



Focusing on the Future: A discussion document

2013 Review of Retirement Income Policies

Commission for
Financial Literacy
and Retirement Income

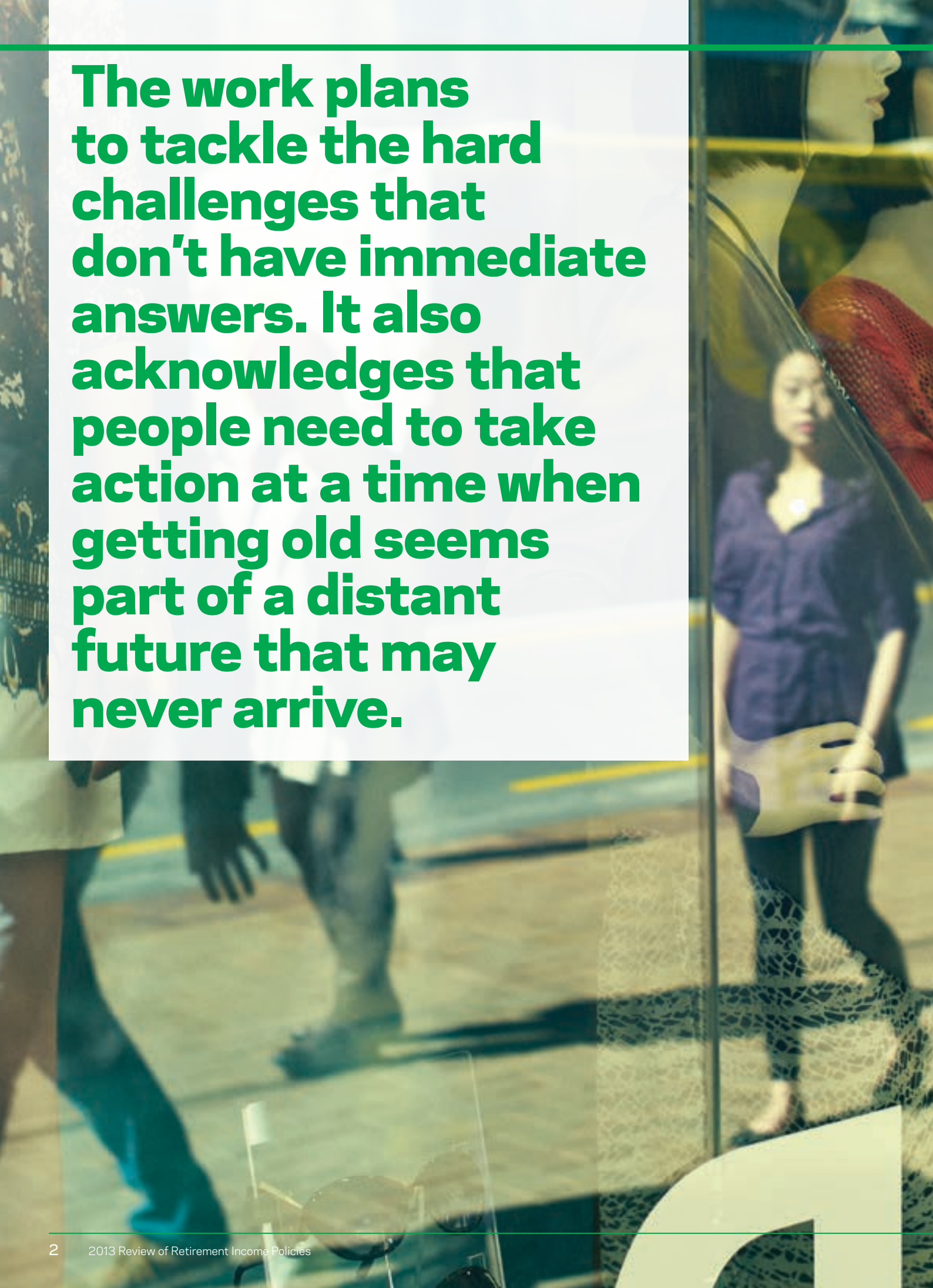




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A woman in a purple top and black skirt is walking in a museum or gallery. In the foreground, a large white number '4' is visible. The background shows other people and museum exhibits.

The work plans to tackle the hard challenges that don't have immediate answers. It also acknowledges that people need to take action at a time when getting old seems part of a distant future that may never arrive.



Review of Retirement Income Policies. A terrible name for a very interesting subject.

This document is the culmination of a year's work and is a precursor to the final document that will be submitted to Government before the end of 2013.

With agreed Terms of Reference as the starting point the Commission began by establishing an advisory group, reference groups, conducting workshops, focus groups, and publishing position papers. Further background papers were produced to help inform the debate. Over 80 submissions were received and reviewed from the private sector, NGOs, community groups and individuals.

Ideas were tested, terms were challenged. Fairness? What does it mean and where does it matter? And where does fairness intersect with economics and pragmatism?

In the midst of the debate we looked again at the unprecedented demographic changes that have made this such an important subject for New Zealand and many of our OECD partners.

Fundamentally, whatever well-thought-through mix of policy levers we arrive at, private provision will play a bigger role in the future for retirees and their financial wellbeing. The shape of our population will have changed and some social norms along with it. It's a positive change but it will require some planning.

A young man who attended one of our focus groups beautifully articulated the point that planning for the future can seem overwhelming, and that tomorrow competes with today for our time and energy.

In his words: 'I feel like there's a whole lot of other things competing for my resource, attention and concerns...it's all reasonably overwhelming even now, let alone thinking in forty years' time about what I might need and where I might be, and where the state of society might be.'

To that end, alongside the recommendations and documents for this policy review, we are releasing a campaign asking New Zealanders about their plans for when they get older. We've called it 'What's Your Story?'

The campaign will extend beyond 2013 and will take the conversation to a much wider group than those listed above. It acknowledges changing expectations around wealth and saving. Wealth as a result of 'little and long' has never been so unpopular in the face of instant gratification, and yet it is the reality of financial wellbeing for most New Zealanders.

The work plans to tackle the hard challenges that don't have immediate answers, and it acknowledges that people need to take action at a time when getting old seems part of a distant future that may never arrive.

Above all, it aims to bring a comfortable retirement within reach for future generations.

Diane Maxwell
Retirement Commissioner

Acknowledgements

This document represents a collective effort, firstly by the many authors and peer reviewers of the background papers which set the scene for the consultation process. We are grateful for the contributions made by the submission writers – in some cases their work has fed directly into the document. Most of this input has been aggregated through the writing process, but where possible we have acknowledged sources.¹

We also acknowledge the contributions made by the organisers and participants in the April workshop held at the Institute of Governance and Policy Studies at Victoria University of Wellington.

Members of the Advisory Group and Reference Groups provided valuable feedback on the process and direction of the review, as did participants in a number of workshops with young New Zealanders and our editing adviser Sarah Brown. However the views expressed in this review document are those of the Commission for Financial Literacy and Retirement Income alone. Thanks are also due to the previous Retirement Commissioner, Diana Crossan.

And finally, a very important acknowledgement for the long hours and effort put in by the Commission team: the review's leader Dr Malcolm Menzies and our coordinator Kathryn Maloney, who worked tirelessly and expertly to produce an outstanding document, plus the broader team who contributed to the debate, the layout and even the photos, many of which were taken by our own staff.

¹ Background papers and submissions are available on the Commission for Financial Literacy and Retirement Income's website: cflri.org.nz/retirement-income/policy-reviews/2013-review-retirement-income-policy.





Introduction

Purpose and process

This discussion document draws on a mix of background papers, submissions, analysis and other research, and aims to raise public awareness of retirement income policy issues. It is expected that the recommendations will be debated publicly and we are looking forward to further discussion prior to the Retirement Commissioner submitting a final report on the review to the Government by December 2013. If you would like to make a comment on this document, please either:

- **use the short response form which will continue to be available until 4 November on cflri.org.nz/retirement-income/policy-reviews/2013-review/short-response-form, or**
- **email us at 2013Review@cflri.org.nz, or**
- **post to PO Box 12-148 Wellington 6144.**

How the document is organised

The document is organised so that it can be read either in sequence as a whole or by sections depending on the reader's requirements:

- To get the main points, go to the Executive Summary and Recommendations on pages 6 and 9
- For a fuller description of the most important challenges facing New Zealand's system of retirement income and rationale for the recommendations that have been reached, go straight to Section Three

▪ A reading of the full document:

- Begins with a brief outline (in Section One) of the international context within which New Zealand's retirement income policies operate. The purpose of this section is to show that developments in New Zealand's policies do not happen in isolation, and that our policies are subject to some of the same pressures and trends that exist in other countries
- Section Two describes how New Zealand's retirement income framework of policies and programmes has developed over time, and how it looks in 2013. This section seeks to bring readers up to date, so they can make sense of the following discussion of potential challenges and changes
- Section Three discusses future challenges and options for response, and includes recommendations throughout
- Section Four provides a summary list of recommendations
- Appendix One discusses a particular issue: the direct deduction policy for international pensions
- Appendices Two, Three and Four provide background to the review: Terms of Reference, a description of structure and process and a list of submissions received

Executive Summary

This document arises from a triennial review of retirement income policies, held during 2012 and 2013. It is designed to inform further discussions about recommendations put forward, prior to a final report being submitted to the New Zealand Government by December 2013 as required under the provisions of the New Zealand Superannuation and Retirement Income Act 2001 (amended in 2005).

The overarching challenge faced by this review, as with all those preceding, is to identify ways in which New Zealand's system of retirement income can remain socially, economically and politically sustainable for many decades to come.

New Zealand has an excellent retirement income framework which achieves good outcomes for the majority of people aged 65 and over. Rates of poverty are relatively low for this group, thanks to a combination of New Zealand Superannuation (NZS), high levels of home ownership and a raft of other government policies and programmes. However, there are signs that in the near future outcomes may be more unevenly spread, with some people arriving at retirement in poor financial shape while others continue to do well.

Private savings are also important, and since 2007 the New Zealand government has encouraged saving through the KiwiSaver scheme. KiwiSaver has been a great success and its continued growth should be promoted, but on current trends, outcomes for members at retirement will be variable and there are some inequities and gaps in knowledge about the scheme to be addressed. Neither is there any obligation for KiwiSaver balances to be used for retirement income, so the scheme is not explicitly linked to the overall retirement income framework. The recommendations at the end of this executive summary propose ways to enable such a linkage to be made.

In common with many other countries, New Zealand's retirement income policies are subject to stresses from permanent change in the age structure of the population because of increases in life expectancy and lower birth rates. There is also a global trend towards the shifting of risks and responsibility for the funding of retirement income, from states and corporations to individuals. As individuals become more responsible for their own financial futures, more focused strategies will be required to boost levels of financial literacy.

NZS is a relatively inexpensive scheme but, due to 'population ageing', fiscal pressures are coming to bear. One way to solve the problem is through economic growth but this is unlikely to be sufficient on its own. A few policy changes will be needed to ensure that our system of retirement remains sustainable. Policy decisions should be made within the next four years, followed by a long period of notice (five to ten years) before changes are actually implemented. This timeframe will allow New Zealanders to confidently plan for their retirements. Changes will need to be made with care, so as not to jeopardise the best features of the current system. The case for having a universal, flat-rate NZS remains very strong. NZS provides efficient protection against the risk of outliving savings by guaranteeing a minimum real level of income for as long as a person lives. It doesn't disincentivise either saving or working beyond the age of eligibility (unlike most overseas pension designs). It is simple to administer because it does not require lifetime earnings or contributions records to be kept. Its clear set of individual, unconditional entitlements by virtue of citizenship, fosters social cohesion and is part of our sense of national identity.

However, there is an increasing gap between the standard of living that NZS can provide for in retirement and the standard of living to which many aspire.

THE OVERARCHING CHALLENGE, IS TO IDENTIFY WAYS IN WHICH NEW ZEALAND'S SYSTEM OF RETIREMENT INCOME CAN REMAIN SOCIALLY, ECONOMICALLY AND POLITICALLY SUSTAINABLE FOR MANY DECADES TO COME.

NEW ZEALAND HAS AN EXCELLENT RETIREMENT INCOME FRAMEWORK WHICH ACHIEVES GOOD OUTCOMES FOR THE MAJORITY OF PEOPLE AGED 65 AND OVER.

NEW ZEALAND'S RETIREMENT INCOME POLICIES ARE SUBJECT TO STRESSES FROM PERMANENT CHANGE IN THE AGE STRUCTURE OF THE POPULATION.



Currently, a high proportion (60 per cent) of those aged 65 and over depend entirely or largely on NZS for their income. At lower income levels, those who still have significant housing costs to meet in retirement will struggle to make ends meet on NZS alone. Decreasing levels of home ownership and affordability of housing are likely to worsen this situation and measures need to be taken to increase the supply of 'age-friendly' housing.

Even at higher levels of income, there is often still a gap between what NZS provides and what is expected in terms of a retirement lifestyle.

Various attempts have been made to estimate the size of the gap between desired levels of individual income and what NZS can provide. The findings of three separate pieces of research, and some industry advice, have been combined on pages 57 to 58 to give a 'ballpark' figure of the sorts of target figures that New Zealanders need to save for their retirements. For most people these targets are achievable with planning, but for those who are unable to save, NZS is still available as a back-stop.

NZS can be 'topped up' in a number of ways, either separately or in combination, through:

- Increased private saving
- Increased income through other sources, e.g. wages and salaries from working longer
- Greater targeting of public expenditure on retirement income and associated policies to areas of greatest need

New Zealand as a country doesn't have a great record of saving. The picture is mixed as to how good at saving individual New Zealanders and households are, but increased levels of private saving can happen through contributions to KiwiSaver or a range of other savings vehicles. There are a number of anomalies in our tax system, which discriminate against some desirable forms of saving and these anomalies need to be addressed.

The costs of NZS can also be partially met by saving through collective means such as the New Zealand Superannuation Fund. Whether individual or collective, Saving As You Go (SAYGO) has some advantages in comparison to Paying As You Go (PAYGO) out of taxes, as is the case with NZS. For example, because SAYGO requires each generation to save for its own retirement, it is fairer to future generations than PAYGO. SAYGO can also potentially be a cheaper approach. On the face of it, a switch from PAYGO to SAYGO makes a lot of sense, but would require a 'transition generation' to pay twice – once for its own retirement and once for the previous generation. The issue of what is a fair balance between PAYGO and SAYGO, and the rate at which that balance is achieved, has to be borne in mind when considering the recommendations of this review.

There are many advantages to be gained from older New Zealanders continuing to participate in the workforce where they are able and want to do so. Older workers contribute to economic growth, pay taxes which help fund retirement income and stay connected and healthier. The assertion that they displace younger workers is not supported by any evidence. Policies should aim at maintaining New Zealand's high rates of workforce participation and to remove ageist barriers.

Greater targeting of expenditure to areas of greatest need is linked with questions of fairness and the affordability of NZS.

Retirement income policy needs to be seen to be fair, so that the potential for resentment or envy is diminished and the system is more politically stable and sustainable. Fairness is needed not just among retirees, but between different life stages (family formation, child development, working life and retirement) and across generations of taxpayers and retirees. Notions of 'what is fair' are dynamic rather than fixed, and culturally determined. New Zealanders' understanding of what is fair will ultimately determine the decisions that are made.

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OF NZS.**

Section Three of this document describes a way of keeping fair each succeeding generation's access to NZS. It proposes a 'schedule and review' process that will keep constant the average proportion of adult life through which NZS will be paid. Under this proposal, NZS will still be paid for as long as a person lives, but because average life expectancy is increasing, the age of eligibility for NZS will gradually increase. This change will have to take into account the needs of those unable to continue working until older ages, or groups with lower-than-average life expectancy.

As well as increasing fairness between generations, the proposed 'schedule and review' process will ease some pressure on the cost of NZS, which is otherwise projected to nearly double by 2060. However, the effect of schedule and review alone will not be enough. There is also a need to consider changes to the rate at which NZS grows over time (i.e. indexation) and whether or not a small increase in Government revenue through taxation might be needed. Other possible measures are briefly discussed, but not recommended.

A new method of indexation of NZS would generate savings but also risk increasing levels of poverty among older New Zealanders. Such a change should be made only if at the same time an adequate proportion of savings were applied to:

- continuously measuring the impacts of change on the living standards and wellbeing of older New Zealanders (so that indexation can be readjusted if necessary); and
- to maintaining the living standards of less-well-off older New Zealanders at acceptable levels.





Recommendations

Keeping New Zealand Superannuation fair and affordable

1. That the proportion of life over the age of 20 in receipt of New Zealand Superannuation be kept at a minimum of 32 per cent² (see pages 35 to 40).
2. That the Government establish, by 30 June 2017, a schedule and review process for New Zealand Superannuation, guided by the principles outlined in this document (see pages 37 to 40).
3. That a new method of indexation of New Zealand Superannuation, based on the average of percentage change in consumer prices and earnings but no less than price inflation in any year, be introduced from 2023 (see pages 44 to 45), subject to an adequate proportion of fiscal savings being applied to:
 - a. Measuring the impacts of the change on the living standards and wellbeing of older New Zealanders, and
 - b. Maintaining the real living standards of less-well-off older New Zealanders at the same levels as provided by the current system of indexation.

KiwiSaver

4. That the age of access to KiwiSaver balances be kept at 65 (see pages 39 and 76).
5. That as soon as fiscally prudent, an auto-enrolment day be held for employees who are not currently members of KiwiSaver, with retention of the right to opt out (see page 66).

² The proportion of adult life spent receiving New Zealand Superannuation for today's new superannuitants is calculated to be 31.6 per cent for men and 34.1 per cent for women. Note however that we recommend the continuation of equal age of entitlement to New Zealand Superannuation for both women and men.

6. That the Government establish a joint working party, chaired by the Retirement Commissioner or her nominee and comprising public and private sector representatives, to identify gaps in the available data on KiwiSaver such as on the savings paths of different segments of the population, and to report by 1 December 2014 on ways in which those gaps can be filled (see pages 75 to 76).
7. That the Government agree to the Retirement Commissioner convening a broadly representative review to determine the viability of different approaches to the voluntary annuitisation of savings including KiwiSaver balances on retirement (see pages 74 to 75).
8. That the Ministry of Business, Innovation and Employment report to the Government by 30 June 2014 on means to fairly maintain the employee contributions of KiwiSaver members while they are on parental leave (see pages 59 and 65).

Financial Literacy

9. That the Government provide the Commission for Financial Literacy and Retirement Income with an explicit mandate to lead the provision of financial education for New Zealanders (see pages 84 to 87).

Taxation

10. That in line with a recommendation of the Savings Working Group, the Government remove tax on the inflation component of interest on simple savings products such as bank deposits and bonds (see pages 51 to 52).

Age-friendly housing

11. That the Ministry of Business, Innovation and Employment report by 1 December 2014 on ways to increase the supply of age-friendly housing (see pages 76 to 79).

Age-friendly workplaces

12. That the Ministry of Business, Innovation and Employment work with employers, industry associations and unions to implement ways to encourage the recruitment, retention, retraining and mobility between jobs of older workers, and report back on progress by 1 December 2014 (see pages 79 to 83).

International pensions (see Appendix One)

13. That an individual's overseas state pension entitlements should be directly deducted against their own individual entitlement to New Zealand Superannuation and that any excess should not then be offset against the individual entitlement of their partner.
14. That the Ministry of Social Development improve information and advice for recent and prospective migrants and returning New Zealanders on the implications of the direct deductions policy for their future retirement income.
15. That the Ministry of Social Development improve the public availability of decisions on the classification of overseas pension schemes whose pension payouts are subject to the direct deduction policy.
16. That the Ministry of Social Development explain the rationale behind each international pension scheme classification.



Section One **Global Context**

This section briefly outlines the international context within which New Zealand's retirement income policies operate. It seeks to show that developments in New Zealand's policies do not happen in isolation, and that our policies are subject to some of the same pressures and trends that exist in other countries.

Global Context

The big picture

New Zealand's system of retirement income does not sit in isolation from the rest of the world. A background paper prepared for this review identifies global trends related to people and economic growth, developments in technology and environmental constraints.³

Many trends are likely to continue, while others are less certain. Even for trends judged to be very likely, the timing is uncertain and surprises can occur. All of these have the potential to impact on people's preparations for retirement and their standards of living once in retirement. An indicative selection of trends is shown in Table 1.

NEW ZEALAND'S SYSTEM OF RETIREMENT INCOME DOES NOT SIT IN ISOLATION FROM THE REST OF THE WORLD.

Table 1:
Likely and uncertain global trends

TRENDS LIKELY TO CONTINUE		
Economy Increasing need for infrastructure build and investment Ongoing systemic risk in financial sector Digitisation – electronic delivery of goods and services	Health Ongoing advances in medicines, life sciences, healthcare innovation, biotechnology, nutraceuticals Rising lifestyle-related illnesses	
Population A growing and ageing world population	Society Changing definitions of family, households and other social structures Increasing length of working life	
UNCERTAIN TRENDS		
Trend	Expected outcome	Possible outcome
Increasing globalisation	Globalisation continues	A rise in localisation
Increasing prosperity and consumption	Return to recent trend	End of the growth phase
Increasing consumer power and expectations	Trend continues	Economies falter, environment erodes and values change
Uptake of alternative investment vehicles	Continuation of product proliferation trend	Disillusionment with financial services industry
Rising health care costs	Trend continues	Research breakthroughs
Increasing life expectancy	Continuation of trend	Diminishing returns
Narrowing gender gap in employment	Trend continues	Steady state reached where gap is closed or progress stops

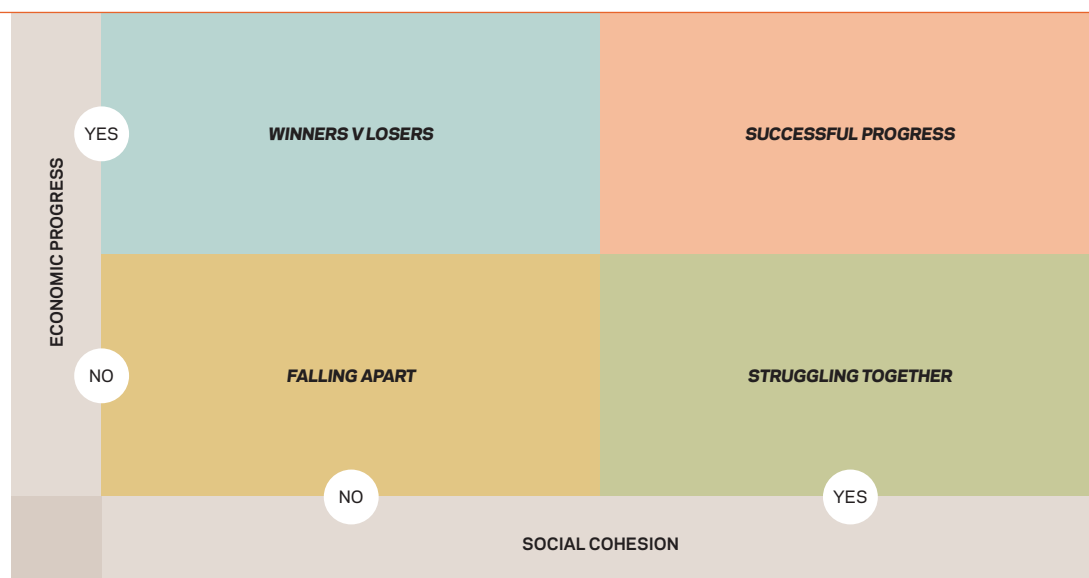
³ See <http://bit.ly/cflri-2013review-global-trends>.



To explore future possibilities, uncertain trends such as those in Table 1 are grouped along two important dimensions of economic progress and social cohesion, to form scenarios or stories about possible futures. These *scenarios* are not predictions, but they alert us to what future might emerge.

Scenarios enable us to test the robustness of strategies and policies, so that we can adapt and be more resilient in the face of inevitable change. The titles chosen for the four scenarios in Figure 1 are fairly self-explanatory and sufficient for the purposes of this document, but further description can be found in the source background paper.

Figure 1:
Scenarios of the future



International trends in retirement income policies

Most countries develop unique sets of policies to meet the needs of their older citizens. Although each policy framework has national characteristics, it is possible to identify some commonly occurring elements. For example, different countries use various combinations of 'tiers' of income support for people in retirement (OECD):⁴

- A first tier to ensure a minimum standard of living and prevent poverty. This first tier is always publicly funded and often 'means tested' so that it is targeted to poorer pensioners and benefits to better-off retirees are reduced. In other words, first tier provision is often used to redistribute

wealth from those who are richer at the time of retirement to those who are poorer⁵

- Second tier provision is based on individual savings, often compulsory and related to workplace earnings (as in Australia).⁶ Even when compulsory, the second tier may be associated with incentives such as lower taxation rates. Second-tier savings are designed to achieve some target standard of living in retirement compared with that when working
- Third tier provision comes from an individual's private, voluntary savings in addition to the first two tiers

⁵ Along with Ireland, New Zealand is quite unusual in the OECD in its reliance on a first tier of retirement income (New Zealand Superannuation) although KiwiSaver has some of the characteristics of a second tier scheme. New Zealand's system is described in more detail in the next section of this document.

⁶ For a comparison of the New Zealand and Australian systems of retirement income, see a background paper prepared for this review at <http://bit.ly/cflri-2013review-auscomparison>.

DIFFERENT COUNTRIES USE VARIOUS COMBINATIONS OF 'TIERS' OF INCOME SUPPORT FOR PEOPLE IN RETIREMENT.

⁴ OECD: The Organisation for Economic Cooperation and Development, consisting of 34 of the world's wealthiest or most 'developed' countries. The reference is to the OECD publication 'Pensions at a Glance' (2011).

Second and third tiers can also be divided into two broad types, depending on the way they are accumulated then paid out in retirement:

- As their name implies, Defined Benefit schemes pay out a predetermined level of retirement income, usually based on the number of years of contributions to a pool of savings and level of income while in employment
- In Defined Contribution schemes, contributions flow into an individual account. The accumulation of contributions and investment returns is then paid out as a lump sum or more often, converted into a pension-income stream at retirement

In New Zealand and across the world, the number of Defined Benefit schemes is declining. This is largely because such schemes created sizeable liabilities for their owners – usually employers – and attendant financial risks that the liabilities would not be able to be met when they fell due. Defined Contribution schemes have become more the norm as responsibility for retirement income has been shifted to individual members and their fund managers along with increased levels of risk, i.e. the actual amount available to fund retirement income is no longer guaranteed, but varies depending on individual investment outcomes.

In most developed countries, a permanent ‘ageing’ of the population is leading to increasing costs associated with the provision of retirement income. A menu of policy responses is available to address challenges associated with these trends, and governments are selecting different combinations of policies to suit their own national circumstances.

Some of the challenges being posed to retirement income policies and options for response are discussed in Section Three of this document, in a New Zealand context. To set the scene, the next section describes New Zealand’s current retirement income framework.

IN NEW ZEALAND AND ACROSS THE WORLD, THE NUMBER OF DEFINED BENEFIT SCHEMES IS DECLINING.



Section Two **New Zealand's Retirement Income Framework**

This section describes how New Zealand's retirement income framework of policies and programmes has developed over time, and how it looks in 2013. It seeks to bring readers up to date, so they can make sense of Section Three's discussion of potential challenges and changes.

New Zealand's Retirement Income Framework

History

New Zealand is similar to other developed countries in having a significant public pension system. Its beginnings go back to the late 19th century, when the growing number of relatively poor elderly people led to a demand for government support.

In 1898 the Government passed the Old Age Pensions Act. The pension was set at about a third of the average wage and was payable from the age of 65. It was asset and income tested, and a 'good character' test applied, which aimed to exclude criminals, drunkards and wife-deserters. Asians were excluded, and Māori were effectively excluded through the way in which communally held land was treated in the asset test. In effect, the pension was paid to only a little over a third of those aged 65-plus.

The policy focused almost entirely on alleviating poverty and hardship in old age, and although the levels of financial support changed in subsequent years according to social developments and economic circumstances, it did little more than cover the necessities of life. Forty years after the introduction of the public pension, the Social Security Act 1938 was passed. This heralded a greater focus on wellbeing and delivering a 'citizenship dividend' (see page 19) while factoring in the constraints of competing demands on public finances.

The Act introduced a two-tier pension structure comprising:

- the Age Benefit, which was effectively the Old Age Pension under a new name. Non-taxed but asset and income tested, the Benefit applied from the age of 60 and provided relatively generous payments, shifting pensioners from a somewhat marginal situation to one that was much more favourable
- Universal Superannuation, under which those not entitled to the Age Benefit received a small payment (13 per cent of the Age Benefit) from the age of 65

The intention was for Universal Superannuation to be increased gradually until the two components were equivalent. This took time; it wasn't until 1960 that the Age Benefit's asset test was abolished, and the Benefit ceased altogether in 1977.

A flurry of activity

By the 1970s the retirement income regime was back on the political agenda. In 1972 the Royal Commission on Social Security recommended higher real pension levels, and in 1975 the Government established a compulsory retirement savings scheme. Designed to be phased in gradually, the scheme was short-lived. It was repealed by the new Government in 1976, which then announced a revised 'National Superannuation' scheme, effective from 1977.

This development signalled a swing back to historically very generous universal public pensions. For example, the pension for a couple applied from the age of 60 and effectively delivered the equivalent of 89 per cent of the after-tax average wage.

THE 1898 PENSION POLICY FOCUSED ALMOST ENTIRELY ON ALLEVIATING POVERTY AND HARDSHIP IN OLD AGE.

THE 1938 ACT HERALDED A GREATER FOCUS ON WELLBEING AND DELIVERING A 'CITIZENSHIP DIVIDEND'.



**COMPULSORY
SAVINGS HAVE NEVER
BEEN FAVOURED.**

Two decades of volatility

There followed two decades of constant adjustments, all aimed at moving the universal pension to some level of perceived affordability. A new consensus was reached, with the pension for a couple paid from age 65 and on the basis of a residency test, at roughly two-thirds the after-tax average wage. The basic tenets of the Social Security Act remained in force – universality, hardship alleviation, wellbeing and paying a citizenship dividend.

Running alongside the universal, state-funded pension was a regime that supported private provision for additional retirement income. Encouraged mainly through tax advantages, the support was eroded by inflation and was interrupted in 1988 when all tax preferences for private savings were phased out. This lack of tax preference continued until the introduction of KiwiSaver in 2007 with its associated Members' Tax Credits (MTCs), although MTCs have also declined in recent years.

At least since 1938, retirement income has never had to fully fund the services that older New Zealanders need. This is because the state has separately funded healthcare and disability services and provided a default safety net of residential care.

The new millennium

The early years of the 21st century have brought more developments in New Zealand's retirement income framework.

In 2001 the New Zealand Superannuation Fund was set up to smooth the costs of the demographic transition to an older age structure, with the aim of pre-funding emerging New Zealand Superannuation entitlements. Between 2004 and 2009, between 1.1 and 1.4 per cent of Gross Domestic Product (GDP) was transferred into the Fund each year. These contributions were suspended in the 2009 Budget.

**GOVERNMENTS
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In 2007 a new policy changed the treatment of investment funds classified as 'portfolio investment entities' (PIEs), which are mainly superannuation funds and other types of managed funds. The change enabled individuals on low or modest taxable incomes to pay less tax than on their investment earnings – making PIEs a more attractive savings option.

2007 also saw the launch of KiwiSaver – a new contributory retirement savings scheme that incorporated a government subsidy, tax advantages and compulsory employer contributions. With New Zealand Superannuation offering a universal flat-rate pension for those residentially qualified and aged 65-plus, New Zealand now has two major retirement provision schemes that are subject to public policy mandates.

Key features

Looking back at the history of retirement income policy in New Zealand, two features stand out, and at times have been unique to this country:

1. Compulsory savings have never been favoured. The one and only experiment with it lasted for about one of the past 115 years
2. Governments have never sought to replicate in retirement the incomes that individuals have earned during their working lives. This has been seen as an essentially personal responsibility, although assisted at times with capped tax advantages and subsidies

Today, policy debate centres on the longer-term sustainability of New Zealand Superannuation, and where KiwiSaver provisions and supports may end up.

Current retirement income policies and programmes

The 2010 Review of Retirement Income Policy identified eight separate objectives that overlap and at times compete with each other.⁷

The challenge is to find a balance between the objectives that is both politically and fiscally sustainable for a long period, and provides people with certainty and confidence in the retirement income framework so they can make long-term financial plans. Certainty and confidence will be eroded if the balance of objectives changes often or with little notice.

New Zealand has chosen a unique mix of the eight objectives that is often admired by other countries. Its retirement income framework is largely set out in the New Zealand Superannuation and Retirement Income Act 2001 (amended in 2005), but older people can access other forms of social assistance under the Social Security Act 1964. The KiwiSaver Act 2006 added another significant component to the legislative framework, as has the Financial Markets Conduct Act (2013).

The objectives of retirement income policy

1. The **income support** objective recognises that people with little or no savings, who can't earn an income or who face particularly high and unavoidable costs, are unable to support themselves financially in retirement. The social welfare system helps by providing a basic level of income support funded out of general government revenue.⁸
2. Retirement income policy can help to ensure older people's **wellbeing** by extending its scope beyond the provision of a basic income in retirement (while acknowledging that income makes an important contribution to wellbeing). This objective emphasises broader living standards and full participation in society, such as through paid work and voluntary service, lifelong education, maintaining family, whānau and community networks, living in a safe and healthy environment, and having access to a range of other services that contribute to overall social and economic wellbeing.
3. A third objective is to encourage New Zealanders **to take responsibility** for managing their own finances in a way that best suits their long-term interests. In a voluntary system, each person chooses when and how much they save given their working life and other circumstances. However, the voluntary model only works if:
 - Individuals and families can earn enough income for them to save
 - People have a good level of financial literacy and access to sound financial advice to support their choices
 - There is a well-functioning and regulated financial market that is transparent and trustworthy
 - There is a generally tax-neutral saving and investment environment to avoid distortions in decision-making.
4. **Longevity risk pooling** aims to ensure that people are protected against their incomes falling below expected or desired levels, even if they live to an older-than-expected age. It gathers together all of a diverse group's individual risks of outliving their savings and relies on the resulting large numbers to reduce overall variability in that collective risk.



THE CHALLENGE

The challenge is to find a balance between the objectives that is both politically and fiscally sustainable for a long period, and provides people with certainty and confidence in the retirement income framework so they can make long-term financial plans. Certainty and confidence will be eroded if the balance of objectives changes often or with little notice.

⁷ For a fuller description of New Zealand's retirement income policies, see the background paper prepared by the Ministry of Social Development at <http://bit.ly/cflri-2013review-currentpolicies>.

⁸ The Human Rights Commission's submission to this review points out that the right to an adequate standard of living is enshrined in the Universal Declaration of Human Rights at Article 25 and explicitly makes reference to security in old age.



5. A person's '**citizenship dividend**' is their automatic entitlement to a public pension once they reach the age of eligibility (and as long as they meet residency requirements). It's not a dividend in the traditional sense of a return on investment or contribution; it's paid no matter how long the person has worked, paid taxes and served in their community. Because everyone is entitled to a citizenship dividend, it delivers benefits in social cohesion and national identity, which in turn build trust and other elements of social capital that contribute to economic growth and national wealth.
6. The objective of **lifetime consumption smoothing** is based on the notion that at different stages of their lives people tend to either save out of their earnings or run down those savings in order to achieve a standard of living in retirement similar to the one they had while working. While it emphasises an individual perspective, some cultures take a more collective approach, and there may be motives to bequeath wealth to the following generation or to 'self-insure' against the costs of ill health.
7. The seventh objective is to **ensure equity between generations** in sharing the costs of retirement income. Ideally, government services (such as public pensions) that each generation receives in its lifetime match in some way the taxes that that generation has paid.
8. The Government must be in a **sound fiscal position** to meet the costs of public pensions alongside other expenditure priorities. 'Soundness' is determined by the balance between the Government's revenue and expenditure, and is strongly influenced by net debt levels.

Policies and programmes supporting older people

A number of measures already in place support the first two objectives. They include New Zealand Superannuation (NZS) and the Veteran's Pension (VP), and a range of policies and programmes managed and provided by government, private and non-profit agencies.

New Zealand Superannuation and the Veteran's Pension

NZS is a simple, universal pension paid to all those aged 65-plus who:

- Are New Zealand citizens or permanent residents
- Have been resident and present in New Zealand for not less than 10 years since the age of 20, of which five years or more must have been since the age of 50
- Are ordinarily resident in New Zealand on the date of application

The Veteran's Pension (VP) is an alternative pension paid at the same rate as NZS to veterans who've served in wars and other emergencies, and have disabilities.

The NZS/VP payment rates vary according to people's living arrangements. The three main rates are:

- Married, civil union or de facto couple (where both qualify for NZS/VP)
- Single sharing accommodation
- Single living alone

In addition, qualified New Zealand superannuitants who are married to, or in civil unions or de facto relationships with, New Zealand permanent residents, or citizens who don't meet the NZS/VP eligibility criteria, can elect to receive a special rate of NZS/VP that includes their spouses/partners. This 'non-qualified partner' rate is subject to an income test against the couples' joint incomes.

As at 31 March 2013, 628,497 people were receiving NZS/VP, an increase of 119,353 since 31 March 2007. The ratio of females to males receiving NZS is roughly 55:45, and 73 per cent of all males receiving NZS live in couple relationships, compared with 48 per cent of all females. These figures reflect women's longer average lifespans (see pages 35 to 36 for a discussion on longevity issues).

Table 2:
Expenditure on NZS and VP, before tax

	NZS (\$000s)	VP (\$000s)	Total (\$000s)
Year ended 31 March 2007	6,675,183	138,852	6,814,035
Year ended 31 March 2010	8,165,022	179,899	8,344,921
Year ended 31 March 2013	10,063,817	172,605	10,236,422

Source: Ministry of Social Development

Calculating NZS/VP payment rates

The NZS/VP payment rates are adjusted on 1 April each year in line with any percentage increase in the Consumers Price Index (CPI) for the year ending the previous 31 December.

The after-tax weekly amount payable to a married, civil union or de facto couple (where both qualify) must be at least 65 per cent, but not more than 72.5 per cent, of the average wage after tax. The current Government's policy is to maintain this rate at a minimum of 66 per cent and, if it's ever less than this following the above calculations, to adjust it to this 66 per cent level.

Following the price and wage adjustment, the single sharing and living alone rates are set at:

- Sixty per cent of the married, civil union or de facto couple rate for single people sharing accommodation (this also applies to many other countries' social security benefit systems)
- Sixty-five per cent of the married, civil union or de facto couple rate for single people living alone and who qualify for the Living Alone Payment

Table 3 outlines the NZS/VP weekly after-tax payment rates from 1 April 2013, based on the 'M' tax code (a higher tax code applies to people for whom NZS/VP is not the main source of income).



Table 3:
Rates of NZS and VP from 1 April 2013

Rate type	Net rate based on 'M' tax code	Gross rate
Married, civil union or de facto couple (where both qualify for NZS/VP)	\$549.88	\$620.68
Single sharing accommodation	\$329.93	\$377.05
Single living alone	\$357.42	\$410.32
Married, civil union or de facto couple (maximum payable to a couple where a non-qualified partner is included)	\$522.62	\$587.46

Source: Ministry of Social Development

The rate paid to a married, civil union or de facto couple (where both qualify for NZS/VP) is the NZS/VP base rate. This rate is then halved and paid to each individual in the couple, and is often referred to as the 'married person rate'.

The fact that the rate for couples living together in married, civil union or de facto relationships is less than double the single rate reflects the belief that couples can take advantage of certain economies of scale (for example in vehicle and insurance expenses) that single people can't.

The rate for single people living alone is about 40 per cent of the average wage. However, because NZS is paid at a flat rate, a diminishing percentage of pre-retirement income is 'replaced' for recipients earning above the average wage (see page 57). In this sense NZS is 'redistributive' in that it's funded out of a system that taxes higher incomes at higher rates and pays proportionately more to those with lower lifetime incomes.

International aspects of eligibility

New Zealand operates a 'direct deduction' policy for residents who qualify for NZS/VP or social security benefits and receive public pensions from other countries. Their New Zealand payments are reduced by up to the amount of the overseas pensions, and in some instances these deductions are made from NZS/VP payments otherwise due to the recipients' spouses or partners.

The Retirement Commissioner is aware of the grievances about direct deductions among a number of overseas pension recipients. Many arise from differences in the definition of a qualifying overseas pension and intending immigrants lacking adequate information about the policy. The 2010 Review of Retirement Income Policy made a number of recommendations on the policy, and these are reiterated in 2013. See Appendix One for more detail.



Table 4:
Overseas pension deductions from NZS and VP recipients

As at end March	Number of recipients	Proportion of total NZS/VP recipients	Average annualised value of deducted pension in NZ\$
2007	47,232	9.3%	\$4,083
2010	53,938	9.9%	\$3,742
2013	65,042	10.3%	\$3,532

Source: Ministry of Social Development

Concession cards

People aged 65-plus can boost their spending power through two key concession card programmes: the SuperGold Card and the Community Services Card (CSC).

The SuperGold Card

Introduced in 2007, the SuperGold Card is a discount and concession card provided to all people receiving NZS/VP. Cardholders have access to a wide range of concessions and business discounts (funded by the businesses themselves), and easy access to government entitlements and local authority services. The Card can also be used at participating Seniors' Card⁹ businesses in participating states in Australia.

Free off-peak public transport travel, which was added in October 2008, now comprises the major component of government concessions. By the end of 2012, Cardholders had taken around 41 million trips at a cost of about \$86 million.

The Community Services Card

The Community Services Card (CSC) is available free to people on low to middle incomes. Originally designed to subsidise the costs of doctors' visits, prescriptions, emergency dental care and some travel and accommodation for treatment, it's now also used as a proxy income test for subsidised access to a wide range of services, from home insulation to swimming pool entry.

⁹ The Seniors' Card is the Australian version of the SuperGold Card.

NZS recipients must meet income test criteria to qualify for a CSC. Cards have been issued to about 45 per cent of those receiving NZS/VP, and to approximately 12,700 other people aged 65-plus who don't receive these benefits, often because they're not residentially qualified.

Social welfare benefits for older people

People aged 65-plus who don't meet the NZS/VP qualifying criteria and have no other means of support may be entitled to benefits such as the Emergency Benefit, Unemployment Benefit, Widow's Benefit, Invalid's Benefit, Sickness Benefit and Domestic Purposes Benefit. In addition:

- Means-tested supplementary assistance is available on the basis of need to people receiving NZS/VP or main social security benefits. Assessed weekly, it includes the Disability Allowance, Accommodation Supplement, Special Benefit and Temporary Additional Support¹⁰

¹⁰ The Disability Allowance is a weekly payment for people who have regular, ongoing costs because of a disability, such as visits to the doctor or hospital, medicines, extra clothing or travel; the Accommodation Supplement is a weekly payment that helps people with their rent, board or the cost of owning a home; and Temporary Additional Support is a weekly payment that helps people who can't meet their essential living costs from what they earn or from other sources.

On 15 July 2013 the benefit system changed, and as yet there are no data available on the uptake of the newly named benefits among older New Zealanders. The following information is based on the previous benefit system.



- Means-tested Special Needs Grants and the Advance Payment of Benefit¹¹ are available to meet immediate and essential needs. However, these have low take-up rates in proportion to the number of people aged 65-plus

Other policies and programmes for those aged 65-plus

A range of other policies and programmes is provided to people aged 65-plus. Particularly suitable for those on limited incomes, they contribute to their social and economic wellbeing and effectively augment their retirement incomes, reducing the pressure on NZS.

Health and disability support

Older people use proportionally more of the public health dollar and related disability services than all other age groups. Those on lower incomes rely on these services more than others.

The policies and programmes for older people cover the spectrum of doctors' visits to long-term residential care:

- Those enrolled with primary health organisations (PHOs) qualify for government-funded subsidies
- Those with ongoing health problems who don't qualify on income grounds for a CSC can apply for a High Use Health Card, which offers the same cost-saving benefits as a CSC
- Older people consulting doctors other than at their PHOs (or who are not enrolled in PHOs) can get a \$15 General Medical Services subsidy if they have a CSC or High Use Health Card

- Listed pharmaceuticals approved by PHARMAC¹² and prescribed by doctors are provided at subsidised rates by pharmaceutical providers with Ministry of Health, district health board (DHB) or PHO contracts. If a provider doesn't have such a contract, people with a CSC or High Use Health Card can still get subsidised fees

- People with long-term disabilities not covered by the Accident Compensation Corporation can be assessed for and provided with free loans of equipment to help them with everyday activities. Help with the costs of hearing aids is also available

Help for people less able to manage in their own homes and who need community care includes:

- The income-tested Disability Allowance for those with disability or health issues
- DHB-funded services to help with personal care and household management
- The Domestic Purposes Benefit for household members caring for people aged 65-plus
- The Residential Care Subsidy for people aged 65-plus assessed as requiring long-term residential care and who meet income and asset thresholds
- The Residential Care Loan for people aged 65-plus who don't qualify for a Residential Care Subsidy. This interest-free loan is secured over the person's former home and is generally due to be repaid when they die or the former home is sold or otherwise disposed of (whichever happens earlier)

¹¹ A Special Needs Grant is a payment to help people in certain circumstances to pay for things when they have no other way of paying for them. They don't usually have to repay the money. An Advance Payment of Benefit is made to people getting benefits who have an immediate need for essential goods or services.

¹² pharmac.health.nz

Housing

Programmes that help older people on low incomes with the costs of housing include:

- State rental housing
- Local government social housing, which is administered by local authorities
- Non-government community housing, which mostly provides concessional or sheltered housing for older people
- The Accommodation Supplement, which subsidises high housing costs for those on low incomes
- Rates rebates, which the Department of Internal Affairs provides to people who don't meet the cost or asset criteria for an Accommodation Supplement, and whose annual income is less than \$23,650
- Local government rates payment-deferral schemes, where a homeowner's rates debt is accumulated and charged against their estate or eventual house sale. These schemes appear to be rarely used, perhaps because on acceptance, people no longer qualify for the Accommodation Supplement or rates rebates
- For CSC holders, subsidies of up to 60 per cent on the Government's subsidised home insulation scheme

These housing assistance programmes clearly have a significant role in the low rates of hardship among older people. However, those on low incomes with limited savings may struggle with major housing-related costs, such as expensive maintenance projects and large increases in property rates.

The rapid growth in the number reaching 65 years and declining home ownership rates suggest that housing affordability issues will become more pressing for a growing proportion of the older age group. Under current support structures, this is likely to put more pressure on the Accommodation Supplement system. See pages 76 to 79 for more on housing and its place in retirement income policy.

Transport and mobility

Transport options other than walking and car travel are important for older people, owing to age-related factors such as increasing frailty and physical disability, deteriorating eyesight, reduced decision-making capacity and reaction times, and limited budgets.

The Government-funded options include:

- Free off-peak public transport: The SuperGold Card provides free public transport in off-peak times, benefiting mainly those living in urban areas with public transport systems
- The Total Mobility Scheme provides subsidies of up to 50 per cent (up to a maximum fare) on taxi services for people with impairments that prevent their travelling unaccompanied on trains, buses or ferries in a safe and dignified way

Older drivers seeking to renew their driver's licences have to pass medical examinations and, if there are doubts about their ability to drive safely, are required to undergo on- and off-road assessments, which can cost up to \$600. No official driving permits are required for motorised mobility scooters.

Communication, social integration and personal safety and security

Older people can access help in maintaining their community connections through initiatives such as:

- SeniorNet's computer skills training courses
- Age Concern's contracts with a number of DHBs to organise visiting services for those affected by social isolation and loneliness.

In addition:

- New Zealand Police helps to address older people's concerns about personal security through initiatives such as Neighbourhood Support groups and Community Patrols
- Age Concern offers a number of other services for older people, including abuse prevention programmes
- A wide variety of community and not-for-profit groups (such as Red Cross, Meals on Wheels, food banks and neighbourhood support groups) respond to people's particular needs and concerns.



HOUSEHOLDS WITH SIMILAR INCOMES CAN HAVE QUITE DIFFERENT LIVING STANDARDS.



Family support

Traditionally, many of the care services needed by older people have been provided by unpaid family members. However, while older people are generally becoming more self-sufficient for longer, and sometimes have friends and neighbours to help them – or can afford professional help – the future supply of these ‘natural carers’ is under threat, owing to:

- People having no or smaller families, which means the ratio of adult children as carers to those who are elderly and needing care will fall
- Family members being separated by distance
- Increases in the number of children (particularly women) working full-time, and therefore being unavailable as carers
- The likelihood of fewer people having long-term partners as they get older

This will be a particular problem for lower-income people, whose need for state-assisted care is likely to expand at a time when public sector budgets are under severe pressure for demographic reasons.

KiwiSaver

KiwiSaver can be seen as supporting the objectives of income support, wellbeing, personal responsibility and lifetime consumption smoothing through its stated purpose:

To encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement... to increase individuals' wellbeing and financial independence, particularly in retirement, and to provide retirement benefits.

KiwiSaver members are paid a ‘kick-start’ \$1000 on joining and can claim Member Tax Credits up to a capped amount. KiwiSaver is discussed in more detail on pages 61 to 76.¹³

THE GREAT MAJORITY OF OLDER NEW ZEALANDERS HAVE A REASONABLE STANDARD OF LIVING.

Outcomes of current support for older New Zealanders

Policies and programmes described in Section Two seek to support the income of people aged over 65 and ensure that they experience general wellbeing. How well do they work? The following discussion canvasses a range of measures to help answer that question.

Non-income measures

Income is not the only determinant of wellbeing in retirement, and households with similar incomes can have quite different living standards.¹⁴ For example, households have differing demands from housing or health costs or the need to support others, or varying abilities to carry out household activities such as cooking, cleaning and repairs and maintenance.

Access to public services and ownership of physical and financial assets are also important and there are many qualitative aspects to wellbeing, for example family connections, satisfaction gained from making a contribution to a community or access to opportunities for enjoyable experiences.

These differences in circumstances make it difficult to design ‘one size fits all’ retirement income policies. Rather, the challenge is to establish stable and clear frameworks with enough flexibility for individuals to make decisions to suit their own particular circumstances, and to allow for the risks of things going wrong.

The Ministry of Social Development has developed a range of measures of material wellbeing for older people. Some of these are income-based and some are not. Overall, the findings are that the great majority of older New Zealanders have a reasonable standard of living. Many have a very good standard of living and there is a small minority (four to seven per cent) who would be considered by most to be living in undue material hardship.

¹³ Also see kiwisaver.govt.nz.

¹⁴ Parts of this section are extracted and/or abridged from Perry, B. (2013a). *The material wellbeing of New Zealanders: background paper for the Retirement Commissioner's 2013 review*. Ministry of Social Development. For the full paper see <http://bit.ly/cflri-2013review-materialwellbeingoldernz>.

These relatively good outcomes for older New Zealanders are due to the mix of current public provision (mainly NZS) and the private provision built up by most of the current cohort over their lifetime. A key component of the private provision is mortgage-free home ownership which is relatively high among the current cohort (Perry, 2013a).

Non-income based measures of material wellbeing focus on the actual living conditions that older people experience. Such measures can be used to identify the range of factors associated with increased risk of hardship and the size of their impact. In addition to income and asset ownership factors, other life-history risk factors include:

- Experiencing adverse events, especially in the decade or so prior to age 65 (e.g. separation or divorce, unemployment, redundancy, imprisonment, long-term hospitalisation)
- Having a low occupational socio-economic status score after the age of 50
- Having no formal educational qualifications.

There are also socio-demographic characteristics associated with a greater risk of hardship:

- Younger older New Zealanders have a greater risk
- Older Māori and Pacific people have a higher risk
- Non-partnered older New Zealanders have a higher risk than their partnered counterparts (and due to their longer average life expectancy, women are more likely to be non-partnered in old age than are men (see pages 35 to 36); although it is notable that New Zealand is one of only three OECD countries where older women do not have poverty rates higher than men).¹⁵

In a background paper prepared for the 2007 review of retirement income policy, it was pointed out that for disabled people the chances of a comfortable retirement income are considerably lowered. There is no reason to believe that these circumstances have changed:

Disabled people have low personal incomes, are less likely to be in the workforce, are more likely to be occupationally segregated, and are paid at a lower rate than their non-disabled colleagues. In addition home ownership appears to be lower than for non-disabled people. As a further complicating variable, there is a gap between disabled men and disabled women, who are more disadvantaged.¹⁶

Findings about the impact of financial, economic and life history factors serve as a useful reminder of the importance of 'pre-retirement' events and circumstances for the material wellbeing of older New Zealanders. While some of the life-course events are of a more private nature (e.g. separation/divorce) and others are driven by economic circumstances well outside New Zealand's control, many are more directly influenced by local social and economic policies over a lifetime. As a consequence, the management of risks of poor outcomes in retirement might be regarded as having partly individual and partly collective imperatives. Striking the right balance in the sharing of these risks is a core challenge for retirement income policy.

Income is the focus

Although it is gratifying that a large majority of older New Zealanders enjoy at least a reasonable standard of living in retirement, the focus of this review continues to be on retirement income policy. While income is not everything, it matters hugely and remains a vital determinant of overall wellbeing.

The great majority of older New Zealanders (aged 66+) are very dependent on NZS and other government transfers for their income:¹⁷

STRIKING THE RIGHT BALANCE IN THE SHARING OF RISKS IS A CORE CHALLENGE FOR RETIREMENT INCOME POLICY.

¹⁶ Wicks, W. (2007). *Disabled People and Provision for Retirement*. See <http://bit.ly/cflri-2007review-disabledprovision>.

¹⁷ Perry (2013a). The age 66+ is used so as to exclude 'part years' of NZS receipts.

¹⁵ OECD Pensions Outlook 2012.



- Forty per cent have virtually no other income source
- The next 20 per cent have on average around 80 per cent of their income from NZS and other government transfers

This degree of dependence has not changed greatly in the last two decades, although there are signs of increased diversity of income sources such as investments (see Table 6)

NZS provides a basic income which helps ensure comparatively low rates of poverty among those aged 65+ but only after housing costs are taken into account – see Table 5. On average from 2009 to 2012, eight per cent of older New Zealanders lived in households with housing costs that were more than 30 per cent of household income. This is up from 6 per cent in the mid-1990s and three per cent in the late 1980s.

Table 5:
Poverty rates (%) using a fixed reference after housing cost (AHC) measure

	Poverty rate (%)	Composition (%)
Total population	15	
Age group		
0-17	21	
18-24	18	
25-44	15	
45-64	12	
65+	7	
Economic Family Unit (EFU) type		
65+ couples	6	
65+ non-partnered	12	
Tenure (65+)		
Owned or FT* mortgage-free**	3	76
Owned or FT with mortgage	12	11
Rented (private, local authority, HNZA)	27	13

Source: Perry (2013a)

*FT = Family Trust

**Owned or FT mortgage-free' means that the dwelling is owned by the householders or a Family Trust, and the householders make no mortgage payments.

Some would disagree with the picture of levels of poverty among older New Zealanders provided by the above data. These different views (see box on page 30) may reflect those of a sub-set of the population or the use of different measures. They do however remind us that the level of income that NZS provides is very close to the OECD poverty benchmark – which is a relative rather than absolute

measure. Small changes in income can show up as large apparent shifts in poverty levels, but these shifts simply reflect the existence of the strong clustering of household incomes for older New Zealanders at and just above the level of NZS in the New Zealand income distribution.

Changes in the cost of living can also have

major impact, particularly if they are happening to goods and services disproportionately consumed by older people and increasing faster than the overall rate of inflation. In general, such impacts should be lessened by the way in which NZS is indexed but several submissions to this review noted the impact of cost of living increases, particularly in the price of electricity. Consumer New Zealand submitted that:

Increasing electricity prices (coupled with the quality of our housing stock) mean it is difficult to heat homes to the minimum 18 degrees recommended by the World Health Organisation. Cold, damp housing is associated with respiratory and other adverse health conditions, and has significant implications for the health of older people.

It is often said that NZS is a 'generous' pension in terms of the income it provides and this is probably true in comparison to the first tier, public pensions of other countries. But many other countries also have a long-standing 'second tier' in their overall framework to top up retirement income. New Zealand's eligibility criteria may be regarded as generous in comparison to other countries, but these relate to access rather than total income in retirement. 'The ratio of the average incomes of older New Zealanders to those of the population as a whole is in the 'low to middle range' on an OECD league table.'¹⁸ Given the extent of dependency on NZS for income, this would suggest that NZS is not overly generous as total retirement income.¹⁹

A further indication is that the level of NZS in comparison to other New Zealanders' incomes has also fallen over the last two decades although it has regained some ground in recent years:

Compared with wages and household incomes, the value of NZS remained fairly steady in real terms from the early 1990s to 2006, then rose by 14 per cent from 2006 to 2012.

Median household incomes rose strongly over most of this period (42 per cent from 1994 to 2012). A consequence of these different growth rates is that NZS fell from 67 per cent of the median in 1994 to just under 50 per cent in 2009, rising a little to 53 per cent in 2012.²⁰

So while NZS has increased in value, it has fallen behind wages and household incomes in general.

That said, an international comparison capturing the impact of all factors, not just income, shows that New Zealand has a low hardship rate among its older population relative to European nations (see Figure 2: comparisons cannot presently be made with countries such as Canada, Australia and the United States because those countries do not yet have the appropriate survey data to allow proper 'apples with apples' comparison).

NZS IS NOT OVERLY GENEROUS AS TOTAL RETIREMENT INCOME.

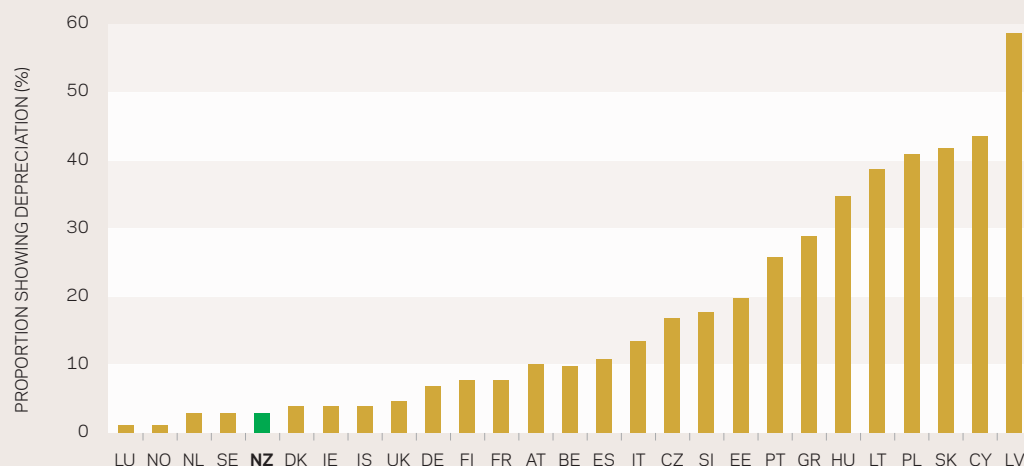
¹⁸ Perry, B. (2013b). *Household Incomes in New Zealand: Trends in indicators of inequality and hardship 1982 to 2012*. Ministry of Social Development.

¹⁹ The connection between income from NZS and total income may be changing, and more research is needed to give us better understanding of the true picture.

²⁰ Perry (2013a).



Figure 2:
Deprivation rates
using the official 9-item
European Union (EU)
index, those aged 65+
EU-25* (EU 2007,
NZ 2008)



*EU-25 means the EU-27 less
Malta, plus Norway, Iceland and
New Zealand

Source: Perry (2013a)

Around one in three older New Zealanders receives more than half their income from sources other than NZS or VP.

For this group, the proportion of income from other sources has grown over recent years, as shown in Table 6.

Table 6:
Number of people aged 65 and over who receive income from various sources - changes between June quarters 2010 and 2012.

Income source	Number receiving this source (thousands)		Percent of all people aged 65+		Average weekly amount for those receiving that source		
	2010	2012	2010	2012	2010	2012	Real change
Government transfers (mainly NZS)	517.8	562.1	96.8%	97.8%	\$294	\$322	3.1%
Investment income	280.9	329.6	52.5%	57.3%	\$143	\$151	-0.6%
Wage or salary income	61.0	70.0	11.4%	12.2%	\$641	\$694	1.9%
Of which:							
Full-time employment	31.6	36.6	5.9%	6.4%	\$955	\$991	-2.4%
Part-time employment	29.0	32.7	5.4%	5.7%	\$299	\$357	12.3%
Other transfers	53.0	56.9	9.9%	9.9%	\$272	\$310	7.2%
Self-employment income	28.4	42.9	5.3%	7.5%	\$448	\$629	32.1%
Total people aged 65+	535.0	574.8					

Source: Submission of R. Hurnard, derived from Statistics New Zealand, New Zealand Income Survey, Supplementary Tables 4 and 5



Responding to emergent trends

It seems that a group of 'affluent elderly,' particularly two income couples, may approach their potential retirements with substantial assets including accumulating KiwiSaver balances and in ongoing paid employment.²¹

It is also likely that another group will arrive at retirement having never owned their own homes, with a long-term history of benefit dependency or in a generally weak financial condition. This will swell the proportion of older people in need of significant amounts of supplementary assistance, including social rental housing and/or accommodation subsidies.²²

In 1970 when virtually all of the current 65- plus age group were young or middle-aged adults, income-tested beneficiaries at 30,961 were only two per cent of the population aged 16–64. Half of these were widows. By mid-2012 the 309,986 beneficiaries in that age group represented nearly 11 per cent of the total.

If these disparate trends continue, the future population of older New Zealanders will become a more 'two-tier' group with a wide range of living standards, possibly echoing the 'winners versus losers' scenario described in Section One. A proactive approach will increase the chances of 'successful progress' instead.

Proactive policies need to be designed to:

- Improve the ability of all New Zealanders to build their personal retirement savings and investment before they reach the age of eligibility for NZS; and
- Ensure more equal outcomes in retirement, possibly through increased targeting of public assistance

These policies will need to be stable enough to give clear, long-term signals to enable people to plan for retirement with confidence. At the same time, retirement income policies operate within a dynamic system and in the face of uncertainty as to how things will actually turn out. There must be some scope to 'fine tune' policies in the future – with sufficient lead time before implementation – as more knowledge comes to hand. The impacts of any changes in retirement income policies will need to be very carefully monitored through a continuous programme of research to determine actual trends and outcomes in living standards among older New Zealanders.

Different views on poverty levels

The Family Centre cites the New Zealand Longitudinal Study of Ageing, which finds that around a fifth of older New Zealanders live below or close to at least one of the standard international poverty thresholds (NB this study investigates income before housing costs, for those aged between 50 and 84).

Grey Power in its submission asserts that:

New Zealand Superannuation in the absence of supplementary retirement income does not adequately fund retirement living of even a basic standard presently and, in future, certainly will not be sufficient to do so.

The Hamilton Budgeting Advisory Service submission notes an increasing number of older people (in their 70s and 80s) seeking budgeting advice, largely because of a lack of reserves for emergencies.

The National Council of Women reports:

An overwhelming response (to their call for comment on this review) expressing the view that the single superannuation payment was inadequate.

PROACTIVE POLICIES NEED TO BE DESIGNED TO:

- Improve the ability of all New Zealanders to build their personal retirement savings and investment before they reach the age of eligibility for NZS; and
- Ensure more equal outcomes in retirement, possibly through increased targeting of public assistance

21 For a wider ranging discussion of these issues, see Preston (2013) *The Contribution of Wider Policies and Programmes to Living Standards of Older New Zealanders* at <http://bit.ly/cfri-2013review-widerpolicies>.

22 Because of the different ways they have been indexed in recent years, the relative value of other government welfare transfers have fallen far behind that of NZS (see the Submission of Roger Hurnard at <http://bit.ly/cfri-2013review-submissions-rogerhurnard>). However, once people take up NZS they are generally on it for the rest of their lives while most who are on working age benefits are not receiving them for long periods.



The role of the financial services sector

The financial services sector has a vital role in underpinning retirement income frameworks as it provides mechanisms for New Zealanders to purchase major assets, save and invest. More broadly, a well-performing sector supports growth in the economy from which future retirement income will be paid.

From 2006, New Zealand suffered the twin blows of finance company collapses and the Global Financial Crisis (GFC). The effects of these were discussed in a paper prepared for the 2010 Review of Retirement Income Policy.²³ The initial, direct impact of the two events on households' aggregate net worth was significant (-9 per cent) but there was a wide dispersion of outcomes, with some households having suffered substantial losses. Overall, New Zealand has weathered the crisis better than some other economies, the banking sector remained AA rated throughout, and there has been a gradual recovery.

The two to three decades preceding the GFC were an era of rapid innovation in the financial services sector. Advances in computing technology made possible new forms of channels for delivery of financial products. It was also a period of increased financial complexity, and for the northern hemisphere banks, a move towards financial engineering in the form of opaque financial instruments. At the time, these advances were viewed by most as positive developments which raised the efficiency of the financial system in mobilising and allocating resources. They were also seen as enablers of risk-transfer and therefore of diversification that helped to improve the resiliency of the system. The GFC resulted in more mixed assessments of these benefits. Complexity is likely to be an enduring feature of the financial system in future, but in retail banking in particular there is also a countervailing trend towards better disclosure and plain English communication between financial services companies and their clients.

New Zealand's capital markets are relatively small and shallow, providing limited opportunities for investment of savings. Building of those markets is a key focus in the current Government's Business Growth Agenda. At the same time, the financial system is open, internationally integrated, and competitive, thus enabling savers and investors to access financial services from abroad. This is against the backdrop of threats that emerged during and since the GFC that have caused financial policy in many countries to turn inward.

Of consequence to retirement income policy (see pages 51 to 52), the financial system has experienced competition from direct investment by savers in real estate, particularly housing. Ironically, some of this competition can be attributed to the sector having financed home lending which, in the face of constraints on the supply of new housing, has resulted in house price inflation rather than returns reflective of economic value-add.²⁴ But there also appears to have been fragility in public confidence in the financial system, compared with direct investment in 'bricks and mortar'.²⁵

Since 2010, measures have been taken to restore confidence in financial markets, with the establishment of the Financial Markets Authority and increased industry regulation and oversight. There have also been national and international moves to raise minimum prudential standards (for capital and liquidity) to backstop the financial system.

23 See <http://bit.ly/cflri-2010review-gfc>. This was updated by the same author for the 2013 review: see <http://bit.ly/cflri-2013review-roleoffinancialsystem>. This section is drawn from both papers.

24 See the report of the New Zealand Productivity Commission's enquiry into housing at <http://bit.ly/productivitynz-housing>.

25 See <http://bit.ly/rabodirect-fci>.





Section Three **Future Challenges**

The previous sections described our system of retirement income as it is, and identified some existing trends. This section goes further and describes the most important challenges facing New Zealand's retirement income policies, discusses options for response and provides rationale for the recommendations that are embedded throughout.

Future Challenges

Keeping the system fair

As described in Section Two, there are eight objectives for retirement income policy, which are supported to varying degrees by New Zealand's current framework.²⁶

Other means of assessing retirement income policies are also available and one of these has been developed by the New Zealand Treasury, based on its living standards framework. Other writers have, between them, identified a number of criteria for assessing retirement income policy: adequacy, efficiency, simplicity, flexibility, stability, certainty, equity, fairness and overall sustainability.²⁷ Several of these criteria refer to the same attribute in a slightly different way, and as with the eight objectives, there is considerable overlap between them.

All of these frameworks reflect the complexity of retirement income policy. There are trade-offs to be made, and it is impossible to empirically determine the 'correct' policy setting. Values, perceptions and political judgement also play their parts so public understanding and 'buy-in' to decision-making processes and outcomes are essential.

A key value underpinning New Zealand Superannuation, stemming from the 1972 Royal Commission of Enquiry, has been the achievement of social inclusion and cohesion by recognising, in a general way, the productive efforts and contributions made by citizens from all walks of life. Each generation is promised the same recognition and entitlement when they reach qualifying age and this has been seen to promote solidarity.

²⁶ A short paper on each of these objectives can be found at <http://bit.ly/cflri-policypositionpapers>.

²⁷ Hawke, R. (2005). Retirement Income Provision in New Zealand: A Way Forward. Institute of Policy Studies, Wellington. Also Cook, L. (2006). *Questions for our times about retirement saving and pensions*. Retirement Commission.

Every New Zealander's entitlement to a standard pension from a standard age effectively removes any stigma that might otherwise be attached to applying for a targeted benefit. Because all citizens have the same entitlement – whether they are rich or poor, male or female and regardless of ethnicity – they are equally valued. The system needs to be seen as *fair*, so potential for resentment or envy is diminished and political stability and sustainability are enhanced. While fairness may sometimes require distribution of wealth from the rich to the poor in order to ensure equal outcomes, this is not the only way to guarantee equity. Fairness also means that talent or success are rewarded, not penalised.

Notions of 'what is fair' are dynamic rather than fixed, and culturally determined. New Zealand therefore has to determine its own position rather than comparing itself with other countries. Our understanding of what is fair will ultimately determine the balance of weights given to each of the different objectives for retirement income policy.

Change in the structure of New Zealand's population

In common with other OECD countries, New Zealand has an ageing population. There are also high numbers of 'baby boomers' born in 1946–65 now reaching age 65. Contrary to popular belief, population ageing is a long-term, permanent change rather than one 'caused' by the baby boomers. Ageing has instead been caused by two persistent demographic trends: New Zealanders are having fewer children and living longer than they used to.

In July 2012, 587,000 people (roughly one in eight of all New Zealanders) were aged 65 or over. The number of people aged 65+ is expected to double between now and 2061, and by then they are expected to make up one-quarter or more of all New Zealand residents. The number of New Zealanders aged 85+ is expected to more than quadruple, from 73,000 in 2012 to 360,000 in 2061.

THE SYSTEM NEEDS TO BE SEEN AS FAIR, SO THAT IT IS MORE POLITICALLY STABLE AND SUSTAINABLE.

WHILE FAIRNESS MAY SOMETIMES REQUIRE DISTRIBUTION OF WEALTH FROM THE RICH TO THE POOR IN ORDER TO ENSURE EQUAL OUTCOMES, THIS IS NOT THE ONLY WAY TO GUARANTEE EQUITY. FAIRNESS ALSO MEANS THAT TALENT OR SUCCESS ARE REWARDED, NOT PENALISED.



Population ageing is a persistent change in the age structure of the population, caused by two long-term demographic trends: New Zealanders are having fewer children and living longer than they used to.

CONTRARY TO POPULAR BELIEF, POPULATION AGEING IS A LONG-TERM, PERMANENT CHANGE RATHER THAN ONE 'CAUSED' BY THE BABY BOOMERS.

One consequence of the ageing of the population will be a change in the ratio of people aged 65+ and the 'working-age' population. This so-called 'dependency ratio' is calculated as the number of people aged 65+ per 100 people aged 15–64 years, and it is projected to increase significantly through the rest of this century. This means that for every person aged 65+, there will be about 2.6 people aged 15–64 in 2036 and 2.3 in 2061, compared with 5.0 people in 2011 and 7.1 in the mid-1960s.

Dependency ratios do not allow for the fact that some people aged 15–64 will not be in the workforce, while some people aged 65+ will continue to be working. The term 'dependency' does not necessarily imply financial or economic dependency, as those aged 65+ are generally living longer, are healthier, and are working longer.²⁸ Indeed, the dependency ratio changes considerably if the definition of 'working-age' population is extended to 70.

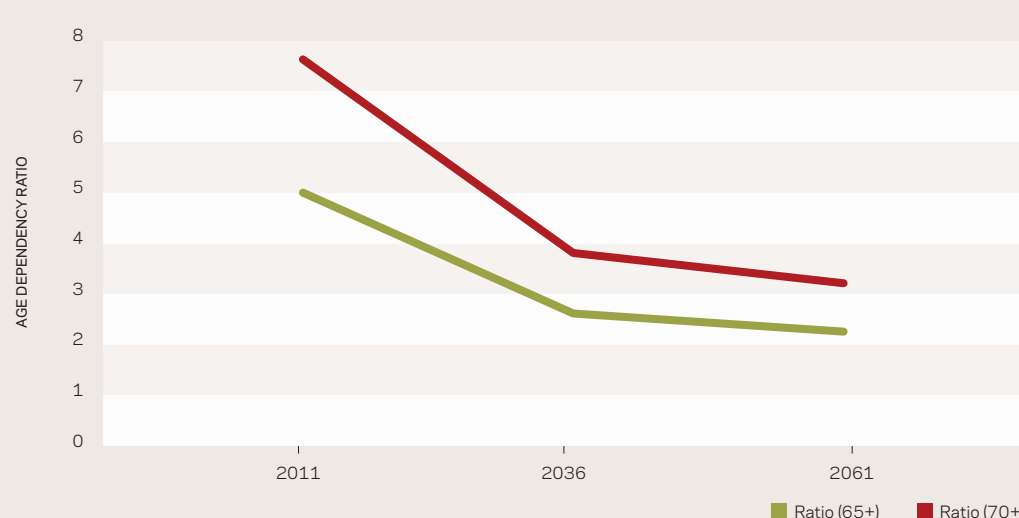
Increasing longevity

Because people are living longer, they are likely to spend longer in retirement than did previous generations.²⁹

Retirement used to be a luxury enjoyed only by the few; now it is an expectation for the many. The huge increase in life expectancy in the 20th century is a wonderful achievement... However, when added to the decline in the birth rate the result is rapid population ageing and a rapidly growing cost of paying for pensions (OECD, 'Pensions at a Glance', 2011).

Most New Zealanders now live to age 65, and it is no longer the case that a significant proportion of the population dies between ages 65 and 70. Today's new superannuitants are more likely to live to age 70 than their parents were to live to age 65.

Figure 3:
Difference in 'Age Dependency Ratios' if people work to 70



Calculated from Statistics New Zealand Data

²⁸ Statistics New Zealand. (2012). *National Population Projections: 2011 (base)–2061*. Wellington: Statistics New Zealand. See <http://bit.ly/statsnz-populationprojections>.

²⁹ This section is largely extracted from a background paper prepared by Dr Alison O'Connell: see <http://bit.ly/cflri-2013review-longevity>.

People reaching age 65 in 1970 could on average expect 13.1 years of remaining lifespan if male and 17.4 years if female. New superannuitants aged 65 in 2013 stand to receive New Zealand Superannuation (NZS) for over 20 years (men) and over 23 years (women) on average. Successive cohorts are expected to live increasingly longer, so that today's 25-year-old men will live for over 25 years after age 65 on average and women for over 27 years.

These data show that NZS is being expected to support retirement income for a far greater part of life than it was originally designed for, and that trend is expected to continue unless we make some conscious policy decisions.

All the main official demographic projections for New Zealand and its peer countries anticipate steadily rising average life expectancy in future. Roughly speaking, life expectancy increases by one year every decade. While there is uncertainty about the exact pace of future change, the overwhelming consensus among experts is that populations will continue to experience longevity increases.

Women tend to live longer than men. Asian New Zealanders have longer lifespans and Māori and Pasifika have shorter lifespans compared to the rest of the New Zealand population. Māori and Pasifika life expectancy is improving, but is only slowly catching up with other groups.

There is a great deal of international research investigating what may lie behind some groups of people being more likely to die earlier or later than the average of their national population. There are very few instances of direct causality. Smoking is the obvious exception: it causes lung cancer. Only associations with a higher chance of early death have been found for a large number of other factors. Associated factors include: being male; never married; divorced or widowed; having worse socio-economic status, lower income or low level of education attainment; belonging to some ethnic groups; having experienced a relatively adverse environment at birth or in early childhood; having an unhealthy diet, obesity, taking

inadequate exercise, excessive alcohol drinking, participating in hazardous sports or other risky behaviour; not accessing medical technology for treatment or prevention. There are also thought to be genes associated with exceptional longevity and overlaying the large number of influencing factors and the complex interplay between them, individual lifespan prospects are still to some extent a matter of chance.

There is inherent variation in lifespans in any population. Retirement income policies cannot be expected to address variable health or lifespan outcomes. Differentiating age of eligibility by any dynamic or self-assessed factor such as ethnicity, income or health status is unworkable. However, addressing variable outcomes should be an active part of health and social policy, and welfare benefits should continue to be available below eligibility age. Retirement income policies can and should *take into account* the variability of lifespans across the whole population.

There is also a need to consider the proportion of longer lives that are likely to be lived free from specified levels of disability or illness. The data for *healthy life expectancy* is not as complete as that for life expectancy but in summary, evidence suggests that in New Zealand healthy life expectancy is increasing, as it is in other developed countries. One consequence of this is that more older people are likely to be capable of continued participation in the workforce, with implications for the 'dependency ratio' as discussed above.

But overall, the continuing increase in life expectancy creates a dilemma: it gets more and more difficult to fund retirement income for a greater length of time over age 65 from a fixed length of time under age 65.

Proportionally smaller working generations are called upon to help support ever-increasing periods of retirement, raising questions of fairness and political sustainability. One logical response is to keep constant the proportion of life in which people receive publicly-funded retirement income. This would mean pushing out the age of eligibility for NZS to match the stretching of lifespans.

IT GETS MORE AND MORE DIFFICULT TO FUND RETIREMENT INCOME FOR A GREATER LENGTH OF TIME OVER AGE 65 FROM A FIXED LENGTH OF TIME UNDER AGE 65.



What's happening internationally?

This pushing out of eligibility ages is happening in many other countries.

'Pension ages' are on the rise in most of the OECD: 19 out of 34 countries for men and 23 for women. Age 65 remains the modal age at which people normally draw their pensions, accounting for 17, or half, of OECD countries for men and 14 countries for women. But 67 – or higher – is becoming the new 65. Some 13 countries (12 for women) are either increasing pension ages to this level or, in the cases of Iceland and Norway, are already there.³⁰

Many of New Zealand's peer nations are planning higher pension ages, as illustrated by this snapshot of what the situation will be in 2030:³¹

- Ten OECD countries will have a pension age for both men and women of 67: Australia, Denmark, Germany, Iceland, Italy, Netherlands, Norway, Spain, the UK and US. In addition, the pension age for men in Israel and Poland will be 67
- One country will have a pension age for both men and women of 68 for its main state pension benefit: Ireland
- Four countries will be on a schedule for further increases to 68 or higher: the Czech Republic (where the pension age will be only 63 in 2030), Denmark, Italy and the UK

Given the strong lifespan link to the rationale for increasing pension ages, there are often calls to *index* the pension age to life expectancy. However, no country is purely automatically linking pension ages to life expectancy.³² Denmark, Greece and Italy are planning a form of indexation, but even for these countries, indexing has not yet taken place, and is not fully automatic as it could be overruled by Parliamentary approval (in the case of Denmark) or minimum expenditure clauses (Italy, Greece).

Proposed Schedule and Review process for New Zealand

Instead of a formulaic link of eligibility age to average life expectancy, this document proposes a more considered approach that still takes into account concerns about the impact of increasing eligibility age. The approach is based on the UK's proposed approach³³ but is adapted here for New Zealand. Called 'Schedule and Review', it puts in place a schedule of planned rises in future based on future forecasts of life expectancy, and also timetables reviews of the schedule so that new information and issues not covered in the forecasts can be considered.

The aim is to give transparency and adequate notice of eligibility age changes, while addressing concerns including uncertainty of forecasts, employment conditions and variation in lifespans across the population. If the forecasts turn out to have been wrong, for example life expectancy does not increase as fast as forecast, the schedule of rises can be slowed.

The core principle proposed as the basis for setting the schedule of increases is to maintain the current proportion of adult life spent receiving NZS. This can be thought of as keeping both the 'value' of NZS and its 'cost' the same for each generation of New Zealanders.

The approach proposed requires decisions on how the schedule will be set, and how reviews would be timetabled and conducted. The recommendation in this 2013 Review of Retirement Income Policy is that Government work with the Commission for Financial Literacy and Retirement Income, demographers and others to develop a Schedule and Review process for New Zealand. An illustration of how Schedule and Review could work is set out in the background paper, and briefly described below.

The illustrative schedule has been developed by roughly maintaining the proportion of adult life spent receiving New Zealand Superannuation. It is adjusted for equity and other issues and the

IF THE FORECASTS TURN OUT TO HAVE BEEN WRONG, THE SCHEDULE CAN BE CHANGED.

³⁰ OECD Pensions Outlook 2012

³¹ The pension age for Denmark and Italy is estimated by the OECD based on projections of future mortality outcomes.

³² OECD Pensions Outlook 2012, p. 65. This publication also describes countries with public defined contribution (DC) or notional DC plans where pension benefits have been linked to life expectancy, but these examples are not relevant for the defined benefit New Zealand Superannuation.

³³ See <http://bit.ly/govuk-statepensionage>.



same schedule applies for women and men.³⁴ The proposal assumes that the necessary policy work, consultation and legislation is completed in four years (by 2017) and that a minimum ten-year notice period of any change would be required, to allow people time to make adjustments to their plans for retirement.

If the illustrative schedule in Table 7 were the one actually adopted, the 1962 birth cohort would be the first to start receiving New Zealand Superannuation later than their 65th birthday (which will fall in 2027). A one-year increase in eligibility age would then be completed every 10 calendar years so the cohort born in 1988 (today's 25-year-olds) would have a scheduled eligibility age of 68 (in 2056). Given continued increases in longevity, it is likely that the age of eligibility would continue to rise after 2053.

For policy purposes, there are two ways of defining life expectancy:

PERIOD LIFE EXPECTANCY

Period life expectancy is the most common form of life expectancy. It means:

The average length of life remaining at a given age, assuming people experience the age-specific death rates of a given period from the given age onwards. For example, life expectancy at birth for the period 2005–07 is based on death rates in that period, and takes no account of changes in death rates after that period.

Period life expectancy is a useful summary comparison of mortality between populations at a point in time.

COHORT LIFE EXPECTANCY

Cohort life expectancy is a better indicator of potential lifespan. It means:

The average length of life remaining at a given age, experienced by people born in the same year. For example, life expectancy at birth for people born in 1900 is based on death rates experienced by those people at each age throughout their life.³⁵

Cohort life expectancy is the better indicator of likely lifespan for an individual because it takes into account how death rates change over time – that is, throughout life – rather than assuming death rates are frozen in one period. Statistics New Zealand now publishes future cohort life expectancies and these figures are used to create Tables 7 and 8.

Table 7:
Illustrative schedule for eligibility age by cohort, males and females

Year of birth	1958	1968	1978	1988
Age in 2013	55	45	35	25
Age of eligibility for NZS	65 y	65 y 9 m	66 y 11 m	68 y

Table 8:
Illustrative schedule for first calendar year that eligibility age reaches age 66, 67 and 68

First calendar year that eligibility age reaches:	Age 66	Age 67	Age 68
Using illustrated structured framework	2036	2046	2056

³⁴ The actual proportion of adult life spent receiving New Zealand Superannuation for today's new superannuitants is calculated to be 31.6 per cent for men and 34.1 per cent for women.

³⁵ Statistics New Zealand (2012).



This schedule would be regularly reviewed with expert input, by a panel tasked with considering specific concerns, which could include, for example, how life expectancy is turning out against previous forecasts, new data on healthy life expectancy, labour market issues and how health and life expectancy is varying across the population.

The result of these reviews could be a recommendation to pause, slow down or speed up the schedule of eligibility ages, subject to any specified notice period for change. It would seem sensible to include this review within the terms of reference for alternate reviews of retirement income policy carried out by the Retirement Commissioner.³⁶

Expected impact of the Schedule and Review approach

The illustrative schedule is relatively slow (compared to other countries) and may be regarded by some as too conservative. However, the pace can be seen as directly compensating for some equity concerns with this policy. Raising the age of eligibility has been said to disadvantage those who are working in physically demanding jobs or suffer ill health or die before they can access NZS.

The review of scheduled eligibility ages would monitor any widening of the gap in (healthy) life expectancy between different groups and make recommendations as necessary to the pace of change in eligibility age.

There are additional policy options to soften the effect of increases in eligibility age. One is to introduce a new 'transition benefit' as recommended by the 2010 Review of Retirement Income Policy. The second is to maintain the age of access to KiwiSaver balances at 65, so that people would have the choice of self-funding a period of retirement before they become eligible for NZS. In this case rather than a specific transition benefit, standard welfare benefits would apply.

Although the second option raises other challenges for ensuring equity (see pages 61 to 76 on KiwiSaver) this is the one that is preferred for its simplicity and fit with other aspects of retirement income policy. For example, as long as KiwiSaver balances are growing in step with increases in the age of eligibility for NZS, KiwiSaver members will be well placed to fund any gap after 65. Non-members may have access to other forms of savings but the resulting increased emphasis on KiwiSaver will add weight to the argument for more 'soft compulsion' to join the scheme and for more investment in financial education and advice to ensure that New Zealanders are well prepared for retirement.

As people live longer, it is becoming increasingly important to preserve the role of New Zealand Superannuation as insurance against 'living too long'. Raising the age of eligibility for NZS will make retirement income policies fairer between generations and ease pressure on the Government's budget. Retention of NZS will therefore become more economically and politically sustainable.

Raising the age of eligibility will also help address New Zealanders' confusion about longevity. Currently, most adult New Zealanders underestimate their likely lifespan. This is at least partly because public messages about retirement and lifespans (such as the age of eligibility) are not as helpful as they could be in setting expectations.³⁷

If people better understand 'we are all living longer', the rationale for raising the age of eligibility may become easier to bear. By promoting the proposed schedule of change and consistently using correct indicators for likely future lifespans,³⁸ individual New Zealanders will be encouraged to think more systematically about their life expectancy and planning for retirement income.

**KIWISAVER HAS
A CRITICALLY
IMPORTANT PART
TO PLAY.**

³⁶ To review these issues every three years seems too frequent, but there should be a meaningful quantity of new data every six years.

³⁷ The 2013 Financial Knowledge and Behaviour Survey found that only 14% of New Zealanders consider how long they will live for in their retirement when thinking about retirement savings, down four percentage points since the 2009 survey.

³⁸ Statistics New Zealand has a calculator that will provide anyone with an estimate of 'how long will I live' at <http://bit.ly/statsnz-howlongwilllive>.

Finally, the Schedule and Review approach proposed here can be said to keep the value of NZS for future generations of New Zealanders. This is because the proposal is based on a principle of maintaining the proportion of adult life receiving NZS constant. In fact, under the illustrated example here, each future cohort of superannuitants would expect to receive NZS for *as long or longer* than the previous cohort. Even with an eligibility age of 68 years, today's 25-year-olds would be expected to receive NZS for longer than today's cohort aged 85 (who had an eligibility age of 60 years – see Figure 4).

Recommendations:

- That the proportion of life over the age of 20 in receipt of New Zealand Superannuation be kept at a minimum of 32 per cent;
- That the Government establish, by 30 June 2017, a Schedule and Review process for New Zealand Superannuation, guided by the principles outlined in this document

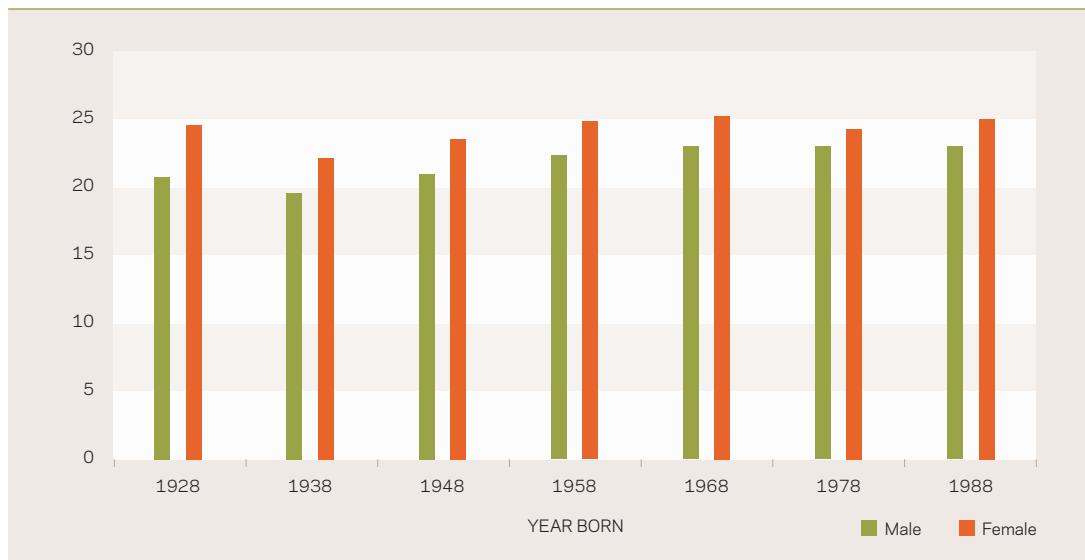


Figure 4: Lifespan from eligibility age (actual past age and future ages using illustrated structured framework) for demonstration cohorts by birth year, in years³⁹

Source: O'Connell

³⁹ O'Connell's calculations using Statistics New Zealand's cohort life tables (September 2012) consistent with 2011-base national population projection mortality assumptions (July 2012), median projection.



IN COMPARISON TO OTHER COUNTRIES' PUBLIC EXPENDITURE ON PENSIONS, NZS IS AN INEXPENSIVE SCHEME.



Affording retirement income

The cost of New Zealand Superannuation

In 2011/12 New Zealand Superannuation cost about 4.6 per cent of Gross Domestic Product (GDP).

This is a gross figure, as superannuitants pay some of their NZS back to the Government through income tax and GST. The net annual

cost of NZS in 2011/12 was four per cent. However under current settings the gross cost of NZS is projected to nearly double as a proportion of GDP, reaching 7.9 per cent by 2060.

In comparison to other countries' public expenditure on pensions, NZS is an inexpensive scheme. Even if the cost of NZS were to reach 7.9 per cent of GDP in 2060, it will be less as a proportion of GDP than the OECD average in 2010 (see Table 9).

Table 9:
Selected countries' projections of public expenditure on pensions, 2010–2060 as a percentage of GDP

OECD Members	2010	2020	2030	2040	2050	2060
Australia	3.6	3.7	4.3	4.7	4.9	NA
Canada	5.0	5.8	6.6	6.5	6.3	6.2
Denmark	10.1	10.8	10.7	10.3	9.6	9.5
France	14.6	14.4	14.9	15.2	15.1	15.1
Germany	10.8	10.9	12.0	12.7	13.0	13.4
Greece	13.6	13.7	14.1	14.9	15.4	14.6
Ireland	7.5	9.0	9.0	10.0	11.4	11.7
Netherlands	6.8	7.4	9.1	10.4	10.4	10.4
New Zealand*	4.3	5.1	6.4	7.1	7.2	7.9
Norway	9.3	11.6	12.9	13.7	13.9	14.2
Sweden	9.6	9.6	10.1	10.2	9.9	10.2
United Kingdom	7.7	7.0	7.7	8.2	8.2	9.2
United States	4.6	4.9	4.9	4.8	4.8	4.7
OECD 28	9.3	9.8	10.6	11.2	11.7	NA

Source: OECD Pensions Outlook 2012

* Figures for New Zealand updated from Treasury Long Term Fiscal Statement

Across all countries, the increase in costs of public pensions is primarily driven by permanently ageing population structures as discussed on pages 34 to 35.

In the financial year 2013/14, a total of \$10.9 billion was budgeted to be spent on payments of NZS. A doubling of this figure would mean an equivalent additional amount in today's dollars would need to be found through growth in the economy, borrowing, increased taxes or reduced expenditure on other items of public expenditure.

On current projections it is highly unlikely that the economy will grow by an amount sufficient to keep constant the proportion of GDP spent on NZS. A doubling of that proportion is much more likely. We can't be sure what the actual outcome will be, but if there is a sharp increase in the rate at which the costs of NZS go up, future generations may be less willing to meet that cost. In other words the sustainability of NZS will come into question. It makes sense to take steps now, to prevent that situation occurring.

Fiscal sustainability

This section refers to material produced by the Treasury for the 2013 Statement on New Zealand's Long-term Fiscal Position ('Affording Our Future'⁴⁰). The Treasury statement focuses on how the ageing of the population structure might impact on the public finances of New Zealand, principally through the increase in the costs of NZS and health care.

When reading about and viewing the Treasury's projections, it should be kept in mind that they are not forecasts. They should instead be thought of as 'what if?' scenarios that are heavily dependent on the assumptions that generate them. Nevertheless they provide useful insights as to the potential impacts of the challenge, based on what has happened in the past and the changes needed to maintain a stable fiscal situation in the future. For example, growing public debt results in ever-increasing interest costs, and the longer this is left unchecked the more difficult it becomes to close the gap between revenue and expenses.

The assumptions used in 'Affording our Future' are described in full in that document, and in a summary paper prepared for this review.⁴¹

In brief, the three scenarios developed by the Treasury in the summary paper are:

1. 'Cost Pressures' (CP), which shows how government expenses might grow from the 2015/16 fiscal year if they were to revert to their average historic rates of growth. This scenario builds in the impacts of the ageing population under current policy settings, and
2. 'Stabilise Net Debt' (SND), which projects what would have to happen in order for Government to maintain a particular level of net public debt (in this case 20 per cent of GDP), and
3. 'Frozen Age Structure' (FAS), which projects what could *theoretically* happen to Government finances if the age structure of the New Zealand population remained the same (i.e. while overall population growth is the same as in the other scenarios, the ageing of the population structure, as described in on pages 34 to 35, does not occur)

The first two of these match the 'Affording Our Future' scenarios called Resume Historic Cost Growth and Stabilise Net Debt.

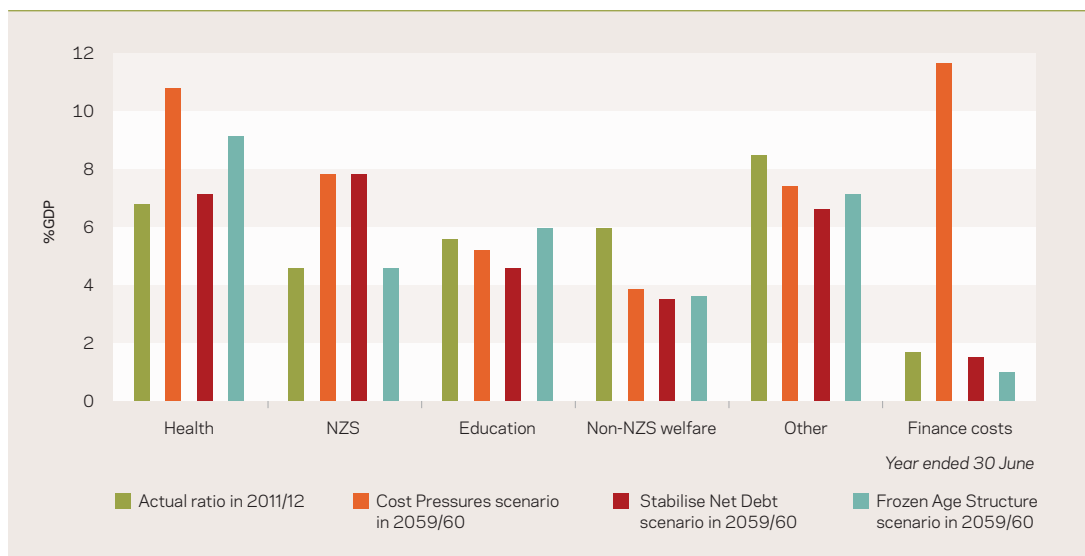


Figure 5:
Core Crown expenses to nominal GDP - now and projected scenarios

Source: New Zealand Treasury

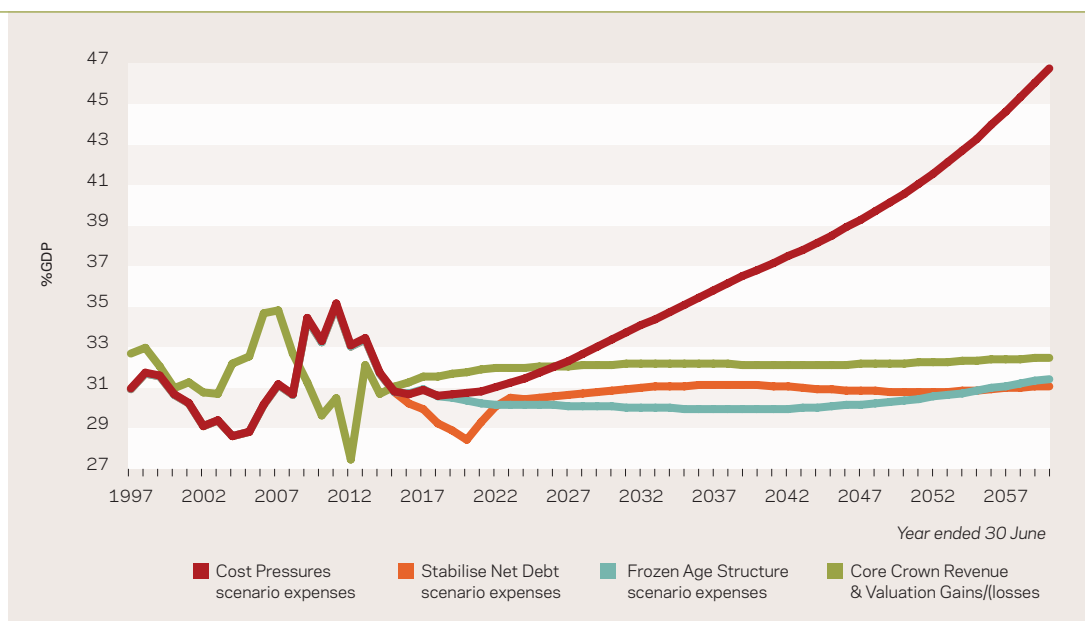
The scenarios of most interest to this review are 'Cost Pressures' and 'Frozen Age Structure' because the difference between them is essentially due to the ageing population.

⁴⁰ <http://bit.ly/treasury-nz-longtermfiscalposition>. The term 'fiscal' is used to refer to overall government income and expenditure, and the difference between them.

⁴¹ Bell (2013) *The Influence of an Older Population Structure on Public Finances*. See <http://bit.ly/cflri-2013review-olderpopstructure>.



Figure 6:
Core Crown expenses
and revenue to nominal
GDP: three scenarios



Source: New Zealand Treasury

Figure 5 depicts core Crown expenses as a proportion of GDP, broken into six major categories. The most recent historical year (2011/12) is depicted, along with the CP, SND and FAS scenarios in 2059/60.

Figure 5 depicts which spending areas increase (or lessen) from current (2011/12)⁴² ratios to GDP under the different scenarios. Figure 6 then translates this to an overall track against revenue and gains. As long as expenses stay below the revenue track, operating surpluses are generated that can be used to decrease debt. But once the expense line surpasses revenue plus gains, deficits occur and borrowing has to increase to cover them. It is clear that if we revert to historic spending patterns, then population ageing is set to open up a widening gap between expenses and revenue. Governments will inevitably face the challenge of how to close the gap between revenue and expenses.

Health and NZS are the main areas of pressure on expenses and the Treasury reports that current revenue settings, especially in regard to tax, may be able to accommodate projected growth in either one of these two areas, but not both.

The source of upward pressure on expenses is not solely due to the ageing demographic structure. For example, between 2011/12 and 2059/60, the projected increase in Health to GDP under FAS is about 60 per cent of that under the CP scenario. This indicates that, while the ageing population does contribute to health spending pressures, it is not the main factor. The ongoing availability of new and more effective treatments, with a corresponding expectation of access to them; a correlation between higher incomes and higher spending on health, including public-funded health services; and significant labour input and accompanying costs that may exceed general economy averages are all factors contributing to the growth of health spending outstripping that of GDP over recent decades.

For NZS, the story is much simpler. With payment rates indexed to wage growth, the 'per recipient' growth is likely to largely keep pace with that of per capita GDP. NZS's recipient growth, that of the '65 and older' age group, is projected to grow considerably faster than the labour force, which is the demographic driver of GDP. The FAS projection, under which NZS to GDP hardly changes, illustrates that (unsurprisingly) an ageing population is the source of cost pressure for NZS.

⁴² While the 2012/13 year is now over, data on it is not available at the time of writing.



Options for reducing the cost of NZS

Without relief in the demand-based NZS costs, significant reductions will need to be found in other expense types in order to prevent increasing fiscal deficits. Diverting expenditure from other areas will potentially create tensions which threaten the sustainability of NZS. The challenge is to ensure that NZS remains affordable while still achieving other objectives such as low levels of poverty and high levels of wellbeing among older New Zealanders. This cannot be done in isolation from developments in other parts of the retirement income framework, for example the growth in KiwiSaver. However the options below are specifically focused on ways to make NZS more affordable and therefore more sustainable in the long run.

Changing the age of eligibility

Pages 37 to 40 has already proposed a Schedule and Review process for raising the age of eligibility for NZS. The underlying principle is that each generation of New Zealanders should be able to expect that NZS will provide retirement income throughout retirement, and for the same proportion of adult life.

Raising the age will also save money. *Affording Our Future* gives an average saving of 0.7 percentage points of GDP from changing the age of eligibility to 67.⁴³ While this may seem a relatively small percentage, in 2013 it is equivalent to \$1.5 billion dollars per year. Treasury analysts have also shown elsewhere that relatively small decreases or increases in the overall gap between government revenues and expenses have a multiplying effect on long term fiscal outcomes, particularly if debt is used to cover the difference.

The cumulative changes to national savings, by 2061, of a two-year increase in the age of eligibility for NZS, have been estimated at 38 per cent of GDP.⁴⁴

Given trends towards longer lives on average, and as long as steps are taken to address risks of increased inequity identified on page 39, changing the age of eligibility is a viable way of making NZS more fiscally sustainable.

Changing the way that NZS is indexed

A way of saving more, but with much greater risks to be managed, is to change the formula for the amount by which NZS is adjusted year by year. The current formula is somewhat complex and is described in more detail on page 20 of this document. Essentially, the formula has seen NZS indexed to wage growth over the years 2006-13 and during that time the amount that NZS pays has increased faster than the cost of living as measured by the Consumers Price Index (CPI). One alternative would be to index only to the CPI, so that retired people would be able to purchase the same amount of goods and services from year to year, but not share in all the economic growth generated by the working population. On the surface such a change might seem fair and it would generate significant savings, but there are two major problems:

- It is not certain that the CPI is an accurate measure of the true cost of living for all older New Zealanders,⁴⁵ and
- As discussed in pages 25 to 30 of this document, even with the current indexation to wages, a large number of older New Zealanders are hovering close to relative poverty levels. Indexation to CPI alone could push more older people into poverty.

AFFORDING OUR FUTURE

Affording Our Future gives an average saving of 0.7 percentage points of GDP from changing the age of eligibility to 67. While this may seem a relatively small percentage, in 2013 it is equivalent to \$1.5 billion dollars per year

44 Law, D. (2013). *Retirement Income Policy and National Savings*. Paper presented to the 2013 NZ Association of Economists Conference, also New Zealand Treasury Working Paper (forthcoming at the time of writing). NB this paper uses a schedule for change to the age of eligibility that is different to the one proposed on pages 37 to 40. The paper also makes assumptions about various cohorts' behavioural response to different policy options in terms of how they adjust via combinations of saving, consuming less in retirement or working longer - illustrating how complex the modelling process can be.

45 See <http://bit.ly/statsnz-CPIadvcttee2013>.

43 Treasury's calculations are based on a schedule for change that is different to the one illustrated in pages 37 to 40.



It should be possible to find a solution that includes measures to avoid the risks of increased poverty.

The 2010 Review of Retirement Income Policy recommended a formula for indexing NZS based on the average of CPI and wages, leading to annual savings of approximately one per cent of GDP by the year 2035.

The same approach to indexation has also been modelled more recently in the same Treasury paper referred to above.⁴⁶ Based on the assumptions used in that paper, if the face value of NZS payments were to increase at the average rate of wage and CPI growth, those payments would increase by 0.75 per cent of GDP less on average per year (at 2.75 per cent) than would be the case under the status quo.

It is clear that a change to indexation of NZS has the potential to achieve considerable savings, and enhance the fiscal sustainability of the scheme. However, such a change could lead to increases in income poverty among older New Zealanders *unless some of the savings were redirected* to prevent that from happening.⁴⁷ In other words, redistribution of some current expenditure on NZS away from those who are doing well in retirement to those who are doing less well and most at risk of falling into poverty (this may include those most at risk of arriving at retirement in a poor state). This would be fair in the sense that NZS was originally set at a level that assumed that most people would have largely cleared their mortgage before retirement, so did not have to pay rent or mortgage principal and interest out of NZS.

The mechanism for redistribution would need further consideration outside this review, but would most likely involve the welfare system or creative approaches to the provision of housing for some groups of older people.

A change of this nature would promote more equity within the retired generation and go some way to avoid the 'winners and losers' scenario discussed in Section One. Conversely, it might be seen to be unfair to those groups who have saved for their retirement – a form of 'cohort means testing'. But the change would need to be considered in the context of what is happening in the rest of the retirement income framework. As the proposed new form of indexation of NZS took effect, KiwiSaver balances would also be growing, with higher income earners accumulating greater levels of retirement savings. Thus any disadvantage suffered by better-off cohorts would to some extent be cancelled out. The inclusion of KiwiSaver in the mix adds further weight to the need to maximise the schemes' membership, level of engagement and connection to the overall retirement income framework. Ideally, the rate of growth of KiwiSaver funds would match the rate at which change happens in NZS.

This leads to another inseparable condition of any change in indexation; greater investment would have to be made in research to monitor both trends in KiwiSaver and the actual impacts on living standards and wellbeing (however measured) among older New Zealanders. Given such investment in research, the three-yearly reviews of retirement income policy would be better placed to make recommendations on whether modifications were needed in the indexation formula, so as to avoid negative impacts.

This proposal for a lower rate of indexation and switching of savings is a way of achieving fiscal savings and increased equity without compromising the 'citizenship dividend' or principles of universal access to NZS at a flat rate. There is, however, a political risk that future governments will not apply savings to areas of greater need, and this would have to be continually addressed through the three-yearly review process.

GREATER INVESTMENT WOULD HAVE TO BE MADE IN RESEARCH.

⁴⁶ Law (2013).

⁴⁷ The focus here is on relative income poverty. As noted in Section Two, there also needs to be consideration given to other measures of wellbeing or living standards, and to the contribution made by other non-income forms of support.

Means testing

Another option for reducing the cost of NZS is to pay less to individuals who have income or assets above a given threshold. Unlike the 'cohort means testing' described above, *individual* means testing results in multiple different rates of NZS. This approach has historically not been accepted by New Zealanders. It undermines the principle of a citizenship dividend and has many other disadvantages. For example, means testing effectively punishes savings behaviour, discourages working longer and incentivises the hiding of wealth. To counter gaming, additional bureaucracy is usually required, along with attendant costs. An individual means-tested NZS would be more complex and more expensive to run, and is not favoured by this review.

Variable ages of eligibility

One proposal is for New Zealanders to have the option of choosing the age at which they access NZS, either earlier than 65 at a lower weekly rate or later (up until 70) at a higher rate.⁴⁸ Key motivations are to increase choice and reduce inequity between groups with different life expectancies or abilities to work up until 65. However, there is a risk that some people would suffer poor long-term outcomes as a result of making short-term decisions to access NZS early. Thus ironically, the proposal would quite likely reduce fairness within the system as a whole. The proposal is also claimed to be 'fiscally neutral' i.e. it would cost no more than the current arrangements. At the time of writing, modelling to show individual and fiscal impacts hadn't been carried out but if increased numbers were to access NZS early – even at a lower rate – it is difficult to see how this would not cost more. The proposal would also bring about an undesirable increase in complexity.

Using KiwiSaver to replace NZS

As discussed on page 75, another option for reducing the cost of NZS to the public purse is to transfer that cost to private individuals. This could happen by using KiwiSaver balances to partially or wholly pay for the costs of NZS. The Treasury paper referred to previously in this section⁴⁹ has modelled the savings to be gained from a compulsory private savings scheme where accumulations are used to reduce NZS entitlements. This modelling is much more complex than that for raising the age of eligibility or changing the rate of indexation, because of having to estimate KiwiSaver balances at retirement for various cohorts while also trying to take account of differences in individuals' income and tax treatments on KiwiSaver contributions and earnings etc. Taking those assumptions into account, the results of the modelling provide an estimated cumulative change in national savings up until 2061 of approximately 38 per cent of GDP – the same as for raising the age of eligibility.

There is a risk of undermining the original purpose of the KiwiSaver scheme if it were to be traded off against NZS income, which in turn could cause a loss of confidence among its members and threaten its continued viability.

KiwiSaver is additive to NZS, not a substitute, and this status must be retained if the overall retirement income framework is to retain its integrity, and if other measures proposed in this document are to be effective.

Tightening up eligibility criteria

Currently, NZS is payable to citizens and permanent residents who have reached the age of 65 and who have been resident in New Zealand for ten years, including five from the age of 50. Another way to reduce the cost of NZS would be to make the residency criteria stricter, thus reducing the number of people eligible to receive it. Various proposals have been made to increase the number of years of residency required for eligibility, or to pay a pro-rated amount of NZS according to years of residency.⁵⁰

**KIWISAVER IS
ADDITIVE TO NZS,
NOT A SUBSTITUTE.**

**DECISIONS AS
TO WHO BECOMES
A CITIZEN OR
PERMANENT
RESIDENT ARE
MATTERS FOR
IMMIGRATION POLICY
TO CONSIDER,
NOT RETIREMENT
INCOME POLICY.**

⁴⁸ See <http://bit.ly/govtnz-flexisuper>.

⁴⁹ Law (2013)

⁵⁰ See <http://bit.ly/RPRC-overseaspensions-2013>.



An increase in the number of years required for eligibility would need to take into account New Zealand's need for migrants, and impacts on the desirability of this country as a migrant destination in the context of increased labour mobility.

Decisions as to who becomes a citizen or permanent resident are matters for immigration policy to consider, not retirement income policy. Paying different rates of NZS to people depending on their country of origin would undermine the citizenship dividend objective and threaten social cohesion. The amount of money saved by the Government would not necessarily be significant, as more needy migrants would still qualify for welfare benefits. This option for reducing the costs of NZS is not supported by this review.

Using the New Zealand Superannuation Fund to defray costs

The New Zealand Superannuation Fund (NZSF) has been established to partly pre-fund NZS over the long term. The NZSF does not necessarily reduce the total costs of NZS, since the number of recipients and rates of payment remain the same. However, it can reduce the costs to the government under conditions where the return to the fund is greater than the rate of growth in the economy. The NZSF remains an important factor in ensuring the sustainability of NZS, and is discussed in more detail on pages 55 to 56.

The option of increasing revenue

All of the discussion so far has assumed a given track of revenue and gains, but reducing costs is not the only way of keeping expenses below revenue. Lifting the revenue track is also an option, with tax settings being the most likely way of implementing this. Tax is not only by far the biggest component of revenue and gains (Core Crown tax revenue averaged over 91 per cent of total revenue and gains for the last five years), it is also the revenue source most easily altered by policy settings and legislation.

Future New Zealand governments will respond to fiscal pressures with a mixture of spending reductions and tax increases. Figures 5 and 6 assume a stable long-run projection of tax

revenue at 29 per cent of GDP, reflecting the current tax regime in an economy that is growing on-trend and cycle-free. However, figures provided to this review indicate that the average tax to GDP ratio for NZ over the last 40 years is 30 per cent, meaning that there is some room to move on tax without taking it to previously unseen levels. Also, as future generations receive higher incomes via productivity growth, they may be willing to pay a little more tax to maintain levels of publicly-funded goods and services. A one per cent increase in tax revenue would equate to around \$2 billion in today's money.

This review can only point out the option of increasing revenue through taxation as a way of helping to make retirement income policies more sustainable. It is beyond the scope of the review to make recommendations on tax increases, how they might happen, or how any increased revenue might be applied. However, the 2013 Long-Term Fiscal Statement discusses potential options for tax changes to assist in maintaining fiscal stability, including both positive and negative impacts on growth, income distributions, asset values etc. A fuller coverage is also provided in background papers to be found on the Treasury website.⁵¹

Summary and conclusion

NZS is an inexpensive scheme by international standards, but its cost as a proportion of GDP is projected to rise dramatically in the future.

The issue that arises is not so much one of affordability as of future generations' ability and willingness to pay the additional cost. It is unlikely that NZS will remain sustainable in its current form, but there is no need to panic about this, or to introduce draconian measures. There are available a number of reasonable policy responses which, if designed in the short term and implemented with plenty of notice, will preserve the affordability and other key features of NZS.⁵²

⁵¹ See <http://bit.ly/treasury-nz-longtermfiscalpanel3>.

⁵² A calculator to help work out preferences for managing the Government's future financial pressures can be found at nzpublicfinance.com/ltf-calculator.

The diversion of KiwiSaver to pay for NZS cannot be justified. Such a measure would be unlikely to be acceptable to members who went into the scheme in the belief that their KiwiSaver balances would be additive to income from NZS, not a substitute. The substitution option is rejected, as is the option of individual means testing.

Raising the age of eligibility is proposed on grounds of fiscal sustainability, in addition to the principle of fairness as discussed on page 36. The amount of money that would be saved is significant. There is a risk of inequity arising for those unable to continue working up until the new age of eligibility, but these risks can be managed through KiwiSaver and the welfare system, and by giving sufficient notice of change. This section of the document endorses implementation of the Schedule and Review process as recommended on pages 37 to 40.

Changing the indexation of NZS to the average of CPI and wages has the potential to save the most money, but carries risks of negative outcomes. These risks can be managed, and the related recommendation of this review comprises two other inseparable parts.

Recommendation

That a new method of indexation of New Zealand Superannuation, based on the average of percentage change in consumer prices and earnings but no less than price inflation in any year, be introduced from 2023, subject to an adequate proportion of fiscal savings being applied to:

- a. **Measuring the impacts of the change on the living standards and wellbeing of older New Zealanders, and**
- b. **Maintaining the real living standards of less-well-off older New Zealanders at the same levels as provided by the current system of indexation**

New Zealand's saving performance

The importance of national saving

As indicated in the previous section, a short-run solvency question arises with respect to the adequacy of the government balance sheet: is it sufficiently robust to meet shocks such as natural disasters?⁵³ The government's additional spending and ability to raise taxes makes it well placed to help New Zealand weather such events.

Since Government debt requires costly servicing, a second question arises as to whether the Government's debt position is sufficient to offset any future expenditure commitments relative to revenue. That is, does debt servicing imply current policy settings (such as taxation rates) are sufficient to meet structural expenditure commitments like superannuation and health costs?

National savings combines both the private and public balance sheets. While the New Zealand government's balance sheet is prudent and sound, private sector borrowing, primarily to fund housing for domestic consumption and investment purposes, is high.

Many economists have expressed concern about the impact of the savings position on macroeconomic imbalances. These imbalances include New Zealand's persistent current account deficit – that reflects the offshore borrowing of domestic households.

The argument runs like this: imbalances have led to higher real interest rates. Higher interest rates provide the mechanism to dampen domestic households' hunger for borrowing and foreign investors need to be compensated via a premium for lending to New Zealand, which has historically been perceived to be a riskier proposition than other developed economies. Higher interest rates reduce domestic investment in the real economy and increase the real exchange rate, reducing export competitiveness.

**THE DIVERSION OF
KIWISAVER TO PAY
FOR NZS CANNOT
BE JUSTIFIED.**

⁵³ For further discussion and references, see <http://bit.ly/cflri-2013review-macromicroNZsavings>.



AT AN AGGREGATE LEVEL, WE KNOW NEW ZEALAND HOUSEHOLDS SAVE AT A MUCH LOWER RATE THAN OECD PEERS.

What do the macroeconomic data tell us?

Government debt levels in New Zealand are relatively low. So at least in the short run, the level of government saving is sufficient to mitigate and guard against future shocks.

And on an income basis, New Zealand has a relatively wide tax base and the government has ample room to increase taxation rates – so there is little risk to the government’s longer term income stream, even though New Zealand sits in the middle of an ageing pack of countries where superannuation and health care costs are expected to rise in the future.

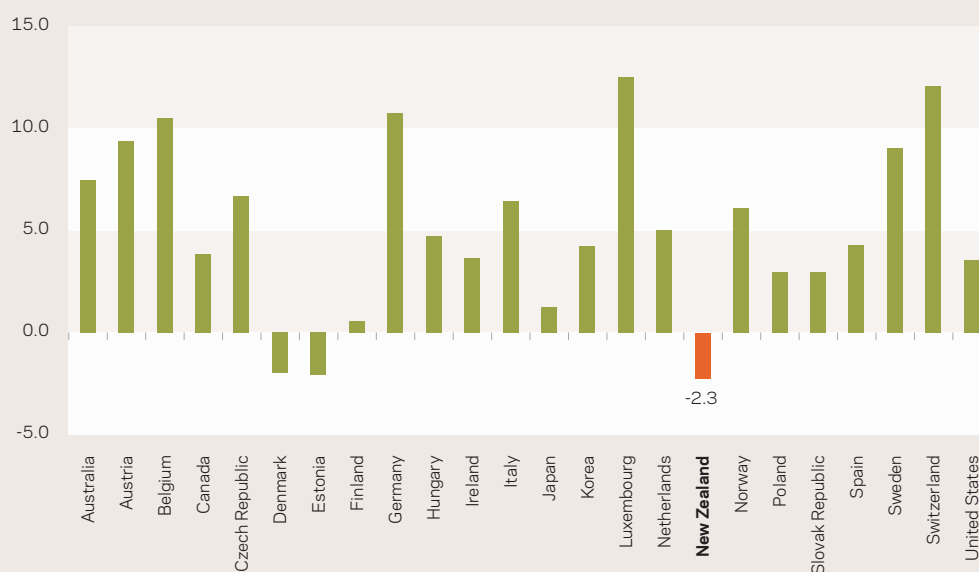
But are individuals saving enough? It’s difficult to answer this question. Any assessment means making a judgement call on what a sufficient income stream is likely to be, and that is likely to be very different for various income groups. Income groups may have particular savings patterns that make generalising about policy interventions not very

helpful. And unfortunately the available data are not ideally suited to assessing whether New Zealanders are saving enough.

However, at an aggregate level, we know New Zealand households save at a much lower rate than OECD peers (see Figure 7).

An approach to assessing the adequacy of savings for *retirement* is to model outcomes that incorporate the behaviour of the whole of the economy, including interest rate and wage rates. One study that takes this approach⁵⁴ concludes that population ageing is unlikely to mean a need to increase savings policy. An alternative approach⁵⁵ reaches conclusions that suggest savings need to increase to accommodate extra years of retirement, but that increasing real wages offset falling real interest rates. It follows from this second set of findings that while saving rates need to increase, the adjustments – if made early – are not particularly severe.

Figure 7:
Average net savings rate as a fraction of disposable income, OECD countries, 2012-2013



Source: OECD

54 Guest, R., Bryant, J. and Scobie, G. (2003). 'Population Ageing In New Zealand: Implications for Living Standards and the Optimal Rate of Saving'. *Treasury Working Paper Series 03/10*. New Zealand Treasury.

55 Lees, K. (2013). 'Golden years? The impacts of New Zealand's ageing on wages, interest rates, wealth and macroeconomy'. *NZIER Working Paper 2013/01*. New Zealand Institute of Economic Research.

What do the microeconomic data tell us?

While microeconomic data offer the best opportunity to deepen our understanding of which groups of society might not be saving enough, microeconomic data sources are underdeveloped compared to macroeconomic data sources. Key data include:

- SoFIE – the Survey of Family, Income, and Employment (SoFIE) collects data on respondents' work, family, income, and importantly net worth. The survey consists of eight annual waves. The same individuals are re-interviewed in each wave. Analysis of wave eight was underway as this review document went to print, so was unavailable for inclusion
- The one off Household Savings Survey that was a cross-sectional nationwide survey on the net worth (assets minus liabilities) of New Zealanders. The survey was commissioned in 2001 by the Retirement Commission and was conducted by Statistics New Zealand
- The regular Household Expenditure Survey (HES) that offers the opportunity to reconcile microeconomic data with macroeconomic measures of saving in the National Accounts

Perhaps surprisingly given Figure 7, much of the microeconomic evidence suggests that most New Zealanders may well be saving sufficiently for retirement. While the data lead to conclusions that are often equivocal, the weight of evidence does not suggest a widespread lack of saving. Rather, it is specific segments of society that are likely to be at risk.

For example:

- A paper written in 2009⁵⁶ concludes that: 'There is a strikingly wide distribution of saving rates. For example, across many categories of individuals around 40 per cent are estimated to have had a decline in net wealth, implying a negative rate of saving.'
- A second paper⁵⁷ uses data from the Household Savings Survey to tentatively conclude: '...there may not be widespread under-saving for retirement'
- A paper from 2012⁵⁸ suggests that 'saving is more strongly correlated with income than with wealth'. Most likely lower income deciles cannot save. The same paper notes: 'Across the income distribution, saving is largest for the top four deciles, while median saving for the bottom 50 per cent centres around zero'

Overall, it has not been established that New Zealand 'has a national savings problem' that needs to be solved through retirement income policies, although other policies may be needed. And on balance, there are some sections of society that are not able to save for retirement so this difference needs to be taken into account. There is further discussion of 'equity in saving' on page 59 to 60 of this document.

56 Henderson, K. and Scobie, G. (2009). 'Saving Rates of New Zealanders: A Net Wealth Approach'. *Treasury Working Paper 09/04*. New Zealand Treasury.

57 Gibson, J., Le, T. and Scobie, G. (2009). 'Are Kiwis saving enough for retirement? Evidence from SoFIE'. *New Zealand Economic Papers*, 43(1). New Zealand Association of Economists.

58 Gibson, J., Le, T. and Stillman, S. (2012). 'Wealth and saving in New Zealand: evidence from the longitudinal survey of family, income and employment'. *New Zealand Economic Papers*, 46(2). New Zealand Association of Economists.



IT HAS NOT BEEN ESTABLISHED THAT NEW ZEALAND 'HAS A NATIONAL SAVINGS PROBLEM' THAT NEEDS TO BE SOLVED THROUGH RETIREMENT INCOME POLICIES.



THE MOST COMMON COMPLAINT IS THAT THE INCENTIVES PROVIDED BY TAXATION DIVERT DISPROPORTIONATE AMOUNTS OF MONEY AWAY FROM DESIRABLE ACTIVITIES SUCH AS SAVING AND INVESTMENT.

Taxation

Tax has many potential and actual effects on retirement incomes depending on what is and isn't taxed, the rate of tax, and the timing of any tax liability coming to bear.⁵⁹ At an individual and household level these effects include:

- The capacity to save (tax on income)
- The desire to save (tax on spending, incentives)
- Which assets to invest in (differential tax treatments, base, rate, liability timing)
- The eventual size of the retirement nest-egg, i.e. the extent to which returns on savings contribute to accumulated savings (tax on investment income and gains, both during pre-retirement accumulation and post-retirement decumulation phases)
- The real value of the retirement savings (e.g. tax treatment of annuities, and taxes on spending in retirement)

New Zealand has a history of major tax-specific policy reviews including most recently the Tax Working Group.⁶⁰ In addition, there have been many other major reviews conducted in which tax policy has been a material feature, such as the Capital Markets Development Task Force⁶¹ and the Savings Working Group.⁶² The Treasury's 2013 Long Term Fiscal Statement also contains discussion of options for taxation. Most of the reports of these reviews (and in many cases also background and research papers) are readily available on-line.

The output of previous reviews of taxation policy is vast and often of a highly technical and contentious nature. It is beyond the scope of this review of retirement income policy to comment in detail on taxation matters, but it is clear that the tax system is still not optimal in terms of consistency of treatment of different forms of savings, investment and income for retirement. Major tax policy reviews of the past few years have identified these inconsistencies as being of major concern, and several submissions have pointed out serious discrepancies in tax treatment of various forms of saving and investment. There appears to be a high degree of consensus as to the issues and the tax changes that should occur, but implementation is proving elusive.

The most common complaint is that the incentives provided by taxation divert disproportionate amounts of money away from desirable activities such as saving and investment in the share market into areas such as housing – particularly rental housing. Of course investment in owner-occupied housing is also desirable from the point of view of retirement income, but a distorted level of investment in this area can lead to negative effects such as overpricing and reduced levels of affordability.

To change this situation is not a simple matter. Although they may have long-term appeal, tax changes which affect the value of land will be detrimental to many retired and near-retired people. In a similar vein, increases in GST, even if mirrored by decreases in income tax, will have disproportionate effects on older New Zealanders who have had little chance to save additional income while being subject to increased tax as they spend their retirement income.

⁵⁹ This section draws on a background paper prepared for the review at <http://bit.ly/cflri-2013review-taxmatters>.

⁶⁰ See <http://bit.ly/nz-taxworkinggroup>.

⁶¹ See <http://bit.ly/nz-capitalmarketdevelopmenttaskforce>.

⁶² See <http://bit.ly/treasurynz-savingsworkinggroup>.

On the other hand they may benefit from lower taxes on investment earnings. According to the Savings Working Group, citing Ezra et al⁶³ (p 44):

...the most important tax from the saver's point of view is tax on investment income. This has a far greater effect on retirement income than a tax on contributions or a tax on retirement income...Ezra derived the '10/30/60 rule'. They use the example of a 35-year-old worker who saves a fixed percentage of an increasing payroll stream until retirement at age 65, and then draws down an inflation-indexed pension until age 90. Using reasonable assumptions with no tax on investment income, they calculate that the total retirement income from age 65 to 90 is financed just 10% from contributions, 30% from investment income before retirement, and a surprising 60% from investment income after retirement. Thus 90 per cent of retirement income is generated by (compounding) investment income. This is why taxing investment income has a much greater effect on net retirement income than taxing contributions or gross withdrawals.

This finding is significant in respect of tax treatment of annuities, which are discussed in more detail in the section on KiwiSaver withdrawals on pages 74 to 75.

A promising alternative to removing the incentives for excessive investment in housing would be to remove *disincentives* faced by the simplest savings products (bank deposits and bonds) in the form of relatively high effective rates of tax. These high relative rates arise from a combination of factors, but the most unfair is taxing the inflation element of interest. In most circumstances, interest paid on savings is made up of two components: one due to inflation – this keeps the real value of the investment at par; and one due to real growth – this represents an actual increase in wealth.

Taxing the inflation component contributes to the erosion of wealth and there is a case for this element to be removed. The Savings Working Group was in favour of taxing interest only to the extent that it exceeds the rate of inflation, i.e. only real increases in wealth would be taxed. Serious consideration needs to be given to this measure, which becomes a recommendation of this review:

Recommendation:

That in line with a recommendation of the Savings Working Group, the Government remove tax on the inflation component of interest on simple savings products such as bank deposits and bonds.

Approaches to funding retirement income

Different countries have adopted a wide range of methods to provide people with retirement income.⁶⁴ The provision of resources to fund that income can be broadly done in two ways (or a combination of both):

- Pay As You Go (PAYGO) such as is the case with NZS, where resources are transferred from the younger, working population to older people through taxation
- Save As You Go (SAYGO) where people accumulate assets while they are working, and exchange them for resources when they are old (i.e. each generation pays for its own retirement income)

PAYGO and SAYGO can be privately arranged, or arranged by the Government.

63 Ezra, D., Collie, B. and Smith, M. X. (2009). *The Retirement Plan Solution: The Reinvention of Defined Contribution*. New Jersey: Hoboken.

64 This section is based on a background paper prepared for the review. See <http://bit.ly/cflri-2013review-tosaveorsavenot>.



WHATEVER APPROACH IS USED, RETIREMENT INCOME HAS TO BE PAID FOR BY THE FUTURE ECONOMY.

Table 10:
Categories of retirement schemes

	PAYGO	SAYGO
Privately arranged	Adults voluntarily provide resources to older parents, and are given resources by their children in turn when they are old. Sometimes the resource transfers are linked through the education adults provide to their children.	Adults voluntarily accumulate assets for their own retirements, selling them to younger adults when they are old.
Government arranged	Government raises taxes that are transferred to older people as pensions. Taxpayers receive a pension from younger taxpayers when they are old.	Government raises taxes that are accumulated into a government retirement fund. The government mandates people to accumulate savings in private accounts.

Generally speaking in a PAYGO system no capital is accumulated. In a SAYGO system, accumulation can be done individually through schemes such as KiwiSaver or other forms of savings and investment, or collectively through the accumulation of public revenues, e.g. in the New Zealand Superannuation Fund (see pages 55 to 56).

It should be noted that whether retirement income comes from a PAYGO or a SAYGO approach, it has to be paid out of the future economy. Savings are not 'cans of beans' that are stored in the pantry for later consumption. Rather, money saved is used in the present day and there is an expectation that in the future someone will pay it back. The ultimate guarantor of retirement income is a healthy economy.

Most OECD countries' retirement income schemes are funded to some degree on a PAYGO basis. In recent years many of those countries have debated whether they should increase the amount of SAYGO in their systems, driven by the realisation that the conditions that made PAYGO-funded retirement systems attractive in the past are unlikely to prevail in the future. During the middle of the 20th century, growing populations, high productivity growth rates and shorter lifespans meant PAYGO-funded retirement incomes could be provided with relatively low taxes. In the 21st century, stable or falling birth rates and increasing longevity mean taxes will need to be increased substantially to maintain the same level of

retirement incomes if PAYGO-based funding is continued, or retirement incomes will need to be cut if taxes are not increased.

Economists have demonstrated that increasing the amount of SAYGO-based funding can reduce the long-term cost to a country of retirement income for its citizens. But this depends on a key condition being met: *that the return to accumulated capital is greater than the rate of economic growth*. The contributions made when a person is working age are invested in productive capital and earn a return that compounds quickly through time. In contrast, when the return to capital is lower than the rate of economic growth, retirement incomes can be funded with lower contributions under a PAYGO system.

Projections are that returns to capital will be greater than the rate of economic growth over the next few decades, but no-one can be certain. The economic case for 'more SAYGO' is strong, but it is far from open and shut.

There are also problems with switching to more SAYGO. Firstly, it requires a 'transition generation' to pay twice – once for their parents' retirement income through taxes (PAYGO) and once for their own retirement through the accumulation of savings and investments (SAYGO). Secondly, a total dependence on SAYGO funding disadvantages those who are unable to accumulate sufficient assets due to lower lifetime incomes. The rate at which a switch to SAYGO is made also has implications for national savings and economic growth.

That said, there is no doubt that when the population is ageing, SAYGO is fairer to future generations. A SAYGO-funded expansion of the cost of retirement income in New Zealand would result in smaller transfers from future generations to current generations and (probably) lower long-run taxes and a greater accumulation of wealth than a purely PAYGO-funded expansion.

It was unsettling to find, in the (admittedly limited) consultations with young people undertaken as part of this review of retirement income policy, that there is a commonly held view among the current younger generation 'that super won't be there for us when we retire.' The New Zealand Union of Students' Associations submission pointed out that student loans and lessening housing affordability are barriers to getting on the first rung of the retirement savings ladder, and even coined the term 'BORAYGO' (Borrow As You Go) to describe the modern condition for young people. There are also signs of resentment against the baby boomer generation although the justification for this is challenged in turn by boomers themselves. Whatever the case, it is important that younger people have confidence in the stability of the system so that they can both plan for their own individual futures and collectively ensure that the desired stability is retained when they come to power.

A mix of SAYGO and PAYGO would help us to share and manage various risks and uncertainties that we face:

- Average life expectancy may turn out to be longer than expected
- The level of economic productivity may be different than expected
- Average capital returns may be different than expected
- A future government may use assets built up for retirement for other purposes

PAYGO helps to protect individuals against the risk of outliving their savings, while SAYGO can reduce the risks that increases in longevity pose to the Government budget. If economic growth is less than expected, future generations will have saved less and there will be a smaller economy out of which retirees can be supported. SAYGO can help mitigate this risk, in part because a portion of accumulated funds are able to be invested in other economies which are growing faster. On the other hand, PAYGO can help mitigate the risks to individuals of poor returns on their savings and investments (which may be due to bad decisions as much as to the overall rate of return).

The risk that future governments will take accumulated savings is a political one, and mainly applies to collective savings since balances in KiwiSaver and other schemes are privately owned (although pensions can be eroded through taxation or inflationary policies). The risk to a fund such as the NZSF is managed through independent governance and accountability arrangements. A more likely risk is that future generations will balk at paying the taxes required to support a purely PAYGO system if those costs are unfairly spread across different cohorts.

There is a need to build a retirement income framework that is fair and sustainable in the face of future risk and uncertainty. A mix of SAYGO and PAYGO is required, although it is difficult to say what the ideal balance should be. It is clear however that each generation will need to save more to help pay for its own retirement. This saving can be on an individual basis through KiwiSaver and other private schemes, or collectively through the New Zealand Superannuation Fund, or a combination of both.

WHEN THE POPULATION IS AGEING, SAYGO IS FAIRER TO FUTURE GENERATIONS.

A MIX OF SAYGO AND PAYGO IS REQUIRED, ALTHOUGH IT IS DIFFICULT TO SAY WHAT THE IDEAL BALANCE SHOULD BE.



Collective saving

The New Zealand Superannuation Fund

The NZSF invests money on behalf of the Government to help pay for the increased cost of NZS in the future.⁶⁵ By doing this the Fund adds to Crown wealth, improves the ability of future governments to pay for superannuation, and ultimately reduces the tax burden of the cost of superannuation on future New Zealanders. The NZSF will not alter the future cost of NZS, but it will improve its affordability through accumulated savings and if investment returns are achieved that are in excess of alternative funding methods.

The NZSF is managed by a Crown entity, the Guardians of New Zealand Superannuation. The Guardians have operational independence from the Government and fund investments are made on a purely commercial basis. The Government may direct the Guardians only about its expectations of the Fund's overall risk and return. This investment independence gives the Guardians confidence to enter into investment arrangements that best suit the Fund's long-term purpose, with minimum agency risk.

Since inception in 2003, the Government has contributed \$14.88 billion to the Fund which, as at May 2013, was worth \$23.17 billion. The Guardians had invested the Government's contributions in New Zealand and overseas, returning 8.99 per cent per annum after costs and before tax. This rate of return is around 4.03 per cent per annum higher than the rate of return on Government debt. To date and in the future, the Guardians expect returns from investments to 'well exceed the nominal growth rate of the NZ economy, which is the 'return' under a PAYGO system, given tax revenues approximately grow with the rate of nominal GDP growth (absent any changes in the tax rates themselves)'.⁶⁵

Since inception, the Fund has paid \$3 billion in tax to the New Zealand Government.

The Guardians include New Zealand tax paid in measurements of the Fund's performance because they consider it to be a return to the Crown.

The Government will begin to withdraw money from the NZSF to help pay for New Zealand Superannuation around 2029/30. However, even once withdrawals begin, the Fund is not projected to peak in size until the 2050s.

There are certain characteristics of the NZSF which help optimise its ability to generate superior investment returns. These include the Fund's long-term horizon, certain cash flow (thanks to the Fund's public funding formula), limited need for liquidity, and ability to invest in growth assets such as listed company equities in New Zealand and globally. In the short term, growth assets can be volatile, moving up and down in price. However, because of its long investing horizon, the Fund has the ability to ride out and potentially benefit from these short-term movements

Having a long investing horizon also allows the Fund to invest in illiquid assets – for example, forests, infrastructure and private (unlisted) companies. These assets can be difficult to sell quickly. This means that they are not suitable for all investors, but are expected to deliver a premium over time.

The Fund's sovereign status is also beneficial, enabling the Fund to pay lower tax in some foreign jurisdictions than private investors. Sovereign status is also often regarded favourably by business partners and can position the Fund well as a potential co-investor.

Among other benefits of significance to retirement income policy are that:

- The NZSF brings diversification to the Government's balance sheet and helps spread risk. Tax revenue (upon which PAYGO is based) is wholly exposed to macroeconomic conditions in New Zealand. By investing globally, the Fund makes future Government revenue and the ability to pay for NZS less dependent on the domestic economy

BY INVESTING GLOBALLY, THE FUND MAKES FUTURE GOVERNMENT REVENUE AND THE ABILITY TO PAY FOR NZS LESS DEPENDENT ON THE DOMESTIC ECONOMY.

⁶⁵ This section is mainly drawn from a paper prepared for the 2013 Review of Retirement Income Policies by the Guardians of New Zealand Superannuation. For a fuller description of the fund see <http://bit.ly/cflri-2013review-nzsf>.

- Over the period 2002–2011, the Fund had the effect of raising the estimate of household saving in New Zealand by an annual average of 2.1 percentage points of household disposable income⁶⁶
- The economies of scale associated with the NZSF are likely to mean that this is a cheaper form of SAYGO funding of retirement income than individual accounts
- By pooling investment risk, a collective fund protects individual savers (taxpayers) against the risk of poor outcomes

The current New Zealand Government has suspended contributions to the New Zealand Superannuation Fund until net core Crown debt falls below 20 per cent of GDP.⁶⁷ The Government's grounds are that once expected Government cash surpluses are achieved (from 2017/18 onwards), it will be more prudent to use those surpluses to reduce debt to more prudent levels than to put money into volatile and risky world share markets while holding higher debt.

New Zealand Superannuation Fund contributions are therefore projected to resume in 2020/21 – two years later than had previously been projected, but the same time as was expected when the Government initially suspended contributions to the NZSF in Budget 2009.

In essence, the Government argues that low debt is equally as important as NZSF assets in meeting some of the future fiscal pressures from population ageing. It is not within the scope of this review to comment on the Government's rationale, except to draw attention to the Fund's performance in consistently achieving a rate of return higher than the rate of return on Government debt. It should also be noted that since 1 July 2009, NZ tax paid by the fund has totalled \$1.63 billion – a net outflow given that Government contributions have ceased during this period.

While past performance is no guarantee of future performance, the NZSF provides an important platform for introducing more SAYGO into New Zealand's retirement income framework. Delays in resuming contributions to the fund have the effect of shifting the cost of NZS further onto future taxpayers, thus compromising intergenerational equity.

Individual saving

The need to save

As described in Section Two, New Zealand Superannuation does a good job in helping to keep most older New Zealanders out of poverty.

The fact that NZS is currently indexed to wage growth means that the material living standards of superannuitants do not fall further behind those of people still in the workforce. Does this then mean that there is no need for individual New Zealanders to save for their retirement? It depends on the standard of living that they aspire to. NZS currently pays for a very basic lifestyle, which may suit those who are used to basic living prior to retirement. Indeed, some low-income earners experience an *increase* in standards of living when they become eligible for NZS. Those used to higher levels of income may wish to preserve those levels (or at least a proportion) into retirement. Many of the baby boomer generation are likely to have higher expectations of retirement than can be supported by NZS alone – in other words there will be a gap between what NZS provides and future retirees want to spend.

The arguments made in the previous section would also suggest that individuals need to save more, as a response to increased pressures on Government expenditure and the proposed widening of the gap to be funded before the age of eligibility for NZS. There is also a prospect that some time in the future (if the way in which NZS is indexed changes), it will buy relatively less than if full wage indexation was to continue.

THERE WILL BE A GAP BETWEEN WHAT NZS PROVIDES AND FUTURE RETIREES WANT TO SPEND.

⁶⁶ See <http://bit.ly/treasurynz-measuringsavingsrates>.

⁶⁷ See <http://bit.ly/treasurynz-budget2013>.



HOW MUCH WILL PEOPLE NEED TO SAVE? IT IS IMPOSSIBLE TO GIVE AN ANSWER THAT WILL SUIT EVERY INDIVIDUAL.

How much is enough?

How much will people need to save? It is impossible to give an answer that will suit every individual. Each person has his or her own goals and expectations, and ideally will develop lifelong financial literacy and create a plan for retirement income. In any case, advice on individual financial plans can be given only by an Authorised Financial Adviser.

Nevertheless there have been some attempts at establishing generalised savings targets and these can be regarded as informative rather than advisory. One approach is to estimate the percentage of pre-retirement income (a replacement rate) that is required to maintain a desired level of consumption in retirement. For example, an individual might aim at accumulating assets that together with NZS and other entitlements will generate 60% of their pre-retirement income. The replacement rate approach is not favoured because it tends to produce very high targets for retirement savings for those earning above average wages. Seemingly unreachable targets can be demoralising and deter saving rather than encourage it.

An alternative approach is to estimate an amount of income required to maintain a certain standard of living. Although this

approach is not generally used in public provision of retirement income, there is a trend towards calculating what people will need to be able to pay for in retirement. The following discussion of three research projects arrives at illustrative savings targets to fund a 25-year retirement on top of NZS. No account is taken of variations in the accumulation phase (through inflation, interest or fees) or the way that savings are used up in retirement. Leaving aside these qualifications, the point of the exercise is to demonstrate that retirement savings targets are not as far out of reach as a replacement rate approach would suggest.

The first of three research projects⁶⁸ has calculated the cost of living for both a 'no frills' lifestyle and one that is more comfortable because it enables more 'choices'. A second project calculated the total minimum income required for *healthy* living⁶⁹ and a third looked at the cost of a typical weekly budget.⁷⁰ These papers all use different methodologies and refer to different years but their findings can be compared on the basis of the weekly gap between the income that NZS provides in the reference year and the income required for the target standard of living. The weekly gap can then be multiplied up to give a 'ballpark' figure for a twenty-five year retirement (see Table 11).

Table 11:
Three findings on the gap between NZS and what is needed per person for a 25 year retirement

Study	Single gap	Couple gap
Choices (Massey)*	\$750	\$261,450
Healthy living (O'Sullivan & Ashton)	\$160,550	\$152,100
Typical weekly budget (Davey)	\$67,600	\$409,500
Per person range**	\$750 - \$205,000	
Average per person gap	\$103,000	

* Average of 'metro' and 'provincial' costs

** Gap based on 2013 single living alone, net weekly rate of NZS after tax at 'M' code; target figures include no allowance for inflation, interest or fees.

68 See <http://bit.ly/massey-retirementexpenditure2013>.

69 See <http://bit.ly/healthylivingretirement>.

70 See <http://bit.ly/cflri-retirementexpenditure2009>.

Note the Massey 'no frills' option is not included here because it found no gap between the target lifestyle and what NZS would provide. The Massey estimates also exclude housing costs as these vary considerably according to personal circumstances, location and so on. A full discussion of the impact of housing costs is contained in the 2013 New Zealand Retirement Expenditure Guidelines, obtainable via the footnoted link.

Taken together, the three pieces of research referred to above provide an unclear picture of the relative costs of living alone or as a couple. However other findings are that those in older couple 'economic family units' (EFUs) tend to have higher per capita non-government income than do those in older single person EFUs,⁷¹ so suggesting the per-person gap on top of NZS is easier to fill.

From the three sets of findings, it is possible to derive a per-person target range for savings of up to \$205,000 on top of NZS for a 25-year retirement. The Financial Services Council has estimated a higher figure than this, at around \$390,000 per person on top of NZS. Interestingly, a poll carried out in the second quarter of 2013 (see Table 12) found that 53 per cent of respondents wanted a weekly

income on top of NZS of up to \$300 - that would require savings of the same order as those discussed above.

The above figures will be daunting to some, but it's worth repeating that *at current rates and assuming housing costs are met, NZS alone is sufficient to provide a no frills standard of living.* This suggests that home ownership is the first goal in retirement planning, although this is becoming more difficult to achieve, as discussed on pages 77 to 79.

People need to save if they want to achieve a better standard of living than NZS alone can provide.⁷² The highest target figure contained in the above discussion is far less than some of the extreme figures that have been spoken of in the past. The rate of saving required to achieve targets will depend on the amount of discretionary income an individual has to save, time left to retirement and investment outcomes, but reasonable sums should be within reach of most people if they seek appropriate advice and plan effectively, for example through use of the Sorted website.⁷³ Starting early and consistently saving small amounts can build up to a large balance.

**STARTING EARLY
AND CONSISTENTLY
SAVING SMALL
AMOUNTS CAN
BUILD UP TO A
LARGE BALANCE.**

Table 12:
In addition to New Zealand Superannuation (single living alone \$348 per week after tax, married couple \$536 per week after tax) what extra income do you realistically want your retirement savings and investments/other sources of income to provide?

Extra income wanted per week	Total
Total	1,146
Up to \$149	22%
\$150-\$299	31%
\$300-\$399	15%
\$400-\$499	6%
\$500 and over	26%

Source: Ipsos/ANZ retirement savings index

71 Perry (2013b). See also Koopman-Boyden, P. and Waldegrave, C. (eds) (2009) *Enhancing Wellbeing in an Ageing Society: 65-84 year old New Zealanders in 2007*; Koopman-Boyden, P. and Waldegrave, C. (eds) (2010) *Midlife New Zealanders: 40-64 in 2008*. Hamilton: The Population Studies Centre, University of Waikato and Wellington: The Family Centre Social Policy Research Unit.

72 Although income is not the only determinant of wellbeing in retirement - see <http://bit.ly/treasurynz-livingstandardsoldernz>.

73 See sorted.org.nz/a-z-guides/retirement-planning for a guide to retirement planning.



PEOPLE NEED TO SAVE IF THEY WANT TO ACHIEVE A BETTER STANDARD OF LIVING THAN NZS ALONE CAN PROVIDE.

Equity in saving

That said, it must be reiterated that it is easier for some people to save than others, most particularly because of differences in income, family life stage and mortgage commitments. New Zealanders do not have high income per capita in comparison with other OECD countries⁷⁴ and those in lower income brackets save little.⁷⁵

While the gender pay gap has diminished slightly in recent years (in part because of a relative deterioration in incomes for middle-aged men), there's still no single industry in which women earn more than men. On a full-time-equivalent basis, New Zealand women in 2011 earned on average only 83 per cent of the average male income.

On the positive side, New Zealand has one of the smallest pay gaps between men and women in the OECD, placing it well ahead of the OECD average and Australia, the UK and the USA. Market dynamics are helping it to reduce: the industrial sectors in which New Zealand women work are less affected by economic cycles that often see men laid off⁷⁶ and female-dominated industries and occupations have grown at a greater rate than those in which men dominate.⁷⁷

Still, the median weekly income gap is 36.4 per cent with men earning an average of \$707 per week (that's \$257 more than women).⁷⁸ Men are far more likely to be employed above the minimum wage and far less likely to have gaps in their working life due to parental leave or caring for family members (other than their children). Also, fewer men work part-time. So it's true to say that on average, women work fewer hours and at a lower rate than men throughout their working lives. Consequently, over a lifetime, a substantial income gap between men

and women accumulates, resulting in a much lower net worth for women at retirement.

NZS helps to address this inequity because it is universal, non-contributory and paid at a flat rate – and on average, women receive it for longer because of their longer life expectancy. As things stand in the workplace, the more we depend on a SAYGO scheme such as KiwiSaver for funding retirement income, the more women will be at a disadvantage (see page 65 for a discussion of current KiwiSaver balances for women).

In addition to income-related factors, women's ability to save for their retirement can also be affected by their personal attitudes, circumstances and cultural backgrounds.⁷⁹ Influences beyond the workplace include:

- Their attitudes and perceptions about what they'll need to retire on and what will be available to support them in their retirement
- Their ability or will to source information about retirement savings
- Their personal circumstances, such as relationships and families
- Their cultural obligations – especially when those obligations are based on collective values, where a commitment to the greater good of the family and extended family overrides the needs of the individual. There can be a tension between these and the 'Western' ways of doing things, particularly in terms of retirement savings – an indication that those developing and implementing New Zealand's retirement income policy need to respect traditional values and acknowledge that the transition to a different culture of financial management needs the courage and cooperation of all those involved

Different ethnicities experience different income disparities as depicted in Table 13 (but note that this comparison does not take into account differences in age structures of different ethnic populations).

THE MORE WE DEPEND ON A SAYGO SCHEME SUCH AS KIWISAVER FOR FUNDING RETIREMENT INCOME, THE MORE WOMEN WILL BE AT A DISADVANTAGE.

74 See <http://bit.ly/OECD-nationalaccounts2013>.

75 Gibson, J., Le, T. and Stillman, S. (2012).

76 Borkin, P. (2011). *Closing the gender gap: Plenty of potential economic upside*. New Zealand: Goldman Sachs & Partners.

77 Newell, J. (2009). 'Converging and diverging strands in the evolution of gendered New Zealand occupational pathways: 1981 to 2006'. *A contribution to the FRST 'Missing Men' Programme, MERA Working Paper 2009/13*, p. 7. Monitoring and Evaluation Research Associates Ltd.

78 Calculated from Statistics New Zealand, *New Zealand Income Survey 2012*.

79 For more on women's retirement income prospects, see <http://bit.ly/cflri-womensretirementincome>.

Table 13:
Median weekly income for different ethnicities

Ethnicity	Median weekly income	Income gap compared to Pākeha
Pākeha	\$597.00	
Māori	\$475.00	20.44%
Pasifika	\$401.00	32.83%
Asian	\$446.00	25.29%
Middle Eastern, Latin American, African	\$465.00	22.11%
Other ethnicities	\$486.00	18.59%

Source: Human Rights Commission

Disabled people of working age (15-64) are more than twice as likely to not be in the labour force as non-disabled people. Data for disabled people are not included in regular employment data, such as the annual State Services Commission Human Resources Capability Survey, the annual Income Survey and the quarterly Household Labour Force Survey, but it is true to say that the average personal income of a disabled adult (even one who is employed) is very low. Over half of all disabled people are on an income below \$15,000 compared with only 40 per cent of non-disabled people. About 72 per cent of those people with disabilities whose income is below \$15,000 receive a benefit.

Behavioural factors

Savings behaviour is also strongly influenced by personal factors, and the way people save (or not) does not necessarily fit theories about rational choice. For example, innate personality traits may affect the propensity for 'deferred gratification' that is required to forgo consumption today in favour of consumption sometime in the future. Preferences for the present over the future may also be affected by cohort or cultural beliefs, which encourage and reward demonstrations of high net worth or an expectation of upward social mobility. The field of behavioural economics (best known through the work of Daniel Kahneman, Amos Tversky and Richard Thaler) offers many insights on why people save (or don't) and these inform approaches to financial education as discussed on page 85. Perhaps

the most well-known concept to come from behavioural economics is the notion of 'nudging' people towards behaviours that are in their best interests. An example of a nudge relevant to retirement income policy is the auto-enrolment of members in KiwiSaver, which is discussed below.

Managing risks

In addition to behavioural factors, adverse events such as being made redundant or losing a business, divorce, death of a spouse, health setbacks (for oneself or for a family member), or natural disasters can all have an effect on preparations for retirement. People may need to save more or insure themselves against unplanned-for events and to build resilience in the face of shocks.⁸⁰ The closer to retirement such shocks happen, the less time there is to recover, and the more likelihood of poor retirement outcomes. Unpublished research carried out for the Commission for Financial Literacy and Retirement Income shows that while a large number of New Zealanders aged 55+ are preparing well enough for retirement, many have very little 'padding' to protect themselves from shocks. For the population at large, other Commission research has found that just 42 per cent of New Zealanders could access up to three months' worth of their income in an emergency through their own savings and investments.⁸¹

THE CLOSER TO RETIREMENT THAT SHOCKS HAPPEN, THE MORE LIKELY ARE POOR RETIREMENT OUTCOMES.

⁸⁰ See <http://bit.ly/HSBC-futureofretirement> and <http://bit.ly/msd-livingstandards2004>.

⁸¹ See <http://bit.ly/cflri-fbi-may2013>.



Responsibility for managing the risk of adverse events is in some cases shared or carried by the payers of taxes or levies (e.g. health care, accidents, natural disasters). NZS is a safety net but on its own is unlikely to provide individuals with sufficient protection against shocks to retirement income. At some stage in the future it may be necessary to consider some additional form of social insurance as part of retirement income policy but no recommendation on this matter is proposed in the 2013 review.

KiwiSaver

Description

The KiwiSaver retirement savings scheme can be joined by all New Zealanders under the age of 65, but is significantly based in the workplace. New employees are automatically enrolled, although they can opt out. Existing employees or any other New Zealander under the age of 65 can also enrol in KiwiSaver. So the scheme is voluntary but there is an element of 'soft' compulsion due to auto-enrolment, and once you join KiwiSaver you have to stay a member until you are 65. You can take a contributions holiday if you are an employee, or you can stop making voluntary contributions if you are not an eligible employee, but you cannot close your account except under exceptional circumstances.

KiwiSaver schemes are managed by private sector companies called KiwiSaver providers. Members can choose which KiwiSaver provider to invest their money with.⁸² If they do not make a choice, they can be automatically placed in a scheme chosen by their employer, or assigned to one of six 'default' schemes operated by providers who are specially contracted to the Government for this purpose. A key feature of KiwiSaver which differentiates it from schemes in some other countries is that each member has one account which they keep as they move jobs. This enhances members' ability to keep track of their balances and makes it more likely that

they and their provider will stay in contact.

KiwiSaver is also available to part-time employees – which tended not to be the case with earlier workplace-based retirement savings schemes. Those who are either self-employed, casual employees or not in work can be members of KiwiSaver and make contributions, but are not subject to any 'soft compulsion' triggers or compulsory employer contributions.

The Government provides incentives for people to become members of KiwiSaver. On enrolment, a \$1,000 'kick-start' is paid into their account. For every dollar saved up to \$1,042 in a year, the Government deposits a 'Members Tax Credit' of 50 cents (i.e. a maximum of \$521 per annum). These Members Tax Credits are not available to members aged under 18 or over 65. In the five years to 30 June 2012,⁸³ the Government made payments to KiwiSaver members of \$4.4 billion. Total funds under management have grown to reach close to 15 billion⁸⁴ by the first quarter of 2013.

In certain circumstances, KiwiSaver balances may be drawn down to purchase a home,⁸⁵ thus increasing the attractiveness of the scheme to younger members. There is also provision for withdrawals on grounds of significant financial hardship, serious illness or moving overseas permanently. Members may take any number of 'contributions holidays' of up to five years each.

KiwiSaver balances are generally locked in until the age of 65 with at least five years' membership. The balance available to provide retirement income will depend on the length of membership, the size of contributions made – less any withdrawals, fees and taxes – and investment returns. Investment income earned within KiwiSaver is subject to relatively favourable tax treatment as schemes are classified as Portfolio Investment Entities (PIEs). Lump sum withdrawals on retirement or other grounds are not taxable in the hands of recipients.

⁸² Some of this section is drawn from kiwisaver.govt.nz. See this site for more information.

⁸³ See <http://bit.ly/ird-KS-annualreport2012>. At the time this document went to press, 2013 figures were not yet available.

⁸⁴ See <http://bit.ly/morningstar-KSsurvey2013>.

⁸⁵ There is a First Home Deposit Subsidy targeted at lower-income KiwiSaver households who are purchasing a lower-quartile price first home within specific regional price caps.

For most people KiwiSaver contributions come straight out of their pay. Members can choose to contribute at the rate of either three, four or eight per cent of gross pay. Employers are also required to contribute at least three per cent of gross pay to the member's account.

KiwiSaver is not guaranteed by the Government. This means that members make choices about investment in a KiwiSaver scheme at their own risk.

As of 1 July 2012, the first KiwiSaver members to both turn 65 and have five years' membership became eligible to withdraw funds from the scheme. KiwiSaver is therefore growing in significance.

Though KiwiSaver has aims related to wellbeing and financial independence in retirement, it is not explicitly linked to the rest of the retirement income framework.

Participation

KiwiSaver was set up from 1 July 2007 in order to *encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement... to increase individuals' well-being and financial independence, particularly in retirement, and to provide retirement benefits.*⁸⁶

The implication is that given current settings for New Zealand Superannuation, the target group for KiwiSaver consists of those who are likely to experience a gap between the standard of living that NZS can provide and the standard aspired to in retirement.

By any standards, the growth in membership of KiwiSaver has been impressive. In the six years from 1 July 2007, total membership (not including opt outs and closures over that time) grew from zero to almost 2.2 million⁸⁷ out of a total New Zealand population of 4.5 million.

Another 250,000 people had opted out (there is some double counting of people who have opted out more than once) and there were about 100,000 members on contributions holidays. The proportions of male and female members were very similar (52 per cent female, 48 per cent male). Unlike many other workplace-based schemes, KiwiSaver is available to part-time workers who are more likely to be female.

Nearly two thirds of all members had opted in to the scheme, either by actively choosing a provider or via an employer. Just over a third of members were automatically enrolled. Approximately 10 per cent of those who had been members at some time during the first six years had opted out. Each year, fewer people have opted out, possibly suggesting a broadening acceptance of KiwiSaver.⁸⁸

As at 30 June 2012, 49 per cent of the eligible population were KiwiSaver members, including 29 per cent of eligible children and 67 per cent of people aged between 18 and 24. The high rate among the latter group probably reflects the high rate of new job starts, although the home purchase incentives may also play a part.

The distribution of membership across other age bands is quite even, but there is variation by other characteristics. There are disproportionately fewer KiwiSavers at lower income levels (below \$20,000 per annum), but disproportionately more KiwiSavers at incomes between \$20,000 and \$50,000 (Figure 8). An early survey in 2007–2008 found KiwiSaver members at that time were less likely to be Māori or Pasific peoples, but more likely to hold a degree or higher qualification.⁸⁹ The Family Centre noted in its submission to this review that their research shows that KiwiSaver is encouraging effective saving practice among low-income people and that consequent asset accumulation is consistently linked to positive wellbeing and health outcomes.

THE GROWTH IN MEMBERSHIP OF KIWISAVER HAS BEEN IMPRESSIVE.

KIWISAVER IS NOT GUARANTEED BY THE GOVERNMENT. THIS MEANS THAT MEMBERS MAKE CHOICES ABOUT INVESTMENT IN A KIWISAVER SCHEME AT THEIR OWN RISK.

WHILE KIWISAVER HAS AIMS RELATED TO WELLBEING AND FINANCIAL INDEPENDENCE IN RETIREMENT, IT IS NOT EXPLICITLY LINKED TO THE REST OF THE RETIREMENT INCOME FRAMEWORK.

⁸⁸ For a fuller description of these trends, see the background paper prepared for the review at <http://bit.ly/cflri-2013review-KS>.

⁸⁹ Gibson, J., Hector, C and Le, T. (2009). 'The Distributional Impact of KiwiSaver Incentives'. *Social Policy Journal Issue 36*, August 2009. See <http://bit.ly/MSD-spj36-KS>.

⁸⁶ KiwiSaver Act 2006

⁸⁷ See <http://bit.ly/KSstats>.



Figure 8:
Income distribution of
KiwiSaver members
(IRD 2012b Figure 5)



Source: IRD: KiwiSaver
Evaluation Annual Report 2012

Base: All members at 30 June 2012 with income for the 2011 tax year. Eligible population are those eligible to join KiwiSaver (i.e. those who are New Zealand citizens or residents and under the age of 65 years), whether or not they have joined, with income for the 2011 tax year. Income relates to the 2011 tax year and includes income from salary and wages (including benefit payments) and IR3 returns (including income from self-employment, overseas income, rental income, estate, partnership or trust income and royalties and other income without PAYE deducted). Those members with no income for 2011 are excluded.

THERE ARE QUESTIONS ABOUT THE LEVELS OF MEMBERS' ENGAGEMENT IN KIWISAVER.

Looking more closely at membership figures raises some questions about the levels of engagement in KiwiSaver as a workplace-based scheme. As at June 2012, around 16 per cent of members were aged under 18 years and under and about five per cent were on a contributions holiday.

Around 25 per cent of members who were eligible for the member tax credit had not made contributions to their account (these were mostly people with no income) and more than half did not contribute enough to gain the full tax credit.⁹⁰

At 31 March 2012, 24 per cent of KiwiSaver members were in a default fund and most (93 per cent) members in an employer-chosen scheme were in the default option of that scheme. The extent to which membership of a default represents disengagement is a moot point (see page 70).

A number of changes have been made to the KiwiSaver scheme since it began, most notably to the rates of minimum contribution, member tax credit and tax treatment of employers' contributions. These changes do not seem to have affected overall levels of participation in the scheme. While new memberships have levelled off to some extent, they are still climbing as shown in Figure 9.

⁹⁰ This is perhaps not surprising as, at a member contribution rate of 2% of gross wages or salary, the maximum MTC is only received at about the average wage. The change to a 3% minimum contribution is likely to see an increase in the level of MTC claimed.

Future Challenges

Continued

Changes since 2010

From 1 July 2011, the maximum annual amount of the member tax credit paid by the Government was halved from \$1,042.86 to \$521.43. This means that for every dollar of member contribution up to \$1,042.86, the Government contributes 50 cents.

From 1 April 2012, all compulsory employer contributions to KiwiSaver (or other complying superannuation schemes) are liable for

Employer Superannuation Contributions Tax (ESCT) at the current rates shown in Table 14. Previously, compulsory employer contributions to KiwiSaver schemes and complying funds were exempt from ESCT.

From 1 April 2013, the minimum contribution rate for both employees and employers was increased from 2% to 3% of gross salary. Higher contributions are permitted.

Table 14:
Current ESCT rates

Total salary or wages*	ESCT rate
Up to \$16,800	10.5%
\$16,801 to \$57,600	17.5%
\$57,601 to \$84,000	30%
Greater than \$84,001	33%

* Including gross employer contributions

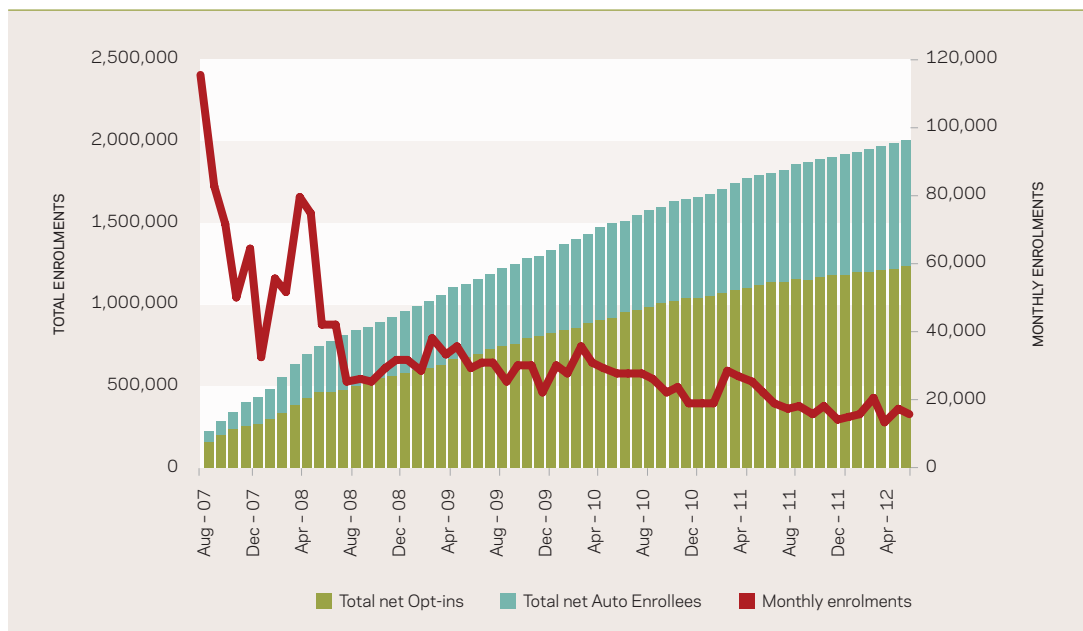


Figure 9:
Total and monthly KiwiSaver enrolments

Source: IRD: KiwiSaver Evaluation Annual Report 2012



Contributions

Most members have contributed at the lowest possible rate and the numbers contributing at

the lowest rate have increased, as shown in Table 15 (Note: two per cent was the minimum contribution rate for both employers and employees during these years.)

Table 15:
Member contribution rates as at June 2012

	Proportion of members 2010	Proportion of members 2011	Proportion of members 2012
2% *	41%	53%	59%
4%	55%	43%	36%
8%	4%	4%	4%
Other %	<1%	<1%	<1%
Total	100%	100%	100%

**It is too soon to say what effect the change in the minimum rate to employees (to three per cent on 1 April 2013) has had on the proportions of members contributing at different rates.*

At an average weekly gross wage of approximately \$1,000, the new total gross contribution rate (three per cent employer plus three per cent employee) is equivalent to \$3,120 per annum. Without adding in the kick-start, members tax credits or investment returns, or deducting fees or taxes, that figure multiplies up over 45 years to \$140,000 in today's dollars – i.e. within the 'ballpark' calculated on pages 57 to 58.

However, the median annual contribution by wage and salary earners in 2010 and 2011 was \$829 and at 31 March 2012 – after almost five years' operation – the average balance across all KiwiSaver accounts was \$6,668.⁹¹ In line with gendered patterns of wages and average hours worked, women's contributions to KiwiSaver accounts are also lower on average than those of men. While it's still early days, according to three KiwiSaver schemes surveyed in 2012, women are saving up to 20 per cent less than men.⁹² There is also evidence from Australia, which has a compulsory workplace retirement scheme (Superannuation Guarantee) that women have significantly less money saved for their retirements.⁹³ A recent report⁹⁴ showed

that the mean superannuation balance of those with super was \$63,412 for women and \$109,609 for men, i.e. 73 per cent greater.

This review recommends, as a way to redress such an imbalance, that the Government finds a fair way to fund the continuation of KiwiSaver members' contributions while they are on parental leave (which is mostly, but not exclusively, taken by women). Topping up balances during working life is likely to be more effective than topping up at the age of retirement (another option) because of the extra time for compound interest to have an effect.

There are a couple of international precedents for such a measure. In Australia, it is the newly governing Liberal Party's policy for mothers to be provided with superannuation top-ups while on paid parental leave and the progress of this policy will be followed with interest. In France, cash maternity benefits count as earnings for pension purposes.⁹⁵

91 Derived from FMA data. There are many possible explanation for this low figure, for example most members have not been in the scheme for the full five years.

92 See <http://bit.ly/FSC-KS>.

93 See <http://bit.ly/AusHRC-gendergap-retirementsavings>.

94 <http://bit.ly/ASFA-equityandsuper>.

95 OECD Pensions Outlook 2012.

Access to more and better data would enable more precise monitoring of trends, but it is reasonable to assume that continuous contributions at the minimum three per cent rate over a long period will help many KiwiSaver members to fill the gap between what NZS can provide and a higher standard of living in retirement. Where this is the case, the purpose of KiwiSaver will have been fulfilled. This of course assumes that NZS remains broadly unchanged. If changes are made and KiwiSaver members need to dip into their funds between 65 and a new age of eligibility for New Zealand Superannuation, they will have a smaller top-up balance available once they qualify for NZS.

Others have made different calculations of the minimum KiwiSaver contribution rate required for a comfortable retirement. The Financial Services Council and Workplace Savings NZ, who represent KiwiSaver providers, have respectively proposed that the minimum rate should reach ten or twelve per cent. It needs to be recognised however that higher minimum contribution rates may deter people from either joining KiwiSaver or continuing to make contributions.

Compulsion

Some submissions to this review have proposed in response that KiwiSaver membership and contributions should become compulsory. However, compulsion would be perceived by members as an additional tax (even though contributions are placed in an individual account) and undermine the objective of encouraging individual responsibility and choice. It is also unclear the extent to which compulsion would allow higher income earners to simply substitute KiwiSaver for other forms of saving⁹⁶ – meaning that compulsion would not affect all members equally. A proportionally greater burden would probably fall on those with low incomes.

A compulsory system can also be expensive because of the need to ensure compliance. In addition tax incentives are often still required to help make compulsion acceptable. With compulsion, there is little incentive for regulators and the finance industry to reduce complexity, increase transparency and allow for comparability of superannuation products.⁹⁷ Financial services providers don't have to work so hard to get and to keep customers, so competition and the pressure for innovation are reduced.⁹⁸

In terms of compulsion being a means of building numbers of KiwiSaver members, it needs to be remembered that these have grown from zero to 2.2 million in six years on a voluntary, albeit incentivised, basis. Slowing numbers of opt-outs would suggest that a more active approach to auto-enrolment could dramatically increase membership without resorting to compulsion (say an 'auto-enrol' day on which all employees who were not already members of KiwiSaver would be enrolled, with the right to opt out retained). The question of how to build members' engagement remains, but this is a job for both general financial education and specific marketing and communication by providers. In particular, it is to be hoped that if the implications of changes to indexation of NZS proposed by this review are clearly signalled, KiwiSaver membership and engagement will both increase.

Finally, the 1992 Task Force on Private Provision for Retirement (The Todd Task Force) noted a likely outcome of a compulsory savings system would be the introduction of means testing for NZS. This would represent a fundamental change to the system of retirement income that has served New Zealand so well over several decades.

**ACCESS TO MORE
AND BETTER DATA
WOULD ENABLE MORE
PRECISE MONITORING
OF TRENDS.**

⁹⁶ A Treasury paper (Law, D., Meehan, L. and Scobie, G. (2011) 'KiwiSaver: An Initial Evaluation of the Impact on Retirement Saving'. *Treasury Working Paper 11/04*. New Zealand Treasury) reports that approximately one third of contributions made to KiwiSaver represented additional savings.

⁹⁷ The 'Cooper Review': supersystemreview.gov.au.

⁹⁸ One submission to this review explicitly disagrees on this point; see <http://bit.ly/cflri-2013review-submissions-BNZ>.



The funding of employer contributions

Most employer contributions are in addition to an employee's gross salary or wages but some employers have negotiated a total remuneration package – that is, an employee receives a fixed amount of remuneration and if that employee is a member of KiwiSaver, the cost of the employer contribution comes out of the employee's pay. A total remuneration approach is allowed under the terms of the KiwiSaver Act (clause 101B) where parties to an employment relationship agree and may become more common as pressures on remuneration budgets increase across the public and private sectors. There are some indications that this is happening with up to 20–30 per cent of employers,⁹⁹ but just one per cent of collective contracts.¹⁰⁰ The Employment Court has ruled that under total remuneration gross wages cannot fall below the minimum wage of \$13.50 an hour, i.e. before tax and excluding the employers' KiwiSaver contribution.¹⁰¹

In Australia, the employers' contribution to workplace superannuation was introduced as an explicit trade-off against wage increases. New Zealand employers' contributions to KiwiSaver were initially regarded as on top of wages and salaries, and widespread use of the total remuneration approach might be seen to be against the original spirit of the scheme. Members generally benefit from employer contributions being an additional payment and inclusion in total remuneration reduces the attractiveness of KiwiSaver. On the other hand, a total remuneration approach makes pay systems transparent and ensures that non-KiwiSaver members are not disadvantaged. The Retirement Commissioner will continue to monitor this situation and revisit it in the next review of retirement income policy.

Performance

KiwiSaver funds have steadily increased in value since the scheme's introduction in 2007 in line with the growth in membership numbers. In the six years to 30 June 2013, total funds under management had reached \$15.16 billion,¹⁰² (more than 17 per cent of the market for managed funds up, from zero per cent six years previously¹⁰³).

Figure 10 provides an overview of performance trends based on data for the March and September quarters between 2004 and 2012. Total funds under management declined in value between 2007 and 2009, presumably as a consequence of the Global Financial Crisis, but they have subsequently recovered and increased in value. Within the total market, life insurance continues to decline while other managed funds (including unit trusts and group investment funds) fell between 2007 and 2009 and have held value since that time. The value of other superannuation funds has begun to grow, following a downward trend in 2007–2009. This uplift is only slight and may be largely investment returns-driven but could equally reflect a slight increase in the attractiveness of non-KiwiSaver work-based schemes given reduced KiwiSaver savings incentives.

99 See <http://bit.ly/stuff-KS-employereductions>.

100 See <http://bit.ly/cflri-2013review-collectiveagreements>.

101 See <http://bit.ly/NZEmpC199>.

102 See <http://bit.ly/morningstar-KSsurveyJune2013>.

103 See <http://bit.ly/ird-KS-annualreport2012>.

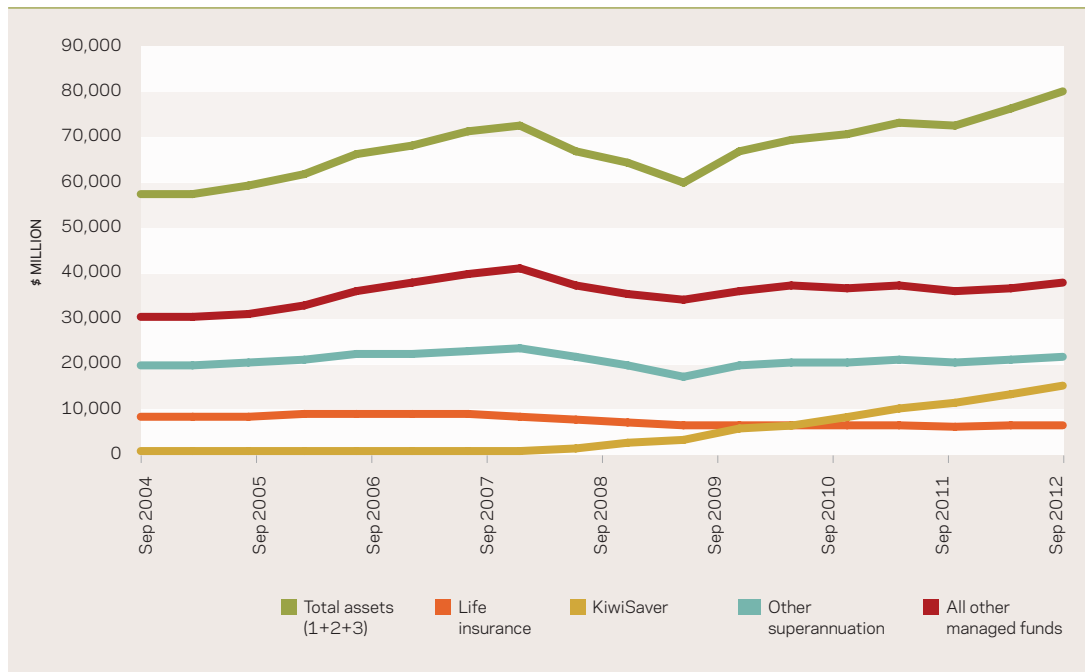


Figure 10:
Changes in funds under management by category

Source: RBNZ, 2013

KiwiSaver is located in a competitive market and members have the option to switch providers at any time. The Financial Markets Authority (FMA) is responsible for the administration, compliance monitoring and enforcement of the KiwiSaver Act. The Reserve Bank's capital market regulations also have an impact and further market discipline comes from self-management and disclosure by KiwiSaver providers. From July 2013, the KiwiSaver Periodic Reporting Regulations require fund managers to report their performance and returns, fees and costs, assets and portfolio holdings, liquidity and liabilities, and key personnel, along with any conflicts of interest, in a standardised format on their websites.

Providers tend to operate various *funds* and members can also choose into which fund or funds they place their contributions, depending on their retirement planning goals. Broadly speaking, funds can be defensive, conservative, balanced, growth-oriented or aggressive depending on their risk profile and proportion of investment in growth assets.¹⁰⁴

104 See sorted.org.nz/a-z-guides/kiwisaver-schemes-and-funds.



Table 16:
KiwiSaver fund types

Type of fund	Risk profile	Investment in growth assets
Defensive	Low risk	20% invested in growth assets
Conservative	Low to medium risk	30% invested in growth assets
Balanced	Medium risk	50% invested in growth assets
Growth	Medium to high risk	70% invested in growth assets
Aggressive	High risk	90% invested in growth assets

Average returns to KiwiSaver were low in the initial years, particularly for more growth-oriented funds. However more recent data show growth-oriented funds performing better than default and conservative funds. A few schemes do not provide data to

Morningstar and the averages disguise variation in returns across schemes. As is the case with balances, there is no information currently about the distribution of earnings for individual groups of KiwiSaver members.

Table 17:
KiwiSaver Peer Group Averages to 31 March 2013¹⁰⁵

Fund type	Assets \$M	1 year	3 years	5 years
Default options	4,577.9	6.6%	5.9%	5.3%
Conservative	5,461.7	7.1%	6.1%	5.5%
Moderate	2,236.3	9.2%	7.2%	5.9%
Balanced	2,716.9	14.0%	8.5%	5.4%
Growth	2,645.9	16.8%	9.4%	5.0%
Aggressive	958.4	18.7%	8.7%	4.7%

Source: Morningstar, 2013

¹⁰⁵ See <http://bit.ly/morningstar-KSurveyJune2013>.

Default funds

The default-provider arrangements for KiwiSaver were reviewed during 2012 and 2013.¹⁰⁶ Key issues under consideration have been the objectives of the default schemes and whether these should change, the best design to achieve the desired objectives and the most appropriate institutional arrangements and transition. In particular, consideration has been given to default arrangements that mandate a life-cycle or 'age appropriate' investment for the savings of default fund members with a view to gaining better investment returns for individuals and to better suit long-run investment needs. This approach has been recommended by government-initiated reviews in New Zealand, including the Capital Markets Development Taskforce and the Savings Working Group.

However, the default fund option was initially set up as a 'parking space' for those who did not make an active choice, and with a capital preservation objective (i.e. the default option is really a savings scheme). Capital preservation is an entirely appropriate objective for the default option and an overriding principle should be no change to the basis upon which members joined KiwiSaver.

While it may be true that a less conservative option or a life-cycle fund is more appropriate in many cases, this is for members themselves to determine.

Even if default members are savers rather than active investors, this situation might change as balances reach some as-yet-unknown 'tipping point' in the future. At that point members may take a greater interest in the performance of their funds and there will be more incentive for providers to provide information and advice.

Were the Government to instead engineer a change in objectives to others that it deemed more suitable for members, it would be either acting in the role of adviser or even *more than an adviser*. While in a strictly legal sense this would not make the Government responsible for investment outcomes, political risks might arise because of expectations that the Government would act as a guarantor standing behind its own advice.

Withdrawals

There are four principal grounds on which KiwiSaver members may withdraw some or all of their KiwiSaver balances: permanent migration, hardship, for the purchase of a house, and reaching the age of 65 with at least five years' membership.

Migration

KiwiSaver members who are permanently emigrating from New Zealand may apply to withdraw their own contributions, their employers' contributions and the \$1,000 kick-start. However they cannot withdraw any member tax credits. The number of withdrawals by permanent migrants is very small; in the year ended 30 June 2012 these amounted to less than 0.2 per cent of the total number of KiwiSaver members.¹⁰⁷

As of 1 July 2013, for KiwiSaver members who move to live permanently in Australia, KiwiSaver accounts and compulsory Australian pension savings are portable across the Tasman. A person who has retirement savings in both Australia and New Zealand can consolidate their savings in one account in their current country of residence.¹⁰⁸

¹⁰⁶ A review of default fund arrangements had been carried out but not reported on as this document was being written. Hence no related recommendations are included, but may be added to the final report to Government.

¹⁰⁷ See <http://bit.ly/FMA-KSreport2012>.

¹⁰⁸ See <http://bit.ly/IRD-KSwithdrawal-permanent>.



THE VAIOLA P.I. BUDGETING SERVICE

The Vaiola P.I. Budgeting Service Trust provides a free financial, budgeting and advocacy service to a wide range of clients. It is culturally tailored to serve its predominantly Pacific Island client group, though it does accept referrals from other ethnicities. Vaiola is experiencing an increasing number of requests for KiwiSaver withdrawals. The service recorded 33 withdrawal requests in the 2011-12 financial year, and received 50 from July 2012-May 2013. Referrals are often directly from the KiwiSaver provider, but none of this work is funded. The service estimates the workload to be 6-8 times greater than for preparation of an ordinary budget.

Hardship

Members who can provide evidence that they're suffering significant financial hardship may apply to Inland Revenue (within the first three months) or their provider (after the first three months) to withdraw some of their KiwiSaver savings.¹⁰⁹ In the year to 30 June 2012, 'Significant Financial Hardship' withdrawals totalled \$28.9 million or 0.2 per cent of total funds under management. The numbers of members involved in these withdrawals is very small in relation to total membership but a crude calculation based on median balances would suggest something in the order of a few thousands. Hardship might also be concentrated among some segments of the population, creating considerable pressure for the individuals concerned and for budget advice agencies to whom providers are in some cases transferring responsibility for counselling and advice on withdrawal procedures.

The Vaiola P.I. Budgeting Service made the following observations in its submission to this review: publicity, local knowledge and referrals are fuelling the demand for withdrawals. There are underlying social issues such as eviction, hardship, mortgagee sales, repossession, rent arrears, rates, loss of jobs or reduced hours and suicide.

There is concern about the appropriateness of accepting low-income clients and beneficiaries into KiwiSaver schemes when they are already under severe financial constraints. This could be addressed by budget assessment for those below a certain income rather than the automatic opt-in.

Housing

As noted on pages 76 to 79, New Zealand Superannuation is more likely to provide an adequate income for older New Zealanders where they own their own home without a mortgage. On this basis, it is appropriate for KiwiSaver to be used in support of home ownership, as long as overall affordability is not adversely affected.

Members who have been a member of the scheme for three or more years may apply to withdraw some or all of their KiwiSaver savings (except for the \$1,000 kick-start and member tax credit) to put towards buying their first home (and in certain circumstances, a subsequent home).¹¹⁰ Members earning less than an income cap may also qualify for a deposit subsidy of between \$3,000 and \$5,000 depending on years of contribution to the scheme.¹¹¹ Three evaluations of the KiwiSaver Home Ownership Package have been undertaken. One of these, a survey undertaken by the Department of Building and Housing in 2012 found that one of the key reasons people joined KiwiSaver was to use the home ownership package.

A report on uptake of the package produced by the Ministry of Business, Innovation and Employment in 2013¹¹² found that the proportion of residential sales drawing on First Home Deposit Subsidy (FDS) support increased from 0.1 per cent in July 2010 (the earliest that the facility could be used) to 5.3 per cent in December 2012. The amount withdrawn in the month of December 2012 equalled \$9.4 million, compared to \$143.5 million total payments made to providers in the same month.

As might be expected, people under 35 are the highest users of the First Home Withdrawal (FHW) and the FDS. Males had a slightly higher overall proportion of FHW use (52.7 per cent) than females (47.3 per cent). However, the number of withdrawals for females and males was very similar in the younger age groups.

¹¹⁰ See <http://bit.ly/IRD-KSwithdrawal-firsthome>.

¹¹¹ See <http://bit.ly/HNZC-KSfirsthome>.

¹¹² Ministry of Business, Innovation and Employment (2012) *An Evaluation of the Use and Experiences of the KiwiSaver Home Ownership Package*. Wellington, New Zealand.

¹⁰⁹ See <http://bit.ly/IRD-KShardship>.



There were 5,855 FDS recipients between July 2010 and December 2012, amounting to 0.3 per cent of the total number of KiwiSaver members at that later date. This may appear to be a small proportion but the number of people using the FHW and the FDS continues to grow. A dampening factor may emerge if rising house prices lead to a scarcity of suitable houses priced under the maximum cap that applies to the FDS.

Thus far, the First Ownership Package has probably had more impact on the housing market than on the KiwiSaver scheme itself. This may be also be true for the foreseeable future but with the proportion of funds withdrawn reaching more than five per cent of those contributed on a month-by-month basis, the package may come to have a significant impact on financial preparations for retirement.

Retirement

On 1 July 2012, the first KiwiSaver members who were 65 years of age and had been in the scheme for five years became eligible to withdraw their savings and investments. The Government has not mandated how or when KiwiSaver funds should be withdrawn at this stage, but an explicit term of reference for this review is to review patterns of withdrawal from KiwiSaver of those retiring and the issues that these patterns may raise.¹¹³

Inland Revenue commissioned a telephone survey with 1,000 KiwiSaver members who were eligible to withdraw their KiwiSaver savings for retirement purposes as at 31 December 2012. The full findings of the survey are contained in a report on the Inland Revenue website.¹¹⁴

Most members surveyed have relatively small KiwiSaver balances and the majority have less than \$100,000 in other savings and investments. Overall, the more KiwiSaver savings a member has, the more likely they are to have other savings and investments.

THESE FINDINGS COME WITH A CAVEAT THAT THE SURVEYED COHORT OF SAVERS HAS ONLY BEEN IN KIWISAVER FOR FIVE YEARS.

Future cohorts will differ in a number of ways including having more significant balances and viewing KiwiSaver as an increasingly important component of retirement income.

Table 18:
Value of KiwiSaver balances among members surveyed

Value	Total (1,000) %
Up to \$15,000	55%
Over \$15,000 and up to \$30,000	13%
More than \$30,000	8%

Source: Colmar Brunton

113 There is a slight discrepancy here. Those qualifying to withdraw their savings and investment from KiwiSaver are not necessarily retiring.

114 See <http://bit.ly/IRD-KSwithdrawal-members>.



Sixteen per cent of members do not have any other savings and investments, 36 per cent have up to \$100,000 and 42 per cent have more than \$100,000 in other savings and investments. Nearly three-quarters (73 per cent) of members believe their retirement income will be either adequate or more than adequate. Conversely, one quarter (25 per cent) believe it will be slightly inadequate, inadequate or totally inadequate.

A quarter of the surveyed population sees KiwiSaver as especially important for meeting their living costs in retirement.

In terms of withdrawal behaviour:

- About a third of the sample reported having withdrawn all of their KiwiSaver balances and over half reported not having withdrawn any. Few (seven per cent) had made a partial withdrawal
- Members with smaller balances were more likely to have made a full withdrawal

- Members with more other savings and investments were somewhat more likely not to have withdrawn any of their KiwiSaver balances
- Taking into account withdrawal behaviour that had already occurred at the time of the interview, as well as the stated intentions of those yet to withdraw their entire KiwiSaver savings, nearly three-quarters (72 per cent) of KiwiSaver members will have fully withdrawn their savings within the next five years
- Lump sums dominated past and planned withdrawals. Only four per cent of the total surveyed population were making or planned to make a partial withdrawal by means of getting regular payments

Drivers and intentions to use KiwiSaver savings are evenly spread across spending and re-investment, with some needing the savings to pay off other debt, as shown in Table 19.

Table 19:
Use of KiwiSaver savings

Withdrawal of KiwiSaver savings				
Use	Total surveyed (990) %	Total balance withdrawn (446) %	Some withdrawn (61) %	Nothing withdrawn (481) %
Put money into other saving or investments	58	69	30	56
Spent/spend the money	50	40	67	54
Use(d) money to pay off mortgage/debt	15	18	34	11
Did something else with money	4	3	6	4

Source: KiwiSaver early retirement withdrawal survey, May 2013

Note: Totals add to more than 100% because some respondents choose more than one option.

Those who want to re-invest their KiwiSaver savings are primarily doing so for a better return and to have better access to their money. Those who have spent or want to spend their savings cite travel or holidays as the most common item of desired expenditure, followed by home improvements or new housing, major purchases such as a car or boat, and health and medical expenses. Further down the list come everyday living expenses such as food and bills.

Around one in seven will use their KiwiSaver to pay off debt. Members with less than \$5,000, and members who have made a partial withdrawal, are the groups most likely to use their KiwiSaver savings to pay off debt (33 per cent and 34 per cent respectively).

It is early days and retiring balances are still small but on the face of it for some, KiwiSaver is facilitating extra consumption in the early years of eligibility to access savings and investments accrued through the scheme. In cases where balances are used to pay off debt, it might be argued that consumption is being brought forward to a time *before* access is possible. This would mirror the experience of Australia, where it has been found that many people are borrowing against a future Super Guarantee 'windfall' and arriving at retirement in debt.¹¹⁵

The New Zealand research report concludes that among KiwiSaver members at present, there appears to be a strong preference for lump sum withdrawals, with little appetite for regular withdrawals. (This might be regarded as a form of annuitisation – see the following discussion). However, the awareness of the regular withdrawal option was not measured.

Annuitisation

Although the research described above cannot project what will happen when KiwiSaver has matured in forty years' time, early indications of tendencies to spend lump sums rather than drawing down savings and investments over the course of members' retirements is a cause for concern. Certainly there is a risk that KiwiSaver

will not achieve its purpose for a significant number who will not be narrowing the long-term gap between their desired standard of living and what NZS can provide. NZS provides a degree of insurance against longevity risk, but KiwiSaver members who spend their balance soon after accessing it are likely to outlive a significant part of their income.

This prospect raises an important policy question – given that a significant part of most KiwiSaver members' savings has been contributed to from taxation (through the kick-start payment and the Member Tax Credit), to what extent should the Government *require* KiwiSaver members to fully or partially convert their balance at retirement to an annuity?

A lump sum can be exchanged for an annuity, which makes regular payments over time. The payments may be a fixed amount or adjusted on an agreed basis (e.g. to take inflation into account). Depending on the terms of the annuity, payments might continue until death or be paid for a fixed term only and have a lump sum component if death occurs prior to the end of the term. Because of the longer life expectancy of women, their annuities tend to be more expensive. (Gender-based ratings are permitted in insurance, although they have been prohibited in the European Union.)

For various reasons, the provision of annuities in New Zealand has been an unattractive proposition and there are almost no annuity products in this country. In their absence there have been many calls for government to facilitate the development of the annuities market.¹¹⁶ It has long been recognised that the absence of such a market will become a pressing problem as KiwiSaver balances grow. Some consideration of this situation is underway in both the private and public sectors, and the Ministry of Social Development has recently released a discussion paper¹¹⁷ that canvasses (among two other options) the establishment of a public annuity fund to accept contributions from eligible persons and pay annuities to them.

THERE IS A RISK THAT KIWISAVER WILL NOT ACHIEVE ITS PURPOSE FOR A SIGNIFICANT NUMBER WHO WILL NOT BE NARROWING THE LONG-TERM GAP BETWEEN THEIR DESIRED STANDARD OF LIVING AND WHAT NZS CAN PROVIDE.

TO WHAT EXTENT SHOULD THE GOVERNMENT REQUIRE KIWISAVER MEMBERS TO FULLY OR PARTIALLY CONVERT THEIR BALANCE AT RETIREMENT TO AN ANNUITY?

¹¹⁵ See 'Household Savings and Retirement: Where has all my super gone?' A report for CPA Australia.

¹¹⁶ For more on this topic, see <http://bit.ly/RPRC-decumulation>.
¹¹⁷ See <http://bit.ly/MSD-assuringretirementincome>.



An alternative line of thought is represented by the architect of KiwiSaver, Hon Dr Sir Michael Cullen¹¹⁸ who has proposed two alternatives for how accumulated balances could be used at retirement:

- Require people to annuitise half of their accumulated KiwiSaver balances on reaching the age of eligibility. The Government would then top up the annuities of those whose balances were not high enough to receive an annuity of the same value as New Zealand Superannuation, or
- Introduce a withdrawal tax on accumulated KiwiSaver savings when a saver reaches the age of eligibility to receive them. The additional revenue collected could be used to fund the future costs of NZS, perhaps even by being explicitly tagged to it.

The first option is essentially a version of switching to a private SAYGO model for funding NZS. It is highly 'regressive' because lower income earners would get very little return from their savings. The second option would change KiwiSaver from a TTE scheme (contributions and earnings taxed, draw-downs exempt) to TTT (all three phases taxed). Both would require enrolment in KiwiSaver to be made compulsory and each to some degree replaces income from NZS with income from KiwiSaver, rather than adding KiwiSaver to NZS as is currently the case.

These are drastic measures, and would represent a significant changing of the rules within which the current membership base has joined KiwiSaver. However, annuitisation of balances on retirement is the most obvious means by which KiwiSaver can be fully integrated with the overall retirement income framework. Given other disadvantages associated with compulsion, as already discussed, priority should rather be given to encouraging market responses, as growing balances make these more commercially viable, and fully exploring other ideas about annuitisation, for example the ideas contained in the Ministry of Social Development paper referenced above.

118 See <http://bit.ly/treasury-nz-longtermfiscalreport> (page 57).

KiwiSaver conclusions

There is no doubt that through its six years of remarkable growth, KiwiSaver has had a significant effect on New Zealand's retirement income landscape. There are however causes for concern about its effectiveness. The additional saving gained through the scheme is not as high as would be hoped, and likely to be insufficient for many individual members. The level of engagement of members is patchy and there is a case for changes in the way providers communicate with members,¹¹⁹ and more investment in financial education. Early uses to which savings and investment are put at the age of 65 reinforce a need to monitor whether KiwiSaver is actually reaching its target group and ultimately achieving its legislated purpose. The lack of annuity products is emerging as a potential problem, although not one of crisis proportions. To some extent, these issues will resolve themselves as balances grow and a normal market response occurs. Some people will also continue to manage their own savings and investments in retirement, possibly by 'self annuitising' – systematically running down their balances. However there remains a membership segment (and a large group of non-members) for which a passive policy approach may be inadequate.

Although KiwiSaver has contributed to women's retirement income prospects through its greater accessibility and flexibility, and significantly changed the wider superannuation landscape toward one that is more gender neutral¹²⁰ too much dependence on the scheme will disadvantage low lifetime earners, who are disproportionately female. This review recommends an additional intervention to help bring about equitable outcomes.

A recurring issue preventing better assessment of KiwiSaver's effectiveness and consequent policy development is that there are major gaps in information and data about the scheme. Ideally, it should be possible to aggregate the value of individual accounts by gender, age and other factors such as employment status. This type of data could theoretically be obtained through sampling the tax records of individuals,

119 See <http://bit.ly/IRD-KWithdrawal-providers>.

120 See <http://bit.ly/cflri-genderneutralitysuperannuation2012>.

as all KiwiSaver schemes must file a return for individual members.

However, access to this data is governed by the Tax Administration Act and there is considerable reliance on KiwiSaver providers supplying information about their schemes. Transparency would be better supported by deep and wide analysis of information held by the FMA and of other membership data within schemes. Data on the characteristics of KiwiSavers compared with the rest of the population (such as ethnicity) and gender effects may also be obtainable from analysis of data from the Survey of Family Income and Expenditure (SoFIE) which was not available at the time this document was being written.

Recommendations

- That the age of access to KiwiSaver balances be kept at 65*
- That as soon as fiscally prudent, an auto-enrolment day be held for employees who are not currently members of KiwiSaver, with retention of the right to opt out
- That the Government establish a joint working party, chaired by the Retirement Commissioner or her nominee and comprising public and private sector representatives, to identify gaps in the available data on KiwiSaver and ways in which those gaps can be filled, and to report by 1 December 2014
- That the Government agrees to the Retirement Commissioner convening a broadly representative review to determine the viability of different approaches to the voluntary annuitisation of savings including KiwiSaver balances on retirement
- That the Ministry of Business, Innovation and Employment report to the Government by 30 June 2014 on means to fairly maintain the employee contributions of KiwiSaver members while they are on parental leave

* This recommendation arises from the discussion on 'Schedule and Review' on page 43.

Other strategies people can use

Housing

As discussed in previous sections, the close links between home ownership and older people's standards of living have important implications for New Zealand's retirement income policy.¹²¹

Home ownership – especially when it's mortgage free – offers a number of benefits, most notably through its long-term lifestyle and use advantages over rental housing. It also has a key role in ensuring that retirement incomes deliver acceptable living standards, and in enabling New Zealand to manage the economic and social costs of age-related health and other services.

However, younger people are now finding it increasingly difficult to buy their first homes. The challenge is to ensure that New Zealand's retirement income policy meets the needs of today's older people, while also enabling the next generation to access appropriate homes and incomes in their own retirement. This highlights the relevance of retirement income policy across all life stages, not only at older ages.

An evolution in home ownership

Historically – and up until the 1980s – most New Zealand households had quite orderly 'housing careers' in which they transitioned from living in parental households to a period of rental housing, followed by owner-occupation and, for some, moving into rest homes or aged-care facilities. Through this model, many of our current older people accumulated substantial housing assets, with most able to pay off their mortgages by the time they retired.

In 1987, 72.7 per cent of all households in New Zealand lived in owner-occupied dwellings; by 2006 this had fallen to 66.9 per cent.¹²²

**THIS HIGHLIGHTS
THE RELEVANCE OF
RETIREMENT INCOME
POLICY ACROSS
ALL LIFE STAGES,
NOT ONLY AT
OLDER AGES.**

¹²¹ For fuller discussion, see the background paper prepared for this review at <http://bit.ly/cflri-2013review-housing>.

¹²² Statistics New Zealand, New Zealand Census 1916-2006.



However, the older people of today still have high rates of home ownership. In 2006, 81.2 per cent of households with an older head of house (65-79 years) were in owner occupied dwellings.

The impacts of home ownership on retirement income and standards of living

Changes in family structures and other social factors mean that the traditional housing career is less prevalent. Today, rising house prices and high home ownership rates among older people mean that those in and nearing retirement are wealthier than other population groups. They may be highly dependent on New Zealand Superannuation and generally earning low incomes, but almost 70 per cent¹²³ of them are mortgage-free.

This situation has fuelled the idea that older New Zealanders can supplement their retirement incomes by liquidating (or 'trading down') at least some of their housing assets. However, a raft of research shows that older people who own their homes free of debt enjoy a number of other benefits, including:

- They're generally more satisfied with life, and can stretch their New Zealand Superannuation further because they spend less on housing and utilities
- Most retain their independence for much, if not all, their old age, so their housing assets are valuable in giving them a home (amenity or use value)
- Owner-occupied dwellings are typically more attractive, more comfortable and in better condition than rental properties, and provide people with better security of tenure and better connections with their communities. This in turn can reduce significantly the health and service costs associated with ageing populations

The viability of 'trading down'

This 'use value' of a home brings into question the option of trading down, and is also questionable in terms of both practicality and effectiveness.

Trading down happens in two main ways:

1. Equity release, in which a property's equity is converted to income through financial instruments such as reverse mortgages. Equity release enables older people to continue living in and enjoying their homes for the agreed mortgage terms.
2. 'Downsizing', which usually means:
 - Moving from a larger house to a smaller one, or
 - Moving from owner-occupation to another kind of tenure, such as rental housing, a licence to occupy,¹²⁴ boarding or living with adult children, or
 - Moving to a lower-priced location, or to a dwelling of a lower standard or condition

Equity release

Internationally, equity release has been shown to have real limitations as a long-term income supplement. Instead, it's more usefully applied as a line-of-credit mechanism for significant household expenditure, such as renovations and essential repairs.

Equity release has a number of risks. For example, older people taking up reverse equity options may find that:

- They don't get enough income to meet their needs
- They have a limited ability to downsize, move to other homes or modify their homes
- They outlive their capital
- The relatively high interest rates they pay affect them and their ability to leave assets to their children

¹²³ Koopman-Boyden and Waldegrave, 2009: p. 103.

¹²⁴ The majority of registered retirement villages in New Zealand offer a licence to occupy. This gives you the right to live in the unit, without ownership rights. It usually means you can't borrow against the value of your unit, though some villages may offer this option (from Building and Housing website, dbh.govt.nz/thinking-living-retirement-village).

- They're unprepared for the unexpected. For example, loan caps and, for some, unexpectedly low property valuations can diminish the equity accessible in housing assets, while external events (such as finance company collapses, regional declines, natural disasters and 'leaky buildings') can rapidly reduce their property values and affect their insurance cover and premiums
- There might be some unforeseen 'gaps' – just as there were for retirement village residents in Canterbury, between the insurance cover they thought they had and what the insurance industry and some retirement villages delivered

In addition, equity release products demand high levels of financial literacy.

Downsizing

Downsizing too has its risks, with negative effects including:

- Higher entry rates to rest home and other higher-dependency environments
- Issues arising from insecure tenure in rental housing
- The cost and connectivity problems associated with moving to lower-priced housing in newly developed or other areas poorly served by public transport and under-served by service, retail and recreational centres
- The health-related costs associated with poorer housing
- Issues arising from reduced inter-generational transfers within families

Those downsizing might find that:

- Their house sales don't release enough equity to generate a supplementary income stream (this depends to a large extent on there being a housing market that delivers buyers who are willing and able to pay)
 - Their expenditure doesn't reduce or, at least, their disposable income doesn't increase
- The smaller houses available to buy at the prices they're prepared to pay have comfort issues, need modifications to be accessible or are sited on large, unmanageable sections. They may also be in less desirable forms (e.g. multi-unit instead of detached), in less desirable locations, and of different tenure types (e.g. rentals)
 - Apartments and multi-units are poorly designed or of poor quality, have complicated management and cost structures that are difficult to understand, and associated fees and unbudgeted expenses that can create very real difficulties
 - Choosing to rent leads to a decline in living standards, with properties in poor condition and rental agreements that prevent property modifications to ensure access and mobility, which can in turn reduce their ability to age securely and safely in place
 - They can no longer access government support such as the Accommodation Supplement and the Rates Rebate Scheme, which helps eligible owner-occupiers if council rates become unaffordable
 - They can't access social housing units, which in the medium term are likely to be in short supply relative to the forecast demand
 - They lose some important social and economic relationships and connections

Retirement villages offer age-appropriate accommodation for many, but bring additional challenges. For example:

- They include a requirement to pay retirement village fees and fund various types of insurance
- Older people often find it difficult to understand the law, and their rights, in relation to retirement homes
- As illustrated in post-quake Canterbury, there could be issues with tenure security and insurance cover in the context of natural adverse events and the financial sustainability of some retirement villages



WELL-DESIGNED HOUSES IN WELL-DESIGNED SETTLEMENTS

Age Concern urges us to begin building 'well-designed houses in well-designed settlements where people of all ages can interact with and support one another' – adding that:

- *'Safer, better-quality homes would increase our chances of ageing in good health and reduce costs associated with home maintenance and the provision of home support*
- *A wider range of age-friendly, affordable housing options would make it easier for older people on limited incomes to be housed safely and with dignity'*

As well as advocating more age-friendly rental housing, the organisation suggests exploring alternative housing forms such as cooperatives, shared ownership, shared living, supervised units, re-locatable housing units and intergenerational living. It also suggests strategies to make home maintenance more affordable and manageable for vulnerable homeowners.

NEW ZEALAND IS LEADING THE TREND TO LONGER WORKING LIVES.

Implications for the future

In the future, it's likely that fewer people will start their retirement with housing assets. This will affect their prospects for equity release later in retirement, as well as their lifestyles and the ability to enjoy the reduced expenditure associated with debt-free home ownership.

It's unlikely that trading down will be a solution for more than a minority – and there remains the issue of the increasing number of older people who have no housing assets at all. These will have implications for the outcomes achieved by New Zealand's retirement income framework.

Solutions for the future

The challenge for the future is not just about finding ways to release some of the equity that older people have in their homes. It's also about ensuring that younger households can build the equity and savings they need to access all the other benefits associated with accumulating housing assets.

There are other ways of relieving the fiscal consequences of ageing populations. Instead of focusing on the liquidation and consumption of housing wealth, policies can aim to improve the 'use value' and functionality of housing itself by ensuring a good fit between households and the dwellings and localities in which older people live.

This means having a range of housing stock that includes functional, resilient and cost-effective dwellings in the lower-value segments of the housing market – and in places that are well serviced and connected to avoid the care costs associated with ageing. This will help to:

- Reduce the costs of in-home support for people with age-related disabilities
- Increase safety and ensure that older people avoid injury
- Reduce the probability of requiring residential care

We also need to ensure that retirement income policy helps enable a future of affordable housing access for younger households, which includes facilitating the intergenerational use of housing equity to sustain access to affordable and secure housing.

Recommendation:

- **That the Ministry of Business, Innovation and Employment report by 1 December 2014 on creative ways to increase the supply of age-friendly housing**

Continued employment

Another strategy for older people to ensure adequate income and savings is to continue working.¹²⁵

New Zealand is one of a handful of OECD countries leading the trend to longer working lives, and is significantly ahead of Australia, Canada, the United Kingdom, the United States and the OECD average. Māori aged 65-plus are more likely to be in the workforce than those of European ethnicity, and both are more likely than Pacific peoples, Asian or 'Other'. It should also be noted that there's no such thing as 'retirement' for many older Māori and Pacific peoples. Moves from the paid workforce tend to lead to an increase in whānau, marae and church-based volunteer work.

Older people's high employment rates are remarkable given the depressed New Zealand and global economic climate since 2008. However, they may reflect a 'need' to keep working to manage increased living costs and/or to recover savings lost owing to the collapse of finance companies. Whatever the reason, they suggest that further large increases may be more difficult to achieve.

The situation may be quite different for the younger generation. Given longer working lives and expectations of more time being spent in retirement, more New Zealanders may opt in to KiwiSaver and other private superannuation schemes. This in turn will affect their decisions on retirement, including decisions to retire earlier rather than later.

¹²⁵ For fuller discussion and references, see the background paper prepared for this review at <http://bit.ly/cflri-2013review-olderworkers>.

The attraction of part-time work

Part-time work has become an increasingly popular option for older people, and increasingly available too. Between 1986 and 2006, part-time work made the largest contribution (56 per cent) to the overall growth in employment for those aged 65-plus.

This trend was especially pronounced for women, with the number aged 65-plus working part-time increasing from 3,000 (slightly more than the number working full-time) to 20,000. At the 2006 Census, two-thirds of working women aged 65-plus worked part-time compared with two-fifths of working older men. Perhaps influencing this, part-time work is more common in the occupations and industries in which women tend to work, such as healthcare, education, professional and scientific services, and retail.¹²⁶

Studies have shown that part-time and temporary or seasonal work increases with age, with older workers having a strong preference for such jobs. Older New Zealand workers also have a much higher rate of self-employment than prime-aged workers, and are somewhat more likely not to employ others.

Prospects for the future labour market

The extent to which the recent trends will be sustained or increase further depends on a number of factors, of which many are outside people's control, such as changes in labour demand, industrial and technological change and the changing nature of work.

While New Zealand has very high rates of workforce participation compared with the rest of the OECD, productivity is low overall, indicating that more skills are needed. However, the need to be skilled – and regularly re-skilled – is likely to generate particular challenges for older workers, with many finding it difficult to access the necessary training. This can be due to workplace factors such as discrimination as well as the financial costs of training.

¹²⁶ It's worth noting that demand for these services will almost certainly increase with population ageing, but there'll be relatively fewer workers to deliver them. That means greater competition for labour from other industries—and countries.

Intergenerational equity

From time to time an argument is made that encouraging older people to continue working is not fair because in doing so they take jobs that would otherwise go to younger workers. This is what economists call the 'lump of labour' theory – that there are a fixed number of jobs allocated on a zero-sum basis, i.e. if someone gets a job then someone else misses out. In fact, the more people there are working, the more the economy grows and the more new jobs are created. While it might be feasible in some industries for a new young worker to directly swap into the job of someone older, in most cases skills are not directly substitutable. It is more common for the skills of older and younger workers to complement each other in increasing productivity. There is no evidence for the lump of labour theory, but there is research that disproves it.¹²⁷ There are no grounds to prevent increased workforce participation of older New Zealanders, but as outlined in this document, there are many reasons why it should be encouraged.

Implications for retirement income and savings

In theory, longer working lives should enable older people to earn more, save more and accumulate more wealth for their eventual retirement. However, the ability to save can be limited – particularly for women – given the preponderance of part-time work and low-pay-scale occupations. In addition, any income gains in older age could be diminished by people's personal and household circumstances, which could lead to a reliance on New Zealand Superannuation.

¹²⁷ See for example <http://bit.ly/IMF-earlyretirementeffects>.

THERE ARE NO GROUNDS TO PREVENT INCREASED WORKFORCE PARTICIPATION OF OLDER NEW ZEALANDERS, BUT MANY REASONS WHY IT SHOULD BE ENCOURAGED.



Enablers of and barriers to workforce participation

A wide range of factors influences older people's decisions to withdraw from or stay in the workforce. They can be both barriers and enablers to participation; for example, while poor health is a barrier and good health an enabler, good health may reflect a higher income and a greater capacity to retire early.

The key factors that enable older people to continue working are:

- The strength of the demand for labour
- The availability of part-time work
- Employers' flexibility in accommodating older workers' needs, interests and competing demands
- Key features of NZS, which simultaneously discourage early withdrawal from the workforce and reward those who continue to work beyond the age of eligibility

Working against these factors are eight barriers:

- Poor or deteriorating health
- Caregiving responsibilities, such as nursing a partner in poor health, looking after grandchildren (which in many cases enables their parents to work) and caring for older family members
- A mismatch between skills and the demand for those skills
- An apparent lack of timely discussions between employers and their employees' about their retirement intentions
- The financial ability to retire
- The desire to retire
- Discriminatory attitudes and practices
- A lack of employer knowledge about the implications of population ageing

The importance of good health - and money

In a 2006 EEO Trust survey, 75 per cent of those surveyed and still in work mentioned health as a factor that would significantly affect their retirement decisions. In another study, participants ranked second the health of others, highlighting the conflict between caregiving and paid employment, which can result in the (involuntary) retirement of the healthier person.

Good health is strongly associated with a longer working life, and poor or deteriorating health is associated with early retirement. However, there are some arguments that poor health can result in increased living costs, which increases the probability of working longer. Early withdrawal from the workforce has also been associated with deteriorating health, making a return to the workforce more difficult.

Policies and practices that improve the health of older people should, therefore, enable greater workforce participation. However, a number of other factors are at play, including older people's financial situations, in which NZS has a major role.

On becoming eligible for NZS, the workforce participation rate for men aged 65-plus drops by around 21 percentage points, and for women by around 7 percentage points. Women experience an additional (typically 'joint retirement') effect a few years before they reach age 65, which lowers the participation rate by a further 11 percentage points.

That said, NZS has three unique features that encourage workforce participation up to and beyond the age of 65, and that may explain New Zealand's internationally high participation rates:

- You can't opt to receive NZS any earlier than age 65
- You don't have to be retired to get it
- NZS isn't subject to any income or means testing

These factors give people considerable flexibility in making the transition from work to retirement – especially those who don't have enough retirement savings and/or who wish to top up their retirement income.

New Zealand's income replacement rate (the rate at which NZS replaces earnings) also influences participation levels. This rate is low relative to workforce earnings especially for higher income earners, and declines as income increases, more rapidly in New Zealand than in other countries, including Australia.

This presents two very different possible scenarios:

- Low-income workers have less to lose than higher-income earners by withdrawing from the workforce at an earlier age (the low replacement rate becomes a barrier to longer workforce participation), while high-income earners may be more interested in staying in the workforce than low-income earners (the replacement rate becomes a potential enabler for those on higher incomes)
- Higher-income earners may seek to top up their retirement income with private funds accumulated during their prime working ages, such as KiwiSaver balances. This could enable early retirement or periods out of the workforce, resulting in a decline, rather than a further increase, in workforce participation at older ages

These propositions are supported by studies showing that working Māori expect to have higher living standards in retirement, reflecting the fact that, for many on low wages, moving to NZS constitutes a rise in real income.

It's important to be aware that unemployment and disability benefits can also act as de facto early-retirement schemes. Certainly unemployment at older ages is associated with high levels of involuntary retirement, most notably owing to people failing to find work.

The role of workplace conditions

Flexible working conditions have considerable appeal for older people – which could explain the increasing popularity of part-time jobs, even when it means they earn less than they would working full-time. These jobs enable them to manage multi-level family demands and participate in volunteering roles, while also enjoying longer working lives – which in turn can be a crucial determinant of their health and psychological wellbeing.

Studies have shown that people's decisions on whether to stay at or leave a job are influenced by:

- Job satisfaction, job control (autonomy, including over the decision to retire) and social cohesion at work
- The job demands – repetitive and low-paid roles are unsuitable
- The ability to 'transition to retirement' according to plans discussed and developed early on with their employers – or alternatively, if they are encouraged by their employers to stay on as valued employees

Many older people find it difficult to transfer their skills and experience to new jobs – so if they lose their jobs they're more at risk of being long-term unemployed or leaving the job market altogether. This highlights the value of offering retraining opportunities to older people looking for work.

The effects of discrimination

There's considerable evidence that, despite widespread legislation banning age discrimination, discriminatory attitudes and practices continue to affect the demand for older workers.

Older employees can be stereotyped as resistant to change and costing too much, and there is evidence that older workers are less likely to be offered job interviews than younger workers with the same objective characteristics. In addition:

- Some older workers receive less pay than younger colleagues for what appears to be the same work



- Older 'more experienced/expensive' workers are more likely to be made redundant while younger/cheaper workers are retained
- Employers are generally unwilling to upskill or retrain older workers

However, age discrimination is expected to reduce through economic necessity: a 2008 survey of New Zealand recruitment consultants showed some improvement in attitudes towards older workers, and there are a growing number of examples of older workers being specifically sought out by entrepreneurial businesses. Employers are also beginning to see the benefits of retaining older workers, but there's still a considerable way to go.

Options for increasing older people's participation in the workforce

In the context of already high participation rates at older ages, and indications that more older New Zealanders would readily work if suitable jobs were available, it seems appropriate to focus policy decisions less on individual inducements and pension reform and more on dismantling the institutional and structural barriers to participation.

The main options for doing this include:

- Educating employers about the realities of population ageing (increasing competition for employees and a likely rise in labour costs) and the value of having older employees
- Resolving the unmet need for part-time work and flexible working conditions
- Providing skill development and employment services that meet both employers' and older people's training needs and identify the sectors more likely to hire older people
- Providing more work opportunities that recognise older people's changing capabilities and aim to minimise the risks of injury
- Providing older people with encouragement and incentives to work longer
- Targeting interventions to different income levels and/or occupational groups to match people's retirement patterns
- Further reducing employers' discriminatory attitudes and practices

New Zealand could also look to overseas models, such as Europe's:

- 'Work-Ability Index' – a self-assessment tool that aims to identify, as early as possible, people's perceived health risks, the risk of premature retirement, organisational constraints to longer and safer working lives, and possible actions and strategies to counteract these risks and impediments
- 'Age Management Planning', which involves reviewing and revising workplace policies and practices (underpinned by legislation that requires discussions of retirement plans with all age groups), providing incentives for older workers, such as additional work breaks and increased training opportunities, assistance with matching skills with demand, and identifying employees' ability to undertake specific tasks

It's important to note the role of NZS in enabling higher participation rates at older ages. This positive situation could be reversed if the regime were altered without a proper consideration of the wide range of complex and interlinking factors that have a key influence on older people's work and retirement decisions and work participation rates.

Recommendation:

- **That the Ministry of Business, Innovation and Employment work with employers, industry associations and unions to implement ways to encourage the recruitment, retention, retraining and mobility between jobs of older workers, and report back on progress by 1 December 2014**

Financial Literacy and Retirement Income Policy

As noted in Section One, there is an international trend towards more responsibility for retirement income being passed from states and corporations to individuals. Along with this increased responsibility come increased levels of risk for the individuals concerned. If those individuals refuse or are unable to accept new responsibilities, their risks of poor outcomes in retirement become even greater. Public pensions exist to address these risks, but are coming under more and more pressure. In most countries, a new balance is being struck between public and private funding of retirement income.

From a public policy perspective, there is a range of responses available to help New Zealanders to save for their own retirement. At one end of the continuum, governments can make saving compulsory, as discussed on page 70. However, it seems contradictory for the state to pass over responsibility to individuals and simultaneously remove their right to exercise that responsibility. Compulsion transfers only risks, some of which might be better borne collectively.¹²⁸ The rationale for such change becomes weaker under a compulsory system.

Alternatively, Governments can provide incentives or 'soft compulsion' to save. This preserves an element of individual choice and responsibility, but involves cost to the public purse, either through direct subsidy or revenue foregone. This cost can be significant – it has been calculated that by 2015–16 the annual cost of taxpayer contributions for private superannuation in Australia will exceed the annual cost of the pension.¹²⁹ The New Zealand Government has spent more than \$4.4 billion on KiwiSaver since its inception.

A third option is for individual saving for retirement to be entirely voluntary, with measures in place to ensure that people are financially competent and plan to suit their own circumstances and aspirations.

The gamut of options from compulsion to a purely voluntary system is associated with increasing investment in financial information, education and advice and greater levels of financial literacy as key elements of retirement income policy.¹³⁰ If the suite of recommendations arising from this review of retirement income policy is accepted, they point to an increased need for individuals to take more responsibility for their own financial futures, and for consequent increases in levels of financial literacy.

The case for Financial Literacy

Research commissioned for this review¹³¹ provides evidence that successful retirement planning depends strongly on an individual's level of financial literacy, of which the ability to plan is an important part.

Several studies in different countries have found that people who plan for retirement accumulate more retirement savings. However, until recently these studies have not been able to prove that retirement planning *causes* higher household wealth. It may be instead that possessing higher levels of wealth causes individuals to plan more for their retirement. Research by Lusardi and Mitchell¹³² and van Rooij, Lusardi, and Alessie¹³³ has addressed this important issue and found that the direction of causality goes from retirement planning to wealth accumulation, rather than from amassing wealth to financial planning.

THERE IS AN INTERNATIONAL TREND TOWARDS MORE RESPONSIBILITY FOR RETIREMENT INCOME BEING PASSED FROM STATES AND CORPORATIONS TO INDIVIDUALS.

INVESTMENT IN GREATER LEVELS OF FINANCIAL LITERACY IS A KEY ELEMENT OF RETIREMENT INCOME POLICY.

130 A fourth option, to have a purely voluntary system with no other measures being employed, virtually eliminates any role for public policy and is not considered here.

131 For fuller discussion, see the background paper prepared for this review at <http://bit.ly/cflri-2013review-caseforinlit>.

132 Lusardi, A. and Mitchell, O. S. (2007). Baby Boomers' Retirement Security: The Role of Planning, Financial Literacy and Housing Wealth. *Journal of Monetary Economics* 54: 205–224.

133 Van Rooij, M, Lusardi, A. and Alessie, R. (2012). Financial Literacy, Retirement Planning, and Household Wealth. *Economic Journal* 122: 449–478.

128 Although compulsion might still involve political risk if there is a perception that the Government guarantees savings.

129 See <http://bit.ly/AusInst-selffundedretirement>.



THE COMMISSION FOR FINANCIAL LITERACY AND RETIREMENT INCOME USES THE OECD DEFINITION OF FINANCIAL LITERACY

The knowledge and understanding of financial concepts and risks, and the skills, motivation and confidence to apply such knowledge and understanding in order to make effective decisions across a range of financial contexts, to improve the financial wellbeing of individuals and society, and to enable participation in economic life.

Financial Education and Financial Literacy, and the relationship between them, are quite complex. For more information see the Commission's website at cflri.org.nz/financial-literacy.

Unfortunately, and 'notwithstanding changes in the retirement landscape and increases in individual responsibility for retirement income... research also reports that the majority of workers in an international comparison of financial literacy does little or no planning for retirement'. This failure to plan is concentrated among specific population subgroups, including respondents with low education levels, minority ethnic groups, and women. These groups are less likely to save for retirement than the general population, leaving them potentially more vulnerable in retirement. For women, the problem is especially worrying because of their longer life spans and barriers to accumulating retirement savings as discussed on page 59.

However, in most countries 'people who are more financially literate tend to plan for retirement, regardless of economic characteristics and circumstances. This result is remarkably consistent, holding across countries regardless of differences in pension schemes, pension privatisation, and pension system generosity'. In other words, anyone and everyone can benefit from being more financially literate.

The financial behaviour of older adults has not yet been adequately studied, but it is also likely that financial literacy will assume greater importance for people who are retired, particularly as life spans increase and the need to manage private retirement savings grows.

In addition to failure to plan, low levels of other elements of financial literacy may detrimentally affect behaviour linked to personal finances. For example, individuals with a poor grasp of interest compounding may engage in high-cost credit card borrowing, pay high fees when using financial services or be more likely to enter into high-cost transactions, incurring high fees and problems with debt. All of these factors may lead to sub-optimal financial outcomes in retirement.

Delivering financial education

How then should financial literacy be increased? There are many organisations in New Zealand delivering financial education through schools, tertiary institutions, workplaces and the wider community. It is well recognised that the most effective education happens when the subject matter is targeted to the learner's immediate situation or life stage; for example being employed for the first time, getting a student loan, buying a house, forming a family etc. There is also a need for further and more formalised investor education programmes.¹³⁴

In the case of saving for retirement, which is increasingly being linked to KiwiSaver contributions from salary and wages, there is a strong argument for targeting financial education through the workplace – either by employers (in the case of large firms) or by independent agencies (in the case of small to medium enterprises). The Commission for Financial Literacy and Retirement Income aims to build this independent capability for financial education through a number of programmes.¹³⁵

THE MOST EFFECTIVE EDUCATION HAPPENS WHEN THE SUBJECT MATTER IS TARGETED TO THE LEARNER'S IMMEDIATE SITUATION OR LIFE STAGE.

¹³⁴ See <http://bit.ly/oconnell-finlit2009> and <http://bit.ly/cflri-chartingacourse>.

¹³⁵ See <http://bit.ly/cflri-finlit-edproviders>.

Financial advice

Another way of enabling people to plan effectively for their retirement is through the provision of financial advice. The 2013 Financial Knowledge and Behaviour Survey shows that the most common source of financial advice for New Zealanders is banks, followed by relatives and friends (who may be well-meaning but are not always ideal sources of advice) (see Figure 11). Financial advisers are identified as sources by only one in six respondents. The type of advice received from various sources is not known, and some further research in this area is needed.¹³⁶

New Zealanders who want a personal financial plan can consult an AFA or Authorised Financial Adviser, who has been authorised by the Financial Markets Authority and can make recommendations on more complex products such as investments. There is an under-supply of AFAs¹³⁷ – around 1,950 – in comparison to potential demand for their services. In addition,

some AFAs do not work with individuals whose net worth is insufficient to sustain a viable commercial relationship. There is a bigger population of RFAs or Registered Financial Advisers, but they can only give advice on simpler products like insurance, bank term deposits and mortgages.

Research shows that New Zealanders are still unsure of how to identify a good adviser from a bad one, what each group of advisers can advise on, and are still reluctant to pay for advice. The FMA, the Commission and the private sector are all working to deliver information via events, brochures and websites on where to go and what to ask when seeking advice. There is also a collective push to communicate the real value of advice, and the impact of not seeking advice, acknowledging the misinformation that can circulate amongst family and friends and the importance of investment decisions in our long-term financial wellbeing.

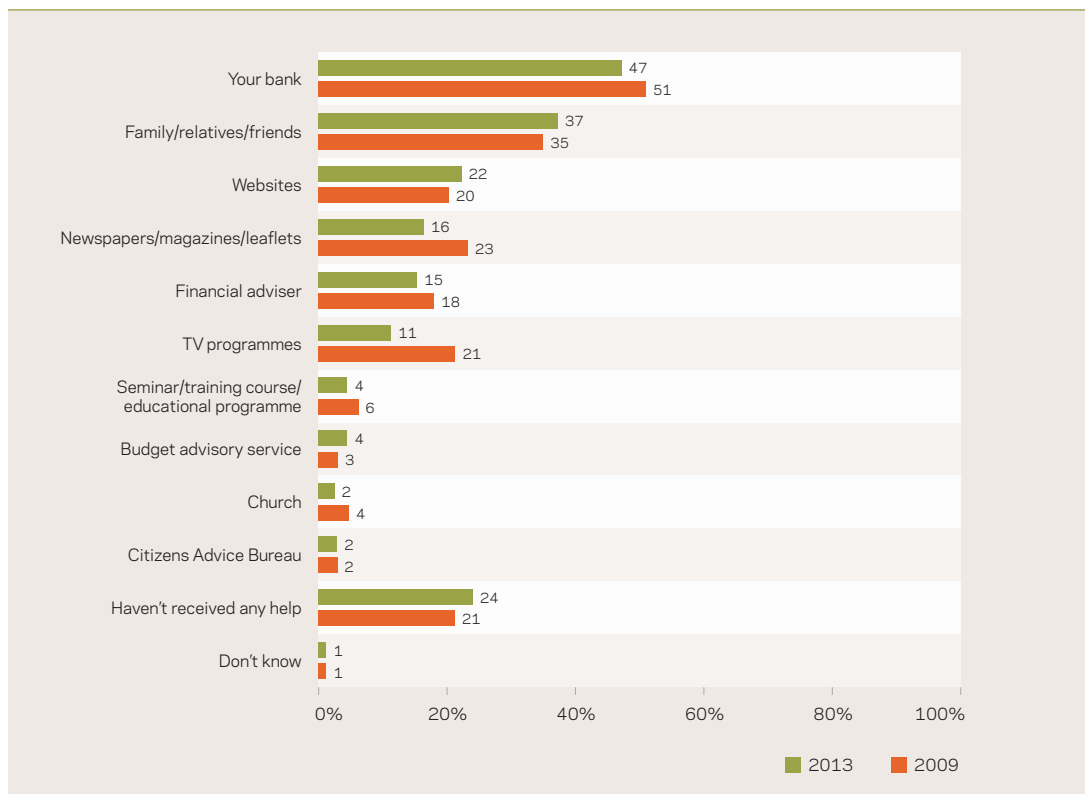


Figure 11:
Sources of advice

Source: 2013 ANZ/Commission for Financial Literacy and Retirement Income Financial Knowledge and Behaviour Survey

Base: All respondents (n 2009=850, 2013=852)

¹³⁶ Financial Advisers Act 2008 Section 10
¹³⁷ There is also a category of Qualifying Financial Entities whose staff are authorised to provide advice on a restricted range of products.



Disseminating financial information

To drive financial literacy and help the public make more informed decisions, general financial information is increasingly being made available through the internet. While branded information is typically provided by the financial services sector, the Sorted programme (sorted.org.nz) provides all New Zealanders with access to free, independent and impartial information and tools. Currently, the Sorted programme of activity includes:

- Interactive tools, including calculators, planners and quizzes
- Online guides, according to subject or life event
- Printed collateral, particularly booklets and posters
- Seminar material and facilitators
- Promotion including advertising, public relations and social media activity
- 'Think, Shrink and Grow,' a memorable framework for personal finance management

A National Strategy for Financial Literacy

From 2008, diverse elements in the field of financial literacy in New Zealand were brought together within a national strategy, guided by a national advisory committee. In early 2013, the advisory committee commissioned a review of the national strategy, which was underway at the time this document was being written. It is essential that the new national strategy be integrated with retirement income policy. The Commission for Financial Literacy and Retirement Income takes responsibility for driving this integration process in collaboration with consortia of other interested parties, but to do this more effectively needs a specific mandate from the Government analogous to the legislative mandate for reviewing retirement income policy.

Recommendation:

- **That the Government provide the Commission for Financial Literacy and Retirement Income with an explicit mandate to lead the provision of financial education and advice to New Zealanders**





Section Four **Future Directions**

This section provides a summary list of recommendations from Section Three.

Future Directions

Recommendations

Keeping New Zealand Superannuation fair and affordable

1. That the proportion of life over the age of 20 in receipt of New Zealand Superannuation be kept at a minimum of 32 per cent.
2. That the Government establish, by 30 June 2017, a schedule and review process for New Zealand Superannuation, guided by the principles outlined in this document.
3. That a new method of indexation of New Zealand Superannuation, based on the average of percentage change in consumer prices and earnings but no less than price inflation in any year, be introduced from 2023 subject to an adequate proportion of fiscal savings being applied to:
 - a. measuring the impacts of the change on the living standards and wellbeing of older New Zealanders, and
 - b. maintaining the real living standards of less-well-off older New Zealanders at the same levels as provided by the current system of indexation.



KiwiSaver

4. That the age of access to KiwiSaver balances be kept at 65.
5. That as soon as fiscally prudent, an auto-enrolment day be held for employees who are not currently members of KiwiSaver, with retention of the right to opt out.
6. That the Government establish a joint working party, chaired by the Retirement Commissioner or her nominee and comprising public and private sector representatives, to identify gaps in the available data on KiwiSaver and ways in which those gaps can be filled, and to report by 1 December 2014.
7. That the Government agrees to the Retirement Commissioner convening a broadly representative review to determine the viability of different approaches to the voluntary annuitisation of savings including KiwiSaver balances on retirement.
8. That the Ministry of Business, Innovation and Employment report to the Government by 30 June 2014 on means to fairly maintain the employee contributions of KiwiSaver members while they are on parental leave.

Financial Literacy

9. That the Government provide the Commission for Financial Literacy and Retirement Income with an explicit mandate to lead the provision of financial education and advice to New Zealanders.

Taxation

10. That in line with a recommendation of the Savings Working Group, the Government remove tax on the inflation component of interest on simple savings products such as bank deposits and bonds.

Housing

11. That the Ministry of Business, Innovation and Employment report by 1 December 2014 on creative ways to increase the supply of age-friendly housing.

Age-friendly workplaces

12. That the Ministry of Business, Innovation and Employment work with employers, industry associations and unions to implement ways to encourage the recruitment, retention, retraining and mobility between jobs of older workers, and report back on progress by 1 December 2014.

International pensions

13. That an individual's overseas state pension entitlements should be directly deducted against their own individual entitlement to New Zealand Superannuation, and that any excess should not then be offset against the individual entitlement of their partner.
14. That the Ministry of Social Development improve information and advice for recent and prospective migrants and returning New Zealanders on the implications of the direct deductions policy for their future retirement income.
15. That the Ministry of Social Development improve the public availability of decisions on the classification of overseas pension schemes whose pension payouts are subject to the direct deduction policy.
16. That the Ministry of Social Development explain the rationale behind each international pension scheme classification.





Appendix One: The residence test for NZS and the direct deduction policy

This appendix does not attempt to cover all the areas and policy issues to do with the interface between New Zealand's social welfare system and other countries' pension arrangements. It sets out to describe, as simply as possible, the part of New Zealand's system that is a particular matter of concern in this Review and the reasoning behind it.

Residence test

When someone moves to reside in New Zealand having spent some of their adult life living abroad (including people who were born in New Zealand), an issue arises regarding their possible eligibility to NZS. New Zealand operates a basically simple 'all or nothing' eligibility test. To be eligible for NZS a person must:

- Be aged over 65, and
- Be ordinarily resident in New Zealand at the time they apply for NZS, and
- Have been legally resident and present for at least 10 years since age 20 including five years since age 50 (time spent living in certain countries outside New Zealand, and with which New Zealand has a reciprocal social security agreement, can count as NZ residence for this purpose, which is an added complication)

Many countries operate a quite different sort of test when determining whether, and how much of, a state pension¹³⁸ should be paid to their residents. State pension entitlements are paid as a proportion of the amount of time someone has resided and contributed in that country. This can mean that people who have contributed to state pension schemes in several countries over the course of their working lives can accrue several 'mini-pensions', which together may add up to close to a full equivalent pension. In effect, each country's state pension system contributes its own share of the cost.

In New Zealand's case, as long as someone meets the 10/5 year residence condition they can receive a full state pension (i.e. NZS) rather than a 'mini-NZS' adjusted for the proportion of their adult life they spent in New Zealand. If someone arrives here with a state mini-pension entitlement from a country (which has no reciprocal social security agreement with New Zealand) and meets the 10/5 rule, then this, combined with a full NZS entitlement would result in a state pension of more than NZS alone.

From New Zealand's point of view this would be unfair in two ways. First, a person who worked in several countries would receive more state pension than someone who had spent all their working life in New Zealand. Second, New Zealand taxpayers would be funding a more than proportionate share of the combined pension, simply because of its 'all or nothing' system.

¹³⁸ The term 'state pension' here refers to an overseas pension that is administered by or on behalf of the government of the country paying the overseas benefit or pension. A more complete definition is in s70(1) of the Social Security Act 1964. Purely private or non-state sponsored occupational pension schemes are not part of this discussion.



The direct deduction policy

There are two possible approaches to dealing with this problem that have been considered.

1. **Proportionality** – abandon the ‘all or nothing’ residency test for NZS and change to a system where NZS entitlements were proportional to the amount of time a person’s adult life had been spent in New Zealand. Such mini-NZS pensions could then be combined with state mini-pensions earned in other countries. Mini-NZS pensions could also be treated as fully portable entitlements for New Zealanders who wished to retire overseas and combine them with other state mini-pensions they may have accumulated elsewhere during their working lives.
2. **Direct deduction** – retain the current approach to residence testing for NZS and keep paying full standard amounts of NZS to all those who qualify. However, to ensure that New Zealand does not pay more than its proportional share of the total state pension entitlements accumulated from people’s working life spent in different countries, the combined value of NZS plus any state mini-pensions is scaled back, by offsetting the amount of these mini-pensions against the cost of NZS.

The direct deduction approach has been part of the New Zealand benefit and pension system since 1938. Its merits in comparison with a proportionality system have been the subject of a number of policy reviews over the years, the latest in 2007, but it remains current policy. Following the 2007 review the government has concluded that the direct deduction policy is reasonably sound, given the difficulties of interfacing the New Zealand system with those of other countries. It also does not favour a proportionality approach because it could lead to inequitable payment rates, require new hardship payments and makes NZS more complex.

The treatment of partnered couples under the direct deduction policy

People receiving NZS are the largest group of people affected by the policy of direct deduction of overseas state pensions. However, this approach also applies to people entitled to overseas state pensions who apply for New Zealand benefits; the amount of an income-tested benefit is reduced by the value of such pension incomes.

This is where different views of the functions of NZS and income-tested benefits have created problems and perceptions of unfair treatment of partnered people under the direct deduction policy.

Direct deduction applied to benefits

The benefit system sits clearly in the category of support based on the income needs of the ‘economic family unit’. This implies that the combined income of the applicant and his/her partner should be used to abate the standard benefit amount and that the resulting entitlement is paid to help support the couple (and any dependent children in the family).

In the case of the direct deduction policy (where one or more overseas state pensions belonging to either partner form part of the couple’s income support) it follows by analogy that all these pensions should be used to reduce the New Zealand benefit amount, thereby effectively sharing the cost of providing income support with the other countries that the applicant or their partner have lived in.

Direct deduction applied to NZS

By contrast, NZS is an entitlement of each qualifying individual and is not centrally based on the concept of an economic family unit.¹³⁹ Furthermore, entitlement is not targeted at need based on low family income¹⁴⁰ so, in the standard case of a person applying to receive NZS, the financial circumstances of their partner are quite irrelevant.

Despite these features, the direct deduction policy is applied to NZS in a very similar way as it is to benefits. Any overseas state pension payments (from a country with which New Zealand has no reciprocal social security agreement) are taken into account in assessing both partners' entitlement to NZS. If one partner's NZS is fully reduced to zero because the overseas pension amount is greater than the rate of NZS, then the excess amount is then applied to directly reducing the other partner's NZS.

In some situations a person can lose complete entitlement to NZS in their own right as a result of their partner's personal overseas state pension offsetting the entitlement of both of them.

Recent activities

On 22 August 2012, the Parliament Social Services Committee initiated a briefing into pension eligibility and entitlements, including portability. Following the briefing, the chair, Peseta Sam Lotu-Iiga, MP, stated:

The New Zealand Labour Party, the Green Party, and New Zealand First are of the view that the information received confirmed that an inquiry was warranted. The majority of the committee, while sympathetic to the anomalies in the system, decided not to initiate an inquiry. Prevailing fiscal constraints were also a consideration in this decision.

139 Partnership status is taken into account to a minor degree in respect of the difference between the single person and partnered person rates of payment of NZS. This is the subject of another recommendation in this Review.

140 The optional special income-tested rate of NZS available to a superannuitant with a non-qualifying partner is an exception to this general principle.

It is extremely disappointing that an inquiry was not held and resulting frustration was reflected by participants in a seminar held by the Retirement Policy and Research Centre at The University of Auckland in June 2013.¹⁴¹ Much of the frustration appears to arise from lack of understanding of the rationale for the direct deduction policy, or the decisions that are made.

Information released in July 2013 from the Treasury Budget 2013 indicates that the Government is increasing the budget to provide more 'assistance to those applying for a foreign pension due to the complexity of the application process for some'.¹⁴² It is regrettable that none of this budget was targeted to better informing migrants, intending migrants and other superannuitants about the direct deduction policy.

The 2013 Review of Retirement Income Policy makes four related recommendations, while noting that there has been no progress in this area since 2010:

Recommendations:

- That an individual's overseas state pension entitlements should be directly deducted against their own individual entitlement to New Zealand Superannuation and that any excess should not then be offset against the individual entitlement of their partner¹⁴³
- That the Ministry of Social Development improve information and advice for recent and prospective migrants and returning New Zealanders on the implications of the direct deductions policy for their future retirement income
- That the Ministry of Social Development improve the public availability of decisions on the classification of overseas pension schemes whose pension payouts are subject to the direct deduction policy
- That the Ministry of Social Development explain the rationale behind each international pension scheme classification

141 See <http://bit.ly/RPRC-overseaspensions-2013>.

142 The Treasury Budget 2013 Information Release July 2013

143 Spousal deductions are the most unfair aspect of the direct deduction policy and their cessation would cost the Government proportionately very little - in the order of \$1 million per annum.



Appendix Two: Terms of reference for this review

Legislative requirements

Under the New Zealand Superannuation and Retirement Income Act 2001 the Retirement Commissioner is required to conduct a review of retirement income policies by 31 December 2013.

Retirement income policies

In New Zealand retirement income policy is a mix of public and private provision. Public provision of retirement income is provided through New Zealand Superannuation and Veterans' Pension, supported by the operation of the New Zealand Superannuation Fund to smooth the cost over time. Policies encouraging the private provision of retirement income include the voluntary KiwiSaver scheme and programmes run by the Retirement Commissioner aimed at educating people about the need to save for their retirement. The Commissioner is supported in this role by the Commission for Financial Literacy and Retirement Income.

Topics for the 2013 Review

1. An update of and commentary on the developments and emerging trends in the retirement income provision area since the 2010 review, both within New Zealand and internationally.
2. The intergenerational impacts of New Zealand's retirement income policy, with due consideration given to:
 - a. the effects of increased longevity on present retirement savings schemes, and
 - b. alternative retirement savings approaches, and
 - c. the sustainability of New Zealand Superannuation.
3. An assessment of the role of private savings for retirement. This assessment should cover:
 - a. trends in KiwiSaver, particularly withdrawal patterns of those retiring and the issues that these may raise, and
 - b. the role of the financial services sector in helping to ensure the adequacy of retirement income for New Zealanders.
4. The contributions made by other policies and programmes, such as in housing and health, to maintaining New Zealanders' retirement income.
5. Women's future retirement income prospects.
6. The role of financial education and financial literacy in retirement income policy.

Appendix Three: Review process and structure

Process

Under the New Zealand Superannuation and Retirement Income Act 2001 (amended 2005) the Retirement Commissioner is required to conduct a review of retirement income policies by 31 December 2013. Terms of Reference for the 2013 review of retirement income policy were therefore confirmed in September 2012 (See Appendix Two) and meetings of the Advisory Group and three Reference Groups commenced at that stage. Over 25 background papers were commissioned and these have been placed on the Commission for Financial Literacy and Retirement Income website.¹⁴⁴

During February 2013, a seminar was held at Victoria University of Wellington to officially launch the process. In early April, the Commission and the Institute of Governance and Policy Studies jointly hosted a workshop on retirement income policy. This was attended by 80 stakeholders and 15 speakers, all of whom participated in break-out groups to identify key priorities for the review. The workshop also launched a wider consultation and issued an invitation for submissions to be made through April and May. Some submissions were entered through a specially designed, online short response form and 45 of these were completed. Thirty-eight substantial submissions and six short emails were also received.

Between March and May, Commission for Financial Literacy and Retirement Income staff attended various forums (convened by the Office of the Children's Commissioner, New Zealand Union of Students' Associations and the Ministry of Youth Development) to discuss retirement income policy issues with young people.

Other processes were happening in parallel and these also informed the review. In June, the Retirement Policy and Research Centre at the University of Auckland hosted an Overseas Pension Forum. In July, the New Zealand Treasury released its Long-Term Fiscal Statement, which provides a starting point for some of the discussion in this discussion document.

During the course of the review process, there was a change of Retirement Commissioner: Diane Maxwell was appointed to the role and began her term in July 2013.

Structure

The structure for the 2013 Review was established by the previous Retirement Commissioner, Diana Crossan, and consisted of the project team, several reference groups and an advisory group. Those listed below were the nominated people for the groups. On occasions, deputies stood in. Reference groups undertook to provide advice that reflected the perspective of their respective sectors. This did not imply any endorsement of the final outcome of the review, which is solely the responsibility of the Retirement Commissioner and the Commission for Financial Literacy and Retirement Income.

¹⁴⁴ See <http://bit.ly/cflri-2013review-backgroundpapers>.



Government Officials Reference Group

- Peter Alsop – New Zealand Productivity Commission
- Margaret Davison – Ministry of Pacific Island Affairs
- Richard Hawke – Economic Development Group, Ministry of Business, Innovation and Employment
- Adam Hunt – Financial Markets Authority
- David Law – New Zealand Treasury
- Michele Lloyd – Statistics New Zealand
- Sacha O’Dea – Ministry of Social Development
- Michael Peters – Ministry of Health
- Murray Shadbolt – Inland Revenue Department

Finance Sector Reference Group

- Kirk Hope – New Zealand Bankers’ Association
- Bruce Kerr – Workplace Savings NZ
- Peter Leitch – Professional Advisers Association Inc.
- Lyn McMorran – Financial Services Federation Inc.
- Peter Neilson – Financial Services Council of New Zealand
- Bill Rosenberg – Council of Trade Unions
- Jill Spooner – Women in Super
- Stephen Summers – Business NZ
- Nigel Tate – Institute of Financial Advisers

Non-Government Organisations Reference Group

- Raewyn Fox – New Zealand Federation of Family Budgeting Services
- Jean Fuller – National Council of Women of New Zealand
- Lisbeth Gronbaek – Age Concern
- Andrew Hubbard – New Zealand Association of Citizens’ Advice Bureaux
- Roy Reid – Grey Power Federation
- Ros Rice – New Zealand Council of Social Services
- Hellene Wallwork – PACIFICA
- Wendi Wicks – Disabled Persons Assembly

Advisory Group

- Catherine Savage
- Sue Chetwin
- Peter Hughes
- Tahu Potiki

Project team

- Malcolm Menzies – Commission for Financial Literacy and Retirement Income
- Kathryn Maloney – Commission for Financial Literacy and Retirement Income
- Sarah Brown – Editorial Adviser

Appendix Four: **Submissions received**

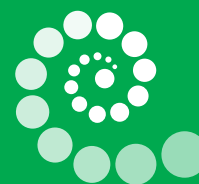
(available online at <http://bit.ly/cflri-2013review-submissions>)

- Age Concern NZ
- ANZ Wealth
- BNZ
- Boyd Klap
- BT Funds Management (NZ) Limited & Westpac New Zealand Limited
- Carers NZ
- Consumer NZ
- Crown Financial Ministries New Zealand
- Dunedin Community Law Centre
- Family Centre
- Financial Markets Authority
- Financial Services Council
- First NZ Capital
- Government Superannuitants Association
- Grey Power New Zealand
- Hamilton Budgeting Advisory Trust
- Human Rights Commission
- KASPANZ
- McGuinness Institute
- Mercer
- Michael Littlewood
- National Council of Women of New Zealand
- New Zealand Bankers' Association
- New Zealand Council of Trade Unions
- New Zealand Income Guarantee
- New Zealand Nurses Organisation
- New Zealand Union of Students' Associations
- Professional Advisers Association
- Professor David Mayes
- Reserve Bank of New Zealand
- Retirement Policy and Research Centre
- Roger Hurnard
- Southern Cross Healthcare Group
- Vaiola P. I. Budgeting Service Trust
- Women in Super
- Workplace Savings NZ

Plus two confidential submissions



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