

Submission in response to Discussion Document "Flexible Superannuation"

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Summary

1. Evidence from other countries suggests that more choice in the age of entitlement to receive NZS is unnecessary and that one half of the policy - deferral - is unlikely to have widespread appeal.
2. Financial hardship from the other half of the Flexi-Super policy - taking NZS early - is likely.
3. The possible "pro" of more choice does not outweigh the risk of financial hardship and other "cons" including additional cost to tax payers.

About this submission

4. My experience relevant to this submission is summarised as follows:
 - Researcher into longevity and public policy. Research Associate at Public Finance New Zealand.
 - PhD at Victoria University, Wellington 2012 *Underestimating lifespans? Why longevity risk exists in retirement planning and superannuation policy.*
 - Author of several reports on superannuation policy, most recently *Longevity trends and their implications for the age of eligibility for New Zealand Superannuation*, commissioned for the 2013 Review of Retirement Income Policy by the Commission for Financial Literacy and Retirement Income.
 - Director 2002-2006 of the Pensions Policy Institute, London, which provides non-political, evidence-based analysis on retirement income policy. During this period I authored several reports on state pension age and on deferring state pension.

Question 1. Does the concept of more choice in the age of entitlement to receive NZS appeal?

5. **The policy appears unnecessary to improve choice.** The underlying policy rationale for Flexi-Super appears to be to give more choice in the age of retirement as on page 5 of the Discussion Document: "Flexi-Super...means that people can choose their own retirement date, rather than have the State impose one on them". The justification for a new tool to give more choice in this way is slim:
- There is no "imposition" by the State on retirement date. It is incorrect to equate age of retirement with age of first eligibility for New Zealand Superannuation (NZS).
 - New Zealanders can and do choose to retire or part-retire at different ages. This is illustrated by the labour force participation rate at 84 per cent for ages 55-59 years, 71 per cent for ages 60-64 and 20 per cent for ages 65 and over¹.
 - "The New Zealand policy environment allows greater timing choice and flexibility in the transition to retirement than is the case in many other OECD countries."²
 - New Zealand already has a relatively high rate of participation in the labour market among older people (as the Discussion Document shows).
6. Further, **Flexi-Super seems unlikely to provide more choice in practice.** Part-or full-retirement decisions are known to be based on many complex reasons with financial situation not usually the main or only one³.
7. Evidence from the UK confirms that **one side of the Flexi-Super option - deferring - is likely to be ineffective at changing retirement decisions.** Research on why people in the UK deferred their state pension found that decisions about staying on in work were generally well established by the time of the deferral decision⁴.
8. Evidence from the UK suggests that **deferral is not in fact generally attractive and few people actually take up the deferral option:**
- In the UK, state pension income can be increased by 10.4 per cent for every year deferred and so is similar to the 10 per cent a year deferral option illustrated in the Discussion Document for Flexi-Super. There is also an option to take deferred pension as a lump sum rather than an enhanced income.
 - Fewer than 10 per cent of eligible people defer in the UK⁵.

¹ Statistics New Zealand. Household Labour Force Survey, June 2013 quarter. Figures rounded.

² Davey (2008)

³ Davey (2008)

⁴ Coleman et al. (2008)

⁵ Cohen (2013)

- Women and overseas residents feature disproportionately among those deferring. It is thought that many people defer by accident, because they wrongly assume their pension is available on their husband's eligibility age⁶ or because they lose touch with the administrative authority⁷. So deferral is actively chosen by even fewer than 10 per cent of eligible people.
- The reasons for this apparent lack of appeal for deferring in the UK have been summarised by research which found that although "many interviewees said that they had heard about State Pension deferral"... "There was strength of feeling against the idea of deferral based mainly on a fear of uncertainty of the future. ... the idea of deferral was seen most positively as something that the better off might profit by. Those on lower incomes either did not know about the measure and/or felt that it was not relevant for them."⁸

9. **A key reason for the limited attraction of the deferral option is the "uncertainty of the future" inherent in the trade-off decision required to defer.**

- There is nothing to stop people who work beyond the age of entitlement collecting their NZS while working. It can be placed in a savings account to earn interest. The money belongs to the individual - together with the flexibility to use it as a supplement to income or to spend on one-off items at any time - and passes to the estate on death.
- The UK evidence suggests that the majority of people forgo higher income later for the certainty of taking pension as early as it is available.
- If many New Zealanders feel the same, which is likely, the attraction of the deferral option in Flexi-Super would be limited.
- As is explored in the answer to Question 2 below, this reason for deferral being unattractive is also likely to mean taking NZS as early as possible will be attractive, even though it will risk hardship.

10. **Those most attracted to the deferral option in Flexi-Super are likely to be higher rate tax payers**, as acknowledged on page 18 of the Discussion Document. This was confirmed by analysis of the UK deferral option, which found the value of deferring to be significant only to individuals who would be higher rate tax payers while working after the age of eligibility and then on a lower rate of tax after retiring and taking an enhanced state pension⁹.

⁶ Women's pension age is still less than the 65 for men in the UK, and the eligibility for state pension still often depends on a husband's work record

⁷ PPI (2003)

⁸ Vickerstaff et al. (2008)

⁹ PPI (2003)

11. Given this negative assessment of the deferral option, it is worth asking why other countries persist with such a policy. There is a rationale in the UK which is not relevant as a reason to introduce the option in New Zealand (see Appendix).
12. **The other half of the Flexi-Super proposal - the option to take NZS before age 65 at a reduced rate - is also unnecessary.**
- Many people do have sources of income other than NZS that would allow them to retire before age 65. The potential other sources of income include earnings (full- or part-time) and savings. As KiwiSaver balances grow, the availability of those funds at age 65 or earlier in case of significant financial hardship or severe illness will become more important.
 - Jobseeker Support, Supported Living Payment and other targeted benefits are available for people who have health problems and for these or other reasons will find work difficult in the period aged 60-65.
 - Even if age of eligibility for NZS were raised, say to age 67, it is envisaged benefits would be available before the new age, and KiwiSaver balances may still be available at age 65. Proposals for raising the age of eligibility suggest sufficient notice period so that affected individuals have time to prepare their finances, and recommend additional transitional relief for people unable to work below the new age¹⁰. A method of transitional relief would be simpler than introducing a permanent complexity to NZS through Flexi-Super.
13. By encouraging a *reduction* in the participation of older people in the labour force, **the early option is contrary to other policy in New Zealand** that seeks to *increase* participation and signal to older people the benefits of staying in work as long as possible.

Question 2: On the risk of higher levels of hardship among the elderly in order to gain flexibility in the age of first entitlement to NZS

14. **It is likely that many New Zealanders will want to take NZS as early as they can.** Overseas evidence is that when there is a choice of ages at which state pension can be taken, the first available is significantly popular.
- As mentioned earlier, 90 per cent of pensioners in the UK take the state pension at the first opportunity.
 - In the US, where social security benefits can be taken between ages 62 and 70, in the latest cohort for which there is data, 45 per cent of men and 50 per cent of women claimed benefits at age 62¹¹.

¹⁰ For example, Retirement Commissioner (2010)

¹¹ Johnson et al. (2013)

15. **Financial hardship is likely as a result of the early taking option in Flexi-Super.**

It is highly likely that people claiming Flexi-Super as soon as they can will live longer than they expect, locked into a low rate of NZS.

- New Zealand adults tend to underestimate how long they will live. On average, men are expected to live over five years longer than they estimate, women over seven years longer¹².
- The number of New Zealanders dying starts increasing significantly after age 70 or 75, as Figure 1 shows.
- Sixty-year-olds may feel that they want to take the early option to be certain of getting NZS in case they die before age 65. But fewer than 4 out of 100 men and fewer than 3 out of 100 women of the current cohort of 60-year-olds are expected to die before their 65th birthday¹³.
- Around half of men currently aged 60 are expected to live to age 87¹⁴. This means that a man taking NZS at age 60 has a roughly fifty per cent chance of having to live at a low rate of NZS for 27 years or more.
- The Discussion Document illustrated the rate of NZS at age 60 to be 73 per cent of the full rate. Twenty-seven years is a long time to live with NZS at 27 per cent lower than the full rate.

16. The discussion document suggests that Flexi-Super is "fair for people with shorter life expectancies" (page 15). **It would be misleading for government to suggest that people should take a lower level of NZS because on average people with their characteristic(s) have shorter life expectancies than the overall population.**

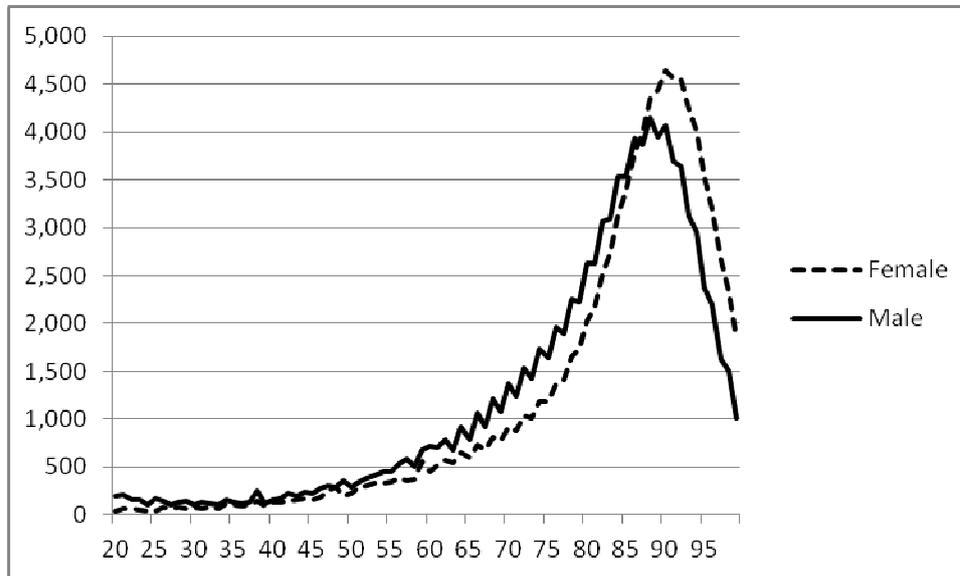
- Life expectancy is more complicated than that - the comment suggests a certainty when lifespan sits on a probability distribution.
- The identifiable differences between subgroups of the population are small compared to the length of time people would be locked into lower rates of NZS.
- For example, Figure 1 demonstrates that men have a shorter life expectancy than women on average, but the distributions of age at death are actually quite close. Both extend many years beyond the period when the option to take early is available. Men generally understand they have a shorter life expectancy than women, and yet it would clearly be harmful for that to be interpreted as an encouragement to claim early.

¹² O'Connell (2012)

¹³ Author's calculations made using figures supplied by Statistics New Zealand, consistent with cohort life tables (September 2012) and 2011-base national population projection mortality assumptions (July 2012), median projection (50th percentile). For cohort born 1953.

¹⁴ Author's calculations made using figures supplied by Statistics New Zealand, consistent with cohort life tables (September 2012) and 2011-base national population projection mortality assumptions (July 2012), median projection (50th percentile). For cohort born 1953.

Figure 1: Number of expected deaths at each age (from age 20 to 99) from 100,000 aged 20 from the cohort born in 1948 (reaching their 65th birthday in 2013), males and females¹⁵



17. For any individual there will be a mix of positive, negative and unknowable characteristics influencing lifespan.

- A large number of factors have been found to be associated with (not causing) a higher chance of early death¹⁶. These include: being male; never married; divorced or widowed; having worse socio-economic status, lower income or low level of education attainment; belonging to some ethnic groups, having experienced a relatively adverse environment at birth or in early childhood; having an unhealthy diet, obesity, taking inadequate exercise, excessive alcohol drinking, participating in hazardous sports or other risky behaviour; not accessing medical technology for treatment or prevention.
- There are also thought to be genes associated with exceptional longevity, and there will be genes associated with a number of causes of death.
- There are very few instances of direct causality with early death. Smoking is the obvious exception: it causes lung cancer.
- However, above all these factors, individual lifespan prospects are still to some extent a matter of chance¹⁷. For example, some smokers still enjoy a long life.

¹⁵ Data from author's calculations made using figures supplied by Statistics New Zealand, consistent with cohort life tables (September 2012) and 2011-base national population projection mortality assumptions (July 2012), median projection (50th percentile). See O'Connell (2012) for more detail.

¹⁶ See O'Connell (2013)

¹⁷ Kuh et al. (2009)

18. The Discussion Document specifically mentions Māori and Pasifika as having lower life expectancy on average, appearing to suggest that a policy of accessing NZS early would be fair or even beneficial to them (page 15). **Rather than being fair, there is a real risk that the policy compounds disadvantage.**
- As the previous paragraphs explain, it would be wrong to suggest that ethnicity is the single driver affecting likely lifespans.
 - The latest period life tables for Māori show a 60-year-old man has a fifty per cent chance of living to age 79. This data is artificial; the outcome is likely to be better¹⁸. Even on this data a Māori man acting on the apparent suggestion that taking NZS at age 60 would be better than delaying to age 65 has a fifty per cent chance of being locked in to the lowest rate of NZS for 19 years or more.

Question 3: weighing up the pros and cons

19. **Evidence in this submission and the arguments in the Discussion Document suggest more cons than pros to Flexi-Super.** The ability to take NZS early is very likely to cause hardship and is contrary to other policy goals. The benefits to being able to defer NZS seem unappealing except to higher rate tax payers. If people taking NZS early are motivated by low income and/or an incorrect perception of their lower life expectancy perhaps associated with low income, Flexi-Super is a policy which benefits higher rate tax payers at the expense of lower income people.
20. Further, **introducing choice is not fiscally neutral:**
- There would be a reduced tax take from higher rate tax payers who defer.
 - There might be a saving from benefits that would otherwise be paid to early takers between the ages 60-65.
 - Even assuming Flexi-Super early discounts and deferral enhancements are set to aim for actuarial and fiscal neutrality overall, there could be a gain or cost to the Crown if the pattern of longevity between those taking early and those deferring was different than expected. The policy requires the Crown to take on this additional risk.
 - Flexi-Super would add complexity and administrative costs to the NZS system.
 - There would be additional cost if the benefits of deferring were given to people who accidentally missed starting payment of NZS at age of eligibility.
 - If Flexi-Super were more successful at encouraging people to leave the labour force early than stay in it later (which is likely) then the economy will suffer through reduced labour force participation.

¹⁸ Statistics New Zealand do not produce cohort life expectancies by ethnic group. Period life expectancies by ethnic group are available but these underestimate life expectancy by not taking account of likely future mortality improvements. The figures used here are from Period Life Table 2010-12 and are not consistent with those used in the analysis of Paragraph 15 which use cohort tables.

Appendix

Paragraph 10 of this submission suggests that the UK has a rationale for persisting with the deferral option which is not relevant as a reason to introduce one in New Zealand. This Appendix explains this point more fully¹⁹:

- Deferral has been an option in the UK for decades, and despite attempts to reinvigorate it in the early 2000s, take-up is low. The UK government recently considered removing the deferral option as part of its planned simplification of state pensions.
- The government has decided to retain a limited version of deferral: to cut-back the value of the incentive probably to half the current level of income enhancement (and so around half of what is proposed for Flexi-Super) and to remove the option to take deferral proceeds as a lump sum (not proposed for Flexi-Super).
- The UK government states its rationale to continue with a deferral option in terms of being a benefit to individuals who decide to continue working after State Pension age. UK policy is very focused on increasing labour market participation among older people, with current levels below those of New Zealand.
- However, a further reason to keep the deferral option is explained by a particular circumstance arising from the timetables of increasing age of eligibility and the introduction of a new state pension in the UK. Deferral enables women whose age of eligibility is increasing (to around 63 years) to enhance their 'old rules' pension so that at age 65 it would be around the higher levels of the new pension²⁰.
- The UK does not have an option to take state pension early.

¹⁹ See Pensions Bill 2013 and DWP (2013)

²⁰ See House of Commons Work and Pensions Committee (2013), para 167 for example

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