Submission to the Savings Working Group

Savings in New Zealand –
Issues and Options
September 2010

Kiwibank Limited
14 December 2010

PART 1

INTRODUCTION

1 Introduction

1.1 This submission has been prepared by Kiwibank Limited ("**Kiwibank**") in response to the call from the Savings Working Group (the "**SWG**") for submissions on savings in New Zealand.

1.2 This submission has regard to the Terms of Reference for the SWG and the discussion document "Savings in New Zealand – Issues and Options" (the "**Discussion Document**"), issued by the Treasury for public consultation in September 2010 to assist the SWG to start its work.

1.3 We would be happy to meet with the SWG to discuss this submission or savings in New Zealand generally. Our contact details are as follows:

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2 Structure

2.1 Our submission focuses on retirement savings, and in particular issues concerning KiwiSaver. We do, however, look forward to commenting in further depth across the breadth of issues canvassed in the SWG's report in early 2011.

2.2 This submission is structured in four parts.

(a) Part 1 sets out some background information in relation to Kiwibank.

(b) Part 2 contains an executive summary of the key points made in this submission.

(c) Part 3 sets out general comments in relation to the Terms of Reference for the SWG; and in relation to savings in New Zealand.

(d) Part 4 sets out comments in relation to KiwiSaver.

3 About Kiwibank

3.1 The Government, as the shareholder of New Zealand Post Limited ("**NZ Post**"), granted approval for the establishment of a publicly-funded bank in 2001. Kiwibank was subsequently established and opened for business in early 2002. Kiwibank's ultimate parent company is NZ Post.

3.2 Kiwibank was established as a New Zealand-owned bank, for New Zealanders. At that time, it was intended that Kiwibank:

(a) would have lower fees;

(b) would benefit customers of other banks by keeping the other banks honest, producing lower fees and interest rates at all banks;

(c) would have more branches than any other bank.

3.3 Today, Kiwibank has the largest branch network in the country, with branches nationwide situated at PostShops around New Zealand. Through a shared cost and host business model, Kiwibank has branches in places that would not otherwise be economically viable. Kiwibank has made local banking accessible to people in areas that would otherwise miss out.

3.4 Kiwibank provides a full range of domestic banking services (retail and business), KiwiSaver and international banking services and investment management services to institutional clients. Kiwibank also provides investment products through AMP Capital Investors, and life insurance through Kiwi Insurance Limited and by way of contractual arrangements with CIGNA Life Insurance New Zealand Limited and TOWER Life respectively.

PART 2

EXECUTIVE SUMMARY

Kiwibank welcomes the opportunity to make a submission to the SWG. In summary:

- **PIE:** We strongly support the PIE tax regime and would not wish to see it undermined to the detriment of the national savings rate. While "un capping" the tax rate for PIEs may be a more theoretically correct approach to ensure that all savings are subject to the same tax rates, in our view it would not encourage saving in practice.
- **Nordic model:** While the Nordic model is theoretically attractive, it is likely to make our tax system more complex and would be difficult to apply in practice. We consider the PIE regime to be an indirect proxy for the differential treatment of capital and labour income suggested under the Nordic model. This provides further support for the continuation of the taxation of PIEs at less than the top marginal tax rate.
- **Annuities:** An ageing population and pending lump sum withdrawals from KiwiSaver suggest that it would be timely for the SWG to build on the Capital Market Development Taskforce recommendation and explore options to enable the development of the annuities market in New Zealand.
- **Student loan scheme:** The student loan scheme has a negative effect on household savings. The SWG may wish to consider options to incentivise early repayment and/or modifications to KiwiSaver to accommodate withdrawals for the purpose of funding tertiary education. This would encourage a culture of saving for tertiary education, rather than reliance on student loans.

KiwiSaver

It is clear that we need to save more effectively for our retirement. We advocate for a transition towards compulsory KiwiSaver for all New Zealanders in paid employment with income above a prescribed threshold. In our view, compulsory KiwiSaver would significantly increase retirement incomes, and therefore quality of life in retirement, for many New Zealanders. It would also provide a significant savings cushion, reducing dependency on Government benefits and health care – effectively lowering the fiscal cost of retirement.

Treasury has proposed options for the SWG's consideration. We support the proposal to boost automatic enrolment; caution against targeting incentives; and oppose the removal of ongoing incentives. We also note that a strong policy argument can be made to move, over time, from a TTE to an EET model for taxing retirement savings. This would substantially reduce the effective tax rate on savings and help provide Government with cash-flow to meet the needs of an ageing population in terms of NZ Super and healthcare when those costs arise.

We also advocate for a more flexible retirement age for KiwiSaver. The existing "lock in" feature penalises members able to retire early, or who are physically unable to continue to work into their sixties. A more flexible retirement age would better accommodate these differences, encourage voluntary contributions and make KiwiSaver more attractive as a retirement savings vehicle.

We also note recent changes to Australia's superannuation system. The SWG may wish to consider increasing the level of compulsory employer contributions; compulsory employer contributions for those over 65; and "catch-up" contributions for older members.

PART 3

GENERAL COMMENTS

1 Terms of Reference

1.1 The Terms of Reference for the SWG play a key role in determining the purpose, structure, scope and objectives of the SWG's examination of savings issues. While the SWG has not invited comments on its Terms of Reference, in our view it is important to note the out of scope areas that constrain the parameters of the SWG's enquiry.

1.2 In an ideal world the Terms of Reference would be broad reaching and without constraint to enable the SWG to have complete freedom to discuss all areas of importance to national saving. While we appreciate that the Government has made policy commitments in certain "out of scope" areas, there is a risk that the SWG will be unable to have a meaningful conversation about savings issues without reference to these areas. For example, consideration of the role of KiwiSaver in improving national saving outcomes will be incomplete if the SWG is unable to consider the parameters of New Zealand Superannuation ("**NZ Super**").

1.3 New Zealand's savings performance to date has been on the back of strong levels of Government saving, whereas private individuals and firms have for the most part been "dis-saving" (consuming more than they earn and relying on foreign lenders to fund that habit). The Global Financial Crisis and the resulting movement of Government's fiscal balances into the red has put additional pressure on New Zealand's national savings rate. In summary, we do not believe that current policy settings are sustainable.

1.4 One of the key challenges the SWG will need to address is the fact that Government debt is likely to reach unsustainable levels if we do not make changes now to address long-term age-related spending trends. Standard & Poor's has warned that an ageing of New Zealand's population and a decline in the working age population could increase age-related spending on pensions and healthcare from 14.4% of GDP to 20.9% of GDP by 2050 if significant reforms are not made.[1] Treasury has warned that New Zealand's net public debt will surpass 100% of GDP without changes to policies on pensions or improvements

[1] Standard & Poor's "Global Aging 2010: An Irreversible Truth". Available at: http://www2.standardandpoors.com/spf/pdf/media/global_aging_100710.pdf.

to New Zealand's economic performance.[2] The SWG's responses need to address this challenge.

1.5 Ideally, consideration of NZ Super would be part of this response and any resulting policy options may be compromised by its exclusion. Inevitably, the SWG response will need to focus on ways of improving private savings performance.

2 Savings levels must increase

2.1 In our view it is clear from the SWG's Terms of Reference that New Zealand has a historical savings problem and is facing a long term increase in Government debt:[3]

> *"…New Zealand has experienced a current account deficit in each year since 1973, implying that national investment has continuously exceeded national saving. Net external liabilities are large and have been rising rapidly over recent years. Budget 2010 predictions show net external liabilities growing from just under 90 percent of GDP to exceed 100 percent by 2014, continuing to rise thereafter. To address this, it is critical that New Zealand increase national savings. As well as helping to address imbalances, higher levels of saving and better allocated savings are likely to benefit economic growth and investment performance."*

2.2 With an ageing population, New Zealand is also facing a declining labour force participation rate, which will act as a drag on New Zealand's trend real economic growth rate – estimated to ease back from an average of 3% p.a. over the next three years to a bit under 2% p.a. from the mid-2020s.[4] An ageing population also means a marked increased spending on social services, including healthcare and NZ Super for the over 65's – projected to rise from around 25% of the Government's annual operating spending today to as high as 40% by 2050.[5] Treasury projections for net debt are for a consistent, uninterrupted upward trajectory. What this means, according to Treasury Deputy Chief Executive Gabs Makhlouf, is that the current settings for Government spending and revenue projected on the basis of historic growth patterns are not sustainable over the long term.[6]

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[2] Hickey, Bernard *"Treasury warns NZ net public debt track still unsustainable by 2050 despite better economic outlook"*, 22 July 2010. Available at: http://www.interest.co.nz/news/treasury-warns-nz-net-public-debt-track-still-unsustainable-2050-despite-better-economic-outlook.
In a recent speech John Whitehead noted that New Zealand's net foreign debt is nearly 90% of GDP.
[3] Terms of Reference for the Savings Working Group, page 1.
[4] Makhlouf, Gabriel *"Long-term Fiscal Outlook: A View from the Treasury"*, speech delivered to the Conference on Retirement Income Policy and Intergenerational Equity, 22 July 2010. Available at: http://www.interest.co.nz/sites/default/files/sp-fiscalview-22jul10.pdf.
[5] Makhlouf, Gabriel *"Long-term Fiscal Outlook: A View from the Treasury"*, speech delivered to the Conference on Retirement Income Policy and Intergenerational Equity, 22 July 2010. Available at: http://www.interest.co.nz/sites/default/files/sp-fiscalview-22jul10.pdf.
[6] Makhlouf, Gabriel *"Long-term Fiscal Outlook: A View from the Treasury"*, speech delivered to the Conference on Retirement Income Policy and Intergenerational Equity, 22 July 2010. Available at: http://www.interest.co.nz/sites/default/files/sp-fiscalview-22jul10.pdf.

2.3 New Zealand currently has a significant balance of payments issue. In short, we spend much more overseas than we receive. As a result we pay more of our national income, which is low by OECD standards, to foreigners in funding costs. Correspondingly New Zealand has a much higher real interest rate than most other OECD countries, reflecting our indebtedness.

2.4 Better private sector savings performance is crucial to improving national income and rectifying the current balance of payments. In relation to the latter, a larger domestic savings pool would ensure capital is available to grow the New Zealand economy or, if invested offshore, that the profits return to New Zealand. New Zealand has targeted significant dollars to be spent on infrastructure in the future. Increasing the domestic private savings pool would reduce current reliance on offshore markets to fund these projects.

2.5 We urge the SWG not to get unduly sidetracked or delayed by the debate around whether New Zealand does, or does not, have a savings problem. In our view the SWG's enquiry should, in accordance with its Terms of Reference, focus on providing high level advice on options that would help deliver better functioning domestic savings performance.[7]

3 Portfolio Investment Entities

3.1 The introduction of the portfolio investment entity ("**PIE**") tax regime has assisted in levelling the playing field within the savings industry, and importantly removed the obvious tax distortions (for those who elected to move to PIE) that exist within the collective investment vehicle regime. It also introduced incentives to invoke a change in consumer behaviour and sentiment to saving and investing generally. We strongly support the PIE tax regime and would not wish to see it undermined to the detriment of the national savings rate.

3.2 Critical mass and simplicity remain important aspects within the funds management industry. It would be disappointing if the structure of the current regime was changed significantly, and we moved back to seeing negative tax distortions to the treatment of savings and investment.

3.3 Currently the tax rate for PIEs is capped at the company tax rate. In our view this is appropriate, as without such a cap, investors could simply move investments into a company structure[8] to obtain the same tax effect. However, this would preclude such investors gaining the risk diversification benefits of investing though collective vehicles. The current personal and entity tax rate differential is

[7] Terms of Reference for the Savings Working Group, page 1.
[8] Alternatively, investors could move investments to a unit trust, which is treated as a company for tax purposes.

the issue here. The PIE rules are a consequence of ensuring that appropriate savings incentives (or at a minimum no tax disincentives) exist.

4 Options currently being considered by SWG

4.1 One alternative that has been considered in the SWG background papers is to 'un-cap' the tax rate for PIEs. This would mean that investors would be taxed at their marginal tax rates. While this may be a more theoretically correct approach to ensure that all savings are subject to the same tax rates, in practice it would not encourage saving. We believe that the 28% maximum tax rate for PIEs has provided a powerful incentive for investors to save. And as we discuss below, differential tax rates on capital (including savings) and labour (personal exertion) income is justified in the economic literature.

4.2 The SWG background papers also consider the Nordic model. This suggests that capital income should be taxed at a lower rate than labour income, given its greater sensitivity to tax rates. Differential rates for capital and labour income would assist with the goal of encouraging and increasing domestic savings.

4.3 While the Nordic model is theoretically attractive, we consider it is less suitable for New Zealand because:

(a) it relies on a capital gains tax, which is not currently in place in New Zealand;

(b) it requires that savings on a widely-held basis should be taxed at a lower rate. As discussed at paragraph 3 of this Part 3, the PIE regime already achieves this, as it already operates on a widely-held basis;

(c) a differential rate would complicate the deductibility of interest expenditure.

In short, a full Nordic model is likely to make the system more complex and we consider it would be difficult to apply in practice.

4.4 We consider that the PIE regime is an indirect proxy ("a next best") for the differential treatment of capital and labour income suggested under the Nordic model, as savers are taxed at a maximum rate of 28% (compared to the top marginal rate of 33%). This provides further support for the continuation of the taxation of PIEs at less than the top marginal tax rate. Furthermore, given the success of KiwiSaver and the effect it has already had on improving the savings behaviour of New Zealanders, we would strongly caution against adversely impacting the taxation treatment of retirement savings through such funds.

4.5 The extension of a capped tax rate to other savings types is consistent with a differential rate for capital and labour. In effect, the lower rate would be targeted to widely-held investment savings income. The PIE regime already has rules to deal with this. A further regime is likely to further complicate the tax system.

5 Investment in New Zealand

5.1 At present, the majority of the New Zealand Superannuation Fund (the "**NZSF**") is invested offshore, and just over 40% of KiwiSaver savings are invested overseas.[9] The SWG may wish to consider whether prescribing a minimum amount of the NZSF's capital to be invested onshore would help improve the depth and robustness of New Zealand capital markets and provide a platform for future growth. While increasing investment potential, a larger domestic savings pool could also lower reliance on offshore funding.

5.2 We acknowledge that this assumes a pool of domestic investments is available so that asset prices are not unduly bid up. It may therefore be necessary for this threshold to be increased over time so that it assists in creating that pool, while not distorting values. Further, we acknowledge that diversification of investments lowers the associated risk, and that the required returns are not likely to be generated by investing exclusively domestically.

6 Annuities

6.1 From 1 July 2012 eligible KiwiSaver members will be able to make lump-sum withdrawals of their retirement savings. The amounts involved will be significant and will increase over time. Retirees will face difficult decisions about how best to invest these lump-sums so as to provide a reasonable standard of living during their retirement. The risk for the Government is that retirees make poor investment choices; viable investment options suitable for retirement are not available; and/or retirees spend their lump-sum retirement payout too early due to poor judgement or a lack of financial literacy, resulting in increased dependency on State benefits (NZ Super).

6.2 An ageing population suggests that it would be timely for the SWG to consider retirement income stream products such as annuities, which can provide a regular, defined and sustainable income in retirement. Annuities make budgeting easier and reduce the need for ongoing management of retirement savings. A lifetime annuity can also mitigate longevity risk and provide peace of mind for retirees and their families.

[9] Hickey, Bernard *"Opinion: The problem with compulsory KiwiSaver: it might not solve New Zealand's domestic capital starvation"*, 17 August 2010. Available at: http://www.interest.co.nz/opinion/opinion-problem-compulsory-kiwisaver-it-might-not-solve-new-zealands-domestic-capital-starvation.

6.3 The SWG may wish to consider the role of the Government in rehabilitating New Zealand's relatively small annuities market. Options may include the following:[10]

(a) A key disincentive to purchase annuity products is their tax treatment. Annuities are presently taxed at the company tax rate of 28% whereas the retiree may have a considerably lower marginal tax rate, if the annuity is acquired when the person is in retirement and when NZ Super is their only other assessable income. The SWG may wish to consider the removal of tax disincentives to invest in annuities and options to achieve tax neutrality between annuities and other investment options such as PIEs, shares and property. This is consistent with the recommendations of the Capital Market Development Taskforce which noted that any solution should attempt to treat annuities in a similar manner to other substitutable investments, meaning taxing annuity holders at their marginal tax rates at the time the product is acquired.[11]

(b) Consider whether Government intervention is required to address consumer lack of trust and confidence that the provider will be there for the long term.

(c) Government-issued long bonds to address the lack of suitable assets to match long term annuity liabilities.

(d) A Government provided annuity product, for example a facility whereby New Zealanders could purchase a "top-up" to their NZ Super.

(e) An automatic annuities purchase with a portion of any lump-sum withdrawn from KiwiSaver at retirement, unless the consumer opts out.[12]

(f) Tax advantages and/or other Government incentives to purchase an annuity.

This work should build on the Capital Market Development Taskforce recommendation that the Government explore options to enable the development of the annuities market in New Zealand.[13]

[10] St. John, Susan, "The annuities market in New Zealand", The University of Auckland Business School Retirement Policy and Research Centre, October 2009. Available at: http://www.med.govt.nz/upload/70712/The-annuities-market-in-NZ.PDF.

[11] Report of the Capital Market Development Taskforce, December 2009, page 107: http://www.med.govt.nz/upload/71047/MDV6220_CMD_TombStone_04c.pdf.

[12] Report of the Capital Market Development Taskforce, December 2009, page 49: http://www.med.govt.nz/upload/71047/MDV6220_CMD_TombStone_04c.pdf.

[13] Report of the Capital Market Development Taskforce, December 2009, page 49: http://www.med.govt.nz/upload/71047/MDV6220_CMD_TombStone_04c.pdf.

7 Student loan scheme

7.1 As noted in the Discussion Document, the student loan scheme is likely to have a negative effect on household savings.[14] As at 30 June 2010, the average loan held by Inland Revenue was $16,731, with the median repayment time ranging from 7.2 years (for those who finished study in 1999) to 6.5 years (for those who finished study in 2006).[15] As a result, New Zealanders are spending a significant period of their productive working years repaying student loan debt rather than saving.

7.2 Arguably, paying off student loans does not impact on the national savings rate, as this is a transfer between a New Zealand borrower (the individual) and New Zealand lender (the Crown). However, the SWG may wish to consider options to incentivise earlier repayment of loans. One option could be to link a discount for early repayment to additional Government contributions to borrowers' KiwiSaver accounts.

7.3 The SWG may also wish to consider modifications to KiwiSaver to accommodate withdrawals for the purpose of funding tertiary education. KiwiSaver encourages members to save, and already allows withdrawals for significant life stage events such as first home purchase and retirement, and emergencies such as significant financial hardship and serious illness. A withdrawal facility for the purposes of funding tertiary education (and possibly other life events) would be a natural extension of KiwiSaver. As with other early withdrawals, specific criteria and safeguards could be applied by way of the KiwiSaver Scheme Rules. This would encourage a culture of saving for tertiary education, reducing reliance on student loans.

[14] Discussion Document, page 34.
[15] Ministry of Education, Student Loan Scheme Annual Report 2010, available here: http://www.educationcounts.govt.nz/publications/series/2555/83822.

PART 4

KIWISAVER

1 Introduction

1.1 The introduction of KiwiSaver in 2007 recognised that many New Zealanders were failing to make adequate provision for their retirement. It marked a distinct policy shift towards "soft compulsion" – supporting and encouraging New Zealanders to save.

1.2 KiwiSaver has been much more successful than originally forecast – in little more than three years 1.54 million people have signed up[16] with an estimated $6 billion in funds under management. Furthermore, there is anecdotal evidence that KiwiSaver has increased total national savings. We believe the recent up-tick in New Zealand's private savings performance can partially be attributed to the success of KiwiSaver. It is vital that we continue to build on this success.

1.3 KiwiSaver is working well, however, we believe more can be done to help cater for New Zealand's ageing population and to further encourage New Zealanders to make appropriate, independent provision for their retirement.

2 Compulsory KiwiSaver

2.1 A significant and growing group of New Zealanders expect a higher standard of living in retirement than NZ Super alone can provide. While NZ Super provides a basic pension,[17] with access to healthcare and increasing life expectancy New Zealanders are more active in retirement and have increasing lifestyle expectations. Prime Minister John Key has said that, for this group of New Zealanders, *"…relying solely on national super …puts them in a precarious position."*[18]

2.2 It is clear that we need to save more effectively for our retirement – as such we advocate for a transition towards compulsory KiwiSaver for all New Zealanders in paid employment with income above a prescribed threshold. If NZ Super provides an essential safety net, KiwiSaver is the key to a comfortable retirement for most New Zealanders. We need to build on the basic purpose of KiwiSaver – to encourage a long-term savings habit and asset accumulation by individuals

[16] http://www.kiwisaver.govt.nz/statistics/ks-stats-10-09-30.html as at 30 September 2010.
[17] The after-tax amount of NZ Super paid to a couple over 65 equates to around 33% of the average wage per partner (66% per couple). See http://www.sorted.org.nz/home/sorted-sections/retirement/new-zealand-superannuation#howmuch.
[18] *"PM sets out case for compulsory superannuation"*, NZPA, 16 August 2010. Available here: http://www.stuff.co.nz/national/politics/4027491/PM-sets-out-case-for-compulsory-superannuation.

who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement.[19]

2.3 In our view, compulsory KiwiSaver would significantly increase retirement incomes, and therefore quality of life in retirement, for many New Zealanders. New Zealanders in retirement would have a significant savings cushion, reducing dependency on Government benefits and health care – effectively lowering the fiscal cost of retirement. We believe this is a key way to help control the looming fiscal liabilities for Government from future age-related spending and care.

2.4 In our view, only New Zealanders in paid employment, with an income above a prescribed threshold (possibly broadly equal to current NZ Super entitlements), should be required to join KiwiSaver. This group has a good level of regular income, and most can be expected to desire a standard of living in retirement that cannot be supported on NZ Super alone. New Zealanders that are not in paid employment or on low incomes should not be required to divert what little income/benefit they have to compulsory KiwiSaver. This group may find that NZ Super provides them with an adequate income in retirement. Those on passive income should, in theory, have sufficient retirement savings.

2.5 We note, however, that due to the impact compulsory enrolment in KiwiSaver will have on New Zealanders' disposable incomes; compulsion may need to be phased to preserve the net income position. We expand on the importance of phased, transitional periods in paragraphs 5.2 and 5.3 of this Part 4 in the context of increased employer contribution rates.

2.6 We would expect members to retain the ability to take a contributions holiday in a compulsory KiwiSaver environment. The ability to take a contributions holiday is an important safety valve for KiwiSaver as it allows members to take a break from contributing in the case of hardship or if financial priorities change. At present, however, a contributions holiday can last for up to five years, and there is no limit to the number of times a member can take a contributions holiday. This may require review in a compulsory KiwiSaver environment to ensure that frequent or back to back contributions holidays are not used to avoid contributions completely in the long term.

2.7 We would also expect members and employers to retain the ability to contribute more than the minimum prescribed contribution rate. Saving for retirement should be encouraged, and members should have the flexibility to save for a higher standard of living in retirement if desired. Some employers include a

[19] KiwiSaver Act 2006, section 3(1).

generous KiwiSaver contribution as part of an overall staff remuneration package, and should be encouraged to continue this practice. The tax features of KiwiSaver could be used to provide additional incentives, if desired.

2.8 We also note the risk of New Zealanders withdrawing from private retirement savings vehicles and superannuation schemes prior to retirement, e.g. on changing employer or profession. This group may receive a lump-sum payout, and there is always the risk that that lump sum will be spent on consumables or other non-retirement related goods and services (the lack of suitable alternative options, such as annuity products (see paragraph 6 of Part 3 above) may also contribute to these amounts being spent rather than reinvested). Compulsion would make KiwiSaver the primary retirement vehicle in New Zealand, keeping more of this money in the "retirement system", i.e. funds would be locked-in until retirement, with only limited withdrawal options prior to that, e.g. first home purchase and significant financial hardship.

3 Options proposed by Treasury

3.1 The Discussion Document indicates that the SWG may wish to consider a number of options to reform KiwiSaver in order to improve its likely impact on national saving.[20] We strongly advocate for compulsory KiwiSaver for New Zealanders in paid employment with a prescribed level of income, and note the following in relation to the options proposed by the Treasury.

Boost automatic enrolment

3.2 Automatic enrolment plays an important role in getting people to join KiwiSaver, and will be an important factor in maintaining current enrolment rates to ensure the expansion of the scheme. This is supported by the Colmar Brunton (2010) *KiwiSaver evaluation: Survey of individuals* (the "**Colmar Brunton KiwiSaver Survey**"),[21] which found that:

(a) 37% of KiwiSaver members surveyed were automatically enrolled when they started a new job;[22] and

(b) just under half (45%) of automatically enrolled KiwiSaver members surveyed said that they would not have joined KiwiSaver if they had not been automatically enrolled.[23]

3.3 The Discussion Document indicates that there is scope to extend KiwiSaver automatic enrolment.[24] If the SWG does not support compulsory KiwiSaver for

[20] Discussion Document, page 39.
[21] http://www.ird.govt.nz/resources/0/3/03e46600437177c5a25eb24e9c145ab7/ks-evaluation-individuals.pdf
[22] Colmar Brunton KiwiSaver Survey, page 51.
[23] Colmar Brunton KiwiSaver Survey, page 55.

those in paid employment with a prescribed level of income, in the alternative we would strongly advocate for an extension of automatic enrolment to people who have been in their jobs for more than five years.

3.4 In our view, apathy is a common barrier to joining KiwiSaver. There is a significant group of workers that just haven't got around to joining KiwiSaver – nor have they been compelled to do so by the current automatic enrolment feature. An extension of automatic enrolment to this group would boost KiwiSaver memberships, which in turn will boost the total savings pool. There will also be benefits from the increased scale of retirement savings and ultimately a higher standard of living in retirement for the average New Zealander.

Better targeting of incentives

3.5 The Discussion Document proposes targeting KiwiSaver incentives to those on moderate or lower incomes as an option for consideration. This is premised on the view that those on lower to middle incomes will benefit the most from any Government incentives.

3.6 In our view the proposal is unlikely to encourage the target group to maintain or increase their level of retirement saving via KiwiSaver. In fact, it may have the opposite effect. In our view, individuals, regardless of income level, are likely to contribute the minimum amount required in order to obtain the maximum member tax credit. This in and of itself is encouraging positive savings behaviour and is what the member tax credit was designed to achieve. However targeting incentives will only result in a reduction in KiwiSaver contributions to match the reduction or withdrawal in available member tax credits.

Remove ongoing incentives

3.7 As stated by the Tax Working Group,[25] the principles of a good tax system are the overall coherence of the system; efficiency and growth; equity and fairness; revenue integrity; fiscal cost; and compliance and administration cost. With these principles in mind the Government then needs to determine what, if any, incentives are required to encourage certain types of behaviour.

3.8 One of the key reasons for the success of KiwiSaver are the incentives (such as the kick start and member tax credits). These incentives have been very successful in getting New Zealanders "across the line" on saving for their retirement (and out of the New Zealand culture of "spend now"). We firmly believe that without these incentives, KiwiSaver would not be the success it is

[24] Discussion Document, page 39.
[25] "A Tax System for New Zealand's Future", Report of the Victoria University of Wellington Tax Working Group, January 2010, available here: http://www.victoria.ac.nz/sacl/cagtr/pdf/tax-report-website.pdf.

today. The Colmar Brunton KiwiSaver Survey supports this view, with 67% of KiwiSaver members surveyed saying that Government contributions were an important reason, and 19% saying that Government contributions were the single most important reason for joining KiwiSaver.[26]

3.9 In our view the existing ongoing incentives should remain, even if New Zealand moves towards a compulsory KiwiSaver environment (we discuss this further at paragraphs 3.13 to 3.15 of this Part 4). A feature of getting public "buy-in" for a compulsory retirement savings model will be to assure New Zealanders that they are getting a better deal with KiwiSaver than without. Retention of the current KiwiSaver incentives will be key to this given the importance of Government incentives to customer behaviour.

Exempt-exempt-tax treatment

3.10 A strong policy argument could be made that we should move away from the existing tax-tax-exempt (TTE) model for taxing retirement savings, to an exempt-exempt-tax (EET) model, which taxes income when it is spent. As noted in the Discussion Paper, this would substantially reduce the effective tax rate on savings, which is supported in a wide body of economic literature. It would also help provide Government with cash-flow to meet the needs of an ageing population in terms of NZ Super and healthcare, when those costs arise (rather than provision having to be made out of current revenues, or worse, additional revenue having to be raised at the time).

3.11 We note that the fiscal cost of switching to such a model immediately could be significant. However, consideration should be given to moving to an EET gradually over time.

3.12 New Zealand's approach to retirement savings is falling well behind that of other countries, most prominently Australia, which has both a compulsory private retirement savings regime, generous mandated contribution rates (for both employees and employers) and a concessionary tax rate for such savings. The Australian model more closely resembles the EET approach.

Tax incentives in a compulsory KiwiSaver environment

3.13 Existing KiwiSaver incentives not only play an important role in motivating consistent, positive, savings behaviour (whether KiwiSaver is compulsory or not) but are also one way of achieving the EET model discussed above.

[26] Available here: http://www.ird.govt.nz/resources/0/3/03e46600437177c5a25eb24e9c145ab7/ks-evaluation-individuals.pdf.

3.14 Incentives for savings can be viewed as a 'negative tax' as they essentially represent a reduction in the tax paid by the investor to the Government. In this way it reduces the effective tax rate and partially achieves the EET model tax outcomes, as investors receive some offset to making contributions from after-tax amounts and when savings income is earned through KiwiSaver.

3.15 We acknowledge that incentives reward savings over and above the minimum level. In our view, in a compulsory KiwiSaver environment:

(a) Ongoing member tax credits should be retained. Member tax credits encourage and reward positive savings behaviour, and incentivise members on lower incomes to save more than the minimum for a comfortable standard of living in retirement. Member tax credits also discourage members from taking contributions holidays in order to save in alternative vehicles (that do not have a "lock-in" feature), or worse, spend funds that would otherwise be saved.

(b) The existing exemption from employers superannuation contribution tax ("**ESCT**") should also be retained. The existing exemption applies up to a maximum of the lesser of 2% of salary or wages and the member's own KiwiSaver contributions. This exemption underlines the importance of retirement provisioning (both to the member and the Government) and, as with member tax credits, discourages contribution holidays for the purposes of alternative activities.

(c) At present, KiwiSaver and other savings in PIE vehicles are taxed at tiered rates (10.5%, 17.5% and 28%) depending on income, which are lower than the current top marginal tax rate (33%). As noted earlier, we support the continuation of the taxation of PIEs at less than the top marginal tax rate. In our view private savings should be encouraged, and KiwiSaver savings should be taxed at the same rate as other superannuation and PIE collective investment schemes.

Most superannuation savings in Australia are generally taxed at a concessionary rate of 15% (both contributions and earnings), which is significantly lower than New Zealand's company and marginal tax rates. The SWG may wish to consider the possibility of lowering the top tax rate for compulsory KiwiSaver savings. This would further incentivise New Zealanders to save in a "lock in" vehicle and provide for their retirement.

4 Flexible retirement age

4.1 KiwiSaver members are currently eligible to withdraw their savings as a lump sum when they qualify for NZ Super (currently age 65) or, if later, after five years of membership. While a "lock in" feature does help preserve retirement savings for retirement, it also penalises certain members, for example members that are genuinely willing and financially able to retire early; members that are forced to retire early due to late-career redundancy; and members that work in heavy industry that may be physically unable to continue to work into their sixties.

4.2 The SWG may wish to consider the impact of a more flexible retirement age for KiwiSaver, or "de-linking" eligibility for standard KiwiSaver withdrawals from the age of eligibility for NZ Super. This would allow members that, for prescribed reasons, retire before age 65 to access their KiwiSaver funds on the grounds of genuine early retirement.

4.3 In our view, a more flexible retirement age could empower New Zealanders to take personal responsibility for their retirement savings, and give them the confidence to do so via KiwiSaver. It would encourage a change in behaviour, incentivising higher income earners to save to "over achieve" and retire early, rather than to achieve only the maximum level of Government incentives for the minimum level of contributions. It would also recognise the reality that some New Zealanders are unable to remain in paid employment until age 65, and may need to access retirement savings early to supplement other Government benefits.

4.4 A more flexible retirement age would also allow New Zealanders to save for retirement using a single product. At present, many KiwiSaver members are also members of other superannuation schemes with more favourable withdrawal terms, and/or invest contributions over and above the KiwiSaver minimum in other managed funds to provide for their retirement. A more flexible retirement age would encourage this group to use KiwiSaver as their preferred retirement savings vehicle, keeping retirement savings in one place, and in a closely regulated, transparent, reasonably priced savings vehicle. This would make it easier for investors to keep track of their retirement savings. It would also lower costs for providers (and therefore members), who would only need to offer one type of investment vehicle to investors.

4.5 Checks and balances would of course be required, for example a minimum age at which members could access flexible retirement (we suggest 55 or 60 for alignment with Australia); statutory declarations from the member and employer confirming retirement; only allowing a set percentage to be withdrawn each year; and/or a waiver of the right to receive certain Government benefits (such as the unemployment benefit) until the member reaches the age of eligibility for NZ Super.

5 Other options

5.1 In our view, recent changes to Australia's superannuation system should be reviewed and considered as potential opportunities for reforming KiwiSaver.[27] In particular:

Increased employer contribution rates

5.2 Given the inadequacy of New Zealanders retirement savings, in our view the SWG should consider the benefits of increasing the level of compulsory employer contributions. Increasing levels of compulsory employer contributions would help increase retirement savings to a level sufficient to provide for a comfortable retirement for most New Zealanders. A higher compulsory employer contribution rate would also bring New Zealand more into line with Australia, where the superannuation guarantee is equal to 9% of ordinary time earnings for eligible employees – and due to rise to 12% by 2019.[28] A significant transitional period would allow employers to take the increased contribution rate into account when negotiating future pay increases, and would help mitigate the risk of a one-time shock to the economy.

5.3 We also acknowledge the reality that additional employer contributions are likely to be considered by the employer as part of the employee's total remuneration package, with salary/wages correspondingly reduced. Any increase in the rate of compulsory employer contributions needs to be balanced with an acknowledgement that this is money that is being diverted from the employee, who may be better advised to use it to pay down expensive debt such as mortgages and credit cards rather than save for retirement. However, we believe this is an important step in transitioning New Zealand savers' behaviour from consumption to investment in their future well being.

Compulsory employer contributions for older members

5.4 At present, an employer does not have to make compulsory KiwiSaver contributions in respect of a KiwiSaver member over 65 years of age.[29] In our view it is inequitable to penalise older workers in this way, many of whom may be forced to work past age 65 due to inadequate retirement savings. The SWG may

[27] In particular changes made in response to the Henry Review (a wide ranging review of Australia's tax system) and the Cooper Review (a wide ranging view of Australia's superannuation system).
[28] *"Superannuation – Increasing the Superannuation Guarantee Rate to 12 per cent"*, Australian Government Fact Sheet. Available here: http://www.futuretax.gov.au/documents/attachments/Fact_Sheet_SG%20_rate_increase.pdf.
[29] See http://www.kiwisaver.govt.nz/already/contributions/employers/.

wish to consider the benefits of increasing the age at which an employer can stop making compulsory KiwiSaver contributions from 65 to 70 or 75 years of age.

5.5 Increasing the age limit for compulsory employer contributions would also incentivise mature workers to remain in the workforce, reducing the strain on NZ Super and mitigating the skills shortage expected to develop as increasing numbers of Baby Boomers retire. Again, Australia has recently announced a similar measure.

"Catch-up" contributions for older members

5.6 Given New Zealand's ageing population, many members will have joined KiwiSaver late in life, with few years of paid employment left prior to retirement. In our view, older members should be incentivised through increased member tax credits to make additional "catch-up" contributions to KiwiSaver as they approach retirement. This would help ensure that New Zealanders nearing the age of eligibility retire with a sufficient nest egg to enjoy a reasonable standard of living in retirement. Australia has recently announced a similar measure.

6 The costs of change and providing certainty to investors

6.1 While significant improvements can, and should, be made to KiwiSaver, this will not be without cost to providers and members. The cost of these changes can be significant in terms of re-drafting trust deeds and offer documents; communicating with participating employers and members; updating systems; and increased ongoing operating costs. Scheme members are likely to end up bearing a significant proportion of the cost of these changes in the form of increased fees and expenses, eroding returns and retirement savings.

6.2 It is important, therefore, that any future reform of KiwiSaver (and retirement savings generally) is done in a systematic, rather than ad-hoc, manner to minimise transition costs for savers, fund providers and Government.

6.3 We note that the Financial Markets (Regulators and KiwiSaver) Bill (the "**Bill**") proposes significant changes to KiwiSaver. It would be helpful if the commencement date for any further KiwiSaver changes recommended by the SWG could coincide with the commencement date of changes proposed in the Bill. Grouping these changes together would reduce overall cost and enable the Government to consider the SWG's recommendations in the broader context.

6.4 Finally, it is important that New Zealanders have as much certainty as possible over the future of the retirement savings landscape (regulatory, tax, etc). We note that KiwiSaver is, at times, used as a "political football". This uncertainty does not help in convincing New Zealanders of the importance of private provision for retirement via KiwiSaver. Whatever options are ultimately considered by the SWG in relation to KiwiSaver (or savings generally), it is important there be broad political consensus on the way forward.