# KIWISAVER 2050
## PATHWAYS TO THE FUTURE

## DISCUSSION PAPER

SEPTEMBER 2019

Financial Services Council.
Growing and protecting the wealth of New Zealanders

# Contents

# Foreword

New Zealand has a comparatively simple and effective Retirement Framework built on the pillars of New Zealand Superannuation, the New Zealand Superannuation Fund and since 2007, KiwiSaver. The Financial Services Council (FSC) believes New Zealand has a robust Framework that has built its reputation on its ability to deliver a basic level of income through its universality and simplicity.

Our view is that New Zealand Superannuation has an important role in providing a basic level of income in retirement, while KiwiSaver provides the opportunity for New Zealanders to continue their lifestyle into retirement.

Over the last two years, the FSC has completed a number of research projects into KiwiSaver which highlighted the size of the retirement income gap for New Zealanders; the attitude and plans of younger New Zealanders towards retirement, as well as a better understanding of the expectation of older New Zealanders. We believe those insights, and this discussion paper has an important role in helping to create policy for New Zealand at a strategic level.

When you look holistically at the Retirement Framework, you can see there are gaps that exist and this raises a number of questions that need to be addressed. As discussed within the paper, concerns exist about whether the level of income for those who are retired is enough. There are 1.2 million KiwiSaver members (FMA 2019) not making regular contributions, and even those who do make regular contributions will find just saving the minimum amount, will not be enough.

There are ongoing issues with those who are unable to save due to illness or accident, and whether self-employed New Zealanders are making plans for their retirement. In addition, the gap in the amount saved in retirement between men and women has not got any smaller, and this is a problem compounded by the longer life expectancy of women.

From a macro perspective, there is a framework that is constantly changing and being debated. There is an ongoing discussion about the retirement age, the eligibility of New Zealand Superannuation, and since launch, there have been over 25 changes to KiwiSaver.

Additional questions continue to be asked about whether New Zealand's health policy and other services will be able to cope with an ageing population, especially if an estimated 50% of the health budget will be dedicated to those over 65 years in 2025/26 (Ministry of Health, 2016).

It is important to face into these questions because, in the next thirty years, when the number of New Zealanders who are over 65 years have doubled, and superannuation payments are nearly $80 bn (gross), we may as a nation have a number of tough choices to make about spending priorities.

Of course, KiwiSaver will also continue to grow, and we estimate that on current trends, funds under management could nominally be close to $911bn (or $498bn in real terms) At this level KiwiSaver not only could have a positive impact on the lives of New Zealanders, but also a positive impact on capital markets and the Retirement Framework overall.

Despite the size of KiwiSaver, the reality is these issues will still exist, and unless they are addressed, they will only get larger with the passage of time. The FSC welcomes the opportunity to have a conversation and a debate about the issues in retirement that affect all of us. As New Zealand starts to plan ahead to 2050 and beyond, it is critical that the KiwiSaver industry, regulators, lawmakers, and New Zealanders come together to create a sustainable future for generations to come.

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# Summary

Having financial security in retirement is critical for New Zealanders, for without it, there is a poor quality of life and a lack of choices from where to live or even access health care. This is why New Zealand's Retirement Framework, underpinned by New Zealand Superannuation (NZS), New Zealand Super Fund (NZSF) and KiwiSaver, has the ambition to provide financial security for the retired, now and the future.

However, with an ageing population, economic headwinds and political uncertainty, we need to ensure New Zealand's superannuation framework can continue to deliver, not just for those in retirement today, but also those planning to retire in 2040, 2050 and beyond.

The purpose of this paper is to start the conversations for what our Retirement Framework could look like. It will provide a high-level overview of our Retirement Framework and make predictions on how it is going to evolve over the next thirty years.

The paper provides several concepts for our discussion:

1. Continue to look for ways the coverage of KiwiSaver can expand through increasing the level of participation.
2. Focus on decreasing the potential income gap New Zealanders may have at retirement through a range of suggestions designed to increase savings rates and individual investment returns. This could be through the use of incentives and the better use of *nudge* based communications to drive engagement and action.
3. To ensure continuity of lifestyle once retired, there needs to be a coordinated approach to decumulation, using the best principles of KiwiSaver.
4. Continue to focus on building the levels of financial literacy in New Zealand through the variety of programmes promoted by the Commission for Financial Capability (CFFC) and our members. This can be supported through better use of Robo-advice, data, and technology.
5. Build and maintain a retirement framework that is stable and focused on providing certainty for New Zealanders in the future.

The ideas the FSC has developed are designed with the single purpose of making retirement better for individuals and New Zealand. The considerations this paper discusses could help reduce the income gap that many New Zealanders will face in retirement and the reliance on New Zealand Super as the sole source of income in retirement.

# PART ONE: THE RETIREMENT CONTEXT

## INTRODUCTION

Having financial security in retirement is critical for New Zealanders, for without it, there is a poor quality of life and a lack of choices from where to live or even access health care. This is why New Zealand's retirement framework, underpinned by New Zealand Superannuation (NZS), New Zealand Super Fund (NZSF) and KiwiSaver, has the ambition to provide meaningful financial security for the retired, now and in the future. Indeed, compared to many Organisation for Economic Co-operation and Development (OECD) countries New Zealand's framework is one to be proud of, not only for the comparative simplicity of NZS and KiwiSaver but for its outcomes with New Zealand having comparatively low levels of poverty in the OECD in retirement.

However, with an ageing population, economic headwinds and political uncertainty, we need to ensure our superannuation framework can continue to deliver, not just for those in retirement today, but also those planning to retire in 2040, 2050 and beyond. New Zealand must start today to have these discussions, as it is the only way we can design and prepare for a future where over one million New Zealanders are retired.

The Financial Services Council (FSC) is well placed to help drive these conversations representing over 90% of KiwiSaver Funds Under Management. We hear the concerns of our members and their KiwiSaver customers about building a future that is sustainable and successful in ensuring a high standard of living for our retired.

This discussion paper begins with a high-level overview of New Zealand's Retirement Framework and makes predictions of how it is going to evolve over the next 30 years. It will then ask questions and discuss the performance of our framework.

The paper will highlight a number of considerations to move forward. This includes the use of incentives to encourage moving from a default fund and a focus on decumulation to help smooth income during retirement. The paper continues to support the progress with financial literacy and encourages the use of technology and Robo-advice to drive knowledge and engagement.

# PART ONE: THE RETIREMENT CONTEXT

## NEW ZEALAND'S RETIREMENT FRAMEWORK

New Zealand's Retirement Framework broadly aligns with the principles and ambitions set out by the World Bank. They believe the core objectives of any pension system is to protect against the risk of poverty at old age and to smooth the consumption of income from work to retirement (World Bank, 2008).

New Zealand's retirement history started with a comprehensive system of public tax-funded old-age pensions from 1938. Then, until 1989, participation in formal private retirement earnings was encouraged through a range of tax incentives, including the tax-free accrual of investment returns, and tax exemptions on contributions.

In 1989 it was felt that workers could be left to make their own choices, without the need for any state incentive and concessions were withdrawn. Consequently, membership fell markedly, and by the mid-2000s coverage of the workforce in employment-based retirement, schemes had dropped to c.14% (St. John, 2007). What followed next was a decade of debate, government reports, and even a referendum[1], and this was the context that gave birth to KiwiSaver, launched on July 1, 2007.

### New Zealand Retirement Framework

| STATE PENSION | | VOLUNTARY RETIREMENT SAVINGS | PUBLIC POLICY |
|---|---|---|---|
| NEW ZEALAND SUPER | NEW ZEALAND SUPER FUND | KIWISAVER / PRIVATE PENSION SCHEMES | KEY AREAS: HEALTH, HOUSING, DISABILITY |
| NZ Super cost (gross) $15.48bn, 4.9% of GDP | NZSF: $39.2bn to support future requirements for NZS | KiwiSaver<br>31 proviers, 154 funds<br>2.8m New Zealanders<br>$48.6bn FUM (FMA, 2019) | Public policy across multiple areas including health, housing, employment |
| Paid to c.794,000 New Zealanders, paid to c.86% over 65 years | | Other superannuation schemes:<br>216 private sector employers were exempt from enrolling new employees into KiwiSaver (June 2018)<br>15 complying superannuation funds (June 2018) | |
| Standard NZ Super rates (April 2019)<br>Single: $21,380<br>Married (both qualify): $32,892 | | KiwiSaver average balance: $17,130 | Of those over 65:<br>54% are in a home without a mortgage<br>68% have savings account<br>39% term deposits |

[1] A referendum on introducing a compulsory retirement savings scheme was held in New Zealand on 26 September 1997. The question put in the referendum was, "Do you support the proposed compulsory retirement savings scheme?" The proposal was rejected by 91.8% of voters, with a turnout of 80.3%.

# PART ONE: THE RETIREMENT CONTEXT

NEW ZEALAND SUPERANNUATION (NZS) is a non-contributory state pension which starts at the age of 65 years. With NZS, there is no income or asset test with the only real requirement to meet a comparatively low residency test[2], which is being reviewed.

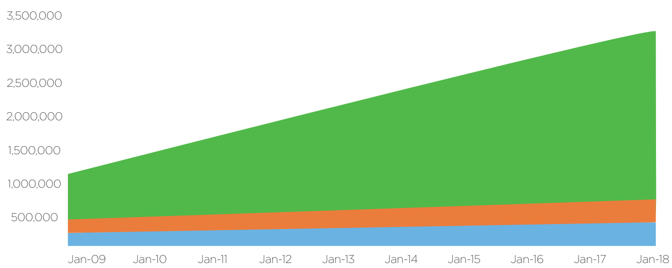
NZS is best seen as a "*sophisticated yet simple variation of social insurance; it is neither earnings-related nor contributory but fulfils a role of a basic income.*" Compared with overseas experience, it is simple and generous, and coupled with high levels of home ownership, means poverty is relatively low (St. John, 2016). These sentiments were echoed by the Retirement Commissioner over a decade ago when NZS was described as a "*remarkably effective, simple and secure foundation for retirement income. It means that New Zealanders - and especially women – are less at risk of hardship in later life than people in many developed countries*" (Crossan, 2007).

The future sustainability of NZS is underpinned by the New Zealand Super Fund (NZSF) which was introduced in 2001, to "*smooth the costs of the demographic transitioning to an old age structure with the aim of pre-funding emerging New Zealand Superannuation entitlements*" (Commission of Financial Capability, 2013)[3]. In June 2018, the NZSF had $39.4bn funds under management with returns of 12.43% (before tax). Between 2003 and 2009, the Government contributed $14.88bn to the Fund, before suspending contribution in 2009 due to the Global Financial Crisis. The new Labour Government restarted contributing with an additional $500m to the Fund in 2017/18 and is projected to provide a further $7.2bn over the next four years. From around 2035/36, the Government is expected to begin to withdraw money from the Fund to help pay for New Zealand Superannuation, peaking in 2053 (Superfund, 2018).

By inference, successive Governments have effectively ruled out altering NZS so that it becomes more affordable in the future. Previously Treasury had modelled alternative options for NZS, including increasing the eligibility age, reducing eligibility or altering the replacement rate calculation (Bell, 2010). Before the 2017 election the National Government policy was to increase the eligibility age to 67 in 2057, an idea recently revised.

KIWISAVER is a defined contribution scheme[4] funded by a mix of employer, employee, and Government contributions. The objective of KiwiSaver, as set out in its legislation is to "*encourage a savings habit and asset accumulation among individuals who may not be in a position to enjoy standards of living in retirement, similar to those in pre-retirement*" (Rashbrooke, 2009). The KiwiSaver 2018 annual report highlights 2.8 million members with total assets over $48 billion (FMA, 2019). There are 31 scheme providers, the majority of which are members of the Financial Services Council.

KiwiSaver Members (IRD, 2019)




[2] The residency test is only to be in New Zealand, 10 years after age 20, with at least five years after age 50. This is currently being reviewed.

[3] It should be noted that some Economists question the conclusion the view that NZS is not sustainable, and that it needs to be underpinned by NZSF. They argue the Government is better off reducing debt or investing in future economic growth Eg, The New Zealand Initiative (2019) or Chamberlain & Littlewood )2019).

[4] Defined contribution is when contributions are invested and the amount available when taken out depends on the investment returns achieved. The investment risk is with the individual. A defined benefit scheme is when the pension benefit is defined by a formula usually related to number of years worked, with no investment risk passed to the investment members.

## KIWISAVER FEATURES

From its inception, KiwiSaver was seen as making retirement easy through its comparatively simple scheme design. This is a crucial reason for its success and why very quickly KiwiSaver became the dominant retirement savings scheme, leading previous employer-based schemes, to slowly decline. Underpinning KiwiSaver are a number of innovative features:

### Auto-enrolment / Soft compulsion:

Workers aged 18-65 years are enrolled automatically into KiwiSaver on the start of new employment and can choose to opt-out if they wish between 2-8 weeks[5]. If they do not opt-out, the employer is then compelled to contribute[6].

KiwiSaver is the world's first auto-enrolment national savings scheme[6] and captures the philosophies of behavioural economics. Research shows that people have high inertia about starting to save for retirement, and auto-enrolment helps overcome this issue. Overall, 43% of KiwiSaver members have opted-in via automatic enrolment, while 47% have opted-in via a provider. Since its inception, nearly 232,000 members have opted out within the window (8% of total members) (IRD, 2019).

### The provision of choice:

Right from the inception of KiwiSaver, there was a focus on choice, which was facilitated by Inland Revenue (IRD). "Savers can choose which KiwiSaver they want to administer their product, and which fund they want to be in [whether it is conservative, balanced, or growth]." An auto-enrolled member does not have to choose as he or she will be allocated to one of the default funds.

The KiwiSaver member can make their choice at any time. Indeed, the Financial Markets Authority (FMA) views switching funds or providers as a sign of engagement. For the year ending March 2018, nearly 190,000 members switched funds, an increase of 10.3% versus the previous years. Of these, approximately 28,000 members made an active choice about their default fund (FMA, 2019).

KiwiSaver members also have the choice of how much they save, choosing to contribute more either directly or by increasing their contribution through their salary (3%, 4%, 6%, 8% or 10%).

### Use of incentives:

From its inception, KiwiSaver has always used incentives to get the savings habit started. Research found that one-third of members said the incentive and design features played a significant part in starting to save for retirement (IRD, 2008).

The incentives include (Rashbrooke, 2013):

- $1000 Kickstart: A tax-free contribution to get New Zealanders to start saving for their retirement. Subsequently, the Kickstart incentive stopped in 2015.
- Government contribution: From the inception of KiwiSaver to July 2011, the Government matched individual contributions by up to $1,043 a year ($20 a week). This was reduced by 50% in 2011, capping the value of the match at $521 a year.
- Compulsory employer contributions: For contributing member employees, employers are required to provide an amount equal to at least 3%.
- Home Loan subsidy: The allowance of members to take some of their own and employer savings to help towards a first home deposit. Also, after three years of contribution, members may be entitled to a subsidy, up to a maximum of $10,000.

As incentives have been shown to work with KiwiSaver, thought could be turned to thinking of other ways the principles could be extended. As discussed in Part Three, incentives could be used to encourage movement from default funds and promoting an additional level of savings.

[5] United Kingdom followed in 2012.

[6] If an individual wants to opt out, and misses the window, they are able to take an early contribution holiday, after 12 months of contribution.

## THE ROLE OF INLAND REVENUE (IRD)

IRD is the underlying administrator for KiwiSaver, which is fundamental for the flow of funds in an efficient and timely fashion. From an administrative cost perspective, KiwiSaver costs only 0.35% of GDP, among the best in the OECD (MacDonald and Guest, 2019).

### Tax

Based on the principle of tax neutrality, all tax concessions for private retirement savings were abolished in 1988-1990. This means that contributions, whether by employer or employee, are out of after-tax income (**T**axed); fund earnings were taxed at a rate that proxies for the individual's marginal tax rate (**T**axed); but withdrawals are a return of tax-paid capital and hence tax-exempt (**E**xempt).

The Tax Working Group (TWG) was an advisory body that was created by the New Zealand Government in late 2017 to investigate ways of reforming New Zealand's taxation system and making it "fairer." It looked at whether much change could be achieved moving to an **EET** approach, and concluded the current approach was best suited for KiwiSaver and New Zealand (TWG, 2018).

Generally, the addition of KiwiSaver to New Zealand's Retirement Framework could be viewed as a success from an outcome, process, and political perspective. Indeed, given the political history with superannuation, and New Zealanders lack of savings, attracting c. 2.8 million New Zealanders in the scheme, with $48.6bn under management in 2018 (FMA, 2019), should be viewed as a success.

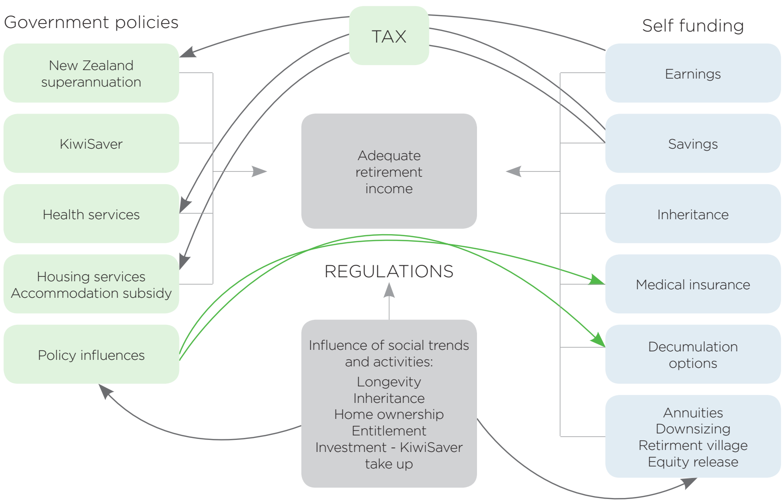
## THE PUBLIC POLICY RETIREMENT ECO-SYSTEM

It is essential when considering the level of income in retirement that the public policy eco-system is considered and not solely focused on NZS or KiwiSaver. Our "*retirement income framework is an eco-system, meaning a complex network of interdependent systems.*"

*The all-dominating subject of the age of eligibility [for NZS] cannot be addressed without also acknowledging the interdependencies: the ageing workforce, the role of KiwiSaver, decumulation options, and more*" (Commission for Financial Capability, 2016, p. 4).

### Interdependence of influences on the adequacy of retirement income

(Davey & Stephens, 2018, p.97)



## THE PUBLIC POLICY RETIREMENT ECO-SYSTEM

The interconnectedness can be seen, in particular when the Government policy on health is considered. An estimated c.45% of the current health spending goes on the 65-plus age group, a figure that is only likely to rise when the wider ageing population is considered. Long(er) waiting lists suggest there may be a requirement for self-funding of medical procedures, which then brings into question medical insurance or long-term care policies. It is unlikely that most individual retirement plans have considered the aspect of health.

Housing is another example, where the current policy is broadly "ageing in place" where home care and services are delivered in the community. As the population ages, coupled with increased longevity, it is likely that specialized housing will become more and more critical.

The accommodation supplement was designed to reduce the impact of housing costs for those with low income, and for older people, this could be invaluable. The problem is that the increases in the accommodation supplement do not keep pace with the rising rents, especially in Auckland. In 2012, 5% of Superannuitants received the accommodation supplement, costing c.$100m. Again, this is expected to rise with the ageing population (Davey & Stephens, 2018, p. 89).

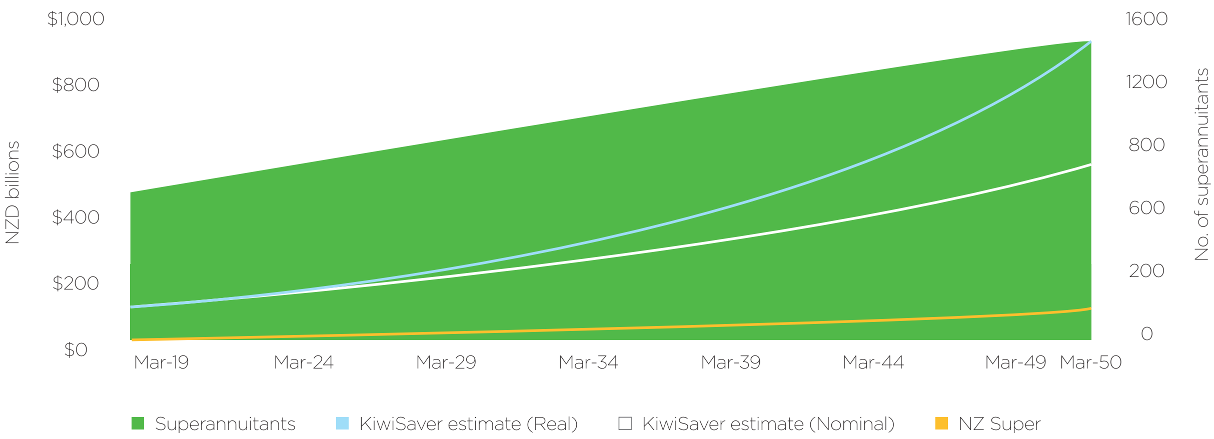
# PART ONE: THE RETIREMENT CONTEXT

## THE NEXT THIRTY YEARS

In 2050 there will be an estimated 1.4 million Superannuitants in New Zealand, more than double what there are today. The impact will be extraordinary not from just a GDP perspective, where it estimated NZS would increase from 4.9% to 7.9% of GDP (gross)[7], but from the standpoint of health, housing, and the workforce.

This is why having a robust and predictable Retirement Framework is so important, especially with KiwiSaver. In 2050, FSC projections estimate that KiwiSaver would nominally be worth $911bn (or $498.4bn in real terms), with a low estimate of $671.3bn and a high estimate of $1,239.4bn[8]. KiwiSaver will continue to grow in its significance and importance not just from a member perspective, but also with its impact on the financial services sector and the broader New Zealander economy.

Projections over the next thirty years
(Treasury, 2019) (MJW, 2019)




As you would expect, there are a number of assumptions that underpin any projection, way too detailed for a discussion paper such as this. While time will be the ultimate test on their accuracy, what is clear is the direction. Increases in all areas are significant, rapid, and too big to ignore.

1. The Economy
Investment interest rates at historic lows.
As a response to the *Global Financial Crisis*, interest rates were reduced to historic lows, and a decade later, this monetary strategy shows no likelihood of ending any time soon. As a significant proportion of those over age 65 rely on the interest income from term investments and savings accounts, this has led to a reduction in income.

[7] By way of comparison, the OECD average was 8.2% in 2015. (Davey and Stephens, 2018)

[8] This work was completed for the Financial Services Council, with more details available upon request. A high level summary is provided in the Appendix.

Overall, 32% of KiwiSaver funds are invested in Cash or Fixed Interest (FMA 2019), and a monetary policy which lowers interest rates can impact on fund returns, especially if it is a conservative fund[9].

### The volatility of international markets

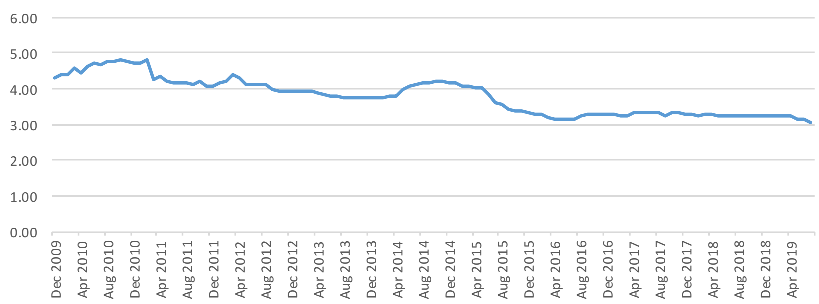
In recent times global markets have become volatile and the impact on retirement funds is multi-dimensional. Some will find the value of the fund eroded just when they need it; while others will have benefit from the lower purchase price in the long term. It is also psychological as many struggle with seeing their funds decreasing in an economic downturn.

### 2. Old age dependency rates keep growing

The success of retirement systems around the globe including New Zealand has depended on one key factor: The number of younger individuals paying into the system has to be large enough to support the number of people taking payments out of the system. The higher the ratio, the greater the burden on workers.

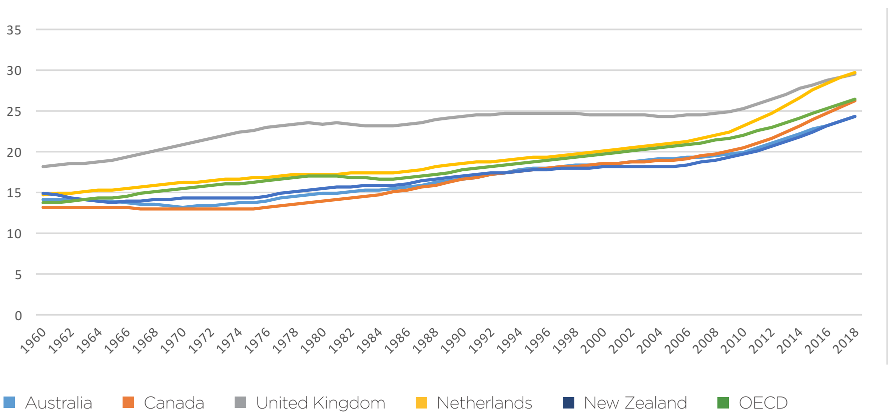
While policymakers have limited tools at their disposal to help alleviate the impact of ageing, few are popular and have been at various times debated in New Zealand. Options have included raising the age of eligibility for retirement, reducing the level of New Zealand Superannuation and even increasing the level of immigration. What is clear is that this will not go away with time and in some way will need to be addressed.

### Six-month term investment %




### Old age dependency rates[10]

(World-Bank, 2019)




[9] Of course, a key reason for the monetary policy which lowered interest rates was to create confidence in investment markets which have shown reasonable growth over the last few years. This would enhance returns, especially for Growth funds.

[10] Old age dependency ratio is the ratio of older dependents--people older than 64--to the working-age population--those ages 15-64. Data are shown as the proportion of dependents per 100 working-age population.

3. Health
There are two critical issues with health impacting those over 65 years. From a micro perspective, technology and lifestyle improvements are leading to healthier, older people. Coupled with significant advances in medical science this will lead to much better outcomes in terms of longevity now and in the future.

However, from a macro perspective, rising health care costs, coupled with a shortage of healthcare staff, will create issues, especially for those over 65 years. Further, the impact on fiscal policy, will be significant and require trade-offs, or hard decisions across the Government's budget.

4. Technology
Technology continues to advance at an exponential rate and impacts everyone in ways that can only be imagined in the future. Whether it is our health, the way we make payments, use robotics or virtual reality, technology will have an impact. In many cases, this will be positive.

While completing a deep dive into technology is outside the scope of this paper, attention should be drawn to its impact with retirement. The use of artificial intelligence and Robo-advice to help New Zealanders make plans for their retirement could be a significant breakthrough with improving financial literacy and engagement.

KiwiBank research found that given less than 20% of New Zealanders have a financial adviser and that most do not engage with their retirement due to time or knowledge, Robo-advice could act as a great alternative. Indeed, their research found that overall 21% of respondents would engage with a Robo-adviser, much higher if the respondent was younger, and lower if they were older (Kiwi Wealth 2016).

The OECD supports the use of Robo-advice platforms due to its potential to deliver financial advice that is objective, consistent, transparent and affordable. They note that policymakers will need to ensure that legislative frameworks are able to meet duty of care requirements, transparency objectives, and access to redress in the case of unfair outcomes for the consumer (OECD 2017).

As discussed in Part Three, the FSC certainly believe there is an opportunity to use technology underpinned by data to engage with KiwiSaver members, and lift levels of financial literacy.

# PART ONE: THE RETIREMENT CONTEXT

## CONCLUSION

The World Bank believes the core objectives of any pension scheme is to protect against the risk of poverty at old age, and the smoothing of consumption from work to retirement. It is with these objectives that we consider how New Zealand approaches retirement and how we can judge its overall success.

New Zealand's approach to preparing and funding retirement is three-fold: New Zealand Superannuation, which provides a pension from the age of 65 years; New Zealand Super Fund, which helps prefund future expenditure requirements of New Zealand Superannuation; and since 2007 KiwiSaver. Underpinning the approach is a range of Government policies, such as health and housing, which directly impact on the quality of life of those who are retired.

In 2050, it is estimated there will be 1.4 million superannuitants in New Zealand, double what there are today. The issues associated with an ageing population are well documented, and even though KiwiSaver is estimated to nominally grow to just over $900bn by 2050, New Zealand needs to ensure we are prepared.

# PART TWO: A POLICY SUCCESS FOR NEW ZEALAND?

## INTRODUCTION

When you look at the New Zealand approach to superannuation, it appears to be relatively successful. New Zealand Superannuation is one of the most straightforward and generous in the OECD. KiwiSaver has approximately 2.8 million members, with approx. $50bn under management, and this is estimated to nominally grow to $911bn (or $498.4bn in real terms) by 2050. It would appear that New Zealanders could be happy with the retirement they can look forward to or are experiencing. Except, this is not the case.

The purpose of Part Two is to highlight from both a macro and micro perspective, where New Zealand is doing well, and where there are areas for improvement.

## INTERNATIONAL EXPERIENCE

The Melbourne Mercer Global Pension Index (MMGPI) provides a useful context as it compares the retirement income systems from 34 diverse countries. The scores are developed from a review of adequacy, sustainability, and integrity, and the survey provides an in-depth analysis of each area. The underpinning research of the MMGPI is at a high level, which can mean some inferences may not be as robust, the study is particularly useful for comparisons and learning from the experience of other countries. Overall, New Zealand rated a B, with a commentary that highlights the sound structure of our Retirement Framework. It recommends increasing the level of KiwiSaver contributions, raising the level of savings generally, increasing the focus on post-retirement income streams, and expanding the coverage of KiwiSaver.

By contrast, the Netherlands' retirement system comprises a flat-rate pension and a quasi-mandatory earnings-related occupational pension linked to industrial agreements. Most employees belong to these schemes, which are defined benefit plans with the earnings measure based on lifetime average earnings. The Netherlands' have started to lift the retirement age to 67 years and like all OECD countries need to boost the level of household savings.

Australia's retirement income system comprises a means-tested age pension, and a mandatory employer contribution paid into a private sector fund. The MMGPI rating has fallen in the last 12 months primarily due to a toughening of the asset test resulting in a reduction in the net replacement rate.

### MMGPI 2018 Ratings

(Mercer, 2018)

| System | Overall Index Value | Grade | Sub Index Values | | |
|---|---|---|---|---|---|
| | | | Adequacy | Sustainability | Integrity |
| New Zealand | 68.5 | B | 65.4 | 63.4 | 80.6 |
| Australia | 72.6 | B | 63.4 | 73.8 | 85.7 |
| Canada | 68 | B | 72.1 | 56 | 78.8 |
| Netherlands | 80.3 | A | 75.9 | 79.2 | 88.8 |
| UK | 62.5 | C | 57.8 | 53.4 | 82.9 |

# PART TWO: A POLICY SUCCESS FOR NEW ZEALAND?

## DOES NEW ZEALAND'S APPROACH TO SUPER PROVIDE AN ADEQUATE INCOME?

An adequate retirement framework is one that provides benefits sufficient to prevent old-age poverty while providing a reliable means to smooth lifetime consumption. (World Bank, 2008, p.4). Indeed, having an adequate income is one of the more "*economic, social and political global challenges of our time, with significant consequences at both the individual and society level. This includes the risk of widespread poverty among the elderly and greater demand for various forms of government social assistance, increasing the likelihood of fiscal imbalances*" (J Burnett, 2017, p. 902).

From a New Zealand perspective, adequacy relates not just to the level of NZS, KiwiSaver and their fiscal sustainability, but also to the broader system of supplementary payments, health and housing and the ability to run down accumulated savings and assets. One way adequacy can be measured is to review the level of poverty amongst the elderly, and on this basis, New Zealand is slightly ahead of the OECD average. This is due to our comparatively generous NZS and high levels of homeownership amongst the elderly (though this is falling). KiwiSaver is yet to have a significant impact on supporting incomes in retirement but will do so as KiwiSaver balances grow.

### OECD Poverty Rates 2014

(OECD, 2019)[11]

| | Income of older people 65+, % of population incomes | Average worker earning USD | Old Age Income Poverty (ratio) | Old Age Income: Poverty (Ranking) |
|---|---|---|---|---|
| New Zealand | 86% | $42,718 | 10.6 | 22 |
| Australia | 71% | $65,196 | 25.7 | 33 |
| Canada | 91% | $42,689 | 9.0 | 17 |
| Netherlands | 83% | $59,165 | 3.7 | 4 |
| UK | 83% | $55,539 | 13.8 | 24 |
| OECD Average | 88% | $40,008 | 12.5 | - |

Research is increasingly showing that there is an income gap for the retired after NZS payment and any other available savings such as KiwiSaver, investments, savings accounts, and a home to downsize. Workplace Savings NZ / Massey University research highlighted a difference ranging from $200 a week to nearly $800 a week, depending on the lifestyle and the location of retirement. This is the gap that must be filled by either savings or making lifestyle trade-offs.

### The retirement gap[12]

(Matthews, 2019, p.8)

| One person household | 2018 Gap | 2017 Gap | Change | Lump sum required |
|---|---|---|---|---|
| No frills metro | -$197.58 | -$200.24 | -1.5% | $193,000 |
| No frills provincial | -$168.56 | -$170.84 | -1.3% | $165,000 |
| Choices metro | -$789.26 | -$784.97 | 0.5% | $774,000 |
| Choices provincial | -$433.30 | -$433.96 | -0.2% | $425,000 |

| Two person household | 2018 Gap | 2017 Gap | Change | Lump sum required |
|---|---|---|---|---|
| No frills metro | -$268.59 | -$271.52 | -1.2% | $263,000 |
| No frills provincial | -$13.31 | -$21.18 | -37.2% | $13,000 |
| Choices metro | -$801.13 | -$799.42 | 0.2% | $785,000 |
| Choices provincial | -$502.20 | -$504.48 | -0.5% | $492,000 |

[11] 2014 is the latest available. For international comparisons, the OECD treats poverty as a "relative" concept. The yardstick for poverty depends on the median household income in a particular country at a particular point in time. Here, the poverty threshold is set at 50% of median, equivalised household disposable income.

[12] The Retirement Expenditure Guideline are the seventh in a series that commenced in 2012. The data used for the survey is the Statistics New Zealand's Household Expenditure Survey (HES) for the year ended 2016. The survey is based on 5,000 Households, targeting New Zealanders who are over the age of 15 years. The New Zealand Retirement Expenditure Guidelines comprise a set of eight expenditure guidelines, with each guideline reflecting a different group of retirees. The retirement groups represent specific combinations of geographic location, household size and budget type. The No Frills guidelines reflect a basic standard of living that includes few, if any, luxuries. The Choices guidelines represent a more comfortable standard of living, which includes some luxuries or treats. For more information please refer to the website.

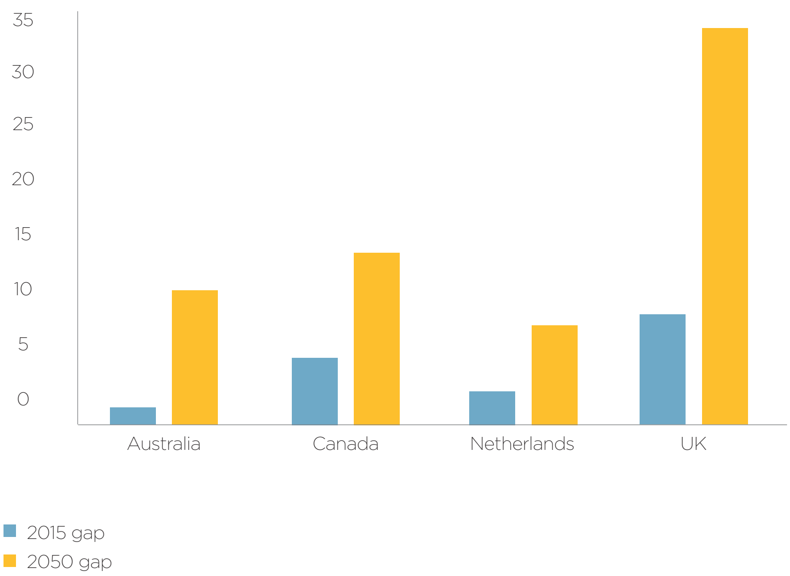
## PART TWO: A POLICY SUCCESS FOR NEW ZEALAND?

FSC research reported that "*most are managing well, but despite the appearance of a large accumulation of wealth, the incomes of those over 65 who are retired are falling an average of $218 a week short of what they believe would make their lives comfortable- and 69% have a larger income gap.*" (Financial Services Council, 2017, p. 6).

It is not surprising then there is a resounding lack of confidence amongst a majority of New Zealanders that they will have enough income for retirement. Further research found that 69% of those under 65, believe they will not have enough. More disturbing is that 25% don't know if they will have enough for retirement (Financial Services Council, 2018)

New Zealand is not unique, World Economic Forum research in association with Mercer, found a significant savings gap, that only continues to grow.

Size of retirement savings gap[13]
(World Economic Forum, 2019)




[13] New Zealand data not available within report.

# PART TWO: A POLICY SUCCESS FOR NEW ZEALAND?

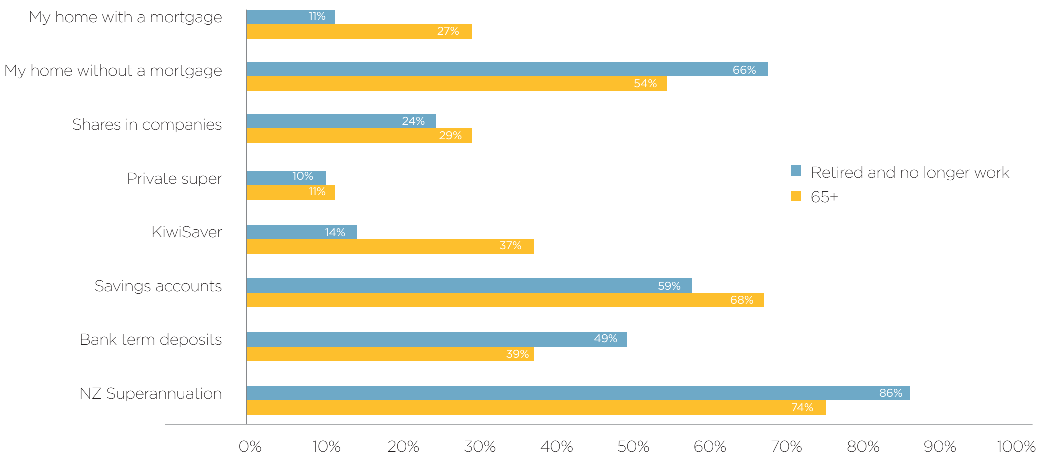
## CLOSING THE GAP

For most of the retired, there is a gap, and it would be difficult to survive on NZS payments solely, especially if rent or mortgage payments are required. This gap is filled through a combination of New Zealanders downsizing their own home and savings (including KiwiSaver) and term deposits.

In the future, KiwiSaver could be well placed to facilitate closing the gap for future retirees, but with average balances currently at approx. $17,000, it may not be as useful as New Zealanders think or hope.

### Current Assets

(Financial Services Council, 2017, p.10)[14]




Several issues do not help this problem:

1. Level of contribution.

Despite having over 2.8 million members in KiwiSaver, many New Zealanders are not contributing or are not contributing enough, to provide a satisfactory retirement.

FMA (2019) statistics highlight that almost 1.2 million members (40.7%) were not making contributions at the end of March 2018. There are many reasons for an individual to stop contributing, including that of earning a low income, where those struggling financially now could find a KiwiSaver contribution only exacerbates the problem. This situation will only be amplified upon retirement, where there may be reduced potential for earning an income.

The second issue is that many New Zealanders are merely contributing to the minimum amount of 3%, or in the case of the self-employed, the minimum level required to maximise the Government contribution. Depending on when they started saving, it will not be enough to close the gap. One reason for contributing the minimum is the lack of awareness and engagement with their KiwiSaver product.

### Minimum Contribution[15]

| Country | Minimum |
|---|---|
| New Zealand | 6% (3% employee + 3% employer) |
| Australia | 9.5% slowly increasing to 12% on July 25 |
| Canada | 5.1% |
| United Kingdom | 8% (with at least 3% from the employer) |

[14] Workplace Savings research in 2018 found that 88% of the retired respondents owned their own home, with most of those (79%) being mortgage-free (Matthews, 2019).

[15] It is easy to equate contribution rates to future poverty levels, but this is not necessarily the case. All of the selected nations have a multi-pillar retirement framework, which individual's contribution form one part off.

# PART TWO: A POLICY SUCCESS FOR NEW ZEALAND?

The third issue is the lack of contribution for time out of the workforce or reduced participation. There are multiple situations where KiwiSaver members may take time out of the workforce, and due to lack of income, effectively op-out of contributing.

For example, when a woman has a child, their participation in the workforce and KiwiSaver can reduce significantly. The consequence is that women are contributing less to KiwiSaver, have lower average balances, and are less likely to have other investments. Nearly a third of women in the survey have less than $5000 in their KiwiSaver accounts (compared with 19% of men) while only 4% had more than $50,000 (compared with 13% of men)[16]. The problem is compounded as women having a longer life expectancy than men (NZ Herald, 2018). It should be noted that having children is not the sole reason savings can differ. Other reasons include the gender pay gap and financial literacy.

As discussed in Part Three, the FSC believes there are several potential solutions for consideration. This could include simple insurance coverage that could help contributions continue in case of illness or accident or ongoing contributions when parental leave occurs.

## 2. Default funds

When an individual starts a new job for the first time in New Zealand, a KS2 deduction form must be completed so they can be automatically enrolled into a scheme, if they are not already a member. If a new member does not choose their preferred fund, they will end up with a default fund, which was only ever designed as a parking space. In 2018 this meant that 511,000 members (FMA, 2019) were conservatively invested and can miss out on the returns of a growth-orientated investment. This problem is exacerbated by many scheme default funds also directing members into a conservative fund option, which is more conservative than other jurisdictions.

The FMA has highlighted the lack of active decision making by KiwiSaver members as a concern; "*We regard active choices as important as they are a good indication that the provider's financial literacy efforts have resulted in a member making a meaningful, informed choice in their own interest*" (FMA, 2019, p. 15). In 2018 only approx. 28,000 default members made an active choice- up from c. 16,000 the year before (FMA, 2019, p. 14). The Ministry of Business, Innovation and Emolpyment (MBIE) has recently started a review of KiwiSaver Default Provider arrangements, seeking to explore these issues in more detail.

The extent of the problem and its impact on savings could be significant. In 2018, the New Zealand Herald reported analysis completed by financial advisers highlighting that "*over 400,000 KiwiSaver members who are in default funds may have missed out on $1bn over the last six years because they are in the wrong type of fund and are being over-taxed*" (Parker, 2018).

In Part Three, there are several suggestions that could be considered, including the use of incentives to encourage default members to engage with other options.

Retirement asset allocation
(World Economic Forum, 2019) (Chaston, 2018)[17]


[16] NB: This is not the sole reason women save less and the CFFC and FMA have been focused on this issue.

[17] New Zealand asset allocation was not part of the World Economic Forum research. The asset allocation was an average across default funds quote from interest.co.nz. It should be seen as Illustrative.

### 3. Greater engagement and understanding

One of the keys to having adequate income in retirement is being prepared for it, and not leaving it too late to decide to start or become more involved. There is ample discussion about the lack of engagement of KiwiSaver members, and there are significant numbers still in their original default fund. Unfortunately, as noted previously, many New Zealanders think that saving the minimum in KiwiSaver is good enough for a great retirement.

Underpinning this are two issues. Firstly, the success of KiwiSaver is the fact it can be set and forget. However, the default settings do not result in an adequate income. Moreover, while there are multiple opportunities to engage with members to discuss different options, the desire from fund managers to continually engage may not be there, given the downward pressure on fees.

Secondly, the level of financial literacy remains low within New Zealand, as it does in the OECD, despite all the work of the Retirement Commission and the Commission for Financial Capability. In 2017, Standard and Poor in association with the World Bank reviewed the levels of financial literacy throughout the world. New Zealand is in the top twenty, just behind Australia, but still, nearly 40% of adults are not considered financially literate.

It is important to understand that engagement is different from financial literacy. It could be suggested that a member could be disengaged with their KiwiSaver, and still be financially literate. Focus needs to be on both engagement, and financial literacy.

Financial Literacy (Oudheusden, 2017)

| Country | Adults who are financial literate % |
|---|---|
| New Zealand | 61% |
| Australia | 64% |
| Canada | 68% |
| United Kingdom | 67% |
| Netherlands | 66% |

# PART TWO: A POLICY SUCCESS FOR NEW ZEALAND?

## ARE THERE VEHICLES AND TOOLS TO HELP WITH DECUMULATION?

A vital aspect of the adequacy of income is the concept of decumulation, and this is a weakness within the New Zealand Retirement Framework. Decumulation is the running down of savings and investments to increase an individual's level of income in retirement. Many people die with a significant asset base, whether it is property or money in the bank, for all sorts of reasons ranging from building an intentional bequest, a rainy day, premature death or they just haven't thought about it. The essence of the issue is how much and when can savings be diverted into later life expenditure, health, and accommodation.

This becomes a risk for all concerned, the individual, their family, and New Zealand, and seemingly undoes all the work getting to retirement with sufficient income. Indeed, most of those aged 65+ expect their incomes from all investments including KiwiSaver, to run out within ten years of retirement, and they hope to live the remainder of their lives on the government pension only (Financial Services Council, 2017).

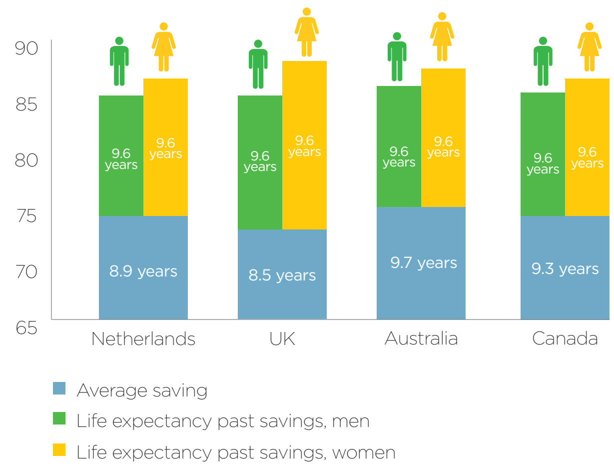
There are several options for decumulation, and indeed, people could use more than one (Davy and Stephens (2018):

- Keep the existing KiwiSaver in place and draw upon it when needed. All of the KiwiSaver funds allow this once the member reaches 65 years.
- Use the interest from savings and investments to supplement day to day incomes, while using the capital for rainy day scenarios.
- Trade down to a smaller / less expensive house which may be more suitable.
- Commercial equity release schemes such as a reverse equity mortgage.
- Commercial annuities which could spread out payments over the life of the retired. The lack of an annuity market is a real weakness in our retirement framework; and "*the costly risks of ageing, especially outliving one's savings, are shifted onto the individual*" (St. John, 2018). Overseas experience shows that without government intervention, the annuities market disappears. Susan St John (2018)describes this "*as a serious market failure.*"

It is also important to understand, that the KiwiSaver market, with average balances at $17,000 is not mature enough for an annuity market. However, as balances grow, and scale becomes possible, the market will start to expand and competition will start to provide choice.

Jeremy Cooper is the chairperson of the Retirement Income Group at Challenger, one of the leading annuity providers in Australia. He noted in 2018 the pressure for change; "*As that pool of savings grows and the average age of the members of it is older, I think policy-makers here will be looking to Australia and see that we've been in this compulsory saving game a little bit longer and I think it's only a matter of time before they look to what we're doing and start thinking about longevity risk management, annuities, or other pool products, as a sort of bolt-on to KiwiSaver.*" (Good Returns 2018).

Retirement savings deficit
(World Economic Forum, 2019)



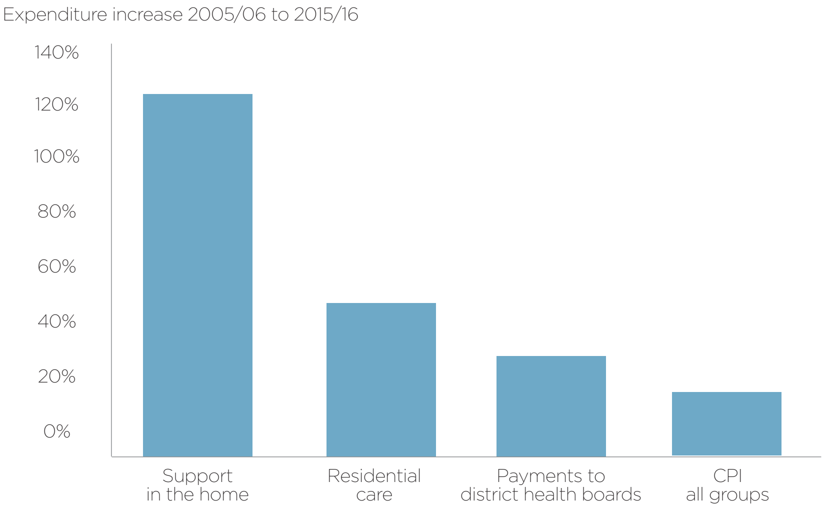
# PART TWO: A POLICY SUCCESS FOR NEW ZEALAND?

## IS NEW ZEALAND'S APPROACH SUSTAINABLE AND FINANCIALLY SOUND, AND CAN IT BE MAINTAINED?

The question of sustainability with superannuation in New Zealand has been the centre of debate and inquiries for over twenty years. We are aware of the critical trends illustrated in Part One, where the ageing population creates a significant increase in expenditure on NZS, where the gross cost will go from 4.8% of nominal GDP to 5.9% in ten years to 7.9% in 2059/2060 (Treasury, 2019). This is why NZSF was launched in 2010, and contributions have re-started under the Labour-led Government.

The effect of the ageing population on health expenditure should also be a concern. In 2015/16 share of the health services used by people aged 65 and over, was 42%, this is expected to increase to 50% in 2025/26. Meanwhile, in the ten years to 2015/16, District Health Board (DHB) spending on services for older people rose twice as fast as their overall expenses, and five times as quickly as inflation (Ministry of Health, 2016). There is no NZSF equivalent for the increases required to the health budget, and from an individual perspective, other than a small rebate for health insurance, there is little support.

DHB expenditure increase
(Ministry of Health, 2016)




The stark reality was highlighted by Dale where "*under median projections and making no allowance for cost increases in this sector, the total costs for the aged of residential care, other services and support and New Zealand Superannuation, by 2017 will approach $15 billion, and by 2022 it will reach almost $17 billion.*" (Dale, 2014). It could be argued, what will be, will be. The Government of the day will create a budget that will cope or not. The Government could increase taxes, raise the debt ceiling, or reduce services, with the ultimate test being an election. Alternatively, as the National opposition argued when KiwiSaver was proposed, the focus instead should be on economic growth, which could fuel prosperity.

# PART TWO: A POLICY SUCCESS FOR NEW ZEALAND?

## IS NEW ZEALAND'S RETIREMENT FRAMEWORK EQUITABLE?

The topic of an equitable retirement framework is subject to much debate and is essential, given the possible level of poverty with those aged over 65.

NZS is mostly an equitable scheme. Assuming an individual has passed the residential requirements, they can receive the regular superannuation payments once they turn 65. As it is not means-tested, this can result in receiving the payment if you have contributed very little through taxes due to low income, or due to your accumulated wealth and income, do not need it. Any previous attempts politically to introduce means testing has been short-lived.

KiwiSaver, by comparison, does have issues in this regard. In short, those who remain vulnerable will tend to stay susceptible within retirement. Those New Zealanders who are in the lower socio-economic group, have shown a reluctance to use KiwiSaver with many, not contributing or opting out. There is no doubt for low-income earners, especially those with dependent children, that KiwiSaver contribution could be a financial burden.

This is exacerbated by the issues that exist with homeownership in New Zealand. Rising house prices and rents make it difficult for many New Zealanders to own a house mortgage-free or pay no rent by the time they retire.

Workplace Savings NZ / Massey University research highlights that "88% of the retired respondents owned their own home, with most of those (79%) being mortgage-free" (Matthews, 2019). It is preferable to be mortgage-free and rent-free in retirement as it will make a marked difference. This will become problematic in the future as FSC research found future generations have lower homeownership rates and with many still expecting to have a mortgage at retirement (Financial Services Council, 2018).

Another aspect of vulnerability, are those New Zealanders who through illness or accident are unable to earn an income. There are approx. 92,000 New Zealanders on Support Living Payments, all of them aged 18-65 years, and approx. 95% receiving the payment for more than a year (Ministry of Social Development, 2019). It is unlikely this group are saving for retirement or contributing to KiwiSaver. Indeed, depending on the nature of their illness or accident, and whether they have insurance, many are being forced to make a hardship withdrawal from their KiwiSaver[18]. In reality, retirement will not be pleasant and may only accentuate the issues they face now.

These are issues discussed in Part Three, and there are opportunities to close this gap through increasing the level of savings, providing basic insurance to continue KiwiSaver contributions, and providing incentives to increase engagement.

[18] Last year, nearly 17,000 KiwiSaver members withdrew $101m for significant financial hardship, an increase of 21% compared to the previous year. (FMA, 2019).

# PART TWO: A POLICY SUCCESS FOR NEW ZEALAND?

## IS THE NEW ZEALAND RETIREMENT FRAMEWORK PREDICTABLE AND ROBUST?

Given New Zealanders need to make decisions about their retirement, forty years away, it is essential that the retirement framework is relatively stable. While the pillars of our retirement platform are in place and seem predictable, there is still significant change and constant debate about multiple aspects, as shown by the table below. Since KiwiSaver inception, there have been over 25 major changes.

Evidence shows that those considering joining, do think about the possibility of further KiwiSaver changes, or even the fact that it may be discontinued; this is a barrier to joining. Constant change does impact on the attitude and behaviour concerning retirement and savings (MacDonald and Guest, 2019).

### Recent debate on retirement

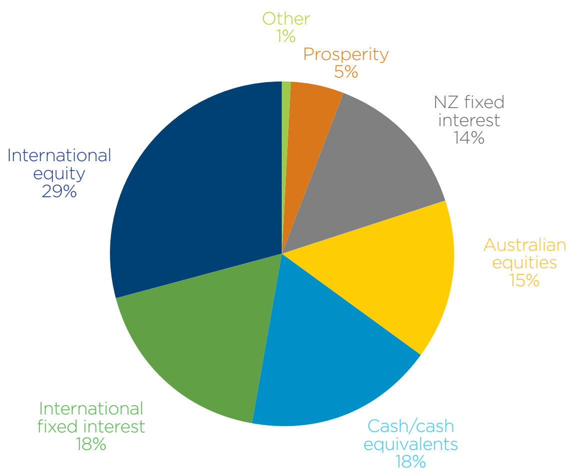
(Just a selection)

| When | What | Story |
|---|---|---|
| August 2019 | New Zealand Super | National Party policy announcement increasing the retirement age to 67 in 2037. |
| August 2019 | KiwiSaver | MBIE review of KiwiSaver default providers<br>Default KiwiSaver scheme set for an overhaul. |
| July 2019 | KiwiSaver | KiwiSaver rules change providing early access for people with a shorter life expectancy |
| July 2019 | KiwiSaver | Allowing those in foster care to enrol in KiwiSaver |
| May 2019 | New Zealand Super | Changes to residency criteria |
| May 2019 | KiwiSaver | 'Peters and Ardern send mixed messages over KiwiSaver Changes' (Radio New Zealand) |
| April 2019 | KiwiSaver | Changes: People over 65 can join; no lock-in for older members;<br>New contribution rates; renaming of a contribution holiday |
| March 2019 | New Zealand Super | Comment: Beware the pitfalls of NZ Super sooner rather than later |
| December 2018 | New Zealand Super | Comment: NZ Super will take money from the working poor and give to rich |

Of course, New Zealanders want to know that when they get to retirement, they have the secure future they had planned. A robust system is one that can withstand significant shocks, including those coming from economic, demographic, or world events. The retirement framework has no greater or lesser ability to withstand a substantial shock than the world economy.

The NZSF and KiwiSaver, due to the level of diversification within its asset classes, probably has a more significant ability to withstand an economic slowdown in New Zealand. Though a GFC type slowdown would have a considerable effect, in reality, though, given so many retirees will rely on selling a house, a market reduction in housing prices could have a more significant impact.

Where is KiwiSaver money invested?
(FMA 2019)



## IS THE NEW ZEALAND RETIREMENT FRAMEWORK EFFICIENT?

A critical feature for an efficient pension system is the level of costs, especially when long term returns from investment markets may be 3-4%. Having an expensive and inefficient system could have a significant impact.

As mentioned in Part One, IRD acting as a conduit between savers and fund managers has helped mean KiwiSaver is one of the more efficient in the world, at 0.32% of GDP. Further, there is always room for improvement, whether it is holistically across the New Zealand Retirement Framework, or more operationally such as with the day-to-day operations of KiwiSaver.

The efficiency of KiwiSaver providers in offering and running KiwiSaver plans can be judged by looking at the total operating costs with assets managed. This includes all costs of administration, communication and investment management involved in the day-to-day management of a KiwiSaver fund.

KiwiSaver members pay fees to fund providers through a management fee. Generally, the fee[19] is designed to cover the cost of providing and managing investments, and in 2018, the average total fee was $173 per member (FMA, 2019, p.13).

Operating expenses of private pension schemes
(OECD, 2017)

| Country | % of total investment |
|---|---|
| New Zealand | 0.6% |
| Australia | 0.8% |
| Canada | 0.4% |
| United Kingdom | 0.2% |
| Netherlands | 0.1% |

The FMA has expressed surprise that the cost per member has not fallen faster and has consequently increased focus on transparency and encouraging greater engagement from KiwiSaver members. Recently MBIE published a default review discussion paper where they proposed a range of measures to lower fees.

KiwiSaver managers[20] have argued that it is "clear that net returns are more important than fees. A number also argued that fees aren't just for investment management, but they also help pay for services like education, member services, and other tools" (Good Returns, 2019).

The OECD found that operating costs of private pension systems reported ranged from 0.1% of assets to 1.5% of assets. In general, countries with a defined contribution plan, and those operating with large numbers of small funds tend to have higher operating costs.

Another aspect to efficiency is considering how easy NZS and KiwiSaver is to access and use for superannuitants and members. Despite recent improvements in fund managers getting balances online, there is still difficulty with a range of manual, paper-based transactions. This includes changing funds, switching providers or even changing contribution levels. If the ease of transaction was improved, then engagement would increase.

[19] Total Fees includes administration fees, investment management fees, trustee fees and other scheme expenses.

[20] Last year, nearly 17,000 KiwiSaver members withdrew $101m for significant financial hardship, an increase of 21% compared to the previous year. (FMA, 2019).

## CONCLUSION

When assessing a retirement framework, it is essential to go back to first principles and focus on the system outcomes; protect against the risk of poverty at old age, and the smoothing of consumption from work to retirement. It is effortless to get caught up in the complexity of the Retirement Framework and lose sight of what it is meant to do, and to whom it is there for.

Already we can question whether the income for retirement is adequate for New Zealanders, and this may deteriorate further given existing economic issues including housing. The trick to solving the questions around the adequacy of income is to consider several alternatives from increasing contributions, increasing levels of engagement and financial literacy and looking at the role and investment profiles of the default funds.

A significant gap is the lack of an established annuity market to assist those who have retired with decumulation of their savings. Ensuring sufficient income throughout retirement is an area worthy of industry and government involvement. Given that most retirees think their savings will only last ten years in retirement, and the rest of their lives will rely on NZS, this should be an area of concern.

# PART THREE: BUILDING TOWARDS 2050

## INTRODUCTION

Part One outlined the structure of the New Zealand Retirement Framework and discussed the components and principles that make it up. In Part Two, an assessment was completed of the Framework and questions were asked about its overall performance. It found that while there were strengths to the Retirement Framework, there were several areas where improvements could be made.

The purpose of Part Three is to highlight concerns and critical areas of focus. With such a complex and interdependent system, it could be tempting to solve every problem. Instead, the focus is on these critical issues, which we believe will could make a material impact.

## ISSUE ONE: EXPANDING COVERAGE AND INCREASING PARTICIPATION

The success of KiwiSaver is its design and the use of auto-enrolment, which has attracted over 2 million KiwiSaver members. On the other hand, part of its design has meant that approx. 1.2 million New Zealanders have stopped contributing and are not saving for retirement for a variety of reasons, including a low level of income, or not being able to work due to illness or accident.

There are also approx. 144,000 self-employed contractors[21] (5% of the workforce) who do not contribute automatically to KiwiSaver. While they can make voluntary contributions and receive the government contribution, they will miss out on the employer contribution. However, more significant concerns are whether self-employed are planning and are saving for their retirement[22].

Considerations:
The FSC believes that KiwiSaver is a central part of New Zealand's Retirement Framework, now and into the future. KiwiSaver continues to grow in membership, it is relatively simple to use and to understand, and has balances approaching a nominal value of $911bn by 2050. KiwiSaver will provide a vital income supplement to New Zealander's retirement.

Considerations include:

1. Minimum contribution. For those who may be unable to contribute due to the level of income, consideration should be given to requiring employers to make a minimum contribution (say 2%), to allow the habit of saving to begin. The advantage of this approach is that it will enable some savings to accumulate for retirement and can help create the savings habit. The disadvantage is an extra cost for employers, and there is an argument that any additional contributions may be better with the employee, immediately.

An alternative to this approach is to decouple member and employer contributions. This would mean that the employer would contribute regardless of whether the member is or not. The Government contribution then could be used as an incentive for members to continue to contribute. This would ensure better equity while encouraging the saving habit.

2. Introduction of built-in protection accident or illness insurance. For those New Zealanders who could suffer from a long term illness and are unable to make contributions, a simple KiwiSaver protection insurance could be built in the scheme. The insurance will ensure contributions continue if the member is unable to earn due to illness or accident, with the anticipation that the required premium would be taken out of the fees charged. The advantage is that those who become seriously injured or ill can continue to build their savings until retirement. The addition of a broad, low level of cover will also increase competition while helping New Zealanders getting some protection that they need. The disadvantage is the complexity it will add to a simple KiwiSaver scheme.

3. Encourage the self-employed to have a plan for their retirement and consider the use of KiwiSaver. This could be through making the cost of talking to an adviser about retirement tax-deductible as well as increasing the level of education for those who are self-employed. Particular focus should be on removing potential concentration risk with being over-invested in their business, through diversification.

[21] There are also approx. 50,000 New Zealanders who identify being self-employed as their main source of income. Some are likely to be included in the 144,000 self- employed contractor statistic.

[22] A similar issue exists within the Australian retirement framework and has become more of a concern with employers hiring contractors, instead of employees to avoid making contributions. The research found that self-employed, on the one hand, were less likely to be saving for their retirement, but on the other hand, more likelihood of investing more money in business assets and trusts. Further, they had higher levels of wealth in their family home, their business or trusts, and this was seen as a likely alternative to a superannuation account. This does mean they are vulnerable to market conditions upon retirement when liquidating business assets, or reliance on the property market (Aaron Elkhishin, 2019).

## ISSUE TWO: ADEQUACY OF SAVINGS

The question of adequacy is multifaceted and complex. The FSC's view is that the default settings should provide an adequate level of savings for retirement, and then members can make informed decisions to trade-up or down from there. Right now, there is an income gap that many in retirement are struggling to fill.

1. There are too many New Zealanders who are contributing just the minimum, and they may also think that because they are saving for retirement, they will have enough. This will not necessarily be the case, and the reality is that they may not discover this fact until it is too late.

2. Too many KiwiSaver members see their default fund as their preferred choice, instead of a parking lot. This is exacerbated by the fact that the default funds are conservative by international standards.

3. Effectively the incentives to encourage saving only creates a minimum level of savings. The Government contribution of $521, only requires $20 a week to achieve the payment.

4. Women, due to time out of the workforce and the gender pay gap, are likely to contribute less to KiwiSaver, have lower levels of saving, while at the same time have a longer life expectancy than men.

5. As efficient as KiwiSaver is, there always is more room for improvement.

Considerations:
1. Consideration can always be argued for increasing the minimum level of contribution from both employers and employees. While the FSC encourages these discussions, there will always be issues with affordability for employees and employers, and any changes should be well signalled, as they are in Australia.

Alternatively, **consideration could be given to the use of incentives to encourage additional saving**. KiwiSaver has had success with a range of Government incentives, and this philosophy could continue. For example, the current Government contribution of $521, could be applied when the KiwiSaver member contributed 4%, or saved at least $2,000 per annum.

2. **Continued focus on reducing the number of members inside conservative default funds (including those by active choice)** by all parties involved. KiwiSaver providers will continue to work with their members to increase engagement and to help them make a choice. This will be helped by extending education requirements and improving the level of reporting. Again, incentives could play a role with the Government contribution applying only if the member makes a choice (even if it is to stay in the default fund).

3. **A new definition of conservative default funds, with higher exposure to growth investments**. This should include a fund that follows a life stage model (one with higher exposure to growth assets early on, then reducing over time). MBIE and Treasury have started work in this area.

4. The ability for **members employee contributions to automatically increase** by small increments (e.g., by 0.25%, 0.5%) for a set period. Even a small increase can make a difference.

5. **Continued focus on efficiency and simplicity**. By international standards, both NZS and KiwiSaver are efficient for a state pension fund and a defined contribution scheme. The FSC believes that we should not get complacent and continue to focus on improvements through the deployment of technology and better use of data. Members should be able to manage their KiwiSaver accounts entirely online, including transferring between providers and/or funds, increasing or decreasing contributions and other necessary administrative tasks. Making it easy through removing manual processes will not only drive a material difference inefficiency, but it will also lead to more engagement.

6. **KiwiSaver contributions are continued while the member is on parental leave**. Already parental leave payments are made from the Government consideration of a 3% additional payment also be made to the member's KiwiSaver account at the same time (assuming they are already contributing). This approach will help towards solving the problem of a significant difference between male and female savings, coupled with the additional life expectancy of females.

# PART THREE: BUILDING TOWARDS 2050

## ISSUE THREE: ASSET DECUMULATION

The question of decumulation cannot be ignored, especially as KiwiSaver balances approach a nominal value of $911 bn in the next thirty years. Already, research highlights that most of the retired expect to spend their savings within ten years of retirement and live on NZS solely for the remainder.

Indeed, it is a complicated issue, compounded by the fact that each person's retirement will be different. Choosing and planning the right decumulation path depends on personal circumstances and goals. As all KiwiSaver accounts can be accessed by those over 65 years and used as a source of income, there is an element of income smoothing built in already.

Perhaps what is missing is a lack of financial planning at retirement, which would explore the vital interlinked questions such as: How long will you live? Will you be working? What sort of lifestyle do you want? What part will homeownership play in this? How will you fund your retirement? (ANZ, 2017).

Considerations:

1. The **Government and industry consider building an annuity market** which could build on the simplicity and strengths of KiwiSaver. The Government will also need to help create assets to back an annuity market, such as a long term (30 years) New Zealand Government bond.

2. **Align the annuity tax rate, with the individual's tax rate**. Annuities have not been popular in New Zealand because they are tax-inefficient. Income derived from an annuity is taxed at the rate of 33 cents per dollar where a retiree's income may often only be taxed at 17.5 or 10.5 cents per dollar. This will need to be reassessed.

## ISSUE FOUR: RETIREMENT AND FINANCIAL LITERACY

No discussion about retirement can take place without consideration of financial literacy. The concept is simple, "*without an understanding of basic economic concepts; people are not well equipped to make decisions related to financial management. People who are financially literate have the ability to make informed financial choices regarding saving, investing, borrowing, and more.*" (Oudheusden, 2017, p. 4). Naturally, this includes planning for retirement.

New Zealand has been well served through the efforts firstly of the Retirement Commissioner and, more recently, Commission for Financial Capability. Their focus has been on increasing the level of engagement of New Zealanders with their retirement and savings through partnering with industry and schools. While we do rank among the best in the OECD, there are an estimated 40% of New Zealanders that may not meet the standard of being financially literate (Oudheusden, 2017).

The key issues are:

1. Lack of awareness by New Zealanders on how much is needed in retirement, and how to save enough.
2. Lack of action by those in default funds to find alternatives with a better risk/return profile.
3. Ongoing issues understanding the fundamentals of investment and finance in general.
4. Lack of understanding of how to decumulate and financially plan.

Considerations:

1. **Continuation of support of the work of the Commission for Financial Capability** in its focus and mandate to increase the level of financial literacy. KiwiSaver providers should be required to deliver tools and materials to their members to help support the CFFC.

2. **Proactive engagement of KiwiSaver members to become more involved** with their saving decisions and understand the outcomes they may want to achieve. With advances in technology and the data held by KiwiSaver providers on their members, it is easier to reach and connect with savings discussions. In particular, a focus on all default member transfers should occur, and consideration should be given whether the Government contribution should only be made to those default members who have made an active choice.

3. **Focus on providing advice to those about to retire**. It is essential that New Zealanders entering retirement get advice to help through the next 15-20 years. At a minimum, information on decumulation and the range of options should be provided with the NZS information pack. Further, advice could be tied into with the Gold Card currently provided to Superannuitants and either provided free or at a discount. Also, with advances in technology, Robo-Advice will eventually be able to help with crucial decisions.

4. **Continued encouragement of Robo-advice for savings and decumulation**. As Robo-advice becomes more entrenched, it will become easier to provide advice to KiwiSaver members, and those in retirement. This will require thought on how to encourage and develop a robust offering in New Zealand. Indeed, it is encouraging to see the work completed by the FMA[23] in this regard.

Firstly, Robo-advice needs to allow a holistic view with its focus, not just on KiwiSaver but on financial planning pre-retirement and post-retirement.

Secondly, Robo-advice needs to allow customers to connect their entire financial lives to enable a complete basis for advice. To do this, data flows between providers, Inland Revenue, and the banking system will need to improve and become available. We note that work is underway with *Open Banking*, it would be good to extend this to the Robo-advice platforms.

Finally, to achieve the promise of Robo-advice, investment will be needed from all providers and the Government. This is to help build the underlying data architecture and platforms that would be required.

[23] For more information refer to Financial Advisers (Personalised Digital Advice) Exemption Notice 2018.

## ISSUE FIVE: STABLE AND PREDICTABLE

If New Zealand's Retirement Framework is to achieve its ambition, it must have a degree of political stability and certainty. Yet, what we see is constant proposals, debates, and changes about elements of the framework. Sometimes this is significant, such as raising the age of retirement to age 67, and other times its relatively minor, such as providing early access to those with a shorter life expectancy. Such discussions can come at the cost of reducing confidence, and we believe stability and certainty are essential so that New Zealanders can have a platform to which plan their retirement.

It is also crucial that there is a degree of consistency and focus across Government Departments. There are already 767,000 Superannuitants, a number that will double in the next 30 years, and as a group, they will take the biggest proportion of the Government's budget. Other than an Office for Seniors, as part of the Ministry of Social Development, or the CFFC there appears too little coordination at times. Is it possible to create public policy about superannuation, without consideration of the approach to health or housing? Both areas have significant issues already.

It is not to say there is a lack of focus by the Government. This is not the case; there are multiple departments and agencies all trying very hard, given the constraints of policy and budget. For example: the Healthy Ageing Strategy (2016), Carers' Strategy (2008), Carers' Strategy Action Plan (2014-1018), The Disability Strategy (2016), the review of social security legislation, MBIE and Treasury review into KiwiSaver Fees (2019), Office for Seniors review (2019) and the CFFC Triennial review (2019).

As the World Bank notes, any reform needs to be effectively aligned with the political economy and supported by an explicit political mandate. Political conditions under which any reform will be implemented needs to be sufficiently stable to provide reasonable likelihood of implementation (World Bank, 2008).The political debate and focus needs to be holistic, predictable, and sustainable:

Considerations:

1. A new political accord is developed for the New Zealand Retirement Framework that can provide political certainty and prevent short-term political thinking.

2. That a new Government Ministry is developed to focus on those who are retired and to coordinate social and public policy. Alternatively, expand and provided increased investment the CFFC.

## CONCLUSION AND CONSIDERATIONS

Over the last two years, the FSC has completed a number of research projects into KiwiSaver, and now, the FSC has undertaken this review to understand holistically how the New Zealand Retirement Framework delivers on its ambition. We have an important role to play in helping to craft a policy framework for the benefit of New Zealand at a strategic level.

The New Zealand Retirement Framework is in a strong position to prosper. Whilst New Zealand is still a comparatively new system by international standards, we are able to learn from the experiences of nations with older and more mature systems, such as Canada or Australia. This review highlights a number of key issues and considerations to address, which are fundamental to the long term success of KiwiSaver and the broader Retirement Framework in New Zealand.

They include the following key issues:

### 1. Increasing participation

There is a need to expand the coverage of KiwiSaver and increase the level of participation. As discussed within the paper, there are 1.2 million New Zealanders not contributing to their KiwiSaver. Some will have stopped contributing due to low incomes; others due to illness or accident and others because they have taken time out of the workforce for children.

### 2. Building contribution levels

For those that are saving, research has found the level of saving for many maybe not enough. A significant number of New Zealanders contribute just a minimum of 3%, and they may very well find they will not have enough income when they retire. In addition, a number of KiwiSaver members remain in conservative default funds and depending on the number of years to their retirement, may miss out on the returns, a better-suited fund could provide.

### 3. From accumulation to decumulation

For those that have retired, the question over decumulation remains unclear. While there are a number of options already available including existing KiwiSaver funds, there is a need to develop further options and improve financial literacy, especially as research found that most expect to have spent all their savings within 10 years of retiring.

### 4. Continue to focus on Financial Literacy

While New Zealand's level of financial literacy is improving, driven by the work of CFFC, the FSC and our Members, there are almost 40% of New Zealanders, who may not be financially literate — not understanding how much to save, where to invest, how markets and managed funds work. An improved level of financial literacy could very well have a material impact on the quality of retirement.

### 5. Deliver efficiency and effectiveness

At a holistic level, NZS and KiwiSaver appear relatively simple and efficient. However, at a member level, there is a significant number of processes that are paper-based or manual, which add to cost and complexity. This can include the processes for switching providers, changing funds or even increasing contribution levels. These are basic transactions, which if automated could provide improved efficiency and member engagement.

Ongoing advances in technology and analytics will allow greater transparency for members and improved reporting with returns and fees. Advances would be able to enable, as an example, KiwiSaver members to work out a more appropriate contribution level, and to be able to enact any changes, digitally.

### 6. Political Leadership and policy stability

If New Zealand's Retirement Framework is to achieve its ambition, it must be stable and predictable, as this is the only way confidence and positive outcomes can be achieved. Instead, there is constant debate and tinkering with policy across the Framework as shown by KiwiSaver having over 25 changes since launch.

## CONCLUSION AND CONSIDERATIONS

To help resolve these issues, the FSC has proposed a number of ideas for consideration following consultation with our members.

These include:

1. It is important to focus on the 1.2 million New Zealanders who don't contribute to KiwiSaver. Whether it is providing a minimum level of saving, or support for those that become sick or injured, we believe it is important to save for retirement.

2. For those who are saving, there is a need to ensure there is an adequate level of income in retirement. There are three key areas to focus on. Firstly, focus on those who are saving the minimum (3%) and encourage consideration of higher levels of contribution. This could be through improved contribution options, and the use of behavioural economics to drive greater engagement.

Secondly, the FSC supports the continued focus by the FMA and CFFC to help KiwiSaver members in default funds to find alternatives that match their time horizons better. In addition, we support suggestions that the Conservative Funds, are too conservative, and could afford to have more growth assets built in.

Finally, considerations should be given to continuing KiwiSaver contributions while a member is on parental leave. A simple step that would encourage the continuation of the saving habit whilst helping to close the gap between the level of savings between male and females.

3. As KiwiSaver balances start to build, consideration should be given to how KiwiSaver members transition from building their wealth, to delivering a reliable income stream in retirement. While there are options with the New Zealand market already, including using an existing KiwiSaver Fund, New Zealand does lack an annuity market as one of the options. Consideration should be given to how to build an annuity market that could complement KiwiSaver and the other decumulation options, and how such a market could be structured and actually work.

4. A continued focus on Financial Literacy in New Zealand cannot be overstated. The FSC supports the continued work of the CFFC and believe that greater engagement with KiwiSaver members is essential. Whether it is getting a member to review their rate of saving, their KiwiSaver fund, or even how much they need in retirement, these are all good steps to helping New Zealanders to be prepared.

Consideration also needs to be given to the role of Robo-advice and retirement as it has the potential to extend levels of financial literacy and engagement.

5. The FSC supports the ongoing focus to improve the efficiency and effectiveness of KiwiSaver and the broader Retirement Framework. This focus needs to continue on making it easy for KiwiSaver members to engage and transact with their fund. This could include making decisions about the level of contribution and being able to enact the change digitally, or even being able to switch providers or change funds. Using the advances in technology and analytics, will not only make KiwiSaver easier and more efficient, it will also increase engagement.

6. Finally, thought should be given to how New Zealanders could have confidence in the New Zealand Retirement Framework. This requires building and maintaining a Framework that is both stable and predictable. This could be achieved through a political accord which focuses on key issues such as the retirement age and maintaining the principles of NZS and KiwiSaver. This could be supported by a dedicated Government Ministry that will focus on retirement and coordinating social and public policy.

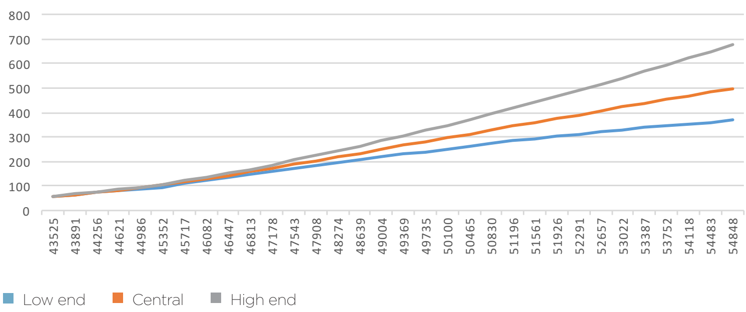
Ultimately, the purpose of any retirement framework is to ensure that those who have retired are protected against the risk of poverty. This is the responsibility of everyone, from the Government and their agencies to our members, and New Zealanders. The FSC hopes by producing this report that we can help create conversations and outcomes for generations to come.

# APPENDIX & REFERENCES

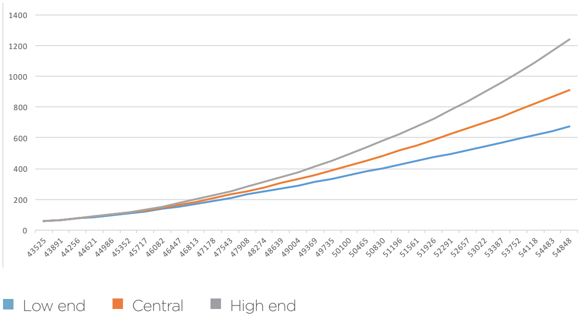
## APPENDIX: FUTURE KIWISAVER PROJECTIONS

In August 2019 the FSC asked Melville Jessup Weaver (MJW) to develop a projection of KiwiSaver over the next thirty years, as shown below.

### Total KiwiSaver size (real) in $NZbn




### Total KiwiSaver size (nominal) in $NZbn




The variation across scenarios is based on the variables below:

| | Low end % pa | Central % pa | High-end % pa |
|---|---|---|---|
| Augmented labour force growth | -0.5 | 0.0 | 0.5 |
| Wage growth | 2.5 | 3.5 | 4.5 |
| Gross investment returns (short-term) | 4.4 | 5.4 | 6.4 |
| Gross investment returns (long-term) | 7.1 | 8.1 | 9.1 |

There are a number of assumptions that need to be factored and trends across a critical variables such as employee contributions, employer contributions, Government contributions, withdrawals due to retirement, all other withdrawals, investment income, investment management fees, and costs and tax on investments. These variables have been modelled under current assumptions and design.

The data has been provided from the: FMA KiwiSaver Annual report; Treasury's Long Term Fiscal Model, and aggregate fund data as of 31 March 2019.

### Disclaimer

This appendix is a summary only, and the report provided to the FSC offers all the details concerning the model and underlying assumptions. There is inherent uncertainty in any future projections of investment or savings schemes. Estimates of the critical terms are based on assumptions, and actual results should be expected to deviate from our forecasts. The FSC and MJW will not be liable for the consequences of any third party acting upon or relying upon any information or conclusions contained within this report. Please contact the Financial Services Council for more details.

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