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POLICY TRENDS IN OECD COUNTRIES TO INCREASE COVERAGE AND CONTRIBUTIONS INTO FUNDED PENSION PLANS

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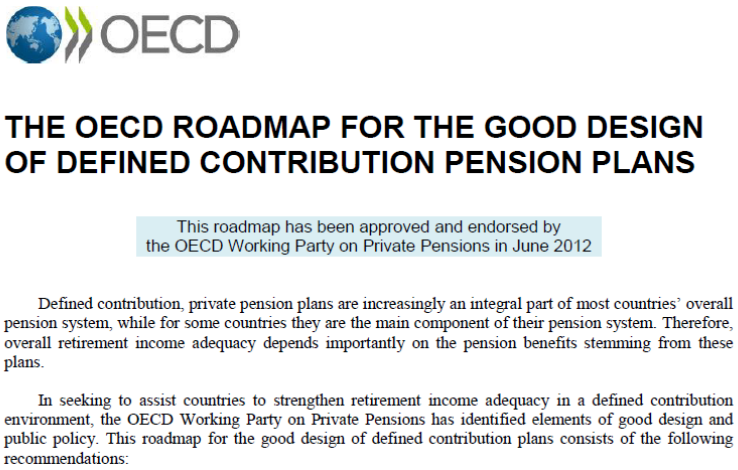
Challenges of the NZL Pension System

- Help people achieving adequate retirement incomes by combining NZ Super and KiwiSaver
  - NZ Super protects low income people from falling into poverty (82% RR for people on half the average earnings)
  - People need twice NZ Super to have a comfortable retirement (NZ Super alone provides only a 43% RR for people on average earnings)
- Increase KiwiSaver coverage and contribution levels
  - KiwiSaver covers 46% of the population
  - Minimum contribution rate since April 2013: 6% (employer + employee)
  - As at June 2012, 5% of members had taken a contribution holiday since the scheme began and more than 20% had not made any contribution in 2010/11
  - According to FSC research, a 10% contribution rate would be needed over 40 years to fund a pension twice NZ Super

OECD Roadmap for the Good Design of DC Pension Plans: 10 Recommendations



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THE OECD ROADMAP FOR THE GOOD DESIGN OF DEFINED CONTRIBUTION PENSION PLANS

This roadmap has been approved and endorsed by the OECD Working Party on Private Pensions in June 2012

Defined contribution, private pension plans are increasingly an integral part of most countries' overall pension system, while for some countries they are the main component of their pension system. Therefore, overall retirement income adequacy depends importantly on the pension benefits stemming from these plans.

In seeking to assist countries to strengthen retirement income adequacy in a defined contribution environment, the OECD Working Party on Private Pensions has identified elements of good design and public policy. This roadmap for the good design of defined contribution plans consists of the following recommendations:

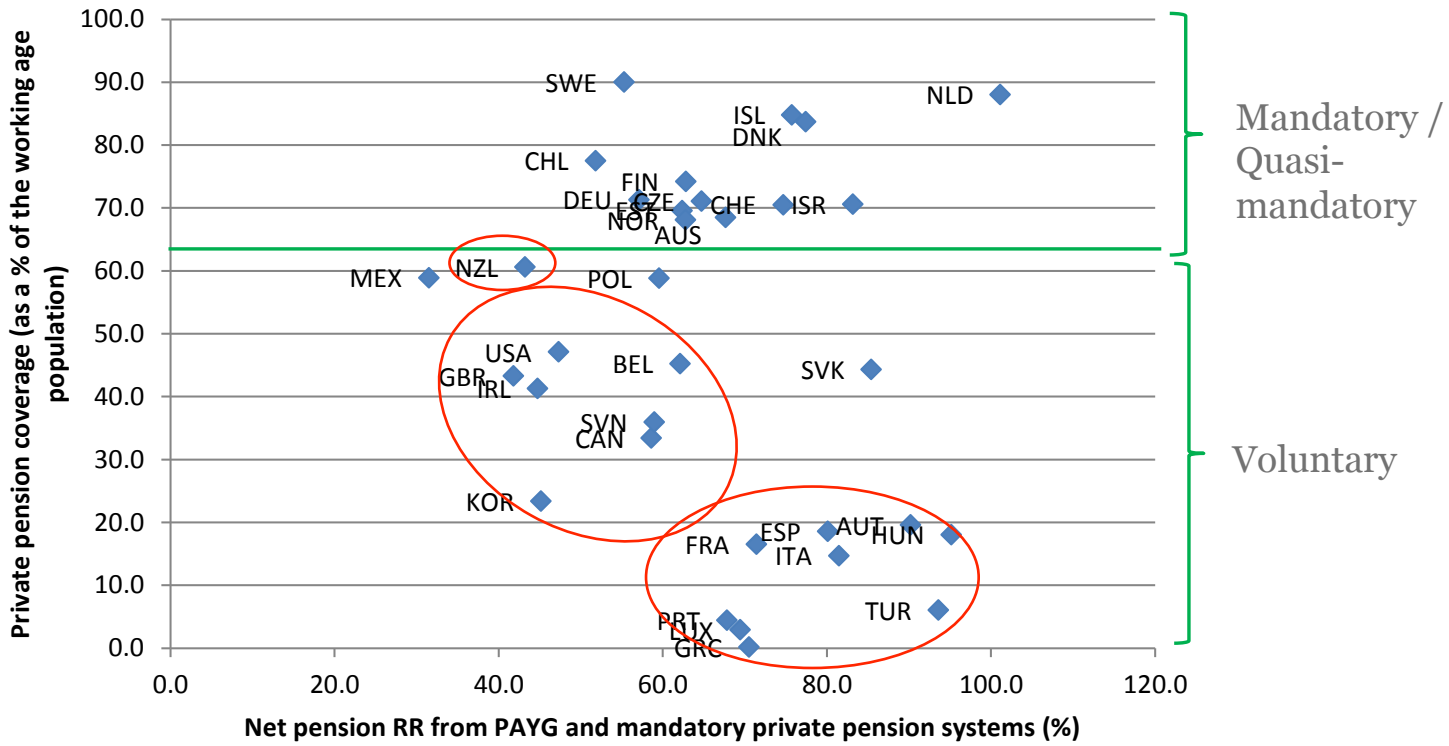
1. Ensure the design of retirement savings plans is internally coherent between the accumulation and payout phases and with the overall pension system. All risks should be accounted for.
2. Encourage people to enrol, to contribute and contribute for long periods
3. Improve the design of incentives to save for retirement
5. Establish appropriate default investment strategies
6. Consider establishing life-cycle investment strategies as a default option

Structure of the Presentation

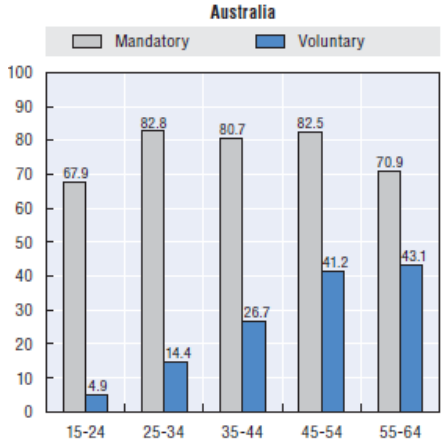
- Coverage of private pension schemes (R1-2)
- Policy options to increase coverage and contribution levels in funded private pensions (R2-3)
- Move the default funds from conservative to balanced/growth investment portfolios with a guarantee? (R5-6)

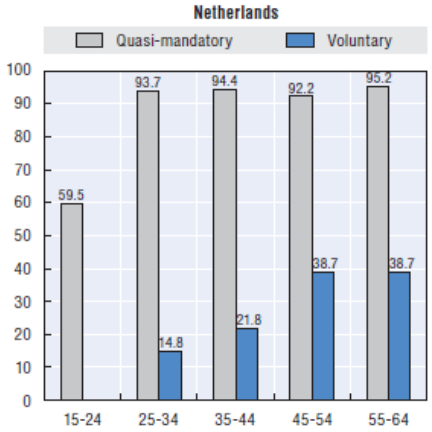
COVERAGE OF PRIVATE PENSION SCHEMES

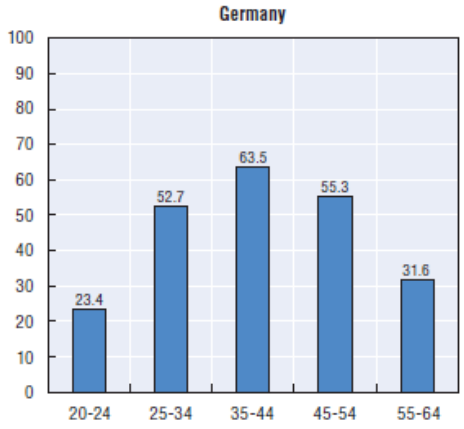
Private Pension Coverage vs. RR

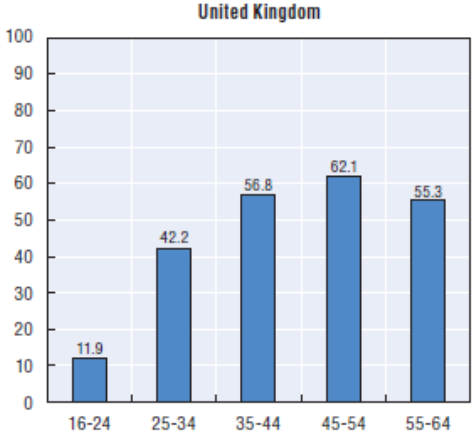


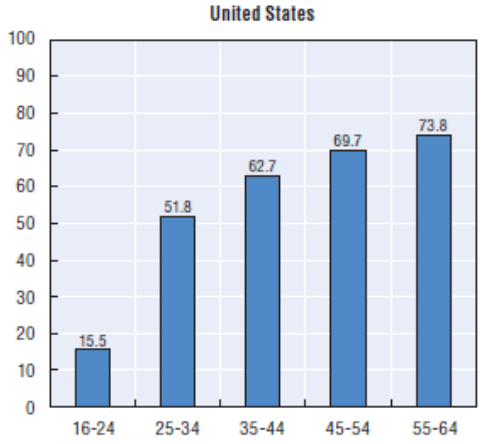
Uneven Coverage in Voluntary Systems: By Age



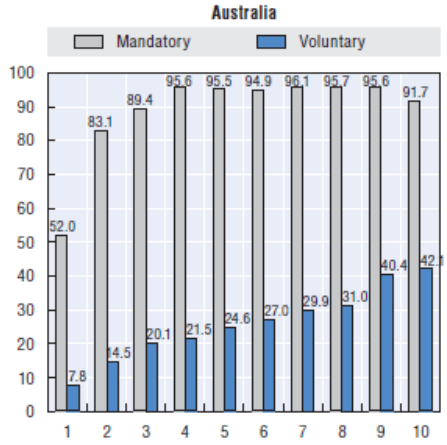


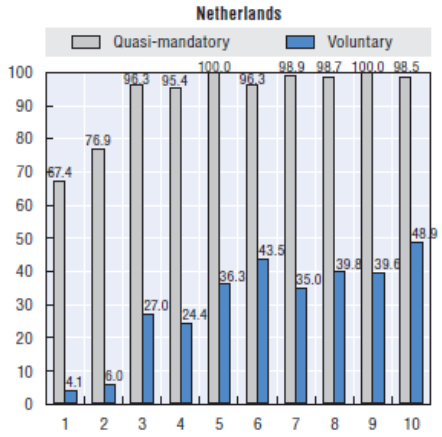


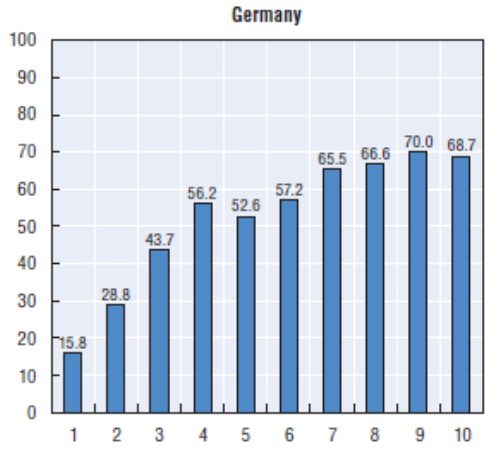


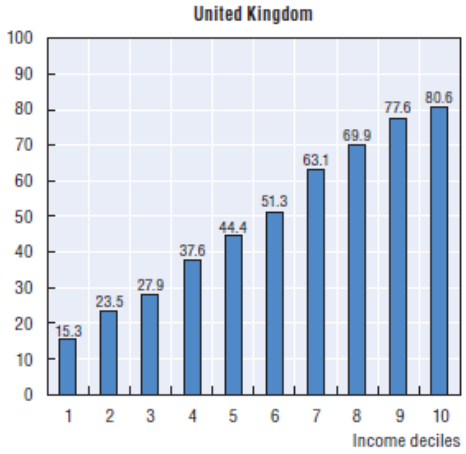


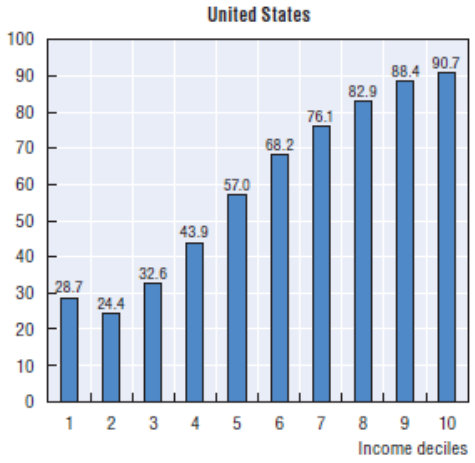
Uneven Coverage in Voluntary Systems: By Income



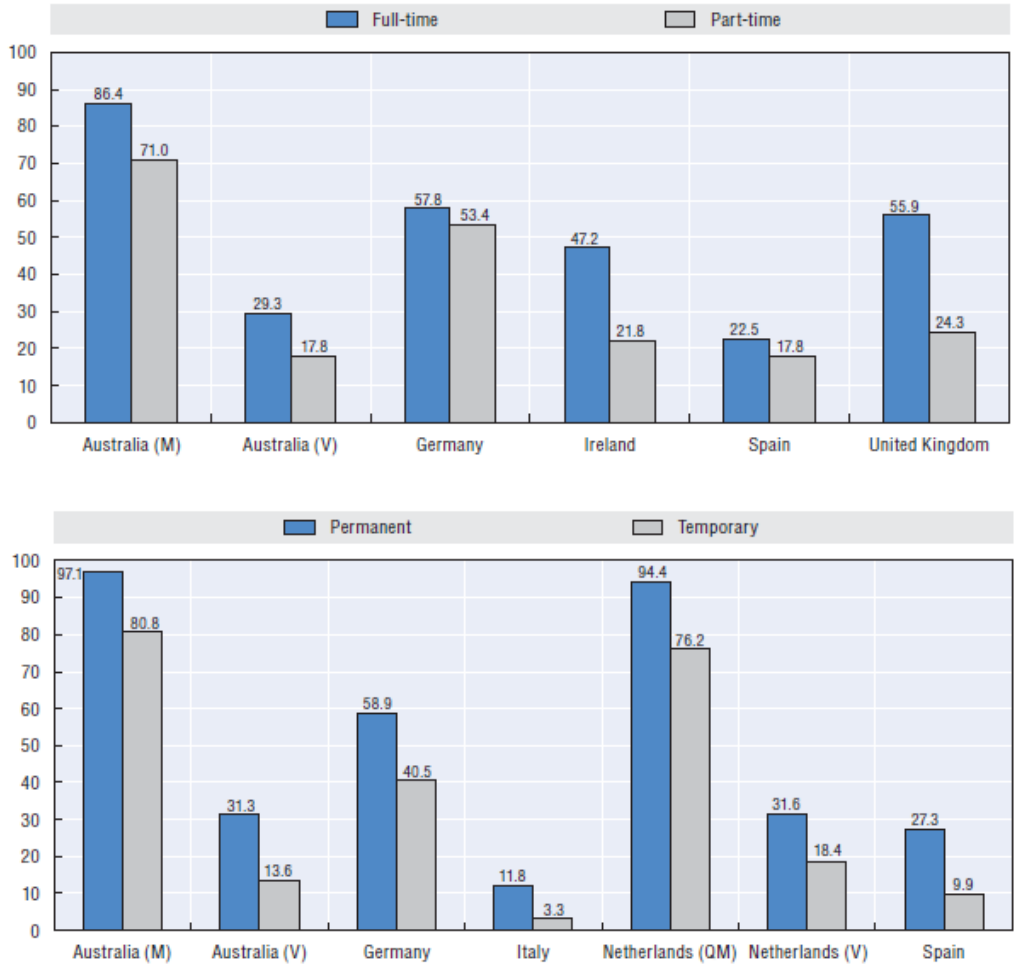




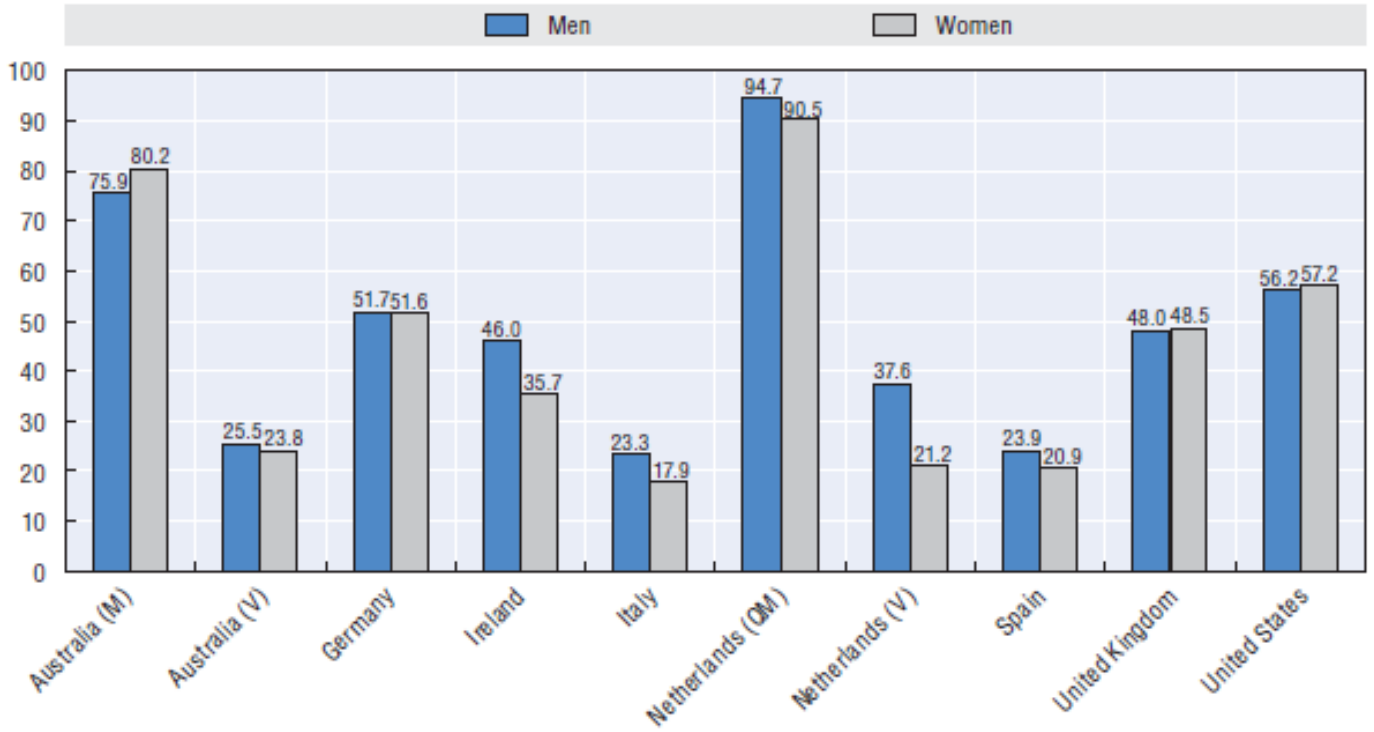




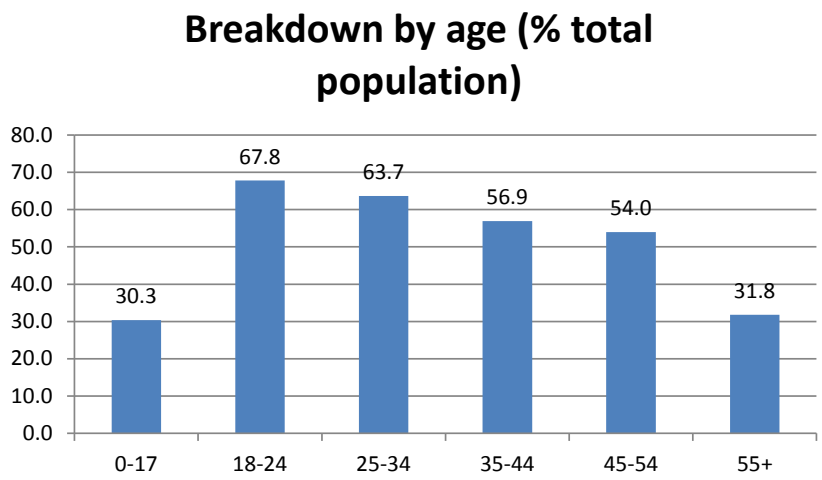
Uneven Coverage in Voluntary Systems: By Type of Employment / Contract



Coverage Not Necessarily Uneven By Gender



What About KiwiSaver?



- Covers 46.0% of the total population at the end of 2012
  - 45.1% of men
  - 46.5% of women
- Coverage is higher for young individuals

POLICY OPTIONS TO BROADEN COVERAGE

Three Options to Increase Coverage

- **Compulsion**: The less costly and most effective approach to reach high and uniformly distributed levels of coverage
- **Automatic enrolment**: Second-best option. Its success depends on how it is designed and on its interaction with incentives in the system. The cost of establishing and managing AE may also be higher
- **Well designed financial incentives**: Flat subsidies and matching contributions can help increasing incentives to save for retirement for middle to low incomes

Compulsory Enrolment

- Both mandatory and quasi-mandatory solutions can ensure high coverage rates
- Less efficient if many workers outside the formal economy
- Limitations:
  - May divert funds from other necessary expenses
  - May be perceived as a tax
  - May lead to a ratcheting down effect if target set too low
  - May not be necessary for all individuals
- Compulsory KiwiSaver for employees supported by ~60% of adults

Automatic Enrolment

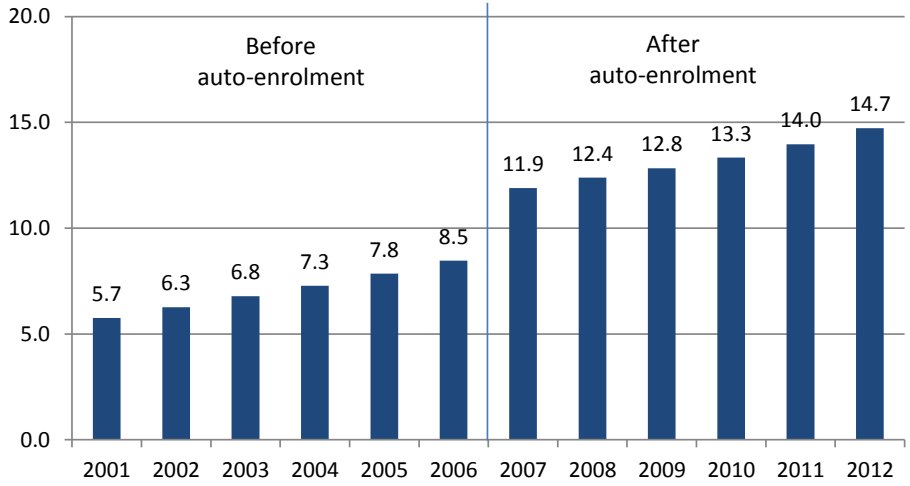
- Has already been introduced in Italy, New Zealand and the UK with different levels of success
- Increased popularity in the US
- Chile also introduced auto-enrolment starting in 2012 for self-employed
- Ireland is considering it

Key Features of AE Schemes in OECD Countries

Country	Year	Target Population	Opting-out window	Contribution rate	Financial incentive	Contribution holidays
Italy	2007	All employed workers in the private sector	Within 6 months following enrolment	Employer: 7% (TFR contributions)	None	Not allowed
New Zealand	2007	New employees	Within 2 months following enrolment	Employee: 3% min Employer: 3%	Member Tax Credit + government kick-start	Allowed after 12 months of membership
United Kingdom	2012	Employees between the age of 22 and SPA	Anytime. Workers are enrolled back every 3 years	From 2018, min 8%, including employer (3% min) and government tax relief	Government tax relief	Allowed as people can opt-out at any time

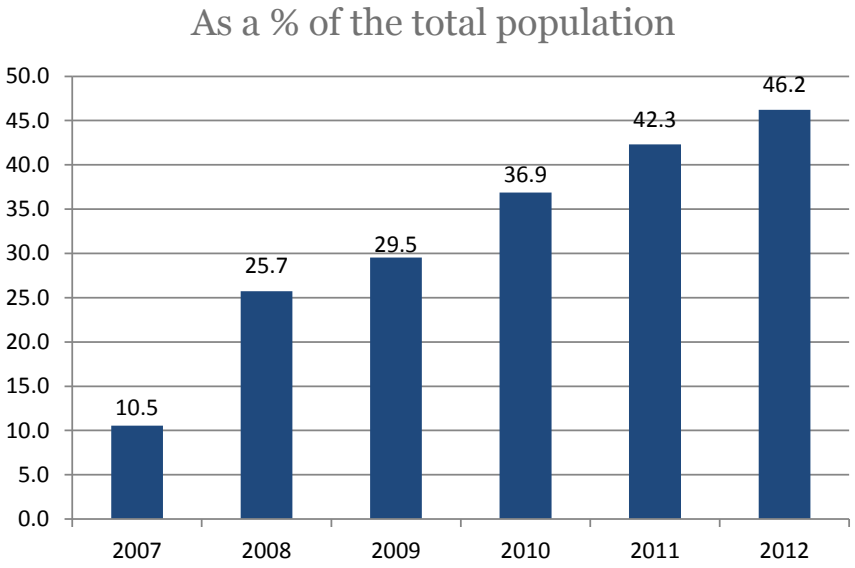
Slight Increase in Coverage in Italy After TFR Reform

As a % of the working-age population



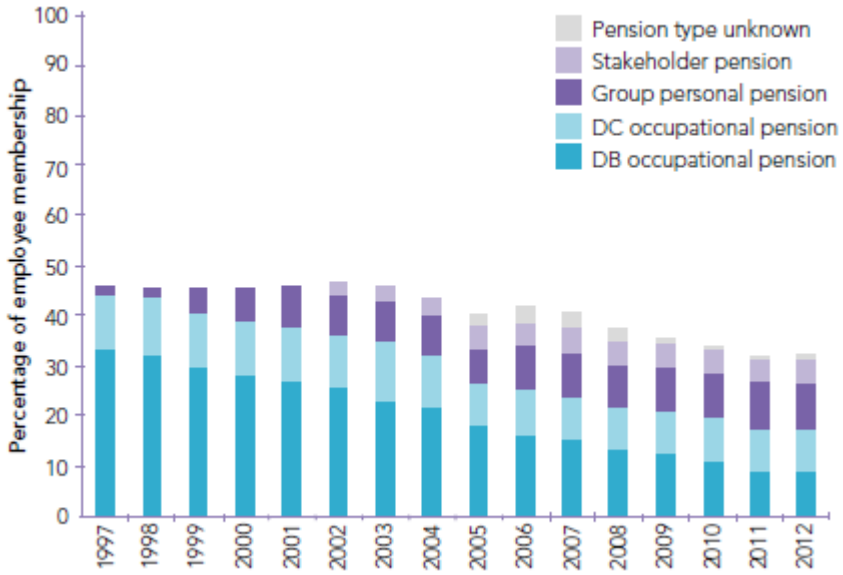
- Increase in coverage significant
- … but below expectations, mainly because the TFR is highly valued by both employers and employees

Coverage has Increased at a Rapid Pace since 2007 in NZL



- End 2012, KiwiSaver plans cover 46% of the population (~61% of the working-age population)
- 38% enrolled automatically
- Declining trend in the number of opt outs
- But membership grows at a lower rate (12% in 2012 as compared to 20% in 2011)
- There is a need to increase coverage further

Trend in the Membership of UK Pension Schemes, Before AE



- 307,598 employees have been automatically enrolled (large employers) between 01/10/12 and 31/03/13
- 9% on average left the scheme during the month following enrolment
- Taking into account those who left outside this window, the opt-out rate so far lies between 10% and 25%

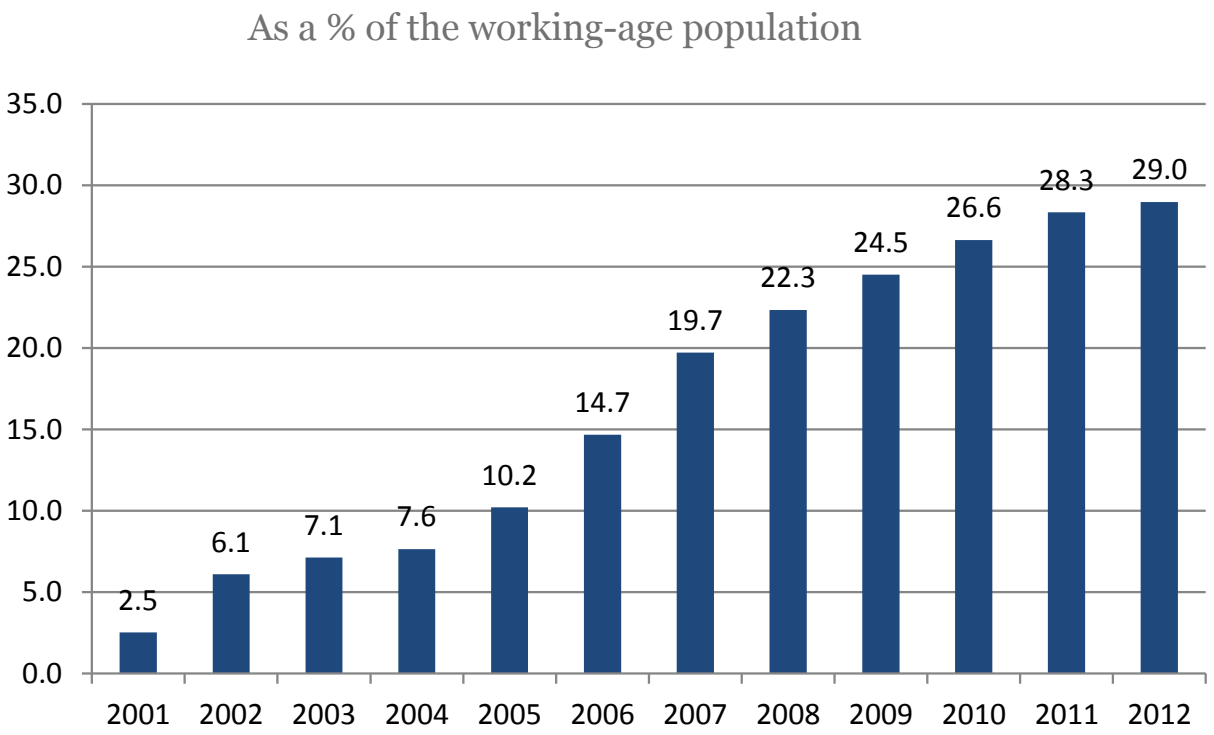
Financial Incentives

- Tax incentives (tax deduction and credits)
  - Benefit higher income households most
- Flat subsidies
  - Czech Rep., Germany, Mexico, New Zealand
- Matching contributions
  - Targeted groups: Chile, Australia
  - All workers: New Zealand

Riester Plans in Germany

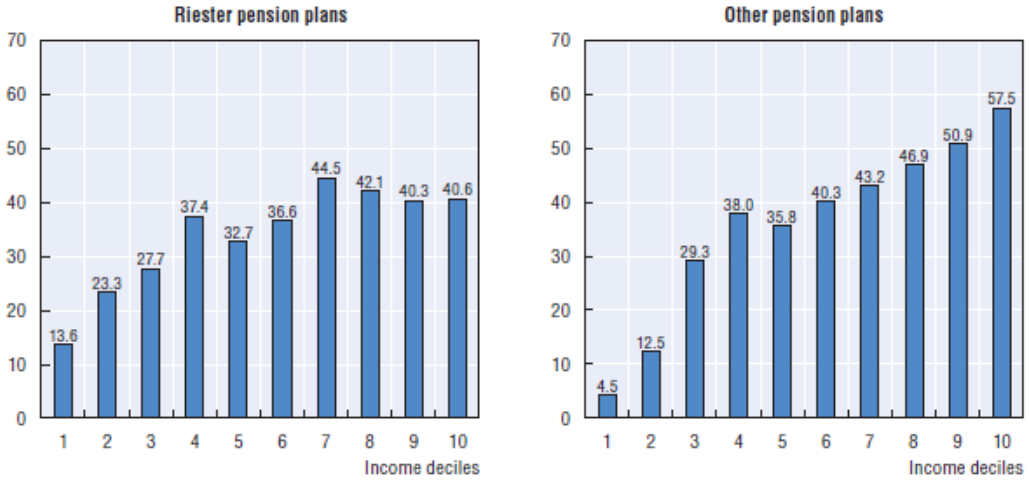
- Riester plans introduced in 2001
- Anyone covered by social insurance system & subject to full tax liability
- Participants must contribute at least 4% to get full state subsidy or tax relief
- The amount of the subsidy depends on the number of children
- End 2012 Riester plans cover 29.0% of the working age population

Coverage of Riester Plans Seems to Have Reached a Peak

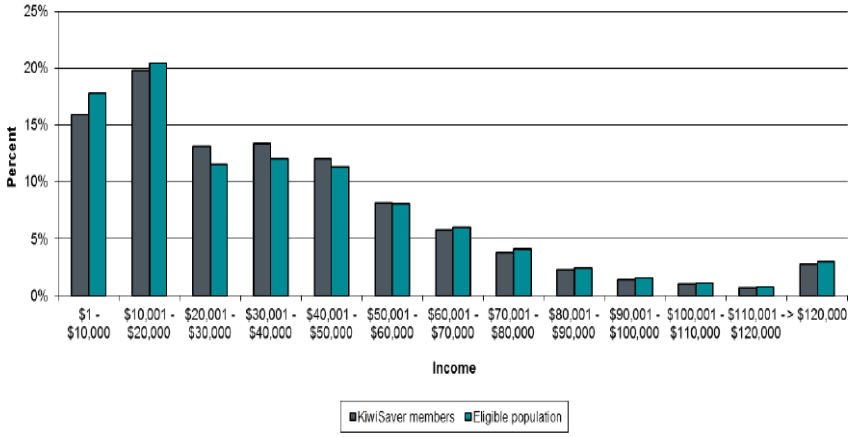


More Homogeneous Distribution by Income

Germany



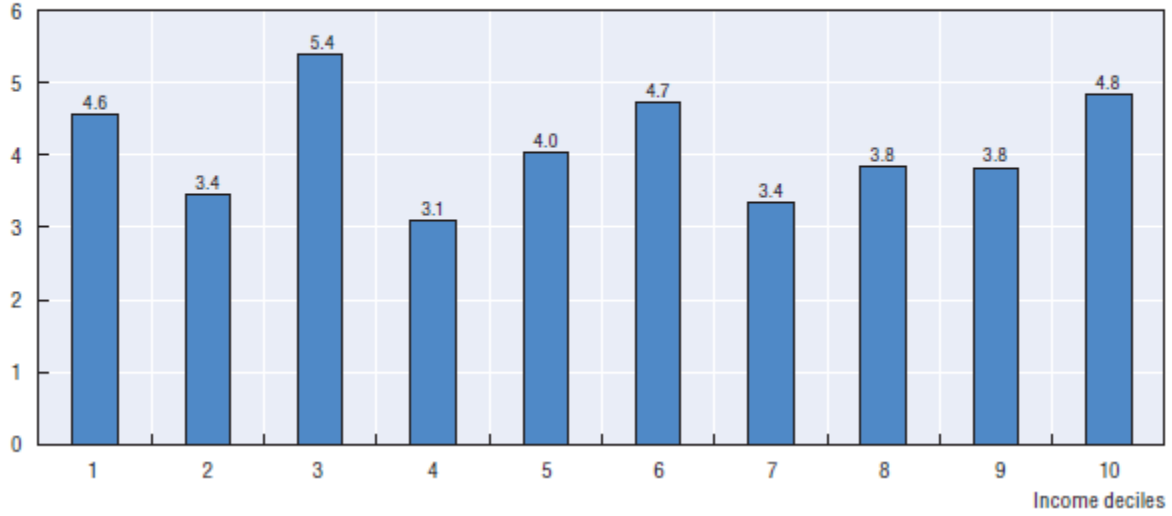
New Zealand



Constant Contribution Rates in Riester Plans Across the Income Scale

Figure 4.11. **Germany: Contribution rates in *Riester* pensions according to the income of the household, December 2008**

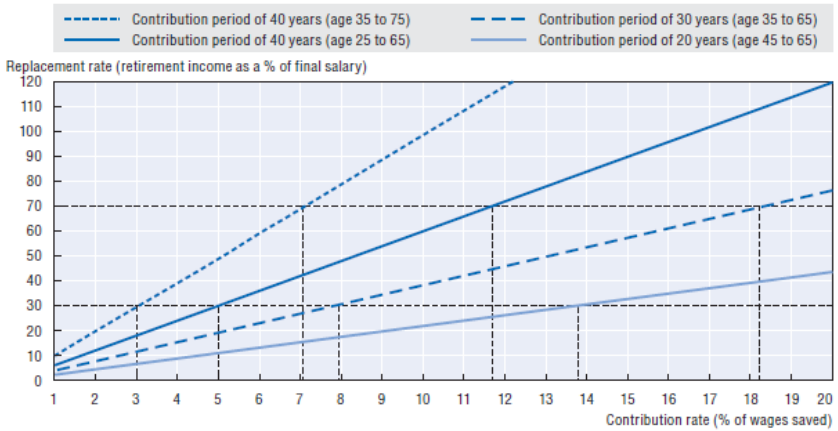
As a % of household net income



Importance of the Default Contribution Rate (KiwiSaver)

- Members joining before 1 April 2009: default 4%
- April 2009-April 2013: default 2%
- As at June 2011, 80% of people who had joined after April 2009 contributed 2%, while 62% of those who had joined before April 2009 were still contributing 4% ➔ Inertia
- As at June 2012, 59% of members contributed 2% and only 36% contributed 4% ➔ Increase in the proportion of members contributing the minimum
- Since April 2013: default 3%

Contribution and Replacement Rates



Note: Contribution and replacement rates when assets are invested in a portfolio comprising 60% equities and 40% fixed income, assuming a nominal rate of return of 7%, a nominal discount rate of 4.5%, and a life expectancy of 20 years at age 65.

- A 6% contribution rate over 40 years may replace 36% of earnings on average
- It drops to 13.1% for a contribution period of 20 years

Contribution and Replacement Rates: Taking Into Account All Risks

Distribution of replacement rates

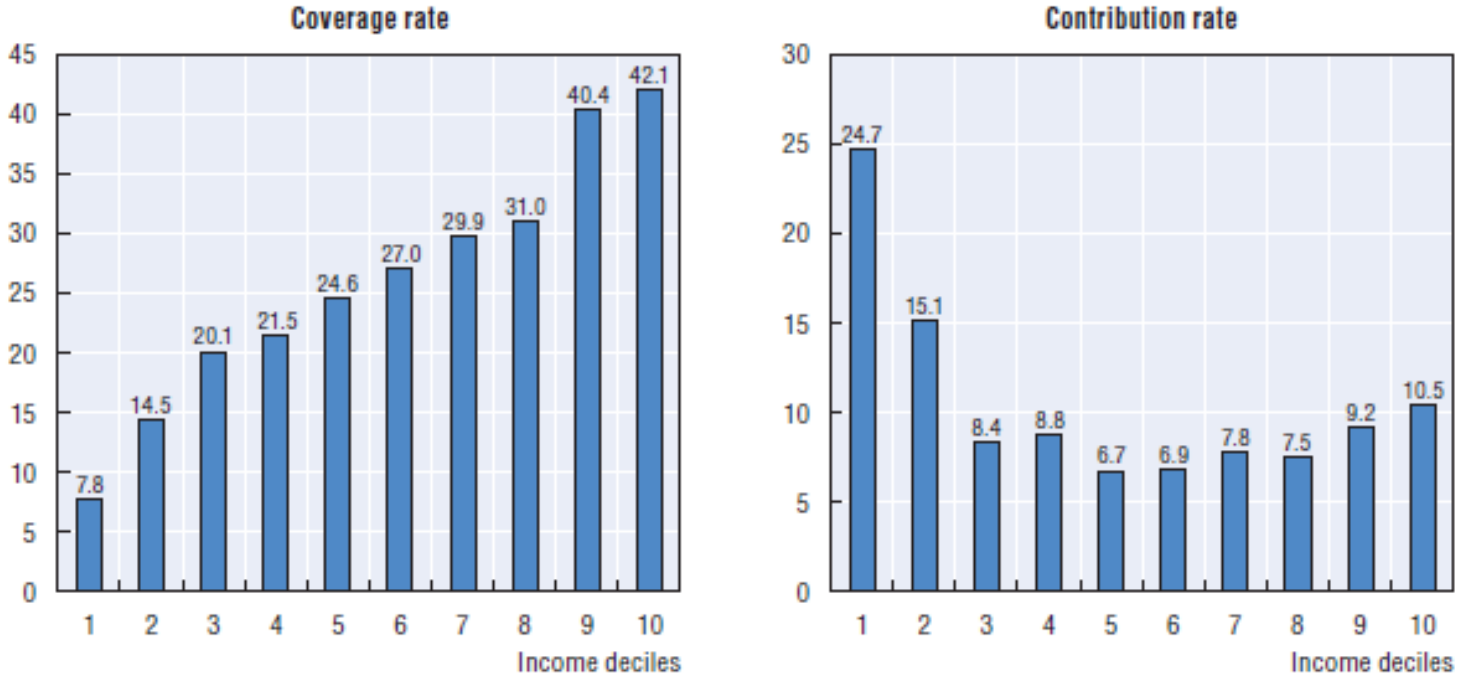
	Percentile of distribution (%) for 40-year contribution period									Probability RR ≥ 30%	Probability RR ≥ 70%
	1	5	10	25	50	75	90	95	99		
5% contribution rate	9.0	12.7	15.9	23.4	36.3	55.0	78.4	95.8	143.5	61.6	13.9
10% contribution rate	17.7	25.5	32.0	47.1	73.3	111.0	159.2	194.8	293.4	91.7	52.8
	Percentile of distribution (%) for 20-year contribution period									Probability RR ≥ 30%	Probability RR ≥ 70%
	1	5	10	25	50	75	90	95	99		
5% contribution rate	3.4	4.6	5.3	7.3	11.4	17.0	22.7	26.7	36.2	2.8	0.1
10% contribution rate	6.9	9.2	10.7	14.7	22.8	34.1	45.6	53.7	72.8	33.0	1.3

Note: OECD calculations, which result from assuming uncertain investment returns, inflation, discount rates, life expectancy and labour market conditions. People contribute either 5% or 10% over a 20 or a 40-year period, and assets are invested in a portfolio comprising 60% in equities and 40% in long-term government bonds.

Super. Co-Contribution in Australia

- Since 2003, low income earners who make additional voluntary contributions to their super. fund get a government matching
- The government pays 50 cents for each dollar contributed up to AUD 500
- Only 15.7% were entitled to a co-contribution in 2010-11

Australia's Voluntary System



- Low-income people less likely to be contribute voluntarily, but those contributing tend to have a higher contribution rate than other income groups

PROPOSED FSC CHANGES TO KIWISAVER DEFAULT INVESTMENT PORTFOLIOS: SOME THOUGHTS

FSC Proposal Regarding KiwiSaver Default Investment Portfolios

- For many people, it may be difficult to save 10% of their income into KiwiSaver to reach a retirement income twice NZ Super
- One way to lower it to 7% would be to move default KiwiSaver assets from conservative to balanced or growth investment portfolios
- An insurance-based capital guarantee would be provided to offset the increased risk

Choosing an Appropriate Default Option

- Yes, moving to balanced or growth investment portfolios would decrease the needed contribution rate (**median**)
- But by increasing the investment risk, the tails of the distribution are pushed back ➔ The needed contribution rate that can be achieved with a **95% probability** may actually be higher
- Default investment strategies should concentrate on reducing the risk of extreme negative outcomes on retirement income
- Life-cycle investment strategies as a default option can protect people close to retirement against extreme negative outcomes. They reduce the impact of market risk on the account balance as the member ages

Guarantees Can also Alleviate the Impact of Market Risk

- Policy makers should assess the potential advantages and costs of introducing capital guarantees
- Such guarantees have to be financed and would increase the needed contribution rate
- Capital guarantees are cheap to provide, **if and only if**:
  - the contribution period is sufficiently long (40 years),
  - the investment strategy is fixed (freedom of choice when entering the plan, but no switch to another investment strategy allowed afterwards), and
  - people cannot switch providers

THANK YOU FOR YOUR ATTENTION

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