Office of the Minister of Finance

Chair
CABINET BUSINESS COMMITTEE

KIWISAVER - VARIOUS ISSUES

Executive Summary

1. In Budget 2005, I announced the creation of KiwiSaver, a new work based savings scheme, to encourage voluntary saving for retirement and home ownership.

2. In light of further consultation and policy development, I am seeking for Cabinet to revisit its earlier decisions on the automatic enrolment process, the minimum contribution period and allowing members to divert their contributions to repay their mortgage.

3. Policy decisions are also needed on further elements of the scheme design, including the selection of providers, privacy issues and the level of penalties.

4. These decisions are necessary now so KiwiSaver can commence on 1 April 2007 and that legislation underlying the scheme can be introduced into Parliament in early 2006.

Proposal

5. This paper seeks Cabinet's agreement to:

- modify the automatic enrolment process and the way investment statements for the products of default providers are provided for new employees;

- extend the minimum period before a contribution holiday can be taken from three months to twelve months;

- select a limited number of default providers by tender;

- permit other active choice products to be registered, subject to meeting minimum conditions;

- not allow members the option of diverting their contribution to repay their mortgage as part of KiwiSaver, in light of feedback from unions, mortgage providers and retirement groups;

- enable multiple job holders to contribute from any or all primary and secondary salary and wage sources to encourage scheme participation;

- monitor the government contribution to fees to individual members;

- cease the fee subsidy when a member becomes eligible to withdraw all of their funds;

- permit the Inland Revenue Department to use and share information internally and externally with other persons in order to fulfil its statutory obligations;

- ensure trustees of schemes are independent;

- adapt the anti-money laundering identity requirements to KiwiSaver; and

- implement an effective offence regime.

Background Information

6. Cabinet has already agreed to the overall design of KiwiSaver (CAB Min (05) 13/9, CAB Min (05) 15/2 and CAB Min (05) 12/1). An overview of the KiwiSaver scheme is provided in Annex 1.

7. The overall timetable to get KiwiSaver up and running by 1 April 2007 is tight. Legislation needs to be passed, providers selected, providers implement significant systems changes, employers modify payroll systems, and information prepared and distributed.

8. I expect to introduce legislation into Parliament by the end of February 2006, with a view to the legislation receiving Royal Assent by October 2006.

9. [text deleted] I have instructed officials to work on this basis so the appointment of default providers can be made as soon as possible after Royal Assent, ideally in October 2006. This would allow default providers around six months from appointment to when KiwiSaver is up and running.

Comment

Automatic Enrolment Process of New Employees

10. Cabinet agreed that new employees between 18 and 65 years of age will be automatically enrolled in KiwiSaver when they start a new job but will have the opportunity to opt out in the second and third week of a new job. Employers would be required to give new employees an information pack in the first week and begin deductions on the first pay day after the employee has been in the job for eight weeks unless Inland Revenue notifies the employer that the employee has opted out [CAB Min (05) 15/2 paras 9 to 14 refer].

11. The automatic enrolment process is designed to encourage participation by using inertia (people are enrolled unless they opt out) and to minimise compliance costs for employees, employers and the government.

12. Employers, providers and consumer groups have raised concerns about some elements of the proposed automatic enrolment process. Key concerns were the compliance costs it would impose on providers and employers, the reliance it places on employers passing on information, the lack of time for employees to make informed decisions, employees may be overwhelmed by receiving multiple investment statements and up to date address information may not be available for new members.

13. Therefore, the Minister of Commerce, the Minister of Revenue and I propose the following process for the automatic enrolment process:

- An employee starts a new job and is given an information pack by their employer in the first week of a new job. The information pack will include an opt out form but no investment statements. This will reduce space required by employers in storing information packs.

- The employer notifies the Inland Revenue Department that a new employee has started and passes on the new employee's name, IRD number and address within three weeks of the employee starting.

- New employees decide whether to opt out or not in weeks two to six inclusive of their new job, and advise the Inland Revenue Department if they are opting out. This longer period will enable employees to opt out after they have been allocated to a default provider and sent the investment statement for that scheme. Employees can seek financial advice during this period, if they wish.

- Once the Inland Revenue Department receives notification from the employer that a new employee has started, it allocates the new employee to a default provider and sends the employee the default investment statement for that provider unless it has been advised that the employee has either already opted out or chosen a provider. Employees are deemed to have received the investment statement once sent by the Inland Revenue Department.

- The Inland Revenue Department processes any opt out forms and advises employers not to commence deductions for these employees.

- The employer commences deductions from the new employee's first pay after week eleven unless advised that the employee has opted out.

14. The new proposed approach would require employers to provide some additional information to the Inland Revenue Department on the name and address of employees but the costs should not be onerous as employers are already required to collect this information for employment purposes. In addition, employers would benefit from not needing to store investment statements and being seen to be less responsible for the operation of the scheme.

15. However, the key difference is that employees only receive one investment statement if they are allocated to a default provider. Employees will be able to request or view additional investment statements.

16. Many investment statements are lengthy and difficult for investors to understand which may reduce their usefulness. Hence, the Minister of Commerce and I propose that investment statements for default products should be required to be concise and simple to understand. This could involve the investments statement cross referencing of material in the information package on the general features of KiwiSaver.

Contribution Holiday

17. KiwiSaver is a voluntary savings scheme which means that people can stop and start their contributions through their working life.

18. Cabinet agreed that employees should be able to take a contribution holiday of up to five years at a time after the person has been contributing for at least three months [CAB Min (05) 15/2 paras 17 and 18 refer].

19. The appropriate minimum contribution period is not straightforward. It should not significantly deter people from participating while requiring a period of contributions in exchange for the $1 000 upfront government contribution and encouraging an ongoing change in savings behaviour. In addition, it should not penalise people for unexpected changes in their circumstances.

20. I propose that the minimum period before a contribution holiday can be taken be extended from three months to twelve months to increase the likelihood that people continue to save and reduce any small balance problem. This will only apply to employees as there is no way to enforce contributions from non-employees.

21. In order to prevent this change introducing undue hardship, I consider that members who suffer significant financial hardship during the twelve month period be able to apply to the Inland Revenue Department for a three month contribution holiday or such longer period as the Commissioner of Inland Revenue considers appropriate given the nature of the financial hardship. Members will also be able to apply to withdraw their contributions (but not the $1 000 government contribution) in the event of financial hardship during the three month holding period with the Inland Revenue Department, and subsequently with providers.

Selection of the Providers

22. Cabinet has agreed in principle that product providers will be selected by a competitive tender process and/or a requirement to meet a set of minimum specified criteria [CAB Min (05) 13/9 para 5.1 refers].

23. I consider that the selection of a limited number of default providers is at the core of KiwiSaver given a high proportion of people will end up in default products (for members that do not choose a product and provider) and it will influence the decision of people to participate in KiwiSaver. Hence, it is important that the appropriate providers of default products are selected.

24. There are two options for how default providers could be selected:

- solely on the quality of the default *product* (conservative investment strategy); or

- based on the suite of investment strategy products offered by default *providers*, including the default product and some other products members could actively choose.

25. The Minister of Commerce and my preference is to select default *providers* rather than providers of default *products* (i.e. not just a conservative product) through a competitive tender process. This approach is similar to that used in the selection of providers for the State Sector Retirement Savings Scheme. Under this approach, KiwiSaver members will still be allocated to a conservative investment product if they do not actively choose a provider and another investment option.

26. This default provider approach will allow the negotiation of fees across a range of products (for example, conservative, balanced and growth investment options), and provide a core group of providers of a range of products that are stable, reputable and able to handle high volumes. Also, it recognises that a conservative product may not be appropriate for all savers.

27. The Minister of Commerce and I consider that other providers should be able to participate in KiwiSaver, subject to submitting a registration form and meeting minimum criteria, to encourage competition, innovation and investor choice. This is similar to the way registered superannuation schemes operate at present. The products offered by these providers would not be default products (i.e. individuals would have to actively choose them) and be subject to the KiwiSaver rules, such as lock-in and permitting a withdrawal to purchase a first home. In addition, providers would be required to ensure that any fees charged are not unreasonable to prevent providers artificially inflating fees given the fee subsidy.

Tax Treatment of KiwiSaver Schemes

28. It is important that if employees are encouraged to save through KiwiSaver, that the earnings from such investments are taxed consistently and fairly. The proposed tax rules for qualifying collective investment vehicles (QCIVs) are designed to achieve this.

29. From 1 April 2007, it is proposed that a pooled fund that qualifies as a QCIV would be able to elect that assessable income be taxed at the rate elected by investors and would generally exclude realised domestic share gains. The proposed tax rules for QCIVs are expected to be included in a tax bill to be introduced in May this year.

30. I consider that in general that the QCIV election decision should be left up to individual trustees. However, I propose that KiwiSaver default providers be required to become QCIV for their specific default funds to ensure low income earners are not over taxed but that providers of active choice KiwiSaver schemes can decide their QCIV status. Default providers would be able to operate funds which do not have QCIV status in order to provide investor choice and not limit providers to one type of investor.

31. Cabinet has agreed that the Government will provide a conversion mechanism for existing registered superannuation schemes wanting to migrate to KiwiSaver [CAB Min (05) 13/9 para 3.21]. Under the Income Tax Act 2004, this could be considered a disposal of property, therefore resulting in taxable income.

32. For certainty, I recommend that the KiwiSaver legislation clarify the treatment of registered superannuation schemes that convert to KiwiSaver and ensure that the transfer of property as part of a KiwiSaver conversion is not treated as a disposal.

Mortgage Diversion

33. Cabinet has agreed that KiwiSaver members will have the option to divert their savings contributions to repay the mortgage on the principal family home for a time, subject to further consultation on whether this is feasible for mortgage providers [CAB Min (05) 13/9, para 3.12 refers].

34. Consultation with banks suggests that mortgage diversion may be feasible, but that they would not be interested in providing this service, due to the mechanism providing little benefit to customers as a result of the time delay before funds reach the banks and the risks of having payments made via a third party.

35. [text deleted] were not very supportive of the mortgage diversion option as it would shift the focus of KiwiSaver away from retirement savings and make the scheme unnecessarily complex. In addition, they were concerned that:

- mortgage diversion is only worthwhile where a member is receiving an employer contribution given the delays in funds being paid to the member's mortgage;
- mortgage repayments may be long lasting, including as people change houses;
- mortgage repayments could be handled through education and contribution holidays;
- potential savers could be faced with too many choices; and
- the repayments may not be locked in as people can draw down equity in their home.

36. In light of this feedback, I propose that KiwiSaver members not be given the option to divert their savings contributions to repay the mortgage on their principal residence as part of KiwiSaver. Mortgage diversion could be reconsidered if it becomes a more viable and widely supported option.

Multiple Job Holders

37. The employment sources and payment types that savers can make contributions to KiwiSaver from will be important for participation and the level of ongoing

saving. Officials have been considering how multiple job holders should be treated. There are three options:

- requiring contributions from all employment sources;
- requiring contributions from the primary employment source only; and
- allowing members to choose whether to contribute from any or all employment sources.

38. I prefer giving individual employees the choice of joining and making deductions from any or all of their employment sources in order to encourage greater participation.

39. This flexibility could be provided by employees having the ability to apply any contribution holiday to all or some employment sources.

Fee Subsidy

40. The fee subsidy is designed to encourage ongoing contributions, increase the net rate of return and reduce the likelihood that small balances that are locked in will be eroded by fees.

41. Cabinet has agreed that the government will negotiate down fees and pay the remaining ongoing fees, and that there will be some cap on the fee subsidy [CAB Min (05) 13/9 para 3.14, CAB Min (05) 15/2 para 8 refer].

42. The Minister of Commerce and I consider that the government should negotiate down fees for default providers rather than all providers as the level of fees for default providers will act as a benchmark for fees of other providers.

43. [text deleted]

Some information about the fee subsidy will be made public with the tender documents.

[text deleted]

44. I consider that it is important that adequate safeguards are in place to ensure accountability. Hence, I propose that trustees be responsible for ensuring that the subsidy is correctly applied to individual’s accounts. The Government Actuary ensures trustees have certified that they have correctly undertaken their required role.

45. Officials have advised me that there is scope for members to continue to receive the fee subsidy once their funds are no longer locked in their KiwiSaver account (when eligible for New Zealand Superannuation or after 5 years from the first

contribution, which ever is the later). Therefore, I recommend that eligibility for the fee subsidy cease when a member becomes eligible to withdraw all of their funds to limit the fiscal cost and prevent members keeping their accounts beyond this point solely to receive the fee subsidy. I acknowledge that this may reduce the incentive of members beyond the age of eligibility for New Zealand Superannuation to continue to work and save and may impact more heavily on women who have lower earnings and work force participation. However, it would not preclude these groups from continuing to save either in KiwiSaver or in other financial products.

Privacy Issues

46. The administration of KiwiSaver will involve the collection and use of personal information as the Inland Revenue Department will need to maintain information about contributions deducted and on-paid, and about providers receiving contributions. The Inland Revenue Department will need to share personal information with, for example, the Government Actuary, providers, employers and members. These roles may breach the current privacy law which prevents information collected for one purpose being used for another distinct purpose.

47. The Minister of Revenue and I propose that the Inland Revenue Department be authorised to use and share personal information across the department and, for example, with the Government Actuary, providers, employers, members and other relevant persons so that it may discharge its duty of administration of KiwiSaver and other statutory obligations. An amendment to the Inland Revenue Department's secrecy provisions and other statutory authority will be needed to permit this information use and sharing.

48. Officials will complete a detailed privacy assessment for KiwiSaver and the views of the Privacy Commissioner will be sought

Independent Trustees

49. KiwiSaver schemes will generally be regulated similarly to registered superannuation schemes to protect member. However, the Minister of Commerce and I consider that some elements of the superannuation schemes regime should be modified to provide additional protection and better suit KiwiSaver.

50. The Minister of Commerce and I propose that KiwiSaver schemes should be required to have an independent trustee as one of the trustee for the scheme to protect the interests of members. An independent trustee would reduce the risk of the trustee facing a conflict of interest between the interests of member and other groups, such as the employer.

51. This requirement should not apply to registered superannuation schemes in existence before 1 April 2007 that convert into a KiwiSaver scheme, which are not currently obliged to meet this requirement. These schemes may have non-KiwiSaver parts so it may impose unnecessary compliance costs if they are required to replace their trustee.

52. In addition, I propose that the independent trustee of the scheme for default providers should be a statutory trustee company governed by the Trustee

Companies Act 1967. Statutory trustee companies are not only independent but authorised to act as professional trustees and are required to have sufficient financial backing.

Anti-Money Laundering Requirements

53. The Financial Transactions Reporting Act 1996 imposes obligations on financial institutions to verify the identity of its customers and to verify the identities of people where money laundering or proceeds of crime are suspected.

54. An exemption to the Financial Transactions Reporting Act 1996 is likely to be needed as it may be impossible to meet the identification requirements for KiwiSaver, especially given the automatic enrolment process where employees become members through inertia.

55. I consider that the risk of KiwiSaver being used to launder money is generally low given funds are locked in until retirement. Hence, I propose that an exemption be given from the initial verification of the identity of clients in the Financial Transactions Reporting Act 1996 for all members allocated to the default product of default providers. These providers would be required to make reasonable efforts to verify the identity of the new client. This exemption would not apply to members that actively choose a provider by filling in an application form. Regulations could specify what constitutes reasonable efforts to identify a new client to reduce the legal risk for providers.

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56. Money laundering risks remain around voluntary payments, voluntary transfers between schemes and withdrawals from KiwiSaver where no identification has previously been provided. Therefore, I propose that providers must verify the identity of any person in accordance with the Financial Transactions Reporting Act 1996 before these requests are processed, unless the identity of the person has already been verified prior to that payment or request.

57. In addition, I consider it desirable that KiwiSaver providers either have or be prepared to put in place anti-money laundering policies and procedures.

Unclaimed Money

58. It is likely that the Inland Revenue Department will receive KiwiSaver deductions which will not be possible to attribute to a person. For example, the IRD number provided may be invalid or a person may give a fictitious name. This money will not be able to be processed and forwarded to a member’s fund.

59. Generally, unclaimed money that is held by the private sector falls under the Unclaimed Money Act 1971, whereas unclaimed money that is held by the public sector falls under the Public Finance Act 1989.

60. The Minister of Revenue and I propose that KiwiSaver contributions held by the Inland Revenue Department be treated as falling under the Unclaimed Money Act 1971 if the Inland Revenue Department cannot identify the person. This approach would be simple and synergies could be achieved given the Inland Revenue Department’s role as central administrator for KiwiSaver and it oversees the Unclaimed Money Act 1971.

Offences

61. A range of offences are needed to ensure KiwiSaver works as intended and provide employers, employees, providers and other people with adequate incentive to fulfil their obligations. Offences are also necessary to provide adequate member and regulatory protection.

62. As parts of KiwiSaver will be administered through the pay as you earn (PAYE) tax regime, the Minister of Revenue and I consider that it is appropriate for the offences and penalties to be the same as the existing tax offences and penalties, particularly the PAYE offences in the Tax Administration Act 1994. Hence, I propose that the parts of the KiwiSaver legislation administered by the Inland Revenue Department be treated as an Inland Revenue Act[1] and the current offences and penalties applying to tax and in particular to PAYE apply to KiwiSaver.

63. The Government Actuary offences need to be consistent with the Inland Revenue offences to ensure consistency of the overall regime but these offences will not be tax offences. The offences relating to regulatory regime will be based around the existing offences in the Superannuation Scheme Act 1989, including offences for the failure to deliver documents as required by the Act or the failure to carry out a direction made by the Government Actuary. The penalties currently imposed by these offences, however, are significantly outdated. Accordingly, I propose that the penalties for the equivalent offences under the KiwiSaver legislation be aligned with the penalties for the tax offences in the KiwiSaver legislation in order to ensure consistency.

64. The level of the penalties is on the same as the current penalties imposed under section 143 or section 143A of the Tax Administration Act for absolute liability and knowledge offences respectively[2]. An absolute liability offence is one where failure to do the specified action is sufficient proof that the offence has occurred, so proof of the person's knowledge or intent is not relevant. Whereas for knowledge offences proof of the person's knowledge or intent is relevant. The standard of proof in relation to such proceedings relating to these offences is beyond reasonable doubt and the onus of proof generally rests with the Commissioner or Government Actuary.

Authorisation

65. Cabinet authorised the Minister of Finance, in consultation with the Minister of Housing and Minister of Education, to agree outstanding detailed design issues for KiwiSaver [CAB Min (05) 13/9 paragraph 7].

66. However, given that there are likely to be additional detailed design issues that relate to the regulatory environment, the role of employers and administration issues, and the tertiary savings scheme may not proceed, I consider that it would

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1 An Inland Revenue Act is an Act administered by the Inland Revenue Department, including Income Taxation Act and Taxation Administration Act.

2 The Tax Administration Act 1994 offences are punishable on conviction to a fine not exceeding $12 000 for absolute liability offences and a fine not exceeding $50 000 and/or a term of imprisonment of up to five years for knowledge offences.

be appropriate to revisit this earlier decision to change the relevant Ministers. I propose that I consult with the Minister of Commerce and Minister of Revenue on all detailed design issues, and the Minister of Housing where decisions may impact on home ownership.

Financial Implications

67. The estimated fiscal cost of KiwiSaver has been set aside in the Savings Allocation, which was included in the Half-Year Economic and Fiscal Update (HYEFU) 2005. The Savings Allocation in the HYEFU updated the Savings Allocation from Budget 2005 (POL Min (05) 9/1 (4)) for forecast changes.

68. The majority of proposals in this paper will not affect this estimated fiscal cost. However, extending the minimum period before a contribution holiday can be taken may reduce participation in KiwiSaver, and therefore fiscal cost, although the effect is very uncertain and unlikely to be significant. In addition, the proposal to change the automatic enrolment process of new employees may increase pressure on administration costs for the Inland Revenue Department, but this is unlikely to be significant. Overall, I expect any changes in fiscal cost as a result of proposals in this paper can be managed within the existing Savings Allocation.

69. As there may be further changes to KiwiSaver, such as any changes to the KiwiSaver Bill arising from the Select Committee process, I will report back to Cabinet at the time funds are sought for appropriation, including how any revised estimate of the fiscal cost compares to the level of the Savings Allocation in the HYEFU 2005.

Legislative Implications

70. Legislative implications for KiwiSaver as a whole were outlined in the initial and subsequent Cabinet paper (CAB Min (05) 13/9 and CAB Min (05) 15/2 refer).

Regulatory Impact Statement

71. Based on the information provided in the attached RIS/BCCS, the Regulatory Impact Analysis Unit considers that … [to come].

72. Some elements in the proposals in this paper will increase compliance costs, such as for providers participating in the tender, seeking registration, preparing investment statements, ensuring their fees are not unreasonable and becoming qualify collective investment vehicle compliant and for employers supplying more information to the Inland Revenue Department. Other elements will decrease compliance costs, such as providers not needing to print investment statements for all employees or provide a mortgage diversion option and not all providers needing to negotiate fees. However, steps will be taken to minimise compliance costs on employers and the financial sector, such as through stakeholder consultation in developing processes.

Treaty Implications

73. KiwiSaver has no treaty obligations as presently designed.

Human Rights Act

74. The proposals in this Cabinet paper appear to be consistent with the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. A final view will be possible once the Bill has been drafted.

Publicity

75. There will be an information campaign closer to implementation as previously noted by Cabinet [CAB Min (05) 13/9 para 14 refers]. In addition, there is likely to be some publicity when the KiwiSaver Bill is introduced. The nature of this publicity will be covered when LEG approvals are sought.

Consultation

76. The following agencies have been consulted in the preparation of this Cabinet paper: the Inland Revenue Department, the Ministry of Economic Development, the Ministry of Justice, the Ministry of Social Development (MSD), Housing New Zealand Corporation, Department of Labour, State Services Commission (SSC), the Ministry of Education, Te Puni Kokiri (TPK) and the Ministry of Women's Affairs. The Department of Prime Minister and Cabinet has been informed.

77. SSC and the Ministry of Women's Affairs have expressed concern that the removal of the fee subsidy when lock-in ends may penalise those that wish to continue to work and save. In addition, SSC thought it would send a strong signal to KiwiSaver members to withdraw the funds in their KiwiSaver account rather than using it to supplement their retirement income over an extended period.

78. The Ministry of Women's Affairs and TPK are concerned that the fee subsidy proposal raises equity issues. In particular, it would impact disproportionately on women (and especially Mäori and Pacific women) relative to men given women earn less on average, spend longer outside the workforce and need to provide for a longer period of retirement given their greater life expectancy. Working past the age when lock-in ceases would enable greater provision for retirement but contributions to KiwiSaver would not qualify for a fee subsidy irrespective of the amount of fee subsidy that the member received during the lock-in phase. The Ministry suggested that additional options be considered, such as capping the total government subsidy per member at some fixed amount over the lifetime of the KiwiSaver account and that this could be implemented in conjunction with or instead of an annual cap.

79. The following employers, providers and employer and industry groups were consulted on the automatic enrolment process for new employees: [text deleted]

80. The following other groups were consulted on mortgage diversion: [text deleted]

The comments of these groups are included in the paper.

Recommendations

81. I recommend that the Committee:

Automatic Enrolment Provisions

1. **note** that on 2 May 2005 Cabinet agreed that:

   1.1. new employees that are automatically enrolled can opt out in the second and third week of a new job [CAB Min (05) 15/2 para 10];

   1.2. deductions for individuals who are automatically enrolled start on the first pay day after the employee has been in the job for eight weeks [CAB Min (05) 15/2 para 12;

2. **rescind** the decisions referred to in paragraph 1;

3. **agree** that an employer must notify the Inland Revenue Department that a new employee has started and pass on the new employee’s name, IRD number and address within three weeks of the employee starting work with that employer;

4. **agree** that new employees that are automatically enrolled can opt out in weeks two to six inclusive of a new job;

5. **agree** that the Inland Revenue Department allocates the new employee to a default provider and sends the employees the investment statement for the default product with that provider, if the Inland Revenue Department has not been advised that new employee has already opted out or chosen a provider;

6. **agree** that employees are treated as having received an investment statement for the allocated default fund if the Inland Revenue Department has sent one;

7. **agree** that deductions for individuals who are automatically enrolled start on the first pay day after the employee has been in the job for eleven weeks;

8. **agree** that investment statements for default funds be concise and simple to understand;

Contribution Holidays

9. **note** that on 2 May 2005 Cabinet agreed that employees should be able to take a contribution holiday after the person has been contributing for at least three months [CAB Min (05) 15/2 paras 18];

10. **rescind** the decisions referred to in paragraph 9;

11. **agree** that employees should be able to take a contribution holiday after the person has been contributing for at least twelve months;

12. **agree** that members who suffer significant financial hardship during the first twelve months of membership in KiwiSaver be able to apply to the Inland Revenue Department for a three months (or such longer period as the Commissioner of Inland Revenue may determine) contribution holiday;

Selection of Providers

13. **note** that on 11 April 2005 Cabinet agreed in principle that product providers will be selected by a competitive tender process and/or a requirement to meet a set of minimum specified criteria [CAB Min (05) 13/9 paragraph 5.1];

14. **rescind** the decision referred to in paragraph 13;

15. [text deleted]

16. **agree** that any provider be able to register an active choice KiwiSaver product if they meet the general KiwiSaver rules, including a requirement that their fees are not unreasonable;

Tax Treatment of KiwiSaver

17. **agree** that default KiwiSaver providers be required to be qualifying collective investment vehicle for their specific default funds, but these providers should also be able to operate funds which do not have qualifying collective investment vehicle status;

18. **agree** that the KiwiSaver Bill clarify the treatment of registered superannuation schemes that convert to KiwiSaver and ensure that the transfer of property as part of a KiwiSaver conversion is not treated as a disposal for income tax purposes;

Mortgage Diversion

19. **agree** that, in light of feedback from unions, retirement groups and mortgage providers, KiwiSaver members not be given the option to divert their savings contributions to repay the mortgage on their principal residence as part of KiwiSaver;

Multiple Job Holders

20. **agree** that employees may make KiwiSaver contributions from any or all primary and secondary salary and wage sources to encourage scheme participation;

Fee Subsidy

21. **note** that on 11 April 2005 Cabinet agreed that the government will negotiate down fees payable to KiwiSaver providers, and pay the remaining ongoing fees;

22. **rescind** the decision referred to in paragraph 21;

23. **agree** that the government will negotiate down fees payable to KiwiSaver default providers;

24. **agree** that that the fee subsidy will be a flat dollar amount payable to each KiwiSaver per annum;

25. **agree** that trustees be responsible for ensuring that the fee subsidy is correctly applied to individuals' accounts;

26. **agree** that eligibility for the fee subsidy cease when a KiwiSaver member becomes eligible to withdraw all of their funds;

Privacy Issues

27. **agree** that the Inland Revenue Department may use and share personal information across the department for administering KiwiSaver and its other statutory obligations;

28. **agree** that the Inland Revenue Department may use and share personal information with, for example, the Government Actuary, providers, employers, members and other relevant persons so that it may discharge its duty of administration of KiwiSaver and other statutory obligations;

Independent Trustees

29. **agree** that KiwiSaver schemes should be required to have an independent trustee as one of the trustees for the scheme to protect of the interests of members;

30. **agree** that the requirement to have an independent trustee should not apply to registered superannuation schemes in existence before 1 April 2007 that convert into a KiwiSaver scheme;

31. **agree** that the independent trustee of each default KiwiSaver provider should be a statutory trustee company governed by the Trustee Companies Act 1967;

Anti-money Laundering Requirements

32. **agree** that an exemption be given from the initial verification of the identity of clients in the Financial Transactions Reporting Act 1996 for all members allocated to the default product of default providers provided that these providers make reasonable efforts to verify of the identity of the new person;

33. **agree** that providers must verify the identity of any person making a voluntary payment in accordance with the Financial Transactions Reporting Act 1996, unless the identity of the person has already been verified;

34. **agree** that providers must verify the identity of any person in accordance with the Financial Transactions Reporting Act 1996 before any withdrawal or voluntary transfer is processed, unless the identity of the person has already been verified prior to that request;

35. **agree** that all KiwiSaver providers have or be prepared to put in place anti-money laundering policies and procedures;

Unclaimed Money

36. **agree** that all unclaimed money held by the Inland Revenue Department be treated under the Unclaimed Money Act 1971;

Offences

37. **agree** that the offences and penalties in the parts of the KiwiSaver legislation administered by the Inland Revenue Department be the same as the existing tax offences and penalties, in particular the pay as you earn offences in the Tax Administration Act 1994;

38. **agree**, where possible, to align the offences and penalties in the KiwiSaver legislation relating to the regulatory regime with existing Inland Revenue Department offences and penalties in the Tax Administration Act 1994;

Authorisation

39. **note** that on 11 April 2005 Cabinet authorised the Minister of Finance, in consultation with the Minister of Housing and Minister of Education, to agree outstanding detailed design issues for KiwiSaver [CAB Min (05) 13/9 paragraph 7];

40. **rescind** the decision referred to in paragraph 39;

41. **authorise** the Minister of Finance, in consultation with the Minister of Commerce, Minister of Revenue and Minister of Housing, where there may be an impact on home ownership, to agree outstanding detailed design issues for KiwiSaver;

Financial Implications

42. **note** that the proposals in this paper, in particular extending the minimum period before a contribution holiday can be taken and changes to the automatic enrolment process of new employees, may have financial implications but these are uncertain, unlikely to be significant, and I expect to manage any changes within the existing Savings Allocation; and

43. **note** that legislation is expected to be introduced in early 2006.

Hon Dr Michael Cullen
Minister of Finance

ANNEX 1: OVERVIEW OF KIWISAVER

The purpose of KiwiSaver is to encourage a long-term savings habit and asset accumulation by individuals who are not currently saving enough, with the aim of increasing individuals' well being and financial independence, particularly in retirement. KiwiSaver is designed to facilitate a change in the savings behaviour of individuals and to complement New Zealand Superannuation (NZS) for those who wish to have more than a basic standard of living in retirement.

The KiwiSaver scheme provides a mechanism for employees to make contributions to long term savings products via the PAYE tax system. KiwiSaver contributions will be administered by the Inland Revenue Department in order to minimise compliance costs for employers and to work off existing processes where possible.

Savers

Participation will not be compulsory. In order to overcome inertia, which prevents some people saving, new employees are automatically enrolled in the scheme and must actively opt out. For all new employees aged between 18 and 65 (age of eligibility for NZS) who begin a job on or after 1 April 2007, such persons will be automatically enrolled in the scheme unless they opt out. This means that people who do nothing will end up enrolled in the scheme.

Existing employees will be able to opt in to the scheme. Employers that have an approved registered superannuation scheme will be able to apply for an exemption from the automatic enrolment requirements.

Persons who are not employees, such as the self-employed, will be able to opt in to the scheme on a voluntary basis and make voluntary contributions. Persons aged under the age of 18 years of age will be able to opt in.

The contribution rates from salary or wages will be either 4% or 8% of the gross salary or wages. The 4% rate will be the default rate unless the higher rate has been elected by the employee.

Savers can select their own fund and can change funds or providers at any time. However, savers can only have one provider at any point in time. Those who do not specify a fund are randomly allocated to a conservative investment strategy fund with a default provider.

An employee after an initial contribution period will be able to apply to Inland Revenue for a contribution holiday of up to 5 years at a time.

Contributions are locked-in until age of eligibility for NZS or five years after the first contribution, which is later, with the exception of withdrawals to purchase a first home, financial hardship and permanent emigration.

Members will receive an up front contribution of $1 000 per participant and an ongoing contribution towards a member's fees paid by the government.

After three years of saving, a first home deposit subsidy of $1 000 per year, up to a maximum of $5 000, will be available for first home buyers who participate in KiwiSaver. This will be available in 2010.

Employers

Employers will be required to provide all new employees from 1 April 2007 with a savings information pack put together by the Inland Revenue Department and supplied to employers.

An employer will be required to make deductions from the gross salary or wages paid to the employee and pays this amount along with PAYE etc to Inland Revenue. Employers will also be able to make voluntary contributions to their employee's savings.

Existing Registered Superannuation Schemes

Existing registered superannuation schemes that meet certain criteria will be able to:

- convert to a KiwiSaver scheme;
- establish a KiwiSaver scheme within an existing registered superannuation scheme, under the existing trust deed;
- apply for an exemption from the automatic enrolment requirements (if it is an employer-based scheme); and
- continue operating independently of KiwiSaver.

Providers

KiwiSaver schemes will be governed by trust deeds and regulated similarly to registered superannuation schemes. All KiwiSaver schemes will need to be approved by the Government Actuary.

REGULATORY IMPACT STATEMENT

STATEMENT OF THE NATURE AND MAGNITUDE OF THE PROBLEM AND NEED FOR GOVERNMENT ACTION

In Budget 2005, the Government announced it would introduce a work based saving scheme, KiwiSaver, to commence from 1 April 2007. KiwiSaver is designed to obtain a change in savings behaviour for people who are currently either not saving or under saving, and to get them into the habit of saving, especially for their retirement.

The Budget decisions provided high level detail on the KiwiSaver scheme. Some of the decisions taken at that time are now being reconsidered in light of further consultation and policy development. There were also a number of detailed design issues that were not taken at that time.

The following problems with KiwiSaver have been identified:

- automatic enrolment process for new employees: KiwiSaver will operate with a number of default providers of savings products. Default providers would be required to provide every new employee with investment statements even if they are not the allocated default for that new employee and regardless of whether the employee wants to opt out or not. Providers have indicated that these costs could be prohibitive and may discourage providers from seeking to participate in KiwiSaver. Employers would also incur costs in storing these investment statements. In addition, new employees may make a poor decision on whether to save through KiwiSaver and which provider to choose by being overwhelmed at receiving too much information and not knowing which provider will be allocated to them in the event of making no active choice.

- contribution holiday: people may join KiwiSaver solely to obtain the upfront government contribution of $1 000 and cease making contributions after a few months with no intention of recommencing contributions at a later date. A three months contribution period may not be sufficiently period to form a long term savings habit and result in a small account balance that is unprofitable for providers. As a result, some providers may be discouraged from participating in the scheme.

- selection of providers: consumers often find it difficult to make financial decisions when confronted with too many savings choices. A large number of providers to select between would exacerbate this problem. In addition, the government may find it more difficult to negotiate lower fees for products for members who do not select their own provider where there are a large number of providers as each provider is less likely to be able to reach an efficient scale.

- tax status of schemes: low income employees may be discouraged from saving in KiwiSaver if the earnings from such investments are taxed at above their marginal tax rate. Registered superannuation schemes may be discouraged to convert into a KiwiSaver scheme given the uncertainty over the taxation implications of conversion.

- mortgage diversion: the ability of contributors to divert their contributions to repay their mortgage may shift the focus of KiwiSaver away from retirement savings and make the scheme unnecessarily complex by providing members with more options. In addition, the mortgage industry has indicated they have little interest in providing mortgage diversion given the time delay before funds would reach the banks and the risks of having payments made via a third party given if a problem arose with a payment a provider would not know immediately if the problem originated with the member, employer or Inland Revenue.

- multiple job holders: if people are required to contribute from all their employment income sources, they may be reluctant to join KiwiSaver or continue to contribute as it would require a higher level of commitment from the person, that is, a willingness to contribute out of all their employment income.

- the government contribution towards the fees paid by a member on their KiwiSaver account: there is a risk that the fee subsidy may not be applied correctly to individual member accounts if the payments are not be appropriately entered or checked. There is scope for members to continue to receive the government contribution towards fees once they are eligible to withdraw their funds (either at the age of eligibility for New Zealand Superannuation or 5 years, whichever is the later) if they keep their KiwiSaver account open. In effect, these members may have an incentive to keep their KiwiSaver account open and use the scheme as a subsidised bank account which would increase the fiscal cost of the fee subsidy without significantly increasing retirement savings or changing saving behaviour.

- privacy. the Inland Revenue may be prevented from being able to use and share personal information on employees and members by privacy laws. This may prevent the Inland revenue from effectively discharging its statutory obligations.

- trustees: trustees of KiwiSaver schemes could prioritise the interests of employers and other groups above members in the scheme and thus make decisions that may not be in the members' interests. For example, trustees could be motivated by the desire for further business with that employer and to ensure their continued employment as the trustee. In addition, trustees may not have adequate experience to oversight KiwiSaver schemes.

- anti-money laundering requirements: trustees and providers may not be able to verify the identity of a potential or new member as the member does not need to fill in an application form or prove their identity before joining. This lack of verification increases the risk of KiwiSaver being used to process the proceeds of crime or counter terrorist financing.

- unclaimed money: Inland Revenue may receive money that it cannot attribute to a person, such as where the IRD number is invalid. When this money becomes unclaimed, it would be treated under the Public Finance Act. This would require a separate process from the other unclaimed money administered by Inland Revenue.

- offences: employers, employees, providers and other people may not have adequate incentives to fulfil their obligations and enable KiwiSaver to work as intended.

STATEMENT OF THE PUBLIC POLICY OBJECTIVES

The primary objectives of KiwiSaver are:

- to support a cultural change in New Zealanders' attitudes toward savings to increase self reliance and forward planning; and
- to help create a financial buffer for New Zealand households through the building up of assets, reducing debt dependency and giving people increased financial independence and flexibility, particularly in retirement.

STATEMENT OF FEASIBLE OPTIONS (REGULATORY AND/OR NON-REGULATORY) THAT MAY CONSTITUTE VIABLE MEANS FOR ACHIEVING THE DESIRED OBJECTIVE(S) AND NET BENEFITS (INCLUDING NON-QUANTIFIABLE BENEFITS) OF THE PROPOSAL, AND OTHER FEASIBLE OPTIONS

The key features of the status quo and the proposed option(s), including the benefits and costs, are outlined below. The key features of the status quo reflect the decisions already taken in regard to KiwiSaver unless specified. The status quo is not preferred as it does not meet the policy objectives to the same extent as the preferred option.

Automatic enrolment process of new employees

Status quo:

New employees between 18 and 65 years of age will be automatically enrolled in KiwiSaver when they start a new job but will have the opportunity to opt out in the second and third week of a new job. Employers would be required to give new employees an information pack, including investment statements for all default providers, in the first week and beginning deductions on the first pay day after the employee has been in the job for eight weeks unless Inland Revenue notifies the employer that the employee has opted out (Cab Min (05) 15/2 paras 9 to 14 refer).

Alternative option:

Other options considered were to require a consolidated investment statement for all default products, providing the investment statement after the opt out period and putting investment statements on a website. These options were not preferred as they would not address all the problems with the status quo.

Preferred option:

The employee is given an information pack by the employer in the first week of the job. The employer notifies the Inland Revenue Department that a new employee has started and passes on the new employee's name, IRD number, and address within three weeks of the employee starting their job. Once the Inland Revenue Department receives notification from the employer that a new employee has started, it allocates the new employee to a default provider and sends the employee a simplified default investment statement for that provider if it has not been advised that the employee has already opted out. New employees can opt out in weeks two to six inclusive of their new jobs by advising the Inland Revenue Department. Employees are deemed to have received the investment statement once issued by the Inland Revenue Department. The employer commences deductions from the new employee's next pay period after week eleven unless advised by the Inland Revenue Department that the employee has opted out.

Providers

Providers may be more willing to become default providers given they will not need to provide investment statements for their default products to all new employees.

Providers may incur some costs in ensuring their investment statements are concise and easy to understand which are outlined below in the Business Compliance Cost Statement.

Providers may set lower fees for members given they do not need to recoup as large an amount to cover the costs of printing and providing investment statements. The lower fees may encourage more people to join KiwiSaver.

Employers

Employers will incur costs in providing the names and addresses of employees to Inland Revenue but these are not expected to be onerous. However, employers will save costs by not having to store large information packs and ensuring that investment statements are kept up to date.

Employers may be asked less questions by their employees if new employees are not confronted with multiple investment statements.

Members

New employees may be more likely to make better financial decisions as they will have a longer period to make a decision about whether to join KiwiSaver, including a greater opportunity to seek financial advice, if they wish. New employees also stand less risk of being overwhelmed by receiving multiple investments statements or being required to opt out before being allocated to a default provider. New employees will still be able to request additional investment statements directly from other providers but this will require effort now by the employee for the default schemes.

Members may be less likely to become lost and not receive information about their account and fund if the Inland Revenue and providers collect their address details.

Government

The government will incur postage costs sending out investment statements to new employees. However, the government's overall fiscal costs may not increase as providers would have sought to pass any administration costs from printing and sending out investment statements on to members (and thus indirectly to the government given it will contribute to paying members' fees).

To the extent that the proposal increases the number of people that opt out of KiwiSaver, the government will incur less fiscal costs from paying the $1000 government contribution and contributing to the fee subsidy.

<u>Contribution holidays</u>

Status quo:

Employees can take a contribution holiday for up to five years at a time after the person has been contributing for at least three months.

Preferred option:

Employees can take a contribution holiday after the person has been contributing for at least twelve months. Members who suffer significant financial hardship during the twelve month period be able to apply to the Inland Revenue Department for a three months contribution holiday, or such longer period as the Commissioner determines. If the hardship continues beyond the period of the contribution holiday, members can apply for a further three month contribution holiday.

<u>Employers</u>

Employers may be less likely to have to process requests from employees to stop or start contribution holidays in the first year that an employee becomes a member of KiwiSaver. This will save administration costs.

<u>Members</u>

Less people may change their saving behaviour and hence accumulate fewer assets if the longer minimum contribution period deters participation in KiwiSaver. However, those that do join KiwiSaver may be more likely to develop a stronger savings habit and accumulate more assets given they cannot take a contribution holiday for at least 12 months. Members that experience financial hardship will still be able to access their funds and obtain a three month contribution holiday.

<u>Providers</u>

Providers may have fewer KiwiSaver members so lower overall balances and profitability initially. Over time, providers may have higher overall saving balances and profitability to the extent that the proposal encourages people to continue to save and take fewer contribution holidays.

Some providers may be more likely to participate in KiwiSaver given members must contribute for a longer period initially.

Trustees may have more requests for financial hardship in the first year of membership as members are not eligible to take a contribution holiday.

<u>Government</u>

The government may have lower fiscal costs if fewer people become KiwiSaver members and entitled to the government $1000 contribution and contribution towards the fee subsidy. Inland Revenue will incur higher administration costs in dealing with financial hardship requests.

<u>Selection of the providers of default products</u>

Status quo:

Product providers will be selected by a competitive tender process and/or a requirement to meet a set of minimum specified criteria (CAB Min (05) 13/9 para 5.1 refers). The government will negotiate down the fees payable to KiwiSaver providers (CAB Min (05) 13/9 para 3.16 refers).

Alternative option:

The product providers of default products could be selected based solely on the conservative default product they propose to offer and by a competitive tender process. This option is not preferred as it would not allow the negotiation by the government of fees across a range of products and the default conservative product may not be appropriate for all savers.

Preferred option:

That the product providers of default products could be selected by the government based on the suite of products offered (for example, conservative, balanced and growth), including the conservative default product they propose to offer, and by a competitive tender process.

Other providers would be able to participate in KiwiSaver, subject to meeting minimum criteria, including that fees are not unreasonable. The products offered by these providers would be registered but would not be default products.

<u>Financial sector</u>

Selecting default providers by tender and other providers based on minimum criteria may enable more providers to offer KiwiSaver products and thus encourage competition, innovation and investor choice. However, the tender process will impose costs on providers which are outlined below in the Business Compliance Cost Statement.

The costs on providers in ensuring that fees are not unreasonable are outlined below in the Business Compliance Cost Statement. The removal of the need for fee negotiations with all KiwiSaver providers should decrease costs on non-default providers, despite the need to ensure fees are not unreasonable, and thus encourage more providers to offer KiwiSaver products. However, non-default providers will still need to compete on fees and provide attractive returns to encourage members to choose their products.

<u>Members</u>

Members will be able to choose from, or be allocated to, a limited number of providers with a range of low cost and basic investment products that are stable, reputable and able to handle high volumes. Hence, members may find it easier to make a financial decision. Members will still be able to select other providers to meet their own specific needs, including the expected risk and return profile.

Members may also benefit from increased competition, innovation, investor choice and the requirement that fees are not unreasonable.

Government

The government will incur lower fiscal costs from not needing to negotiate fees with all KiwiSaver providers.

Multiple Job Holders

Status quo:

No decision had been made on how people who hold multiple jobs would be able to participate in KiwiSaver. Employees are able to contribute to KiwiSaver at either 4% or 8% of their gross salary and wages (4% is the default contribution rate).

Alternative options:

People with multiple jobs could be required to contribute from their sources of employment income or people with multiple jobs could be required to contribute their primary employment source only. These options are not preferred as they would decrease continued participation in KiwiSaver as employees would be less likely to join or save where they are obliged to contribute all or a significant proportion of their employment income.

Preferred option:

People with multiple jobs could choose whether to contribute from any or all of their employment sources of income after the initial twelve month period. This may mean that people with multiple jobs could end up contributing less than 4% of their gross aggregate salary and wage income. This flexibility could be provided by employees having the ability to apply any contribution holiday to all or some employment sources

Providers

Providers may benefit from a greater number of people seeking to save in KiwiSaver. These extra people may increase the ability of providers to achieve an efficient size which is often determined by the aggregate amount of funds invested.

Members

People with multiple jobs would be more likely to save through KiwiSaver given they can choose whether to contribute from all or any jobs. Hence, this may increase the likelihood of people with multiple jobs have higher living standards in retirement. People with multiple jobs may end up on average with lower savings balances on reaching retirement that other people given they may choose to contribute at less than 4 per cent of their entire employment income.

Government

The government may incur a higher fiscal cost as more people with multiple jobs choose to contribute.

Tax Treatment of Schemes

Status quo:

Default providers would be able to elect whether to offer their specific funds as qualifying collective investment vehicle (which would tax assessable income at investors' elected tax rates and would generally exclude realised domestic share gains) or not. The conversion of existing registered superannuation schemes into KiwiSaver schemes may constitute a disposal for tax purposes, resulting in taxable income.

Preferred option:

Default providers will be required to offer a suite of qualifying collective investment vehicle funds. Default providers would also be able to operate other funds which do not have qualifying collective investment vehicle status. The transfer of property as part of a KiwiSaver conversion will not trigger an income tax liability.

Providers

Default providers may incur costs in ensuring their specific funds are QCIV compliant. These costs are likely to be greater for existing registered superannuation schemes that convert into a KiwiSaver scheme. These costs are further outlined in the Business Compliance Cost Statement.

Registered superannuation schemes may more likely to convert into a KiwiSaver scheme given greater certainty over the taxation implications of conversion.

Members

Low income earners may receive higher returns from investing in KiwiSaver as their earnings would be taxed at above their marginal tax rate and any realised domestic share gains would generally not be taxable. This may increase the attractiveness of KiwiSaver and participation from low income earners.

Higher income earners may gain as realised domestic share gains would generally not be taxable.

Members of existing registered superannuation schemes which convert into KiwiSaver schemes will have higher returns as conversion will not trigger a taxable disposal of property.

Government

The Government is more likely to achieve its policy objectives if default funds are qualifying collective investment vehicles. It is estimated that the fiscal cost of the QCIV proposals is $50 million. The tax treatment of converting into a KiwiSaver scheme will be more certain. However, the Government may collect less revenue as there will be no taxable disposal of property on conversion.

Mortgage Diversion

Status quo:

KiwiSaver members will have the option to divert their savings contributions to repay the mortgage on the principal family home for a time (CAB Min (05) 13/9, para 3.12 refers). This payment would be made via Inland Revenue.

Preferred option:

KiwiSaver members will not have the option to divert their savings contributions to repay the mortgage on the principal family home.

Government

The proposal will decrease the administration costs on Inland Revenue.

Financial sector

Mortgage providers would not need to implement systems and processes to enable them to apply the contributions received via Inland Revenue to the appropriate mortgage payments. In addition, if a problem arises with a mortgage payment, mortgage providers may be able to more easily identify the source of the problem.

Members and society

The proposal would increase the focus of KiwiSaver on retirement savings and make the scheme simpler. Hence, potential savers may be less confused about what options are available to them. Members would lose the opportunity to divert their mortgage payments via Inland Revenue. However, members could still take a contribution holiday after contributing for an initial twelve months and use this income to repay their mortgage directly. Hence, the change should have limited, if any, impact on overall participation in KiwiSaver.

Members would avoid the risk of being financially disadvantaged by the time difference between when payments are deducted from their salary and wages and when they are passed on to their mortgage provider. This delay may result in members incurring higher interest and other fees on their mortgage as interest is charged daily on the loan balance by mortgage providers.

The government contribution towards fees

Status quo:

The government will pay the ongoing fees levied on a member's KiwiSaver account, subject to some cap on the fee subsidy (CAB Min (05) 13/9 para 3.14 and CAB Min (05) 15/2 para 8 refer). This payment continues to be available when the member's funds are no longer locked in.

Alternative option:

The government contribution to fees would continue to be available after a member's funds are no longer locked in provided the member is continuing to contribute and not making any withdrawals. This option is not preferred as it would increase the complexity of KiwiSaver, impose additional compliance costs on providers and have a higher overall fiscal cost.

Preferred option:

The government contribution to fees would be a flat payment per member per annum. The government contribution to fees would cease when a member's funds are no longer locked in upon reaching the age of eligibility for New Zealand Superannuation or five years from the point of the first contribution, whichever is the later.

Trustees would be responsible for ensuring that the subsidy is correctly applied to individual's accounts.

<u>Financial sector</u>

The proposal may decrease slightly the aggregate amount of savings held in KiwiSaver both by deterring contributions by older members and encouraging people to withdraw their funds when possible. This may result in a slight loss of business in the sector. Over time, the proposal may increase the demand for other financial products as members close their KiwiSaver accounts on reaching retirement given they will no longer be eligible for any government contribution to fees.

The removal of the fee subsidy when a member becomes eligible to withdraw all their funds will impose some administration costs on providers which providers may either absorb or pass on in higher fees. These compliance costs are outlined below in the Business Compliance Cost Statement.

Trustees of schemes will incur costs in administering the government contribution to member's fees. These costs are likely to be lower with a subsidy expressed as a flat dollar amount. These costs are outlined in the Business Compliance Cost Statement.

<u>Members</u>

The proposal may reduce the incentive of members beyond the age of eligibility for New Zealand Superannuation to continue to work and save. However, these individuals could still continue to work and save either within or outside of KiwiSaver. Members with funds that are no longer locked in will incur higher fees if they leave their funds in KiwiSaver because they will no longer receive the government contribution towards fees.

A flat fee subsidy will be easier for members to understand. In addition, there is a lower risk of members not receiving the fee subsidy they are entitled to if it is a flat fee.

<u>Government</u>

The government may incur less fiscal costs as it is no longer contributing to the fees of members when their funds are no longer locked in.

Privacy

Status quo:

Inland Revenue may only use personal information collected for the purpose it is sought.

Preferred option:

Inland Revenue be able to use and share personal information across the department for KiwiSaver and its other statutory obligations. Inland Revenue would be able to use and share personal information with, for example, the Government Actuary, providers, employers, members and other relevant persons.

Providers

The preferred option is likely to reduce costs on providers in that Inland Revenue will provide relevant information its holds to providers thereby reducing the need for the provider to obtain it.

Members

Members may have personal information used for a purpose they had not intended. However, members will not have to provide the same information to both Inland Revenue and providers, thereby reducing compliance costs. There should be a lower risk that members become lost.

Government

Inland Revenue may better discharge its duty of administration of KiwiSaver and other statutory obligations.

Independent trustees

Status quo:

KiwiSaver schemes are not required to have independent trustees or use statutory trustee companies as the trustee of the scheme.

Preferred option:

KiwiSaver schemes are required to have independent trustees. Registered superannuation schemes in existence on or before 1 April 2007 that convert into a KiwiSaver scheme would not be obliged to meet this requirement. Default schemes are required to use statutory trustee companies.

Employers and providers

It may limit the choice of potential trustees for employers and providers thereby increasing the cost of employing a trustee. However, many registered superannuation schemes already employ independent trustees and statutory trustee companies so may not incur any additional costs.

Employers may have less control over any employer run or operated KiwiSaver scheme given the trustee must be independent.

Trustees

Trustees may have less conflict of interest in carrying out their role by being independent.

Statutory trustee companies may increase in size and hence profitability given the higher demand for their services.

Members

Members' interests may be better protected through using independent and more experienced trustees which should increase confidence in KiwiSaver.

Anti-money laundering requirements

Status quo:

Providers would be required to verify the identity of any person in accordance with the Financial Transactions Reporting Act before accepting them as a customer.

Preferred option:

Default providers will be exempt from the initial verification of the identity of clients in accordance with the Financial Transactions Reporting Act for all members allocated to their default product provided that these providers make reasonable efforts to verify of the identity of the new person.

Providers must verify the identity of any person making a voluntary payment, withdrawal or voluntary transfer in accordance with the Financial Transactions Reporting Act, unless the identity of the person has already been verified.
All KiwiSaver providers must have or be prepared to put in place anti-money laundering policies and procedures;

Financial sector

Providers will be required to take reasonable efforts to verify the identity of people dealing with them and put in place anti-money laundering policies and procedures. These costs are outlined in the Business Compliance Cost Statement.

Providers will benefit from a lower risk of KiwiSaver being used for money laundering purposes that might otherwise diminish the reputation of and confidence in the New Zealand financial sector.

Members

Members will be required to verify their identity before being able to access or transfer their funds. However, they may have more confidence in KiwiSaver and the financial sector overall.

<u>Unclaimed Money</u>

Status quo:

Unclaimed KiwiSaver money held by Inland Revenue would be treated under the Public Finance Act (PFA) section 70. However, it is not clear how this section would apply in practice, as it would not be practical to apply the definition of unclaimed money in section 70 (1) of the PFA to KiwiSaver due to the fact that KiwiSaver funds are generally locked-in. Hence, a new process for handling these funds will need to be developed.

Preferred option:

Unclaimed KiwiSaver money held by Inland Revenue would be administered by Inland Revenue and treated under the Unclaimed Money Act 1971.

<u>Members</u>

Members may find it easier to identify and find unclaimed KiwiSaver money as information on unclaimed money is available on Inland Revenue's website.

<u>Government</u>

The costs of administering the unclaimed KiwiSaver money may be lower given Inland Revenue already oversees most other unclaimed money and it may generate synergies with Inland revenue's central administrator for KiwiSaver role.

<u>Offences</u>

Status quo:

No offence provisions have been created.

Preferred option:

The offences will be consistent with existing tax offences, particularly the pay as you go (PAYE) offences in the Tax Administration Act 1994. The offences relating to the regulatory regime will be consistent with the tax offences to ensure consistency of an overall regime, but be based around the existing offences in the Superannuation Schemes Act. For example, a person will commit an offence if he or she does not keep the books or documents required to be kept (whether knowingly or not).

<u>Employers and providers</u>

Employers and providers may commit an offence if they fail to fulfil their obligations under the KiwiSaver legislation.

<u>Members</u>

Members will have a stronger incentive to advise their employer when starting a new job that they are already a member. Hence, members are more likely to contribute to

KiwiSaver continuously, especially during the first twelve months when a contribution holiday cannot be taken, and end up with higher assets.

<u>Government</u>

The Government is more likely to achieve its policy objectives if an effective offence regime is in place.

STATEMENT OF CONSULTATION UNDERTAKEN

Stakeholder Consultation

Consultation meetings were held with the [text deleted]

on the mortgage diversion option. These groups were not supportive of mortgage diversion being part of KiwiSaver given it would reduce the focus on retirement and providers were uninterested in offering the mortgage diversion facility for the minimum payment required under the mortgage contract. This consultation informed the development of the preferred option on mortgage diversion and material included in this Cabinet paper.

Consultation meetings were held with the following employers, providers and employer and industry groups were consulted on the automatic enrolment process for new employees: [text deleted]

Focus groups were also established with employers. The key concerns of employers, providers and employer and industry groups are outlined in the Cabinet paper and resulted in the development of the preferred option.

Government Departments/Agencies Consultation

The following agencies have been consulted in the preparation of this Cabinet paper: Inland Revenue Department, Ministry of Economic Development, the Ministry of Justice, the Ministry of Social Development, Housing New Zealand Corporation, Department of Labour, State Services Commission, the Ministry of Education and the Ministry of Women's Affairs. The Department of Prime Minister and Cabinet has been informed.

The State Services Commission and the Ministry of Women's Affairs raised concerns about the proposal to cease the fee subsidy when lock-in ends as it may send a strong signal to KiwiSaver members to withdraw the funds in their KiwiSaver account rather than using it to supplement their retirement income over an extended period and penalise those that wish to continue to work and save. The proposal does not preclude members using any lump sum withdrawn to supplement their retirement income over an extended period. Financial education may also play a role in mitigating this.

In addition, the Ministry of Women's Affairs noted that the proposal may impact disproportionately on women relative to men given women earn less on average than men, women take more time out of the workforce on average than men and women have to provide for a longer period of retirement given their greater life expectancy.

BUSINESS COMPLIANCE COST STATEMENT

[text deleted]

Providers will incur upfront and ongoing costs in ensuring their investment statements are concise and understandable and in printing their investment statements and providing to the Inland Revenue. Providers may need additional legal advice and consideration before investment statements are signed off, especially initially given there are no precedents on what comprises a simple and understandable investment statement. In addition, providers need to ensure that their fees are not unreasonable, such as calculating and monitoring the costs of providing their KiwiSaver products, and in complying with the legal obligations in this regard, such as, for example, any reporting or disclosure obligations. The approximate cost of printing one investment statement may be around one dollar. The cost of providing investment statements to Inland Revenue may not be high, especially as default providers are likely to provide statements in bulk.

Providers who want to provide KiwiSaver products and who are not default providers will incur costs in registering KiwiSaver products and ensuring they meet the minimum criteria. The registration process is likely to be similar to the process of registering a registered superannuation scheme under the Superannuation Schemes Act 1989. There will be additional costs for existing superannuation schemes that wish to register as a KiwiSaver provider, including obtaining legal advice to determine the correct process that providers will need to go through and the necessary amendments for their trust deeds, and seeking the agreement from all members if the entire scheme is to become a KiwiSaver scheme. The cost of obtaining the agreement of all members is likely to be high.

Providers will incur some ongoing costs in verifying that the fee subsidy is correctly paid into each member's account and to ensure the subsidy is not received by members after they can access their funds. Verification may include ensuring that appropriate systems and procedures are in place. The compliance costs for administering the ceasation of the fee subsidy after members can access their funds should not be significant as providers normally notify members when they are eligible to access their funds.

Default providers will incur costs in their changing systems to comply with the proposed qualifying collective investment vehicle rules.

Other proposed elements of this proposal will lower compliance costs on the financial sector compared to the current KiwiSaver design. Non-default providers will not be required to negotiate on fees with the government thereby saving on legal, negotiating and contracting costs and the time required to be registered. In addition, the removal of the option for members to divert their contributions to repay their mortgage will not require mortgage providers to develop systems and processes to permit these payments to be made.

The introduction of rules to clarify the tax treatment of a registered superannuation fund converting to a KiwiSaver scheme will mean more certainty. This will reduce the need for and cost of specialist advice. Ensuring that the associated transfer of property does not constitute a taxable disposal will also reduce the financial cost of conversion

Employers will incur compliance costs in providing employer name and address information to the Inland Revenue Department on new employees. Employers already collect this information. Employers will incur lower compliance costs by not needing to store and provide investment statements to their employees.

It is not possible at this stage to estimate the compliance costs of the proposed changes to KiwiSaver. Steps will be taken to minimise compliance through stakeholder consultation on the mechanism for employers providing information on new employees and in developing the tender and registration processes for providers, and the legislation will provide options to facilitate the “conversion” process for registered superannuation schemes.