JacksonStone House
3-11 Hunter Street
PO Box 1925
Wellington 6140
New Zealand

Tel: 04 496-6555
Fax: 04 496-6550
www.businessnz.org.nz

BusinessNZ
GROWING PROSPERITY AND POTENTIAL

31 October 2019

Commission for Financial Capability
PO Box 106-056
Auckland City 1143

review@cffc.org.nz

Dear Sir/Madam

Re: 2019 Retirement Income Policy Review

Background
I am writing in response to the terms of reference that have been published for the 2019 retirement income policy review that the Commission for Financial Capability (CFFC) has released.

We note that feedback is sought on eight primary topics to be discussed in the Retirement Commissioner's 2019 report. BusinessNZ wishes to comment on three of these topics. Our views are primarily aimed towards identifying policies and actions that could be taken to assist in meeting the objectives of the review.

Background
Superannuation issues continue to be a source of significant debate and discussion in New Zealand, as in many other developed countries. One of the fundamental issues is how to ensure New Zealanders age have resources and incomes adequate to enable a reasonable standard of living in their later years.

While we support the examination of measures such as the one proposed, we believe it is more important to take a step back and address the key issue relating to superannuation, namely the need to respond to demographic trends and circumstances of the economy by way of lifting the eligibility age of New Zealand superannuation (NZS).

As most are aware, the issue of superannuation in New Zealand comes down to three broad areas:

- NZS;
- KiwiSaver; and
- The New Zealand Superannuation Fund.

While all three elements are interlinked and play a vital role in the current and future delivery of retirement provision, there are clearly options available in respect to the future provision of superannuation via NZS.

BusinessNZ has generally argued for some time that the main focus should be on tightening the criteria for age-related benefits, which could be in the form of the following (or possible combinations):

- Extending out the age of eligibility (either in line with increases in life expectancy or on an ad hoc basis to keep costs manageable);
- Stepping up the level of benefit depending on age e.g. 50 percent of average income at 65 years of age, 70 percent of average income at 75 years of age;
- Reducing the amount paid (currently two-thirds of the average wage) over time either through freezing benefits or indexing them to the Consumers' Price Index rather than to wages;
- Means testing benefits either through asset and/or income testing;
- Discontinuing NZ Superannuation payments by phasing them out over time e.g. those currently below the age of 50 would not be entitled to any state provision; and/or
- Having (possibly) a tiered approach depending on when a person opts to take superannuation e.g. the later someone "opts in" the higher the level of payment for the rest of their life.

While aspects of these options are discussed more below, many of these approaches have significant drawbacks. For instance, in the case of freezing benefits, this would have a severe impact on those dependent on NZ Superannuation as a sole source of retirement income. Different levels of benefit depending on age could raise issues of equity for those of different ethnicities, given differing life expectancies. And the pitfalls associated with income and asset testing are generally well known.

Despite possible drawbacks the key point is that, given projected demographic trends and associated costs, we should undertake a serious search for the optimal way of ensuring the country has enough resources to adequately provide those most in need with a reasonable standard of living in their later years. With individuals generally living longer on average, and with medical advances enabling an improved quality of life, it is reasonable to expect that changes to our retirement system will be needed. Those changes need to be made carefully and urgently.

<u>Topics for discussion</u>

1. An assessment of the effectiveness of current retirement policies for financially vulnerable and low-income groups, and recommendations for any policies that could improve their retirement outcomes.

Financial education as a key building block to retirement savings

BusinessNZ believes that any long-term changes to addressing retirement outcomes for financially vulnerable and low-income groups should be focused at the early stages of a person's life. We are more interested in policies that focus on the top of the cliff rather than the bottom. Lessons learned and decisions made early in life have significant effects later in life, particularly around the time value of money. Therefore, BusinessNZ believes further resources should be put into savings and financial education schemes that apply to all people even before they enter the workforce, e.g. primary and secondary school teaching of simple budgeting and saving.

Currently there are selected resource products available for primary schools such as BANQER[1], a financial education platform that provides a hands-on environment for students and teachers to learn about a variety of topics such as saving, interest, KiwiSaver, tax, real estate, and insurance. It is currently used in half of New Zealand's primary schools, yet it is often piecemeal in its use, as it can be taught one year but not followed up the next in terms of helping to build upon children's understanding of financial matters. Often, it comes down to the individual interests of teachers as to whether it is incorporated into their daily classroom activities.

In relation to the point above, we would also like to point out that the larger picture of effective money management by individuals needs to be considered (a 'whole of life approach'), as the focus of savings should not be totally concentrated on retirement savings/superannuation. It is axiomatic that the stage of life of individuals determines their money management priorities, such as saving for education or debt reduction. We believe the CFFC should continue to play a vital role in supporting the development and promotion of an education campaign targeted at all New Zealanders to improve their overall level of wealth, starting with simple money management once children start school.

Recommendation: That financial education, particularly at school level, is viewed as a key mechanism in which improve retirement outcomes for the financially vulnerable and low-income groups over the long-term.

Changes to the KiwiSaver default funds setting

BusinessNZ recently submitted on MBIE's review of the KiwiSaver default provider arrangements[2]. There were parts of our submission that we believe need to be repeated for the retirement income policy review, in particular those parts relevant to improving the position of financially vulnerable and low-income groups.

For more than a decade, a large proportion of KiwiSaver members has been in (conservative) default funds on a long-term basis. Although the same issue was looked at by the 2012 MBIE review, the use of this default option persists. Unfortunately, the default option produces the least positive outcome for KiwiSaver members, who would be in a far better financial position on retirement had they opted for a less conservative fund. Although BusinessNZ does not have data from previous research, it would not be a significant leap of logic to suggest that many KiwiSaver default members are on low incomes, as there is often a link between poor financial decision making and low income/financially vulnerable groups.

Many individuals will tend to remain in a default KiwiSaver option where it is available, tending to 'set and forget' their chosen option, no matter how much additional information is provided. Therefore, a more proactive stance needs to be taken.

The MBIE review provided four options for addressing the default investment mandate:

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[1] https://www.banqer.co/

[2] https://www.businessnz.org.nz/__data/assets/pdf_file/0006/178602/190909-Review-of-KiwiSaver-Default-Provider-Arrangements.pdf

1. Life-stages investment mandate;
2. Balanced investment mandate;
3. Growth investment mandate; or
4. Conservative investment mandate.

Obviously, option 4 (retaining the conservative investment mandate) does nothing to move the needle towards putting KiwiSaver default members in a better financial position, particularly on retirement. Therefore, we do not support a continuation of the status quo. Our view is backed up by the point made in the MBIE review that option 4, on balance, would have a negative effect compared with the other three options.

Any of the other options would be significantly better than option 4 and so we would have no concerns if any other option was adopted. However, in 2012 we submitted that a life-stages investment approach would be a positive way forward. This option would place greater emphasis on asset allocation based on age, while still providing a level of protection for older KiwiSaver members who would not have time to rebuild their funds if the market experienced a swift downturn.

Recommendation: That KiwiSaver default funds move from a conservative fund to a life-stages one.

Tax cuts to boost low income levels

BusinessNZ has long held the view that a Broad-Based Low Rate (BBLR) tax system is the most efficient and growth promoting system for New Zealand. Therefore, as we have stated previously in other submissions, one of the most direct and effective ways to enable taxpayers to receive higher take home pay is by reducing tax rates or lifting tax rate thresholds. Doing this would not only assist towards alleviating financial hardship but would also provide a way for financially vulnerable or low-income groups to make decisions around whether to save more generally or sign up for a personal retirement scheme (such as KiwiSaver). Given various studies over time have shown that day-to-day spending habits before and during retirement are often similar for low income people, it is clear that providing them with the ability to better save for retirement would help mitigate some of their costs as they get older.

We would also like to point out that any reduction and/or exemption that applies to one set of taxpayers and not another moves New Zealand further away from the BBLR tax ideal. Therefore, any change to personal taxes should not lead to a larger differential between the top and lower levels of tax paid. Instead, we would want to see a lower rate of tax paid for all personal taxpayers, but not a lift in the differential.

At the very least, to assist low income groups the Government should look to undertake:

- An initial adjustment of all personal tax brackets for the full impact of inflation since 2010, and
- A timeframe for future periodic reviews of both tax rates and brackets (say every 4 years).

Recommendation: That the CFFC look to recommend personal tax rate/threshold changes so that New Zealanders have a higher level of take-home pay.

2. **An assessment of the impact that the following will have on government retirement income policies, including KiwiSaver and New Zealand superannuation:**

   a) **The changing nature of work, including the increasing number of people who are self-employed and/or working in temporary and flexible jobs.**

   b) **Declining rates of home ownership; and**

   c) **Changes in labour market participation of those 65 years and older.**

The changing nature of work, particularly in regard to how people are connected to the workforce, will obviously have flow-on effects for retirement income policies in general. In particular, as the accepted norm of being a long-term permanent employee continues to decrease over time, retirement income policies should be flexible enough to fit with changes around how people work.

Compulsory KiwiSaver is not the answer

BusinessNZ continues to support the ideal of a truly voluntary KiwiSaver scheme, given that individuals have different financial priorities at different stages of their life, e.g. reducing a mortgage may be the best form of saving for a person at a certain stage of life, compared with depositing equivalent money into a superannuation scheme.

The main problems with compulsion is that it would drag in those who for whatever reason did not want to join, while those who are part of the scheme and may have joined exclusively for the tax credits and/or employer contributions could find those benefits withdrawn. Also, if we look across the Tasman at the Australian equivalent, which is compulsory, it indicates that the level of private saving in an economy does not necessarily increase and instead, other forms of saving can be replaced by the compulsory contributions.

For the self-employed, a requirement to pay a certain contribution towards compulsory superannuation could well affect their ability to expand their business. For many who are self-employed, their business *is* their retirement plan. Many have made a conscious decision to build their own business in order to financially provide for the future, and have invested whatever resources are available to build it, with the hope of selling it in later years, or reaching a level of income from the business that would provide for them in retirement.

Making KiwiSaver compulsory may also mean they might have to borrow from financial institutions to cover such expenditure. Given that the returns from compulsory superannuation might well be lower than the amount they have to borrow from financial institutions, the requirement to provide compulsory contributions would result in a net loss to the self-employed person.

Recommendation: That any support by other submitters towards making KiwiSaver compulsory to take into account the changing nature of work, including those self-employed, does not proceed.

Flow-on effects on older workers

BusinessNZ believes older workers will play an increasingly critical role in terms of their contribution to the workforce, and to productivity and economic growth. As in many countries, New Zealand's population is ageing, which means older workers are likely to form an increasingly large proportion of the total workforce. While older workers have the opportunity to continue working beyond the age of 65, changes to the overall retirement scheme to reward those who remain in employment longer (and therefore pay more taxes longer) seems from our perspective a pragmatic approach.

The discussion around older workers in the workplace is one that the business community is well alive to. BusinessNZ and Southern Cross have since 2013 conducted a biennial *Workplace Wellness* survey, which is designed to provide a picture of the status of health and wellbeing in the New Zealand workplace[3].

Both the 2015 and 2017 surveys asked questions about managing older workers, as this is becoming an increasingly important issue among employers. Overall, the results showed that three out of four businesses still do not have policies or arrangements in place for older workers, although there was an improvement in the results from 2015 to 2017. The survey shows that the age staff typically retire is not predominantly 65, but predominantly in the 65-70 age bracket, particularly in larger businesses. The survey shows the main initiatives undertaken by businesses to assist older workers include reduced and flexible hours of work, information packs about retirement and dialogue about retirement plans.

At a macro level, we believe that a tight pool of skilled labour, increasing day-to-day costs and a general societal acceptance that 65 is not 'old' will lead to an increasingly higher proportion of people staying on into the workforce beyond 65. To what degree these factors might be reflected in government retirement income policies, including KiwiSaver and New Zealand Superannuation, is difficult to ascertain. Given current rules mean that New Zealand Superannuation can be received at age 65, an increasing proportion of older workers continuing to work past 65 will most probably mean a larger proportion receiving both New Zealander Super and work income. Overall, policy changes are required to meet these challenges.

Flexi-Super as a future option

One option that was previously examined in 2013 yet has gained little traction since is the idea of flexible superannuation. At the time this was being examined by the Government, we believed further work on this option was warranted, as it may enable individuals to manage their retirement income and lifestyle with more flexibility than currently by giving them greater choice of when to first take NZS. BusinessNZ would support further analysis of this option including its potential for fiscally neutral implementation.

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[3] https://www.businessnz.org.nz/resources/surveys-and-statistics/wellness-in-the-workplace-survey

When BusinessNZ formally submitted on this topic, we wanted the Government to ensure that any flexi-super option going forward provided a greater advantage to those who elected to delay NZS, while ensuring that those who decided to take early NZS were not so disadvantaged that very few would choose that option.

Some have noted that a possible disadvantage of introducing flexi-super is the adding of further complexity to retirement savings. Considering that New Zealand currently has three separate pools of superannuation savings via NZS, KiwiSaver and the New Zealand Superannuation Fund, we would expect the Government to take all related factors into account when making significant policy changes to superannuation. From our perspective, the most important interrelationship is that between NZS and KiwiSaver.

To keep New Zealand's broad superannuation policy schemes as simple as possible, we believe further work into the flexi-saver policy should also consider having similar flexi-arrangements for the KiwiSaver scheme. If individuals took early KiwiSaver in line with Superannuation we assume it will be financially beneficial for Government given the reduced yearly top up to be provided to KiwiSaver accounts.

Last, given our view that KiwiSaver should be exclusively focused on the provision of income for retirement, we believe the option of flexi-super has considerably more relevance when compared to already-introduced social policy schemes, such as the first homeowner withdrawal scheme within KiwiSaver.

Recommendation: That flexi-super is further considered as an option to both keep people in work longer and ensure retirement income best works for each individual.

3. **Information about the public's perception and understanding of ethical investments in KiwiSaver, including:**

    a. **The kinds of investments that New Zealanders may want to see excluded by KiwiSaver providers; and**

    b. **The range of KiwiSaver funds with an ethical investment mandate.**

In contrast with the 2012 KiwiSaver default review, the 2019 review looks at the issue of responsible investment, given product disclosure statements must currently state whether investment policies and procedures take responsible investment into account. As mentioned above, BusinessNZ recently submitted on the review of the KiwiSaver default provider arrangements, and there were parts of our submission that we believe need to be repeated for the retirement income policy review.

First, BusinessNZ would point out that we are not against any form of <u>legal</u> investment available in the market. We believe consumers should be able to invest in areas such as weapons manufacturing, alcohol, fossil fuel options or cigarette manufacturing, since these are lawful forms of investment. It is the right of all investors to make their own choice about the investments they are comfortable with, given that money invested is the personal money of the investor, not the state.

At the same time, we are not against the establishment of any voluntary investment vehicle that chooses to take a particular 'responsible investment' path. KiwiSaver members, whether through the default mechanism or through their own choice are free to choose a more responsible fund if they wish. Freedom of choice is a key element when looking at any form of investment.

However, in principle we believe the subjective nature of what is deemed 'responsible investment' means there should be no requirement for any retirement income provider to exclude certain legal activities from their default fund portfolios. What is considered responsible investment one day can quickly be considered not responsible the next. Also, constraining areas where funds can be invested leads to an increasingly smaller pool of options, harming the balance between risk and return required for long term retirement savings. Any move to restrict the pool of possible investment needs to meet a very high threshold in terms of standard policy practice.

Given responsible investment vehicles already exist for a number of providers, we think any discussion of responsible investment around these is largely irrelevant. If some KiwiSaver holders are not pleased with investment changes made, there is nothing stopping them from switching to a fund that complies with their view of responsible investing.

Recommendation: That investments deemed to be legal are not excluded from KiwiSaver investment funds.

Thank you for the opportunity to comment.

Kind regards

Stephen Summers
Economist
BusinessNZ