

KiwiSaver...in the workplace

New Zealand's KiwiSaver is a late comer to the group of nations with a successful personal retirement savings programme.

Australia, the UK, the US, Singapore – and even Mexico, have over a decade of a head start on New Zealand. As a result, their working populations are significantly ahead of us in getting financially equipped for their retirement.

But, here in New Zealand, KiwiSaver is adding significant impetus to the trend of working households increasing the proportion of their income they are committing to retirement savings. This is in contrast to the decline in savings rates that was evident in the two decades preceding the launch of KiwiSaver.

As KiwiSaver grows there are important themes we can observe from the experiences of those countries' that are further down the retirement savings track. It is our belief that these themes are very likely to repeat themselves here in New Zealand

Employer Contributions Will Grow

Take the US for example.

Named with far less imagination than its New Zealand counterpart, the US workplace retirement savings vehicle of choice is the 401k programme. Around 401k there is fierce competition between employers to offer additional staff benefits in the form of generous employer 401k contributions - all aimed to help them attract skilled workers. It is not unheard of for employers to contribute in excess of 10% of a workers salary into their 401k account.

Faced with the same competition for quality employees here in New Zealand, we think it is very likely that employer contributions will grow sharply in coming years. Employers here will begin to view their contributions towards KiwiSaver as a business investment to compete in the employment market. As a result, they will expect a return on that investment.

But Individuals will Underestimate their Retirement Wealth Needs

Again using the US experience as a reference point, a recent article in the Wall Street Journal stated that:

"the median household headed by a person aged 60 to 62 with a 401(k) account has less than one-quarter of what is needed in that account to maintain its standard of living in retirement."

In most cases that retirement shortfall has not been made up for through other savings undertaken in addition to their 401k. In most cases the individuals are blissfully unaware of their predicament until it is too late. Commentators have observed that the act of saving into a 401k tends to trigger a complacency; a belief that they had done enough by saving into a 401k.

The same can be said of KiwiSaver. While many individuals are contributing between 2-4% of their income to their KiwiSaver account, global rules of thumb would suggest

that the appropriate level may be 3 to 4 times that amount if one is to enjoy a reasonable standard of living in retirement

The high impact factors such as increased longevity, inflation and realistic long term investment returns need to be made tangible and personal in the retirement savings plans of New Zealanders as early as possible if we are to avert the same under funded retirement fate as those in the US.

Individuals Will Make Poor Choices

What has been missed in the retirement programmes of other nations has been insightful financial advice. Financial advisers have not been interested in clients who had little or no money and little or no willingness to pay an appropriate fee. The respective governments have also been unwilling to bear this cost.

This defies the overwhelming global academic and practical evidence that individuals, left to their own devices, will tend to make poor investment decisions - decisions that will cost them dearly over the long term.

Very few individuals have had the opportunity to sit down early in their retirement savings programme with a financial professional and crunch the figures to determine how much they are likely to need in retirement and to build a plan for achieving that target.

We have the opportunity at this early stage to avoid repeating that mistake, but to do so we need to work out how to make quality personalised advice available in the workplace.

Inertia is One Poor Choice

The 401k think tank, the Profit Sharing Council of America, suggests that only 12% of 401k participants made any change to their savings programme in 2009; one of the most volatile years on record in financial markets.

401k savers are generally inert – more through indecision than deliberate thought, they are reluctant to alter or refine their savings levels, plan or portfolio over time.

On the one hand this is a positive “discipline”. On the other, this inertia will likely be detrimental in the long run.

Consider the following simple example...a 58 year old 401k saver started their programme in 2002 by allocating 70% of their savings to a growth fund and 30% to an income fund. They diligently saved into this allocation – without rebalancing.

By 2007, aged 63 and ready to retire in two years, rising growth markets would have taken their overall portfolio allocation to something like 85% growth/15% income. Sadly, you know what happened next.

Over the long run the portfolio imbalances created though inertia can be much, much more pronounced.

Based on the global experience that only around 10% of retirement savers deliberately manage their allocations, 90% of those in KiwiSaver should be in

lifecycle vehicles or other programmes which automatically ensure that their portfolio allocations remain appropriate to them.

Portfolio Management Matters

Just as in KiwiSaver, it is the tax advantages and employer contributions that have drawn so many people into 401k's.

For most of those in KiwiSaver the sole decision to date has been how much to contribute out of their precious take home pay. Most have given little or no thought to how their hard earned savings is allocated and invested.

Increasingly, as the size of individuals' portfolios grow, the impact of investment returns will get greater and greater. By contrast the impact of employer contributions and government tax benefits will diminish.

The corollary is that individuals need to take greater care and responsibility in their KiwiSaver investment decision making (at the very least they need to understand why they are invested in the Scheme and fund options they are in) and we believe that employers will play a growing role and responsibility in this process. Just as they have internationally.

Based on these themes, NZ Funds Management are soon to launch a wealth@work programme designed specifically to help New Zealand employees take control of their financial futures.

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