A submission to the Treasury in response to the discussion paper:

“Saving in New Zealand – Issues and Options”

From ANZ New Zealand

December 2010

1. ABOUT ANZ NEW ZEALAND

1.1 ANZ New Zealand, including OnePath, welcomes the opportunity to contribute to the work of the Savings Working Group (SWG) in its task of providing the Government with advice on how New Zealand can improve its national saving.

1.2 ANZ New Zealand is one of New Zealand's largest companies and the country's oldest registered bank, operating through its brands ANZ and The National Bank. ANZ New Zealand offers a full range of financial products and services, including a significant range of financial advisory services, personal banking, institutional, and wealth management services. ANZ New Zealand operates the following businesses in New Zealand:

- ANZ
- The National Bank Limited
- OnePath
- UDC Finance
- EFTPOS New Zealand
- Direct Broking
- Bonus Bonds

1.3 ANZ New Zealand employs around 9,000 staff in New Zealand. Nearly one in every two New Zealanders has a relationship with the bank. ANZ New Zealand is a subsidiary of the ANZ Group, one of only nine banks in the world with an AA Standard & Poor's rating. OnePath is wholly-owned by ANZ New Zealand, and provides investment, life insurance and real estate products and services for the bank's customers and intermediaries.

1.4 ANZ New Zealand is committed, as New Zealand's largest bank, to playing a crucial role in facilitating New Zealand's future economic growth and prosperity. Increasing New Zealand's rate of savings and investment is one of the most vital ingredients,, along with export –led growth tax reform and reduced indebtedness, to the lifting of New Zealand's economic performance and to the generating of higher incomes and hence improved living standards for all New Zealanders. ANZ New Zealand is active in supporting export-led growth and has recently announce a $3 billion business lending package to small and medium sized New Zealand businesses.

1.5 As the largest bank serving one in two New Zealanders, ANZ New Zealand plays an important role in providing high-grade deposits for New Zealanders to invest in. ANZ

New Zealand supports higher rate of growth in financial investments and retirement savings, including through KiwiSaver and deposit/cash PIE growth.

1.6 ANZ New Zealand is the number one provider of KiwiSaver via OnePath, which has a history of more than 20 years in managed funds management. OnePath has significant expertise in KiwiSaver and is the largest KiwiSaver provider in terms of funds under management, currently $1.624 billion[1].

1.7 OnePath is the manager of four KiwiSaver schemes (including being a government-appointed provider for one of the six default schemes) with approximately 380,000 members, representing 24 percent of the total market[2]. It has nearly 5,000 employer agreements, or 27 percent of that market[3] and it is both FundSource Fund Manager of the Year 2010 and KiwiSaver Scheme Manager of the Year 2010.[4]

1.8 The Treasury's discussion document poses a number of specific questions. Rather than answer them individually, we have chosen to adopt a more discursive approach in an effort to express our view on the issue of saving and its importance to New Zealand and the New Zealand economy. However, this approach still provides answers to most of those specific questions.

1.9 Finally, it is important to note the role the Australian owned banks have played in assisting New Zealand weather the Global Financial Crisis. Their influence on the financial sector and their continued support of New Zealand businesses and households is providing a stable platform for New Zealanders to save and invest. In so doing, the banks contribute considerably to the country's economic wellbeing.

Executive Summary and Key Recommendations

Overview

1.10 The Global Financial Crisis has brought home to New Zealanders, and their governments, the importance of better financial management, including the need to save and reduce debt. Adjustment has been slow and painful. But there are signs that people are moving from a spending to a savings mentality. This shift creates an opportunity to change, for the better, some hitherto poor and deep-seated attitudes to consumption and investment on the part of too many New Zealanders.

1.11 ANZ New Zealand believes the issue is not saving per se, but the growth of financial investments and assets in New Zealand.

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[1] FundSource Marketshare report September 2010

[2] IRD Figures November 2010

[3] IRD Figures November 2010

[4] These awards were announced on 19 November 2010 by FundSource, the investment strategy and research company. The awards should not be read as a recommendation by FundSource. For further advice on the relevance of this award to your personal situation consult your financial adviser, or visit www.fundsource.co.nz

1.12 Policy settings around the growth of financial assets in New Zealand should aim to:

- Capture the additional savings from growth and investment.
- Support a higher rate of domestic deposit growth.
- Support a higher rate of growth in financial investments and provide for retirement income through schemes like KiwiSaver.

Growing savings and investment

1.13 There is no magic bullet to improving New Zealand's rate of saving and investment.

1.14 Rather, ANZ New Zealand believes there are a number of initiatives the SWG could recommend to Government to steadily grow savings and investment in New Zealand. These include the development of:

- A clear savings and investment policy framework that provides consistency over time, allowing people to plan their savings, their investments and their retirement income.
- A national retirement income strategy (as part of the above framework), focused on certainty, clarity, transparency, fairness, security, choice and understanding. In particular, New Zealanders require advance warning of any settings changes to retirement income parameters and the choice to be able to select from a variety of retirement savings and investment options that best suit their individual expectations, circumstances and requirements.
- Sensible and cost- effective regulation, giving people the confidence to save and invest.
- Measures to improve New Zealand's standards of financial literacy, giving people the knowledge to have more confidence in their own investment decisions.
- Enhancements to KiwiSaver to encourage greater uptake.
- A tax regime more supportive of savings and investments.
- A wider range of saving and investment opportunities in New Zealand capital markets and in central and local government bonds.

ANZ New Zealand believes that the above initiatives should be considered before any decision to make retirement savings compulsory.

KiwiSaver

1.15 There is little doubt that KiwiSaver has introduced the savings habit to a significant proportion of the population who were previously unfamiliar with long term savings schemes. Its success is demonstrated in the fact that more than 1.5 million people have joined the scheme since its inception three years ago.

1.16 There is little evidence that compulsion would increase national savings, though it may affect the composition of those savings. Compulsion also raises complex distribution and equity issues for those on low incomes and those who workforce participation is non-existent, or intermittent.

1.17 The present high tax rate on post-retirement investments and withdrawals sends a negative message to the general population, especially those coming into the workforce or considering joining KiwiSaver.

1.18 ANZ New Zealand believes there are a number of enhancements that could make the existing KiwiSaver scheme more compelling as a good savings option. These would include:

- Maintaining the current $1000 joining incentive under any continued voluntary based scheme.
- Designing a “lifetime’ approach to investment whereby contributors are first enrolled in less conservative investment options and moved to more conservative options as they approach retirement.
- Raising KiwiSaver contribution levels in small but consistent steps (e.g. half a percent per annum) towards a level more comparable to schemes operating in other parts of the world.
- Automatically enrolling non-members who have been in the workforce for more that five years but giving them an ‘opt out’ provision.
- In a voluntary scheme, targeting tax incentives towards low and middle income earners and the self-employed.

Overview

1.19 We consider there are three important points that should frame any discussion on saving and investment and its importance to economic growth, productivity and, ultimately, higher incomes for all New Zealanders. These are:

- The need for a clear Government policy framework that provides consistency over time, allowing people to plan their savings, their investments, and to plan their retirement income.
- The development of sympathetic and supportive policies that encourage people to save, reward those who contribute to superannuation schemes like KiwiSaver and lead to the development of a wider range of saving and investment opportunities.
- The creation of an environment that gives people the confidence to save and invest through sensible regulatory protection and measures to improve the nation's standards of financial literacy.

1.20 Importantly, we consider the time is right for a concerted approach on all three fronts for the benefit of individual New Zealanders and the New Zealand economy.

2. SAVING AND A NEW OPPORTUNITY

Overview

2.1 ANZ New Zealand considers that saving must be considered in the context of growing saving and investment opportunities for the benefit of New Zealand and New Zealanders.

2.2 Discussion about KiwiSaver tends to focus on compulsion. We support choice and diversity in saving and investment. For this reason, we support initiatives that will grow saving and investment short of compulsion in the short to medium term. However, we recognise that, in time, and if saving and investment levels do not increase following such initiatives the Government, at that time, may wish to consider whether retirement saving should be compulsory.

2.3 We focus on initiatives to grow savings and investment in New Zealand that the SWG may consider in its recommendations to the Government. They include:

- Developing a savings and investment policy framework,.
- Providing certainty around the state's role in retirement income.
- Further improvements to the regulatory environment to protect consumers and give certainty to market participants.
- A greater focus on financial and investment literacy.
- Enhancements to KiwiSaver to encourage higher uptake.
- A tax regime more supportive of saving and investment.
- Increasing the range of saving and investment opportunities in capital markets and in Central and Local Government bonds.

2.4 Our submission begins with the current saving and investment environment. Our view is that this environment is a real opportunity to grow the level of saving and investment in New Zealand.

Policy settings for saving

2.5 As noted, we consider the issue is not saving per se, but the growing of financial assets in New Zealand.

2.6 Policy settings growing financial assets should be underpinned by three fundamental principles. These are:

- Capturing the additional saving from higher growth and productive investment.
- Supporting the higher rate of domestic deposit growth (e.g. savings accounts, cash PIEs and term deposits). This grows the pool of high-grade domestic deposits, and creates more systemic stability.
- Supporting the higher rate of growth in financial investments and providing for retirement income through schemes such as KiwiSaver.

2.7 We also believe New Zealand needs to focus not just on retirement saving, but on growing a wider and deeper suite of saving and investment products across the board. This wider focus offers the best opportunity to enhance New Zealand's prospects for economic growth.

An opportunity

2.8 Most commentators agree that there would be considerable individual and national benefits from increasing the present level of household, business and government saving and investment.

2.9 We consider, however, that a narrow focus on the level of saving and investment has the potential to overlook a great opportunity to change some deep-seated financial and investment habits in New Zealand.

2.10 An unintended consequence of the Global Financial Crisis in New Zealand has been an improvement in national saving. According to Statistics NZ, national saving for the entire New Zealand economy was $NZ3.173 billion in the year ended March 2010, as national disposable income rose more than consumption spending.

2.11 National disposable income, which measures income available to New Zealand residents for current consumption or saving, rose 4.3 percent in the year ended March 2010. This increase was larger than the increase in spending (as measured in final consumption figures), resulting in higher national saving.

2.12 There are signs the culture shift is already taking place. We consider the global financial crisis is bringing home to New Zealanders the importance of better financial management, including the need to save and take part in a broader range of investment opportunities. In short, people are moving from a spending mentality to a saving mentality and moving beyond investment opportunities in residential housing.

2.13 Households and businesses are paying down debt, and curtailing their borrowing. We consider this environment offers an ideal opportunity to reinforce the value of saving and investment and direct people away from the consumption-driven behaviour of the past.

2.14 The challenge for the Government and the New Zealand financial sector is to ensure this shift in community thinking is not transitory, but becomes embedded in a new attitude to the value of saving and investment.

2.15 We acknowledge that in the shorter term, increased savings from reduced consumption will have a negative impact on economic growth. In the longer term, however, the economy will benefit from internally sourced and cheaper funding for capital development.

2.16 Saving is made up of the three components – household, business and government saving.

New Zealand's economic growth and our net national indebtedness will be improved if our level of national savings was higher. The Government has a key role to play in creating a more sustainable saving and investment environment through its own goal, reflected in the 2010 Budget, of a return to operating surplus by 2015/16. Reducing fiscal deficits and the level of government debt will secure the long term ability of governments to provide a sustainable and equitable retirement income for all New Zealanders.

2.17 Our submission suggests a number of initiatives that the SWG could consider to reinforce this new shift in the public's mindset. These include:

- A clear government retirement income policy framework.

- The development of a multi-party government savings framework, policy principles and settings designed to provide certainty for people - particularly around retirement income.

- A government retirement savings strategy, which includes:
  - Restoration of public confidence in the quality of financial advice and financial services through improved regulation.
  - Initiatives designed to improve levels of financial literacy in New Zealand.
  - Encouragement for a greater uptake and growth of KiwiSaver.
  - A taxation policy that *better* supports saving and investment.
  - The creation of more investment opportunities in capital markets.

New Zealand's saving record

2.18 The Savings' Working Group (SWG) discussion document asks whether we agree that New Zealand's level of national saving is too low. It suggests that one measure of saving performance, our net national saving rate, has been constantly and significantly below the median of countries in the OECD.

2.19 Our analysis supports the view that, on balance, there are a number of ways to grow significantly the level of saving and investment in New Zealand. But first it is necessary to account for the factors that, historically, have contributed to New Zealand having a lower than desirable level of saving and investment.

2.20 The first of these is a "borrow to spend" mentality which impacts on New Zealand at a national level, as well as on individuals and families.

2.21 Other factors contributing to a low saving and investment record include:

- Relatively low levels of New Zealand household financial assets.
- Relatively low income on a national basis.
- A high level of net external debt, net private-sector indebtedness and net government debt is too high.
- A national preference for investing in residential property.

Household financial assets

2.22 In economic terms, 'saving' is the portion of national income accruing to a country (or sector) that is not consumed and is therefore available to finance future investment or future spending. This investment includes physical assets such as property (houses, non-residential property, including rural), business investment (including plant and machinery) and infrastructure. While household saving has been trending downwards and, since the early 1990s, has become negative, the same cannot be said for households' financial assets.

2.23 According to the Reserve Bank of New Zealand's (RBNZ) Household Income and Outlay Account, the household sector has been dissaving: that is, consuming in excess of its disposable income. However, 'dissaving' does not mean that households' holdings of financial assets have gone down. In fact, as the RBNZ's Household Income and Outlay Account data shows, they have grown significantly over the period:

2.24 RBNZ data shows, however, that household incomes have been boosted by proceeds from the sale of assets that have inflated in value, typically financed by borrowing by another household, and ultimately sourced through the lender by borrowing from overseas.

2.25 This cannot be sustained indefinitely because it ultimately involves substantial new borrowing on the part of the household sector, which becomes constrained by the following:

- Limits on the borrowing capacity of new borrowers (affordability).
- Limits on New Zealand's ability to continue to finance additional borrowing from overseas on favourable terms.

2.26 We are now at the point where households are deciding that they are unable or unwilling to take on more debt and/or that current debt levels are too burdensome to service. Household indebtedness (as a percentage of disposable income) has fallen from 159.3 percent in 2008 to 153.5 percent in 2010.

2.27 The recent Standard & Poor's announcement reducing New Zealand's credit rating outlook to "negative" reflected the rating agency's concern about New Zealand's widening external imbalances and low fiscal flexibility.

2.28 New Zealanders continue to be reluctant to accumulate wealth through financial assets other than residential housing. The share of financial assets as a proportion of total wealth in New Zealand appears to be low by international standards.

2.29 Many households appear to have a deep-seated concern about investing in financial assets. Possibly, many households have been reluctant to invest in equities or managed funds, following their experiences in the late 1980s, in the late 1990s and early 2000s and after the Global Financial Crisis. Many investors appear more comfortable with property.

The benefits of saving

2.30 It is useful to record the widely accepted benefits of a greater level of saving and investment in New Zealand from a wider range on saving and investment products and opportunities. Some of these benefits were clearly identified in the RBNZ's submission to the SWG. Benefits include:

- The cushioning of the New Zealand economy from future global economic shocks.

- An increase in retirement income levels from all sources for more New Zealanders.
- An increase in the range of opportunities for New Zealanders to save and invest.
- A reduction in real interest rate levels and a lowering of the real exchange rate.
- The provision of a platform for faster, better balanced and, hence more sustainable economic growth.

3. A NATIONAL RETIREMENT INCOME STRATEGY FOR NEW ZEALAND

3.1 In our view, the primary task of the SWG is to advise the Government on a national saving strategy with clear objectives and outcomes. A critical component of that strategy should be a national retirement saving strategy.

3.2 We note that retirement income adequacy is out of scope for the SWG. It is important, however, to have more policy certainty so people can plan, save and realise an adequate retirement income, including the use of retirement savings vehicles (e.g. KiwiSaver).

3.3 In terms of a national saving strategy, superannuation funds and retirement vehicles typically constitute a large proportion of the total pool of retail investment funds under management in developed countries. As such, a national savings strategy is incomplete without a complementary retirement saving strategy.

<u>Retirement pension system</u>

3.4 Currently, New Zealand has a simple, two-tier pension system. The World Bank's (1994) pension system model rests on three tiers. They are:

- **Tier 1:** The basic pension payable by the state. In New Zealand, Government Superannuation (NZS) is a universal taxable pension payable from 65 years of age with modest residency requirements.
- **Tier 2:** A compulsory earnings-related pension, with contributions payable by employees, employers or both. There is currently no compulsory New Zealand Tier 2 pension.
- **Tier 3:** Voluntary retirement saving - either workplace related, or individually arranged – through the workplace, or directly, through formal saving plans or by direct investment. Individual choice is the principle underpinning Tier 3's voluntary retirement saving. In New Zealand, Tier 3 includes KiwiSaver, which is a voluntary, work-based saving scheme. KiwiSaver is the world's first auto-enrolment, opt-out, national saving scheme and is often described as a "quasi compulsory scheme".

<u>Key principles</u>

3.5 Regardless of the system, there are some key principles necessary to establish a sustainable retirement saving strategy

- **Certainty:** Policy certainty, time and a commitment to continuing contributions are the important factors in accumulating individual savings accounts for retirement. Changes to retirement saving policy results in costs for both investors and employers.
- **Clarity:** The design of retirement saving schemes and policy settings need to demonstrate a clear and singular objective distinct from other forms of savings vehicles. A clear focus at a national strategy level allows financial service providers to demonstrate and deliver the benefits of long-term retirement schemes.
- **Transparency:** Long-term visibility for policy settings for savings allowing individuals, employers and saving scheme providers to prepare well in advance for any changes to settings. Transparency in terms of settings and a political agreement to signal revisions well in advance enables providers to focus on delivering consistent communications and improving the delivery of the schemes. Clear disclosure and monitoring of retirement saving advice, products and providers are also required.
- **Fairness:** All policy settings for long-term, superannuation and retirement savings must be considered in the best interests of all New Zealanders, and with a view for consistency over the long-term. Fairness and equity also needs to be viewed in terms of inter-generational fairness. Encouraging every New Zealander to participate in long-term retirement schemes will improve the national savings pool and support improving conditions for economic growth.
- **Security:** All New Zealanders need a guarantee of security to continue their lifestyle in retirement and also a sense of ownership and individual responsibility for this.
- **Choice:** New Zealanders should be able to choose from a variety of retirement saving and investment options that best suit their individual expectations, circumstances and requirements.
- **Understanding:** With greater financial awareness and literacy, New Zealand's participation in retirement saving is expected to continue to grow. As members' KiwiSaver balances increase throughout their working life, they will begin to accumulate money and will need investment education and advice to take responsibility for these investments. Investment education about the whole range of financial assets available to New Zealanders is necessary for people to make educated decisions. People need to understand

the products they are investing in and that they align with their goals and financial circumstances.

The need for long term certainty

3.6 When announcing the SWG's Terms of Reference, the Minister of Finance, the Hon Bill English, said that the only exclusion in the terms of reference were Government Superannuation, which the Government would not change, and broad taxation of capital gains and land, which the Government has said it would not introduce.[5]

3.7 However, the Treasury's discussion paper invites comment on Government Superannuation. It makes the point that it reduces the amount households have to save for retirement, it reduces the Government's ability to save and its "pay-as-you-go" approach means that the Government and individuals are not saving enough to fund sustainable retirement income. We were pleased to see the inclusion of this matter in the Treasury discussion paper because it is integral to any discussion about retirement income policy.

3.8 We consider the best decisions about saving and investment are made when investors have all the facts in front of them, allowing them to make quality investments for their long- term benefit.

3.9 Most people investing for their retirement have to factor the Government's contribution to their retirement income into their long-term investment strategy. Therefore, it is important that a long-term, evidence-based, multi-party saving strategy is developed for New Zealand. The development of such a strategy is especially important when considering compulsory retirement saving and the consequences of this for two critical aspects of current government superannuation settings – universality and age of entitlement. The commitment to support the population through retirement in order to prevent people falling into a poverty trap is one of the founding principles of New Zealand Superannuation and should continue as such.

3.10 We note the views of the Retirement Commission and others that the age of entitlement should be moved from 65 years of age to 67 over a long time-frame. We also note the policy debates and decisions other OECD countries have made as they review their current settings of the age of entitlement and the fact that these changes have been signaled well in advance of their enactment.

Enhancing KiwiSaver

The role of KiwiSaver

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[5] Media statement from the office of the Minister of Finance, Hon Bill English, 24 August 2010.

3.11 A clear long-term commitment to KiwiSaver as a retirement savings scheme is necessary as part of a national saving strategy and to focus people's attention on developing a long-term savings habit in productive investment assets.

3.12 As the market-leading provider of KiwiSaver by Funds Under Management (FUM), we have seen a positive impact on the savings habits of many New Zealanders. One of the key benefits is that a member's interest in a KiwiSaver scheme is held in the investor's own name, and is locked in until retirement, whereas units in a unit trust are not personal and can be traded between owners. This means investors have a personal sense of ownership and security around their future. However, it is still unclear whether at this early stage everyone understands all the benefits of the KiwiSaver initiative, including those already enrolled.

The uptake of the scheme

3.13 There is little doubt that KiwiSaver has introduced the savings habit to a significant proportion of the population who were previously unfamiliar with long term savings schemes. Its success is demonstrated in the fact that more than 1.5 million people have joined the scheme since its inception three years ago. The Government has contributed around 44 percent of total funds, employers 18 percent, and individual KiwiSaver members 38 percent.

3.14 It needs to be noted that the Government proportion will fall over the lifetime of individual balances. So the present alarm in some circles at the supposedly high rate of government contribution needs to be seen in context (e.g. average FUM is now $5000 because of the short duration of the scheme, and the $1000 kickstart is a major proportion of that FUM). So, over time, the proportion of total government contribution will decrease.

3.15 As financial commentator Bryan Gaynor wrote recently: "KiwiSaver has been a huge winner because it has delivered fantastic returns for individuals, mainly because of Government and employer contributions."[6]

3.16 However, approximately 50 percent of the workforce is yet to join a scheme. The majority of the working population in the 18-24 age group has joined KiwiSaver through auto enrolment, (according to Inland Revenue Department figures when compared against 2006 census figures.) The majority of all members in KiwiSaver are in the $10,000-$50,000 gross wage band. The challenge is to encourage the remaining 60 percent of the eligible population, and 50 percent of the workforce, to join KiwiSaver.

Measuring success

3.17 Membership alone does not mean that New Zealanders have developed a long term commitment to *contributing* to their KiwiSaver scheme. IRD statistics demonstrate that a large proportion of current members are non-contributing members.

[6] *KiwiSaver target for Government killjoys,* New Zealand Herald, 11 December 2010

3.18 285,287 members are under 18 years of age, with very few of these members making regular contributions. We also understand that many self-employed members make contributions at the minimum level, in order to receive the Member Tax Credit and do not receive an employer contribution.

3.19 The combined effect of these factors and the relatively short duration experience of KiwSaver since its inception mean that average funds under management (FUM) per member is now approximately $5000. The most important factor in improving this average FUM and, in so doing raising the national saving pool, will be to focus on developing the level of commitment to continuing contributions into the scheme throughout a contributor's working life.

Consistency and long-term certainty

3.20 Since 2007, there have been a series of changes and revisions to the policy settings and design of the scheme. Changes include the following:

- Removal of member fee subsidies.
- Reduction of minimum contribution rates from four to two percent.
- Removal of mortgage diversion.
- Reduced tax rates that apply to PIE vehicles (that pay tax on the basis of the investor's marginal tax rates).
- Changes to minors' enrolment.

3.21 There are already provisions within KiwiSaver for withdrawals for a first home and, while there is no inherent problem with this feature, it does not necessarily fit with a retirement savings scheme objective. Further revisions to KiwiSaver, and its benefits, to allow for other withdrawals for different spending objectives will also reduce the focus on long-term retirement saving. Continual changes to KiwiSaver also send the wrong message to investors and are certainly not helpful for providers trying to deliver consistent communications about the design and benefits of KiwiSaver.

3.22 We consider long-term cultural change can only be embedded with clear and consistent communications around the benefits and design of KiwiSaver and the understanding that there is a clear commitment to KiwiSaver that will serve the interests of people entering the workforce until they retire.

3.23 Essentially, we believe the success of KiwiSaver will be dependent on a 40 year commitment to a set of guiding principles rather than on piece-meal changes brought about by individual governments and short-term withdrawals.

The question of compulsion

3.24 Over time and with better regulation and financial awareness, the patterns of savings that is emerging with KiwiSaver will continue to grow.

3. 25 With 40 percent of the eligible population already enrolled in a scheme after three years and enrolments continuing at approximately 27,000 a month, (down on the peak average of 30,000 enrolments a month experienced in the year to September 2010), voluntary enrolments encouraged by incentives is driving a continual increase in membership. To ensure that there is not a proportion of the population who are disadvantaged by not joining KiwiSaver, it may be important to assess at what point voluntary enrolment has ceased to be effective and compulsion is required. Otherwise in the longer term, there is a risk of a significant gap between the people who have embraced KiwiSaver and those who have not.

3.26 ANZ New Zealand believes there is little evidence that compulsion would increase national savings, though it may affect the composition of total national savings. Compulsion also raises complex distributional and equity issues, such as affordability for lower income earners and the need to consider those who do not take part in the workforce at all, or whose workforce participation is intermittent.

3.27 Raising the national saving pool and improving KiwiSaver as part of a broader national retirement saving strategy can be achieved by means other than by compulsion.

3.28 We therefore consider compulsion should be considered only as a last resort. If compulsion is to be considered however then clearly the $1000 kickstart incentive would be no longer necessary. We would however recommend, that the tax credits be continued, especially for lower and middle income earners to at least partially offset their compulsory contributions.

Tax treatment of KiwiSaver withdrawals

3.29 From 2012, we expect a large sum of funds to be progressively returned to a group of members as they reach the eligible age to draw down their funds. i.e. decumulation of KiwiSaver balances that will become available in 2012 to those who have reached 65 and been in a scheme for five years.

3.30 There is an opportunity to review and improve the environment for post-retirement investments prior to this. In particular the taxation settings that are discussed elsewhere in our submission around improving the tax treatment of annuity products, which currently stands at the marginal tax rate. It is vital that we are able to offer financial solutions to customers that will assist them in maintaining the bulk of their hard-earned savings and help provide more certainty for their income in retirement. Otherwise there is a risk that the bulk of the capital in saving vehicles such as KiwiSaver will be dissipated as soon as people reach 65 years of age.

3.31 If this issue is not attended to, the high tax rate on post-retirement investments or withdrawals sends a negative message to the general population and particularly those coming into the workforce or considering joining KiwiSaver.

Enhancements to the current scheme

3.32 We consider there are a number of other changes and commitments that could be made to the existing KiwiSaver regime to make it more compelling as a good saving option. These include:

- Maintaining the $1000 incentive to join. Currently under the voluntary incentive based design of the scheme, this benefit is worth maintaining. **If however, the government wishes to reduce its fiscal liabilities in a voluntary scheme, then we would recommend maintaining the $1000 incentive to join, but reviewing the tax credits to target them towards lower and middle income earners.**

- Designing a “stepped” or “lifetime” approach to investment whereby contributors are first enrolled in less conservative investment options and moved to more conservative options as they approach retirement. Approximately 90 percent of members in OnePath’s auto enrolled scheme are allocated to conservative funds. While these funds are appropriate for preserving wealth accumulated over a lifetime of saving, as individuals approach superannuation eligibility, conservative funds may not the best means of building a strong saving ‘nest egg’ through an investor’s lifetime ahead of retirement. Using the “lifetime” option as the default allocation would increase allocations to more diversified and growth assets and build up the national saving pool.

- Raising KiwiSaver contribution levels in small but consistent incremental steps (e.g. half a percent per annum) towards a level more comparable to other schemes operating in other parts of the world. For example, Australia has reached a nine percent minimum contribution rate and the government has proposed increasing contribution rates to 12 percent with small incremental increases from 2013 to 2020. This kind of revision also falls under the same consideration of long-term visibility for intended changes to settings, to allow employers and employees to prepare for the incremental increases.

- Targeting people who have been in the workforce for more than five years and who have not joined and enrolling them automatically with an “opt out” provision.

- Rather than blanket tax incentives for all members, target incentives towards low to medium income earners and self-employed, and/or align other government incentives to make the scheme affordable for more people.

3.33 These modifications to the existing KiwiSaver initiative would not only encourage greater take-up and help cement the saving culture in the New Zealand psyche, they would also support the growth of the national saving pool.

3.34 According to a leading independent retirement income policy specialist, Alison O'Connell, research is also developing to understand other drivers for improved personal financial well-being. This research prompts some ideas for policies which could complement financial literacy initiatives, or help to improve their effectiveness.

3.35 O'Connell notes that insights from behavioural economics are fairly new, but beginning to be used more widely. She notes, for example, KiwiSaver's use of auto-enrolment and default funds recognises the strength of potential investors' inertia. More broadly, the use of product constructs, like KiwiSaver, which provide rules and norms as well as information and education, are thought to be helpful for people with little confidence in investing.[7]

<u>Recommendations</u>

<u>ANZ New Zealand recommends:</u>

3.36 *The SWG considers the development of a retirement income policy framework for the Government's consideration.*

3.37 *Certainty, clarity, increasing understanding, fairness, transparency and security are the underpinning principles of the Government's retirement saving strategy.*

3.38 *The SWG recommends that, to create increased certainty for retirees, the Government explores the possibility of multi-party agreement around any changes to the parameters of the national superannuation scheme.*

3.39 *A retirement saving strategy needs to establish a framework for the review and coordination of personal retirement saving schemes supported by the Government, such as KiwiSaver and Government funded annuities such as New Zealand Government Superannuation.*

3.40 *Modifications to the existing KiwiSaver scheme to encourage greater uptake considered, including maintaining the $1000 joining incentive, taking a lifetime*

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[7] *Financial Literacy in New Zealand*, prepared for the Capital Market Development Taskforce by Alison O'Connell, May 2009

approach to investment risk, raising contribution levels in small and incremental steps, automatic enrolment for those who have not joined after five years with an "opt-out" provision, and targeting incentives towards low to middle income earners, and/or aligning other government incentives to ensure affordability.

3.41 *The SWG recommends to the Government that it reviews the tax settings around post-retirement investments before 2012.*

3.42 *The SWG recommends to the Government that before making any decisions about compulsion, it should consider initiatives designed to increase uptake of KiwiSaver short of compulsion.*

4. RESTORING PUBLIC CONFIDENCE

4.1 We agree with the Capital Market Development Taskforce and many others that restoring public confidence in financial markets and saving vehicles is vital to increasing New Zealand's rate of savings and investment. Recent events have demonstrated that New Zealand's regulatory investment and saving framework needs strengthening. It is also clear that investor confidence has been seriously damaged and must be rebuilt.

4.2 Accordingly, we consider that the Government has a primary role in creating an efficient and cost-effective regulatory framework that ensures a high level of public and investor confidence in financial sector institutions. The restoration of confidence is critical, not only to encourage greater investment and saving, but to encourage investors to feel comfortable about taking more responsibility for their investment decisions. For these reasons, we have broadly supported the following legislative initiatives:

- An amendment governing the activities and responsibilities of financial advisers and those entities that offer financial advice.
- Increased customer protection and disclosure requirements, provided these are cost-effective, around the provision of financial advice.
- A simplified product disclosure regime for investors, where appropriate.
- The regulation of products according to their economic form, rather than their legal substance.
- The establishment of the Financial Markets Authority (FMA) and the resultant consolidation of regulator functions, duties and powers.
- The introduction of greater transparency and responsibility around the governance and management of KiwiSaver schemes.
- The provisions of the Anti Money Laundering and Countering Financing of Terrorism Act.

4.3 While in the main supportive of changes to restore public confidence, we would like to suggest that such proposals for reform be accompanied by detailed costing, performance and impact analysis to ensure changes work effectively for all financial markets participants. Exposure drafts of all proposed legislation to enable reasonable consultation on technical matters would be of considerable assistance.

4.4 We would also caution that proposed regulatory changes need to be carefully considered to ensure they do not stifle financial markets innovation or deter people from assuming directorships in the financial sector. In addition any costly and overly-bureaucratic compliance requirements are almost inevitably passed on to savers and investors, thereby lowering rates of return.

4.5 That said, we will continue to support effective and cost-efficient ways to restore public and investor confidence in the New Zealand finance sector through the development of more appropriate regulatory frameworks.

5. IMPROVING LEVELS OF FINANCIAL LITERACY

5.1 The recent Global Financial Crisis, along with New Zealand's rising household debt levels, over concentration of household assets in housing, recent company collapses and low saving rates, have all combined to focus increased attention on the importance of the delivery of financial literacy programmes for all New Zealanders.

5.2 The 2009 ANZ New Zealand–Retirement Commission Financial Knowledge Survey showed that banks are the main source of financial knowledge for 51 percent of New Zealanders. The Financial Knowledge Survey also showed that, while there has been an overall improvement in New Zealanders' financial knowledge since 2006, an alarming 31 percent of New Zealanders are in the low financial knowledge group. Those with low levels of financial literacy tend to be the young (18-24), the very old (75+) and those on low incomes.

5.3 In New Zealand, a number of organisations, including government entities (such as the Retirement Commission, the RBNZ and the Securities Commission), along with the banking sector and not-for profits, (such as the New Zealand Federation of Family Budgeting Services, the New Zealand Association of Citizens' Advice Bureaus and Consumer New Zealand) deliver a variety of financial literacy services.

5.4 These services range from budget advice, through to debt management, consumer protection and investment knowledge. In addition, the Ministry of Education is committed to improving the teaching of financial literacy in schools in 2011, and the soon-to-be established Financial Markets Authority (FMA) is to facilitate the development of financial markets by providing education, guidelines, information and warnings.

5.5 We take our responsibilities for financial literacy very seriously. We work actively and in partnership with the Retirement Commission, iwi and the not-for-profit sector to measure and to improve New Zealanders' levels of financial literacy.

5.6 For example, we have undertaken the following initiatives:

- Supported the Retirement Commission's past two nationwide financial literacy surveys.
- Played a key role in the Retirement Commission's 2008 distribution of 216,000 *Sorted* booklets to New Zealanders, via our branch network.
- Partnered with Te Runanga o Ngai Tahu to enhance money management skills and financial knowledge amongst iwi members. As part of this project, we commissioned the world's first–ever indigenous financial literacy survey

and we are funding 15 trainers and associated materials to deliver a financial education pilot programme to iwi members.

- Assisted almost 10,000 ANZ New Zealand customers. to restructure their financial commitments via our Financial Wellbeing Programme

- Participated in the development of the Retirement Commission's National Strategy for Financial Literacy. We are also a member of the New Zealand Bankers' Association's Financial Literacy Advisory Group.

5.7 However, we agree with recent reports on financial literacy in New Zealand that, to be truly effective, financial literacy needs to encompass more than the provision of budget and debt management advice.

5.8 We also agree with these reports that one objective around improving financial literacy should be to build New Zealanders' confidence to make investment decisions and thereby encourage greater investment in capital markets and retirement savings.

5.9 We have noted from these reports that, whilst existing New Zealand financial literacy initiatives, and especially those undertaken by the Retirement Commission, have a usage, scope and cost-effectiveness that exceeds those of most of their equivalents overseas, there is more that could be done.

5.10 For example, one report notes that "investing tends to be a relatively small part of financial literacy initiatives in all countries", including in New Zealand, and that "New Zealand has been behind other countries in getting personal finance into the national schools curriculum[8]". The same report also notes that many New Zealanders do not appear to accept that investing in shares is a way to receive good enough returns over time.

5.11 As noted, New Zealand has a large number of financial literacy providers. Many do an excellent job and some (such as the Retirement Commission) are world-leaders. But, despite this, we agree with recent reports that more could be done to improve financial literacy in New Zealand, and much more could be done to strengthen the linkage between financial literacy and investment literacy.

5.12 We also believe it is timely to initiate a review of government-funded financial literacy education in New Zealand with the objective of tasking one agency with the job of developing comprehensive, well-designed, well-directed and well-delivered financial and investment literacy programmes for all New Zealanders.

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[8] *Financial Literacy in New Zealand* by Alison O'Connell, pgs 19 and 21, May 2009. Report prepared for the Capital Market Development Taskforce.

Recommendation

5.13 *In line with recent reports on financial literacy in New Zealand, ANZ New Zealand recommends that the SWG considers a review of government financial literacy programmes with a view to their consolidation.*

6. A SAVING SYMPATHETIC TAXATION POLICY

6.1 The current taxation regime is less supportive of saving than is desirable. For example, current tax settings act as a disincentive to maintaining savings capital and converting to annuity products.

6.2 Both the SWG's discussion document and the Reserve Bank's submission to the SWG promote the concept of the taxation of income earned on capital to be taxed at lower rate than taxation on labour income. This is sometimes known as the Nordic dual income tax (henceforth termed the DIT) system.

6.3 The DIT is a particular form of income tax which combines progressive taxation of labour and transfer income with a low flat tax on all capital income.

6.4 An important part of the philosophy underlying the DIT is that the capital income tax base should be broad, to ensure the greatest possible degree of tax neutrality. Under a consistent DIT, the personal capital income tax base would include the following components:

- Interest
- Dividends
- Capital gain.
- Rental income
- Royalties
- Imputed returns on owner-occupied housing
- Imputed returns on capital invested in non-corporate firms

6.5 In case the sum of these components is negative, the taxpayer is entitled to a tax credit equal to the capital income tax rate times the negative balance.

6.6 The strongest argument for a low marginal tax rate on income from capital is in respect of inflation. Income tax is typically levied on the full nominal return to capital, including the inflation premium that compensates for the erosion of the real value of nominal assets. Thus many forms of capital income are overtaxed if charged at the top marginal tax rate applying to labour income.

<u>Recommendation</u>

<u>ANZ New Zealand recommends that:</u>

6.7 *The SWG suggests that the Government undertakes a review of the current tax treatment of annuities. This to include the consideration of a lower marginal tax rate on income from capital, deposits and PIE vehicles as part of the development of a more savings sympathetic taxation model, including a Nordic style tax treatment of saving and investment.*

7. GROWING OUR CAPITAL MARKETS

7.1 It is one thing to encourage greater saving, but that saving has to be turned into investment. We believe that to grow our national saving rate, we need to consider ways to increase investment and retirement saving from more that just changes to KiwiSaver or changes to the parameters around national superannuation.

7.2 Offering New Zealanders choice from a wider range of quality investment products than are currently available would be one effective way in which New Zealand could increase its saving rate.

7.3 In its 2009 report to the Government, the Capital Market Development Taskforce commented extensively on the limits imposed on New Zealand savers and investors by the absence from our capital markets of "good-quality investment products". In particular, the Taskforce noted that "a limited range of quality products is likely to have been a factor encouraging investment in finance companies and other products offered to the public that have fewer disciplines than, for example, exchange listed companies".[9]

7.4 We agree with the Capital Market Development Taskforce that New Zealand needs to develop a greater and more diversified range of quality investment opportunities for New Zealand savers and investors

7.5 We believe that a greater range of investment opportunities will lead to a number of benefits, including:

- Greater choice for New Zealanders around how, when and where they choose to invest and save.
- Greater opportunity to increase investments and saving through a more attractive and less complex route than compulsory superannuation.
- Increased participation in New Zealand capital markets and improved business access to capital from a wider variety of sources.
- Increased efficiency and productivity gains in areas of key importance to the growth of the New Zealand economy.
- Greater opportunities for governments to reduce debt and/or invest more in health, education, law and order and other vital social services.

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[9] Report of the Capital Market Development Taskforce, *Capital Markets Matter,* pub. December 2009.

- The promotion of market discipline and returns to the taxpayer in terms of returns on central and local government publicly owned assets.

- Increased opportunities for investors and savers to more easily diversify their investments in terms of products and risk ratings between products, thereby reducing the risk to their savings and investments in the event of failure in one or two areas of the market.

7.6 One of the benefits of increasing levels of domestic saving and investments is that more funds will be available to grow New Zealand capital markets. Of course, any sound investment strategy will ensure that investments are diversified domestically and internationally. At the moment, however, the limited universe and lower creditworthiness of many domestic “investment-grade” investment opportunities mean that fund managers and individual investors may probably look abroad more than they otherwise might.

7.7 The deepening of our domestic capital markets to provide greater investment options will capture more investor funds for the benefit of New Zealand companies. Increasing domestic investment from increased domestic savings will benefit all New Zealanders in terms of employment opportunities, infrastructure development and increased government revenue growth.

7.8 The Capital Markets Taskforce Report suggests a number of areas where high quality capital market offerings could be made available to New Zealanders in order to grow their, and thereby New Zealand’s, savings and investments levels. The suggestions include the following:

- Partial listing of central and local government companies in areas such as energy, transport, water, land, infrastructure and telecommunications.

- Investigation by the New Zealand Stock Exchange of a specialist exchange to facilitate increased public investment in some of New Zealand’s largest export sectors, such as agriculture and food processing.

- The development of a Local Government bond bank.

- Encouragement for the Debt Management Office (DMO) to expand the range of government debt securities on offer, including longer-term debt, inflation-indexed bonds and foreign currency debt –these to include publicly listed retail issues where appropriate.

7.9 We support all of these recommendations. We also suggest that more opportunities be given for New Zealanders to invest and save at central and local government level through greater use of Public Private Partnerships (PPPs) and the issuing of Infrastructure Bonds. We believe that PPPs and long-term bonds, or Infrastructure

Bonds offer real opportunities for investors in areas such as roading, public transport, irrigation, health, education and housing.

Recommendation

7.10 *The SWG encourages the Government to adopt the recommendations of the Capital Market Development Taskforce designed to deliver capital markets that better contribute to the New Zealand economy and, in so doing, provide a wider range of quality investment opportunities for savers.*

8. CONCLUSION

8.1 In the introduction to our submission, we argued that the global financial crisis has presented New Zealand with a great opportunity to change some deep-seated financial and investment habits in New Zealand. People are switching on to the importance of saving and investment.

8.2 Our submission contains a number of initiatives the SWG could suggest the Government takes to encourage this change in the national mindset. We consider our changes will assist in restoring investor confidence in the financial sector, encourage participation in a wider range of investment opportunities and provide citizens with the skills to save and invest with confidence.

8.3 We commend this submission to the Treasury for its favourable consideration.

9. FURTHER COMMENT

ANZ New Zealand would welcome the opportunity to discuss this submission with either The Treasury or the Savings Working Group. Please contact:

John Body
Managing Director Private Bank
ANZ Centre PO Box 92210
23-29 Albert St, Auckland
Business phone +64 9 2526062
Email John.Body@anz.com

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