

INVESTMENT SAVINGS & INSURANCE ASSOCIATION
OF NZ INC

SUBMISSION

ON

THE
RETIREMENT COMMISSIONER'S

2007

REVIEW of RETIREMENT INCOME POLICY

4 May 2007



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ISI Submission to ORC's Review of Retirement Income Policy

1. Introduction

- 1.1 The Investment Savings and Insurance Association ("ISI") welcomes the opportunity to submit comments to the Retirement Commissioner's 2007 Review of Retirement Income Policy. ISI members are the issuers and managers of life insurance, superannuation and managed funds in New Zealand and hence have a keen interest in the development and success of policies to encourage saving for retirement. A list of ISI members is attached.
- 1.2 We note that the terms of reference for the review require it to focus on those aspects of retirement income that build on the foundation made up of New Zealand Superannuation and KiwiSaver.
- 1.3 While we are aware that the timing of this review is set by legislation, it is somewhat unfortunate that it coincides with the introduction of KiwiSaver and the PIE tax changes, both of which will have an impact on savings levels in New Zealand. It may take until the next triennial review to form a view on the extent of their impact.
- 1.4 This submission will start by setting out the long-term policy position of ISI and acknowledging recent welcome changes in the areas of tax and regulation. It will then review the current state of household savings in New Zealand and discuss further policy changes that we consider would be beneficial.

Summary of Recommendations

- KiwiSaver is a welcome new development but still has design flaws. In order for it to be successful, it should be focused on long-term saving and not also used as a mechanism to facilitate first home purchase.
- Consideration should be given to delivering any planned personal tax cuts via KiwiSaver, in the form of a flat-rate rebate or a deduction on employee contributions to KiwiSaver. This would provide a non-inflationary means of delivering a personal tax cut while providing an incentive for people to continue contributing or to 'opt in' to KiwiSaver.
- The Retirement Commissioner's public education programme should illustrate the 'retirement savings gap' that the average wage earner will need to self-fund.

2. Background

- 2.1 ISI's position for many years has been to recommend removal of the disincentives to saving presented by the tax regime and, preferably, a 'kick start' in the form of a tax incentive to encourage people to start saving.
- 2.2 At the time of the last PRG in 2003 ISI held a one-day workshop ('Saving NZ') which identified the barriers to saving and recommended workplace savings as the most effective way for it to be facilitated.
- 2.3 The framework ISI recommended to the PRG in 2003 was a variation of the 3 tier model recommended by the World Bank.:

The overall framework for the provision of retirement income should:

- Provide diversified sources of funding for retirement as reflected in a three tier structure for retirement incomes:
 - Tier 1 – New Zealand Superannuation;
 - Tier 2 – Workplace saving; and
 - Tier 3 – Voluntary superannuation/savings.
 - Encourage coherent integration between these three tiers.
 - Encourage the provision of retirement benefits, with increased focus on the provision of income streams.
 - Be equitable between individuals, across lifetimes and between generations.
 - Recognise the importance of disclosure for consumers and a robust consumer protection regime, together with consumer education.
- 2.4 The ISI submission to the PRG in 2003 included recommendations that:
- PRG acknowledge that agreement on a framework for public and private provision of retirement income is an essential first step for public acceptance of the need for their own private savings to supplement NZ Superannuation.
 - PRG recommend that the Government draft a comprehensive plan for the public and private provision of retirement income for public discussion.
 - PRG acknowledge that the impact of the tax system on collective investments is a significant barrier to increasing the level of private savings in New Zealand and recommend the removal of the tax disincentives that currently apply.
 - PRG acknowledge that the 'improved voluntary' regime recommended by the 1992 Task Force on Private Provision for Retirement has not achieved the objective of increasing the level of private saving and reconsider some of the other options identified by that Task Force.
- 2.5 Since 2003 there have been significant changes in the area of retirement income policy, with the implementation of the PIE tax regime and the imminent commencement of KiwiSaver.

3. KiwiSaver

- 3.1 As noted above, ISI policy has been to support workplace saving as an effective means of enabling workers to establish a fund for retirement income by having contributions deducted from their wages.
- 3.2 ISI supported encouragement for workplace savings and welcomed the development of KiwiSaver as a step in the right direction. At the very least, an 'opt out' scheme such as KiwiSaver might be expected to overcome the problem of inertia, thus removing one of the barriers to people making a start on their savings.
- 3.3 ISI continues to have concerns, however, that certain design aspects of the regime are likely to inhibit its effectiveness. Our earlier submissions counselled against including a facility for withdrawing funds for first home purchase and allowing mortgage diversion. While we would not oppose the Government providing that support to first home buyers, it is not appropriate for it to form part of a scheme designed for long-term saving. The inclusion of that facility creates a disincentive for ongoing contributions and an additional administrative complication.
- 3.4 The tax treatment of contributions to KiwiSaver makes saving in a KiwiSaver scheme unattractive in comparison with paying off a mortgage. There will continue to be an economic incentive to withdraw funds from the scheme for purchase of a first home and to take a contribution holiday while paying off the mortgage. Additionally, there is no incentive to choose saving in a KiwiSaver scheme over investment in residential housing.
- 3.5 We would like to see some consideration of options such as a deduction on employee contributions or an annual flat-rate rebate on contributions to KiwiSaver. If this rebate was limited to KiwiSaver, and contingent on contributions having been made for the year, it would provide an attractive incentive, as well as giving the Government a way of delivering personal tax cuts without further stimulating inflation.

4. Taxation of Collective Investments

- 4.1 The PIE tax regime has gone a long way towards removing the disincentive of investment income in a superannuation scheme being taxed at 33%, whether or not the saver was in a lower tax bracket. For some contributors (those earning more than \$60,000pa) there will now be a slight tax advantage in that tax on investment earnings in a KiwiSaver scheme will be capped at 33%. In addition, employer contributions to a KiwiSaver scheme will be exempt from Specified Superannuation Contribution Withholding Tax ("SSCWT"), subject to certain conditions, and PIE funds will be exempt from tax on capital gains on NZ shares and certain Australian shares.
- 4.2 The FDR regime will reduce but not remove the inequalities between the taxation of collective investments and direct investment within New Zealand and offshore. ISI made a strong recommendation to the Finance and

Expenditure Select Committee that direct investment offshore should not be tax advantaged in comparison with collective investments. We were disappointed that the decision was made to retain this inequality.

- 4.3 Further work is needed on the provision of decumulation products such as annuities and home equity release products to enable efficient utilisation of assets accumulated pre-retirement. ISI acknowledges the work done by Susan St John in this area¹ and recommends further work on the areas identified for potential change.

5. Personal Savings Rates

- 5.1 After decades of successive governments maintaining that the level of personal savings within New Zealand was not important, the current government has acknowledged the need for an increase in the rate of personal saving. In a speech on 17 April², Dr Cullen noted that, compared with other countries, NZ has a poor record of household saving.

- 5.2 ISI recognises that care is needed not to conflate flows and stocks when referring to saving and that, although New Zealanders have a poor record of saving, our net worth has been rising. We agree, however, with Dr Cullen's comments that more savings would be beneficial in enabling New Zealanders to:

- Have a better standard of living in retirement
- Own more of our own businesses
- Have more robust capital markets
- Have lower interest rates and less pressure on the dollar
- Have a stronger economy with more exports and less imports

- 5.3 A paper prepared for a Reserve Bank workshop in November 2006³, showed that household savings in New Zealand have been negative since the early 1990s. At the same time, household net worth has been increasing due to revaluation of assets, mainly housing.

- 5.4 According to the Statistics NZ Household Income and Outlay Account⁴, the household sector spent 14.8% more than its disposable income in 2005. The difference has been funded by borrowing and/or running down assets. The Reserve Bank estimates that over the past 4 years there has been \$7 billion of housing equity withdrawal. The fact that net worth is still positive is largely due to the massive increase in the value of housing stock.

- 5.5 Other countries have also had a fall in the rate of household savings as a percentage of household disposable income, but not to the same extent as NZ.

¹ *The Policy Implications of Decumulation in Retirement in New Zealand*, Susan St John, University of Auckland, July 2006

² Dr Michael Cullen, speech notes for Business Breakfast, Westport Motor Hotel, 17 April 2007.

³ *Household saving and wealth*, Bernard Hodgetts, Phil Briggs and Mark Smith, Reserve Bank, November 2006.

⁴ *Ibid*, p.7

Comparative rates for 2005 are as follows⁵:

Canada	-0.2%	Japan	2.4%
USA	-0.4%	Netherlands	5.7%
Australia	-2.6	Germany	10.7%
New Zealand	-14.8	France	11.6%

5.6 The Reserve Bank also noted that the level of NZ's gross indebtedness makes us vulnerable to offshore lenders deciding either to discontinue supplying us with funds or changing the rate at which they are prepared to do so.

5.7 A recent Statistics NZ report describes the increasing level of net worth disparity in New Zealand and suggests some of the possible economic and social implications for the future. The data, taken from the Survey of Family, Income and Employment (SoFIE) conducted in 2003/04, show that ten percent of the population owns 51.8% of the country's net worth, with the next 40% of the population owning 43% of total net worth and the bottom 50% owning only 5.2%⁶.

5.8 The survey results illustrate that most New Zealanders over retirement age, and those in the 55-64 group approaching retirement, do not have a large nest egg. The net worth shown includes owner-occupied housing.

Percentage distribution of population and net worth, mean and median net worth, by age:

Age	% share in		Net Worth	
	Population	Total net worth	Mean \$	Median \$
15-24	18.0	1.5	13,300	2,400
25-34	17.3	7.0	65,000	31,100
34-44	20.0	20.4	162,400	82,400
45-54	17.2	26.8	247,800	142,900
55-64	12.8	22.8	285,300	170,000
65+	14.7	21.5	233,700	149,500
Total	100.0	100.0	159,600	69,800

Source: Statistics NZ: *Wealth Disparities in New Zealand*, April 2007, p.15

5.9 The same survey shows net worth split into number of people, total and median values of asset, liability and net worth.

Personal Income	Population	Asset Value		Liability Value		Net Worth Value	
		Total (million)\$	Median \$	Total (million) \$	Median \$	Total (million) \$	Median \$
(1) <=1,500	291,700	21,510	4,500	4,258	0	17,253	3,200
(2) 1,501-9,300	293,000	28,379	20,900	4,993	1,300	23,386	15,100
(3) 9,301-13,400	294,300	35,908	77,700	3,700	100	32,208	67,000
(4) 13,401-18,000	293,900	38,004	98,000	3,344	-	34,660	81,500
(5) 18,001-24,100	292,200	41,506	74,300	5,133	1,300	36,373	50,800
(6) 24,101-30,400	291,200	45,177	90,000	7,501	3,500	37,676	53,500
(7) 30,401-38,100	295,800	50,295	105,500	10,675	6,700	39,620	64,100
(8) 38,101-48,100	291,600	61,276	143,600	12,510	15,000	48,766	88,500
(9) 48,101-65,200	296,700	86,231	192,000	17,043	25,900	69,188	132,300
(10) 65,201+	289,000	151,126	333,800	22,570	26,000	128,556	255,000

Source: Statistics NZ: *Wealth Disparities in New Zealand*, April 2007, p.15.

⁵ *Household saving and wealth, November 2005, p.8*

⁶ *Wealth Disparities in New Zealand, Statistics New Zealand, April 2007, p.7.*

- 5.10 This reveals that, although the split into age groups shows the 65+ age group with median net assets of \$149,500, when the split is done on income deciles it shows that those people in the 4th decile, which is likely to include many people living on NZS and little else, do not have much in the way of either assets or liabilities, with a median net worth of only \$81,500.
- 5.11 While NZS may provide income for a basic standard of living if the recipient owns a home, it is more problematic if it must also cover the cost of housing. The increasing difficulty faced by young New Zealanders trying to enter the housing market may result in lower levels of home ownership in the future. Also, the advent of revolving credit mortgages, which effectively enable people to ‘eat the house’ to supplement their income during their working lives, may mean that more people in the future will reach retirement with higher levels of liability than those shown in the table above.
- 5.12 OECD statistics demonstrate that the income of those relying on NZS is not generous in comparison with those living on earnings-related pensions in other countries:

**Gross pension wealth by earnings level, mandatory pension programmes, men.
Individual earnings, multiple of average (selected countries)**

	<u>0.5</u>	<u>0.75</u>	<u>1</u>	<u>1.5</u>	<u>2</u>	<u>2.5</u>
Australia	5.7	6.2	6.7	7.7	8.3	8.6
Canada	5.5	6.0	6.5	6.5	6.5	6.5
France	7.6	7.6	9.5	13.7	17.1	20.5
Germany	4.3	6.2	8.3	12.5	13.7	13.7
Japan	5.7	7.0	8.3	10.9	12.2	12.2
Netherlands	5.2	7.7	10.3	15.5	20.6	25.8
New Zealand	5.7	5.7	5.7	5.7	5.7	5.7
UK	5.0	5.2	5.5	6.6	6.7	6.7
USA	3.5	4.5	5.5	7.1	8.0	8.9
OECD average	5.7	7.2	8.9	12.1	14.8	16.8

Source: OECD, Pensions at a Glance, 2005, table 6.2

Thus, the value of NZS is not out of line with some other countries we may compare ourselves with (but still below the OECD average) for someone earning up to the average wage but, beyond that, NZS is well below the average.

- 5.13 ISI considers that more recognition is needed of the ‘retirement savings gap’ in New Zealand. That is the gap between the current level of savings and what will be available from NZS and the amount that will be needed to maintain a lifestyle post-retirement that is not too dissimilar to the pre-retirement lifestyle.
- 5.14 In Australia the Investment and Financial Services Association (“IFSA”) estimated the retirement savings gap in 2003 and again in 2005. Over that

period it had reduced by \$16,500 (15%) per person but still stood at \$93,523⁷. ISI is planning research to identify the corresponding retirement savings gap in New Zealand.

- 5.15 In his speech on 17 April, Dr Cullen predicted that within ten years half the workforce would be KiwiSavers. Other forecasts suggest that, although KiwiSaver will remove some barriers to saving, it is unlikely to increase new savings by more than 4%.
- 5.16 ISI accepts that some time should be allowed to assess the impact of KiwiSaver, and the PIE tax changes, on the level of personal savings. In addition to that, ISI and its members have committed a great deal of resource to the development and implementation of the new regimes and the systems to implement them. However, we consider that further augmentation of KiwiSaver will be necessary to enable it to have the necessary impact on personal savings rates.

6. Incremental Change

- 6.1 ISI has, in the past, recommended an ‘incremental’ approach to policy development, but we have warned against ad hoc change. There needs to be a coherent long-term plan so that New Zealanders can understand the policy settings for long term savings and feel confident about planning for the future.
- 6.2 The introduction of KiwiSaver has been a major policy development for the Government but there are still too many opportunities for contributions to halt, or to be withdrawn for first home purchase. Any policy changes should build on the KiwiSaver foundation and encourage continuing contributions towards an income stream at retirement to supplement the basic income from NZS.
- 6.3 We recommend consideration of amendments that could be made to KiwiSaver to make investment in financial assets more attractive than investment in housing.
- 6.4 The majority of European countries, as well as Canada and the United States, have some form of EET regime for private pension schemes. ISI commissioned research in 2001 to work out the cost of moving from TTE to other tax treatments, including EtT. On the assumptions used in that research, the cost of moving to EtT would have been \$340million in the first year, rising to \$500 million after 20 years and becoming positive after 45 years. The conclusion of ISI’s research at that time was that a rebate may be the most cost-effective way of providing an incentive to save.
- 6.5 Treasury work in 2001⁸ also recognised the potential benefits of a tTE system with a rebate, although it identified certain administrative complexities that would not apply in the current KiwiSaver environment. If the rebate were limited to KiwiSaver schemes it would be able to be implemented reasonably

⁷ *Retirement Incomes & Long Term Savings Policy Options*, Investment and Financial Services Association Ltd, Australia, 2006, p.5

⁸ *Savings Incentive Options, Consultation and Analysis*, Treasury Report T2001/1967.

easily. The advantages of extending a tTE regime to KiwiSaver as a whole include:

- enables the Government to provide a non-inflationary tax break.
- Alleviates the current over-taxation
- Provides an incentive up-front, where it is likely to attract most attention.
- A flat rate rebate would not be seen as providing disproportionate advantage to high earners.
- A rebate credited to schemes by IRD would be easier to administer than a lower tax rate on contributions
- Would encourage contributions to continue if the rebate was credited only to contributing members.

6.6 There appears to be general acceptance that a tax incentive for KiwiSaver would give the Government a way of providing a tax break without the risk of worsening inflation.

6.7 Ultimately, additional encouragement in the form of a tax rebate on contributions to KiwiSaver may start more people saving but may not have the dramatic impact that is needed to move the bulk of New Zealanders from the current pattern of dis-saving.

6.8 The provision for employer contributions to an employee's KiwiSaver account to be exempt from SSCWT provides an ETE basis for those contributions. Extension of this tax basis to employee contributions would provide a substantial incentive for more employees to opt in to KiwiSaver.

6.9 Ultimately, some form of compulsory saving remains the failsafe means of countering inertia and short sightedness amongst those who are able to save. In the same way that a rebate or deduction could easily be built into the existing KiwiSaver structure, the framework is now in place for a scheme that could be made compulsory at some time in the future if necessary.

7. ISI Research on Savings Issues

7.1 ISI has commissioned an update of the work done in 2001 on modelling the cost of various tax treatments for savings, including a rebate.

7.2 ISI also intends to undertake a replication of the IFSA research on the 'retirement savings gap'.

7.3 Other areas of research under consideration include an analysis of the possible impact of compulsory savings on the NZ economy.

8. Positive Potential of Proposed Regulation Changes

8.1 For several years (since 2003) ISI has been working internally and responding to officials' discussion papers on regulation of investment advice and advisers. While we have not yet seen draft legislation, ISI has been reasonably happy with the proposed regulatory changes and we believe they will have a positive

effect in improving public understanding of investment products and increasing confidence in investment advice.

- 8.2 During the second half of 2005 ISI committed considerable time and effort into preparing submissions to MED on the Review of Financial Products and Providers (“RFPP”). ISI supported the overall trustee supervisory model proposed, together with registration of financial institutions and an improved form of consumer complaints resolution.
- 8.3 Subject to seeing the legislation when it is drafted, we consider that the regulatory changes resulting from the RFPP will form a sound basis upon which the office of the Retirement Commissioner can rely in ongoing public education on the place of financial investments in provision for retirement income.

List of ISI Members

ISI MEMBERS

American International Assurance
AMP Financial Services
Asteron Life Ltd
AXA New Zealand
BNZ Investments and Insurance
CIGNA Life Insurance NZ Ltd
Equitable Group
Fidelity Life Assurance Co Ltd
Gen Re LifeHealth
Hannover Life Re of Australasia Ltd
ING New Zealand Ltd
Medical Assurance Society NZ Ltd
Munich Reinsurance Co of Australasia Ltd
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