# Questions and Answers: Capital Guarantees for KiwiSavers Accounts

## How Could a System of Guarantees for KiwiSaver Work?

At the moment if you enrol in KiwiSaver you are automatically allocated to a default provider and a conservative fund if you don’t make your own selection of investment style and provider.

Many default KiwiSavers, particularly those who feel least confident of their ability to make investment decisions, stay in a conservative fund even though it is likely to cost them more than $100,000 in terms of a smaller retirement nest egg.

If instead of defaulting into a conservative fund the KiwiSaver was defaulted into a balanced or growth fund with the guarantees in place they would benefit in several ways:

* + a lower contribution rate would be required to achieve a certain retirement nest egg balance by saving in a balanced or growth KiwiSaver fund
	+ effective tax rates are usually lower on growth assets as KiwiSaver investments in New Zealand shares and some Australian shares are not subject to tax on capital gains, and
	+ the guarantees help protect against bad investment returns in either the year prior to your retirement or in the three years before you use your KiwiSaver balance to make a deposit on a first home.

This would require that when you enrolled in KiwiSaver you would tick a box if you had already purchased your first home.

The annual contribution to pay for the guarantee would be then deducted by your KiwiSaver to pay the Crown for the guarantee.

You would retain the option of moving to a fund with a different investment style and pay the appropriate contribution rate for the guarantees required for that type of fund.

You would pay the retirement guarantee contribution each year you were saving in KiwiSaver until you were eligible to withdraw your balance. The first home deposit guarantee would be paid for the first 20 years if you had not purchased a first home prior to enrolling in KiwiSaver. (Horizon Polling in October 2013, identified that 64% of KiwiSavers who had not owned a first home previously expected to purchase a first home by age 44).

## Is this proposal consistent with what the FSC was recommending last year?

Yes. Last year we suggested that a plan to get most working New Zealanders into a comfortable retirement living on two times New Zealand Super, currently $282 per week after tax for each of a couple, would consist of the following:

* + Gradually increase KiwiSaver contributions till they reach 7%, split between employer and employee.
	+ Keeping NZ Super as it is linked to average wages and not subject to any income or asset test.
	+ Defaulting KiwiSavers into balanced or growth funds to earn more and to enable the contribution rate required to fund a comfortable retirement to be cut and with guarantees to offset the additional risk.
	+ Remove the over-taxation of KiwiSaver funds so KiwiSavers paid the same effective tax rates as they pay on their other income.
	+ Target the money spent on KiwiSaver incentives to lower tax rates to make it fiscally neutral.

The work undertaken by Infometrics this year and last year has provided estimates of the cost of guarantees that are a fraction of the benefits that would be received by KiwiSavers in terms of larger retirement nest eggs.

## Would having a guarantee mean you could not switch your KiwiSaver and investment style or provider?

No. You could still change your fund investment style or provider. If you changed the investment style you would just start paying the guarantee contribution rate for that style of fund.

## Have any KiwiSaver providers offered capital guarantees?

Yes. Fidelity Life’s KiwiSaver options included one with a capital guarantee (now run by Grosvenor) and Westpac has offered a KiwiSaver fund with a capital guarantee in the past.

Internationally they were quite a popular product immediately after the Global Financial Crisis but as financial markets recovered they became less sought after by investors.

## Won’t this just increase fees for the financial services sector?

Surprisingly, the answer is no for a typical current KiwiSaver. While fees for managing balanced or growth funds are usually higher than for managing conservative assets, with higher earnings comes lower contribution rates and fewer assets to manage to achieve the same retirement income. As fees are mainly linked to the level of funds being managed, less funds under management means less fees for providers.

For someone on the average wage saving over 40 years the fees you pay would drop by $43,000 over 40 years if you moved from a conservative to a balanced fund and would drop by $45,000 over 40 years if you moved from a conservative to a growth fund to fund the same income in retirement (Infometrics April 2014). Obviously if more people join KiwiSaver because capital guarantees are available then the industry would earn more fees from the new customers.

## Why does the retirement guarantee covering just one year’s risk cost more than the first home deposit guarantee that cover three years risk?

Firstly, the amount of assets being protected in your KiwiSaver nest egg is much bigger when you get close to retirement compared to when you are usually younger saving for your first home deposit. Secondly, you can only use your own KiwiSaver contributions to make a withdrawal to put toward your first home deposit so your whole account does not need to be guaranteed.