New Zealand Society of Actuaries (Inc)

26 February 2016

Financial Markets Policy
Ministry of Business, Innovation & Employment
PO Box 3705
Wellington
New Zealand

By email faareview@mbie.govt.nz

Submission on the Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008

The New Zealand Society of Actuaries (the "Society") welcomes the opportunity to comment on the Options Paper for the Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

Actuaries are experts in identifying and managing the financial implications of risk. As such, they are well aware of the complexities involved in providing financial advice. We have responded in respect of Q5 which asks "Are there any other viable options? If so, please provide details."

The Society's Retirement Income Interest Group has also recently presented at a Society conference on the topic of decumulation and the importance of advice in a retirement context, particularly focussing on the appropriateness of simple "rules of thumb" for individuals with modest retirement savings. I have enclosed a copy of this presentation, which is entitled "Decumulation debate". Further information, including some commentary on the appropriateness of different forms of advice for different individuals, is contained in this presentation.

This presentation follows the paper released by the Society last year titled "Income Streaming in Retirement: Options for New Zealand", which is available on the Society's website (http://www.actuaries.org.nz/) and contains further information, including comment on the rationale for improving access to affordable financial advice at and during the decumulation phase.

The Society would be pleased to provide further information on our submission. Please feel free to contact me by email at society@actuaries.org.nz or by telephone on 027 742 6498.

Yours faithfully
New Zealand Society of Actuaries

Redacted

Richard Beauchamp
President

How to have your say

Submissions process

The Ministry of Business, Innovation and Employment (MBIE) seeks written submissions on the questions raised in this document.

- Submissions on the questions in Part 3 of this paper (relating to the Financial Service Providers Register) are due by **5pm on Friday 29 January 2016**.
- Submissions on the questions in Part 1 and Part 2 of this paper are due by **5pm on Friday 26 February 2016**.

Your submission may respond to any or all of these questions. We also encourage your input on any other relevant work. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

Please include your name, or the name of your organisation, and contact details. You can make your submission:

- By filling out the submission template online.
- By attaching your submission as a Microsoft Word attachment and sending to *faareview@mbie.govt.nz*.
- By mailing your submission to:

  Financial Markets Policy
  Ministry of Business, Innovation & Employment
  PO Box 3705
  Wellington
  New Zealand

Please direct any questions that you have in relation to the submissions process to: *faareview@mbie.govt.nz*.

Use of information

The information provided in submissions will be used to inform MBIE's policy development process, and will inform advice to Ministers on the operation of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

We may contact submitters directly if we require clarification of any matters in submissions.

Submissions are subject to the Official Information Act 1982. MBIE intends to upload PDF copies of submissions received to MBIE's website at ***www.mbie.govt.nz*** and will do so in accordance with that Act.

Please set out clearly with your submission if you have any objection to the release of any information in the submission, and in particular, which part(s) you consider should be withheld, together with the reason(s) for withholding the information under that Act.

If your submission contains any confidential information, please indicate this on the front of the submission, mark it clearly in the text, and provide a separate version excluding the relevant information for publication on our website.

MBIE reserves the right to withhold information that may be considered offensive or defamatory.

The Privacy Act 1993 establishes certain principles with respect to the collection, use and disclosure of information about individuals by various agencies, including MBIE. Any personal information you supply to MBIE in the course of making a submission will only be used for the purpose of assisting in the development of policy advice in relation to this review.

Permission to reproduce

Chapter 3 – Barriers to achieving the outcomes

1. Do you agree with the barriers outlined in the Options Paper? If not, why not?
   Enter text here.

2. Is there evidence of other major barriers not captured in the Options Paper? If so, please explain.
   Enter text here.

Chapter 4 – Discrete elements

3. Which options will be most effective in achieving the desired outcomes and why?
   Enter text here.

4. What would the costs and benefits be of the various options for different participants (consumers, financial advisers, businesses)?
   Enter text here.

5. Are there any other viable options? If so, please provide details.
   As opposed to proposing an alternative option, we would like to draw attention to some complementary thinking which we have been doing in the retirement space. In our previous submission we outlined some of this work, in particular our thinking regarding two possible approaches which may be worth developing in order to help retirees use their resources to meet their individual needs. These complementary options are outlined below:

   1. Freely available, simple, approved, "rules of thumb" for financial decisions such as "how much to drawdown" will be useful for KiwiSavers with small balances and relatively simple financial affairs.

   2. Those with larger KiwiSaver balances or otherwise relatively complex financial affairs will benefit from access to simple forms of approved independent guidance at key times before and during retirement. We use the term "guidance" to distinguish from full financial advice,

although we envisage this guidance being more than pure information and including personalised cash flows.

These considerations cut across the issues outlined in the Options Paper. We support the diagnosis of the issues and barriers which lead to the design of the proposed packages. We urge the assessment of these packages to be widened to cover the specific tests of whether they would make it easier (and lower cost) for those with maturing KiwiSaver balances to access simple forms of guidance, including “rules of thumb" through robo-advice and in face to face settings.

We believe there is merit in exploring a decision tree approach which could simply guide individuals through a series of questions to identify the most appropriate decumulation option for his or her circumstances and preferences, and to signpost how to access further advice. An individual could navigate the decision tree alone via robo-advice, or be guided through it by an on-line, telephone or face to face advisor. We suggest consideration of a standard regulator-approved decision tree and single set of “rules of thumb” for New Zealand to prevent the confusion that a proliferation of competing frameworks may cause.

We have no set view on which package is preferable at this stage, but believe the package selected should enable the provision of these or similar methods of providing new types of guidance to a growing demographic.

The New Zealand Society of Actuaries’ Retirement Income Interest Group recently presented at a Society conference on the topic of decumulation and the importance of advice in a retirement context, particularly focussing on the appropriateness of simple “rules of thumb” for individuals with modest retirement savings. We have enclosed a copy of this presentation, which is entitled “Decumulation debate”. Further information, including some commentary on the appropriateness of different forms of advice for different individuals, is contained in this presentation.

This presentation follows the paper released by the Society last year titled “Income Streaming in Retirement: Options for New Zealand”, which is available on the Society’s website (http://www.actuaries.org.nz/) and contains further information, including comment on the rationale for improving access to affordable financial advice at and during the decumulation phase. Representatives from the Society would be happy to contribute further to the Review.

4.1 Restrictions on who can provide certain advice

6. What implications would removing the distinction between class and personalised advice have on access to advice?
   Enter text here.

7. Should high-risk services be restricted to certain advisers? Why or why not?
   Enter text here.

8. Would requiring a client to ‘opt-in’ to being a wholesale investor have negative implications on advisers? If so, how could this be mitigated?
   Enter text here.

4.2 Advice through technological channels

9. What ethical and other entry requirements should apply to advice platforms?
   Enter text here.

10. How, if at all, should requirements differ between traditional and online financial advice?
    Enter text here.

11. Are the options suggested in this chapter sufficient to enable innovation in the adviser industry? What other changes might need to be made?
    Enter text here.

4.3 Ethical and client-care obligations

12. If the ethical obligation to put the consumers' interests first was extended, what would the right obligation be? How could this be monitored and enforced?
    Enter text here.

13. What would be some practical ways of distinguishing 'sales' and 'advice'? What obligations should salespeople have?
    Enter text here.

14. If there was a ban or restriction on conflicted remuneration who and what should it cover?
    Enter text here.

4.4 Competency obligations

15. How can competency requirements be designed to lift capability, without becoming an undue barrier to entry and continuation in the profession?
    Enter text here.

16. Should all advisers be subject to minimum entry requirements (Option 1)? What should those requirements include? If not, how should requirements differ for different types of advisers?
    Enter text here.

4.5 Tools for ensuring compliance with the ethical and competency requirements

17. What are the benefits and costs of shifting to an entity licensing model whereby the business is accountable for meeting obligations (Option 1)? If some individual advisers are also licensed (Option 2), what specific obligations should these advisers be accountable for?
    Enter text here.

18. What suggestions do you have for the roles of different industry and regulatory bodies?
    Enter text here.

4.6 Disclosure

19. What do you think is the most effective way to disclose information to consumers (e.g. written, verbal, online) to help them make more effective decisions?
    Enter text here.

20. Would a common disclosure document for all advisers work in practice?
    Enter text here.

21. How could remuneration details be disclosed in a way that would be meaningful to consumers yet relatively simple for advisers to produce?
    Enter text here.

4.7 Dispute resolution

22. Is there any evidence that the existence of multiple schemes is leading to poor outcomes for consumers?
    Enter text here.

23. Assuming that the multiple scheme model is retained, should there be greater consistency between dispute resolution scheme rules and processes? If so, what particular elements should be consistent?
    Enter text here.

24. Should professional indemnity insurance apply to all financial service providers?
    Enter text here.

4.8 Finding an adviser

25. What is the best way to get information to consumers? Who is best placed to provide this information (e.g. Government, industry, consumer groups)?
    Enter text here.

26. What terminology do you think would be more meaningful to consumers?
    Enter text here.

4.9 Other elements where no changes are proposed

The definitions of ‘financial adviser’ and ‘financial adviser service’

27. Do you have any comments on the proposal to retain the current definitions of ‘financial adviser’ and ‘financial adviser service’?
    Enter text here.

Exemptions from the application of the FA Act

28. Are those currently exempt from the regime posing undue risk to consumers through the provision of financial advice in the normal course of their business? If possible, please provide evidence.

Enter text here.

Territorial scope

29. How can the FA Act better facilitate the provision of international financial advice to New Zealanders, without compromising consumer protection? Are there other changes that may be needed to aid this, beyond the technological options outlined in Chapter 4.2?
Click here to enter text.

30. How can we better facilitate the export of New Zealand financial advice?
Enter text here.

The regulation of brokers and custodians

31. Do you have any comments on the proposal to retain the current approach to regulating broking and custodial services?
Enter text here.

Chapter 5 – Potential packages of options

32. What are the costs and benefits of the packages of options described in this chapter?
Enter text here.

33. How effective is each package in addressing the barriers described in Chapter 3?
Enter text here.

34. What changes could be made to any of the packages to improve how its elements work together?
Enter text here.

35. Can you suggest any alternative packages of options that might work more effectively?
Enter text here.

Chapter 6 – Misuse of the Financial Service Providers Register

36. Do you agree with our assessment of the pros and cons of the options to overcome misuse of the FSPR?
Enter text here.

37. What option or combination of options do you prefer and why? What are the costs and benefits?
Enter text here.

38. What are the potential risks and unintended consequences of the options above? How could these be mitigated?
Enter text here.

39. Would limiting public access to parts of the FSPR help reduce misuse?
Enter text here.

Demographics

1. Name:
   New Zealand Society of Actuaries

2. Contact details:
   PO Box 10087
   Wellington 6143
   Ph 04 8158179

3. Are you providing this submission:
   ~~☐As an individual~~
   ☐✓On behalf of an organisation

   The NZSA is the professional body for actuaries practising in New Zealand. Our purpose is to ensure the work performed by actuaries in New Zealand meets internationally recognised professional standards.

   NZSA has 251-500 members

4. Please select if your submission contains confidential information:

☐I would like my submission (or specified parts of my submission) to be kept confidential, and attach my reasons for this for consideration by MBIE.

Reason: Enter text here.

Decumulation debate

New Zealand Society of Actuaries
Financial Services Forum
16 November 2015

Contents

- Recap of our conclusions
- International developments and relevance
- Importance of advice
- Rules of thumb

Prepared by the Retirement Income Interest Group of the New Zealand Society of Actuaries:

Alison O'Connell, Catherine Edgar, Christine Ormrod (Convenor), Daniel Musset, Janet Shirley, Joe Benbow, Kelvin Prisk and Mark Channon

Recap of our conclusions

1. Diversity, uncertainty and change through retirement spell problems with any standard or default strategy
2. There is no universal rule for if or when an annuity is better than drawing down money from savings
3. Market innovation is likely to meet the growing market for income-streaming products, but they are unlikely to be reasonably-priced fully guaranteed lifetime annuities
4. A state-provided lifetime guaranteed annuity would be possible, but not straightforward
5. The critical question is less “What products are needed?” but more “What financial guidance is needed?”

In thinking about retirement income needs, New Zealand is unique …

- **Annuity markets exist where they are mandated or encouraged by policy settings, e.g. a low &/or means-tested public pension**.

  ✗ NZS is relatively high and universal.

- **The tax in the decumulation phase will affect the optimisation of decumulation**.

  ✗ NZ is one of very few countries where retirement savings are "TTE".

Value and coverage of State provided pensions

	Relative benefit value (% of AW earnings)				Relative benefit value (% of AW earnings)		
	Basic	Targeted	Minimum		Basic	Targeted	Minimum
Australia	x	29	x	Japan	16	20	x
Austria	x	28	x	Korea	x	3	x
Belgium	x	25	28	Luxembourg	10	31	39
Canada	14	19	x	Mexico	x	x	28
Chile.	16	51	x	Netherlands	30	x	x
Czech Republic	9	x	12	**New Zealand**	**41**	**x**	**x**
Denmark	18	18	x	Norway	x	x	32
Estonia	13	15	x	Poland	x	15	25
Finland	x	x	21	Portugal	x	17	34
France	x	25	23	Slovak Republic	x	22	x
Germany	x	19	x	Slovenia	x	31	13
Greece	x	14	36	Spain	x	20	34
Hungary	x	x	12	Sweden	x	15	24
Iceland	7	20	x	Switzerland	x	22	16
Ireland	37	35	x	Turkey	x	5	37
Israel	15	28	x	United Kingdom	16	20	10
Italy	x	22	19	United States	x	18	x

source: Pensions at a glance 2013: OECD and G20 Indicators

Tax treatment of retirement benefits

Source: OECD Economic Studies No. 39, 2004/2

Country	Individual/ employer	Contributions[2]	Fund income	Annuities	Lump sums
Australia[3]	Individuals	T	7.1%[4]	T/PC	PE/I 6.5%
Australia[4]	Employers[5]	15%	7.1%[4]	T/PC	PE/I 6.5%
Austria[3]	Individuals	T/PE	E	T/PE	T/PE
Austria[4]	Employers	E	E	T	T
Belgium[3]	Individuals	T/PC	E	T/PC	10%
Belgium[3]	Employers	E	E	T/PC	I 6.5%
Canada		E	E	T	T
Czech Republic[3]	Individuals	T/PE/S	E	15%/PE	15%/PE
Czech Republic[3]	Employers	E/S	E	15%/PE	15%/PE
Denmark		E	15%	T	40%
Finland		E	E	T	T
France		E	E	T/PE	T/PE
Germany		E	E	T/PE	T
Greece		E	E	T	T
Hungary[3]	Individuals	T[5]	E	E	E
Hungary[3]	Employers	E	E	E	E
Iceland		E	E	T	T
Ireland		E	E	T/PE	T/PE
Italy		E	12.5%	T/PE	T/PE

Country	Individual/ employer	Contributions[2]	Fund income	Annuities	Lump sums
Japan		E	E	T/PE	T/PE
Korea		E	E	T/PE	T/PE
Luxembourg[3]	Individuals	E	E	T	T/PE
Luxembourg[3]	Employers	20%	E	E	E
Mexico		E/S	E	T/PE	T/PE
Netherlands		E	E	T	T
New Zealand[3]	Individuals	T	33%	E	E
New Zealand[3]	Employers	21%	33%	E	E
Norway		E	E	T	N/A
Poland		E	E	T	T
Portugal[3]	Individuals	T/PC	E	20%/PE	T/PE
Portugal[3]	Employers	E	E	20%/PE	T/PE
Slovak Republic		E	E	15%	15%
Spain		E	E	T	T/PE
Sweden		E	15%	T	T
Switzerland		E	E	T	T
Turkey		E	E	E	5%/PE
United Kingdom		E	E	T	T/PE
United States		E	E	T	T

E = exempt
T = taxed under personal income tax;
PC = partial credit;
PE = partial exemption or deduction from taxation;
S = state subsidy

1. Private pension refers to mandatory or voluntary funded privately managed pension schemes.
2. Tax-deductible contributions are subject to a certain limit in most countries.
3. The tax treatment of the employers contribution is different from that of the employee's.
4. The effective tax rate assuming a portfolio with 60% interest-bearing assets and 40% equities.
5. Mandatory contributions are fully taxed, but voluntary contributions receive tax credits.

… although other countries are also struggling to find the answer

- **Australia**: Financial System Inquiry recommended trustees pre-select a low-cost comprehensive income product to provide regular and stable income stream, longevity risk management and flexibility. Feasibility?
- **UK**: reeling from *Freedom and Choice*; rules of thumb being examined; looking elsewhere for wisdom on drawdown and longevity products; concerns over availability of advice. New normal not till after 2016?
- **US**: fragmented markets with different product features. Drawdown prominent. Complex annuities in the market.

General retirement income framework can be adapted for New Zealand

3. Desired additional income
e.g. drawdown from higher return KiwiSaver; buy annuity?

2. Conservative, flexible income doubles as emergency fund
e.g. bank accounts, term deposits, liquid PIEs/KiwiSaver – c. $100,000??

1. Minimum guaranteed income - NZS

New forms of “Advice” or “Guidance” needed

- **People vary in ways which are fundamental to what the appropriate product(s) is for them**
- **Rules of thumb** may be appropriate for people with modest KiwiSaver balances (the majority).
    - Rules of thumb need to be appropriate for New Zealand longevity and investment conditions - these may change over time.
    - Rules of thumb need to be simply communicated – standardise for NZ to avoid confusion
- **For people with higher wealth**: full advice or a simpler form of approved independent financial guidance should be available at suitable moments during retirement – auto-enrol KiwiSavers with significant balances to a guidance scheme?

Rules of Thumb

- Starting point of $100k to decumulate from age 65
- Overview of the rules analysed
- Modelling assumptions
- Results

Things to consider

- Thoughts on appropriateness of these rules. Any others we should include?
- What criteria should be used to assess these rules of thumb?
- How best to communicate this output and help people come to an informed decision?

Rules of Thumb

Rule 1 – “4% rule”

- 4% of original assets drawn down each year
- No inflation adjustment
- i.e. drawdown each year is $4,000

Rule 2 – “6% rule”

- 6% of original assets drawn down each year
- No inflation adjustment
- i.e. drawdown each year is $6,000

Rules of Thumb

Rule 3 – "4% rule + inflation"

- 4% of original assets drawn down each year
- Withdrawals inflation adjusted each year
- i.e. drawdown in year t+1 is \$4,000 * $(1 + inf)^t$

Rule 4 – "6% rule + inflation"

- 6% of original assets drawn down each year
- Withdrawals inflation adjusted each year
- i.e. drawdown in year t+1 is \$6,000 * $(1 + inf)^t$

Rules of Thumb

Rule 5 – "Straight line over 20 years"

- 20 year withdrawal period
- i.e. drawdown in year t+1 is $Fund_t$ / (20 – t)

Rule 6 – "Straight line over 25 years"

- 25 year withdrawal period
- i.e. drawdown in year t+1 is $Fund_t$ / (25 – t)

Rules of Thumb

Rule 7 – "Life expectancy, yearly recalc"

- Withdrawal period based on life expectancy
- i.e. drawdown in year t+1 is $Fund_t / e_{65+t}$

Rule 8 – "Life expectancy, 3 year recalc"

- Withdrawal period based on life expectancy
- As Rule 7 but drawdown amount only recalculated every 3 years
- i.e. drawdown in years t+1=1, 4, 7, … is $Fund_t / e_{65+t}$

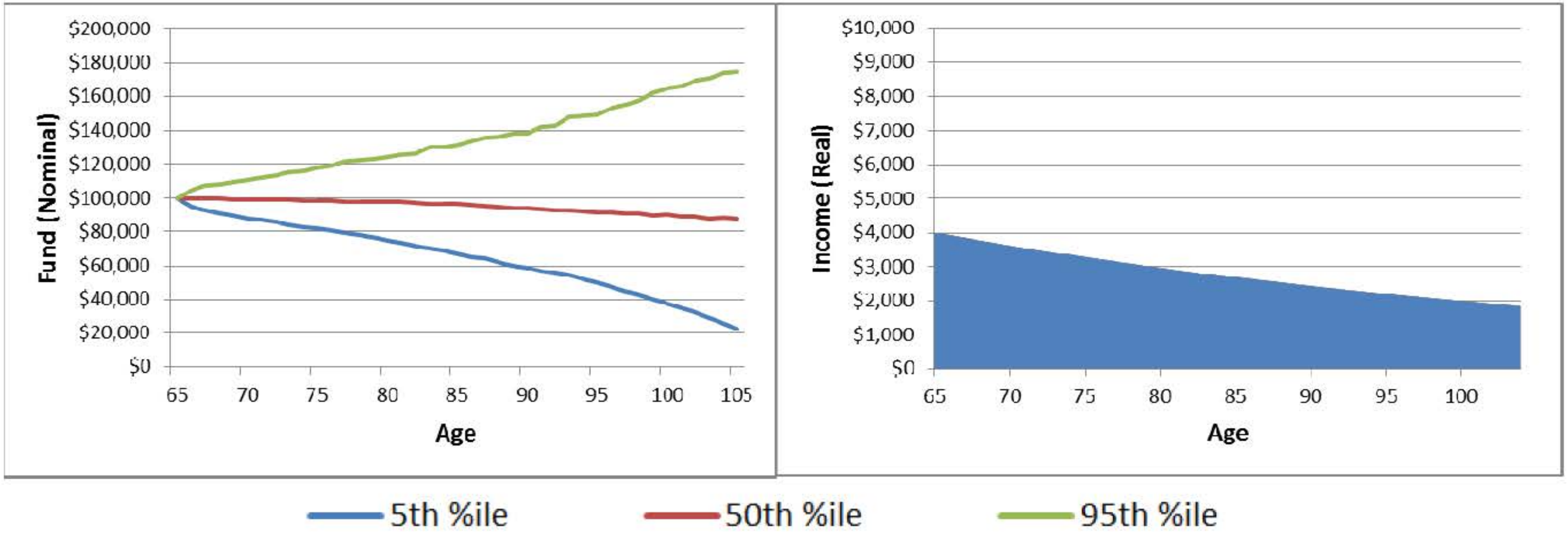
Modelling assumptions

- Lump sum of $100,000 to drawdown from age 65
- Investment returns follow a normal distribution with mean 4% (nominal), standard deviation 3% (fairly conservative)
- Returns are net of tax and investment management fees
- Future inflation of 2% (deterministic)
- 1000 simulations
- Mortality rates derived from Statistics NZ female cohort life tables (updated September 2014) and 2014 (base) national population projection mortality assumptions, based on medium death rates.
- Income shown in addition to any NZ super
- Basic model at this stage – just illustrating concept

Modelling results

Rule 1 – “4% rule”

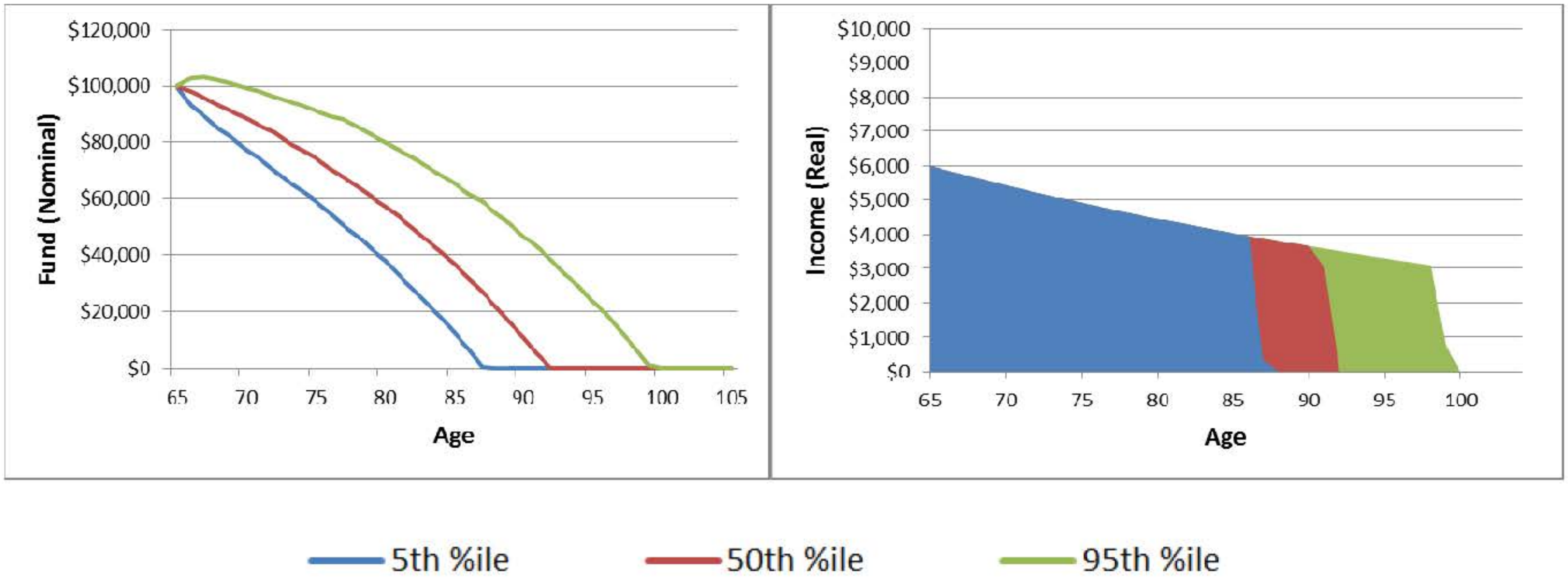
- Very simple
- Almost 0% probability of running out of money
- Wide variation in outcomes for fund
- Could leave a significant inheritance
- Stable income, but doesn’t keep up with inflation



Modelling results

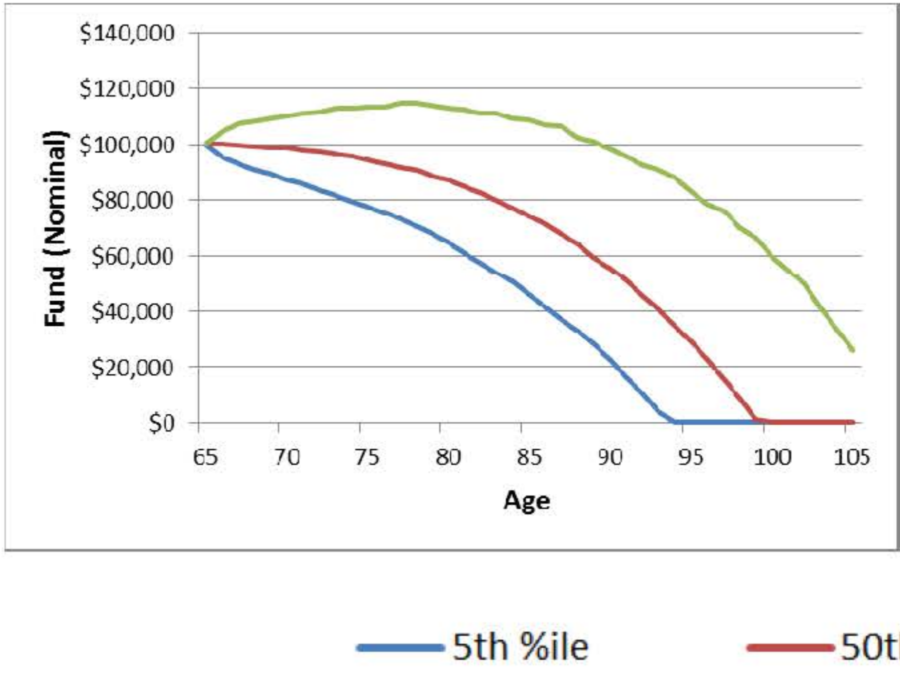
Rule 2 – "6% rule"

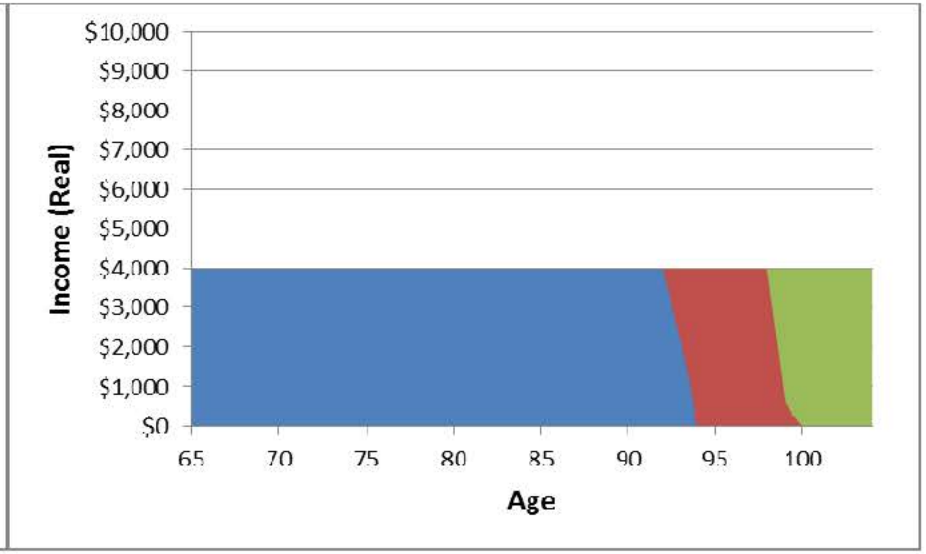
- Better pattern for returning capital…
- …though income still declining in real terms
- Higher chance of running out of money



Rule 3 – "4% rule + inflation"

- Inflation proofed income
- Fund likely to last until age 100
- More complicated for the consumer

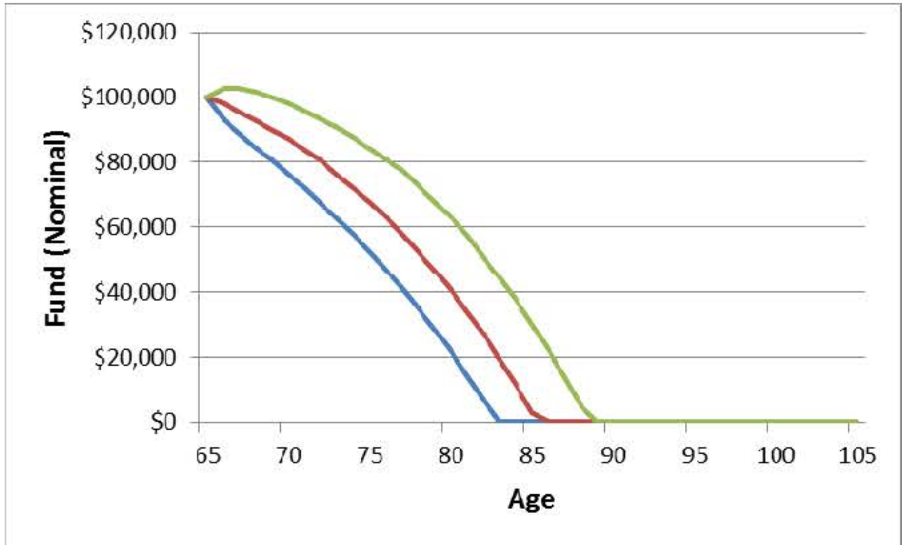


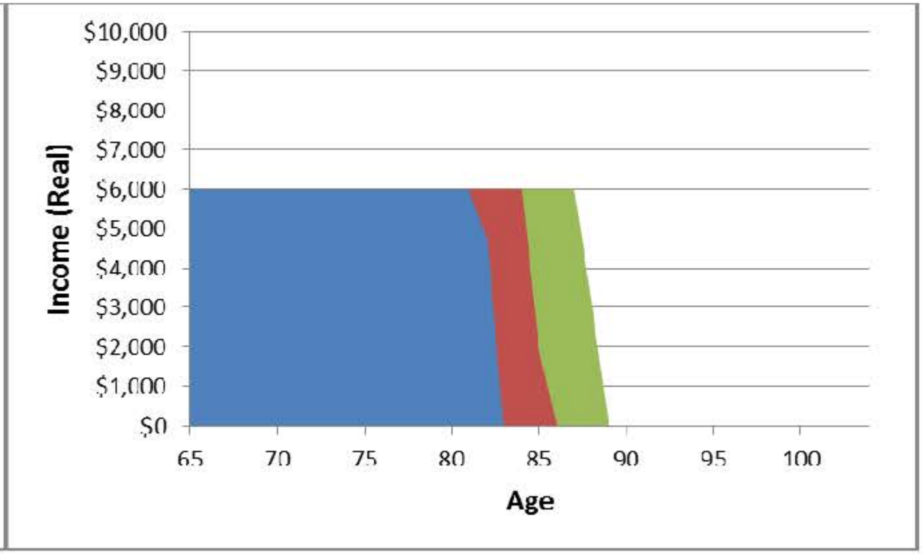


Modelling results

Rule 4 – "6% + inflation"

- Higher inflation proofed income
- Fund likely to last until age 86

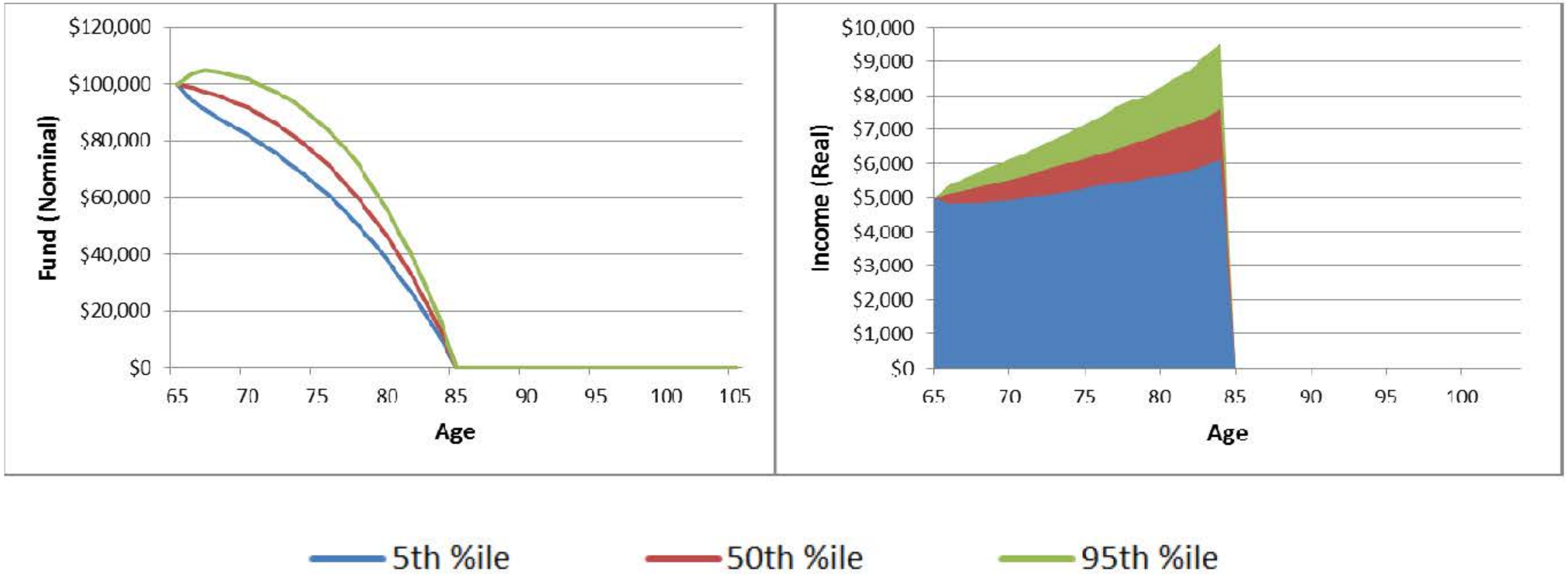




5th %ile 50th %ile 95th %ile

Rule 5 – "Straight line over 20 years"

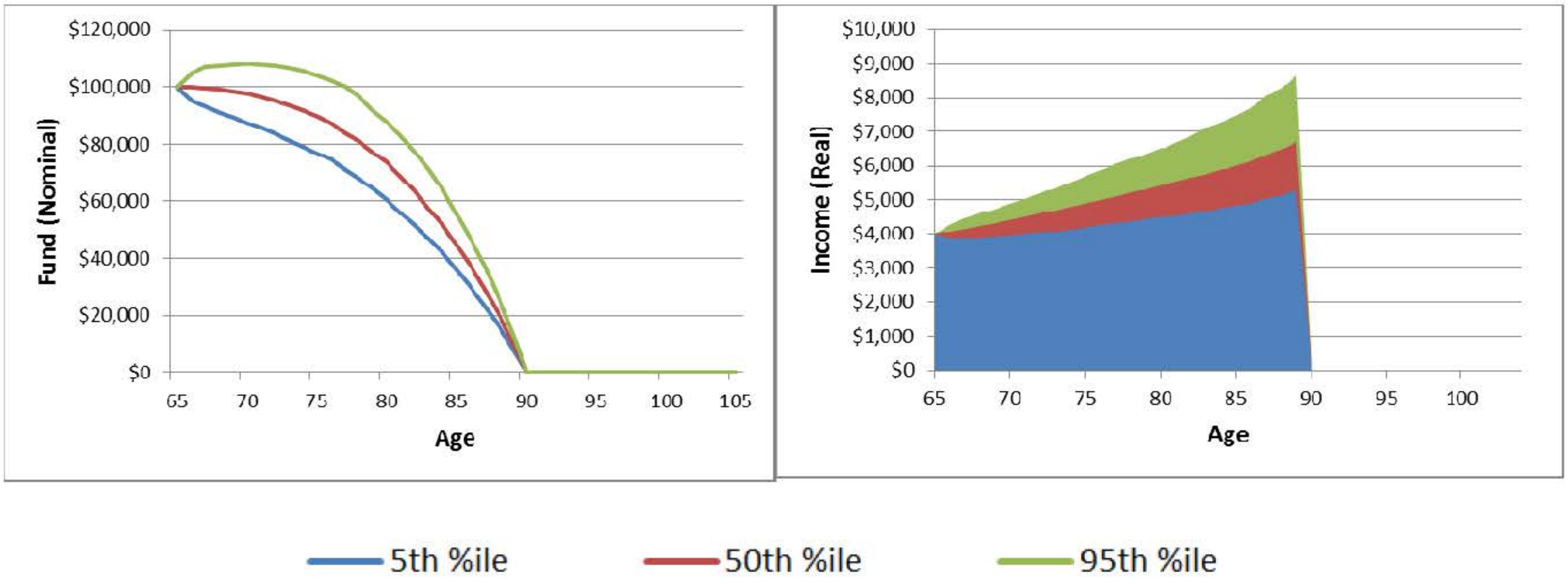
- Provides certainty as to when fund expires
- Real income increases over time
- Relatively straightforward to understand
- Leaves no inheritance and a reliance on NZ super if still alive at age 85



Modelling results

Rule 6 – "Straight line over 25 years"

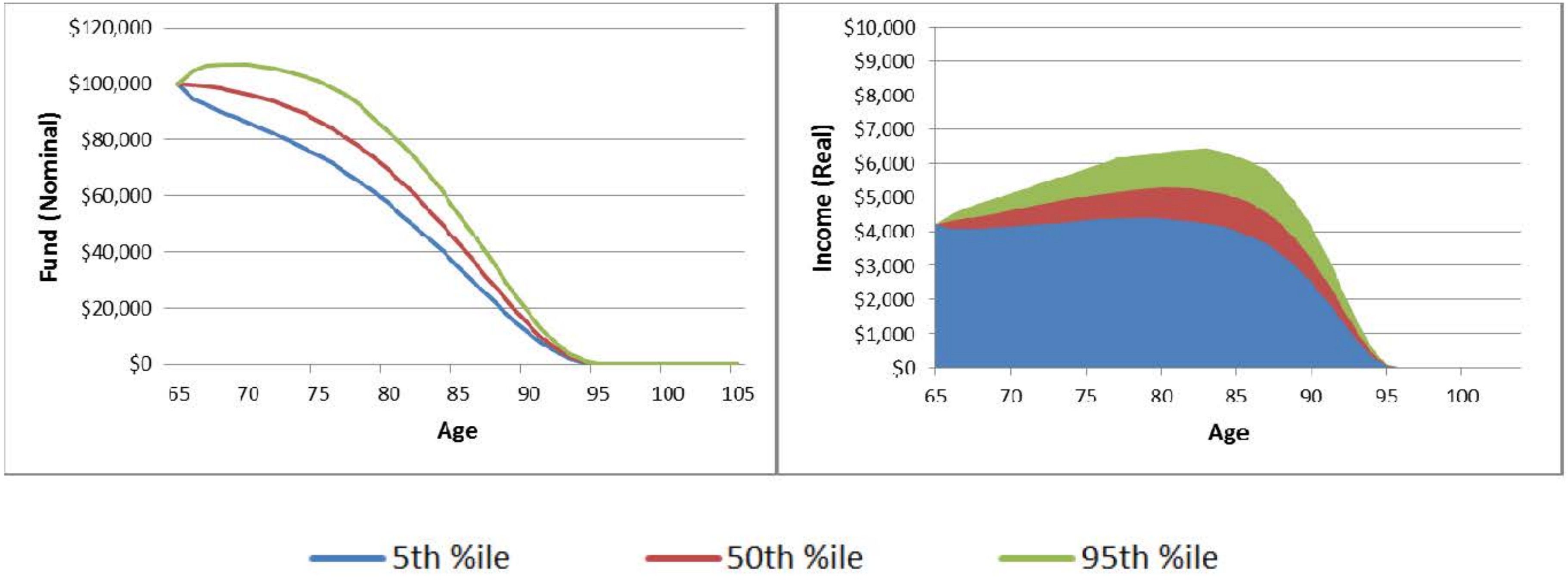
- Provides certainty as to when fund expires
- Real income increases over time



Modelling results

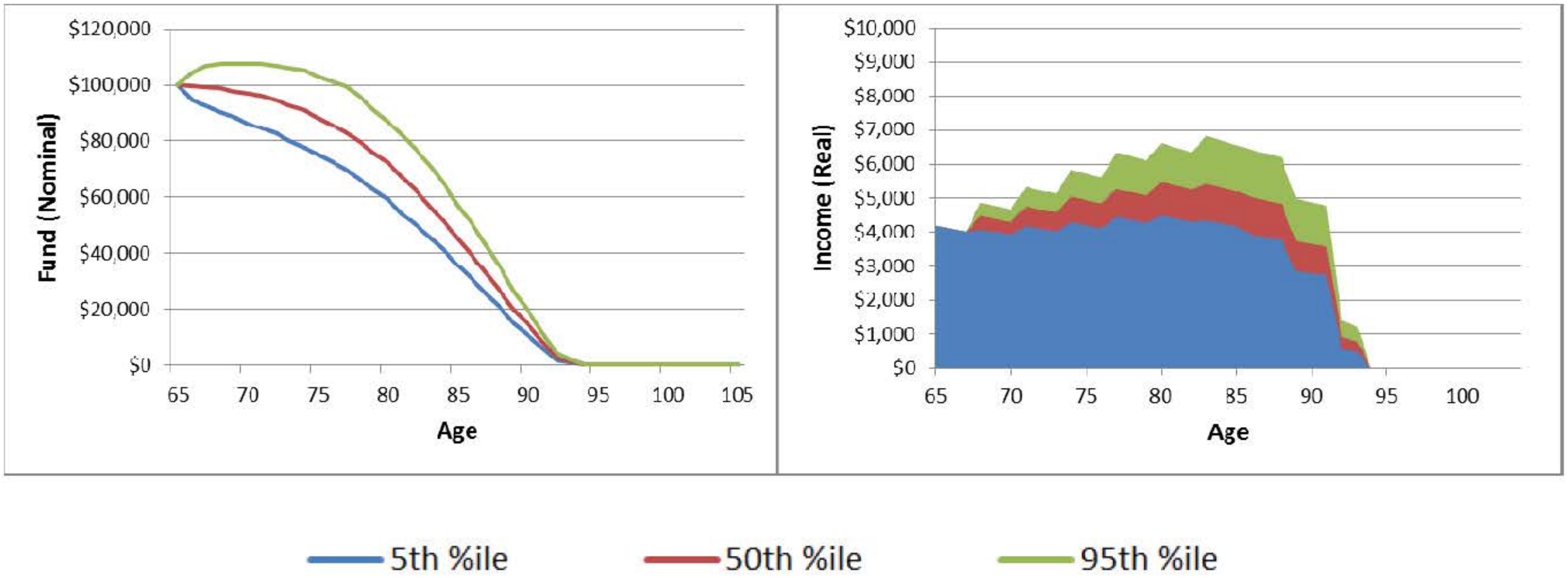
Rule 7 – "Life expectancy, yearly recalc"

- Maintains reasonable levels of real income, though tails off in later years
- "Actuarially" makes sense
- But is it too complicated for a rule of thumb?

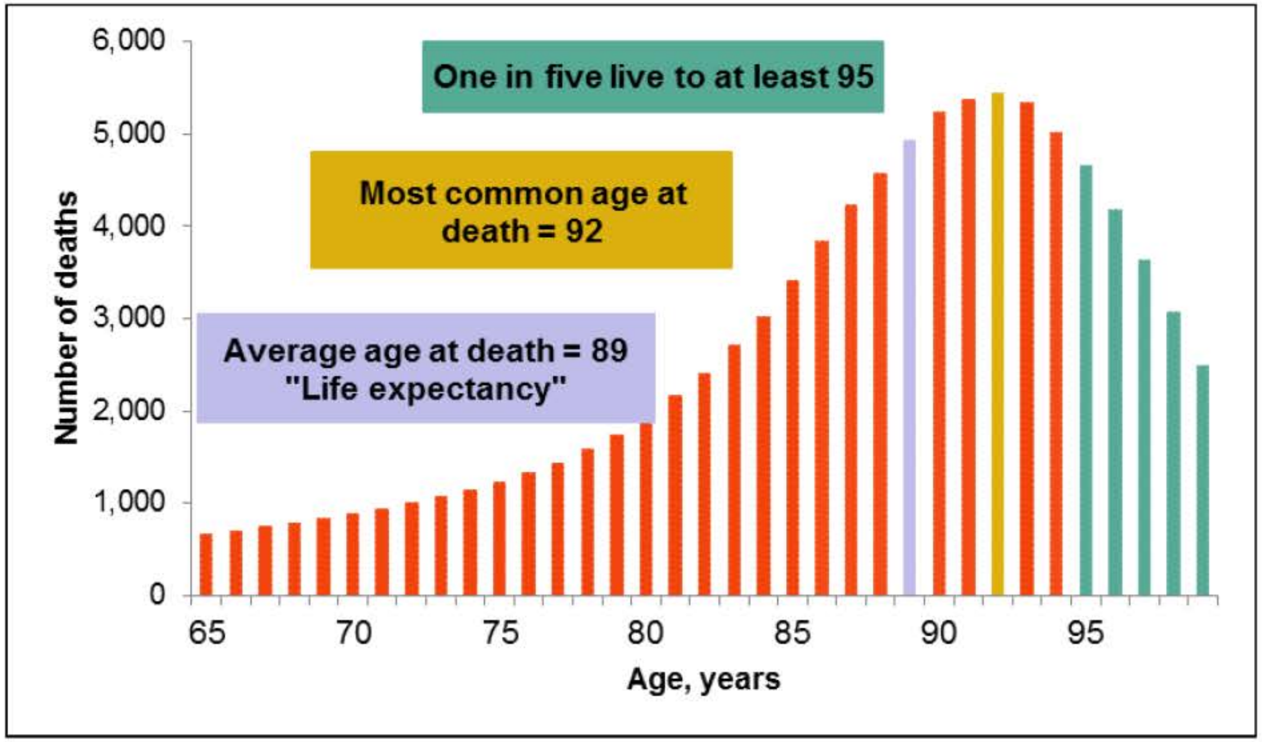


Rule 8 – "Life expectancy, 3 year recalc"

- Doesn't differ much from previous rule
- Recalculation should involve updated mortality assumptions
- Probably too complicated for a rule of thumb?



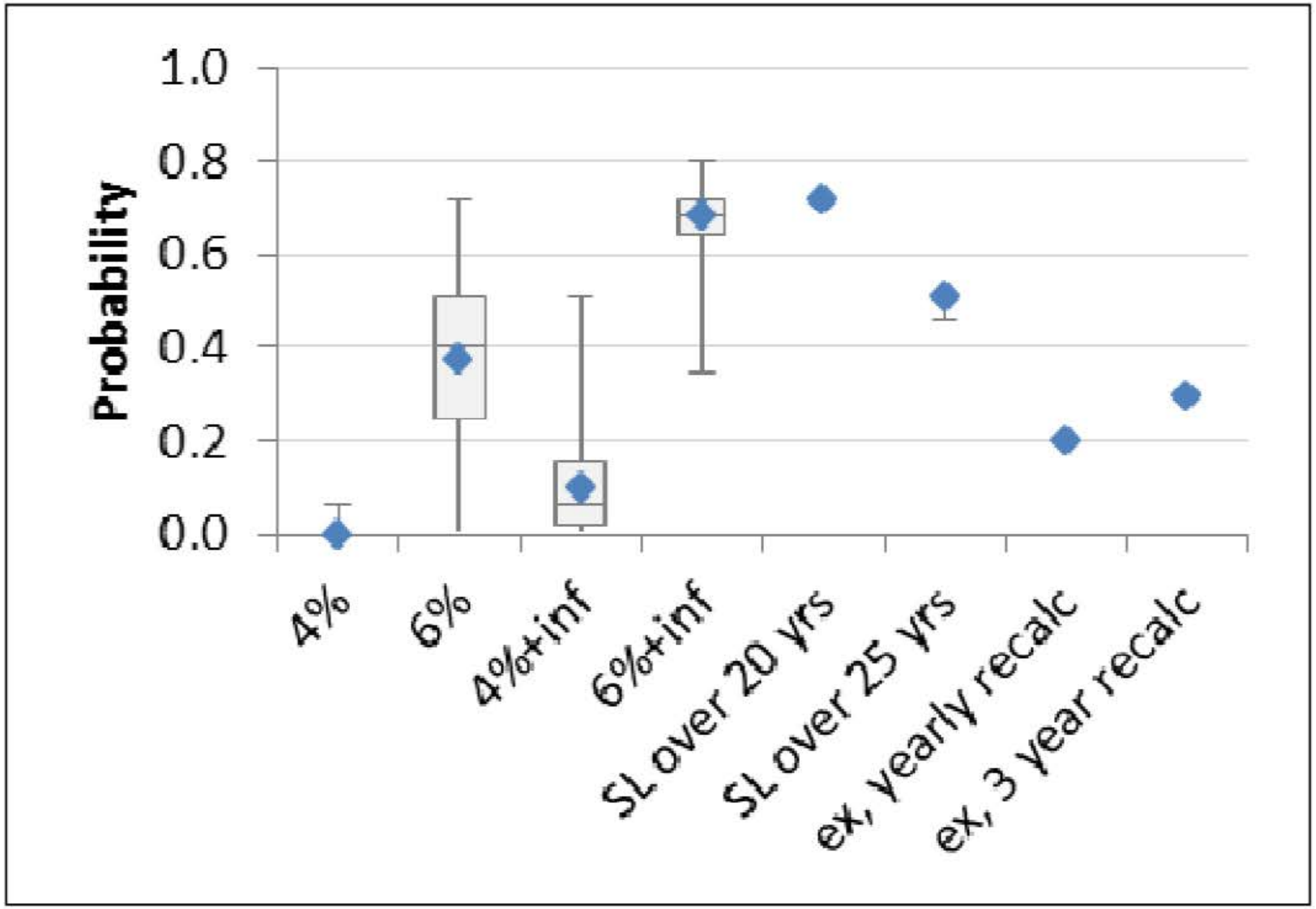
Cohort life expectancy



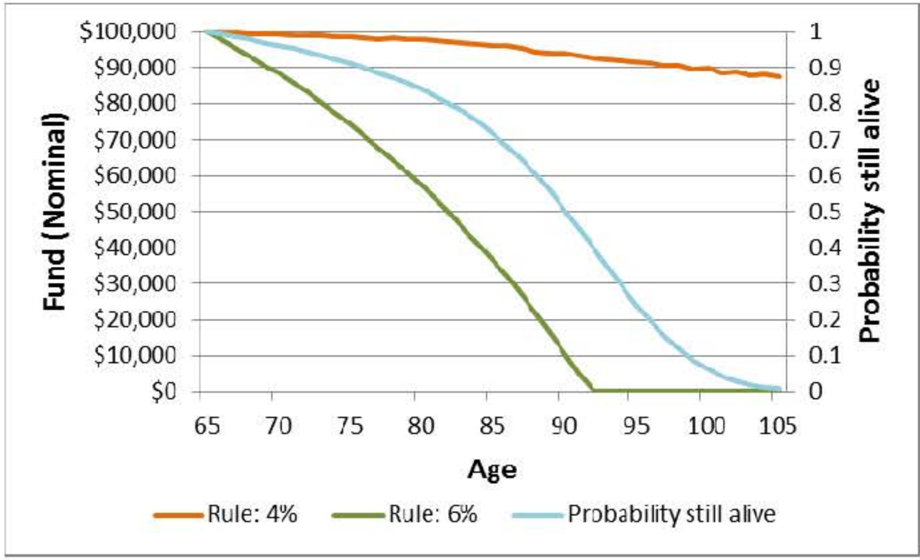
Estimated number of deaths at each age (from 65 to 100) for 100,000 female New Zealanders who reach their 65th birthday in 2015

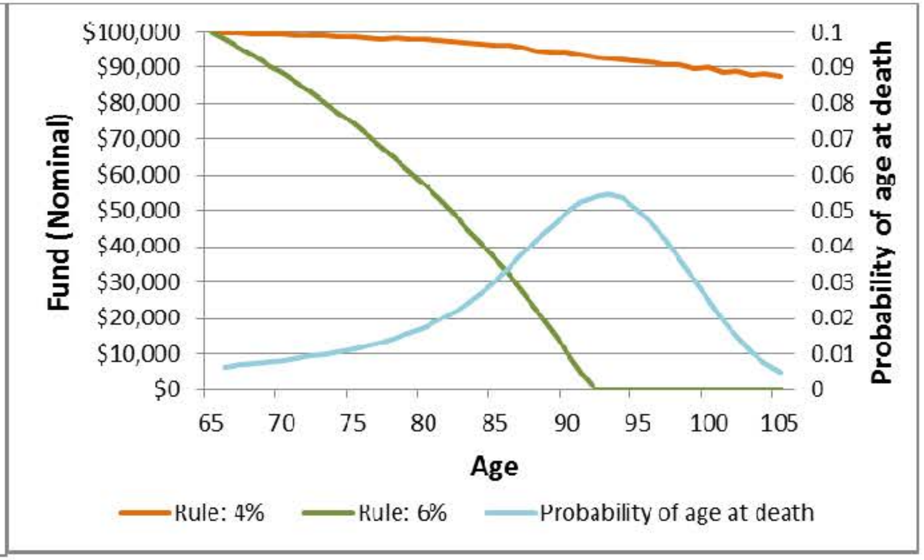
Source: Calculated from Statistics New Zealand cohort life tables (updated September 2014) and 2014 (base) national population projection mortality assumptions, based on medium death rates. Average age at death (cohort e65) from *How long will I live?*

Probability of outliving the fund

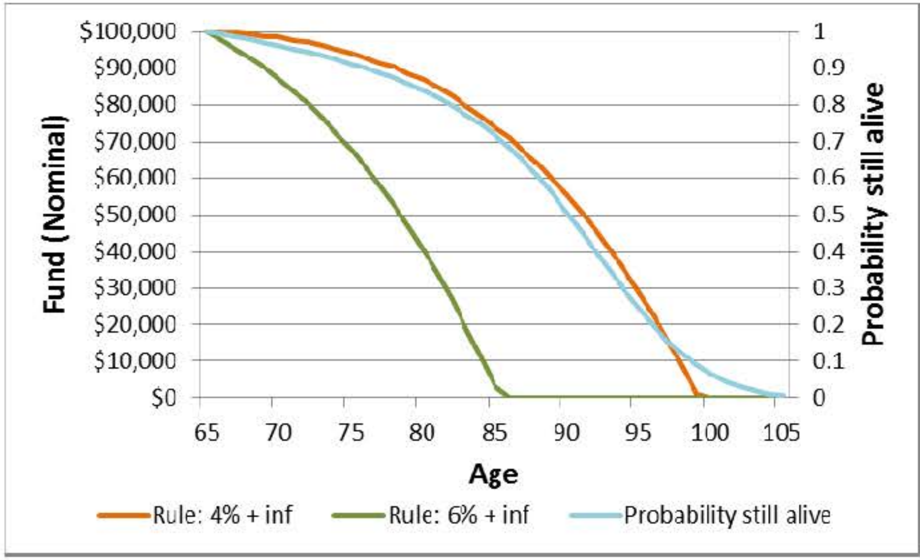


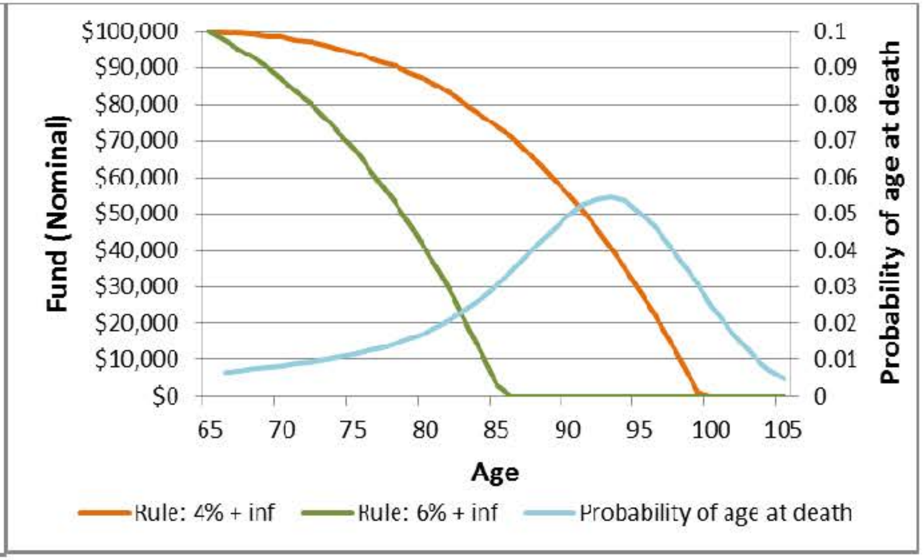
Mean fund size against longevity indicators



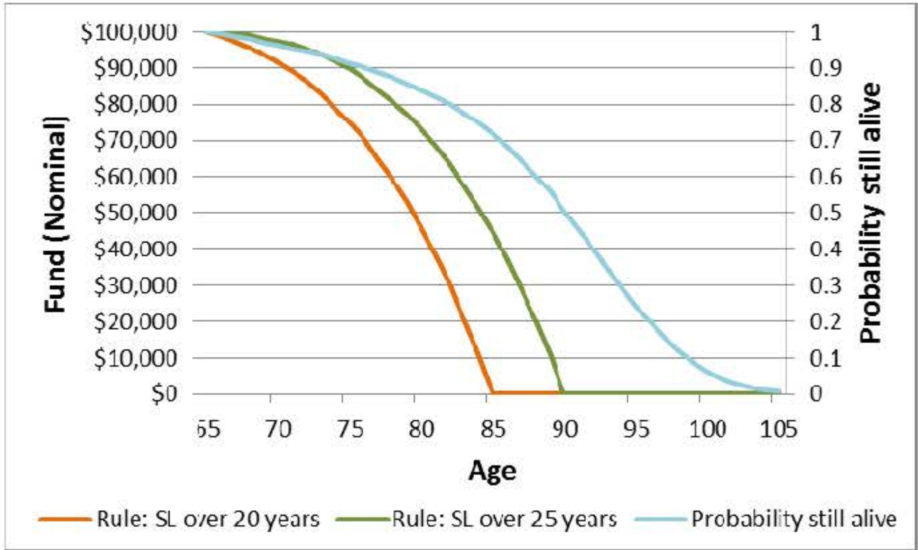


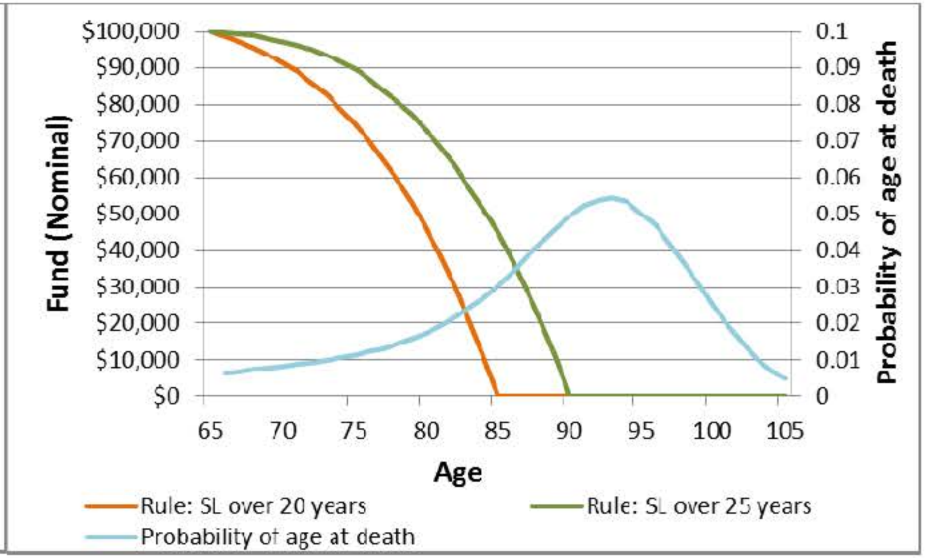
Mean fund size against longevity indicators





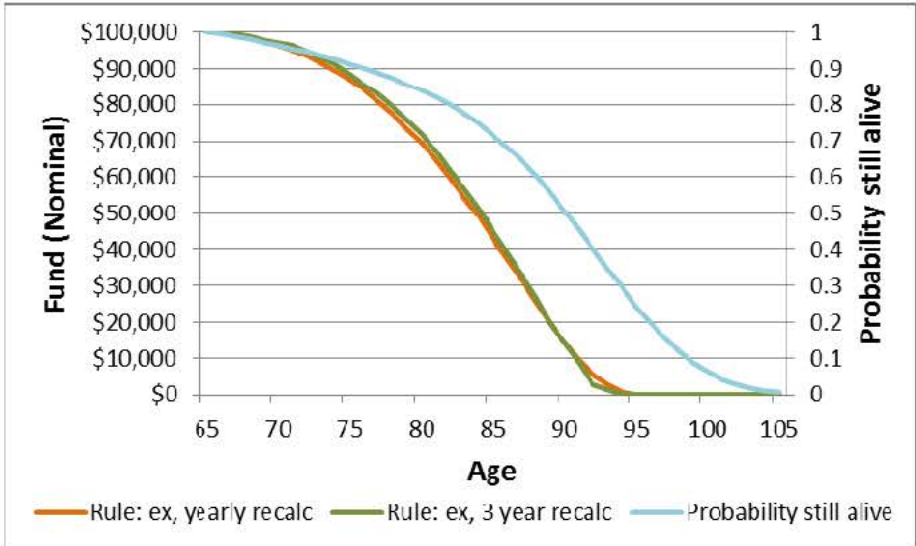
Mean fund size against longevity indicators

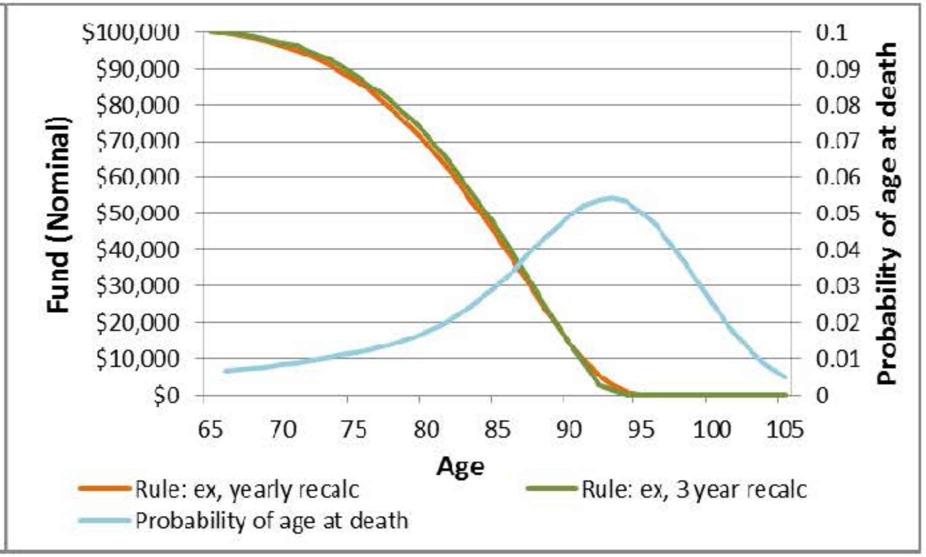




Modelling results

Mean fund size against longevity indicators





Summary

Rule of Thumb	Pros	Cons	Suitable for
4%	- Very simple	- No inflation protection - Capital remains high	Those wanting to retain/bequeath their capital
6%	- Very simple	- No inflation protection	Those wanting to "front-load" their spending
4% with inflation	- Inflation protection - Fund likely to last lifetime - Matches mortality profile well	- Lower income than some other options	Most people, especially if they want to leave an inheritance
6% with inflation	- Higher income with inflation protection	- Fund likely to last average lifetime only	Those happy to spend later years relying on NZ super and not concerned with inheritance
Straight line	- Certainty of expiry	- Higher volatility of income, increasing over time	Those wanting certainty of when fund will expire
e_x	- Real income which tails off	- More complex	Those wanting to maximise income over expected lifetime; not concerned with inheritance

Questions/Discussion

- Are these the best rules of thumb to consider? Any others we should consider?
- What criteria should be used to assess these rules of thumb?
- How best to communicate this output and help people come to an informed decision?
- What other ways can actuaries get involved in the debate?
- More general comments/discussion about the decumulation problem