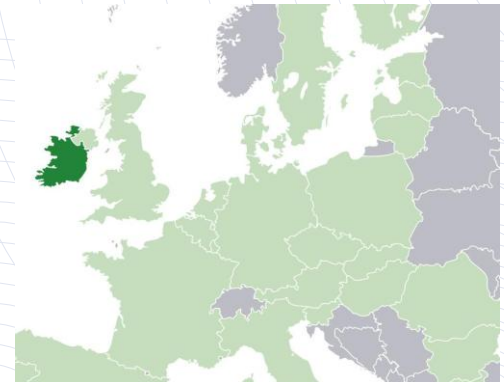
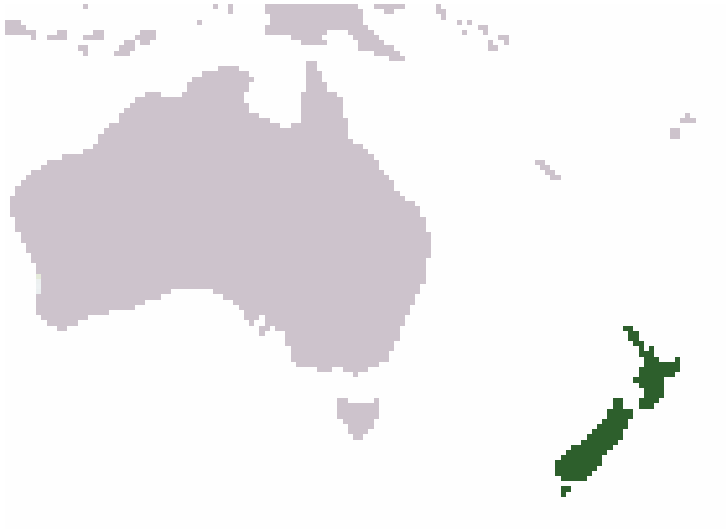




# New Zealand Superannuation and KiwiSaver

Dr Brian McCulloch

Green Paper on Pensions  
Learning from International Experience Conference  
Dublin, May 29<sup>th</sup>, 2008



# The New Zealand policy framework is built around...

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- **New Zealand Superannuation (NZS)**
  - Universal state pension funded from General Revenue
- **New Zealand Superannuation Fund**
  - Sovereign wealth fund
- **KiwiSaver**
  - Voluntary private savings with incentives
- **Retirement Commission**
  - Independent information
  - Financial literacy
- **Various social programmes and private provision**

# New Zealand Superannuation is a universal state pension paid from General Revenue ...

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- Paid to all residents 65 years and over
- Married couple receives 65% of the national average wage (32.5% each = NZD \$13,747 each before tax)
- Indexed annually
- Taxed along with all other income
- No income test
- No requirement to retire from paid work
- No asset test
- Unrelated to past earnings history
- Not contributory

# NZS is simple, clear and easy to understand. It has proved durable. It...

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## ... provides confidence and certainty

- Lower-income earners are assured of post-retirement incomes comparable to their pre-retirement earnings.
- For higher-income earners, it provides a baseline of certainty from which they can plan additional saving.
- Protection against longevity risk
- Indexing to national wage levels maintains relative living standards of older people.

## ... enables choice

- Neutral in terms of those who choose to continue working after 65 and those who don't

## ... is seen as fair and equitable

- Everyone who is eligible gets the same, regardless of employment and earnings history
- Treats men and women equally, irrespective of marital status and earning history

## ... is efficient

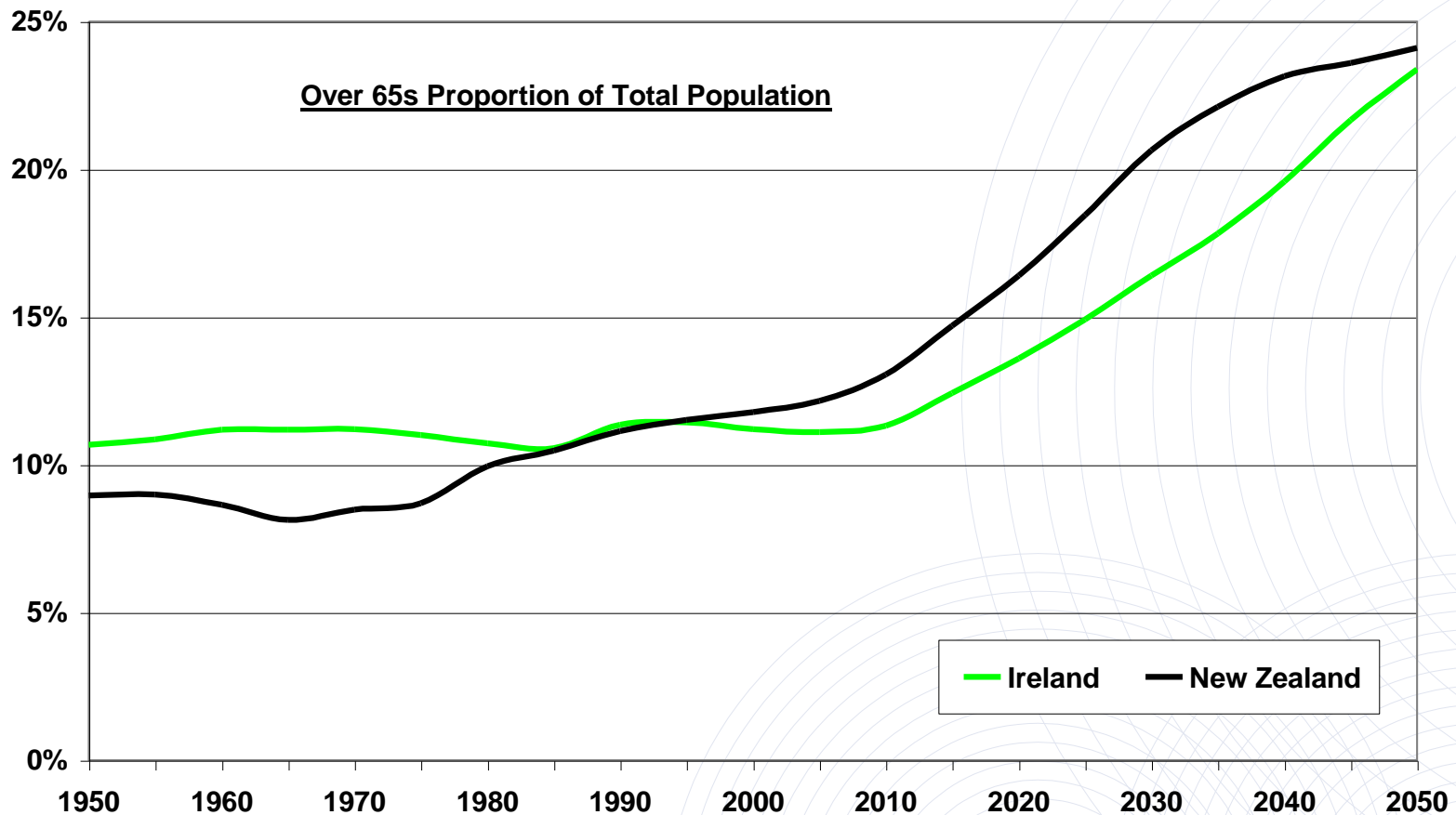
- Low administration cost
- Simple to explain and operate

... but NZS alone raises two concerns ...

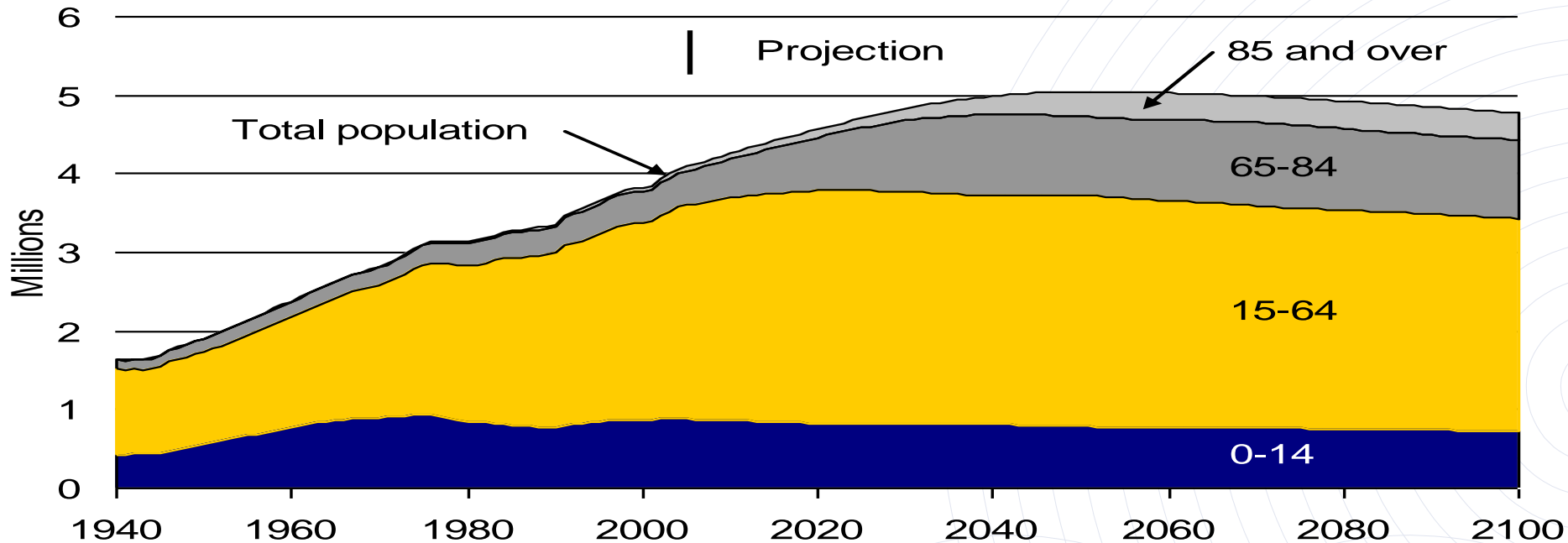
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- Sustainability
  - With an ageing population, is NZS fiscally sustainable?
- Adequacy
  - While NZS may be adequate as a complete income replacement for some lower-income earners, are higher earners making adequate additional private provision to meet their future aspirations?

# Like many economies, New Zealand has an ageing population.



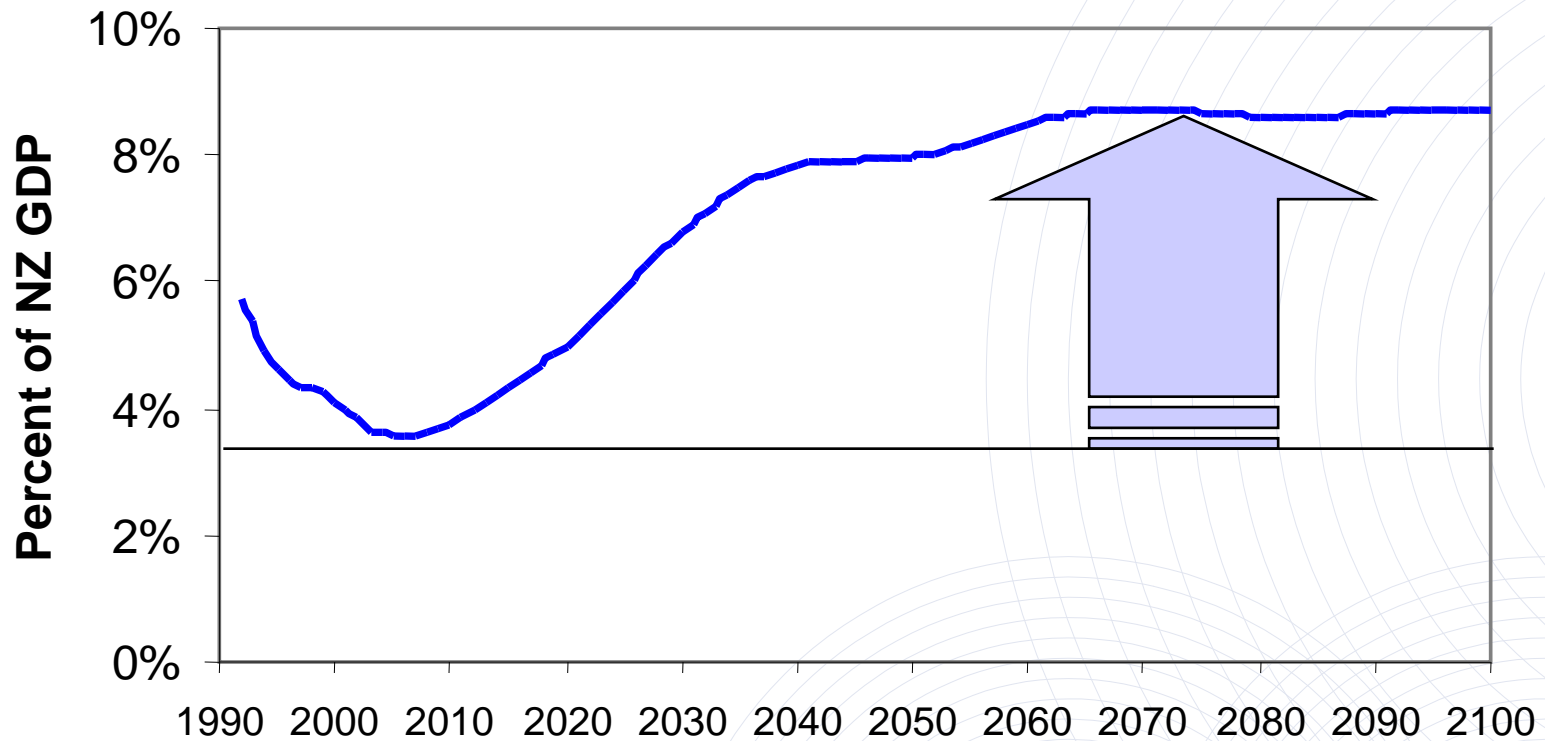
# Both the population level and structure will change markedly ...



- A larger proportion of “elderly”, especially “older elderly”.
- Some “unexpected longevity” – people underestimating how long they live.
- People available for work for longer and/or longer in retirement or semi-retirement.
- There will be changing demands on Crown finances.



All else equal, the fiscal cost of NZS will rise...



**...from around 4% of GDP now to 8% by mid-century.**

# Future governments will have options ...

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- Who should get it?
  - Income targeting or means testing
    - Fundamentally changes the universal nature of NZS
  - Longer residence requirement
    - Not likely to be significant
- How much?
  - Reduced level relative to average wage
    - Issues of fairness and adequacy
- When?
  - Phase up the age of entitlement beyond 65
    - Politically difficult and raises ethnic issues
- Other areas of government expenditure and revenue?

# New Zealand Superannuation Fund – Policy Rationale

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- Stronger Crown Balance Sheet cushions the impact on Crown finances ...
- ... Public Debt is already at relatively low levels, so ...
- ... build up a fund of Crown-owned financial assets to...
- ...partially pre-fund the extra fiscal costs (tax smoothing) with...
- ...a diversification benefit of broadening the Crown financial portfolio across capital markets but...
- ...good governance arrangements are vital to avoid repeating the international record of poor financial performance of public funds.

# New Zealand Superannuation Fund – Design of Governance Arrangements

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*“A clearly defined portfolio of Crown financial resources ...*

*... managed by an independent governing body ...*

*... with explicit commercial objectives ...*

*... and clear accountability.”*

# Great minds ...

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National Pensions Reserve Fund



NEW ZEALAND  
SUPERANNUATION  
FUND

- Same underlying purpose
- Similar governance objectives
- Similar investment strategy
- Responsible investment

**NZSF does not “solve” the sustainability issues, but it does provide additional fiscal headroom as budget adjustments need to be made over time.**

# KiwiSaver – a brief description

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- **A voluntary work-based savings scheme**
  - ❑ But also available to people not in the workforce
  - ❑ Complements other initiatives
- **Announced in Budget 2005**
  - ❑ With modest incentives to join
- **Expanded in Budget 2007**
  - ❑ Additional incentives
  - ❑ Employer contributions
- **Started on 1 July 2007**
  - ❑ So now been operational for 11 months



**Why?**

**How?**

**Progress?**

# KiwiSaver policy objectives encompass savings, investment, financial markets and retirement income

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- “Better income in retirement for those who want it”
  - ❑ NZS provides many with comparable post-retirement income
- Increase national saving...
  - ❑ by encouraging a long-term savings habit and asset accumulation...
- Focus on household saving, in financial assets
  - ❑ bias towards low-to-middle income households
  - ❑ may not be saving enough for retirement
  - ❑ overly reliant on housing wealth, potentially vulnerable
- Maintain government saving levels
  - ❑ so no reduction in NZSF contributions
- Support long-run fiscal aims
  - ❑ prudent debt
  - ❑ long-run sustainability

# KiwiSaver – summary of original design

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- Voluntary, open to all
- Workers auto-enrolled on joining workforce or changing job
- One-off kick-start payment (\$1,000) and annual fee subsidy for all members
- For employees, contribution rate 4% (or 8%) of gross salary or wages, deducted by employer
- Non-employees – no specified rate – at provider discretion
- One account per person
- Funds under private management
- Funds locked-in till superannuation age
- Portability across employers
- Members elect which provider and fund, or default allocation
- Default provider tender process
- Contribution holidays, “hardship” withdrawal
- Mortgage diversion and first home deposit subsidy

**Full details at [www.kiwisaver.govt.nz](http://www.kiwisaver.govt.nz)**

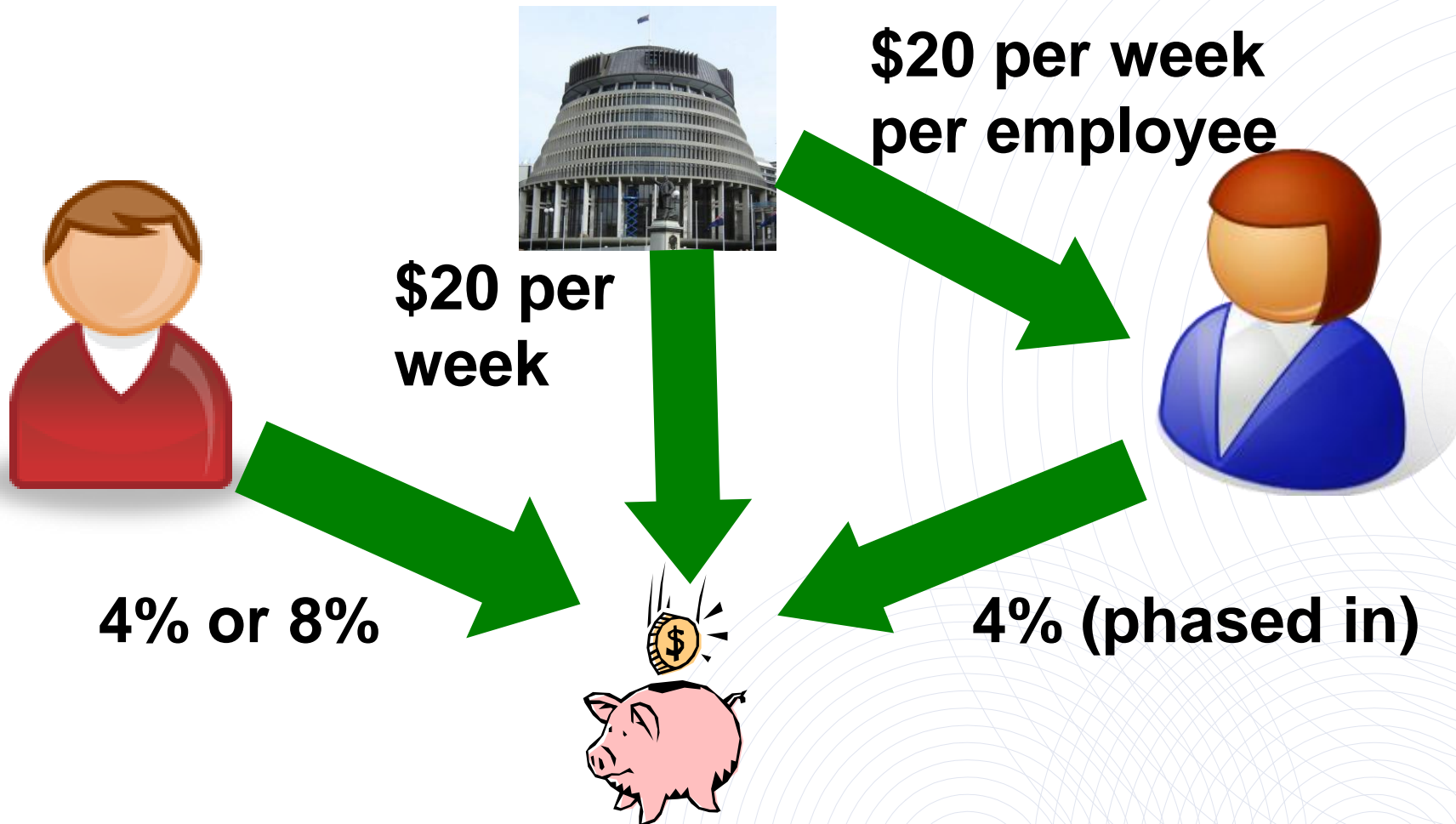


# KiwiSaver – 2007 enhancements

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- Member tax credit (MTC) – up to \$20 per week (from 1 July 2007)
- Compulsory employer contributions – starting at 1% (from 1 April 2008), rising annually to 4% of gross salary
- Employer tax credit – up to \$20 per week
- MTC available to non-employees and self-employed
- These features available from 18 years of age to age of eligibility for NZS (65 years)

# Enhancements - tax credits, employer contribution



# KiwiSaver – progress since launch on 1 July 2007

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- >600,000 members as of end-April 2008
- Well ahead of forecast.
- Fiscal cost of incentives also ahead of forecast
- Demographics of membership:
  - ❑ 51:49 (F:M)
  - ❑ Age profile:
    - 0-17 8%
    - 18-24 16%
    - 25-44 33%
    - 45-65 40%
  - ❑ Members on average slightly older, slightly better off than non-members
- ❑ 33 providers, offering 48 different schemes
- ❑ Additional funds under management - \$600 million and rising

## ...and for those who don't/won't choose – default schemes and providers

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- Established for members who don't choose a scheme for themselves, or by employer
- Default to conservative fund
  - ❑ Lower risk, lower earnings
- Member may switch fund, with no charge
  - ❑ If dissatisfied with service, returns
- A guaranteed client base
- Selected by open and competitive tender
- Six appointed
- Re-tender in 2014
- Relevant Ministers may review before then

# KiwiSaver – taxation and regulation

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- Influenced by parallel processes already under way...
  - ❑ Reviewing supervision and regulation of non-bank financial institutions
  - ❑ Portfolio Investment Entities tax regime - equalised tax treatment of portfolio and direct investment
- Want even-handedness between KiwiSaver and similar products so...
  - ❑ Schemes operate under trust deeds (like existing registered superannuation schemes)
  - ❑ No government guarantee of scheme balances
- But had to recognise that Government incentives will attract new (more naïve) savers. Therefore, in addition, KiwiSaver providers must...
  - ❑ Ensure schemes have independent trustee
  - ❑ Set fees at level that are “not unreasonable”
  - ❑ Disclose approach to responsible investment

Design philosophy - preserve choice and competition, reduce “churn” between existing savings and new scheme, minimise compliance costs

# KiwiSaver choices – What we did and why (part 1)

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- A targeted replacement rate? No
  - NZS already guarantees a minimum income level tied to average earnings
  - Something else that would have to change with demographic shifts
  - But used for modelling illustrative examples
- Full compulsion? No
  - Inflexible, mandated saving not right for all
  - NZS maintains income levels for many low earners
  - Political reaction – referendum in 1997 roundly rejected (92:8)
- Decumulation rules/annuitisation? No (not yet)
  - NZS already guarantees a minimum income level, effectively an annuity
  - Reluctance to dictate withdrawal strategy

# KiwiSaver choices – What we did and why (part 2)

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- Defined fee levels? No (not yet?)
  - “Fees must not be unreasonable”. Fee levels monitored.
  - Risk that it becomes floor, set at wrong level
  - Want to encourage competition and innovation in prices and services
  - Fee subsidy more transparent
  - Remains an option in light of experience
- Government guarantee? No
  - Entry is voluntary
  - Sends wrong signals to market and members
- Dictate asset allocations? In part
  - For default conservative funds only

# KiwiSaver choices – What we did and why (part 3)

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- Mandated disclosure? Yes
  - Fees and charges. Consistency a challenge. May need to define
  - Responsible investment policy, but not required to have one
  - Specific requirements on content of statements to fund member
  - Specific requirements on content of published annual report
- Incentives to reduce switching and crowding out? Yes
  - Value of incentives capped. Gives proportionally more to less well off
  - Established “complying fund” rules. Existing workforce schemes may attract KiwiSaver incentives on adopting lock-in, portability
  - Regulation/Supervision/Taxation even-handedness



# KiwiSaver summarised

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- Voluntary, open to all
- Complements NZS, not a replacement
- Incentives to enter, stay a member
- Low compliance for members, providers
- Taxed and regulated like similar products
- Delivered exclusively by private providers
- Encouraging competition and innovation
- All decisions sit with individual except:
  - Mandated contribution rate (if an employee)
  - Matching member contribution (if an employer)

# Retirement Commission ...

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- Develops and promotes methods of improving the effectiveness of retirement income policies
- Promotes education about retirement income issues and publishes information
- Monitors the effects of retirement income policies and reports to Ministers
- Works with financial services providers, regulatory authorities to improve clarity and transparency of information to support personal decision-making
- Provides a range of tools and support services such as:
  - ❑ “Sorted” – web-based calculators and information on managing personal finances
  - ❑ KiwiSaver calculator and decision guide
- Consulting now on draft financial literacy strategy. Aims to:
  - ❑ “achieve a financially literate population where New Zealanders are financially well-educated and can make informed financial decisions throughout their lives.”

# New Zealand's design – quick recap

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- **New Zealand Superannuation (NZS)**
  - Universal state pension funded from General Revenue
- **New Zealand Superannuation Fund**
  - Sovereign wealth fund
- **KiwiSaver**
  - Voluntary private savings with incentives
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  - Independent information
  - Financial literacy
- **Various social programmes and private provision**

# Tomorrow's challenges

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- Durability and sustainability of the framework:
  - ❑ General Election 2008 – attitude of a new Government
  - ❑ Financial market turbulence – impact on savers, providers
  - ❑ Tighter fiscal conditions/pressures over time – adjusting the model
- KiwiSaver evaluation:
  - ❑ Stage 1 – operational performance, “debugging”
  - ❑ Stage 2 – effectiveness relative to policy objectives
- Productivity and growth:
  - ❑ Turning funds under management into a more developed financial sector and potentially to help finance more productive investments by New Zealand enterprises

# More Information

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- New Zealand Superannuation
  - [www.winz.govt.nz](http://www.winz.govt.nz)
- New Zealand Superannuation Fund
  - [www.nzsuper.co.nz](http://www.nzsuper.co.nz)
- KiwiSaver
  - [www.kiwisaver.govt.nz](http://www.kiwisaver.govt.nz)
- Retirement Commission
  - [www.retirement.org.nz](http://www.retirement.org.nz)
  - [www.sorted.org.nz](http://www.sorted.org.nz)
- New Zealand Treasury
  - [www.treasury.govt.nz](http://www.treasury.govt.nz)
  - [brian.mcculloch@treasury.govt.nz](mailto:brian.mcculloch@treasury.govt.nz)