Institute of Finance Professionals New Zealand Inc.

SUBMISSION

To: **Savings Working Group**
c/o The Treasury
Wellington
savingsworkinggroup@treasury.govt.nz

Subject: **Savings Working Group – Invitation to make submission**

Date: **19 November 2010**

INTRODUCTION

1. INIFNZ is the peak industry body for capital markets professionals in New Zealand. INFINZ has a membership of approximately 680 individuals drawn from across the capital markets and includes treasury professionals, investment analysts, fund managers, bankers, lawyers and students.

2. The objectives of INFINZ are to:

   - To promote quality, expertise and integrity in the New Zealand finance and capital markets.
   - To promote the proper control and regulation of the New Zealand finance and capital markets.
   - To promote, support and improve the availability, relevance and standard of professional development and education of members and within the New Zealand finance and capital markets.
   - To provide a forum for members to meet, discuss and educate themselves on issues relating to the New Zealand finance and capital markets.
   - To work to ensure the New Zealand finance and capital markets are relevant and efficient and generally to add value to the operation of the New Zealand finance and capital markets.
   - To act as an advocate for its members wherever necessary to support and promote the objects.
   - To serve the investing public by ensuring the standards of members are maintained.

3. INFINZ has been invited by the Savings Working Group secretariat to make a submission, which is set out below.

4. This submission is broken into five parts; (i) Data Issues, (ii) Supply Creates Its Own Demand, (iii) Is Compulsion Necessary, (iv) What Happens After 65, and (v) Other Matters. Each Part focuses on a particular issue that INFINZ would like to see addressed by the Savings Working Group

5. INFINZ is happy for this submission to be posted on the Treasury website and released under the Official Information Act 1982.

Part One - Data Issues

6. INFINZ is concerned at the apparent size and number of gaps in the statistical data related to savings, and thereby the understanding of the savings environment in New Zealand. New Zealand may continue to suffer poor quality policy settings that are inappropriate to the circumstances.

7. Numerous papers[1] raise the issue of data quality, coverage and timeliness in respect of savings in New Zealand. The most influential dataset on savings in recent years has been the Household Income and Outlay Account (**HIOA**) published by the Department of Statistics. It is the most widely cited source of savings statistics in New Zealand[2]. This is remarkable given its 'experimental' status by the Department of Statistics, which notes on its website that;

   "The household income and outlay account is available on the Statistics NZ website, subject to the following caveat. In the absence of a full suite of institutional sector accounts, cross-sector transactions are unable to be fully confronted within the national income and outlay account framework. As a consequence, all data should be considered experimental, and caution should be exercised when interpreting these results."[3]

8. The statistical series produced by the Reserve Bank on household assets and liabilities is well known to exclude a number of important components from household balance sheets. These include equity in farms, commercial real estate, unlisted businesses, unincorporated businesses, consumer durables and overseas assets.

9. Further, household net worth as calculated by the Reserve Bank may be understated by the level of residential mortgages used to support business

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[1] For example see Implications of Household Savings Patterns for Capital Markets by Nick Davies of Martin Jenkins, May 2009, prepared for the Capital Markets Development Taskforce, page 7.

[2] Household Wealth and Savings In New Zealand: Evidence from the Longitudinal Study of Family, Income and Employment. Motu Working Paper 10-06, September 2010, page 18

[3] http://www.stats.govt.nz/browse_for_stats/economic_indicators/NationalAccounts/NationalAccounts_HOTPyemar09/Tables.aspx

lending, following the practice of banks securing loans to small businesses over residential property. This lending should more properly be allocated to business balance sheets and away from household balance sheets. The actual indebtedness of households is currently being overstated, which in turn implies a lower level of household saving than is actually occurring.

10. The recent analysis of household savings coming from the Survey of Family, Income and Employment (**SoIFE**) suggests a quite different savings outcome from that shown in the HIOA data noted above. A recent paper by Motu[4], suggests that rather than the received wisdom of negative savings by New Zealand households there was in fact reasonably robust savings between 2004 and 2006. Motu estimates that the savings rate of households, at its most conservative, was no less than 14% of gross income[5]. Work done by The Treasury[6] also supports the analysis undertaken by Motu.

11. What makes these results interesting is that these savings were created before the introduction of Kiwisaver and other subsidised savings schemes. This raises the obvious question of whether there is in fact a household savings problem in New Zealand to begin with and whether incentivised savings was required.

12. INFINZ considers that the development of a pool of long term contractual savings is beneficial to the New Zealand economy, a point that is developed further in the next Part. However, the justification of the use of subsidies and transfers from taxpayers to Kiwisavers seems questionable based on the more robust and complete data coming from the SoIFE.

13. Approximately $2.3 billion of Government subsidies have been paid into Kiwisaver accounts to March 2010[7], with an expected annual ongoing cost of a further $1 billion[8]. Thus to the end of September 2010 up to $2.8 billion will have been paid to Kiwisaver accounts by the Government. To March 2010 subsidies paid by the Government represent 43% of total Kiwisaver funds, and actually exceed the funds contributed by Kiwisaver members.

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4 Household Wealth and Savings In New Zealand: Evidence from the Longitudinal Study of Family, Income and Employment. Motu Working Paper 10-06, September 2010

5 Ibid, page 19

6 Savings Rates of New Zealanders; A Net Welath Approach. Grant Scobie and Katherine Henderson, Treasury Working Paper 09/04 December 2009

7 Report on Kiwisaver Supply Side Evaluation, Ministry of Economic Development, July 2010, page 4

8 Submission to Savings Working Group, New Zealand Business Roundtable, September 2010, page 23

14. There is the serious risk that the Government is transferring funds (it currently doesn’t have) into a savings scheme to solve a problem that based on the most recent analysis of detailed savings data suggests may not in fact exist.

15. INFINZ suspects that a large portion of the initial growth in Kiwisaver will have come primarily from transfers between savings vehicles and that in future actual growth will be predicated by the value of the incentives made available. It may be that there is no increase in aggregate savings across the economy, although actual data to support this assumption will not be available for some years yet. In any case, any increase in household saving from the provision of Government subsidies will be offset by an equivalent increase in Government borrowings to pay for the subsidies.

16. INFINZ notes that other submitters to the Savings Working Group[9] have called for Government subsidies to be abolished. INFINZ agrees that there should be a robust debate on the incidence of savings incentives and their place in aggregate national savings.

17. INFINZ also notes the time lag between the collection of the SoIFE data and its availability for analysis. The 2006 data only became available to researchers in 2009, three years after its collection. Analysis from these researchers has only become available this year; so a four year delay between the collection of the data and publication of analysis of the data.

18. The SoIFE is a complex survey requiring significant collation and data work to bring the dataset into a useable form. However, these delays appear to be inordinately long, and thus make the findings from the data less useful. As it stands the data collected into the 2010 SoIFE survey will not make it into the public domain in the form of published reports until 2014. Thus we won’t know the impact on how savings have changed in the wake of the global financial crisis (**GFC**) or the introduction of KiwiSaver for another four years.

19. INFINZ notes that the world of 2010 is very different from the world of 2006, and likewise the world of 2014 will be quite different from the world of 2010. Policy formation and implementation is made more difficult by these delays in understanding and interpreting the raw data.

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[9] See for example the submissions from Michael Littlewood and the New Zealand Business Roundtable.

20. We don't know what we don't know. There are still large gaps in our understanding of savings in New Zealand, large gaps in various measures of savings and significant time lags between collecting and analysing data. INFINZ considers that greater effort needs to be expended in the data collection and analysis area to provide the hard data and robust analysis on which proper, balanced and timely decision making can be made.

21. In the absence of hard data, quality and timely analysis policy ends up being based on assumptions, hearsay and received wisdom. As Motu notes:

> *"Policies such as the State Sector Retirement Savings Scheme (SSRSS) and KiwiSaver, and the introduction of other tax-favoured savings vehicles, including Portfolio Investment Entities (PIEs), were developed by policymakers because of the belief that New Zealand currently has negative levels of household saving. However, our results indicate that, on average, people were already saving one-eighth to one-sixth of their income prior to the introduction of KiwiSaver and PIEs. While we do not attempt to ascertain whether the level of household saving we estimate is 'optimal', the fact that actual saving appears to be strongly positive while policymakers have (wrongly) perceived it to be negative likely undermines some of the rationale for why these distortionary pro-savings policies were needed."*[10]

22. Further Motu notes:

> *"Given that the government operating balance, which was strongly positive until 2008 ($2.38 billion in 2008), was -$10.5 billion in 2009 and is forecast to remain negative for a decade and that larger than anticipated KiwiSaver costs are an important contributor to these anticipated deficits, these pro-savings policies may be at best unnecessary and at worst counterproductive for promoting future economic growth."*[11]

23. The question that arises is whether these funds could have been better deployed in the economy or perhaps not allocated in the first place. KiwiSaver is a sound initiative to change the nature of savings in New Zealand but the cost to the taxpayer and Government seems large compared to the actual need, rather than the assumed need.

BETTER QUALITY AND MORE TIMELY DATA IS URGENTLY NEEDED

24. INFINZ calls on the Savings Working Group to impress upon Government the urgent need to do a better job with its statistics and analysis of the savings environment in New Zealand. Savings policies have long term fiscal consequences as noted above. These are too important to get wrong.

[10] Household Wealth and Savings In New Zealand: Evidence from the Longitudinal Study of Family, Income and Employment. Motu Working Paper 10-06, September 2010 page 20

[11] Household Wealth and Savings In New Zealand: Evidence from the Longitudinal Study of Family, Income and Employment. Motu Working Paper 10-06, September 2010, page 21

25. INFINZ recognises that the data regarding savings can never be ‘perfect’, but there is certainly room to make datasets regarding savings in New Zealand significantly less imperfect than they are now.

26. More funding should be made available to the Department of Statistics and Reserve Bank to improve the timeliness and coverage of their savings data. The significant timing lags in the SoIFE data are as much a problem as the coverage gaps in the Reserve Bank data.

PART TWO – SUPPLY CREATES ITS OWN DEMAND

27. There is significant international research that shows that development of long term contracted savings in an economy aids in the development of that economy’s capital markets.[12]

28. The effect is more pronounced in developing economies compared to developed economies, however, there is still a positive payoff. The New Zealand capital markets, while developed, in an institutional sense are nevertheless small and illiquid. Part of the challenge to grow the capital markets, as set out in the Capital Markets Development Taskforce (**CMDT**) final report, is improvements to regulatory settings and removing barriers for companies seeking to raise capital.

29. The focus of recent legislative activity[13], partially responding to the recommendations of the CMDT, has been on policy settings and this work is set to continue for two to three more years.

30. However, a more positive signal to the economy would be the willingness of Government to use the capital markets for its own purposes; partially funding the capital expenditure requirements of the Government. .

31. Regarding the Government utilising the capital markets, a number of commentators and market participants have discussed the concept of partial listings of State Owned Enterprises (**SOE**s) and the CMDT also made a recommendation to partially list SOEs as a way of broadening choice for investors whilst making the markets more vibrant, effective and robust

[12] See for example, Pension Funding and Capital Market Development, Taro Niggemann and Jörg Rocholl, August 2010, Contractural Savings or Stock Markets Developments; Which Leads, World Bank Financial Development Department, August 2000, and Capital Market Development in a Small Country: The Case of Slovenia, IMF Working Paper WP/07/229, September 2007.

[13] Financial Markets (Regulators and KiwiSaver) Bill, Audit Regulation and External Reporting Bill, Ministry of Economic Development Review of Securities Law Discussion Document and related regulatory impact statements and Cabinet papers.

32. The rationale is that listing the equity of large well developed corporates will add depth and liquidity to the share market. There is an expectation of a flow on effect that would encourage private sector companies to also view the share markets as an attractive place to raise capital, and further enhance the markets; a virtuous circle particularly as it would offer further investment opportunities for savers.

33. INFINZ agrees that this would benefit the capital markets to a significant degree.

34. However, framing the debate in this form is perhaps looking at the issue of Government participation in the capital markets from too narrow a perspective.

35. Rather than focusing on what the Government can do for capital markets, which seems to be tenor of most commentary, the issue should rather be considered in terms of what the capital markets can do for Government.

36. Government is reported to have funding requirements across a number of areas that require very large amounts of capital over the next few years. The National Business Review reports up to $70 billion of gross capital investment is required over the next five years across all levels of central government.[14] Details on the make up of this requirement are expected in the Half Yearly Fiscal Update to be released by the Minister of Finance in December.

37. To fund this requirement the Government would typically look to three sources:

    - Raising the funds by further borrowings;
    - Taking funds from elsewhere (say by payment of dividends from SOEs or reallocating spending priorities); and
    - Increasing revenue via higher taxes or prices for Government services.

38. There is a fourth option; being the raising of funding from the capital markets, in particular equity capital. The Government itself and a number of SOEs are already participants in the debt markets therefore extending involvement into the equity market is not a big step.

39. It should be possible, for example, for a SOE to issue new equity (as opposed to Government selling existing equity) and list on the share market in pursuit of its corporate objectives. An SOE raising capital in this way could

[14] National Business Review "Is the private sector being crowded out by big spender government?" 22 October 2010.

still have constraints on issuance to preserve public ownership and control.

40. From the Government's perspective it potentially reaps a higher level of future dividends, retains its interest in the listed entities, and shares the risks of the enterprise with others prepared to invest. There is also a benefit to the Government from the share market (institutional investors) taking a role in the areas of governance, disclosure and management oversight.

41. From a savings perspective the Government needs to raise less debt because it is using the savings of others to invest in equity. Clearly, if the Government were to also sell down some of its interests in SOEs then the cash generated could be used to either repay debt or invest in economic development, which suggests that debt increases could be avoided elsewhere across the Government sector.

42. INFINZ would be most concerned if cash generated from the sale of SOEs were to be used to fund current consumption.

43. International research on privatisations shows that people are not concerned so much with the sale of state assets per se but with the appropriateness and transparency of the sale process.

44. A paper this year by four academics[15] reviewed survey results from 28 ex-communist bloc countries that included questions about attitudes towards privatisation[16]. In all 28,000 individuals were asked their opinion; 1,000 from each country.

45. The authors note:

> *"Dissatisfaction with privatization should not be equated with a preference for state property. Public support for revising privatization in the post communist world is broad and deep. More than 50% of the population in each of the 28 countries and over 80% of all respondents support some form of revision of privatisation from levying additional taxes on current owners or privatized assets to the full expropriation and re-nationalization of assets.*
>
> *However, only 36% out of the 80% who support revision of privatization (29% of all respondents) have such a view because of their preference for state ownership, the remaining 64% of supporters of privatization revision (a little over half of all respondents) prefer private property despite their support for privatization revision. Such views are due to massive discontent with the process and outcome of privatization in transition economies."*[17]

[15] Everyone Hates Privatization, but Why? Survey Evidence from 28 Post-Communist Countries, Irina Denisova, Markus Eller, Timothy Frye and Ekaterina Zhuravskaya, May 2010

[16] Life in Transition Survey, World Bank and ERBD, 2006.

[17] Everyone Hates Privatization, but Why? Survey Evidence from 28 Post-Communist Countries, Irina Denisova, Markus Eller, Timothy Frye and Ekaterina Zhuravskaya, May 2010, page 21

46. The paper concludes thus:

> *"Two optimistic lessons emerge from our analysis for those who are concerned about the consequences of revising privatization. First, while support for revising privatization in the region is very high, about 70% of respondents ultimately support private property. Second, most of the support for the revision of privatization due to illegitimacy comes from negative personal experiences during the transition, and these transition experiences are likely to play a smaller role in shaping attitudes over time."*[18]

47. It is highly probable that similar sentiments over previous privatisations in New Zealand still exist, particularly those privatisations undertaken in the 1980s. However, it is clear that it is not the fact of privatisation that is the issue; rather it is the process by which privatisations have taken place.

48. As INFINZ sees it, the challenge for Government in accessing the capital markets to raise equity is ensuring that the process is transparent and robust, and that the costs, benefits and trade-offs are clearly explained.

49. If in the longer term the Government decides to further reduce its stake in its partially listed enterprises then the value should be clear, via market prices, to all participants. The concept of the assets being purloined by the purchaser at an unjustified discount simply doesn't arise.

The Market for Information

50. In addition to the opportunities to manage national savings outcomes through the use of the capital markets by Government there is also a need to address issues related to the supply of information about investment opportunities for savers.

51. It is clear that not all savers use managed funds or will hold all their savings in Kiwisaver accounts. The SoIFE and Reserve Bank data shows that households hold a large portion of their financial assets in bank deposits and other lower risk forms of investment.

52. Investors need information upon which to base their investment decisions, particularly in respect of listed issuers. Investors are presented with offering documents at the time of initial subscription; however, once shares are trading in the secondary market updated information can be difficult to come by.

[18] Ibid, page 22

53. The CMDT recommended that:

> *"NZX, Treasury and MED develop a proposal for an analyst research scheme to extend coverage to small (and particularly newly listed) firms."*[19]

54. This recommendation recognised that the failure of the market to provide research on many listed companies, primarily those with an annual traded turnover of less than $20 million was because no viable business case exists to generate that research output[20].

55. Research is paid for from brokerage on share turnover so a lack of turnover limits the revenue to support research. Research is reasonably expensive to produce so for companies with lesser levels of share turnover it simply becomes uneconomic for analysts to generate research. Information provided to investors is therefore restricted. This problem is likely to be further exacerbated by the application of the Financial Advisers Act, whereby brokers will only discuss investment opportunities with clients where they have research available.

56. Brokers, who are the main producers of investment research, restrict distribution to their own clients (and provide different levels of research for different tiers of clients) because of the economics of producing research. As a result the market for information about listed securities is left unfulfilled. Consumers, facing the cost of establishing a relationship with a broker to access this information are likely to go elsewhere for investment opportunities.

57. While the savings research shows that New Zealand does not have an overinvestment problem in respect of real estate, it does have an underinvestment problem in respect of financial assets.[21]

58. INFINZ would suggest that many savers have a predisposition towards property investment because of its familiarity and ease of access to information about property investment and that a lack of independent information about other investment opportunities is clearly impacting upon where savings dollars are being directed.

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19 Capital Markets Matter, Report of the Capital Markets Development Taskforce, December 2009, page 70
20 The Research Market In New Zealand; Debt and Equity, Esperance Capital Ltd, July 2009, page 12
21 Implications of Household Savings Patterns for Capital Markets by Nick Davies of Martin Jenkins, May 2009, page 31

59. From an economy wide perspective it is important that businesses have access to the finance they need. Savings either directly or indirectly invested into real estate do not directly assist in the growth of the economy. The problem of unproductive investment in real estate assets in New Zealand has been well documented.

60. INFINZ suggests that consideration be given to improving the information flows about financial assets (shares, mutual funds) to investors. As noted above, there is a supply problem with this information because of the economic model currently required to produce this type of information.

61. INFINZ sees a role for Government to assist funding the provision of this information and extending the recommendation of the CMDT to encompass a broader range of investment products.

62. INFINZ notes the provisions of the Financial Markets (Regulators and KiwiSaver) Bill in regards to standardised and comparable information about KiwiSaver fund performance, fees and returns. INFINZ endorses this approach and notes the discussion on this subject for all collective investment schemes included in the Review of Securities Law published by the Ministry of Economic Development earlier this year.

Improving Supply of Information

63. INFINZ calls upon the Savings Working Group to look closely at the issue of how the Government can use the capital markets (and in particular the equity markets) for its own capital requirements.

64. Notwithstanding current Government policy, greater use of the capital markets by Government may well lead to better overall outcomes for the economy in terms of savings, debt levels and returns for savers.

65. INFINZ also calls upon the Savings Working Group to assess how more information about investment opportunities can be made available to savers and advisers. Increasing the supply of quality information and making this available to savers will enhance outcomes for savers.

Part Three – Is Compulsion Necessary?

66. INFINZ notes the commentary in recent months about whether to make KiwiSaver 'compulsory'. The concept of compulsion is attractive at first blush because of the potential to increase the level of domestic savings, and capturing people within KiwiSaver who would otherwise be unlikely to join.

67. However, INFINZ has some concerns with a move to compulsion. The first concern is with affordability. As noted in the Motu report[22], around half of all New Zealanders do not have any savings, which may be indicative of spendthrift behaviour, but is far more likely to be as a result of not having sufficient surplus cash flow in the first place.

68. INFINZ notes that the Motu report only covers savings activity until 2006, thus its analysis does not include the start of Kiwisaver or include the rapid growth that Kiwisaver has experienced. In all likelihood the percentage of the population not saving has fallen, but we don't know by how much.

69. Given the large percentage of the population that appear unable to save, because of low incomes or minimal surplus cash flow the imposition of compulsion into KiwiSaver would likely lower the cash flow of those least able to afford it further. Alternatively, solving the unaffordability problem via direct Government support, offset by lower future claims against National Superannuation, will have very large fiscal implications. It also begs the question about whether any actual saving, from an aggregate point of view, is actually going to occur.

70. The second concern is that INFINZ considers that KiwiSaver already has a number of 'compulsion' elements built into it. Once savings are invested into Kiwisaver they cannot be withdrawn until at least age 65, although there are some special conditions for first home buyers. Further, it is an active opt-out scheme, with employees having to actively exit the scheme. The growth rate of KiwiSaver shows that automatic enrolment has a powerful effect of increasing participation in Kiwisaver, particularly when coupled with an incentive.

22 Household Wealth and Savings In New Zealand: Evidence from the Longitudinal Study of Family, Income and Employment. Motu Working Paper 10-06, September 2010, page 10

71. The MED notes that:

> *"We expect, based on trends over the last year or so, that the membership to KiwiSaver will continue to grow for the next three years around the current rate of 1,000 per day."*[23]

72. This implies that total Kiwisaver membership will grow to approximately 67% of the population under 65 by 2013 with the current policy settings. Given that approximately 240,000 people have actively opted out[24], this would imply that total Kiwisaver numbers would be close to approaching the total working age population of New Zealand within the next three years.

73. Given the continued steady increase in enrolments, and expectations of future enrolments, INFINZ is not convinced that there is an urgent problem to solve.

74. If the Savings Working Group considers that increasing KiwiSaver enrolments is an important policy objective for Government then a useful alternative to compulsion could be to greatly incentivise New Zealanders by distributing the assets of the New Zealand Superannuation Fund (**NZSF**) to individual KiwiSaver account holders.

75. Based on the latest reports from the NZSF the Fund holds assets worth almost $4,400 for every person under the age of 65 in New Zealand.

76. Looking at this issue from a high level conceptual perspective these funds could be distributed to individuals, with the proviso that the funds be invested into a KiwiSaver account. For those currently without a KiwiSaver account this would provide a significant incentive to enrol.

77. Concurrently, the claim by individuals to National Superannuation would be progressively reduced according to the age of the individual account holder.[25]

78. One objection to an idea such as this would be that it would increase the costs for investors and that the scale benefits of having a large investment manager would be lost. Against this it could be argued that the funds would be spread around a number of investment managers, who may generate higher returns than the NZSF, thus offsetting the increase in costs for investors.

[23] Report on Kiwisaver Supply Side Evaluation, Ministry of Economic Development, July 2010, page 34
[24] Ibid, page 34
[25] INFINZ notes that National Superannuation is specifically excluded from the Term of Reference given to the Savings Working Group by the Minister of Finance, although it is difficult to discuss long term contractual savings without bringing National Superannuation into the discussion.

79. For those without KiwiSaver currently, a distribution of this nature may well provide the catalyst to increase savings further. For existing KiwiSavers the extra infusion of cash would make a meaningful difference to their level of savings.

80. Clearly, with such a proposal there are a number of policy matters to resolve. INFINZ is only tabling this as an idea for consideration and would want to see far more detail developed before deciding whether to support such a proposal.

Part Four – What Happens After 65?

81. The focus of the SWG is on the creation of savings however considerable attention needs to be given to the growing portion of the population that is actively dis-saving; those over 65 who are receiving National Superannuation, many of whom are also utilising personal savings to meet their daily consumer needs.

82. The CMDT commissioned a research paper on the annuities market in New Zealand however relatively little else has been said. Motu notes from the SoIFE data that those over the age of 65 are dis-saving, which is consistent with life cycle theory[26].

83. The needs of those over the age of 65 appear to have been passed over in the design and structuring of KiwiSaver. As it currently stands KiwiSaver will deliver a lump sum payment to an account holder on their 65th birthday. In current dollar terms those payments could be several hundred thousand dollars, depending on how long the account holder has been a member of KiwiSaver and their rate of contribution.

84. Based on the New Zealand Period Life Tables 2005 – 2007, published by the Department of Statistics on average women will live a further 21 years and men a further 18 years beyond the age of 65, to the ages of 86 and 83 respectively. It is a truism that on average, the longer one lives the longer one will live. Based on the current Period Life Tables, on average a woman aged 86 will live until they are 92, while a man aged 83 will live until they are 89. For every 100 women living at aged 65, 22 will still be alive at aged 92,

[26] Household Wealth and Savings In New Zealand: Evidence from the Longitudinal Study of Family, Income and Employment. Motu Working Paper 10-06, September 2010, page 13

while 23 out of 100 men will still be alive at age 89.

85. Clearly, retirement can be a long-term endeavour, and one of the great challenges faced by all over the age of 65 is ensuring that their savings will last. Receiving a large lump sum payment at 65 will present challenges to retirees as they seek to manage their cash flows and ongoing investments through an extended period of time which is a challenge few will be qualified to meet.

86. Historically, annuities have been seen as a way for retirees to manage their cash flow and pool of savings over an extended period. Before the move away from defined benefit to defined contribution superannuation schemes, which began in the late 1980's, there was little need for an active annuities market as most pension schemes were designed and required to make annual payments to retirees. Despite the move to defined contribution schemes INFINZ understands that only one life insurance company now offers an annuity product, compared to several companies 20 years ago.

87. INFINZ does not recommend that all KiwiSaver funds be locked away into an annuity product, however, a mandated proportion of savings that should be directed into the purchase of an annuity is recommended to ensure that a failure to manage the capital/consumption balance does not result in some future re-emergence of a need for government support for retirees.

88. INFINZ sees a role for insurance companies to once again participate in the annuity market, however, if these entities are unwilling to re-enter the annuity market INFINZ suggests that a SOE be created to provide such a service. We would also see a need for a strong prudential oversight of the annuity market to ensure these long term contracts are offered by highly credible providers.

89. INFINZ charges the Savings Working Group with turning its attention towards the needs of savers in their retirement as a natural outworking of improving/increasing savings.

PART FIVE – OTHER COMMENTS

FINANCIAL LITERACY

90. INFINZ notes the commentary and discussion about the level of financial literacy in New Zealand and potential negative impact on savings and investment outcomes. INFINZ is not convinced that the Financial Markets Authority (**FMA**) is the best organisation to lead Government initiatives in the field of financial literacy. INFINZ considers that the primary and sole focus of the FMA should be on market conduct and that financial literacy should be the responsibility of another part of Government.

91. This does not downplay the important role of financial literacy, rather it is about ensuring that this is undertaken by an appropriately resourced Government agency and is not 'another thing to do' for an organisation with its primary focus elsewhere.

92. INFINZ commends to the Savings Working Group a recent Statement from the Australia And New Zealand Shadow Financial Regulatory Committee[27]. Statement No. 7 covers the subject of financial literacy. In its Summary the Committee:

> *"Recommends that information about finance principles, markets, institutions and history be incorporated into national high school curricula within courses that are taken by all students, and, to the greatest extent possible, these topics be integrated with tools and concepts taught in the mathematics curriculum, particularly through the use of case studies and experiential learning."*[28]

93. INFINZ strongly endorses the concept of placing financial literacy in the path of students where they cannot help but be exposed to and assessed on it. While this is clearly a longer term strategy in respect of improving financial literacy it is important to start somewhere.

94. In this regard INFINZ notes that currently, whilst the New Zealand Curriculum does expect students should be 'enterprising' there is little requirement for teachers to introduce financial literacy into the core curriculum. Financial capability is suggested as a 'nice to do' area rather than a 'must do' area. Enterprise is referred to in the Principles section of the curriculum which means it is mandated.

[27] Retail finance: A path forward for education, advice and disclosure, Australia And New Zealand Shadow Financial Regulatory Committee Statement No. 7

[28] Ibid, page 1

95. Financial literacy is offered in secondary schools as a unit standard within NCEA rather than an achievement standard which means that it has no curriculum as its basis and is not a field of academic study. As such students will bypass financial literacy as it has no academic status for their NCEA, especially at level 3. Neither does Financial Literacy have approved subject status, which means that a large number of curriculum committees and principals are reluctant to allow it to be taught at the senior school level. Unless Financial Literacy receives approved subject status it will disappear from the senior school curriculum. .

96. Anecdotally we understand teachers are saying that without an upgrade to achievement standard status or a signal towards such a change within one or two years then there will be no financial education teaching in the upper secondary school and likely not much at the junior level.

97. What makes this situation worse is that schools can, and do in great numbers when their involvement in standards provided by the likes of the Young Enterprise Trust is considered, refuse to offer financial literacy within schools. Many that do are dependent upon the enthusiasm of a sole teacher or a dedicated head of department.

98. There is a belief within the financial services sector that financial literacy is an important aspect to consider when reviewing and considering changes to securities laws and the introduction of new legislation relevant to finance and capital markets. To find that education in financial literacy is not broadly available to New Zealand students is a surprise and a concern. We simply can't establish meaningful policy and legislation in financial services when the assumption that financial literacy will be beneficial when its availability is limited.

99. INFINZ charges the Savings Working Group with the task of bringing financial literacy into the core mandatory New Zealand curriculum and have it given the standing of an achievement standard. Financial literacy is more than a life skill; it is as fundamental as english and mathematics.

100. Further, INFINZ considers the resources provided by the Retirement Commission, particularly the 'Sorted' website (www.sorted.org.nz) should be the key focus area for adult financial literacy in New Zealand and that the Retirement Commission should be the peak Government body charged with financial literacy outcomes outside of the education system.

HOME BIAS

101. One of the frequently quoted benefits of promoting savings is the emergence of a pool of capital to meet the funding needs of New Zealand and New Zealand businesses. INIFNZ believes that caution should be exercised in making this assumption, as large amounts of the savings created will be placed into pooled savings schemes such as KiwiSaver, which are managed by professional investment managers.

102. As a result the pool of savings created will not result in a large inflow of funds into the New Zealand economy as professional managers will properly allocate a large percentage of their funds to offshore investments and only a relatively minor portion to New Zealand investments.

103. Similarly, the allocation to non-traditional asset classes will be capped by the proper application of portfolio management disciplines as represented by diversified benchmark portfolios.

104. INFINZ notes anecdotal evidence that local investment managers struggle to allocate funds to pure New Zealand equity portfolios once those portfolios reach between $300m and $400m in size, depending on the investment style of the manager. This is due to liquidity concerns and the inability to get exposure to sectors such as banking and resources in the New Zealand equity market.

105. INFINZ does not recommend nor does it support any form of home bias in investment portfolios. INFINZ notes the direction given to the NZSF by the Government related to increasing its allocation of investments into New Zealand. INFINZ also notes the substantial body of academic research that shows that mandated home bias leads to poorer outcomes for savers and investors.[29]

106. An increasing portion of funds in KiwiSaver accounts will go overseas. At an aggregate level this benefits New Zealand's international investment position and thus improves the net foreign debt position, and there is clear evidence that international diversification leads to better returns for investors. Again, in aggregate this also benefits New Zealand international investment position.

[29] See for example The World Price of Home Bias, Sie Ting Lau, Lilian Ng, and Bohui Zhang, November 2009 and Is Locking Domestic Funds Into The Local Market Beneficial? Evidence From The Polish Pension Reforms, Anna Zalewska, August 2006

107. Compared to other countries New Zealand may have more of a foreign bias (corollary of home bias) issue because of the inherent problems of small, illiquid capital market; investment managers may want to allocate funds into New Zealand but may not do so because of market constraint issues such as liquidity.

108. Investment managers may allocate a larger portion of funds into New Zealand if market constraint issues lessened. The options set out earlier in this paper regarding the Government's use of the capital markets would be one approach to reducing these constraints.

109. The allocation of funds by investment managers to New Zealand needs to remain a market driven outcome. Mandating a higher allocation to New Zealand will not generate the types of outcomes investors are looking for.

110. The result of a large pool of savings arising in New Zealand may not be a large pool of funds invested in New Zealand but rather an increase in investment offshore.