is being offered. This is particularly necessary because there are some concerns about some operators who are working in what is a vulnerable market. However, unnecessarily heavy regulation would add to the costs of the product. Some providers, but not all, already adhere to a code of practice administered by an industry body[70]. A code of practice for home equity release providers is currently being developed by the Office for Senior Citizens (OSC).

The case for government action

One argument for home equity release being more likely to attract the attention of government than annuities is that it may help the older people of today who have no financial assets other than their home, and little income above NZS. In contrast, the market for annuities is focused on people with enough financial assets for annuitisation to be worthwhile.

However, as with annuities, it is still difficult to make the case that government should intervene in the commercial market, or take on risk itself, when more straightforward actions could remove barriers to the development of the home equity release market.

69. Section 3(1) and 3(4) of the Social Security Act 1964.
70. The Safe Home Equity Release Products Association (SHERPA).

In view of the likely market of older people for home equity release (especially if market predictions of growth in demand are correct), and the serious consequences of a loan rolling up to exceed the sale value of the property[71], the market conduct and security of product providers and advisers must be an urgent priority. This should be achieved by taking the code of practice into legislation, and therefore, making it mandatory for all providers.

Given that the regulation being introduced for the financial sector by the Ministry of Economic Development is focussed on providers, not products, home equity release regulation needs to be part of different legislation. Whatever legislation is used, the OSC should continue to be involved, to ensure that the necessary focus on the older market for this product is not lost.

Recommendation 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.

There is also a case for government to clarify the interaction of released home equity with benefits. This is particularly important for potential home equity release product purchasers of limited means. Any decision to change the rules to favour home equity release by periodic payments will have implications in the rest of the benefit system and in the tax system, so will involve several government departments. Whatever the decision, a set of rules with as much clarity as possible should be easily available to consumers.

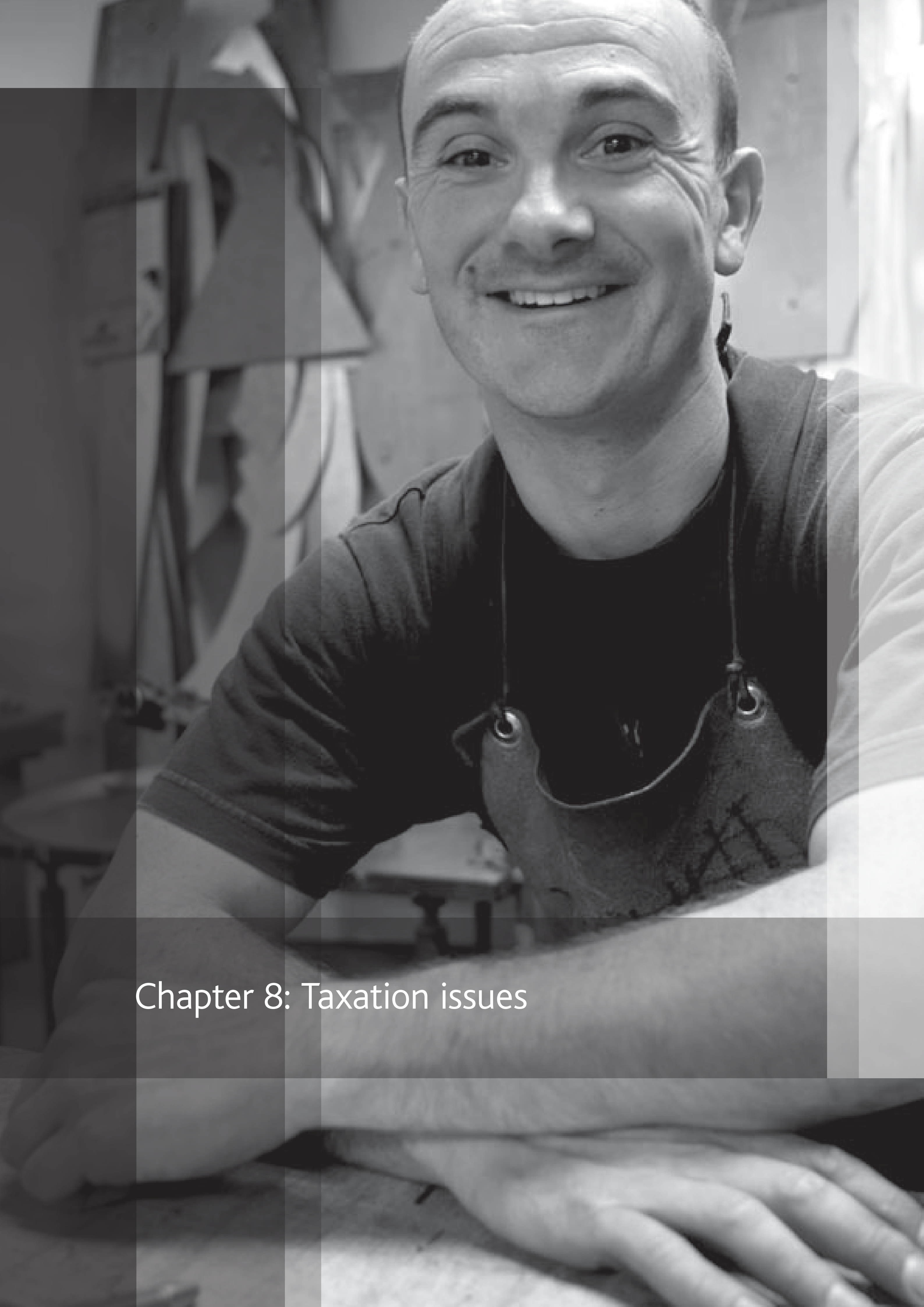
Recommendation 27

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.

Given the difficult decisions around home equity release, independent information and education to help potential customers think through the options should be easily available. As part of **Recommendation 23**, the Retirement Commission will keep its material on home equity release options up to date and accessible to older people in a variety of ways. This information will include clear guidance on the potential risks, details of the protections available to consumers, and information on the interaction of home equity release with state benefits.

Monitoring the size and distribution of financial assets held by older people over time, noted above in relation to **Recommendation 22**, will give an early indication of the potential demand for home equity release products as it emerges. As with annuities, the 2010 Review should consider the progress of the home equity release market to see whether any stronger policy change is then warranted.

71. Some providers give 'no negative equity' guarantees, but not all.



Chapter 8: Taxation issues

This chapter considers taxation issues relevant to retirement policy. Taxation is an integral part of savings and investment. To consider tax separately is to risk taking issues out of context, but this chapter is intended as a brief accessible summary.

It begins by commenting on the general savings taxation landscape. It then reviews some taxation issues already considered in this report, and tackles a further specific issue to do with taxation in retirement. It has been informed by a paper prepared for this Review by Paul Mersi of PricewaterhouseCoopers[72].

The general saving taxation landscape

Since the 2003 Periodic Report, a number of significant legislative changes have been made to the New Zealand tax system, as it applies to saving for retirement in particular. The most significant changes relevant to saving are:

» Portfolio Investment Entities (PIEs) remove the distortion that previously meant direct investment in property or equity was taxed differently from the same investment made through intermediaries. Tax payable on PIE investments will now be at the investor's marginal rate (which could be 19.5%), but will be capped at 30% (from April 2008), instead of being levied at the fund's marginal rate of 33%. Overall, the PIE rules make direct and collective investment in the same underlying asset more tax-neutral, although the costs of investing in a managed fund would have to be compared with those of direct investment to see whether overall returns were affected.

» Foreign Investment Fund (FIF) reform removes biases towards investing in certain countries. A new Fair Dividend Rate (FDR) method of calculating taxable income from offshore portfolio share investments has also been introduced. FDR favours investment in higher yielding shares, as the taxable income is capped at 5% of the opening market value every year. Although controversial, FIF and FDR do give New Zealand savers a wider choice of non-tax-disadvantaged investments.

Any changes to the tax system need to continue to follow the principle of tax neutrality between asset classes. The effect of the above changes has been to remove many distortions which previously existed, and generally improve tax neutrality. Those distortions which remain are not necessarily detrimental for savers. As discussed below, new distortions have been deliberately introduced to make saving for retirement, especially in KiwiSaver, attractive. All these changes have made the tax system more complicated. For some savers, saving decisions will have to take into account a new and more complex set of tax issues.

KiwiSaver

KiwiSaver contributions are calculated as 4% or 8% of gross pay (for employees), but tax is paid on total gross pay. However, the kickstart incentive, fee subsidy, member tax credit, and SSCWT exemption for employer contributions all add to the member contribution in the KiwiSaver account. Investment earnings in KiwiSaver are taxed (as most KiwiSaver accounts are PIEs, the new rules noted above apply), but the funds can be taken tax-free.

72. See Appendix C for access details.

As chapter 4 explains, KiwiSaver is now more attractive than other collective investment schemes, and would be expected to distort savings behaviour. Chapter 4 also covers the extent to which this will cause gaps in retirement income between people with and without KiwiSaver accounts, and the risk to the stability of retirement policy from the structure and high cost of KiwiSaver incentives.

Recommendation 11 is that the evaluation of KiwiSaver should explicitly include an identification of where the money spent on incentives ends up, to highlight any distortions, and an assessment of the value for money the taxpayer will get from the incentives. **Recommendation 12** is to publish the likely long-term fiscal cost of KiwiSaver, so that the cost of the incentives can be part of long-term planning.

Annuities

The taxation disadvantage for annuity products is discussed in chapter 7. **Recommendation 25** encourages Inland Revenue to report on plans to tackle the issue.

Paying tax in retirement

Superannuitants with significant other income will often opt for a higher 'non standard' tax code on their NZS payment, in order to avoid being under-deducted on their total income. However, this tax code may later become too high if their income drops. This can then lead to a situation where the superannuitant is over-deducted for tax. The extent of this problem is not known, as such a situation is not proactively identified and rectified by Inland Revenue (nor is unpaid due tax collected). Therefore the individual taxpayer has to monitor the situation and take action when necessary.

The Retirement Commission will ensure that its information about managing assets in retirement, as described in **Recommendation 23**, includes up to date advice on managing IRD Personal Tax Summaries.