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Feedback on the 'strawman' proposal for Irish pension reform from New Zealand experience[1].

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[1] Consultations in Ireland 2018 are being conducted by the Department of Finance and Department of Employment Affairs and Social Protection. Feedback report was prepared for Insurance Ireland and TOR Financial Consulting.

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Purpose

This report provides specific feedback from the New Zealand experience and perspective on the proposed Auto-Enrolment (AE) scheme for Ireland. It will, in particular, discuss and draw lessons from New Zealand's experience of:

- the default provider regime;
- tax incentives for retirement saving on tier 2 pension coverage;
- TTE and the alternatives;
- Gender and other issues

Introduction

The Irish pension arrangements consist of

- A contributory state pension and a non-contributory supplementary pension
- Second tier subsidised saving
- Voluntary savings

Tier 1

Ireland has a tradition of using the contributory principle for the Tier1, Irish state pension. Many women face complex and confusing rules, with only a minority of women qualifying for a full contributory state pension. There is an urgent need for simplification of Tier 1 and a need for the basic state pension to be adequate for all.

While reforms of the state pension to adequacy and indexation are proposed in the 'Roadmap for pensions reform' (see Government of Ireland, 2018b), the contributory basis remains so that a full 40 years of social insurance contributions are required for a full pension. While 20 years of time out of the workforce for care-giving may be credited, there will be many women who will be disproportionately represented in the group who still need top-ups from the means-tested supplementary pension or must rely on their partner.

The proposed reforms may improve outcomes for some, but do not constitute a fundamental rethink. There is a need to question the case for maintaining such a complex system that has such clear inequities for women. The 2013 review of the Irish state pension system by the OECD suggested there were many signs of a weakening of the contributory principle (see discussion p 89-91OECD, 2013). They concluded:

> *This brief discussion shows that, contrary to public impression, the link between contributions and benefits in the current State pension scheme is very weak and that there are already numerous elements of redistribution in the system which have a more universal character. When the total contributions approach is adopted in 2020, some of these problems will be remedied. On the other hand, paying a full-rate pension on condition of 30 years of contributions will raise further questions on the contribution benefit link. The treatment of non-contributory periods, such as time out of work for reasons of childcare or unemployment, will be crucial. If, as planned, up to ten years will be credited for such periods, workers will receive the same benefit whether they pay contributions for 20 or 30 years. The system would then take more and more of the characteristics of a flat-rate universal pension system.* ***At that point, there would appear to be a strong case for changing the***

***logic of the scheme in a more transparent way by moving either to a universal or a means-tested pension system which is no longer based on contribution requirements.* (OECD, 2013, p 91)**

New Zealand has chosen to provide a simple Tier 1 through its basic universal residency-based state pension upon which other savings can be built. It is one of the factors that has made the introduction of the AE scheme (KiwiSaver) more straightforward[3].

The Roadmap discusses the need for actuarially assessed Social Insurance funded by appropriate social security rates:

> *Social insurance contribution rates will be adjusted to ensure that there are sufficient funds available to Government to finance the payment of pensions. At present, social insurance rates are set as part of the annual budget process. This is a process that by its nature has a short-term focus and is not suited to setting rates to fund long term liabilities, such as pensions. In response to this challenge other countries, notably New Zealand and Australia, have implemented, or are considering implementing, an actuarial approach to balancing payment and contribution rates. In Ireland we do not use actuarial analyses to set rates in an explicit manner.* (Government of Ireland 2018b, p 9-10).

Comment: This misinterprets the arrangements in New Zealand: while a national fund has been set up (New Zealand Superannuation Fund) it has no actuarial basis, nor are there separate social insurance contributions. New Zealand's state pension is a flat rate, universal, taxable non-contributory payment to all who meet the residency test. It is best described as PAYG with partial prefunding from the NZ Superannuation Fund. That in turn is funded from contributions from budgetary surpluses, not contributions.

The New Zealand experience suggests it is easier for people to understand the impact of KiwiSaver on their retirement position if there is a secure Tier 1 universal basic pension based on residency not contributions. It is suggested:

> *The key to reform in Ireland will be to relinquish two sacred cows; a contributory basis for the state pension, and income and asset tests for the non-contributory pension. The two state pensions should be joined up into one simple adequate comprehensive wage-linked individually-based state pension. Once that is done, a good centrally administered, auto-enrolment IrishSaver can be grafted on and begin to replace the multiple 'not fit for purpose' current employer-based schemes.*[4]

Tier 2.

The coverage in Ireland under the second tier has been low as had been the case in New Zealand. Coverage in schemes is available to less than half of the workforce and, because women's participation in the labour force is lower, women are much less likely than men of working age to have a pension scheme.

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[3] See Appendix and St John (2016) for details

[4] St John, S We really don't know how lucky we are, New Zealand Herald, October 12th, 2016

There is a plethora of small workplace schemes in Tier 2, some may not be high quality and many appear not particularly transparent or accountable. Many Defined Benefit (DB) schemes are facing funding problems for pensions in a time when longevity is increasing and interest rates are low.

> *With 160,000 occupational pension schemes and just 1% of the EU population, Ireland is home to about 50% of all pension schemes in the EU. Notwithstanding this disproportionately high number of schemes, the proportion of employees in Ireland with supplementary pension cover is low by comparison with those countries that have mandatory/quasi-mandatory systems – just 35% of the private sector workforce has such cover (despite the availability of generous tax reliefs.* (Government of Ireland 2018b, p14).

Tax concessions remain an expensive embedded part of the system.

> *Tax support for private pensions peaked at 1.9% of GNP in 2006, which was not far short of public support for state pensions at 2.1% of GNP (Hughes & Maher, 2016)*

Comment: The roll-out of automatic enrolment scheme in Ireland 2022 is expected to complement, not replace, existing schemes (Government of Ireland 2018c, p 8). In contrast in New Zealand, it is expected that KiwiSaver will eventually supplant most conventional superannuation schemes, i.e. KiwiSaver will continue to grow while other schemes are static or falling in both membership and asset share.

The dramatic fall in the membership and number of occupational and retail superannuation schemes in New Zealand (excluding the Government Superannuation Fund that closed in 1992) is shown in Table 1. The introduction of KiwiSaver in 2007 and its widespread adoption was both facilitated by this decline and is contributing to further decline.

Table 1 Changes in registered NZ superannuation schemes 1990-2015. Source: Financial Markets Authority (2016)

Superannuation schemes in force on scheme balance dates in 2015

All registered schemes except investment only schemes

		Number of schemes			Total assets			Total membership		
		2015	2014	1990	2015	2014	1990	2015	2014	1990
	Assets grouping				$m	$m	$m			
1	Under $0.5m	127	140	1,881	27	29	227	162	188	16,607
2	$0.5m to under $1m	70	78	314	53	58	225	324	330	12,929
3	$1m to under $5m	91	77	415	175	141	943	1,459	1,366	58,582
4	$5m to under $20m	46	55	166	503	589	1,524	11,881	14,098	63,595
5	$20m to under $50m	35	37	44	1,110	1,174	1,312	20,884	24,420	77,023
6	$50m and over	69	69	43	21,446	20,022	6,801	310,049	322,721	318,617
TOTAL		438	456	2,863	23,314	22,014	11,032	344,759	363,123	547,353

Table 1 shows that the biggest changes have been to small schemes with a dramatic fall in membership, while the largest schemes have grown in number reflecting in part consolidation of small schemes in master trusts.

The Irish AE reform debate

The Government of Ireland (2018b) produced a roadmap for consultation on pensions reform, a separate paper on the universal social charge (Government of Ireland, 2018a) and a paper for final consultation on the design of a new AE savings 'strawman' programme (Government of Ireland, 2018c). The current consultation is set out in the Strawman:

Component Elements of Automatic Enrolment which form part of this Consultation

a) The preferred operational structure and governance of the AE system.

b) Whether the preferred overall AE structure for member choice should be –
   - Option A: Open to all providers (subject to satisfying specified standards).
   - Option B: Delivered using a small number of AE 'Registered Providers' selected by tender process.

c) The means by which enrolled members who elect not to exercise choice will be allocated to a default fund.

d) The target membership – i.e. exactly who will be automatically enrolled.

e) The contribution rates that may be required of employees and employers.

f) The financial incentives that may be provided by the State.

g) The range of savings products/investment options and providers available to members.

h) Conditions relating to member opt-out, re-enrolment and members' 'Saving Suspension' periods.

i) Options available at the income draw-down/pay-out phase.

This report will examine these points sequentially drawing lessons from the NZ experience.[5]

[5] A more detailed description of the NZ experience can be found in St John (2016).

The preferred operational structure and governance of the AE system.

STRAWMAN PROPOSALS

UTILISING A NEW CENTRAL PROCESSING AUTHORITY AND LIMITED NUMBER OF APPROVED AE 'REGISTERED PROVIDERS'

- A new Central Processing Authority (CPA) will be established and be responsible for sourcing, on a competitive basis via an open tender, a limited number of AE Registered Providers (maximum of four) to provide a defined suite of retirement savings options.
- The CPA will establish minimum standards for service delivery and product features required of all providers, e.g. the number of investment fund options for members, service response times, etc.
- Registered Providers will be expected to deliver retirement savings services, potentially on a 'Master Trust'[9] or other multi-employer basis, at low unit cost via an online portal to be provided by the CPA. This will encompass the full range of scheme services including account administration, investment management and member communication.
- The CPA will establish and operate a web-based 'AE Provider Information and Administration Portal'. This will provide access to AE services and a central repository of key AE information.
- Contributions will be collected by the employer via payroll systems and transferred to the CPA. The CPA will remit contributions thereafter to the selected AE Registered Providers[10].

It is proposed the new AE scheme will allocate members who do not choose a provider into a default scheme of a registered provider by carousel administered via a clearing house.

Strawman features

- The member will be able to keep track of their contributions, and the contributions remitted to the provider on their behalf, via the CPA Portal. The portal will also provide access to online account statements to be populated by the providers.
- Employers will be responsible for the initial enrolment of employees via the CPA Portal.
- Employees will be responsible for selecting a provider and savings fund option. In the absence of any savings decision, the enrolled employee will be automatically allocated to the default fund of one of the AE Registered Providers on a carousel basis.
- As the CPA will be publicly operated, each employee's PPSN will be used as a unique identifier to support service transactions and to facilitate the pot-follows-member approach.

Comment: The structure differs substantially from New Zealand's AE scheme, KiwiSaver. The following comments are offered from the perspective of the NZ approach.

Clearing house

NZ has utilised the Inland Revenue (IR) as the clearing house and contributions are made alongside PAYE tax remittances. The IR also ensure the correct tax credits are allocated to members. The Strawman proposals suggest that the CPA is an independent body separate from the tax department. This may be unnecessarily complex especially when the design of the AE scheme requires that bonuses (tax credits) are paid to members' AE accounts, presumably via the tax department, and are based on total employee contributions up to a cap.

The process for registration

The CPA is also tasked with licencing providers. In NZ this is separated from the clearing house and carried out by the regulatory authority - the Financial Markets Authority (FMA) who also report annually on KiwiSaver statistics. This separation works well.

NZ providers are registered and supervised by the FMA. **Any provider** that meets the requirements can be registered by the FMA. Over time there has been some consolidation and mergers so that there are now just 31 providers in 2018.

While economies of scale are often cited - and are currently in the Irish Strawman thinking as the reasons to have only a few providers - this is less of a reason to exclude smaller providers when there is a central clearing house and other possible outsourcing of administration:

In a Government review in 2012, it was noted that:

> *Establishment costs for a KiwiSaver scheme vary across providers and scheme profitability will be driven to a large degree by utilising existing infrastructure. This is where the banks have a significant competitive advantage in leveraging off a ready-made distribution network. Approximately two-thirds of all KiwiSaver funds are now with the banks. However, a number of small boutique KiwiSaver funds have launched since inception in 2007.* ***This would suggest barriers to entry can be overcome. The ability to out-source back office functions and concentrate on the core investment management function has enabled smaller players to participate in the market. (Ministry of Business Innovation & Employment, 2012)***

The 4 providers proposed in the Strawman seem too few and may not deliver the anticipated economies of scale or lower fees. Default to these 4 by carousel may deliver funds too easily to too few members and lock too many in conservative funds.

Default providers

After a review and request for proposals in 2014, nine out of the 31 register providers in New Zealand were chosen by open tender process to be default providers. The tenders were assessed by an independent panel according to a range of criteria including a provider's organisational and investment capabilities and fee levels. The default providers must offer investor education to encourage people to make an active choice. The intention was also that the fees would be lower than had been the case, in particular, for smaller fund balances. At this time, around 22 per cent of all KiwiSaver members were in default funds.

Default providers must: educate default members about the choices that may be more appropriate for them; report numbers of members who made a choice; and have fees that pass the test of reasonableness. Nevertheless, there have been many criticisms of the default provisions:

- The default providers are unfairly advantaged over other registered providers
- The default option is too prescribed- only up to 25% can be in growth assets
- Big banks have tended to dominate the default sector

- The regime has not stopped the investment of default funds into the banks' own securities.
- Default providers have not done a good job in making sure employees know about their options for more suitable products.
- Fees have not fallen as they were expected to do. Unreasonable fees may be challenged by the FMA but it is a slow process in practice.

In the NZ arrangements, it is clear there is a trade-off between requiring a default provider to have sufficient size and scale versus encouraging smaller providers who may be more nimble and cost-efficient. Minimum size and scale requirements invariably limit default provider appointments to large financial institutions such as banks. These institutions have proved to be slow to deliver.

The latest assessment of the default provider regime shows that the FMA is less than happy with some default providers especially in their efforts to help default members make active choices (Financial Markets Authority, 2018). They also note that while higher risk is correlated with higher returns there is 'no clear link between higher fees and higher returns part from a couple of standout funds'.

Table 2 shows that active choice by default members has no obvious relation to economies of scale with AMP having the largest number of default members but the smallest percentage of members that have made changes.

Table 2 How effective are default funds in aiding effective member choice? (FMA, 2018)

	Total default members	Default members making an active choice within the named scheme number					
Scheme	**2018**	**2018**		**2017**		**2016**	
Booster	18,308	2,797	15%	1,282	9%	2,205	22%
ANZ Default	72,443	7,615	10%	3,651	5%	4,868	6%
Mercer	81,861	6,263	8%	2,553	3%	5,033	5%
BNZ	22,172	1,112	5%	449	3%	355	3%
KiwiWealth	22,295	1,064	5%	624	4%	478	4%
Fisher Two	68,508	3,316	5%	3,462	5%	2,781	4%
ASB	90,456	3,766	4%	1,394	2%	1,441	1%
Westpac	22,492	660	3%	385	2%	440	4%
AMP	112,620	2,073	2%	2,286	2%	11,007	8%
	511,155	**28,666**		**16,086**		**28,608**	

There is a groundswell of dismay in New Zealand about the way the default regime has denied so many members the chance of good returns and low fees (Retirement Policy and Research Centre, 2018).

In June 2018 in an open letter to the Financial Markets Authority and Reserve Bank, the Independent Financial Advisors drew attention to the foregone returns and high fees in default funds, and suggested that default providers may have a conflict of interest:

> *Several of the default providers had a serious conflict of interest which possibly explains their failure to switch default members to more suitable funds. Were they acting in their own interests by dragging their feet with this requirement? Statistics suggests they were acting in their own interests. There was a sudden large spike in switching activity in the run-up to the review of default suppliers and their re-appointment in 2014, which tailed off immediately after re-appointment.*
>
> *The potential conflict of interest is demonstrated by the portfolio composition comparison between default conservative funds and KiwiSaver balanced funds. On average, bank owned default conservative KiwiSaver funds in April/May 2018 had 22.4% more of their portfolios invested in bank products than they did in their own balanced funds. In 2018 the five bank default KiwiSaver providers on average had 34% of their default funds invested in bank products. Effectively charging default members for investing in their own and typically other Australian banks products*

The NZ experience suggests there is a case for registering all providers who meet the criteria and allowing any registered provider who meets the credentials to be a default provider.

An alternative suggested in NZ (Retirement Policy and Research Centre, 2018) is that there is a holding fund, maybe the IRD, where members who do not make choice are defaulted for up to 12 months. If they have not made the choice to shift after 12 months they would be put on a contribution holiday.

It has also been suggested that the state should not prescribe the default asset allocation (currently very conservative and unsuitable for most people) but each provider should develop its own default options – perhaps lifecycle based. The emphasis on member education and clear communication remains essential.

Fees

Ireland has chosen to cap fees. There is still a lot of faith in NZ that no cap is best and different providers will legitimately have different fees structures. The expectation is that sunlight, full disclosures and FMA scrutiny for 'reasonableness' will win out. It remains to be seen if this faith is justified.

To help members make choices KiwiSaver funds' performance, fees and service can be compared online at. http://fundfinder.sorted.org.nz/ Since April 2018, providers have been required to show the total fees in dollar terms paid by the member in annual statements.

MOBIE (2012) also noted a conflict if lower fees are given too much emphasis. It has been difficult to align performance with fees and low fees may discourage effective active investment.

> *… in managed funds there is an inherent misalignment between investor interests (which are to maximise risk-adjusted investment returns over the long-term) and fund manager interests (which are to increase funds under management, usually*

best achieved through a focus on short-term gains rather than the long-term investment profile that their members may have). (MOBIE 2012)

It is noted that even after 11 years NZ has a high fees structure: eg conservative 0.85% average; aggressive 1.3% average (Financial Markets Authority, 2018). The default regime in NZ will be reviewed in 2019 with an emphasis on lowering fees.

The target membership – i.e. exactly who will be automatically enrolled.

STRAWMAN PROPOSALS

Target Membership

- Thresholds based on annualised gross earnings and employee/member age will be used to determine who will be automatically enrolled.
- Current and new employees aged between 23 and 60 years of age and earning €20,000 or above per annum would be automatically enrolled.
- Those earning under €20,000 per annum and those employees aged under 23 and over 60 will be able to 'opt-in' to the system.
- There will be no employee waiting period before enrolment.
- Rather than being automatically enrolled, self-employed people will be able to 'opt-in' to the system.
- Employees who are existing members of a pension scheme/contract which meets prescribed minimum standards and contribution levels will not be automatically enrolled.
- An opt-in facility will also be considered for those outside of the paid workforce.

Comment: The chosen threshold income of €20,000 is extraordinarily high. Is such a threshold, or any, necessary? For those whose income is variable, sometimes above and sometimes below €20,000, it is likely to be very complicated.

It is very important to make sure that the Irish AE does not disadvantage the growing number of workers in the 21st century who experience more precarious employment, variable work hours, other labour market uncertainties and the need to retrain from time to time. In these cases, a threshold based on annualised income may work unfairly, especially for those with several employers. Women, already disadvantaged in the state pension arrangements and whose working life may involve casual part-time employment with several employers are most at risk here. Their exclusion from auto-enrolment gives the impression that they should not join the scheme when, in fact, they need the strongest of signals to join.

KiwiSaver does not have a minimum income threshold of annualised earnings for auto-enrolment. All new employees are auto-enrolled if over 18 although some employers are exempt. Those over 64, or employed less than 4 weeks, or already employed when KiwiSaver started in 2007, are not auto-enrolled but may join if they wish.

Confining AE to 23-60 age band is also problematic even if those outside it can opt in. By 23, a manual worker may have lost many years of accumulated AE funds, and may have far lower capacity to keep working in later life. Auto-enrolment is *supposed* to address the problem of myopia among this group. Many others would be disadvantaged by the 60-year cut off and miss-out on very valuable years of accumulation. Women with time out for caregiving could be particularly unfairly treated as many enter the workforce later in life after child rearing.

Some of these women may be in a double bind if they do not have the full basic Tier 1 state pension because the means test supplementary age benefit may capture the AE saving.

Gender imbalances require ongoing efforts to address. In 2018, male and female membership of KiwiSaver is about equal, in contrast to the low overall coverage of the early 1990s and the very low female participation in traditional schemes. Even so, there are still major gender issues in New Zealand. Data on KiwiSaver balances are not available by gender, but in line with the Australian experience it is expected that at age 65 the mean balances for females will be well below that for males (St John 2016).

In New Zealand, tax subsidies to KiwiSaver stop at 65, and it is up to the employer whether they continue to make an employer contribution. As more people are working and feel they have to work past 65 this may come under increasing pressure for change. It is more likely to change if the age of entitlement to the NZ state pension is ever raised from 65.

As in the AE Irish case, the employer contribution in New Zealand is a subsidy to members paid for by those not in KiwiSaver whose total remuneration is lower. If the goal is to improve equity for women and low income people, there is a case for reviewing the employer contribution and taking the emphasis away from employment earnings as the basis.

It is not only important that the self -employed and those outside the formal labour market are encouraged to opt in but that the contributions they make are rewarded. In NZ, the reward of the member tax credit NZ$523 (€288) is based on the first NZ$1043 (€598) contributed each year and is not related to being in employment. To get this subsidy, women in unpaid work at home may have their contribution paid from household income.

The contribution rates that may be required of employees and employers

Comment: The Strawman's 1% initial contribution rate seems to be low especially if there is no kickstart or fees subsidy. If small contributions are eaten away by fees and poor returns there may be less acceptance of the AE scheme. New Zealand did start at 1% employee and employer however, rising to 4% and then in 2011 reduced to 2% later rising to 3% each with options for employees to contribute at 4% or 8%. But initially there was a $1000 (€570) kickstart and a fees subsidy that cushioned small contributions.

The eventual rollout to 6% employee and employer will mean that those out of the AE scheme will be seriously disadvantaged in a total remuneration sense. Employer contributions disadvantage those who do not belong because the increasing employer subsidy is at the expense of general wage rises. For those with periods out of the workforce altogether such as for child rearing or other care responsibilities it is worse.

The problem with setting a maximum level of €75,000 for employer-matching contributions is that it gives a signal that contributions at that level will be adequate. It is also unfair if people have two jobs, that in total exceed €75,000. Ireland might seriously consider whether instead employer contributions should be scaled down over time with a shift to a total remuneration approach. The employer contribution for old time pensions schemes were a means of shackling skilled largely male employees to stay with the employer while encouraging exit at retirement age. The AE scheme does not confer these benefits on the employer any more.

The New Zealand contribution default rates of 3% employee and 3% employer are widely viewed as inadequate. There is an inevitable tension in higher rates however as even the 3% contribution is too high for many struggling low wage workers. Over time requests for access to funds on hardship grounds have increased (Figure 2 below).

The financial incentives that may be provided by the State.

STRAWMAN PROPOSALS

FINANCIAL INCENTIVES PROVIDED BY THE STATE

- The State will provide an incentive for people to participate in the AE system.
- Although both the value and the mechanism for providing this incentive will only be finalised following this consultation, the incentive is, for the purpose of this Strawman, presented as a contribution worth €1 for every €3 the employee contributes towards their retirement savings account.
- Where the employee makes contributions in excess of minimum requirements, the State may also make additional contributions subject to a maximum level of contributions of 2% of annualised salary.
- The State contributions will match employee contributions on a pro-rata basis subject to a cap – possibly linked to a defined annual earnings level such as the proposed €75,000 maximum earning threshold or an average annual earnings threshold as reported by the Central Statistics Office.

Comment: If the state provides an incentive, it is not clear that the employer needs to provide one too. The employee could be given a total remuneration package and make contributions of 2% rising to 12% contributions over time.

The state can tailor its incentive to achieve equity goals. The €1 for €3 subsidy up to €75,000 implies a maximum subsidy of €250 for a 1% contribution rising over time to a maximum subsidy of €1500 on a 6% contribution. This is in direct contrast to the NZ approach which was to start with generous subsidies that lured people into the scheme, and then progressively remove these over time. The remaining tax subsidy in KiwiSaver is minimal and targeted to be maximised at low annual contributions levels. Given that contributions on earnings are automatic for those in KiwiSaver, incentives are not needed for those already in KiwiSaver.

In spite of low subsidies, by 2018, KiwiSaver had achieved very wide coverage, with 2.88 m members (of which 423,000 are younger than 19 or over 65). In total, 1.68m are active contributors, 1.2 m are not making regular contributions but may make lump sum contributions. Coverage is about 80% of the eligible population.

The tension is that subsidies are either expensive, inequitable and largely ineffective in incentivising saving, or cheap, fair and still largely ineffective in incentivising saving. These tensions are not easily resolved. Nor should it be overlooked that because incentives are costly to the state they either reduce public saving or necessitate higher taxes elsewhere. They do, however, provide some compensation for the fact that funds are 'locked up' and hence different to other savings. If state subsidies are minimal in the accumulation phase there may be more scope for well-designed subsidisation of the decumulation phase, discussed further below.

It is hard to make definitive statements about Irish proposals as the NZ background is very different. Because it may offer some insights, this history is briefly discussed next.

New Zealand's experience with tax neutrality

The tax treatment of the AE saving in Ireland is of critical importance and the New Zealand experience is set out below to explain the different approach. This section examines how NZ manged to change from the traditional EET to TTE approach[6], the effects of this, and how this has facilitated the roll out of KiwiSaver[7].

As in other countries, tax subsidised private pensions were originally the preserve of employees in large companies and the government sector. The chief beneficiaries in the private sector were characteristically white, male, high-income long-term employees of large companies. In the state sector, public sector employees in the post war period had wide coverage under a generous defined benefit scheme called the Government Superannuation Fund (GSF).

Pension schemes received preferential tax treatment on both employee and employer contributions and on fund earnings. While pensions were taxed as income, up to 25% of pension savings in these schemes could be taken as a tax-free lump sum. Pure lump-sum schemes were also tax subsidised, but less generously after reforms in the early 1980s.

The transition 1987-1990

In the late 1980s, as part of much wider economic and tax reforms, the government flattened the tax scale and abolished all tax subsidies for saving. The shift from EET to TTE required that DB schemes had a one-off opportunity to write down the value of pensions in payment to reflect that they were now tax-free. Many company pensions were not written down because the schemes were in surplus, or were only partially written down conferring an advantage especially to high marginal tax rate payer. The GSF sector pensioners, for example, gained overall and there was a very significant future tax loss (St John & Ashton, 1993).

From this point New Zealand's tax regime for retirement income saving no longer distinguished between pension and lump-sum schemes. With no tax concessions, no restrictions could apply as to how scheme benefits were to be received although the trust deed could specify such details. Also, there was no restriction on the amount of the employer's contribution. Rather than tight regulation, New Zealand adopted a full disclosure approach as consistent with free market reforms.

The intent of removing privileges from certain classes of saving was to encourage investment in more productive areas, and the policy change was done in the context of other wide tax

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[6] In the 'Taxed - Taxed - Exempt' (TTE) approach to the taxation of retirement saving, investments are made from taxed income (T); the income earned from the investment is taxed (T); but amounts withdrawn from the investment are not taxed (E). Most OECD countries tax some retirement savings on an 'Exempt - Exempt - Taxed' (EET) basis. Other capital income is usually taxed on a 'TTE' basis.

[7] For a discussion of these reforms which were implemented between 1988-1990 see St John & Ashton (1993), pp.21-45.

reforms. The industry was not well organised to resist and while many other reforms of this period have been modified, the TTE reform has largely remained intact.

The experience 1990-2005

Many DB schemes were closed to new members after the removal of tax incentives including the government's Superannuation Fund (GSF) that closed in 1992. Active membership of private sector employer and government employee schemes dropped from 22.6% of the employed labour force in 1993, to 14.1 % in 2003 (see Table 3).

Table 3 Occupational Superannuation 1993-2003

Table 1 Active Membership of Occupational Schemes 1993-2003 Year	Private 000's	Government 000's	Labour force, 000's	Private	Total
1993	273	61	1,475	18.5%	22.6%
1995	254	58	1,608	15.8%	19.4%
1997	244	52	1,731	14.1%	17.1%
1999	222	49	1,741	12.8%	15.6%
2001	218	45	1,806	12.1%	14.6%
2003	217	51	1,898	11.4%	14.1%

Within this overall decline, membership of employer-sponsored registered defined benefit (DB) schemes fell markedly more than membership in defined contribution (DC) schemes, reflecting not just the changed tax environment in New Zealand, but a world-wide trend (Disney & Johnson, 2001, pp 23-27). Labour market changes probably made this shift inevitable. As Barr (2001) for example argued, the new realities of the modern world, increasing globalisation, labour market mobility, and different family structures including more divorce, all act to make defined contribution plans more practical.

Along with a sharp decline in occupational schemes generally, "total remuneration" packages became more common in the 1990s. In these, income is grossed up and the employee chooses the nature of the savings instrument and how much to save in it, while the employer's role may be limited to facilitation and/or administration only.

Unfortunately, tax neutrality for saving (TTE) in the 1990s in New Zealand required that the full suite of reforms be implemented including removing the tax advantages enjoyed by housing (TEE). The ideal was that all income no matter what the source would be treated the same. The reforms proposed a wide-ranging capital gains tax but this was one aspect of the package that was not achieved. While the reforms achieved neutrality between saving in the bank and saving in superannuation schemes, the distortion of the under-taxation of housing remained an incentive for over-investment in the property market, and a factor in the subsequent speculative housing boom that has seen New Zealand lead the developed world for unaffordability of housing and growth in wealth inequality.

The decline in occupational pensions coverage by the early 2000s suggested that many middle-income people were going to be poorly prepared for retirement. NZ Superannuation (state pension) provides a reasonable rate of replacement for low income people but a poor rate for middle income people. Workplace saving was seen as the primary way to facilitate the accumulation of additional retirement funds and political pressure grew for a new approach.

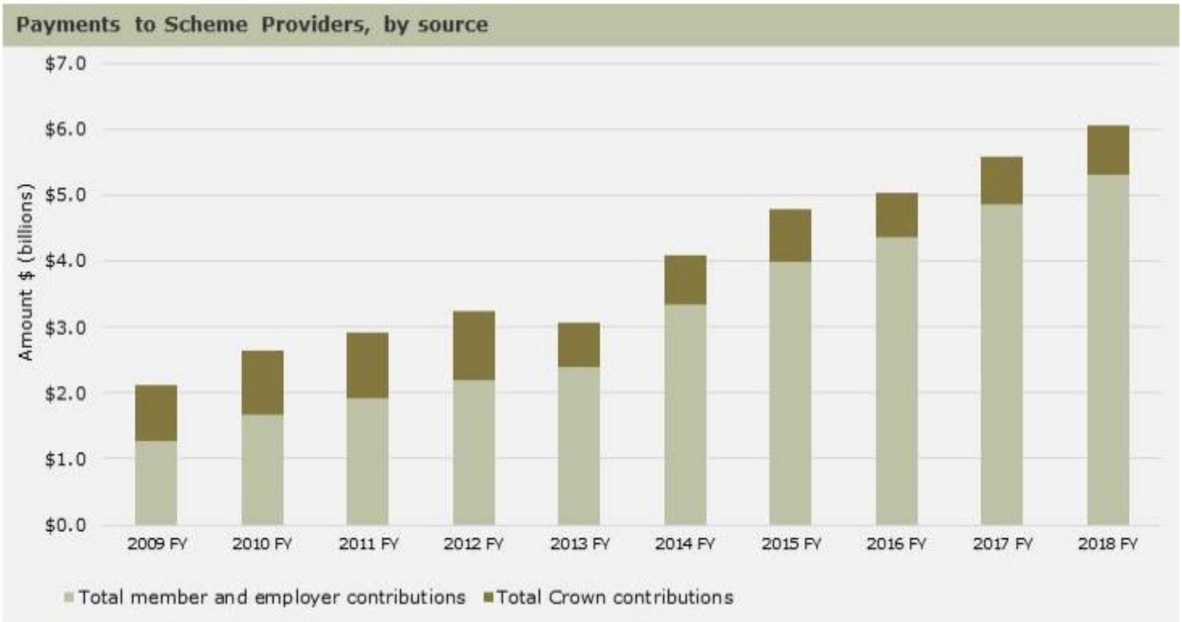
Auto enrolment KiwiSaver 2007

KiwiSaver was rolled out very quickly from 1 April 2007 after the government announced its intention in budget 2005[8].

Initially there were 'sweeteners' (eg a kickstart of $1000, a fees subsidy an employer tax credit and a member tax credit) that were relatively generous, but as overall membership soared these have been cut back to make fiscal savings. Figure 1 shows the relative importance of government subsidies has fallen substantially.

The case for any such 'sweeteners' could be justified by lack of access to KiwiSaver until age of 65, except for exceptional circumstances, or first home purchases. By 2018 the only tax incentive left in KiwiSaver is a modest maximum $522 (€288) member tax credit for contributions up to $1043 (€598) a year.

Figure 1 Share of state subsidies (2018 KiwiSaver statistics website[9])



This graph shows the total amount of member and employer contributions against the total amount of crown contributions paid to Scheme Providers during each financial year since KiwiSaver was introduced.

In New Zealand, overall Crown subsidies have been of most benefit to those who joined in the early years and were closest to retirement. While clearly the incentive of the flat rate $1000 Kickstart was to join, not to contribute, its abolition in 2015 did not include a detailed distributional analysis. Initially, it was a way of government to dispose of early budget surpluses in a way that fended off demands for tax cuts which would have been economically unsound in that part of the business cycle.

[8] See St John (2016) for a review of the implementation detail.

[9] Inland Revenue https://www.kiwisaver.govt.nz/statistics/

Distributionally, the policy had merit although access to the Kickstart by children was more problematic. For new KiwiSaver members especially the young and women joining after child rearing is over, the kickstart was especially welcome.

Employees are also incentivised by the matching (3%) employer contribution. The employer contribution was initially tax-free but became fully taxed at the marginal tax rate of the employee in 2012.

Income in the KiwiSaver fund is taxed under the Portfolio Investment Entities (PIE) regime which aims to effectively tax returns at the member's own marginal tax rate but has been designed in a way that gives a modest advantage to higher income earners. The top income tax rate in NZ is 33%, while the top PIE rate is only 28%.

While the original intent was that KiwiSaver would not replace other occupational schemes, over time that has tended to be the case. Existing superannuation schemes could convert to KiwiSaver, subject to meeting certain criteria. The various sweeteners made this an attractive option. People could also join KiwiSaver while a member of their own employer's scheme and although the employer did not have to contribute, the member tax credit was still accessible.

The closure of the public sector DB scheme in 1992 accelerated the move out of DB schemes. The removal of the traditional tax incentives in the older schemes was helpful in aiding the successful introduction of KiwiSaver.

Moving from EET to TTE. Why not ETT?

The NZ experience of removal of tax incentives and a shift from the traditional EET to TTE was a major disruption and entailed the loss of future tax revenue. Such an approach may not be possible in other countries.

If the intent was to level the playing field it was argued at the time that ETT would have been less disruptive. It would have meant pensions in payment would have continued to be taxable and prevented a lot of windfall gains. One of the disadvantages was that it would have meant an immediate loss of tax revenue compared to TTE. This may have required caps placed on the amounts that could be contributed.

More detail can be found in (St John, 1999, 2001, 2004, 2005a, 2005c, 2007a, 2007b; St John & Ashton, 1993)

Conditions relating to member opt-out, re-enrolment and members' 'Saving Suspension' periods.

STRAWMAN PROPOSALS

POLICY FOR OPT-OUT AND RE-ENROLMENT

- Members will be automatically enrolled on the CPA by their employer on commencement of employment.
- Contributions during the first six months of membership will be compulsory.
- Member opt-out of the system will be facilitated in a two month 'opt-out window' (between the start of the 7th and end of the 8th months).
- Thereafter, under prescribed circumstances limited member 'Saving Suspension' periods will be facilitated where members wish to temporarily cease making contributions. Employer and State contributions will also cease in this scenario.
- Members who opt-out will be automatically re-enrolled after three years but will have the ability to opt-out again under the same circumstances just described.
- Members who opt-out during the opt-out window will receive a refund of personal contributions paid (less management fees) up to the point of opt-out. Employer and State contributions, with management fees deducted, will be transferred to the CPA as a contribution to its administrative costs thus lowering overall costs and fees to remaining members.

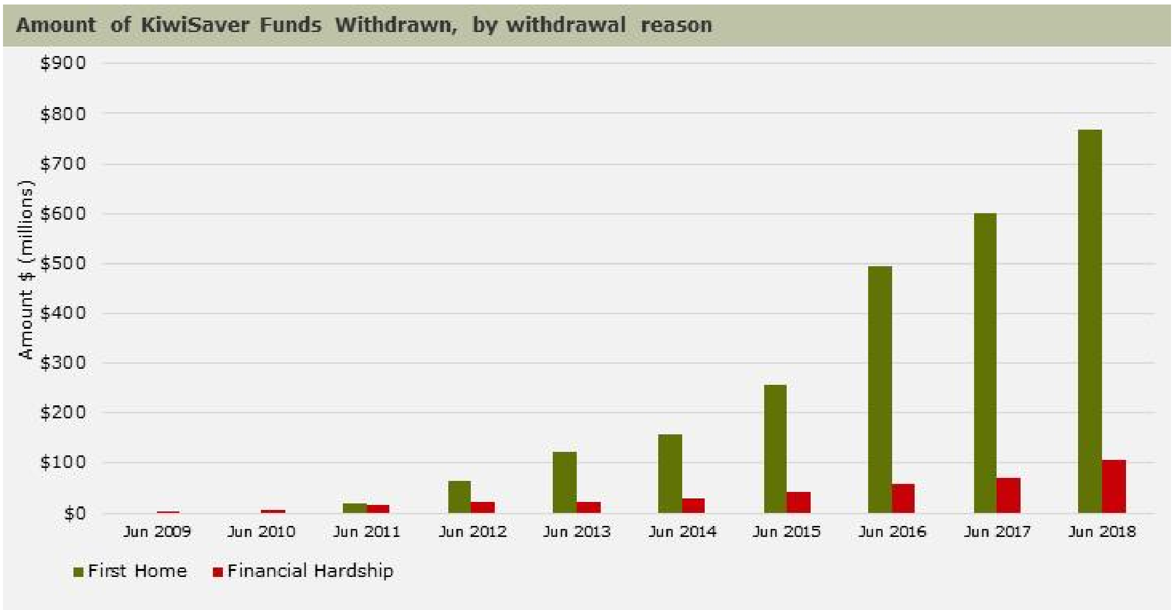
Comment: The period allowed before opt-out appears very long. The New Zealand experience suggests it is best to confine opt-out to the period before funds are allocated to a provider. In NZ it is 2-8 weeks and the funds are held by IR for 3 months before being allocated to a default provider if no provider is selected. This makes refunds to the employer and employee on opt out more straightforward.

Early access to AE funds?

The NZ experience has been that over time there has been more access for hardship reasons, but in particular for first home ownership. It is not clear that Ireland will have such a provision, but neither is it clear that such a provision is desirable.

Figure 2 shows that the dramatic rise in the use for housing. Like Ireland, New Zealand has experienced an unsustainable housing boom (see St John 2016) and it is increasingly difficult for younger people to find the deposit to get on the housing ladder. One response to this problem has been to make it easier for buyers to access their KiwiSaver funds. The problem be that many accumulation years are lost and some may never return to regular contributions as they repay high mortgages. Having said that, it is one feature that has been very popular and recent policy changes have liberalised access to include withdrawal of the employer contributions and tax credits as well as individual contributions. The impact is yet to be analysed and there may be other more preferable ways to encourage home ownership.

Figure 2 Withdrawals by reason (2018 KiwiSaver Statistics website)[10]



This graph shows the dollar amount of fund withdrawals each financial year for both first home and financial hardship withdrawals.

Options available at the income draw-down/pay-out phase

Comment. One of the advantages of a tax incentive for KiwiSaver, even though minimal, is that it allows the government to prescribe lock-in until the age of 65. Other occupational savings scheme (unsubsidized) have no such statutory requirement although the trust deed may specify lock in.

New Zealand has chosen not to prescribe decumulation choices. KiwiSaver remains a lumpsum scheme with no guidance on how the lumpsum should be drawn down. Nevertheless, for the future it may be possible with carefully designed and limited tax incentives to encourage annuitisation up to a maximum amount. Well-designed subsides for decumulation products that offer longevity protection could include inflation protection and could possibly also include a long-term care insurance aspect (St John, 2004, 2005b).

New Zealand may have been wiser to require compulsory annuitisation from the outset when KiwiSaver was first introduced. It is hard to require this retrospectively. One possible way forward for New Zealand is to build on the infrastructure for KiwiSaver, and default members at age 65 into an annuity, or draw down product, permitting members to opt out if they so choose. There is a concern that under current arrangements KiwiSaver lumpsums may be dissipated too quickly on lifestyle expenditures, leaving the state to pay for longer term costs.

The clear lesson to be learned is that it is better to have the debate about decumulation before the AE scheme is introduced.

[10] https://www.kiwisaver.govt.nz/statistics/annual/withdrawals/

Final comments and possible lessons for Ireland

Will the AE reform in Ireland deliver desired results?

1. The AE reform in Ireland has been driven by the concern expressed in Strawman document

   A system with the capacity to systematically deliver to employees across multiple employers under one structure would also begin to address the fragmentation of pension provision in Ireland. This has been identified as a significant shortcoming by the Pension Authority and sees Ireland accounting for 50% of the pensions schemes in the EU, even though we have just 1% of the EU population. Ireland's average membership of 24 people per scheme (excluding single member schemes) is in sharp contrast to international practice which routinely achieve economies of scale with hundreds of thousands, and even millions, of members (Government of Ireland, 2018c, 24)

   The problem is that there is nothing in the roll out to suggest this proliferation of 'not fit for purpose' small schemes will diminish in Ireland. The Irish AE scheme has been described as a complement to existing schemes rather than a replacement. The New Zealand experience suggests that for the AE scheme to be successful there needs to be a rethink of how the new scheme will replace or absorb these multiple small schemes over time and the mechanisms for achieving this.

2. NZ has had rapid success in the roll out and now has wide coverage and equal gender balance in KiwiSaver. One reason for wide coverage can be traced back to the abolition of tax incentives for retirement saving in the 1987-1990 period. This accelerated the already declining membership in other occupational schemes and the shift from DB to DC schemes. By 2005 the coverage was so low that there was much pressure for a workplace alternative that could address the shortcomings of the traditional schemes including gender imbalance.

3. While some of the old schemes remain, it is clear that KiwiSaver is widely accepted as the main vehicle now for retirement saving. One feature that has helped was that people could belong to KiwiSaver as well as their own scheme. Another was that KiwiSaver alone was government subsidised. Another was that the state closed its own DB scheme to new members in 1992 and that helped lead the way to the shift from DB to DC.

4. Ireland appears to be retaining full subsides for existing schemes including DB schemes for state employees. These are expensive and regressive and may inhibit the adoption of the AE scheme. The new AE scheme also has expensive and regressive tax subsidies even though they are income capped. It is difficult see how the cap applies in practice in situations where people have several jobs or to the self-employed. It would be more targeted to give kickstart to new enrolees and to design the state subsidies so that they can be readily accessed by members who may make contributions outside the paid workforce or as self employed.

5. The subsides in KiwiSaver (originally generous) were designed to be of most value to small savers and their progressive removal did not seem to harm the popularity of KiwiSaver. In contrast to what is proposed for Ireland, the remaining member tax credit in New Zealand is small and fixed in dollar terms and so is eroding with inflation. It is important nevertheless as it enables the state to require, that apart from provisions for first home ownership and limited hardship there is no access until 65.

6. Women have been systematically disadvantaged in the Irish pension system, both state and occupational. It would be a pity to introduce an AE scheme that further entrenches this disadvantage with high earnings thresholds and auto-enrolment age exemptions. It is not only women who will be disadvantaged as the modern labour market becomes more casualised and precarious and self-employment becomes more common.

7. There seems little justification for maintaining the contributory basis to Tier 1 provisions. A simple comprehensive residency-based, universal state pension may facilitate the roll out of the Tier 2 contributory AE scheme and greatly improve equity for women.

8. Care is needed to ensure the goals of the provider regime are achieved especially the default arrangements. The New Zealand experience shows the regime including the operation of default providers needs to be constantly reviewed. Big players such as banks may be less receptive to monitoring, there can be inertia around default members, and economies of scale and lower fess may be a chimera.

9. Are tax incentives in the AE strawman scheme adequately leveraged to ensure sensible decumulation? They are not in New Zealand's KiwiSaver and that is a lost opportunity. There is time to design a default decumulation option in Ireland that is attractive and that may be a better focus for subsidies.

10. Finally, it has been important for branding and acceptance to have a catchy name. KiwiSaver sits alongside KiwiBank, KiwiRail and now KiwiBuild. The Government of Ireland might give some thought to a name that will fire the imagination.

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Appendix 1

The KiwiSaver scheme (St John 2016)

- KiwiSaver membership was expected to plateau in 2012 at only 1.4 million (Inland Revenue Department 2009) but by the end of June 2016, membership at almost 2.65 million, represents nearly 80% of the eligible population under age 65 excluding children.
- KiwiSaver is a voluntary, work-based savings scheme, administered by the IRD using the existing PAYE (pay as you earn) tax system.
- The self-employed, beneficiaries, children and non-workers can join, making payments if any, directly to the scheme provider.
- Employees, automatically enrolled into KiwiSaver when they start a new job, have the 2nd to 8th week of employment to 'opt-out' and must advise their employer or the IRD of their decision. Having opted out, they cannot be auto-enrolled again until they change jobs but can re-join at any time.
- Scheme enrolment is not automatic for workers under 18, over 64, employed less than 4 weeks, or employed when KiwiSaver started in 2007. They may join if they wish.
- Existing superannuation schemes may convert to KiwiSaver, subject to certain criteria. Members of other schemes may open a KiwiSaver account, instead of, or as well as, their existing scheme. The employer does not have to contribute to the KiwiSaver if they are subsidising another scheme
- The automatic enrolment provisions do not apply in workplaces where the employer is "exempt" i.e. running a scheme that is portable, open to all new permanent employees, with a total contribution rate (employer plus employee) of at least 6%.
- The only remaining tax-funded inducement is a matching subsidy is paid by the government for the member's contributions (50 cents for each dollar of contributions to a maximum of $1,043 contributions a year).
- Employees' contributions start from the first pay day with an employer. Deductions from net wages are at a rate of 3% of gross pay, unless the individual opts for the higher rate of 4% or 8%. Employers are compelled to contribute 3% of the pay of KiwiSaver members, but only the net amount after tax is contributed to the member's scheme.
- All savings are managed by private providers that are free to offer different investment options.
- Contributions are held by the IRD for an initial three month period after auto-enrolment during which the employee can seek financial advice and select a fund provider. Savers can select their fund and can change provider without penalty, but can only have one provider at any time. Those who do not specify a fund are randomly allocated to one of the default providers chosen by the government.
- Savings are 'locked in' until age 65 (eligible for NZS), except in cases of: financial hardship, permanent emigration, serious illness, or after a minimum of five years (for those first joining after age 60), or to contribute toward a deposit on a first home. However, after a minimum 12 month contribution period, employees can apply for a 'contributions holiday'. Contributions resume at the end of the five years unless the individual applies for a further 'contributions holiday'. Individuals on contributions

holidays can contribute what they wish, when they wish and can stop the 'holiday' at any time.

- After three years' membership, all KiwiSaver funds (except $1000) may be withdrawn for a first home purchase if income and house price caps are met. Further subsidies may apply to low income purchasers.
- As at June 2016, 127,193 or less than 5% of members are on a contributions holiday, in which both the member contributions and the compulsory employer contributions are halted for up to 5 years. The holiday may then be extended or rolled over. Earlier holidays (before the full 12 months membership is satisfied) may be granted in limited cases of financial hardship.
- Longer duration holidays are an increasingly dominant share of the overall members on contributions holidays.
- The age profile of KiwiSaver members has remained relatively constant. Just under 30% of eligible children are members however numbers of children are falling as the 2015 policy to remove the Kickstart takes effect. Those under 18 are not entitled to the MTC either, but may benefit later from being able to access their savings for housing.
- Ove time, the non-indexed nature of the MTC will its value erode in real terms. The figures show, that in the year ended 2016, 27% of members had a zero claim. It is also clear that some those who do get the full MTC contribute only enough to just qualify. When women and others out of the paid workforce or on contributions holidays, make the minimum contributions and receive the MTC, some useful redistribution may be achieved. For others, the dilemma is that the MTC may signal that a minimal saving will be enough.
- If KiwiSaver members do not make an active choice, they are directed into one of the nine default providers and into a default investment option. The default providers are dominated by the major banks and are perceived as having an advantage in the market.
- The default scheme has a default investment option that is required by regulations to have no more than 25% of funds invested in shares/property. The rest must be in cash/bond-style investments. Default funds are required to have lower fees but are widely regarded as unsuited to the needs of younger members. A comparison of international default type schemes found that New Zealand's KiwiSaver was the most conservative. For example, Australian defaults have a 80%/20% split between growth and income assets (Heuser, Kwok et al. 2015).
- Kiwisaver members are cajoled into making deliberate choices to leave such default funds. Total scheme transfers have generally increased each year. The proportion in default schemes was 38% in 2008 but by 2015 default funds had only 21% of the total KiwiSaver membership and 14% of the total assets invested (Financial Markets Authority 2015). As at 31 March 2017, the number of default fund members was 446,534, five years earlier in 2012 it was 447,274 a drop of only 740 members, while the value of default funds increased from $2.9 billion to $4.6 billion.

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