

The New Zealand superannuation fund

Jane Frances and Brian McCulloch explain the plans to cope with the seemingly inevitable increase in numbers of pensioners.

LIKE THAT OF MANY COUNTRIES, New Zealand's population is ageing. The proportion aged over 65 has increased from 9% in 1951 to 12% in 2001 and it is projected to increase to 26% by 2050, during which time the working-age population will decline as a proportion of the total population from 65% to 59%.

While this trend is accentuated by the passage of the 'baby boom' generation, there appears to be a permanent change in the age profile caused by increasing longevity, declining fertility, and later childbearing. This change has direct implications for the cost of New Zealand superannuation, which is a non-contributory universal wage-indexed benefit paid to all citizens over the age of 65. New Zealand superannuation is set to increase from its current level of 4% of GDP to 9% of GDP by 2050. This higher level is comparable to the existing costs of public pensions in several European countries.

Smoothing the transition

Seeking to help ensure the continuation of the existing universal benefit structure, the New Zealand government has decided to establish the New Zealand Superannuation Fund. The fund's purpose is to smooth the transition to the permanently higher long-term cost of New Zealand superannuation.

The Finance and Expenditure Select Committee of parliament is currently considering the New Zealand Superannuation Bill. The analysis below is based on this Bill. The committee may well recommend changes before it is finally passed into law.

Comparison with Irish Stability Fund

International experience, particularly from Ireland and Canada, has been drawn upon extensively in developing the details of the legislation for the New Zealand Superannuation Fund. Like the Irish Stability Fund (outlined in the February 2001 issue of *The Actuary*), the New Zealand Superannuation Fund would be managed on a commercial basis by an independent board. However, there are two key differences.

First, the Irish legislation is not specific about what that fund is to be used for once drawdowns are allowed after 2025, except that the amount cannot exceed the total outlay on social welfare pensions and public service pensions. By contrast, the New Zealand Superannuation Fund can only be applied to paying the New Zealand superannuation benefits specified in the legislation.

Second, the rate of contribution to the Irish Fund is set in the legislation at 1% of GNP, and the Irish minister for finance will determine the rate of drawdowns after 2025. In the case of the New Zealand Superannuation Fund, the rate of capital contribution from the Crown will be calculated annually on the basis of a rolling 40-year moving average of the future cost of New Zealand superannuation. Based on current projections, this would start at about 2% of GDP and wind down to zero by the late 2020s. This same calculation rule provides the basis for drawdowns from the fund after that time, rather than leaving discretion for disbursement of such a large fund with the minister of the day.

The effect of this formulaic approach to fund contributions is that the combined cost of current New Zealand superannuation payments and capital contributions/drawdowns rises steadily from about 6% of GDP (4% current cost plus 2% capital contribution) to the long-term average cost of 9% of GDP by the end of this century when the fund converges toward zero. Using a formula based on future expected costs also means that if elements of the entitlement policy change (for example, the age of eligibility or the payment rate), the required capital contribution would adjust accordingly.

Fund management

An element crucial to the success of this policy will be the appointment of an independent and well-qualified board to manage the fund. Drawing on the legislation for the Canadian pension plan investment board, New Zealand's minister of finance will be required to appoint qualified members from a shortlist prepared by a separate nominating committee. This is a departure from the practice, in both Canada and New Zealand, for other public board appointments, in which the government is not normally limited to a choice from an independently prepared shortlist of qualified candidates.

Investment strategy

Equally important is the investment mandate under which the fund's board must operate. The board would be required to 'invest the fund on a prudent, commercial basis and, in doing so, must manage and administer the fund in a manner consistent with best-practice portfolio management; and maximising return without undue risk to the fund as a whole; and avoiding prejudice to New Zealand's reputation as a responsible member of the world community.'

Clear parallels can be seen with the mandates of other independently managed public funds. A distin-



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guishing feature is that fund investments must avoid prejudice to New Zealand's reputation. This provision was incorporated to reflect the fact that the Crown ultimately owns the fund, and so the actions of the board would reflect on the Crown. The alternative of requiring the government of the day to determine, or to approve, the investment policy was considered to be too open to political influence.

Ethical considerations

The 'avoiding prejudice' provision implicitly requires the board to take account of ethical considerations in its investment decisions. Drawing on the recent changes to United Kingdom pensions legislation, the New Zealand legislation would also require the board to report its policies regarding ethical investment in its statement of investment policies, standards, and procedures.

There are only two significant constraints on the investment of the fund included in the legislation.

First, as for the Irish Stability Fund and the Canada Pension Plan, no controlling interests are allowed. This constraint will not have a significant impact in the normal course of events because investment funds usually avoid taking controlling interests in entities anyway. However, it is important to be clear about it in this case because the Crown, as ultimate owner of the fund, does not want to become the owner of businesses simply because of the decisions of an independent board. Further, it raises a host of issues about government guarantees and public accountability of government-controlled entities that are best not encountered.

The second constraint is that, except with the approval of the minister of finance, the fund would not be permitted to borrow, or hold any financial instrument that places a liability or contingent liability on the fund or on the Crown. Unlike the Irish fund, the New Zealand Superannuation Fund would not be precluded from investing in its government's securities, if the board chose independently to do so.

Performance review

In addition to the auditor-general's office exercising its full auditing mandate over the fund, a similar approach has been adopted as for the Canada Pension Plan of requiring periodic reviews of the performance and operations of the board by an independent person.



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Next steps

New Zealand has a unicameral system of government, so the next step will be for the legislation to be reported back to parliament and a vote taken on its passage into law. After that, a nominating committee would be appointed to prepare the shortlist of qualified candidates for appointment to the board. Once the board is appointed, it would be able to establish its investment strategy and its fund management infrastructure. Contributions to the fund are intended to be put aside from 1 July 2001 and will be held by the Treasury until the board is ready to take over and implement its investment strategy. □

More details on the fund, including a copy of the legislation and an Excel model of the fund, can be obtained from www.treasury.govt.nz/release/super. Specific queries can be addressed to brian.mcculloch@treasury.govt.nz or jane.frances@treasury.govt.nz.