portfolio construction forum

Age of entitlement

David Maida | financialalert | 05 December 2013

Across the ditch, Australia's Productivity Commission has recommended a jump in the entitlement age for superannuation to 70. We spoke to Kiwi academics and financial advisers about the likely future of NZ Super.

Dr Malcolm Menzies, research manager for the Commission for Financial Literacy and Retirement Income (CFLRI), compiled a discussion paper on retirement, called Focusing on the Future. His final report is due out this month.

Menzies told financialalert that there is the real shortage of financial advice, as many advisers already know. "There is an issue there about how to increase the supply of basic financial advice and get Kiwis to seek it," Menzies said.

The most important issue highlighted in Menzies's report is the fundamental lack of financial advice most people are receiving, particularly from financial advisers. Just 15% took advice from a financial adviser in 2013, down from 18% in 2009. And it's no surprise that the majority of that advice (47%) is coming from the banks. Even TV programmes were mentioned by 11% of people, while 24% of those surveyed received no help on financial matters at all.

Menzies said there is a really strong international consensus around increasing the age of entitlement and he is adamant that to make NZ Super sustainable, the entitlement age must increase. "With increases in life expectancy, to keep public pensions sustainable and fair, the age does need to go up," he said, adding that it's an issue of intergenerational equity. "I'm a baby boomer. Why should my generation get all the benefits of increased longevity? I live longer and expect the next generation to fund a longer retirement? That's not fair.

There is also quite a bit of a consensus among New Zealanders for a rise in the entitlement age. Last year, a TV3 Reid Research poll showed 63% of 1,000 voters questioned said the entitlement age should move to 66 or 67 years from 2020 or even earlier. However, the National government has well and truly kicked that can down the road. Prime Minister John Key has repeatedly said there is nothing wrong with the entitlement age of 65.

Even though CFLRI is an autonomous crown entity, Menzies has an idea as to why the Prime Minister is not taking his advice. "Most of the arguments hinge around the question of affordability. And what's affordable to one person is not affordable to someone else. It's been pointed out that raising the age will save 0.7% of GDP which seems like a small number but it converts to about NZ$1.4 billion every year. That's NZ$1.4 billion that doesn't go somewhere else. It's more a question of priorities than affordability."

As of 1 April 2013, NZ Super payments are $550 per week for a married couple and just $360 for an individual living alone. Some Kiwis will be entirely reliant on Super to fund their retirement. Some are even worse off.

"There is a group of New Zealanders, and it's hard to say how big it is, for whom NZ Super alone won't be enough," Menzies said. "There is a gap between what NZ Super provides and what they aspire to."

However, there is a lower income group who might be on a benefit who will actually see an increase in income when they draw their pension because the income from benefits is much lower than NZ Super.

The Focusing on the Future discussion paper highlights that compulsory KiwiSaver would place too high a burden on low income groups. Menzies suggests that for lower income earners, if the age of entitlement were to go up for NZ Super, it would be appropriate to keep the KiwiSaver entitlement age at 65.

For now, NZ Super is one of the most sustainable in the world according to OECD standards, but that could change. Between now and 2056, the number of workers there are per superannuitant halves from five to two and a half. And we also know that life expectancy is expected to go up even faster than the proposed increases to eligibility that we have stated.

Michael Littlewood, co-director of Retirement Policy and Research Centre at the University of Auckland, is not convinced the age of entitlement should change. But, with the Baby Boomers (born 1945-1966) are starting to reach 65 and Littlewood told financialalert we need to plan ahead.

"My first question is, 'Do we as a country think the taxpayers in 2060 will be prepared to pay 6.6% of GDP for New Zealand Super?' If they decide that 6.6% is too much, they will change it overnight, if necessary," Littlewood warned.

Currently NZ Super is 4.1% of GDP. But New Zealand is better off than other OECD countries which average 9.3% of GDP to pay for their state pensions.

Despite numerous reports and studies about retirement, Littlewood said there are still significant gaps in our knowledge of what the future will be like. "Having gathered the information and run the discussion, any change which is made should be with a reasonable lead time and then gradually."

Any discussion about the increasing cost of ageing also needs to include the cost of healthcare, Littlewood said, as this will likely double over the next 30 to 40 years. But, he said, there is no reason to think we're in any real trouble just yet. "What I'd like to ask is, 'Where is the evidence that New Zealanders are actually under-saving for retirement?'

Because I know there isn't any."

He also disputes the idea that mortality improvements will continue indefinitely. He doesn't believe the average Kiwi will live to 100 but acknowledges technology will improve our lives. "I think it's more likely that we'll be dying healthier rather than living on to 120."

Littlewood acknolwedged, though, that if people are perfectly healthy at age 65, they are less likely to want to retire.

Retirement is also becoming more of a process than a one-off event. More retirees are likely to have some sort of part-time work before they retire fully. For many, retiring is simply the beginning of the dying process.

Littlewood does not believe the age of entitlement should be debated in the political trenches - he doesn't think it's fair to expect politicians to resolve such a difficult issue which involves a 20- to 30-year timeframe. "This is something which should be debated amongst society as a whole, not just among the politicians or the people who support those political parties," he said. "Someone like the Retirement Commission (CFLRI) needs to be leading the national discussion."

The National Party continually refuses to discuss changing the age of entitlement - but Labour is happy to. Labour plans to increase it gradually by two months per year starting in 2020 up to the age of 67.

David Parker, Deputy Labour Party leader and finance spokesperson, told financialalert it's important to give people ample time to adjust their retirement planning. He said financial advisers should feel secure that NZ Super will be there for their clients and will be sustainable.

"So long as we're responsible with the age of eligibility, we can secure universal government superannuation. They can rely upon that as being there for them in the future," Parker said.

The cost to the government of NZ Super has gone up from $7.3 billion in 2008 to $10.2 billion in 2013. Parker admits it's a difficult issue to address but argues that a $3 billion increase over five years is just too much. At the current rate, in two years, the country will be spending more on superannuation than education, he said. "That's preschool, primary, secondary, tertiary and trade training combined. That's just wrong. The drivers of this cost are increasing life-expectancy. A responsible government reacts to that."

Parker believes that if the cost of superannuation does exceed the cost of education, the government will be pressured to look at the universality of NZ Super. Labour fully opposes means testing but sees the risk of other future governments imposing it. "Already, a substantial portion of the population chooses to work past the age of eligibility. Now if, you're means tested, you'd force people to choose between NZ Super and other income."

The clients of most financial advisers would be hit hard by means testing. It would also reduce public acceptance of KiwiSaver, Parker argued. "We introduced KiwiSaver and we think that we need to move toward universality, that everyone should be in it."

What advisers say

We also asked a couple of financial advisers what their impressions are of where we are at in terms of the age of entitlement and how they view NZ Super within their client's portfolios.

Norman Stacey, principal at Diversified Investment Strategies, tells his clients not to rely on NZ Super as it is just a small portion of their retirement plan anyway.

He expects the age of entitlement will go up at some point. "My expectations are that it will be raised. It makes perfect sense. I guess the quibble is about the pace and the onset of it. We fully expect it to be raised to 67 or even 70 over time. It's almost actuarially inevitable," Stacey told financialalert.

He hopes any change in the age is gradual and not a sudden five-year jump like Australia is proposing. "The people most affected are those poor souls who are absolutely reliant on it. There are some people who don't and probably shouldn't have KiwiSaver because they're not earning sufficiently to save. They will be reliant on the support level of NZ Super."

Stacey admits that these people are not his clients - but said they should be of concern to all Kiwis. "None of the country wants distressed citizens."

The universality of NZ Super creates the problem of affordability, and Stacey points out that the needy as well as millionaires receive the same superannuation payments. He believes means testing should be considered along with raising the age of entitlement. "Means tested or taxed back, it could be abated in some form. To be reliant on super if you can afford to do otherwise, would be a high-risk strategy that we don't counsel."

Greg Moyle, director of New Zealand Financial Planning, takes a different view of NZ Super, largely due to his mature client base.

"It's actually a critical part of the retirement plans I do for a lot of my clients now. I'm dealing with people in their 50s and 60s and 70s. I've got clients in their 80s and 90s who've been with me for a number of years. For that group, NZ Super is pretty significant because a married couple getting anywhere between $26,000 to $28,000 net per anum and a single person will get around $18,000," Moyle told financialalert.

They are old enough that any proposed changes to the age of entitlement will come into force after they retire.

Moyle said that NZ Super might not seem significant to a lot of people. But, if a client needed to fund that same net outcome over a 25 to 30 year period, they'd need to have about

$400,000 to receive a $26,000 per annum pay-out. It would take $300,000 to fund the single person income of $18,000 per annum.

Unfortunately, many people coming up to retirement don't have a hope of maintaining their current lifestyle on NZ Super. Moyle recommends his clients have around $400,000 invested on their own to supplement their NZ Super payments.

"What I'm always looking for is the difference between what you need as opposed to what you want. I call that your 'financial independence gap'."

He sees NZ Super as a social contract to provide a baseline so that if people run out of money they won't be living in the street. "It is that minimum amount of money that you can't live on but you can exist on. It can pay for the essentials in life but it won't give you any discretionary expenditure."

Garry Moore, branch manager Forsyth Barr Christchurch, told financialalert he does not believe the age of entitlement needs to be raised - but he sees other problems with the system.

"I think there should be a more sophisticated means of making sure that it's affordable for the nation up until that point. I think that there should be greater focus on self-styled superannuation."

Moore said NZ Super needs to remain universal and not be means tested. "I think means testing just penalises the people that make more of an effort."