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KiwiSaver: Four years on¹

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by

Susan St John,² M.Claire Dale³ and Michael Littlewood⁴

Retirement Policy and Research Centre

Economics Department
Business School
The University of Auckland
Private Bag 92019
Auckland, New Zealand
www.rprc.auckland.ac.nz

Contact email: Dr Susan St John: s.stjohn@auckland.ac.nz

¹ The original version of this paper was delivered by Susan St John to the Pension Policy Research Group, School of Business, Aras an Phiarsaigh at Trinity College, Dublin, on 2 June 2010.

² Associate Professor Susan St John is Co-director of the Retirement Policy and Research Centre.

³ Dr M.Claire Dale is Research Fellow at the Retirement Policy and Research Centre.

⁴ Michael Littlewood is Co-director of the Retirement Policy and Research Centre.

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The Retirement Policy and Research Centre

The Retirement Policy and Research Centre is pleased to publish this Working Paper on New Zealand's KiwiSaver, introduced 1 July 2007. The UK is starting a similar private retirement saving scheme in 2012, and Ireland is in the process of considering the introduction of a scheme. Since its announcement in the 2005 budget, KiwiSaver has been well accepted by the public, despite multiple revisions, and despite mild opposition from employers who have experienced extra compliance costs in the auto-enrolment processes.

New Zealand's experience suggests that automatic enrolment and large incentives to entice people to remain opted-in may ensure initial take-up is high. It also suggests the incentives may be reduced significantly ex post with little impact on membership. Core tax-funded KiwiSaver subsidies have been both deliberately reduced and not indexed so that the real value reduces over time.

Lessons on what to avoid in the design of a retirement saving scheme include: opening it to children; offering housing subsidies; allowing too many providers; ignoring the issue of decumulation; and obscure objectives.

The Working Paper surveys the four years of KiwiSaver's evolution. In that time, the fundamental questions around KiwiSaver's purpose have not been resolved: is it to enhance an individual's ability to consume in retirement; to reduce the pressures on the economy of an ageing population; or to solve the national saving problem. When the purposes are unclear, the scheme may be vulnerable to the industry determining the design of the scheme to meet its own objectives.

The Retirement Policy and Research Centre welcomes this contribution to a needed debate. However, the views expressed in this Working Paper are those of the authors.

Comments welcome to Dr Susan St John: s.stjohn@auckland.ac.nz



Dr Susan St John



Michael Littlewood

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1 Introduction

This paper begins by describing the nature of the New Zealand pension system and the evolving nature of KiwiSaver, New Zealand's national private saving scheme. Some statistics are reported along with a discussion of emerging problems with KiwiSaver's design, and some implications for countries contemplating auto-enrolment schemes.

KiwiSaver, announced in the 2005 Budget and introduced in July 2007, is the world's first auto-enrolment, opt-out national saving scheme (O'Connell, 2009). It runs alongside the universal Pay As You Go (PAYG), partially prefunded pension: New Zealand Superannuation. The design, implementation and outcomes of KiwiSaver are of potential interest to countries like Ireland and the UK that are adopting similar schemes based on the auto-enrolment, opt-out concept, or 'soft compulsion'.

New Zealand commentators have been adulatory, with few, if any, arguing for a reversal of policy or questioning the fundamental design of KiwiSaver:

New Zealand Superannuation is simple. KiwiSaver is rather less so, but nonetheless no more intrinsically complicated than voluntary private savings schemes encouraged in some places and compulsory ones mandated in others – and having both PAYG and fully funded approaches operating together is now seen as optimal. The auto-enrolment method adopted for KiwiSaver is arguably more complicated than either the voluntary or compulsory approaches, but preserves an element of choice seen as highly desirable. (Rashbrooke, 2009)

After only three years, KiwiSaver was lauded in many New Zealand financial circles:

KiwiSaver has proved to be a huge success, far beyond the Government's expectations. At the end of March [2010] the scheme had a phenomenal 1,369,609 members,⁵ net of opt outs and closures, compared with the Treasury's projections of 680,000 members by June 2014. (Gaynor, 2010)

It is timely to ask: a success for whom? Is KiwiSaver a numbers game? Has it had the effect on the economy that was originally desired? What are the macro implications as opposed to the micro effects of subsidising some citizens to have more resources in retirement? Will they in fact have more, or will members simply reduce other savings to compensate? In the long term, what are the implications for New Zealand's overall pensions framework, and in particular the very successful universal state pension?

While not as badly affected by the Global Financial Crisis (GFC) as many European countries and the US, the New Zealand economy is in the unenviable position of having one of the highest net international liabilities/GDP ratios in the OECD (Bedford, 2009; Statistics New Zealand, 2010).⁶

The Current Account Deficit (CAD) reached unsustainable levels of 8-9% of GDP in the years 2005- 2008. New Zealand has traditionally run a tight monetary policy to contain inflation at the cost of a high real interest rate and large CAD. In the recessionary years 2008-2011, the CAD improved, but the structural issues relating to the external accounts have not yet been addressed, with predictions that a return to economic growth will once again cause the CAD to rise rapidly (Minister of Finance, 2011a).

⁵ The population of New Zealand in 2010 is 4.3 million. At 1 November 2011, the number of members reached 1,829,142 (Inland Revenue Department, 2011c).

⁶ 90% of GDP in December 2009 (Statistics New Zealand, 2010), 70% of GDP in June 2011 (English, 2011).

In the years to 2008, the government ran large fiscal surpluses and so the national saving problem exemplified by the CAD was seen as a problem of the low saving of the private sector, in particular households borrowing for housing and consumption. The GFC-driven recession, and the costs of large earthquakes in a major city, then caused a further deterioration in the fiscal position. Nevertheless in October 2011 the Government was predicting a return to surplus in 2014/15, and the Treasury was predicting average annual growth of almost 3% between 2012 and 2016, with more than 150,000 new jobs created and strong growth in wages and household incomes (Minister of Finance, 2011b).

Despite repeated informed challenges (including Le, Gibson, & Stillman, 2010), the lack of household savings is held to be the cause of New Zealand's poor economic performance and indebtedness (see for example Bennett, 2011; Bollard, Hodgetts, Briggs, & Smith, 2006; Fallow, 2010; Gaynor, 2008; N. Perry, 2011; Savings Working Group, 2011). This local lack is compared unfavourably with the good fortunes of New Zealand's closest neighbour, Australia. There, a much stronger economy and higher productivity is often attributed to its compulsory superannuation scheme which has reportedly added to the capital base and encouraged domestic investment and strong growth (The NZ Institute, 2010).

On the eve of the introduction of KiwiSaver, the then Minister of Finance said:

KiwiSaver now presents the chance for a new beginning for New Zealand in terms of saving and investing. It is the individual's equivalent to the New Zealand Superannuation Fund – the opportunity for greater security in retirement. At the same time it will significantly increase the flow of funds in New Zealand for investing both here and overseas. The effects of such funds can be seen in Australia. By some measures Australia is now the world's fourth largest offshore investor. We, on the other hand, are one of the world's largest borrowers relative to our size. (Cullen, 2007)

In 2010, the Labour Opposition suggested that more household saving would be the solution to New Zealand's economic problems (Wilson, 2010). In the pre-election campaign Labour proposed to achieve this by making KiwiSaver compulsory and by restarting contributions to the New Zealand Superannuation Fund (NZSF).⁷ With assets in NZSF of NZ\$16.6 billion as at 31 September 2011,⁸ it could be said to have delivered on its promise of being a way in which the government could save on behalf of New Zealand households (New Zealand Superannuation Fund, 2010).

Ireland and the UK

Following the Green paper (2007), the Government of Ireland signalled a desire to introduce a savings scheme similar to the UK's personal pension accounts (Government of Ireland, 2010a), to be implemented in 2014 (Government of Ireland, 2010b). Unlike New Zealand, the driver there is the concern that the state pension costs will rise unsustainably as the population ages. Projections indicate that public spending on pensions, health and long-term care will increase from around 12% of GDP (14% of GNP) today, to 26% (31% of GNP) by 2050 (Government of Ireland, 2007, p. 25). Raising the state pension age to reach 68 by 2028 is proposed, along with a new national auto-enrolment, opt-out, defined contribution scheme. Unlike KiwiSaver in New

⁷ These contributions, running at NZ\$2 billion pa, were put on hold in 2008 when the government's fiscal position deteriorated. The NZSF was designed to partially smooth the pension costs of the ageing population.

⁸ See http://www.nzsuperfund.co.nz/files/Fund_performance_to_30_September_2011.pdf.

Zealand, however, it appears that there will be sufficient lead-in time for the detail to be carefully developed.

The new National Pensions Framework (2010a) that is to be administered by the government is the result of a comprehensive public consultation process that began with the publication of the Green Paper on Pensions in October 2007 and was informed by the proposals in the McCarthy Report and the Report of the Commission on Taxation. The key elements of the Framework are, in summary:

- The State pension will be reformed and will remain as the fundamental basis of the pension system in Ireland. Every effort will be made by the State to keep the value of this pension at 35% of average earnings;
- A new supplementary pension scheme will be introduced to provide additional retirement income for employees who are not already in a pension scheme. Employees earning above a certain income threshold will be automatically enrolled in this new scheme, and the State and employer will support this by providing matching contributions;
- There will be matching State and employer contributions. The State contribution will equal 33% tax relief – the delivery mechanism for this to be decided;
- The same matching State contribution (and delivery mechanism once decided) will apply to existing occupational and personal pension schemes and will replace the current system of tax relief at the standard and higher rates;
- A new pension scheme for new entrants to the public service will take effect from 2010;
- The age at which people qualify for the State Pension will be increased – to 66 years of age in 2014 , 67 in 2021 and 68 in 2028;
- A revised and more secure defined benefit (DB) model is proposed which schemes may wish to consider if restructuring in the future (Government of Ireland, 2010b).

The first UK proposals were made a year after KiwiSaver began to be discussed (Pensions Commission, 2005), and the start date is set for 2012. The UK's Turner Commission recommended that, if employees join, they must contribute the equivalent of 4% of their pay above a threshold and the employer must then contribute 3% to a new National Pension Savings Scheme. A benefit worth about an additional 1% of pay will come from tax relief (Pensions Commission, 2005). What is now called the National Employment Savings Trust (NEST) administered by the Personal Accounts Delivery Authority (PADA) starts in 2012.⁹ Contribution requirements recommended by the Turner Commission will apply to incomes of £5,000 to £35,000 a year (2009 values) unless employers offer an alternative 'qualifying' scheme that is at least as generous.

Another important difference between KiwiSaver and the UK scheme is that no consideration was given in the design of KiwiSaver to decumulation. The UK scheme, following the Turner recommendations, will make a tax free lump sum available of up to 25% of the total funds, and the remainder, which must be annuitised by age 75, is taxed as income (Turner, Drake, & Hills, 2006).

2 The New Zealand pensions framework

New Zealand introduced the old-age pension in 1898 to provide some protection for the deserving poor aged over 65. Over a hundred years later, the retirement income framework in New Zealand has, at its foundation, New Zealand Superannuation (NZS), a flat-rate, universal, taxable benefit, paid out of current taxation. To address the issue of

⁹ See: www.padeliveryauthority.org.uk.

an ageing population, under the 2001 New Zealand Superannuation and Retirement Income Act, the NZSF was established to provide some pre-funding for NZS, with the draw-down from the fund set to begin around 2031.

Until the introduction of KiwiSaver in 2007, New Zealand had been unique in offering little or no tax concessions for additional private retirement saving (St John, 2005, 2007). Excluding the Government Superannuation Fund (GSF),¹⁰ in 2005, 14.7% of the working age population was covered in traditional employer-subsidised retirement saving schemes (Government Actuary, 2008). By 2010, that had decreased to 10.88% of the working age population (with total assets of \$12.949 billion) (Government Actuary and Financial Markets Authority, p. 11), as KiwiSaver membership exceeded expectations.¹¹

Entitlement to NZS is achieved on reaching the age of 65 years, and meeting the residence requirement of 10 years in New Zealand after age 20, with at least five of those after age 50 (the 10(5) Residency Requirement).¹² Although there is a specified 'couple rate', individual entitlement applies, and each partner of a married couple receives an individual pension that is taxed with other individual income. The net rate for a couple is at least 66% of the net average wage (33% for each married person). Indexation is annually via the Consumer Price Index until the floor of 66% is reached, then pensions rise with the net average wage.

Table 2 shows the dollar amounts, both for superannuitants who pay at the lowest tax rates, and for high income earners whose NZS is all taxed at the highest rate of 33%. In the past, with a more progressive rate structure and for the years from 1985 (St John, 2010; St John & Familton, 2010) when a surcharge applied to other income, the top income earners retained far less than today. The tax system now provides a limited clawback only, with top income earners receiving 76-78% of the amount received by those with no other income.

Table 1. New Zealand Superannuation rates at 1 April 2011

Category	Percentage of net average wage*	Annual rate	Annual Net	Annual Net
		NZ\$ (gross)*	(Primary Tax)	(Tax at 33%)**
Single, living alone	42.9%	\$20,235	\$17,676	\$13,496
Single, sharing	39.6%	\$18,585	\$16,317	\$12,396
Married person or partner in civil union or de facto relationship (each)	33%	\$15,292	\$13,597	\$10,200

Source: Work and Income website: <http://www.workandincome.govt.nz/>. Note: supplementary income-and asset-tested benefits may also be paid.*NZ \$38,546 (\$48,609 before tax). 1NZ \$ = €0.58 2 November 2011.

** The columns shows the amount retained in net terms when NZS is all taxed at the top tax rate

NZS is best seen as a sophisticated yet simple variant of social insurance; it is neither earnings-related nor contributory but fulfils the role of a basic individual income. The Retirement Commissioner has described NZS as "a remarkably effective, simple and secure foundation for retirement income. It means that New Zealanders - and especially

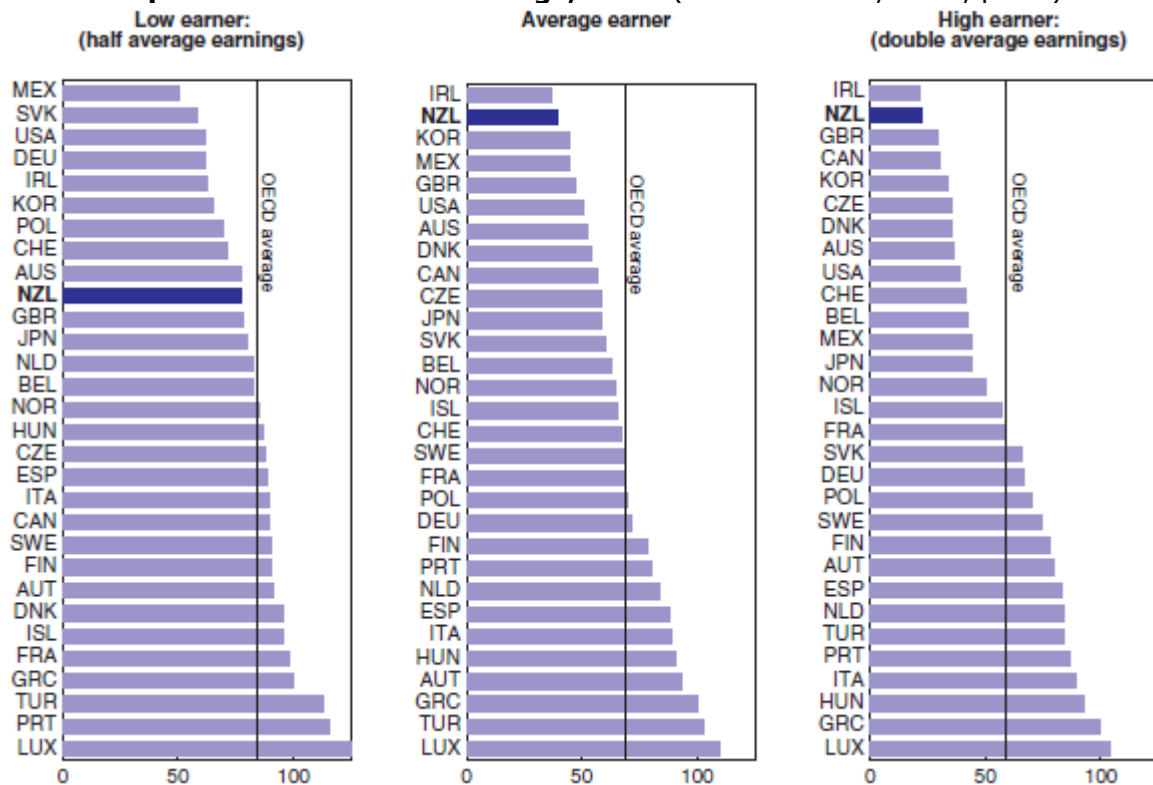
¹⁰ The GSF was closed 30 June 1992. At 30 June 2010 it had \$2.946 million in assets and 67,391 members of whom 52,804 were receiving pensions or had deferred pension entitlements

¹¹ Membership in the three State Sector Retirement Savings Schemes (SSRSS) schemes was 36,898 on 30 June 2011 and the SSRSS accounts at the three scheme providers were valued at \$749.3 million. See: <http://www.superscheme.govt.nz/ssrss>.

¹² The residence requirements can also be achieved after age 65.

women – are less at risk of hardship in later life than people in many developed countries.” (Crossan, 2007, p. 4). Compared with basic age pensions internationally, and with other welfare benefits domestically, NZS is relatively generous. As a consequence, New Zealand has very low rates of pensioner hardship, despite high rates among those on welfare benefits (B. Perry, 2009).

Figure 1. Net replacement rates at different earnings levels: Per cent of individual pre-retirement net earnings, 2002 (Source: OECD, 2007, p. 72)



Nevertheless, while low-income earners do fairly well in an international comparison of public pensions, Figure 1 above shows workers on average earnings or above have relatively low replacement rates (Source: OECD, 2005; OECD, 2011, p. 121).¹³ Replacement rates decline as income increases more quickly in New Zealand than in other countries. The counter consideration is that high replacement rates in other countries are usually only for those with a full contributions record.

3 KiwiSaver 2007 - 2011

Until the advent of KiwiSaver, saving for retirement in New Zealand had been a voluntary, unsubsidised activity. The tax regime for private and occupational superannuation schemes was the same as for saving in a bank account. Contributions, whether by employer or employee, were out of after-tax income (T), fund earnings were taxed at a rate that proxied the individual’s marginal rate (T), but withdrawals were like a return of capital and hence tax-exempt (E). This TTE tax treatment contrasts with the EET treatment conventional for retirement savings in other countries.

¹³ Note that the OECD takes the ‘living alone’ rate for the New Zealand calculations. Figure 1 reflects only the mandatory state-provided pension arrangements and ignores private provision. See Appendix 1 for a more detailed presentation of this information.

The first tax break for private saving in New Zealand since 1990 was introduced in 2000 when the top personal marginal tax rate was raised to 39% and the rate applied to employers' contributions for employees remained at 33%. This however was a modest concession and did not indicate a loss of faith in the doctrine of tax neutrality (TTE) with respect to saving (St John, 2007).

The government is not considering upfront tax incentives. These are likely to have to be very large - with fiscal costs running to many hundreds of millions of dollars a year - before they have any desirable effect on overall savings. Their abolition in the mid-1980s represented sensible tax policy on both equity and efficiency grounds. (Minister of Finance, 2002)

There was still a concern that many workers did not have access to an occupational saving scheme and that New Zealanders were not saving 'enough'. It was in this context that KiwiSaver, a contributory, employment-based, retirement-saving scheme, was conceived.

KiwiSaver I

In the scheme as announced in the 2005 Budget, KiwiSaver members were to contribute 4% or 8% of their gross income to a KiwiSaver account. While employers could contribute, there was no compulsion to do so. The key premise of KiwiSaver I was that people are more likely to commit to saving regularly if they are automatically enrolled rather than deciding whether to 'opt-in'.

The government subsidies were a flat \$1,000 'sweetener' (the Kickstart) paid on joining, and an annual fees' subsidy of \$40. These subsidies avoided the problems of the regressivity of tax concessions and left the TTE tax regime for saving unaffected. At this point, New Zealand looked like it was offering the world a natural experiment to ascertain the pure effect of an auto-enrolment, opt-out policy, uncomplicated by other incentives.

But the climate was about to change. In August 2006 (ten months before KiwiSaver's start date), the Government announced that matching contributions by employers up to 4% would be tax-exempt. Cabinet papers released under the Official Information Act show alarm bells were ringing:

Officials do not recommend exempting employer contributions to KiwiSaver from SSCWT.¹⁴ On the one hand, this would create benefits for an employee to sacrifice his/her salary or wages in exchange for an employer contribution, higher amounts could be saved and compliance costs for employers would be reduced. On the other hand, this would create a tax distortion in favour of employer contributions to KiwiSaver relative to existing schemes, could have a fiscal cost of up to \$330 million, could lead to pressure to exempt all employer contributions, and would lead to no tax on employer contributions under the taxed/taxed/exempt (T/T/E) model. (Inland Revenue Department, 2006)

Concerns were echoed by the OECD:

Over the years, there has been a move toward granting more exceptions, constituting a break with the "broad base, low rate" policy endorsed in the 2001 Tax Review (McLeod et al., 2001). Non-neutral tax policies that are unevenly applied to various activities encourage New Zealanders to devote resources to

¹⁴ SSCWT was the Specified Superannuation Contribution Withholding Tax applied to employer contributions as a proxy for the tax that the employees would have paid if the contributions had been treated as their income.

less-taxed activities, rather than to those that generate the greatest economic returns. ...The tax exemption for employer contributions to registered superannuation schemes is a further departure from the comprehensive income approach. (Mourougane, 2007)

As might have been predicted, the employer contribution tax-break was the thin end of the wedge. The Association of Superannuation Funds of New Zealand argued that there was a serious risk that many existing superannuation schemes would be wound up, undermining the government's goal of increased saving. Thus almost immediately, a further Supplementary Order paper extended similar tax privileges to all employer superannuation schemes that met lock-in provisions. Cabinet papers acknowledged that the extension to other schemes had little to do with the goal of increasing new saving, and essentially subsidised existing saving.

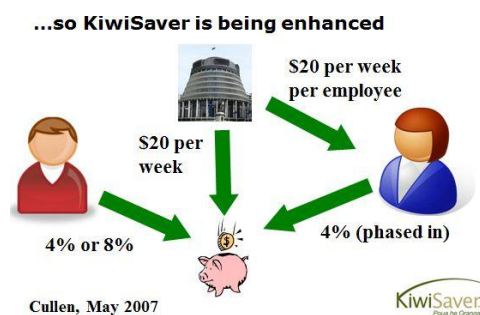
There appeared to be little in-depth analysis of the regressivity of the reintroduction of tax incentives, although the Inland Revenue Department (IRD), concerned about the potential costs, noted that the higher the employee's salary the higher the benefit. The IRD also noted that: "the benefit of the \$1000 government contribution to KiwiSaver and the fee subsidy pale over time in comparison with the benefit of the tax exemption" (Inland Revenue Department, 2006).

KiwiSaver II

In the May 2007 Budget, on the eve of the introduction of KiwiSaver, dramatic changes were announced to take effect on 1 July 2007. The revised scheme, identified here as KiwiSaver II, may have reflected a concern that the uptake would be low. More importantly, apparently healthy fiscal surpluses had emerged in a strongly growing economy, and along with contributions to the NZSF, KiwiSaver offered a way to lock up these surpluses. The very significant changes imposed large compliance costs on employers, on scheme providers, and on the IRD that was required to administer the scheme.

The three elements to the changes were:

- First, a member tax credit (MTC) to savers to match their contributions into KiwiSaver (or a complying superannuation fund) up to a maximum of \$20 per week from 1 July 2007;
- Second, compulsory matching employer contributions for employees, starting at 1% from 1 April 2008, and then rising by a further 1% each year, reaching 4% from 1 April 2011;
- Third, an employer tax credit (ETC) that reimbursed contributions at a rate of 100% up to \$20 per week per employee from 1 April 2008. (Cullen, 2007)



The new MTC and ETC which applied to the first \$20 contributed by employees were less regressive than pure tax exemptions, however the cost was still high. In addition, the MTC was not limited to those in employment and could be accessed by beneficiaries, unpaid caregivers, and the self-employed, for contributions up to \$20 a week. The New Zealand Treasury (2007) estimated that by

2011, the fiscal cost would be NZ\$1.2 billion a year, while the positive effect on household saving was expected to be only NZ\$1.1 billion.

In the first two years when the compulsory rate was 1% and 2% the ETC meant that the cost to the employer, even for higher waged employees, would be minimal. Also, the compulsory employer contributions of 1% (rising to 4% of employees' gross pay by 2011) applied only to those employees in the scheme, leaving much confusion as to what would happen with remuneration packages and wage negotiations. Nevertheless, the quasi-compulsory employer contribution was clearly expected to play a part:

There is no doubt that employer contributions will create a greater sense of employee loyalty.¹⁵The accumulation of savings funds in this way will also create greater incentives for workers to stay in New Zealand. The Government expects that the phase-in of the compulsory matching employer contributions will be taken into account in wage and salary bargaining. (Cullen, 2007)

KiwiSaver I included a housing subsidy for first-home buyers, and KiwiSaver II introduced an additional mortgage diversion scheme, despite its rejection by the Select Committee. Under this scheme, after one year, up to half of the employee's own KiwiSaver contributions could be directed to mortgage repayments. Given that a key concern that promoted KiwiSaver in the first place was over-investment in housing, providing mortgage repayments and a first-home deposit subsidy from what was intended to be retirement savings appeared counterintuitive (Mourougane, 2007).

Although mortgage diversion was quietly dropped in 2009, the first home deposit and subsidy scheme remained a feature of KiwiSaver III.

The introduction of KiwiSaver II was timed to coincide with the reform of the taxation of collective investment vehicles (CIVs) including superannuation schemes. The intent was to retain the tax-paid nature of superannuation schemes, but to align the proxy tax rate on the scheme's investment income more closely with the tax rate of the individual investor. Superannuation schemes (and other CIVs) can become 'Portfolio Investment Entities' (PIEs), and the effect for most was that investment income in the fund was taxed preferentially. Advantages were greatest for taxpayers on the then top marginal income tax rate of 38% because the maximum PIE rate was only 33% (reduced to 30% from 1 April 2010, and to 28% from October 2010) and many could re-organise their affairs to qualify for a PIE rate of only 19.5% (reduced to 17.5% from 1 April 2010). PIEs have continued to offer considerable rewards for restructuring the way in which earned income is received (Chamberlain & Littlewood, 2010)

KiwiSaver III

In late 2008, the newly elected National-led government, never a supporter of KiwiSaver or the NZSF policies, made changes to KiwiSaver to provide the revenue to reduce income taxes, and to make KiwiSaver more affordable to both the individual and the state.

With effect from 1 April 2009, the annual state-provided \$40 fee subsidy was abolished; the minimum employee contribution was reduced from 4% to 2%; the employer's compulsory contribution was capped at 2%; the tax-free employer contribution was limited to 2% of the employee's gross salary or wages; and the ETC was abolished. The

¹⁵ An odd contention as the employer's contribution was compulsory.

government also halted contributions to the NZSF, arguing that emerging fiscal deficits implied that they would have to borrow to maintain contributions.

There had been concern that, under KiwiSaver II, some wage-earners could be penalised on joining by being offered a lower gross wage than others:

*The KiwiSaver Act will be amended to make it clear that upon joining KiwiSaver, no employee can have their gross pay reduced as a result of employer contributions. ... The changes will also provide employers and employees with the ability to negotiate their own arrangements in good faith.*¹⁶ (English, 2008)

Box 1 sets out the dimensions of the KiwiSaver III scheme. The scheme was open to all New Zealand residents under the age of 65 (3.7 million people), of whom about 1.7 million out of a total labour force of 2.29 million, were potentially entitled to the employer contributions. Those not entitled to contributions were employees under age 18 and over age 64, temporary employees, domestic staff and some employees in seasonal agricultural work.

As at 31 March 2010, the Crown was still the largest contributor to KiwiSaver with an estimated contribution of \$2.3 billion. Members had contributed approximately \$2.1 billion and employers \$0.9 billion (Ministry of Economic Development, 2010). KiwiSaver was still a small part of the overall managed funds sector, making up only 9% of total funds under management compared to 29% for other superannuation schemes (Ministry of Economic Development, 2010). As at March 2010, there was around \$5 billion held in KiwiSaver funds. The annual inflow, including the government's contribution, was around \$2.14 billion.¹⁷ KiwiSaver home ownership assistance became operational in July 2010.

Box 1. KiwiSaver III (as at March 2010)

- KiwiSaver is a voluntary, work-based savings scheme, administered by the IRD using the existing PAYE (pay as you earn) tax system. Employees, automatically enrolled into KiwiSaver when they start a new job, have the 2nd to 8th week of employment to 'opt-out' and must advise their employer or the IRD of their decision. Having opted-out, they cannot be auto-enrolled again until they change jobs.
- Scheme enrolment is not automatic for workers under 18, over 64, employed less than 4 weeks, or employed when KiwiSaver started in 2007. They may join if they wish. The self-employed, beneficiaries, and non-workers can join, making payments directly to the scheme provider.
- A maximum \$20 a week matching subsidy is paid by the government for the member's contributions.
- Employees' contributions start from the first pay day with an employer. Deductions from wages are at a rate of 2% of gross pay, unless the individual opts for the higher rate of 4% or 8%. Employers are compelled to contribute 2% of the pay of KiwiSaver members, and that 2% is tax deductible for the employer, and tax free for the employee.
- Contributions are held by the IRD for an initial three month period after auto-enrolment during which the employee can seek financial advice and select a fund

¹⁶ In fact, this mis-stated the true position: while employers could not reduce pay directly, they could eventually incorporate the employer's 'compulsory' contributions into future pay rises.

¹⁷ See <http://www.kiwisaver.govt.nz/statistics/ks-stats-10-03-31.html>.

provider. Savers can select their fund and can change provider, but can only have one provider at any time. Those who do not specify a fund will be randomly allocated to one of, currently, six default providers chosen by the government.

- Savings are 'locked in' until age 65 (eligible for NZS), except in cases of: financial hardship, permanent emigration, serious illness, or after a minimum of five years (for those first joining after age 60), or to contribute toward a deposit on a first home. However, after a minimum 12 month contribution period, employees can apply for a 'contributions holiday'. Contributions resume at the end of the five years unless the individual applies for a further 'contributions holiday'. Individuals on contributions holidays can contribute what they wish, when they wish.
- Existing superannuation schemes may convert to KiwiSaver, subject to certain criteria. Members of other schemes may open a KiwiSaver account, instead of or as well as, their existing scheme.
- The automatic enrolment provisions will not apply in workplaces where the employer is "exempt" i.e. running a scheme that is portable, open to all new permanent employees, with a total contribution rate (employer plus employee) of at least 2%.
- After three years' membership, the government will also offer a first home deposit subsidy of \$1,000 per year of membership in the scheme, up to a maximum of \$5,000 for five years.

Source: derived from <http://www.treasury.govt.nz/kiwisaver/>

KiwiSaver IV

In the May 2011 Budget, three significant changes to KiwiSaver were announced that are expected to save the government \$2.6 billion over 4 years. First, From 1 April 2012, all employer contributions to employees' KiwiSaver accounts and complying superannuation funds will be subject to employer superannuation contribution tax (ESCT). Second, for the year ending 30 June 2012, the MTC is reduced to 50c for every \$1 contributed by members up to a maximum of \$521 a year. Third, from 1 April 2013, the minimum employee contribution and compulsory employer contributions will rise from 2% to 3% (Inland Revenue Department, 2011a).

An initial evaluation of KiwiSaver home ownership assistance found that the number of members receiving a first home withdrawal or a subsidy was higher than forecast. By 31 March 2011, there had been 1,274 withdrawals, with an average value of \$9,640; and 619 subsidies of \$3,000 each (Inland Revenue Department, 2011b).

KiwiSaver V?

In a press release on 18 October 2011,¹⁸ the Minister of Finance announced that "as part of its programme to build genuine national savings", and subject to returning to surplus, the Government would require KiwiSaver auto-enrolment for all employees in 2014/15. This would be a one-off exercise, with details finalised after public consultation in 2012. Employees in the workforce not already in the scheme would be signed up with the ability to opt out. At the same time there would be a re-tendering of KiwiSaver default providers.

¹⁸ See <http://www.beehive.govt.nz/release/govt-proceed-kiwisaver-auto-enrolment>.

With about 1.8 million members, KiwiSaver funds are expected to rise rapidly, accelerated by auto-enrolment, from about \$8 billion in 2011¹⁹ to \$25 billion by 2015 and almost \$60 billion by 2020 (Inland Revenue Department, 2011d). The Minister of Finance announced that officials estimate KiwiSaver auto-enrolment could cost the Government up to \$550 million over four years, for the one-off \$1,000 kick start payments to new members and ongoing annual MTC.

However, the cuts to the MTC will provide some offsetting cost saving. In year ended June 2011, \$998 million was transferred by the Crown to KiwiSaver providers, mainly as MTCs (Inland Revenue Department, 2011b).

4 Analysis of KiwiSaver 2011

KiwiSaver membership was expected to plateau in 2012 at 1.4 million (Inland Revenue Department, 2009b), however, the 30 June 2011 data shows membership had already reached 1.76 million, 44% of the eligible population under age 65, with 63% opting-in (Inland Revenue Department, 2011b).

Those enrolled automatically and choosing to opt-out declined from 34% in 2009 to 28% in 2011, and more people are now choosing their own scheme, often moving their KiwiSaver account to their bank (Inland Revenue Department, 2011b). Table 2 shows that while a significant proportion (37%) had been automatically enrolled, almost half of all members (49.9%) had made an active choice to join KiwiSaver.

Table 2. Membership as at 31 August 2011

Method of joining KiwiSaver	Members	Percentage
Opt-in via provider (active choice)	895,035	49.9%
Opt-in via employer	235,113	13.1%
Automatically enrolled	663,912	37.0%
Total membership (net of opt-outs and closures)	1,794,060	100%
Opt-out	251,208	
Closed (left country, died, mistakenly enrolled)	26,489	
Active contributions holidays (includes financial hardship holidays)	67,115	

Source:(Inland Revenue Department, 2010)

As at 31 August 2011, a small proportion of KiwiSavers (up from 40,517 in 2009 to 67,115, about 3.7% of members) are on a contributions holiday in which both the member contributions and the compulsory employer contributions are halted. This is likely to reflect heightened financial hardship during the recession.

Table 3 provides the age profile of KiwiSaver members, showing a surprisingly even spread of members across the age bands. However, there are substantial differences in membership as a proportion of age bands. There are 310,070 members between the age of 0 and 17 (17.3% of all members). Given that only a small proportion would have part-time jobs or have left school by age 17, most have opted in, or were joined up to KiwiSaver by their parents. Children under 18 are not entitled to the MTC, but may

¹⁹ IRD figure is higher at \$9.2 billion in KiwiSaver schemes, consisting of member contributions, employer contributions, and Crown payments of MTCs and the kickstart (Inland Revenue Department, 2011b).

benefit later from the housing subsidy and may be able to access their own saving in the scheme as a deposit for their first home.

Table 3. Age profile at 31 August 2011 (Source: Inland Revenue Department, 2011d)

Age band	Members	As % of total members	As % of population in age-band ²⁰
0-17	310,070	17.3	(0-19) 25.5%
18-24	276,374	15.4	(20-24) 85%
25-34	304,354	17.0	(25-34) 53.8%
35-44	290,548	16.2	(35-44) 48.2%
45-54	289,719	16.1	(45-54) 46.9%
55-65	312,116	17.4	(55-64) 63.1%
No Information	10,879	0.6	
Total	1,794,060	100.0	(Total population) 40.7%

A survey in 2010 of KiwiSaver members revealed some key demographics, including:

- female membership is slightly greater (923,804 females and 861,488 males);
- members are predominantly New Zealand European (71%);
- 31% are in the 50 to 65 age group and 28% are aged between 18 and 29;
- They are generally employed either full time (51%) or part time (25%);
- 50% are home-owners;
- 64% have a combined annual income of less than \$80,000 (those reporting this level of income are predominantly single individuals although a few are couples);
- 42% do not have a partner and 61% have no dependent children (Evaluation Services, 2010, p. 6)²¹

While very much watered down since KiwiSaver II, in 20 or so years, KiwiSaver is likely to be an important component of retirement income for many. However, it has been a costly scheme for the Crown: for the 2011-12 financial year (as at October 2011) of the \$1,605 million to date in payments to providers, total member contributions were \$716 million, while total Crown contributions were \$888 million.²²

5 The underpinning theory for auto enrolment

Influence from the US behavioural studies

The rationale for KiwiSaver I was influenced by the results of studies from the US based on behavioural finance (see, for example, Mitchell & Utkus, 2003), showing that most employees do not understand what decisions to make about saving schemes: whether to join; how much to contribute; what investment strategy to choose.²³ Too much choice is seen as preventing employees from making any decisions, let alone making appropriate decisions. The research typically shows higher rates of joining if employees are guided to join, and to pick a 'realistic' contribution level and an 'appropriate' investment strategy, but then given the opportunity to change those decisions. That research also shows that employees tend not to move away from the default selections.

²⁰ Population numbers from

http://www.stats.govt.nz/browse_for_stats/population/estimates_and_projections/subnational-pop-estimates-tables.aspx.

²¹ See <http://www.ird.govt.nz/resources/7/9/797f4780436e4f83a0b1b24e9c145ab7/ks-evaluation-individuals-summary.pdf>

²² See <http://www.kiwisaver.govt.nz/statistics/ks-stats-11-10-31.html>

²³ One of the reasons the decisions seem so complex in countries like the US is the plethora of rules created by increasingly complex tax and regulatory environments.

The applicability of these studies to New Zealand's KiwiSaver scheme was unclear (Toder & Khitatrakun, 2006). In the US, the employer often subsidises contributions to the scheme, so it is not hard to demonstrate that an employee who joins a scheme will be better off financially than one who does not. If the employee did not join, s/he would miss out on some available remuneration and valuable tax concessions. Despite that, many appear to act against their own best interests and fail to make the decision to join.

KiwiSaver I had none of the generous tax concessions available in the US, nor was it intended that it would be employer-subsidised (as has been decided for the equivalent arrangement in the UK). In fact, the only subsidies were from taxpayers in the shape of the kickstart \$1,000, and on-going administration fee subsidies (Toder & Khitatrakun, 2006).²⁴ Nevertheless, it was believed that the design of a savings scheme and the regulatory environment in which it exists can have a significant effect on both participation rates and the decisions that savers make during their membership.

One of the key concepts, particularly for an unsubsidised opt-out scheme, is that of the default settings. Such defaults can have:

...a tremendous influence on realized savings outcomes at every stage of the savings lifecycle: savings plan participation, contributions, asset allocation, rollovers, and decumulation. That defaults can so easily sway such a significant economic outcome has important implications for understanding the psychology of economic decision-making. But it also has important implications for the role of public policy towards saving. Defaults are not neutral - they can either facilitate or hinder better savings outcomes. Current public policies towards saving include examples of both. (Beshears, Choi, Laibson, & Madrian, 2006)

Investment fund strategy - the default option

Auto-enrolment for KiwiSaver on changing jobs necessarily involves having the default scheme regime already described. Because members have not chosen to join, a default investment strategy is a necessary consequence. The Government has decided that the default options of the default schemes shall have no more than 25% in shares or property.

In terms of the default investment strategy, there can be no single default setting that is appropriate for all. The issues are not clear-cut (Toder & Khitatrakun, 2006). The first observation is that the default option is the simplest option, and is bound to be the popular choice (for example, see: Beshears, et al., 2006; Madrian & Shea, 2001). One possibility is to have a default option that is diversified across shares, property, bonds, and cash and where the proportion invested in 'riskier' assets (shares and property) automatically reduces as the member's age increases. In that way, savers who made no decision would be given a strategy that was at least age-appropriate. However, the issue is more complex than first appears as people differ in their risk aversion or exposure to human-capital risk.

This illustrates one of the difficulties with using behavioural research as a way of informing regulatory intervention: the intervention may be assumed to imply that the regulator (or employer, or scheme trustee, as the case may be) is effectively standing in the place of the investor and inevitably will be held responsible for the outcomes.

²⁴ The government estimated that KiwiSaver I would cost about \$167 million in each of the first three years (0.1% of GDP) and \$100 million a year after that (*Budget 2005 Savings Package: Work Based Savings Scheme*, Budget Paper 6 April 2005).

Getting it wrong at least some of the time seems inevitable. Despite the fact that, in most cases, investors can move away from the default settings, evidence shows that most do not move even if it appears in their best interests. The design of the default option is therefore important both in itself (its effect) and also for the 'signal' it sends members as to what might be a 'good' strategy (Tapia & Yermo, 2007).

It has also been found that advertising can influence people toward more active choices, for example, "a majority of participants in the Premium Pension program, a mandatory retirement saving program in Sweden, actively made their own investment choices when active choices were encouraged through extensive advertising" (Cronqvist & Thaler, 2004, p. 436). However, while in 2000, 67% of first time choosers in Sweden made an active choice, after the significant reduction in the Government's expenditure on advertising the scheme, by 2006, the proportion of active choosers had reduced to 7.5%²⁵ (Tapia & Yermo, 2007, p. 17).

It is noteworthy that as time has passed, more people are choosing their own KiwiSaver scheme, often moving their account to their bank (Inland Revenue Department, 2011b), and banks have heavily advertised their KiwiSaver schemes.²⁶

Default strategy and the savings environment

Specifically, it is clear that participation increases considerably if enrolment is made default and opt-out, instead of a non-participation default but with an option to opt-in (Beshears, et al., 2006). But care is needed when transplanting 'solutions' helpful in a US context of 401(k) saving schemes, into an environment with different economic drivers such as tax and public pension provision. The US regulatory environment for both public and private provision is very complex and the so-called lessons from behavioural research may be no more than regulatory intervention that is really designed to help savers make sense of complexity. The regulators may be better served with policies that simplify the pensions and savings landscapes.

6 KiwiSaver design

Soft compulsion

While the underpinning rationale for KiwiSaver's 'auto-enrolment, opt-out' approach is that people ought to save for their retirement, most people need to be nudged into that decision. The principle is that people are affected by inertia and once opted-in, they are unlikely to opt-out even if they would not have made the initial active decision to join.

Under KiwiSaver I, and because of the tax-neutral treatment of formal retirement saving schemes, there was a strong case to suggest that some employees who were 'defaulted' into KiwiSaver would have been better off to use those required contributions to reduce debt. The significant tax subsidies given to employer and employee contributions in KiwiSaver II changed that economic equation.²⁷ As with the US's 401(k) schemes, joining KiwiSaver II would usually leave the member in a better economic position than

²⁵ A considerable proportion of the drop-off is also attributed to the young age of the new entrants.

²⁶ There is also some anecdotal evidence that banks are making the switch to their KiwiSaver scheme a prerequisite of loan approval.

²⁷ Whether the employer's contributions are an economic advantage to employees depends on the employer's remuneration strategy. If the employer's contributions to KiwiSaver are taken into account in setting the member's remaining taxable pay then the only net advantage to the employee-member would be the fact that the employer's contributions, under KiwiSaver III, are, until March 2012, tax-free to a maximum of 2% of the employee's pay.

not joining. The reduction of these subsidies in KiwiSaver III and KiwiSaver IV and now KiwiSaver V post-elctoin 2011 makes the position more ambiguous.

Under the KiwiSaver rules, members who are auto-enrolled and do not exercise the 8 week opt-out provision must contribute for a 12 month minimum period to be entitled to the \$1,000 government contribution and the matching MTC for the first \$1,043 of the member's own contributions (reduced in July 2011 from 'matching' to '50%' of first \$1,043 of the member's contributions). While that might be a reasonable requirement, the process will accidentally capture some people who should have opted-out for reasons of affordability or appropriateness.

Many low-income potential contributors have significant debts including student loans and mortgage debt. New Zealand's tax treatment of savings means that it will usually make financial sense for all employees with any kind of personal debt to stop contributing as soon as possible. Contributions holidays, available after the initial 12 months of contributions, add further complexities. Whether saving minimal contributions through managed funds is desirable either from an individual or a societal point of view is debateable. In addition, the option of a renewable 5 year contributions holiday raises the potential of hundreds of thousands of dormant accounts with, perhaps, \$3,000 or less in contributions.

Exempt employers

The engagement of KiwiSaver with existing schemes has been complex and problematic. If an existing scheme offered KiwiSaver-equivalent conditions, they may be classified as 'complying' funds and attract government subsidies but not the kickstart. An 'exempt' scheme must comply with the normal KiwiSaver contribution requirements, and must be available to all new employees, but does not qualify for the government-provided subsidies. An employer with an exempt scheme does not however have to comply with the auto-enrolment conditions. Employees can still be KiwiSaver members however, and exempt employers must comply with KiwiSaver conditions for those employees. If the employer offers an employment-based scheme that is exempt, employees do not have to belong to both.

As of 30 June 2009, only 483 employers had been granted exempt status but no new exempt schemes were possible after 6 October 2009. A further 29 employers offered 'complying funds' that offered KiwiSaver-equivalent conditions.

Some very large employers such as the universities have been 'exempt' so that the auto enrolment feature has not been universally applied. Overall, the provisions have probably had an adverse effect on existing schemes, and as already noted, have resulted in decreasing members of the employer-subsidised retirement saving schemes from 14.65% of the working age population in 2005 (Government Actuary, 2008) to 10.88% in 2010 (Government Actuary and Financial Markets Authority, p. 11).

The Government Actuary (the regulatory authority for occupational schemes prior to the establishment of the Financial Markets Authority in 2010) stated in 2009:

It is too early to look for significant signs of substitution from Registered Superannuation into KiwiSaver Schemes. Trends may be beginning to emerge. There has been a continuation of Registered Schemes winding-up or moving to a Master Trust structure as a participating employer within a Master Trust. There are

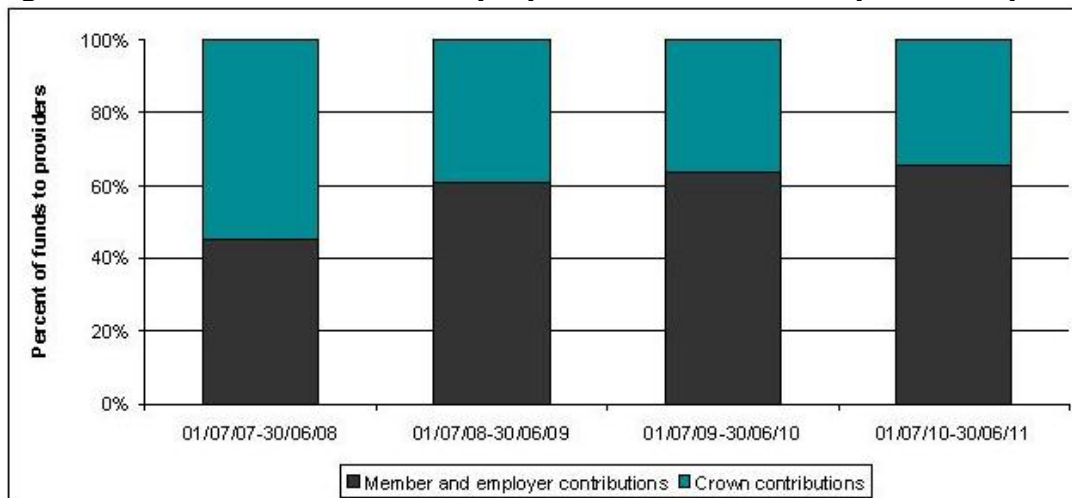
also examples of employers closing schemes in favour of KiwiSaver. (Government Actuary, 2009a p. 12)

Role of incentives

Figure 2 shows funds paid to providers during each year according to the source of the funds. There are often suggestions in the media that these government incentives are too good to ignore (Gaynor, 2010), and indeed, contributions from the Crown totalled 40% of payments to providers for each of the first three years, implying that stronger than forecast uptake can be linked to the level of government-provided incentives.

Throughout the four years of KiwiSaver, there has been a change in relative weighting of each government incentive in the makeup of members’ funds. The kickstart one-off \$1,000 payments represented over 50% of funds contributed in the first year to June 2008, but they have since declined in importance as members’ and employers’ contributions have flowed in.

Figure 2. Crown contribution as proportion of total funds passed to providers



Base: Crown contributions passed from Inland Revenue to providers for October 2007 to June 2011 (cash basis).
 Source: Inland Revenue administrative data.

Source: (Inland Revenue Department, 2011a)

Not accounted for in Figure 2 is the tax expenditure implied in the tax exempt status of the employer contribution, the most regressive of the tax subsidies. This will change from 1 April 2012. The tax subsidies for an employee member reduce to \$521 from 1 July 2011.

Members who qualify for the first home subsidy also receive \$1,000 for each of the first five years’ contributions. Apart from the first home subsidy the member tax credit is the only ongoing subsidy for non-employees (other than children).

These rules will probably see employees contributing no more than the required percentage of wages as long as that is at least \$1,043 a year so the MTC of \$521 can be paid (as noted, the MTC of \$1,043 was halved in the 2011 budget). For those earning less than \$52,150 a year, a top-up voluntary contribution can be made before 30 June to ensure that minimum contribution. Non-employees should contribute no more than \$1,043 a year in order to maximise the subsidy. However the Inland Revenue data (2011a) show that 55% of those who get any MTC do not get the full amount.

Given that KiwiSaver benefits are locked in until age 65, it may be preferable for any additional retirement savings to be made to an accessible scheme. In New Zealand, KiwiSaver is the only scheme with regulated age-based restrictions on access to retirement benefits.

Choice and competition

New Zealanders can exercise choice at multiple levels in KiwiSaver.

They can choose:

- to opt-out as this is a voluntary not a compulsory scheme;
- one of three levels of contribution: 2%, 4% or 8% of gross taxable pay;
- unlimited contributions holidays for five years at a time;
- from a range of 54 providers²⁸ and change their initial decision at any point;
- to cash in savings for a first home and receive a government subsidy for the deposit on their first home, if they qualify;
- the investment strategy: most providers offer many different options including varying levels of shares, cash, property, and bonds in the mix;
- what they do with the lump sum at age 65.

Offering too much choice, for example as in Australia and Sweden, is not necessarily a good thing. The OECD concluded that it can create:

...information overload, resulting in greater confusion and complexity, and, consequently, in greater use of the default option. This is confirmed by the international evidence, as the percentage of contributors who exert choice is higher in Chile (approximately 74%)²⁹ and especially in Central and Eastern European countries (over 85%) than Australia or Sweden (less than 10%). (Tapia & Yermo, 2007)

The 'lessons' derived from studies of behavioural finance suggest that savers need help to navigate their choices through the setting of default options that they can change if they wish. The rules governing KiwiSaver use this principle in a number of ways. There remains a tension between offering choice, based on the premise that the informed individual will know what is best for them, and more directive policy based on the need to maximise advantages for society. Thus for example, the individual currently has an unconstrained choice as to how to use KiwiSaver funds in retirement, but the choice to run these savings down early in retirement may not be in society's best interests.

The default schemes

A KiwiSaver default scheme is required to have a default investment option: a portfolio with no more than 25% invested in 'growth' assets (shares and property), as well as offering a suite of other investment products. The contributions of a person allocated to a default provider's scheme are invested in the scheme's conservative investment fund

²⁸ Although there were a total of 54 KiwiSaver schemes at August 2011 (Financial Markets Authority, 2011, p. 4), despite a number of providers exiting the market while others entered it, membership of at least 15 of those was limited to employees of a particular employer or members of a group or society.

²⁹ This information is misleading as in Chile, unlike Australia, there is no default option, so choice has to be exercised (Rozinka & Tapia, 2007, Table 6)

option. New employees are auto-enrolled into KiwiSaver and the IRD allocates them randomly to one of the six 'default providers'.³⁰

The six providers were chosen following an "open competitive tender process where Ministers were assisted by advice from independent external experts who carried out detailed evaluation of potential providers" (Cullen & Dalziel, 2006). The government suggested that it had "...followed a fair, consistent and transparent process which ensured all potential default providers were assessed on an equal basis" (Cullen & Dalziel, 2006).

One of the difficulties with the current default provider process is that it assumes a static market in financial service providers. The re-structuring of the market in New Zealand has already seen the full takeover of one default provider by another provider (not default) and the merger of two of the current six providers and the sale of a third, yet the original six appointments will not be reviewed until 2014. The original six KiwiSaver default providers, appointed in 2006, are likely to be challenged during the 2014 Ministry of Economic Development's re-tendering.

The default providers dominate the membership and asset statistics, showing the commercial value of default status to the incumbents. The 2011 Financial Markets Authority annual report shows there were 54 registered schemes, including the six default providers, and funds under management exceeded \$9.1 billion at 31 March 2011. The default providers manage approximately 24.5% of all funds, and charged \$43 million in fees on fund earnings of \$104 million (Financial Markets Authority, 2011).³¹

At 30 June 2011, 64% of KiwiSaver members had chosen their scheme, and 36% had been default allocated by the IRD or allocated to an employer-nominated scheme.³² Default schemes totalled 26% of all members and 33% of assets (Government Actuary, 2009, p. 22). During the 12 months to 30 June 2009, only 4,081 members or 0.7% had switched out of a default investment option.

There is little doubt that default provider status was of commercial value to the original appointees. It seems appropriate to review the process for their appointment prior to the scheduled retendering. One approach would be to open up the pool of default providers. For example, providers could be required to comply with a number of conditions; and all providers that continuously met the conditions could have default status. This approach would automatically accommodate changes in the markets and provide the government the relative certainty it needs before conferring a privileged economic position on a private business. It would also distance the government from any suggestion that it will stand behind the failure of a default provider. The newly created Financial Markets Authority, which already has oversight of all providers, could facilitate the transition to this proposed new, fairer system.

³⁰ The original default scheme providers are: AMP Services (NZ) Limited; ASB Group Investments Limited; AXA New Zealand (National Mutual Corporate Superannuation Services Limited); ING (NZ) Limited; Mercer (NZ) Limited; Tower Employee Benefits Limited. ING (NZ) Limited has since been taken over by OnePath (NZ) Limited, while retaining the status of default provider, and AXA has been taken over by AMP. If the employer has a 'chosen scheme', new employees are first allocated to that scheme, but may transfer to a provider of their choosing.

³¹ It is noted here that the figure of \$43 million in fees on fund earnings is being challenged by KiwiSaver scheme providers.

³² Defined as members who had been enrolled under the default scheme process rather than actively joining the default provider.

The default position for contributions

At June [2009], most members were contributing at 4% of their salary or wages to their accounts; 12% were contributing at the lower 2% rate. However, of those who joined KiwiSaver since the changes were in place, approximately half were contributing at 2% and just less than half had chosen to contribute at a higher rate (either 4% or 8%). Of those who joined before 1 April 2009, most have not changed their previous contribution rate. This suggests that most individuals are being influenced by the default arrangements in place at the point that they join KiwiSaver, although the early figures for those joining after 1 April suggest that members are exercising some choice over their contribution rate. (Inland Revenue Department, 2009a)

There is a significant incentive for the mainly commercial providers of KiwiSaver schemes to persuade members to contribute more than the minimum 2% of pay, particularly where commissions are payable to advisers. Currently (2011) 53% contribute 2% only, however 80% of members who have joined after 1 April 2009 contribute only 2%. Employers (91%) are largely choosing to contribute no more than the minimum 2% (Inland Revenue 2011a).

Fees and returns

In introducing KiwiSaver, the Government recognised that financial service providers would benefit from a government-endorsed initiative. Accordingly, it gave a supervisory role to the regulatory authority for superannuation schemes, the Government Actuary, who had oversight of existing schemes as well as registering new KiwiSaver schemes. That role, to ensure and enable eligible schemes to be registered in a timely manner, including: ensuring that the trust deed complies with the requirements of the legislation; that matters covered in Schedule 2 of the Act are adequately disclosed; and that fees are not unreasonable (Government Actuary, 2009, p. 3), was transferred to the Financial Markets Authority (FMA) on 1 May 2011 (Financial Markets Authority, 2011).

The requirement with respect to fees is set out in Schedule 1 to the Act. Clause 2 of that Schedule states that the following persons must not charge a fee that is "unreasonable":

- the trustees of the scheme;
- the administration manager of the scheme;
- the investment manager of the scheme;
- the promoter of the scheme;
- any other person who charges a fee for services in relation to the provision of a KiwiSaver scheme.

In fact, understanding the fees is not straightforward even before addressing the issue of whether they are 'reasonable' (or, 'not unreasonable').

The main difficulties centre around the number of different parties that may potentially charge a fee (the list above). In addition, a KiwiSaver scheme may not own most of its assets directly but rather may hold investment products that may be commercially linked to the scheme's promoter. It is also possible for a scheme to create entities to fill each of the roles listed above, and charge a 'not unreasonable' fee at each point. A total fee charged by the KiwiSaver provider that would be deemed 'unreasonable' may appear 'reasonable' when broken down into various 'sub-provider' charges, even if they are linked commercially to the provider. This merely disguises the 'unreasonable' fee.

Then there is the difficulty of deciding what issues can be taken into account in assessing 'reasonableness'. Might, for example, the low uptake of membership justify higher fees because many costs are unrelated to membership size?

A relatively simple scheme like KiwiSaver should, in theory, present fewer problems of fee comparison than other retirement saving vehicles. The Retirement Commission provides an on-line calculator that attempts a fees comparison. However, fees associated with the management of investment assets vary with the type of asset managed. Of the 21 KiwiSaver providers for whom published investment performance data are available, there are more than 165 investment options, stretching across the risk spectrum from those invested wholly in cash to those with 100% in shares. It is not possible to directly compare the fees of all those options because, for example, cash-based investments require less skill and knowledge and are (or should be) less expensive to manage than shares-based alternatives. When investment options combine asset classes, then fees will naturally vary between those with more share-based assets than those with fewer.

As the Retirement Commission's web site states:³³

Fees are charged so your scheme can pay for investment, management and administration costs. A more active investment policy usually means higher fees but also provides the potential for higher returns and greater variation in those returns. A greater proportion of equity investments (like shares) also provides the potential for higher and more variable returns. It's important to note that fees are just one factor to consider when selecting a KiwiSaver product or provider. The level of risk (and associated return), service level and communication offered by the fund provider should also be considered.

Given the difficulties of comparisons and of even identifying all the possible fees and their amounts, the attempts to control fees through legislation are fraught. It may be more useful to require full disclosure, including the amounts charged by sub-providers and sub-sub-providers, and to require that members be informed of what the total dollar amount charged to their individual saving accounts were for the year. There may also be an advantage in requiring providers to disclose fees on the basis of common opening and contribution values, giving commentators (and the FMA, as regulator) basic comparative data in similar markets across all providers. The government's role could even extend to funding ongoing research on comparative costs by an independent group.

Overseas research has also found that competition among providers does not necessarily ensure reduced costs for consumers (Calderon-Colin, Dominguez, & Schwartz, 2010). The lack of transparency, as described above, combined with consumer ignorance or financial illiteracy, creates markets with 'noise' that protects the providers, enabling higher fees to be charged to KiwiSaver members. Calderon-Colin et al (2010, p. 44) also found that the selection of pension fund manager was determined primarily by the size of the fund's sales force. The New Zealand equivalent would be the level of positive media exposure for the fund or fund manager. Some providers regularly write for the newspapers on investment matters and may advertise their funds in the same papers.

Overall the existence of so many competing providers and products has been confusing for the public, and the lines of responsibility for regulatory oversight have been obscure.

Investment return comparisons are equally problematic. What matters to a KiwiSaver member is the after-tax and after-fee investment returns. The key drivers for any

³³ See <http://www.sorted.org.nz/calculators/kiwisaver-fees/page2.php>.

investment return are the before-tax sector returns (cash, local bonds, overseas bonds, local shares etc.), investment strategy (what proportions of the total invested there is in cash, bonds, shares etc), income tax, and fees.

Looking at just the after-tax investment returns, the central issue is investment strategy (for a given set of gross returns across all the sectors) and tax. It is therefore impossible to directly compare returns across providers unless the investment strategy (and its implementation) is identical. In a rising share market, one provider may appear to have done better than another but that may be due to the proportion of shares held in the apparently better performer.

This difficulty does not prevent comparisons being made. There are at least four different comparisons that purport to directly compare KiwiSaver investment returns.³⁴ It is difficult to interpret and compare returns from such widely dispersed strategies, even when they have similar, low risk objectives. A difference in returns might simply indicate the difference in asset mix and provide no indication of the manager's skills. It is no coincidence that, of the 16 funds that stated their growth asset proportions under the heading 'Multi-sector, conservative', those with the highest proportion of shares did best over the 12 months to 31 March 2010 (in a growth market) while those with the smallest proportion were at the bottom of that comparison.

This does not diminish the importance of investment comparisons to members, particularly over the long timeframes involved with KiwiSaver. It does suggest, however, that New Zealand has some way to go before there are reliable, transparent, comparative reports of KiwiSaver schemes for the purpose of informing scheme members. It is one thing to legislate disclosure requirements; quite another to make that disclosure meaningful and helpful to members. Again, the government's role could extend to funding ongoing research and regular publication on comparative costs by an independent group.

Overall, it is fair to identify a lack of rigorous monitoring to date. The Securities Commission raised an alarm at the lax regulation of KiwiSaver schemes and the potential for deception and bad practice in 2010, for example. A provider was found to have inflated returns by putting in personal money (Bridgeman, 2010). In addition, some providers have recruited students to promote KiwiSaver accounts to children, and to enrol members on a commission basis. The FMA has greater powers for action, and may prove more prepared to respond to evidence of bad practice and provide consumer protection.

Other KiwiSaver design features

The premise of KiwiSaver is that it is a long-term savings scheme, with the assets not accessible until the age of 65. As shown below, there are some provisions for hardship and a member's own savings may be exported when they leave New Zealand permanently. The lock-in can be subverted by the provisions for housing; and there are generous provisions for contributions holidays that do not give access to the money but

³⁴ For example, the Morningstar Australia report for 31 March 2010 attempts to compare like with like, by grouping options with similar investment strategies, such as all 'Multi-sector, conservative' funds. Of the 18 products listed under 'Multi-sector, conservative', the benchmark investment strategies show 'growth' assets (shares and property) varying from as little as 0% (for both the Fisher Funds Conservative KiwiSaver Fund and the Grosvenor KiwiSaver Enhanced Income Fund) to as much as 23.2% (AMP KiwiSaver (Default) Fund).

stop the future automatic deductions by the employer (and the employer's contributions).

In line with the view that owning a home is a "critical part of long term financial security" (Cullen, 2006), after 3 years, KiwiSaver members can qualify to withdraw some or all of their saved funds, excluding the kickstart and MTC, to buy their first home. KiwiSaver members who have previously owned a home (but no longer own a home) and seek to use their saved funds to purchase again, can, through their providers, request Housing New Zealand to assess their financial situation. If it is the same as a 'first home-buyer', they may also qualify.

In addition, a member may qualify for a government subsidy of \$1,000 for each year they have been in KiwiSaver, up to an individual maximum of \$5,000. Members of employer superannuation schemes exempt from the KiwiSaver automatic enrolment can also qualify for this home ownership deposit subsidy.

With the intention of further aiding New Zealanders' home-ownership aspirations, KiwiSaver originally included a mortgage diversion facility, enabling members to direct up to half of their contributions towards mortgage repayment. This was based on the idea that repaying the mortgage is an effective way of saving. The mortgage diversion scheme added compliance costs for providers and banks and was abolished by the National Government from 1 July 2009, although the 600 members who had previously signed up were able to continue. The Minister of Revenue also noted at this time that the diversion scheme offered members an opportunity to bypass the lock-in of their funds as by selling the home they would gain access to diverted contributions, and this contradicted a fundamental objective of KiwiSaver: the principle of accumulating assets for retirement (Dunne, 2009).

7 Assessing the KiwiSaver experience

One key lesson from New Zealand is the importance of clarity about the problem to be addressed. For example, with KiwiSaver there has been some slippage from the original view that it ought to be a means of increasing national savings, to the view that it should augment retirement income savings and provide a higher standard of living than the state pension alone can provide. To date, the analysis has lacked evidence of KiwiSaver's actual improvement in national saving (Inland Revenue Department, 2011a; Law, Meehan, & Scobie, 2011); and even if it does assist, whether that necessarily influences the growth of the economy through higher and better investment,

The second goal of improving retirement incomes is inherently contradictory in light of both the first goal, and of the increased fiscal pressures in pensions and healthcare brought about by an ageing population (Bell, Blick, Parkyn, Rodway, & Vowles, 2010). Unless there is attention to decumulation issues and some integration with the universal pension, KiwiSaver may simply facilitate extra consumption by the wealthier cohort of a larger retired population. Another crucial lesson from the New Zealand experience is that competition among providers, and a system of default providers, may not improve consumer outcomes.

The taxpayer-funded subsidies to KiwiSaver are distributed to members based on the contributions made by individuals and their employers. Over time, the subsidies relating to the employers' contributions become relatively more important as the real value of

the (now reduced) fixed-dollar MTC, and the kickstart \$1,000, diminish (Retirement Policy and Research Centre, 2009).

The RPRC analysis showed that changes made to the KiwiSaver scheme in 2009 (KiwiSaver III) would have had a major impact on the total value of the lump sum benefit members could have expected at age 65 assuming 40 years' membership. The most significant impact resulted from the 2009 reduction in the compulsory, tax-exempt employer contribution from 4% to 2% of employee's pay. The loss of the \$40 pa fee subsidy results in a \$2,416 reduction in the lump sum benefit at age 65.

Table 5. Changes in lump sum benefit KiwiSaver II to KiwiSaver III (assuming 4% contribution rate; 40 years' membership, 2% p.a. net real return

Income pa	KiwiSaver II	KiwiSaver III	Difference
\$20,000	\$197,910	\$123,012	-\$74,898
\$30,000	\$275,587	\$173,931	-\$101,657
\$40,000	\$323,909	\$210,172	-\$113,737
\$50,000	\$372,231	\$246,413	-\$125,817
\$60,000	\$420,552	\$282,654	-\$137,898
\$70,000	\$468,874	\$318,896	-\$149,978
\$80,000	\$517,195	\$355,137	-\$162,059
\$90,000	\$565,517	\$391,378	-\$174,139

Source: (Retirement Policy and Research Centre, 2009)

Overall, changes made to KiwiSaver in 2009 resulted in an average benefit reduction of 34%. While the highest income earners had the largest dollar reduction, the highest percentage reduction (38%) was experienced by those on the lowest incomes, \$20,000 a year; and the smallest reduction (31%) was experienced by those earning \$80,000 p.a. and above.

The 2009 changes also had an impact on the taxpayer-funded proportion of lump-sum benefit, with the greatest change to the proportions due to discontinuing the employer tax credit. Other factors contributing to lower member returns were cessation of the \$40 fee subsidy, and reduced total value of the tax-exempt employer contribution.

There is no statutory requirement for the real value of the MTC and the \$1,000 kickstart to be maintained by the government, and the KiwiSaver IV changes in fact halve the MTC. Without indexation their real value will reduce each year by the rate of inflation. This has an impact on the distributional effects of KiwiSaver. Members who joined in the first year of the scheme received the full value of the kickstart, while future members will receive less in real terms. Once the payment is invested, the interest rate earned on the investment should cover the rate of inflation. Thus the MTC is the only future benefit negatively affected by inflation for members joining in the first year.

Limiting the tax-exemption of the employer contribution to 2% of the member's income reduced the regressivity of KiwiSaver and thus improved the distributional nature of the scheme as it existed under KiwiSaver II. However, from a distributional point of view, the most progressive change the government could make to KiwiSaver was the

elimination of the tax-exempt nature of the employer's contribution. This change was announced in the 2011 Budget.³⁵

Another of the intentions of KiwiSaver is to encourage the spread of financial literacy. A report prepared for the Capital Markets Taskforce (O'Connell, 2009), notes that New Zealand has an active and well-supported National Strategy for Financial Literacy led by the Retirement Commission, and is one of the few countries to have completed a survey of financial literacy levels in the population. While this report found that New Zealand is a world leader in the delivery of financial education in terms of organisation, cost-effectiveness and mode of delivery; it also found education about investing, in particular, could be improved. Most New Zealanders appear to understand the basic concepts of risk, return and diversification, and appreciate that investing is a way to achieve financial goals, however they are sceptical about share market returns over the long term (O'Connell, 2009).

In October 2011, the Retirement Commission's name changed to the Commission for Financial Literacy and Retirement Income, formally recognising the importance of financial literacy in preparation for retirement, and the Commission's work in helping Kiwis manage their money (Crossan, 2011). The name change followed the transfer of responsibility for the Commission from the Minister of Social Development on 1 July 2011 to the Minister of Commerce.

Improving the financial literacy of the young may have been the goal of allowing their participation in KiwiSaver. Their inclusion was more likely to have been accidental. And, unfortunately, there are reasons to suspect the impact may be negative. Children have little incentive to contribute to a scheme that locks-up their saving until they reach age 65. They may also observe that the kickstart either grows very slowly or even diminishes over time in nominal terms now that fees are not subsidised, providing the perverse object lesson that managed funds are not to be trusted. Providers will also find that multiple small, inactive accounts are administratively costly.

When KiwiSaver was first announced, the pivotal problem was seen to be one of low national saving. New Zealand is heavily reliant on foreign saving with persistently large current account deficits (CADs) and accumulated overseas debt. However it was not clear that KiwiSaver was capable of lifting national saving.³⁶ By the time the Bill was introduced, there was little mention of the problem. The purpose of the Kiwisaver Act 2006 is described thus:

The purpose of KiwiSaver is to encourage a long-term savings habit and asset accumulation by individuals who are not currently saving enough, with the aim of increasing individuals' well-being and financial independence, particularly in retirement. KiwiSaver is designed to complement New Zealand Superannuation (NZS) for those who wish to have more than a basic standard of living in retirement. (KiwiSaver Act 2006)

³⁵ The tax-exempt employer's contribution is regressive: the benefit associated with the exemption is highest for those in the highest income tax brackets. Also, because the benefit is proportional to members' incomes, the real value of the exemption is not affected by inflation (to the extent that incomes are protected from inflation). The exemption is a tax expenditure costing approximately, for example, \$170 million in 2009 in forgone tax revenue (Policy Advice Division of Inland Revenue Department & Treasury, 2009). It is irrational for taxpayers to give greater retirement-saving assistance to the highest paid KiwiSaver members.

³⁶ The best thing the government has done recently to improve national saving was to staunchly run surpluses during the upswing of the six years preceding the global financial crisis.

A reference to the hope that national saving will improve was buried on p. 36 of the Bill:

If the behavioural changes flow through into increased domestic saving, then economic growth may increase as more funds may be available to fund domestic investment and reduce New Zealand's reliance on borrowing offshore.

Gibson, Hector and Le (2008) provided a preliminary estimate of household saving and show the 'shift' effect, "...[i]t appears that out of every dollar in KiwiSaver accounts, only 9-19 cents is new saving" (Gibson, Hector, & Le, 2008, p. 27). Statistics New Zealand's eight year longitudinal Survey of Family Income and Employment (SoFIE), starting in 2004 and continuing until 2010, collected financial data from participants allowing analysis of households' savings that may eventually shed light on KiwiSaver's impact.

Using the first available pre-KiwiSaver SoFIE data, Henderson and Scobie (2009) have estimated that New Zealand households saved an average 16% of their gross incomes in the two years 2004-2006. Taking property revaluations out of that estimate reduced the saving rate to 5%. When the next tranche of SoFIE's financial data is available from 2008, it might be possible to see if KiwiSaver has affected households' saving patterns. However, separating out the specific impact of KiwiSaver is likely to be problematic, especially in times of changing economic conditions.

The Inland Revenue (2011a, p 31) refer to the 2009 analysis and conclude:

The analysis also explored the impact of the scheme on national savings. It estimated, on the conditions and settings of the scheme at that time, that over the ten years to 2021 the net contribution of KiwiSaver to national savings would be marginal at best in the longer term, and may in fact reduce national savings. When sensitivity analysis in the form of allowing for much higher rates of additionality on employer and Crown contributions were conducted, the analysis found modest increases in national saving. In either case, fiscal costs over the period were projected to total nearly \$8 billion in net present value terms. As outlined above, this estimate will decrease due to the reduction in member tax credit and removal of the employer superannuation contribution tax exemption proposed from 2012 onwards.

In the meantime, Law et al. (2011) have estimated that only about one third of the members' contributions to KiwiSaver are 'new' savings.

Even if there is an impact on household saving, there is no guarantee that national saving (the sum of private and public saving) will improve. KiwiSaver is not the only change since 2007: a combination of reduced contributions to the NZSF; lower income taxes; a rebalancing towards the tax on goods and services; lower rates of tax on investment earnings and the impact of the recession are but a few of other contemporaneous influences. Moreover, while some of the rhetoric suggests that more KiwiSaver savings equals more investment and growth, in practice more saving from any source does not 'cause' more or better investment.

8 Decumulation and overseas pensions

Decumulation

With the provision of tax-funded subsidies in KiwiSaver, the Government had the option of imposing restrictions on spending of KiwiSaver lump-sums in retirement. That option was ignored. New Zealand had a unique opportunity with a tax neutral TTE regime to design an explicit subsidy to recognise the gains to society from annuitisation with few of

the disadvantages of traditional tax incentives (St John, 2006).³⁷ One possibility was the provision of a limited value, inflation-adjusted, gender neutral annuity to supplement NZS, purchased out of lump-sum saving and a suitable share of home equity. This annuity would require subsidisation to be viable but may have also included a cost-effective insurance rider for long-term care. This opportunity is now passing while New Zealand runs the dangers of an EtE regime, with unregulated lump sums coming out of KiwiSaver (and other tax-advantaged schemes). In the meantime, private home equity release schemes are aimed at younger old-age groups for consumption, not for long-term retirement income purposes.

Unfortunately New Zealand's annuities market is almost non-existent and under current tax rules, lack of government support including inflation indexing, annuities are rarely purchased voluntarily. A more careful development phase for KiwiSaver might have allowed some attractive options, such as the purchase of a top-up to NZS, to be developed (St John, 2009).

Overseas pensions

Every New Zealander over the age of 65, after meeting the residency requirement, is eligible to receive NZS. Since 2007, New Zealand residents can also save for extra retirement income in KiwiSaver. This makes the deductions of some overseas pensions appear anachronistic and anomalous (Dale, St John, & Littlewood, 2009), and those with entitlement to a second-tier overseas state pension analogous to NZS find it unjust that their NZS is offset by their overseas pensions dollar for dollar. At the same time, inconsistently, other payments are exempt, including those from compulsory private saving schemes in Australia and Chile. This issue will become increasingly problematic as people become increasingly mobile during their working lives and in retirement.

9 KiwiSaver: a summary of lessons from the first 4 years

The current design of KiwiSaver does not appear to be the outcome of any research-based policy development process. After four years, it is still unclear what problems KiwiSaver was to address, and how they would be addressed. Where was the evidence that New Zealanders were under-saving for retirement, and KiwiSaver would provide the solution? What impact is there on national saving? If KiwiSaver was to ensure more income in retirement, why was there no attention to decumulation of the lump-sum? How does KiwiSaver help moderate the fiscal pressures of an aging society?

The time-frames around KiwiSaver's introduction were unreasonably short and New Zealand continues to pay the price with poor quality regulation and constant change. KiwiSaver's introduction was a copybook illustration of how not to go about such a major change to a retirement savings environment. Four years after its introduction on 1 July 2007, KiwiSaver is still undergoing change, including suggestions of a movement to compulsion. These constant, significant shifts over such a short period perpetuate the opaque way in which the original design and subsequent re-design was conceived and developed. It also illustrates the point that because there was no clear vision and widely

³⁷ Tax incentives often have the one clear redeeming feature of allowing prescription of the nature of the final benefit. Provision of income via a pension or an annuity can, in an EET environment, give society some pay-back for foregoing tax revenue in the accumulation process. While the annuity provides longevity protection for savings supplementary to the state pension and thus protects the longest-lived individuals, society also gains because there is certainty of an income stream that can in principle be used to pay for the additional costs of long-term care and other health costs. Given the personal nature of the concessions, pensions are not easily disguised by the use of trusts, nor can the underlying capital sum be dissipated too early in retirement.

agreed purpose for KiwiSaver, it has become a hostage to politics, and further change is now expected.

KiwiSaver is a form of 'soft compulsion'. Most KiwiSaver schemes by volume of members are owned by Australian-based financial service providers that have profited by Australia's compulsory retirement savings scheme. Despite the fact that KiwiSaver has been in place only since 2007, there are many calls, especially from the industry, to make it compulsory. Also, as noted, in the lead-up to the 2011 election, the Labour Party, the Maori Party and New Zealand First suggested that making KiwiSaver compulsory would create more household saving and solve New Zealand's economic problems. The framework for compulsion is in place; the only change needed would be to remove the opt-out.

Two principal concerns about compulsion are: forcing those who cannot afford it to be in the scheme, and the inevitable need to integrate KiwiSaver with NZS. Demographic change implies that the cost of NZS in its current form will double over the next 40 years, from about 4% of GDP to 8%. The costs of healthcare will also reflect the changing age structures of New Zealand's population. Given the contribution that taxpayers make to the accumulation of KiwiSaver benefits, it would seem logical that a future government might link NZS and KiwiSaver through a means test.

As far as children are concerned, it is difficult to justify their eligibility for a national, subsidised retirement saving scheme. Although care was taken to exclude them from the auto-enrolment conditions that apply from age 18, the payment of the \$1,000 kickstart (and previously the \$40 a year administration fee), seems anomalous. There are over 295,000 KiwiSaver members aged 17 or under. This might be seen by some as admirable, but in the long term, their accounts need continued savings to be viable. Currently, it is believed that over 90% of such members make no contributions (Financial Markets Authority, 2011, p. 7).

Distribution across generations depends on whether the Kickstart and the MTC are maintained in real terms. Once a person has joined KiwiSaver, the generosity of the subsidy appears to matter less, as inertia leads to them maintaining their membership.

KiwiSaver ended New Zealand's relatively neutral tax treatment of retirement savings, although in 2011 the subsidies are diminished. What remains raises concerns that apply to all pay-based interventions in retirement saving schemes. Those workers who for whatever reason do not belong to KiwiSaver, effectively subsidise those that do belong, both from higher taxes to fund the (reduced in 2011) MTC and the kickstart; and from wages that grow more slowly over time because of the employer contributions for those who do belong. The gender imbalances in retirement savings are reinforced to the extent that subsidies favour higher paid workers.

Most observers expect that the total number of providers, currently 54, including employer-specific schemes, will reduce substantially. It is difficult to understand why employers would set up KiwiSaver arrangements specific to their own employees, and those are likely to disappear. Of the remaining 35 or so 'public' schemes, possibly half will merge with other schemes. The question is whether the remaining 20 to 25 KiwiSaver providers is too many; or, would the single scheme approach chosen by, for example, the UK and Sweden be preferable? Having more than one provider means that

disclosure and regulatory oversight needs greater care and there are emerging problems in New Zealand.

The regulatory regime overseeing KiwiSaver schemes is relatively light-handed, relying more on registration and filing than on approval and oversight. KiwiSaver has been slotted into the existing regime that applies to all other 'superannuation schemes'. Although it has its own legislation, the KiwiSaver Act 2006, it remains to be seen whether this delivers the protection that a government-mandated regime requires.

The current environment is best described as self-regulation, but as noted, the Securities Commission raised issues with the behaviour of some providers and the unsatisfactory regularity environment. It is too early to say whether the FMA will promote an authentic mechanism whereby schemes' investment performance, fees and costs can be compared. Full disclosure, such as for commissions, is supposed to provide the requisite member protection. But firms gain financial advantage from sales, and disclosure does not impose an obligation to explain the range of alternatives (Sheather, 2010). The GFC may call into question the robustness of a regulatory regime founded largely on the 'prudent person' requirement that trustees act in the best interests of their beneficiaries. It is clear that different trustees interpret this provision in different ways.

In a defined contribution environment where the benefits from a given set of contributions depend on the investment returns, it is almost inevitable that members should say where their money is invested. That implies that they should have the right to decide who manages that money. But too much choice in a small country can be costly for individuals, providers and regulators. The balance between individual choice and what is sensible and what is cost effective has yet to be reached, although as already noted, more KiwiSaver members are exerting the right to choice of provider.

The rationale for conferring a commercial advantage on the six default KiwiSaver providers is unclear. Equally, it is difficult to see why the government would impose investment restrictions on the default investment option of only the default providers. If there were any justification for such rules, why might they not apply to all KiwiSaver schemes? An auto-enrolment regime necessarily requires default providers but not default investment options. Prior to the 2014 re-tendering of default provider status, the Government has the opportunity to amend the flawed selection structure, another by-product of the haste and secrecy that accompanied KiwiSaver's introduction.

Most of the research relating to behavioural finance focuses on the relationship between scheme members, their market incomes (usually just from the employer that sponsors the scheme), and financial assets directly invested in the scheme itself for retirement. It does not usually include other assets that a scheme member might own, such as housing, entitlements to the state pension and other assets, including direct investments and the household's capacity to earn income during the period to retirement. Such assets have a significant bearing on a member's willingness (or need) to join a scheme at all, or to take on the risks associated with investing financial assets in shares and/or property in that particular savings scheme.

Many New Zealanders still make most of their 'retirement' savings through owning a mortgage-free home by the time they reach retirement age. Requiring someone who is not already a home-owner to save through KiwiSaver, rather than use those savings to

purchase and pay off a home, was antithetical to New Zealanders.³⁸ KiwiSaver accommodated that by the concessions and subsidies for first home purchases, and the now defunct mortgage diversion facility. However, it compromised KiwiSaver's fundamental objective: to increase financial savings for retirement. The lesson here is that a government's intervention needs a clear, unambiguous focus.

From a public policy perspective, the question is whether governments should be designing a regulatory framework that influences private behaviour to save particular amounts of money for retirement at particular times and in a particular way. It is one thing for the principles of behavioural finance to help employers, for example, to design a workplace retirement saving scheme and influence the choices the scheme offers. The employer's saving scheme is part of its remuneration strategy and one of the objectives should be that the scheme's design 'works' in the way the employer wants. It is another step for governments to force employers to intervene directly in a particular way in the compensation framework offered to employees, as has been illustrated by KiwiSaver.

It is also worth noting that while auto-enrolment is supposed to nudge people to behave in the 'right' way; in this case, to save more for their retirement. It is impossible to assess whether the 'nudge' has been successful if at the same time there are significant monetary incentives to change behaviour.

10 Conclusion

Based on the events of the last five years, New Zealand can expect KiwiSaver to continue to 'evolve' but it is hoped that evolution will be informed by careful research and debate rather than more knee-jerk reaction.

There may be a number of lessons for other countries in the KiwiSaver experience. Despite the apparent instability of the many changes to KiwiSaver, it has been well accepted by the public, as evidenced by the remarkable take-up of the scheme. Employers and the IRD have experienced extra compliance costs in the auto-enrolment processes but there has been only mild opposition from employers.

While it is dangerous to draw lessons after only four years, the experience may suggest that large incentives to get the scheme off the ground and entice people to remain opted-in may be then reduced significantly ex post with little impact on membership. Moreover, non-indexation of core tax-funded subsidies may allow the real cost of fixed incentives to reduce over time.

Opening the scheme to children has little justification, and most young adults need help today to pay debts and mortgages before they save for tomorrow. Compensating them by offering housing subsidies only muddies the waters and adds complexity.

New Zealand's experience shows that too many providers is wasteful of resources and costly to consumers. It is important to get the regulatory framework and the default arrangements right from the beginning. Tax-funded subsidies may insulate members from the impact of poor returns and high fees, and reduce the market demands for adequate protections and policing of provider behaviour.

³⁸ While employees could opt-out, they then lost the advantage of the significant tax breaks and employer's contributions that were part of KiwiSaver II and remain, in reduced form, in KiwiSaver III. Also, everyone's taxes (including non-homeowners) are higher to pay for the incentives.

The New Zealand experience also shows the danger of setting up a tax-subsidised scheme without attention to decumulation. Although KiwiSaver rules and conditions have been regularly changed since its inception, it would be difficult to gain acceptance now of a loss of control over the accumulated savings in the scheme, when people joined on the understanding they would have free choice over their accumulated lump-sums.

Finally, to the extent that the scheme is evaluated against its objectives, the objectives must be clear: Is KiwiSaver's purpose to benefit the individual in retirement? Is it to reduce the pressures on the economy of an ageing population? Or, is KiwiSaver supposed to solve the national saving problem? As long as the purposes are unclear, the scheme is vulnerable to the industry determining the design of the scheme to meet its own objectives.

Appendix 1

Gross pension replacement rates from public, mandatory private and voluntary private pension schemes (Source: OECD, 2011, p. 121)

	Percentage of individual earnings														
	Public			Mandatory private			Voluntary DC			Total mandatory			Total with voluntary		
	0.5	1	1.5	0.5	1	1.5	0.5	1	1.5	0.5	1	1.5	0.5	1	1.5
OECD members															
Australia	37.9	11.8	3.2	35.4	35.4	35.4							73.3	47.3	38.6
Austria	76.6	76.6	72.3							76.6	76.6	72.3			
Belgium	60.1	42.0	32.7				15.6	15.6	12.3	60.1	42.0	32.7	75.7	57.6	45.0
Canada	61.2	38.9	25.9				30.8	30.8	30.8	61.2	38.9	25.9	92.0	69.7	56.7
Chile	18.8	3.2	0.0	41.3	41.7	41.8				60.0	44.9	41.8			
Czech Republic	80.2	50.2	37.4				11.3	11.3	11.3	80.2	50.2	37.4	91.5	61.5	48.6
Denmark	64.7	28.9	17.0	55.9	50.7	49.0				120.6	79.7	66.1			
Estonia	37.7	25.5	21.5	22.5	22.5	22.5				60.2	48.0	44.0			
Finland	66.4	57.8	57.8							66.4	57.8	57.8			
France	55.9	49.1	41.3							55.9	49.1	41.3			
Germany	42.0	42.0	42.0				16.9	16.9	16.9	42.0	42.0	42.0	59.0	59.0	59.0
Greece	95.7	95.7	95.7							95.7	95.7	95.7			
Hungary	44.4	44.4	44.4	31.4	31.4	31.4				75.8	75.8	75.8			
Iceland	63.0	15.0	5.1	81.9	81.9	81.9				144.9	96.9	87.0			
Ireland	57.9	29.0	19.3				37.6	37.6	37.6	57.9	29.0	19.3	95.5	66.5	56.9
Israel	38.9	19.4	13.0	61.3	50.2	33.4				100.1	69.6	46.4			
Italy	64.5	64.5	64.5							64.5	64.5	64.5			
Japan	47.9	34.5	30.0							47.9	34.5	30.0			
Korea	64.1	42.1	31.9							64.1	42.1	31.9			
Luxembourg	97.9	87.4	83.8							97.9	87.4	83.8			
Mexico	30.5	4.0	2.7	26.9	26.9	26.9				57.5	30.9	29.6			
Netherlands	58.5	29.2	19.5	34.6	58.9	67.0				93.0	88.1	86.5			
New Zealand	77.5	38.7	25.8				14.6	14.6	14.6	77.5	38.7	25.8	92.1	53.4	40.5
Norway	57.7	46.1	34.2	5.7	7.0	7.5	8.6	12.0	17.1	63.4	53.1	41.7	72.0	65.0	58.8
Poland	28.7	28.7	28.7	30.2	30.2	30.2				59.0	59.0	59.0			
Portugal	63.3	53.9	53.1							63.3	53.9	53.1			
Slovak Republic	26.0	26.0	26.0	31.6	31.6	31.6				57.5	57.5	57.5			
Slovenia	64.3	62.4	62.4							64.3	62.4	62.4			
Spain	81.2	81.2	81.2							81.2	81.2	81.2			
Sweden	45.6	31.1	22.8	22.7	22.7	45.9				68.3	53.8	68.7			
Switzerland	52.3	34.5	23.7	12.8	23.4	17.1				65.2	57.9	40.9			
Turkey	76.4	64.5	64.5							76.4	64.5	64.5			
United Kingdom	53.8	31.9	22.6				36.7	36.7	36.7	53.8	31.9	22.6	90.5	68.6	59.3
United States	51.7	39.4	35.3				38.8	38.8	38.8	51.7	39.4	35.3	90.5	78.2	74.1
OECD34	57.2	42.1	36.5							71.7	57.2	51.9	84.3	64.4	55.4
Other major economies															
Argentina	90.7	78.1	73.9							90.7	78.1	73.9			
Brazil	85.9	85.9	85.9							85.9	85.9	85.9			
China	97.9	77.9	71.2							97.9	77.9	71.2			
India	95.2	65.2	55.0							95.2	65.2	55.0	95.2	65.2	55.0
Indonesia	14.1	14.1	14.1							14.1	14.1	14.1			
Russian Federation	35.0	35.0	35.0	17.3	17.3	17.3				52.3	52.3	52.3	35.0	35.0	35.0
Saudi Arabia	100.0	100.0	100.0							100.0	100.0	100.0			
South Africa	15.1	0.0	0.0				33.1	33.1	33.1	15.1	0.0	0.0	48.2	33.1	33.1
EU27	58.3	49.0	44.6							70.1	61.6	58.3			

DC = Defined contribution.

Source: OECD pension models.

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