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Pension reform: Evidence from international experience

Sharon Collard, Director and Senior Research Fellow

University of Bristol

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About PFRC

- Policy-focused social research
  - **Pensions, savings and assets**
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  - Credit use and over-indebtedness
  - Financial exclusion and poverty
  - Banking and financial services
- Recent research
  - Analysis of Wealth and Assets Survey (ONS, BIS)
  - Attitudes to pension investment choice and risk (DWP)
  - Money Guidance Pathfinder evaluation (FSA)
  - **Review of international pension reform** (DWP)

Research aims and methods

- To draw together potential learning points and areas of distinction between UK and comparator countries to inform workplace pension reform (2012)
- Eight case study countries
  - **New Zealand** (Kiwi Saver, 2007)
  - **Australia** (Superannuation Guarantee, 1992)
  - Canada, Denmark, Norway, Poland, Sweden, Uruguay
- Literature review and telephone interviews with pension experts in case study countries

Key findings

- Outcomes for individuals
  - Participation rates
  - Contribution levels
  - Living standards in retirement
- Pension scheme key features
  - Fund choice
  - Default funds
  - Fees

BACKGROUND TO PENSION REFORM

Pension landscape pre-reform

- Australia pre-1992
  - Means-tested pension (Age Pension)
  - Compulsory superannuation for public sector employees and private sector managerial employees only
  - Voluntary superannuation and other private savings

- New Zealand pre-2007
  - Flat-rate pension (New Zealand Superannuation)
  - Low levels of private pension coverage among workers
    - 14.7% occupational pension, 5% personal pension

Drivers for pension reform

- Macro-economic policy objectives
- Increase private pension provision to improve living standards in retirement
  - Aus: Limited superannuation coverage among workforce, concerns about adequacy of 3% employer contribution
  - NZ: Decline in occupational pensions following withdrawal of tax concessions in 1990s and low personal pension coverage
  - UK: Lack of suitable products for those on lower incomes, lack of employer provision, especially in smaller firms; prefer a good standard of living today; don’t understand enough about pensions; inertia

As long as my bills are being paid and I’ve got a roof over my head, ***I’ll worry about getting old when I’m old****. Hopefully I’ll go senile and be put in an old people’s home and I won’t have to worry about it.*

(Woman, early 20s, middle income; UK Baseline Survey of Financial Capability focus group)

MAIN FEATURES OF NEW SCHEMES

UK workplace pension reforms

- Employers must auto-enrol *all* eligible employees into qualifying workplace pension scheme
  - Employees can opt out
- Total contribution 8% of qualifying earnings
  - Employers must make minimum contribution (3% by 2017)
  - Government contributes 1% tax relief
  - Employee makes up the rest
- Introduction of simple, low-cost pension scheme
  - NEST (National Employment Savings Trust)

New Zealand: KiwiSaver

- Legal requirement for employers to auto-enrol all *new* eligible employees
  - Employees can opt-out
  - Anyone under 65 can choose to set up KS account
- Compulsory employee contribution
  - Minimum initially 4% gross earnings; 2% from 2009
  - Annual tax credit and one-off tax-free payment to encourage contributions
- Compulsory employer contribution
  - Minimum initially 1% gross earnings, up to 4% by 2011
  - But frozen at 2% from 2009

Australia: Superannuation Guarantee

- Membership compulsory for eligible employees
- Compulsory employer contribution
  - 3% in 1992, increased over time to 9% from 2002/03
  - 12% from 2013
- No compulsory employee contribution
  - Government matched savings for lower income workers
  - Tax incentives for certain groups

Summary of scheme features

	UK	NZ	Aus
Auto-enrolment with opt-out	√	√	x
Compulsory employer contribution	√	√	√
Compulsory employee contribution	√	√	x
Total contribution	8% qualifying	4% gross	9% qualifying
Incentives to members	x	√	√
Simple low-cost scheme	√	x	x

OUTCOMES FOR INDIVIDUALS

Participation rates

Australia (mandatory)

- Coverage 62% in 1988, up to 91% in 2007

New Zealand (soft compulsion)

- Take-up higher than anticipated
  - Forecast 346,000 members at end 2008 – actual 716,637
  - Drivers: financial incentives, publicity
- 1.7 million members by end March 2011
  - 37% auto-enrolled (and not opted out)
  - 49% opted in through provider
  - 13% opted in through employer

KiwiSaver membership

- Roughly even split by gender
- Increasing proportion of under 25s enrolling
  - 1 in 5 members (18%) are children under 18
- Those aged between 18 and mid-20s over-represented compared with eligible population
  - Auto-enrolment has encouraged participation among younger people
- Income distribution of auto-enrolled skewed to lower end compared with those opting in

Employee contributions: New Zealand

- Of 1.4m KiwiSaver members at 30/06/2010:
  - 60% contributing (down from 77%)
  - 2% not contributing because on contribution holiday
  - 38% not contributing for another reason (up from 21%)

- Most contributing 4% (original default)
  - Of joiners since 2009, majority contribute 2% (new default)
  - Of joiners before 2009, most continued to contribute 4%
  - ‘Set and forget’
- 90% of employees receive min. 2% from employer

Employee contributions: Australia

- Voluntary contributions encouraged by tax incentives and matched saving for lower earners
- But only small proportion do so
  - 22% aged 15+ in 2007
- Strong association with gross income
- Cost is main reason for not contributing
  - 15-24s: Lack of interest, too young, employer contribution enough
  - 25-34s: Prioritise mortgage payments over pension

Impact on retirement income

- Some evidence of positive impact
  - Retirees with superannuation have higher gross weekly incomes than those without (Aus)
  - Early indications of some new saving, but also substitution (NZ)
  - Anticipated that replacement rates should improve (Aus, NZ)
- But may be affected by...
  - Early access to savings, contribution holidays (NZ)
  - Options to finance retirement (e.g. no annuity market)

PENSION SCHEME FEATURES

Fund choice

- Australia
  - 457 superannuation funds (excluding small funds)
  - 62 per cent of funds offer investment choice
    - Average 38 investment options
  - Small proportion exercise fund or investment choice
- New Zealand
  - 52 KiwiSaver schemes (up from 30 in 2009)
  - 61% members choose scheme
    - Less than 1/5 of those auto-enrolled
  - Main drivers of choice: financial security, familiarity with provider, investment risk
  - Preference for conservative/balanced funds

Default funds

- Relatively high levels of use of default funds
  - 51% of fund assets remain in default strategy; 80% members don’t make active investment choice (Australia)
  - 39% of KiwiSaver members allocated to default scheme by Inland Revenue or employer-nominated scheme
    - Much higher among auto-enrolled (82%)
- Investment strategies vary, concerns about outcomes
- Proposed changes to default funds
  - MySuper: simple low-cost fund with single diversified investment strategy (Aus)
  - New low-cost default scheme, limited investment options (NZ)

Fees

- Aus: Not capped, but prohibits admin fees that exceed returns on small balance accounts
  - Higher cost structures as result of investment choice
  - Fees vary markedly by fund type
  - Proposals to reduce cost of superannuation to individuals
- NZ: Providers prevented from charging ‘unreasonable’ fees
  - Competition hampered by complexity of fee structures
  - Proposed that providers produce regular reports specifying all fees and charges, and net investment returns

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- **KiwiSaver fees calculator**

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- Comprehensive mortgage calculator

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KiwiSaver fees calculator

This calculator presents the fees charged by KiwiSaver providers. The fees are automatically deducted from your KiwiSaver balance to meet management and administration costs.

KiwiSaver fees

Age	
Employment status	Employed
KiwiSaver contributions (as a % of your before tax salary):	
Salary	$
Employee	4 %
Employer	2%
Risk profile	All

Go to page: 1 2 Calculate

Notes on this calculator

1. Results are in today's dollars - this means that any amount you pay or receive in the future will have the same buying power as this many dollars today.

   For example, if you could buy something worth $1000 now, in 10 years time, you would need $1220 ("nominal dollars") to buy that same thing (assuming 2% inflation). The $1220 nominal dollars in ten years time is equivalent to $1000 today's dollars. This means that the actual dollar amounts that you pay or receive are likely to be more than the figure quoted here, but it will have the same current buying power.

   Learn more about Today's Dollars.

2. Expected KiwiSaver balance is the projected total accumulation at age 65 (in today's dollars) of the expected contributions from the member, employer and government (including tax credits) as well as the potential return that each fund is expected to earn based on the given investment mix from that fund's current investment statement. We have not displayed figures for potential KiwiSaver balance as speculation of this amount could be misleading to users. A generic

CONCLUSIONS

Scheme level

- Political, social, cultural context important
  - What are the public/private pension foundations?
- KiwiSaver closest comparator to UK re. scheme features but important differences
  - More like a glorified ISA?
- Australia similar to UK in terms of policy goals i.e. extension of workplace pensions
- No NEST equivalent in any of the case study countries

Employee level

- How to encourage contributions over and above the minimum required?
- Is it possible to capitalise on inertia?
  - KiwiSaver minimum reduced to 2%, but people continued to save at original 4% default rate
- Little empirical evidence to date about the impact of reforms on retirement living standards
  - Impact of scheme rule changes?

Threats to reforms achieving policy goals

- Lack of clarity around policy goals
- Politically-driven changes to scheme that may impact negatively on participation and retirement benefits
  - More of a risk in relatively complex schemes where there's more scope for change, such as KiwiSaver?
- Low/no voluntary pension saving on top of relatively low mandatory minimum contributions
- Large variations in investment returns for members
  - Investment choices they made, fees they pay
  - Structure of default funds

‘[e]ven very similar policies implemented in very similar ways may produce divergent outcomes in different institutional and cultural contexts’. (Hay, 2004: 246)

Thank you for listening!