



**BUSINESS SCHOOL**

**Retirement Policy and Research Centre**

# New Zealand Superannuation policy and overseas state pensions<sup>1</sup>

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<sup>1</sup> Commissioned report for the 2016 Retirement Commissioner's 3 yearly review of retirement income policies.

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## Table of contents

|  |    |
|--|----|
| Executive Summary.....   | 3  |
| 1. Overview .....  | 4  |
| The state pension in New Zealand .....                                     | 4  |
| Historical context of eligibility .....                                    | 5  |
| Demographic trends .....   | 6  |
| The ageing of the old.....   | 7  |
| Migration trends.....  | 7  |
| Fiscal considerations.....   | 9  |
| 2. Legislative environment .....   | 9  |
| Portability of NZS .....   | 9  |
| Section 70 of the Social Security Act .....                                | 10 |
| The rationale for the DDP .....  | 11 |
| 3. Operation of the DDP.....   | 11 |
| How much NZS is saved? .....   | 12 |
| Spousal deductions .....   | 13 |
| Appeals against the operation of the DDP.....                              | 14 |
| 4. Classification of overseas pensions .....                               | 15 |
| Determining what is a state pension .....                                  | 15 |
| Reciprocal agreements and the DDP .....                                    | 16 |
| Particular issues for UK .....   | 18 |
| Particular issues for Australia.....                                       | 19 |
| Particular issues for Canada .....   | 20 |
| Particular issues for China .....  | 20 |
| 5. Challenges to current policies .....                                    | 21 |
| 6. Policy framework for reform .....                                       | 22 |
| 7. A fair way forward? Canvassing the options.....                         | 24 |
| Option 1 Enhancing the status quo: adapting the DDP .....                  | 25 |
| Option 2 Voluntary DDP and pro rata NZS .....                              | 26 |
| Option 3 Pro rata entitlement for all applications for NZS .....           | 27 |
| Option 4 Abolish DDP and increase residency requirements to 25 years ..... | 27 |
| In summary .....   | 29 |
| 8. Conclusion.....   | 29 |
| 9. References .....  | 30 |
| 10. Appendix1 .....  | 33 |

## Executive Summary

- There is no internationally agreed age or state pension design, which makes the rules concerning state pension portability an increasingly urgent issue as populations become more and more mobile.
- Many people spend time working in more than one country and contributing to retirement savings schemes and/or accruing rights to a state pension in each of those countries. In New Zealand, increasing numbers of those who qualify for New Zealand Superannuation (NZS) also have entitlement to an overseas state pension.
- The Direct Deduction Policy (DDP) allows for deduction of state pensions analogous to NZS from the NZS entitlement.
- When the overseas pension is accumulated through employer and employee contributions, such deductions have been perceived by those affected as unjust.
- When the overseas pension is greater than NZS, the spousal provision allows a deduction to be applied to the spouse's NZS entitlement and is widely perceived as unjust and an infringement of human rights.
- Required residence in New Zealand to qualify for NZS is only 10 years after age 20, with 5 of those years after age 50. Internationally, many countries are increasing their qualifying age to a minimum of 67 years, and most countries require contributions for 30 to 50 years in order to qualify for a full state pension. The low hurdle for access to NZS has the potential to make New Zealand a desirable retirement destination particularly for those not affected by the DDP.
- A framework for problem identification and policy reform is proposed, suggesting clear objectives and criteria are needed to guide policy to better suit the changed environment of the 21<sup>st</sup> century. Fairness in the treatment of all retirees, especially requiring horizontal equity is paramount.
- The analysis suggests the spousal provision of the DDP is deeply flawed and inequitable. The removal of the spousal provision may require legislative change but is a relatively simple matter that could be actioned immediately. For the broader reform of the DDP, four options are outlined. These are:
  - Option 1 Enhancing the status quo: adapting the DDP
  - Option 2 Voluntary DDP and pro rata NZS
  - Option 3 Pro rata entitlement for all applications for NZS
  - Option 4 Abolish DDP and increase residency requirements to 25 years.
- All options are complex and have parameters that can be debated and changed. Once a final option and any grandfathering provisions has been decided, it can be fully evaluated and costed with a clear time table for implementation.

## 1. Overview

Populations are becoming more and more mobile, with many people spending some time working in other countries and contributing to retirement savings schemes in those countries. Pension portability is a growing global issue, raising complex questions around human rights and equity (Dale, Lazonby, St John and Littlewood 2009). A consequence of this global trend is that an increasing number of those who qualify for New Zealand Superannuation (NZS) at age 65 also have entitlement to an overseas state pension. Section 70 of the Social Security Act 1964 sets out the Direct Deduction Policy (DDP) that allows for deduction of analogous state pensions from NZS. Such deductions are perceived as unfair by many of those affected, particularly if there is an impact on the spouse's entitlement, and when the overseas pension was believed to be accumulated through employer and employee contributions.<sup>4</sup>

The DDP is applied when the overseas pension is state-administered and its purpose is seen to be the same as that of NZS, e.g. to meet the same life contingencies. While the DDP may capture some pensions that are considered to be private savings accumulated through employer and employee contributions, other overseas-accumulated retirement savings, including mandatory private savings schemes, are excluded.

As well as being 65 years old, the other main qualifying condition for NZS is residence in New Zealand for 10 years after age 20, with 5 of those years after age 50. Most countries require contributions for 30 to 50 years in order to qualify for a full state pension, and many countries are increasing their qualifying age to a minimum of 67 years (OECD 2015).

This report focusses primarily on the context of the DDP and its relationship to residence, describes how it is applied, and sets out reform options for discussion. A public policy framework is used to assess these options as a contribution to the Retirement Commissioner's 2016 Review of Retirement Income Policies.

### **The state pension in New Zealand**

The Ministry of Social Development's (2016) background paper to the Retirement Commissioner's Review sets out a full description of New Zealand's current public provision of retirement income. In brief, NZS is a universal, non-contributory, taxable state age pension paid at different rates determined by living arrangements: married, single sharing and single living alone. NZS is indexed to prices but also wage adjusted so the net pension for a married couple never falls below 66% of the net average wage. Unlike most other income support payments, NZS is not income-tested.

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<sup>4</sup> This disquiet is outlined on two websites: <http://www.nzpensionprotest.com/Home/the-fight/nz-pension-abuse-website> and <http://nzpensionabuse.org.s3-website-us-east-1.amazonaws.com/portability-retiring-overseas.html>.

As at the end of March 2016, 99% of the 713,753 people aged over 65 receiving a state payment were supported by NZS or the equivalent veteran's pension.<sup>5</sup> Those who have high costs relative to their income and/or assets may qualify for additional means-tested assistance, for example, 18.5% have a Disability Allowance, 5.8% have assistance from the Accommodation Supplement, and 0.7% have Temporary Additional Support/Special Benefit.(Ministry of Social Development 2016, p. 17). NZS and these means-tested additions are largely successful in preventing hardship, although around 9% of those aged over 65 have incomes under the unofficial poverty line<sup>6</sup> and 3% experience material deprivation (Perry 2015, p 157). Of the around 21,000 experiencing deprivation, some are supported by other welfare benefits but most receive NZS and may still fail to make ends meet. It is clear from case studies<sup>7</sup> that some pensioners who are subject to the DDP fall into this category and are suffering deprivation and/or require supplementary assistance.

### **Historical context of eligibility**

When the Old Age Pensions Act was passed in New Zealand in 1898, eligibility at age 65 was determined by a stringent income and asset test (abolished in 1960), a "good character and sober habits" test, and a residency requirement of 25 years. In 1937 the residency became 10 years (Ashton & St John). The 1938 Social Security Act introduced a two-tier public pension system: the means tested Age Benefit at age 60 years and a small universal Superannuation Benefit at age 65 embodying the principle of an 'as of right' individual pension not based on need (Booth 1977). Both payments required 20 years residency with grandfathering of the 10 years for those living in New Zealand on March 15 1938 (Ministry of Social Development 2013). For a couple, each partner needed to qualify in their own right. By 1960, the taxable universal pension and the Age Benefit reached parity. In 1972, the residence qualification for the Age Benefit was reduced to 10 years while Superannuation Benefit remained at 20 years.

In 1977 a new National Superannuation scheme of a taxable universal pension set at 70% (increased in 1978 to 80%) of the gross average wage for a couple was introduced. The residency requirement was complex: a person must have resided in New Zealand for a total of 10 years since reaching the age of 16, and seven of these years must have been in the 10 years immediately preceding application. This period of seven years could be reduced by one year for every complete 10 years of residence in New Zealand after the applicant turned 16.

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<sup>5</sup> Most receive NZS but at the end of March 2016, a total of 7,768 are supported by the equivalent Veteran's Pension or another main welfare benefit. There are some over 65 who do not apply for NZS, for instance when they choose to instead access their overseas pension (Ministry of Social Development 2016)

<sup>6</sup> The unofficial poverty line is: 60% constant value, after housing costs, equivalised household income (Perry, 2015, Table I3).

<sup>7</sup> The RPRC has a range of case studies on file covering pensioners affected from many different countries.

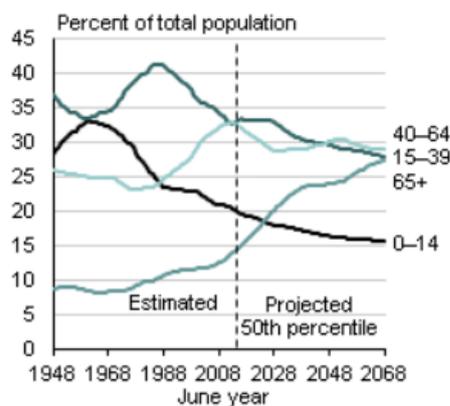
Subsequent changes reduced the net pension for a couple to a band of between 65% and 72.5% of net wages, and in 1985 a surcharge to claw back payment from high income recipients was introduced. In 1990, the residency requirement was simplified to 10 years, with 5 after age 50. Between 1992 and 2001, the age of entitlement was increased from 60 to age 65 but no changes were made to the low residency requirement. The surcharge was removed in 1998 making NZS fully universal. Because it is a taxable pension the tax system provides a small degree of claw back from high income recipients ( for more detail see St John and Ashton 1993; St John 1999)

In light of increased immigration at older ages, the low ten year residency requirement for NZS is highly significant as discussed below.

### Demographic trends

New Zealand's population is 4.7 million in 2016 and is projected to climb slowly to between 5.3–5.9 million by 2041 and to between 5.3–7.2 million by 2068.<sup>8</sup> Within this growth is a substantial and enduring shift in the age structure of the population as shown in Figure 1.

**Figure 1. The age distribution of the population 1948-2068** Source: (Statistics New Zealand 2016)



Jackson (2011) notes that New Zealand had the longest and most pronounced baby-boom (born 1946-1966) of the OECD countries, making numerical ageing very significant. In addition, structural ageing is driven by lower fertility, a loss to net migration at the younger ages (Jackson, 2011, p2), and by increasing longevity. In 2016, five years of baby-boomer retirement has already occurred. By 2031, this cohort will all be aged over 65, and the percentage of the population over 65 is expected to be 21% to 22% compared to 14.4% as shown in Table 1 for 2013.<sup>9</sup> By 2068, when the youngest baby-boomers will be over

<sup>8</sup> With a 90% probability, see [http://www.stats.govt.nz/browse\\_for\\_stats/population/estimates\\_and\\_projections/NationalPopulationProjections\\_HOTP2014.aspx](http://www.stats.govt.nz/browse_for_stats/population/estimates_and_projections/NationalPopulationProjections_HOTP2014.aspx) (Statistics New Zealand 2016)

<sup>9</sup> See Statistics New Zealand: [http://maps.stats.govt.nz/apps/StatsMaps324/index.html?webmap=map\\_config.txt&viewer=July2015\\_EstimatedResidentialPopulation.txt](http://maps.stats.govt.nz/apps/StatsMaps324/index.html?webmap=map_config.txt&viewer=July2015_EstimatedResidentialPopulation.txt).

100 years of age, the proportion over 65 is projected to be between 24–32% of the population.<sup>10</sup>

**Table 1. Proportion of population, by age group, 1981–2013** Source: Statistics New Zealand (Ministry of Social Development 2016a)

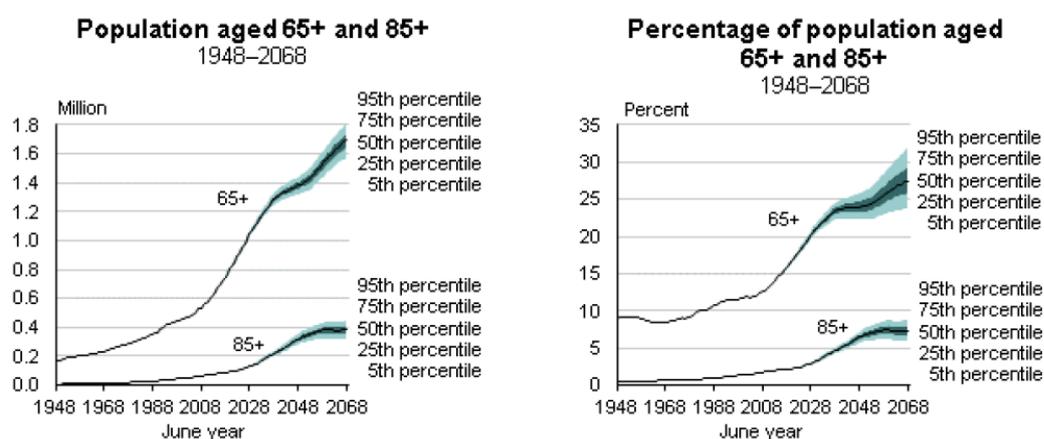
| Age group (years) | 1981 Census | 1986 Census | 1991 Census | 1996 Census | 2001 Census | 2006 Census | 2013 Census |
|-------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 0–14              | 26.9        | 24.4        | 23.2        | 23.0        | 22.7        | 21.5        | 20.4        |
| 15–39             | 39.6        | 40.9        | 39.9        | 38.3        | 35.6        | 34.6        | 32.3        |
| 40–64             | 23.6        | 24.2        | 25.6        | 27.0        | 29.7        | 31.6        | 33.0        |
| 65–74             | 6.3         | 6.4         | 6.7         | 6.8         | 6.6         | 6.6         | 8.2         |
| 75 and over       | 3.5         | 4.0         | 4.6         | 4.9         | 5.5         | 5.7         | 6.2         |

### The ageing of the old

Within the 65+ age group, the number of people aged 85 and over (85+) is expected to increase dramatically, trebling by 2041 and more than quadrupling by 2068. By mid-century around 1 in 4 people aged 65+ will be 85+, compared with only 1 in 8 in 2014 (Statistics New Zealand 2016).

This ageing of the old can be expected to produce fiscal pressures around health and custodial care under current policy settings,<sup>11</sup> and also to put pressure on individual's budgets as they are faced with the extra costs associated with old age care (Dale 2013; Dale 2014).

**Figure 2. The ageing of the old** (Source: Statistics New Zealand (2016))



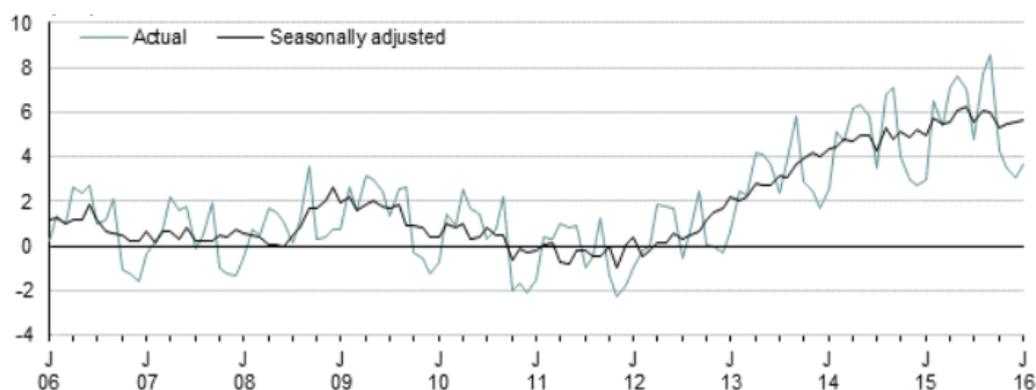
### Migration trends

Overall net migration into New Zealand has accelerated in recent years as the monthly data in Figure 3 below shows. In the year ended June 2016 there was a historically high net inflow of 69,090 people. This net figure constitutes 72,229 of non NZ-born permanently settled in New Zealand and 3,139 New Zealanders who left permanently.

<sup>10</sup>These projections are based on assumptions about future migration patterns and may be inaccurate if the current immigration trends continue.

<sup>11</sup> For example, access to free hospital care and to the Residential Care Subsidy (once assets have reduced to around \$210,000), protects the aged, but at the taxpayers' cost.

**Figure 3. Migrations trends: Monthly net permanent and long-term migration, June 2006-2016 (000s)** (Source: Statistics New Zealand)



Those born overseas rose from 19.5% of New Zealand’s population in 2001 to 25.2% in 2013. In this period, proportionately more came from China, India, South Africa, Fiji and the Philippines and proportionately fewer from England, Australia, Samoa and Scotland (Ministry of Social Development 2016 p. 26). This suggests that over time there will be corresponding changes in the numbers that are affected by the DDP.

**Table 2. Origin of NZ residents born overseas** (Source: Ministry of Social Development 2016a, Table P1.3)

| Birthplace                 | 2001 Census |         | 2006 Census |         | 2013 Census |         |
|----------------------------|-------------|---------|-------------|---------|-------------|---------|
|                            | Number      | Percent | Number      | Percent | Number      | Percent |
| England                    | 178,203     | 25.5    | 202,401     | 23.0    | 215,589     | 21.5    |
| People's Republic of China | 38,949      | 5.6     | 78,117      | 8.9     | 89,121      | 8.9     |
| India                      | 20,892      | 3.0     | 43,341      | 4.9     | 67,176      | 6.7     |
| Australia                  | 56,259      | 8.1     | 62,742      | 7.1     | 62,712      | 6.3     |
| South Africa               | 26,061      | 3.7     | 41,676      | 4.7     | 54,276      | 5.4     |
| Fiji                       | 25,722      | 3.7     | 37,746      | 4.3     | 52,755      | 5.3     |
| Samoa                      | 47,118      | 6.7     | 50,649      | 5.8     | 50,661      | 5.1     |
| Philippines                | 10,134      | 1.5     | 15,285      | 1.7     | 37,299      | 3.7     |
| Korea                      | 17,931      | 2.6     | 28,809      | 3.3     | 26,601      | 2.7     |
| Scotland                   | 28,680      | 4.1     | 29,016      | 3.3     | 25,953      | 2.6     |

In 2014/15, family-sponsored immigrants made up 35% of all residence approvals: 8,922 people were approved through the Partnership Category; and 4,477 people were approved through the Parent Category, with China the largest source country of approvals in the Parent Category (50%), and slightly behind India (16%) in the Partnership Category (China 15%) (Ministry of Business Innovation & Employment 2015). It is relevant to residency requirements for NZS discussed below to note that in 2013 over half (52.6%) of those born in Asia and living in New Zealand had been in New Zealand for less than 10 years. This contrasts with only around one third of those who had been born in the United

Kingdom, Ireland or Australia. In 2013, 50% of the population born overseas were older than 41.8 years. This is an older demographic profile than that of New Zealand as a whole and compares with the median age of 36.2 years for people born in New Zealand.

New Zealand can expect more migration at older ages in the future as world events make New Zealand an increasingly desirable place for retirement.

### **Fiscal considerations**

Gross Expenditure on NZS is forecast to rise from \$12.26 billion in 2015/16 to \$14.92 billion in 2019/20 (The Treasury 2016). Longer term fiscal projections show the rise of expenditure on NZS from 4.3% of GDP in 2010 to 7.9% of GDP by 2060 and health spending from 6.8% to 10.8% of GDP (The Treasury 2013, p. 4). The projected NZS expenditure appears modest, especially if net rather than gross spending is counted,<sup>12</sup> and when compared to current pension spending in other countries. However over time, mechanisms to reign in this expenditure are likely to attract a high priority in pension debates especially in light of the extra medical demands associated with the ageing of the old (Dale 2014; St John 2015).

The cost of NZS is to a small extent offset by the comparatively high workforce participation rates of those aged over 65, climbing from 25,000 in the late 1980s to an estimated 150,000 or more in 2015 (6% of the labour force). Labour force participation among those aged 65 is now about 22% (about 28% among men and 17% among women) and is projected to increase to perhaps 27% overall by the late 2020s. By 2068, between 9% and 16% of the labour force is expected to be aged over 65 (Statistics New Zealand 2016). The offset comes from having more of the NZS payment taxed at higher rates when there is significant other income.

## **2. Legislative environment**

### **Portability of NZS**

The rules for people in receipt of NZS leaving New Zealand are provided for comparative purposes but are not the focus of this report. In general, a superannuitant may spend up to 26 weeks in another country without loss of NZS. If the superannuitant retires permanently to a country where a bilateral social security agreement is not in place, they may take up to 100% of gross NZS with them. The exact amount is calculated from their residency in New Zealand between the ages of 20 and 65 on a monthly basis. A full 540 months is required for a full NZS and there is no provision for accruing more months after the age of 65 (Work & Income 2016).

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<sup>12</sup> In 2015/16 tax paid in NZS was \$1.832 billion and this will increase as more people work beyond 65.

New Zealand has 'reciprocal' or 'bilateral' social security agreements with Australia (including Norfolk Island from 1 July 2016), Canada, Greece, Denmark, Jersey and Guernsey, Ireland, Malta, the Netherlands, and the United Kingdom (Work & Income 2016a). There is significant variation in the rules that apply under the individual social security agreements.

For example, the Work & Income (2016a) website confirms that a person qualifying for and receiving NZS who moves to Australia in their retirement, with significant other income and assets, will no longer receive NZS (after the 26 week maximum) and may not qualify for any of the income- and asset-tested Australian Age Pension. Any NZS they receive will be capped at the rate of the income- and asset-tested Australian Age Pension they would be entitled to receive given their income and assets, if they were an Australian citizen. However, a person qualifying for and receiving NZS who moves to Canada, Denmark, Greece, Jersey and Guernsey, Malta or the Netherlands would receive NZS, although supplementary benefits and allowances such as Disability Allowance and Accommodation Supplement would not be paid.

The agreements also allow people to apply for NZS while they are resident in one of these countries (normally they would have to be resident in New Zealand on the date of application). Under the provisions of New Zealand's agreement with the UK people who move from New Zealand to the UK receive a UK pension rather than portable NZS.

New Zealand also has a Special Portability Arrangement with Pacific Island States. The NZS rate is based on the number of years of New Zealand residence since turning 20, and marital status. NZS (and Veteran's Pension) are paid into the Pacific at 50% of the gross rate (residency 10 years) to 100% (residency 20 or more years) (Work & Income 2016b).

These rules for people taking NZS to another country are in sharp contrast to the rules for those with overseas pensions when they apply for NZS.

### **Section 70 of the Social Security Act.**

Under Section 70 of the Social Security Act 1964, a New Zealand resident who is eligible and applies for NZS (or a social security benefit), has their NZS reduced by any public pension they are entitled to receive from overseas up to the amount of the overseas pension. This policy is referred to as the 'direct deduction policy' (DDP).<sup>13</sup>

There is a spousal provision in the DDP so that when one partner of a couple has an overseas pension, any excess above the married rate of NZS is offset against the partner's entitlement. When a couple has one superannuitant and a spouse who has not reached

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<sup>13</sup> The gross overseas pension is deducted from the gross NZS and other benefits (including Accommodation Supplement). (More detail in MSD, 2016)

qualifying age for NZS, that spouse must apply for any overseas pension they may be entitled to and this is offset against the superannuitant's NZS. Around five hundred people and their partners are affected by the spousal deduction.

### **The rationale for the DDP**

The origins of the DDP are found the 1938 Social Security Act. It appears that the DDP was introduced to deal with UK state pensions that were payable in New Zealand at the time. Other state pensions were not payable in New Zealand until much later, eg Canada in 1960 and Australia in 2002 (Ministry of Social Development 2013).

The MSD (2013) reports Hansard debates at the time indicated the purpose of the policy was threefold: First to recognise the 'one pension' principle so that double dipping would not occur; second to reflect attitudes at the time that saw people with overseas pensions as having more means to support themselves and thus require less from New Zealand's government; and third to achieve a measure of equity so that people from overseas did not receive more than someone that had spent their whole life in New Zealand.

The rationale for the spousal provision, introduced in 1955, appears to derive from the notion of means-tested welfare in the 1938 Act where one spouse's income is assumed to be available to support the other. When National Superannuation was introduced in 1977, the rate per married person was lower than that for a single person but men and women were treated independently regardless of their work experience (McClure 1998). Each married person was entitled in their own right and paid tax on their pension along with their other individual income. Even when an indirect income test called the surcharge operated between 1985 and 1998, it was based on each individual's income not their joint position as a couple.

In 2008, the Hon Ruth Dyson explained that the need for the DDP arises from the low residency requirement for NZS:

*Ms Dyson said the Government could not let overseas pensioners keep their foreign pensions on top of full NZ super because that would be unfair to people who never worked overseas and paid taxes for their whole lives in New Zealand. "We have a very short period of residency in New Zealand as a qualification for the NZ pension, 10 years. Most New Zealanders wouldn't feel it's fair for a person who spent only 10 years in New Zealand to get a full pension in addition to a pension from their country of origin." (Collins 2008)*

### **3. Operation of the DDP**

MSD administrative data (2016) show that the average overseas pension deducted is small, but that the DDP affects a growing percentage of NZS recipients. In 2016 about 84,000 or 12% of the NZS population are affected. The annualised amount reported in Table 3 is also affected by the higher exchange rate in 2016. The small proportion of the

65+ population who do not receive NZS or another main benefit may have an overseas pension in excess of the rate of NZS.

### How much NZS is saved?

Table 3 shows that the costs saved by government under the DDP since 2010 has increased by around 50%. The total of \$343 million in 2016 is set to increase further as the numbers reaching retirement age with an overseas pension grow. This cost saving is likely to be viewed as a significant and growing fiscal contribution to the offset the costs of an ageing population.

**Table 3. Overseas pension deductions from recipients of New Zealand Superannuation and Veteran's Pension** (Source: MSD administrative data (2016))

| As at end March | Number of recipients | Proportion of total NZS/VP recipients | Average annualised value of deducted pension in \$NZ | Total recovered from section 70 deductions | Total number of NZS recipients |
|-----------------|----------------------|---------------------------------------|--|--|--------------------------------|
| 2010            | 53,938               | 9.90%                                 | \$3,742  | \$201,835,996                              | 544,828                        |
| 2013            | 65,042               | 10.30%                                | \$3,532  | \$229,728,344                              | 631,476                        |
| 2016            | 83,982               | 11.90%                                | \$4,084  | \$342,986.147                              | 705,686                        |

Table 4 shows that in 2012 over 70% of those affected by the DDP have their NZS offset by under \$150 a week. Very few have overseas pensions as large as \$400 per week and thus lose all or most of their NZS. It is likely also, as MSD noted in 2005, that evasion or under-reporting is an issue:

*The policy poses ongoing policy issues and administrative difficulties, due to attempted evasion of the deduction by recipients of overseas pensions, and the difficulties Work and Income have in identifying which overseas pensions should be deducted. (MSD 2005, p. 7)*

**Table 4. Mean deduction by numbers affected and share of total 2012- (derived from 2012 administrative data)**

| Mean weekly deduction | Annualised deduction | numbers affected | total weekly deductions | Annualised total | Percentage share |
|-----------------------|----------------------|------------------|-------------------------|------------------|------------------|
| \$25                  | \$1,300              | 28,494           | \$712,350               | \$37,042,200     | 15               |
| \$75                  | \$3,900              | 22,833           | \$1,712,475             | \$89,048,700     | 37               |
| \$125                 | \$6,500              | 7,184            | \$898,000               | \$46,696,000     | 19               |
| \$175                 | \$9,100              | 3,267            | \$571,725               | \$29,729,700     | 12               |
| \$225                 | \$11,700             | 1,599            | \$359,775               | \$18,708,300     | 8                |
| \$275                 | \$14,300             | 708              | \$194,700               | \$10,124,400     | 4                |
| \$325                 | \$16,900             | 354              | \$115,050               | \$5,982,600      | 2                |
| \$375                 | \$19,500             | 111              | \$41,625                | \$2,164,500      | 1                |
| \$400+                | \$20,800+            | 120              | \$48,000                | \$2,496,000      | 1                |
|                       |                      |                  |                         |                  |                  |
| totals                |                      | 64,670           | \$4,653,700             | \$241,992,400    | 100              |

## Spousal deductions

2007 estimates showed that the amount recovered by the state from the spousal deduction was of the order of \$1 million per annum and affected about 1,000 people (Ministry of Social Development 2013). Without analysing every case, the best estimate by MSD for 2016 is that there are 500 couples affected by the spousal deduction and that the average amount deducted is \$4,000 per year (i.e. the total amount deducted is approximately \$2 million per year). This amount too is likely to be influenced significantly downwards by the exchange rate. A high exchange rate decreases the excess overseas pensions to be deducted and reduces the number affected. This may explain the lack of growth in the total numbers but this picture would change with a lower exchange rate.

An analysis of the annualised deductions based on the position at the end March 2016 in Table 5 shows that in rare instances, a spouse may lose all of their NZS; that the lowest 50 people contribute very little to overall savings; and over one quarter of savings is attributed to the top 50 people or 10% of the group affected.

There is little information from the individual case records that allows attribution of the spousal deduction to country of origin of the affected superannuitants. Nevertheless it can be inferred that since the age pension in Australia is comparable to NZS then most of the spousal deductions must be from those with high earnings-related pensions from countries such as the US, Canada, Germany, the Netherlands, Norway, Italy and the UK.

**Table 5. Spousal deductions under the Spousal Provision Section 70 by amount**  
(Source: derived from MSD administrative data 2016)

| Spousal Deductions           | Weekly \$ | Annualised \$ | % of total |
|------------------------------|-----------|---------------|------------|
| Highest deduction            | \$331     | \$17,234      |            |
| Lowest deduction             | \$0       | \$10          |            |
| average top 50 deduction     | \$217     | \$11,261      |            |
| Average                      | \$76      | \$3,966       |            |
| Median                       | \$61      | \$3,187       |            |
| Total deduction top 50       |           | \$563,066     | 28.40%     |
| Total deduction lowest 50    |           | \$8,549       | 0.43%      |
| Total all spousal deductions |           | \$1,982,832   |            |

The MSD website provides four case studies of how the spousal deduction works in practice.<sup>14</sup> One of the more egregious aspects shown in Case 4 is when a spouse may have the full amount of the partner's overseas pension deducted from their NZS even when the partner is not a NZS recipient (see Appendix 2).

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<sup>14</sup> See: <http://www.workandincome.govt.nz/pensions/travelling-or-moving/moving-to-nz/overseas-pensions-deduction-examples.html>.

## Appeals against the operation of the DDP

Many superannuitants argue that part or all of their overseas pension has arisen from their own and their employers' contributions and is akin to a supplementary pension scheme, analogous to KiwiSaver, for example, rather than to NZS. MSD argues that pay-as-you-go social insurance systems, with the current pensions of the retired paid from the current premiums of the not yet retired, and where there are no individual accounts with money sitting in them, are not so different from pay-as-you-go NZS. The difference with overseas social insurance systems is that a portion of tax is earmarked as being for the pension, and the pension paid is based on years of contribution.

If people feel they have not been treated fairly, they can have their case heard by a Benefits Review Committee (made up of two people from the MSD who were not involved in the decision being reviewed, and one other person appointed by the Minister for Social Development). If the superannuitant disagrees with the Benefits Review Committee decision they can appeal to the Social Security Appeal Authority (SSAA). The SSAA is a Court, and the appellant may choose to take their case further up the Court system. An alternative route, if the complainant is not satisfied with the SSAA outcome, is to take their issue to the Human Rights Commission (HRC). If the HRC agrees there may be valid grounds for a complaint, an opinion may be sought from Crown Law.

Unfortunately, the difficulties and apparent injustices resulting in the many complaints brought to the SSAA and the HRC in recent years have produced little resolution for complainants. Many have subsequently taken their complaints to Members of Parliament, the Retirement Commissioner, the Retirement Policy Research Centre, and the media.

While the MSD's response has been that they apply the law correctly, it is noteworthy that their 2007 review and frequent interim reports on New Zealand's pension system and its relationship to those of other countries (Ministry of Social Development 2004; Ministry of Social Development 2005; Ministry of Social Development 2008a; Ministry of Social Development 2008b) have produced many recommendations that would largely resolve the primary issues with overseas pensions. The following recommendations are included (2008a, pp. 13-21):

*Remove foreign state pensions built up by voluntary contributions from the scope of section 70 of the SS Act; Discontinue the policy of deducting a person's overseas pension from their partner's NZS entitlement; Clarify the wording of section 70 so it is in plain English, and set out each country's pension regulations.*

Both deducting a foreign state pension built up by voluntary contributions, and deducting a person's overseas pension from their partner's NZS entitlement, could be considered to be human rights' infringements. Since 2002 the Government can also be challenged under Part 1A of the Human Rights Act when people feel they have been discriminated against

in public policy. The Office of the Human Rights Proceedings has been investigating the spousal deduction issue on the grounds of discrimination by reason of family status.

In July 2016 a case was filed on behalf of 3 plaintiffs and awaits the Statement of Reply from the Ministry of Social Development. The process is lengthy and the case is not expected to be heard in the Human Rights Review Tribunal (HRRT) until 2017. While any decision that there is a breach of the right to be free from discrimination imposes a moral duty on the government to address the issue the HRRT cannot itself mandate the removal of discrimination.

#### **4. Classification of overseas pensions**

The MSD Briefing to Incoming Ministers (2014, p. 32) noted:

*New Zealand has a range of international social security agreements and we are increasingly being approached to enter into additional agreements and to make our policies more consistent with other countries. A key feature of these discussions is our Direct Deduction policy. The principles behind this policy are sound, but it is still unpopular with other countries and with those affected by it.*

The issue is further complicated as populations in most developed countries are ageing, and age pension systems are constantly being reviewed and revised (for example, see Milligan 2015).

#### **Determining what is a state pension**

The MSD provide the following guidelines to determine whether an overseas pension is subject to the DDP:

*An overseas pension means a pension, benefit or periodical allowance that forms part of an overseas programme that provides pensions, benefits and periodical allowances for any of the circumstances for which New Zealand benefits and pensions would be paid (including old age, invalidity, death of a spouse); and is administered by or on behalf of the Government of the country from which the pension, benefit or periodical allowance originates. It doesn't matter whether the overseas pension is funded by general taxation or by compulsory contributions. For example, the Canada Pension Plan pension is funded by compulsory employer and employee contributions, but it is still subject to direct deduction. (Work & Income 2016c)*

The critical elements here are whether the overseas pension payment is for the same purposes as NZS, and whether it is government administered. The definition is problematic as the complexities of pension schemes evolve both here and overseas in the 21<sup>st</sup> century. The purposes of NZS are not solely the relief of poverty as the history of the state pension outlined above suggests. Mandatory second tier pensions such as the Superannuation Guarantee in Australia, and the earnings-related pensions in Chile, are gaining in importance but would not be affected by the DDP if the pensioner decided to immigrate to New Zealand.

Government administered pensions are deducted even though for some, such as the Canada Pension Plan (CPP), there are no government contributions. The problem is caused in part by confusion between 'state administered' and 'state provided'. Mandatory second tier pensions such as in Australia and Chile escape the DDP because they are administered privately. But mandatory second-tier schemes can be administered by the state, as with the CPP. Their purpose is different from the basic pension. Importantly, many if not most second and third tier privately administered retirement savings schemes that are outside of the DDP have large state subsidies built into their accumulations.<sup>15</sup>

### Reciprocal agreements and the DDP

New Zealand has bilateral social security agreements (SSAs) with the countries in Table 6 whose state pensions are deducted under the DDP.

**Table 6. Overseas old age pensions that reduce NZS and other benefits**

| Country             | Retirement Income Scheme   |
|---------------------|--|
| Australia           | Age Pension  |
| Canada              | Old Age Pension<br>Canada Pension Plan   |
| Denmark             | Old Age Pension<br>Anticipatory Pension<br>Labour Market Supplementary Pension |
| Greece              | Old Age Benefit  |
| Ireland             | State Pension (Contributory)<br>State Pension (Transition)                     |
| Jersey and Guernsey | Old Age Pension  |
| Malta               | Two-thirds Pension   |
| The Netherlands     | Old Age Benefit (AOW)  |
| United Kingdom      | State Pension  |

The SSA between countries does not usually have special waivers for the DDP policy. These agreements offer 'totalisation' so that years of residency in the overseas country counts for entitlement to the state pension in New Zealand. The MSD advised (2014, p. 32):

*The growing movement of people between countries and immigration and emigration trends provide an opportunity to consider whether there are alternatives to social security agreements that could provide better outcomes for people who have lived and worked in two or more countries during their working life.*

Non agreement countries also pay pensions that fall under the DDP policy. Data show that 83,982 NZS recipients affected by the DDP come from around 70 countries (see Appendix 1). Table 7 shows data from the 24 most affected countries analysed by significance and average deduction. The bulk of these deductions are for pensions against NZS. The UK is the major contributor in this picture with 59,034 pensioners affected, contributing 77% of New Zealand's total saving in NZS payments. The average deduction is highest for the USA, as might be expected from its two-tier pension system, with the second tier being

<sup>15</sup> For example, in Australia, research has shown that the tax concessions on Superannuation Guarantee contributions cost the government almost as much as the Age Pension (Ingles 2009).

earnings-related. The first tier, Supplemental Security Income (SSI) is a social assistance scheme, fully funded by the US Government, and payable to those who have limited or no other means of retirement support.<sup>16</sup>

**Table 7. Overseas pension deductions by country in NZ\$ at end of March 2016**

| Country                  | Number of Overseas Pensions | Annualised Value of NZS & Supplements | Annualised Value of Overseas Pensions | Percentage of total | Average deduction |
|--------------------------|-----------------------------|---------------------------------------|---------------------------------------|---------------------|-------------------|
| United Kingdom           | 59,034                      | \$949,118,639                         | \$264,305,726                         | 77.06%              | \$4,477.18        |
| Australia                | 15,082                      | \$247,911,308                         | \$42,191,855                          | 12.30%              | \$2,797.50        |
| The Netherlands          | 4,307                       | \$66,307,093                          | \$15,708,815                          | 4.58%               | \$3,647.28        |
| Canada                   | 2,285                       | \$29,781,889                          | \$7,625,826                           | 2.22%               | \$3,337.34        |
| United States of America | 558                         | \$4,148,073                           | \$3,597,656                           | 1.05%               | \$6,447.41        |
| Germany                  | 424                         | \$4,880,001                           | \$1,514,212                           | 0.44%               | \$3,571.26        |
| Switzerland              | 317                         | \$3,702,850                           | \$1,081,165                           | 0.32%               | \$3,410.62        |
| Ireland                  | 278                         | \$4,342,455                           | \$982,378                             | 0.29%               | \$3,533.74        |
| Russian Federation       | 215                         | \$2,926,749                           | \$720,685                             | 0.21%               | \$3,352.02        |
| Philippines              | 207                         | \$2,983,459                           | \$704,472                             | 0.21%               | \$3,403.25        |
| Taiwan                   | 128                         | \$1,646,401                           | \$431,365                             | 0.13%               | \$3,370.04        |
| Denmark                  | 122                         | \$1,614,598                           | \$356,611                             | 0.10%               | \$2,923.04        |
| Japan                    | 120                         | \$1,305,221                           | \$440,403                             | 0.13%               | \$3,670.03        |
| Guernsey                 | 115                         | \$1,819,455                           | \$461,709                             | 0.13%               | \$4,014.86        |
| Jersey                   | 109                         | \$1,638,990                           | \$423,599                             | 0.12%               | \$3,886.23        |
| France                   | 78                          | \$1,025,062                           | \$263,145                             | 0.08%               | \$3,373.65        |
| Sweden                   | 73                          | \$842,383                             | \$217,462                             | 0.06%               | \$2,978.93        |
| Fiji                     | 56                          | \$771,126                             | \$173,933                             | 0.05%               | \$3,105.95        |
| Isle of Man              | 48                          | \$622,565                             | \$149,810                             | 0.04%               | \$3,121.05        |
| Romania                  | 37                          | \$394,138                             | \$152,351                             | 0.04%               | \$4,117.60        |
| Bulgaria                 | 36                          | \$506,498                             | \$117,199                             | 0.03%               | \$3,255.54        |
| Korea Republic of        | 35                          | \$465,255                             | \$105,509                             | 0.03%               | \$3,014.54        |
| Singapore                | 24                          | \$296,825                             | \$92,525                              | 0.03%               | \$3,855.21        |
| Macedonia                | 23                          | \$311,892                             | \$92,875                              | 0.03%               | \$4,038.04        |
| Croatia                  | 22                          | \$298,553                             | \$82,064                              | 0.02%               | \$3,730.19        |
| Other                    | 249                         | \$3,194,675                           | \$992,794                             | 0.29%               | \$3,987.13        |
| <b>Grand Total</b>       | <b>83,982</b>               | <b>\$1,332,856,152</b>                | <b>\$342,986,147</b>                  | <b>100.00%</b>      | <b>\$4,084.04</b> |

Table 8 below shows the changes from 2010 to 2016 in the numbers of people affected by the DDP. The United Kingdom numbers have increased by around 15,000 (up 34% from 2010),<sup>17</sup> while the numbers of Australians and Canadians affected have doubled, increasing by around 8,000 and 1,000 respectively.

<sup>16</sup> See <https://www.ssa.gov/ssi/text-over-ussi.htm>.

<sup>17</sup> The decreases could be explained in part by mortality.

**Table 8. Growth of DDP amounts by significance by country** (Derived from Administrative data for year ended March 2016 and Ministry of Social Development (2011), p 316)

| Country         | Number of Overseas Pensions 2010 | Number of Overseas Pensions 2016 | Percentage increase 2010-2016 |
|-----------------|----------------------------------|----------------------------------|-------------------------------|
| Australia       | 7,248                            | 15,082                           | 108%                          |
| Canada          | 1,152                            | 2,285                            | 98%                           |
| Germany         | 245                              | 424                              | 73%                           |
| Switzerland     | 191                              | 317                              | 66%                           |
| Ireland         | 207                              | 278                              | 34%                           |
| United Kingdom  | 44,681                           | 59,034                           | 32%                           |
| USA             | 447                              | 558                              | 25%                           |
| The Netherlands | 3,539                            | 4,307                            | 22%                           |

### Particular issues for UK

In the mid-2000s the UK State Pension system comprised a Basic State Pension and an Additional State Pension. While entitlement is built up through National Insurance (NI) contributions or credits if caregiving, and the amount of pension paid depends on a person's qualifying years, the basic age pension can be taken to have a similar purpose to NZS as a first tier state pension and therefore correctly subjected to the DDP.

More controversially, the second tier additional state pension, previously called the State Earnings-Related Pension (Serps) is also subject to the DDP. It was possible to contract out of the second tier and opt for a private pension scheme instead in which case the DDP did not apply. Recent reforms rationalise the two state pensions into one (Department for Work and Pensions 2016).

UK entitlement ages differ for men (65) and women (60). Under a State Pension Deferral policy an incremental payment to the basic State Pension for delaying access to the pension could be taken as either an ongoing increase in the UK basic pension or as a single lump sum payment.<sup>18</sup>

The SSA between the UK and New Zealand allows retirees from the UK to use UK residency to meet the residence criteria for NZS, and Article 15(1) provides for the deduction of UK pensions and benefits from NZS entitlements. Controversially, the MSD assert:<sup>19</sup>

*The second tier Additional State Pensions, such as the State Second Pension, are deducted primarily because they are part of the UK Government's programme of social assistance for those who are retired, and are paid for the same contingencies as NZS. Their deduction from New Zealand entitlements falls squarely within the overall scheme for administering overseas pensions.*<sup>20</sup>

<sup>18</sup> See <https://www.theguardian.com/money/2014/jul/26/pensioner-lose-delay-state-pension>. In April 2016, along with the introduction of a new flat-rate 'single-tier pension' worth around £155 a week, the reward for deferring the basic state pension plus any Serps/state second pension for a year reduces from an extra 10.4% to 5.8%.

<sup>19</sup> Ministry of Social Development 'The UK system as documented by MSD in 2005', 4 August 2016.

The DDP does provide a measure of protection for UK recipients of NZS because the UK do not inflation index state pension payments in New Zealand. Thus as NZS goes up with prices and wages, over time the deducted amount shrinks relative to the NZS received.

### **Particular issues for Australia**

As Dale and St John (2012) outline, the relationship with Australia requires special attention for both the short and the long-term. Australian retirees in New Zealand may enjoy a clear advantage, given that, unlike the universal NZS, the Australian Age Pension is means-tested, and the Superannuation Guarantee employment-based pension can be cashed up and brought to New Zealand without being affected by the DDP. The richest Australian may immigrate to New Zealand with their employment-based savings, and get the full NZS, whereas in Australia they would be disqualified from the Age Pension by the means-test. In 2016 the government in Australia is tightening the means test for the age pension which will further aggravate this problem (Department of Human Services 2016).

While there are presently only 15,000 superannuitants (Table 7) with an Australian pension in New Zealand, there are more than 600,000 former New Zealand residents under retirement age now living in Australia (Chenery 2016). With Australia increasing the state pension age from 65 to 67 between 2017 and 2023, and introducing a harsher income test (Department of Human Services 2016), and because 'totalisation' can be applied under the SSA, New Zealand may become an even more attractive place for Australians to retire. The wealthier they are, the less the Australian government pays to offset NZS. This may prove costly and inequitable for the working age population of New Zealand.

The MSD advised a fundamental review (2014, p. 32):

*The movement of people between Australia and New Zealand has particular implications for the social security agreement with Australia. This agreement is complex, making it difficult for people to understand and expensive to administer. There may be a case for a fundamental review of this agreement.*

In 2016, the social security agreement is being renegotiated but is not expected to radically change:

*New Zealand and Australian officials are aware that the age of entitlement to the Australian Age Pension will begin to rise from July 2017 while the age of entitlement to NZS will not. There are policy interventions that could minimise the risk of New Zealanders returning to New Zealand to access NZS while the Australian Age Pension age of entitlement is rising. This is one of the matters that officials are considering as part of the revision of the Social Security Agreement between New Zealand and Australia. We are unable to provide any further information at this time as the details*

*of these negotiations remain confidential until the Australian and New Zealand Governments have reached an agreed position. (Personal communication MSD)*

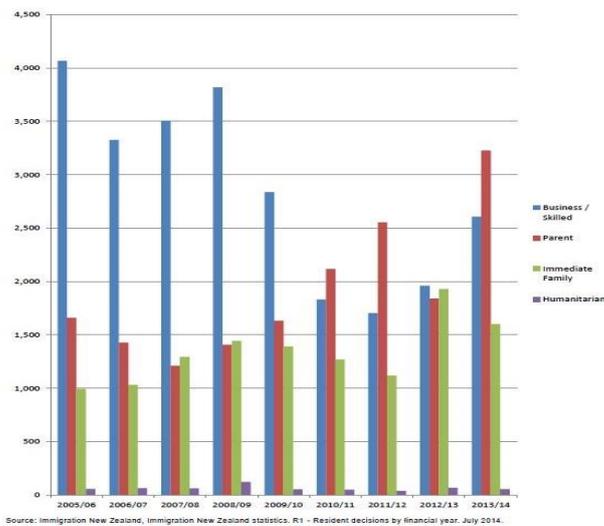
**Particular issues for Canada**

A ‘government-administered’ scheme like the Canada Pension Plan (CPP)<sup>21</sup> is not the same as a ‘government-funded’ scheme, like the income-tested Canadian Old Age Security (OAS)<sup>22</sup> programme. The OAS pension if paid to a recipient in New Zealand is deducted under the DDP as it is clearly equivalent to NZS. The CPP is funded entirely by employers and their employees, with their contributions calculated by the CPP’s actuary. Retirement pension amounts are determined by reference to individual contributions, and when a CPP pensioner dies, survivor benefits may be paid to their surviving spouse. Although contributions to the CPP are compulsory and the payments are income streams not lump sums, arguably it is structurally a closer equivalent to KiwiSaver than to NZS, calling into question the deduction CPP from NZS entitlements (Dale 2016).

**Particular issues for China. Parental reunification programmes**

As immigrants from China and other countries without formal state pensions, or with small state pensions and yet access to other resources increase, the complexity compounds. For example, state pensions in China began in 1997 and are only payable after 15 years (Chen 2015). So an immigrant from China who has to wait for 10 years residency and has a state pension would not be affected until 2022. Many ageing immigrants arriving under parental reunification programmes are not subject to the DDP. Figures 4 and 5 give a visual picture of particular issues that arise from parental immigration where entitlement to NZS can be achieved after only 10 years residency.

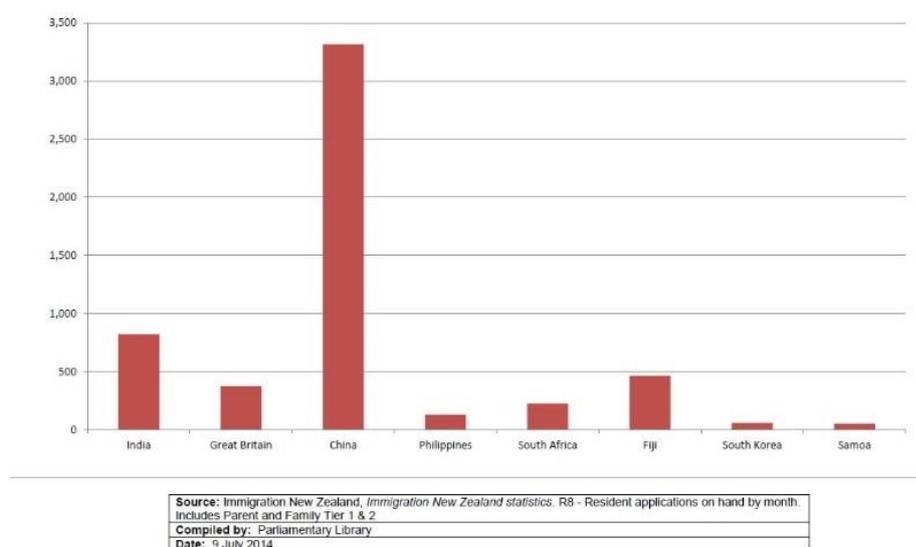
**Figure 4. Immigration from China 2005-2014, yrs ended June**



<sup>21</sup> See <http://www.esdc.gc.ca/en/cpp/index.page>.

<sup>22</sup> See [http://www.esdc.gc.ca/en/cpp/oas/index.page?\\_ga=1.74286801.2100941495.1468878168](http://www.esdc.gc.ca/en/cpp/oas/index.page?_ga=1.74286801.2100941495.1468878168).

**Figure 5. Parental applications on hand June 2014**



As already noted, in 2014/15, of the 4,477 people approved in the Parent Category of family-sponsored residence approvals, China was the source country of 50% (Ministry of Business Innovation & Employment 2015).

## 5. Challenges to current policies

As Dale, St John, Littlewood and Smith (2011) note, on at least four occasions between 2003 and 2008, MSD published interim reports on its review of New Zealand's pension system and its relationship to those of other countries. On the basis of each report, the MSD made almost identical recommendations (Ministry of Social Development 2008a; Ministry of Social Development 2008b), including the following:

- Discontinue the policy of deducting a person's overseas pension from their partner's NZS entitlement, and make a consequential amendment to the Special Banking Option (SBO) so that only one partner needs to choose this option
- Clarify the wording of section 70 so that it is in plain English, and set out the treatment of each country's pension regulations;
- Remove foreign state pensions built up by voluntary contributions from the scope of section 70 of the Social Security Act (Ministry of Social Development, 2008, pp. 13 - 21).

To date, while agreed to by government in principle, few changes have been made.

*Since 2005, MSD has been deferring the deduction of the part of an overseas pension derived from voluntary contributions from a person's New Zealand Superannuation payment, based on a direction that the Social Security Appeal Authority (SSAA) made in response to some specific cases. The direction of the SSAA does not mean that voluntary components of overseas pensions have stopped being deductible but rather that there is a delay before these components begin to be deducted. The SSAA was*

*clear that section 70 of the Social Security Act 1964 (s70) does not differentiate between pension components that arise from voluntary contributions to an overseas pension scheme and those that arise from compulsory contributions – both components are deductible where the two criteria specified in s70 are met.<sup>23</sup>*

Neither of the other recommendations have been actioned.

The Periodic Report Groups (1997, 2003), the RPRC, Retirement Commissioner's reviews (2004, 2007, 2010, 2013) and the 2014 MSD Briefing to Government have drawn attention to the need to remove the spousal provision. For example the Retirement Commissioner's Review (2010, p. 79) stated:

*If one partner's NZS is fully reduced to zero because the overseas public pension amount is greater than the rate of NZS, the excess amount is then applied to directly reducing the other partner's NZS. In some cases it can mean that a New Zealand citizen who has lived and worked all their lives in this country receives no NZS because their partner receives a public pension from overseas. This is an inconsistent piece of policy that goes against the principle of universal individual entitlement and needs to be changed.*

The MSD Briefing to the Incoming Government (2014, p. 32) stated:

*There are policy and technical issues related to this policy that could be addressed. For example, one of the most unpopular aspects of the policy is that, where one partner of a couple has an overseas state pension that is more than their New Zealand Superannuation, the excess amount is deducted from the New Zealand Superannuation entitlement of the other partner.*

## **6. Policy framework for reform**

Good policy development requires a sequence of steps are followed as discussed in St John and Dale (2012). Good policy is dynamic, so that when the situation changes the policy should be continually evaluated against its objectives, and the objectives themselves kept relevant to the problems of the day as they too evolve.

### **a. Problem identification**

First, it is necessary to identify the problem to be solved. Historically, the DDP policy has been conceptualised as one of achieving equity between those who can claim an overseas pension that serves a similar purpose to NZS and those who cannot (Ministry of Social Development 2016). The DDP was introduced specifically in the 1938 Social Security Act because at that time UK pensions were payable in New Zealand. The rationale appears to have been the 'one pension' principle, and that someone from overseas was not to have better benefits than 'our own people'. Australian pensions were not paid in New Zealand until 2002, and Canadian pensions until 1960 (Ministry of Social Development 2013).

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<sup>23</sup> Personal communication from MSD 30 September 2016.

The rationale in 1938 may also have reflected current attitudes that stressed government transfers were to meet need, and those with overseas pensions were assumed to have less need (MSD 2013, p 3). In New Zealand at the time there was also a social security tax paid to the social security fund which may have given the impression there was a contributory basis to the pensions (Ashton and St John 1988).

While the reports published by MSD 2002-2008 concluded that the DDP was reasonably sound and should be maintained, circumstances have altered greatly since 1938. For example the concern about access to 'only one pension' may not be appropriate in light of the rise of contributory savings schemes, public and private in most countries. Nor is the principle of payment according to need relevant when NZS is universal, and when people immigrating to New Zealand may have had access to a wide variety of tax-favoured retirement savings schemes in their origin country.

Most schemes similar to NZS base their entitlements on years of work or contributions over a full career. This can mean a requirement of 30 to 50 years of contributions in order to receive the full state age pension (Ministry of Social Development 2012). For NZS, only 10 years' residence in New Zealand after age 20 are required, with at least five of those after age 50 (the 10(5) Residency Requirement). The residence requirements can also be achieved after the State Pension Age of 65 years. These features make access to NZS unusually easy when compared globally. This easy access to an age pension is particularly attractive to citizens of countries without such pensions, with the added advantage in New Zealand of access to emergency support in the years prior to meeting the residency qualification.

As mobility increases, and populations in developed countries experience the demographic change of ageing, NZS becomes an increasingly desirable option internationally, thus creating a fiscal risk. To some extent, the DDP does mitigate this risk, but it is a blunt instrument that captures, for example, Canadian and US second-tier pensions, and ignores Australia's Superannuation Guarantee.

In light of the changed environment of the 21<sup>st</sup> century, the problem is best conceptualised as a lack of fairness in the treatment of all those over 65, epitomised by the spousal provision and the apparently arbitrary operation of the DDP, and the potential fiscal risks of the current residency requirement.

#### **b. Quantifiable objective**

The objective needs to be measurable so the success of the policy can be evaluated. Equal treatment is as difficult to quantify as age pensions are to compare. Over the years there seems to have been a slippage of the objective from fairness into 'savings of the state

money' as the quantifiable objective. If however that is the objective, the DDP is far from the obvious best way to achieve that. In light of the discussion above, a suitable objective may be the achievement of *horizontal equity*- treating those over 65 with equal resources (income or assets) equally and equitably.

### **c. Clear criteria**

The choice among policy options to meet the objective should be guided by clear criteria and an appreciation of any trade-offs. Usual criteria include: equity, efficiency, effectiveness, human rights, simplicity, social acceptability, fiscal responsibility, and political feasibility. The current use of the DDP to meet cost saving objectives does not fulfil these criteria well.

### **d. Implementation**

Once the best policy is selected, its implementation has to be done well and with political consensus to ensure longevity of policy changes.

### **e. Evaluation**

This step requires asking questions such as: Has the problem been solved or addressed- what are the unintended consequences? Is there a need to rethink the problem and objectives for today? Does the evaluation suggest different policies are more appropriate?

## **7. A fair way forward? Canvassing the options**

Accepting the identification of problem as set out in the last section, reforms that can best meet agreed objectives and satisfy agreed criteria are now considered.

### **Short term solutions**

The spousal deduction is widely perceived as iniquitous as discussed above, offending the principle of horizontal equity. There is no comparison to be made between NZS and other benefits where spousal deductions are applied because those other benefits are jointly income-tested, while NZS is a universal pension.

The DDP can impact in a draconian and unexpected way on spouses who by virtue of marital status alone are treated differently to others. In today's world of fluid relationships, it is often difficult to establish who should be counted as 'married' so that this policy is open to arbitrary outcomes when accessing state assistance or support (St John, MacLennan, Anderson and Fountain 2014). Much time has been spent in fruitless appeals and in expensive legal challenges and yet this is the one aspect of section 70 that is easiest to resolve.

In the absence of political acceptance of an overall review of the DDP, reform of the spousal deduction should be considered separately and urgently in light of the injustices of the

current policy. Removal of the spousal provision would greatly enhance horizontal equity and in many instances vertical equity by reducing hardship, (see p4). It would greatly simplify arrangements, accord with human rights legislation, have very little fiscal consequence (costing currently only \$2m per annum), and have broad political and public support. While it would require legislative change, it would be extremely easy to implement. An argument could be made for reimbursement to those who have been affected by the spousal deduction,<sup>24</sup> however that is not as essential as removing the current anomalous treatment.

The removal of the spousal provision is likely to enhance the living standards of many, including some spouses experiencing hardship, but the main justification is that it is currently an irrational policy that offends principles of equality of treatment. As outlined above, there have been many calls to abolish the spousal deduction showing that political feasibility and approval of this policy would be high.

### **Longer term solutions**

None of the options for the reform of the DDP to better meet objectives and criteria are straightforward. The following section sets out 4 broad, realistic options that have been outlined in different forums and reviews, lists their strengths and weaknesses, and then evaluates them using the framework set out above. Within each option there is much scope for changing parameters from the ones discussed.

#### **Option 1 Enhancing the status quo: adapting the DDP**

This option would leave the DDP in place but modify its operation. For example it might use more liberal criteria to determine which state pensions are more like NZS and which are more like KiwiSaver and should not be deducted. For this to work fairly, every country's pension scheme would need evaluation according to agreed criteria, and regular monitoring for changes. Decisions are bound to be contentious and add complications rather than simplification.

This option resolves some of the horizontal equity issues between state and private pensions, but would not resolve all of the inequities of the DDP. In particular it does not achieve full horizontal and vertical equity by considering a retiree's full access to retirement income streams. Maintaining the status quo of the DPP but targeting deductions by total income, allowing a free zone of overseas pension to escape deduction or a phasing out of the DDP based on length of residency were modifications to address some of these issues that were canvassed by the MSD (2005).

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<sup>24</sup> At RPRC's public forums on overseas pensions in 2010, 2014, 2015, there has been agreement that backdating reimbursement of deductions is not feasible.

Enhancing the DDP may improve on the status quo for some but does not address the growing fiscal costs of a low residency requirement for NZS, nor the complexity of issues of access to different income streams that have arisen in modern times.

### **Option 2 Voluntary DDP and pro rata NZS**

Under this option, those with an overseas state pension could choose the most advantageous of either having the DDP apply, or receiving a pro rata amount of NZS while keeping their overseas pension. Entitlement to NZS would be 1/45<sup>th</sup> for each year of residence in New Zealand between ages 20-65. This option was canvassed by the MSD (2005, p. 22) and described as administratively complex because of the need to calculate may be up to 540 different rates. The current system has only three rates of NZS: married, single sharing and single living alone, and the overseas pension is deducted from the applicable rate. Littlewood and Dale (Littlewood and Dale 2012) proposed a variation of this when a person has a pension from overseas that is analogous to NZS: the entitlement to NZS would be 1/540<sup>th</sup> of NZS for each month of residence in New Zealand between ages 20-65, and the overseas pension entitlement would be paid in full. Each country would pay the pension that accrued during the period the pensioner lived/worked in that country. Adding those entitlements together would give a full, blended pension without any country 'subsidising' another; and the total income received would be subject to the usual income tax rules. A problem here is that some countries do not pay into NZ. For example, in the absence of a social security agreement, the US will only pay pensions to NZ residents who are US citizens (NZ citizens receive nothing).

The advantage of this option is that it reflects the 540 month system applied to emigrants under the 2009 Social Assistance (Payment of New Zealand Superannuation and Veterans Pension Overseas) Amendment Act. The flaw in this option is the difficulty of tracking one's residence over a working life of 45 years, and the inequity if not poverty risk imposed on those who have lived overseas, but not necessarily accumulated a significant overseas entitlement. For example, although some systems compensate for the childrearing years, a mother raising children for 20 years overseas and not in the paid workforce may only have an entitlement to 270/540<sup>ths</sup> of NZS.

This option is likely to be very complex to administer. Many more numbers would be involved than for the existing pro-rata portable system and full pro rata would require integration into the main IT programme SWIFTT-a big and very expensive task. Customs movement checks go back to the early 1990s but previous periods of declared residency maybe harder to verify. The resulting multiplicity of different rates of payment would also complicate the administration where there are other forms of assistance provided.

An additional problem with Option 2 (and Option 3, below) is that UK pensioners in New Zealand have non-indexed pensions. Over time, the combined amount of the UK age

pension and NZS would be less than the amount of NZS and/or overseas pension received by other superannuitants.

### **Option 3 Pro rata entitlement for all applications for NZS**

NZ First proposed this option in the New Zealand Superannuation and Retirement Income (Pro Rata Entitlement) Amendment Bill, and its first reading was on 16 September 2015 (Hansard 2015). The Bill sought to alter the amount of the NZS entitlement based exclusively on residence between the ages of 20 and 65 years; and to abolish section 70 of the Social Security Act 1964. The Bill proposed that every resident would get NZS on reaching age 65, with the amount based entirely on their period of residence between the ages of 20 and 65, a period of 45 years (540 months). Periods of absence of up to 2 months per year would be disregarded, allowing for overseas holidays, and an aggregate of up to 5 years would be exempt allowing for a young person's OE, postgraduate study, or whatever without affecting NZS on their retirement.

The Attorney General found that the Bill breached the Bill of Rights Act by limiting accrual to under the age of 65; and "... the Bill limits the right to be free from discrimination and the right to freedom of movement affirmed in ss 19(1) and 18 of the Bill of Rights Act respectively, and that the limits cannot be justified under s 5 of the Bill of Rights Act" (Attorney-General 2015, p. 2).

A further problem with Options 2 and 3 is the high administrative cost: monitoring every citizen's overseas travel, and calculating the impact. One of the benefits of NZS is its simplicity, and that is undermined especially in Option 3.

The New Zealand Seniors Party set up in 2016 propose a variant<sup>25</sup> in which residency for full NZS would be between 30-35 years with a minimum qualifying period of 10 years (after being granted citizenship). Pro rata NZS would be paid for time worked as a fraction of the 30-35 years required for a full pension. The policy is not clear regarding pensions for those in caring roles, such as raising children, or caring for disabled or elderly family members, but any policy that counts only paid work is problematic.

### **Option 4 Abolish DDP and increase residency requirements to 25 years**

Rather than tinker with administrative rules to apportion NZS a possible solution may lie in reform of the residency requirement for NZS, and abandoning the DDP. If NZS required a much longer residency between the ages of 20 and 65, it may unnecessary to identify the kinds of overseas pensions that are brought into New Zealand. Requiring longer residency in New Zealand gives far less time to accumulate significant overseas contributory state pensions.

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<sup>25</sup> See: <http://www.scoop.co.nz/stories/PO1608/S00168/the-truth-about-section-70.htm>.

The residency requirement for eligibility to NZS, for example, could be increased from the current 10(5) rule to a single test of, say, 25 years' residence between ages 20 and 65. Unlike the current arrangement, there would be no possibility of meeting the requirement using residency after age 65 (this is consistent with the way NZS is treated on emigration to non-agreement countries, see above). Where there is a Social Security Agreement, if totalisation is used to get the required years of residence only one basic pension would then be payable according to the agreement. For example, any entitlement to the UK's Basic State Pension may be deducted if those years of residence in the UK were used to qualify for NZS.

Where there is no Social Security Agreement, or the 25 years of residence is satisfied without totalisation, any overseas pension would not be taken into account in the calculation of NZS (except as taxable income) (Dale and St John 2012).

Ministry of Social Development (2005) reported that 85% of those caught by the DDP had lived in New Zealand for more than 30 years.

- 25 A significant majority of overseas pensioners have been resident in New Zealand for a considerable length of time. Eighty five percent of overseas pensioners have lived in New Zealand for 30 years or more. It is this group of pensioners who strongly disagree with the direct deduction policy because they believe they have earned the right to receive the full rate of NZS.

A 25 year residency record could largely eliminate the perceived inequities related to the DDP of current cohorts. This policy change would help these retirees, the bulk of whom have modest resources only. The MSD (2005) noted:

- 26 Overseas pensioners typically belong to low income households. Over sixty percent of overseas pensioners have an income level below the threshold which would preclude entitlement to a Community Services Card.

In the future there may be larger number especially from Asia that do not have 25 years by age 65. To prevent hardship, an income-tested benefit would continue to be available, and any overseas pension would be taken into account in the benefit's household income-test. That would reduce the income-tested benefit but not by as much as the existing dollar for dollar DDP arrangement.

With regard to the Trans-Tasman issues, the existing Social Security Agreement with Australia would need to be renegotiated. For example, if a New Zealander retiring to Australia had fulfilled the 25 years in New Zealand, they might get the full pro rata NZS with a top up Australian Age Pension if they qualify. An Australian retiring to New Zealand would also need to meet the 25 year requirement to receive the full NZS (without totalisation). If totalisation is used to meet the 25 years they should not receive NZS at a greater rate than their entitlement to the Australian means-tested Age Pension. Under the stricter residency requirement, those qualifying would be able to supplement their NZS

with additional retirement income derived domestically, like KiwiSaver, or from state and private sources from overseas.

In general, this option for reform improves equity and transparency and acknowledges the complexity of state involvement. Vertical equity considerations may require reform of the taxation of other income and NZS, so that local and overseas retirees with higher incomes, including incomes from lump sum superannuation benefits, pay appropriate taxation (St John 2015).

### **In summary**

With each of these options, there are many issues at the margin that would need to be addressed to ensure new inequities are not created. The transition from the pension policies that prevail now to a new system would require careful consideration. Backdating would not be possible: the new system would need to begin with a 'clean slate'. Nevertheless some grandfathering provisions may be needed and principles would need to be clearly stated to determine what would happen at the margins, for example in Option 4, if a person resided in New Zealand for 24 years and 3 months prior to reaching age 65.

## **8. Conclusion**

The ageing of the population is producing fiscal pressures in pensions and health, intensified by increased immigration especially at older ages. The DDP and residency requirements in many instances as described here, operate as an inadequate and unfair way to address these problems.

In the 21<sup>st</sup> century, growing complexities of overseas provisions make clear definitions of what counts for the DDP difficult and the administration of DDP is complex. There appears little justification for the DDP outside of social security agreements that allow totalisation and agreement between 2 countries to share the costs of the basic pension. To remove the DDP however without reforming entitlement to NZS would be fiscally expensive, and cause a growing fiscal loss over time. While loss of revenue may appear to justify retention of the DDP, there are better ways for the state to save money.

The spousal provision is unjustified even on fiscal grounds. Moreover the inherent punitive approach for those who are married is likely to be in breach of Human Rights legislation on family status grounds and offends the principle of horizontal equity. The spousal provision should be immediately abandoned.

Four broad options have been considered here for further discussion. The first, enhancing the status quo, does not overcome the inherent problems of the DDP.

The second and third options involve the use of pro rata NZS and while they may be an improvement in equity for those affected, this may be a step too far for many New

Zealanders who treasure their universal simple flat rate NZS and the way it performs a useful equalising function on incomes in retirement.

The fourth option is the simplest and likely to be seen as fair in principle. Longer residency however needs care in introduction and protection of those already in or close to retirement. Nevertheless for those with overseas pensions already satisfying longer residency between ages of 20 and 65, abandonment of the DDP would provide them with modest small additional incomes. Given that NZS is a basic income floor only this would be welcome and may save costs elsewhere.

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## 10. Appendix 1

| Appendix 1   |                                    |   |  |
|--|------------------------------------|---|--|
| <b>Overseas pension deductions from recipients of New Zealand Superannuation, Veteran's Pension, and Main Benefits as at the end of March 2016</b> |                                    |   |  |
| Source: MSD 2016   |                                    |   |  |
| <b>Country</b>   | <b>Number of Overseas Pensions</b> | <b>Annualised Value of NZ Bft &amp; Supps</b> | <b>Annualised Value of Overseas Pensions in NZ\$</b> |
| Australia  | 15,082                             | \$247,911,307.80                              | \$42,191,855.41                                      |
| Bulgaria   | 36                                 | \$506,497.68                                  | \$117,199.40   |
| Canada   | 2,285                              | \$29,781,888.76                               | \$7,625,826.31                                       |
| Croatia  | 22                                 | \$298,552.80                                  | \$82,064.21  |
| Denmark  | 122                                | \$1,614,598.44                                | \$356,610.58   |
| Fiji   | 56                                 | \$771,126.20                                  | \$173,933.22   |
| France   | 78                                 | \$1,025,061.96                                | \$263,145.01   |
| Germany  | 424                                | \$4,880,000.84                                | \$1,514,212.45                                       |
| Guernsey   | 115                                | \$1,819,454.52                                | \$461,709.25   |
| Ireland  | 278                                | \$4,342,455.00                                | \$982,378.38   |
| Isle of Man  | 48                                 | \$622,564.80                                  | \$149,810.27   |
| Japan  | 120                                | \$1,305,220.80                                | \$440,403.01   |
| Jersey   | 109                                | \$1,638,989.56                                | \$423,599.18   |
| Korea Republic of  | 35                                 | \$465,255.44                                  | \$105,508.87   |
| Macedonia The Former Yugoslav Republic   | 23                                 | \$311,891.84                                  | \$92,874.92  |
| Philippines  | 207                                | \$2,983,459.44                                | \$704,472.13   |
| Romania  | 37                                 | \$394,138.16                                  | \$152,351.04   |
| Russian Federation   | 215                                | \$2,926,749.28                                | \$720,684.73   |
| Singapore  | 24                                 | \$296,824.84                                  | \$92,525.11  |
| Sweden   | 73                                 | \$842,382.84                                  | \$217,462.22   |
| Switzerland  | 317                                | \$3,702,850.32                                | \$1,081,165.13                                       |
| Taiwan   | 128                                | \$1,646,401.12                                | \$431,365.32   |
| the Netherlands  | 4,307                              | \$66,307,093.32                               | \$15,708,814.73                                      |
| United Kingdom   | 59,034                             | \$949,118,638.52                              | \$264,305,725.76                                     |
| United States of America   | 558                                | \$4,148,072.76                                | \$3,597,655.64                                       |
| Other  | 249                                | \$3,194,674.60                                | \$992,794.34   |
| <b>Grand Total</b>   | <b>83,982</b>                      | <b>\$1,332,856,151.64</b>                     | <b>\$342,986,146.62</b>                              |

Notes: This report includes overseas pensions paid directly to the client and paid through the Special Banking Option  
The annualised value of NZ Benefits and Supplementaries and Annualised Overseas Pension amounts, are an approximate value of the yearly amount based on the weekly amount at the time of the report  
Main Benefits, include Jobseeker Benefit, Sole Parent Support benefit, Supported Living Payment and Emergency Benefit.