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RPRC Update

Retirement Policy and Research Centre

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Spending the Savings: Decumulation & Middle-Income Retirement

Commission for Financial Literacy and Retirement Income

Symposium 30 November 2012 sponsors: Retirement Policy and Research Centre and Commission for Financial Literacy and Retirement Income (CFLRI).

The Symposium explored how New Zealand retirees, especially those with modest savings in the middle of the income and wealth distribution, can best use their retirement savings given the uncertainty around the duration of their retirement, investment returns and the possibility of large health care costs.

New Zealand's demographic change is exerting pressure on labour market, health, pension and retirement policies. Today we have around 600,000 people over age 65, one for every five of working age. We expect around 1,300,000 people over age 65 by mid-century, or two for every five of working age. More dramatic is the expected quadrupling of those aged over 85 years by 2050, and the impact that will have on both the demand for in-home and residential long-term care, and on the cost of that care.

Individuals and societies have a vested interest in processes that support the financial and physical well-being of older citizens. While concern about our ageing future has resulted in policy developments like improving financial literacy and introducing KiwiSaver to help people ***accumulate*** savings to fund longer retirements, the symposium shifted the focus to the way accumulated wealth is ***decumulated*** in retirement. Potentially, products that help run down accumulated assets can avoid imposing all the costs of catastrophic health events - such as long-term care - on the working age population.

As in many other countries, there has been very little discussion in New Zealand on how public policies might help the decumulation phase. There are virtually no products such as annuities available to support New Zealand Superannuation in spreading the risk of outliving capital. Nor has the market for home-equity release products or Long-Term Care Insurance developed. KiwiSaver will become increasingly important in accumulating wealth for retirement, but it is paid out as a lump-sum. Little or no policy thought has been given to how the lump-sums should be distributed during a potentially long, expensive retirement.

Symposium participants included representatives from the Ministry of Business, Innovation and Employment, Inland Revenue, the Treasury, most major banks, investment and insurance firms, the Financial Markets Authority, the Financial Services Council, the Retirement Villages Association, and researchers from other universities. Presenters included Hazel Bateman, Director of the Centre for Pensions and Superannuation, University of New South Wales (sponsored by the CFLRI); Bridget Browne, Research School of Finance, Actuarial Studies and Applied Statistics, Australian National University; Natalie Jackson, Director of the National Institute of Demographic and Economic Analysis, the University of Waikato; Toni Ashton, School of Population Health, the University of Auckland; Malcolm Menzies, Research Manager, CFLRI; and experts from the financial services sector.

The Symposium Proceedings are available here.

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Fiscal Sustainability in an Ageing Population: Adapting Universal Provision

RPRC co-director, Associate Professor Susan St John, was appointed to the external panel reviewing the Treasury's long-term fiscal projections statement for 2013. The panel met over four months to review papers. Susan St John contributed a paper on reducing the fiscal costs of New Zealand Superannuation, and presented the paper summarised below to **Treasury's Affording our Futures Conference, Victoria University 10-11 December, 2012.**

Raising the age of eligibility for New Zealand Superannuation (NZS) is not the only policy lever available to improve future pension affordability, nor is it necessarily the most equitable. A subtle mix of the three possible parametric changes: age, level and means-testing, may be preferable.

While acknowledging the unpopularity of the idea, the paper argues that intergenerational concerns and immediate fiscal pressures suggest a modest means testing operating through the tax system should be on the table for discussion.

While recipients of NZS, especially if aged close to 65, may still be in well-paid work, and/or have other large private incomes and assets, approximately 40% of recipients have virtually no other cash income. The next 20% have on average only 20% of their income from non-governmental sources. However for couples aged 66-75, around one half have more than 50% of their income from non-governmental sources, and it is clear that there is considerable wealth and income in the top decile, with many still in the fulltime workforce.

In the 1980s, the retention of net NZS by the top income earners was only 34% (with a top tax rate of 66%). Now it is 67%, or more with tax planning. The ratio of the highest income earner's net NZS to net NZS for those with no other income is over 75%. Thus the current tax system itself now provides only a modest degree of targeting.

If NZS was removed only from the top decile of recipients, 10% of the gross cost could be saved. But "Targeting is more easily done in theory than in practice" (Rodway 2012). The challenge is to design a means-test that achieves worthwhile savings with least pain.

Susan St John suggested that the Australian means test is unlikely to appeal to New Zealanders. Under a New Zealand standard welfare test, a couple would retain only an extra $80 a week between them before facing an effective marginal tax rate of 89.2% (with ACC levy, tax and benefit loss). History suggests this is untenable.

Because the 'surcharge' that operated 1985-1998 has political baggage, a simpler way using the tax system may be acceptable. Susan St John suggested a 'NZS Grant' (NZSG), paid at the net married person's rate, with all additional earnings, taxed at the 'NZSG tax rate' using a separate tax scale for superannuitants. Under assumptions that could potentially remove all NZS from the top 10% of earners while leaving the bulk of retirees either unaffected or minimally impacted, effective marginal taxes could be modest and comparable to rates faced by many others in the workforce.

Various tax combinations are possible. With, say, 20% on the first $15,000 and 40%, the cut out point where all NZS is effectively removed is about $112,000. The weekly losses for low income superannuitants are minimal and could be compensated in various ways.

However, income in PIEs and trusts, and rents (actual and imputed) from owning property should be included for there to be integrity in the targeting approach.

The paper is available here.

RPRC in the media and public presentations and contributions

18 September *FST Media/Bravura*, *Kiwisaver: The Next Five Years - Staying in the Game,* Michael Littlewood as keynote speaker here.
12 October *NZ Herald* in *Oz KiwiSavers may get money early*, Michael Littlewood comments on the issues here.
12 October *NZ Herald* in *KiwiSaver: The pack spreads out,* Michael Littlewood suggests questions for fund managers here.
12 October *NZ Herald* in *Abuse rate 10 times higher in welfare families: study*, M.Claire Dale quoted here.
19 October *TVNZ Breakfast* in *Paying the Pension Bill*, Michael Littlewood interviewed here.
25 October External Panel on *Long term fiscal projections*, Susan St John presentation here.
28 October *Otago Daily Times* in *Tasman Sea no longer a barrier for savings*, Susan St John & M.Claire Dale quoted here.
29 October *ACC Futures Symposium*, Wellington, Susan St John Workshop on funding and experience rating, here.
20 November *The Village Lectures,* Susan St John invited lecturer, *Rethinking the welfare state for the 21st century.*
24 November *TVNZ Breakfast* in *Bringing your Super home from Oz*, Michael Littlewood interviewed here.
26 November, RadioLive, the forthcoming *symposium on middle income retirement,* Susan St John interviewed.
29 November TVNZ Breakfast in *How to Manage Your Retirement Savings*, Michael Littlewood interviewed here.
8 December *NZ Herald* in *KiwiSaver a good move for children,* RPRC Symposium used as a resource by Mary Holm here**.**
9 December NZ Herald in *House price fears*, RPRC Symposium presenter Natalie Jackson quoted here**.**
9 December *stuff.co.nz* in *Boomers facing shortage of buyers***,** RPRC Symposium presenter Natalie Jackson quoted here**.**
10 December Amnesty International, Wellington, Susan St John Breakfast guest speaker on human rights day.
10-11 December *Victoria University* *Affording Our Future Conference*, Susan St John contributes. Papers and presentations available here.
12 December Policy Advice Division, Inland Revenue Department, Susan St John seminar on retirement income issues.
15 December *NZ Herald* in *KiwiSaver still worthwhile for kids*, Mary Holm quotes home equity release from RPRC Symposium here**.**
17 December *NZ Herald* in *Zero-interest loans to help poor families*, M.Claire Dale interviewed here.
17 December *WTV* in *No-interest loans help poor families*, M.Claire Dale interviewed.
18 December *RadioRhema* in *Zero interest loans in New Zealand*, M.Claire Dale interviewed.

KiwiSaver Evaluation Annual report July 2011 – June 2012

Prepared by the National Research and Evaluation Unit, Inland Revenue, for the KiwiSaver Evaluation Steering Group, the Report is available here.

The KiwiSaver evaluation is a joint project between Inland Revenue and the Ministry of Business, Innovation and Employment. The Treasury and the Department of Building and Housing also participate. Next year is the last planned year of the KiwiSaver evaluation.

The Annual Report section entitled "Research into the impact on retirement saving" (p. 27) quotes RPRC's Working Paper 2011-2, *KiwiSaver: Four Years On*: *"… The Retirement Policy and Research Centre consider that unless there is attention to decumulation issues and some integration with the universal pension, KiwiSaver may simply facilitate extra consumption by the wealthier cohort of a larger retired population. Another crucial lesson from the New Zealand experience from the perspective of the Retirement Policy and Research Centre is that competition among providers, and a system of default providers, may not improve consumer outcomes."*

RPRC evaluation of KiwiSaver:

Although KiwiSaver now has more than 1.9 million members and $12 billion in assets, a closer look at the numbers puts these into perspective. For example, fully 858,000 (45%) of members were non-contributors at 31 March 2012. That probably includes nearly all of the 312,000 children (16% of all members).

Then there are the 447,300 members (23%) who made no decision to join (default enrolments) and who have presumably made no subsequent decision about an appropriate investment strategy but have retained the 'low risk' default option.

Despite the large amount of money now held by KiwiSaver schemes, the average member balance at 31 March was just $6,700, to which taxpayers as a whole have contributed about one third.

The accumulated total cost of KiwiSaver to taxpayers has been $4.25 billion over the period to 31 March 2012. This significant cost seems to have 'purchased' a quite modest change in behaviour, as preliminary evidence suggests that only about one third of the average balance was actually 'new' savings – the rest represents a re-direction from other savings.

It is also past time to expose the pervasive myth about KiwiSaver: it is not guaranteed by the Government. KiwiSavers make their investment choices in a KiwiSaver scheme at their own risk.

RPRC Working Paper 2011-2 *KiwiSaver: Four Years On*, here.

RPRC Submission on KiwiSaver Default Provider Scheme

KiwiSaver Poua he Oranga

The default provider concept is a necessary consequence of auto-enrolment. Employees who have not chosen a KiwiSaver provider have to be put somewhere. Each default provider must also have a default investment option. The first appointments to the role of *default providers* to the KiwiSaver scheme were for seven years ending on 30 June 2014.

The Ministry of Business Information & Employment is seeking submissions on a Discussion Document of November 2012 that asks what we have learned from the experience of the first five years of KiwiSaver. The RPRC has made a submission, with a number of recommendations as to KiwiSaver's structure after 2014.

The submission noted that there has been no follow-up on the performance of the current default providers such as published comparisons on fees, investment performance or standards of administration, so we have learned little from the experience to date.

Given the requirements with which all KiwiSaver providers must comply for approval under the KiwiSaver Act 2006, it seems difficult to justify selecting six (or any number) for the favoured default provider status. Accordingly, the RPRC recommends either that there be no auto enrolment or default providers or that, if auto enrolments were retained, all KiwiSaver providers satisfying the necessary requirements should be on the default provider list. It does not matter whether that list is 30-40 providers long because the process of allocating default-enrolled members is already automatic.

Another possibility would see the Inland Revenue retain default enrolments for up to 12 months with each member choosing a provider by the end of that period. That would simplify the current arrangements considerably.

The RPRC also suggests that each default provider should decide on the default investment option. Currently, the government sets the rules.

RPRC Submission on KiwiSaver Default Providers here.

Congratulations and thanks to RPRC's Post-graduate students 2012:
Judith Hanna: retirement research; Glenn Riddell: tax reform Masters Dissertation

Susan St John, invited commentator on **Andrew Coleman's paper, *Saving a super scheme: The economics of PAYGO and SAYGO retirement schemes in New Zealand*,** Motu, Auckland, 18 November

Andrew Coleman: This talk examines the economics of PAYGO and SAYGO funded saving schemes in New Zealand. It argues that it is likely that the annual tax contributions needed to support the current New Zealand Superannuation scheme could be halved if the scheme were fully converted to a SAYGO scheme, and that feasible transition paths to a partially funded SAYGO scheme exist. Converting New Zealand's retirement scheme to a SAYGO funding basis is therefore a possible solution to the issues associated with population ageing. A comparison with Australia, where people are reaping the rewards of making the transition to a mixed SAYGO- and PAYGO pension scheme, is offered."

Susan St John's response:
Susan first looked at the debate among today's economists on this issue. Her commentary acknowledged that the issues raised by Andrew are serious propositions, but the crux of the debate is one that cannot be resolved by rational argument. The reason is that the issues are profoundly philosophical and therefore normative, ie requiring value judgements. She suggested that if the strong value judgement is made that each generation should get no more or less than it saves for itself then SAYG is the inevitable answer in an aging population. But other value judgements are valid. In particular, the idea that resources should be shared fairly between old and young at a point in time has wide appeal.

Journalists draw on this concept of intergenerational equity when they criticise the babyboomers' excessive claim on scarce resources in a world of high unemployment, minimal welfare benefits, child poverty and widening inequality. In such a world, loading the young with requirements to save twice as much in KiwiSaver is inimical to equity. It also requires huge assumptions about the role of savings investment and economic growth that may be less appropriate in an uncertain world.

pensionreforms

Two of the 31 abstracts loaded in the last quarter looked at two reports that illustrate ordinary people's reactions to very different public policy settings.

Did we really need KiwiSaver?
This report looks at how much New Zealand households actually saved between 2004 and 2006. At the time of KiwiSaver's introduction in 2007, supporters of change said things like 'New Zealanders are spending $1.14 for every dollar they earn'. That was based on macro-economic data derived from the government's Household Income and Outlay Accounts (HIOA).

In fact, New Zealand households saved quite a lot between 2004 and 2006 despite the HIOA numbers. Data from the Survey of Family Income and Employment (SoFIE, a longitudinal study) show why finding what savers are actually doing is more important than asking them what they think. It seems that New Zealanders were behaving quite 'sensibly' pre- KiwiSaver. more

Why do retiring Australians have greater debt?
The report asks of Australia's compulsory Superannuation Guarantee (SG), which is now 20 years old: Is it working? Are Australians really retiring with greater financial wealth? It suggests the SG and means-tested Age Pension are having some unintended consequences.

First, the environment seems to encourage taking earlier retirement. Next, it seems Australians have higher levels of debt at retirement than previously, apparently borrowing in anticipation of the lump sums they will receive on retirement, thus 'pre-spending' their savings. Most will probably miss the target retirement income, although higher contributions and time may help. more

PensionReforms suggests that governments tend to over-estimate their capacity to change citizens' behaviour so it will be interesting to see, in New Zealand's case, how much KiwiSaver has actually changed household saving behaviour when the 2008 and 2010 SoFIE data become available. In Australia's case, it will also be interesting to see what the increase in the SG contributions from 9% to 12% might do. It might mean even higher debt levels at retirement.

PensionReforms abstracts and search function are available here.

The Retirement Policy and Research Centre congratulates Diana Crossan on her successful 10 years as Retirement Commissioner. As she steps down in December this year, the RPRC thanks her for the support she has given us over the years, for her important contribution to the protection of New Zealand's unique retirement savings policies, and for her passion for financial literacy.

Best wishes for a safe and happy summer

from the Retirement Policy and Research Centre