Households' attitudes to saving, investment and wealth

Janice Burns and Maire Dwyer

Household saving – the difference between household disposable income and household consumption – has declined over the last two decades and now appears to be negative. On the other hand, household wealth has risen. This has been due to rises in house prices, which have pushed up the equity held by households in residential property.

While a downward trend in household saving is evident across many developed countries, New Zealand's household saving rate has been among the lowest, or the lowest, for much of the last 20 years. Also, New Zealand households have lower levels of wealth than households in Australia, Canada, the UK and the US. While New Zealanders' wealth in housing, as a proportion of disposable income, is around the same as for these other countries, it seems that on average New Zealand households own less financial wealth (e.g. shares and bonds).

In view of this pattern, the Economics Department of the Reserve Bank decided to undertake a small-scale exploratory study of households' attitudes to various forms of investment. The idea behind this work was to get a view, from a sociological perspective rather than an economic perspective, on why wealth in New Zealand is held in the way it is. This perspective contributes to the Economic Department's ongoing programme of work on the financial position of households.

Two consultants, Janice Burns and Maire Dwyer, undertook the initial study. The study was designed to provide an overview of:

- what is known about investment attitudes and behaviour in New Zealand; and
- factors that are likely to influence saving and investment attitudes and behaviour.

The study drew on three sources of information:

- a review of policy settings and published studies on saving;
- interviews with individuals knowledgeable about investment and saving behaviour and attitudes ('key informants'); and
- background interviews with a small number of 'consumers' aged between 30 to 50 years. It was felt that people in this age group were more likely to be turning their attention to investment issues than people in other age groups.

The report notes that wealth is more unevenly distributed than income. Financial skills are also unevenly distributed. People with high financial knowledge generally have higher education, higher incomes and their own homes. A recent survey showed that only 15 percent of the population had advanced financial knowledge, in that they understood basic and advanced financial concepts, were in control of their borrowing and debt, and were financially confident.

The report looks at the role of property and financial investments. According to the report, the decline in the share of wealth held as financial assets has been driven by a number of factors, including the following:

- a valuation effect from house prices, which rose strongly relative to prices of financial assets;
- a continuing desire by New Zealanders to own their own home;
- a rise in average dwelling size;

- historically high returns from rental property compared to shares;
- the absence of price crashes for housing in recent decades, in contrast to shares;
- the ability of owners to use their house as collateral in order to buy additional property;
- perceptions that there are tax advantages regarding property;
- perceptions that there are lower risks in 'what you know', which for many people is residential property;
- unease by investors regarding the recent performance of financial assets (eg managed funds), the level of fees, and the complexity of products;
- a decline in recent years of employer-based superannuation schemes; and
- the lack of any compulsory retirement saving.

The advantages of being in property – especially in recent years when house prices have shown such strong growth – appear to be widely acknowledged. However, the risk that the future may not reflect the past and that house prices might undergo a sharp downward correction does not appear to be widely understood.

Studies suggest that consumers often have difficulty in ascertaining the quality of investments, and faced with lots of information, some people come up with 'rules of thumb' on how to proceed. The consumer interviews suggested that advice from family and friends was also important regarding investment decisions. Only a small proportion of people appear to use professional financial advisers.

The report suggests that households will tend to be better at saving when there is a regular and contractual element to it – like paying off a mortgage, or contributing to a superannuation scheme.

The report concludes that a number of factors may have a positive impact on investment in financial assets in the future. These include: the introduction of Kiwisaver, lower taxes on managed funds, and recent changes in the regulatory regime for the financial sector. The consultants emphasise the need for clear information regarding financial products. They also strongly support educational measures to increase financial literacy.

An edited version of the report's findings is printed below. The views expressed in the paper are those of the authors and do not necessarily reflect the views of the Reserve Bank. The full report is available from www.rbnz.govt.nz.

The findings are grouped into a number of sections. Each section refers to information from the three sources of information – published studies, key informants, and consumers.[1] Key informants are listed in Appendix 1.

1 Factors impacting on the level of household savings

The studies

A wide range of factors impact on household saving, spending and debt. Saving can be motivated by: provision for retirement and bequests; precautionary motives; and the need to acquire a target level of savings. Saving can be undertaken for its own sake and tends to increase with income. The saving constraints on low earners are mirrored in the distribution of wealth, with wealth of Pacific and Maori New Zealanders being substantially lower than that held by Pakeha and Asian New Zealanders.

The proportion of income saved varies with age and is lower for those with children. (Scobie *et al*, 2005; Skilling and Waldegrave, 2005). Cohorts also exhibit different savings patterns due to the differential effects of policy and socio-economic factors (Cook, 2006; Scobie and Gibson, 2003).

1 Given that only eight consumers were interviewed as part of this exploratory study, their views are presented largely for illustrative purposes.

A broad range of factors impact on saving. The provision of universal superannuation at age 65 in New Zealand means that people with low or modest incomes are unlikely to be motivated to save in order to provide for their retirement because the level of national superannuation will provide an equivalent or better living standard. Scobie *et al* (2004) concluded that for "(many of) the lowest 40percent of the income distribution...additional saving for retirement would not be a preferred strategy, assuming they were aiming to smooth their consumption over the lifecycle".

A worldwide phenomenon is that individuals feel wealthier as their homes increase in value, and this, along with the ease of borrowing against revalued homes, leads to increased spending (*The Economist*, 2004). Housing is also costing more; dwelling values, particularly the land component, have increased, and so have expectations of house quality and size. The size of mortgages, and their duration, will have increased as a consequence.

Higher rates of tertiary education – which could perhaps be counted as another form of investment – have also contributed to increasing debt.

It has also become easier for households to accumulate debt through a greater diversity of credit products, including flexible mortgages and credit cards. This, along with the rise in the costs of servicing mortgages, unrealised wealth effect of increases in house values and the increase in government saving are all likely to have contributed to the fall in net household savings over recent years (Hodgetts, Briggs and Smith, 2006).

Observation of actual savings behaviour led to Richard Thaler restating the rules that people use to guide their saving and spending as:

- Live within your means. Do not borrow to increase consumption except during well-defined emergencies (such as unemployment).
- During emergencies, cut consumption as much as possible.
- Keep a rainy day account equal to some fraction of income. Do not raid the account except in emergencies.
- Save for retirement in ways that require little self-control.
- Borrow only on the security of a real asset.[2]

Thaler's "rules of thumb" suggest that people are better at saving where there is a contractual element – paying off the mortgage or contributing to superannuation schemes – and that the lack of strong motivation to save for retirement justifies having a contractual element for such saving (Easton, 2004).

Views from key informants

Key informants differed in their views about whether there was a "savings deficit" in New Zealand. One mentioned that student debt has created a culture of debt acceptance and several mentioned pressures to consume. Another informant said we did not have a savings culture. For Maori and Pacific people, the absence of investor role models (outside those investing in land and housing) was mentioned.

On the other hand, several informants drew attention to the difficulties some people had in saving for a house, let alone further investments, given their incomes. One informant said that many people saw investment in their children as an important investment in their own future.

Several informants did not consider there was a problem, from an individual point of view, with household savings being too low. Points to back this up included that:

- for many low-income people, being on national superannuation was not much different from the living standard they were used to;
- for many people, obtaining a house was a reasonable and achievable investment for retirement and the market in equity withdrawal products was beginning to grow;
- paying off debt was properly a top priority and locking people into too much saving could lead to worse debt and/or lowered living standards; and

[2] Thaler, Richard (1992) *The Winner's Curse: Paradoxes and Anomalies of Economic Life*, Princeton University Press, cited in Easton, Brian (2004) "Lock into savings" New Zealand *Listener*, October 23, p54.

- many people planned to provide for an adequate income in retirement by continuing to work, at least part time, after 65.

2 Decline in the share of wealth held as financial assets

The studies

Several factors have contributed to the decline in the share of wealth held as financial assets over recent years.

Firstly, the large increase in the value of housing assets throughout most of the country, and the tendency for the growth in the value of housing assets to outstrip the growth in the value of most other assets, means that, if nothing else changes, they become a larger share of total asset value. From 1979 to 2000, housing equity was a relatively constant share (55 percent) of total net wealth but this rose to 68 percent in 2004 with the boom in house prices (Van Zijll de Jong and Scobie, 2006).

> **Consumer view**
>
> *Interviews with consumers showed two views of property – one view was that "rental property is a low risk and low effort option" and the other that rental properties bring unwelcome "responsibility and hassle". No one disputed the recent past and current returns on property.*

Secondly, people are choosing larger dwellings (on a per head basis). The average number of people per dwelling declined from 2.8 people per household in 1991 to 2.7 people per household in 2001 and is predicted to further decline to 2.4 people by 2021 (Scion and Branz, 2006). The average dwelling size is also increasing; the proportion of four, five and six bedroom dwellings increased from 19.3 percent in 1991 to 25.8 percent in 2001 (Statistics New Zealand Census data, cited in Scion and Branz, 2006, p16). For new residential dwellings, the average floor area increased from 139 square metres in 1991 to 176 square metres in 2002; in other words, new stand-alone dwellings were approximately 50 percent larger in 2005 than they were in the early 1990s.

At the same time, the proportion of homes that are owner-occupied has dropped so there is a concentration of investment in property in a smaller proportion of the population. However, owner-occupation of housing, while it has fallen, is not markedly out of line with that of other comparable countries. Private ownership of rental properties has risen substantially, and is now at a similar level to that in Australia (Scobie *et al*, 2006).

Thirdly, returns on rental housing have been better than average returns on shares, bonds and cash over the 18 years to 2006.[3] A sample survey found that rental stock in New Zealand is overwhelmingly owned by landlords who have one (42 percent of landlords) or two (20.6 percent of landlords) rental properties. Only 5.6 percent of landlords owned 10 or more properties. Three-quarters of rental properties are owned as personal assets, 14 percent within family trusts and 12.5 percent within companies (Saville-Smith and Fraser, 2004). More recent analysis in Auckland concurs that the small investor is primarily motivated by capital gain and identifies most private rental market investors as couples over 45 and earning more than $70,000 per year (DTZ and NZIER, 2007).[4]

By contrast, average returns on financial assets have been unimpressive. *Consumer*'s analysis of returns to balanced managed funds between 1994 and 2004 prompted them to note that "the big balanced funds gave poorer returns than term deposits...More worryingly, if the decade has been so bad for clients, why are balanced funds still being promoted as good five year savings options?"[5] In all cases, the funds fell short of the Retirement Commission's expectation that balanced products would, on average, yield a net return of 2.6 percent above inflation.[6]

3 www.garethmorgan.com/performance/longterm.asp.
4 Data is from a small sample of 35 investors and a regional cut from the Survey of Family Income and Employment (SoFIE) The data is therefore indicative only.
5 www.consumer.org.nz.
6 http://www.sorted.org.nz/home/sorted-sections/investing/different-returns-from-different-product-types

Consumer view

Only one interviewee was currently investing in managed funds, and this was seen as being a low-effort option. One had a small share portfolio in New Zealand businesses and one had shares in a New Zealand business owned by a friend. For other investors, financial assets were beyond their experience and capacity for personal control.

Two people mentioned the time required to effectively invest in the share market. The market needs to be regularly monitored and this was considered to be extremely personally time-consuming. A few people had experience of friends who did well through committing a lot of time to the investment.

The structure and level of fees and the limited disclosure of information about fees is also likely to be a factor in the reduction in assets held in managed funds. *Consumer* notes that fees are almost never shown in dollar terms so it is difficult for investors to understand them, or make simple comparisons across different funds.

Skilling and Waldegrave (2005) comment that the withdrawal of specific supports to saving – eg the fall in employer-based superannuation schemes – is an important part of why financial asset holdings are so low in New Zealand. There is some evidence that workplace superannuation is associated with greater total retirement wealth (Scobie and Le, 2004). Hawke (2006, p3) similarly comments that we should not be surprised that New Zealand has relatively little private savings in financial assets since "the main vehicle for participation in equities around the OECD world is a pension fund".

Consumer view

Superannuation was discussed in all the interviews. One couple would not consider superannuation (including Kiwisaver), based on personal experience of a scheme losing money. Others were positive and a few already had a scheme, and most actively welcomed Kiwisaver. A majority of those interviewed had done some work to understand Kiwisaver and the choice of a provider. Having a financial inducement to join was clearly important.

Widdowson and Hailwood (2007), however, attribute the concentration of household assets in housing, and the growth of household debt levels, to a need for increased financial literacy. Higher financial literacy would allow householders to choose better options for managing their debt and have a better understanding of the risks associated with concentration of wealth in particular asset categories.

Views from key informants

Key informants generally concurred that property has been an attractive investment proposition over the last two decades. The steady growth in house values, with no price crashes in recent history, was an obvious counterpoint to the more chequered performance of shares.

One informant said:

"If (someone) buys two to three rental properties, and these increase in value by an average of 5 percent pa and they pay interest only...no other investment can match these returns."

Other factors cited as making property investment attractive, and reflected in the experiences and view of consumers interviewed, included:

- the opportunity for leverage against the value of one's own house to buy a second property;
- the possibility that small players in the rental housing market avoid tax on capital gain; and
- the relatively low cost of entry into the rental property market.

Informants saw tax advantages in property investment, both through the option of setting up a Loss Attributing Qualifying Company and through untaxed capital gains. One informant noted that while some property investors focus on the income stream, others are focused on capital gain. There was also a view that many people who trade in property in a small-scale way, by, eg, buying apartments from plans and then selling when built, should, but may not, be paying tax on capital gains.

Consumer view

Most consumers were either aware or somewhat aware of both the current tax advantage of property versus other investments and had read of possible changes to the tax treatment of investment property. However, this information did not figure large in decision making.

Several informants drew attention to our history. The close relationship that both Maori and other New Zealanders have with land and property was noted. Moreover, even from early times, government policies, including those related to initial European settlement, tended to reinforce and support home ownership. Other government policies have include dthe provision of State Advances loans, the capitalisation of family benefits, and tax rebates for first-home buyers. Until recently, we have had higher home ownership rates than comparable countries. Several informants mentioned that home ownership was still a strongly internalised goal for New Zealanders, including Maori and Pacific people.

Consumer view

The importance of the experience of family and friends was a theme throughout the interviews. A person's 'cultural' approach to investment was very much influenced by these experiences. Family and friends not only influenced the range of 'comfort' that a consumer had with different investments, but they were also consistently used as key sources of trusted advice.

The concept of investment itself is likely to have some cultural specificity. Two informants spoke of the difference between cultural and financial investments – some land for Maori is a cultural rather than a financial investment. The ability for some New Zealanders to have access to money for family purposes is also important.

Consumer view

A Maori consumer favoured "having some money available to provide informal loans to her family".

Provisions that enable owners to evict tenants swiftly in order to sell a property make rental properties a more fungible and hence desirable asset and, in addition, strengthen the desirability of home ownership. Other factors cited as reinforcing the attractiveness of property investments included the DIY culture and the familiarity people had with property through home ownership.

One informant raised the absence of any compulsory retirement saving, and the relatively low level of employment-based superannuation, as possibly having led to investment in housing being higher than it otherwise would be. Kiwisaver was seen as having the potential to shift the balance towards financial assets.

On the other hand, another informant commented that most people had taken on board the strong messages about paying off their mortgage and student loans and it might therefore be difficult to get people to buy into Kiwisaver or to take account of any message about diversifying investments. This point mirrors the behavioural economists' view discussed later that, in the light of complexity, people are likely to operate on the basis of simple "rules of thumb".

Informants identified a number of barriers to investing in financial assets:

- The sharp falls in 1987 and 2002 in the values in stocks and shares, and the perceptions of lower returns and greater risks across these products. "People don't trust shares and business investment – everyone knows of failures."

- The size of, and fallout from, the 1987 share market crash, including a loss of trust arising from subsequent trials and prosecutions.
- Declines in the value of managed funds in the 2001-2004 period, which made it hard to attract people back to these investments.
- Recent increases in the value of the New Zealand dollar, which have meant a drop in returns from overseas investments, particularly in the US.
- The complexity of products and people's uncertainty about the products.
- The view that managed funds involve "lots of people taking cuts along the way".
- The fact that managed funds can take up to a week or longer to cash up, and that this is a risk factor during a downturn.
- The 33 percent tax rate on earnings in funds (this will be set at an individual's tax rate from October 2007 and reduce to a maximum of 30 percent from April 2008).

A couple of informants commented that they wished they had gone into property instead of managed funds, on the basis of the respective yields on these investments.

Another informant said that if the Reserve Bank or government wanted more investment in the productive sector, they needed to look at the incentives to invest in businesses. The informant drew attention to the negative impact of high interest rates on investments and profit.

3 Financial literacy

The studies

Financial knowledge contributes to skills in budgeting, money and investment management, and financial planning. Financial literacy has been defined as "the ability to make informed judgments and to take effective actions regarding the current and future use and management of money". Widdowson and Hailwood (2007) break this down into:

- basic numeracy skills;
- an understanding of the benefits and risks associated with particular financial decisions including spending, borrowing, leveraging and investing;
- the ability to understand the trade-off between risk and return, the attributes of different types of investments, the benefits of diversification and the time value of money; and
- the capacity to know when to seek professional advice and to know what to ask and be able to understand the advice given.

The ANZ-Retirement Commission survey found that financial knowledge varied widely in New Zealand (Colmar Brunton 2006). It found the population split into three equal-sized groups of low financial knowledge, medium knowledge and high knowledge. As a general pattern, the higher the financial knowledge group, the higher the proportion of people having higher education, higher incomes, and owning their homes. Around 15 percent of the population had advanced knowledge, in that they understood basic and advanced financial concepts, were in control of their borrowing and debt, and were financially confident.

Consumer view

Almost all the consumers interviewed had a relatively high personal or family income. However, most people appeared to have undergone a sharp learning curve in relation to making their investment decisions. As well as holding discussions with trusted and experienced family and friends, people used the web or professional advisers who they either knew of or had targeted because of their particular investment expertise. In most cases it appears that people asked for advice once they had made up their mind on their investment preference.

One said that she "had always used friends and family for advice and chooses those to ask based on their own ability to manage money". She also commented that she was not sure how she would go about choosing a good adviser.

The ANZ-Retirement Commission survey also found that 75 percent said having a variety of investments was a way to reduce risk, but 20 percent considered investing only in property was a way to reduce investment risk. In addition, around a half of respondents indicated that they would invest lightly in an investment offering above normal returns and, if nothing adverse occurred, would commit themselves more fully without any further investigation. Sixty percent of respondents had a current will, and one-third had an enduring power of attorney.

Widdowson and Hailwood (2007) report that a poll commissioned by the Reserve Bank of New Zealand found that 60 percent of respondents (87 percent of those under 30) expected the government or Reserve Bank to bail out a collapsing bank, and that over 80 percent of those surveyed were either not aware of mandatory disclosure by bank and non-bank deposit takers, or did not use disclosures for decision-making.

At this stage, there is no definitive, comparative data from which to judge whether New Zealanders' levels of financial literacy are similar to those in comparable countries. There is also no data to indicate how literacy has changed over time although the Retirement Commission intends to replicate the 2006 survey of Financial Knowledge. The Commission's on-line surveys of its Money Management website www.sorted.org.nz suggest that frequent users progress in literacy and money management.

Consumer view

One interviewee said that in spite of having done as much research as they could before buying their investment property, it was all well beyond their or their immediate family's experience – and to some extent they "were flying blind".

Views from key informants

Key Informants generally thought there was scope to improve financial literacy in New Zealand. A useful distinction made was that while basic budgeting skills are vital, and within the grasp of most people, being able to read and vet investment statements is likely to always be a less common, specialised skill.

While one informant considered that financial literacy here was likely to be similar to that in the UK, USA and Australia, most thought literacy was likely to be lower in New Zealand than in comparable countries, or indicated that they could not generalise.

Several informants saw current low literacy as a product of the relatively simple financial world of the recent past, with one commenting that older people – the "mum and dad" investors – had grown up with a much smaller range of products than exist now. Another drew attention to the relatively small New Zealand share market as an example of the small role of these assets in our investments.

Literacy was seen as particularly important to ensuring people could manage and consolidate debt. Several informants saw it as likely that products that provided an opportunity for hands-on involvement – such as on-line banking, on-line options for buying shares, and the introduction of Kiwisaver – are likely to lead to improved financial literacy. The website www.sorted.org.nz was also referred to positively as an education tool. Getting basic financial literacy established at school was seen by several informants as being key to higher overall literacy standards. Improving financial literacy was seen as being particularly important for children in households where there is low income and/or no savings/investment experience.

4 Complexity of, and information about, investment products

The studies

At the best of times, investment products are complex and returns are uncertain. It is difficult for consumers to ascertain the quality of the alternatives. As discussed earlier, most people, when faced with lots of information they aren't sure how to process, come up with rules of thumb on how to proceed.

Literature on behavioural economics points to many investors being backward looking – something that may explain continued optimism about property investments – and that consumer investment decisions are influenced by swings between optimism and caution, by a bias towards the status quo (the investments they already have), and by the way investments are framed or described (Grimes, 2005).

Consumer view

The interviews supported the view that lower 'risk' is more likely to be associated with investment products that people feel familiar with in some way.

Thaler and Cronqvist found that, when Sweden partially privatised its social security scheme, Swedes who actively invested their own pensions chose more expensive, less diversified funds than those picked by the default plan. To quote Richard Thaler, "...there's no reason to think that markets always drive people to what's good for them. Markets also drive people to what's good for the people selling" (Stewart, 2005).

The complexity of the market and products, as well as the costs of switching products, set up demand-side limitations that mitigate competition in the investment market. Grimes notes that "the New Zealand market appears particularly susceptible to the marketing of complex, high-fee products that may be inappropriate for consumers' needs". He also notes that "...if this pattern of savings behaviour (New Zealanders holding a small proportion of their net wealth in financial products) is to alter, New Zealand investors need to be able to place greater trust in the range of investment products on offer, and particularly on the investment advisers who help direct investors into available products". (Grimes, 2005, pp18-20).

A gap in the New Zealand market is the provision of independent and expert financial advice and comparisons of investment products and performance. *Consumer* produced some Managed Fund surveys for its paying clients in 2004 and 2005, and the Retirement Commission is in the process of producing a comparison of fees, and the impact of fees on earnings, for the different Kiwisaver providers. One factor regarding this gap is likely to be the absence of effective demand, with people being unwilling to pay for advice, given that no advice can eradicate risk. Independent advice based on comparisons is expensive to produce and update and, unless undertaken with considerable care, could risk litigation.

Consumer view

Only one consumer had paid for independent financial advice.

Litigation risks also limit the role of the media in the case of a poorly performing company (Hargreaves, 2007). The Securities Commission is also constrained in its ability to act. For example, as evidenced in the case of the recent Bridgecorp receivership, a firm first has to inform the Commission that it is in default and then be given the chance to comment on the proposed cancelling of prospectuses, before the Commission can cancel any prospectus (Securities Commission, 2007).

View from key informants

Informants considered information about financial products could be improved, and the lack of good information contributed to a low-trust environment. Key informants were generally keen on better disclosure about products, particularly fees, charges, and what terminology means. Examples that informants had come across included people who:

- thought that an A credit rating was the top rating, not realising there was a triple A rating;
- thought that secured debenture stock was completely secure and without risk; and
- only consulted trusted people that they knew, or who were from the same cultural background, even if this meant paying more charges.

Several informants expressed a lack of confidence that the industry would willingly disclose information in a simple form, given the prevalent practice of producing unduly complex financial statements. One informant considered that a campaign to simplify information, associated with awards for simple investment statements, might be helpful. Another view was that there could be a standard disclosure statement developed that all products needed to comply with.

Most informants pointed to commission selling of products as leading to a conflict of interest for advisers, given that they are acting for both the buyer and the seller. The incentives are to promote products with the best commissions. It was noted that commissions or incentives such as bonuses existed right across the sector, including in the large financial institutions and banks. One informant identified the way forward as being the growth of fee-for-service advice – advice independent of any relationship to particular financial products. Another informant considered that most New Zealanders would not be prepared to pay for advice directly, so commission selling was likely to continue.

Several informants identified current disclosure provisions as being inadequate, with one saying you needed to know the questions to ask. Two noted there was no "cool-off" period when purchasing investment products.

In contrast to information about fees and charges, the quality of investment management in funds was identified as one area where it was very difficult to have adequate disclosure and information, due to ongoing changes in the mix of investments and recruitment of investment personnel. One informant said careful investment in managed funds would work fine if you were a sizeable player and could play close attention to the decisions of fund managers. This was not, however, feasible for individual investors.

A further issue raised was the lack of commitment by government officials to simple information systems and that, in desiring to cover all bases, their requirements on financial statements might also reinforce their complexity.

5 Quality of financial institutions, products and the regulatory framework

The studies and policy settings

Government's regulatory interest stems from the complex nature of financial products, the size and significance of investments for households, and the importance of products working well for businesses.

While New Zealand has a wide mix of financial products, New Zealand's small size means there are likely to be more challenges in achieving economies of scale. New Zealand has a small share market, which means it is difficult to get a well-balanced portfolio just from New Zealand shares.

New Zealand is in the process of introducing a more robust regulatory framework for the financial sector. This framework, and the financial sector itself, has come in for criticism both within New Zealand and internationally.[7] *Consumer*, for example, in its analysis of managed funds raised the issue of how fees are managed and communicated.[8]

Kiwisaver, a new voluntary retirement savings regime that is subsidised by government now, and in future by compulsory employer contributions that will be phased in between 2008 and 2011, has the potential to significantly alter the quantity and nature of financial investments.

Major reforms have addressed disclosure, insider trading and the powers of the Securities Commission to take action in the case of breaches of the law (Diplock, 2007).

Recent reviews covering financial products and providers, and the regulation of financial intermediaries (advisers) in New Zealand, have been completed. These aim to ensure New Zealand meets its international obligations and achieves a more effective and consistent regulatory environment that improves consumer confidence and keeps compliance costs to a minimum.

The Taskforce on the Regulation of Financial Intermediaries (2005) found that, in comparison with the comparable

[7] Jane Diplock (2007) notes the IMF and World Bank had a number of concerns about New Zealand's regulation of the financial sector in 2003.

[8] See www.consumer.co.nz.

jurisdictions of Australia, the UK, Ontario, British Columbia, Hong Kong, Singapore and Ireland, New Zealand has the lowest level of regulation of financial intermediaries, the least state involvement in regulation and the least state involvement in sanctions and remedies. New Zealand regulations are product/sector specific and therefore variable, in contrast to the UK, Australia and Ireland, which have regulation covering all investment activity.

Government has announced that legislation will implement the following:

- registration of all financial service providers;
- licensing of trustees that act as supervisors of debt issuers, non-bank deposit takers, and collective investment schemes;
- improved prudential supervision of non-bank deposit takers, who will need to be licensed by the Reserve Bank; and
- provision for a comprehensive approach to consumer dispute resolution and redress.

A second round of legislation will be undertaken later.[9]

From 1 October 2007, earnings in managed funds will be taxed at each investor's specific tax rate and capital gains on New Zealand shares and certain listed Australian resident company shares will no longer be subject to tax. Specific regulations have also been introduced for Kiwisaver providers.

Even when all these changes are bedded in, the regulatory regime will remain relatively light-handed by international standards.

Grimes's investigation of ways to improve trust in the retail savings industry recommended a number of other prescriptive actions:

- a standard disclosure form for all investment products;
- a mandatory requirement for investment advisers to declare their fees and income (from all sources) for a client's product, and a mandatory requirement to offer a range of similar products to clients;
- an increase in the Retirement Commission's educational activities;
- the Retirement Commission or some other body undertaking a regular 'mystery shopper' programme amongst investment advisers and reporting the results publicly; and
- the creation of a financial ombudsman to cover complaints across a broad range of services (Grimes, 2005).

Views from key informants

Several informants raised the importance of having more robust regulations in place to provide a better balance of power between the sellers and buyers in the financial product market. An effective regulatory framework, quality of information about products, and financial organisations operating with integrity, were seen as important to building more public confidence in financial assets and to making it easier for people to judge the quality and risk of what is on offer, and to gain redress in the case of unfair practice.

Several informants commented on the high fees and poor performance of larger managed funds. One noted the emergence of better-performing niche investment companies.

Another issue canvassed was the education of fund managers. One informant considered that, in the future, all financial advisers, both the small operators and those working within large finance companies and banks, would end up with diplomas in financial planning. Another informant was not so optimistic, noting that banks and the larger finance companies had been resistant to setting up industry training and had large internal training systems and a vested interest in their people being good at marketing their products.

Informants differed in their views on the proposed changes to regulations. One felt it was important to retain a relatively light-handed approach to regulation and to focus on eliminating the power imbalance, while another supported relatively light-handed regulation because more complex systems had not proved effective elsewhere.

[9] For more details, see http://www.med.govt.nz/templates/ContentTopicSummary____27653.aspx.

Several informants thought Kiwisaver was likely to assist the financial market to develop and become more profitable. One described the expected process as more interest in shares pushing up prices, which would then attract more companies to sell shares in the New Zealand market, which in turn would attract more buyers.

One informant considered that the absence of sizeable not-for-profit operators (such as cooperatives or trusts) in the financial product market in New Zealand meant that there was a lack of an alternative paradigm in the market and less real choice for the public.

6 Concluding comments

Changing investment environment

A number of factors are likely to work together over the next few years to increase the assets of, and improve public confidence in, the financial sector:

- the introduction of Kiwisaver, and its associated inducements;
- the application of lower tax rates to earnings in managed funds; and
- forthcoming regulatory changes that will improve disclosure and prudential arrangements applying to financial products, providers and advisers.

Research informants and broader conversations in the course of this project suggest that the necessity to choose a Kiwisaver provider is leading people, often previously uninformed or unfamiliar with the financial industry, to investigate and discuss their options. This is likely to increase financial literacy and create greater familiarity with non-property investment products. All interviewees were aware of Kiwisaver and most were actively considering their options. The opportunity for 'structured' or 'contractual' savings seems appealing.

The consumers interviewed seemed to know that investment involves risks that can be reduced but not eradicated. Those who had chosen to invest in property often cited 'lower risk' as a key consideration. Perceptions of relative risk may be currently informed or reinforced by reported instability and volatility in worldwide markets and the seeming lack of control New Zealand investors have over these movements. This may confirm property as the low-risk option.

Consumer view

Having control over their own investments was a key theme of the interviews. One woman was very forceful in her view. She was "not convinced that the people who manage the money are experts – they are just employees".

One consumer said that when they sold their land they would "hold term deposits – investments are looking risky at the moment".

Investment in property vs financial/business products

Property investment emerged as a fairly logical investor response to perceptions of relative risks, returns and the desire for personal control over investments. In addition, property is seen by New Zealanders as the only investment that can be funded by borrowing – generally against an owner-occupier house.

While consumers did not indicate a strong association between tax and investment options, the attractiveness of "free money" in Kiwisaver was evident. It may be that, over time, behaviour could be influenced by increasing the attractiveness of financial products. This could be assisted by:

- ensuring that publicly funded league tables and/or consumer checks on investment products, providers and advisers are available;
- providing for a 7 day "cooling off" period when specified financial products are purchased;
- mandatory "plain English" disclosure of products, fees, and investment performance on a simple, standard template; and
- developing more sophisticated financial literacy for the future through education in schools.

As far as property investment is concerned, some key informants suggested better enforcement of existing provisions of tax capital gains on individuals, trusts or companies that trade in property. However, interviews with consumers (bearing in mind the small number) indicated that this might not be currently key in their decision-making.

Overall, the review supports a view that adequate income and money management skills are important precursors to sound saving and investment behaviours.

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Appendix 1

Key informants

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