

9 November 2006

# **New Zealand as a Case Study**

## The KiwiSaver initiative



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# Agenda

- What is it?
- Why do this?
- Who's involved?
- How does it work?
  - ℳ* role of employers
  - ℳ* role of public sector
- What's the reaction so far?

**First Let's Recap...**  
Last year's presentation



# Last year's Agenda

## ■ Historical context

- ∞ 1898-1974: progressive social policy
- ∞ 1975-2004: public pension policy instability
  - 1984: beginning of major economic reforms
  - 1987: removal of tax 'concessions' (EET to TTE)
  - 1996: major electoral reform (FPP to MMP)

## ■ Contemporary public provision policy (post 1984)

1. for employees: from pension (DB) to retirement savings (DC) policy
2. for citizens: state pension as the supreme political football
  - **NZSF**: a decent attempt to address ageing population problem

## ■ Contemporary 'private' provision for retirement (post 1990)

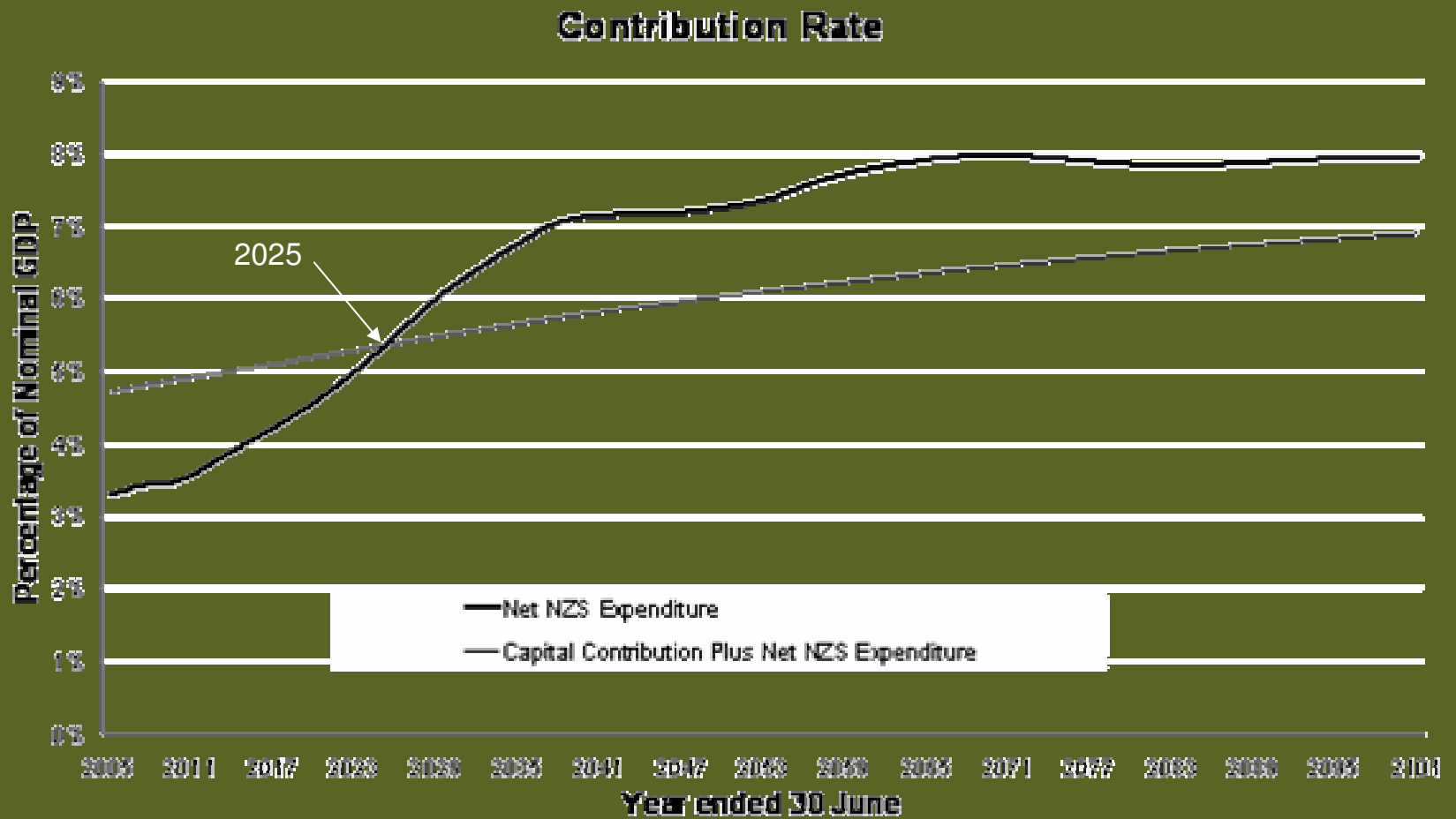
- from DB to DC to 'No B or C' from employers
- new government initiative: **KiwiSaver** (from April 2007)

## ■ Reflections on the New Zealand case



# Cost of New Zealand Superannuation

Source: New Zealand Treasury

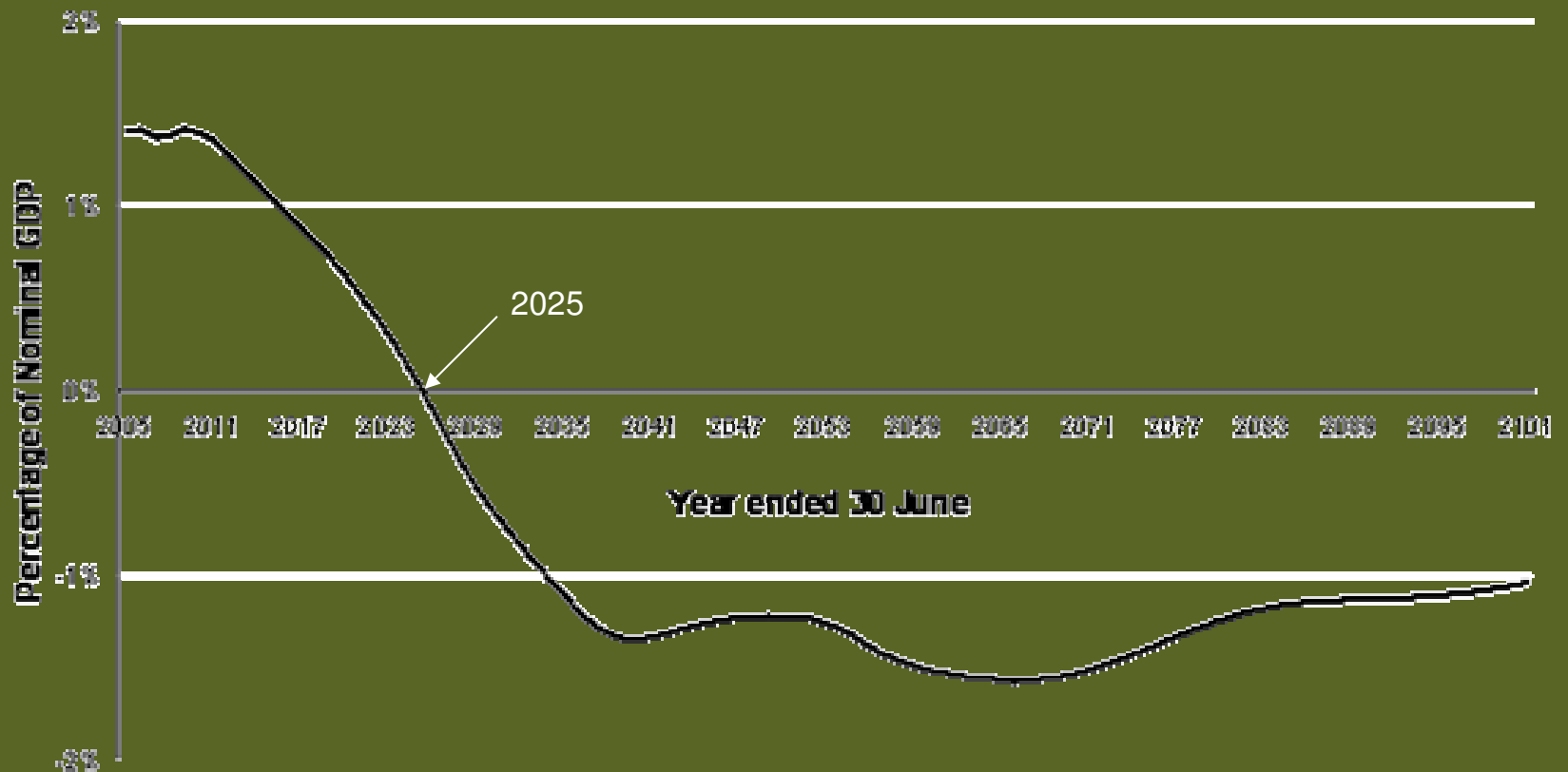




# Capital contributions

## Over and above pension payouts

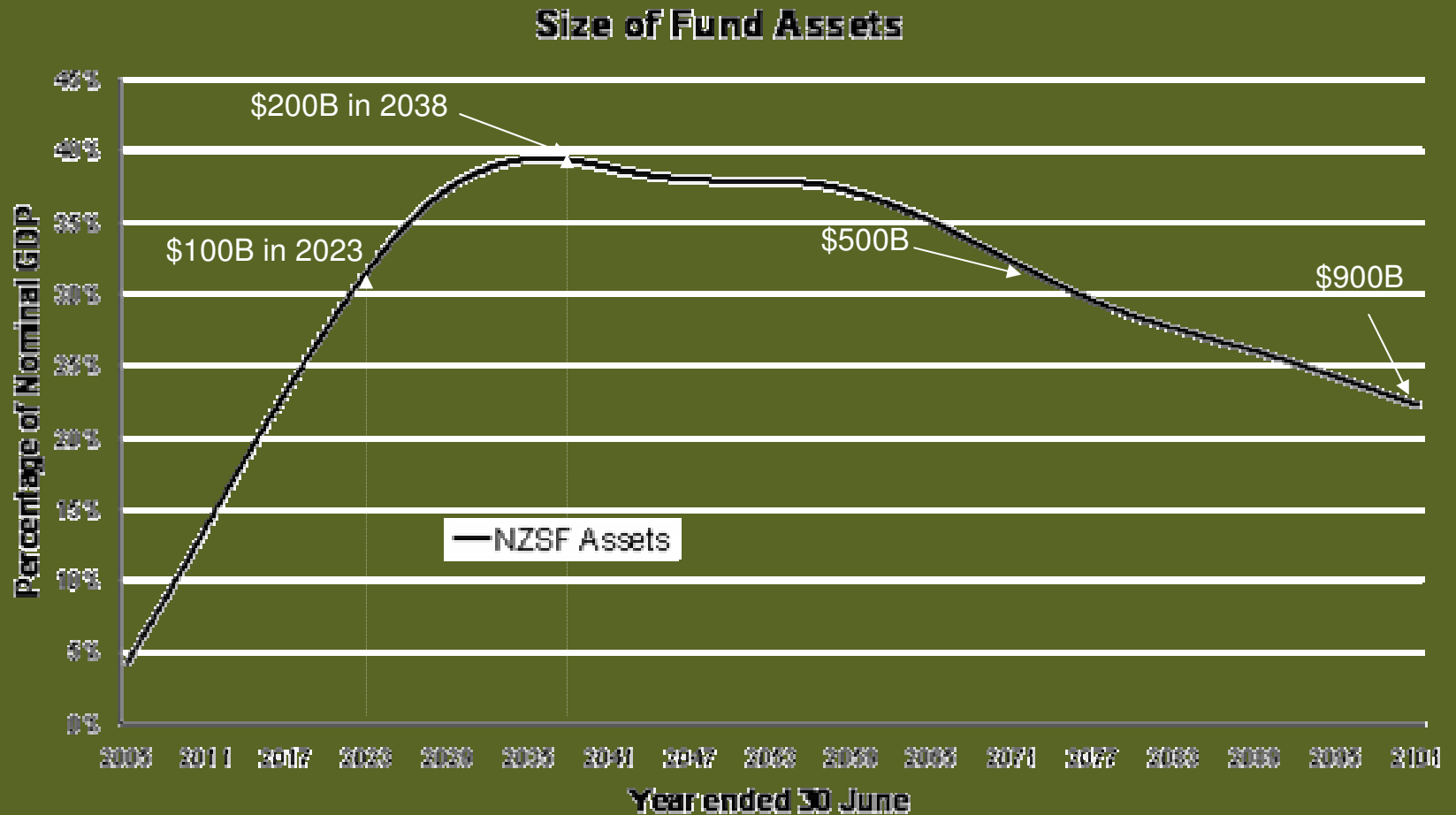
Capital Contribution to Fund





# Projected Fund size

Exceeds \$900 billion after year 2100





# Voluntary provision not working well

## KiwiSaver to the rescue

- Cumulative effect of bad (or no) policy
  - ☞ participation in work-based plans declined from 23% (in 1990) to 13%
  - ☞ no sign yet of any improvement or a reversal of that trend
- Officials now (!) recognize the importance of work-based savings
- KiwiSaver announced in Budget 2005
  - ☞ **designed to complement the NZ Super Fund**
  - ☞ already praised by *The Economist* and *Pensions Policy Institute* (UK)
- Blurring of 'public' and 'private' provision in store (any precedents?)



# Some observations

## Good and bad

- We started with a modest, means tested, 'old age' pension
  - ☞ we now have a universal benefit still payable from age 65
- Politicians use pension policy as a political football, so:
  - ☞ 75% majority in the House should be required for changes
- Unique policy mix: voluntary private provision + universal pension
  - ☞ could work, but needs refinement and invigoration
- Unique in providing no tax concessions for retirement savings
  - ☞ is New Zealand right and the Rest of the World wrong?
- Innovative solutions: **NZ Super Fund** and **KiwiSaver**
  - ☞ greater role of central government?

# **What Is KiwiSaver?**

Work based savings initiative



## KiwiSaver

- ‘Compulsory’ opt-out workplace savings scheme
  - ☞ applicable to all employers
- Part of a strategy to help facilitate (*rather than compel*) Kiwis to save
- Starts on 1 July 2007
  - ☞ employers must offer to all new employees
  - ☞ existing employees can also elect to join
- Will provide for 1<sup>st</sup> time cost-effective facility to save for many individuals (especially for SMEs & self-employed)
- Will significantly change how workplace retirement savings programs are designed and operated



## Key design feature

Based on behavioral finance

- All new employees (18-65) automatically enrolled (from 1<sup>st</sup> payment of salary or wages in new job)
- Employees have the chance to opt out (between 2 and 8 weeks after joining the employer)

So:

1. enrolment is compulsory but...
2. ongoing membership is voluntary
  - specific action will be required of any enrolled employee in order NOT to continue to be a 'KiwiSaver'
  - pragmatic counter-example to classic compulsion
3. means it CAN work even if continues to be complacency!



## Other main features

- Contribution rates are either 4% or 8% of base salary
- 4% or 8% can be split between employee/employer
  - ☞ provided employer contributions are fully vested
- Savings are locked in until age 65
  - ☞ except for mortgage diversion & 1<sup>st</sup> home purchases
- Savings made available as a lump sum at age 65
- Inland Revenue may select a default KiwiSaver provider
- Ministry of Economic Development (MED) is currently running a tender process for selecting default providers



## Other main features

Government making it attractive

- Government will meet cost of central administrator (IR)
- Employer contributions exempt from tax (“SSCWT”)
- Government will make an upfront once only ‘kick-start’ contribution of \$1,000 and provide a fee subsidy (?)
- A housing allowance of up to \$5,000 for 1<sup>st</sup> home buyers available from the government (“deposit subsidy”)
- Up to half of employee’s contributions can be diverted toward paying mortgage (“mortgage diversion facility”)

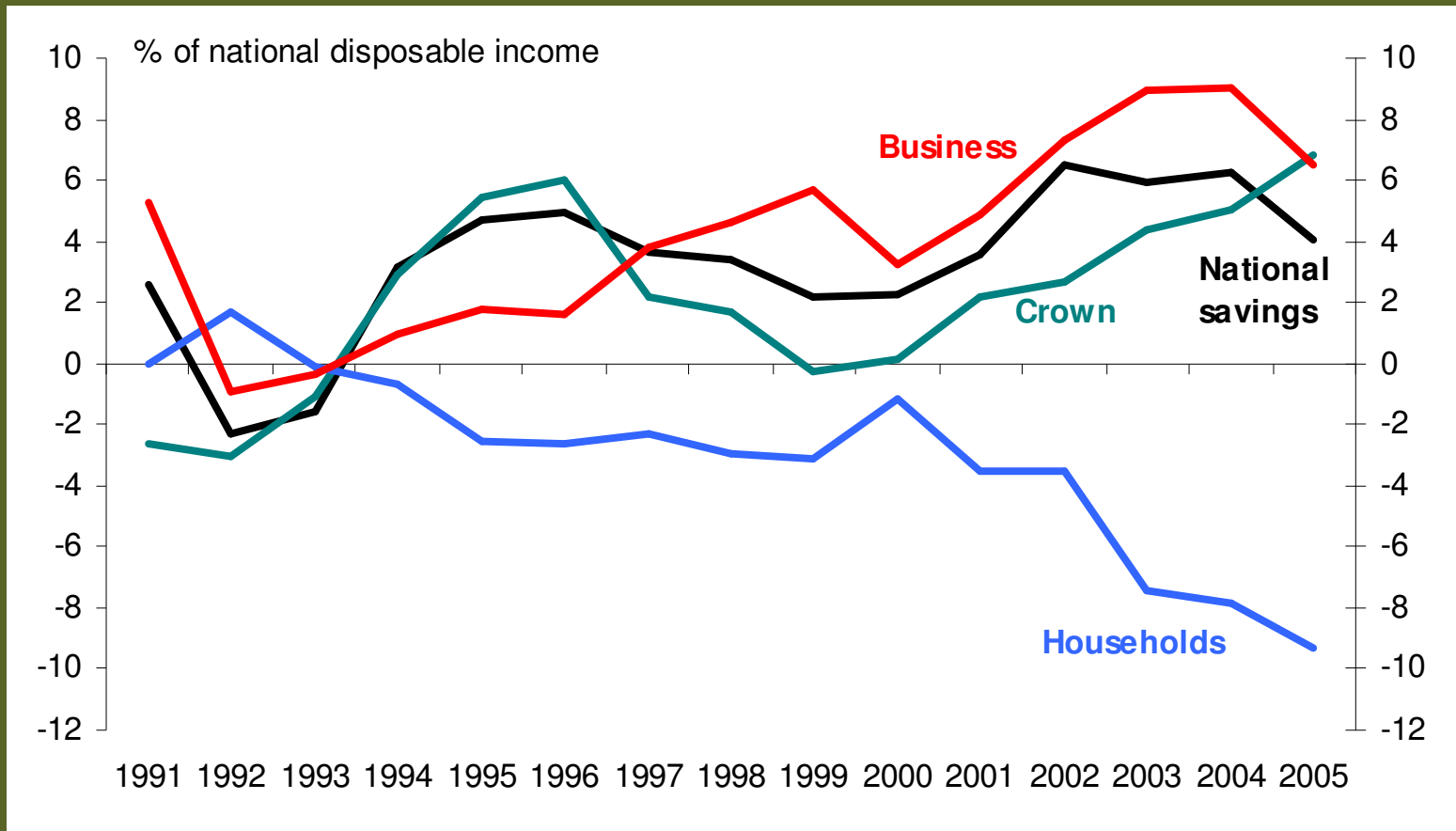
# **Why Do This Now?**

To address the savings problem



# Households simply don't save

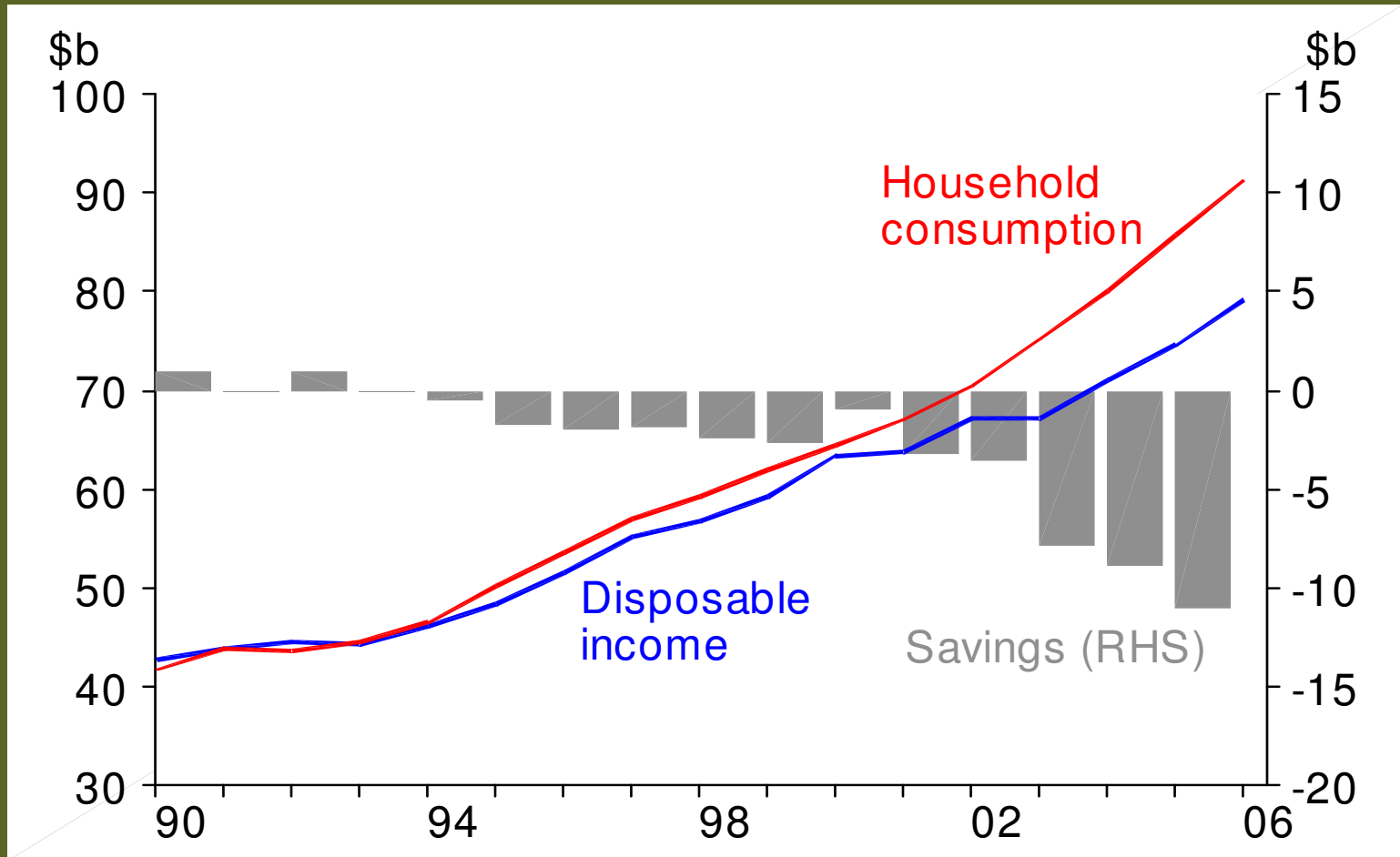
Source: Reserve Bank of New Zealand





# Households consume more than they earn

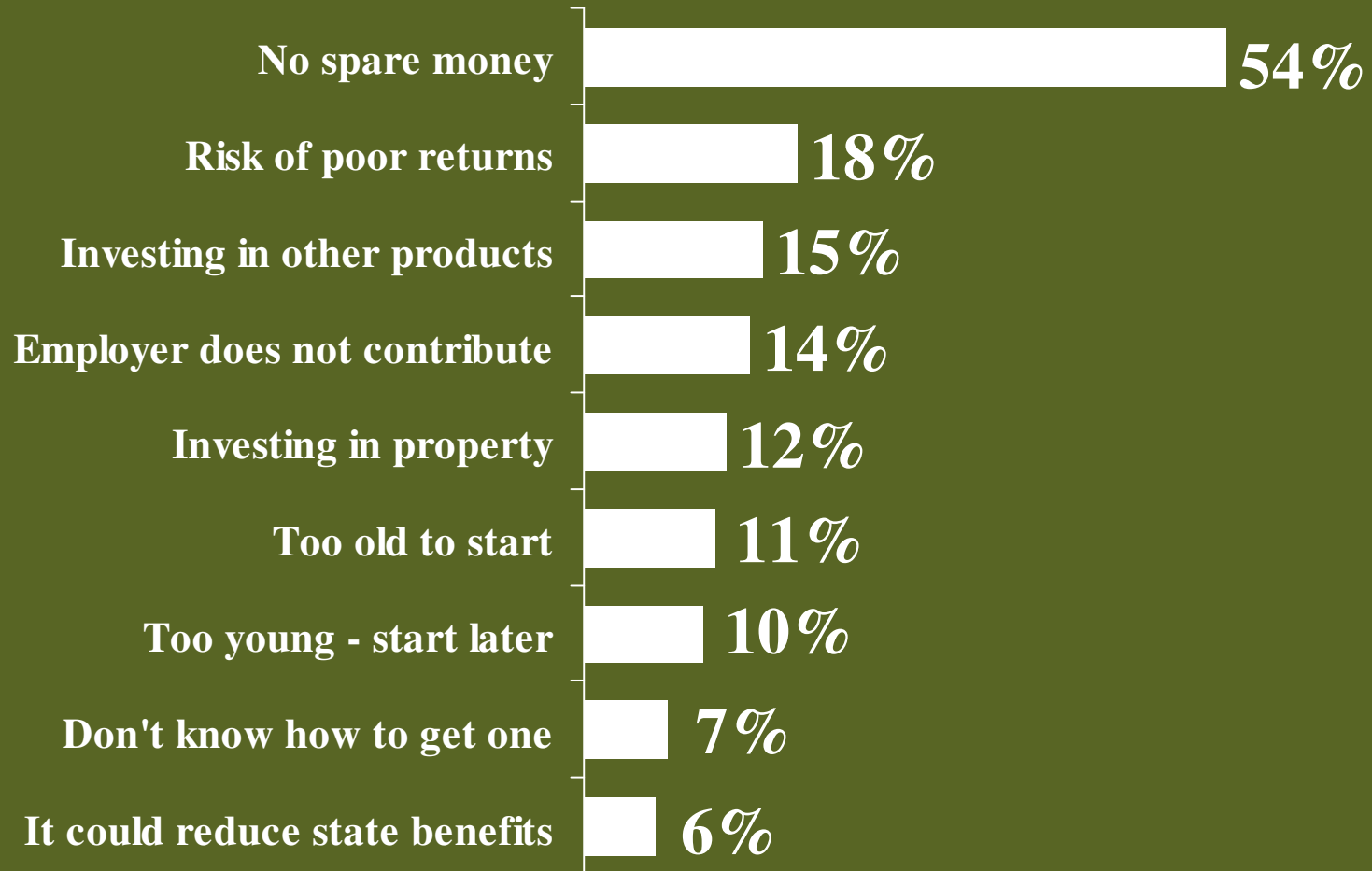
And it's not getting better





## Multiple reasons for not saving

Source: ABI & PPI (UK), 2005





## Purpose of KiwiSaver

*“...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 Act



## Aim of KiwiSaver

- Encourage a savings culture
- Substantial shift in attitudes to long term savings is required if level of savings is to change
- *“KiwiSaver aims to switch the bias towards making savings easy rather than difficult”*
  - NZ Officials’ Report on the KiwiSaver Bill June 2006
- Bring costs down to more affordable level for ‘ordinary’ Kiwis
- Target as many people as possible as simply as possible
  - ⌘ *700,000 employees change jobs every year*
  - ⌘ *1,200,000 job changes every year*

# **Who's Involved?**

Government initiative



# Who is involved?

<b>Employees</b>	Save
<b>Employers</b>	Deduct and send contributions
<b>Financial advisors</b>	May provide financial advice if requested
<b>Scheme providers</b>	Develop & market KiwiSaver schemes
<b>Retirement Commission</b>	Independent financial education
<b>Housing NZ Corporation</b>	Housing deposit subsidy
<b>Ministry of Economic Development (MED)</b>	Tender process Regulation of financial sector Government Actuary
<b>Inland Revenue</b>	Central Administrator



## **Inland Revenue**

### Central administrator

- Communicating public information – raise awareness and understanding of KiwiSaver amongst employers and employees
- Provide information to employers for employees
- Provisionally allocate new employees to a default provider
- Receive employee information & contributions from employers – transmit to scheme providers
- Administer contributions holidays, opt outs, and payment of kick-start contribution



# Inland Revenue

## Dos and don'ts

### Will:

- Act as a conduit
  - ❧ information, automatic enrolment, refunds
  - ❧ contributions and contribution holidays
- Establish standards and ground rules for providers

### Will not:

- Offer a platform for the industry
- Offer a fund/plan administration service
- Offer financial advice or education



## Retirement Commission

Focus on personal financial education

- Kiwis are enthusiastic borrowers and poor savers
- Why?
  - ☞ we don't know for sure but...
  - ☞ we know that “banging on” about savings doesn't work
  - ☞ we know that traditional incentives don't work either
- What's the answer?
  - ☞ a kick start approach with ability to opt out
  - ☞ simplified products and trusted advice
  - ☞ education and financial literacy
    - financial education in schools
    - financial education at work

## **How does it work?**

Automatic enrolment and opt out



# KiwiSaver will affect every employer

- Employer exemption is available if existing plan meets certain conditions
  - ☞ employer arrangement must be open to all employees
  - ☞ employer arrangement must be registered
  - ☞ trust deed must allow transfers to and from other plans
  - ☞ must provide for contributions of at least 4% of base salary
- But employees can still elect to join KiwiSaver if they wish to do so
  - ☞ so each employer (exempt or not) must at least:
    - provide Inland Revenue with new employee details
    - provide new employees with information packs
    - accept and process employee elections to opt out
    - remit contributions to Inland Revenue
    - manage contribution holidays and changes to contribution rates



## Employers with existing plans

Several options to choose from

1. Apply to Government Actuary for an exemption (if existing plan meets criteria)
2. Convert the existing plan to a KiwiSaver scheme
3. Establish a KiwiSaver 'section' within the existing plan
4. Make no (or minor) changes to existing plan and comply with KiwiSaver obligations outside the plan
  - a. e.g. if KiwiSaver house 'deposit subsidy' has major appeal with employees → alter existing plan so 1<sup>st</sup> 4% of member contributions directed to KiwiSaver scheme
  - b. many other creative design solutions being born...



**And the Reaction so far is?**  
In New Zealand and overseas



## The reaction

So far...

- Very positive overseas (UK, Australia)
  - ☞ KiwiSaver seen as potential solution applicable more globally (*The Economist, UK Pensions Policy Institute*)
- Local stakeholders very active in getting ready
- But outside the industry there is still much to be done locally to raise awareness
  - ☞ many employers have no idea what's coming
  - ☞ media activity is planned to start later this month
  - ☞ employer kits will be distributed in April next year
  - ☞ public information campaign starts in May next year
  - ☞ employee packs distributed nationally in May next year



## For more information on KiwiSaver

- Official website:
  - ☞ <http://www.kiwisaver.govt.nz>
- Inland Revenue:
  - ☞ <http://www.ird.govt.nz/kiwisaver>
- The Treasury:
  - ☞ <http://www.treasury.govt.nz/kiwisaver>
- Retirement Commission:
  - ☞ <http://www.retirement.org.nz>
  - ☞ <http://www.sorted.org.nz>

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# Thank You Questions?



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