

SEPTEMBER 2011

INTRODUCTION

This paper reviews the financial challenges New Zealanders have in preparing for retirement and the role their employers can play in facilitating growing financial knowledge and preparedness.

SUMMARY POINTS

1. RETIREMENT INCOME PLANNING IS NEEDED MORE THAN EVER - WHY?

People are living longer - and correspondingly, spending longer living in retirement.

Current NZ Super (NZS) entitlement terms will become fiscally unaffordable – forcing the Government to reduce these terms.

Lifestyle expectations mean that the gap between NZS and desired household expenditure in retirement will widen.

Households need to prepare to fund more of their retirement years themselves.

2. CAN KIWISAVER DO IT?

For households who desire either an average lifestyle, or above average lifestyle in retirement, only a small proportion will build sufficient retirement wealth via KiwiSaver alone. For most households, accumulating wealth outside their home and in addition to KiwiSaver will be essential.

3. WORKING OUT YOUR WEALTH TARGET - AND ACHIEVING IT

Most regular savers do not know what they need to accumulate to fund a comfortable retirement yet view participation in KiwiSaver as sufficient to achieve this.

4. ROLL OF EMPLOYERS

Enabling savers to work out how to optimise their wealth accumulation and what they will need to achieve their wealth target is a level of financial knowledge many in

New Zealand presently do not have or have easy access to. This in contrast to the US, UK and Australia where employers have embraced the facilitation of financial guidance programmes for their employees.

There are clear benefits to employers for offering such programmes to their employees as there are for employees to participate.

NEW ZEALANDERS' LONGEVITY

Statistics NZ annually update their mortality tables and 5 yearly period life tables. In each situation, based on the most recent actual mortality, they provide updated longevity forecasts for each current group in 5 year age intervals.

If you're a married couple and 65 years of age today, ON AVERAGE, there's a near 50% chance you'll both live into your mid 80s - with one of you having a 50% chance of living till your early 90s.

TABLE 1

Lifespan	65 year old man today	65 year old woman today	65 year old couple (for 1 survivor)
50% chance	86 years	87 years	92 years
25% chance	90 years	91 years	95 years

Source: Statistics NZ, NZ Period Life Tables (2005-2007, 2010)

The methodology of age forecasting based on the most recent data has consistently underestimated the actual increase in longevity. NZ Funds has used the change trend in longevity of the last 30 years for estimates in Table 2.

Based on NZ Funds' estimates; if you're married and 35 years of age today, extrapolating the increase in average ages over the last 30 years into the next 30 years, by the time you are 65 years of age we estimate there will be a near 50% chance you'll live into your late 80's - with one of you having a 50% chance of living till your mid 90s.

TABLE 2

Lifespan	35 year old man today	35 year old woman today	65 year old couple (for 1 survivor)
50% chance	88 years	90 years	94 years
25% chance	92 years	94 years	97 years

Source: NZ Funds estimates.

NZ SUPERANNUATION (NZS) RELIANCE TIMESPAN (AVERAGE)

The forecast increases in longevity appear highly reliable.

Based on retaining the existing entitlement age for NZS, we can on average expect a rising timeframe under which each of us receive NZS income.

Given NZS is substantially funded on a pay as you go (PAYG) basis, the increase in state funded income combined with the rising proportion of the population receiving NZS has both intergenerational and financial sustainability problems.

TABLE 3

	Men – Year attained 65 years of age			Women – Year attained 65 years of age		
	1990	2010	2040	1990	2010	2040
Subsequent years reliant on NZ Super	16.4	21	23	20.1	22	25

Sources: Statistics NZ, NZ Funds

NZ SUPER (NZS) - A RISING PROPORTION OF GDP

Present demographic and longevity trends indicate there will be a rising percentage of the population over 65 years with each of these retired New Zealanders receiving NZS for a longer period.

No surprise that the cost of NZS will become an increasing burden on the economy. The costs of these demographic trends become even greater when combined with the rising health costs associated with an increasingly older population (the average person aged 65 or over costs the public health system 5 times as much as the average person under 65)¹.

TABLE 4

Lifespan	2000	2020	2040
NZS as a % of GDP	4.5	5	7
Over 65s share of public health budget	40%	n/a	60%

Source: The Treasury

INCREASING THE AGE OF ENTITLEMENT

TABLE 5

Effective in decade	66	67	68
2000-2009	USA	Iceland, Norway	
2010-2019	Ireland (2014) Australia		
2020-2029	United Kingdom Netherlands Denmark New Zealand?? (as recommended by Retirement Commission)	Ireland (2021) Australia Netherlands Denmark USA Germany	Ireland (2028)
2030-2039		United Kingdom New Zealand?? (as recommended by Retirement Commission)	
2040-2049			United Kingdom

Source: Retirement Commission '2010 Review of Retirement Income Policy'

While on many comparatives, New Zealand is in a relatively more fortunate position than most of the developed world (as represented by the OECD), many OECD countries are already responding to the rising financial burden associated with an ageing population by one or more of the following;

- increasing the age of entitlement (see Table 5)
- reducing eligibility to state pensions
- reducing state pension incomes in real terms

(1) Population Aging and Government Health Expenditure, The Treasury, March 2005.

LIFESTYLE EXPECTATIONS IN RETIREMENT ARE RISING

In contrast retirement lifestyle expectations are rising – which is creating a material gap between the income a household might expect to receive from NZS and their planned expenditure level.

TABLE 6 - ALL IN 2011 \$

Household Income & Expenditure in Retirement	Average	Above Average ²
NZS Replacement as a % of pre-retirement household income	41.5%	29.4%
Post-tax Retirement Income Target (70% of household pre-retirement income)	\$45,000	\$70,000
Annual retirement income shortfall after subtracting NZS at couples rate	\$17,800	\$42,800

Sources: OECD 2011, NZ Funds estimates

The shortfall in table 6 will need to be made up from private retirement provision, with 1.7 million individuals opening up KiwiSaver accounts since 2007 principally to support the private provision of retirement income.

WHICH MAY ONLY IN PART BE FILLED BY KIWISAVER

The take up of KiwiSaver since it commenced in 2007 is well above pre launch Treasury forecasts. We believe this reflects;

- The latent need for a Government 'sponsored' standard regular savings investment vehicle for retirement income (missing since 1989)
- The boost in KiwiSaver member account values from employer and Government contributions.

Recent surveys indicate that the reliance on KiwiSaver by New Zealanders is rising;

"Over the past year KiwiSaver has climbed from last place to third equal in return perceptions, the highest level yet," Mr Beale says. "Those expecting KiwiSaver to be their main source of retirement funding also reached a new high of 62 percent (61 percent in Q4 2010), while respondents

(2) This is 150% of average household expenditure.

(3) ASB Investor Confidence Survey Q1, 2011.

currently using KiwiSaver climbed 5 percent to 43 percent – another high."³

While KiwiSaver's rising participation is a good start, it's still highly uncertain whether this crop of KiwiSaver members have also gone through the exercise of working out the level of their retirement expenditure they can reasonably anticipate being funded from their KiwiSaver account balance.

WORKING OUT HOW MUCH IS NEEDED

So how much will a household need to have accumulated by retirement ('Wealth Target') to sustainably fund their retirement income shortfall post receiving NZS?

Combining the forecast lifespans for today's 65 years olds from Table 1 with the retirement income shortfalls from Table 6 provides an answer.

TABLE 7 - ALL IN 2011 \$

Retirement Wealth Target	Income (Average)	Income (Above Average)
50% chance – 22 years in retirement	\$320,000	\$757,000
25% chance – 25 years in retirement	\$340,000	\$810,000

TABLE 8 - ALL IN 2011 \$

KiwiSaver \$ Value Accumulated by Retirement (by Household)	Household Income \$75,000 pa (Average)	Household Income \$112,500 pa (150% of Average)
Start at 25 (40 years saving)	\$510,200	\$663,400
Start at 35 (30 years saving)	\$299,800	\$399,200
Start at 45 (20 years saving)	\$157,700	\$214,350
Start at 55 (10 years saving)	\$62,800	\$86,500

Source: Sorted.org.nz

Note: The calculations assume two adults in the household are employed, they contribute and receive employer and Government KiwiSaver contributions at the minimum rate.

FINANCIAL PREPAREDNESS BEYOND KIWISAVER – RISKS OF CONFUSION AND COMPLACENCY

In most instances the sums required in Table 7 (the 'liability') exceed the sums accumulated via KiwiSaver (the 'asset') in Table 8.

Accumulating sufficient wealth for retirement income needs via KiwiSaver alone requires that a household sticks to a disciplined KiwiSaver savings plan, beyond paying off mortgage debt, for at least 30 years.

Anything less than that requires one or more of the following:

- An accelerated savings plan late in one's working life
- Home equity release
- Intergenerational wealth transfer (the 'inheritance')
- Working beyond 65 years (full or part-time) OR
- **ACCEPTING A MATERIAL REDUCTION IN LIFESTYLE IN RETIREMENT!!**

Even in retirement, savers require a structured decumulation strategy to ensure what has been accumulated is consumed in a sustainable manner. As recently noted;

'Both the quantum of saving and its allocation to home equity or other financial assets are key decisions to be made and require a considerable degree of financial literacy or guidance from a trusted adviser.'⁴

And from the Retirement Commission in their 2010 Review of Retirement Income Policy;

'The message for younger people that KiwiSaver will give extra income in retirement is reassuring but unless it is backed up by good financial education and advice it risks confusion and complacency...'

A view which is not unsurprising given the evidence in other markets of retirement savers naively believing their participation in a savings programme of itself will ensure a comfortable retirement eg;

'Australians (55-64 years) do not typically save enough to finance a modest lifestyle even with the public pension⁵ while in the US 'the median household headed by a person 60 to 62 with a 401(k) account has less than one quarter of what is needed in that account to maintain its standard of living in retirement.'⁶

SPREADING FINANCIAL PREPAREDNESS – EMPLOYERS AS FACILITATORS

With the evidence clear that financial preparedness knowledge needs to be spread more widely the natural question is;

'How can this be done both time efficiently and cost effectively?'

Note the following;

- 1.2m of the 1.7m KiwiSaver members are employed (70%)
- 15% of KiwiSaver members have opted in via an employer chosen scheme ('preferred provider')

Following on from the practices in the US, UK and Australia – facilitating financial preparedness through the workplace has had well documented benefits from both an employer and employee perspective.

Evidence of benefits for employees being;

- Increased savings programme participation
- Increases in the rate of debt reduction
- Increases in contribution levels to savings plans

(4) Mixed messages: The future direction of New Zealand's retirement income policies, Roger Hurnard, July 2011.

(5) 2010 Report on Retirement Income, Retirement Commission, pg62.

(6) Wall Street Journal, February 11, 2011.

While employers have benefited from;

- Employees being less distressed or distracted by financial problems
- Lower employee absenteeism
- Enhanced employee productivity.

All leading to improved business profitability.

Delivering financial insights via the workplace enables providers to reach audiences of sufficient size while participants are in the more focused and objective mindset associated with the workplace vs. the home environment.

There are also clear benefits for employers both humanistically and financially – the former from heightened employee loyalty and retention, the latter from a more productive workforce.

For further information please contact:



David van Schaardenburg Ph: 09 377 2277
Principal - Workplace Wealth
New Zealand Funds Management Limited

DISCLAIMER: THIS DOCUMENT HAS BEEN PROVIDED FOR INFORMATION PURPOSES ONLY. THE CONTENT OF THIS DOCUMENT IS NOT INTENDED AS A SUBSTITUTE FOR SPECIFIC PROFESSIONAL ADVICE ON INVESTMENTS, FINANCIAL PLANNING OR ANY OTHER MATTER.

THE VIEWS EXPRESSED IN THIS DOCUMENT ARE THOSE OF NEW ZEALAND FUNDS MANAGEMENT LIMITED AS AT THE DATE OF THIS DOCUMENT AND ARE BASED ON INFORMATION AND SOURCES BELIEVED BUT NOT WARRANTED TO BE CORRECT. WHILE THE INFORMATION PROVIDED IN THIS DOCUMENT IS STATED ACCURATELY TO THE BEST OF OUR KNOWLEDGE AND BELIEF, NEW ZEALAND FUNDS MANAGEMENT LIMITED, ITS DIRECTORS, EMPLOYEES AND RELATED PARTIES ACCEPT NO LIABILITY OR RESPONSIBILITY FOR ANY LOSS, DAMAGE, CLAIM OR EXPENSE SUFFERED OR INCURRED BY ANY PARTY AS A RESULT OF RELIANCE ON THE INFORMATION PROVIDED AND OPINIONS EXPRESSED IN THIS DOCUMENT, EXCEPT AS REQUIRED BY LAW.