FinancialServicesCouncil.
growing and protecting the wealth of New Zealanders

Financial Services Council
of New Zealand
Level 12, City Chambers
Cnr. Johnston & Featherston Streets
PO Box 1514, Wellington 6140
New Zealand
Ph: +64 4 473 8730
Fax: +64 4 471 1881
Email: fsc@fsc.org.nz
www.fsc.org.nz
www.yourwealth.org.nz

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Flexible Superannuation
The Treasury
P O Box 3724
Wellington 6140

Flexi-super@treasury.govt.nz

Flexible Superannuation Discussion Document

1. Introduction

The Financial Services Council (**FSC**) appreciates the opportunity to make a submission on the discussion document *Flexible Superannuation*.

FSC member companies issue and manage life insurance, superannuation and managed funds in New Zealand and they are trusted by 2 million New Zealanders to help grow and protect their wealth. Knowing at what level and when New Zealand Superannuation ("NZS") will be available is an integral part of planning for security in retirement and accordingly is a topic of keen interest for FSC members and their clients.

A list of FSC members is included at the end of this submission.

In the past year FSC has undertaken significant research into the level of income in retirement that most people consider would allow them to be "comfortable". As well as commenting on the proposals in the discussion document, our submission shares some of the conclusions of that research and suggests alternate ways of funding the gap between the desired age of retirement and a possible later age of eligibility for New Zealand Superannuation. Our responses to the specific questions posed in the discussion document are at the end of this submission.

Copies of our research reports will be available from 14 October 2013 on our web site www.fsc.org.nz.

We endorse the view expressed in the discussion document that 'Providing dignity and certainty for those in retirement is an important part of the New Zealand way of life'. We also consider that certainty is important for people saving for or nearing retirement so they have clear information on which to base their plans.

We commend the National and United Future Parties for their attention to these important issues.

2. Main Submission Points

- We support policy changes to enable more choice in the ages at which people may retire from paid work
- The objective of flexibility in the age of first receiving NZS has merit but there are some potential problems
- Increasing longevity will mean providing NZS to more people over a longer period with a consequent increase in cost, which is likely to produce an outcome that is not fiscally neutral
- That increase in cost could be limited by moving the age of eligibility for NZS to 67 and facilitating ways for people to fund the gap through savings if they want to retire earlier
- FSC research shows options for achieving that.

3. Context

An FSC research report released in 2012, *Pensions for the Twenty First Century,* examined the issues arising from increased longevity. The main points are covered below and were also made in our submission to the 2013 Review of Retirement Incomes Policy.

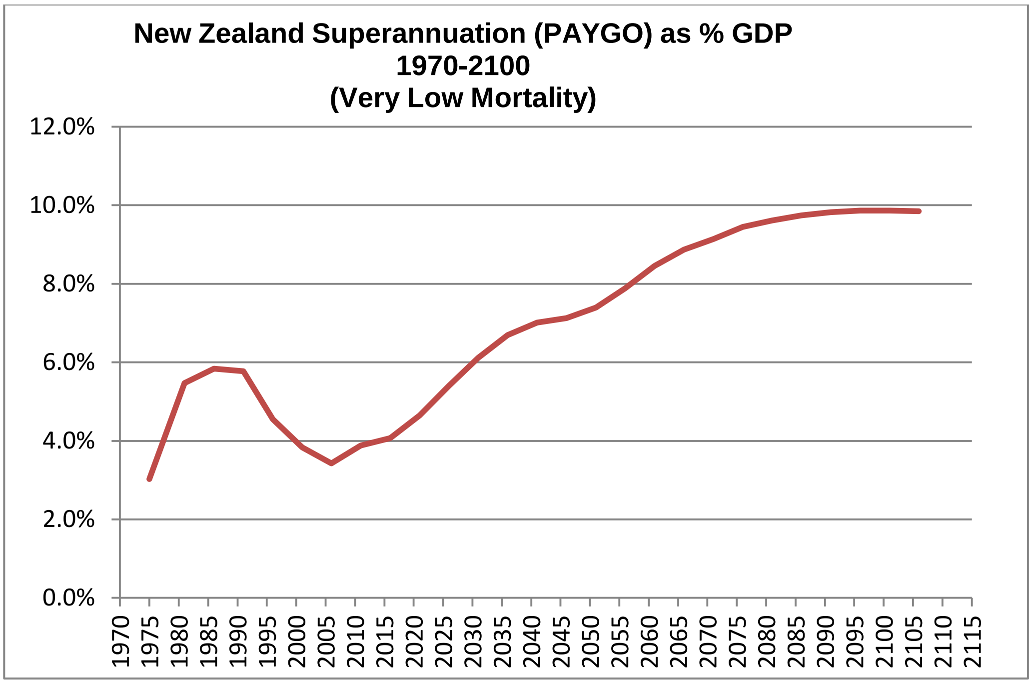
If the trends of the past 40 years continue longevity after age 65 will increase dramatically by the mid-21st century to reach 30 years for both men and women. The following table compares the situation that existed at the middle of the last century and what we can expect by the middle of this century.

Retirement in the 20th Century	**Retirement in the 21st Century**
Funding retirement incomes in 1955 Over 65 population less than 300,000 Life expectancy at 65 - 12.8 years for males and 16.9 years for females. Seven working age people support one pensioner. Age pensions cost 3% of GDP when the universal pension was available from 65.	*Funding retirement incomes in 2055* Over 65 population will be almost 1.7 million. Life expectancy at 65 – 30.9 years for males and 30.7 years for females. Two working age people support one pensioner. Age pensions will cost 9-10% of GDP if the age of eligibility for NZ Superannuation stays at 65.

Source: Updated version of table 35 p49 of Pensions for the Twenty First Century: Retirement Income Security for Younger New Zealanders Report 2012

The key effect of increased longevity in NZ will be the increased cost of providing NZS. More people will be claiming NZS and they will be claiming it for a longer period. The long term trend has longevity increasing at approximately 2 years per decade but between 1996 and 2006 the increase in longevity in NZ was an extra 3 years after age 65. The 2006 Census results indicated that in 2051 there are likely to be 160,000 more people over the age of 65 than was previously expected based on the Statistics NZ Series 5 projections.

We are currently paying around 4% of GDP to fund NZ Super for those currently retired. If we take the Statistics New Zealand (SNZ) Very Low Mortality projections as our assumption, the cost will rise to nearly 10% of GDP later this century. (The VLM projections assume the trend improvement in longevity from age 65 observed over the last 40 years continues.) While we could decide to increase tax rates by over 20% to pay for this, on past experience if the cost has risen to close to 6% of GDP we have acted to reduce the cost by moving out the age of eligibility for NZ Super and looked at reducing the value of NZ Super.



Source: Infometrics

4. The Flexi-Super Proposal

As noted above, the FSC supports the objective of people being able to choose the age at which they retire from paid work and the Flexi-Super proposal provides one way of achieving that. We do, however, also acknowledge the disadvantages identified in the discussion document and we comment further on those below.

Fairness

More work is needed to understand the linkages between entitlements under ACC and the current social welfare benefits system and earlier access to NZS. It is possible that some people may prefer early access to NZS rather than a social welfare benefit if it means that they move onto a higher rate benefit without any abatement for additional earnings. However, there may also be concern at possible unfairness if people between the ages of 60 and 65 are **required** to apply for NZS early (and consequently remain on a low rate for the rest of their lives) rather than having access to ACC or social welfare benefits in that 5 year period.

The Impact of pessimism around life expectancy

Our research has indicated that people tend to have an unduly pessimistic view of their life expectancy.

The following table illustrates the gap.

Understanding Longevity

Year of Entitlement for NZS at Age 65	Expected Lifespan (years)					
	Statistics NZ Very Low Mortality (VLM)		Survey Reported self-expectation		Percent Gap	
	Male	Female	Male	Female	Male	Female
2011	83.8	86.2	86.5	86.3	-3.2%	-0.1%
2012-2021	84.7	86.9	84.1	83.4	0.7%	4.0%
2022-2031	86.9	88.6	81.6	83.3	6.1%	6.0%
2032-2041	89.3	90.5	83.6	84.9	6.4%	6.2%
2042-2051	91.8	92.5	83.4	84.1	9.2%	9.1%
2052-2058	94.2	94.4	85.8	86.0	8.9%	8.9%
2059-2061	95.6	95.5	88.0	94.4	7.9%	1.2%

Source: FSC Horizon Research Dec 2011 and Statistics NZ

These pessimistic expectations may be the deciding factor in some people taking up NZS earlier than age 65 and at a reduced rate for the remainder of their lives. As well as potentially leading to a large number of people unhappy with the impact of the policy change on their standard of living, this will have a detrimental effect on fiscal neutrality if it results in future governments being pressured to increase the level of NZS as more people fall into relative poverty over time.

Fiscal neutrality

The current proposal may not be fiscally neutral. The fiscal neutrality depends on paying a lower rate to those who take up the benefit early and providing an incentive to those who delay. It envisages that those with lower life expectancy will take up the benefit early and those with longer life expectancy will defer. However, as noted above, the evidence points to people consistently under-estimating their likely longevity. That means there is likely to be a greater than expected number of people opting to collect NZS before the age of 65 and smaller than expected number opting to defer.

International research indicates a consistent pattern that, on average, those with low socio-economic status have shorter life expectancies than those with higher socio-economic status. Flexi-Super is therefore likely to increase inequality in retirement as those with the highest incomes are likely to retire on much higher deferred pensions than those on lower incomes who may need to retire earlier.

There will potentially be a large group of unhappy elderly finding it difficult to manage and requiring assistance, with the risk that the savings from paying the benefit to the early group at a lower rate may not be achieved. In 2011 Horizon Research was commissioned by the FSC to ask New Zealanders what level of income would provide a comfortable income in retirement. The result was that most New Zealanders believed they would have a comfortable retirement if they were to receive about $300 (for a single person, living alone) or $500 (for a couple) above the then level of NZ Super. This is approximately twice the level of NZ Super.

Consequently, it is likely that the proposed lower rate of NZS may not provide a sustainable income for those who go on this benefit earlier, particularly if they subsequently discover that they were unduly pessimistic about their life expectancy. People in that situation are likely to need/demand supplements to their NZS which may increase Government expenditure in the longer term.

The Discussion Document notes at footnote 13 that there are roughly 34,000 60-64-year-olds receiving a social security benefit. Assuming that the bulk of those beneficiaries opted to take NZS early rather than remaining on a lower rate income-tested benefit, the level of public expenditure would increase immediately. That may be partially offset by some of those recipients being willing (if able) to undertake work which would not be income tested but would be taxed.

We also have a concern that the general preference for taking NZ Super earlier than age 65 may be greater than expected. Results of polling conducted for the FSC by Horizon Research in September/October of this year (see Appendix 1) indicate that 31% of respondents expect to stop work either before or at age 65. This suggests that there may not be the expected number of people opting to defer receipt of NZS beyond age 65. As NZS is not a pre-funded pension, but is paid for out of current year taxation receipts, that means increased public expenditure required to provide NZ Super to those opting to receive it early.

5. The FSC Alternative

The FSC supports flexibility but we consider there are better alternatives to provide it in the short and the long-term. We recommend that NZS should be kept as the first tier of retirement income provision but with a later age of eligibility phased in as longevity increases. New Zealanders should be encouraged to save in KiwiSaver schemes and to use their KiwiSaver funds to provide income if they wish to retire before they are eligible to receive NZS.

Obviously, these changes need to be phased in and therefore do not provide a solution in the short-term for people who have not had long enough to build up their KiwiSaver balance. An interim short-term alternative would be to allow early access to NZS on an income-tested basis to people aged between 60 and the age of eligibility who are unable to work and would otherwise be receiving a social security benefit.

Most New Zealanders agree that we need to act. A 'no change' policy in NZ is expected to mean the cost of providing NZS would increase from 4% of GDP to 10% by 2100. Paying for this out of taxes would mean tax rates would need to increase by more than 20% which is likely to make NZ a less attractive proposition for working age people able to relocate to Australia or elsewhere.

Increased longevity and better health at later ages makes employment past age 65 a realistic option for many people but, unless the age of eligibility for NZS is moved out, this does nothing to reduce the fiscal cost of NZS, although it will boost tax revenue.

The FSC alternative involves acting early by maintaining NZS in its current form but agreeing to a gradual increase in the age of eligibility as longevity increases. This reduces the fiscal cost while providing the choice for people to retire earlier than the age of eligibility for NZS by stepping up contributions into and coverage of KiwiSaver.

The gap between the age that people may like to stop paid work and the age of entitlement to NZS could be funded relatively easily by minor amendments to KiwiSaver to increase membership and gradually raise contribution rates to a level sufficient to fund a save-as-you-go (SAYGO) second pension. Provided the earning rate on savings is greater than the growth rate of the economy, contributing to an asset accumulating fund (SAYGO) is a more efficient way of saving for retirement than directly paying for pensions from taxation (PAYGO).

The relative size of SAYGO and PAYGO pensions when rates of returns and productivity change*

REAL RETURN	LABOUR PRODUCTIVITY GROWTH RATE	SAYGO PENSION ($)	PAYGO PENSION ($)	RATIO
UNFAVOURABLE CONDITIONS FOR SAYGO (LOW CAPITAL RETURNS, HIGH GROWTH)				
3.0%	2.0%	35,738	25,982	1.38
AVERAGE CONDITIONS FOR SAYGO				
3.0%	1.0%	32,072	16,678	1.92
3.0%	1.5%	33,804	20,828	1.62
3.5%	1.5%	39,921	20,828	1.92
4.0%	1.5%	47,252	20,828	2.27
4.0%	2.0%	49,638	25,982	1.91
FAVOURABLE CONDITIONS FOR SAYGO (HIGH CAPITAL RETURNS, LOW GROWTH)				
4.0%	1.0%	45,111	16,678	2.70

** The pensions assume the average wage begins at $45,000 and grows at the productivity growth rate. Each year a person contributes 10% of their income to either an accumulated SAYGO pension fund or to the Government to fund a PAYGO pension. Pensions increase at the productivity growth rate. The working life is 45 years and the retirement period is 19 years. When the working age population increases by 0.25% per year, the cost of providing a PAYGO pension reduces by 10%.*
Source: Andrew Coleman, Motu Research

With extension of KiwiSaver membership and higher contribution rates it is a realistic prospect for someone on the median or average wage, who contributes to KiwiSaver over a 40 year working life, to save enough to fund a pension that would double their income from NZS alone. Someone on minimum wage for 40 years could also achieve this if they delayed their retirement until age 67.

The FSC proposal is to introduce a combined approach which would see people accumulating sufficient savings to fund the gap before they become eligible for NZS, if they wish to retire earlier, and provide an additional top-up pension after that.

Other means to help KiwiSaver members accumulate a substantial pot of savings include introducing a lower initial contribution rate (say 1% split between employee and employer) with automatic increases of 1% on 1 April of each year, or when a pay increase occurs, until a contribution rate of 10% of income is achieved, based on current policy settings.

New research about to be released by FSC demonstrates that, by removing the tax distortions that penalize compounding savings products and phasing out the current KiwiSaver incentives, it would be possible to accumulate that same pot of savings over a 40 year working life on a contribution rate of around 7%.

6. Responses to Specific Questions

Does the concept of more choice in the age of entitlement to receive NZS appeal to you?

We support the concept of more choice in the age of ceasing paid work but consider that the impact of increased longevity means the age of first entitlement to receive NZS will need to be delayed for everyone in the future.

The FSC view is that people can still have the choice to cease paid work earlier than the date they receive NZS. Their income during that "gap" can best be provided by a KiwiSaver fund built up over their working life which would also provide additional income to top-up NZS.

Are you comfortable with the risk of higher levels of hardship among the elderly in order to gain flexibility in the age of first entitlement to NZS?

FSC would not support any increase to the risk of higher levels of hardship among the elderly. In our view that risk can be avoided for future retirees by increasing coverage of and contributions to KiwiSaver, with appropriate tax and investment policies, so that everyone can have a retirement income equivalent to twice the current level of NZS by saving around 7% of their income.

Weighing up the pros and cons identified regarding Flexi-Super, are you in favour of having Flexi-Super?

As noted above, while we support the objective of people being able to choose earlier or later retirement, we believe there is a better way of achieving the objective without the fiscal and fairness risks inherent in the Flexi-Super proposal.

The FSC alternative would enable the age of eligibility for NZS to be moved out (reducing the fiscal cost) while enabling those who want to retire earlier to 'fund the gap' before they receive NZS.

We are available to meet with officials to discuss the matters contained in this submission.

Yours sincerely,

Peter Neilson
CHIEF EXECUTIVE

List of FSC Members

FSC Members
AIA NZ
AMP Financial Services
ANZ Bank
Asteron Life Ltd
BNZ Insurance
CIGNA Life Insurance NZ Ltd
Fidelity Life Assurance Co Ltd
FNZ
Gen Re LifeHealth
Hannover Life Re of Australasia Ltd
Kiwibank Ltd
Mercer
Munich Reinsurance Co of Australasia Ltd
Partners Life
Pinnacle Life
Public Trust
RGA Reinsurance Co. of Australia Ltd
SCOR
Sovereign Ltd
Swiss Re Life & Health Australia Ltd
TOWER New Zealand
Westpac Bank

Associate Members
Bell Gully
BNP Paribas
Bravura Solutions
Burrowes & Co
Chapman Tripp
Davies Financial & Actuarial Ltd
Deloitte
DLA Phillips Fox
Ernst & Young
KPMG
Kensington Swan
Melville Jessup Weaver
Minter Ellison Rudd Watts Lawyers
Morningstar Research Ltd
PricewaterhouseCoopers
Russell McVeagh
Trustees Executors Ltd

8. At what age do you expect to completely stop paid work?

Results for 1942 total responses (format: Multichoice)

A. Never	3%
B. I plan to stop paid work before 65	10%
C. 65	21.4%
D. 66	1.4%
E. 67	3.7%
F. 68	3.3%
G. 69	1%
H. 70	14%
I. 71	0.2%
J. 72	0.4%
K. 73	0.4%
L. 74	0.3%
M. 75	2.8%
N. 76	0.2%
O. 77	0.1%
P. 78	0.2%
Q. 79	0%
R. 80 or more - but plan to stop paid work at some stage	2.4%
S. I don't know - there are too many things to consider	35.2%

Source: Horizon Research Poll for FSC, September/October 2013