



Retirement Policy and
Research Centre

Working Paper 2014-1

Now we are six Lessons from New Zealand's KiwiSaver¹

Now We Are Six - A.A. Milne

When I was one I had just begun
When I was two I was nearly new
When I was three I was hardly me
When I was four I was not much more
When I was five I was just alive
But now I am six, I'm as clever as clever
So I think I'll be six now for ever and ever.

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The Retirement Policy and Research Centre

New Zealand's KiwiSaver was introduced on 1 July 2007. 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 and Ireland. While there have been numerous changes to KiwiSaver as outlined in this paper, six years on, the retirement saving scheme appears well accepted by the public and membership has exceeded most expectations.

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. Core tax-funded KiwiSaver subsidies have been both substantially reduced and not indexed while membership has continued to grow strongly.

Whether this auto-enrolment scheme, featuring generous provisions for withdrawals and contributions holidays, is sufficient to ensure that those who should be saving for their retirement are saving, and saving enough, is open to debate. 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, New Zealand Superannuation.

Lessons from KiwiSaver on what to avoid in the design of a national retirement saving scheme 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. Advantages over previous work-based retirement saving schemes include the portability of KiwiSaver accounts facilitated by the IRD's role as a clearing house. New Zealand has also limited regressivity in the design of its very modest tax incentives, but at a cost: many save just the minimum required to maximise the subsidies.

The Working Paper surveys the first six years of KiwiSaver's evolution to July 2013. In that time, the fundamental questions around its purpose and design have not been resolved. Is its purpose to enhance access to suitable wealth accumulation vehicles for those who have missed out on traditional work-based schemes? Or is it to reduce the pressures on the economy of an ageing population; or to solve the national saving problem? Will KiwiSavers in fact have more to spend during their retirement, or will they 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?

As 2014 is an election year, political parties are positioning themselves on KiwiSaver policy. In the meantime there is strong international interest in New Zealand's retirement saving scheme, with its unique features such as auto-enrolment.

The Retirement Policy and Research Centre is pleased to publish *KiwiSaver: Now we are six*. It updates earlier working papers, including Working Paper 2010 *KiwiSaver: lessons for Ireland*. The views in this Working Paper's commentary are those of the authors.

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1. Introduction

New Zealand Superannuation (NZS) forms the foundation of New Zealand's retirement income policy. NZS is a universal, Pay As You Go (PAYG), taxable age pension, partially prefunded by accumulated assets in the New Zealand Superannuation Fund (NZSF).

Following a concern that New Zealanders were not saving 'enough' to supplement NZS to provide for their chosen lifestyle in their old age and that existing workplace schemes had poor coverage, the Government set up the Savings Product Working Group (2004) to advise on the design and implementation of a broad-based generic work-based savings product in a voluntary savings regime.

Drawing on that advice, the government announced a national private savings scheme called KiwiSaver in the 2005 Budget. The scheme was implemented just two years later in July 2007. The purpose of KiwiSaver as set out in the enabling legislation, the KiwiSaver Act 2006, is:

to encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement. The Act aims to increase individuals' well-being and financial independence, particularly in retirement, and to provide retirement benefits.

Additional purposes of KiwiSaver, excluded from the Act but included in the original Bill (p. 26) and in political rhetoric were: to improve national saving and to provide investment funds to promote business growth and economic growth. For example, on the eve of its introduction, Hon Michael Cullen, then the 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 ... 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)

KiwiSaver was the world's first auto-enrolment, opt-out, national retirement saving scheme. Unlike other countries where extensive, complicated incentivised workplace pensions are supplemented by voluntary private savings schemes, KiwiSaver offers a unified and simple approach (O'Connell, 2009). Moreover, through KiwiSaver and the universal state pension, NZS, New Zealand provides a uniquely comprehensive, simple and transparent retirement income framework of interest as a working model in international comparative pension analysis.

It is timely to review the New Zealand experience of KiwiSaver and its first 6 years, especially in light of the UK's and Ireland's new auto-enrolment plans. As with any new scheme, there have been teething problems and there are lessons to be learned that suggest further adjustments to KiwiSaver may be appropriate, or that its implementation could have been better.

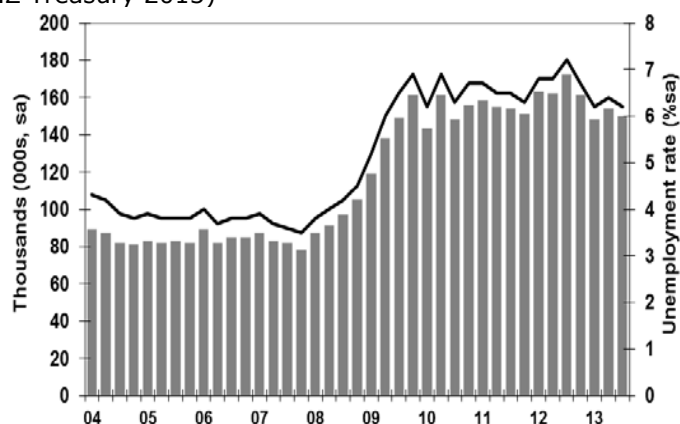
Every country has a different economic and social structure as well as cultural differences in saving philosophies. The Paper first outlines the critical features of the New Zealand economy and concerns about saving, and then describes the retirement income framework. The multiple iterations of KiwiSaver since 2007, as well as membership and other statistical data, are summarised, and the various policy issues that have arisen are outlined. Some tentative lessons are drawn from the experience of the first six years, but many issues such as the adequacy and effect on saving require a longer time-frame.

In offering a critical examination of the outcomes of 'soft compulsion' in the New Zealand experience, the authors are mindful that there is no single right answer and each country's retirement income framework will always reflect its own unique historical and institutional factors.

2. Background: the New Zealand economy

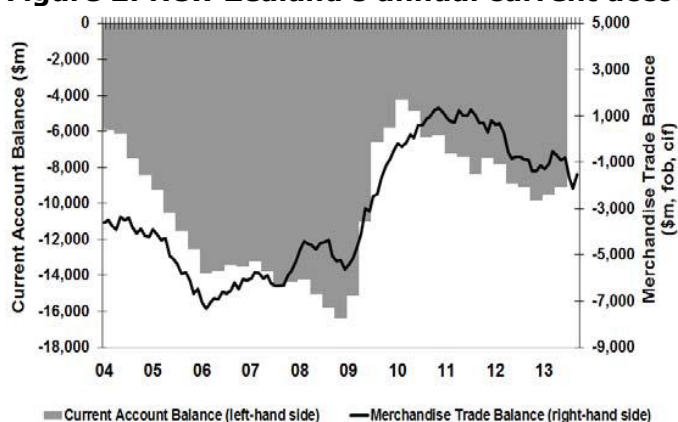
While not as badly affected by the Global Financial Crisis (GFC) as many European countries and the US, unemployment in New Zealand rose sharply in 2008 from historically low levels as Figure 1 shows. While unemployment levelled off and is falling as the economy finally enters a growth phase in 2014, it will take time to reverse the full extent of underemployment and exits from the labour market by discouraged workers.

Figure 1: New Zealand's numbers unemployed and the unemployment rate (Source: NZ Treasury 2013)



The largest imbalance in the New Zealand economy is the external one. The New Zealand economy is in the unenviable position of having one of the highest net international liabilities/GDP ratios in the OECD. New Zealand's net international liability position at 30 September 2013, was \$150.1 billion (69.5 % of GDP) (Statistics New Zealand, 2013).

Figure 2: New Zealand's annual current account deficit (Source: NZ Treasury 2013)



As shown in Figure 2 the current account deficit (CAD) reached alarming levels of 8-9% of GDP in the buoyant years 2005-2008 (Bedford, 2009; Statistics New Zealand, 2010). In the recession following the global financial crisis, the CAD improved, but the structural issues relating to the external accounts were not addressed.

A return to economic growth in 2013/14 and the effects of the rebuild of a major city in Canterbury devastated by earthquakes is once again causing the CAD to rise with further deterioration projected out to 2018 (see Table 1). These CADs indicate a shortfall in domestic saving and add further to New Zealand's level of international indebtedness.

Compounding the problem, overseas borrowing is fuelling a widespread housing bubble and helping to keep the New Zealand dollar overvalued with implications for the trade balance. As a small trading nation New Zealand benefited from favourable terms of trade in a commodity boom post 2009, but the high exchange rate is eroding the beneficial impact on the trade balance (see Figure 2).

Table 1: Treasury forecasts (Source New Zealand Treasury (2013))

March years, %	2013	2014	2015	2016	2017	2018
	Actual	Forecast	Forecast	Forecast	Forecast	Forecast
Economic growth	2.7	2.7	3.6	2.7	2.0	2.2
Consumer Price Inflation	0.9	1.4	2.4	2.4	2.3	2.2
Unemployment rate (March quarter)	6.2	5.8	5.6	5.4	5.2	4.7
Current account (% of GDP) ²	-4.5	-4.2	-5.5	-6.3	-6.5	-6.4
Current account excluding Canterbury rebuild investment (% of GDP) ²	-3.8	-3.1	-3.9	-4.4	-4.5	-4.7

In the years to 2008, the government ran large fiscal surpluses hence the national saving problem exposed 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, in combination with two serious earthquakes in Christchurch 2010 and 2011, began a sharp deterioration in the fiscal position. Nevertheless as the economy recovers the Government predicts a return to a small operating surplus by 2014/15 (Minister of Finance, 2013).

Despite repeated informed challenges (including Le, Gibson, & Stillman, 2010), the lack of household savings was widely held to be the cause of New Zealand's poor economic performance and indebtedness (Bollard, Hodgetts, Briggs, & Smith, 2006; Fallow, 2010; Gaynor, 2008). An expert group set up to advise government on saving put it baldly:

New Zealanders – the people and the government – are not saving enough. Unless we make some rapid changes, we are risking a major economic disruption likely to leave practically all New Zealanders worse off. It's as if we are standing on top of a cliff that may collapse dramatically or crumble slowly. Either way, it would be a bad fall. We need to move back from the brink – and fast. (Savings Working Group, 2011)

More recently, alarm about the 'saving'³ issue has continued. Possibilities for increasing incentives for private saving have even been raised by the Reserve Bank of New Zealand:

Since the saving and investment gap plays a prominent role in New Zealand's exchange rate story, it seems reasonable to suggest that it will be necessary to tackle our reliance on foreign saving to finance our consumption and investment. The dependency on foreign saving means that we have persistently needed interest rates above those in most developed economies. Addressing the residential investment needs of a growing population and increasing the incentives for private sector saving, such as the tax treatment of investment income and issues around the long-term design of public and private pension systems, are the sorts of issues that need to be debated to see what would work best in New Zealand. (McDermott, 2013)

This local lack of saving is usually 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 is purported to have added to the capital base and encouraged domestic investment and strong growth (Brogden, 2013; The NZ Institute, 2010).⁴

In the 2011 pre-election campaign the Labour Opposition suggested that more household saving would be the solution to New Zealand's economic problems (Wilson, 2010). Labour proposed to achieve this by making KiwiSaver compulsory and by restarting contributions to

³ While not consistent in the New Zealand references used here, the term saving is generally reserved for the annual difference between income and consumption (a flow concept) while savings is the 'stock' of accumulated wealth.

⁴ The mining boom is often ignored in these analyses.

the NZSF⁵ discussed below. In 2014, another election year, there are some strong calls for New Zealand to make KiwiSaver compulsory, especially from the Financial Services Council and from the Labour Opposition.

3. The New Zealand retirement income 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. Eligibility for 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).⁶ Although there is a specified 'couple rate', each partner of a married couple receives an individual pension that is taxed with other individual income. 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 2).

NZS is indexed annually via the Consumer Price Index until the wage-floor of 66% is reached, then pensions rise with the net average wage. In the past, with a more progressive tax rate structure, and for the years 1985-1998 when a surcharge applied to other income, the top income earners retained far less after tax than today (St John, 2010, 2013; St John & Familton, 2010). In contrast, the tax system now provides only a limited clawback, with top income earners receiving a net 76-77% of the net amount received by those with no other income.

Table 2: New Zealand Superannuation rates at 1 April 2013

Category	% net average wage*	Annual rate	Annual Net	Annual Net
		NZ\$*** (gross)	Primary Tax	33% Tax**
Single, living alone	43%	\$21,337	\$18,586	\$14,296
Single, sharing	40%	\$19,607	\$17,156	\$13,136
Married person or partner in civil union or de facto relationship (each)	33%	\$16,138	\$14,297	\$10,812

Source: Work and Income website: <http://www.workandincome.govt.nz/>.

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

** net amount retained when NZS is taxed at the top income tax rate of 33%.

***\$NZ= €0.61 or £0.51

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 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. Home ownership rates are high and housing costs are relatively low. As a consequence, New Zealand has very low rates of pensioner hardship, despite high rates of hardship among those on welfare benefits (Perry, 2013)

Nevertheless, 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

⁵ 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.

⁶ The residence requirements can also be achieved after age 65.

(OECD, 2011, p. p125).⁷ Replacement rates decline as income increases more quickly in New Zealand than in other countries because of the flat rate nature of the basic pension. The counter consideration is that high replacement rates in other countries are usually only for those with a full contributions' record.

Prefunding NZS

In 2001, the government introduced a mechanism to set aside tax revenues to help pay for the future cost of NZS. This allowed some of the then significant fiscal surpluses to be diverted in preference to reducing income taxes. The NZSF was intended, over the long-term, to meet about 15-20% of the expected pension payout by the time all baby boomers were over the state pension age (2025). The mechanism did not change the expected cost of NZS (the benefits were unchanged) but was intended to change the incidence of that cost by providing some tax smoothing.

The NZSF is a 'sovereign wealth fund', the contributions to which were initially about 1% of GDP. As a consequence of the fiscal impact of the GFC, the government suspended contributions in 2008 but says it intends to resume them when structural fiscal surpluses return. The NZSF is managed by 'Guardians' at arms-length to the government and 79 % of the now NZ\$23 billion (about 10% of GDP) is invested overseas (New Zealand Superannuation Fund, 2013).

There has been discussion from time to time about using the NZSF as a default fund for KiwiSaver, especially as over time it has performed strongly and enjoys economies of scale. To do so, however, would muddy its purpose, which is to prefund the non-contributory NZS.

Pre-KiwiSaver

With NZS as the foundation, individuals have been expected to save privately, including in retail⁸ and employer-sponsored superannuation schemes, to achieve higher effective replacement rates in retirement. Until the introduction of KiwiSaver in 2007, New Zealand had been unique in offering little or no tax concessions for additional private retirement saving or private pension schemes. The dramatic income tax reforms of the 1988-1990 period were based on the principle of tax neutrality between different kinds of income generating activity (St John, 2005, 2007). The tax regime for private and occupational superannuation schemes was aligned with 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 a return of tax-paid capital and hence tax-exempt (E). This TTE tax treatment contrasts with the heavily subsidised EET treatment conventional for retirement saving in other countries.

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% while the rate applied to employers' contributions to occupational savings schemes for employees and to the investment earnings of those schemes remained at 33%. This however was a very modest concession and did not indicate a loss of faith in the doctrine of tax neutrality (TTE) with respect to saving (St John, 2007). There was no consideration of any reversal of this policy in the early 2000s:

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)

The removal of all tax concessions for private saving in the late 1980s saw many employer schemes closed, or changed from Defined Benefit to Defined Contribution (see Table 3). In 1995, 22 % of the labour force was covered in traditional employer-subsidised retirement

⁷ Note that the OECD takes the 'living alone' rate for the New Zealand calculations. The international comparisons reflect only mandatory state-provided pension arrangements and ignore private provision.

⁸ Registered Superannuation Schemes open to the public.

saving schemes, including public sector schemes, but this had fallen to only 14.7% by 2005 (Government Actuary, 2008). There was 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, auto-enrolment retirement-saving scheme, was conceived (Savings Product Working Group, 2004). KiwiSaver, a Tier 3 scheme, extended the opportunity for work-based saving to a wide population.

The number of employer-based schemes and the percentage of the labour force covered continued to fall reflecting the ongoing trend and the impact of KiwiSaver. By the end of 2012, there were 45% fewer employer-sponsored schemes than in 2006. Coverage of the labour force was just under 10% (Financial Markets Authority, 2013b). Annual contributions and net assets showed a modest increase (8%).

Alongside the reduction in employer-sponsored membership the number of retail scheme members fell 45% (2006-2012) with a 55% reduction in annual contributions and a 35% reduction in net assets (FMA 2013b, p 10).

Despite the cautions of the original Saving Product Working Group in 2004 who wanted to design a product that did not displace existing schemes, statistics showed:

that the advent of KiwiSaver, along with a number of other factors, such as a tighter economic climate, employer rationalisation of employee benefits and the amalgamation of stand-alone employer sponsored schemes into retail master trust schemes, has had an impact on registered superannuation schemes. (FMA, 2013b, p 10)

Table 3 shows the changes to registered schemes since the tax changes of 1990 were introduced, including the decline of defined benefit schemes.

Table 3: Registered superannuation schemes in force on scheme balance dates, 2012: all employer-sponsored schemes (excluding GSF) and retail schemes (Source: derived from FMA, 2013b)

Employer Sponsored Schemes									
	Defined Benefit			Defined Contribution			Total		
	2012	1990	% Change	2012	1990	% Change	2012	1990	% Change
Number of Schemes	101	452	-78%	74	1,790	-96%	175	2,242	-92%
Total Assets (\$ Millions)	4,551	6,691	-32%	9,825	2,817	249%	14,377	9,508	51%
Total Members	51,912	101,217	-49%	175,799	209,524	-16%	227,711	310,741	-27%
Retail Schemes (Membership Available to General Public)									
Number of Schemes	n/a	n/a	n/a	74	113	-35%			
Total Members	n/a	n/a	n/a	172,849	236,062	-27%			
Closing Balance (\$ Millions)	n/a	n/a	n/a	4792.50	1465.70	227%			

4. KiwiSaver 2007 - 2014

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 NZ\$1,000⁹ 'sweetener' (the Kickstart) paid on joining, and an annual fees' subsidy of NZ\$40. These subsidies avoided the regressivity problem of traditional 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.¹⁰ 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 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 Zealand¹¹ 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 akin to Kiwi Saver's requirements. 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

⁹ The current exchange rate is \$NZ= €0.61 and \$NZ =£0.51 (Jan 2014)

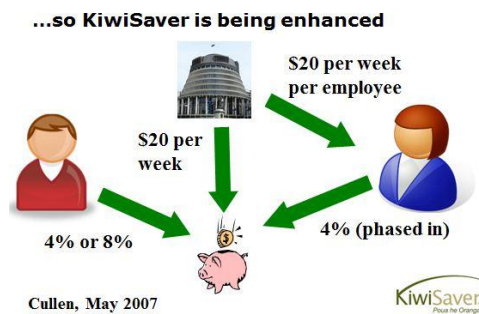
¹⁰ SSCWT was the Specified Superannuation Contribution Withholding Tax applied to employer contributions as a proxy for the tax that the employees would have paid if the contributions had been treated as their income. It is now called 'Employer Superannuation Contribution Tax' (ESCT).

¹¹ This was the local equivalent of the UK's 'National Association of Pension Funds'.

noted that: “the benefit of the \$1,000 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, further dramatic changes were announced to take effect on 1 July 2007 (seven weeks later). 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 main elements to the changes were:

- First, 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;
- Second, a member tax credit (MTC) to savers that matched their contributions into KiwiSaver (or a complying superannuation fund) up to a maximum of \$20 per week from 1 July 2007;
- 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, applied to the first \$20 contributed by employees, were less regressive than pure tax exemptions, however the fiscal 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.¹² The 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 Parliament’s 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

¹² An odd contention as the employer’s contribution was compulsory.

savings appeared counterintuitive (Mourougane, 2007). Although mortgage diversion was quietly dropped in 2009, the first home deposit and subsidy scheme remains a feature.

The introduction of KiwiSaver II in 2007 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 (TTE), 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%¹³ 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).

In reporting on New Zealand's capital markets, the 2009 Taskforce re-affirmed the advantages of New Zealand's consistent and comprehensive broad-based low-rate income approach. They stressed the need for tax neutrality between tax treatment of income from investment including owner-occupied and rental property and other income. The tax advantage of those on the top tax rate in the PIE regime was seen as unjustified (Capital Markets Development Taskforce, 2009).

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 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 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.*¹⁴ (English, 2008)

KiwiSaver IV

In the May 2011 Budget, three further significant changes to KiwiSaver were announced that were 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 became subject to employer superannuation contribution tax (ESCT). Second, for the year ending 30 June 2012, the MTC was 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 rose from 2% to 3% (Inland Revenue Department, 2011a).

¹³ The top tax rate since 2009 is 33% for incomes over NZ\$70,000.

¹⁴ 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.

KiwiSaver V?

In a press release on 18 October 2011,¹⁵ 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. To justify this proactive move, government pointed to a 2010 Colmar Brunton survey that indicated 28 per cent had simply not got around to joining KiwiSaver and 13 per cent wanted more information (English, 2011).

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. KiwiSaver auto-enrolment was estimated to 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.

The government rejected compulsion as an alternative to auto-enrolment, citing advice from the Savings Working Group (2011). The arguments recognised that there are valid reasons for not joining, especially for those on low incomes, or with large mortgages, or if already in other superannuation schemes. There are also other ways to save, such as repaying mortgages and investing in education that may be more appropriate for certain individuals at certain stages of their lifecycle.

The current (2014) KiwiSaver design features are set out in Box 1.

5. KiwiSaver statistics

Nature of Membership

As at census date March 2013 New Zealand’s population is 4.2 million, around 2.5 million are aged 19-64 years and 1.2 million are 18 and under (Statistics New Zealand 2013¹⁶). KiwiSaver membership was expected to plateau in 2012 at only 1.4 million (Inland Revenue Department, 2009). While growth has slowed, data in Table 4 shows membership had already reached 2.15 million, or 53% of the eligible population under age 65, by 30 June 2013, (Inland Revenue Department, 2013).

Table 4: Membership as at 30th June 2013 (Source: Inland Revenue Department, 2013)

Method of joining KiwiSaver	Members	%age
Opt-in via provider	1,060,080	49%
Opt-in via employer	256,302	12%
Automatically enrolled	830,461	39.0%
Total membership (net of opt-outs and closures)	2,146,843	100%
Opt-out	249,872	
Retirement	28,549	
Other	43,171	

¹⁵ See <http://www.beehive.govt.nz/release/govt-proceed-kiwisaver-auto-enrolment>.

¹⁶ Data accessible here: <http://www.stats.govt.nz/Census/2013-census/profile-and-summary-reports/quickstats-about-national-highlights.aspx>

Box 1: KiwiSaver as at January 2014¹⁷

- 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 but can re-join at any time.
- 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. Some employers are exempt from auto-enrolment. The self-employed, beneficiaries, children and non-workers can join, making payments if any, directly to the scheme provider.
- A matching subsidy is paid by the government for the member's contributions (50 cents for each dollar of contributions to a maximum of \$1,043 a year).
- Employees' contributions start from the first pay day with an employer. Deductions from net wages are at a rate of 3% of gross pay, unless the individual opts for the higher rate of 4% or 8%. Employers are compelled to contribute 3% of the pay of KiwiSaver members, but only the net amount after the ESCT is contributed to the member's scheme.
- All savings are managed by private providers that are free to offer different investment options. There are 27 current providers and 45 schemes, (about to reduce to 41) (FMAa, 2013)
- 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 provider. Savers can select their fund and can change provider without penalty, but can only have one provider at any time. Those who do not specify a fund are 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 and can stop the 'holiday' at any time.
- 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 do 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 6%.
- After three years' membership, the member's contributions may be withdrawn for a home purchase if income and house price caps are met. 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 may apply.

¹⁷ Derived from <https://www.kiwisaver.govt.nz/>

As Table 4 shows, as many as 61% members have proactively opted-in. Initially around a third of those enrolled automatically chose to opt-out. This rate has fallen each year. As at June 2013, of all of those automatically enrolled (1,080,300) a cumulative 249,872 had opted-out and remained out of the scheme: an overall net opt-out rate of 23%. The net cumulative figure actually decreased between June 2012 and June 2013. The IRD (2012) notes that 32% of those who opted out have since joined. The figures for closing accounts to rise as people who have reached age 65, and been in the scheme for five years, begin to access funds for retirement. Table 4 shows that while a significant proportion (39%) had been automatically enrolled and remained members, almost half of all members (61%) had made an active choice to join KiwiSaver either through their employer or by approaching a provider directly.

As at June 2013, 101,415 or less than 5% of members are on a contributions holiday, in which both the member contributions and the compulsory employer contributions are halted. The numbers on a contributions holiday have increased steadily since 2008 reflecting heightened financial hardship during the recession.

The age profile of KiwiSaver members has remained relatively constant since 2010 (Inland Revenue Department, 2013, p. 11). About 31% of eligible children are members reflecting the inducement of the Kickstart entitlement. Those under 18 are not entitled to the MTC however, but may benefit later from the housing subsidy and may be able to access their own savings in the scheme as a deposit for their first home. Over one half of the population aged 18 and to 64 are members. The highest membership rate (72%) is found in the 18-24 age bracket. These are young people likely to be auto-enrolled in their first job.

The gender distribution of members has remained constant at 52% female and 48% male.

Member Contributions

The minimum or default employee contribution rate for KiwiSaver has changed several times as outlined in the history discussed above. Table 5 shows that while rates of 4% and 8% can be chosen, the default rate has been the most popular. However when the required 4% dropped to 2% in 2009, the percentage of members contributing 4% dropped only slowly, and remained at 36% in 2013. This shows that the default rate once chosen may be subject to some inertia.

Table 5: Contribution rates 2010- 2013 (Source: IRD 2013)

Contribution rate	Proportion of members 2010	Proportion of members 2011	Proportion of members 2012	Proportion of members 2013
2%	41%	53%	59%	n/a
3%	n/a	n/a	n/a	58%
4%	55%	43%	36%	36%
8%	4%	4%	4%	5%
Other %	<1%	<1%	<1%	1%
Total	100%	100%	100%	100%

Over one half of members (56%) earn only salary and wage income. These members contribute a median annual value from all sources of \$859, which is below the \$1042 required to maximise the MTC of \$521 (IRD, 2013,p 16). Employers may also choose to contribute a higher rate, but most (81%) contribute only the required minimum of 3%.

Members with self-employment income or no income tend, if they contribute, to contribute \$1040 to maximise the MTC. Data available for the years 2009-2012, (see Table 6) show only 45% received the maximum of those who got any MTC at all. Of those entitled to the full MTC there are disproportionately fewer aged 18-24 which reflects their lower wage levels. Those aged 55 and over account for 36% of those receiving the full MTC, reflecting both their higher incomes and proximity to retirement.

Table 6: Member Tax Credits (Source: IRD, 2013)

MTC payment	2008		2009		2010		2011		2012	
	Members	%	Members	%	Members	%	Members	%	Members	%
Maximum payment*	82,763	14%	363,069	46%	421,095	44%	477,515	43%	556,652	45%
Less than maximum payment*	519,177	86%	425,601	54%	525,707	56%	645,754	57%	675,801	55%
Total	601,940	100%	788,670	100%	946,802	100%	1,123,269	100%	1,232,453	100%

Contributions holiday

After 12 months or more of contributions members can elect to take a contributions holiday of between three months and five years. Earlier holidays may be granted in limited cases of financial hardship. The numbers on contributions holidays has continued to increase as shown in Table 7. This possibly reflects the ongoing recession.

Of the members who were on a contributions holiday at 30 June 2013, the proportion on long contributions holidays (5 years) continues to increase while the proportion on short holidays (up to 12 months) continues to decline. Together with opt outs, about 350,000 members who would otherwise be paying 3% of income do not formally contribute to KiwiSaver. However most members on a contributions holiday make some contribution (Inland Revenue Department, 2012)

Table 7: Members on contributions holiday (Source: IRD, 2013)

Holiday type	2008	2009	2010	2011	2012	2013
Ordinary holiday	-	25,122	45,069	63,324	83,151	101,141
Financial hardship holiday	3,280	813	494	383	219	274
Total active holiday	3,280	25,935	45,563	63,707	83,370	101,415

Base: All members at 30 June 2008 to 2013 who were on contributions holidays as at 30 June.
Source: inland Revenue administrative data.

Choice and default funds

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), in 2006 six 'default providers' were chosen. 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). New employees are auto-enrolled into KiwiSaver and the IRD allocates them randomly to one of these six default providers.¹⁸ A default provider is required to have a default investment option with 15% to 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 option.

Since its inception the numbers of people consciously choosing their own provider has risen as Table 8 shows. Today, most KiwiSaver members (67%) choose their own provider. Those who are first auto-enrolled and defaulted to a default scheme by IRD or to the employer chosen scheme, can transfer within the provisional holding period of three months or at a later date. Total scheme transfers have generally increased each year. For the year ended June 2013, transfers totalled 136,167 or about 6% of total membership.

¹⁸ The original default scheme providers were: 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.

Table 8: Current members' scheme entry method (years ended 30 June) (IRD, 2013)

Scheme entry method	2008		2009		2010		2011		2012		2013	
	Members	%	Members	%	Members*	%*	Members	%	Members	%	Members	%
Default allocated	268,868	38%	369,577	34%	419,250	29%	458,013	26%	503,826	26%	527,325	25%
Employer nominated	94,895	13%	129,963	12%	150,157	10%	165,500	9%	183,097	9%	190,112	9%
Active choice	352,483	49%	600,709	55%	890,356	61%	1,132,193	64%	1,279,256	65%	1,429,048	67%
Unspecified at year end	391	<1%	291	<1%	179	<1%	226	<1%	265	<1%	358	<1%
Total	716,637	100%	1,100,540	100%	1,459,942	100%	1,755,932	100%	1,966,444	100%	2,146,843	100%

Base: All members at 30 June 2008, 2009, 2010, 2011, 2012 and 2013. Totals may not add to 100% due to rounding.

Around 36 per cent of those initially enrolled in a default fund have chosen to move to another fund or scheme. Default funds have 22.2 % of the total KiwiSaver membership and 20.5 % of the total assets invested (Financial Markets Authority, 2013a).

First home buyers option

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 complying employer superannuation schemes can also qualify for this home-ownership deposit subsidy.

Since 2010, KiwiSaver members have been able to access their own KiwiSaver funds and a subsidy for a first home. As at December 2012, more than 11,000 first home withdrawals had been made and 5,800 were recipient of the subsidy. About 5% of residential sales drew on this support (IRD 2013, p 20).

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 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).

Fees and returns

The requirement with respect to fees is set out in Schedule 1 to the KiwiSaver 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 even 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.

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 Commission for Financial Literacy and Retirement Income (CFLRI) provides an on-line calculator that attempts a fees' comparison.¹⁹ 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.

Crown costs

The government has contributed various subsidies outlined in the history discussed above. Since the abolition of the Employer Tax Credit and the halving of the Member Tax Credit, the contribution from the Crown has fallen. This also reflects that fewer Kickstart payments are made as membership plateaus. Of the total funds under management in 2013 the Crown contributed \$5.3 billion in direct subsidies, employer \$3.5 billion and employees \$6.4 billion (Inland Revenue Department, 2013).

Table 9: Crown costs (years ended 30 June) (\$m) (IRD, 2013)

Cost	2008	2009	2010	2011	2012	2013	Total (\$m)
Payments to members	572	839	962	1,000	1,045	677	5,095
Employer tax credit	38	206	n/a	n/a	n/a	n/a	244
Total	610	1,045	962	1,000	1,045	677	5,339

Base: All Crown contributions to members passed from Inland Revenue to providers for the period October 2007 to June 2013 (cash basis). All ETC payments for the years ended 30 June 2008 and 2009 (cash basis).
Source: Inland Revenue administrative data.

6. Policy Issues arising from KiwiSaver

Auto-enrolment or compulsion?

The original rationale for KiwiSaver 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

¹⁹ See <http://fundfinder.sorted.org.nz/>.

join; how much to contribute; what investment strategy to choose.²⁰ 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.

The applicability of these studies to New Zealand's KiwiSaver scheme was unclear (Toder & Khitatrakun, 2006). In the US, the employer usually 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 (see above) originally had none of the generous tax concessions available in the US, nor was it intended that it would be employer-subsidised (as 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). These were estimated to be of minor ongoing cost. 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.

Exempt employers

Some very large employers such as the universities have been 'exempt' so that the auto-enrolment feature has not been universally applied. 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.

Overall, as already noted, the introduction of KiwiSaver has resulted in fewer members of other employer-subsidised and retail retirement saving schemes. New employees of exempt employers may miss out on the benefits of auto-enrolment

Role of default funds

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)

KiwiSaver has two different types of default settings – first, there is the default scheme into which new employees are automatically enrolled. That scheme then has a default investment option that is required by regulations to have no more than 25% of funds invested in shares/property. The rest must be in cash/bond-style investments. A default scheme can have other investment options and non-default schemes can have default investment options. Default schemes and options are a consequence of a failure to actively choose. Auto-enrolment necessarily requires a default scheme regime; a failure to actively choose an investment option necessarily requires a default fall-back.

²⁰ 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 operation of the default provider arrangements

By late 2013, KiwiSaver had 2.15 million members with \$19 billion of funds under management²¹. The six default providers manage approximately 22.2% of KiwiSaver membership and 20.5% of total assets invested:

The default provider regime is an important part of that scheme, with about 465,000 New Zealanders remaining in the default fund to which they were allocated, and those default funds currently managing about \$3.4 billion. (English, 2013)

The number of providers and of schemes is reducing as time passes, repeating the process noticed in Chile. When the Administradora de Fondos de Pensiones (AFP) fund was introduced in 1981, there were 21 providers, reduced to 15 by 1997 (Littlewood, 1998, p. 85). By February 2012, there were only six AFPs (Shelton, 2012, p. 3). In contrast to Chile's population of just over 17.5 million and 6 providers, in 2013, New Zealand's population of 4.5 million had 27 providers offering 45 schemes (Ministry of Business, 2013).

There is little doubt that default provider status was of commercial value to the original appointees. Since 2006, one default provider was taken over by another provider (not default), two of the current six providers merged and a third has been sold, yet the original six appointments were not reviewed until 2014. The Ministry of Economic Development has sought submissions from interested parties and will make new appointments by 30 June 2014. It appears that up to 10 default providers may be appointed.

The vexed problems of fees comparisons and regulation

Given the difficulties of comparisons and of even identifying all the possible fees and their amounts, any 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.

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 protect the providers, potentially enabling higher fees to be charged to KiwiSaver members.

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. Different regulatory institutions, such as the Government Actuary and the Securities Commission were responsible for monitoring different parts of the financial products market but had little power to exert much control. As a rationalisation in 2011 the Financial Markets Authority was set up to oversee financial markets and administer the legislation in a much more hands-on approach. In 2013, new requirements for disclosure came into force.²² As a result reliable, transparent, comparative reports of KiwiSaver schemes for the purpose of informing scheme members may emerge.

However, that will be no small task. KiwiSaver is, in retirement saving terms, a simple product. For each member, there is a single provider and a single account within that provider. The Inland Revenue enforces the regular transactions (contributions) through the PAYE tax system. There is a single benefit entitlement and fixed rules around when that is paid. At least initially, disclosure documents reflected that simplicity but, with more active regulatory involvement, that has changed. For example, the scheme that the authors of this report are members of issued in 2007 a member booklet of 10 pages and an application form with attached investment statement of a further six pages. The current disclosure document (including the application form) is 50 pages long. In addition, the certified

²¹ At 30 September 2013 total managed funds were \$87.7 billion including \$19.0 billion in KiwiSaver. <http://www.rbnz.govt.nz/statistics/tables/c15/>

²² Under the KiwiSaver (Periodic Disclosure) Regulations 2013.

quarterly disclosure reports for that single KiwiSaver scheme total four pages for each of the 19 investment options followed by a further certified annual statement for each option, (the first annual statements are due for the year-ended 31 March 2014). Turning all this material into accessible information for the ordinary saver across all 45 schemes looks daunting.

Another regulatory issue concerns the appointment of 'independent' trustees for KiwiSaver schemes. The Financial Markets Authority administers the issuing of licences under the Securities Trustees and Statutory Supervisors Act 2011. In summary, the regulations effectively require the appointment of external, commercial trustees (similar to those required for other public offerings for a number of years). This is another move away from the less formal regulatory regime that applied to superannuation schemes for many decades. Whether that results in a more 'secure' environment for KiwiSaver members remains to be seen.

Too much choice?

New Zealanders can exercise choice at multiple levels in KiwiSaver:

- to opt-out as this is a voluntary not a compulsory scheme;
- one of three levels of contribution: 3%, 4% or 8% of gross taxable pay;
- unlimited contributions holidays for five years at a time;
- from a range of 45 KiwiSaver schemes²³ and change their initial decision about the provider or nature of fund invested in 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 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%)²⁴ 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 informed individuals 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.

Role of incentives

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 the stronger than forecast

²³ Although there were a total of 45 KiwiSaver schemes at 30 June 2013, (FMA, 2013) 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. As explained above, a number of providers have more than one scheme so there are 27 current providers.

²⁴ 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).

uptake can be linked to the level of government-provided incentives. Even in 2014, the incentives for anyone who intends to save anyway may be 'still too good to ignore'.

A traditional problem with incentives for saving is their contribution to inequality: the bulk of the tax benefits are usually enjoyed by those with the highest incomes. The original Member Fee Subsidy avoided this regressivity as does the current Kickstart being a flat rate and unrelated to contributions. However the incentive here is to join, not to contribute. The remaining member tax credit incentivises personal contributions, but up to only \$20 a week.

Given that KiwiSaver benefits are locked in until age 65, it may be preferable for an individual for any additional retirement savings past the minimum that attracts the full subsidy to be made to an accessible scheme, especially one that enjoys the advantages of the PIE tax regime. In New Zealand, KiwiSaver is the only scheme with regulated age-based restrictions on access to retirement benefits.

The Financial Services Council has recently advocated the abolition of existing exemptions to allow a lower tax rate on KiwiSaver earnings (Financial Services Council, 2013). While this may incentivise higher contributions it would do so at the cost of reintroducing a much more regressive regime.

These tensions are not easily resolved. Nor should it be overlooked that incentives are costly to the Crown and either reduce public saving or necessitate higher taxes elsewhere.

Lack of a decumulation policy

An important difference between KiwiSaver and the UK NEST scheme is that no consideration was given in the design of KiwiSaver to decumulation. However the UK has had a tradition of annuitisation not enjoyed in New Zealand and there, saving has been highly subsidised in the accumulation phase.²⁵ 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).

With the provision of initially generous, tax-funded subsidies in KiwiSaver II, the Government might have felt justified in imposing restrictions on spending of KiwiSaver lump-sums in retirement. That option was ignored, and indeed not even discussed. Moreover 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, 2009).²⁶ One possibility was the provision of a limited value, inflation-adjusted, gender neutral annuity to supplement NZS, purchased out of lump-sum savings and a suitable share of home equity if required. This annuity would require subsidies to be viable but may have also included a cost-effective insurance rider for long-term care (St John, Dale, & Ashton, 2012). This opportunity may have now passed as requiring annuitisation ex post, even with subsidies, would be resisted in a voluntary scheme.

Overseas pensions and relation to KiwiSaver

Every New Zealand resident over the age of 65, after meeting the 10 year residency requirement, is eligible to receive NZS. However, the NZS is reduced by an overseas

²⁵The UK scheme however reflects some antipathy to the way the annuities market works with complex alternatives to annuities of 'capped drawdown', 'GAD limit history', 'designated drawdown' and 'reference period'. See http://www.pruadviser.co.uk/content/support/technical_centre/retirement_benefit_options/#8 for an explanation of the new complex rules.

²⁶ 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. On the other hand, the 'price' for this redeeming feature is that tax concessions are complex, expensive, regressive, distortionary and inequitable. They also probably do not have much influence on the quantum of retirement savings.

pension that is deemed to be equivalent. Since 2007, New Zealand residents can save for extra retirement income in KiwiSaver making some deductions of overseas pensions appear anachronistic and anomalous (Dale, St John, & Littlewood, 2009). Thus those with entitlement to a second-tier overseas state pension analogous to KiwiSaver 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 (Dale, 2012).

Should there be 'holidays' and access to funds for hardship or housing?

The premise of KiwiSaver is that it is a long-term savings scheme, with the assets not accessible until the age of 65. However, the lock-in can be subverted by the provisions for housing; and there are generous provisions for contributions holidays. These do not give access to the money but stop the future automatic deductions by the employer (and the employer's matching contributions). As noted, 101,415 members are on a contributions holiday, although most continue to make some contribution to their accounts (Inland Revenue Department, 2013). By allowing up to 5 years for contributions holidays with freely available roll-over provisions employees are enabled to access the member tax credit by contributing only the minimum, thus undermining the saving objectives of auto-enrolment. Nevertheless, such employees may have other pressing needs including mortgages and student loan repayments.

Also over 11,000 members have accessed their savings for first home deposit, and this purchase must be recognised as an alternative form of saving. Whether the additional subsidies for some members are justified is debateable.

Remuneration policy

Subsidised occupational saving schemes of all kinds (including for retirement) suffer a fundamental problem when they are voluntary (like KiwiSaver). Those who join receive a higher total remuneration than those who do not. Those who can afford to join will tend to have higher disposable incomes. However, the more serious issue should be for the employer that should find it difficult to justify (for two otherwise equivalent employees) a higher total remuneration for the member over the non-member. New Zealand employment law allows this to be taken into account when setting pay. If the employer has a 'total remuneration' policy, those who join KiwiSaver can see an adjustment to direct, taxable pay that reflects the requirement that the employer must contribute to KiwiSaver.²⁷ There was an attempt to outlaw this but it was unwound by the incoming National-led government in 2009.

There is limited information on employers' overall remuneration approaches. The Employers and Manufacturers Association (EMA) advises that its *National Employers Wage & Salary Survey* for April 2013 showed the following:

- Across all measured positions in the survey, between 26% to 28% of employees are paid under a formal 'total remuneration' policy.
- The dominant employer contribution rate across all measured positions was 2%-2.99% (between 72-80% of employers by job levels). In other words, employers were mostly paying the minimum required KiwiSaver contribution.

There is an inevitable tension when employer subsidies are part of the picture. A total remuneration approach or compulsion may appear to resolve equity issues, but will also reduce the attractiveness of membership for workers if membership remains voluntary.

²⁷ As long as the minimum wage requirements are still met with direct, taxable pay.

Financial literacy and children's participation

Another of the intentions of KiwiSaver is to encourage the spread of financial literacy. 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).

Improving the financial literacy of the young may justify 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.

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 CFLRI, 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).

The 2013 *Financial Knowledge and Behaviour Survey* found that since the first survey in 2009, financial knowledge has remained statistically equivalent. However, there have been falls since 2009 in both the ability to make forward calculations (how long to save an additional amount) and backward calculations (how much has already been saved) from a bank statement, and only 32% of New Zealanders understand the impact of compound interest (ColmarBrunton, 2013, pp., pp. 7 - 8).²⁸

Gender issues

While women are generally disadvantaged by pension arrangements that link retirement income to previous contributions to the paid workforce, KiwiSaver is remarkably egalitarian. First the sweeteners are designed to be inclusive and are of most relative value for low and middle income people, not high income. Second, non-earners are entitled to the same member tax subsidy if they contribute the minimum. Third, the overall scheme includes a universal individualised basic state pension that recognizes unpaid contributions by women. Nevertheless access to the employer subsidy requires employment in the paid workforce and over time the median balances held in KiwiSaver schemes can be expected to be significantly below that of men. Guest (2013) compares the average KiwiSaver balances for different ages with the average superannuation balances in Australia to show that there is a much smaller gap for males and females in New Zealand. But the Australian scheme is far more mature than KiwiSaver and the gender gap in New Zealand can be expected to grow over time. Moreover the *median* gap between male and female in either country is much more pronounced.

Proposals from the FSC include requiring KiwiSaver balances to be used to support early retirement say between 65 and 70, with a top-up when balances are not sufficient to fund a pension equal to NZS (Financial Services Council, 2012). This is not in most women's best interests. The KiwiSaver would be used up by age 70 for many women who will have insufficient to fund this period and need a top-up. These women would have no ongoing

²⁸ It is perhaps, then, cause for concern in the OECD that in the 2012 OECD International Network on Financial Education pilot study comparing financial literacy among adult residents of 14 participating countries (ColmarBrunton, 2013, p. 11), New Zealand's knowledge score was significantly higher than all other participating countries.

income supplement for the rest of their retirement despite women experiencing higher average longevity than men.

7. KiwiSaver: lessons from the first 6 years

KiwiSaver purpose

One key lesson from New Zealand is the importance of clarity about the problem to be addressed. 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.²⁹ By the time the Bill was introduced, there was little mention of the problem. As noted in the introduction, 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.

The Inland Revenue Department (2011b) concluded:

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.

Thus to date, the analysis has lacked evidence of KiwiSaver's actual contribution to improving to national saving and even if it does assist, whether that necessarily influences the growth of the economy through higher and better investment.

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. 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.

Nevertheless concern about national saving underpins government's recent policy announcements for an auto-enrolment day for employees not already auto-enrolled.

²⁹ 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.

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.³⁰ 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.

The 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 cohorts of a larger retired population.

Another crucial lesson from the New Zealand experience is that competition among many providers, and a system of default providers, may not improve consumer outcomes and subsequent rationalisation with mergers and takeovers may be costly.

The taxpayer-funded subsidies to KiwiSaver are distributed to members based on the contributions made by individuals. 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 halved 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 (Retirement Policy and Research Centre, 2009).

KiwiSaver design and implementation

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

Auto-enrolment may precede compulsion

KiwiSaver is a form of 'soft compulsion': the lesson may be that it can lead to demands for proper 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 and now in 2014, 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 major changes needed would be to remove the opt-out and inevitably, the contributions holidays provisions.

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. 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 much as in

³⁰ 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 V. Also, fiscal choices are constrained by the high cost of tax incentives.

Australia. This may undermine the advantages of a universal pension, although there is a case that can be made for more clawback on NZS using the tax system (St John, 2012).

It is also worth noting that 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. These are now less about tax breaks and more about the requirement for matching employer contributions. These do not, of course, apply to KiwiSaver members who do not have an employer, including the now 53.7% of all members who are non-contributory (FMA 2013a, p13). Behavioural changes when there are generous holiday provisions can be expected.

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. About one third of those aged 17 or under are KiwiSaver members.³¹ This might be seen by some as admirable, but in the long term, their accounts need continued savings to be commercially viable. Currently, it is believed that over 90% of such members make no contributions (Financial Markets Authority, 2011, p. 7).

Improved regulation, choice and default options

The former regulatory regime was founded largely on the 'prudent person' requirement that trustees act in the best interests of their beneficiaries. The old environment was best described as self-regulation, but the Securities Commission raised issues with the behaviour of some providers and the unsatisfactory regulatory environment. The regulatory regime for KiwiSaver schemes and other managed funds had to improve and with the transfer of regulatory responsibility to the Financial Markets Authority, a more hands-on, comprehensive oversight has been introduced.

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 choose where their money is invested. That implies that they should have the right to decide who manages that money. But too much choice 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 and investment fund.

The rationale for conferring a commercial advantage on the initially appointed six default KiwiSaver providers was 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. In the 2014 re-tendering of default provider status, the Government appears not to have taken the opportunity to amend the flawed selection structure but will require tenderers to have a savings education plan for default enrollees.

Centralised administration and portability

A particularly successful aspect of the design of KiwiSaver is using the IRD as clearing house for collection of employer and member contributions, and allocation of those contributions to the appropriate fund. This has avoided the problems found in both Chile and Australia, where many individuals have multiple small sums in mislaid accounts. It appears that \$AUD15 billion in Australia's SG scheme are sitting in lost or unclaimed accounts.³²

³¹ 15% of all KiwiSaver members are age 17 and under (FMA 2013 p 20).

³² See <http://www.thorner.co.nz/tag/australian-superannuation-guarantee/>.

8. Conclusion

Based on the events of the last six 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 knee-jerk reactions and political expediency. If current trends continue, KiwiSaver will continue to supplant the role of employer-subsidised superannuation and retail schemes, with an ambiguous effect on total saving.

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 six 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 allows the real cost of fixed incentives to reduce over time.

Auto-enrolment has been of international interest but its significance may be overstated in a scheme that is open to everyone under 65 not just new employees. Employers are affected by compliance with this requirement and would be resistant to any attempt by the government to proceed with its blanket auto-enrolment day in 2014. Nevertheless, auto-enrolment may have played a useful role in establishing acceptance of the scheme, and far fewer net opt-outs over time is encouraging. The role of contributions holidays in undermining the effects of auto-enrolment must be balanced against the flexibility of individuals to save at appropriate times.

One of the clear advantages of the New Zealand scheme is that it is fully portable and the IRD acts as the clearing-house. It is also inclusive and the minimal tax incentives have been designed to limit regressivity. This is a two edged sword when there are options to only pay in the minimum amount to attract the government subsidy. For many middle income and higher income people who are already saving, KiwiSaver may simply substitute for other non-subsidised saving. There is a high cost to the Crown and to the objective of increasing national saving.

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 given they effectively miss out on part of their pay and suffer wages that rise less quickly over time as employers shift the incidence to all workers through lower future pay increases.

One solution to this is compulsion or simply requiring employee contributions at the 6% rate. But the real issue around the compulsion debate should be whether the costs to those who are compelled to save in a non-optimal way can be justified by the higher good. The higher good may be the welfare of those compelled, or it may be increased national saving. 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 the compulsory retirement saving benefit, the Superannuation Guarantee. 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.

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 can be wasteful of resources and therefore 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.

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.

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? 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.

The major focus 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, KiwiSaver must be designed primarily to achieve meaningful amounts of extra income for them to supplement the state pension. Of course issues of affordability are important but objectives such as enhancing national saving are secondary to the design of a comprehensive retirement system that aims for a more equitable division of future output.

Finally, the first six 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. But it is best seen as a way to augment a well-supported universal state pension that has comprehensive coverage. Therefore policy attention to allow it to provide secure and regular income in retirement is critical (Retirement Policy and Research Centre, 2012).

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