
KiwiSaver: New Zealand's New Subsidized Retirement Savings Plans

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Introduction

Since July 1, 2007, New Zealanders have had a new option for their retirement savings—KiwiSaver—a type of subsidized, defined contribution retirement savings plan offered by private-sector providers. New labor force entrants in permanent positions who are aged 18 or older are automatically enrolled in a KiwiSaver plan, but are able to opt out of the plan if they wish. Also, all individuals younger than age 65, including anyone not in the labor force, are permitted to set up a KiwiSaver account.

A law passed in September 2006 created the KiwiSaver to encourage New Zealanders to save more for retirement and to supplement the New Zealand Superannuation (NZS) benefit, a flat-rate universal old-age pension. Although lower earners mainly rely on NZS benefits for their retirement income, middle and higher earners must supplement this benefit to maintain their preretirement standard of living. Workers may also purchase supplementary retirement plans, called superannuation plans either through their employers or directly from an insurance or other financial services company.¹ The New Zealand government introduced the KiwiSaver, in part, because by the end of 2005, less than 30 percent of the active labor force was covered by some type of superannuation plan.

This note provides a brief description of the New Zealand public pension system and its sources of funding, statistics on the country's savings rates before the KiwiSaver law was passed, and a detailed description of KiwiSaver.

New Zealand's Public Pension

New Zealand Superannuation is the flat-rate public pension available to all New Zealand residents aged 65 or older who have lived in the country for 10 years since age 20, or for 5 years since age 50 (SSA 2007). NZS benefit amounts depend on marital status and living arrangements and are taxed as income. Each year benefit amounts for a married or civil union couple are adjusted for inflation and then adjusted to fall between 65.0 percent and 72.5 percent of the country's net average wage.² The NZS retirement benefit for other categories is computed as a percentage of the benefit amount for married couples and civil unions: single persons living alone receive 65 percent of the benefit, and single persons living with others receive 60 percent. NZS benefits are adjusted according to changes in the consumer price index (Toder and Khitatrakun 2006). NZS is the government's largest single budget item with a current net cost of 3.4 percent of gross domestic product (GDP), which is expected to rise to 6.9 percent of GDP by 2050 with the aging of the population (NZSF 2006).

Although NZS currently is funded by general revenues, as the population ages this program will need an additional source of funding to meet benefit payment projections. The New Zealand Superannuation Act 2001 created a separate investment fund called the New Zealand Superannuation Fund (NZSF, or the Fund) to partially finance the projected rise in costs of New Zealand Superannuation benefits as the country's population ages. From 1970 through 2005, while the

overall population grew by 44 percent, the number of people aged 65 or older doubled. In 2006, the number of people aged 65 or older represented 12 percent of the population and is expected to reach 26 percent by 2051 (Statistics 2006). According to the National Population Projections, the ratio of the working-age population (aged 16–64) to the population aged 65 or older was 5.5 to 1.0 in 2004. This figure is expected to drop to 3.0 to 1.0 in 2028 and to 2.2 to 1.0 by 2051 (Statistics 2004).

The government expects to finance the NZSF from general revenues with an average contribution of NZ\$1.95 billion (US\$1.6 billion) a year until about 2027.³ In September 2003, the government made the first payment to the NZSF of NZ\$2.4 billion (US\$1.9 billion). By October 30, 2007, its assets totaled NZ\$14 billion (US\$11.3 billion), and the average nominal rate of return since 2003 was 14.29 percent.

By law, the government may not withdraw any capital from the Fund before July 1, 2020. The New Zealand Treasury estimates that by about 2028, when the ratio of the working-age population to the population aged 65 or older falls to about 3 to 1, the government will stop contributing to the NZSF and begin taking money out of the Fund to cover about 15 percent of the net yearly superannuation costs from 2055 through 2075.⁴ The Fund is expected to continue growing over time because the capital withdrawals are projected to be less than the Fund's income (NZSF 2006 and 2007; MSD 2007; Treasury 2006).

The Fund operates “at arms length” from the government. The Guardians of New Zealand Superannuation, a separate government organization, manages and administers the Fund's assets. The Board, which oversees the Guardians, is made up of five to seven members who are recommended by the Minister of Finance and appointed by the Governor General. A formal review of the Guardians' performance will be conducted about every 5 years by an independent agent appointed by the Minister of Finance (NZSF 2006).⁵

Saving for Retirement

KiwiSaver was introduced to help New Zealanders save more for retirement. In March 2007, Finance Minister Michael Cullen stated that New Zealanders have one of the lowest household savings rates among the developed countries. Cullen (2007a) cited the New Zealand Reserve Bank estimates of current household

savings rate at negative 17.5 percent. A March 2007 New Zealand Treasury study concluded that about 20 percent of the population aged 45–64 needs to save more for retirement, including about 9 percent of individuals and 13 percent of couples aged 55–65 (Hosking 2007).⁶

A 2003 report from a panel of experts found that economic well-being in retirement may be substantially different for the future cohort of retirees, compared with current retirees.⁷ The report concluded that a large percentage of current retirees are able to maintain their standard of living through a variety of sources: NZS, private savings, and mortgage-free home ownership. The report also found that although those nearing retirement should be able to meet their needs, younger workers may have lower standards of living in retirement because of high levels of debt, student loans, child-bearing at later ages, and potentially fewer mortgage-free homes (IBIS 2004).

Participation in supplementary retirement plans has been relatively low. In New Zealand, voluntary supplementary retirement plans (called superannuation plans) are available through employers or directly from an insurance or other financial services company. At the end of 2005, more than 600,000 individuals were enrolled in some type of superannuation plan with a total of NZ\$18.2 billion (US\$14.6 billion) in assets. Half of these individuals (about 13 percent of the labor force) were enrolled in employer-sponsored retirement superannuation plans with a total of NZ\$11.5 billion (US\$9.2 billion) in assets (MED 2006).⁸ According to the 2001 Household Savings Survey, less than 20 percent of those who earned between NZ\$15,000 and NZ\$50,000 (US\$12,000 and US\$40,000) per year were enrolled in some type of superannuation plan. The government is targeting this group of earners with KiwiSaver (Cullen 2007b).

KiwiSaver

KiwiSaver is a new type of subsidized, defined contribution retirement savings plan created to supplement NZS and help increase an individual's retirement income.⁹

Eligibility

Beginning July 1, 2007, new permanent workers aged 18–65 are automatically enrolled in a workplace KiwiSaver plan, but have from the second to the eighth week of their employment to opt out of the plan.¹⁰ Anyone younger than age 65, including

the self-employed and anyone not in the labor force, may choose to set up a KiwiSaver account with any provider. Workers who are automatically enrolled in a KiwiSaver plan may choose to move their account to another provider at any time. Those aged 65 or older may continue to contribute to their KiwiSaver account as long as they joined a plan before age 65. Although individuals are permitted only one KiwiSaver account, workers with multiple jobs may contribute to their account from each of their current jobs.

Individuals who are younger than age 65 and either citizens of New Zealand or entitled to stay in New Zealand indefinitely are permitted to have a KiwiSaver account as long as they reside in the country. New Zealand government employees working outside of the country may also opt into a KiwiSaver plan.

Contributions and Government Subsidies

Workers may select a monthly contribution rate of either 4 percent or 8 percent of gross earnings; those who do not choose either rate will automatically be assigned a 4 percent contribution rate. Workers may increase their contribution up to the 8 percent rate at any time. KiwiSaver account holders who contribute to their account will receive a tax credit of up to NZ\$20 (US\$16) a week and NZ\$1,040 (US\$836) a year that will be deposited directly into their KiwiSaver account.

Until April 1, 2008, employers had the option of paying part or all of an employee's KiwiSaver contribution. The employer's contribution of up to 4 percent of the employee's gross earnings was tax-exempt to the employer.¹¹ Because this is not a matching contribution, the total employer/employee contribution was either 4 percent or 8 percent.

Beginning April 1, 2008, all employers are required to contribute to an employee's KiwiSaver account: starting with 1 percent of the employee's gross salary in 2008 and adding 1 percent each year until the mandatory employer contribution reaches 4 percent of gross salary by April 1, 2011. Employers receive a tax credit of up to NZ \$20 (US\$16) per week per employee (Cullen 2007).

Another arrangement is possible between April 2008 and March 2011. If both the employer and the employee agree, they are permitted to divide the employee's contribution: in 2008, each would contribute 2 percent of the employee's gross earnings; by 2010, each would contribute 3 percent; and by 2011, they both would contribute 4 percent.¹²

Employers must withhold contributions beginning with a new employee's first paycheck, unless the employee opts out of the program (between the second and eighth week of employment). Those who opt out of the program will receive a refund of their contributions. The government tax authority, Inland Revenue, collects the contributions from employers and distributes them to the employees' KiwiSaver plans.

The New Zealand government provides two other subsidies (in addition to the tax credit): a one-time tax-free payment of NZ\$1,000 (US\$804) to each KiwiSaver account after the individual plan receives the first contribution to that account; and, a NZ\$40 (US\$32) annual fee subsidy to each account holder to defray administrative costs. The fee subsidy is payable up to age 65, or 5 years after a worker older than age 60 first sets up a KiwiSaver account. The government has not set a limit on how much providers may charge account holders for administrative fees.

"Contribution Holiday" and Early Withdrawals

After the first 12 months of membership, automatically enrolled workers may take a "contribution holiday" for a minimum of 3 months, up to 5 years at a time for any reason. However, workers with a serious illness or experiencing a financial hardship may take the "contribution holiday" before the end of the first year of membership. Details of the "contribution holiday" provision for those who contract directly with a plan (the self-employed, those who are not in the labor force, and workers younger than age 65 who choose a KiwiSaver plan that is not sponsored by their employer) are dependent on the particular plan provider. Also, some plans and mortgage providers may allow account holders to divert up to one-half of their contribution to pay for a mortgage after contributing to a KiwiSaver account for 12 months.

After the opt-out period expires, KiwiSaver participants may withdraw all of their funds at age 65 or 5 years after they opened their account, whichever is later, and at any time in the event of serious illness.¹³ Participants may withdraw all of their contributions and any vested employer contributions if they:

- face significant financial hardship such as the member's or dependent's medical care, a dependent's education, or the member's inability to meet minimum living expenses according to normal community standards determined by law;
- leave the country permanently; or,

- make a down payment on the purchase of a first home after at least 3 years of saving in a KiwiSaver account. Beginning in 2011, the government plans to provide an eligible first-time home buyer who has a KiwiSaver account (subject to income and housing cost limits) with a home ownership subsidy of NZ\$1,000 (US\$804) per year, up to a maximum of NZ\$5,000 (US\$4,018) per person (Treasury 2007).

Providers

Workers who have been automatically enrolled and do not choose a registered provider are assigned to a default provider.¹⁴ The Ministry of Economic Development approves all KiwiSaver providers including a limited number of default providers selected through a tender process.¹⁵ It is also responsible for supervising KiwiSaver plans, issuing provider and plan regulations, and negotiating fees with the default providers. Although the default providers offer only plans with a conservative investment portfolio, other registered providers are permitted to provide a variety of investment portfolios such as conservative, balanced, or growth. KiwiSaver accounts are portable and members may change plans and investment risk portfolios at any time. The government provides no guarantees for the funds in KiwiSaver accounts.

Employers must provide access to a KiwiSaver plan to all employees although workers may choose any registered KiwiSaver plan. Employers may convert their existing employer-sponsored superannuation plan to a KiwiSaver; they may also request an exemption from the government from providing their employees with access to a KiwiSaver plan, if their registered superannuation plan meets certain criteria such as limiting employees' access to their retirement savings and requiring them to contribute at least 4 percent of earnings to their employer's superannuation plan.

Financial Education

The New Zealand Retirement Commission is charged with providing workplace financial education programs to help workers make informed decisions about establishing a KiwiSaver account. The Commission, established in 1993, has been conducting financial education programs around the country on a wide range of topics including saving, debt management, housing, and understanding net worth. Until now, workplace financial education focused solely on retirement seminars for workers nearing retirement. The new financial education program will help individuals

assess whether or not KiwiSaver is appropriate for them (Feslier 2006). The Commission's public information Web site, <http://www.sorted.org.nz>, provides free financial education information including online tools to help workers make an informed decision about KiwiSaver (MSD 2007).¹⁶

Recent Tax Incentives for Retirement Savings

The original KiwiSaver bill submitted to Parliament in February 2006 did not contain any tax exemptions.¹⁷ However, just before its passage by Parliament in August 2006, tax incentives for employer contributions to KiwiSaver plans were added to the bill. As a result, the Association of Superannuation Funds of New Zealand lobbied the government to extend the same tax breaks to these occupational pension plans so that KiwiSaver plans would not have what was perceived as an unfair advantage over superannuation plans. Thus, the December 2006 tax bill passed by Parliament contained a provision that allows the same tax breaks to superannuation plans with the same requirements as the KiwiSaver: fully portable, full vesting, and "lock-in until retirement." In May, Finance Minister Cullen announced in his "Budget 2007" speech some additional changes to KiwiSaver and qualified superannuation plans: a tax credit for employees and phased-in mandatory employer contributions. Legislation for the employee tax credit was enacted in May 2007 (Tax Policy 2007) and the provision for mandatory employer contributions was enacted in December 2007.

Take-up Rate

Before the tax incentives for workers were added to the KiwiSaver bill, the government had predicted that 345,000 workers would have a KiwiSaver account in the first year and by 2013, that figure would reach 700,000—about 25 percent of all eligible individuals. When the KiwiSaver law was passed (with tax incentives), the government estimated that 50 percent of those eligible would have a KiwiSaver account no later than 2017. Based on the later estimates, the government predicted that its annual expenditures on KiwiSaver could be close to NZ\$2 billion (US\$1.6 billion) per year as early as 2012 (Cullen 2007b).

By the end of 2007, the take-up rate far exceeded government predictions—more than 300,000 workers were enrolled in a KiwiSaver plan.¹⁸ According to the Retirement Commission's 2007 Review of Retirement Income Policy, based on the current rate

of enrollment, the government incentives could be much more costly than the most recent estimates. The Commission urged Treasury to estimate the likely future costs of KiwiSaver to the government including the sustainability of the current incentives (Retirement Commission 2007c).

Program Evaluation

Researchers have pointed out a number of unresolved issues concerning KiwiSaver, which include the following:

- The government could negotiate such low administrative fees with the default providers that smaller, nondefault providers might not be able to compete.
- Saving for retirement and saving for a first home could be conflicting goals that could undermine the retirement savings aspect of KiwiSaver.
- An individual may contribute for only 12 months to qualify for the government subsidy and then take a “contribution holiday.” The potential for thousands of inactive accounts with very low balances could be very costly to administer.
- The choice between contribution rates of only 4 percent and 8 percent of salary can limit the amount an individual is able to contribute to an account. If there were more options, such as gradually increasing the rate from 4 percent to 8 percent of salary over a period of 4 years, a larger number of account holders might be able to afford to contribute more to their KiwiSaver account as their salaries rise.
- Many first-time home buyers would be excluded from a KiwiSaver housing subsidy because the limits on household income and the cost of the house are likely to be relatively low. (Because this aspect of KiwiSaver will not be introduced until 2011, the limits have yet to be established.)
- The KiwiSaver law does not address the issue of how to protect the value of the savings after withdrawal. A lump-sum withdrawal is permitted at retirement and there is no requirement to use these funds for retirement. Also, the law does not include measures to encourage the growth of the annuities market. Because only a few companies currently offer annuities, rates are not competitive and the types of annuities available are limited. (Toder and Khitatrakun 2006; St. John and Littlewood 2006a and 2006b).

The government is in the process of developing the KiwiSaver Evaluation Program to assess the strengths and weaknesses of KiwiSaver. The program could address some of the previously mentioned unresolved issues. Inland Revenue, Treasury, the Ministry of Economic Development, and the Ministry of Social Development are working on this policy initiative. The government intends to evaluate KiwiSaver from its inception to make program improvements quickly. Areas of study will include levels of participation, cost effectiveness, and public awareness of KiwiSaver. The New Zealand government hopes that the data they collect will help other countries that are considering automatic enrollment retirement savings programs (MSD 2007; Retirement Commission 2007a).

Notes

¹ In New Zealand, the term “superannuation” means retirement.

² This figure has been raised to 66 percent during the term of the current government as a result of an agreement with a coalition party. The floor is set by law at 65 percent (MSD 2007); according to the New Zealand Superannuation Act 2001, average wage is determined by the last Quarterly Employment Survey published by the Department of Statistics before March 1 each year. For more information on the average wage, see Statistics (2007).

³ For more information on the government’s contribution to the NZSF, see sections 42 and 43 of the New Zealand Superannuation Act 2001.

⁴ A portion of NZS funding will continue to come from general revenues.

⁵ For an evaluation of the NZSF, see Littlewood (2005) and St. John (2001).

⁶ See Le and others (2007).

⁷ The 2003 report was produced by the Periodic Report Group, a panel of public- and private-sector experts that reviewed New Zealand’s retirement income policy every 6 years. The review function was transferred to the Retirement Commissioner who presented her first report at the end of 2007. After that, the Commissioner is required to present a report every 3 years (Retirement Commission 2007a).

⁸ As of 2005, about 50 percent of the U.S. labor force participated in some type of employer-sponsored retirement plan (Costo 2006).

⁹ Unless otherwise noted, the source for the information on KiwiSaver in this section is <http://www.kiwisaver.govt.nz>.

¹⁰ This includes new entrants to the labor force and workers who are starting a new job.

¹¹ For example, if the employer contributes 4 percent of the employee's earnings, the entire 4 percent is tax-exempt to the employer. If the employer and the employee each contribute 2 percent of the employee's earnings, the employer's 2 percent contribution was tax-exempt. Employers pay a special tax called specified superannuation contribution withholding tax (SSCWT) on the rest of their contributions to an employee's account.

¹² This measure was added in December 2007.

¹³ According to the law, the definition of serious illness is either permanently or totally disabled or near death.

¹⁴ Providers include banks, insurers, and management companies.

¹⁵ The Ministry of Economic Development has selected six default providers (New Zealand Government 2007).

¹⁶ Other functions of the Retirement Commission include collecting research on retirement planning behaviour and attitudes and providing information that aids development of national policies impacting on retirement. For more information go to http://www.retirement.org.nz/retirement_commission_home.html.

¹⁷ In New Zealand, investment earnings are taxed.

¹⁸ Close to 20 percent of these workers are younger than age 25 and more than half are younger than age 45.

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