

INCENTIVISING SAVING

A Public Option for KiwiSaver

→ The Green Party's plan to encouraging savings by reducing the high costs of saving

The current situation

We are living beyond our means. Much of the prosperity of the last decade has been built on the back of cheap credit and the inflation of house prices.

The lack of a capital gains tax has led many New Zealanders to invest disproportionate amounts of their wealth into property to secure tax-free income.

And why wouldn't you? Traditional savings products have offered relatively low returns, attract tax, and are eroded by inflation and high fees.

Closing the capital gains tax-free loophole is an essential ingredient to addressing the wider private savings crisis we're going through.

Another practical solution is to make savings more attractive. Labour's introduction of KiwiSaver in 2007 was a good first step towards this goal.

Today, 1.8 million New Zealanders are enrolled in KiwiSaver saving for their retirement.

The Green Party supports automatic enrolment in KiwiSaver (with an option to opt out) to further boost the number of New Zealanders saving for their retirement.

The Government appointed Savings Working Group (SWG) reported to Government in January of this year also recommending that the overall value of KiwiSaver can be significantly increased through harnessing better economies of scale by offering one default fund.¹

The larger the fund, the cheaper it is to run. Lower costs and fees lead to higher returns.

And when you compound these savings over time, you end up with much bigger nest eggs at retirement — according to the SWG, this could be up to \$2.5 billion bigger across the industry within 20 years.

What we're going to do about it

A Public option to reduce costs

In light of the Saving Working Group's recommendations and similar moves in Australia, the Green Party will create a public option KiwiSaver fund to lower costs and boost people's nest egg on retirement.

To achieve the necessary economies of scale, the fund will be managed by the Guardians of the New Zealand Superannuation Fund — a \$16 billion fund.

The front-end provider could be Kiwibank or the Inland Revenue Department, as recommended by the SWG, depending on where the most efficiencies of scale can be located.

The Savings Working Group estimates that a single large provider can reduce the costs of KiwiSaver by a factor of two-to-three.

Assuming a 40 percent saving² in fees over the lifetime of a typical KiwiSaver, this can result in a bigger nest egg on retirement of up to \$142,000 (\$64,000 in today's dollars).³

The public KiwiSaver option will be one of seven default providers. When KiwiSaver is reviewed in 2014, we will examine the option of making the public fund the sole default provider.



Dr Russel Norman MP
Green Party Co-leader
Russel.Norman@greens.org.nz
04 817 6716

“Over the lifetime of a typical KiwiSaver, our scheme will result in a bigger nest egg on retirement of up to \$142,000”

KiwiSaver Public Option Q&A

Why change KiwiSaver?

By introducing economies of scale to KiwiSaver, we will reduce the fees and costs incurred by KiwiSavers. By making KiwiSaver more attractive, we can dramatically increase the nationwide level of savings in the economy with next to no cost to Government. The Green Party will make KiwiSaver more attractive to New Zealanders avoiding the need for compulsion or the need for increased Government spending on saving incentives.

Why provide a public option for KiwiSavers?

The current costs and fees faced by KiwiSavers are prohibitively high reducing the incentives to join and eroding the value of KiwiSavers' nest eggs at retirement. ASB, the second largest KiwiSaver provider, actually increased their fees in April 2011 against market expectations. A public option will increase competition in the superannuation market reducing the costs of saving overall.⁴

Why the Guardians of the New Zealand Super Fund?

The Super Fund is the only purpose-built superannuation fund that's big enough to secure wholesale cost savings. The Guardians manage a \$16 billion fund compared with the \$2.9 billion of assets managed by the six current default providers. Another advantage is that the Guardians run their fund on a commercial basis as arm's length from the Government.

How will the Guardians deal with the management of thousands of individual KiwiSaver accounts?

The Guardians are not set up to deal with the administration of individual KiwiSaver accounts. Their expertise is in long-term fund management. We would use either Kiwibank, who already provides front-end management of individual KiwiSaver accounts, or Inland Revenue, as recommended by the Savings Working Group. Both are similarly well placed to interface between the scheme and its members.

Why is the Green Party promoting the New Zealand Super Fund when their record for ethical investment has been poor?

The Superannuation Fund has become a more responsible investor over time as a result of pressure from the Green Party and others. Few other private KiwiSaver providers are managed with any ethical considerations.

How much extra savings could the public option provide?

Fees and costs vary according to the amount invested, the risk profile of the KiwiSaver scheme, and the efficiency of the scheme provider. More aggressively managed 'high-growth' funds are more expensive. A twenty-five-year old entering KiwiSaver for the first time, earning an average wage and contributing 4 percent of their salary, could pay up to \$68,000 dollars in today's dollars in fees before they turn 65.⁵

A 40 percent fee reduction with the resulting savings reinvested would increase the value of the KiwiSaver investment by \$142,000 by age 65. Savings for a minimum 2 percent contribution in a low risk, low cost KiwiSaver scheme are more modest, increasing the value of the KiwiSaver investment by \$23,000 by age 65.

Why are the savings so high?

Roughly speaking, \$1 taken in fees would have otherwise compounded to be worth \$3-\$5 in 45 years' time, depending on the average rate of return. This is one of the reasons why KiwiSaver providers often make the amount of fees and costs they're charging so difficult to decipher.

Will it be compulsory?

No. KiwiSaver is one of many possible savings and investment vehicles and may not necessarily be the best choice for some New Zealanders. KiwiSaver is a good choice for most, however, so we favour automatic enrolment with an opt out option.

Who else is doing this?

The Australian Government announced similar but more sweeping measures to their superannuation industry in September.⁶

What will be the impact on private superannuation scheme providers?

The introduction of a large, low-cost fund will increase competition in the industry considerably. Fees and costs should decrease as a result and fund providers will diversify their product range to fill niche markets. Some consolidation could also be expected as private providers seek similar economies of scale.

1. Savings Working Group (2011), *Saving New Zealand: Reducing Vulnerabilities & Barriers to Growth & Prosperity*, pp99-100. Retrieved from <http://purl.oclc.org/nzt/r-1348>.

2. Similar reforms in Australia are expected to reduce average fees by 40 percent. See *Super System Review, Final Report* (2010). Retrieved from <http://www.supersystemreview.gov.au>.

3. Parliamentary Library research (2011)

4. The Savings Working Group calculates the total industry management and expense ratio (MER) across all KiwiSaver providers is 1.46%. This is considerably higher than the 0.40% MER of a large wholesale scheme.

5. Based on figures from the Retirement Commission's website www.sorted.org.nz.

6. Australian Government (2011), *Stronger Super*. Retrieved from <http://www.supersystemreview.gov.au>.