Brent Sheather's
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SAVING FOR YOUR RETIREMENT – DO YOU NEED TO BE A MILLIONAIRE? Part 1

In the last two columns we looked at the lobbying from fund managers and financial advisors for tax incentives to improve the level of retirement savings and contrasted those unsupported claims with the academic research on the impact of tax incentives which shows that they don't actually increase the overall level of retirement savings. As part of the industry's aspirations for tax incentives, fund managers and financial advisors selling KiwiSaver inevitably state that "we are not saving enough for our retirement." Whilst how much one "needs " for retirement depends very much on the individual and, admittedly, rest home costs in the last years of one's life can be very high (one client of my firm advises they are paying $8500/month), for the average individual these conclusions look to me to be as fallacious as the casuistry around tax incentives.

In a submission to the Tax Working Group fund manager, Milford, said that "saving only 6% of our income to KiwiSaver is not enough to fund a comfortable retirement". Financial advisory firm Newton Ross, also submitting to the Tax Working Group, declared that New Zealanders were saving too little in KiwiSaver - and the lack of tax incentives on the scheme could be to blame. "Once an employee has contributed up to 3% of his or her salary, there is no incentive for him or her to contribute anymore under the KiwiSaver scheme. A contribution rate of 3% for most people is not going to result in a "comfortable" retirement. With the amount of New Zealand Superannuation likely to diminish because of population demographics, the New Zealand government needs to incentivise Kiwis to save more." Continuing that theme, Rupert Carlyon, Managing Director of Koura Wealth, writing in NBR said: "Our KiwiSaver contribution rates are the lowest in the OECD and well below the average OECD contribution rate of 18%. In Australia, contribution rates will grow to 14% of the average salary by 2025. The scary thing is what people will get from their KiwiSaver; many people assume their retirement is sorted because they contribute to the scheme. A recent survey we did found 68% of people saw KiwiSaver as being important for their retirement, and the same survey showed 49% of people under the age of 45 had no savings outside KiwiSaver. Unfortunately, the average Kiwi will only get 60% of their current income (including NZ Super) if they stick to the 3% contribution rate. That requires a massive life adjustment, just when life is meant to get easier. We would like to see changes made to contribution rates to ensure KiwiSaver delivers what people expect of it. In action, this would look like the gradual increase of contributions to 12% - rising 6% over time, in line with the Australian model."

Scary indeed, but is the horror real or imagined? Dr Andrew Biggs, of the American Enterprise Institute, is an expert on retirement saving and he's not afraid. What does worry him however is the tendency for fund managers and financial advisors to consistently overstate the size of the nest-egg required for a comfortable retirement. Dr Biggs recently wrote on this issue in the Wall Street Journal: "According to a new survey from Northwestern Mutual, the average American thinks he'll need $1.46 million in savings to be financially secure in old age. If that were true, it'd be bad news. As USA Today recently reported, the average U.S. adult has saved only $88,400 for retirement. The good news: The survey results are implausible. So are even less audacious goals, such as Fidelity's rule of thumb that households should amass savings equal to 10 times their final salary before retiring. These theoretical figures serve investment firms that have a product to sell, as well as the media, for which bad news makes good headlines. They also serve politicians who distrust private retirement savings." Dr Biggs uses research from the Federal Reserve to rebut this fake news: The Federal Reserve Survey of Household Economics finds that only 3% of US households where the respondents are aged 65-74 were "finding it difficult to get by" with 12% "just getting by". In terms of assets saved for retirement only 19% of retirees had less than $10,000 in savings but 52% of retirees at this asset level said they were either "doing ok or living comfortably". In the WSJ story Biggs asks the question: "Why, then, do seniors report such high levels of security with seemingly paltry levels of savings? One reason is that Social Security benefits are more generous than people think. An average couple retiring in 2022 received total annual benefits of nearly $46,000. While hardly extravagant, a typical couple can expect an income more than twice the elderly poverty threshold before they touch a penny of their own savings. Conventional financial planning also overstates the income seniors need. That owes partly to planners assuming that seniors require the same amount of money throughout retirement. Yet as economists Michael Hurd and Susanne Rohwedder of the Rand Corp. have shown, average household spending drops by roughly 40% from age 65 to 90. Seniors aren't running out of money—spending on gifts and donations increases with age. Retirees simply spend less on themselves than financial planners assume." Biggs finishes by acknowledging that America faces retirement challenges as life spans increase but he says "scaring people with unrealistic retirement – savings goals isn't part of the solution".

As an aside, materially increasing KiwiSaver contributions along with tax incentives similar to the US/Australia/UK would have a number of implications above and beyond the inevitable transfer of savings from taxable to non-taxable vehicles:

- It would increase the level of mortgage debt incurred by households and government debt as a % of GDP as wages were re-directed into equities rather than paying off mortgages and tax receipts available to treasury fell due to the need to fund the tax incentives.
- As per the experience in the USA/UK/Australia substantially increase the complexity of investing with tax planning becoming as important as investment strategy with fee levels rising accordingly due to the greater workload and the financial sector appropriating some of the tax benefits for itself. These moves would constitute a subsidy to the investment sector as large as, if not larger, than the PIE tax dodge regime without which many local fund managers would likely be as competitive as was the PYE TV factory in Waihi.
- Vastly expand the size of the finance sector as a percentage of GDP

Those are big issues in themselves but our focus will just be on how much money one really needs for a "comfortable" retirement in NZ. We will then compare that number with the likely terminal sum achieved by an individual "saving only 6% of our income to KiwiSaver". That will be the subject of the next column. Spoiler alert – the first number is less than the second number.

Brent Sheather is a Financial Advice Provider. A disclosure statement is available upon request. Brent Sheather may have an interest in the companies discussed.