Factors Influencing Investor Choice of Retirement Funds

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Introduction

When New Zealand launched KiwiSaver in 2007, it joined a growing international trend towards second-tier personal pension schemes. KiwiSaver is a work-based retirement savings scheme, also referred to as a defined contribution scheme. It supplements New Zealand Superannuation, a first-tier universal benefit that all citizens are entitled to when they reach retirement age, currently 65 years. KiwiSaver's introduction was a response to concerns that New Zealand Superannuation may not be sustainable given the country's expanding population of pensioners. The early uptake of KiwiSaver exceeded expectations, with 1.97 million people joining by June 2012 (Inland Revenue Department, 2012), thanks mainly to an auto-enrolment provision and financial incentives from the government and employers.

When they join KiwiSaver and sign up with a provider (there are about 30 providers including banks, insurance companies, trusts and fund managers), new recruits receive an initial $US850 ‘kick-start’ contribution from the government. Members then contribute to their personal accounts a regular percentage of their gross pay that is matched by contributions from their employer up to a maximum of 3 per cent. As well as choosing their provider, scheme members can also choose the

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investment fund or asset class into which their savings will be invested (ranging from low-risk conservative, to balanced, to higher-risk growth funds). KiwiSaver members get access to their accumulated contributions and investment returns when they reach retirement age.

New members declining to choose a provider or a fund are automatically allocated to conservative funds run by government-appointed default providers. The architects of KiwiSaver decided that default funds would be conservative, 75–85 per cent invested in cash and fixed income assets, minimizing costs for both pension providers and investors and reducing the risk of loss for members declining to actively choose a fund. Concerns have been raised, however, that too many KiwiSavers are investing in conservative funds that do not match their age and risk profile (Ministry of Economic Development, 2008; Gaynor, 2010). By June 2011, 57 per cent of total funds under management in KiwiSaver were invested in broadly conservative, including default, funds (Morningstar, 2011). Conservative funds may be ideal for older members of the scheme, but asset class performance data (Goetzmann and Ibbotson, 2006; Siegel, 2007) suggests a conservative investment strategy may be inappropriate for younger members of the scheme. By June 2011, 32 per cent of KiwiSaver members were aged between 18 and 34.

Implicit in giving KiwiSaver members the responsibility of choosing an appropriate investment fund is an assumption that their financial acumen is up to the task. Several studies suggest it is not (Colmar Brunton, 2009; O’Connell, 2009). One study found 40 per cent of members did not even know what kind of fund they have invested in (Inland Revenue Department, 2010).

This study aims to identify the key factors influencing KiwiSaver members when they make – or opt out of making – the fund choice decision when they join the scheme. Previous studies have shown people investing for their retirement are influenced by their age, education and wealth (Baker and Haslem, 1974; Foster, 1996; Devaney and Su, 1997; Prenda and Lachman, 2001; Goetzmann and Kumar, 2008; Petkoska and Earl, 2009); by their peers, pension providers and the design of the pension scheme, including the default rules (Madrian and Shea, 2001; Choi et al, 2002; Sunstein and Thaler, 2003; Beshears et al, 2008; Iyengar and Kamenica, 2010); and by their attitude to risk (Joo and Grable, 2000; Rickwood and White, 2009). A qualitative approach was adopted in the belief that in-depth discussion provided by focus group interviews would tease out the factors influencing fund choice. Focus groups were supplemented by a fund selection exercise and a brief questionnaire.