Executive Summary and Recommendations only

Focusing on the Future: A discussion document

2013 Review of Retirement Income Policies

Commission for
Financial Literacy
and Retirement Income

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.

CHANGES WILL NEED TO BE MADE WITH CARE, SO AS NOT TO JEOPARDISE THE BEST FEATURES OF THE CURRENT SYSTEM.

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

GREATER TARGETING OF EXPENDITURE TO AREAS OF GREATEST NEED IS LINKED WITH QUESTIONS OF FAIRNESS AND THE AFFORDABILITY OF NZS.

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.

Section Three of the complete discussion 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 cent[1] (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*).
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*).

1 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.

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*).

* Page numbers refer to complete discussion document.

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.