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AON Hewitt

9 November 2010

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Dr Brian McCullough
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Savings Working Group
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Dear Mr McCullough

SUBMISSION
Savings Working Group

Thank you for your letter of 9 September 2010 inviting Aon to make a submission to the Savings Working Group. A brief background on Aon Hewitt and our views on Savings in New Zealand are presented below.

Aon Background

Aon Hewitt is a global corporation that has been providing actuarial advice and superannuation administration in New Zealand since 1979, under various names.

We are philosophically committed to workplace savings and employer sponsored superannuation schemes. We have a strong actuarial and consulting presence to provide associated services. In 2007, our business grew significantly with the introduction of KiwiSaver.

We currently administer 60 stand-alone superannuation schemes including 22 KiwiSaver Schemes, 9 complying Superannuation Funds and 14 Defined Benefit Schemes. The superannuation schemes managed have a combined membership of approximately 60,000 members and combined funds under management of over $2b.

Our views centre on KiwiSaver.

Compulsory Superannuation

We believe superannuation in New Zealand should be compulsory. In particular, all working New Zealanders between 18 and 65 should be required to contribute to either KiwiSaver or a Complying Superannuation Fund (CSF). We have concerns about the economic sustainability of the universal State pension and many Kiwi's over-reliance on this as their only source of income in retirement.

Many Kiwi's have already joined KiwiSaver so compulsion is a relatively small next step on a national scale.

Australian Experience

Australia has had compulsory superannuation for many years and in many areas and at many levels they tend to lead the way. Their share market and savings industry are well developed.

A recent comparison of individuals' "savings" (defined for the purposes of the study as net assets in things that can be realised at retirement) of Australians with Kiwis was carried out by New Zealand's Retirement Policy and Research Centre (RPRC).

This survey showed that the average Australian has 18.6% of their net assets in superannuation schemes compared to 2.1% of New Zealanders. On the other hand Australians have 9.3% of their net assets directly invested in businesses compared to 22.2% of Kiwis.

While the savings levels in aggregate between NZ and Australia are roughly comparable (54.5% Australia compared to 51.2% NZ) the typical Australian's assets are much more diversified than those of the average Kiwi. Furthermore, the average Kiwi is exposed to concentration of risk, having most of their savings in a few asset classes. Should Kiwi businesses or the economy fail to grow, the individual's current income and retirement savings will be negatively impacted. Compulsory superannuation will increase the diversification of New Zealanders' savings.

Increased Contributions

We believe that contribution rates should be increased gradually to around 8% of earnings over a period of time. The current KiwiSaver contribution rates are 2% employee and 2% employer, or 4% in total. The following table shows the expected results of saving at different rates from age 25 to 65.

Savings Rate % Gross Earnings	Annuity (est) at 65 % Gross Earnings at 65 (before tax)
4	20%
6	30%
8	40%
10	50%
12	60%
14	70%

Assumptions:
40 years of savings from age 25
Earnings Inflation 3.5% pa
Investment Earnings 5% pa after tax
Average income tax rate 25%
Latest NZ mortality statistics
Single life pension [payable for life, inflation indexed

Based on the assumptions stated above, a savings level of 4% of earnings from age 25 for 40 years is expected to result in a pre-tax income in retirement from age 65 of around 20% of gross earnings at retirement. An 8% savings level is expected to result in a pre-tax annuity at age 65 of 40% of gross earnings at retirement.

Please note that in carrying out these calculations we have made a number of assumptions. We have also assumed there are no changes in future to the taxation treatment of annuity providers or annuitants. However, please see our recommendation below.

In our opinion the current 4% savings level needs to at least double in order to provide sufficient income in retirement, together with a base level of New Zealand Superannuation, for the average New Zealander.

Access to Savings

Savings should continue to be locked away to age 65 to remove the temptation of individuals frittering away their retirement savings. Retirement saving is a long term discipline.

Access to locked in savings through hardship should be harder to get. Payments only for extreme cases should be permitted and a separate independent body should be set up that reviews all cases.

From our experience of administering superannuation schemes and processing hardship benefit applications we see little long term benefit to individuals of paying out their savings on hardship. It costs the member and the scheme to process these applications and more often than not the member is soon back wanting further funds.

Incentivising Savings

It would seem unfair to require members to save without giving them sufficient reward for doing so. Australia offers strong incentives to its savers. We believe that Member Tax Credits (MTC's) should continue to be paid and they should be doubled to accommodate a 4% / 4% savings regime (proposed above). Our experience shows that members value existing MTC's.

Annuity Market

In future years, KiwiSaver will result in New Zealanders reaching age 65 and receiving large lump sum retirement benefits. For many New Zealanders this will be the largest single sum of money they have ever had access to. Many will not know how to handle it and the risk of it being frittered away or ill invested is heightened. Security of a steady flow of income in retirement is essential. The eroding affects of inflation are significant over time and annuities should be inflation indexed.

New Zealand has a very small and expensive annuity market. There is currently only one annuity provider.

We recommend that the Government incentivise annuity providers to enter the market by changing the way their businesses are taxed. Annuity providers have long term liabilities and a sizeable portion of their assets need to be in long term secure Government fixed interest securities. The NZ Government Bond market is relatively small and the longest dated NZ Government bond is under 10 years. If a sizeable and effective annuity market is to be set up in NZ then the Government will need to offer annuity providers with longer dated fixed interest securities.

These changes will help encourage more providers to enter the annuity market and will provide New Zealanders with a wider choice of providers and products at competitive prices.

Financial Literacy

We believe many New Zealanders are not sufficiently financially literate enough to choose a suitable investment strategy or KiwiSaver provider. Poor financial literacy negatively impacts individuals' views on financial markets and the appreciation and need of saving for retirement. Regrettably, many New Zealanders are still suspicious of KiwiSaver and managed funds. We believe financial literacy education should be made compulsory at school. This will foster a greater understanding and appreciation of KiwiSaver and saving for retirement.

Yours sincerely

Greg Lee
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