pensioncommentary

An article from the Retirement Policy and Research Centre

KiwiSaver: A world-class savings plan

RPRC contributes to the Retirement Commissioner's review on the topic of KiwiSaver

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Introduction

The three yearly review of retirement incomes policies is underway. Each month starting May 2016 a different aspect is being examined by the Commission for Financial Capability. This commentary draws on an article written for the AARP journal in early 2016: How to save like a Kiwi Spring 2016.

Background

New Zealand has a very simple retirement income framework comprised of a universal state pension New Zealand Superannuation (NZS); an auto-enrolment savings scheme called KiwiSaver; and supplementary unsubsidised voluntary savings. Widespread home ownership has also underpinned living standards in retirement.

KiwiSaver is designed to build on the basic income protection provided by the state. In New Zealand, since the 1970s the non-contributory, taxable state age pension, NZS, has provided a very substantial first tier. Currently there is no income or asset test, and meeting a low residency test of 10 years is all that is required, although there may be offsets when retirees have overseas state pensions. The rate is adjusted to never fall below a floor of 66% of the average wage for a couple, with higher rates for single people and those who live alone.

Unlike most other countries, private saving for retirement in New Zealand has been viewed as little different to other forms of saving. Where traditional tax regimes provide an exemption from tax on contributions both employer and personal (E), a tax exemption on earnings in the fund (E), and taxable pensions (T), in New Zealand all tax concessions for retirement saving were abolished in late 1980s. Contributions since then are made out of after tax income (T), earnings in the fund are taxed (T) but withdrawals are tax-free (E). In response, many employment-based retirement schemes were closed and many Defined Benefit (DB)

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[1] An RPRC Pension*commentary* is an opinion piece designed to provoke discussion on an issue of public significance.

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schemes were replaced by Defined Contribution (DC) schemes. Public sector DB schemes were closed to new members in 1992.

As a consequence, by the mid-2000s, coverage of the workforce in employment-based retirement schemes had fallen to only around 14%, with very few in DB schemes. In 2007, KiwiSaver, the world's first national auto-enrolment, national saving scheme was introduced to extend the opportunities of work-based saving.

Over time, KiwiSaver appears to be gradually supplanting other remaining employment-based schemes. Excluding children under 18, there were 2.2 million members by June 2015, representing approximately 75% of the working age population. Membership is not confined to employees: non-earners over 18 who opt-in may also benefit from the member subsidy.

Generous subsidies initially fuelled a strong uptake but these have been progressively eliminated. By 2016, the only remaining subsidy is a matching 50% Member Tax Credit (MTC) on the first NZ$1,040 of member contributions. This limited, progressively designed incentive is in sharp contrast to the regressive and expensive tax concession design common in other countries.

Employers are required to contribute 3% of an employee's gross wages, while members can choose to contribute 3%, 4% or 8%. The majority of employees (58%) contribute the default amount of 3% only. In line with the TTE regime described above, the employer contribution is taxed, while the employee contribution is made out of after-tax income.

One of the clear advantages of the New Zealand approach is the use of the Inland Revenue Department (IRD) to act as a clearing house. Contributions are collected along with PAYE income tax and on-sent from the IRD to the employee's provider, achieving administrative efficiency and full portability. Each member holds a personal KiwiSaver account with their chosen provider, which goes with them if they shift between employers. The scheme has been well received by employers including those of small and medium enterprises (SMEs) who have found their compliance costs to be low.[i]

Choice and competition are at the heart of KiwiSaver design, with competing private providers, a broad choice of investment funds, and a wide disclosure of fees. If KiwiSaver members do not make an active choice, they are directed into one of nine default providers and into a default investment option. About 25% of members are in default schemes.

Tensions

1. One of the tensions in KiwiSaver is the balance between objectives of increasing individual financial retirement saving and flexibility to recognise different circumstances. New employees are automatically enrolled but, between 2 and 8 weeks, can opt-out and have any contributions refunded. A relatively small number (234,252 by June 2015) have opted out. After one year of membership, it is also possible to take a contributions holiday of up to five years. This is renewable, and being on a contributions holiday does not preclude making contributions to gain the full MTC.[ii] At the end of June 2015 only 119,153 were taking such a holiday with most making some contribution.[iii]

2. While membership has outdone predictions, as many as 27% over 18 do not currently make any contributions and get neither an employer contribution nor the MTC.[iv] Nearly one half of all members who get some MTC, make contributions under the NZ $1,040 needed for the maximum subsidy. The explanation appears be that the default 3% rate ensures the contribution for many minimum and part-time earners is low.

More flexibility, say in contribution rates, will have a price in greater complexity. The employer contribution is at the expense of those not in KiwiSaver.

3. Another feature of KiwiSaver is the facility to access savings, now including state subsidies, after a minimum of three years for the purchase of a first home. The state also offers additional subsidies for housing purchases for low income people. In part this recognises the importance of a debt-free home for retirement planning. However it again provides some tension, as the original purpose of KiwiSaver was to reduce the traditional over-emphasis on real estate as an attractive way of saving.

   The tax advantages of real estate as a vehicle for saving needs review.

4. With the demise of DB schemes, few retirees can expect to have private pension income to supplement the state pension. Retirees may take a tax-free lump sum from KiwiSaver and must manage their longevity and other risks such as inflation. Drawdown arrangements are becoming common whereby members can leave their funds with the same provider and same portfolio allocation. There is however, no longevity protection from such arrangements.

   The lack of ability to annuitise modest lumpsums with protection is a serious gap for middle income New Zealanders.

Conclusion

KiwiSaver is in its 9th year. It has achieved remarkable acceptance, low administration costs and wide transparency. However, low levels of contribution, its use for housing, too many in default schemes, low default contribution rates, and lack of decumulation policies and products remain as concerns.

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[i] Inland Revenue. (2015). KiwiSaver evaluation: Final summary report. A joint agency evaluation 2007–2014.
[ii] St John, S., Littlewood, M., & Dale, C. (2014). Now we are six. Lessons from New Zealand's KiwiSaver. Auckland: Retirement Policy and Research Centre.
[iii] Inland Revenue, 2016, Annual KiwiSaver Statistics (http://www.kiwisaver.govt.nz/statistics/monthly/)
[iv] Inland Revenue. (2015). KiwiSaver evaluation: Final summary report. A joint agency evaluation 2007–2014.