MEDIA RELEASE

FinancialServicesCouncil.
growing and protecting the wealth of New Zealanders

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Plan Released to Make a Comfortable Retirement Affordable for New Zealanders

The Financial Services Council has developed a plan that makes KiwiSaver fair, accessible and affordable for everyone so that all New Zealand employees can have a comfortable retirement with savings that enable them to buy a second pension to have an income, double NZ Super.

CEO, Peter Neilson says the evidence-based options, released today (October 14) at the Future of Super Conference hosted by the FSC, show that a comfortable retirement would be achievable and affordable if contribution rates to KiwiSaver progressively increased to 7% per annum.

The Council, whose members are entrusted with $80 billion in savings from 2 million New Zealanders, has based its package of options on independent consumer research, expert tax analysis and financial modelling.

The FSC plan seeks to:

- gradually increase the contribution rate by 1% a year, split with your employer, until you reach 7% so you can buy a second pension to provide a retirement income double NZ Super- that's only 1% more if you are already putting aside 6% (3% from the employee and 3% from the employer) – and provide a new KiwiSaver 1% starter contribution rate to get people into the scheme
- keep NZ Super as is

To get the required KiwiSaver contribution rate down to 7% four things need to happen:

- move default KiwiSaver savings into higher earning funds depending on your life stage
- offset the additional risk with insurance to guarantee a level of savings at retirement
- level the tax playing field for KiwiSaver investments with other forms of retirement savings
- re-target the $740 million government spends on KiwiSaver incentives to fund the lower tax rates on savings and make the new policy fiscally neutral (Horizon Research 2013: 7.8% of KiwiSavers say they only put in the minimum $1024 contribution p.a. so they can get the $521 tax free credit)

And to get that to happen all parties represented in Parliament need to agree and commit to providing a retirement savings policy that:

- continues to support KiwiSaver to help New Zealand employees save for a comfortable retirement over their working lives
- progressively steps up KiwiSaver contributions and coverage
- does not put New Zealanders who save for retirement in KiwiSaver at a tax disadvantage compared with other savers
- lowers taxes on KiwiSaver fund earnings over time to level the playing field so KiwiSavers are not at a tax disadvantage.

Mr Neilson said the research shows people know they have to save if they want more than NZ Super, but they can't do it alone.

"We want our opinion leaders and decision makers to get to grips with what is going to become an increasingly costly problem for the country with the faster than anticipated growth in the over 65s living longer, and the number of retirees who do not have adequate savings to live anything more than a meagre existence," he said.

"We need a new resilient retirement income policy that will see all New Zealanders have a comfortable retirement – like our better off Australian neighbours can expect. We look forward to starting that conversation."

FSC work shows that on the current policy settings people need to save 10% of their income every year over 40 years from age 25 and that amount escalates to 50% of annual income needing to be saved if you leave it till you are 55.

"That rate can be reduced to a 7% annual KiwiSaver contribution rate with sensible tax and investment policies," Mr Neilson said.

While 2 million people have enrolled in KiwiSaver, close to half of them are not actively contributing and many of those who are saving are saving just 6% of their income – it is not enough, especially for those nearing retirement, and insufficient to buy a second pension to fund a comfortable retirement which our research says New Zealanders believe is an annual income double NZ Super.

"It will be no surprise that there is such a big shortfall. People are not saving anywhere near sufficient and are also miscalculating how much they need to save as their longevity increases but their savings do not. There is also the need to factor in the impact of very high effective tax rates on KiwiSaver savings and whether they are in the right fund for their life stage."

Researchers tell us that of your final KiwiSaver nest egg, 10% come from your initial contributions and 90% from compound returns (interest on interest). KiwiSavers need to also be aware that the impact of tax on compound returns in New Zealand increases considerably the amount you need to save each week to fund a comfortable retirement. Over 40 years the impact of the effective tax rate on your investment returns reduces your retirement nest egg by more than 50%. (see Rule of 72 below)

For research, tax modelling, financial analysis and a media backgrounder please go to: http://fsc.org.nz/SuperSizeRetirementIncome.html

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Understanding Compound Returns and the Impact of Tax and Time:

APPLYING THE RULE OF 72 - IF YOU CAN DO THIS YOU ARE SMARTER THAN MOST NEW ZEALANDERS

Have you ever wondered if there is an easy way to calculate how long it takes to double your savings? There is a way, just divide the number 72 by the interest or growth rate. The rule of 72 provides a very good estimate of how compound returns (interest on interest) works.

It is less accurate once the interest or growth rate exceeds 20%, but if you are promised a 20% interest rate or growth rate it is probably a scam.

A simple illustration of how tax and time can eat into your potential savings

Suppose your Grandmother gives you a $1000 investment bond earning 6% a year tax free as a 17th birthday present for you to cash in when you are 65. How much will you have at 65 (using the rule of 72)?

72 ÷ 6% = 12 years

So your money doubles every 12 years at 6% interest tax free:
$1000 becomes $2000 in 12 years
$2000 becomes $4000 in 24 years
$4000 becomes $8000 in 36 years
$8000 becomes $16000 in 48 years
After 48 years your $1000 would have grown to $16,000 by the time you get to 65, assuming you kept reinvesting all the interest each year and paid no tax on the interest earnings. So $1000 of savings has produced a $16,000 nest egg at retirement.

Now……

Imagine instead of it being tax free you were taxed at 50 cents in the dollar on any interest you earned. That is a 50% tax rate. That means that rather than 6% interest each year you are earning just 3% interest after tax.

72 ÷ 3% = 24 years

So your money only doubles every 24 years at 3%
$1000 becomes $2000 in 24 years
$2000 becomes $4000 in 48 years
After 48 years your $1000 would have grown to only $4,000 when you get to 65 because of the impact of tax.

Ouch....

You can see the impact of the 50% tax rate on that initial $1000 investment, but what you can't see is that the effective tax rate is actually 75% over 48 years

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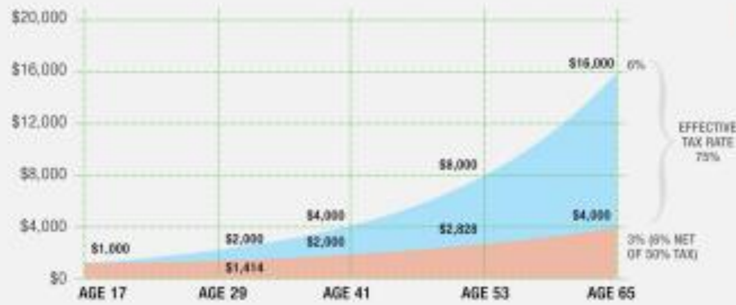
Rule of 72 provides a good estimate of returns over time
(The nominal tax rate is 50%, but the effective tax rate is 75%)



If the New Zealand economy grows by 2% a year

it takes 72 ÷ 2

= 36 years for us to double our incomes.

Moving from 6% with no tax to 3% after tax does not halve your retirement nest egg it cuts it by three quarters. That's the difference between the marginal tax rate and the effective tax rate, when you earn compound returns over time .