# The Treasury

## Budget 2011 Information Release

## Release Document

## June 2011

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THE TREASURY

Kaitohutohu Kaupapa Rawa

# Treasury Report: Preliminary Assessment of KiwiSaver Options

| Date: | 22 July 2010 | Report No: | T2010/1346 |
|---|---|---|---|

## Action Sought

| | Action Sought | Deadline |
|---|---|---|
| Minister of Finance<br>(Hon Bill English) | **Note** the contents of this report; and **indicate** whether you want officials to explore any of the options further. | 28 July 2010 |

## Contact for Telephone Discussion (if required)

| Name | Position | Telephone | 1st Contact |
|---|---|---|---|
| Linda Cameron | Senior Analyst, Financial Markets | [1] | ✓ |
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## Minister of Finance's Office Actions (if required)

| |
|---|
| None. |

**Enclosure:** **No**

# **Treasury Report:** Preliminary Assessment of KiwiSaver Options

## Executive Summary

This report provides a preliminary assessment of some possible options for KiwiSaver changes outlined in the recent report on Savings, Tax and Fiscal Consolidation (refer T2010/1225). The aim is to explore ways to change KiwiSaver that could potentially increase the level of private savings, while better targeting the fiscal incentives, thereby reducing the fiscal cost of the scheme and contributing towards fiscal consolidation. It has been assumed that current retirement settings remain unchanged.

Our advice is that it would be preferable that any changes that are made to KiwiSaver are part of a more general approach to savings aimed at ensuring the settings are sustainable and enduring over the medium to long-term.

The options are unlikely to be used on their own: it is more likely that a combination of changes would be required to achieve the desired policy objectives. The preliminary assessment covers:

- the administrative complexity;
- degree of targeting of the fiscal incentives;
- likely impact on the fiscal cost; and
- potential impact on the level of savings in *KiwiSaver members' accounts.*

At this stage it is not possible to accurately estimate the impact of changes to KiwiSaver on the level of private and national savings. This is because KiwiSaver has the potential to encourage the reallocation of existing savings and the full evaluation of the scheme has not yet been completed.

A summary of the options is provided in Table One on page 4. Background outlining key facts and numbers on the current KiwiSaver scheme is attached as Annex One.

A key feature of the KiwiSaver scheme is automatic enrolment, which appears to have been very effective in encouraging voluntary membership. Evidence of this was seen when a large proportion of KiwiSaver members (approximately 95%) maintained their contributions at 4%, due to the "inertia effect", when the minimum rate was reduced to 2%. The proven effectiveness of the opt-in and default settings indicates that more reliance could be placed on these settings to encourage people to join the scheme and save at certain levels, with less reliance on fiscal incentives. To achieve effective incentives at lower fiscal cost there is scope to be more relaxed about one-off payments (e.g. the kick start) and to focus more on reducing ongoing fiscal costs.

An overall increase in private savings appears possible through options that increase KiwiSaver membership (1 and 2) and increase the contribution level (10 and 11). It also appears feasible to generate higher savings in members' accounts while reducing the current cost of KiwiSaver by better targeting the fiscal incentives (options 5 to 7).

As a first step, we therefore suggest making use of the opt–in and default settings and exploring changes to the existing scheme to signal a desire for greater private savings. Some of the voluntary options are complementary and could be implemented together with a programme aimed at raising people's understanding to help encourage a savings culture (options 17 and 18). Work is already underway on these wider options. The question is whether more is required and we are not suggesting that this would be the case.

At this stage it is important to keep the options open to allow for medium term solutions that could have positive impacts on growth to be more widely canvassed.

While compulsion (through modifying KiwiSaver) is one option that could raise private savings, it could be expected to be associated with a demand for more regulation and would be a significant course change. The key to introducing compulsion, if this were seen as desirable, would be to have a view on overall long term objectives for the retirement income system, and the respective roles government-provided superannuation, compulsory and voluntary retirement savings may play in that system in the long term. It could also mean consideration can be given to an overall "life cycle" savings approach, which could well be wider than just encouraging savings for retirement (e.g. saving for tertiary education).

It should be noted that estimates of the fiscal impact of the options, outlined in Table One, are simply indicative and need fuller exploration with Inland Revenue to get a better sense of the overall costs and benefits. They should not be used as official estimates for that reason.

The administrative complexity of each of the options has been considered separately. Preliminary informal views are provided in the report and the detail is outlined in Annex Two.

## Table One – Summary of short term savings options

| Option | Description | Admin Complexity | Better Targeting of Fiscal Incentives | Fiscal Cost (Saving) ($ million) | | | Potential Impact on KS Accounts |
|---|---|---|---|---|---|---|---|
| | | | | First year[1] | Ongoing | Variance | |
| **Changes to existing KiwiSaver** | | | | | | | |

[2][6]

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| 3 | Incentive for self employed to join – extra MTC | High | No | 10 | 10 | ±2 | Increase |
| 4 | Reduce contribution holiday from 5 to 3 yrs | Low | N/A | 1 | 1 | - | Small increase |
| 5 | Remove ESCT exemption for employer contributions over $1000 | High | Yes | (60) | (60) | ±5 | Small decrease |
| 5b | Remove ESCT exemption completely | Low | No | (210) | (210) | - | Decrease |
| 6 | Abate MTC for high income earners | Medium | Yes | (140) | (150) | ±10 | Decrease |
| 7 | Require higher contribution from high income earners to get full MTC | High | Yes | - | - | - | Small increase |
| 8 | Save More Tomorrow - Encourage members to increase contributions when they get a pay rise | Medium | N/A | 15 | 15 | ±5 | Small increase |
| 9 | Lifecycle approach - Increase minimum contribution level as age increases | High | N/A | 15 | 15 | ±5 | Increase |
| 10 | Increase minimum contribution level e.g. to 4% | Low | N/A | 65 | 65 | ±5 | Increase |
| 11 | Employers match contributions up to 4% | Medium | N/A | 200 | 200 | ±20 | Increase |

Note - The shaded areas highlight options that in Treasury's view may be worthwhile exploring further

[1] Options 1, 2, 2B, 3, and the compulsory options have significantly higher costs in year 1 because of the kick-start payment.

| Option | Description | Admin Complexity | Better Targeting of Fiscal Incentives | Fiscal Cost (Saving) ($ million) | | | Potential Impact on KS Accounts |
|---|---|---|---|---|---|---|---|
| | | | | First year | Ongoing | Variance | |
| **Compulsion**[2] | | | | | | | |
| 12 | Compulsion with 2% contribution | Medium/High | N/A | - | - | - | Increase |
| 13 | Compulsion and increase contribution to 4% | Medium/High | N/A | - | - | - | Increase |
| 14 | Compulsion – employer contributes 8% | Medium/High | N/A | - | - | - | Increase |
| **Wider options** | | | | | | | |
| | | | | | | | [2][3] |
| 17 | Introduce regulations to reduce household debt (e.g. debt cost disclosures). | The Ministry of Consumer Affairs is already leading work in this area. The question is whether more is required. | | | | | |
| 18 | Raise people's understanding to encourage savings culture | This option is complementary to all of the options outlined above and could leverage off work already underway by the Retirement Commission, but incentives to learn are weak given current policy settings. The question is whether more work is required. | | | | | |

[2] Under compulsion it would be possible to completely remove the fiscal incentives, but it is likely that a gradual reduction in incentives may be required to get "buy-in" from the public. Under option 12 if current incentive levels were to remain in place, the fiscal cost is estimated to be $1,900m in the first year, and $900m ongoing with a variance of $50m. It should be noted that the compulsory options are likely to involve higher regulatory cost.

## Recommended Action

We recommend that you:

a **note** that at this stage it is not possible to accurately estimate the effectiveness of these options in increasing national savings. A number of the options may have a positive impact, but this impact is likely to be relatively small;

b **note** our view that:

i. changes to KiwiSaver would be better made as part of a more general approach to savings to ensure that the settings are coherent, sustainable and enduring;

ii. the proven effectiveness of the opt-in and default settings indicates that more reliance could be placed on these settings to encourage people to join the scheme and to save at certain levels, with less reliance on fiscal incentives;

iii. to achieve effective incentives at lower fiscal cost there is scope to be more relaxed about one-off payments (e.g. the kick start) and to focus more on reducing ongoing fiscal costs;

c **note** that to achieve all of the objectives (i.e. an increase in private savings, better targeting of KiwiSaver incentives and a reduction in the fiscal cost), while using the default settings, a combination of measures such as some of those listed in Table One are likely to be required;

d **note** our view that the options in Table One that could be worthwhile exploring further are options, keeping in mind the medium and long-term, that aim to:

i. increase membership (1 and 2);

ii. increase the contribution level (10 and 11); and

iii. better target the fiscal incentives (5 to7).

e **note** that the estimates of the impact of these options on the fiscal costs are very preliminary and need a fuller exploration with Inland Revenue (as they operate the forecasting model) to get a better sense of the overall costs and benefits;

f **note** that if you would like Inland Revenue to undertake fuller exploration of the costs and benefits you will need to discuss this with the Minister of Revenue;

g **indicate** whether you want officials to:

i. explore any of these, or other options further; and

ii. more fully explore the costs and benefits of the options with Inland Revenue.

Joanna Gordon
**Manager, Financial Markets**
**for Secretary to the Treasury**

Hon Bill English
**Minister of Finance**

# **Treasury Report:** Preliminary Assessment of KiwiSaver Options

## Purpose of Report

1. This report provides a preliminary assessment of some possible options for KiwiSaver changes outlined in the recent report on Savings, Tax and Fiscal Consolidation (refer T2010/1225). The aim is to explore ways to change KiwiSaver that could potentially increase the level of private savings, while better targeting the fiscal incentives, thereby reducing the fiscal cost of the scheme and contributing towards fiscal consolidation. It has been assumed that current New Zealand retirement settings remain unchanged.

2. Our advice is that it would be preferable that any changes that are made to KiwiSaver are part of a more general approach to savings aimed at ensuring the settings are sustainable and enduring over the medium to long-term.

3. The preliminary assessment of Kiwi Saver options covers:

   - the administrative complexity;
   - degree of targeting of the fiscal incentives;
   - likely impact on the fiscal cost; and
   - potential impact on the level of savings in *KiwiSaver members' accounts*.

4. A summary of the options is provided in Table One on page 4. Background information outlining key facts and numbers on the current KiwiSaver scheme is attached as Annex One.

## Approach

5. At this stage it is not possible to accurately estimate the effectiveness of these options in increasing national savings. This is because KiwiSaver has the potential to encourage the reallocation of existing savings. However, a full evaluation of the KiwiSaver scheme is currently underway and will provide quantitative and qualitative data on the impact that KiwiSaver has had on the nature and extent of new saving, and the relationship between private and government saving. Results of the full evaluation will be available in 2012.

6. Currently, there is limited data on the impact KiwiSaver has had on national and household saving levels, and on wider financial market performance. These data deficiencies constrain our ability to quantify the costs and benefits of changes to the current KiwiSaver scheme and the introduction of compulsory employee contributions. This report therefore provides a qualitative indication of the potential increase in saving in KiwiSaver members' accounts. (Note that this does not necessarily represent the change in the overall level of private savings).

7. Estimates of the impact of the options on the fiscal costs are outlined in Table One. These estimates are simply "indicative" of the scale of the possible fiscal impact and should not be used as official estimates for that reason. They will need a fuller exploration with Inland Revenue (as they operate the forecasting model) to get a better sense of the overall costs and benefits. Under compulsion it would be possible to completely remove the fiscal incentives, but it is likely that a gradual reduction in incentives may be required to get "buy-in" from the public.

8. The administrative complexity of each of the options has been considered separately. Preliminary informal views are provided in the report and the detail is outlined in Annex Two. However, the options are not mutually exclusive and some could be complementary. If a combination of options were to be explored in the future, then Inland Revenue have advised that the complexity and administrative cost of all the changes would need to be reconsidered as a package.

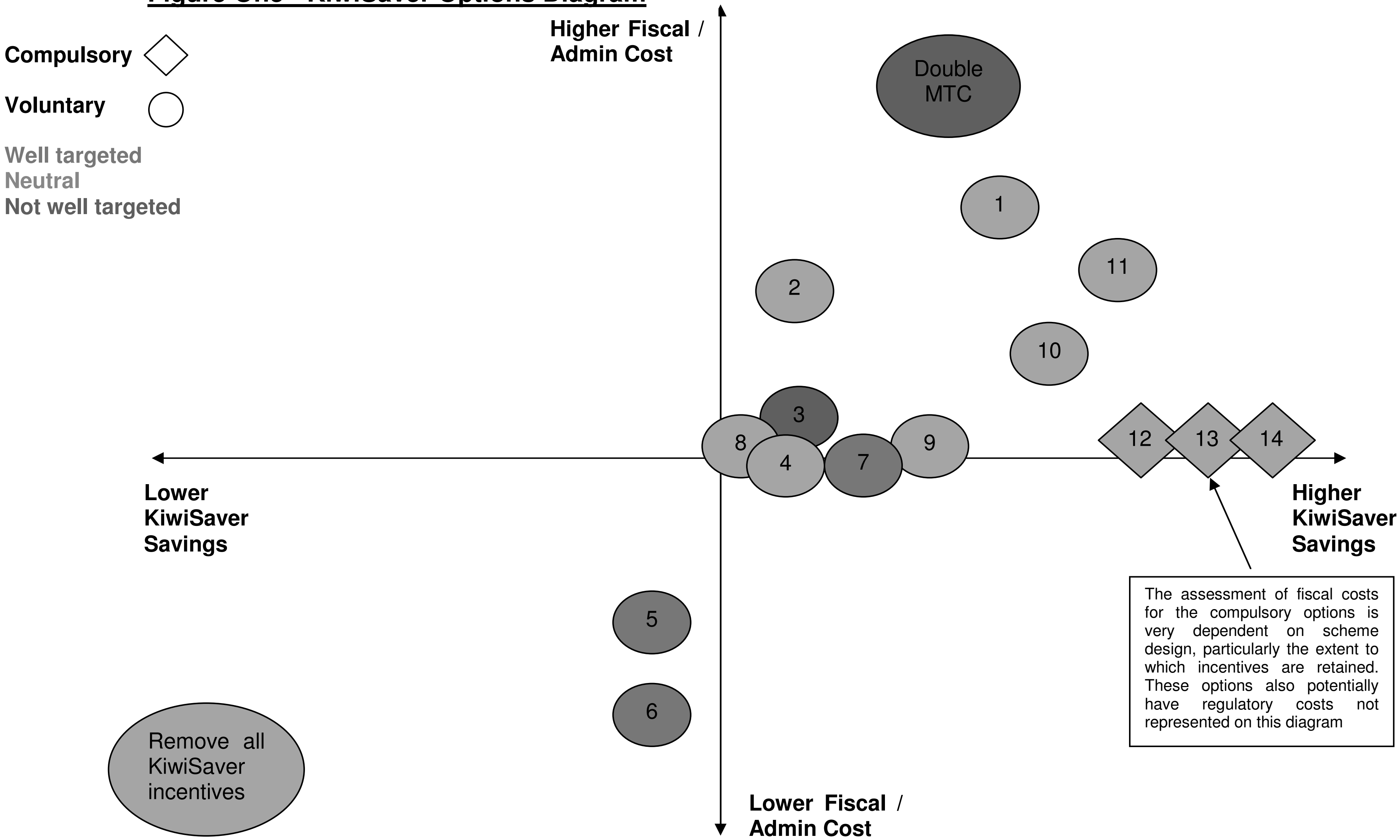
## Preliminary assessment of KiwiSaver options

9. The following section provides a preliminary assessment of the KiwiSaver options previously identified (refer T2010/1225), including: the administrative complexity; degree of targeting of the fiscal incentives; likely impact on the fiscal cost and potential impact on the level of savings in members' accounts.

10. We have grouped the options according to their main approach: raising participation rates (options 1 – 4), better targeting the incentives (5 – 7), raising contributions from members (8 – 11) and compulsion (12-14). Issues related to compulsion are discussed as a preamble to the specific options.

11. The options are discussed in detail in this section and are summarised in the following diagram:

## Figure One - KiwiSaver Options Diagram



**Lift participation rates**

12. These options are intended to build on the effectiveness of automatic enrolment in encouraging without enforcing participation.

**[2][6]**

***Option 3: Introduce provision for the self-employed who contribute to the scheme to receive extra Member Tax Credit***

20. A significant proportion of the labour force that are not currently in the KiwiSaver scheme are self-employed (i.e. around 10% of the labour force). The logic of this proposal is that allowing self-employed people who contribute to the scheme to receive extra member tax credit would encourage them to join. The extra MTC would be approximately equal to the government subsidy received by employees whose employer contributions are exempt from ESCT. For example, the MTC would match a self-employed person's contributions up to $1040, then from there would match at a rate of 20 cents in the dollar up to $2,080. Thus, the maximum MTC claimed by the self-employed person would be $1248 ($1,040 + $208).

21. This would require an enhancement to IRD's systems to accommodate the additional calculation of the MTC with significant compliance cost for providers to determine who qualifies as "self-employed" especially if income is from both self employment and employment.

22. Initial estimates of the fiscal cost are around $10 million per year ongoing resulting from the extra MTC payments and from new members' eligibility for KiwiSaver incentives. There is likely to be an issue calculating the fiscal incentives for those who have a mixture of self-employment and employment income.

***Option 4: Reduce the period of contribution holidays from 5 years to 3 years***

23. The objective here would be to encourage KiwiSaver members to review their decision about contributing to the scheme on a more regular basis, and thus encourage them to recommence contributions earlier than they would have otherwise.

24. A minimal administrative cost would be incurred to make minor system changes and product changes**.**

25. Although, it is not possible to estimate the number of members who would curtail their contribution holidays, the impact in terms of member savings is expected to be positive.

26. Fiscal costs are expected to be minor (around $1 million per year ongoing).

### Reduce the fiscal cost

27. These options are intended to reduce the fiscal cost of KiwiSaver, in particular by addressing regressive aspects which have the effect of delivering greater benefit to higher income earners at the expense of lower income earners. It is not likely that any of these options will increase the total level of KiwiSaver saving, but this may not be a major concern in the case of higher income earners.

***Option 5: Remove KiwiSaver's exemption from ESCT for employer contributions over $1000***

28. Employer contributions to superannuation schemes are usually subject to Employer Superannuation Contribution Tax (ESCT). ESCT is a progressive tax as higher income

earners pay a larger amount of tax on their employer's contribution. The current tax revenue forgone from exempting ESCT is estimated to be $210 million per annum.

29. However, with KiwiSaver (and complying funds), all employer contributions of up to 2 percent of members' gross salary are exempt from ESCT. This is regressive in nature as it provides high income earners with a higher benefit (i.e. a higher tax-free employer contribution) compared to low income earners.

30. This option therefore proposes removing the ESCT exemption for employer contributions over $1,000. KiwiSaver members earning more than $50,000 per annum would be targeted under this option (assuming a 2 percent employer contribution rate, i.e. the minimum requirement). This would have positive distributional effects. Initial estimates of the fiscal saving are around $60m per year ongoing. (Note that if the ESCT exemption were removed completely the ongoing fiscal savings would be around $210 million).

31. Inland Revenue has indicated that removal of the ESCT option would be relatively simple to implement and administer. Inland Revenue already has a vehicle to collect ESCT (the IR345). This would just require a change in what payments are liable for this tax. Changes would be required to payroll specifications, publications and communications. As information is currently aggregated at the employer level, there would be issues where employees have more than one employer, but this is a second order issue that would need to be worked through. Overall, any system changes and administration costs would be minimal.

32. There is a minor compliance cost for employers, but as employers have information on their contributions, this is unlikely to be large.

33. Because ESCT is one of KiwiSaver's largest incentives this is likely to have a negative impact on the incentives to save and the level of members' savings among the affected groups. If the ESCT exemption were removed for employer contributions over $1000 the disincentive effect on members' savings is likely to be relatively small. If the ESCT exemption were removed completely, there would be a further decline in members' savings but not necessarily to a large extent as the ESCT exemption is a relatively hidden incentive to employees. The decline in savings could possibly be offset by tax recycling measures. More time would be required to explore this variation further.

**Better targeting of existing incentives**

The next two options are targeted at the Member Tax Credit for high income earners. Both involve administrative complexity for IRD and would require a number of system and process changes as well as compliance costs for employers, scheme providers and members.

***Option 6: Abate the Member Tax Credit (MTC) for high income earners based on broad income levels***

34. This option proposes that KiwiSaver members earning gross salary or wages of:

- $78,000 or less would be eligible for the full MTC of $1,040 per annum;
- Between $78,001 and $130,000 would be eligible for the half MTC of $520 per annum; and
- Over $130,001 would be eligible for zero MTC.

35. Based on forecasted KiwiSaver members and income distribution, fiscal savings are outlined in Table Two below:

**Table Two – Fiscal Cost of Option 6**

| *$million* | 2010/11f | 2011/12f | 2012/13f | 2013/14f | 2014/15f | **5 year total** |
|---|---|---|---|---|---|---|
| Expected cost of MTC | 865 | 935 | 971 | 993 | 1,014 | **4,778** |
| Expected cost of MTC with abatement of MTC | 726 | 790 | 823 | 844 | 862 | **4,045** |
| **Expected fiscal savings** | **138** | **145** | **148** | **150** | **151** | **733** |

Source: IRD forecasts as at May 2010

36. This could be implemented by requiring KiwiSaver members to nominate their MTC rate according to their income level. This could be relatively easy to administer. As all KiwiSaver funds are PIEs, allocating members to the appropriate MTC rate could be just another filter that PIEs apply each year. To ensure compliance, members could be required to provide income information to their providers, or they would be automatically placed in the highest income group, therefore receiving zero MTC. Penalties would be required to stop people gaming the system.

***Option 7: Require higher contributions from higher income earners to get the full MTC***

37. This option increases the required contribution by higher income earners to get the maximum MTC of $1,040 per annum, as set out below. For example, an individual on $60,000 gross salary or wages would have to contribute $1,387 per annum to the KiwiSaver scheme to receive the full MTC of $1,040 per annum – compared with present contributions of $1,200 per annum (assuming a 2 percent contribution rate).

**Table Three – Example matching rates and contribution required under Option 7**

| **Gross salary or wages per individual member** | **MTC Matching *(Contribution rate / MTC)*** | **Contribution required** |
|---|---|---|
| $0 - 52,000 | $1 / $1 | $1,040 |
| $52,001 – 69,000 | $1 / $0.75 | $1,387 |
| $69,001 - 104,000 | $1 / $0.50 | $2,080 |
| $104,001+ | $1 / $0.25 | $4,160 |

38. The main advantage of this option is that it would be seen as fair and equitable. Also, **a higher level of savings by KiwiSaver members could be achieved for the same or lower fiscal cost.** However, the impacts under this option are difficult to measure. It is hard to determine how many people would increase their contribution to receive the full MTC subsidy and how many would leave their contributions unchanged, therefore receiving a lower MTC subsidy. Overall, fiscal savings are uncertain but expected to be modest under this option, as a large number of KiwiSaver members have incomes of $52,000 and below.

**Increase contribution levels on a voluntary basis**

***Option 8: Encourage members to increase their contributions on a voluntary basis when they have a pay raise***

39. KiwiSaver members could be encouraged to sign up to a "save more tomorrow scheme", whereby they increase their contributions to KiwiSaver whenever they have a pay rise, over and above the increase that would take place automatically anyway. This option would help to encourage a savings culture. Other than simple exhortation, there are two possible ways the option could be implemented that would need to be further investigated:

- The member's percentage contribution level could be increased at an equivalent rate to the pay rise; or

- A lump sum payment equivalent to the pay rise could be made by the employer into the employee's KiwiSaver account.

40. A greater number of contribution rates would increase the complexity and costs of the KiwiSaver rules. This would create significant additional compliance costs for employers and payroll providers, including the requirement to update their payroll systems to reflect the change. Inland Revenue systems would also have to be changed to allow for additional rates.

41. The current rules already allow for sufficient flexibility in KiwiSaver contribution levels with ways available for members to make voluntary payments.

42. There is likely to be a positive impact on the level of members' savings under this option, but it is difficult to estimate as it would depend on the level of take-up. There would be an increase in the fiscal cost of the scheme of approximately $15 million per year ongoing.

***Option 9: Life cycle approach - increase the minimum contribution level as age increases***

43. The contribution level could be increased automatically with age (e.g. 20 years = 2%, 30 years = 3% etc.) unless the member indicates they do want not to increase their contribution level. A life cycle approach has intuitive appeal as it would enable young people with high outgoings (e.g. student loans, first house purchase, young children) to contribute less at that stage in their life cycle and more when they are older and more financially established. By giving members the option not to accept the increase in contribution level, the current hardship provisions within the KiwiSaver scheme could still apply and would not need to be revised. In any case, due to privacy issues with age information, this option may have to be opt-in rather than the default option.

44. This option would increase the level of members' savings in the long term, but is more difficult to quantify than some of the other options.

45. As under option 6 an increased number of contribution rates would increase the complexity and costs of the KiwiSaver rules, significantly increasing costs for Inland Revenue, employers and payroll providers. Inland Revenue systems will have to be changed to allow for these rate changes. Any additional opting out rules, when a rate change is not accepted, would further increase these costs.

46. A life cycle model could be built around the three existing contribution rates initially, with a more flexible approach once Inland Revenue's systems have been updated. If this option is considered further it would need to be scoped out and developed in more detail. There would be an increase in the fiscal cost of the scheme of approximately $15 million per year ongoing.

***Option 10: Raise the minimum contribution level for all members e.g. from 2% to 4%***

47. This option increases the signal encouraging individuals to save for retirement by retaining the "opt out" provision but raising the minimum contribution level from 2% to 4%. The increase in member savings achieved is expected to be modest as most employees are already contributing at 4%. The "opt out" provision in the existing KiwiSaver scheme has been very effective in terms of the take-up rate due to the "inertia effect" and this is expected to continue if the minimum contribution rate were raised to 4%. Evidence of this was seen when a large proportion of KiwiSaver members (approximately 95%) maintained their contributions at 4% when the minimum rate was reduced to 2%.

48. When the minimum contribution rate was signalled to be lowered to 2% in 2008, it was indicated that contribution rates could be raised later if economic conditions permitted. To help manage perceptions that this is simply a reversion to a previous policy, a different voluntary contribution rate could also be used, but would need to be explained (as would the 4%).

49. A change in the minimum contribution level on its own will incur minor administrative costs. Fiscal costs of $65 million per year ongoing are expected.

***Option 11: Encourage members to raise their contribution level by making employers match contributions up to 4%***

50. This option would involve increasing the compulsory matching employer contribution to 4%, possibly stepping up from 2% over two years. This provides an incentive for employees contributing at 2% to change their contribution to 4% as they will attract higher employer contributions. The rate of the ESCT exemption would increase with the minimum employer contribution, meaning employer contributions would be exempt from ESCT up to 4%.

51. This has clear benefits through increased savings and participation rates. However, there could be large costs, not only to employers due to the extra contributions, but also to the government through more tax revenue forgone due to increasing the ESCT exemption. However, as with previous increases in mandatory employer contribution rates (from 0-2%), we expect this will form part of future wage negotiations and the cost will eventually be borne by the employee. It would be necessary to have very clear rules at the point of implementation regarding remuneration negotiations.

52. As approximately 80% of current KiwiSaver members are contributing 4%, the savings in member accounts is expected to increase largely from additional employer contributions. There will be a corresponding increase in the level of fiscal incentives.

53. Inland Revenue would need to make minor system changes to accommodate the employer contribution rate increase from 2% to 4%. Initial estimates of the fiscal cost are approximately $200 million per year ongoing.

## Compulsion

54. The options below are potential approaches for retaining the KiwiSaver system but replacing voluntary membership with compulsion. The options differ in terms of who is required to contribute and the level of contribution required.

| ***Compulsory KiwiSaver contributions*** |
|---|
| **Option 12: Compulsory contributions from both employees and employers at current minimum contribution levels (i.e. 2% for employees and 2% for employers).** |
| **Option 13: Compulsory contributions from both employees and employers at a higher contribution level (4% for employees and 4% for employers);** |
| **Option 14: Compulsory contributions by employers only, with the minimum contribution level gradually raised to reach 8% over time – similar to the Australian Superannuation Guarantee Scheme.** |

## Generic effects of introducing compulsory contributions

55. Before considering the potential impacts of these specific options, it is useful to briefly consider a number of issues associated with introducing compulsion to KiwiSaver more generally that are therefore relevant to all 3 options. An important consideration will be the extent to which any changes in government policy setting in this area are received as sustainable and enduring. Frequent and ad hoc changes to long-term savings vehicles and policies will detract from the end objectives. Hence the desirability of having clear medium and long-term objectives. Our view is that these medium and long-term settings need to change as they are not currently sustainable.

56. There are no international examples of a mandatory individual contribution scheme that is additional to a generous universal pension. Consequently, the impact of this approach is more uncertain in the New Zealand context. **[2][3]**

*Impact on long-term approach to retirement income provision*

57. Introducing compulsion is a significant direction change and once used is not available to be used again. As such, it needs to be considered against the longer term picture for retirement (and other savings). Consequently, there is significant value in having a view on long-term objectives for the retirement income system as a whole, and the respective roles government-provided superannuation, compulsory and voluntary retirement savings may play in that system in the long term, before making such a change.

*Impact on savings*

58. The magnitude of the increase in saving depends on the extent to which compulsion forces individuals to save differently than they would otherwise – this is either at higher rates or in a different form - the ability of individuals to offset compulsory saving by increased borrowing, and in respect of national saving any offset by Government or business. Compulsion may have a positive impact on national savings although the size is uncertain and is likely to be relatively small. There is limited empirical evidence on the additional savings generated by compulsory individual savings, with the mixed results dependent on the specific design of the retirement income system. For

**[2][3]**

example, the combined effect of Australian compulsory superannuation scheme's increase in the superannuation guarantee rate from 9 to 12% and the additional incentives announced this year to increase savings by low income and older workers are, over time, expected to boost national saving by a further 0.4 per cent of GDP by 2035.

*Capital market development*

59. Likewise the international evidence on financial market develop is limited and mixed, but overall, compulsion has been found to be likely to have a positive impact on capital market development. The findings are influenced by scheme design and delivery and the nature of the financial markets, including the regulatory environment, in which they are operating. The Australian studies suggest the superannuation guarantee scheme has led to an expansion of financial markets and the financial system, though some studies contend that this expansion would have occurred anyway with the globalisation of financial markets.

*Labour market impacts*

60. Compulsory savings affects decisions to work and decisions to hire in particular for people who would have, or have, already opted out of Kiwisaver. Compulsory saving may be perceived as a tax and can give rise to labour market disincentives for low income earners that would have a negative impact on the growth rate. It may also be seen as a cost on labour by employers, affecting hire decisions, at least in the short-term before any employer increases are able to be offset by future remuneration strategies. It can also affect choices to either work more or less in response to individuals' assessments about the rewards for labour and rewards from leisure. The nature of labour market impacts are design dependent, including upon the size of compulsory contributions.

61. However, in terms of the tax system development, compulsion could help to move New Zealand to a situation where labour is taxed more than capital.

*Impact on well-being*

62. Making KiwiSaver compulsory will require contributions from individuals who have or would have in the future made an active choice not to contribute to KiwiSaver. Given the financial and behavioural incentives to join KiwiSaver, individuals decision to opt-out/take a contributions holiday may be rational given their circumstances and any forced saving could be sub-optimal.

63. Compulsory superannuation savings will impact differently on different groups, for example, women, Maori and Pacific Islanders. These issues would need to be addressed as part of any decision regarding compulsion.

## Design choices will be important

64. As noted above, the nature of these impacts, such as the extent of any increase in national savings or the impact on labour markets, and on particular groups is significantly affected by the detailed design of the scheme. Key design choices which would need to be considered include:

- ***Contributions*** – Who must contribute (minimum and maximum ages, income limits, and employment status). An important issue here is the treatment of the self-employed. Chile recently decided to require mandatory contributions from self-employed people, gradually phasing in the contribution levels until it reaches 10% in 2015. By contrast, the Australian Tax Review has recently recommended against extending the superannuation guarantee due to the diverse and varying risks and circumstances of business and entrepreneurship. The Panel raised the treatment of contractors within the superannuation guarantee system as an issue for further consideration.

- ***Savings form*** – Issues include the extent of provider choice, the nature of default funds and the extent of investment options.

- ***Incentives*** – Fiscal savings of approx $1bn could be achieved if the MTC and the kick start payment are removed, and additional savings could be realised by changing KiwiSaver's exemption from Employer Superannuation Contribution Tax. While there is the option of removing all KiwiSaver incentives up front, a gradual approach may be easier to implement, but it may take time to realise the fiscal savings. An issue for consideration is whether to include some incentives, such as subsidies or concessional tax treatment, to encourage additional voluntary savings, as occurs in Australia. Consideration could also be given to whether any targeted incentives are provided, for example to groups with disrupted workforce participation, such as women.

- ***Financial market risk*** - Issues here include to what extent regulatory safeguards are needed to reduce risk, and what is the extent of any explicit or implicit government guarantee. This is where increased pressure for regulation (to reduce risk) is most likely to arise.

- ***Form of payout*** – How to deal with longevity risks, annuities, lump sums, timing of payout, variation in payout according to contributions.

**Specific impact of these options**

65. Given the impact of specific design features and the limited information currently available on the impact of KiwiSaver on savings, these options can currently only be assessed in a very limited way.

*Impact on membership*

66. Each of these three options significantly increases the number of members saving through KiwiSaver. KiwiSaver participation is currently 55% of the labour force. If self-employed people are not included, requiring contributions from all wage and salary earners would increase membership of KiwiSaver by an estimated 1.29 million employees.

*Administrative impacts*

67. There would be significant implementation, administrative, system and resource costs associated with making the scheme compulsory. Existing systems would require modification and new policing functionality to identify non contributors would be required.

68. A highly significant increase in transactions (processing) and contacts from members will be slightly offset by the removal of the opt-out and holiday contribution requirements.

69. Employers' compliance costs would over time reduce with the removal of these two features.

70. A high level of external communications with a wide variety of audiences would be required and all associated products, guides and forms will need updating.

*Relative impact on savings*

71. Option 13 and 14, both requiring contributions of collectively 8% of earnings, would give rise to a greater increase in savings through KiwiSaver, than option 12, requiring total contributions of 4% of earnings.

72. The additional savings achieved through raising the minimum contribution to level to 4% are expected to be modest as most employees are already contributing at 4%, but the increase to 4% for employers would have an impact as currently only a few employers are contributing at 4%.

73. In option 14, the target savings rate could be gradually phased in to allow the labour market time to adjust to changes in the contribution rate. Over time this could be passed on through a reduction in the real wage rate i.e. wages are held constant instead of the employee receiving wage increases. In Australia the Superannuation Guarantee was effectively phased in at 0.5% per year to minimise the impact on real wages.

**Wider options**

**[2][3]**

**[2][3]**

***Option 17: Change regulation in order to reduce the accumulation and holding of household debt thereby placing households in a better position to save***

81. The Ministry of Consumer Affairs (MCA) is leading work to help New Zealanders to understand and better manage debt and is currently reviewing the Credit Contracts and Consumer Finance Act.[4]

[4] http://www.consumeraffairs.govt.nz/legislation-policy/policy-reports-and-papers/disscussion-papers/review-of-the-operation-of-the-credit-contracts-and-consumer-finance-act-2003

82. Poor decision-making by borrowers can have significant consequences, especially for those on low incomes and those with little resilience in the face of financial pressures. Several amended or additional disclosure provisions are proposed for consideration to allow more informed consumer decision-making. This includes for example:

- Providing better information to consumers on mortgage break fees/prepayment;
- Providing clear information to consumers on the implications of not paying off credit card monies owing;
- Not allowing the unsolicited extension of credit provision without a consumer expressly agreeing to the extension (i.e. opting-in).

83. The Ministry will be making recommendations to the Minister of Consumer Affairs for any changes to the Act that may be required before the end of 2010. This option is largely occurring. The question is whether more would be required. At this point we are not suggesting that this would be the case.

***Option 18: Measures to raise the level of people's understanding that could encourage a savings culture and increase the uptake of savings***

84. This option is complementary to all of the options outlined above and could build on work already underway for example through the National Strategy for Financial Literacy coordinated by the Retirement Commission[5] and work prepared for the Commission that explores the influence of identity on financial behaviours and performance[6].

85. However, in the face of poor overall incentives to save, it is unlikely that such a strategy will engage interest beyond the "already motivated to save" group, as is currently the case.

[5] http://www.retirement.org.nz/centre-financial-literacy/national-strategy-financial-literacy

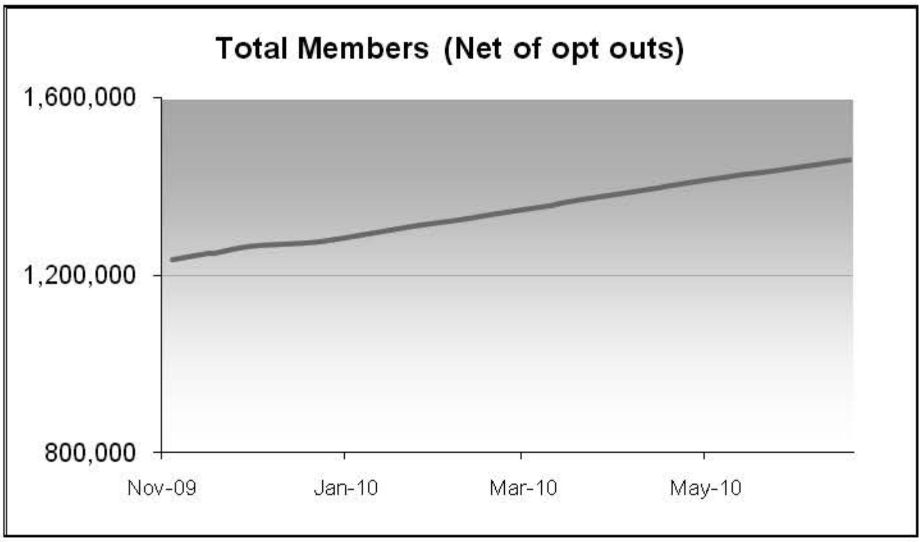
[6] http://www.fulbright.org.nz/voices/axford/docs/axford2009_dupuis.pdf

## Annex One: Key facts and numbers on the current KiwiSaver scheme

The following section outlines key facts and numbers on:

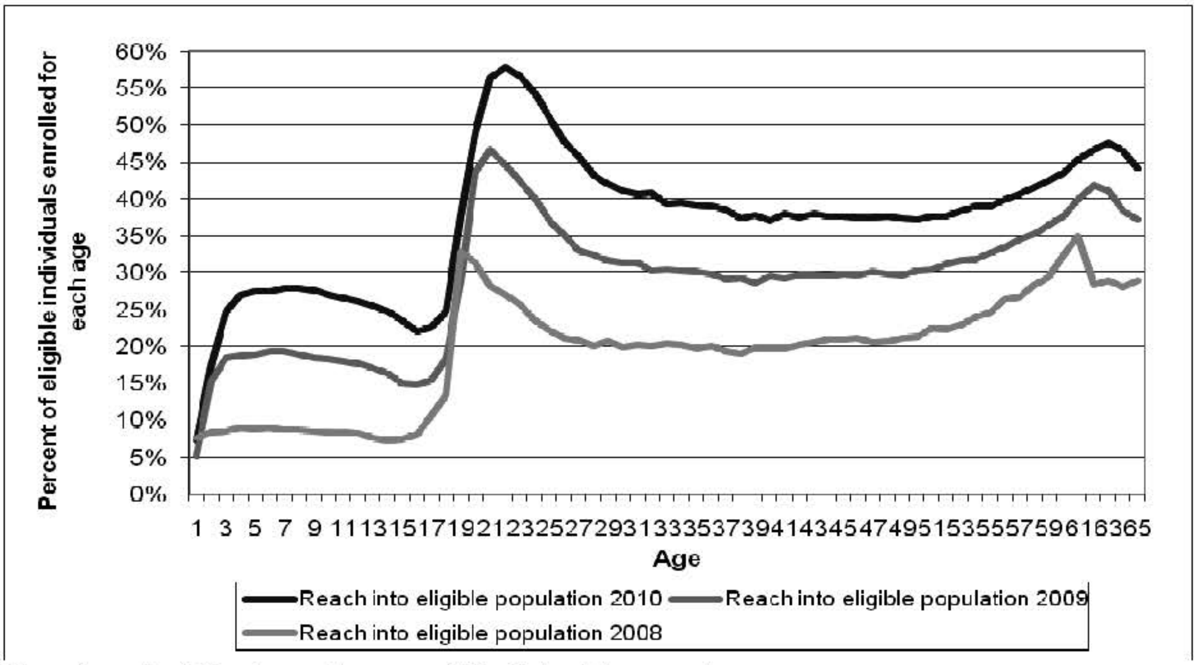
- total KiwiSaver members and reach into the eligible population;
- fiscal cost of the incentives and the latest forecasts;
- size and flow of KiwiSaver funds; and
- income and age distribution of members.

***Figure 2: Total KiwiSaver Members (Net of opt outs)***




Total Members as at 30 June 2010 = **1,459,942**

*Figure 3: KiwiSaver reach into eligible population 2008, 2009 and 2010*




## Fiscal cost of the incentives and the latest forecasts

*Table 4: Fiscal Cost of KiwiSaver's incentives as at Budget 2010*

| Befu10 | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
|---|---|---|---|---|---|---|
| Kick-start payment ($m) | 381 | 377 | 293 | 107 | 63 | 58 |
| Fee subsidy ($m) | 31 | 6 | 0 | 0 | 0 | 0 |
| Interest ($m) | 12 | 6 | 6 | 6 | 6 | 5 |
| Member Tax Credit ($m) | 651 | 656 | 880 | 941 | 959 | 1000 |
| Employer Tax Credit ($m) | 206 | 0 | 0 | 0 | 0 | 0 |
| | 1281 | 1045 | 1179 | 1054 | 1028 | 1063 |

In addition, KiwiSaver's exemption from Employer Superannuation Contribution Tax results in government revenue forgone of around $230m per year.

*Table 5: Summary of KiwiSaver membership as at Budget 2010*

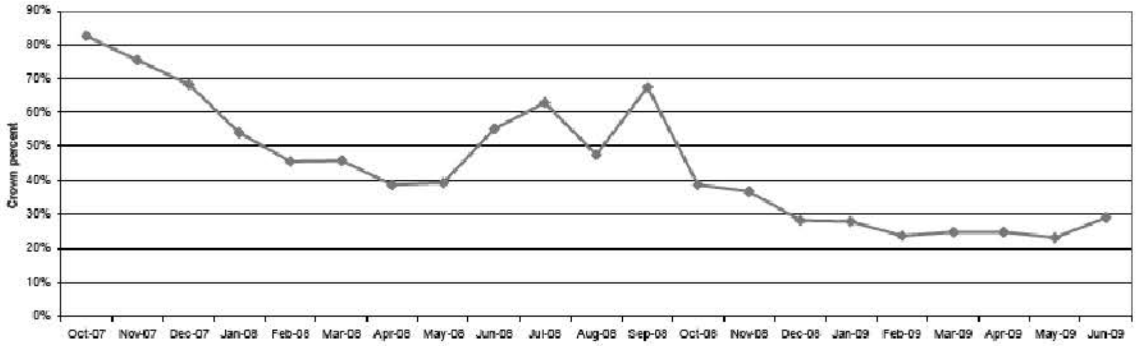
| | 2008/09 | 2009/10f | 2010/11f | 2011/12f | 2012/13f | 2013/14f |
|---|---|---|---|---|---|---|
| Auto-enrolment | 426,629 | 544,000 | 634,000 | 674,000 | 694,000 | 707,000 |
| Opt-in via providers | 477,971 | 704,000 | 885,000 | 941,000 | 917,000 | 930,000 |
| Opt-in via employers | 195,940 | 211,000 | 223,000 | 235,000 | 232,000 | 228,000 |
| total members: ex CF, incl CH | 1,100,540 | 1,459,000 | 1,742,000 | 1,850,000 | 1,843,000 | 1,865,000 |
| total new members | 383,903 | 360,000 | 283,000 | 107,000 | 63,000 | 58,000 |
| complying funds (CF) | 7,500 | 8,000 | 8,200 | 8,000 | 7,800 | 7,600 |
| contributions holidays (CH) | 25,935 | 44,000 | 45,000 | 44,000 | 45,000 | 44,000 |
| total members: incl CF, ex CH | 1,082,105 | 1,423,000 | 1,705,000 | 1,814,000 | 1,806,000 | 1,829,000 |

## KiwiSaver funds under management

Figure 4 below shows that the contribution from the Crown is declining over time. The Crown has contributed 45 percent of the total value of funds saved over the first two years. The Member Tax Credit (MTC) payments will comprise the greater proportion of the Crown's costs as:

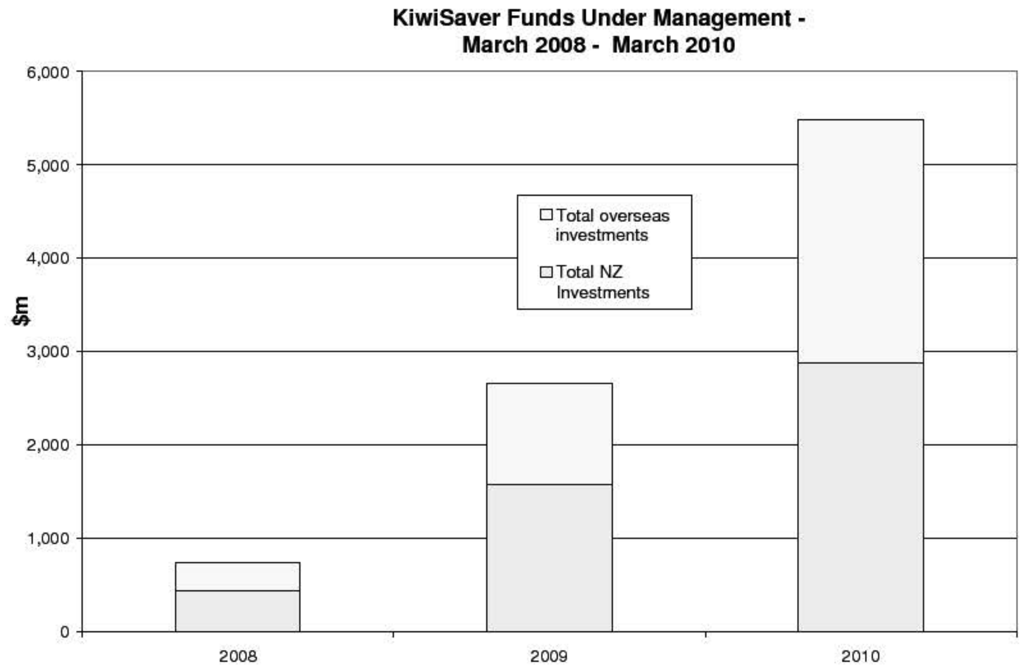
- the number of new members joining KiwiSaver will decline which will reduce kick-start payments; and
- the total number of members in KiwiSaver will increase resulting in higher MTC payments.

*Figure 4 – Crown contribution as proportion of total funds passed to providers*




At the end of the March 2010, total KiwiSaver funds under management had grown to just under $5.5 billion as shown in Figure 5 below. Figure 5 also shows the proportion of KiwiSaver funds invested in New Zealand compared to overseas.

*Figure 5 – Total KiwiSaver funds under management*



### Income and age distribution of members

Figure 6 below shows that the income distributions of members and the eligible population are similar. There are slightly lower proportions of KiwiSaver members than the population at income levels up to $20,000 (many of whom will be children) but slightly higher in the $20,001 to $40,000 band. Just over 50 percent of both the KiwiSaver members and the eligible population earned up to $30,000 in 2008 and just over three-quarters of both populations earned up to $50,000 that year.

***Figure 6 – Income distribution of KiwiSaver members***

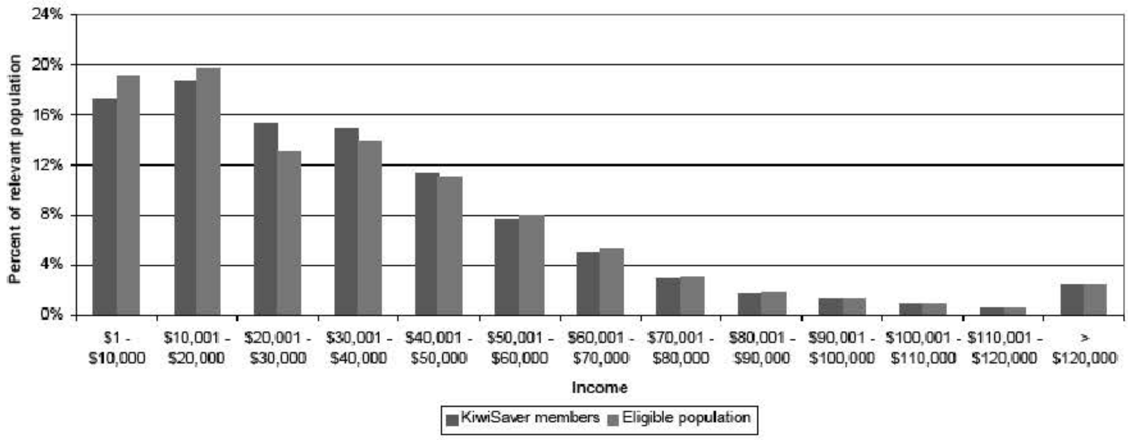
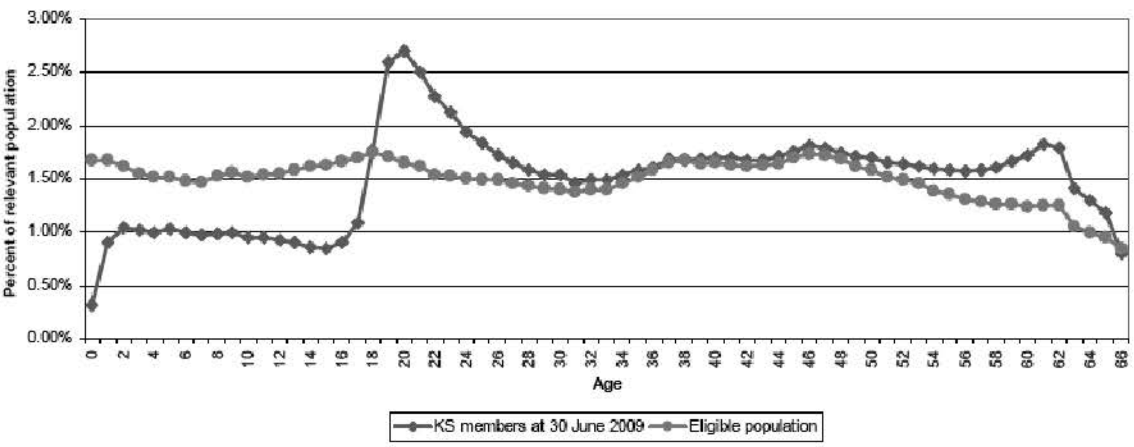



Figure 7 below shows the age distribution of the KiwiSaver member population at 30 June 2009 (i.e. not their age at point of joining) alongside the distribution of the eligible population. The KiwiSaver population is over-represented from the age of 19 years through to the mid-20s and also from the mid-50s up to 65 years. The figures for the 50s and 60s group reflect their high uptake in early months of the first year of KiwiSaver. The results for those in their 20s reflect the effectiveness of automatic enrolment in encouraging participation.

***Figure 7 – Age distribution of KiwiSaver members***



## Annex Two: Administrative Impacts of KiwiSaver Options

| Option | One-off Impacts | On-going Impacts | Comments |
|---|---|---|---|

[2][6]

| Option | One-off Impacts | On-going Impacts | Comments |
|---|---|---|---|
| 3<br>Introduce provision for the self-employed who contribute to the scheme to receive extra Member Tax Credit | • Minimal system changes to deal with additional MTC<br>• Medium profile campaign to communicate changes | • Low impact for Inland Revenue | • Significant compliance cost for providers to determine who qualifies as self-employed especially if income is from self employment and employment. |
| 4<br>Reduce maximum contribution holiday from 5 years to 3 years | • Change to triggers in systems<br>• Low profile campaign to communicate changes | • Minor administration costs associated with this initiative | • Minimal impact on the objective of encouraging private saving |
| 5<br>Remove KiwiSaver exemption from ESCT for employer contributions over $1000.00 | • Existing process (IR345) would be used to collect<br>• Change to payroll specifications<br>• Low profile campaign to communicate changes | • Minor administration costs associated with this initiative | • Non compliance would only be identified through audit |
| 6<br>Abating the MTC for higher income groups<br><br>&<br><br>7<br>Requiring higher contributions from higher income earners. | • Moving to IRD management of the MTC process (including calculating entitlements) would be a fundamental change to the administration of KiwiSaver. Consequently, there would need to be a number of system and process changes that would have a significant impact on the department. | • There would be additional compliance costs for employers and scheme providers, as well as members. For example, it would likely mean a large increase in income data enquiry requests to IRD and employers.<br>• It is probable that there would be an increase in customer contacts. | • Providers do not have sufficient information about members' income details, so would not be able to claim the correct amount of MTC.<br>• There are difficulties with determining the income of self-employed people (who can make voluntary contributions to KiwiSaver and receive the MTC) for calculating MTC entitlements.<br>• If scheme providers continue to manage the MTC process, there would be privacy and secrecy issues about IRD supplying member income details to providers, in order for providers to accurately calculate a member's MTC entitlement.<br>• These options would lead to integrity concerns: If a household has one working and one non-working spouse, the non- |

| Option | One-off Impacts | On-going Impacts | Comments |
|---|---|---|---|
| | | | working spouse could make voluntary KiwiSaver contributions using joint household income (although his or her taxable income may be zero). This would increase the household's MTC entitlement. |
| 8<br>Encourage members to increase their contributions on a voluntary basis when they get a pay rise | • Minor system change required to allow acceptance of various rates<br>• Low profile campaign to communicate changes | • Potential increase in customer contacts as they understand what rate is applicable for them<br>• Greater complexity to apply contribution rates for employers<br>• Difficult for Inland Revenue to enforce | • Current KiwiSaver rules enable members to make additional voluntary savings |
| 9<br>Life cycle approach – increase the minimum contribution level as age increases | • System changes required to allow for policing of non compliance of minimum contribution<br>• System changes required to identify and advise of age/rate change<br>• Payroll specifications will need updating<br>• Medium profile campaign to communicate changes<br>• Products, forms, guides and other information sources require updating | • New process to be developed to allow for people to opt out of the increases<br>• Added compliance and complexity for employers | • Potential privacy/discrimination issues if Inland Revenue is required to advise an employer when payments need to increase due to age change<br>• Assumption that this process would be administered similar to the opt-out process.<br>• Relies on robust data for each member. |
| 10<br>Raise the minimum contribution level for all members | • Minimal system changes required for new rates<br>• Payroll specification updates<br>• Medium profile campaign to communicate changes | • Minor administration costs associated with this initiative | |
| 11<br>Increase employer contributions to 4% | • System changes required for new rates<br>• Payroll specification updates<br>• Communicate changes<br>• Medium profile campaign to communicate changes | • Minor administration costs associated with this initiative<br>• Compliance costs for employers | |
| Compulsory Options | • System changes required to create a | • Higher level of invalid enrolments | • Estimated 1.29 million employees would be |

| Option | One-off Impacts | On-going Impacts | Comments |
|---|---|---|---|
| (12, 13, and 14)<br><br>Compulsory membership for all salary and wage earners (no contributions holiday or opt outs) | new policing functionality and removal of opt-out and contribution holiday functionality<br>• Payroll specifications will need updating<br>• Policy change on hardship rules required<br>• Products, forms, guides and other information sources require updating<br>• High profile campaign to communicate changes | • Removes the administration of opt outs and contribution holidays<br>• Higher level of contacts<br>• Additional compliance costs for employers<br>• Increase in level of contributions passing through the systems | auto enrolled<br>• Simplify enrolment rules for employers<br>• Difficult for Inland Revenue to identify and enforce employer non compliance<br>• Increase in processing and output for Inland Revenue over time |