ASB BANK LIMITED

23 November 2010

Savings Working Group
C/o The Treasury
P.O Box 3724
WELLINGTON 6140

Email: savingsworkinggroup@treasury.govt.nz

SUBMISSION ON NEW ZEALAND'S SAVINGS OPTIONS

Background on ASB

ASB Bank Limited (ASB) welcomes the opportunity to make this submission to the Savings Working Group (SWG). ASB is a leading financial services provider of investments, insurance and consumer credit contracts in New Zealand. It operates a nation-wide branch network and online service model and employs approximately 4,500 staff. ASB distributes the largest KiwiSaver Scheme in New Zealand, provided by a wholly owned subsidiary of ASB.

Some key metrics about ASB are as follows:

- Has been part of New Zealand's commercial and community fabric for more than 160 years.
- Has over 135 branches nationwide and more than 1.5 million customers.
- Vision is to be world class for customers, colleagues and communities.

ASB is wholly owned by the Commonwealth Bank of Australia, one of Australia's leading providers of integrated financial services.

General Comments

The SWG's Terms of Reference are to *"provide high level advice on options that would deliver better functioning domestic savings performance."*[1] However, the SWG is not expected to discuss the parameters of New Zealand Superannuation and other specific forms of benefits / income support. The Terms of Reference note that the Government has also recently said that it will not introduce broad and widespread taxation on capital gains or land.

ASB believes that any discussion or advice on options for better functioning domestic savings performance should include welfare and other State income benefits (despite them being addressed by the Welfare Working Group). The savings environment is inextricably linked to welfare and retirement income policy outcomes. The Terms of Reference impose an inappropriate constraint on the ability of the SWG to develop comprehensive options.

ASB also believes that, despite the Government's recent tax policy announcement, the SWG should not hesitate to comment on capital gains or land tax options if it considers those matters will contribute to an improved domestic savings performance.

ASB agrees with the problem identified by Treasury that New Zealand's net foreign asset position ("NFAP") leaves the economy vulnerable to financial shocks and unforeseen

[1] *Savings Working Group Terms of Reference*, August 2010

change in investor sentiment.[2] ASB takes this opportunity to comment on that problem from two perspectives: the macro-economic perspective and, in particular, the banking perspective. ASB notes Treasury has acknowledged that the strength of New Zealand's institutions has to date contributed to the resilience in the economy.[3]

Macro-economic perspective

There is consensus that New Zealand needs to take steps to rebalance the economy. Policy options to achieve this, for example reducing debt-fuelled consumption, developing domestic capital markets, removing tax distortions to encourage productive investment, reducing Government spending, and lifting productivity, incomes and economic growth, have been well traversed by the Capital Markets Development Taskforce (CMDT), the 2025 Taskforce and the Tax Working Group (TWG).

Think tanks such as the New Zealand Institute, Business Roundtable and NZIER have also voiced opinions on the problem definition and solutions. For this reason, we do not submit in detail on these points, but rather lend our support to specific positions addressed by others.

ASB agrees with Treasury that coordinated management of various levers across the economy is necessary to produce optimal outcomes for "New Zealand Inc". Policy outcomes, including savings policies, should focus on ways of encouraging economic growth and which can improve our NFAP. A key point identified by Treasury is that domestic investment in non-productive assets (residential housing) is too high relative to other investment assets.

While the 2010 Budget took some steps to rectify this, we encourage further thinking and informed debate on other measures to remove tax distortions including those discussed by the TWG. While we do not necessarily support a general capital gains tax, international experience suggests the "too difficult to administer" argument which has underpinned current Government thinking is inconclusive. A targeted capital gains tax may be an alternative that warrants further consideration.

Differentiated taxation of labour and investment income may also drive desirable behaviours in domestic savings and lead to greater depth and breadth of the capital markets. We also support debate on the merits of further re-weighting of the tax base away from personal and corporate income tax to consumption tax.

As advocated by the CMDT and 2025 Taskforce amongst others, Government assets suitable for market-based competition should be open to local and offshore investment. Greater household investment both in equity and debt markets will encourage a better understanding of financial assets and provide local funding to domestic enterprises, thereby stimulating the growth of the New Zealand economy. It may also reduce the need for offshore borrowing with its associated costs so again we endorse the need for constructive and informed national debate on its merits.

We should encourage appropriately incentivised alternative funding mechanisms for business such as venture capitalists. More focus needs to go on incentivising private sector research and development; innovation should be encouraged and not stifled – again, this has been well traversed by a number of think tanks. We endorse some of the New Zealand Institute's thinking around an "innovation ecosystem" lead by a Prime Minister chaired innovation council.

---

[2] *Saving in New Zealand- Issues and Options*, New Zealand Treasury, September 2010, at page 4.
[3] *Ibid* at page 7.

ASB Bank Limited; Ph (03) 377 8930 Facsimile (09) 374 8077, Level 5 ASB Bank Centre, P.O Box 35 Shortland St, Auckland 1140, New Zealand

New Zealand's ageing population means that National Superannuation must be reviewed irrespective of its exclusion from the scope of the working group. The second report of the 2025 Taskforce provides further recent substantiation of the issue and the justification for a review, including a notable comment: "New Zealand Superannuation appears to provide the most generous universal state pension relative to average earnings anywhere in the developed world"[4]. A key issue is the sustainability of the current system; would this be improved by raising the age of eligibility beyond 65; would consumer price rather than wage indexation provide a better 'rate of payment'; should it be means tested?

We strongly encourage an informed national debate on the merits of the current model, including analysis of the incentives to join KiwiSaver and Australian superannuation comparatives. Consideration of the existing "taxed, taxed exempt" (TTE) regime relative to an "exempt, exempt, taxed" (EET) regime should also be considered. We note that New Zealand already has certain modifications to a pure TTE regime (e.g. the KiwiSaver exemption for employer contributions).

Rebalancing the economy is achievable at a macro-economic level by implementing a range of policy mechanisms. Below, we provide a banking specific perspective on the issue and possible solutions.

Banking perspective

The major banks remain the primary intermediaries facilitating the flow of money in the domestic economy, through lending. The global financial crisis has resulted in regulators taking significant steps to strengthen the banking sector and "financial stability" generally. Banks are required to hold more and higher quality capital and meet new liquidity standards, which place increasing reliance on domestic, not international, savings to fund lending.

Within this context, however, customer demand remains the primary driver for products and services offered by the banking sector. Our research shows not only that consumer demand focuses mainly on two distinct goals: high returns and capital protection, but that people consider themselves relatively financially literate.

The predominant savings account has been and remains for most a term deposit, cheque or on-call account; each a relatively low risk / low return offering. They represent approximately 95% of ASB's retail deposit base. As customers move through their life cycle, their requirements for particular products and services changes. For example, annuity type products would be suitable for retirees who have 'cashed in' their KiwiSaver or other superannuation schemes.

The tax treatment of annuities is extremely important to their lack of utilisation. Some incentive is required for the development of an annuity market. The current regime, which results in the relative over taxation of investment income, is generally seen as the key reason why there is little demand and consequently very few annuity products available in the market.

When KiwiSaver balances are accessible, the entire balance becomes immediately available to the individual. It may be appropriate for there to be an annuity-type payment plan required for a portion of KiwiSaver balances to ensure that the economic benefit of this form of savings is maximised; i.e. that the savings are not immediately consumed. It will be important that the tax treatment of any such payment scheme does not give rise to any disincentive to save via KiwiSaver.

[4] Page 91, *Focussing on Growth*, The Second Report of the 2025 Taskforce

Conversely, the high concentration of home lending on New Zealand banks' balance sheets is well known, and results in a unique dilemma in resolving the savings issue. Historically banks have met borrower demand to fund the purchase of residential property, yet this investment is “unproductive” in an economic growth context. ASB’s residential property exposure is weighted approximately 72% owner-occupiers and 28% investment property – in total approximately 65% of ASB’s asset base.

Our view, based on customer behaviour and feed back, is that real property, relative to financial assets, is perceived as safe and better understood as an investment class. It has historically met the ‘twin goals’ goals of capital gain and capital protection. Removing property tax incentives relative to other asset classes is the primary lever available to curb this demand over time – Budget 2010 took the first steps in this process. ASB is of the opinion that there is merit in the SWG considering further measures to remove tax incentives.

Recognising the role of banks and other lenders in the economy, constraining lending concentrations in an attempt to limit the growth of asset bubbles and/ or investment in unproductive assets has been considered (e.g. Basel III) by Governments and regulators seeking wider economic stability. While not explicitly considered by most of the recent commentary on the savings issue, this ‘supply channel’ point nevertheless requires very careful consideration, as products and services continue to be demand driven based on underlying consumer incentives. It is imperative that financial product design operates with regulatory certainty and that consumers have access to savings and investment products that cover the full spectrum of the human life cycle and risk appetite.

The Government has recognised and is acting on a number of ‘sell-side’ deficiencies resulting from the finance company and financial adviser sectors amongst others. But there remains a complementary but no less critical ‘buy-side’ behavioural deficiency which must also be addressed to build a savings base and culture in New Zealand – financial literacy and in particular the concept of risk and return.

We endorse the CMDT’s recommendation that better coordination of financial literacy education is necessary between the Government and private sector – ASB is committed to this now through our community engagement and schools strategy. We look forward to the impending report from the Retirement Commissioner on the issue, as this is a long-term challenge requiring simplicity in the message and high visibility and accessibility.

Conclusion

ASB concurs with the consensus view that New Zealand has a savings imbalance. It is disappointing that the SWG's terms of reference unnecessarily constrain a thorough analysis of, and delivery of advice on, all options to redress that imbalance. We endorse a lot of the macro-economic thinking that has occurred through various forums but have also sought to provide a banking specific view on the issue. We would welcome the opportunity for further dialogue with the SWG.

Yours sincerely

Simon O’Brien
General Manager Regulatory Affairs
Phone Direct: (09) 337 4545
Email: simon.o’brien@asb.co.nz