Ministry of Economic Development

KiwiSaver - Evaluation of Supply-side Impacts

November 2008

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David Bartle
Ministry of Economic Development
PO Box 1473
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12 January 2009

Dear David

Please find attached our final report as per our contract of 30 June 2008. Please refer to the disclaimer on page xviii for the conditions of use for this report.

Our evaluation was completed in November 2008 and reflects the KiwiSaver market as at October 2008 based on the KiwiSaver Act 2006. Any subsequent changes made to legislation and the resulting impacts on Providers have not been considered in this report.

It has been a pleasure working with you and the Project Team on this evaluation.

Yours sincerely

Suzanne Snively
Partner, Public Sector Advisory

Paul Rhodes
Partner, Actuarial Services

Executive Summary

Introduction

i. This evaluation is part of the joint evaluation of KiwiSaver being undertaken by Inland Revenue (IR), the Ministry of Economic Development (MED) and Housing New Zealand Corporation (HNZC). The specific focus of this evaluation is the supply-side impacts of KiwiSaver; that is, the effect of KiwiSaver in relation to the superannuation and managed funds market and the wider financial services sector. The effect on overall household savings is outside the scope of this part.

Research and Evaluation

ii. Further research into the supply-side impacts of KiwiSaver will take place over the next five years (as part of a wider evaluation work programme). This report details the findings from this first phase of work, carried up between 1 July and 6 November 2008. Specifically this report:

- describes the superannuation market and the managed funds sector prior to the introduction of KiwiSaver, establishes a pre-KiwiSaver base point and defines a baseline for the evaluation of the changes in the superannuation and managed funds industries with the introduction of KiwiSaver;

- describes the characteristics of an efficient market and considers the KiwiSaver market against these measures;

- presents findings of the impact that KiwiSaver has had on KiwiSaver Providers (Providers) and the superannuation industry in its first year;

- presents a framework for monitoring the supply-side impact of KiwiSaver in the longer-term, based on the efficiency assessment and research based on consultation with Providers; and

- makes a number of recommendations for the ongoing monitoring and evaluation of the supply-side impact of KiwiSaver.

iii. KiwiSaver has been particularly successful, despite the uncertainties surrounding the financial and capital markets, since its introduction in July 2007. This, in large part, is due to the generous subsidies that were offered. Providers consulted as part of this evaluation said that its introduction represented a significant boost for the industry that was largely static in terms of asset growth and that was experiencing declining membership.

iv. This evaluation focuses on the 31 Providers who have Scheme Provider Agreements (SPA) with IR as at 1 July 2008. Between them, these Providers manage 54 KiwiSaver schemes of which 36 are publicly available.

v. The number of Providers, the membership and the level of contributions has all been higher than the government's projections[1]. KiwiSaver schemes have attracted new members and for some Providers, KiwiSaver has reversed the decline in their active membership base. Providers, utilising IR as a clearing house, have generally handled the extra uptake well.

vi. According to responses to question C9 of the KiwiSaver Evaluation Survey (KES) carried out as a part of the evaluation, over 91 percent of Providers expect their KiwiSaver products to be profitable in the next 10 years. The impact of KiwiSaver on New Zealanders' demand for retirement savings and the overall growth in savings is unclear at this point.

vii. Based on the KES and Provider interviews, the market is working well. It exhibits the key characteristics of a viable industry where the funds under investment are earning market returns and where there is innovation, growth and consumer choice.

viii. A striking feature of the introduction of KiwiSaver is the way the private and public sector have worked together, fulfilling their particular roles to respond to a tight implementation timeframe and higher than expected enrolments. This evaluation has highlighted a number of areas whereby changing the relationship between the government and Providers has the potential to generate even better outcomes. IR's clearing house role is important as are the roles of the MED, MSD, IR and Treasury in advising government on KiwiSaver industry policy.

ix. The openness of the Providers and their willingness to support this evaluation has been invaluable. Similarly, key government agencies, industry associations and other stakeholders (including those involved in collecting comparative data about the superannuation sector) have been formally and informally consulted. The response from these stakeholders has also added significant value.

x. There are two distinct areas addressed by this evaluation. The first, called firm dynamics, is an examination of factors effecting KiwiSaver provider efficiency and the development of the KiwiSaver market. The second area of focus, called market dynamics, is the consideration of the impacts that KiwiSaver is having on the superannuation and managed funds market itself – KiwiSaver and non-KiwiSaver superannuation and managed funds providers and schemes. This includes the wider impacts of KiwiSaver on the financial sector, particularly the impact on funds managers and their advisers, trustees, other market participants (e.g. personal financial advisers and brokers), domestic capital markets and relevant aspects of financial system stability.

[1] Budget forecasts initially projected that the number of members would get to 700,000 by 2011, this number was surpassed in 2008 with 716,637 member enrolled by June 2008.

xi. The approach adopted had a number of steps, briefly described below.

- The report documents the changes to the superannuation market and the wider financial sector since the introduction of KiwiSaver. This was based on desk research, interviews and a survey of Providers.

- Stakeholders were surveyed and interviewed to gain qualitative and quantitative information about the key characteristics of the superannuation market. This included information about existing trends to the introduction of KiwiSaver in 2007 and other features resulting from the introduction of KiwiSaver and the changes in the market since then. All but two of the 31 Providers have been interviewed and/or surveyed and those two have both responded by phone and email.

- This report documents what market participants are saying about the key influences of KiwiSaver on the market, including impacts on fees, financial performance, marketing, and overall savings levels. This is covered in the main text and in the appendices that include the full aggregated KES response and a summary of the Provider interviews.

xii. For the purpose of this evaluation, the baseline was defined from two perspectives. The first measure is the base point which is defined as total superannuation funds as at 30 June 2007, prior to the KiwiSaver implementation. The baseline, then, is the change in total managed funds between the base point of 30 June 2007 and 30 June 2008. The base point and baseline have been quantified in Chapter 6 where the details of the market dynamics component of the evaluation framework are described. The baseline period is the period applied by the evaluation framework, covering both KiwiSaver firm and market dynamics.

xiii. Additional quantitative indicators have been established to make up the evaluation framework. These are covered in specific detail in Chapters 5 and 6. These indicators measure key changes in the superannuation market prior to and following the introduction of KiwiSaver, drawing on existing data sources, including the KES.

xiv. A comprehensive review and analysis of managed funds and KiwiSaver data collected (or to be collected) found key information gaps. To be able to develop comprehensive knowledge relating to firm and market dynamics, different data collected at more regular intervals in required. The KES was developed to fill some of these information gaps and it provides an industry perspective about future trends and expectations.

xv. It has been helpful also to receive detailed member and contribution data, as well as other information from IR during this evaluation. This was complemented with information from the Project Team members representing the MED, IR and The Treasury. Due to the current small size of KiwiSaver funds under management relative to the size of the financial markets, this evaluation focussed primarily on impacts on the superannuation and managed funds market rather than wider financial sector impacts. In particular, while the housing sector is mentioned in passing, it was designated as outside the scope of the analysis.

xvi. Chapter 7 includes conclusions and recommendations for the design and staging of future phases of the evaluation and on changes to KiwiSaver policy to support better outcomes[2].

[2] Joint evaluation strategy documentation.

Evaluation Framework

xvii. As described above, the evaluation framework has been designed with two components – firm dynamics and market dynamics.

xviii. The framework has been designed to provide insights about supply-side performance. The framework includes indicators of market and firm dynamics, to put the baseline, substitution effects and other analysis of KiwiSaver in perspective. Used in isolation, it will not be able to answer the over-riding question of whether KiwiSaver has resulted in increased savings. To answer this question, the KiwiSaver supply-side evaluation framework needs to be considered in conjunction with the wider monitoring and knowledge development about New Zealand savings, investment, financial literacy and capital markets.

xix. The following page sets out the KiwiSaver Supply-Side Evaluation Framework. It presents key indicators derived from the evaluation. They profile the size of the KiwiSaver market at 30 June 2008 and provide consistent figures for the superannuation market and managed funds to be compared with the 30 June 2007 base point and the June year 2008 baseline.

KIWISAVER SUPPLY-SIDE EVALUATION FRAMEWORK

Firm Dynamics [a]

Aspect	Measure	Source	Period	Schemes	Providers
Competition	Number of Providers with greater than 5 percent of market share	PwC [b]	As at June 08		7
Consumer choice	Number of retail schemes and Providers	GA register	As at June 08	36	31
Innovation	Number of new schemes / new Providers	GA register	June 08 year	25	11
Profitability	Providers expecting profitability	Survey [c]	As at June 08		91%
Return on investment	Number of Providers with payback periods of less than 8 years [d]	Survey [c]	As at June 08		91%
Consolidation	Number of schemes and Providers	GA register	As at June 08	54	31
Market entry	Number of new companies offering publicly available KiwiSaver schemes[e]	GA register	June 08 year		11

[a] The table above is designed to apply available data. In many cases, individual fund data may be more useful than scheme or Provider data; however, it was not available at the time of this evaluation.
[b] This measure was estimated by PwC within the time period of this evaluation. It can be calculated by the GA in future periods.
[c] KES – KiwiSaver Evaluation Survey.
[d] Future evaluations may wish to adopt other measures if appropriate data becomes available.
[e] The relationship between schemes, promoters and Providers is still evolving and future evaluations may measure schemes.

Market Dynamic Indicators as at 30 June 2007 and 2008

		Managed Funds			Superannuation			KiwiSaver		
		2007	2008	a	2007	2008	a	2007	2008	a
Assets [b]	$m	66,505	60,223	▼	22,004	21,056	▼	bK	1,087	▶
NZ Investment [b]	percent	57	59	▲	44	43	▼	bK	61 [d]	▶
NZ equities [b]	percent	15	11	▼	13	9	▼	bK	21 [d]	▶
Membership	number	NA	NA		635,297 [c]	tbp	▼	bK	716,637 [e]	▶
Schemes	number	NA	NA		560 [c]	tbp	▼	29 [f]	54 [f]	▲

NA=data not available; tbp=data to be provided; bK=before KiwiSaver

[a] The arrows indicate the direction of change for the corresponding variable from the previous period to the latest period. A green up arrow corresponds to an increase, a red down arrow corresponds to a decrease and an orange right-pointing arrow indicates no change.
[b] Sourced from the Managed Funds Survey, June 2008 quarter.
[c] Sourced from the Report of the Government Actuary for the year ended 30 June 2008, with the addition of the Government Superannuation Fund.
[d] Estimates supplied by Statistics NZ as part of the joint RBNZ and Statistics NZ Managed Funds Survey (31 March 2008 figures were available at the time of this evaluation).
[e] Supplied by Inland Revenue.
[f] Sourced from the KiwiSaver Schemes Register maintained by the Government Actuary as at September 2008.

Evaluation framework baseline

xx. The managed funds and superannuation market was stagnant prior to the introduction of KiwiSaver. The key base point data as at 30 June 2007 are:

- superannuation funds were valued at $22,004 million;
- superannuation funds were equal to 13.2% of gross domestic product (GDP);
- total number of superannuation schemes was 560;
- total number of active superannuation members was 635,297;
- the total value of funds under management, including superannuation was $66,505 million; and
- 57% of managed funds were invested in New Zealand and 15% in New Zealand equities.

Future data collection for the evaluation framework

xxi. Future work on the evaluation of KiwiSaver needs to consider the ongoing framework for evaluation, the process to support it, and the approach to filling data gaps. This includes producing more timely data at more regular intervals. Going forward, the evaluation framework would generate more powerful knowledge if it was expanded to include:

- an agreed framework for the communication and comparison of fees and investment returns;
- a description of the motivations that led to enrolment choices, including passive enrolment; and
- further indicators of the efficiency impact of KiwiSaver on Providers.

xxii. The evaluation framework was developed based on the assumptions briefly described below.

- The MED will lead a centrally-coordinated process to enhance the monitoring and development of the KiwiSaver industry.
- The data collection and publishing carried out in relation to KiwiSaver by the GA, IR, RBNZ and Statistics NZ will continue, with timeliness and coverage improving over time.
- The Treasury and IR modelling of KiwiSaver trends for government budgeting purposes be further developed as knowledge emerges about the factors driving KiwiSaver decisions, membership and funds saved.
- An annual survey, based on the one conducted for this evaluation, will be established, noting that there are several surveys that have been conducted since KiwiSaver was introduced – there may be value in combining these.
- There will be further information collection and dialogue on sector performance, possibly through an association representing KiwiSaver Providers.

Continuation of the KiwiSaver Evaluation Survey

xxiii. The KES has been designed to generate information directly from Providers about the immediate and future state of their industry. This information is the basis for indicators within the evaluation framework. Furthermore, industry development relies on information about the future to make sensible investment decisions. Because of the value of this knowledge, it is recommended that the KES become embedded in the evaluation programme. Consideration should be given to making Provider response mandatory as KES is designed to be a quick opinion-based survey.

IR and KiwiSaver

xxiv. IR played a pivotal role in implementing KiwiSaver and will continue to perform the clearing house function. It played a unique role within a non-compulsory tax environment and did so successfully. Providers interviewed and met at the IR – sponsored Provider meetings said that they appreciated IR's collaborative approach and would like to continue the partnership.

xxv. A collaborative partnership arrangement has been established between IR and the KiwiSaver Providers. This collaborative approach has contributed to the stability and success of the KiwiSaver product so far and should be continued.

xxvi. The key roles for IR include:

- monitoring and the provision of information; and
- clearing house, moving KiwiSaver contributions through the pipeline quickly and reducing the transaction costs for Providers.

Fees and investment returns

xxvii. There is a lack of consistency and transparency in fee disclosures and how these relate to expected investment returns, making the comparison of funds unnecessarily confusing for investors. This could be mitigated through the development of an agreed framework for examining and comparing fees and investment returns in a way that informs the public about the returns on investment, and concentrates on long-term performance and risk, rather than short-term performance.

xxviii. As recommended by the Retirement Commission, the MED is reviewing options for monitoring of fees. An industry board is an option, facilitating the development and implementation of a standard for fees, along with the collection of industry statistics.

Savings and capital markets

xxix. Across the whole market, savings through KiwiSaver are locked in, creating a guaranteed pool of funds available to be invested in the long term. As a result, the KiwiSaver market as a whole is relatively immune to the liquidity issues faced by other investment products. This opens up the possibility for investment in infrastructure, venture capital, private equity, commercial property and/or other direct investments. The portability of KiwiSaver, however, means that individual Providers have no guarantee that their investment can remain invested over a long term. This may constrain the nature of the portfolio mix and stymie the development of alternative illiquid assets. The portability feature of KiwiSaver is positive from the saver's perspective, but may have unintended consequences on capital markets. There are potential ways of mitigating this effect if it is deemed to be important. For example, introducing a mechanism for directly transferring assets between schemes.

xxx. If in fact savers began to show patterns of transfers that impact on asset selection, then the MED and Providers could work together to design a more effective portfolio management approach.

xxxi. The notion that KiwiSaver will automatically lead to improvements in New Zealand's capital markets, as witnessed after the introduction of saving schemes in countries like Chile and Australia, needs to be seen in relation to other factors. The compulsory feature of saving in Chile and Australia is only one. The current trend, both in superannuation and the wider managed funds sector, is that the New Zealand equities proportion of portfolios has been decreasing. If this trend is mirrored in KiwiSaver portfolios, then the impact on the New Zealand's capital markets will be slower and over a longer period of time. In addition, the future impact on capital markets will depend significantly on the asset allocations related to the KiwiSaver funds. Most significant are the amounts invested in New Zealand as opposed to off-shore, and in particular the amount invested in NZ growth assets. A move to a larger proportion of NZ growth assets is largely reliant on member choice to move away from conservative or default funds.

xxxii. Future evaluations need to coordinate with other capital market analysis: KiwiSaver is one small player in capital market development. Consideration should be given to the development of a specific component of the evaluation framework for monitoring the features of KiwiSaver that may inhibit the development of the long-term investment market in New Zealand.

Financial literacy

xxxiii. Providers interviewed indicated that there is some concern within the industry that many investors do not seek advice on their KiwiSaver decision. As a result, they are ending up in the conservative default funds that do not match their risk profile. Providers suggested that many of these people should be in other funds.

xxxiv. On the other hand, Providers are concerned that the tight margins in KiwiSaver provide restricted resources for engagement with members to provide investment advice and information intended to increase their financial literacy. A challenge for the industry going forward will be to find new ways of informing investors.

xxxv. Historically, a large proportion of personal superannuation plans have been distributed through trained financial advisers, who assess the client's circumstances, and recommend a suitable investment profile. KiwiSaver has commoditised superannuation into a retail product that can be obtained without any professional financial advice.

xxxvi. The success of KiwiSaver, however, will be influenced by financial literacy. A key factor to monitor is whether the participation in KiwiSaver itself enhances financial literacy.

Substitution effects

xxxvii. It is difficult to obtain data sources to isolate substitution effects of KiwiSaver in regard to other forms of superannuation.

xxxviii. The best source of information to date is Provider interviews and the KES. Providers interviewed noted that substitution effects related mainly to the redirection of future contributions and a drop-off in new business sales of personal superannuation products other than KiwiSaver. Substantial transfers of lump sums from other superannuation schemes into KiwiSaver had not occurred at the time of this evaluation.

xxxix. It is also too early to identity any correlation between changes in contributions and asset levels between the various asset types that may be due to KiwiSaver. The level of KiwiSaver funds under management, while growing rapidly, is still less than two percent of total managed funds. This is too low to have changed any other series that might indicate if KiwiSaver is having an impact.

KiwiSaver feature requirements

xl. There is ongoing interest in default Provider status. The designation of default Providers would benefit from a review, within the next year or two, to test the assumptions used to guide the selection process. Currently, there are six default Providers who maintain that status until June 2014 as long as they continue to meet the negotiated arrangements set for that period. Consideration could be given to setting up guidelines for default Provider status based on the fulfilment of clearly outlined and predetermined criteria. The review could give consideration to:

- standards required of Providers, including the specification of related services, e.g. financial literacy;
- how fees are set; and
- a seamless transition at June 2014 for those default Providers who meet the criteria.

xli. Mortgage diversion was one aspect of KiwiSaver where the interviewed Providers raised significant questions. There were concerns raised about its current design, applicability, costs and the timing of the diversion of regular contributions from the Provider to meet mortgage repayments. Providers noted that the administration of mortgage diversion is complicated and onerous for a number of reasons that are not straightforward. Providers feel that the benefits do not justify the cost and operational implications.

Risks to Provider operations of government policy change

xlii. Providers have made a substantial investment in implementing KiwiSaver and the payback period for this investment is longer than their other core activities. While the changes Providers have made to their systems and processes in preparation for KiwiSaver and PIE may have beneficial flow-on effects to their other product offerings, this payback will take time too.

xliii. As the report notes in Chapter 7 (based on the KES and Provider interviews), uncertainty about government policy is a concern to Providers. This uncertainty (accentuated through potential changes raised in the election campaign and others already taken) has the potential to undermine the KiwiSaver industry stability and growth. Therefore, it is important for long-term stability that all stakeholders have time to adjust to any future changes. A collaborative approach would help ensure future changes to the scheme minimise disruption to the industry. As the government agency responsible for industry development, MED is an appropriate agency to act as a facilitator.

xliv. Government incentives have encouraged households to join KiwiSaver and start savings plans earmarked for retirement. Hence, any reduction to these incentives may have a significant effect on the stability of the market.

KiwiSaver one year in

xlv. The most significant features of the KiwiSaver market at the moment are:

- the number and diversity of Providers, giving opportunities for innovation in respect of distribution, service and approach to investment, and providing a competitive market place for the public, where new Providers have entered the market;
- currently there is a healthy competitive market and signs that there will be a continuation of the critical mass of contributing members to maintain this;
- regulatory oversight of fees has kept the KiwiSaver fees low relative to other similar New Zealand schemes;
- market dominance by seven large Providers, including the six default Providers and one non-default, indicating default Provider status is not a pre-requisite to large scale in the market;
- a trend towards investment in default conservative investment funds;
- Providers are positive about the outlook of the industry with KiwiSaver; and
- if the incentives are continued and KiwiSaver becomes the primary retirement savings vehicle, there will, however, still be a role for other forms of retirement savings that are not locked in until retirement to provide investments with greater flexibility.

Recommendations for Steering Group

Recommendation 1: Adopt the evaluation framework

Adopt the evaluation framework developed in the report for the ongoing evaluation and monitoring of the KiwiSaver supply-side.

Recommendation 2: Adopt the base point and the baseline

That the level of managed funds as at 30 June 2007 be adopted as the base point for the indicators to measure changes to the supply since the implementation of KiwiSaver on 1 July 2007. As at 30 June 2007:

a) superannuation funds were valued at $22,004 million;
b) the total number of superannuation schemes (as governed under the Superannuation Act) was 560;
c) the total number of active superannuation members was 635,297;
d) superannuation funds were equal to 13.2 percent of GDP;
e) the total value of funds under management, including superannuation, was $66,505 million; and
f) 57 percent of total managed funds were invested in New Zealand and 15 percent in New Zealand equities.

Recommendation 3: Increase the quality and effective use of KiwiSaver data

Assess existing data collection and reporting arrangements, identifying any gaps and opportunities for improvements to ensure the quality and effective use of information particularly:

a) evaluation to inform policy, and
b) contractual and compliance monitoring.

Based on the above, a recommendation can be made to Ministers to clarify access and confidentiality requirements for information held by the relevant government agencies.

Recommendation 4: Implement the KiwiSaver Evaluation Survey

Subject to the outcome of Recommendation 3, MED facilitates the continuation of the KiwiSaver Evaluation Survey of Providers on an annual basis in July each year and considers the benefit of carrying out the survey at more frequent intervals in the future to monitor the savings industry confidence. Note that the survey design should:

a) look to address information gaps identified in Recommendation 3;
b) be relevant and simple and accessible on the internet with analysis of individual results kept confidential and only aggregate results published;
c) consider whether supplying evaluation information, particularly participation in the survey, be a requirement to obtaining a Scheme Provider Agreement with IR; and
d) collect additional data where it enhances knowledge about improving KiwiSaver results, in this case, increasing the additional amount of individual savings each year and the return on that savings when invested.

Recommendation 5: Role of Inland Revenue

IR continues its monitoring, clearing house and member registration role. IR and Treasury continue to work together to use IR analysis to enhance the government's budget forecasts of KiwiSaver trends.

Recommendation 6: Regulatory role of MED

MED, working in consultation with the industry, develops a consistent approach to disclosure requirements that is meaningful to the members and is transparent, simple, relevant and timely with low-compliance costs covering:

a) fees;
b) investment returns; and
c) the development of best-practice guidelines for registered KiwiSaver schemes, covering in particular, a standardised approach for the disclosure and reporting of fees and investment returns.

Recommendation 7: Savings and capital markets

That consideration be given to coordinating the evaluation with other capital market analysis to monitor the features of KiwiSaver that contribute to the development of the long-term investment market in New Zealand.

Recommendation 8: Financial literacy

Consideration should be given to actions to:

a) encourage providers to produce retirement savings information for KiwiSaver members, including comprehensive standards for default Providers; and
b) enhance the government work programme to increase levels of financial literacy in New Zealand including establishing realistic milestones and benchmarks for performance.

This would enable individuals to make better informed choices on KiwiSaver membership and the appropriate savings vehicle for their circumstances.

Recommendation 9: Other actions related to the KiwiSaver supply-side

Agree an inter-agency plan to:

a) establish an explicit and transparent performance framework for incumbent and new default Providers prior to 2014;
b) maintain a regular forum with all Providers with participation by the government agencies involved in KiwiSaver; and
c) re-examine the mortgage diversion policy on the basis of cost-benefit analysis.

Recommendation 10: Address risks of government policy to Provider operations

Consultation with the sector to develop a set of guidelines to manage future changes to the KiwiSaver scheme. This is to ensure that Providers are involved so that workable, cost-effective, timely solutions are found in advance of new policy introduction.

Layout of Report

- Chapter 1 provides background to this evaluation
- Chapter 2 describes the conceptual background to this evaluation
- Chapter 3 examines the superannuation market and discusses the baseline and conditions prior to the introduction of KiwiSaver
- Chapter 4 describes the Providers, their schemes and products
- Chapter 5 evaluates the KiwiSaver firm dynamics
- Chapter 6 describes the baseline and the market dynamics component of the evaluation framework, discussing the approach to assessing the extent of substitution effects
- Chapter 7 presents conclusions and recommendations.

Glossary of Terms

ASFONZ	Association of Superannuation Funds of New Zealand
Base point	The KiwiSaver evaluation framework base point provides a snapshot of retirement savings prior to the introduction of KiwiSaver based on information published by the Managed Funds Survey and the Government Actuary as at 30 June 2007.
Baseline	The KiwiSaver evaluation framework baseline is defined as the change in the level of savings accumulated between 1 July 2007 and 30 June 2008, since the adoption of KiwiSaver.
BTB	Business to Business – mainly refers to connectivity related to IT systems that enable transactions to happen as seamlessly between businesses as they do within businesses (see 3.3).
Costs	Amounts expended by KiwiSaver Providers, their Schemes and Funds included in the Schemes.
CSR	Corporate Social Responsibility
Evaluation	Examination of the efficiency and effectiveness of government policy with the aim of providing evidence based feedback to enhance value and desired impact. When KiwiSaver was announced, the Government established an objective and comprehensive evaluation strategy covering its implementation, long term impacts on savings behaviour and on the superannuation market and other matters.
Fees	Amounts charged to KiwiSaver members by Providers, Schemes and Funds.
Firm dynamics	Factors effecting KiwiSaver provider efficiency and the development of the KiwiSaver market.
FUM	Funds Under Management (e.g. accumulated savings invested through schemes into managed funds).
GA	Government Actuary
GDP	Gross Domestic Product
GSF	Government Superannuation Fund
HFAL	The Reserve Bank's Household Financial Assets and Liabilities dataset.
HNZC	Housing New Zealand Corporation
IR	Inland Revenue
IRR	Internal Rate of Return
ISI	Investment Savings and Insurance Association
ISU	Ministry of Economic Development - Insurance and Superannuation Unit
KES	KiwiSaver Evaluation Survey, conducted by PwC
KiwiSaver business	A division (possibly notional) of the Provider that has all the revenue and expenditure from KiwiSaver products.
KS2	Refers to the additional features added to KiwiSaver through the Government's 2007 Budget, including the introduction of compulsory employer contributions and tax incentives.

Market dynamics	The impacts that KiwiSaver is having on the superannuation and managed funds market itself. This includes the wider impacts of KiwiSaver on the financial sector, particularly the impact on funds managers and their advisers, trustees, other market participants (e.g. personal financial advisers and brokers), domestic capital markets and relevant aspects of financial system stability.
MED	Ministry of Economic Development
MFS	Managed Funds Survey administered by the RBNZ and carried out by Statistics NZ
NPF	National Provident Fund
NZSF	New Zealand Superannuation Fund
Payback period	Time required to recover the investment expense from profits for KiwiSaver business.
PIE	Portfolio Investment Entities – specific taxpaying entities designed to reflect the operations of portfolio investment businesses.
Private Promoter	For the purposes of this report, employers or other organisations that offer KiwiSaver products to their employees or members only. These promoters do not administer their own scheme.
Profit	Revenue less expenditure from KiwiSaver business
Providers	Organisations that administer schemes and that have a scheme provider agreement (SPA) with Inland Revenue. They may or may not offer a scheme to the public.
Public Promoter	For the purposes of this report, organisations that offer KiwiSaver products that are available to the public but are administered by others.
PwC	PricewaterhouseCoopers
RBNZ	Reserve Bank of New Zealand
Responsible investing	Responsible investment – investment policies and processes that take into account environmental, social, and governance considerations.
SIPO	Statement of Investment Performance Objectives
SoFIE	Survey of Family, Income and Employment managed by Statistics New Zealand
SPA	Scheme Provider Agreement: agreement required for Providers to be registered with IR's clearing house process for KiwiSaver funds.
SRI	Socially Responsible Investments
SSRSS	State Sector Retirement Savings Scheme
Statistics NZ	Statistics New Zealand (also SNZ)
Substitution effects	The extent that KiwiSaver is a replacement for other forms of savings. A key evaluation question is whether KiwiSaver generates new savings and investments.
Tables	Format for recording data in regards to managed funds – for the purposes of this evaluation, the data recorded is in nominal terms unless otherwise indicated.

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Disclaimer

This report has been prepared by PricewaterhouseCoopers for the Ministry of Economic Development to assist in establishing a framework for the evaluation of the impact of KiwiSaver on the Managed Funds and Superannuation industry. The report is provided in accordance with the terms and conditions of the contract dated 30 June 2008.

In preparing this report and forming our views, we have relied upon, and assumed the accuracy and completeness of all information available to us from persons with whom we have spoken in the course of consultation, or from public sources, or furnished to us by the Ministry of Economic Development. We have evaluated that information through analysis, inquiry and review but have not sought to verify the accuracy or completeness of any such information. We have assumed the accuracy of the information provided to us by other entities. We have not sought to independently verify this data.

We will not accept responsibility to any other party other than to the Ministry of Economic Development, to whom our report is addressed, unless specifically stated to the contrary by us in writing. We will accept no responsibility for any reliance that may be placed on our report should it be used for any purpose other than that for which it is prepared. A list of documents relied on is attached. This report must be read in its entirety. Individual sections of this report could be misleading if considered in isolation from each other.

This report has been prepared with care and diligence. The statements and opinions expressed in this report have been made in good faith and on the basis that all relevant information for the purposes of preparing this report is true and accurate in all material aspects and not misleading by reason of omission or otherwise. Accordingly, neither PricewaterhouseCoopers nor its partners, employees or agents, accept any responsibility or liability for any such information being inaccurate, incomplete, unreliable or not soundly based, or for any errors in the analysis, statements and opinions provided in this Report resulting directly or indirectly from any such circumstances, or from any assumptions upon which this Report is based proving unjustified.

We reserve the right, but are under no obligation, to revise or amend our report if any additional information (particularly as regards the assumptions we have relied upon) which exists on the date of our report, but was not drawn to our attention during its preparation, subsequently comes to light.

1 Background and Scope

1.1 The KiwiSaver retirement savings scheme became operational from 1 July 2007[3] and has recently experienced its first year anniversary of funds going to Providers. It is a non-compulsory, incentive based scheme that combines individuals savings with contributions from both government and their employer on an ongoing basis.

1.2 A reason given as to why the scheme was introduced was New Zealand's low savings performance[4] and the need to "encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement"[5].

1.3 According to the Minister of Finance, the scheme represents "the opportunity to increase our security in retirement and to build a large pool of domestic capital to drive economic growth."[6]

1.4 New Zealander's response to KiwiSaver has far exceeded the expectations of all parties. In the first 12 months to 30 June 2008, Inland Revenue (IR) reported 716,637 KiwiSaver members; well in excess of Treasury's estimate of 345,000 (this forecast included an expected 70,000 members of complying superannuation funds)[7]. Membership, as at the end of August 2008, exceeded 750,000.

Project Participants

1.5 This project focuses on the 31 KiwiSaver Providers (as defined in Chapter 2 and listed in Table 1.1).

1.6 Providers act as signatories to the 54 Scheme Providers Agents (SPA), relating to the 54 KiwiSaver schemes, with IR. Provider examples include AXA, Aon or Westpac.

1.7 New Providers can enter the market, as long as they meet the conditions of IR's scheme provider agreement. Refer to Appendix C for the list of schemes that the Providers administer.

1.8 The Providers represent a range of financial institutions including fund managers, insurance and superannuation providers, retail banks, interest groups such as the Anglican Church and specialist funds such as Real Property KiwiSaver Limited.

1.9 Public Promoters are those organisations that offer a KiwiSaver product to the public but pass the administration and management of this product to another organisation. The ANZ / National Bank is an example of a Public Promoter.

1.10 The third group, Private Promoters offer schemes to their employees only, with administration contracted out to a KiwiSaver Provider. Examples are Foodstuffs and Tait Electronics.

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[3] Contributions made through IR began being passed to Providers from 1 October 2007.
[4] Linda Cameron (2007) cited New Zealand's low savings performance as one of the factors contributing to the under-performance of New Zealand's financial sector.
[5] KiwiSaver Act 2006; part 3 (1).
[6] Cullen M. *KiwiSaver breaks through 750,000 mark.*
[7] Cullen M. *Early signs positive for KiwiSaver,* Press release August 9th.

Table 1.1 – KiwiSaver Providers

KiwiSaver Providers	
ABN Amro Craigs	ING NZ
AMP	Law Retirement
Anglican Church	Medical Assurance
Aon	Mercer
ASB	MSF
AXA	New Zealand Local Government Insurance Corporation Ltd
Brook Asset Management Limited	Real Property KiwiSaver Limited
EO financial services (NZ) limited	Smartshares Limited
Fidelity	Southland Building Society
First NZ Capital Investment Management Limited	Staples Rodway
Fisher Funds	SuperLife
Forsyth Barr Limited	The Trustees of the New Zealand Harbours Superannuation Plan
Gareth Morgan	Tower
Grosvenor	Waterfront Industry Superannuation Fund
Guardian Trust	Westpac
Huljich Wealth Management (New Zealand) Limited	

Source: IR record of signatories to Scheme Provider Agreements, as at August 2008.

Scope

1.11 PricewaterhouseCoopers (PwC) was commissioned on behalf of the Ministry of Economic Development to carry out an evaluation of the supply-side impacts of the KiwiSaver scheme. IR, the Treasury, the Reserve Bank, Statistics NZ, the Retirement Commission and KiwiSaver Providers assisted by providing data, advice and analysis via interviews and a reference group.

1.12 This evaluation of the supply-side impact is part of a wider evaluation of KiwiSaver being undertaken by IR, MED and HNZC. The specific focus of this evaluation is the supply-side impacts of KiwiSaver, that is, the effect of KiwiSaver in relation to the superannuation market and the wider financial services sector.

1.13 The Terms of Reference state that this evaluation seeks to:

- define and confirm with stakeholders the key characteristics of the superannuation market in the lead up to the introduction of KiwiSaver in 2007 (noting any existing trends and changes resulting from providers gearing up for its introduction) and the changes in the market since then;
- document what market participants are saying about the key influences of KiwiSaver on the market, including impacts on fees, financial performance, marketing and overall savings levels;

- establish a baseline of quantitative indicators, which reflects the above information, to measure key changes in the superannuation market prior to and following the introduction of KiwiSaver, drawing on existing data sources to the fullest extent;

- document the changes to the superannuation market and the wider financial sector, since the introduction of KiwiSaver (due to the current small size of KiwiSaver funds under management relative to the size of the financial markets, we expect that this phase of the evaluation will focus primarily on impacts on the superannuation market rather than wider financial sector impacts);

- establish an evaluation approach and framework for examining the future impacts of KiwiSaver on capital markets and related aspects including specialisation, innovation, skills and financial stability; and

- make recommendations for the design and staging of future phases of the evaluation and KiwiSaver policy to support better outcomes.

Key features of KiwiSaver

1.14 KiwiSaver was designed with incentives to motivate New Zealanders to save for retirement by making this form of superannuation both more attractive (through government contributions) and easier to participate in. A further initiative to facilitate this was the introduction of Portfolio Investment Entities (PIEs). PIEs removed existing unfavourable tax treatment of superannuation and managed fund products by allowing investors to be taxed at no greater than their personal marginal tax rate.

1.15 A distinctive feature of KiwiSaver is that it is not compulsory. Instead, it includes an auto-enrol mechanism which makes it easy for employees to join. Auto enrolment means that most workers are enrolled when they start a new job. If, once auto-enrolled in KiwiSaver, an employee does not wish to remain in KiwiSaver, they are able to opt-out within eight weeks of being automatically enrolled.

1.16 Combined, the auto-enrol and opt-out mechanics means that undecided or indifferent workers will be captured by the scheme. In comparison, under an opt-in mechanism these same workers would have remained outside of the scheme. Existing employees may opt-in through their employers. Others can also opt-in through Providers.

1.17 Financial incentives for KiwiSaver membership include a one-off government kick-start contribution, a tax credit for members and matched employer contributions up to 4 percent of gross salary[8]. These are designed to make KiwiSaver an attractive savings proposition, and greatly enhance the return the member receives on his or her own contributions.

1.18 The KiwiSaver product is similar to existing retail superannuation products where the funds are held in a trust. Individual memberships are recognised but most Providers unitise[9] the contributions. The product is invested in a similar manner to other managed funds. However, managed funds have not generally had such regular contribution flows nor are contributions locked in for as many years.

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[8] Employer contributions will be phased in gradually reaching 4 percent in 2011.

[9] Unitising refers to the division of funds grouped from multiple investors into equally valued ownership portions, known as units. Units are revalued frequently (usually daily), and a unit price calculated. New contributions then purchase units in the fund at the prevailing unit price.

1.19 A feature of KiwiSaver, compared to retirement savings policies in other countries is that the government role has focused on incentives and support for the market, as opposed to compulsion. New Zealanders can voluntarily decide to save through KiwiSaver.

Roles and Responsibilities

1.20 This section describes the role of government and of specific government agencies.

1.21 The ***Ministry of Economic Development (MED)*** is responsible, through its Insurance and Superannuation Unit (ISU), for the registration and regulation of KiwiSaver schemes and scheme providers. It administers the regulatory framework and is responsible for policy work with regards to the regulatory control of KiwiSaver and other registered superannuation schemes.[10]

1.22 ***The Government Actuary (GA)*** is part of the MED Insurance and Superannuation Unit (ISU) and is the Registrar of the KiwiSaver schemes register as identified under the KiwiSaver Act 2006. The GA's responsibilities, therefore, include the registration and regulation of KiwiSaver schemes. This includes monitoring of KiwiSaver scheme fees and assessing if the fees are not "unreasonable".[11] The GA is also responsible for informing IR when an employer is exempt, as well as when this exemption has been revoked, as stipulated under the KiwiSaver Act.[12]

1.23 ***IR*** provides policy advice to the government and is the central administrator for the KiwiSaver programme[13], administering many members' KiwiSaver contributions through the pay as you earn (PAYE) tax system. IR's role in KiwiSaver differs from other superannuation schemes as IR administers the collection of contributions from the employer through the PAYE system and then forwards members' contributions to their KiwiSaver scheme Provider.[14]

1.24 Together with the IR and the MED, the Retirement Commission provides information about KiwiSaver to employees, employers and the registered scheme Providers.

1.25 ***The Treasury*** is responsible for providing the Government with policy advice on the KiwiSaver scheme and forecasting, especially in relation to fiscal and budgetary costs. Treasury also plays a role in the ongoing monitoring of the KiwiSaver scheme, gathering feedback and suggestions of possible improvements that could be made.[15]

1.26 ***HNZC*** administers the first home deposit scheme and will be responsible for processing applications for the first home deposit subsidy and the first home withdrawal scheme (there will also be rules relating to second chance home buyers - people who have previously owned a house but currently do not). HNZC is also responsible for providing advice on the appropriate level of the subsidy caps by house price and income with the current subsidy set at $1,000 for each year of contribution to the scheme, up to a maximum of $5,000 for five years for each member.[16]

[10] MED's Involvement available from MED website at http://www.med.govt.nz/templates/MultipageDocumentTOC____27054.aspx
[11] *KiwiSaver schemes,* available from the KiwiSaver website at http://www.KiwiSaver.govt.nz/KiwiSaver-schemes/
[12] KiwiSaver Act 2006 – *Exempt employers*, Part 2 s 32
[13] Inland Revenue SOI 2008-
[14] *KiwiSaver for scheme providers – the role of KiwiSaver scheme providers,* available from the Inland Revenue website at http://www.ird.govt.nz/KiwiSaver/providers/how/provider-role/
[15] *KiwiSaver – The Treasury's Role,* available from the Treasury website at http://www.treasury.govt.nz/topics/KiwiSaver/index.htm
[16] *KiwiSaver home ownership features – deposit subsidy*, available from HNZC website at http://www.hnzc.co.nz/hnzc/web/rent-buy-or-own/home-loans/kiwi-saver-home-ownership-features.htm

1.27 ***The Retirement Commission*** (the Commission) is involved with public communication about KiwiSaver through its financial education programme.[17] This falls under the Commission's scope of preparing New Zealanders for retirement. It is therefore responsible for ensuring that the New Zealand public is aware of KiwiSaver as a savings option and what it entails. The Retirement Commission is required to review retirement income policy every three years, post its initial review at the end of 2007, and this will incorporate the evaluation of KiwiSaver.

1.28 ***The Securities Commission*** is responsible for enforcement of securities law which includes relevant legislation as identified under the KiwiSaver Act 2006. As of 1 April 2008, this includes the production of an Investment Statement and Prospectus, and ensuring that each KiwiSaver scheme discloses its approach to responsible investing.

Industry Board Representation of KiwiSaver Providers

1.29 KiwiSaver Providers are currently represented by two industry bodies. These are the Investment Savings and Insurance Association (ISI) and the Association of Superannuation Funds of New Zealand (ASFONZ).

1.30 The ISI represents investment and life insurance companies in New Zealand, and has 20 investment and life insurance members. The membership is characterised by medium to large companies.

1.31 ASFONZ was established to represent employer based superannuation schemes, and its members include employers and the trustees of these schemes. ASFONZ membership also includes a number of companies that provide services, including administration and investment management, to employer superannuation schemes. Many of these companies are also KiwiSaver Providers. [18]

Method

1.32 The terms of reference and associated documentation for this evaluation made it clear that this was an early stage evaluation of the impacts of KiwiSaver characterised by a paucity of data and few international benchmarks. Additionally, as the KiwiSaver scheme opened to members less than a year ago the evaluation period is too short to carry out trend analysis. The time period is also too short to make definitive conclusions about causality.

1.33 Data collection was the focus from the early stage of this evaluation and included both quantitative and qualitative elements. The various elements employed made the best of historically available data while questions for which there were no relevant sources were addressed by additional data collections. Desk based research focused on capturing, sorting and making use of the existing sources of data. The literature review expanded our base of knowledge to include international experiences. Interviews and an evaluation survey (the KES) were conducted to collect much of the data that was missing from these historical sources and to set a platform for the future collections that will be necessary.

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[17] *KiwiSaver for employers – who's involved,* available from the Inland Revenue website at http://www.ird.govt.nz/KiwiSaver/employers/about/who/

[18] Those Providers who did not have a superannuation scheme prior to KiwiSaver are not currently represented by ASFONZ.

Desk Based Research

1.34 The approach to quantitative desk based research was to find and assess all the relevant data sources listed in the terms of reference and additional sources from the financial sector and national statistical databases. Current information about KiwiSaver supply-side trends was available through IR, industry associations, the Retirement Commission, MED and the government's budget forecasting model. This was able to be supplemented by other related data sources including Statistics NZ, the reports of the GA on private superannuation funds, government sourced data for government superannuation funds and other stakeholders.

1.35 Given that this is the first year of operation of KiwiSaver, it is not surprising that there are a number of data constraints that limit the conclusiveness of the evaluation relating to the timing, quality and completeness of data. Given the importance of being able to isolate KiwiSaver trends in order to reach conclusions about competition and substitution effects, the absence of data such as this is noted in relation to specific discussions during this report.

1.36 IR currently plays a pivotal role in data collection. It collects information about KiwiSaver Providers and Providers' members on a timely basis through employer monthly PAYE returns. Commercial confidentiality and taxpayer privacy legislation limit what IR can pass on to third parties. This means that PwC received data in grouped format. Also, most of the information which IR collects in relation to contributions relates to employed KiwiSavers whose contributions flow through IR but there are other increasingly significant contributions not counted that go through IR or directly to the Providers.

1.37 The GA collects from KiwiSaver Providers a wide range of statistical data in the form of annual returns for year ended 31 March, in accordance with the KiwiSaver legislation. This data is released at an aggregate level. The GA's 2008 report containing those aggregate results was presented to parliament on 10 September 2008. The GA also provides reporting on Superannuation schemes governed under the Superannuation Act 1989 and the Government Superannuation Fund. PwC was able to consult with the GA in respect to the accuracy of estimates prior to the public release of the report.

1.38 A full list of data sources is provided below:

- Reserve Bank (RBNZ) / Statistics New Zealand's (Statistics NZ) Managed Funds Survey (MFS);
- GA's annual reports to the Minister in respect to Superannuation and KiwiSaver;
- Annual returns from KiwiSaver schemes to the GA;
- IR administrative data and evaluation reports;
- RBNZ Financial assets and liability statistics;
- Statistics NZ National accounts;
- Statistics NZ business demographics;
- Statistics NZ Household Economic Survey;
- OECD National Statistics;
- Investment statements of KiwiSaver schemes;
- Quotable Value Housing Consents and Sales;
- Mercers Investment Surveys;

- Government Super Fund (GSF) Annual Reports and Actuarial Valuations;
- New Zealand Super Fund Annual Reports;
- NZX capitalisation; and
- Fundsource market reports.

1.39 The qualitative research also included a review of articles and references provided specifically for context.

1.40 Data sources were compared and contrasted to select the best estimate. For example the estimate of funds under management by KiwiSaver schemes considered data from IR, the GA, Statistics NZ and the KES.

1.41 The selection of our indicators considered the:

- key questions to be addressed by ongoing performance monitoring;
- nature of the information required;
- periodicity of reporting;
- continuity of data; and
- ongoing appropriateness of data.

Literature Review

1.42 The literature review was an extension of the desk based research focussing particularly on international superannuation evaluations in Chile and Australia. This review identified articles relating to the measurement and evaluation of these compulsory superannuation schemes with the intention of identifying features of internationally established measurement, monitoring and reporting tools that had potential application for evaluating the supply-side for KiwiSaver.

Interviews

1.43 The basis of qualitative data was interview data collected from consultations with Providers (14), industry experts and stakeholders (14).

1.44 The interview process provided a unique opportunity to consider the experience of Providers first hand; this has allowed the evaluation to provide a balanced perspective on the implementation and future expectations of KiwiSaver. More details are provided in Appendix B.

1.45 A formal interview process was conducted with a structured set of questions around firm efficiency. In addition, those interviewed were given the opportunity to provide open comment about KiwiSaver's implementation and ongoing delivery.

KiwiSaver Evaluation Survey (KES)

1.46 The KES was conducted to, among other things, expand and augment the data collected in the interviews. The KES provided the opportunity for all Providers to provide input on key issues and to provide a unified data set across all types of Providers for key economic indicators. The survey was sent to 31 Providers and achieved a response rate of 87 percent (27 Providers). More details are provided in Appendix A.

1.47 The design of the survey focussed on creating a time series of survey data that will continue to yield information as the survey is repeated in future years. The first survey conducted by PwC provided a benchmark of results relating to issues such as compliance, profitability and strategy. Future evaluations will benefit greatly from a continuation of the data series.

1.48 The survey was supplemented by two Provider presentations where some of the results of the survey were reported and discussed.

Report Layout

1.49 Chapter 1 has provided a background for this evaluation.

1.50 Chapter 2 elaborates the dynamics of supply-side efficiency. It makes a case to recognise that all of these factors are important to the evaluation. The next chapters apply these factors in further detail to examine conditions prior to the introduction of KiwiSaver and what has happened since, concluding with the design of an evaluation framework for KiwiSaver that is comprehensive and multi-faceted.

1.51 Chapter 3 examines the superannuation market and discusses the baseline and how things were prior to the introduction of KiwiSaver.

1.52 Chapter 4 describes the Providers, their schemes and products.

1.53 Chapter 5 describes the KiwiSaver firm dynamics.

1.54 Chapter 6 describes the baseline and the evaluation framework in detail and discusses what is known and what needs to be known in order to assess the extent of substitution effects.

1.55 Chapter 7 draws together the existing quantitative and qualitative information into a set of conclusions. Further work is required over time to better understand how to measure some of the key features of the supply-side of KiwiSaver. Meantime, qualitative data (such as the data collected by the KES and Provider interviews) can provide useful evaluation measures.

1.56 The second part of Chapter 7 covers recommendations based on this evaluation. The recommendations look to the future and the approach to fill knowledge gaps. The development of a quantitative and qualitative evaluation framework is recommended.

2 Evaluation Framework

2.1 Chapter 2 sets out a framework for establishing and monitoring the efficiency of the KiwiSaver market. It describes what an efficient KiwiSaver market would look like and notes how the efficiency of the KiwiSaver market would ideally be measured. The extent to which the framework is feasible, given current data availability, is discussed in Chapters 5 and 6.

Evaluation Scope

2.2 The focus of this evaluation is the supply-side of the KiwiSaver market with the supply-side defined as the supply of KiwiSaver services. The services supplied are administration and investment of the savings of KiwiSaver members. These services are provided in the form of KiwiSaver schemes, structured as Trusts and governed by Trustees. These schemes are administered by Providers. For the purposes of this evaluation, Providers are defined as those with an SPA with IR as at 30 June 2008. Under this definition, there are 31 KiwiSaver Providers who administer 54 schemes of which 36 are publicly available. Also of interest are the related services provided by KiwiSaver Providers, namely other Superannuation products and managed funds.

2.3 Determining the impact of KiwiSaver on individuals' savings levels is a core question for the wider evaluation programme. The purpose of KiwiSaver is to motivate individuals to save a larger proportion of their incomes and to spend less. The effectiveness of KiwiSaver as part of government policy to increase individual savings is outside the scope of this evaluation, as it would require a description and analysis of the drivers of the savings behaviour of individuals. This is largely a demand-side feature, although clearly the availability of a supply of savings services at different prices is also relevant.

2.4 This supply-side evaluation focuses on the examination of the efficiency of the supply of KiwiSaver products. Features of an efficient market include the matching of supply and demand at different prices and market signals and information flows that attract investment to areas that maximise long-term returns. This view of efficiency is taken largely from the perspective of the consumer and/or market regulator. Another aspect relates to the business operations of the Providers as firms and the decisions they make to improve their own internal efficiency/profitability.

2.5 There are two distinct areas of focus for the KiwiSaver supply-side evaluation. The first is to evaluate the impacts that KiwiSaver is having on the superannuation and managed funds market itself – KiwiSaver and non-KiwiSaver superannuation and managed funds providers. This is referred to the firm dynamics component of the evaluation.

2.6 The second area of focus is to evaluate the wider impacts of KiwiSaver on the financial sector, particularly the impacts on funds managers and their advisers, Trustees, other market participants (e.g. personal financial advisers and brokers), domestic capital markets and relevant aspects of financial system stability. This is referred to as the market dynamics component of the evaluation.

2.7 This Chapter outlines topics to be addressed by the evaluation framework. Where appropriate, it also relates these topics to features of the industry identified through the consultation process that accompanied this evaluation.

Market Dynamics

2.8 As well as having products that are able to be bought and sold through normal market activity, other indicators that KiwiSaver is affecting savings include those that show growth over time in the overall market. An evaluation framework should be designed to examine whether the market is growing.

2.9 An ongoing evaluation gains knowledge from examining market dynamics that influences KiwiSaver trends and which are, in turn, influenced by KiwiSaver. Several measures for the wider managed funds market, the subset of superannuation and finally for KiwiSaver, are presented in this chapter.

2.10 The efficiency and effectiveness of KiwiSaver, as one tool for retirement savings, is a complex question where measures must be considered in context. Ideally, the wider framework and ongoing evaluation of the results will be designed to identify causality.

2.11 To develop an evaluation framework that can be applied, several data sources have been examined to arrive at the best estimate. For example, to estimate the level of KiwiSaver funds in the first year requires consolidation of the contribution data from IR, survey data collected by PwC and data contained in the Report of the GA in respect to KiwiSaver.

2.12 There is a growing acknowledgement that to gain an understanding about capital markets, more ongoing monitoring of capital markets is required, both by the market participants and by those responsible for macroeconomic policy. For the latter, the annual data returns will need to evolve over time into quarterly and monthly information so that turning points and other impacts are able to be isolated and more immediately identified.

2.13 To gain a perspective on how things were before KiwiSaver and what has happened since its introduction, consideration was given to the definition of a baseline. In reality, the baseline should capture dynamic change. The available data, current applications of that data and the limited timeframe since KiwiSaver was implemented will determine (and limit) the baseline to a static snapshot. Aspects of the dynamic change in the industry will need to be captured through consultation with the industry.

Firm Dynamics: Efficiency in the KiwiSaver Market

2.14 There are several characteristics of efficiency that could be considered, but four common characteristics are competition (including the cost of market entry), consumer choice, responsiveness to change (which can be broadly seen as innovation), and profitability (sustainability and consolidation).

2.15 KiwiSaver schemes can be seen as substitutes for other retirement savings products. The reverse relationship, whether other forms of retirement savings are a substitute for KiwiSaver, is not likely to be as strong given the government subsidies and compulsory employer contributions are tied directly to KiwiSaver schemes rather than all forms of retirement savings.

Competition

2.16 Given the KiwiSaver environment, where incentives are offered to motivate savings, the level of competitive pressure on KiwiSaver from other forms of investment is limited. Other research and evaluation is required to understand New Zealand household savings behaviour. Based on what is known, the competitive forces shaping savings behaviour appear to be related largely to the appetites of households for consumption, home ownership and some investment, including in businesses, managed funds and/or equities. Therefore, the driver of efficiency in the supply-side, from the consumer's perspective and the regulator's perspective, is more likely to come from competition between Providers.

2.17 The appointment of six default schemes was intended to ensure the market had a degree of competition whilst ensuring default Providers obtained critical mass.

2.18 A feature of a truly competitive market is that fees are driven by market transactions where willing buyers meet willing sellers. For this to happen efficiently, however, fees and the value of services need to be transparent. This question is examined in Chapter 5.

2.19 Given that this is the first year of operation, competition between the Providers to attract membership can be based on the following attributes of the schemes they offer:

- whether default or non-default;
- fees;
- investment philosophy and expertise;
- information provision;
- customer service;
- networks of customer centres;
- choice of funds with a range of features, including niche and sector specific products;
- access to investment advice and other financial literacy knowledge;
- brand/image; and
- investment returns: both past performance and the future perception that the scheme will provide a sustainable investment return at market interest rates or above.

2.20 The regulatory environment needs to enable these behaviours to occur. Regular monitoring is desirable to inform objective discussion on market conditions. An annual survey of KiwiSaver Providers could collect further information on the form of competition between Providers and how it changes over time.

2.21 It is anticipated that the rate of growth in new KiwiSaver members will slow, when this occurs the above factors will play an important role in increasing members' contributions, and the retention and attraction of customers.

Consolidation

2.22 As the rate of growth in KiwiSaver membership declines, some Providers may target expansion of membership from competitors' membership base either through attracting customers away from their competitors or through mergers and acquisitions. An indicator of market efficiency is when Providers' decisions about their KiwiSaver business objectives (including whether to stay, consolidate or exit) are well informed.

Market Entry

2.23 Another important aspect to competition is the ease of entry into the market for new Providers. A low cost of entering the market increases the likelihood that this will occur. The threat of new competitors helps drive efficiency and innovation by existing Providers as this is a deterrent to those looking to enter the market, and secondly increases the chance of maintaining market share.

2.24 The implementation costs did, of course, vary based on a number of factors unique to each Provider. In the case of market entry, the implementation costs for new Providers will also vary.

2.25 New entrants could also consider the level and type of service provision they wish to undertake versus what they might contract out to organisations that are already set up to administer KiwiSaver accounts. Outsourcing the administration is sometimes a means to reduce the implementation costs for a new Provider.

Consumer Choice

2.26 Where competition is present, consumer choice is likely to follow. This can be seen in the KiwiSaver market where profitability is driven by membership and funds under management and the existing Providers are competing to increase both. This is particularly true for non-default Providers who, because they have not benefited from the high number of auto-enrolees, need to attract members to sustain their business. Choice can be seen in the range of schemes available and through the forms of competition listed above. Greater choice will allow members to be better able to match their preferences to products being offered.

2.27 As it turned out, with the introduction of KiwiSaver, the variety of publicly available (i.e. retail) schemes for KiwiSavers currently stands at 36. Within each scheme, choice is further expanded as most schemes offer a choice of funds members can invest in.

2.28 Summing up the discussion above, the effect of the design of KiwiSaver, including the appointment of the default Providers and the choice of non-default Providers, is that there is a wide choice for KiwiSaver members and prospective members.

Innovation

2.29 Another attribute of an efficient industry is one where innovation is continuous over time. Competition (whether it is a threat or actual) can be a factor forcing existing businesses to become efficient as quickly as possible, aspiring to a level of profitability that enables investment in developing new products and other service innovations, thus benefiting KiwiSaver members.

2.30 These factors have the potential to motivate innovation for both default and non-default Providers, depending on whether they can gain sufficient critical mass to invest in new products and services.

2.31 As noted above, there are many investment funds available within the 36 publicly available KiwiSaver schemes and these currently offer many investment choices including:

- cash funds;
- balanced funds with a range of growth profiles;
- ethical funds or similar;
- property-only funds;
- options funds;
- capital protected funds; and
- funds where risk is adjusted by age.

2.32 There are a number of Providers that have a unique investment philosophy with only one investment fund and they differentiate themselves on this basis, including some who have an express aim to focus on customer service as part of a package where investment return is only a part.

2.33 Other Providers have a large range of funds. For example, ABN Amro Craigs offers more than 130 investments covering portfolios with active and passive funds, and individual shares. Some Providers allow customers to invest in more than one fund at once, i.e. to split contributions between several funds. Several Providers offer a “lifesteps” fund, where the risk profile is automatically changed according to the age of the member.

2.34 In addition to investment, the other ways that Providers have been innovating are listed below (but the main point of the evaluation will be how these modes of innovation change over time):

- distribution methods;
- administration systems;
- strategic alliances;
- customer service, for example, internet banking type facilities; and
- employer relationships.

Profitability

2.35 Efficiency and competition from the Provider’s perspective can be examined with reference to the theory of the firm and the drive for profit maximisation. Providers will look to expand their customer base in order to decrease the average cost per customer through spreading the fixed cost of service provision over a greater number of members (or a greater level of contributions from members) and to receive profits on a greater customer and funds base.

2.36 Where the cost of service provision has large upfront and implementation costs, such as, the development of IT systems and processes related to the introduction of PIE, it may be several years before these costs are recovered through income earned (the payback period). Once Providers reach a position where their fixed costs have been largely covered, they begin to make profits. Further, each additional customer enrolled lowers ongoing fixed costs on a per member basis.

2.37 KiwiSaver businesses have two distinct revenue streams, one depends on member numbers and the other depends on funds under management (FUM).

Consequently, the revenue pattern is significantly different to other businesses, with small returns to begin with, increasing at a similar rate as the growth in total funds. This means a deferral of revenue from FUM while the fund size increases. This results in, generally, a longer payback period on initial investment and higher capital requirements. It follows then, that profitability will be dependent on the future growth of the scheme, and for FUM in particular. Given KiwiSaver is only one year into operation, the likely future growth in members and contributions can only be estimated based on a range of assumptions.

2.38 Both the revenue and the costs will be dependent on the size of the business in terms of members and FUM.

2.39 Consistent with the operations of other businesses, the cost of running a KiwiSaver scheme will normally include both a fixed and variable component. Their fees will be set based on a business model to cover these costs over the shortest period of time possible, ideally going through a breakeven position and moving to earn a profit/surplus. Note that it is this surplus that provides the resources to be able to continually improve service, innovate, improve investment analysis and so on.

2.40 The level and range of the fees not only needs to reflect what is acceptable in the market place but are further constrained through oversight by the GA. In the short-term at least, some Providers may have to reduce service levels or increase efficiencies compared with other similar products in order to live within the current level of income they receive through fees. This is supported by the interview and survey responses of Providers, where it was indicated that the per member fees are unlikely to cover per member costs and a proportion of revenue from FUM fees may be needed to cover the shortfall. Consequently, for the first few years of KiwiSaver, when FUM fees are insignificant, the total fees are unlikely to match the per member costs.

2.41 Fees deducted by Providers will more easily cover fixed and variable costs in future years when the level of FUM is higher because of growth through regular contributions and asset growth. As the market develops, a key driver of success will be administrative efficiency for both large and small Providers.

2.42 Ways of improving profitability include on the revenue side; membership growth, funds growth, directing customers to higher fee funds (e.g. growth funds instead of default funds), and on the expense side: administrative efficiencies and/or service level reductions.

2.43 Those Providers that are not able to grow membership and FUM are likely to struggle to earn sufficient revenue to cover fixed costs, this, coupled with other Providers looking to expand their customer base, as the rate of growth in KiwiSaver membership declines, is likely to be driving the view that there will be consolidation in the KiwiSaver market.

2.44 In part, growth in FUM is dependent on investment returns. Current volatility in local and international financial markets and events in mid September 2008 such as the sale of Merrill Lynch, the crash of Lehmans and the United States Federal Reserve Bank’s support of AIG insurance are factors that contribute to uncertainty about fund growth and returns. For managed funds this fact is compounded by the net funds outflow when investment conditions are bad. The locked in nature of KiwiSaver will reduce this effect.

2.45 Another cost for Providers is the additional administration required and investment opportunities lost from savers switching between Providers, schemes and funds. It is important to keep in mind that a consequence of market volatility may be a greater proportion of savers switching their investment. Hence, the monitoring and evaluation of behaviours around switching between funds is required to ensure that the design of the scheme supports an efficient market.

2.46 Each Provider's experience is different. As the next Chapters will discuss, the evaluation has found a range of key influences on the level of fees and costs.

2.47 An alternative method to look at the efficiency of KiwiSaver Providers is to look at the return on investment for shareholders. The return on these investments can be compared to other ventures in which the shareholders might invest capital. This is likely to be difficult to evaluate precisely but commonly business investments have short payback periods because their access to debt capital for the investment tends to be short.

Investment Returns

2.48 Investment returns are crucial to the members' ultimate retirement outcome. Members make the decision on the high level investment strategy and have a choice of risk and return profiles. Within this brief the final return is subject to markets and the abilities of the fund manager. Over time this will become a market focus and a variety of organisations, such as consumer advocates and the providers themselves, will monitor and compare results.

2.49 Investment returns are also important to Providers as their fees are directly linked to FUM and some have an additional performance fee. In addition, investment returns will be a factor in attracting new members.

Portfolio management

2.50 Communicating the Providers' investment strategies (including how they are defined, how they are exercised, the process to make well-informed choices) transparently to savers and financial advisers is a way of meeting the requirements of informed decision making. This behaviour underpins a market that is responsive to accurate signals of portfolio management competency. The evaluation framework will want to look carefully at the incentives for continual improvement in the way that information about investments and returns is reported to the market.

2.51 Transparency is supported by standards of reporting and standards of oversight of the Providers' investment approach. The evaluation of efficiency aspects will consider the value of better information to Providers.

KiwiSaver as a loss leader

2.52 An area where some Providers may be able to offset the costs associated with KiwiSaver will be through the ability to cross sell other products to new members or additional products to members who had previously been customers. A common business model is to use a new product, such as KiwiSaver, as a loss leader. Given the expectation of increased financial literacy from KiwiSaver, a strategy to increase profitability from other financial products is consistent with this model. This is another question to be addressed through the evaluation of firm dynamics.

Other Market Activities

2.53 A third aspect of efficiency from the supply-side of KiwiSaver is the impact of all the activities of the Providers on wider asset markets. This is outside the scope of this evaluation.

2.54 A key area for future analysis is the cost benefit of KiwiSaver as a whole.

2.55 The purpose of KiwiSaver is to motivate households to save a larger proportion of their incomes and to spend less. To understand this outcome, it will be necessary to examine the value to taxpayers from the investment made to date to develop KiwiSaver. Over half of the money in KiwiSaver so far has come from the taxpayer/consolidated account. Over time, it will be important to show the return from this public investment. The return will come from the public-good benefits of additional savings that would not other wise occur. The efficiency of the market is essential to enabling these returns to grow. The value proposition is the ability of the market to encourage and grow savings and not destroy them (or the value of the other economic activity).

3 Superannuation before KiwiSaver: Baseline

The Evaluation Baseline

3.1 This evaluation is in respect to the KiwiSaver industry and its impact on the superannuation and wider managed funds market. Therefore, the scope of the analysis of the baseline is focused on superannuation and managed funds.

3.2 KiwiSaver is designed to encourage individuals to increase their savings for retirement, and like other superannuation products, savings will be in the form of funds under management. For this reason, any evaluation of the supply-side will need to consider the definition, reporting and monitoring of funds under management. The baseline provides the foundation for making comparisons to show what has changed.

3.3 The baseline relates firstly to the level of savings in superannuation products prior to the introduction of KiwiSaver, secondly to the total level of managed funds and thirdly, the baseline concept refers to the level of retirement savings that would happen in the absence of KiwiSaver.

3.4 In the short time KiwiSaver was introduced, there was insufficient information about savings behaviours to isolate what would have happened if KiwiSaver was not introduced. What can be measured is the overall change in savings and what the change in savings was from the day that KiwiSaver was introduced. To measure these two trends, the evaluation framework includes a baseline and a base point.

3.5 KiwiSaver was introduced in July 2007, with the first funds transferred from IR to Providers on 1 October 2007. The base point of 30 June 2007 is used as the date for the baseline. There is a stock (and hence static) element to the baseline and a flow (dynamic) element.

3.6 Growth in managed funds in nominal terms will be due to two main factors. Firstly, the investment return on the assets and secondly the net funds flow (contributions less withdrawals) into the product. These two factors are not, however independent with funds flow for managed funds that are not locked in likely to be smaller or negative when returns have been negative. In order to be meaningful in the future, the effects reflected by the baseline indicators need to isolate and compare separate trends, and in the case of funds, the specific investment returns.

3.7 For the purposes of the evaluation framework, the indicators for FUM combine investment return and net contributions into one measure of expected growth.

3.8 There are three key questions to be answered by this evaluation:

- What is the baseline to address changes from KiwiSaver against? As this evaluation is about the supply-side from the Providers perspective, it focuses on changes in superannuation funds.
- Having established the baseline, what can be understood about changes happening already and changes that may have come about because of KiwiSaver?
- What can be understood about the changes and trends in the various funds under management in order to evaluate whether KiwiSaver has a substitution effect and what the magnitude of it might be?

Baseline Data

3.9 The data discussed in the section comes from the following sources:

- GA;
- Managed Funds Survey;
- RBNZ;
- OECD; and
- Statistics NZ.

3.10 The choice of the base year and base point reflects both the timing of the introduction of KiwiSaver and the relevant collection points and periods for the most timely and reliable sources of available data that describes the retirement savings supply-side.

3.11 The figures reported here are nominal and the convention in this report is to report nominal vales unless stated otherwise.

The Superannuation and Managed Funds Market

3.12 Prior to KiwiSaver, the superannuation market in New Zealand effectively operated on a level playing field with other types of collective investments, such as managed funds (including unit trusts) and life insurance savings products. There were two main types of superannuation - personal (or retail) superannuation and private (including corporate) superannuation.

3.13 While many people regard their managed funds investments as a retirement savings vehicle, they are not locked in until retirement. Superannuation providers tend to provide a range of retirement savings products, including managed funds as well as locked-in superannuation products.

3.14 KiwiSaver was designed during a long cycle of rapidly rising housing prices. It was introduced at the peak of the housing boom. Since late 2007/early 2008, however, softening house prices and a slowing New Zealand economy were key factors impacting on the savings environment.

3.15 The impact of slower economic conditions was evident in the wider financial services sector, and is certainly potentially a major factor behind the trends in managed funds. The MFS to June 2008 showed a sharp drop in the overall level of assets. The Master Trust Survey results to 30 June 2008 report that real returns on managed funds were negative in the preceding 12 months. Even conservative funds returned less than two percent after tax, expenses and fees were deducted[19]. Mercer's Quarterly Survey of Wholesale Superannuation Fund Managers indicated that balanced funds overall were returning a negative gain over the same period.[20] A key question is whether the dramatic decline in managed funds between June year 2007 and June year 2008 was also (or even largely) impacted by people making plans to invest in KiwiSaver.

[19] Erickson & Associates Ltd.

[20] Mercer (2008), *Mercer Survey of Fund Managers: New Zealand.*

Table 3.1 – Managed Funds (June years)

Year	2004	2005	2006	2007	2008
Managed Funds ($m)	52,648	55,428	61,610	66,505	60,223

Source: RBNZ Managed Funds Survey

3.16 The New Zealand superannuation market had experienced a steady decline in membership in the years prior to the introduction of KiwiSaver. There are a number of factors which may have contributed to this. The existing schemes were voluntary, with the government providing little in the way of incentives to stimulate savings for retirement. There were other apparently attractive investment assets such as holiday homes that had been showing a higher return on investment.

3.17 Superannuation and managed funds operated at a tax disadvantage to direct investments up until 30 June 2007. The new PIE tax regime was introduced to address these anomalies which include high tax rates of retirement savings for those with lower marginal tax rates on other incomes, capital gains tax for Australasian equities and inconsistencies in the taxation of foreign investments.

3.18 Over the same period up to 2007, house and property prices were rising at rapid rates with the characteristics of a price boom.

Table 3.2 – Total Superannuation Scheme Membership Prior to KiwiSaver (for balance dates)

Year	2003	2004	2005	2006	2007
Members	715,483	697,916	691,605	656,086	635,297
Schemes	675	625	590	576	560

Source: Reports of the Government Actuary, Appendix 2 and the GSF as described on the next page.

3.19 According to the 2008 GA report, 75 schemes (13%) of the total number of schemes had assets of $50 million or more, and accounted for 86% of the total superannuation asset value and 85% of total superannuation membership.

3.20 Corporate superannuation schemes had experienced the greatest percentage decline, with the number of employees covered by corporate superannuation schemes reducing significantly over the last ten years. High compliance costs relative to other comparable products, due to the need to comply with both the Securities Act (1978) and Superannuation Scheme Act (1989), as well as changing employment trends (where core staff changed careers more frequently), led many employers to revisit their superannuation policy. Many schemes were closed to new members, wound up, or shifted from individual trust deeds to Master Trusts, which are less individualised but significantly more efficient to administer.

3.21 The last twenty years has also seen a move away from defined benefit schemes (where the employer carries the investment risk but spreads the effect of this over time) to defined contribution schemes (where the employer's cost is known and the employee's final benefit is related to the investment returns from the superannuation fund).

3.22 In part, this change has occurred due to changes in working patterns, with most employees now more likely to change careers and employers. It also reflects a move to greater transparency and a societal move away from mutual savings.

3.23 The State Sector Retirement Savings Scheme introduced in 2004 has now been closed to new members. This is a voluntary scheme for government employees, with matched contributions of up to 3 percent of salary. This Scheme introduced the feature that allowed a choice of Providers, which also became a feature of KiwiSaver.

3.24 Other significant government or semi-government superannuation schemes are the Government Superannuation Fund (GSF) and the National Provident Fund (NPF). Both of these schemes are closed to new members.

3.25 Individual superannuation schemes have also experienced a decline in membership in recent years. It appears that other savings vehicles, such as unit trusts, group investment funds (GIFs), bank term investments and deposits, as well as direct investment in shares, bonds and term loans, have been used to save for retirement. When compared to the untaxed capital gains from house price increases, long-term savings through financial products were perceived by an increasing number of employees and individuals as less effective for the purposes of retirement accumulation.

3.26 Even though superannuation scheme membership numbers have been declining, ongoing new contributions from existing members and the return on investment ensured these schemes were still seeing growth above the rate of inflation (five percent per annum increase from 2003 to 2007 in real terms). Table 3.3 below shows the growth in superannuation fund assets reported by the GA over the five years to December 2007. The table records private and public superannuation and excludes assets from the New Zealand Superannuation Fund (NZSF). The March 2008 MFS indicates that the recent poor stock market performance will have reduced this total significantly in calendar year 2008 (to levels closer to those in 2004/05[21]).

Table 3.3 – Superannuation Assets[22] Prior to KiwiSaver (balance dates across the December year)

Year	2003	2004	2005	2006	2007
Assets ($m) [(a)]	18,857	20,241	21,716	24,515	25,914
Assets ($m) [(b)]	-	18,651	19,671	21,034	22,004

Source: [(a)] Reports of the Government Actuary (2003 to 2007), [(b)] MFS.

3.27 The NZSF commenced in 2003 to set aside excess Government funds to assist with meeting state retirement benefit provisions when the current population hump reaches retirement age. It began with a government injection of $2.4 billion and has continued to receive regular government contributions. These are recorded from 2004 in Table 3.4 below. In the 2006/07 financial year, the NZSF Annual Report indicated that the government contributed just over $2 billion. The value of the fund has increased 259 percent since 2004.

[21] Mercer, *Managed funds survey*
[22] This includes traditional superannuation schemes monitored by the GA and The GSF which is reported separately.

Table 3.4 – New Zealand Superannuation Fund Assets (June years)

Year	2004	2005	2006	2007	2008
Public Equity ($m)	3,956	6,555	9,864	12,992	14,212

Source: NZSF Annual Report Financials (2004 to 2008).

3.28 Superannuation savings (excluding NZSF) as a percentage of gross domestic product (GDP) have remained static over the last four years. When NZSF is included, total superannuation grows as a percentage of GDP to 21percent The Table below records both the rate of superannuation assets to GDP, without and with NZSF.

Table 3.5 – Superannuation Assets as a Proportion of New Zealand's GDP

Year (Normalised to a March year end)	2004 (percent of GDP)	2005 (percent of GDP)	2006 (percent of GDP)	2007 (percent of GDP)
Superannuation as a proportion of GDP	13%	13%	13%	13%
Superannuation (including NZSF) as a proportion of GDP	16%	17%	20%	21%

Source: Derived from MFS, NZSF and Reserve Bank – C15 Household Financial Assets and Liabilities Statistics (see Appendix F)

3.29 In other jurisdictions, such as Australia and Chile, superannuation as a percentage of GDP is substantially higher. This is due in part to the compulsory nature of their schemes and the fact that they have been in operation for many years (since 1992 for Australia and 1980 for Chile). Australia's superannuation funds have grown from 63 percent of GDP in 2002 to 99 percent in 2006[23]; while the aggregate value of pension funds in Chile in 2000 was 55 percent of GDP[24]. This suggests that there is potential for KiwiSaver to become a significant part of the New Zealand economy.

3.30 OECD's Global Pension Statistics Database puts New Zealand's pension reserves at a lower absolute level relative to GDP and still considerably below other countries. Further work is required to ensure the New Zealand data is fully comparable before this database becomes a reliable evaluation tool and international comparator. It is included here because it is commonly used by international sources.

3.31 It is likely the New Zealand funds are considerably above 10 percent of GDP when measured in a comparable way. Nevertheless, even with adjustments, New Zealand figures are likely to be considerably lower than most OECD countries.

3.32 It is important to consider New Zealand's low level of pension funds in the context of government policy for universal superannuation for all those over 65 years of age. Though New Zealanders are effectively saving for their retirement through their taxes and generational transfers, these savings are excluded from the OECD's definition of pension funds.

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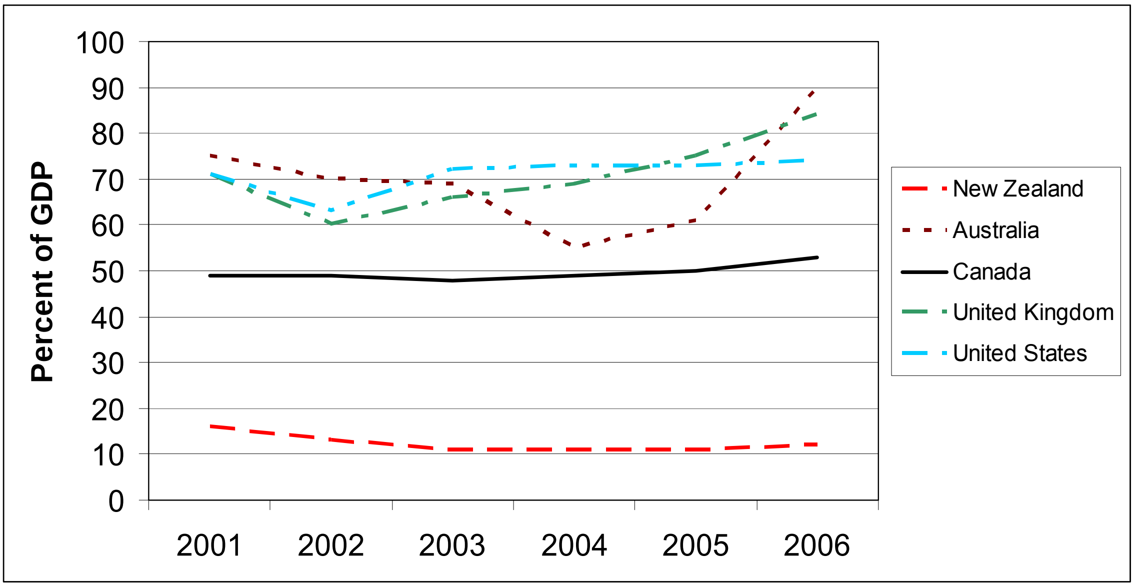
[23] Australian Prudential Regulation Authority (2007), *Celebrating 10 years of superannuation data collection 1996-2006*, pp18.
[24] Rodrigo Acuna R and Augusto Iglesias P (2001).

3.33 Figure 3.1 is for illustration purposes only as the information from each country is an aggregate of a number of different databases.

Figure 3.1– Pension Funds as a Proportion of GDP



Source: OECD Pension Statistics Database

Superannuation in the Absence of KiwiSaver

Likely Trends in Superannuation

3.34 A key long-term objective of an evaluation of the supply-side impact of KiwiSaver is to examine what would have happened to the superannuation market in the absence of any change. This counterfactual proposition is complex and to be able to isolate specific consumer inputs, will require a longer time series of data correlated against other trends.

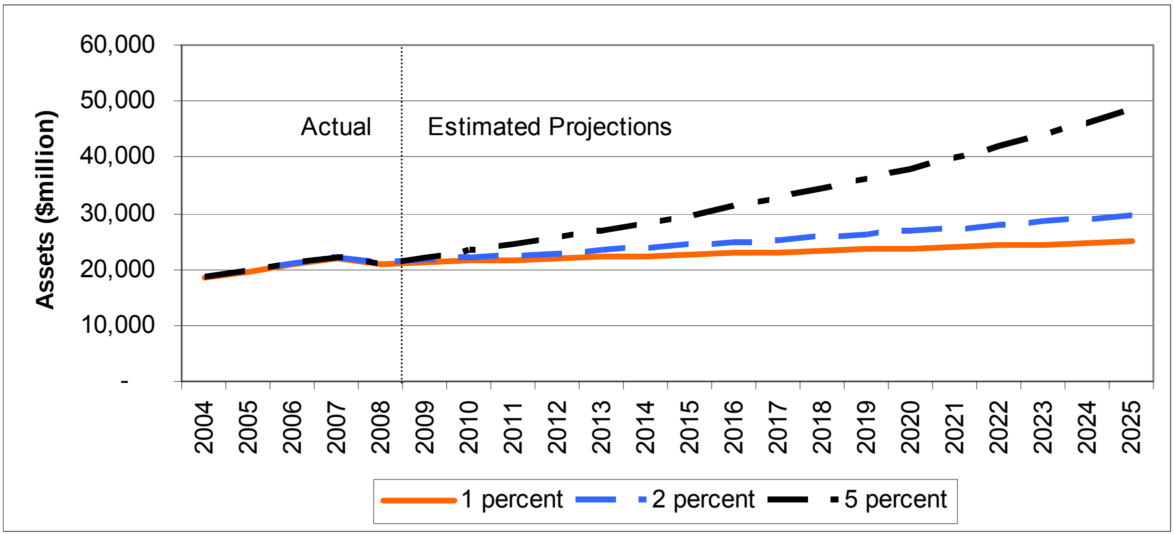
3.35 Although the effects of different influences on the superannuation market (including KiwiSaver) cannot be separated, the government has identified what it sees as an issue to address. The purpose of KiwiSaver, as defined in the KiwiSaver Act, is "…to encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement. The Act aims to increase individuals' well-being and financial independence, particularly in retirement, and to provide retirement benefits".[25] An interpretation of this view is that New Zealand's households required specific incentives to develop a savings habit. It follows from this that the features of existing superannuation and managed funds were insufficient to attract individuals to increase the proportion of their annual incomes that were contributed to savings.

3.36 Over the past five years, the number of members in traditional superannuation schemes (including the GSF), has been decreasing at two percent per year. The majority of funds growth in these superannuation schemes over this period has come from investment returns. Managed funds grew at three percent per annum over the same period, which was principally due to investment returns rather than new investments.

[25] KiwiSaver Act 2006 Part 1, 3(1).

3.37 Even in light of pessimistic economic conditions, it seems reasonable to assume that superannuation funds would have continued to increase over time in a similar fashion to recent history. Figure 3.2 projects superannuation funding based on recorded trends and a range of annual growth rates from 2008.

Figure 3.2 – Superannuation Asset Projections in Absence of KiwiSaver (June years)



Source: PwC based on superannuation data up to 2007.

Economic Conditions Prior to Introduction of KiwiSaver

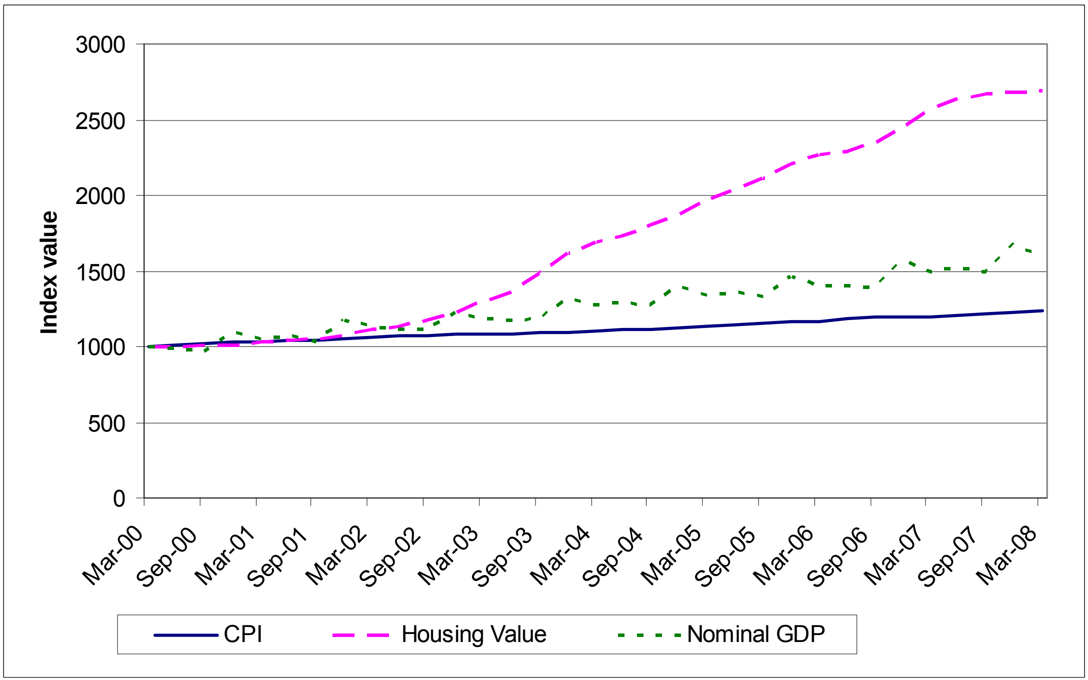
3.38 One of the key indicators of success for KiwiSaver is the influence it may have on the overall level of household savings and, particularly, on the level of retirement savings. To gain an understanding of how KiwiSaver changes the level of savings, it is important to understand where people's contributions to KiwiSaver are coming from. For example, are the contributions funded by a switch from other forms of savings and investment, or do they represent a net increase in deferment of consumption now in favour of consumption in retirement?

3.39 This section starts with an examination of the economic conditions when KiwiSaver was introduced and in this context it addresses the subject of savings, KiwiSaver's impact on the New Zealand Stock Exchange, employer superannuation schemes and the potential for substitution effects that may arise as the KiwiSaver schemes grow.

3.40 The years leading up to the introduction of KiwiSaver in July 2007 were characterised by strong growth in house asset values and, to a lesser extent, in the NZX. From 2003, the RBNZ repeatedly raised the official cash rate (OCR) in order to curb inflation, exacerbated by house price rises. The OCR increase was mirrored in the floating and two year fixed mortgage rates. This period of strong growth in household assets is a sharp contrast to the conditions in the months immediately prior to July 2007. Figures 3.3 and 3.4 illustrate the volatile economic conditions in New Zealand prior to and during the first year of the KiwiSaver scheme.

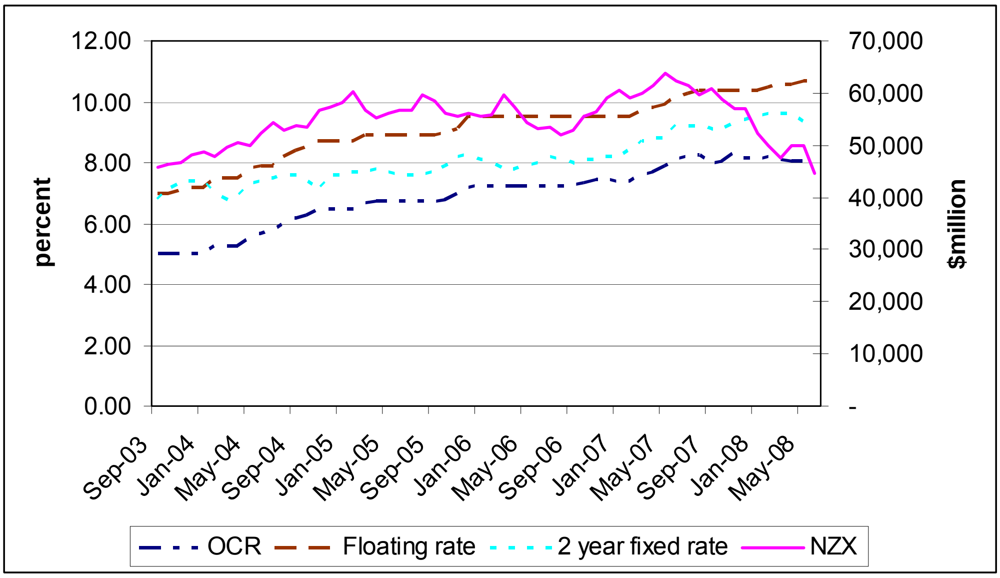
3.41 A comparison of CPI, housing value and GDP shows the rapid rise in house prices in New Zealand over the early part of this decade. As Figure 3.3 shows, the trend in house prices had levelled out by June quarter 2007. Figure 3.4 shows the decline in the stock exchange's capital value at the same time.

Figure 3.3 – Comparison of CPI, Housing Value and GDP (Quarterly Mar 00 – Mar 08)



Source: RBNZ (quarterly).

Figure 3.4 – Comparison of OCR, NZX, Floating and Two Year Fixed Interest Rates (Monthly, Sep 03 – June 08)



The right hand scale applies to the NZX only.
Source: RBNZ, New Zealand Stock Exchange

Household Savings

3.42 Household savings, as reported by the OECD, highlights New Zealand's poor savings performance compared to other OECD countries (see table 3.6 below). The Reserve Bank Bulletin reports that savings over the last 15 years have fallen sharply but that this is an international trend, not a problem isolated to New Zealand.[26]

[26] Reserve Bank Bulletin…+bib

Table 3.6 – Selected Country Household Savings Rates (period averages as a % of Household Disposable Income

	1970s	1980s	1990s	2000-04	2005
Australia	14.2	11.1	5.4	-0.5	-2.6
United States	9.6	9.1	5.2	2.1	-.04
Canada	12.0	15.3	9.1	3.4	-0.2
Germany	13.1	12.8	11.4	9.9	10.7
France	13.2	9.5	11.6	12.2	11.6
Netherlands	4.1	14.3	14.1	8.4	5.7
Japan	23.7	16.3	12.4	5.0	2.4
New Zealand	3.6	2.8	-1.6	-7.2	-14.8

Source: OECD, cited in A Synopsis of Theory, Evidence and Recent Analysis on Saving, The Treasury 2007. Data for Japan for 1970s are for period 1972-1979.

3.43 The complexities of measuring household savings are detailed in the Statistics NZ paper *Selected issues in the measurement of New Zealand Savings*[27], published in 2006. The paper describes four measures of household savings as briefly described in the Table 3.7. A challenge when analysing savings is to separate flow measures from stock measures. This distinction becomes particularly important for the analysis of the drivers of the growth of savings.

3.44 There is considerable debate over the validity of the Household Savings Rate and further work is required in this area. This is outside the scope of this evaluation and these figures have not been used in our analysis.

Table 3.7 – Savings Measurement Instruments

	Flow: Income less expenditure	Stock: Change in net worth
Unit record data (e.g. household)	Household Economic Survey (HES)	Survey of family, income and employment (SoFIE)
Macroeconomic aggregates	Household Income and Outlay Account (HIOA)	Reserve Bank of New Zealand

Sources: Compiled from publicised statistical series by PwC based on selected issues in the Measurement of New Zealand Savings, Bascand G, Cope J and Ramsey D (2006)

3.45 The macroeconomic measures outlined above, while not able to attribute substitution to KiwiSaver, will provide a basis for the evaluation framework to measure changes at an aggregate level and provide a comparison for understanding the impact of potential substitution effects reported under other parts of the KiwiSaver evaluation. For New Zealand, the RBNZ and HIOA data sources are based on accepted standards for measuring macroeconomic information. While they do not align perfectly, they both show declines in New Zealand household savings consistent with earlier OECD data over the past ten years.

[27]Bascand G, Cope J and Ramsey D (2006).

3.46 According to these measures, household savings have been declining at an average of $5-6 billion per year over the 10 year period.

3.47 The Reserve Bank Household Assets and Liabilities Report (for an extract see Table 3.8) puts net financial wealth of New Zealand households at $30 billion in 2007 (net household wealth less housing value plus student loans). This included a $22 billion in superannuation assets owned directly by households. In comparison, net housing value is estimated at $458 billion at the same date (72 percent of net wealth in 2007 compared to 60 percent in 1998). Housing debt has increased by $107 billion over the past ten years.

Table 3.8 – New Zealand Household Financial Assets and Liabilities in $billions, nominal values (December years)

	2000	2001	2002	2003	2004	2005	2006	2007
Trading Bank Deposits	45	49	54	59	65	73	82	90
Other fixed interest assets	8	8	10	12	14	14	16	19
Superannuation	22	21	19	18	19	20	22	22
Life insurance	10	9	8	9	9	9	9	9
Managed Funds	25	26	24	26	27	30	36	37
Direct domestic equities	11	11	11	13	15	14	16	15
Direct overseas equities	6	5	4	5	5	6	8	9
Housing Value	231	247	282	370	429	506	559	614
Less household financial liabilities	74	80	88	102	117	135	152	170
Less student loans	4	4	6	6	7	8	9	10
Household net wealth	**279**	**293**	**318**	**403**	**458**	**528**	**586**	**634**

Source: Reserve Bank – C15 Household Financial Assets and Liabilities Statistics

3.48 In their paper, *How much of new savings will KiwiSaver produce?* John Gibson and Trinh Le of Waikato University suggest that over the first months KiwiSaver was introduced, national savings were not increasing. Using data from their nationwide survey of individuals, they found that although every dollar of KiwiSaver balances represents between 9 and 19 cents of new savings for a household, the remainder was being offset by declines in savings in other economic sectors. If the dead weight loss of the incentives are taken into account, Gibson and Le suggest that savings may be lower as a result of KiwiSaver.[28]

3.49 It is important to put Gibson and Le's analysis in context. It relates to the early stage of the introduction of KiwiSaver when many of those enrolling were doing so to be able to gain the incentives offered by the scheme. In this introductory period, even those enrolling who intended to increase their savings over time may still have been in a learning phase, wanting to understand more about how the scheme would work in practice and the impact of the initial reduction in weekly income before deciding to increase their overall level of savings.

[28] Gibson J and Le T (2008).

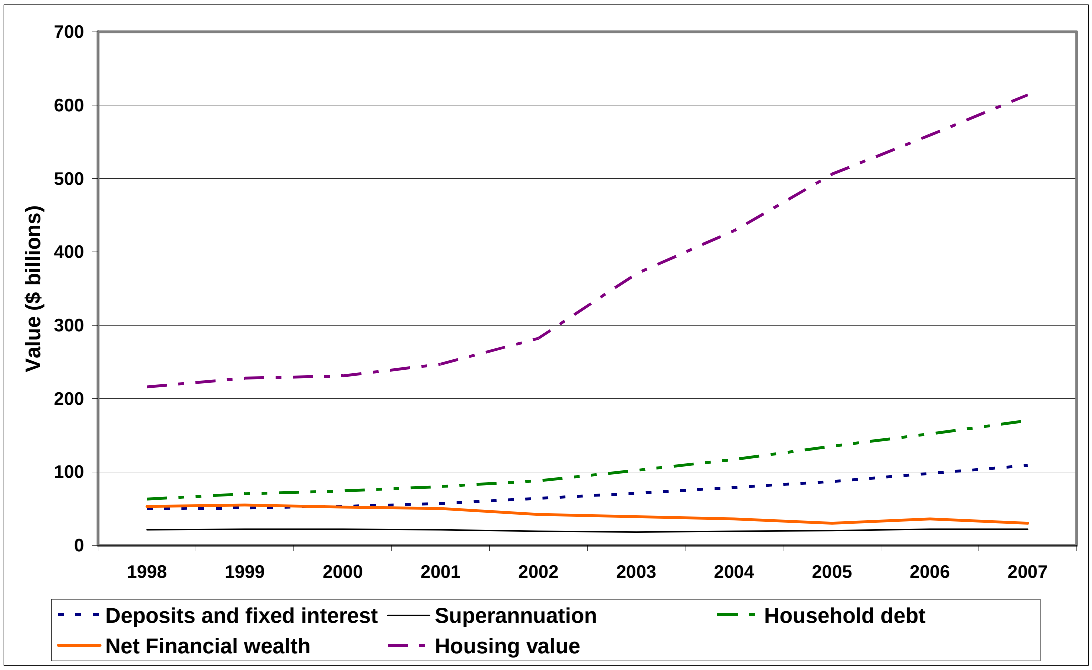
3.50 It will be important to monitor the impact of the scheme against indicators, such as the RBNZ Household Financial Assets and Liabilities Statistics and others over a longer period before making a conclusive statement about the impact of savings and any substitution with other forms of savings (and debt reduction).

Housing

3.51 Home ownership is important to KiwiSaver because of the strong propensity New Zealanders have for home ownership. Historically, New Zealanders have had high levels of home ownership (especially compared with European countries, though less so compared with Australia), but the proportion of home owners has been falling since the early 1990s.

3.52 The value of the New Zealand housing stock has seen a surge in value since 2002 and although individual property ownership has decreased, housing assets are still likely to form a large part of many New Zealanders retirement plans given housings value compared to other assets (see Figure 3.5).

Figure 3.5 – Selected New Zealand Household Financial Assets and Liabilities



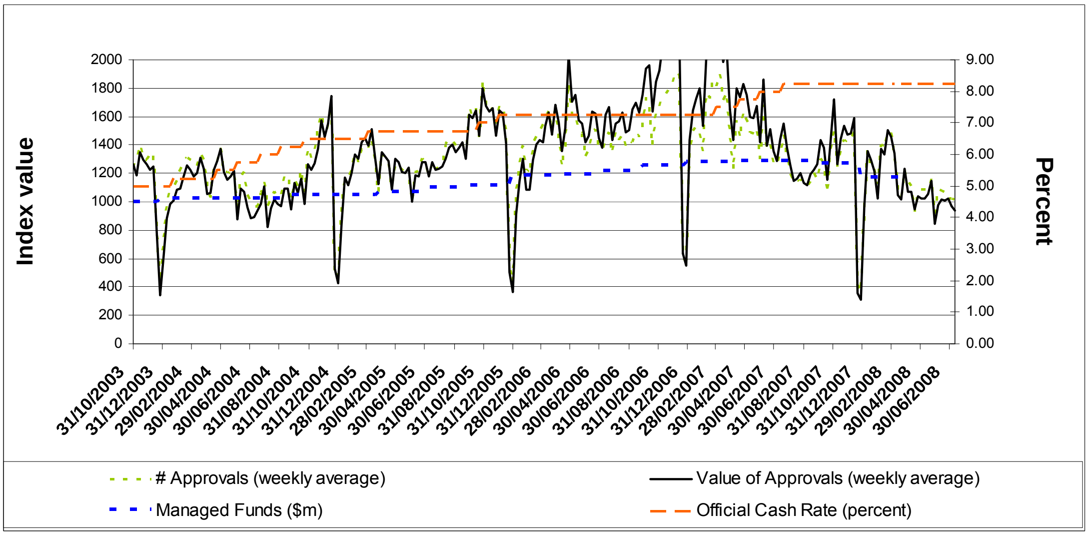
Source: Reserve Bank – C15 Household Financial Assets and Liabilities Statistics

3.53 Three features of KiwiSaver, mortgage diversion, deposit subsidy, and first home withdrawals, are designed to support the acquisition and repayment of mortgages for principle residence. According to government estimates, the first home buyer's withdrawal is likely to be taken up by 3,000 households a year.[29] The average amount of the withdrawal is likely to increase with time as funds build up, but will depend on the period of time members have been in the scheme before they make the withdrawal. The Government funds the deposit subsidy separately. Mortgage diversion's effect will depend primarily on the take-up rate of this option.

[29] *Budget 2005: Scheme gives $5000 leg-up for first time home buyers*, The New Zealand herald 20 May 2005.

3.54 The housing market has seen considerable growth since the turn of the century but consents and building values have both dropped back to 2004 levels in the year to August 2008. Managed funds have followed a similar pattern, levelling in 2007 and dropping considerably in 2008. The official cash rate has been slower to respond. Figure 3.6 illustrates some key housing trends.

Figure 3.6 – Indexed Housing Comparisons (October 03 – June 08)



(1) All series are indexed on data from the Dec 2003 quarter.
(2) Housing approval data was obtained from QV via the RBNZ.
(3) Managed funds is a quarterly data sourced from the RBNZ Managed Funds Survey.
(4) Base period is 31 October 2003 where the index value = 1000, nominal values were: Number of approvals = 5,847, value of approvals = $683,000,000, OCR = 5.00%, Managed funds = $51,581,000,000.

3.55 Gibson and Le (2008) suggests in their paper that homeowners are at least as likely to fund their KiwiSaver contributions from a reduction in spending, suggesting that the additional funds may come from a reduction in mortgage repayments.[30] This may represent homeowners lowering their direct repayments but it may also come from a decrease in the size and frequency of lump sum payments.

New Zealand Stock Exchange

3.56 The New Zealand Stock Exchange (NZX) has seen a recent drop in market capitalisation to levels approaching that in 2003 after reaching a high in 2007.

3.57 Between 2004 and 2008, superannuation investments in New Zealand equities was constant until 2008 when they reduced, consistent with the market capitalisation (see Table 3.9).

[30] Gibson J and Le T (2008).

Table 3.9 – NZX Statistics (As at March)

	2004	2005	2006	2007	2008
Superannuation invested in NZ equity ($ millions)	2,793	2,776	2,625	2,867	1,950
NZX Capitalisation ($ millions)	49,543	56,746	59,654	59,999	47,526
Superannuation investment in the NZX (percent)	15	14	12	13	9

Source: NZX, MFS.

3.58 The early indications from the Managed Funds survey, for March quarter 2008, suggest KiwiSaver Providers are investing a larger proportion in New Zealand (61 percent) than superannuation providers are in general (46 percent). For the same period KiwiSaver Providers are also investing slightly more in New Zealand equities (11 percent) than superannuation providers in general (10 percent).

3.59 Investment in equities, however, is a function of the risk profiles adopted by KiwiSaver members. Many members have been placed into default funds, which are required to have a conservative risk profile and therefore have low investment in New Zealand equities and equities generally.

3.60 Australia's experience provides an example about the effect of developing financial literacy to support a compulsory superannuation program. This includes the establishment of the Financial Literacy Foundation. The results of the Foundation's latest survey in September 2007 shows that Australians have "high levels of ability with their money", that 69 percent of Australians have the ability to invest and that 63 percent say they can ensure they have enough money for retirement.[31] It should be noted that survey respondents self-assessed their ability. In contrast, it has been argued that compulsory superannuation may have reduced the incentive for investment in financial understanding by participants who believe that simply saving for retirement is enough and that each fund is as good as the other.

3.61 The Australian experience provides evidence that compulsory savings schemes can lead to increased financial literacy amongst households. In addition, investment fund managers have the opportunity to gain experience about the continuation and requirements of KiwiSaver contributions, opt-outs and so on. Once fund managers have more certainty about these factors they can develop and test the returns from different investment portfolios. Through the combination of greater financial literacy, more savings experience and a range of understandable risk/return tradeoffs New Zealanders can be expected to move to having more growth elements in their funds.

3.62 An increase in the investment pool is not, however, the only requirement for growing a stronger equity market, as evidenced by increased listings, capitalisation and market growth. The Forum on Improving the Investment Environment, facilitated by MED in November of 2007, identified a number of other causes for the inability to grow NZX listings and attract new ones. The causes included: "a funding gap between start up and listing, the fact that trade sales are often the easiest and cleanest exit method for shareholders, perceived pricing differentials, entrepreneurial preference for control rather than growth, and potentially a lack of global entrepreneurial ambition."

3.63 A strong venture capital market, primarily managed through private equity investors, is another building block of a strong economic growth model.

[31] Financial Literacy Foundation (2007).

3.64 Venture capital is characterised by a high level of intangible assets such as intellectual property and early negative earnings. This makes normal financing difficult to obtain and it is venture capital that can fill the gap.[32]

3.65 It is anticipated that an increase in KiwiSaver assets and risk profiles would result in a greater pool of venture capital, however it is not monitored as part of this evaluation. In assessing these factors, it is important also to keep in mind comments throughout this report on the influence of liquidity requirements on the decision making of Providers and their fund managers.

KiwiSaver's Effect on Employer Superannuation Policy

3.66 A survey of 52 large employers, conducted by the Retirement Policy and Research Centre (RPRC), examined the impact of KiwiSaver on the superannuation plans of employers[33]. The survey found:

- 70 percent of employers surveyed had a superannuation plan (other than KiwiSaver) that was open to at least one employee;
- 88 percent of employers had already, or were about to change, their superannuation policies as a result of KiwiSaver;
- of the employers with an open plan that answered the question, 76 percent said that, given the opportunity, they would not start the existing plan again, the most frequently cited reason was KiwiSaver's introduction; and
- employers recognise that they have a role to play in supporting the retirement savings of employees but that enthusiasm reduced as contributions increased.

3.67 Employer sponsored superannuation is an important factor to consider in analysing the baseline for KiwiSaver, as has been discussed in this report.

3.68 Stobo (2008) draws on the work of RPRC to identify substitution effects between existing employer based superannuation schemes and KiwiSaver, and reports that 66 percent of employers responding to their survey said that KiwiSaver had prompted changes in their superannuation policies and a further 22 percent said that KiwiSaver was likely to prompt changes but that these are still yet to occur.

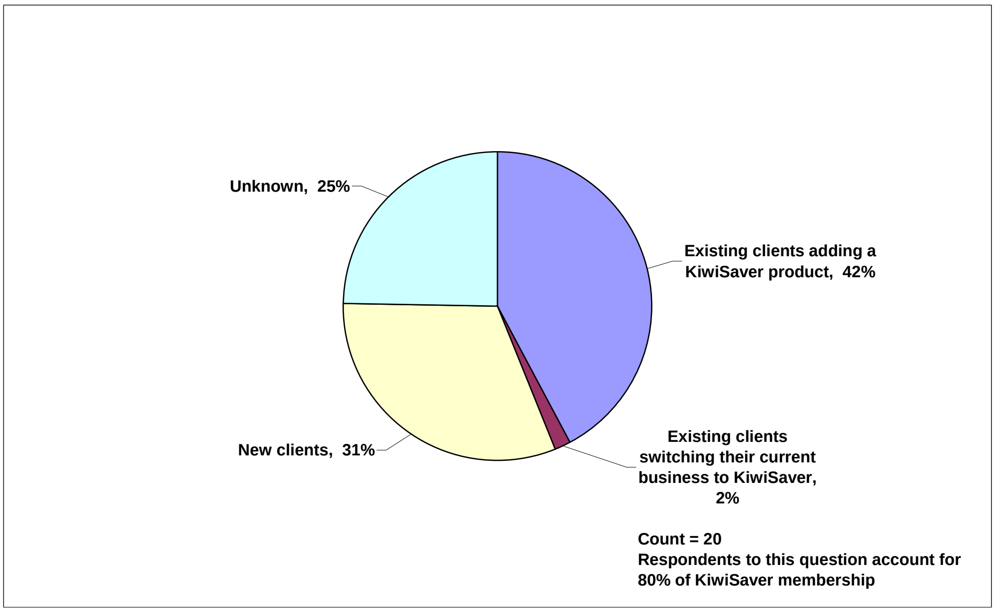
Substitution Effects

3.69 With only 12 months of KiwiSaver data, it is too early to ascertain what proportion of member contributions represents new savings and what part represents substitution from other forms of savings. This picture will continue to be coloured by the slower economic climate, the downturn in housing consents and sales, and inflationary pressures. The evaluation has identified some measures that give an indication that KiwiSaver may represent new savings or additional people saving. Certainly, while it may mean a switch from other forms of investment (such as mortgage repayments), it is clear that many new people are saving directly for their retirement for the first time. On the other hand, early studies, such as that by Gibson et al., suggest that KiwiSaver savings are a direct substitute for other savings and investment activity.

[32] Lerner J, Moore D and Shepard S (2005).
[33] Retirement Policy & Research Centre (2008). This survey provides a snapshot of what 52 large employers, employing 217,721 New Zealanders, were doing in early 2008. Of the 52 employers 48 responded to this survey question.

3.70 In contrast, Providers that responded to the KES report that only two percent of their KiwiSaver members are existing clients substituting KiwiSaver for other products. Figure 3.7 below illustrates the KES, question B2, responses.

Figure 3.7 Source of KiwiSaver Members



Source: KES, B2.

3.71 After one year since KiwiSaver was introduced in June 2008, total membership (716,637) already exceeds that of existing superannuation schemes (635,297), though not when members under 18 years are removed (625,865).

3.72 Some other features that support the basis for believing that KiwiSaver has the potential to generate new levels of individual savings can be ascertained from the interviews and the KES of Providers carried out through this evaluation. The KES found that:

- 38 percent of Providers are using advertising to attract new customers (KES, A2); and
- 63 percent of Providers have noticed an overall increase in their superannuation and managed funds products since KiwiSaver was introduced (KES, B1).

3.73 As noted above, a survey conducted by Gibson and Le of Waikato University of New Zealand suggests that KiwiSaver has increased household savings by between 9 and 19 cents for every dollar invested, with the remainder appearing to be offset by a reduction in other forms of economic savings. Given that household asset prices (especially in the form of housing but also investors in equities of financial companies) were falling at the time KiwiSaver was introduced and the prices of key household goods such as petrol, energy and food were rising, this result makes sense for the 2007/08 year. More time needs to pass before the magnitude of the substitution effect can be understood.

3.74 In the meantime, Providers have the opportunity to address the requirements of their many new retail members. Provider's success in growing their members' funds will be a factor that leads confidence in the market and potentially additional savings in the future.

4 KiwiSaver Supply-Side

4.1 This Chapter contains a description of KiwiSaver Providers and schemes, investments, fees and profitability, and, the general characteristics of the KiwiSaver market. The Chapter is based mainly on the KES (see Appendix A) and the Provider interviews (see Appendix B), as well as information from the MED, IR, Treasury and the GA. Based on the description of KiwiSaver Providers, Chapter 5 then analyses the Firm Dynamics of KiwiSavers and Chapter 6 analyses the Market Dynamics.

KiwiSaver Providers

4.2 KiwiSaver has attracted a wide range of organisations as Promoters and Providers.

4.3 This section discusses the characteristics and behaviour of KiwiSaver Providers and Public Promoters. It excludes Private Promoters and, as such, it is focused on an analysis of publicly available ("retail") schemes. Promoters are those organisations who offer a scheme but do not administer it themselves.

4.4 According to the KES responses, reasons for becoming a KiwiSaver Provider differed. The most common driver for a Provider offering a KiwiSaver product was that superannuation/funds management was a part of its core business (39 percent of respondents). A further 15 percent believed that not offering a product would harm their business and this was the key driver for them (KES, A1).

4.5 Providers entering the KiwiSaver industry from outside the superannuation funds market saw KiwiSaver as an opportunity to grow their brand and expand their business into a new market. Often they felt they had a competitive advantage in respect of products, systems or loyalty of their existing client base.

4.6 In some instances, KiwiSaver presented an opportunity for Providers to offer a retail product for the first time. They were enthusiastic about the opportunities KiwiSaver provided to investors and Providers alike.

4.7 KiwiSaver, combined with the PIE tax changes, was seen by many of those Providers interviewed as an opportunity to turn declining membership trends around. In Chapter 3, Table 3.1 records that, for some of the last five (in fact the last ten) years, traditional superannuation scheme membership has declined. There were an estimated 715,483 super scheme members as at June 2003, this reduced to 635,297 as at June 2007.

4.8 In a comment that is indicative of Providers interviewed, Brian Gaynor of Milford Asset management commented to the Independent "In ten years it will be the No 1 game in town …"[34]

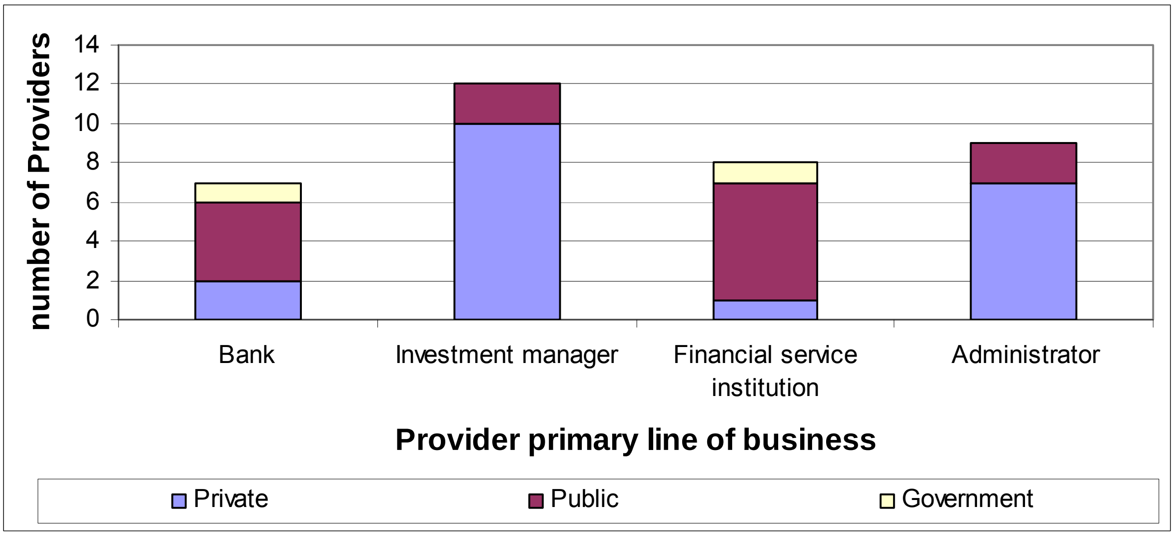
4.9 Many of the Providers outsource the administration function to a specialist administration provider. In addition, many outsource the investment management function.

[34] Lori Nims (2008), *Feel the flair: Boutiques add extra dimension*.

Ownership Characteristics

4.10 There are 36 KiwiSaver Providers and Promoters. These are a mixture of banks, financial services institutions (insurance and investment companies), investment managers (investment houses) and superannuation administration companies. Amongst these are a number of New Zealand-based banks who are Promoters. Of New Zealand registered trading banks, only Westpac and ASB are KiwiSaver Providers. Ownership varies between publicly held companies, private companies and government sector organisations (see Figure 4.1 below).

Figure 4.1 – KiwiSaver Provider Characteristics



Source: PwC research

4.11 Most Providers are New Zealand (24) or Australian (7) based firms. Providers include firms with head offices in the Netherlands (2), United States (2) and France (1). By far the most common type of Provider (by number) is locally owned investment managers.

Default Providers

4.12 A feature of KiwiSaver is the existence of six default KiwiSaver Providers. Auto-enrolled members, and Active Choice members who do not select a Provider, are randomly but evenly allocated to these Providers.

4.13 Prospective KiwiSaver default Providers entered into a competitive tender to obtain this status and were evaluated on criteria such as:

- security and organisational credibility;
- organisational capability;
- proposed design of the Provider's default KiwiSaver Scheme;
- administration capability;
- competitive fee levels; and
- investment capacity/capability[35].

[35] KiwiSaver Default Providers: Questions and Answers, http://www.med.govt.nz/templates/MultipageDocumentTOC____24459.aspx.

4.14 The Provider interviews found that generally those who had obtained default Provider status were happy with the process.

4.15 It is clear that a number of Providers, particularly those that were unsuccessful in the initial round of default Provider selection, regard the default Provider designations as providing a significant competitive advantage. They will pursue this accreditation in the future. Some Providers felt the process of granting default status and the reason for a set number of default Providers lacked transparency. They believed consideration should be given to reviewing the process, including re-examining how default Provider status is achieved, with one possibility being the establishment of a clear set of quality standards, if maintained, would enable Providers to automatically qualify (or renew) as a default Provider. The government could consider levying a fee for the attainment of default status and use this to promote financial literacy, and/or to include the production of investor education material as criteria for default Provider status.

4.16 The six default Providers selected by MED were:

- AMP;
- AXA;
- ING;
- TOWER;
- ASB;
- Mercer.

4.17 Four of these are traditional financial services companies, providing insurance, superannuation and investment products. One is a bank (which owns an insurance company), and the last one, Mercer, is a superannuation administration and investment consulting company, which has recently set up a fund of funds investment management capability.

4.18 Default Provider status was awarded for an initial term of seven years and will expire in June 2014. Default Providers were required to nominate a default investment product (default fund) within their default scheme.

4.19 Providers interviewed noted that a large number of New Zealanders have left their Provider decision to the IR's random allocation process and thus been allocated to the conservative default fund. A longer period of data is required to understand whether these decisions are deliberate choices to be conservative investors or simply reflect a willingness to accept the default option as being appropriate. IR's data shows that, as at June 30 2008, 259,299 or 36 percent of members were initially 'auto-enrolled'. This includes those auto-enrolled into their employer's nominated scheme (65,428 members).[36] This suggests that these members are comfortable with the selection of default Providers or they have confidence in their employer's choice. Default Provider status has been a significant source of membership. As at 30 June 2008, default scheme membership stood at 421,697 or 59 percent of total members.

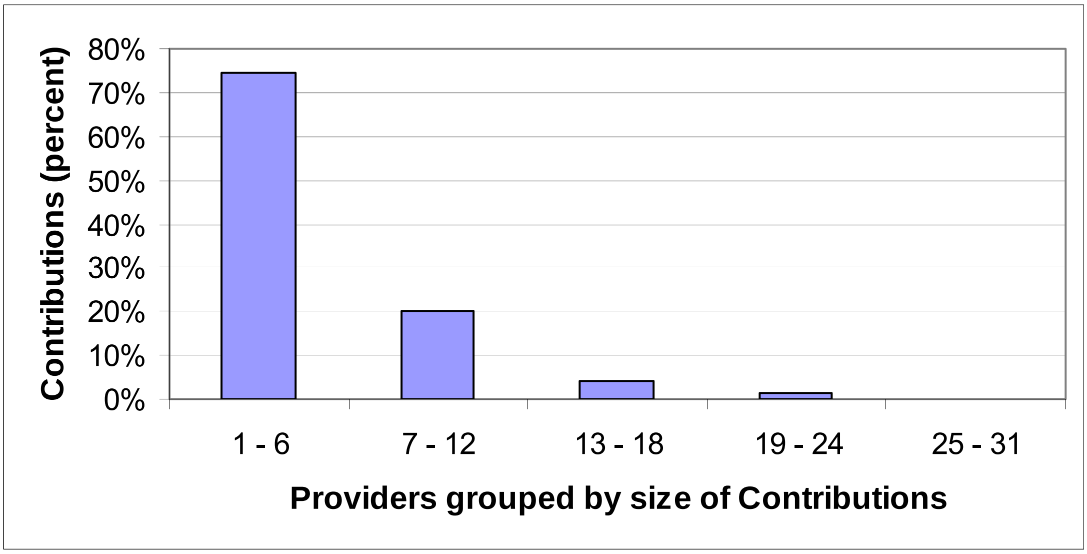
[36] Note that members may subsequently transfer to another fund with the same scheme or a different scheme altogether (sometimes with the same Provider, sometimes with a different Provider).

Distribution of Providers' Funds and Membership

4.20 Both membership and funds under investment vary greatly across the range of Providers. Only one non-default Provider matches any of the default Providers in terms of these criteria[37]. Default Provider status has been of significant assistance in growing a sizeable KiwiSaver membership, but it is clear that it is not a prerequisite.

4.21 The figure below shows the distribution of contributions to date. The six largest Providers have received 74 percent ($770 million) of all contributions and contain 77 percent of all members. In contrast, the smallest seven Providers (25-31) have received an average of only $181,000 each. Their total KiwiSaver funds make up less than 0.1 percent of the total funds (and members).[38]

Figure 4.2 – Distribution of Contributions processed through IR.



Source: Inland Revenue, as at June 2008 (Ranked by IR contribution data). Data relating to funds passed to providers are provisional. IR is currently reconciling final payments.

4.22 Many Providers spoke of the need to have a reasonably sized KiwiSaver membership for that part of their business to be financially viable. Almost all those Providers interviewed and 68 percent of those who answered this KES question (KES, B3.2) believe that in the future there will be some consolidation in the number of Providers in the market. Many of the successful Providers interviewed would be interested in buying further business. Opinions differed as to what size of membership was needed. In the Provider interviews it was noted that many smaller Providers, with good systems in place, were satisfied with their achievements to date.

4.23 Table 4.1 reports the IR data as at June 2008 in more detail. Around one fifth of Providers account for 75 percent of the contributions IR passed through IR. While the bottom two-fifths of Providers (by the level of contributions received) account for only around one percent of the contributions.

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[37] Some default Providers run two schemes, a default scheme and a non-default scheme. Contributions and members for both schemes and any other schemes administered by the Provider are included in the totals.

[38] The contribution data includes only those contributions made through IR as at 30 June 2008 and not those made directly to Providers. Note that IR is not able to provide data grouped by smaller numbers of Providers.

Table 4.1 – Average Accumulated Contributions and Memberships by Providers Size, as at June 08

Ranked providers	Total contributions	Average contribution per provider	Contributions (percent)	Total membership	Average membership per provider	Membership (percent)
1-6	$770,841,000	128,474,000	74	551,981	91,997	77
7-12	$208,797,000	34,800,000	20	128,045	21,341	18
13-18	$43,997,000	7,333,000	4	28,462	4,744	4
19-24	$12,445,000	2,074,000	1	7,050	1,175	1
25-31	$1,267,000	181,000	0	722	103	0
TOTAL	**$1,037,000,000**	**33,451,613**	**100**	**716,637**	**23,117**	**100**

Source: Inland Revenue, Providers are ranked in relation to the number of members enrolled with them through IR. Data relating to funds passed to providers are provisional. IR is currently reconciling final payments.

4.24 The 12 largest Providers accounted for 94 percent of accumulated contributions and 95 percent of members as at June 2008. For the top 6 of those, membership averaged nearly 92,000 after 12 months.

Distribution Channels Used by Providers

4.25 Providers have used a number of different distribution channels and strategies to enrol members into KiwiSaver. These include advisers, branches, existing clients, Employer Choice Agreements, advertising and default Provider status.

4.26 Although the channel or source of business itself is not particularly relevant to this evaluation, it is instructive to consider the success of different channels for the changes that will be wrought in the distribution of financial products in the future.

4.27 In particular, KiwiSaver has brought about a retailisation and commoditisation of the superannuation market. The banks, in particular, have been successful in picking up large numbers of enrolments through their branch networks, and their frequent interaction with their large existing client base at a retail level.

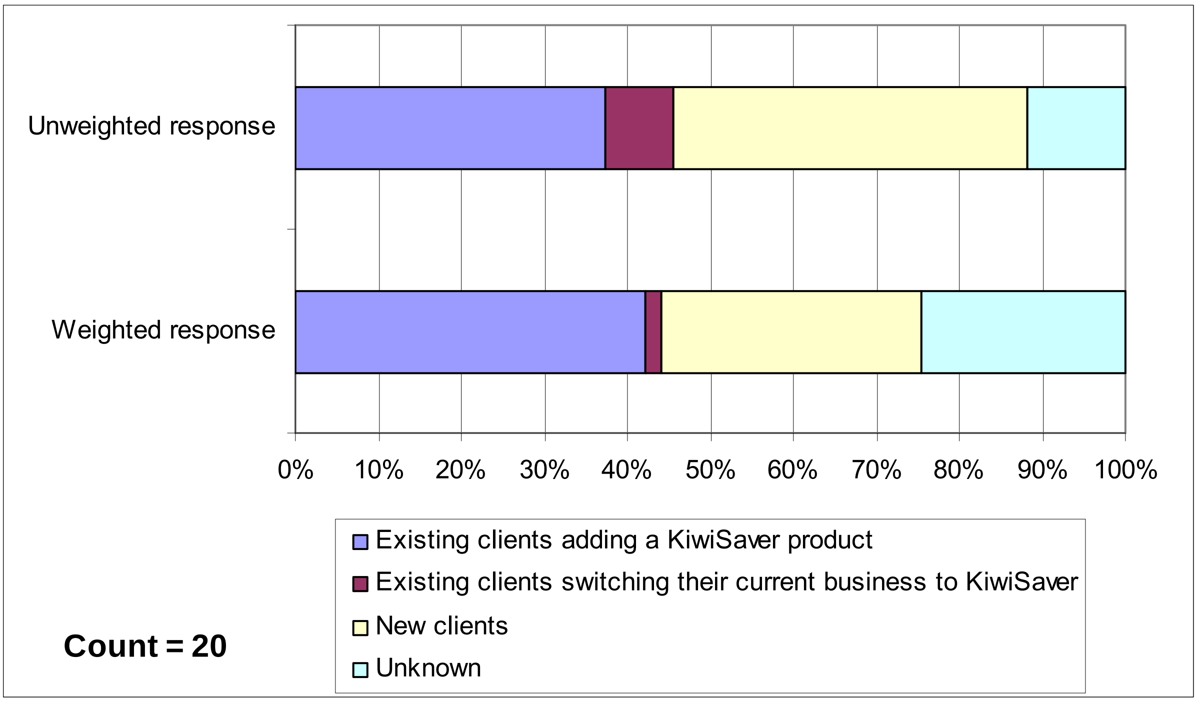
4.28 For those financial services organisations which traditionally sell their products through advisers, there has been a mixture of results. Many of these companies have gained KiwiSaver business through their existing clients and their families. An outcome of this is that they may have ended up with a large number of children's accounts with little immediate contribution flow.

4.29 KiwiSaver may be a harbinger of change in the intermediary market as well. The tight profit margins on KiwiSaver leave less ability for Providers to pay the commission to advisers recommending their products.

4.30 Many of the Providers interviewed, including the superannuation administration firms, have utilised existing corporate relationships to secure Employer Choice Agreements. Some were very successful in doing this; however, many reported both some resistance from employers to signing such an agreement, based on concerns regarding being seen to give financial advice, and often a relatively low take-up rate from employees once the Employer Choice Agreement was in place.

4.31 The KES asked Providers to estimate the source of their KiwiSaver membership with regards to new or existing clients. The source of about 25 percent of members was reported as unknown (weighted responses), but of the remainder, the results suggest that only 2 percent of existing clients who took up a KiwiSaver product switched from an alternative product, while 42 percent added KiwiSaver to their existing mix. The survey indicates that 31 percent of KiwiSaver membership came from clients who were new to the organisation (but may have substituted from another company's product).

Figure 4.3 – Source of KiwiSaver Members (August 2008)



Source: KES, B2.1.

4.32 The popularity of different strategies to attract new members is summarised below. (Note that this does not reflect the membership gained by the strategy.)

Table 4.2 – Member Growth Strategies

Strategy	Percentage of providers using strategy
Direct marketing to existing client base	81%
Employer choice agreements	65%
Approaching clients/cross selling	58%
Financial advisers	46%
Advertising	38%
Default Provider status	23%

Source: KES, A2.

KiwiSaver Schemes

Governance of KiwiSaver Schemes

4.33 Trustees are charged with the overall governance of KiwiSaver schemes. Trustees are initially appointed by the Promoter of a KiwiSaver scheme and are the issuer of the KiwiSaver (or superannuation) scheme. The Trustees can replace the investment manager or administrator of the scheme if, in their judgement, it fails to perform adequately.

4.34 Section 116 of the Act requires new KiwiSaver schemes to have at least one Independent Trustee, i.e., a Trustee who is not a director or employee of the promoter, administration manager or investment manager of the scheme, nor a member or member representative. The Act makes clear that Independent Trustees "must in managing the affairs of the KiwiSaver scheme, exercise the care, diligence and skill that a prudent person engaged in the profession or business of managing trusts must exercise" [39].

4.35 The role of the Trustees is varied. At a basic level it involves ensuring that the scheme is administered in accordance with the Trust Deed and legislation and in the best interest of the members. All funds are invested through a Trust on the members' behalf. The Trustees monitor that funds are invested in accordance with the Statement of Investment Performance Objectives (SIPO), although the fund of funds nature of many investments can make it difficult to ascertain the final underlying assets. For example, Fund A may invest in Fund B which in turn may invest in Fund C. The Trustees then need to understand the investments underlying all of Funds A, B and C.

4.36 A scheme's Trustees are a matter of public record.

4.37 Default schemes are required to appoint an Independent Trustee Company. There were also 16 non-default Schemes using an Independent Trustee Company. There are four such companies who are retained (or for whom a subsidiary acts) as Independent Trustees on behalf of KiwiSaver schemes. These are New Zealand Guardian Trust Co Ltd, Public Trust, Perpetual Trust Limited and Trustee Executors Superannuation Limited. These four are retained by 22 of the public schemes, including all of the banks and the other default schemes. None of the private schemes employ the services of an Independent Trustee.

4.38 Some Providers have chosen not to use an Independent Trustee Company and instead use a Trustee Company that is set up as a subsidiary or related company. In this case the level of independence of the Trustee may be perceived to be lower than using an arm's length Independent Trustee. In both cases, the quality of Governance ultimately depends on the ability, independence and integrity of the individuals who are Trustees within the Trustee Company.

[39] KiwiSaver Act pp 66.

Table 4.3 – KiwiSaver Schemes Use of Independent Trustee Companies

Trustee type	Public	Private	Total
Independent Trustee Company	22	0	22
Other	17	15	32
Total	39	15	54

Source: KiwiSaver scheme register.

4.39 The Trustee's role for KiwiSaver is consistent with that for other Superannuation Schemes. One Independent Trustee Company commented, when interviewed, that the amount of Trustee involvement required for KiwiSaver schemes is higher than for other schemes because of their extensive public interface. Examples of the additional workload carried out by Trustees are the large amount of marketing material, and higher than usual levels of financial hardship withdrawal applications, as members of the general public join KiwiSaver without understanding the financial consequences of their money being locked away.

4.40 New Zealand has not yet seen any significant issues with the integrity of its superannuation schemes, but clearly an effective Trustee industry is required for this to be continued.

4.41 The Trust invests the funds with an investment manager who may or may not be associated with the Provider. The fees paid out of the Trust are specified in the prospectus and investment statement.

Scheme Characteristics – Distribution of Funds and Members

4.42 In July 2008, there were 54 schemes on the KiwiSaver schemes register.[40] This register includes schemes available publicly (retail schemes), and, private schemes whose access is restricted to specific industry, employer or other groups. The schemes of primary interest in this evaluation are the 36 retail schemes accessible to the general public. All 54 schemes are managed by 31 Providers who hold scheme Provider agreements with IR. There are six default schemes offered by six default Providers.

4.43 Continuing on from our analysis of Providers characteristics, we can see a similar pattern in relation to schemes, with the largest six schemes accounting for the majority of members (64 percent) and contributions received (62 percent). These results do not directly correspond to the split between default and non-default schemes (see Table 4.2 and 4.3), with default schemes accounting for 59 percent of membership and 60 percent of contributions received.

[40] KiwiSaver schemes register available from the MED website at http://www.isu.govt.nz/templates/ISU/KiwiSaverSchemesRegister____22800.aspx?keyword=&page=2 [accessed September 2008]

Table 4.4: Distribution of contributions passed to Providers by IR – Grouped by scheme (Data as at 30 June 2008)

Ranked by scheme	Contributions passed to Providers ($'000)	Membership count
1-6	$ 641,858	456,027
7-12	$ 262,711	174,892
13-18	$ 84,856	56,402
19-24	$ 28,041	16,990
25-30	$ 13,848	8,908
31-36	$ 4,477	1,958
37-54	$ 1,552	1,038
Total	$ 1,037,346	716,260
Unidentified		377[41]
		716,637

Source: Inland Revenue, 54 schemes represented in table. Data relating to funds passed to Providers are provisional, IR is currently reconciling final payments. Table 4.2 ranks schemes by contributions passed from IR. The contributions columns represent the funds that IR has passed to Providers as at 30 June 2008. The membership column represents all the members of KiwiSaver as at 30 June 2008. The membership number includes provisional members (those within the eight week opt-out period) but excludes those who have opted out. The funds passed will not correspond to all the members in the member column, largely because of the three month holding period for new members' contributions.

Table 4.5: Distribution of contributions passed to Providers by IR – Grouped by scheme default status (Data as at 30 June 2008)

Ranked by scheme	Contributions passed to Providers ($'000)	Membership count
Default scheme	$ 618,680	421,697
Non-default	$ 418,666	294,563
Total	$ 1,037,346	716,260
Unidentified		377[42]
Grand Total		716,637

Source: Inland Revenue, 6 default schemes and 46 non-default schemes represented in table. Data relating to funds passed to Providers are provisional. IR is currently reconciling final payments.

41 Members who the Providers have not identified/assigned at 30 June 2008.
42 Members who the Providers have not identified/assigned at 30 June 2008.

KiwiSaver Investments

Investment Process

4.44 The day to day operation of the investment process for KiwiSaver funds will be performed by the investment manager who in many cases will be the Provider. A generic structure for this process is as follows:

- strategic asset allocation – ranges for this will normally be pre-set for each fund, and be at an asset class level, for example, cash, fixed interest, property and equities, as well as the split between domestic and overseas;
- tactical asset allocation – this has more of a short term focus and involves varying the asset allocation mix within the strategic ranges to take account of short term market features;
- stock selection – within an asset class, the selection of which particular shares or securities to buy, hold or sell; and
- other – for example hedging of foreign currency exposure.

4.45 Within the structure outlined above, the manager/Provider may use other managers. For example, each asset class may be outsourced to a different fund manager perhaps by investing in another fund. Particularly common is outsourcing the offshore assets, which may then be invested in funds for particular countries. The end result is that many funds are in fact "fund of funds" and the chain may be many levels deep.

Investment Funds within Schemes

4.46 KiwiSavers are offered a wide range of investment options, ranging from Conservative to High Growth Funds. There are many smaller organisations in the market promoting their products to different market groups. A number of boutique KiwiSaver providers offer niche investment options. An example is the most recently approved Provider, Real Property KiwiSaver, which specialises in commercial property. Although boutique investment managers have generally stayed away from offering KiwiSaver, some do provide specialist investment funds into which other KiwiSaver schemes invest.[43]

4.47 There can be more than one fund offered within each scheme. A person may only be in one KiwiSaver scheme at any one time but, depending on the Provider, may be able to invest in more than one fund within the chosen scheme.[44] The funds within a scheme vary in investment type and the level of associated risk. The most common types of funds offered are classified under the following categories:

- cash;
- conservative;
- balanced;
- growth;
- aggressive; and
- single sector (e.g. property). [45]

[43] Lori Nims (2008), *Feel the flair: Boutiques add extra dimension*.
[44] Government Actuary (2008), appendix 6.
[45] There was also nearly $40 million of investment (8.7 percent) in single sector funds (e.g. property), Holm, M. (2008a).

4.48 The fund types listed above represent a range in risk, from cash which is low risk to aggressive funds classified as high risk. The level of associated risk is dependent on the characteristics of the underlying investments.

4.49 Investment theory generally suggests that there is a risk/return trade off on investments where higher risk funds are generally regarded as providing a greater potential for higher returns.

4.50 As well as these traditional investment classes, some more innovative options are also available. Holm in her presentation at Women in Super / ASFONZ breakfast (2008) provided a number of examples of this innovation including:

- Fidelity Life's Options Kiwi Fund uses cash deposits as collateral to write options contracts on movements in US, Australian, Euro and UK 10-year government bonds.
- Fidelity Life Capital Guaranteed Kiwi Fund is invested 80% cash, 10% fixed interest, 10% global shares and comes with a guarantee that the 31 March unit value will never be lower than the previous year's 31 March value.

4.51 The default schemes are required to specify a default fund which is conservative. The default funds are required to have a restricted percentage of growth assets (15 – 25 percent[46]) as specified in the instrument of appointment[47] that governs the appointment of default Providers.

4.52 There is no government guarantee on KiwiSaver investments. As assets are held in Trusts, failure of the Provider should not directly affect asset values. The main risks associated with the assets are therefore, market risk (falling value of the underlying investments) and fraud (criminal misuse or theft of funds). Market risk is usually mitigated through asset diversification.

Investment Strategy

4.53 The Trustees of a scheme have oversight of the investments, and the scheme will have a Statement of Investment Performance and Objectives (SIPO) specifying investment objectives and strategy. This will cover a range of items such as the asset allocation ranges for each fund (conservative, balanced, growth), the appointment and monitoring of investment managers, the benchmarks against which performance will be monitored and whether an active or passive investment style is adopted.

4.54 The investment profile of KiwiSaver, according to the March 2008 Managed Funds Survey, confirms a larger allocation to low risk New Zealand asset classes than for other superannuation products. There is also more investment in New Zealand asset classes (61 percent) than for traditional Superannuation products (46 percent) [48] but similar to managed funds generally (60 percent).

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[46] Unless given permission by the Ministers of Finance and Commerce.
[47] Ministry of Economic Development (2007), Instruments of appointment, http://www.isu.govt.nz/templates/ContentTopicSummary____26303.aspx [accessed September 2008].
[48] As reported in the Mercer Managed Funds Survey.

Table 4.6 – Superannuation Investment by Asset Class March 2008[49]

Asset Type	Superannuation	KiwiSaver
New Zealand	46%	61%
Cash	13%	32%
Fixed Interest	48%	22%
Property	15%	7%
Equity	22%	39%
Other	0%	0%
Overseas	54%	39%

Source: Managed Funds Survey RBNZ, Statistics New Zealand and KES.

4.55 The RBNZ Managed Fund Survey has been designed so that KiwiSaver trends will be published on a quarterly basis and can be analysed separately, also showing trends in household savings (though not the returns on different funds).

4.56 As many KiwiSaver Providers are substantial, experienced financial institutions, the majority use in-house expertise to make their investment decisions on strategic and tactical asset allocation. According to KES (KES, E3), 36 percent take some advice from local professionals and 34 percent from overseas colleagues.[50] Each Provider brings its own approach to investments, resulting in a competitive range of offerings for KiwiSavers.

Responsible Investing

4.57 From September 2008, all investment statements for a KiwiSaver scheme must include a statement to tell investors whether or not responsible investment is taken into account in the scheme's investment procedures and policies. [51]

4.58 "Responsible investment" (or "Socially Responsible Investment" ("SRI") is a term used to mean that fund managers have screened their investments to ensure companies in which they buy shares meet environmental, social, and economic governance guidelines. For example, they may avoid investing in businesses involved in alcohol, tobacco, weapons, or unsustainable environmental practices.

4.59 A review of the investment statements shows that as at August 2008, 7 out of 36 public schemes (20 percent) have adopted responsible investment guidelines as defined in this way. Mary Holm's (2008) survey of the KiwiSaver schemes also identified seven schemes offering a SRI fund or similar fund, one scheme claiming to

[49] This superannuation column uses data from the Managed Funds Survey where KiwiSaver is reported as a subset of superannuation.

[50] These responses have been weighted based on respondents KiwiSaver FUM for unweighted results see KES question E3 in Appendix A.

[51] Securities Commission (2008).

have a partial SRI fund, two KiwiSaver schemes stating they will be launching a SRI soon, and an additional nine schemes considering offering a SRI fund.[52]

4.60 Several schemes that do not offer SRI funds (or do not comply with the Securities Commission's definition of responsible investing[53]) still screen their investments according to particular criteria. These can range from sustainable investing to avoiding investing in companies related to landmines.

4.61 Holm in her presentation at *Women in Super / ASFONZ breakfast* (2008) provided the following examples of ethical and/or socially responsible funds[54]:

- ABN Amro Craigs - 50% shares, 40% cash and fixed interest, 10% property.
- ASB Group Investments - 100% world shares.
- Asteron - 100% NZ and Australian shares.
- Fidelity - 40% world shares, 35% fixed interest, 20% NZ and Australian shares, 5% cash.
- NZ Anglican Church - Conservative Fund 20% growth; Balanced Fund 50% growth; Growth Fund 75% growth.
- SuperLife - 60% NZ and world shares and property, 40% cash and bonds.

4.62 Compliance with this requirement of the Act is outside the scope of this KiwiSaver supply-side evaluation. It should be a straightforward matter for MED, however, to go through Provider statements issued since September 2008 and pick up whether there are statements of responsible investment in them.

Tax

4.63 The tax rate on investment earnings is dependant on the type of scheme. A scheme can be either a:

- widely-held superannuation fund, or a
- portfolio investment entity (PIE).[55]

4.64 The tax rate for investment earnings from a widely-held superannuation fund is currently 30%. The tax rate for investment earnings from a PIE is referred to as the "prescribed investor rate" (PIR). Investors provide scheme providers with their PIR every year. Effective from 1 April 2008, the tax rate for lower-income investors will be 19.5% while upper-income investors in the 39% tax bracket will pay only 30% tax on their PIE income.[56]

4.65 All of the KiwiSaver default schemes are PIEs. According to Mary Holm (2008), only one of the 31 Providers offering KiwiSaver schemes to the public has some non-PIE investments. This is due to the range of investments they offered – not all of which qualified as PIE.

[52] Holm, M. (2008a). p128
[53] The Securities definition of responsible investing available at http://www.seccom.govt.nz/publications/documents/kiwisaver-disclosure/print.shtml
[54] Socially responsible funds were not defined separately from ethical funds in Holms book.
[55] KiwiSaver schemes available from the KiwiSaver website at http://www.kiwisaver.govt.nz/kiwisaver-schemes/ [accessed September 2008].
[56] PIEs and PIRs available from the Sorted website at http://www.sorted.org.nz/home/sorted-sections/investing/pies-and-pirs#lower [accessed September 2008].

KiwiSaver Fees and Profitability

Fees

4.66 Fees associated with KiwiSaver schemes maybe implicit or explicit. The charges paid by KiwiSaver members are the revenue streams for the Providers, and consist of two main categories:

- per member fees – expressed as a dollar amount and generally related to some aspect of administration and account management;
- asset management fees – generally related to the investment of KiwiSaver funds and expressed as a percentage of funds under management; and
- other – such as trustee and audit fees, which are paid out of the funds.

4.67 Under the Act (section 4(1)) the term fee:

a) means a fee charged directly or indirectly in respect of a member's membership of a KiwiSaver scheme; and

b) includes a fee charged to a member's account for—

I. administration of the member's account:

II. management of the member's funds in the KiwiSaver scheme:

III. the transfer of the member's account or the member's funds in the KiwiSaver scheme to different sections of the KiwiSaver scheme or to a different KiwiSaver scheme; and

c) includes any other fee or charge prescribed to be a fee for the purposes of this Act; but

d) does not include a fee referred to in section 200 or charged under regulations made under section 228(c) except in the context of those provisions

4.68 The Act also requires under Part 2(2) of Schedule 1 that fees must not be unreasonable and that the following persons must not charge a fee that is unreasonable:

a) the Trustees of the scheme;

b) the administration manager of the scheme;

c) the investment manager of the scheme;

d) the promoter of the scheme;

e) any other person who charges a fee for services in relation to the provision of a KiwiSaver scheme (KiwiSaver Act 2007).

4.69 Fees come in many forms and can include:

- trustee fees
- administration fees

- investment fees
- performance fees
- withdrawal and exit fees
- switching providers
- switching funds with same Provider

Government's Role in Relation to Fees

4.70 While fees on certain options in default schemes cannot be increased for three years, in other cases Providers are free to change their fees. The Trustee has to approve the change, they must not be unreasonable (the requirement of Rule 2 of Schedule 1 in the KiwiSaver Act 2006), and they must be included in the scheme's investment statement. The Provider needs to consider whether the fee matches the service provided. The GA is responsible for the monitoring of KiwiSaver scheme fees and assessing if the fees are "not reasonable". To assist in this process the GA has produced guidelines for fee setting, KiwiSaver Guideline No KSGN1.

4.71 The aim of the Government's regulatory oversight of fees is to keep the cost of KiwiSaver membership low. In addition to regulating the reasonableness of fees, the Government will pay a subsidy of $20 into each KiwiSaver account every six months ($40 a year) in order to offset some of the fixed fees.

4.72 The MED has a monitoring role in relation to default Providers. This includes reviewing quarterly reports and fees of the default Providers.

Set Up Costs

4.73 There was considerable discussion led by Providers during interviews with them about the implementation costs associated with setting up a KiwiSaver scheme. For some organisations, the costs arising from KiwiSaver and PIE changes were high, with organisations spending tens of millions of dollars. Others, with systems which were either more adaptable or already providing similar services fared better. It is clear that the financial services sector has made a significant investment in the future of KiwiSaver. It will be important to monitor the characteristics of this commitment by KiwiSaver Providers as it has aspects that are unlike normal commercial decisions including a longer than usual break-even period.

4.74 The KES found that for a quarter of those Providers who responded, the setup costs of KiwiSaver were comparable to other products. About half found these costs to be higher or considerably higher than those incurred for comparable products. Staff resources and system integration were the areas of cost that seemed most disproportionate to other comparable products (KES, D1). As discussed elsewhere in this evaluation, Providers told us that staff resource requirements and systems costs were particularly high because of the uniqueness of KiwiSaver which required different skills, different (retail instead of wholesale based) operating systems specified to deal with PIE and more capacity. The Table below compares KiwiSaver set up costs to the Providers' set up costs from other similar products.

Table 4.7 – How did Setup Costs Compare to other Similar Products?

Response	Staff Resources (percent)	Software development (percent)	System integration (percent)	Marketing (percent)
Considerably higher	30	35	39	17
Higher	30	7	22	22
Similar	22	26	17	30
Lower	0	4	0	9
Considerably Lower	0	0	0	0
Do not know	4	4	4	9
N/A	13	21	17	13

Source: KES, D1.

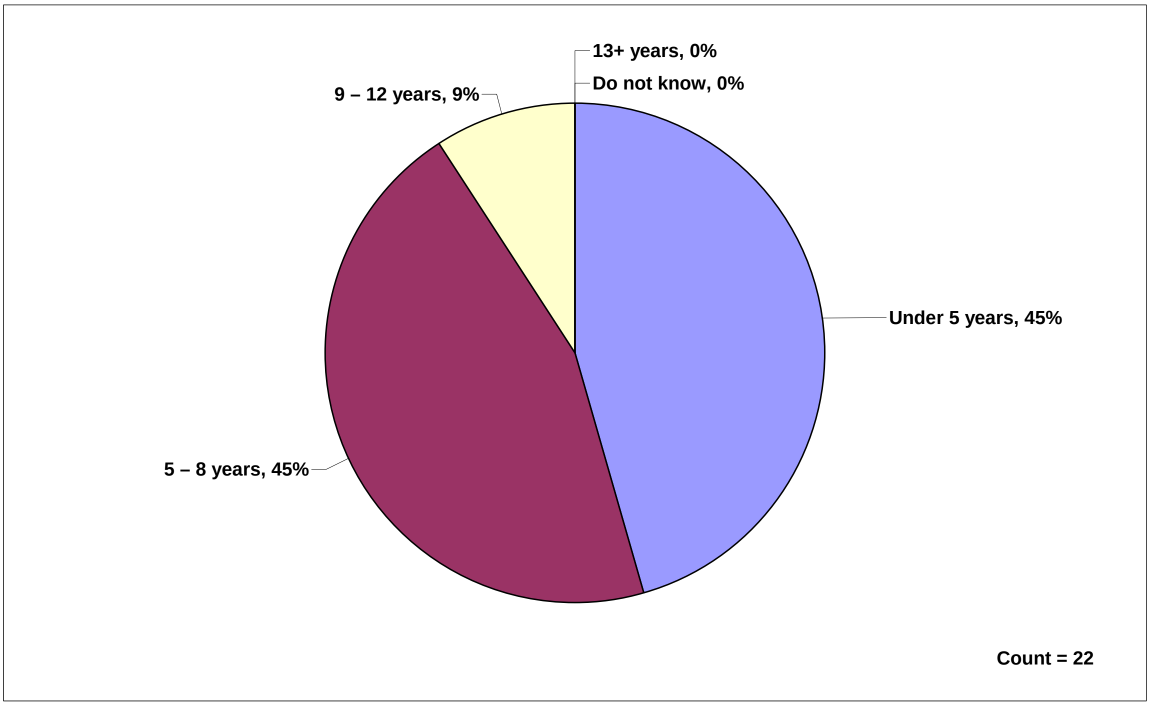
4.75 Although their set up costs were higher than expected, some Providers interviewed said that infrastructure investments they had made will benefit other products as well, for example, access to information over the internet.

4.76 Of the costs incurred in setting up a KiwiSaver offering, it was estimated by Providers responding to the KES that 23 percent of the total cost was attributable to implementing the Portfolio Investment Entities (PIE) legislation (KES, D3). This was less than the most commonly quoted figure from the interviews of 50 percent.

4.77 Providers were asked about their expected payback timeframes on the investment they have made in KiwiSaver. In many cases (particularly the default Providers), payback periods have improved from the initial business case because of the higher than expected initial take-up. In most cases, however, it will be several years before KiwiSaver in itself meets its own running costs, and several further years to repay initial set-up costs.

4.78 As the Figure below shows, more than 90 percent of Providers who responded to the KES (KES, C7) anticipated that their KiwiSaver offering would payback within eight years with an average payback of six years reported. This is consistent with a low to medium profitability forecast (KES, C9). In the KES (KES, C6), the number of members was identified as the key variable affecting profitability (90 percent consider it important or very important), followed by contribution per member (87 percent) and total funds under management (83 percent).

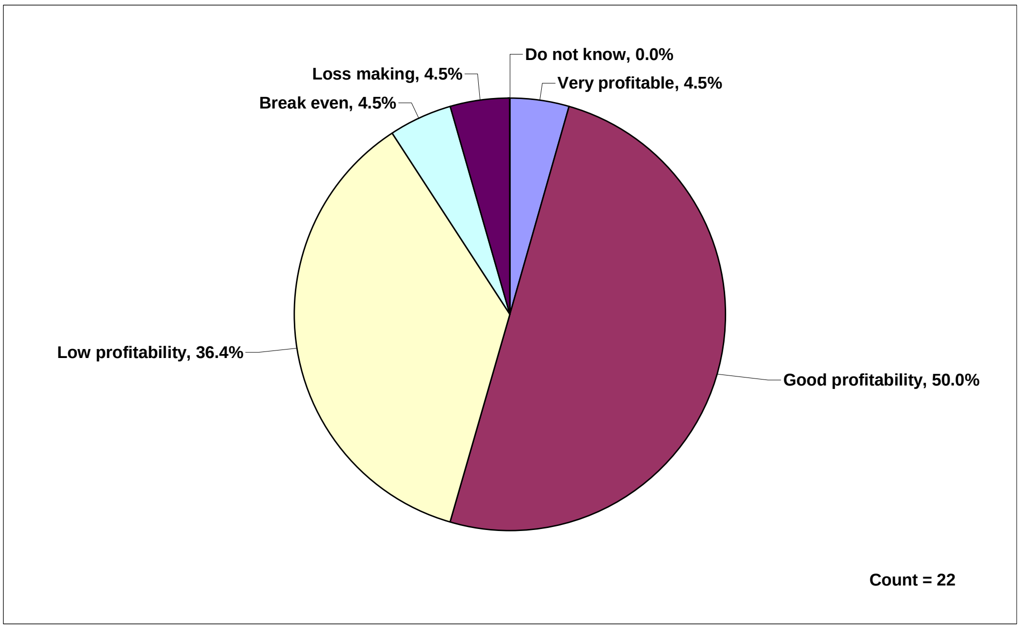
Figure 4.4 – Payback Period Expected for your KiwiSaver Investment (including recouping set up costs)?



Source: KES, C7.

4.79 Most Providers (50 percent) expect profitability to be good within ten years' time (KES, C9). Other responses to the KES and interviews indicated, however, that many believed that not all Providers would manage to achieve a sufficient return on their KiwiSaver business, and consolidation is to be expected over the next three years.

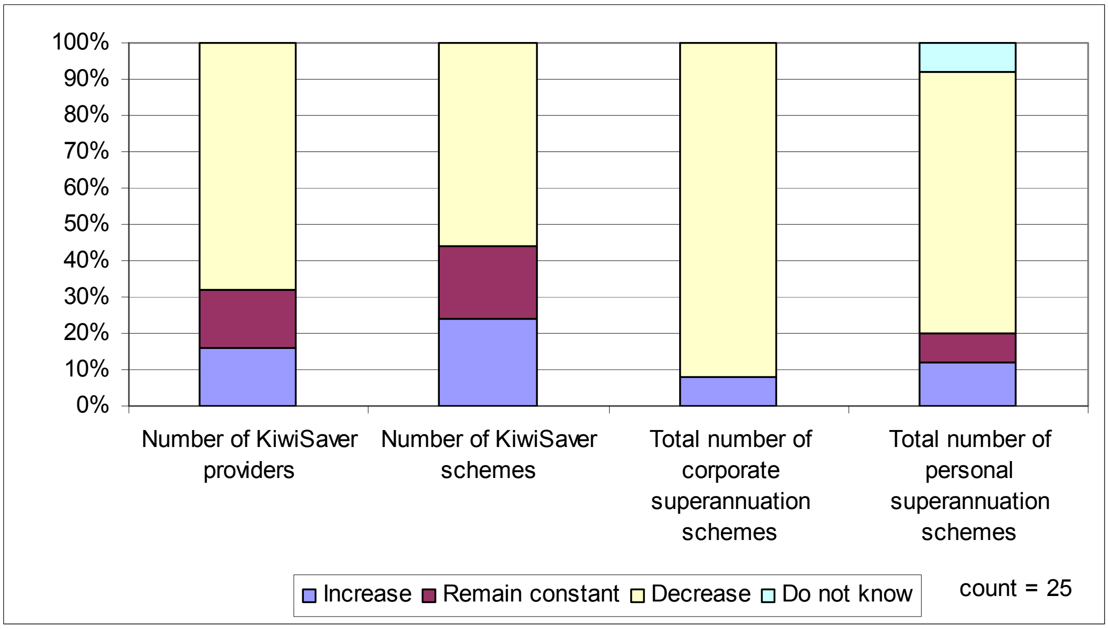
Figure 4.5 – Expectation of 10 year Financial Performance as at August 2008



Source: KES, C9.

4.80 The figure below illustrates Providers' expectations about changes in the KiwiSaver market over the next three years. When analysed by number of respondents, four expected an increase in the number of KiwiSaver Providers, four expected that they would remain constant and 17 expected a decrease in the number of Providers. Fourteen Providers expected a decrease in the number of KiwiSaver schemes, 18 of the 25 respondents expected a decrease in personal superannuation schemes (i.e. non-KiwiSaver personal schemes) and 23 respondents expected a decrease in the number of corporate superannuation schemes.

Figure 4.6 – Market Outlook for Next Three Years as at August 2008



Source: KES, B3.2.

4.81 Further analysis of the KES responses shows that it is mainly small Providers that are not expecting a decrease in KiwiSaver Providers.

Provider Profits

4.82 The revenue for the Provider, and the costs to the member, consists of two main components:

- per member fees – expressed as a dollar amount; and
- asset management fees – generally expressed as a percentage of funds under management.

4.83 Initially, the member fees will be the main source of revenue for Providers. As the funds grow, the revenue from the asset management fees will increase. Providers per member fees are generally insufficient to cover the administration costs and consequently the product relies on the funds under management reaching a sufficient level to cover costs. In general, there are two drivers for this. These are the number of members and the level of investment made by each. In addition, where fixed costs are shared across a larger number of members, they form a smaller proportion of the fee and create greater profitability for the Provider. It follows that for some Providers, the product will not be profitable for a number of years. Schemes with small balances are more likely to remain uneconomic to administer.

4.84 A breakeven point will be achieved when the fund has grown to a sufficient size so that the implementation and ongoing costs to date have been covered. The successful Providers will be those who have recovered set-up costs and maintain ongoing costs below their fees after a reasonable period of time.

General Characteristics of the KiwiSaver Market

Investment Choices and Financial Literacy

4.85 Although there are a range of investment options available from the different KiwiSaver Providers, a number of Providers interviewed believed that the large number of KiwiSavers defaulting into conservative funds was a matter for concern. In particular, those default Providers who have traditionally sold business through advisers (who take the time to sit with a client and determine an appropriate risk profile) wondered whether KiwiSavers will receive the long term return they should if the default funds are chosen because of their conservative investment approach without consideration of the risk profile of individual members with different investment time horizons.

4.86 Members have shown little appetite to pay separately for financial advice on the appropriate KiwiSaver product. There is a risk that investors miss out (discovering this later in life when it will be difficult to make up the lost investment opportunities), but there is also seen to be a risk to Providers of being thought of as performing inadequately when members have chosen a low-returning fund.

4.87 Many Providers felt that there were insufficient profit margins built into KiwiSaver to allow them to spend time and money advising clients on the appropriate investments for their risk profile. These Providers look to the Government and Retirement Commission to fill this role. Some have still managed to produce educational material, such as DVDs explaining KiwiSaver, or a risk profiler included within the Investment Statement to assist clients with their investment decision. Some Providers suggested the Government review its decision to require conservative default funds, suggesting that balanced funds would be, on average, a more appropriate option.

4.88 Non-default Providers did not share this concern to the same degree as, in this case, members were generally making specific choices. Even so, it still could be an issue, as any member who does not actively select a fund may be allocated to a conservative option by a non-default Provider with more than one fund as well.

4.89 Providers working through financial advisers were happy that their clients were appropriately invested. Those Providers offering a stepped investment portfolio, which automatically adjusts for the investor's age, indicated that this was a popular choice with their clients. Where active investment choices are being made, comparison of returns will provide important knowledge to investors about the implications of their decisions over time.

4.90 A public survey of financial literacy conducted by ANZ, the Retirement Commission and MED found that New Zealanders had "a reasonable level of personal financial knowledge"[57] but that the level of knowledge was largely tied to the respondent's socio-economic status. Considerable confusion existed over the nature of New Zealand Superannuation, with many believing it was means tested in retirement.

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[57] Colmar Brunton (2006) *ANZ-Retirement Commission financial knowledge survey*.

4.91 An indication of increasing financial literacy will be the number of people making proactive choices within the KiwiSaver market. This will be observed through the number of people moving out of default schemes either into other funds within the default scheme or to other KiwiSaver schemes altogether. According to the Report of the GA in respect to KiwiSaver, 6,345 members transferred out of default schemes into other schemes from inception to 31 March 2008.

4.92 In the first few months since the introduction of KiwiSaver, stock market returns have been poor so a conservative investment portfolio based on set terms and investment rolls has not been a bad short-term option. The issue of initial risk appetite needs to be seen in the context of current investment markets. Additionally many KiwiSavers will be making their very first investments of this nature, perhaps preferring a bank account style risk profile. One Provider interviewed commented that the challenge for the industry in the next 12 to 24 months is to engage with investors around risk appetite and savings strategy.

Provider Relationships with Government

4.93 As noted in Chapter 1, Providers interact with several different government agencies. Most significant is the relationship with IR, whose official role is as a central administrator and clearing house for the scheme. Providers also have requirements to meet set out by the MED, who, amongst other roles, runs the process of selecting the default Providers and the GA, who is a Crown Entity accountable to Parliament.

4.94 There has been a considerable amount of interaction with IR both in the lead-up to the KiwiSaver and since KiwiSaver schemes were opened. IR has filled an important role in facilitating the development of workable solutions in very short timeframes. During our interviews, many Providers commented positively on how IR had improved in this role, from an initially formal approach, to working more directly with Providers. To achieve pragmatic resolution of issues, IR has opened up the channels of communication between the legislators and the industry.

4.95 The interviews found that many Providers are very happy with the IR’s clearing house role, indicating it is a considerable cost-saving for them, appropriate to the nature and pricing of KiwiSaver. The role filled by IR account managers also received positive feedback.

4.96 Providers interviewed noted the importance of IR advising the industry early on of its planned developments and future requirements in regard to KiwiSaver. Information about changes in the scheme needs to be provided with sufficient notice so that Providers can include provision for them in their budgeting, business planning and operational development.

4.97 Providers also raised a number of minor technical issues that required resolution. Issues around transfers, such as confirmation of transfers, and passing of information regarding the timing of the transferee’s contributions for tax credit processing, were mentioned several times.

4.98 Default Providers are required to report quarterly to the MED. Many commented that this was a fairly substantial undertaking, on which they received little feedback.

4.99 The Providers' annual reporting to the GA requires a substantial range of statistics. Some Providers' returns for the first GA's report required a number of iterations to meet the GA's requirements. A common template is used and any future evaluation should consider whether the process of meeting these requirements becomes routine and whether all the information required is useful to building knowledge about KiwiSaver.

4.100 Several Providers commented on the overlap in the information they are required to provide to each of these government agencies. This, in addition to the large number of industry and official surveys they are requested to participate in, has caused frustration. This is complicated by the legislative restrictions on both IR and the GA on sharing Providers' information they collect. A review and consolidation of the information required from Providers may address these issues. For example, Providers thought that IR should be primarily concerned with statistics relating only to the business that passes through its clearing house facility as apposed, for example, to information on actions taking place once the member is enrolled.

KiwiSaver Industry Representation

4.101 IR has played a pivotal role during the set up of KiwiSaver through working with Providers to facilitate a complicated implementation process within a restricted timeframe. A question remains about how best to coordinate and facilitate industry response going forward. There is general consensus that there is a need for a central point, but there are issues around many of the options suggested.

4.102 Currently, KiwiSaver Providers do not have a common industry association. Some are members of ASFONZ and some belong to the ISI. As the superannuation industry body, ASFONZ has a slightly different focus in that it specifically represents employers providing superannuation, rather than the funds managers, although many KiwiSaver Providers are also members.

4.103 Industry representation can play a role in the collection of industry data, such as market share, fees and investment performance. The ISI collects market share data for the insurance industry and previously collected market share data on managed funds and superannuation. This role has largely been taken over by private companies who charge Providers for the information, for example, FundSource and Morningstar.

4.104 Scheme fees and investment performance need to be consistently defined and structured for valid comparisons of equivalent conditions to be made. A number of Providers were seriously concerned about the quality and consistency of the comparisons that are being published, and wonder about the comparability of information that is being made directly available to the public.

Risks to Market Stability

4.105 The unanticipated magnitude of enrolments has meant that most Providers have been busier than expected. High enrolments have contributed to the creation of market stability for some KiwiSaver Providers at a time that the world's volatile financial market conditions were impacting on New Zealand's financial markets.

4.106 Government intervention was listed by 86 percent of KES respondents as a major risk to the stability of KiwiSaver going forward. In comparison, investor confidence and market performance was listed by 38 percent of respondents. Financial literacy and unrealistic fees were also mentioned by a lower percentage (KES, C10).

4.107 Government intervention was ranked most highly by Providers, reflecting the operational implications from the implementation of KiwiSaver and the PIE tax changes in 2007 that were fresh in the minds of interviewees and respondents. In particular, the effort and timeframe involved in response to the May 2007 budget changes saw large additional expenditure and systems changes required at very short notice, on a product Providers had committed to providing based on previous business assumptions.

4.108 One smaller Provider reported discarding over a hundred thousand dollars worth of printed materials that became out of date with the 2007 announcements. Clearly, the overall impact of those changes has been favourable in the increased take-up of KiwiSaver, and the financial investment companies have made will, in most cases, be worthwhile. The consultation found, however, that the effort and cost of KiwiSaver implementation saw organisations struggle with resources, finances, corporate attention and systems. Several reported staff leaving the industry due to the excess pressures and it is clear there was a personal toll on others.

4.109 Providers interviewed commented that a period of stability, without further changes to KiwiSaver's operation, is important. Providers are asking for time to bed in their operations, consolidating the systems that have been put into place, and building off the work that has been done. Several commented that the time and effort required to implement KiwiSaver (and PIE) had distracted corporate attention away from their other endeavours and market share had been lost accordingly. One Provider said that the time frame was so short that instead of using a two year old registry system which could not be amended in time, the registry operations were outsourced.

4.110 The industry accepts that change is inevitable. Those Providers interviewed suggested that future changes are implemented with due regard to workability, timeframes and cost. Early consultation is likely to lead to the best solutions, in terms of workability and for allocating financial and human resources.

4.111 Investor confidence and market performance is seen as a risk, though perhaps less so by those within the industry than by government agencies. This is an area that will benefit from monitoring and evaluation in order to understand if investor confidence improves with greater knowledge and experience. Many Providers commented that the poor performance of investment markets during the first year of KiwiSaver has been met with a reasonable level of equanimity by investors. Investors realise that KiwiSaver is a long term investment, and that they are still financially ahead by virtue of the $1,000 kick start from the Government, employer contributions and the favourable tax treatment (including tax credits). Those within the managed fund industry, including Independent Trustees, do not see this as another finance sector collapse waiting to happen.

4.112 KiwiSaver investments are held in Trust, marked to market and receive market rates of return on diversified portfolios, unlike the finance sector which is committed to fixed interest rate payments to be funded by investments which are not publicly scrutinised.

4.113 A risk not mentioned specifically by Providers interviewed and/or surveyed, is liquidity. Liquidity within KiwiSaver funds plays an important role in two ways. KiwiSaver members are entitled to transfer their investments from one Provider to another as they choose. While this aspect of consumer choice has the positive effect of encouraging good service and performance, it also means that Providers must ensure their investments are sufficiently liquid to facilitate transfers as required. Although no KiwiSaver product would be invested totally in illiquid funds (such as the mortgage-backed bond funds which have recently been frozen, preventing all or large withdrawals) a small level of investment into such a fund is possible and does present a theoretical liquidity risk. Investments through a chain of wholesale fund managers could complicate this effect. Any liquidity issues would degrade confidence in a KiwiSaver scheme, and potentially lead to a run of transfers to other schemes, worsening the liquidity further.

4.114 The high level of portability offered by KiwiSaver, therefore, has the potential to artificially restrict the investment options of schemes and funds. There is a balancing act here which scheme investment managers will need to work on over time. Time will tell whether KiwiSaver members will frequently move their investments around chasing the best investment performance, or whether they will stick with one Provider and one investment portfolio in the longer term.

4.115 In aggregate, the locked in nature of KiwiSaver creates a guaranteed long term pool of assets that could be invested in illiquid assets, such as commercial property. In practice, the high level of portability of KiwiSaver means that each Provider does lack certainty of tenure and must take into consideration the level of liquidity of all investments.

4.116 Finally, another key risk mentioned by those interviewed and surveyed was whether fees could cover the costs and risks faced by Providers. KiwiSaver and PIE have been the impetus for a number of organisations to upgrade their computer systems and review their operating strategies.

4.117 Consultation with Providers found that some have implemented efficient systems and processes which will enable them to successfully run their KiwiSaver business. Others have less capability and capacity to adapt to this new low touch, low cost paradigm. No one's margins are large, but those with good internal mechanisms are confident about the future of their business. Others are concerned over small account balances, low contribution flow, less than expected uptake and lack of efficiency gains. KiwiSaver has brought change across the superannuation industry in this respect and the responsive will benefit from it, while those who fail to adapt may slowly fall from the market.

Changes to KiwiSaver

4.118 In the interviews, Providers were asked what changes they would like to see made to KiwiSaver. Some reflected specific issues relating to the Provider, such as a difficulty in processing member tax credits. One issue, however, that came through in a large number of interviews was mortgage diversion, where contributions are used to fund regular mortgage payments. Many Providers believe there are significant issues with the administration of mortgage diversion in its current form, although most are still gearing up or ready to provide it.

4.119 Several Providers suggested mortgage diversion would be more effective to manage and operate if funds were directed to mortgages directly from IR rather than passing to Providers and then being deducted and remitted.

4.120 Specific issues raised by Providers about mortgage diversion during the interviews include:

- money being unitised in Providers' systems when it is being paid straight out, again creating unnecessary processing and tax implications;
- mortgage payments changing with interest rates and needing to be updated;

- timing of payments, as contributions are received irregularly from the IR, dependent on employer returning times and IR processing times; and

- time spent answering queries and chasing payments on funds which the Provider is not earning any investment income.

4.121 Other suggestions received from Providers interviewed included:

- consideration of life insurance costs being met out of or alongside KiwiSaver; and

- allowing employers with an Employer Choice Agreement to remit contributions directly to the Provider, as for complying and other superannuation funds, to remove the processing time taken by IR and the resultant member queries on the location and timing of their payments.

5 KiwiSaver Firm Dynamics

5.1 The objective of this evaluation is to develop a framework for ongoing monitoring of the supply-side impact of KiwiSaver. This involves research to identify the best information currently available and an examination of the gaps in that information. From this examination, the most appropriate indicators can be selected to cover the current and ongoing measurement of the performance and impact of KiwiSaver.

5.2 As discussed in Chapter 2, a comprehensive framework is one that considers the individual firm and the market dynamics effecting KiwiSaver. Chapter 5 addresses the firm dynamics of KiwiSaver considering the factors effecting Provider efficiency, while Chapter 6 considers the market dynamics of superannuation and the wider financial markets.

The Measurement of KiwiSaver Firm and Market Dynamics

5.3 As described in Chapter 2, the selection of key indicators considers the:

- key questions to be addressed by ongoing performance monitoring;
- nature of the information required;
- periodicity of reporting;
- continuity of data; and
- ongoing appropriateness of data.

5.4 The indicators have been selected to monitor the impact of KiwiSaver on the market for superannuation, managed funds products and savings generally. In selecting indicators, a range of options must be considered as each have a different degree of timeliness and quality. For example, the Managed Funds Survey covers 85 to 90 percent of managed funds and is available quarterly within a month or two of the close of that quarter. In this respect, it provides a short-term measure for the size of the superannuation market.

5.5 The report of the GA provides a way of examining the superannuation trends and assessing how the magnitude compares with the amounts returned by the private superannuation and KiwiSaver funds. It provides, among other things, additional analysis describing transfers, single sector funds and the size of schemes.

5.6 Some indicators provide direct evidence of changes in the KiwiSaver market. The causality of changes is harder to prove and needs to be considered in conjunction with other measures to reach a certain conclusion. For example, growth in the KiwiSaver asset base says little about the effectiveness of the market in and of itself. The rate of growth is better understood by comparing it with the growth rate in managed funds and superannuation generally. Small changes in individual measures may not be a cause of concern in isolation. When changes are occurring in many measures simultaneously, however, each measure becomes symptomatic and provides a warning sign of an underlying issue.

5.7 The data sources that are most useful in evaluating the efficiency of the KiwiSaver market are those that are specific and targeted. In this respect, the GA reports with respect to KiwiSaver and the KiwiSaver Evaluation Survey (KES) are particularly appropriate sources for the evaluation.

5.8 The KES will become increasingly important because of the timeliness and specificity of the data collection. The KES collects specific data which allows an evaluator to produce:

- Time series of the quantitative data;
- objective demographic measures;
- subjective measures of expectation with regard to profitability, consolidation, costs, barriers to entry; and
- perspective on investment strategy, outlook, and business practice.

5.9 A survey is flexible and provides a balance of established time series information with the development of new questions to address issues of immediate concern.

5.10 The data collected by the GA enables objective and precise analysis on the dynamics of KiwiSaver providers. It breaks down, among other things, the size, the income and expenses, and transfers between the KiwiSaver providers. The report only shows this data on a default and non-default level.

5.11 In addition, in its supervisory role, the Office of the GA maintains the register of KiwiSaver schemes which is used to monitor the changing state of the market. This is updated regularly.

5.12 Although existing data sources are applied in the evaluation framework for both firm and market dynamics, the frequency of the reporting by these sources does not allow for real time monitoring of the KiwiSaver market or the analysis of leading indicators. IR data has been useful and timely to this point, in part because of the high correlation between funds under management and contributions cleared by IR during the first year. Going forward, however, the contributions cleared by IR will be become a smaller proportion of the total as self-employed contributions, withdrawals and investment returns are outside the employer PAYE system and data covering these trends will need to be collected from other sources. Although membership data will still be critical, developing timely reporting from other sources will become increasingly important.

5.13 Good data may be available on scheme aggregates, but no data source yet provides enough detail to analyse the dynamics of the different schemes. It is, however, possible to obtain annual reports of individual schemes. Similarly, the returns on investment, and comparability of fees are areas in which comparable individual provider information is essential to inform rational consumer behaviour and competitive provider behaviour.

KiwiSaver Firm Dynamics

5.14 Concepts defined by Firm Dynamics are outlined in Chapter 2. This section sets out the evaluation framework designed to answer questions about firm dynamics and to develop a KiwiSaver industry efficiency baseline. It has been informed by Provider interviews and the KES.

5.15 The indicators and their measures show that for the year ended June 2008 are briefly listed below:

- **Competition** – 15 schemes had asset bases of $10 million or more as at March 2008, and seven providers had more than five percent of market share;
- **Consumer Choice** – there were 31 Providers with 36 schemes open to the public;
- **Innovation** – 25 new schemes had been registered by the 2008 June year end with six of those additions occurring in the 2008 calendar year;
- **Profitability** – more than 90 percent of Providers surveyed expected their KiwiSaver business to be profitable over the next ten years;
- **Investment returns** – averaged -2.1 percent across all KiwiSaver schemes, according to the GA;
- **Consolidation** – the base point for future comparison is 54 schemes and 31 Providers; and
- **Market entry** – the GA registered 11 new Providers between 1 July 2007 and 30 June 2008.

Table 5.1 – KiwiSaver Provider Indicators of Firm Dynamics [a]

Aspect	Measure	Source	Period	Schemes	Providers
Competition	Number of Providers with greater than 5 percent of market share	PwC [b]	As at June 08		7
Consumer choice	Number of retail schemes and Providers	GA register	As at June 08	36	31
Innovation	Number of new schemes / new Providers	GA register	June 08 year	25	11
Profitability	Providers expecting profitability	Survey	As at June 08		91%
Return on investment	Number of Providers with payback periods of less than 8 years [c]	Survey	As at June 08		91%
Consolidation	Number of schemes and Providers	GA register	As at June 08	54	31
Market entry	Number of new companies offering KiwiSaver schemes[e]	GA register	June 08 year		11

[a] The table above is designed to apply available data. In many cases, individual fund data may be more useful than scheme or Provider data, however, it was not available at the time of this evaluation.
[b] This measure was estimated by PwC within the time period of this evaluation. It can be calculated by the GA in future periods.
[c] KES – KiwiSaver Evaluation Survey.
[d] Future evaluations may wish to adopt other measures if appropriate data becomes available.
[e] The relationship between schemes, promoters and Providers is still evolving and future evaluations may measure schemes.

5.16 Two other measures considered, but not included in the framework were the level of responsible investment (related to consumer choice and innovation) and the number of enterprises for the superannuation and finance sectors to provide context to analyse consolidation and market entry.

5.17 Although all of the investment statements examined complied with the regulations, only 20 percent indicated they invested with this in mind. Of the seven that had specific responsible investment statements, there was a lack of detail about these in the investment statements. Research indicates that socially responsible companies in the US can command a premium on their share price; hence, monitoring the trend in New Zealand may become increasingly important. It was not considered a critical factor in evaluating the KiwiSaver supply-side, however, and was excluded from the framework.

Competition

5.18 The number of KiwiSaver Providers, including both traditional retirement savings providers and new entrants to the industry, currently create the environment for a competitive market.

5.19 It appears that a significant competitive advantage, however, has been awarded to default Providers. The drivers behind the large market share earned by default Providers can be identified but not quantified. These drivers include:

- large enrolment numbers through the default process;
- default status and the government endorsement that goes with it;
- established reputation and visible profile;
- retail presence in the case of Mercer, through partnership with KiwiBank;
- marketing investment; and
- product diversity.

Table 5.2 – KiwiSaver indicators as at June 2008

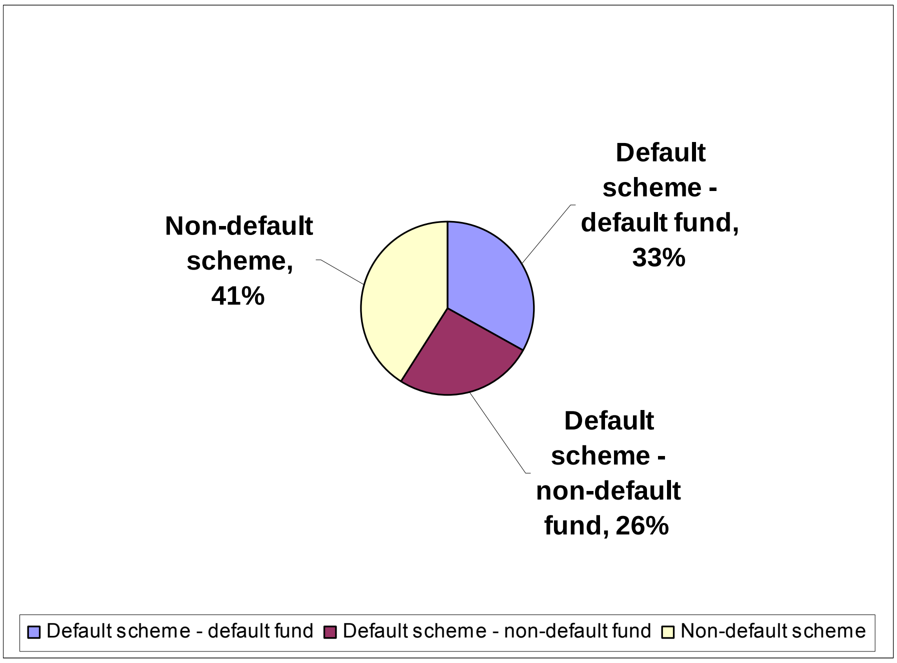
Default members	percent of total	59	▶
Default contributions	percent of total	60	▶
Contributing members	percent of total	87	▶
Providers	number	31	▶

Source: Inland Revenue, PwC research.
An orange right pointing arrow indicates no change, in this case it represents the first period of information collected.

5.20 KiwiSavers may end up in a default scheme for a number of reasons. They may be conservative or uncertain in their decision making and elect for a government nominated scheme on this basis. The data to date indicates that many employees leave the choice of Provider to their employer who then tends to nominate a conservative investment approach. They may even be auto enrolled and exercise no proactive choice over their placement.

5.21 Not all of these motivations can be distinguished from the data. The size of this membership pool, however, can be monitored knowing that the larger the pool, the more conservative the overall investment mix of KiwiSaver assets will be. If default membership were 100 percent, for example, the impact on the NZX would be less than from non-default scheme memberships of KiwiSaver.

Figure 5.1 – Estimated Composition of KiwiSaver Members (June 2008)



Source: Developed by PwC with default scheme percentage data from IR (June) and a measure of default fund data from the GA (March).

5.22 It should be recognised that although default Providers have a comparative advantage in the KiwiSaver market, they are still exhibiting competitive characteristics. Among other things, they are reflecting behaviours of competition between themselves.

5.23 Approximately a third of all members are in default funds, while a further quarter of all members are in other funds within default schemes (see Figure 5.1). The successful continuation of the market will require ongoing review of the number and requirements for default Provider status. In addition to default Provider status, a large retail base, both of customers and bricks and mortar presence, has to date been an advantage in attracting members.

5.24 Early indications are that there is a concentration of members within the seven largest Providers, one which is a non-default Provider. Dominance by as many as seven organisations is a healthy sign, however, non-default Providers express concern that the existence of default status for a selection of providers gave them a significant competitive advantage. This is both in terms of members being enrolled through the default mechanism, and the perceived government endorsement of their brand. One of the largest Providers is, however, a non-default Provider.

5.25 KiwiSaver has moved superannuation from distribution through advisers to a product that can be purchased directly with no intermediary. In the initial scramble for customers following KiwiSaver's commencement, a large existing retail client base was clearly advantageous to becoming a major player, partly because this meant the Provider had marketing and promotion processes in place to encourage existing clients to enrol in their KiwiSaver schemes. This effect is likely to continue, but perhaps not to such a degree, as KiwiSaver enrolments reach a steady level. Organisations with no or minimal retail presence have had to employ other methods to attract KiwiSaver members, such as Employer Choice Agreements.

5.26 Some Providers believe that a large market share is unnecessary. A number of niche providers have indicated that they expect to run profitable KiwiSaver books based on their specific membership base. Those interviewed said that they saw KiwiSaver as just one of the financial products they will provide to their clients.

5.27 Recent new entrants to the market indicate that barriers to entry are manageable, and that KiwiSaver is seen as a product offering that has business potential, even after missing out on the windfall of initial members. It is likely that new entrants will already be experienced in the provision of investment products. An area to be covered in the future evaluation of KiwiSaver is product development. While there is considerable information available about Providers and Schemes, the information about products is diverse. It is an area for separate analysis once the increase in enrolments slows and it becomes clearer what products members have chosen. An important aspect of this research will be whether these are active or passive choices.

5.28 Scheme memberships for some Providers for the first year are very low and much will have to be done, both to attract members and to profitably grow their investments, if they are to stay in the KiwiSaver business. It is clear from those Providers interviewed that there will be competition to purchase the KiwiSaver business of any Provider who chooses to exit the market. This competition is likely to come from either existing KiwiSaver Providers who see a way of profitably managing additional members or new entrants who either have a specific niche product and service or who have efficient retail-based administration structures in place.

5.29 Given the importance of FUM fees as a driver of profit, one measure of competition is the number of large KiwiSaver Providers. According to the report of the GA there were nine schemes with assets over 25 million, as at March June 31 2008, and a total of 15 schemes with assets in excess of $10 million.

*Table 5.3 – Number of KiwiSaver Schemes in Force by Size of Assets**

Scheme size	Number of schemes
Under $0.5m	13
$0.5m – $2.5m	8
$2.5m – $10m	10
$10m – $25m	6
Over $25m	9
Total	46

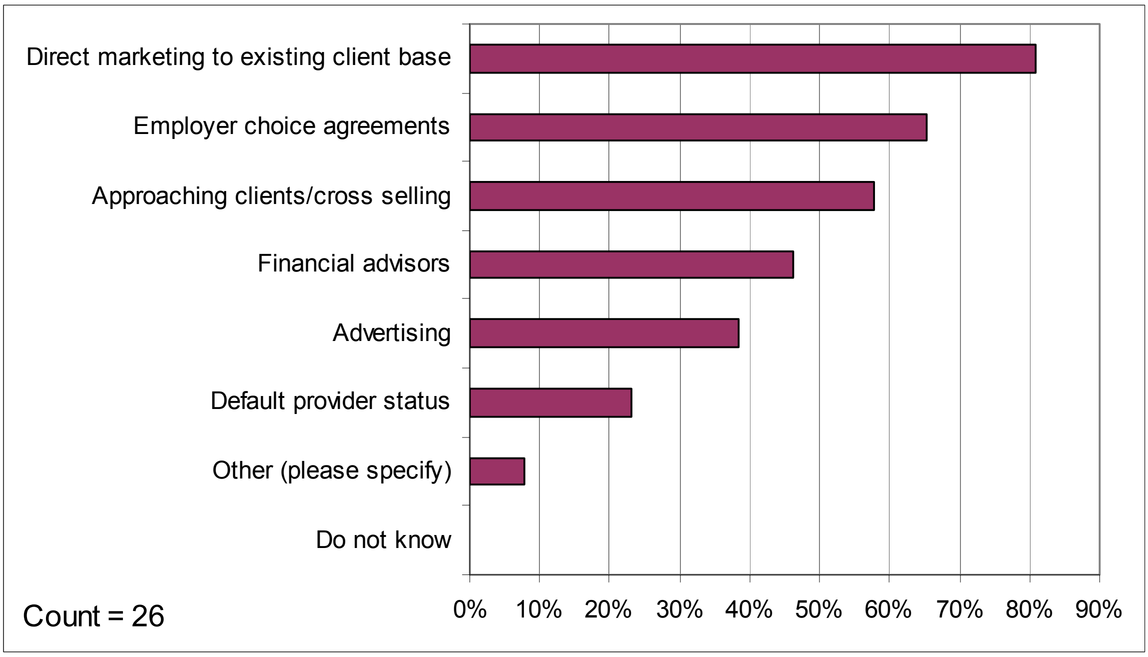
Source: Government Actuary report in respect of KiwiSaver 2008, appendix 9
* Schemes without assets are not included in this table

5.30 On an ongoing basis, a market share definition of a large provider is more appropriate, as it is robust to scheme growth. The proposed definition is a greater than five percent market share of FUM. Therefore, this is the recommended indicator for competition within the KiwiSaver market. At 30 June 2008, PwC estimate that seven providers have more than five percent market share.

5.31 Not all KiwiSaver Providers are seeking to dominate the market through membership and FUM. A number of smaller niche Providers seek to differentiate themselves by distribution method, service and investment returns, to current and perspective members. The existence of these Providers and the emergence of ‘single sector funds’ within more traditional schemes is also a very healthy sign that there is choice and competition within the KiwiSaver market. According to the report of the GA, targeted single sector funds across all providers represent 5.6 percent of all FUM.

5.32 The KES (KES, A2) indicates that the most popular method of attracting new members has been direct marketing (81 percent of respondents have used this method of attracting new customers).

Figure 5.2 – Strategies to Attract Membership



Source: KES, A2.

5.33 The successful continuation of the market will require ongoing review of the Providers and in particular, the number and requirements for default Provider status to ensure that receiving default Provider status is not a prerequisite for success in the market.

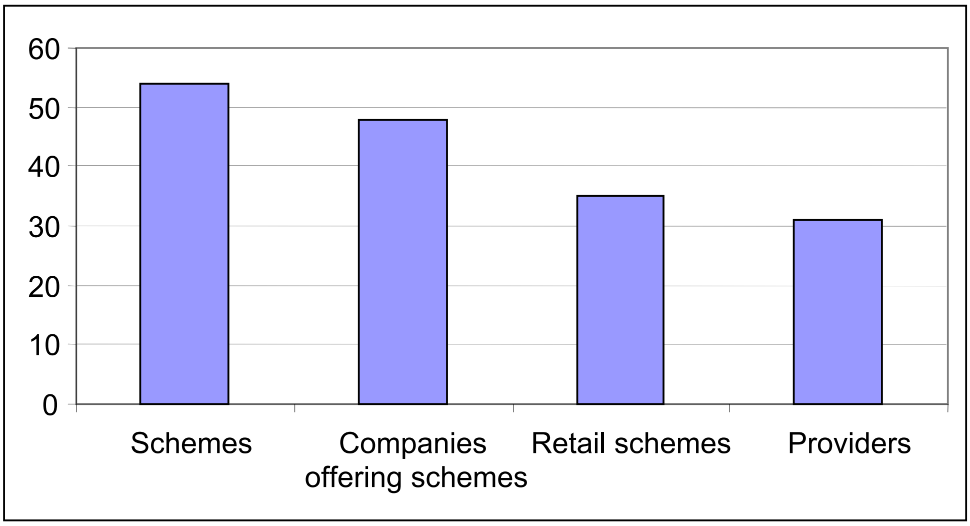
Consumer Choice

5.34 This section approaches consumer choice from the perspective of product offerings and, therefore, based on this logic, the number of retail schemes and Providers is a key measure of consumer choice. To understand what is driving actual choices made by members is outside the scope of this project, but could be covered by a member survey if required.

5.35 Where competition is present, consumer choice follows. This will be reflected in the KiwiSaver market where profitability is driven by membership and FUM and the existing Providers are competing to increase both. This is particularly true for non-default Providers who have not benefited from the high number of auto-enrolees and need to attract members to sustain their business. Choice can be seen in the various forms of competition. Greater choice will allow members to better match their preferences to the products being offered.

5.36 Of the 54 registered schemes, current and perspective members can currently choose between 36 different retail schemes with a further 19 schemes available to specific corporate groups. Choice is expanded further because most schemes offer multiple funds and even combinations of funds. The 54 schemes are offered by 48 different companies (only four offer multiple schemes) and administered by 31 different Providers.

Figure 5.3 – Offering Statistics (June 08)



Source: PwC

5.37 The portability feature of KiwiSaver allows members to exercise choice between funds, schemes and providers. Furthermore, it promotes the provision of choice by providers and competition.

5.38 The nature of the choice available to members and potential members requires further evaluation over time because:

- the large proportion of savers up to now who are in the default schemes suggests that the existence of the incentives to save is a larger influence on the decision to save than the features of the schemes and their investment funds; and

- although there are 36 schemes to select from, the selection of schemes by members so far is heavily weighted to just a few options; however, this may simply reflect the niche offerings of some providers.

5.39 In the absence of readily available information it is recommended that the number of retail schemes and providers be adopted as the measure of consumer choice.

Innovation

5.40 Another attribute of an efficient industry is one where innovation is continuous over time. Competition (whether it is a threat or actual) can be a motivating factor forcing existing businesses to become efficient as quickly as possible, aspiring to a level of profitability that generates profits that can be invested in developing new products and other service innovations, thus benefiting customers.

5.41 The identification of a measure of innovation for the evaluation requires reference to features of the KiwiSaver industry. One feature is the number and range of investment funds.

5.42 As noted above, there are many investment funds available within the 36 public KiwiSaver schemes and these currently offer many investment choices. Holm's[58] research has found that Providers' current fund offerings include:

- ethical or similar;
- property-only;
- options;
- capital protected; and
- risk is adjusted by age.

5.43 There are a number of Providers who have a unique investment philosophy exercised through only one investment fund and they differentiate themselves on this basis. Some of these have an expressed aim to focus on customer relationships as part of a package where investment return is only a part of the service offering.

5.44 Other Providers have a large range of funds. For example, ABN Amro Craigs offers more than 130 investments covering portfolios with active and passive funds, and individual shares. Some Providers allow customers to invest in more than one fund at once, i.e. to split contributions between several funds. Several Providers offer a "lifesteps" fund, where the risk profile is automatically changed according to the age of the member.

5.45 Sustainable industry development is one where there is innovation. An indicator of this is when new schemes and Providers can enter the market. This is the reason that a core measure for the firm dynamics component of the KiwiSaver evaluation framework is the number of new schemes and Providers entering the market in a given year. A specifically tailored question to a range of Providers or industry experts has the potential to provide a qualitative perspective on KiwiSaver supply-side innovation. It may also measure opinion above future trends in a similar way that the business confidence surveys do for economic outlook.

5.46 In addition to developing their investment approaches, the other ways that Providers have been innovating include:

- distribution methods;
- administration systems;
- strategic alliances; and
- customer service, for example, internet banking type facilities for savings.

[58] Holm M (2008a)

5.47 The concepts of consumer choice and innovation are closely linked, and, similar to the case of consumer choice, there is an absence of readily available information on innovation. Based on the data that are available, the evaluation framework uses the number of new schemes and providers entering the market as a proxy for innovation.

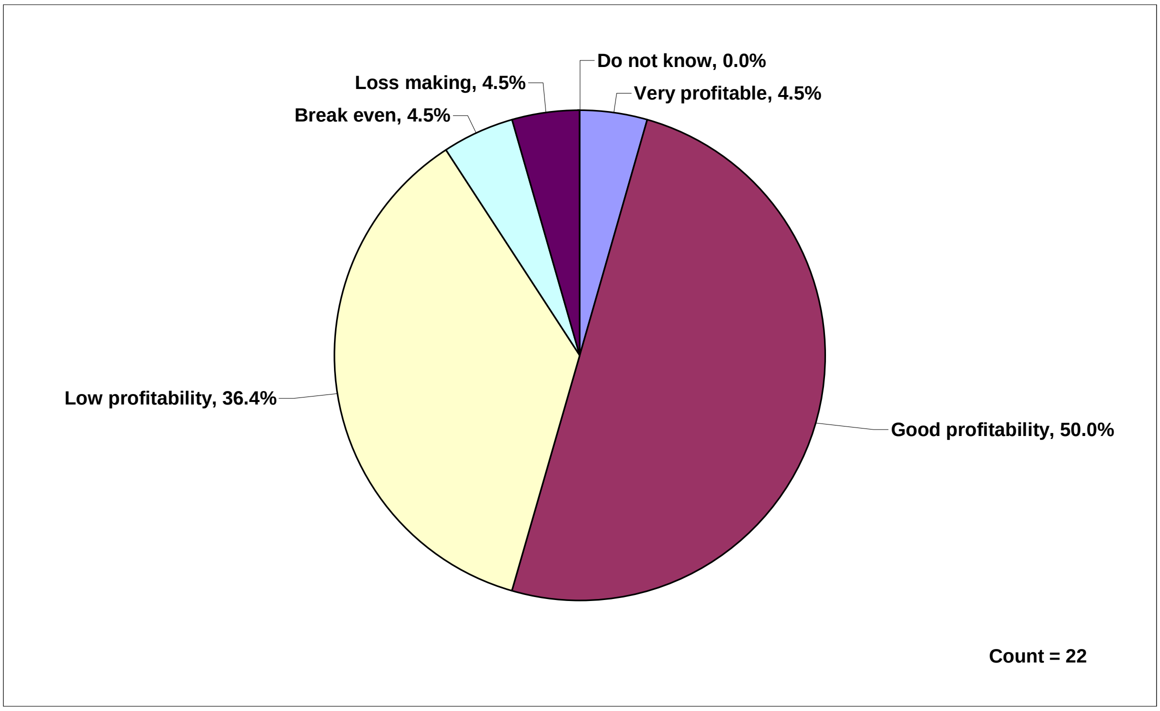
Profitability

5.48 Efficiency and competition of the KiwiSaver supply-side can be examined with reference to the theory of the firm and the drive for profit maximisation. Providers will look to expand their customer base in order to decrease the average cost per customer through spreading the fixed cost of service provision over a greater number of members (or a greater level of contributions from members).

5.49 An indicator of profitability available at the time of this evaluation is KES, question C9. This question is especially applicable because it is forward looking and captures opinions relevant to a new financial product in this case, KiwiSaver.

5.50 When questioned on their expectation of profitability, 91 percent of those 27 Providers who replied to the survey, indicated that they expected their KiwiSaver products to be profitable over the next ten years.

Figure 5.4 – Profitability expectations



Source: KES, C9.

5.51 Understanding the start-up costs facing Providers gives important context for examining Provider viability and the evaluation framework, including the KES, is designed with this purpose in mind. The impact of start-up costs will be better understood over time as the experience of membership and funds growth unfolds.

5.52 With the first year's enrolment numbers exceeding expectations, many Providers have been focused on managing the enrolment process whilst they integrate new systems and processes. This, and the usual restrictions on disclosing competitive information, limits the examination of the breakdown of costs between those that are a normal part of any start-up business and those that may be higher, perhaps, because of the complexity of KiwiSaver.

5.53 Based on the Provider interviews, for the first year of KiwiSaver, the fees received per member are unlikely to match the per member costs. Similarly, with the relatively low levels of funds invested so far, the FUM fees are unlikely to cover costs. Consequently, profitability will be dependent on the future experience of the scheme. Given KiwiSaver is only one year into operation, future growth in members and contributions is unknown.

5.54 Providers interviewed also commented that their systems integration with IR's clearing house for employer-submitted contributions has been bedded in now and is generally working well.

5.55 Seventy-four percent of KiwiSaver Providers who responded to the KES reported that overall KiwiSaver compliance costs are higher or considerably higher than that of other similar products (KES, D4).

5.56 The examination of those costs however, needs to be cognisant of the following:

- Providers entered the market voluntarily;
- as described in Chapters 2 and 4, there are a range of costs faced by any business when it sets up a new service; and
- the modifications that Providers made to their business may have helped drive system and process innovation across other areas of their business and will deliver efficiency benefits.

5.57 Providers were already well down the track to implementing KiwiSaver schemes when the May 2007 Budget announcements considerably changed the way that KiwiSaver would be implemented. Because of those changes, significant new costs relating to documentation, training and information/management systems now had to be recovered from revenues based on pricing structures which, for some, had already been negotiated with the GA/MED. The addition of compulsory employer contributions as part of the same new business, however, seemed likely to generate management for KiwiSaver.

5.58 Each Provider's experience is different. As other Chapters discuss, the evaluation has found a range in the key influences on the level of fees and costs. For example, some Providers have experienced stronger than anticipated membership growth and hence higher than anticipated revenues from fees. On the other hand, there are Providers who experienced unexpectedly high costs, for example from setting up new IT systems. Some have experienced both high enrolments and high costs. Those who had efficient operations in place and who experienced strong membership growth will be better placed to become profitable than those with high set up costs and low enrolments.

5.59 The evaluation framework adopts the KES survey question C9 on Providers' expectation of profitability as the indicator for Profitability.

5.60 Another method of examining the efficiency of KiwiSaver Providers is to look at the return on investment that the Providers will achieve. The return on these investments can be compared to other ventures in which the shareholders might invest capital. This is likely to be difficult to evaluate precisely but commonly business investments have short payback periods because their access to capital for the investment tends to be for terms of two years. In broad terms, then, the payback periods of five to eight or more years, as indicated by some KiwiSaver Providers as likely, would be regarded as too long for a normal commercial investment. This is further evidence that there is likely to be consolidation in the future.

5.61 The KES survey question C7 on Providers' expectation of the payback period on their KiwiSaver investment has been adopted by the evaluation framework as the indicator for Return on Investment.

Consolidation

5.62 The number of KiwiSaver Providers, per the overall number of members, is a measure of market concentration. The superannuation and managed funds industry is one in which volume (both in terms of members and funds managed) plays an important part in the long-term viability of providers and this is highlighted through the KES results where Providers see consolidation in the industry as inevitable (KES, B3.2).

5.63 The KES and interviews indicated that Providers expect that some Providers will never attain a profitable level of business and will eventually exit from the market. According to KES, 68 percent of those responding believed the number of Providers would decrease over the next three years while 56 percent believed the number of schemes would decrease over the same period (KES, B3.2).

5.64 Consolidation could be measured in by past events, i.e., actual changes in the number of schemes and Providers. Objectivity is gained by asking respondents to consider their future expectations, as this also indicates their views of the health of the sector.

5.65 The KES survey question B3.2 on Providers' expectation of the number of Providers and schemes has been adopted as the indicator for Consolidation.

Market Entry

5.66 Another important feature of a competitive market is the ease of entry into the market for new Providers. The lower the cost of entering the market, the higher the chance that this will occur. The existence of competition helps drive efficiency and innovation, deterring those looking to enter the market, unless they are equipped to provide the required services and products, reduces the chances of losing market share if there are new entrants.

5.67 Based on the KES response, the range of set up costs experienced by new or enhanced Providers was between $50,000 and several million. The costs were high where business to business (BTB) systems were required. Other factors adding to the Providers' cost were the short timeframe to customise systems to the KiwiSaver design, PIE and the changes which had to be made as a result of the Budget 2007 announcements. The majority of respondents indicated that these costs were higher than for introducing similar products (KES, F4).

5.68 The implementation costs will vary based on a number of factors unique to each Provider. In the case of market entry, the implementation costs for new Providers will also vary. The KES indicated that PIE costs were 23 percent of all implementation costs on average (KES, D3).

5.69 New entrants could also consider the level of and type of service provision they wish to undertake versus what they might contract out to organisations that are already set up to administer KiwiSaver accounts. Outsourcing the administration could considerably reduce the implementation costs to a new entrant.

5.70 Another factor that could influence entry of new Providers is the extent to which the organisation was already set up to provide retail financial products. This has the potential to reduce implementation costs. Most new market entrants are likely to have an existing retail base with an operating framework better structured to cope with what is a retail savings product. Other entrants may come through as employer-based Providers.

5.71 Ultimately, the test of the barriers to entry will be reflected in the number of new participants in the market. This is best measured by counting the number of new companies offering schemes, irrespective of whether they are Providers or not. The GA keeps a register of these schemes. A further 13 companies offered schemes to June 2008 with six of them being added in the 2008 calendar year.

5.72 The number of new companies offering publicly available KiwiSaver schemes, as per the GA's register, has been adopted as the indicator for Market Entry.

KiwiSaver in the First Year

5.73 The influence of the auto-enrol mechanics and financial incentives on KiwiSaver has resulted in a much higher uptake rate than initially forecast by the government. Enrolments reached 716,637 by 30 June 2008. A survey of KiwiSaver members is required to gain a fuller understanding of the drivers of KiwiSaver uptake.

Table 5.4 – Year one KiwiSaver enrolments

Enrolment Period	Enrolments	Percentage of 30 June 08 membership	Total Membership
July 07 – Aug 07	115,980	16	115,980
Sep 07 – Oct 07	148,631	21	264,611
Nov 07 – Dec 07	112,355	16	376,966
Jan 08 – Feb 08	88,782	12	465,748
Mar 08 – Apr 08	130,937	18	596,685
May 08 – Jun 08	119,952	17	716,637
Total	**716,637**	**100**	

Source: Inland Revenue, monthly reports, 2007/2008.
Base: all members at 30 June 2008.

5.74 One way to measure the success of KiwiSaver at encouraging individuals to save for their retirement is to monitor the number of contributing members separately from total membership.

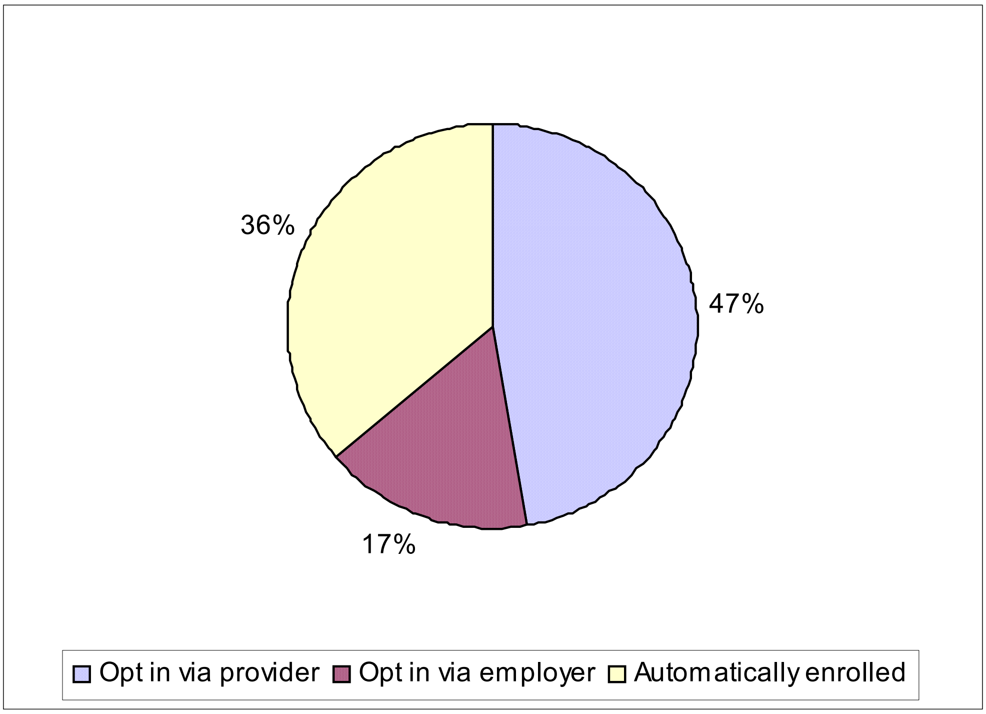
5.75 Contributing members are those who are actively saving for their retirement by making regular contributions, most often automatically deducted from their income. IR has the information to report this annually by counting the number of members receiving a member tax credit. Tax credits can only be claimed by those aged 18 years and over, however, and can only be claimed against contributions made.

5.76 Although this excludes contributors under the age of 18, the tax credit data is a stable measure that will allow future evaluations to track the change in contributors from existing centralised data. This data had not been compiled for publication at the time of this evaluation. An estimate based on IR data puts contributing members at 87 percent of the total in July 2008[59]. As more members become eligible for contributions holidays (after one year of membership), the percentage of contributing members may decrease.

5.77 The number of members coming through auto enrolment, 259,299 or 36 percent, reflects the passive inertia of the auto-enrol mechanism. These members have been randomly allocated to a default scheme. In addition to the members that have been automatically enrolled, many of the members recorded as opting in via their employer have also not made a proactive choice of provider.

5.78 Figure 5.5, below, illustrates the percentage of members who join in each of the different ways.

Figure 5.5 – Method of Enrolment[60]



Source: Inland Revenue
Base: all members at 30 June 2008.

5.79 Of the opt-in members, comment from Providers suggests that many self-employed people are contributing only the amount which qualifies for tax credits ($1040 per year). Children's accounts also receive a minimal level of ongoing contributions. Comprehensive data about opt-in members is not yet available from IR.

[59] Contributing members can be estimated as [*total membership*] less [*under 18 membership*] minus [*those taking contributions holidays*]
[60] For the 12 months to June 2008

5.80 IR data covers opt-in and auto-enrol data for employees – salary and wage earners – and all other members that make contributions through IR, with the latter group being insignificant to the former. This data show that, to date, salary and wage earners are contributing the most substantial part of the investment assets.

5.81 The GA report (tabled September 2008) gives the level of default membership at 33 percent as at 31 March 2008.

5.82 The propensity to enrol in conservative funds has the potential to reduce the returns from KiwiSaver over time. A feature of services offered by KiwiSaver Providers is to increase the financial literacy of members, which in due course, may lead to savers investing less conservatively into funds that offer a higher rate of return.

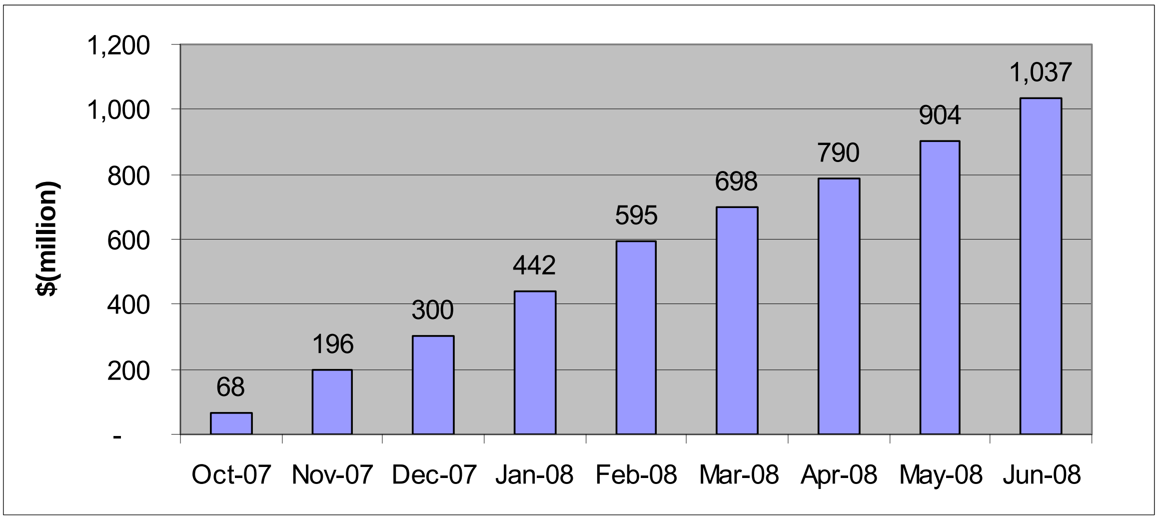
5.83 Annual information on the level of assets under investment in respect of KiwiSaver schemes is recorded in the GA's report. As at 31 March 2008, this figure was $702 million.

5.84 Funds under management were estimated at $697 million for March 2008 and $1,086 million in June 2008. These estimates were calculated from the following information:

- industry sources such as FundSource;
- copies of the GA returns provided to PwC in confidence; and
- KES data.

5.85 At this stage, the KiwiSaver asset values, reported above, roughly correspond to the level of contributions made to KiwiSaver via IR (see Graph 5.6). Contributions include member, employer and government contributions.

Figure 5.6 – Cumulative KiwiSaver contributions made through Inland Revenue



Source: Inland Revenue
Base: all funds passed from IR to Providers to 30 June 2008. Data relating to funds passed to Providers is provisional. IR is currently reconciling final payments.
Note: total contributions from member, employer and government.

5.86 Accumulated KiwiSaver contributions were 3.3 percent of superannuation assets in March 2008, according to the Managed Funds survey, up from December 2007 when the ratio was 1.5 percent[61]. By June 2008, this is estimated to rise to 5.2 percent.

Fees Disclosure and Comparison

5.87 Feature of fees, relevant for examination by the evaluation of firm dynamics are:

- they represent a key performance factor for both members and Providers;
- competition can regulate fees to an extent, but only with clear disclosure;
- quality of fee information varies in the market place;
- the Retirement Commission and the MED have a role to play in increasing the transparency of fees; and
- the GA has a role in monitoring fees, and can intervene if fees are deemed to be "unreasonable".

Fees Disclosure and Comparison

5.88 There is wide variation in how fees are disclosed. Although all fees are required to be fully disclosed in the investment statement and prospectus, the disclosures are difficult to understand and compare.

5.89 Although fees must be "deemed not to be unreasonable" by the GA, it is difficult for investors to adequately compare costs and performance. This has been brought to public attention by the Retirement Commissioner. There are a number of organisations who do fee comparisons, notably the Retirement Commission's sorted website. None of these fee comparisons have yet managed to achieve universal support for the robustness of the analysis.

5.90 The Retirement Commission and others are calling for changes to government regulations that would make KiwiSaver and other fees easier to compare. The Commission's goal is 'to provide the consumer with transparent information on charges, in an understandable way.' The MED is looking into disclosure of KiwiSaver fees, fee levels and regulatory control as part of a Review of Financial Products and Providers. It is expecting to issue a report to the public by late 2008 or early 2009. Depending on the outcome, this may in the future allow fees to be included as part of the evaluation framework.

5.91 Mary Holm (2008) also raises the issue of disclosure, stating that there is a wide variation in how fees are disclosed and what constitutes expenses that apply to KiwiSaver. Holm points out, for example, that some Providers include the fees of managers they hire and/or consider tax effects, while others include neither.

[61] Based on KiwiSaver contributions from Inland Revenue.

5.92 Quite apart from the problems of getting good data, there are many challenges to making it comparable. Firstly, investment management fees need to be considered in relation to the complexity of the investment options chosen. Secondly, the fees can vary for each option depending on the amount invested. There have been complaints about newspapers' fee tables because of this. Thirdly, fees can change over time. Illustrating the effect of this requires assumptions about future investment returns this brings subjectivity into the comparison. Managers with high fees will claim that they will make higher returns and that comparisons on the investment return assumptions are unfair.

5.93 To assist consumers, the Retirement Commission has developed a fee calculator that compares fees across different providers and funds. The Commission is independent and has worked with providers to make the calculation as fair as possible. The calculator is available on the Retirement Commission's website, www.sorted.org.nz. Some providers are not happy with this calculator, however, as discussed above.

5.94 There is a fixed and a variable component to fees and this is primarily what makes comparison difficult.

5.95 For small account balances, the fixed or per member fee is the most important, whereas for larger account balances, it is the variable fee that is most important. Consequently, different comparisons are required for different contribution levels and ages to determine the lifetime effect of fees. Complicating this is the fact that fees are generally higher for growth funds than conservative funds.

5.96 For investors to make informed decisions they must first, be able to assess the costs and expected returns of an individual scheme simultaneously, and second, be able to compare those margins against other schemes. Currently, they are often unable to do both. It is also only meaningful to compare fees for funds with similar expected returns or growth profiles.

5.97 Performance fees are even more difficult to evaluate, primarily because they depend on the volatility of returns rather than the net outcome when the funds become available at retirement.

5.98 Industry associations can play a role in the collection of industry data, such as market share, fees and investment performance. The ISI collects market share data for the insurance industry and previously collected market share data on managed funds and superannuation. This role has largely been taken over by private companies who charge Providers for the information, for example, FundSource and Morningstar.

5.99 For consistent and comparable measures of fees and return to be produced, an agreed framework for the calculation and comparison of fees and returns on investment is required. A fair, equitable and transparent basis for the comparison of fees and returns is essential from the regulator's perspective. From the point of view of the supply-side, the purpose of fee data is for there to be a fully informed market to underpin efficient resource allocation and good business decision-making and planning.

5.100 As recommended by the Retirement Commission, the MED is reviewing the approach to monitoring of fees. Consideration should be given to initiating the development of an agreed framework, in conjunction with KiwiSaver Providers, for the communication and comparison of fees.

5.101 Sixty percent of members are enrolled in default schemes with a strong trend towards conservative default funds. Given the granularity of the data it is difficult to ascertain when this is an informed proactive choice and what role fees have played in influencing participation in default schemes.

5.102 There has been debate about whether additional fees should be charged for special investment approaches, such as ethical investing.

5.103 The GA says:

> *"In general, the costs associated with an ethical fund are similar to the costs associated with a normal equity fund when bottom-up analysis is undertaken. Hence, for funds with similar asset profiles, I would expect the fee levels of ethical funds to be similar to the fee levels of non-ethical funds. However, if a global overlay is used, I would expect the additional cost necessary for the additional services to be quantified."* [62]

Measuring Investment Performance

5.104 Investment performance is dependent on many factors. Investment theory states that in the long term, higher returns will be achieved by more risky investments but at the expense of short term volatility.

5.105 Generally, as the risk or the proportion of growth assets is increased, the more expensive the fund will be to manage. It will, therefore, incur a higher fee. The intention is that the higher expected returns will cover the higher fee. Higher fees are generally charged for growth asset classes and also for a more active (as opposed to passive) management style.

5.106 Actual investment performance will depend on a number of factors including the:

1. strategic asset allocation of the fund;
2. performance of the markets within each asset class;
3. manager's tactical asset allocation within strategic ranges;
4. manager's success in outperforming the market in each asset class; and
5. success of the manager's foreign exchange exposure management.

5.107 The most significant components are the first two, both of which are outside of the manager's control. Evaluating a manager's performance is not as simple as comparing the returns. This is especially true for the higher risk profile or higher volatility funds. There are a number of independent private firms providing analysis of returns for superannuation and managed funds. These include Fundsource and Morningstar and a number of consulting actuaries.

[62] (http://www.isu.govt.nz/upload/56568/guideline-no-KSGN2.pdf)

5.108 Tax is applied at a member specific rate, the impact of tax will also depend on the components of investment income, for example, capital gains on Australasian equities are tax free in a PIE. Therefore, the effect of tax will depend on the member's tax rate and the nature of the fund. Currently, tax information is not collected by the GA because of industry feedback, and most Providers quote returns gross of tax. The justification for this is that it would be meaningless to compare net returns because they depend on the member's tax rate. As a result there is currently limited information to evaluate the overall impact of tax on KiwiSaver performance and also to specifically evaluate the tax efficiency of individual funds.

5.109 The above points illustrate that a fair comparison is a complex issue. But we can conclude that a performance comparison that is valid for all members consequently has to be on gross investment return and fund based fees.

Conclusion: the Firm Dynamics Concept of the Evaluation Framework

5.110 KiwiSaver supply-side firm dynamics reflects the operations of the businesses that supply KiwiSaver products.

5.111 A priority is the reporting and monitoring of detailed information on the various funds within schemes. This data is especially important to be able to examine competition and innovation. In addition, it provides information about the diversity of the market outside of the default funds and outside of non-default Providers most popular funds.

5.112 The second area of urgency relates to the visibility and comparability of fees. Although fees are approved by the GA and published they are not transparent in the sense that they can be readily compared, being distorted by the large number of variable components and methods of calculation.

5.113 Complicating this is the trade off between higher yield growth investments with higher fees, and conservative funds with lower fees. An investor is two steps from being able to make an informed decision. First, investors are unable to assess the costs and returns of an individual scheme, and second, they are unable to compare those margins against other schemes.

5.114 Transparent and frequent reporting of investment returns for investors is essential for a stable and competitive market. Knowledge and comparison of returns on a monthly or quarterly basis is important step to developing the KiwiSaver market in a similar way to shares and other managed funds. A robust methodology for the comparison of fees and investment returns is essential.

5.115 Absent from the pool of data is a measure and description of the passive response to KiwiSaver. Understanding the number and nature of people who simply accepted the auto-enrolment process is important to Providers. This understanding allows Providers to better assess the risk profile and serve their customers better.

5.116 Investors may be passive for many reasons. These reasons may include, for example, apathy, confidence in government decision making or lack of financial literacy. However these reasons cannot be ascertained by currently available statistics. In fact it is not possible for enrolment statistics to differentiate between those who proactively select the default scheme they are allocated or those that are passively enrolled.

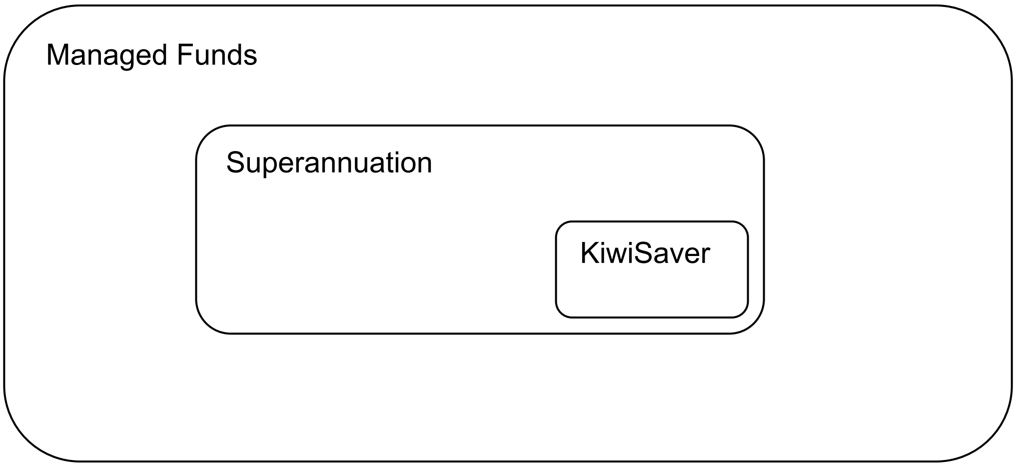
5.117 One solution may be a longitudinal investor survey that explores, among other things, the motivations behind passive enrolment choices. Waikato University has indicated that further editions of their survey may consider asking questions around enrolment choices. There is also further research planned through the joint evaluation strategy on these topics.

6 KiwiSaver Market Dynamics

6.1 An ongoing evaluation gains knowledge from examining market dynamics (the economic and business cycle trends) that influence KiwiSaver trends and which are, in turn, influenced by KiwiSaver. This Chapter sets out the part of the evaluation framework that has been designed for evaluating the market dynamics of KiwiSaver. The framework has been developed to use existing data.

6.2 Several measures to understand the performance of the wider managed funds market superannuation and KiwiSaver, are presented in this Chapter. Figure 6.1 illustrates the relative size of KiwiSaver funds to managed funds as at June 2008.

Figure 6.1 – Funds markets – Relative size as at June 2008



Source: PwC, illustration to put KiwiSaver in context. KiwiSaver contributions were approximately 2 percent of managed funds as at 30 June 2008.

6.3 The efficiency and effectiveness of KiwiSaver, as one tool for retirement savings, is a complex question where an understanding of the context for an evaluation is key. Ideally, the design of the wider framework and ongoing evaluation of the results will enable causality to be isolated and evaluated.

6.4 Given that KiwiSaver was introduced just over 12 months ago, many of the data sources that are most useful for the measurement of KiwiSaver are as yet undeveloped. The background has also found that there is considerable room for improvement of other published data around managed funds. In this respect, the indicator framework is populated using data that has been derived from alternative and sometimes less than ideal sources.

6.5 There is a growing acknowledgement that to gain an understanding about capital markets, more ongoing monitoring is required, both by the market participants and by those responsible for macroeconomic policy. For the latter, some data currently supplied in the annual data returns by KiwiSaver Providers, would benefit from quarterly (and, in some cases, monthly reporting). This more granular reporting enables turning points and other impacts to be isolated and more immediately identified.

Market Dynamics KiwiSaver Supply-Side Evaluation

6.6 This section discusses features of the market dynamics component of the KiwiSaver Supply-Side Evaluation Framework. It considers the options for recording information about the levels of funds (assets), the percentage of investment in New Zealand and in the New Zealand equity market, the number of members and the number of schemes.

Market Indicators

6.7 The focus of the evaluation framework is to monitor the development of the KiwiSaver market and the impact of KiwiSaver on the superannuation market and wider managed funds sector. The impact on national savings attributable to KiwiSaver is outside the scope of this evaluation. The indicators focus on the superannuation and managed funds markets and the effect KiwiSaver has on savings in the form of managed funds.

6.8 To gain a perspective on how things were before KiwiSaver, what has happened since its introduction and what has changed, a baseline was defined. Ideally, the baseline should capture dynamic change, that is, the future changes in the indicator variables in the absence of KiwiSaver. Given the available data, and the short time since KiwiSaver was introduced, the available baseline data is little more than a static snapshot. Some aspects of the dynamic change in the industry, however, have been captured through the KES and the Provider interviews, as discussed in previous Chapters.

6.9 The baseline indicators are also selected to gain a perspective of the superannuation market and its relationship to the wider managed funds sector prior to the introduction of KiwiSaver. June 30, 2007 has been selected as the base point. It is a snap shot of retirement savings just prior to when KiwiSaver was introduced on July 1, 2007. As quarterly data will be helpful for analysis over time, the framework is based on quarterly data where it is available. Measures relating directly to KiwiSaver are zero on this date and are tracked from 30 June 2008.

Table 6.1 –Market dynamic indicators as at 30 June 2007 and 2008

		Managed Funds			Superannuation			KiwiSaver		
		2007	2008		2007	2008		2007	2008	
Assets [b]	$m	66,505	60,223	▼	22,004	21,056	▼	bK	1,087	►
NZ Investment [b]	percent	57	59	▲	44	43	▼	bK	61 [d]	►
NZ equities [b]	percent	15	11	▼	13	9	▼	bK	21 [d]	►
Membership	number	NA	NA		635,297[c]	tbp	▼	bK	716,637[e]	►
Schemes	number	NA	NA		560 [c]	tbp	▼	29 [f]	54 [f]	▲

NA=data not available; tbp=data to be provided; bK=before KiwiSaver

[a] The arrows indicate the direction of change for the corresponding variable from the previous period to the latest period. A green up arrow corresponds to an increase, a red down arrow corresponds to a decrease and an orange right pointing arrow indicates no change.

[b] Sourced from the Managed Funds Survey June 2008 quarter

[c] Sourced from the Report of the Government Actuary for the year ended 30 June 2008, with the addition of the Government Superannuation Fund

[d] Estimates supplied by Statistics NZ as part of the joint RBNZ and Statistics NZ Managed Funds Survey (31 March 2008 figures were available at time of publication)

[e] Supplied by Inland Revenue

[f] Sourced from the KiwiSaver Schemes Register maintained by the Government Actuary as at September 2008.

Table 6.2 – Data sources

Assets	The value of all managed funds as reported in the Managed Funds Survey (MFS) published quarterly by the Reserve Bank of New Zealand in conjunction with Statistics NZ. KiwiSaver data are experimental series produced by Statistics NZ.
NZ Investment	Calculates [funds in New Zealand / all funds,] for each product type from the MFS.
NZ equities	Calculates [funds invested in equities / total funds in New Zealand] for each product type from the MFS.
Membership	Includes all schemes registered with the GA under the Superannuation Schemes Act 1989 and the KiwiSaver Act 2006.
Schemes	As above.

6.10 The framework described in this Chapter is best used as an evaluation tool. In contrast to a score card, where the score card can be analysed on a stand-alone basis, data collected about KiwiSaver market dynamics needs to be interpreted in context of other information about managed funds and relevant economic trends.

Funds Under Management

6.11 The level of FUM is a good indicator of one source of long-term savings. For this reason, the framework from the evaluation of the supply-side includes reporting and monitoring of funds under management.

6.12 Nominal growth in FUM is due to both the investment return on the assets and new funds flowing into the products. These two factors are not independent. Funds flow may be smaller when returns have been low or negative. For KiwiSaver, the impact of negative returns on contributions is likely to be less due to the set contribution levels required for salary and wage earners.

Table 6.3 – Funds under management (June years)

Year	2004	2005	2006	2007	2008
Managed funds ($m) [(a)]	52,648	55,428	61,610	66,505	60,223 [(b)]
Percent Change		5.3%	11.2%	7.9%	-9.4%
Superannuation ($m)	18,651	19,671	21,034	22,004	21,056
Percent Change		5.5%	6.9%	4.6%	-4.3%
KiwiSaver ($m)					1,087
Percent Change					
KiwiSaver Investment Return [(c)]					-2.1%

[(a)] Source: RBNZ Managed Funds Survey, including Superannuation each year and KiwiSaver in 2008).[63]
[(b)] Managed funds less KiwiSaver were $59,136 million.
[(c)] Source: Report of the GA with respect to KiwiSaver (2008).

63 Including Superannuation and KiwiSaver from 2008 (total of $1,087,000)

6.13 The RBNZ publishes quarterly statistics on New Zealand's Managed funds sector through its Managed Funds Survey (MFS), which is estimated to cover 85 - 90 percent of the market. Other data collections such as FundsSource and the Master Trust survey provide a specific picture of the biggest market participants' contributions but the MFS provides the most robust overall picture of managed funds.

6.14 When asked about their expectation for the total level of managed funds over the next three years, Providers representing 63 percent of all KiwiSaver funds under investment expected a large increase and 93 percent overall expected at least a small increase.[64]

6.15 Superannuation funds are most accurately reported to the GA on an annual basis. All registered superannuation funds are required by law to provide annual returns at their balance date, using a set format. The GA combines all these returns at the end of each June year.

6.16 The GA's report under the Superannuation Scheme's Act excludes the Government Superannuation Fund (GSF). A measure of all superannuation funds under investment in New Zealand is the GSF figures added to those reported by the GA. The GSF funds are published as at 30 June each year and relate to the total funds in the GSF at that point in time. Development of the KiwiSaver evaluation over time will benefit from consistent, reliable data, ideally with monthly data points. Collaboration with the sector to agree standards for, and frequency of, data collection will ensure that these benefits are shared by Providers and other key players with minimal compliance costs.

6.17 This wider measure of superannuation funds under management excludes the New Zealand Super Fund (NZSF). A consideration for future evaluations is whether the performance of this fund impacts on KiwiSaver supply-side activities.

6.18 The GA's analysis of superannuation returns is focused on ensuring the robustness and reliability of the data in the returns. The GA builds in time to check all the returns and to ask for incomplete data to be rectified (or inaccurate data to be corrected) if necessary. The GA's calculation of total funds relates to membership at various balance dates over the calendar year. Ideally, the distribution of balance dates should be taken into account when this information is applied in relation to other trends, however the GA does not provide this information publicly. For the purpose of this evaluation, it is assumed that the average return dates are as at 30 June. The latest report for the 2007 calendar year was released to Parliament in late September 2008.

Table 6.4 – Comparison of data collected for superannuation funds under management by the Managed Funds Survey and the Government Actuary (June years)

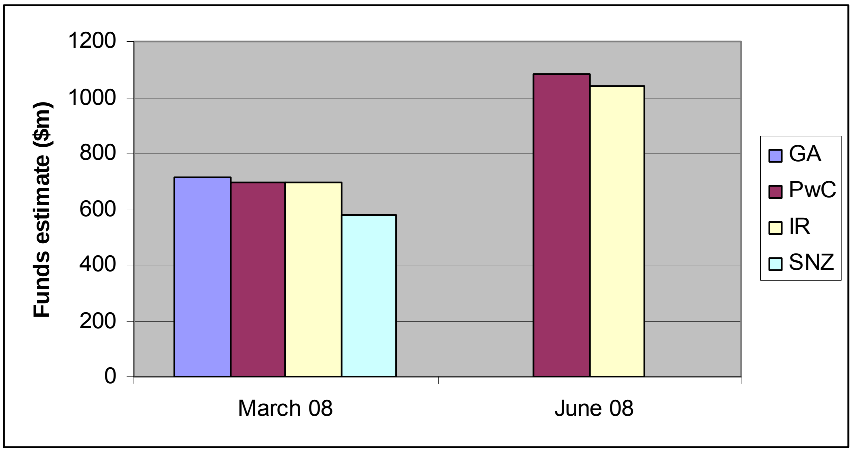
Year	2004	2005	2006	2007	2008
Managed Funds Survey ($m)	18,651	19,671	21,034	22,004	21,056
Government Actuary ($m)	20,241	21,716	24,515	25,914	
Ratio (MSF to GA)	0.921	0.906	0.858	0.849	

Sources: RBNZ Managed Funds Survey; Government Actuary Report, June 2008.

64 Refer to append A question D3.

6.19 The ratio in Table 6.4 indicates that the coverage of the MFS has been decreasing. There is a legislative requirement for all superannuation funds to supply annual reports to the GA while participation in the MFS is voluntary. The difference between the two series, then, is partly the result of the natural difference between a survey and a census. Also, there were changes to the MFS participants in 2007 and a subsequent revision of figures. The three funds managers that were removed managed more superannuation assets than the four that were added and this will have caused a drop in the ratio.

Figure 6.2 – Comparison of estimates of Accumulated KiwiSaver Funds under Management (March / June 2008)



Sources: GA - Report of Government Actuary (March 2008); PwC – PricewaterhouseCoopers estimates (March / June); IR - KiwiSaver contributions passed to providers (March / June) – Statistics NZ unpublished Managed Funds Survey data.

6.20 March 2008 was the first period for which the MFS recorded KiwiSaver as a subset of superannuation funds. This data was not published because of the experimental nature of the data collection. Statistics NZ, however, did release provisional figures for publication as part of this KiwiSaver evaluation. The Statistics NZ survey found $578 million of funds under management at March 2008.

6.21 In contrast, the data collected by PwC from the KES, GA returns supplied directly to PwC by Providers and other industry sources found $697 million invested at March 2008 and $1,086 million as at June 2008. These numbers can be compared with the $693 million recorded as the level of contributions collected by IR to May 2008 and $1,037 million to June 2008. The Report of the Government Actuary (2008) gives the level of contributions to KiwiSaver schemes for the year (as at 31 March) as $715 million, and total funds under management for the period end as $702 million. These discrepancies are not significant at this stage but need to be understood and resolved over time. On an ongoing basis the report of the GA provides the most complete information on KiwiSaver funds on an annual basis while the MFS will, in the future, provide timely quarterly estimates.

6.22 Business demographics data from Statistics NZ could also be used in the evaluation to monitor the employee or enterprise numbers in the wider financial sector. A broader evaluation might use this data to describe the industry and deem changes in this measurement to be reflective on the success of savings policies. At the time when this KiwiSaver evaluation was carried out by (July to September 2008), the MFS provided a more detailed estimate of the sizes of the relevant markets.

IR Data

6.23 IR has been collecting and publishing data about KiwiSaver on a monthly basis since the beginning of the scheme on 1 July 2007. The timeliness, robustness, regularity and granularity of this information (it can be analysed according to age and income of the savers, for example) has provided information during the important start up period of KiwiSaver. It is important for any ongoing evaluation that this data continue to be recorded, collected and published. Because of IR's role for tax purposes and for the transmission of funds from employers to Providers, IR has a double entry accounting process that assists in recording and testing the accuracy of the data.

6.24 IR contributions data provides a good basis for reporting funds under management in year one of KiwiSaver because most funds have been cleared by IR as the central body and there is little effect as yet from investment returns.

6.25 IR's data collection relates primarily to its clearing house role and other data is needed to gain the full picture of KiwiSaver funds and membership. Another source of growth in KiwiSaver funds, for example, will come from contributions paid directly to Providers. While these are likely to be small in year one, they will grow over time.

6.26 In addition, the IR data is input data only. It records the amount invested into schemes where KiwiSavers save as part of their employment. KiwiSaver funds also earn investment returns on the KiwiSaver savings once they are invested.

Investment in New Zealand

6.27 The MFS provides a useful breakdown of managed funds across different investment vehicles and between investment in New Zealand and overseas. Tables are published that express individual managed funds investment in New Zealand as a percentage of the total managed funds.

Table 6.5 – Percentage of total managed funds invested in New Zealand (June years)

Year	2004	2005	2006	2007	2008
Percent (%)	61	60	56	57	59

Source: RBNZ Managed Funds Survey

6.28 The evaluation framework base point for the percentage of managed funds investment in New Zealand is the position as at 30 June 2007, which was 57 percent.

Table 6.6 – Percentage of superannuation funds invested in New Zealand (June years)

Year	2004	2005	2006	2007	2008
Percent (%)	50	47	42	44	43

Source: RBNZ Managed Funds Survey

6.29 The Superannuation investment in New Zealand as at 30 June 2007 was 44 percent.

Investment in New Zealand Equities

6.30 The ratios in Table 6.6 below represent the proportion of New Zealand investment that is made in equities and indicates the propensity of the different products to invest in this higher risk asset class. Currently, the MFS is the best source of share market investment by managed funds.

Table 6.7 – Investment in New Zealand equities (June years)

Year	2004	2005	2006	2007	2008
Managed funds investment in NZ equities (percent %)	14	14	14	15	11
Superannuation investment in NZ equities (percent %)	15	14	12	13	9

Source: RBNZ Managed Funds Survey

6.31 KiwiSaver investment in New Zealand equities was reported by the Statistics NZ survey to be 21 percent of all KiwiSaver investment in March of 2008. This number is similar to the derived number from the KES. Statistics NZ emphasises the experimental nature of its series and cautions against reading too much into this number before observing a trend with larger sums of investment.

6.32 The base point for these indicators is the position as at 30 June 2007, when managed funds equity investments were 15 percent of the total, and equity investments were 13 percent of the total investments by superannuation funds.

Membership

6.33 Membership data can be obtained alongside investment data in the GA's reports and with the same restrictions. The GSF is not included in the GA's report but can be added from separate records. Unfortunately, there is no feasible option for managed funds membership data.

Table 6.8 – Superannuation memberships (for balance dates for the listed calendar year)

Year	2003	2004	2005	2006	2007
Members (#)	715,483	697,916	691,605	656,086	635,297

Source: Report of the Government Actuary, Reports of the Government Superannuation Authority, Appendix F.

6.34 Monthly data for KiwiSaver membership has been obtained directly from IR. Its clearing house role provides accurate membership numbers of those involved through their employment. IR's data is published monthly. Its data will be different to the membership on Providers registry systems, due to the processing lags.

Table 6.9 – KiwiSaver membership (selected months)

Year	October 2007	December 2007	February 2008	April 2008	June 2008	August 2008
Members	264,611	376,966	465,748	596,685	716,637	785,095

Source: Inland Revenue

Schemes

6.35 The number of schemes is an important measure as this can be an indication of the stability of the market, the effects of competition, substitution, and the effects of consolidation. This includes retail schemes, corporate or industry sponsored schemes, and KiwiSaver schemes. A defining characteristic of the superannuation market prior to KiwiSaver was the decreasing number of corporate sponsored schemes in the market.

6.36 Scheme data is collected by the GA for Superannuation and KiwiSaver schemes. Any scheme that wishes carry out business must be registered under the legislation and approved by the GA.

6.37 The table below shows that the number of registered superannuation schemes has been declining over the past five years.

Table 6.10 – Number of superannuation schemes (calendar year balance dates)

Year	2002	2003	2004	2005	2006	2007
Schemes	727	675	625	590	576	560

Source: Report of the Government Actuary

6.38 After an initial flurry of KiwiSaver scheme registrations during 2007 and the first few months of 2008, the number of schemes has remained steady with only three schemes added in the three months to June 2008. As at September 2008, there are 54 registered schemes, including both retail and privately managed schemes.

Context for Examining KiwiSaver Market Dynamics

6.39 The following section provides context for understanding the market dynamics of the introduction of KiwiSaver.

6.40 The table below compares superannuation fund data and other economic indicators. The table below compares data points not trends, comparing superannuation funds in relation to GDP, net wealth and the value of housing stock as at June 2007.

Table 6.11 – Superannuation Ratio Indicators as at June 2007

		2006	2007	
Superannuation funds	$million	21,034	22,004	▲
GDP	$ million	157,525	166,234	▲
Superannuation / GDP	ratio	13.4	13.2	▼
Net wealth	$ million	586,000	634,000	▲
Superannuation / Net wealth	ratio	3.6	3.5	▼
Housing value	$ million	559,000	614,000	▲
Superannuation / Housing	ratio	3.8	3.6	▼

Source: PwC compilation based on available data.

6.41 Superannuation relative to GDP is an internationally recognised measure. This is a benchmark for comparing New Zealand savings behaviours with overseas expenditure, though it is important to ensure that the definitions of what is covered by international superannuation definitions are consistent. It shows New Zealand superannuation funds were 13 percent of GDP in the base year, June 2007.

6.42 The indicators are the superannuation assets as reported by the MFS, and the standard measure of GDP published quarterly by Statistics NZ as part of its National Accounts data set.

Table 6.12 – Superannuation as a proportion of GDP (June years)

Year	2004	2005	2006	2007
Proportion of GDP (percent)	13.3	13.1	13.4	13.2

Source: RBNZ

6.43 Net wealth is a measure of all types of saving including housing and is produced by the Reserve Bank as part of its Household Financial Assets and Liabilities (HFAL) dataset. It includes assets such as life insurance, managed funds and deposits, as well as liabilities in the form of bank loans and student loans.

Table 6.13 – Superannuation as a proportion of Net Wealth (June years)

Year	2004	2005	2006	2007
Proportion of Net Wealth (percent)	4.1	3.7	3.6	3.5

Source: RBNZ

6.44 New Zealanders, on average[65], have traditionally saved through investing in housing and as at December 2007, private housing represented about 93 percent of the total household wealth in New Zealand. Due to the recent boom in house prices, this is a higher than normal, with the proportion tending to fluctuate around 80 percent in past years. If increases in national savings do occur through KiwiSaver, than investment in housing as a proportion of net wealth should begin to decline below 90 percent and superannuation as a proportion of housing value should increase. Housing value is calculated by Quotable Value and is sourced in the HFAL.

Table 6.14 - Superannuation as a proportion of housing value (June years)

Year	2004	2005	2006	2007
Proportion of housing value (percent)	4.3	3.9	3.8	3.6

Source: RBNZ

6.45 As noted in Chapter 5, 59 percent of members are enrolled in default schemes. Default investment products are required to be conservative. Hence, the level of contributions to these products will influence how KiwiSaver affects the wider financial sector and the long-term returns to investors. For example, the more funds that are invested in conservative default schemes, the less likely it is that KiwiSaver will result in increases in investment in the NZX. Given the current trend of auto-enrolled members subsequently not making an active choice concerning their investment options, having these members automatically enrolled in a conservative product could have a major influence on the development of financial products and how KiwiSaver impacts on the wider financial sector.

[65] Only two-thirds of New Zealanders are home owners, however, with the remainder living in rented accommodation.

Substitution

6.46 Chapter 3 discusses the concept of substitution and its wider implications. One of the key evaluation questions explored with Providers is the extent to which KiwiSaver is simply substituting for existing superannuation products (or what would have been invested in superannuation in the future if KiwiSaver had not been introduced) and/or other wider financial products. Direct substitution effects can be both corporate and private superannuation arrangements.

6.47 Direct substitution can appear in a number of forms, including:

- new products sold to those members making an active choice are KiwiSaver schemes, instead of existing savings schemes;
- contributions to an existing product are redirected to KiwiSaver schemes; and/or
- existing fund balances are transferred to KiwiSaver schemes.

6.48 The three above effects will impact over different timeframes and be influenced in different ways. If the ongoing evaluation records these impacts over time, it will be possible to examine direct substitution effects.

Corporate Superannuation

6.49 For corporate superannuation schemes, market opinion, as expressed by those Providers interviewed, is that KiwiSaver is "another nail in the coffin". Employers who have provided superannuation benefits to staff in the past, have had to review their strategy. The legislation enabling KiwiSaver allows employers to act to prevent "double-dipping" (employees receiving a contribution in the corporate superannuation scheme as well as the compulsory employer contributions payable under KiwiSaver). Some schemes have continued as they were, or moved to operate a KiwiSaver section alongside the existing arrangements. Several schemes have closed to new members or wound up. The Government's own State Sector Retirement Scheme and Teachers Schemes were closed to new members in 2008

6.50 A recent survey of some of New Zealand's largest employers by The Retirement Policy and Research Centre showed that: "88 percent had already (66 percent) or were about to (22 percent) change their superannuation policies as a result of KiwiSaver."[66]

6.51 A number of Providers, who also have corporate superannuation clients were asked about the substitution from corporate schemes. They commented that substitution from corporate schemes is mainly in the form of diversion of future contributions to KiwiSaver schemes. This will mean those schemes will accumulate far less funds in the future. Providers interviewed saw little evidence of lump sum payments into KiwiSaver from schemes that have discontinued. Instead, that money may have ended up in other financial sector products. Employees are unlikely to transfer balances from existing corporate schemes to KiwiSaver, as the funds would no longer be available on resignation from the current job or early retirement.

[66] Retirement Policy & Research Centre (2008).

6.52 The focus on retirement provision has led some employers to set up new schemes which complement KiwiSaver arrangements. For example, savings in the new schemes are locked-in only until resignation, not age 65. Even with these new schemes, in general those Providers interviewed felt the corporate superannuation market is diminishing.

6.53 For a number of financial services organisations, who have traditionally provided superannuation administration services, KiwiSaver has been the impetus to change their offerings. They have discontinued services to stand-alone schemes or complying funds. As the market has diminished, there have been difficulties in attracting and retaining appropriately skilled staff which has been another contributing factor. The beneficiaries of this change have been, in the main, the specialist superannuation administration organisations, who report significant new business in this area.

Retail Superannuation

6.54 Providers who were previously offering retail superannuation products commented in their interviews that there has not yet been any significant cannibalisation of existing business by KiwiSaver. New individual superannuation business, however, has generally been dropped in favour of KiwiSaver. Similarly to corporate superannuation schemes discussed above, there has been an element of redirection of future contributions away from existing products and into KiwiSaver (though not of lump sums).

6.55 Providers of individual superannuation products give us little indication that they were finding this change of concern for their overall business. Instead, those interviewed see it as part of the natural evolution of KiwiSaver as it moves towards becoming the dominant retirement savings vehicle in the New Zealand marketplace. KiwiSaver products generally have lower profit margins than existing Providers' products, due to the requirements for approval from the GA. This is expected to be compensated by the high level of members and high level of funds invested with them in the future.

6.56 The KES (KES, B1) recorded that 61 percent (17 out of 27 responses) of responding Providers had experienced an increase in the overall contributions to their superannuation and managed funds products. Only one respondent reported a decrease in contributions.

6.57 Those Providers interviewed noted that there would still be a role for other retirement savings products in the future. Most Providers agreed that healthy competition in the KiwiSaver market is an important factor for market stability.

Conclusion: the Market Dynamics Component of the Evaluation Framework

6.58 The KiwiSaver supply-side evaluation framework design has considered measures that were practical and workable in the current data environment. Several areas would improve if data gaps were addressed. Measures for these items are essential for future evaluations.

6.59 More generally, existing data could add considerably more value if it were available more frequently. The example set by IR with regard to contribution and membership data appearing monthly shows the value that can be added by frequent monitoring and reporting. Credit should be attributed to the Reserve Bank for the development of the quarterly Managed Funds Survey and the detail it provides. The addition of KiwiSaver to this survey will prove a valuable augmentation.

7 Conclusions and Recommendations

7.1 This section draws together key conclusions from Chapters 1 to 6. Recommendations for consideration by the Evaluation Steering Group are linked to the conclusions. The recommendations are listed on their own at the end of this Chapter.

Conclusions

7.2 The numbers of Providers of KiwiSaver products, membership and the size of contributions have all been higher than the government's initial projections[67]. KiwiSaver schemes have attracted new members and for some Providers it has reversed the decline in their overall active membership base of retirement savings schemes.

7.3 Providers, working through IR as a clearing house, have generally handled the extra uptake well. According to the survey carried out as a part of this evaluation, over 91 percent of Providers expect their KiwiSaver product to be profitable in the next ten years (KES, C9).

7.4 Based on the KES and Provider interviews, the market is working well. It exhibits the key characteristics of a viable industry made up of increasingly efficient Providers, good products for customers with the funds under investment earning market returns, and where there is innovation, growth and consumer choice. The viability of Providers is essential to optimise savings and superannuation investment returns and these factors contribute to economic stability.

7.5 The incentives offered by the government are a feature of KiwiSaver that have motivated the high level of enrolments. Without these incentives, it is likely that there would have been lower (and/or slower) levels of enrolments.

7.6 In the future, the comparison of the default Provider and non-default Providers will provide significant knowledge about some of the dynamics of the KiwiSaver industry. The frameworks developed in the evaluation are designed to increase this knowledge.

7.7 The best frameworks for future monitoring and evaluation are those that generate knowledge by analysing the trends and change variables. For the KiwiSaver supply-side, this includes trends and changes in the assets, membership and investment ratios for each of managed funds, superannuation and KiwiSaver. The recommended evaluation framework also includes some specific measures to monitor KiwiSaver's behaviour and impacts, such as trends in default membership (which indicates changes in risk profiles and investment behaviour).

7.8 Over time, it should be possible to collect and analyse information about KiwiSaver in a manner that is comparable with information collected overseas about savings growth and superannuation funds. An important reason to do this is to be able to learn from overseas experience. International comparison is a further means of benchmarking the success of the KiwiSaver industry.

[67] Budget forecasts initially projected that the number of members would get to the level enrolled for the year-ended June 2008 by 2011.

KiwiSaver Supply-side Evaluation Framework

7.9 The evaluation framework has been designed, based on existing information sources, to provide insights about supply-side performance. The complete framework appears below, combining the features as discussed in Chapters 2, 3, 5 and 6. The framework's two components, firm and market dynamics, include indicators of market and firm dynamics, for examining the baseline, substitution effects and other analyses of KiwiSaver. Used in isolation, even this comprehensive evaluation tool will be unable to answer the over-riding question of whether KiwiSaver has resulted in increased saving. To answer this question, the framework needs to be considered in conjunction with the wider monitoring research and other knowledge development about trends in New Zealand savings, investment, financial literacy and capital markets.

7.10 An important point for future evaluations is isolating the effects of changes in the macro economic environment related to KiwiSaver so that the indicators show its underlying trends as distinct from other trends in the economic cycle. It is recognised that this is a difficult area and at some level would arguably require a full-blown general equilibrium (GE) model to fully isolate and analyse drivers, impacts and outcomes. In the absence of a GE model, both membership and asset growth, for example, will need to be interpreted in light of other factors.

7.11 For example, to analyse trends in KiwiSaver membership, consideration should be given to the numbers entering the labour force and the overall changes in the total labour force population. Asset growth should be considered in light of trends in similar investment vehicles such as managed funds and superannuation where information on cyclical and underlying trends is more likely to be available. Asset growth should also be analysed in terms of changes due to contributions versus investment returns.

7.12 The KiwiSaver evaluation framework has been developed from available data, the Provider interviews and the KES. The knowledge required to answer key questions in relation to the performance of KiwiSaver requires some different information and data from that currently collected[68].

7.13 Evaluation tools to evaluate the impact of the scheme on the supply-side over time can be improved with greater understanding of the factors that influence the Providers as businesses. These factors include external, exogenous factors, as well as factors that impinge directly on the Providers as part of normal competition.

7.14 An example of a major factor that underpins the future stability of the supply-side is certainty about government policy. Providers recognise that change is a fact of doing business. By providing them with advanced knowledge about future changes to the scheme, however, the government shows respect for the operational requirements of running a business and in this way supports the ongoing viability of KiwiSaver Providers.

7.15 An important feature of any evaluation is to be able to analyse data collected over a time period long enough to isolate trends. Given the importance of this aspect of analysis, this evaluation has generated an approach based on information available at this time and recommends that this approach become standardised.

[68] A review of data requirements might also show that new data could replace some that is currently collected. For example, there have been a number of surveys of KiwiSaver Providers and it may be more optimal to combine these into one quarterly survey.

Table 7.1: KiwiSaver Supply-side Evaluation Framework

KIWISAVER SUPPLY-SIDE EVALUATION FRAMEWORK

Firm Dynamics [a]

Aspect	Measure	Source	Period	Schemes	Providers
Competition	Number of Providers with greater than 5 percent of market share	PwC [b]	As at June 08		7
Consumer choice	Number of retail schemes and Providers	GA register	As at June 08	36	31
Innovation	Number of new schemes / new Providers	GA register	June 08 year	25	11
Profitability	Providers expecting profitability	Survey [c]	As at June 08		91%
Return on investment	Number of Providers with payback periods of less than 8 years [d]	Survey [c]	As at June 08		91%
Consolidation	Number of schemes and Providers	GA register	As at June 08	54	31
Market entry	Number of new companies offering publicly available KiwiSaver schemes[e]	GA register	June 08 year		11

[a] The table above is designed to apply available data. In many cases, individual fund data may be more useful than scheme or Provider data, however, it was not available at the time of this evaluation.
[b] This measure was estimated by PwC within the time period of this evaluation. It can be calculated by the GA in future periods.
[c] KES – KiwiSaver Evaluation Survey.
[d] Future evaluations may wish to adopt other measures if appropriate data becomes available.
[e] The relationship between schemes, promoters and Providers is still evolving and future evaluations may measure schemes.

Market Dynamic Indicators as at 30 June 2007 and 2008

		Managed Funds			Superannuation			KiwiSaver		
		2007	2008	[a]	2007	2008	[a]	2007	2008	[a]
Assets [b]	$m	66,505	60,223	▼	22,004	21,056	▼	bK	1,087	▶
NZ Investment [b]	percent	57	59	▲	44	43	▼	bK	61 [d]	▶
NZ equities [b]	percent	15	11	▼	13	9	▼	bK	21 [d]	▶
Membership	number	NA	NA		635,297 [c]	tbp	▼	bK	716,637 [e]	▶
Schemes	number	NA	NA		560 [c]	tbp	▼	29 [f]	54 [f]	▲

NA=data not available; tbp=data to be provided; bK=before KiwiSaver

[a] The arrows indicate the direction of change for the corresponding variable from the previous period to the latest period. A green up arrow corresponds to an increase, a red down arrow corresponds to a decrease and an orange right-pointing arrow indicates no change.
[b] Sourced from the Managed Funds Survey, June 2008 quarter.
[c] Sourced from the Report of the Government Actuary for the year ended 30 June 2008, with the addition of the Government Superannuation Fund.
[d] Estimates supplied by Statistics NZ as part of the joint RBNZ and Statistics NZ Managed Funds Survey (31 March 2008 figures were available at the time of this evaluation).
[e] Supplied by Inland Revenue.
[f] Sourced from the KiwiSaver Schemes Register maintained by the Government Actuary as at September 2008.

Recommendation 1: Adopt the evaluation framework

Adopt the evaluation framework developed in the report for the ongoing evaluation and monitoring of the KiwiSaver supply-side.

7.16 Based on information sources available as at September 2008, the evaluation framework has been developed with a base point providing a snap shot of retirement savings prior to the introduction of KiwiSaver. The baseline adopted, given the short timeframe since KiwiSaver was introduced and the evaluation of knowledge about new retirement savings behaviour, is the change in retirement savings between 30 June 2007 and 30 June 2008 with the introduction of KiwiSaver.

7.17 The base point for this evaluation is 30 June 2007. As at 30 June 2007:

- superannuation funds were valued at $22,004 million;
- superannuation funds were equal to 13.2 percent of GDP;
- total number of superannuation schemes was 560;
- total number of active superannuation members was 635,297;
- total value of funds under management was $66,505 million; and
- 13 percent of these funds were invested in New Zealand equities.

7.18 The baseline for this evaluation relates to changes since KiwiSaver was introduced.

Recommendation 2: Adopt the baseline

That the level of managed funds as at 30 June 2007 be adopted as the base point for the indicators to measure changes to the supply since the implementation of KiwiSaver on 1 July 2007. As at 30 June 2007:

a) superannuation funds were valued at $22,004 million;

b) the total number of superannuation schemes (as governed under the Superannuation Act) was 560;

c) the total number of active superannuation members was 635,297, as reported by the GA;

d) superannuation funds were equal to 13.2 percent of GDP;

e) the total value of managed funds under management, including superannuation was $66,505 million; and

f) 57 percent of total funds under management were invested in New Zealand and 15 percent in New Zealand equities.

7.19 Both monitoring and evaluation is required to inform policy about the KiwiSaver industry. The impact of KiwiSaver on the managed funds and superannuation market and wider financial sector involves consideration of both firm (Chapter 5) and market (Chapter 6) dynamics, the two components for monitoring the industry. It is also important to put in place reporting and monitoring plans, as well as an evaluation plan based on both frameworks over the longer-term.

7.20 The baseline indicators are selected to reflect the characteristics of the superannuation market and its relationship to the wider managed funds sector prior to the introduction of KiwiSaver. June 30 2007 has been selected as the snap shot date for the baseline as KiwiSaver was introduced on July 1 2007. As quarterly data will enable more timely analysis over time, the framework is based on quarterly data where it is available. Measures relating directly to KiwiSaver are zero on this date and are tracked over the year ending June 30 2008.

7.21 Going forward, the evaluation framework would generate more powerful knowledge if it was expanded to include:

- an agreed framework for the communication and comparison of fees and investment returns;
- a description of the motivations that led to enrolment choices, including passive enrolment; and
- further indicators of the efficiency impact of KiwiSaver on Providers.

7.22 The framework, for the purpose of the KiwiSaver supply-side evaluation, has been based on the following assumptions.

- The MED leads a centrally-coordinated process which to enhance the monitoring and development of the KiwiSaver industry.
- The GA continues to collect and collate annual scheme returns, with timeliness improving as Providers become able to file completed returns immediately after the end of the March year.
- The data collection and publishing carried out in relation to KiwiSaver by the GA, IR, RBNZ and Statistics NZ will continue, with timeliness and coverage improving over time.
- The IR continues to maintain/report the monthly statistics of contributions received from employers and employees.
- The RBNZ continues the Managed Funds Survey, including KiwiSaver as a separate category, and works with Statistics NZ to improve the accuracy of estimates and reduce the time between the date the information is published and the date to which it corresponds.
- The MED quarterly reporting in regard to the default Providers be deepened to include analysis of the trends which have greater granularity because of the collection of quarterly data, integrated with other sources of information to add depth to the analysis.
- The establishment of an annual survey, based on the KES conducted for this evaluation, will be established, noting that there are several surveys that have

been conducted since KiwiSaver was introduced and that there may be value in combining these.

- The Treasury and IR modelling of KiwiSaver trends for government budgeting purposes will be further developed as greater knowledge emerges about the factors driving KiwiSaver decisions, membership and funds saved.

- There will be further information collected and dialogue on sector performance, possibly through an association representing KiwiSaver Providers;

<u>Recommendation 3: Increase the quality and effective use of KiwiSaver data</u>

Assess existing data collection and reporting arrangements, identifying any gaps and opportunities for improvements to ensure the quality and effective use of information particularly:

a) evaluation to inform policy, and

b) contractual and compliance monitoring.

Based on the above, take a recommendation to Ministers to clarify access and confidentiality requirements for information held by the relevant government agencies.

7.23 Industry development relies on information about the future to make sensible investment decisions and in this regard, the KES has been designed to generate information directly from Providers about the immediate and future state of their industry. Because of the value of this knowledge, it is recommended that the KES become embedded in the evaluation programme. Consideration should be given to the making Provider response mandatory as KES is designed to be a quick opinion-based survey.

<u>Recommendation 4: Implement the KiwiSaver Evaluation Survey</u>

Subject to the outcome of Recommendation 3, MED facilitates the continuation of the KiwiSaver Evaluation Survey of providers on an annual basis in July each year and considers the benefit of carrying out the survey at more frequent intervals in the future to monitor the savings industry confidence. Note that the survey design should:

a) look to address information gaps identified in Recommendation 3;

b) be relevant and simple and accessible on the internet with analysis of individual results kept confidential and only aggregate results published;

c) consider whether supplying evaluation information, particularly participation in the survey, should be a requirement to obtaining a Scheme Provider Agreement with IR; and

d) only collect additional data where it enhances knowledge about improving KiwiSaver results, in this case, increasing the additional amount of individual savings each year and the return on that savings when invested.

Inland Revenue's Role

7.24 IR plays a pivotal role in the transmission of the KiwiSaver contributions. It played a unique role during KiwiSaver's implementation within a non-tax environment and did so successfully. Providers appreciated IR's collaborative approach and would like to continue the partnership. The collaborative approach has contributed to the stability and success of the KiwiSaver product so far.

7.25 The key roles for IR include:

- clearing house, collecting contributions from employers and moving money through the pipeline quickly, reducing the transaction costs for Providers.
- monitoring and the provision of information (monthly); and
- working with industry on the implementation of ongoing developments.

Recommendation 5: Role of Inland Revenue

IR continues its monitoring, clearing house and member registration role. IR and Treasury continue to work together to use IR analysis to enhance the government's budget forecasts of KiwiSaver trends.

Performance to Date of KiwiSaver Providers

7.26 The sections below discuss the conclusions using the firm dynamics of evaluations. These conclusions are based on the discussion in Chapter 5.

Competitive behaviour

7.27 KiwiSaver has attracted a number of new organisations into the provision of retirement savings products, in addition to the majority of existing organisations. This is an important achievement for the New Zealand market and evidence of a competitive market.

7.28 The number of KiwiSaver Providers, including both traditional retirement savings providers and new entrants to the industry, currently ensures that there is a competitive market. To date, a large retail base, both of customers and bricks and mortar presence, has also been an advantage. Those organisations with default Provider status, have a further advantage in terms of receiving auto-enrolled membership, but there are six default Providers competing for members.

7.29 A number of smaller niche Providers seek to differentiate themselves by distribution method, service and investment returns, to attract existing and new clients. The existence of niche Providers and the emergence of 'single sector funds' within more traditional schemes is also a very healthy sign that there is choice and competition within the KiwiSaver market. According to the report of the GA, targeted single sector funds across all providers represent 5.6 percent of all funds under management.

Consumer choice

7.30 Consumer choice was evaluated from the perspective of product offerings. Some Providers interviewed noted that they could see their portfolios evolving over time based on the choices that their customers are making. Understand what is driving the actual choices made by members is outside the scope of this project as a member survey would be required.

7.31 Where competition is present, consumer choice is likely to follow. This will be reflected in the KiwiSaver market as profitability is driven by membership and funds under management and the existing Providers are competing to increase both. Choice can be seen in the forms of competition discussed above. Greater choice will allow members to be better match their preferences to products being offered.

Innovation

7.32 Another attribute of an efficient industry is one where innovation is continuous over time. Competition (whether it is a threat or actual) can be a factor motivating existing businesses to become efficient as quickly as possible, aspiring to a level of profitability that allows investment in new developments and other service innovations, thus benefiting KiwiSaver members. More years of experience and deeper analysis is required to be informed about the degree of innovation in the market.

7.33 As noted above, there are many investment funds available within the 36 public KiwiSaver schemes and these currently offer many investment choices. Holm's research has found that Providers' current offerings include:

- ethical funds or similar;
- property-only funds;
- options funds;
- capital protected funds; and
- funds where risk is adjusted by age.

7.34 There are a number of Providers that have a unique investment philosophy with only one investment fund and they differentiate themselves on this basis (including some who have an express aim to focus on customer service as part of a package where investment return is only a part).

7.35 Other Providers have a large range of funds. Some providers allow customers to invest in more than one fund at once, i.e. to split contributions between several funds. Several providers offer a "lifesteps" fund, where the risk profile is automatically changed according to the age of the member.

7.36 In addition to investment, the other ways that Providers have been innovating include:

- distribution methods;
- administration systems;
- strategic alliances;
- customer service, for example, internet banking type facilities; and
- employer relationships.

7.37 The fund types offered by Providers are very similar to those for non-KiwiSaver superannuation schemes.

Profitability

7.38 Efficiency and competition from the Providers' perspectives can be examined with reference to the theory of the firm and the drive for profit maximisation. Providers will look to expand both their customer base and funds under management to improve profitability.

7.39 Many Providers had substantial implementation costs which will take a long time to recoup.

7.40 Fees are the main source of revenue for the KiwiSaver businesses. There is further discussion about these from other perspectives in Chapter 4. The level of the fees needs to reflect a combination of what is acceptable in the market place and the point where the business needs to break even in order to maintain viability.

7.41 KiwiSaver Provider fees are constrained by competition and legislation. Based on the interviews, for many Providers, the fees received in the first year of KiwiSaver, are unlikely to match costs.

7.42 Business decisions are dependent on setting fees to match the pace of growth and level of membership numbers and costs associated with the pace of growth, size of FUM and the possible costs of savers switching between Providers, schemes and funds.

7.43 Consequently, profitability will be dependent on the future experience of the scheme. Given KiwiSaver is only one year into operation, it is premature to reach a conclusion about the likely future growth in members and contributions. The KES question about future expectations found 91 percent of respondents expect to be profitable in the next 10 years and 95 percent expect to have achieved break even and above (KES, C9).

7.44 Each Provider's experience is different in regard to fees and costs. As earlier Chapters have discussed, the evaluation has found a range in the key influences on the level of fees and costs. For example, some Providers have experienced stronger than anticipated membership growth and hence higher than anticipated revenues from fees. On the other hand, there are Providers who experienced unexpectedly high costs, for example, from setting up new IT systems. Some have experienced both high enrolments and high costs. Those who had efficient operations in place and who experienced strong membership growth will be better placed to become profitable than those with high set up costs and low enrolments.

7.45 Providers interviewed reported that KiwiSaver profit margins are lower than for other products. This and other factors have lengthened the pay back period.

7.46 On the other hand some Providers have gained operational efficiencies or developed innovations which will carry over the other products. It is too early to tell if this will place pressure on fees for those products, but given the efficiency advantages some providers have obtained, some competitive downwards pressure may occur.

7.47 This market dynamic of lower profit margins is likely to be driving the view that there will be consolidation of KiwiSaver providers and schemes as individual providers look to expand their customer base and others look to exit the market. As the rate of growth in new KiwiSaver membership declines, expansion of membership will come increasingly from competitors' membership bases.

7.48 Seventy-four percent of KiwiSaver Providers who responded to the KES reported that overall KiwiSaver compliance costs are higher or considerably higher than that of other similar products (KES, D4).

7.49 The cost of developing staff resources, the extra time imposed on staff and the costs related to systems integration were regarded by the largest number of respondents as higher, or considerably higher, than for other products (KES, D4).

7.50 Like the Providers, government agencies were also on a steep learning curve with the introduction of KiwiSaver.

7.51 The KES reports that 91 percent of Provider's use in-house advisers to determine their investment asset allocation (KES, E3).

7.52 The transparency of the Providers' investment strategies allows informed decision making by the market. The evaluation framework will want to look carefully at the incentives for continual improvement in the way that information about returns is reported to the market.

7.53 An aspect of this is around standards of reporting, standards of oversight, and of investment approach. The evaluation showed that while this is an area for future development, there is value to Providers as businesses for better information.

Return on Investment

7.54 It is important to distinguish two aspects of return on investment when analysing dynamics of KiwiSaver:

- the return to the shareholders of the Provider as a business in its own right; and
- the investment returns to the members on the KiwiSaver contributions invested in funds.

7.55 The evaluation framework related to firm dynamics is concerned with the former.

7.56 A method for analysing the efficiency of KiwiSaver Providers is to look at the return on investment that the shareholders of the Providers will achieve. The return on investment can be compared to other ventures in which the shareholders might invest capital. This is likely to be difficult to evaluate precisely but commonly business investment payback periods are related to their access to debt and equity capital. Debt investment tends to be for shorter terms of 2 to 5 years because this tends to be the length of debt finance available from prudential sources. In broad terms, then, the payback periods of 5 to 8 or more years, as indicated by some KiwiSaver Providers as likely, would be regarded as long by a prudent source of capital. This is further evidence that there is likely to be consolidation in the future and that KiwiSaver implementation has been a significant decision for Providers.

7.57 Given the current state of equity markets, equity is an unlikely source of longer-term finance to KiwiSaver Providers in the short-term. An active and responsive equity market would take into account the expected large number of KiwiSaver enrolments and the impact on future profitability. Expectations of future profitability for Providers that are attractive to potential equity investors include:

- the predictable cash flow from members;
- the ongoing involvement of the government and employers as contributors; and
- the potential for KiwiSaver to attract new customers for Providers other retail financial products.

Consolidation

7.58 The KES and interviews indicated a view that some of the 31 Providers will not attain a profitable level of business. It is likely they will eventually exit from the market and their membership base will be taken over or purchased by another Provider (KES, B3.2).

Market Entry

7.59 Another important aspect to firm dynamics is the ease of entry into the market for new providers. A low cost of entering the market increases the threat to existing Providers that this will occur. The threat of competition helps drive efficiency and innovation by existing providers as efficiency and innovation act as a deterrent to those looking to enter the market and they reduce the chances of losing market share if there are new entrants.

7.60 New entrants could also consider the level of and type of service provision they wish to undertake versus what they might contract out to organisations that are already set up to administer KiwiSaver accounts. Outsourcing the administration could considerably reduce the implementation costs to a new Provider. Any new market entrants are likely to have an existing retail base with the operating framework structured to cope with what is a retail savings product. Other entrants may come through as employer based providers.

7.61 Providers interviewed suggested that another factor that could influence entry of new Providers is the extent to which a new Provider was already set up to provide retail financial products.

Impact of KiwiSaver on the Superannuation Market

7.62 The section below discusses the conclusions from the analysis for the overall economy and aggregate supply of KiwiSaver investment and how it provides content for understanding the efficiency of the market. These conclusions are based on the analysis of the market dynamics component of the evaluation framework as discussed in Chapter 6.

Participation

7.63 The measures show that for the year ended June 2008:

- there was a healthy level of competition and consumer choice with 15 schemes that had asset bases of $10 million or more as at March 2008 and seven providers had more than 5 percent of market share;
- 25 new schemes had been registered in the 2008 June year end with 6 of those additions occurring in the 2008 calendar year;

- more than 90 percent of providers surveyed expected KiwiSaver to be profitable over the next ten years; and
- the overall investment return for all KiwiSaver scheme was -2.1 percent.

Comparison with baseline

7.64 In a dynamic economy, the baseline describes the features of a sector in a way that distinguishes change variables. The ability to do this in the absence of modelling would take time beyond that available for this evaluation. For the purposes of this early stage analysis, a base point was defined.

7.65 The managed funds sector was stagnant prior to the introduction of KiwiSaver. The number of superannuation members had been dropping since 2003 and the value of superannuation funds had been growing below the rate of inflation. Over of the last five years, growth in managed funds has averaged four percent per annum and superannuation, two percent per annum.

7.66 There are a number of possible reasons for growth rates of superannuation assets and membership being on the low side including:

- the greater certainty around the continuing provision of New Zealand Superannuation for over 65 year-olds;
- a decline in employer-provided retirement savings schemes, due to running costs and changing employment patterns;
- substantial government savings in NZSF;
- no incentives, and prior to PIE, tax inefficiency;
- an interest in investment property as a retirement accumulation vehicle; and
- a general lack of understanding of the products and the relative attractiveness of deposits with banks and finance companies.

7.67 It is too early to tell what the impact of KiwiSaver will be on the level of superannuation investments, the level of investment in managed funds overall, or in national savings. A comparison between the base point in 2007 and comparable data (where available) in 2008 does not provide sufficient time series information to make conclusive judgements. Further, the impacts of relatively low levels of investment in KiwiSaver are swamped by the influence of wider economic factors making it difficult to isolate the market impact of KiwiSaver so far. As most KiwiSavers make small, regular contributions, it will take time for the asset pool to build up, and for effects on other aspects of the financial sector to show up conclusively.

7.68 Recent negative returns on funds invested do not appear to have put investors off as evidenced by the continued take-up rate. This may be due to the long-term outlook KiwiSavers are taking, and the enhanced value KiwiSavers have received through the government incentives package. It is important to continue to monitor this with the KES once more information on the returns of KiwiSaver schemes is known.

Substitution Effects

7.69 It is difficult to obtain data sources to isolate substitution effects in regard to other forms of superannuation.

7.70 The best source of information to date is Provider interviews and the KES. Providers interviewed noted that substitution effects related mainly to the redirection of future contributions, and a drop-off in new business sales of personal superannuation products other than KiwiSaver. Substantial transfers of lump sums from other superannuation schemes into KiwiSaver had not occurred. When weighted by FUM of the respondents, the KES found that only 7 percent of superannuation members substituted KS for other superannuation arrangements during the first year (KES, B2.2). There has been a negative impact on corporate sponsored superannuation schemes, with a number closing to new members or winding up.

7.71 It is also too early to identity any correlation between changes in contributions and asset levels between the various asset types that may be due to KiwiSaver. The level of KiwiSavers FUM, while growing rapidly, is still less than 2 percent of total managed funds. This is too low to have changed any other series that might indicate if KiwiSaver is having an impact. KES could be expanded to include further questions to address substitution effects in greater detail when KiwiSaver funds grow to a meaningful size.

Role of MED

Actions to increase the transparency of fees

7.72 When there is a lack of consistency and transparency in fee disclosures, the comparisons and choices between funds make it unnecessarily confusing for investors. There needs to be an agreed methodology for examining and comparing fees and investment returns in a way that informs the public about the real returns on investment, and concentrates on long term performance and risk, rather than short term performance.

7.73 It is important to informed customer choice that comparisons of fees and performance are standardised.

7.74 Fees require transparency the monitoring of fees and investment performance needs to be conducted on a fair, equitable and transparent basis. As recommended by the Retirement Commission, the MED is reviewing the monitoring of fees. This could also be conducted or managed by an industry association, along with the collection of industry statistics. Consideration should be given to initiating the development of an agreed framework for the communication and comparison of fees.

Default Provider Status

7.75 Being selected as a default Provider was seen by those interviewed as an endorsement of their brand. Some non-default Providers questioned the process of granting default status. They noted that the reason behind a set number of default Providers lacked transparency, arguing that consideration should be given to reviewing the process.

7.76 Currently there are 6 default Providers who are able to maintain that status until June 2014 and the negotiated arrangements are set for that period. Consideration could be given to setting up guidelines for default Provider status clearly outlined and predetermined.

7.77 The designation of Default Providers would benefit from a review within the next year or two to consider entry requirements where non-default Providers show evidence of characteristics that match those of default Providers. The Review could consider how there is a seamless process of transition, recognising also the role that fees play in enabling Providers to maintain viability.

7.78 A review of the awarding of default Provider status would address factors such as whether other applications should be considered and the ongoing standards to be met by incumbents and any new applicants.

Assign departmental responsibilities for collection, monitoring and reporting

7.79 To facilitate the quality performance dialogue between stakeholders as well as integrated and effective monitoring and evaluation, there are some specific roles for government agencies.

7.80 The maintenance of the KiwiSaver supply-side evaluation framework requires continual improvement in the identification of relevant indicators, and the reporting and monitoring of them. Based on experience and evidence gained about the effectiveness and timeliness of the information in building knowledge about the sector, existing data sources about the KiwiSaver supply-side can be developed and deepened.

7.81 Addressing the adequacy of publicly available information on the market would assist in building knowledge about KiwiSaver, about savings behaviours and about the conditions required for a stable Provider industry. Features of more effective data on the superannuation industry include:

- readily available data about funds under management;
- continuation of IR data monthly data of new members and new contributions;
- monthly data to monitor the distinction between new growth in funds under management and returns to those funds through the way they have been invested;
- GA annual reporting widened to include data about Providers as businesses;
- default Provider quarterly reporting managed within MED to support the Industry and the firms within it;
- IR member enrolment reporting to be related to other data sources to gain knowledge of how this information can be used to make projections, observe turning points and to better understand the conditions being faced by Providers;
- Statistics NZ SoFIE to be resourced to be further developed and to become a regular statistical series to go on beyond 2013;
- RBNZ to continue to carry out its Managed Funds survey and to link it with other analysis it does of market and business cycle trends;
- the KES to be continued and integrated with these other series; and

- all of the above to be the basis for maintaining the evaluation frameworks developed for this early stage evaluation, underpinning the growth in the KiwiSaver industry into the long-term ensuring that viability of superannuation for savers when they retire.

7.82 MED's mandate for New Zealand industry development should be further defined in regard to the KiwiSaver Industry ensuring that it takes on the role of hearing industry views about progress and problems with the scheme. This includes consideration of:

- Options for consolidating the information requirements of its evaluation role, restricting it to the information required to maintain informed government policy and an informed industry – this means addressing existing data requirements, data gaps, adoption of the KES enhanced by a process of regular communication with Providers about their activities;

- based on this knowledge of the industry, maintaining a consultation role aimed at ensuring Providers' perspectives are considered in future policy development, including their analysis in response to policy changes of perspectives around the time required to achieve changes in operations;

- KiwiSaver reporting requirements (for example, contribution holiday information is provided to both IR and the GA). In such cases, consideration should be given to information being supplied once and that MOUs be agreed between government agencies for sharing such information; and

- given the percentage of Providers interviewed who stated that compliance costs related to information provisions were high[69], consideration should be given to undertake a review of which government agency (or industry body) is best suited to the collection of relevant data, with a particular focus on the reduction of duplication.

Recommendation 6: Regulatory role of MED

MED working, in consultation with the industry, develops a consistent approach to disclosure requirements that is meaningful to the members that is transparent, simple, relevant and timely with low-compliance costs covering:

a) fees;

b) investment returns;

c) the development of best-practice guidelines for registered KiwiSaver schemes, covering in particular, a standardised approach for the disclosure and reporting of fees and investment returns.

[69] According to KES 70 percent of survey respondents consider the compliance costs associated with reporting to government are higher or considerably higher than for other similar products (KES, D40.

Impact on Capital Markets

7.83 Future evaluations need to coordinate with respect to capital market analysis, recognising that currently KiwiSaver is a small player in capital market development. By monitoring the features of KiwiSaver that are believed to inhibit or enhance the development of the long-term investment market in New Zealand, understanding of ways to develop capital markets will be expanded.

Recommendation 7: Savings and capital markets

That consideration be given to coordinating the evaluation with other capital market analysis to monitor the features of KiwiSaver that contribute to the development of the long-term investment market in New Zealand.

7.84 KiwiSaver investments across the whole market are locked in, creating a guaranteed pool of funds available to be invested in the long term. This means the KiwiSaver market, as a whole, is relatively immune to the liquidity issues faced by other investment products. This also opens up the possibility for investment in infrastructure, venture capital, private equity, commercial property or other direct investments.

7.85 The portability of KiwiSaver, however, means that individual Providers have no guarantee that these investments will be with them for the long term. This effect may constrain the nature of each investment manager’s portfolio mix and the development of markets for alternative illiquid assets. The portability feature is positive from the saver’s perspective (and from the perspective of industry efficiency), but may have unintended consequences on capital markets. There are potential ways of mitigating this effect if it is deemed to be important including, for example, introducing a mechanism for directly transferring assets between schemes. If in fact savers began to show patterns of transfers that impact on asset selection, then the MED and Providers could work together to design a more effective portfolio management approach.

7.86 The current trend by New Zealand managed fund and superannuation fund managers is to reduce their holdings of New Zealand equities. This trend is shown in Figure 7.1 and is opposite to the experience in Australia. The Australian compulsory superannuation has led to increased investment in domestic (Australian) equities.

7.87 The declining investment in New Zealand equities is also reflected in the NZSF asset allocation. If this trend in FUM continues with the introduction of KiwiSaver, then the impact of KiwiSaver on the NZ equity market will lag significantly behind the Australian experience. It may be that because Australian superannuation is compulsory and has higher contribution levels, its impact on the Australian equities market has been greater than otherwise (total assets grew to AUS$1.17 trillion, which is greater than Australia’s GDP of AUS$1.04 trillion, for the year ended June 2008).

7.88 Providers interviewed and met at workshops and presentations expressed the view that their responsibility is to maximise the returns to their members. They regard the development of NZ capital markets as outside their role. If NZ markets are offering an attractive return, then fund managers will invest here. Further to some extent the asset allocation is outside of the control of the fund managers. Asset allocation ranges are constrained by the mandate of the fund that members select, so ultimately it is members that drive the level of investment in NZ equities.

7.89 The current balance of investment towards fixed interest will, if it continues, potentially impact on the New Zealand debt market. There is currently a shortage of New Zealand Government stock. This means that the increased demand from KiwiSaver is likely to increase pressure for creation of deeper markets for alternatives. This is likely to be positive for the availability of corporate debt.

Other KiwiSaver Observations

Access to information and literacy

7.90 Providers interviewed indicated that there is concern within the industry that too few investors are seeking advice to contribute to their KiwiSaver decision. As a result, they are ending up in the default funds, which have a very conservative investment mix. Classical investment theory would suggest that many of these people would be better off in the long term if they invested more aggressively. The risk and return of balanced or growth funds is likely to be more appropriate to many as KiwiSaver is a long term investment.

7.91 On the other hand, Providers are concerned that the tight margins in KiwiSaver do not allow much engagement with members in which they would provide investment advice and information to increase their financial literacy. A challenge for the industry will be to find new ways of educating investors.

7.92 Financial advisers have had a different role to play in KiwiSaver enrolments, compared to other forms of investment. Historically, a large proportion of personal superannuation plans have been distributed through trained financial advisers, who assess the client's circumstances, and recommend a suitable investment profile. KiwiSaver has commoditised superannuation into a retail product that can be obtained without any professional financial advice.

7.93 Providers interviewed noted that to date most New Zealanders have not sought personalised advice on KiwiSaver although some Providers still sell mainly or solely through adviser networks. IR data indicate that in more than 36 percent of cases, savers have auto-enrolled, leaving the default Provider allocation process to essentially make the Provider and fund decision for them. This hints at a change to the way advisers will likely operate in the future, although it is not yet clear what that will entail.

7.94 Financial literacy is a shared responsibility of Providers, educators and others: The work of the Retirement Commission to promote financial literacy provides a basis to close gaps in financial literacy and develop ways KiwiSaver Providers would be best equipped to assist. The awarding of default status provides an opportunity to require those awarded to promote financial literacy and products of investor education material.

Recommendation 8:* *Financial literacy

Consideration should be given to actions to:

a) encourage providers to produce retirement savings information for KiwiSaver members, including comprehensive standards for default Providers; and

b) enhance the government work programme, including the process led by the Retirement Commission, to increase levels of financial literacy in New Zealand including establishing realistic milestones and benchmarks for performance.

This would enable individuals to make better informed choices on KiwiSaver membership and the appropriate savings vehicle for their circumstances.

Expectations of Trustees

7.95 Trustees for KiwiSaver schemes have identical responsibilities as under other superannuation schemes. The Trustee role is important because KiwiSaver funds are all invested into Trusts. The mix of independent external and related party trustees varies across the 31 Providers.

Industry Association

7.96 An industry association focused on KiwiSaver has the potential to speak for the industry and oversee industry standards: Consideration should be given to the specific features of such an organisation and whether it is MED's role to invite its establishment.

7.97 An existing association, such as ISI or ASPONZ, could fulfil or complement this role.

7.98 The industry association could also work with Government agencies on the issue of financial literacy, partnering with the Retirement Commission, the MOE and MED. This group would share responsibility for developing financial literacy with an industry overview, an investment perspective, an education perspective and a consumer perspective.

Mortgage diversion policy

7.99 Mortgage diversion was one aspect of KiwiSaver where the interviewed Providers raised questions about design, applicability, costs, and timing of the diversion of regular contributions from the Provider into mortgages.

7.100 Specific issues raised by Providers about mortgage diversion during the interviews include:

- money being unitised in providers' systems when it is being paid straight out, again creating unnecessary processing and tax implications;
- mortgage payments changing with interest rates and needing to be updated;
- timing of payments, as contributions are received irregularly from the IR, dependent on employer returning times and IR processing times; and

- time spent answering queries and chasing payments on funds which the Provider is not earning any investment income

<u>Recommendation 9: Other actions related to the KiwiSaver supply-side</u>

Agree an interagency plan to:

- establish a explicit and transparent performance framework for incumbent and new default Providers prior to 2014;
- maintain a regular forum with all providers with participation by the government agencies involved in KiwiSaver; and
- re-examine the mortgage diversion policy on the basis of cost benefit analysis.

KiwiSaver Providers' Key Risk: Cost of Changed Government Policy

7.101 The announcements of further changes in the May 2007 Budget (KS2) were not expected, placing further strain as Providers prepared for the commencement of the KiwiSaver scheme on 1 July 2007, with the first contributions to Providers through IR in October 2007.

7.102 The default Providers had already had their fees agreed (and set for 3 years) through their KiwiSaver default Provider Notice and other Providers and schemes had their fees assessed by the GA.

7.103 There will always be costs associated with the introduction of a new product such as KiwiSaver, these costs will however vary depending on how it is developed, implemented and the time in which the changes will occur. With KS2, there were significant challenges in regards to time available to implement the new requirements which drove up costs. If there are to be further changes, Providers need to be consulted on both the substance and timing of the changes.

7.104 The 14 Providers interviewed said that they would benefit from a period for KiwiSaver to be bedded down, free of operational changes. KES results indicated that 60% of respondents believed that changes to government policy would play a major part in determining the size and shape of the superannuation industry over the next 3 years (KES, B3.1). 18 of the 27 KES respondents saw government intervention as the key risk to the stability of the KiwiSaver market (KES, C10). Those interviewed suggested that future changes could be better managed if they were given the time and opportunity for consultation and planning.

7.105 There was also concern around potential changes to the existing incentives built into KiwiSaver and the existing taxation rates such as those for PIEs. The evidence suggests that these factors played an important part in the greater than expected uptake of KiwiSaver and any future changes is likely to have a similar response.

Recommendation 10: Address risks of Government policy change to Provider operations

Consultation with the sector to develop a set of guidelines to manage future changes to the KiwiSaver scheme. This is to ensure that Providers are involved so that workable, cost-effective, timely solutions are found in advance of new policy introduction.

Recommendations for Evaluation Steering Group

Table 7.2 - Recommendations

Evaluation Framework: KiwiSaver Provider Firm and Market Dynamics	
Recommendation 1: Adopt the evaluation framework	Adopt the evaluation framework developed in the report for the ongoing evaluation and monitoring of the KiwiSaver supply-side.
Recommendation 2: Adopt the base point and the baseline	That the level of managed funds as at 30 June 2007 be adopted as the base point for the indicators to measure changes to the supply since the implementation of KiwiSaver on 1 July 2007. As at 30 June 2007: a) superannuation funds were valued at $22,004 million; b) the total number of superannuation schemes (as governed under the Superannuation Act) was 560; c) the total number of active superannuation members was 635,297; d) superannuation funds were equal to 13.2 percent of GDP; e) the total value of superannuation, including funds under management, was $66,505 million; and f) 57 percent of total managed funds were invested in New Zealand and 15 percent in New Zealand equities.
Recommendation 3: Increase the quality and effective use of KiwiSaver data collected	Assess existing data collection and reporting arrangements, identifying any gaps and opportunities for improvements to ensure the quality and effective use of information particularly: a) evaluation to inform policy; and b) contractual and compliance monitoring. Based on the above, take a recommendation to Ministers to clarify access and confidentiality requirements for information held by the relevant government agencies.
Recommendation 4: Implement the KiwiSaver Evaluation Survey	Subject to the outcome of Recommendation 3, MED facilitates the continuation of the KiwiSaver Evaluation Survey of providers on an annual basis in July each year and considers the benefit of carrying out the survey at more frequent intervals in the future to monitor the savings industry confidence. Note that the survey design should: a) look to address information gaps identified in Recommendation 3; b) be relevant and simple and accessible on the internet with analysis of individual results kept confidential and only aggregate results published; c) consider whether supplying evaluation information, particularly participation in the survey, should be a requirement to obtaining a Scheme Provider Agreement with IR; and d) only collect additional data where it enhances knowledge about improving KiwiSaver results, in this case, increasing the additional amount of individual savings each year and the return on that savings when invested.

Government Agencies Role Re KiwiSaver Supply-side	
Recommendation 5: Role of IR and Treasury	IR continues its monitoring, clearing house and member registration role. IR and Treasury continue to work together to use IR analysis to enhance the government's budget forecasts of KiwiSaver trends.
Recommendation 6: Role of MED	MED working, in consultation with the industry, develops a consistent approach to disclosure requirements that is meaningful to the members that is transparent, simple, relevant and timely with low-compliance costs covering: a) fees; b) investment returns; and c) the development of best-practice guidelines for registered KiwiSaver schemes, covering in particular, a standardised approach for the disclosure and reporting of fees and investment returns.

Evaluation of KiwiSaver Features	
Recommendation 7: Savings and capital markets	That consideration be given to coordinating the evaluation with other capital market analysis to monitor the features of KiwiSaver that contribute to the development of the long-term investment market in New Zealand.
Recommendation 8: Financial literacy	Consideration should be given to actions to: a) encourage providers to produce retirement savings information for KiwiSaver members, including comprehensive standards for default Providers; and b) enhance the government work programme, including the process led by the Retirement Commission, to increase levels of financial literacy in New Zealand including establishing realistic milestones and benchmarks for performance. This would enable individuals to make better informed choices on KiwiSaver membership and the appropriate savings vehicle for their circumstances.
Recommendation 9: Other actions related to the KiwiSaver supply-side	Agree an interagency plan to: a) establish a explicit and transparent performance framework for incumbent and new default Providers prior to 2014; b) maintain a regular forum with all providers with participation by the government agencies involved in KiwiSaver; and c) re-examine the mortgage diversion policy on the basis of cost benefit analysis.

<table>
<tr><th colspan="2">Managing KiwiSaver Providers Key Risk: Government Intervention</th></tr>
<tr><td>Recommendation 10:
Address risks of government policy change to Provider operations</td><td>Carry out consultation with the sector to develop a set of guidelines to manage future changes to the KiwiSaver scheme. This is to ensure that Providers are involved so that workable, cost-effective, timely solutions are found in advance of new policy introduction.</td></tr>
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Appendix A KiwiSaver Evaluation Survey 2008

Introduction

As part of the KiwiSaver supply-side evaluation, 31 Providers were surveyed. This section provides the aggregated responses to the PricewaterhouseCoopers survey of KiwiSaver providers. The survey was designed to gain an understanding of the impact of KiwiSaver on providers over the first year of KiwiSaver. Also, the survey has the potential to contribute information that could be used to define the baseline in addition to information currently collected by the Government Actuary (GA), Inland Revenue (IR), the Retirement Commissioner, the RBNZ Quarterly Managed Funds Survey and the Companies Office.

Both qualitative and quantitative questions were asked. The survey was designed to be completed within a short time with the questions designed to provide information and analysis helpful to the KiwiSaver activities.

Throughout this Evaluation, the survey results are used in two ways:

- firstly, as evidence for the analysis and the conclusions; and
- secondly, as a means of comparison for double checking other information sources and putting them into context.

The survey was broken into six sections:

A. general information;
B. effect on your business (parts one, two, and three);
C. KiwiSaver performance;
D. implementation and compliance costs;
E. contributions received and asset allocation; and
F. further comments.

The 31 Providers represented all the KiwiSaver Providers who had entered into Scheme Provider Agreements (SPA) with the IR as at 31 July 2008. Although a number of these Providers administer more than one KiwiSaver scheme, the questions were, in the main, targeted towards the Provider's experience of implementing KiwiSaver and therefore only needed to be addressed once by each Provider. Using this definition of Provider also ensures consistency with Provider information received from IR.

Responses were received from 27 Providers giving an 87 percent response rate. The 27 Providers who responded covered approximately 86 percent of KiwiSaver members. The survey was open from 4 August to 22 August, 2008.

Responses that were left open, e.g. in the form of *other please specify*, are reported beneath each table with each response listed. The responses to the four open-ended questions (B3.1, C10, E2 and F2) have been summarised to represent the broader themes of the individual responses, with the number of providers expressing this view indicated in brackets.

A number of responses were weighted to reflect the Provider's KiwiSaver membership numbers and/or size of KiwiSaver funds under management (FUM). The weighting of the responses was to ensure that the analysis was not skewed by Providers that currently reflect a small portion of KiwiSaver members and/or total KiwiSaver FUM. The weighted response is based on the total KiwiSaver membership numbers and/or KiwiSaver FUM. Both the weighted and unweighted responses have been provided for comparison.

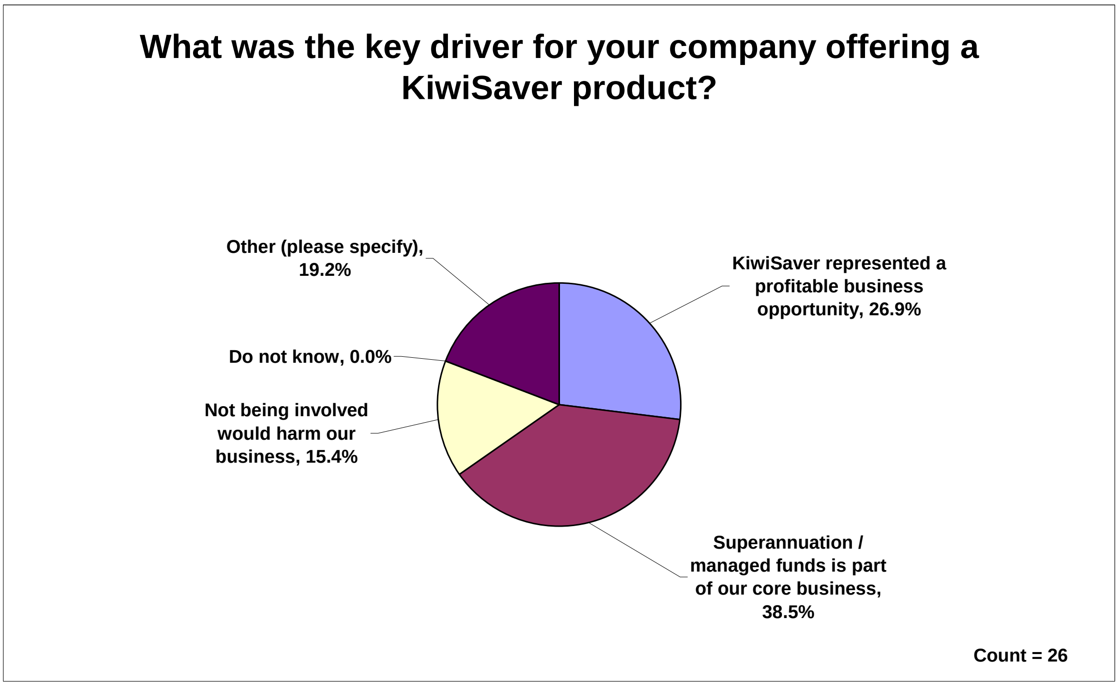
A – General KiwiSaver Provider Information

Question A1

What was the key driver for your company offering a KiwiSaver product?		
Answer Options	**Response Percent**	**Response Count**
KiwiSaver represented a profitable business opportunity	26.9%	7
Superannuation/managed funds is part of our core business	38.5%	10
Not being involved would harm our business	15.4%	4
Do not know	0.0%	0
Other (please specify)	19.2%	5
	answered question	***26***
	skipped question	***1***

Response – *Other (please specify):*

1. The first three points combined. Profitable business opportunity (not at first but will be eventually) superannuation/ funds manager is part of our core business and not being involved would harm our business.
2. KiwiSaver is likely to represent a profitable business opportunity in 5 years.
3. Scheme was initially developed to manage staff KiwiSaver savings. We then widened offer to existing clients and the wider public.
4. Complement employer sponsored superannuation scheme and provide members with improved benefits via Government subsidies.
5. To provide a service to our shareholders' employees.

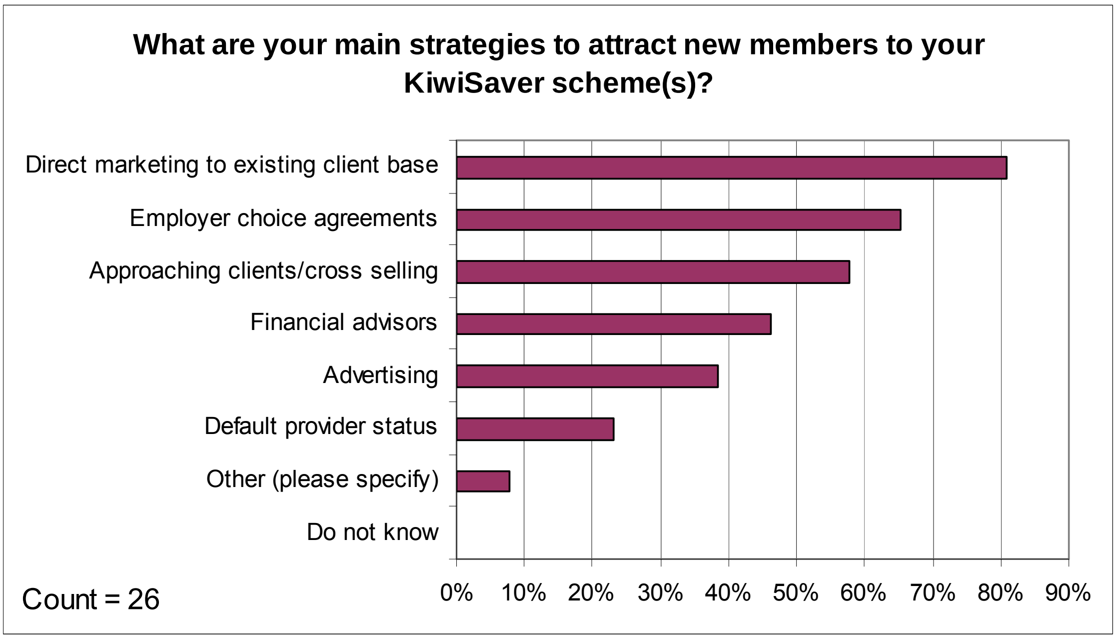


Question A2

What are your main strategies to attract new members to your KiwiSaver scheme(s)? [Tick all that apply]		
Answer Options	**Response Percent**	**Response Count**
Direct marketing to existing client base	81%	21
Employer choice agreements	65%	17
Approaching clients/cross selling	58%	15
Financial advisers	46%	12
Advertising	38%	10
Default Provider status	23%	6
Other (please specify)	8%	2
Do not know	0%	0
	answered question	***26***
	skipped question	***1***

Response – *Other (please specify):*

1. Road shows, press and media.
2. Targeting specific groups, having the best product in terms of quality, value for money and flexibility.

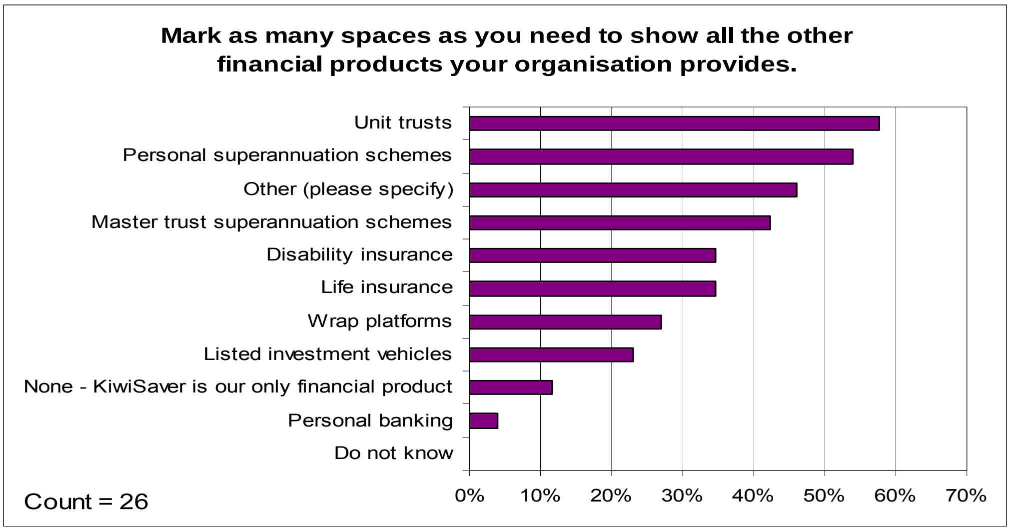


Question A3

Mark as many spaces as you need to show all the other financial products your organisation provides.		
Answer Options	**Response Percent**	**Response Count**
Unit trusts	58%	15
Personal superannuation schemes	54%	14
Other (please specify)	46%	12
Master trust superannuation schemes	42%	11
Life insurance	35%	9
Disability insurance	35%	9
Wrap platforms	27%	7
Listed investment vehicles	23%	6
None - KiwiSaver is our only financial product	12%	3
Personal banking	4%	1
Do not know	0%	0
	answered question	*26*
	skipped question	*1*

Response – *Other (please specify):*

1. Asset management
2. Home loan
3. Management of discrete institutional mandates
4. Employer sponsored superannuation schemes
5. Personal and business general insurance, loans, home loans
6. Stand alone superannuation schemes
7. Trauma cover, personal savings plans, Bonds unitised
8. Housing Loans, Registry, Custody, Trusts and Estate Management
9. Private portfolio management
10. Direct stock broking
11. Death benefit funded out of reserves
12. Medical insurance, employer superannuation, quality investment advice, education, strategic advice.



Question A4

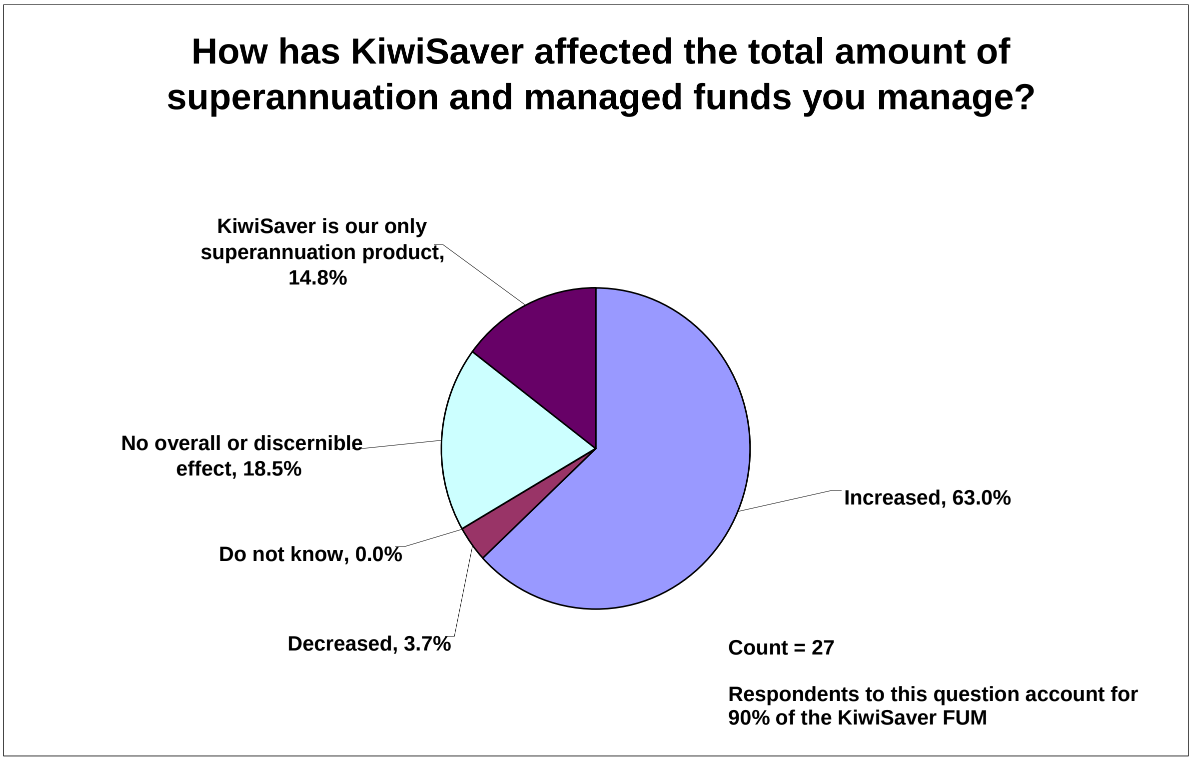
Where applicable please estimate the total value of the assets that you manage and if possible the split between the following categories.		
Answer Options	**Response Total**	**Response Count**
KiwiSaver superannuation	$595,000,000	11
Non-KiwiSaver superannuation	$5,657,000,000	10
Life insurance	$3,399,000,000	4
Unit trusts and other group investment funds	$6,196,000,000	9
Other managed funds	$4,695,000,000	7
Total	$26,092,000,000	14
	answered question	**14**
	skipped question	**12**

Overall, 14 Providers responded to this survey question, of which 12 provided a breakdown across the five categories and two provided a total figure only. Where a Provider did not supply a figure for a particular category they were not included in the response count for that category, this includes one Provider who did not supply a figure for KiwiSaver superannuation but did so for other categories.

B1 – Effect on Your Business – Part One

Question B1.1

How has KiwiSaver affected the total amount of superannuation and managed funds you manage?		
Answer Options	**Response Percent**	**Response Count**
It has increased the overall contributions to our superannuation and managed funds products	63.0%	17
It has decreased overall contributions to our superannuation and managed funds products	3.7%	1
Do not know	0.0%	0
There has been no overall or discernible effect on the contributions to our superannuation and managed funds products	18.5%	5
KiwiSaver is our only superannuation product	14.8%	4
	answered question	*27*
	skipped question	*0*



B2 – Effect on Your Business – Part Two

Question B2.1

Approximately what percentage of your KiwiSaver membership has come from:			
Answer Options	**Response Average**	**Weighted Average***	**Response Count**
Existing clients adding a KiwiSaver product	37.3%	42%	20
Existing clients switching their current business to KiwiSaver	8.4%	2%	20
New clients	42.5%	31%	20
Unknown	11.9%	25%	20
		answered question	***20***
		skipped question	***7***

*Weighted by number of members, based on 18 respondents who represent 80% of KiwiSaver membership as at June 2008.

Question B2.2

Please estimate the percentage of your superannuation membership (from prior to the introduction of KiwiSaver) that has:			
Answer Options	**Response Average**	**Weighted Average***	**Response Count**
Added KiwiSaver to their existing superannuation product(s)	13.2%	23%	18
Substituted KiwiSaver for a Superannuation product	3.4%	7%	18
Remained unchanged	37.1%	12%	18
Been lost to your organisation	1.0%	1%	18
Unknown	45.2%	57%	18
		answered question	***18***
		skipped question	***9***

*Weighted by number of members, based on 17 respondents who represent 80% of KiwiSaver membership as at June 2008.

B3 – Effect on Your Business – Part Three

Question B3.1

What factors will play an important part in determining the size and shape of the superannuation industry over the next three years?	
answered question	*20*
skipped question	*7*

Summary of response (number of responses)

- Changes to government policy regarding KiwiSaver (16)
- Financial literacy/attitude towards investment, investor confidence, service, media influence (9)
- Investment markets/economic conditions (6)
- Consolidation (4)
- Scheme returns (4)
- Transparency of KiwiSaver (3)
- Regulation and governance of industry (2)
- Shift to retail sales (1)
- Trans Tasman portability of funds (1)
- Demographics (1)

Question B3.2

Over the next three years, what do you consider will happen to:

Answer Options	Increase	Remain constant	Decrease	Do not know	Response Count
Number of KiwiSaver Providers	4	4	17	0	25
Number of KiwiSaver schemes	6	5	14	0	25
Total number of corporate superannuation schemes	2	0	23	0	25
Total number of personal superannuation schemes	3	2	18	2	25
				answered question	*25*
				skipped question	*2*

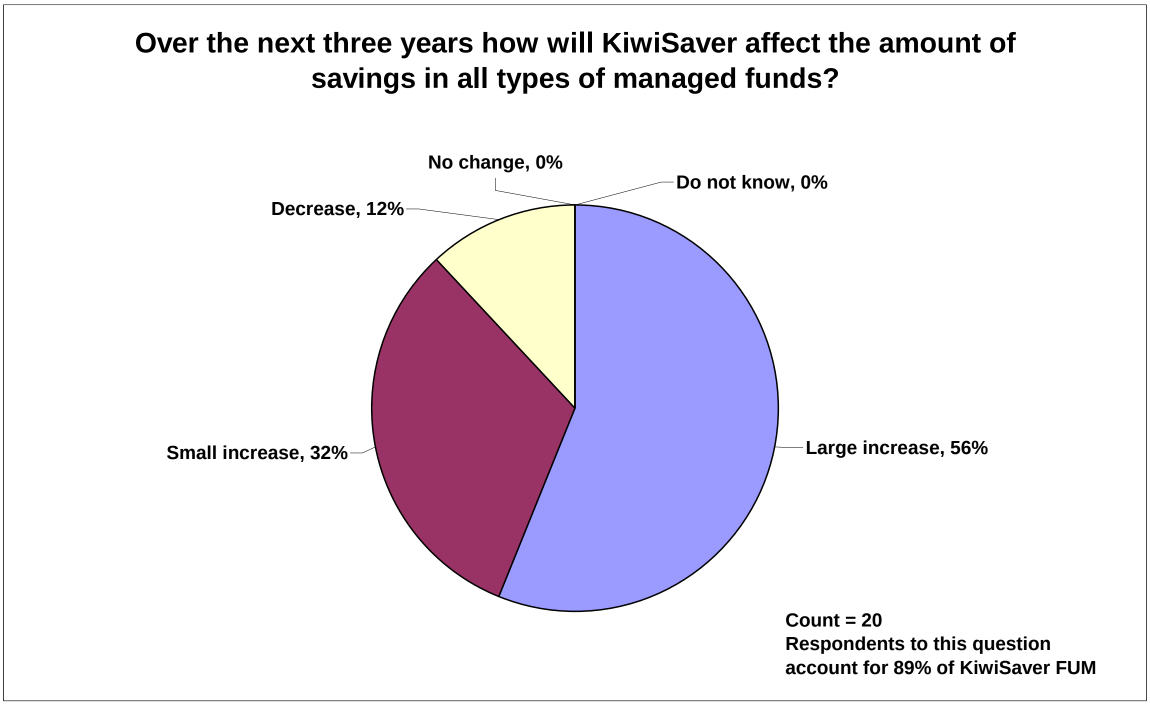
Over the next three years, what do you consider will happen to (weighted response*):				
Answer Options	**Increase**	**Remain constant**	**Decrease**	**Do not know**
Number of KiwiSaver Providers	1%	0%	98%	0%
Number of KiwiSaver schemes	25%	20%	55%	0%
Total number of corporate superannuation schemes	0%	0%	100%	0%
Total number of personal superannuation schemes	1%	10%	82%	6%

*Weighted by estimated FUM, based on 20 respondents who represent 89% of KiwiSaver FUM as at 31 March 2008.

Question B3.3

Over the next three years how will KiwiSaver affect the amount of savings in all types of managed funds?			
Answer Options	**Response Percent**	**Weighted Response Percent***	**Response Count**
There will be a large increase in the level of savings in managed funds	56.0%	63%	14
There will be a small increase in the level of savings in managed funds	32.0%	30%	8
There will no change in the level of savings in managed funds	0.0%	0%	0
There will be a decrease in the level of savings in managed funds	12.0%	7%	3
Do not know	0.0%	0%	0
		answered question	*25*
		skipped question	*2*

*Weighted by estimated FUM, based on 20 respondents who represent 89% of KiwiSaver FUM as at 31 March 2008.



88% of respondents said there would be an increase in savings in all types of managed funds.

C – KiwiSaver Performance

Question C1

Approximately how many members do you have on your registry system as at 30 June 2008?					
Response statistics	**Response Average**	**Lower Quartile**	**Response Median**	**Upper Quartile**	**Response Total**
	27,861	1,094	4,000	22,625	612,945
				answered question	***22***
				skipped question	***5***

Question C2

Could you please estimate the percentage of membership gained from each source?			
Answer Options	**Response Average**	**Weighted Average***	**Response Count**
Active choice	65.8	40%	23
Auto enrolled	19.7	50%	23
Opt in – via employer	14.0	10%	23
Other	0.5	0%	23
		answered question	***23***
		skipped question	***4***

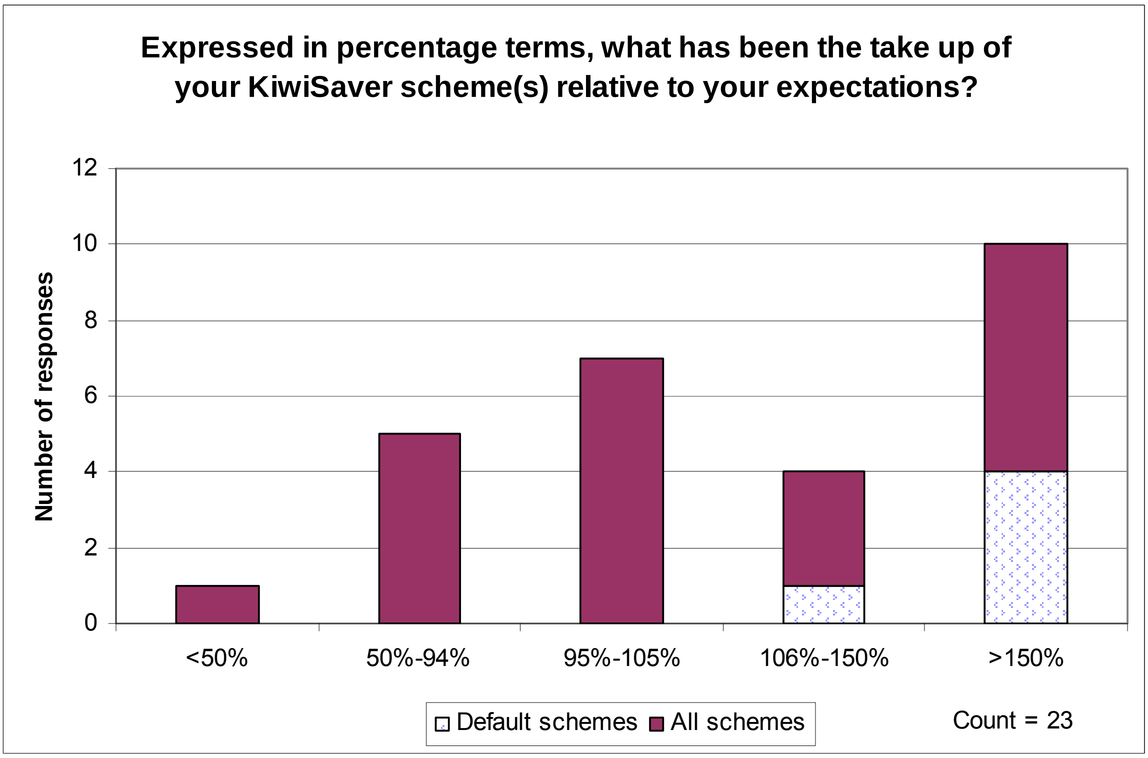
*Weighted by number of members, based on 22 respondents who represent 86% of KiwiSaver membership as at June 2008.

Question C3

Expressed in percentage terms, what has been the take up of your KiwiSaver scheme(s) relative to your expectations? [e.g. 110% = 10% above, 90% = 10% below]		
Answer Options	**Response Average***	**Response Count**
Default scheme percent	143%	5
Other schemes percent	118%	22
answered question		*23*
skipped question		*4*

*Note this is an unweighted average of individual responses and does not represent an estimate of the industry average.

Distribution of individual responses

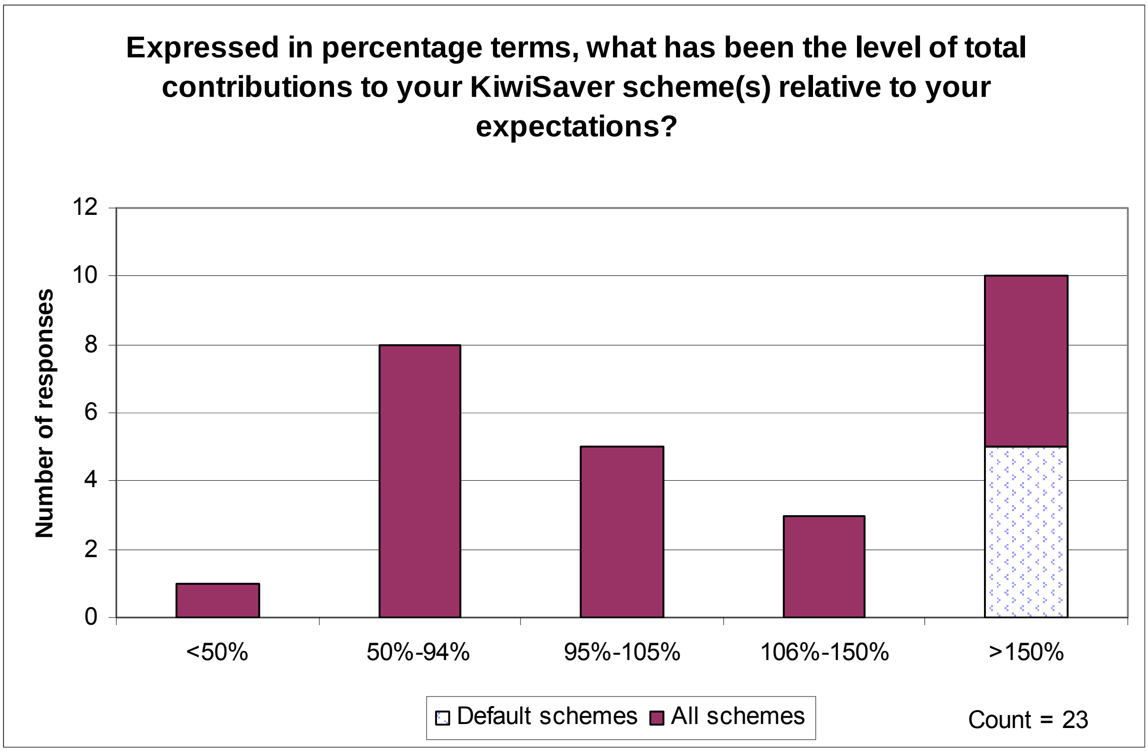


Question C4

Expressed in percentage terms, what has been the level of total contributions to your KiwiSaver scheme(s) relative to your expectations? [e.g. 110% = 10% above, 90% = 10% below]		
Answer Options	**Response Average***	**Response Count**
Default scheme percent	180%	5
Other schemes percent	112%	22
	answered question	*23*
	skipped question	*4*

*Note this is an unweighted average of individual responses and does not represent an estimate of the industry average.

Distribution of individual responses

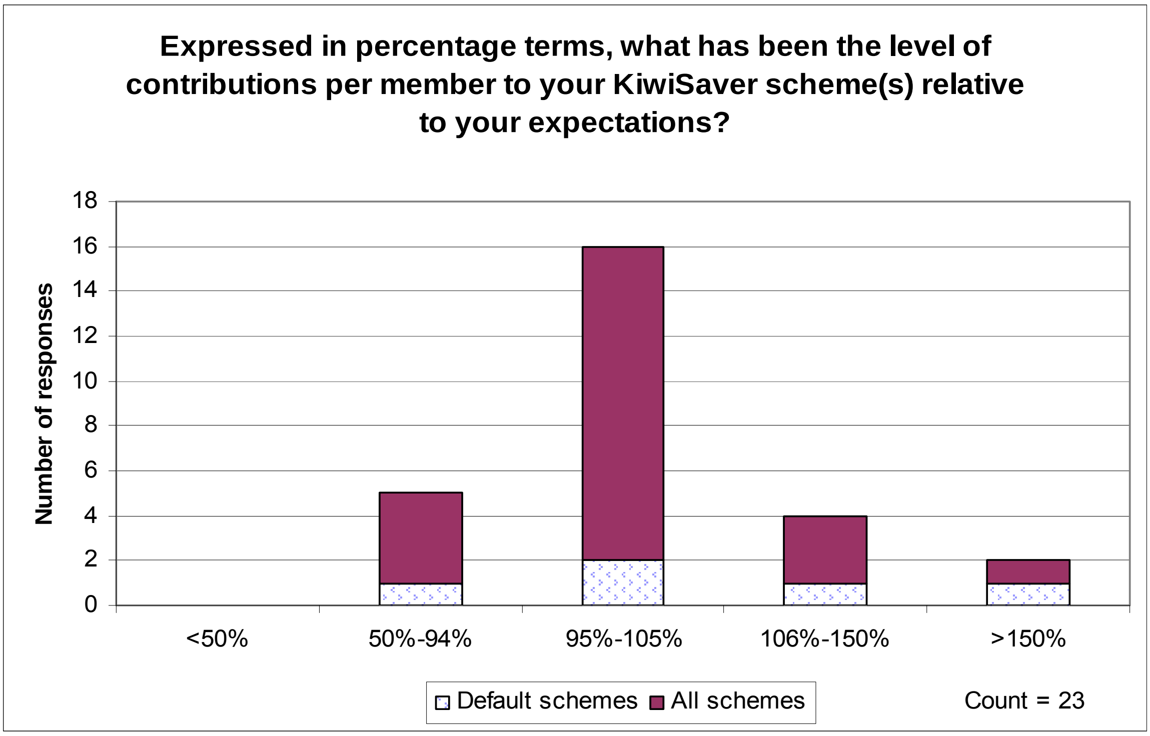


Question C5

Expressed in percentage terms, what has been the level of contributions per member to your KiwiSaver scheme(s) relative to your expectations? [e.g. 110% = 10% above, 90% = 10% below]		
Answer Options	**Response Average***	**Response Count**
Default scheme percent	108%	5
Other schemes percent	98%	22
answered question		*23*
skipped question		*4*

*Note this is an unweighted average of individual responses and does not represent an estimate of the industry average.

Distribution of individual responses



Question C6

Please indicate the importance of the following factors in influencing the profitability of your KiwiSaver scheme(s)?							
Answer Options	**Very important**	**Important**	**Somewhat important**	**Not important**	**Do not know**	**N/A**	**Response Count**
Number of Members	11	10	1	0	0	1	23
Total contribution per member	9	11	0	2	0	1	23
Total funds under management	16	3	2	1	0	1	23
Distribution of members across investment funds	3	2	4	11	0	3	23
Administration costs	7	8	5	2	0	1	23
Opportunities to leverage other parts of our business	1	6	6	8	0	2	23
Position as a default Provider	5	1	0	2	0	15	23
Fee structure constraints	3	5	4	8	0	2	22
Other (please specify)							5
						answered question	*23*
						skipped question	*4*

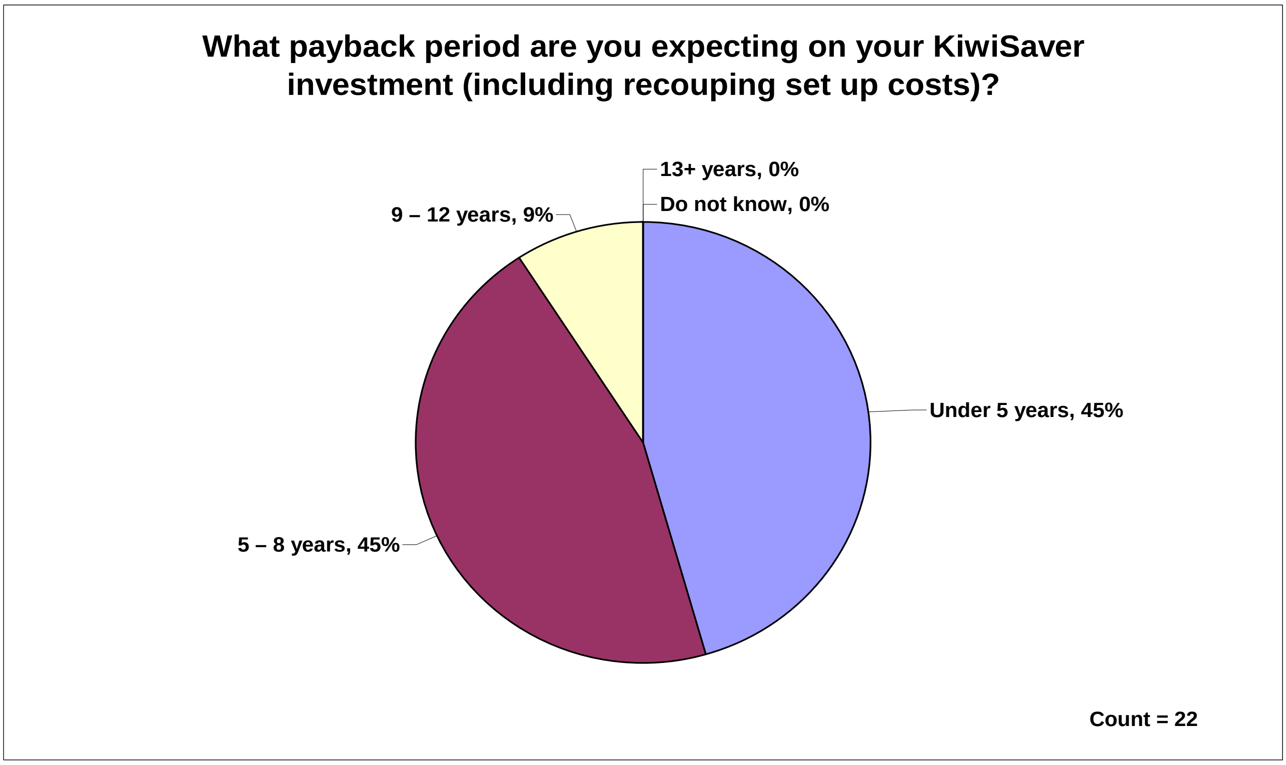
Response - *other (please specify):*

1. Returns are a big influence on profitability for us as we have a performance fee.
2. System Cost from regular processing changes and development. Costs associated with Government changes.
3. Member numbers will become less important over time as FUM grows.
4. We are not providing a KiwiSaver scheme with the objective of profit.
5. Having default Provider status.

Question C7

What payback period are you expecting on your KiwiSaver investment (including recouping set up costs)?		
Answer Options – Total	**Response Percent**	**Response Count**
Under 5 years	45.5%	10
5 – 8 years	45.5%	10
9 – 12 years	9.1%	2
13+ years	0.0%	0
Do not know	0.0%	0
answered question		*22*
skipped question		*5*

Four out of the five default Providers reported a payback period of less than five years.



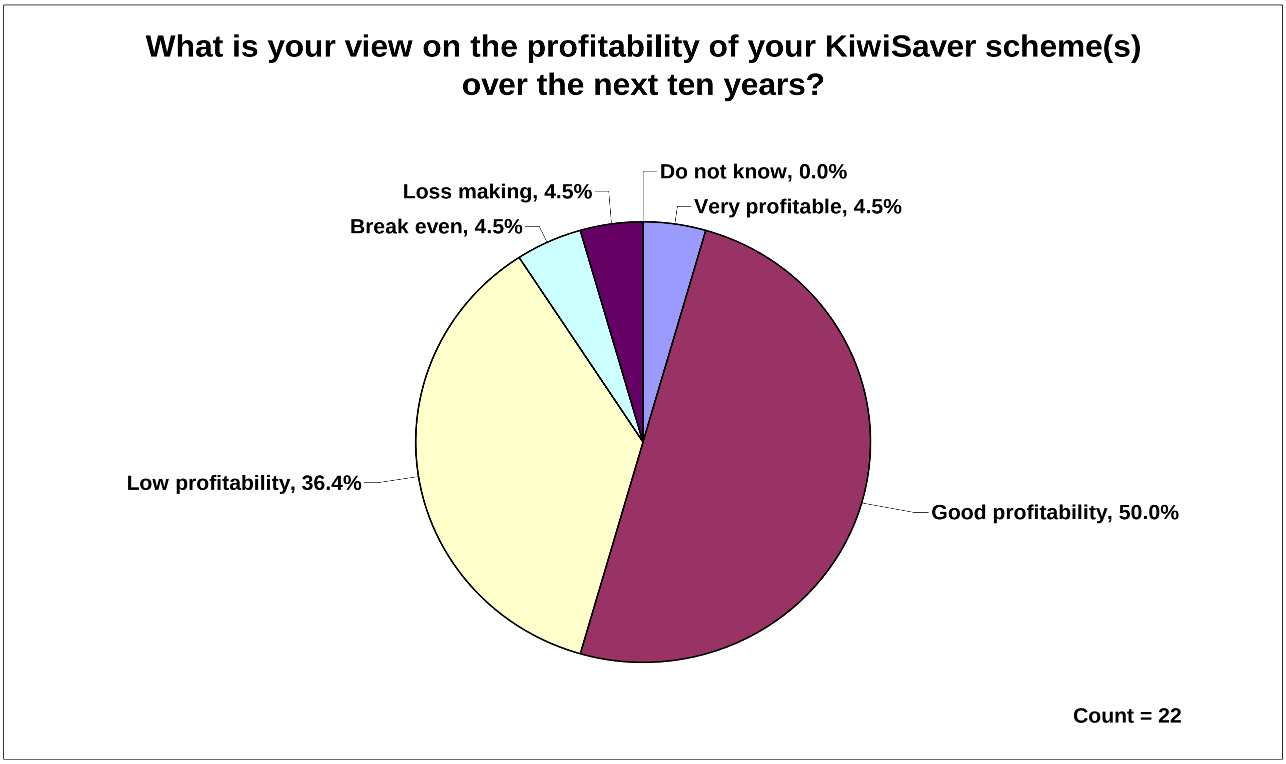
Question C8

In what year do you expect your KiwiSaver scheme(s) to become profitable?					
Answer Options	**Minimum**	**Lower Quartile**	**Response Median**	**Upper Quartile**	**Maximum**
Year	2008	2010	2011	2013	2015
answered question					*20*
skipped question					*7*

Question C9

What is your view on the profitability of your KiwiSaver scheme(s) over the next ten years?		
Answer Options	**Response Percent**	**Response Count**
Very profitable	4.5%	1
Good profitability	50.0%	11
Low profitability	36.4%	8
Break even	4.5%	1
Loss making	4.5%	1
Do not know	0.0%	0
answered question		*22*
skipped question		*5*

91% of 22 respondents believe their KiwiSaver schemes will be profitable over the next ten years.



Question C10

What are the major risks to the stability of the KiwiSaver market going forward?	
answered question	*21*
skipped question	*6*

Summary of response (number of responses)

- Government intervention (18)
- Financial market/economic performance, investor confidence (8)
- GA – unrealistic expectation of fees (2)
- Lack of financial literacy (2)
- Failure to regulate advisers (1)
- Trans Tasman portability of funds (1)
- Process problems between IR and Providers (1)
- Trust/transparency of system (1)
- Discrimination between KiwiSaver member and non-KiwiSaver members by employers (1)
- Major players withdrawing (1)
- Reduction in the number of Providers (1)
- Weight of money could distort the NZX (1)
- Too many options (1)

D – Implementation and Compliance Costs

Question D1

How did the KiwiSaver set up costs compare to the set up costs of similar products, in relation to the following factors? (numbers in brackets indicate the number of default Provider responses)

Answer Options	Considerably higher	Higher	Similar	Lower	Considerably Lower	Do not know	N/A	Response Count
Staff resources	7 (1)	7 (2)	5 (2)	0	0	1	3	23
Software development	8 (2)	2 (1)	6 (2)	1	0	1	5	23
Systems integration	9 (2)	5 (2)	4 (1)	0	0	1	4	23
Marketing	4	5 (2)	7 (3)	2	0	2	3	23
Other influential factors (see below)								10
							answered question	*23*
							skipped question	*4*

Response - *Other influential factors:*

1. Changes in government policies. Lack of experienced Inland Revenue resources
2. Outsourced administration
3. Legal and accounting costs huge
4. Legal costs were a big expense
5. PIE
6. Outsource all back office functions
7. We do not have a similar product to compare set up costs to
8. We outsource the systems development and admin to an external provider. We did not incur set up costs and ongoing admin/registry costs are charged to members through the annual fee.
9. KiwiSaver is our only product, therefore the questions above are not applicable
10. Legislative change. Printing costs were twice budgeted as the government changed the rules 6 weeks prior to 1 July 2007. Also IRD did not have time to define specifications before you had to start developing. The complexity of rules on MTC, ETC etc.

Question D2

Please make an estimate of your KiwiSaver set up costs.

Response statistics	Minimum	Lower Quartile	Response Median	Upper Quartile	Maximum
	$50,000	$250,000	$500,000	$2,000,000	$5,000,000
				answered question	*20*
				skipped question	*7*

Question D3

What percentage of the set up costs relate to PIE?			
Answer Options	**Response Average**	**Response Median**	**Response Count**
Percentage	23%	15%	20
		answered question	***20***
		skipped question	***7***

Question D4

How do the following compliance costs associated with KiwiSaver compare to other similar products? (numbers in brackets indicate the number of default Provider responses)								
	Considerably higher	**Higher**	**Similar**	**Lower**	**Considerably lower**	**Do not know**	**N/A**	
Specific KiwiSaver reporting requirements to government are...	7 (1)	9 (4)	3	1	0	1	2	23
Information disclosure requirements...	2	7 (1)	11 (4)	0	0	1	2	23
Quality assurance requirements...	2	8 (2)	9 (3)	0	0	2	2	23
Overall KiwiSaver compliance costs are...	6	11 (4)	3 (1)	0	0	1	2	23
Feel free to make further comments on the compliance arrangements below.								3
							answered question	***23***
							skipped question	***4***

Response - *Feel free to make further comments on the compliance arrangements below:*

1. The short timeframes for implementation imposed an enormous amount of pressure on scheme providers. The KiwiSaver concept is great but the execution poor and was under resourced by government.
2. We have no similar product to compare KiwiSaver to.
3. Compliance costs are higher because of change and because many officials do not understand the financial services industry and superannuation in particular KiwiSaver is complex with its rules e.g. mortgage diversion.

E – Contributions Received and Asset Allocation

Question E1

Please estimate the total amount of KiwiSaver funds you had received as at:			
Answer Options	Response Average	Response Total*	Response Count
31 March 2008 NZ$	$28,000,000	$476,000,000	17
30 June 2008 NZ$	$42,000,000	$765,000,000	18
		answered question	*18*
		skipped question	*9*

* Refer to Chapter 6 FUM for a comparison.

Question E2

Broadly, what are the investment strategies for your KiwiSaver scheme(s)?	
answered question	*19*
skipped question	*8*

All, except three responses, interpreted this question as *what investment strategies/options do you offer to your members*, rather than *how do you choose these options/asset mix*.

Summary of response (number of responses)

- The scheme invests in small to medium growing companies in NZ, Australia and international markets that have the potential to double their earnings in the next 3-5 years. (1)
- Value based manager, looking for good value in any asset class. (1)
- We take a cautious approach. (1)

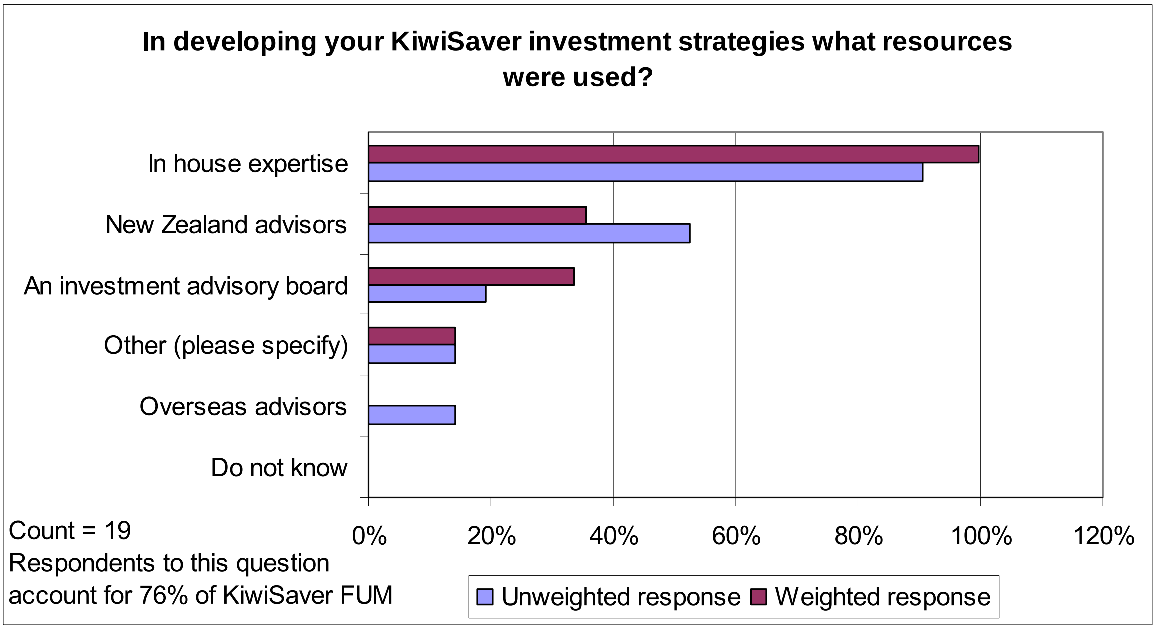
Question E3

In developing your KiwiSaver investment strategies what resources were used? [Tick all that apply]			
Answer Options	**Response Percent**	**Weighted Response Percent***	**Response Count**
In house expertise	90.5%	99.6%	19
New Zealand advisers	52.4%	35.7%	11
Overseas advisers	14.3%	33.6%	3
An investment advisory board	19.0%	14.2%	4
Do not know	0.0%	0.0%	0
Other (please specify)	14.3%	0.0%	3
		answered question	*21*
		skipped question	*6*

*Weighted by estimated FUM, based on 19 respondents who represent 76% of KiwiSaver FUM as at 31 March 2008.

Response - *Other (please specify):*

1. We outsource global investment to leading global managers.
2. Continued with investment strategies in place. These were familiar to existing members.
3. Specific investment management company.



Question E4

What percentage of your members' contributions do you:			
Answer Options	Response Average	Weighted Average*	Response Count
Invest yourself	49.6%	54%	21
Invest through an external funds manager	50.4%	46%	21
		answered question	*21*
		skipped question	*6*

*Weighted by estimated FUM, response based on 19 members who represent 76% of FUM as at 31 March 2008.

Question E5

Could you please estimate your percentage split of assets by portfolio risk profile across all schemes as at 31 March 2008?			
Answer Options	Response Average	Weighted Average*	Response Count
Cash and fixed interest only funds (0% invested in growth assets)	1.8%	2%	18
Low risk profile funds (1% - 29% invested in growth assets)	29.5%	49%	18
Low to medium risk profile funds (30% - 49% invested in growth assets)	8.2%	11%	18
Medium risk profile funds (50 - 60% invested in growth assets)	15.2%	15%	18
Medium to high risk profile funds (61 - 84% invested in growth assets)	19.3%	11%	18
High risk profile KiwiSaver funds (85% - 100% invested in growth assets)	25.9%	12%	18
		answered question	*18*
		skipped question	*9*

*Weighted by estimated FUM, response based on 17 respondents who represent 76% of FUM as at 31 March 2008.

Question E6

What is the split between KiwiSaver funds invested in New Zealand versus overseas as at 31 March 2008?			
Answer Options	Response Average	Weighted Average*	Response Count
Percentage invested in New Zealand	51.4%	46%	17
Percentage invested overseas	48.6%	54%	17
		answered question	*17*
		skipped question	*10*

*Weighted by number of members, response based on 16 respondents who reported 67% of FUM as at 31 March 2008.

Question E7

What is the percentage of KiwiSaver funds invested in the following asset classes in New Zealand as at 31 March 2008?			
Answer Options	**Response Average**	**Weighted Average**	**Response Count**
Cash	31.6%	43%	17
Fixed interest	21.7%	26%	17
Equity	39.3%	24%	17
Property	7.4%	7%	17
		answered question	***17***
		skipped question	***10***

*Weighted by estimated FUM, response based on 16 respondents who represent 67% of FUM as at 31 March 2008.

Question E8

What is the percentage of KiwiSaver funds invested in the following asset classes overseas as at 31 March 2008?			
Answer Options	**Response Average**	**Weighted Average***	**Response Count**
Cash	11.2	6%	17
Fixed interest	26.3	42%	17
Equity	57.9	47%	17
Property	4.6	5%	17
		answered question	***17***
		skipped question	***10***

*Weighted by estimated FUM, responses based on 17 respondents who reported 67% of FUM as at 31 March 2008

F – Further Comments

Question F1

Would you be interested in providing membership, contribution and funds under management statistics for a regular industry wide survey and market share report, similar to that produced by the ISI for insurance products?		
Answer Options	**Response Percent**	**Response Count**
Yes	65.0%	13
No	35.0%	7
	answered question	***20***
	skipped question	***7***

Question F2

Please feel free to make any other comments about the impact of KiwiSaver on the superannuation market overall.	
answered question	8
skipped question	19

Summary of response (number of responses)

- Negative impact on existing superannuation schemes (3), and other FUM (1), government assistance needed to help individuals out of historical superannuation contracts. (1)
- KiwiSaver has increased the awareness of the importance of superannuation savings. (2) Increasing competitiveness amongst providers and providing more alternatives for people to consider. The end result is that the consumer is the winner. (1)
- KiwiSaver will change the way people save but will not increase the level of savings (2), and will increase the risk of the average household. (1)
- KS has put pressure on fees charged by traditional superannuation and fund management providers. (1)
- It is also ushering in some innovation in how peoples' savings are managed. (1)
- Very positive move for NZ and for the NZ residents. There is an aspect (the first home deposit aspect) that is unique and that may be an obstacle in superannuation calculations and savings, but the benefits of providing this facility far exceeds the alternative ... and helps attract the younger workforce. (1)
- Many Providers that do not have expertise have entered the market. Ultimately they will fail and create confusion and a shambles. (1)
- The default Providers have been given property rights and not had to pay a fee for that. They will distort the market. (1)

Appendix B KiwiSaver Provider Interviews

A selection of Providers were interviewed during July and August 2008, after KiwiSaver had been in existence for 12 to 14 months. The purpose of the interviews was to gain a more detailed understanding of the survey questions and responses. The interviews provided the opportunity to discuss a wider range of themes directly with Providers than were covered by the survey. The knowledge gained from the interviews is covered below.

A feature of the interviews is that it was possible to explore key themes from different perspectives, making it possible to make comparisons of the different experiences of non-default and default Providers, of large and small, of those who commonly dealt in the wholesale market with those who dealt in the retail market and so on. This knowledge has contributed to the development of the evaluation approach.

Fourteen Providers were interviewed, including all the default Providers. The interviews were structured around the five key topics covered by the survey. These themes were:

a) general information about the Provider;

b) effect on the Provider's business;

c) KiwiSaver performance;

d) KiwiSaver implementation and compliance costs; and

e) contributions received and asset allocation.

The information conveyed in the interviews varied according to other areas of interest and the roles and responsibilities of the representative(s) of the Provider who attended the interviews. When there was sufficient time, Providers were specifically asked for their views about areas of KiwiSaver that had not been covered by the formal interview questions.

In addition, four other non-government organisations that have a role in KiwiSaver were interviewed.

The interviews enhanced the understanding of key market efficiency issues. It included both qualitative and quantitative responses from those interviewed. Some of the Providers assisted the evaluation and the development of the evaluation framework by sending a confidential copy of the information they returned to the GA. As this evaluation began in July and the GA's report on KiwiSaver was tabled in September, these returns provided a useful means of double checking and supplementing information about KiwiSaver from other sources such as that from IR.

Additional comment and analysis of the Provider interviews is included in Chapter 4 of the report.

The KiwiSaver Industry

Providers said that KiwiSaver:

- Represented a significant boost for an industry that was largely static in terms of growth and whose members were declining.

- KiwiSaver has changed the nature of the distribution of superannuation products in the New Zealand market. Previously these were mainly provided through corporate superannuation schemes and financial advisers. KiwiSaver has seen the "retailisation" of this product, although some smaller players are still dependant on adviser forces.

Efficiency in the KiwiSaver Market

A focus of the interview questions was to understand more about how the Providers responded to attributes of KiwiSaver that were designed to ensure that there would be a market with choice and the conditions that enhance healthy competition.

Competition between KiwiSaver Providers

The GA has oversight of KiwiSaver fees in regards to ensuring that schemes comply with clause 2 of the KiwiSaver scheme rules (which relates to a requirement that fees not be unreasonable). Providers said that this and the fees contracted with the default Providers has meant that the fees relating to KiwiSaver are lower than on other retail products Providers offer. Those Providers who started out with efficient computer and administration systems see themselves as having a definite competitive advantage in the marketplace, particularly over the longer term.

An area of competitive advantage mentioned in several interviews is default Provider status. This has been a significant source of membership, and a number of Providers who do not currently have default Provider status are keen to acquire it in the future and wondered if there was any potential for further tenders and/or an earlier re-tendering date.

The majority of Providers interviewed believed that they had a competitive advantage in a particular aspect of KiwiSaver. The form of the competitive advantage was very diverse, as described briefly below.

- Distribution – for example, Providers who had a large retail customer base, strong adviser relationships and strong relationships with employers. An indication of the diversity is the method of accessing employers, with connections ranging from existing superannuation provider, to advisers and business banking relationships.

- Investment Philosophy – several Providers saw their competitive advantage being a unique approach or philosophy to investment management, in some cases linked to the profile of an individual.

- Administration – several medium sized Providers regarded their efficient administration systems as giving them a significant competitive advantage. Significantly, they were efficient because of good operation, not as a result of economies of scale as may be expected.

Market Entry

A majority of those interviewed also noted entry to the market by new Providers as a possibility. Most Providers, however, were not expecting a significant number of new entrants to the market, as a new Provider would be at a significant disadvantage due to missing out on the initial enrolment unless they were to acquire an existing Portfolio. Several Providers commented that outsourcing of administration had been a successful strategy for reducing the start up costs, and that this would also apply to new entrants to the market.

Recent new entrants to the market indicate that there are not insurmountable barriers to entry, and that KiwiSaver is seen as a worthwhile product offering even after missing out on the windfall of initial members. It is likely that new entrants will already be experienced in the provision of investment products.

Consumer Choice

Providers interviewed regard the range of KiwiSaver schemes in the market as good for the KiwiSavers. They regard that there is sufficient opportunity for entry and exit of schemes to ensure that there is competition supporting the availability of ongoing consumer choices. Several Providers commented that once the initial drive to capture members is completed over the next year or so, then competition on investment returns and other factors will intensify.

Innovation

Several Providers commented that their KiwiSaver products are more advanced in many respects than other products. This has required development of new processes and systems. Some Providers commented that these developments were, or could be, used to enhance other product offerings.

KiwiSaver is a new and innovative approach to long-term savings in the New Zealand market. Its features will lead to significant changes in the way Providers run their businesses, particularly in the areas of systems, administration and electronic interfaces.

Future Profitability

On balance, those interviewed were anticipating reaching a break-even point where revenue is equal to costs in several years. For some the initial decision to become a KiwiSaver Provider was driven by the objective of being early in the market to gain market share.

First year fee revenue and fund size is up on the predictions of those Providers interviewed. A majority of those interviewed said that enrolments, so far, have greatly exceeded their expectations. Offsetting this, however, were implementation costs which were generally significantly higher than expected.

The majority of Providers expected their KiwiSaver product to become profitable after a number of years, however there would be a significant extra period to recoup the implementation expenses incurred.

There was a wide range of implementation costs, depending on number of factors, such as the flexibility of current systems with the older and larger “legacy” systems being the hardest to update. The cost of implementation was also influenced by current business practices and how much of a change was required to cope with KiwiSaver. In general, there were no obvious economies of scale apparent, particularly for systems implementation costs other than the ability to spread this fixed cost over a greater number of members.

Although these costs were higher than expected, some Providers saw KiwiSaver as a good reason to make infrastructure investment that would benefit other products as well. For the larger Providers, the cost could be spread across a range of product offerings. A number of Providers have commented that KiwiSaver was the impetus to improve and upgrade other services, such as access to information over the internet.

Interviewees said that the initial set-up costs were generally high relative to other products. For the managed fund trusts, this was a function of mainly dealing with wholesale products. For the banks and other Providers, it was a function also of setting up in a way that integrated with the IR clearing house system. Some of the Providers commented on how well this was working but did not go into detail about how it may have also saved costs.

Interviewees did highlight that a significant contributor to cost was due to the PIE tax changes which had to be implemented at the same time. Many Providers estimated that the cost of PIE was about 50% of the total implementation cost, but some Providers had incurred minimal cost in implementing PIE.

Consolidation

Many Providers believe there will be some consolidation within the market, with some smaller Providers exiting due to lack of critical mass. No Provider interviewed, however, said that they would be exiting.

Many of the Providers interviewed did say that they would be happy to purchase business from those exiting the market.

Not all Providers believe that a large market share is necessary. A number of niche providers have indicated that they expect to run profitable KiwiSaver books based on their specific membership base. They often see KiwiSaver as just one of the financial products they will provide to their clients.

Return on Investment

The return on the investment made by the Providers in establishing a KiwiSaver business is an important consideration for market efficiency.

Providers would generally require a positive Net Present Value (NPV) or a minimum internal rate of return (IRR) from the business case to form a new venture. Many Providers commented that whilst they had prepared such business cases, there were such big uncertainties that these measures were largely overridden by strategic considerations, such as to remain a participant in the sector they had to have a KiwiSaver offering. An important driver of the return on investment is the implementation costs.

There was a wide range of payback periods estimated by the Providers we interviewed, ranging from 2 to 15 years, with an average of 8 years. One Provider commented that an 8 year payback would not be attractive to an investment manager assessing an investment opportunity. Mitigating this fact is that the revenue growth is a lot higher than most business investments because revenue is linked to increasing funds under management.

Key Issues Raised by Providers Interviewed

The interviews were structured to gain insights on the topics discussed above. During the discussion, however, providers proactively raised a number of issues which are addressed below. Comments were proactively offered in the KiwiSaver Evaluation survey on these same issues.

(1) Government Intervention and Legislative Change

Many Providers commented that, whilst a good thing, the late changes to KiwiSaver resulted in significant extra implementation costs, and that other than the mortgage diversion issue, the most preferable option is for no more operational changes that will be expensive to implement. Another common comment was the need for consultation with the industry on the practicalities of any proposed legislative change, principally because it is not feasible for Government officials to fully understand the practical business issues without consultation.

Future legislative change was mentioned by many Providers as a key risk to KiwiSaver.

(2) Mortgage Diversion

The majority of Providers consider that the implementation of mortgage diversion will be extremely expensive in terms of administration costs. Also, it is not attractive for the banks and the current interpretation is that only a small percentage of mortgages will be eligible anyway (the widening of the rules around what mortgages are eligible for mortgage diversion occurred after the interviews were conducted).

General comments from those interviewed about mortgage diversion included:

- it should be centrally administered by the IR as there is no reason for the money to pass through the Provider;
- alternatively, it should be removed completely; or
- that they may offer it for competitive reasons (to attract members) who might otherwise go to other Providers.

Specific features relating to mortgage diversion raised by Providers during the interviews included:

- money being unitised in Providers' systems when it is being paid straight out, affecting calculations of return, generating tax events and affecting liquidity etc;
- mortgage payments changing with interest rates and needing to be updated;
- timing of payments, as contributions are received irregularly from the IR, dependent on employer returning times and IR processing times; and
- time spent answering queries and chasing payments on funds which the Provider is not receiving fees or earning any investment income.

(3) PIE

Interviewees did highlight that a significant contributor to cost was due to the PIE tax changes which had to be implemented at the same time. Many Providers estimated that the cost of PIE was about 50% of the total implementation cost, but some Providers had incurred minimal cost in implementing PIE.

In order to separate out the effect of PIE from the increase in overall savings, Providers were asked to estimate the effect of PIE with no KiwiSaver in their business. The consensus was that it would have a minimal effect on the savings habits of investors. Funds would grow slightly faster due to the investor being taxed on a lower and fairer basis, but the general view was that this was not a significant enough or easily understood incentive to change investor behaviour.

(4) Legal Costs

Providers incurred significant legal costs in both the establishment of the entities required and in the prospectuses and investment statements required. It was commented that there were significant bottlenecks caused by the limited number of law firms with the required expertise to service all Providers starting up at the same time.

An associated issue that was raised by many Providers, is that the prospectus and investment statements, being legal documents, are difficult to understand by the customer. This is viewed as a major impediment to transparent and understandable disclosure of fees to the customer.

(5) Liquidity

A few interviewees raised concerns that there is a potential liquidity constraint on KiwiSaver funds due to the guaranteed portability, between funds, schemes and Providers. Based on the responses of the 14 interviews, however, Providers are more focused on other aspects of KiwiSaver.

(6) Default Providers

The majority of Providers acknowledged that it was a significant advantage to be a default Provider, both in terms of the default allocation and the authentication of the Provider by the Government.

There were a range of views on the default Provider selection process. In general, the negative views were from non-default Providers. Some Providers felt that the Providers should be able to apply for default Provider status some time in the future to increase the number of default Providers, but conversely one non-default Provider stated that there should only be three or four default Providers.

(7) Investment Advice

A number of Providers, particularly default Providers were concerned with the high number of customers that were in the most conservative funds. The concern was that these customers were either default customers or active choice customers that had not made a choice of fund and been automatically allocated to the most conservative fund. These Providers did not feel that they were easily able to address this situation because they had no means of providing advice when there was no financial adviser involved.

Related to the point above, Providers raised the importance of educating KiwiSavers on their appropriate investment option. The margins on KiwiSaver alone are too low to support individually funded advice.

(8) Life Insurance and Employer Choice Agreements

Other suggestions received from Providers were in relation to Life insurance and Employer Choice Agreements. They were:

- consideration of life insurance costs being met out of or alongside KiwiSaver;
- allowing Employers with an Employer Choice Agreement to remit contributions directly to the Provider, as for complying and other superannuation funds, to remove the processing time taken by IR and the resultant member queries on the location and timing of their payments; and
- allowing Employers with an Employer Choice Agreement to remit contributions directly to the Provider, as for complying and other superannuation funds, to remove the processing time taken by IR and the resultant member queries on the location and timing of their payments.

Appendix C Inland Revenue SPA KiwiSaver Providers and the Schemes they Administer

Default Providers and default schemes:

AMP:
AMP KiwiSaver Scheme
ASB:
ASB KiwiSaver Scheme
AXA:
AXA KiwiSaver Scheme
ING NZ:
ING KiwiSaver Superannuation Scheme
Mercer:
Mercer KiwiSaver Scheme
Tower:
Tower KiwiPlan

Default Providers and non-default schemes:

ASB:
FirstChoice KiwiSaver Scheme
ING NZ:
SIL KiwiSaver Scheme
ANZ KiwiSaver Scheme
National Bank KiwiSaver Scheme
Mercer:
Credit Union KiwiSaver Scheme
Mercer Super Trust KiwiSaver Scheme

Active Choice Providers:

ABN Amro Craigs:
ABN AMRO Craigs START KiwiSaver Scheme
ABN AMRO Craigs START KiwiSaver Scheme 2
Anglican Church:
Koinonia Fund
Aon:
AonSaver Scheme
Aon Master Trust
Ecolab KiwiSaver Scheme
Tait Electronics Limited KiwiSaver Scheme
Douglas Pharmaceuticals KiwiSaver Scheme
IRIS KiwiSaver Scheme
N.Z. Maritime Officers KiwiSaver Scheme
PSBG KiwiSaver Scheme
Ravensdown KiwiSaver Scheme
Stevenson Group KiwiSaver Scheme
Turners & Growers KiwiSaver Scheme
Griffins KiwiSaver Scheme
Allied Farmers KiwiSaver Scheme
Hexion KiwiSaver Scheme
Foodstuffs KiwiSaver Scheme

SRF KiwiSaver Scheme
Foodstuffs (Wellington) KiwiSaver Scheme

Staples Rodway:
The Staples Rodway KiwiSaver Scheme

Medical Assurance:
Medical Assurance Society KiwiSaver Plan

Law Retirement:
Law Retirement KiwiSaver Scheme

eo financial services (nz) limited
eosaver KiwiSaver Scheme

MSF:
MSF KiwiSaver Scheme

Fidelity:
Fidelity KiwiSaver Scheme

Gareth Morgan:
The Gareth Morgan KiwiSaver Scheme

Grosvenor:
Grosvenor KiwiSaver Scheme

Guardian Trust:
Asteron KiwiSaver Scheme

Smartshares Limited
Smartshares KiwiSaver Scheme

New Zealand Local Government Insurance Corporation Ltd
KiwiSaver Supereasy Superannuation Scheme

Waterfront Industry Superannuation Fund
Waterfront Industry KiwiSaver Scheme

The Trustees of the New Zealand Harbours Superannuation Plan
The New Zealand Harbours KiwiSaver Scheme

SuperLife:
SuperLife KiwiSaver

Fisher Funds
Fisher Funds Growth KiwiSaver Scheme

First NZ Capital Investment Management Limited
First NZ Capital KiwiSaver Scheme

Huljich Wealth Management (New Zealand) Limited
Huljich KiwiSaver Scheme

Brook Asset Management Limited
Brook Professional KiwiSaver Scheme

Real Property KiwiSaver Limited
Real Property KiwiSaver Scheme

Forsyth Barr Limited
Forsyth Barr KiwiSaver Scheme

Westpac:
The Westpac KiwiSaver Scheme

Southland Building Society
Lifestages KiwiSaver Scheme

Appendix D Letter from MED: An Evaluation of the impacts of KiwiSaver on New Zealand's superannuation market

We have commenced a study of the impacts of KiwiSaver on New Zealand's superannuation market and the wider financial sector. We seek input from KiwiSaver providers and other stakeholders into the study. The study is led by PricewaterhouseCoopers, who will protect the confidentiality of any information received.

> Evaluations examine the efficiency and effectiveness of government policy with the aim of providing evidence based feedback to enhance value and desired impact. They are an integral and routine part of government policy process. When KiwiSaver was announced, the Government established an objective and comprehensive evaluation strategy covering its implementation, long term impacts on savings behaviour and on the superannuation market and other matters.

There are two distinct areas of focus for our study. The first is to examine the impacts that KiwiSaver is having on the superannuation market itself – KiwiSaver and non-KiwiSaver superannuation providers and schemes.

The second area of focus is to consider the wider impacts of KiwiSaver on the financial sector, particularly the impacts on funds managers and their advisers, trustees, other market participants (e.g. personal financial advisers, brokers etc), domestic capital markets and relevant aspects of financial system stability.

The evaluation will seek to:

- Define and confirm with stakeholders the key characteristics of the superannuation market in the lead up to the introduction of KiwiSaver in 2007 (noting any existing trends and changes resulting from providers gearing up for its introduction) and the changes in the market since then
- Document what market participants are saying about the key influences of KiwiSaver on the market, including impacts on fees, financial performance, marketing, and overall savings levels
- Establish a baseline of quantitative indicators, which reflects the above information, to measure key changes in the superannuation market prior to and following the introduction of KiwiSaver, drawing on existing data sources to the fullest extent
- Document the changes to the superannuation market and the wider financial sector, since the introduction of KiwiSaver. Due to the current small size of KiwiSaver FUM relative to the size of the financial markets, we expect that this phase of the evaluation will focus primarily on impacts on the superannuation market rather than wider financial sector impacts.
- Establish an evaluation approach and framework for examining the future impacts of KiwiSaver on supply of long-term funds to capital markets and related aspects including specialisation, innovation, skills and financial stability
- Make recommendations for the design and staging of future phases of the evaluation and on tweaks to KiwiSaver policy to support better outcomes.

It is intended that subsequent phases of work will examine changes in the market and compare them with the baseline established through this piece of work. Subsequent evaluation phases are planned to occur in 2009 and 2011.

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Appendix F Core Source Data

Appendix F records the core data used in the design of the evaluation frameworks to monitor firm and industry market dynamics. The data is set out in a spreadsheet that follows on from this discussion of the data sources.

Managed Funds Survey (MFS)

The MSF is a quarterly survey that began in September 1995. The RBNZ took over the operations of the survey at the end of 1998. Since the December 2003 quarter the MSF covers an estimated 90% of the total managed funds market.

The MSF collects data for the RBNZ and SNZ as described below. The funds data from the MSF is classified in four groups:

- unit trusts and group investment fund vehicles;
- funds with a life insurance component;
- superannuation funds; and
- 'other'.

The survey does not include funds from the New Zealand Superannuation Fund (NZSF).

The KiwiSaver Evaluation is based on the annual MSF published data as at August 2008 for the June years 2004 to 2008. The following data categories are used in this evaluation:

- managed funds assets under management;
- managed funds investment in New Zealand;
- managed funds investment in NZ equities;
- superannuation assets under investment;
- superannuation investment in New Zealand; and
- superannuation investment in NZ equities.

Statistics New Zealand Managed Funds Survey

Statistics NZ, as part of its involvement in the Managed Funds Survey, has been developing experimental series about the KiwiSaver funds under management. These results are not yet published but have been released provisionally for this evaluation. They are subject to future revision due to the untested nature of the data.

The evaluation makes use of data from this series relating to:

- KiwiSaver assets under investment;
- KiwiSaver investment in New Zealand; and
- KiwiSaver investment in NZ equities.

Statistics NZ was also the source for gross domestic product (GDP) and inflation figures for years 2000 – 2007.

Government Actuary Reports (GA)

The GA produces two annual reports to the Minister in respect to Superannuation (under the 1989 Superannuation Act) and KiwiSaver (under the 2006 KiwiSaver Act).

The GA, as part of the Insurance and Superannuation Unit (ISU) in MED, is responsible for registering all new superannuation schemes. The GA has been providing annual reports on all the registered Superannuation schemes since the year ended June 1996. Data from these reports includes data on the Government Superannuation Fund, which is specifically excluded from the Act. The New Zealand Superannuation Fund is not included. The KiwiSaver Evaluation Framework developed in this report is based on the annual GA report for the years ended June 2002 to 2007 The data used in the Evaluation include the annual value of Superannuation assets under management, the number of Superannuation schemes registered and the Superannuation membership numbers.

The GA is also responsible for providing annual data on all the KiwiSaver schemes on the KiwiSaver Register administered by the GA. This aggregated data includes member numbers and asset allocation. The KiwiSaver Evaluation Framework is based current information for the number of Providers, schemes and members published by the GA report for the year ended June 2008. More detailed analysis on single sector funds and assets within default funds is also referenced in the report.

The KiwiSaver Scheme Register, maintained by the GA, is also referenced.

Inland Revenue (IR)

IR is, among other things, the clearing house for all KiwiSaver contributions made via PAYE as described in Chapter 1. IR has responsibility for new member funds during their 3 month probationary period and clears funds for Government Kick Start bonus. For this reason, IR is able to provide reporting of:

- member numbers
- the funds transferred through its clearing house from employers to Providers; and
- The classification of members' default and non-default schemes

Although the IR contribution data has proved invaluable as a year one proxy for assets under management there are limitations to its future use. The biggest is that contributions made directly to Providers will not be recorded. This group includes self-employed earners.

PricewaterhouseCoopers (PwC)

In addition to the conducting the KiwiSaver evaluation Survey PwC also conducted various pieces of research to inform the development of the Evaluation Framework. These included:

- analysing investment statements to assess their responsible investment status and default fund asset balances;
- estimating funds under management; and
- researching schemes and trustee arrangements.

Core data for examining KiwiSaver available September 2008

Name	Unit	As at	Source	2002	2003	2004	2005	2006	2007	2008
Managed Funds										
Managed funds assets under management	$ million	June	MFS			52,648	55,248	61,610	66,505	60,223
Managed funds investment in New Zealand	$ million	June	MFS			32,225	33,310	34,654	38,013	35,455
Investment in NZ - Managed funds	percent	June				0.61	0.60	0.56	0.57	0.59
Managed funds investment in NZ equities	$ million	June	MFS			7,625	7,999	8,379	9,670	6,844
NZ investment in equities - Managed funds	percent	June				0.14	0.14	0.14	0.15	0.11
Superannuation										
Standard Superannuation assets under management	$ million	June	GA	17,011	15,675	16,867	18,195	20,722	21,906	
Government Super Fund assets under management	$ million	June	GSF	3,287	3,182	3,374	3,521	3,793	4,008	
Total Superannuation	$ million	June		20,298	18,857	20,241	21,716	24,515	25,914	
Superannuation assets under investment	$ million	June	MFS			18,651	19,671	21,034	22,004	21,056
Superannuation investment in New Zealand	$ million	June	MFS			9,331	9,298	8,937	9,652	8,970
Investment in NZ - Superannuation	percent	June				0.50	0.47	0.42	0.44	0.43
Superannuation investment in NZ equities	$ million	June	MFS			2,793	2,776	2,625	2,867	1,950
NZ investment in equities - Superannuation	percent	June				0.15	0.14	0.12	0.13	0.09
KiwiSaver										
KiwiSaver assets under management	$ million	June	PwC							1,086
SNZ KiwiSaver assets under management	$ million	March	SNZ							578
KiwiSaver investment in New Zealand	$ million	March	SNZ							355
Investment in NZ - KiwiSaver	percent	March								0.61
KiwiSaver investment in NZ equities	$ million	March	SNZ							124
NZ investment in equities - KiwiSaver	percent	March								0.21

Core data for examining KiwiSaver available September 2008

Name	Unit	As at	Source	2002	2003	2004	2005	2006	2007	2008
Membership										
Membership - Superannuation	number	June	GA	684,851	662,016	644,443	638,123	602,744	582,035	
Membership - Government Super Fund	number	June	GSF		53,467	53,473	53,482	53,342	53,262	
Total Membership - Superannuation	number	June			715,483	697,916	691,605	656,086	635,297	
Membership - KiwiSaver	number	June	IR							716,637
Schemes										
Schemes - Superannuation	number	June	GA	727	675	625	590	576	560	
Schemes - KiwiSaver	number	June	GA							54
Retail Schemes	number	June	GA							35
New KiwiSaver schemes	number	June	GA							6
Ratios										
Gross Domestic Product	$ million	December	SNZ		130,996	139,928	149,936	157,525	166,243	
Superannuation versus Gross Domestic Product	percent					0.133	0.131	0.134	0.132	
Net Wealth	$ million	December	RBNZ		403,000	458,000	528,000	586,000	634,000	
Superannuation versus Net Wealth	percent					0.041	0.037	0.036	0.035	
Housing Value	$ million	December	RBNZ		370,000	429,000	506,000	559,000	614,000	
Superannuation versus Housing Value	percent					0.043	0.039	0.038	0.036	

Core data for examining KiwiSaver available September 2008

Name	Unit	As at	Source	2002	2003	2004	2005	2006	2007	2008
Other										
KiwiSaver default scheme members	number	June	IR							421,697
KiwiSaver default membership	percent	June								0.59
KiwiSaver contribution to default schemes	$ million	June	IR							619
KiwiSaver total contributions	$ million	June	IR							1,037
KiwiSaver default contributions	percent	June								0.60
Under 18 members	number	June	IR							90,722
Hardships	number	June	IR							3,506
Contributing KiwiSavers	number	June								622,409
Contributing KiwiSaver members	percent	June								0.87
KiwiSaver Providers	number	June	GA							31
KiwiSaver schemes investing responsibly	percent	June	PwC							0.20
Efficiency										
Number of schemes with greater than $10m assets	number	March	GA							15
Number of schemes with greater than $25m assets	number	March	GA							9
Annual Investment Income	$ 000	March	GA							7,297
Scheme Assets	$ 000	March	GA							01,718
Investment Returns - Estimate	percent	March	GA							-2.1