Retirement income policy in New Zealand: A discussion of context and principles

By the Retirement Income Interest Group
of the New Zealand Society of Actuaries

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Purpose

This discussion paper outlines the views of the Retirement Income Interest Group (RIIG) of the New Zealand Society of Actuaries on what makes for good retirement income policy in New Zealand.

We set out first some key points of context in which retirement income policy operates. We then set out our views on a set of principles which retirement income policy should follow and comment on the extent to which current policy is consistent with each principle.

This discussion paper forms part of our submission to the 2019 Review of Retirement Income Policy, along with a research report *Longevity in New Zealand: Implications for Retirement Income Policy*.

This paper relates to items 2 and, especially, item 7 in the Terms of Reference. Item 7 asks about the purpose and principles of NZ Superannuation.

Our view is that **the primary purpose of New Zealand Superannuation is to protect the population against longevity risk (living longer than expected) and that it should do so in a way that is consistent with the principles of equity, adequacy, empowerment, sustainability and access**, as defined in more detail in what follows.

The term “retirement” is used in this paper for the phase of life when most people do significantly less or no paid work and generally need income from their savings or other sources. While some individuals may transition from full employment to being fully retired on a specific, pre-planned day, the reality is rarely this straightforward.

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This paper represents the collective personal views of the members of RIIG and does not necessarily reflect the positions of our employers or other members of the New Zealand Society of Actuaries. Any errors are our own.

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Retirement income context

1. Retirement income policy operates in a complex environment.
2. Retirement income comes from many sources.
3. The New Zealand population is diverse; individuals' resources and needs are diverse.
4. The factors influencing future income requirements are uncertain.
5. Needs change throughout retirement.
6. There is a wide range of financial capability among New Zealanders.
7. Many different areas of legislation affect retirement income outcomes.
8. Once in retirement, retirees have limited ability to improve their financial position.

Retirement income principles

Retirement policy should:

1. be **equitable**,
2. provide for an **adequate** level of income for retirees,
3. be **empowering**, by encouraging people to save for their retirement and enabling people to plan for their retirement with confidence,
4. be **sustainable**, and
5. be **understandable and easily accessed** by the majority of retirees.

Context

1. Retirement income policy operates in a complex environment

There are many challenges to creating effective retirement income policy. As with many other areas of public policy it is about trade-offs, especially equity vs. adequacy vs. sustainability vs. simplicity.

There are many other sectors of society needing resources and attention.

Many areas of policy affect retirement income outcomes including those governing entitlements to statutory benefits, employment, taxation, financial services regulation, healthcare, aged care and more.

Individual lives are complex, and there is no standard path to, or through, retirement. Health, life choices or financial shocks can make large differences to retirement outcomes.

2. Retirement income comes from many sources

Private income in retirement may come from:

- wages from employment
- KiwiSaver
- retirement savings
- an employer-sponsored retirement scheme
- income from rental property or business ownership.

New Zealand Superannuation is provided if an individual:

- is aged 65 or older
- is a New Zealand citizen or permanent resident
- has been resident and present in New Zealand for not less than 10 years since age 20, of which 5 years must be since age 50
- is ordinarily resident in New Zealand at the time of application.

A Super Gold card is provided to all New Zealand Super recipients. It gives discounts at participating retailers and service providers. The most valuable benefit is likely to be the local public transport benefit (often free).

There are various means-tested supplementary benefits provided to persons in need, for example:

- disability allowance
- accommodation supplement
- temporary additional support
- residential care subsidies
- residential care loans
- funeral grants
- council rates rebate scheme.

There is fairly comprehensive universal healthcare. The Community Services Card provides subsidised healthcare services to those on low incomes including those over 65 years of age. Costs relating to accidents are covered by ACC.

3. The New Zealand population is diverse; individuals' resources and needs are diverse

Health and employment opportunities vary among individuals and over time, before and after retirement. Income during working life varies both among individuals and over time, affecting the ability to contribute to the individual's private and public retirement benefits. While most people living in New Zealand are entitled to New Zealand Superannuation, not all are.

Support networks and dependents' requirements vary both among individuals and over time.

Income expectations and concepts of what is "adequate" vary.

Average life expectancies for certain groups within the general population vary. People in some groups can be expected, on average, not to need retirement income for as long than the all-population average. People with certain risk factors may be expected to spend longer in ill-health than the average, or to be at higher risk of multiple years with cognitive challenges, such as dementia. However, individual experiences within groups can vary even more widely, with some individuals living significantly longer or dying significantly earlier than their group average.

4. The factors influencing future income requirements are uncertain

There are many unknowns influencing future income requirements on an individual basis, but the most significant are a person's actual lifespan and future health. This uncertainty affects the individual's ability to plan, especially:

- the amount of time the person will spend in each of the stages of retirement (see below) and spending requirements throughout
- the amount of private savings required and the rate at which to consume those savings.

Other factors which affect the retirement system and make planning difficult for policy makers and individuals include the unknown future changes to:

- the New Zealand economy
- the global economy
- political priorities
- society's expectations
- technology
- the nature of the workforce

A person may not plan in detail for retirement or do so only implicitly. Longevity risk is the possibility that people live for longer than they expected when they did their financial planning for retirement.

5. Needs change throughout retirement

It can be helpful to think of retirement as broadly three phases: active, restricted and frail. Not all retirees will spend time in every phase and the duration spent within phases will differ. For many people, the boundaries between phases will blur.

This framework suggests that spending is U-shaped, that is, high when newly retired, low when activity reduces and then higher again if health worsens, but this largely depends on the nature and incidence of any health problems and the availability of support. Individuals will move through these stages at different ages based on their own health and financial situation.

6. There is a wide range of financial capability among New Zealanders

This means it is an ongoing challenge to equip all New Zealanders with the knowledge and tools they need to plan and manage their retirement effectively. Product providers have a responsibility in this area, as well as regulators and government agencies.

7. Many different areas of legislation affect retirement income outcomes

As described above, retirement income can come from many sources and includes indirect income and benefits. Legislation affecting any of these will affect retirement income.

The impact can be indirect, for example the amount of New Zealand Superannuation is determined based on wages and so any legislation affecting wage growth or remuneration definitions may affect the amount of New Zealand Superannuation payable. In addition, taxation has a strong influence on employment and investment choices both before and after eligibility for New Zealand Superannuation. It affects the way in which people save and how much they save.

Legislation relating to statutory benefit entitlements directly effects retirees. Eligibility for the benefits available from New Zealand Superannuation, the health system, ACC, the Gold Card and the welfare system, and the quantum of those benefits, can and do change over time.

8. Once in retirement, retirees have limited ability to increase their savings

Individuals' outcomes are uncertain: private savings may not grow as quickly as expected, inflation may erode spending power, expenses may be greater than expected and individuals may live longer than they expect.

There has been a strong trend of increased employment after age 65 in New Zealand. Even so, as people age it generally becomes harder to provide for unexpected changes which require increased personal income or capital. Additional future income or capital can only come from further employment (including self-employment), release of equity from property, unexpected gains on accumulated assets, or gifts, whether from family, trust, or some other voluntary contributions whether in the form of money or in kind.

Policy Principles

1. Equitable

What

Retirement policy should aim to treat all retirees and potential retirees fairly and equitably, regardless of their circumstances or personal attributes, including across generations.

Why

While retirement income policy should work for a diverse population, it should not be at the expense or advantage of any particular group if it is to serve the population as a whole fairly.

Fair and equitable can mean different things to different people but, in this context, we mean fair and equitable in line with social conscience and natural justice. Treating people fairly and equitably does not necessarily mean that everyone should receive the same level of income but neither does it preclude doing so.

How

The near-universal nature of New Zealand Superannuation is the main contributor to equity in New Zealand retirement income policy. Employer contributions to KiwiSaver are at the same rate of earnings (3%) for all employed members, and the member tax credit is at the same matching rate to members contributions, capped at $521.43 a year, which prevents significant inequity between high and low earners.

2. Adequate

What

The amount of income a retiree has in retirement should be adequate to provide for their individual needs and take account of their individual circumstances e.g. their lifestyle, family situation, related spending patterns and how long they live.

However, at a minimum, Government-provided income should alleviate old age poverty and hardship, promote positive and active ageing, and facilitate the development and maintenance of social cohesion.

Why

An adequate level of retirement income enables individuals to sustain themselves and contributes to social cohesion, positive aging and individual and societal wellbeing.

However, not everyone will be able to build up their individual private resources to achieve an adequate income. Government-provided income is the efficient and effective way to provide a modest basic income for all.

How

The level of New Zealand Superannuation and KiwiSaver policy settings (especially default member contribution rates and employer contributions) contribute to a basic level of adequacy of retirement income. Adequacy beyond this is a matter of personal choice and circumstances, with information and tools provided (for example, on *sorted.org.nz*) for individuals to plan for their own perceived adequacy gaps. Retirement saving through other retirement vehicles is further supported by a regulatory framework.

3. Empowering

What

Retirement systems should at least not penalise, and at best encourage, individuals to save towards their own retirement income.

In addition, whilst retirement systems need to react and evolve in response to changes in the environment in which they operate, changes should be gradual rather than sudden so as to allow people to plan for their retirement with confidence.

Public confidence should be safeguarded with appropriate supervision. Regulatory authorities have a key role in this regard. However, it is important that an optimal balance of regulatory requirements is struck: too much regulation can be onerous, stifle innovation and discourage participation and hence undermine competition. Too little regulation can leave stakeholders vulnerable to risks and unfair treatment.

Why

Systems which discourage personal saving, or a failure of public confidence in retirement policy or retirement savings products, could result in a reluctance to save and lead to a decline in standards of income adequacy and wellbeing in retirement.

People need to be able to plan many years ahead for their retirement and once they are retired their ability to increase savings is limited. Therefore, any adjustments to an individual's savings requirements, or in policy settings, should be eased in gradually where possible. "Cliff-edge" changes can create intractable unfairness and adversely affect confidence in the system.

How

New Zealand Superannuation empowers people by being an individual entitlement and by not dis-incentivising work or saving, as it is not means-tested. KiwiSaver incentivises saving, empowering through choice of participation, scheme provider, fund options and savings rate. Prudential and market conduct regulation applies to promote confidence in sound and efficient financial markets.

4. Sustainable

What

Retirement income policy should be sustainable in the sense of being likely to be affordable in future, and to have the continued support of New Zealanders.

Why

Retirement income is largely met from general taxation and personal savings. To be sustainable, retirement income policy needs to be able to be paid for. Future changes to population and employment in New Zealand have a direct impact on the future cost of New Zealand Superannuation and other government benefits to retirees, including healthcare, and the sources of revenue to pay for such benefits. Future longevity and health are critical determinants of the future cost of State-provided benefits to retirees and of the amount retirees will need to accumulate in private savings.

How

Regular reviews of retirement policy help to keep policy sustainable. The Retirement Commissioner has a crucial role in ensuring that reviews are informed by up to date evidence on key trends, changing needs and public perception that policy is addressing their needs and values.

5. Understandable and easily accessed

What

Retirement income policy should be simple to understand and easily accessible, with decision-making made easy for all individuals.

Why

Retirement income policy has to operate in an environment where complexity and suboptimal financial capability is widespread.

As a result, retirement income policy must cater for those who do not have high levels of knowledge, capability or for other reasons cannot deal with retirement income choices throughout their life or at times. For example, many New Zealanders underestimate how long they are likely to live, how much income they may need and how much they may therefore need to save. As individuals age, cognitive abilities can reduce, with some individuals being less likely to be able to (or want to) make well-reasoned decisions for themselves.

How

New Zealand has well-developed financial capability tools in public and private sectors. Compared to other countries' systems, New Zealand's retirement income policy is relatively simple, which helps greatly in making it understandable and accessible. The eligibility criteria for New Zealand Superannuation are straightforward to understand and operate. It is easy to join and stay a member of KiwiSaver because of auto-enrolment to a KiwiSaver account which is kept throughout life.