New Zealand KiwiSaver: Automatic Enrolment Experiences - Lessons for the UK, Ireland and US.

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\(^1\) This paper draws on work done in the Retirement Policy and Research Centre, Auckland Business School, University of Auckland and in particular St John, Littlewood, & Dale (2014). Susan St John was invited to Ireland and the UK in February 2014 to address key stakeholders on the design features of the NZ framework.
Abstract

New Zealand’s KiwiSaver success with the ‘soft compulsion’ of automatic enrolment is an influence in the design of opt-out schemes in the UK, Ireland and the US. Some have described KiwiSaver as ‘clever’ avoiding many of the problems that beset reform in other countries.

Nevertheless, there are lessons from KiwiSaver on what to avoid in the design of a national retirement saving scheme. These may include: opening it to children; offering housing subsidies; allowing too many providers and privileging some of these as ‘default providers’; ignoring the issue of decumulation; and obscure objectives.

Some of the ‘clever’ aspects of KiwiSaver have been facilitated by earlier unique reforms especially to the taxation of superannuation saving. New Zealand’s experience suggests that auto-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. The employer contribution may provide an addition incentive for employees to opt in or stay auto-enrolled. However it raises an issue of remuneration policy and unfairness for those who are not in KiwiSaver.

Advantages over previous work-based retirement saving schemes include the portability of KiwiSaver accounts facilitated by the IRD’s role as a clearing house. If current trends continue, KiwiSaver will continue to supplant the role of employer-subsidised superannuation and retail schemes.

The first seven years show that KiwiSaver is a firmly established part of the New Zealand retirement income framework. It has the potential to contribute to financial literacy and it reminds people of their need to prepare for retirement. Yet the fundamental questions around its purpose and design have not been resolved. Is KiwiSaver's purpose to allow low and middle income people to augment a well-supported universal state pension? Is it to reduce the pressures on the economy of an ageing population and solve the national saving problem? Or, does it lead inevitably to an Australian type of integration with the state pension?
1. Introduction

New Zealanders don't realise that they are regularly regarded in other countries as world leaders, not just in sport. New Zealander of 2010, Ray Avery, points to the 'never say it can't be done' attitude that has produced many astonishing results in science. In social policy too we have often been ahead of world thinking. One very under-trumpeted innovation is our retirement incomes policy that, along with ACC, is unique on the world stage.

New Zealand Superannuation (NZS), the foundation of New Zealand’s retirement income system, is a universal, Pay As You Go (PAYG), taxable age pension, partially prefunded by accumulated assets in the New Zealand Superannuation Fund (NZSF). Alongside NZS sits KiwiSaver, the world’s first national auto-enrolment saving scheme.

New Zealand’s success with the ‘soft compulsion’ of automatic enrolment has been, and is continuing to be an influence in the design of opt-out schemes in the UK, Ireland and the US. Seven years on, this retirement saving scheme is both well accepted by the public and has certain clever design features.

If KiwiSaver is made compulsory, as some powerful lobbies propose, there are large complexities to resolve, including the future role of the universal state pension, NZS. It is timely to reflect on the really good things about our retirement incomes framework before making ill-considered changes. Looking to the future, this paper suggests New Zealand is in a unique position to build on this framework and offer leadership in helping solve some of the intractable issues around decumulation that are plaguing other countries.

2. New Zealand Superannuation

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 has, at its foundation, a flat-rate, universal, taxable benefit, paid out of current taxation. Eligibility is from the age of 65 years, if modest residency requirements are met.2 Under a current political agreement, the combined net NZS rate for a couple has to be at least 66% of the net average wage (33% per married person). Higher rates apply for single people either living alone or sharing accommodation (see Table 1). NZS is indexed annually via the Consumer Price Index until the wage-floor of 66% is reached, then net pensions rise with the net average wage.

Table 1: New Zealand Superannuation rates at 1 April 2014

<table>
<thead>
<tr>
<th>Category</th>
<th>% net average wage</th>
<th>Annual rate (gross)</th>
<th>Annual Net</th>
<th>Annual Net</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single, living alone</td>
<td>43%</td>
<td>$21,932</td>
<td>$19,080</td>
<td>$14,494</td>
</tr>
<tr>
<td>Single, sharing</td>
<td>40%</td>
<td>$20,154</td>
<td>$17,613</td>
<td>$13,503</td>
</tr>
<tr>
<td>Married person or partner in civil union or de facto relationship (each)</td>
<td>33%</td>
<td>$16,633</td>
<td>$14,678</td>
<td>$11,144</td>
</tr>
</tbody>
</table>


* supplementary income-and asset-tested benefits may also be paid.

Home ownership rates are high amongst the ‘baby-boom’ generation, and thus housing costs are relatively low. When compared with basic age pensions internationally, and with other welfare benefits domestically, NZS is generous. As a consequence, New Zealand has low rates of pensioner hardship, despite high rates of hardship among those on welfare

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2 10 years in New Zealand after age 20, with at least five of those after age 50.
benefits (Perry, 2013). In the future however, falling home-ownership rates may affect the degree to which NZS is adequate to remove hardship for those who rent.

The level of welfare benefits, indexed only to prices since 1991 when the level of welfare benefits was cut, has fallen well behind NZS over time. Figure 1 illustrates how indexation of NZS to wages has continued to produce a growing gap between NZS and welfare benefits.

**Figure 1 Married unemployment benefit v NZS payments**

At retirement, while low-income earners do fairly well in an international comparison of public pensions, those on average earnings or above have relatively low replacement rates if just the state pension is considered (OECD, 2011, p. p125). Individuals have been expected to save privately, including in employer-sponsored superannuation schemes, to achieve higher effective replacement rates in retirement.

### 3. KiwiSaver

KiwiSaver is the world’s first national auto-enrolment saving scheme. It was initially conceived as a purely voluntary saving scheme with a modest government-provided kickstart and a fees subsidy as ‘sweeteners’. KiwiSaver is fully portable. Thus when members change jobs or they leave employment their scheme goes with them providing a valuable simplification over traditional employer-based schemes. With some exceptions, all new employees are automatically enrolled into KiwiSaver if they are not already members. Currently, employees and employers each contribute 3% of gross wages. The employer contribution is taxed and the employee contribution is made out of after-tax income. Enrolled employees can chose to opt out or go on a contributions holiday after a year of contributions.

In 2014, the tax-funded subsidies comprise just the kickstart at $1,000 for new members and a maximum $520 government contribution for the first $1,040 of annual member contributions. By international standards these subsidies are extremely modest and their unindexed nature implies they will fall in value quite quickly over time.

KiwiSaver is not designed solely as an employment-based scheme and is widely inclusive in its conception. This interesting feature has helped membership reach over 2.1 million,\(^4\) in a total population of 4.3 million.

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3 For more detail see St John et al. (2014).

Purpose of the scheme

The purpose of KiwiSaver has been, at times, confused. Is KiwiSaver's purpose to benefit the individual in retirement? Is it to reduce the pressures on the economy of an ageing population? Is KiwiSaver supposed to solve the national saving problem? Or, is it to expand the managed fund industry? As long as the purposes are unclear, the scheme is vulnerable to the industry's determining the design of the scheme to meet its own objectives.

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 is not clear that KiwiSaver is capable of lifting national saving. By the time the KiwiSaver Bill was introduced, there was little mention of the CAD problem. The purpose of the KiwiSaver Act 2006 is described thus:

... 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)

A reference to the hope that national saving will improve was buried on p. 36 of the Bill, and was not included in the Act:

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.

Law et al. (2011) 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. Importantly, 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.

The Inland Revenue Department (2011) concluded:

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.

The goals of improving retirement incomes and expanding national saving are inherently contradictory. Unless there is attention to the decumulation issues discussed below, KiwiSaver may simply facilitate extra consumption by the better-off cohorts of a larger retired population imposing more pressure on the working age population.

Tax reforms and success of auto-enrolment

New Zealand is fortunate to have reformed its tax treatment of saving for retirement many years before KiwiSaver was introduced. Based on the principle of tax neutrality, the New Zealand tax reforms of 1988-1990 abolished all tax concessions for private retirement (St John, 2005, 2007). Contributions, whether by employer or employee, are out of after-tax income (T), fund earnings were taxed at a rate that proxies the individual’s marginal rate (T), but withdrawals are a return of tax-paid capital and hence tax-exempt (E). Under TTE, saving for retirement the same as saving in a bank account contrasts with the heavily subsidised EET treatment conventional for retirement saving in other developed countries including Australia.

The removal of all tax concessions accelerated both the shift from Defined Benefit (DB) employer-based pension schemes to Defined Contribution (DC) or lump sum schemes and a decline in coverage. Importantly, even public sector DB schemes were closed to new members. The lack of impediments from a strong, tax-incentivised, employer-based
superannuation culture allowed a relatively clean roll out of KiwiSaver as the new auto-enrolment national saving scheme in 2007.

With well-designed but modest ‘sweeteners’ KiwiSaver has become the occupational saving vehicle of choice for most New Zealanders, including for many within the public sector. Even when subsidies were greatly extended and enhanced on the eve of the introduction of KiwiSaver in 2007, there was never any intention of a return to the regressive tax concessions of the past. In the last few years these subsidies have been cut back as detailed in St John et al (2014). Interestingly, it appears once sweeteners have helped establish KiwiSaver, they can be reduced with little impact, at least, on the formal membership numbers.

In contrast to the ease of introduction in New Zealand, the UK and Ireland face two impediments in introducing their auto-enrolment schemes. First, they have retained their over-generous, unreformed DB schemes for public sector employees. Second they have a proliferation of employee-based DC schemes. These diverse and poorly regulated schemes are the beneficiaries of new auto-enrolment proposals. The OECD (2012) notes “much can be done to improve the design of DC pension plans and to strengthen retirement income adequacy in these plans” In their ‘Ready for ageing’ report the House of Lords (2013) observed “the current DC pensions system is not fit for purpose for anyone who is not rich, or who moves in and out of work … [there is a need to] tackle the lack of certainty in DC pensions and address their serious defects”

Second, compounding these issues, the very generous tax incentives for both DB and DC schemes are widely viewed as regressive, expensive and unnecessary. They are however difficult to remove, making a more rational framework like that in New Zealand near impossible to adopt.

**Administration**

A clever feature of KiwiSaver is the administration by a central collection agency, the Inland Revenue Department (IRD) with a unique tax identifier for individuals who have one provider, that they chose, and one account. This has avoided the problems found in Australia, where many individuals have small sums in multiple accounts\(^5\). In the UK, the National Employment Saving Trust (NEST) auto-enrolment plan has required a separate infrastructure for administration. Auto-enrolment can be into the employer’s existing DC schemes, so that the NEST scheme is not a generic national saving plan.

Similarly, in the US auto-enrolment for employer-based 401K plans is voluntary, and no national clearing house is proposed. The WorldatWork and American Benefits Institute (2013) note that: “Ultimately, companies without auto enrolment are more likely to report lower employee participation rates than those with automatic enrolment.” When employees change jobs, 401 K plans must be either retained with the former employer or transferred, providing an additional complexity not faced by KiwiSaver members.

**Monitoring and regulation**

As a generic product, KiwiSaver has facilitated the umbrella regulation and oversight provided by the newly established and fit-for-purpose Financial Markets Authority (FMA). While individual providers can offer separate products, they do not have to do the marketing and branding of KiwiSaver itself.

**4. The flaws in KiwiSaver**

**Lack of a decumulation policy**

Despite clever features, there are nevertheless substantial flaws in the New Zealand approach if it is assumed that income supplementation is the point of KiwiSaver. Currently

\(^5\) It appears that $AUD15 billion in Australia’s SG scheme are sitting in lost or unclaimed accounts. See [http://www.thorner.co.nz/tag/australian-superannuation-guarantee/](http://www.thorner.co.nz/tag/australian-superannuation-guarantee/)
there are no rules as to how Lump sum KiwiSaver funds accessed at age 65 must be run down over the retirement period. The danger is that funds will be dissipated far too early in retirement, with many people finding they live much longer than they anticipated. While New Zealand was an early adopter of the world-wide trend to shift risks from employers to individuals in private superannuation schemes, lump-sum or DC schemes including KiwiSaver do not currently assist with the management of risks in retirement as noted in the three yearly review by the Commission for Financial Literacy and Retirement Income (2013). Specifically these are the longevity risk that may see an individual outliving their capital; the risk of loss through poor investment; and the inflation risk (see for discussion Cooper, 2014). Older people using capital too early in retirement and requiring a state subsidy for long-term care is also a risk for society.

In other countries, there are emergent issues with the risks of the period of decumulation. The UK has until recently required mandatory annuitisation of lump sum savings from subsidised DC retirement schemes by age 70. However the Conservative–Liberal-Democrat Coalition Government announced in 2010 that it intended to end the requirement for DC pension scheme members to purchase annuities by the age of 75 (Blake, Cannon, & Tonks, 2010). Noting that “the annuities market is currently not working in the best interests of all consumers. It is neither competitive nor innovative and some consumers are getting a poor deal.”, the government has recently announced:

... a radical set of reforms which will allow people more choice over how they access their defined contribution pension savings. From April 2015 the government proposes to change the tax rules to allow people to access these savings as they wish at the point of retirement, subject to their marginal rate of income tax (rather than the current 55% charge for full withdrawal). (HM Treasury, 2014)

While is clear that the market for annuities suffers many aspects of market failure, this decision is an extreme response, akin to throwing the baby out with the bathwater and is causing great uncertainty within the industry. There may be a stronger case for better annuities rather than no annuities at all, if the risks retirees face are to be addressed.

**New Zealand’s unique opportunity.**

With the provision of initially generous, tax-funded subsidies, the Government might have been justified in imposing restrictions on spending the maturing lump-sums. That option was ignored, indeed not even discussed, and the opportunity was lost. It is hard to imagine that retrospectively, compulsory annuitisation could now be imposed.

New Zealand’s annuities market is virtually non-existent and under current tax rules, lack of government support including inflation indexing or long-term bonds, a viable annuities market is unlikely to emerge (St John, 2009).

However, there are now opportunities for innovative thinking. New Zealand has a unique opportunity with a largely tax neutral TTE regime for accumulation to design an explicit subsidy to recognise the gains to society from annuitisation with few of the disadvantages of traditional tax incentives.

One of several possibilities is the provision of a tax-subsidised limited value, inflation-adjusted, gender neutral annuity to supplement NZS, purchased out of lump-sum savings including a suitable share of home equity if required (St John, Dale, & Ashton, 2012). Let’s call this annuity ‘KiwiSpend’ and imagine it as a generic product like KiwiSaver where private providers may play a role. Like KiwiSaver, KiwiSpend would be regulated by the FMA. It would require considerable state oversight, maybe even state provision, and subsidies to ensure the annuity is inflation-proofed, has low fees and the same capital cost for women and men, and includes long-term care insurance.

As outlined in St John, Dale, & Ashton (2012) a retiree’s private saving, including KiwiSaver, could be used to buy an inflation-adjusted annuity of up to $10,000 per annum, with an insurance rider that provides a trebling of the annuity if the recipient is assessed as needing
residential long-term care. Success in New Zealand in designing such a product would once more attract considerable international attention.

The dangers of compulsion

The economic success of Australia is often attributed to the fact its superannuation scheme is compulsory. This is purported to have added to the capital base and encouraged domestic investment and strong growth (Brogden, 2013; The NZ Institute, 2010). 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 (Financial Services Council, 2014). In the lead-up to the 2011 election, and now in the lead up to the 2014 election, the Labour Party, the Maori Party and New Zealand First have suggested that making KiwiSaver compulsory would create more household saving and help solve New Zealand’s economic problems. The framework for compulsion is in place; the major changes needed would be to remove the opt-out and the contributions holidays provisions.

There are two principal concerns about compulsion. First, it is undesirable to force those who cannot afford to save into the scheme, but it is difficult to design exemptions that are fair. Second, there will be inevitable pressures to integrate KiwiSaver with NZS. Given the contribution that taxpayers make to the accumulation of KiwiSaver benefits, it would seem logical that a future government might link KiwiSaver and NZS, either directly with the kind of offset suggested recently by the architect of KiwiSaver, Sir Michael Cullen (2013), or through a general means-test much as in Australia. This may undermine the many advantages of a universal pension, although there is a case that can be made for more claw-back on NZS using the tax system (St John, 2012).

Evidence from Australia suggests that compulsion has not stopped offsetting borrowing that sees retirees reach retirement with more debt. Also, Australians seem to retire earlier and collect their compulsory retirement savings as a lump sum. Compulsion, including the employer-matching contribution may please people who work in payroll and in financial service provision but would also be seen as an additional cost to employers.

5. Conclusion

The New Zealand combination of universal taxable floor of income NZS combined with a voluntary auto-enrolment saving scheme to supplement, not replace, the universal state pension, is a successful model with a lot to offer the rest of the world.

If current trends continue, KiwiSaver will continue to supplant the role of employer-subsidised superannuation and retail schemes. While this may have an ambiguous effect on total saving (Savings Working Group, 2011), the scheme should not be judged on its presumed macroeconomic effects.

One of the clear advantages of KiwiSaver is that it is fully portable. This is facilitated by the unique tax identifier and IRD acting as the clearing-house. It is also inclusive and the minimal tax incentives have been designed to limit regressivity.

The major focus now ought to be firmly on improving the outcomes of security in retirement for those who have not traditionally enjoyed the advantages of work-based plans. If the needs of formerly disenfranchised people, including many women and other disadvantaged groups, are placed at the centre, the decumulation of KiwiSaver must be designed primarily to achieve meaningful amounts of extra, secure income for them to supplement the state pension regardless of how long they live. New Zealand has a unique opportunity to design a generic KiwiSpend decumulation product that adopts some of the clever features of KiwiSaver, possibly also incorporating long-term care insurance (Retirement Policy and

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6 The mining boom is often ignored in these analyses. Other voices are more sceptical (Ingles, 2009)
If successful it is likely to become a beacon of light in an increasingly complex international pensions world.

References


