OFFICIALS' REPORT ON THE KIWISAVER BILL

COVERING REPORT

26 June 2006

This Covering Report addresses:

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10. Privacy (pages 47-51).

1. Purpose of KiwiSaver

Submissions

The submissions process raised a large number of comments regarding the purpose of KiwiSaver. Submitters' comments can be organised in the following categories:

1. *Broadly supportive*

- Supportive of the intent of the Bill or consider it sets a laudable objective (21- FINSIA, 39-AON, 24-Business NZ);
- Supportive of the concept of workplace-based savings as a method to improve retirement savings (4-IRIS, 9-ING, 12W-First NZ Capital, 17W-PSIS, 35-Public Trust, 71W-Eriksens Actuarial);
- Supportive of the need for 'culture change' and the development of a long-term savings habit (3-Fidelity, 27W-BNZ) and to encourage home ownership (69W-REINZ) for low-to-modest income New Zealanders (67-The Salvation Army);
- Supportive of KiwiSaver as a means to improve savings rates (38W-Westpac) or as a means to change the direction of savings policy (68W-NZX);

2. *Supportive with reservations*

- Consider that given the right environment even lower income New Zealanders will save. Savings does not just cover financial assets but also includes housing. However, even with KiwiSaver many people will still under-save (55-PSA);
- There are potentially broader macroeconomic benefits associated with increased domestic savings (48-CTU) but KiwiSaver is not bold enough to prompt a long-term change in savings behaviour (36-ISI); or to address the magnitude of the issue (62-AMP); or to achieve a higher savings rate, with associated macroeconomic benefits (8-NZ Institute, 58W-WT Stevens);
- KiwiSaver has the desirable attribute of developing a pool of domestic capital (38W-Westpac, 58W-WT Stevens) but needs to be much bolder by investing in aspirational, knowledge-intensive New Zealand companies (28W-Stephen Tindall);

3. *Moderate to considerable reservations*

- The purpose of the scheme is unclear and will not change long-run economic performance, which is the critical issue. A key problem is an environment that encourages over-investment in housing (66-RPRC);
- The home loan assistance provisions are inconsistent with the objectives of the Bill (5-Kelvin Prisk, 9-ING, 10-MFL Mutual Fund Limited & Superannuation Investments Limited, 41-ANZ, 66-RPRC). Confusing saving for retirement with saving for a house through the subsidised first home purchase may aggregate the problem of low individual savings (66-RPRC);

- The scheme objectives will not be achieved but considerable expense involved (19-ASFONZ) with no work undertaken to assess the level of demand (20-Mercer). There has not been enough consultation around foundational principles (19 – ASFONZ), and no opportunity for discussion around whether KiwiSaver will help improve national saving (66-RPRC);
- Question whether the assumptions of employee inertia are typical of New Zealand workers (59-Meat Industry Association) and the evidential support for the behavioural assumptions around automatic enrolment (56-NZ Business Roundtable);
- Question whether New Zealand actually has a 'savings problem' (19-ASFONZ) with particular reference to the research conducted by Scobie et al. (24-Business NZ, 66-RPRC, 20-Mercer). Long run living standards determined by economic growth, which is driven by investment rather than savings (56-NZ Business Roundtable);
- KiwiSaver will displace other forms of savings (24-Business NZ, 56-NZ Business Roundtable);
- KiwiSaver will not prepare New Zealand for an ageing population as economic growth is the only practical method to alleviate this pressure. A large proportion of the funds will be invested overseas (66-RPRC);
- Does not support the intention of the Bill (49W-Dr Peter Ashley).

Comment

As the list of issues compiled above indicates, many of the submitters raised issues for the Committee to note rather than presenting points that require a detailed response. This is especially the case for the *broadly supportive* and *support with reservations* categories. The key concerns raised fit broadly into the following areas:

- KiwiSaver does not go far enough to increase savings rates or achieve broader macroeconomic objectives, and will displace other forms of saving;
- The home ownership assistance is inconsistent with the purpose to encourage saving for retirement;
- KiwiSaver is expensive and there has not been enough discussion on whether it will increase saving or whether there is any demand;
- Is there any evidence for the behavioural assumptions around automatic enrolment and is employee inertia typical in New Zealand?;
- Where is the evidence that New Zealand has a 'savings problem' and how does KiwiSaver fit with the research conducted by *Scobie et al*?; and
- KiwiSaver will not prepare New Zealand for an ageing population.

KiwiSaver does not go far enough

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. This is the primary objective of the scheme. This does not detract from the fact that KiwiSaver may have benefits for the economy at large, such as if KiwiSaver increases the level of national savings or increases the pool of domestic savings; rather, that such objectives are secondary. Broader macroeconomic issues such as New Zealand's long term trend rate of growth are important, but are not the fundamental reason for promoting KiwiSaver.

Therefore in the design of KiwiSaver, the focus has been on assisting people who are not currently saving enough by encouraging a long-term savings habit. KiwiSaver is designed to benefit those who want to have a higher standard of living in their retirement compared to that provided by New Zealand Superannuation. Features of KiwiSaver, such as automatic enrolment and deductions at source, are designed to make savings easy. KiwiSaver also incorporates a financial literacy component that, over time, will allow people to make better choices as to what their ideal level of savings should be. Some people may decide that KiwiSaver is not appropriate for them, and may choose either not to save or to save in an alternative vehicle. Others may save in KiwiSaver and reduce saving elsewhere, with the result that KiwiSaver displaces savings that would have occurred anyway. However, KiwiSaver aims to switch the bias towards making savings easy rather than difficult, while still allowing people to make informed decisions not to save or not to increase their overall savings.

The issue of whether KiwiSaver is 'bold enough' is a subjective question that is highly dependent on the initial comparison made. It is reasonable to note, however, that key scheme design issues such as automatic enrolment, a default deduction rate and allocation to a default scheme make KiwiSaver a highly innovative approach to long-term savings.

A further suggestion is that KiwiSaver should invest in aspirational, knowledge intensive NZ companies. When making investment decisions, a prudent investor will make a decision regarding the level of risk and degree of diversification desired within an investment portfolio. While there is nothing wrong with investing in aspirational, knowledge intensive firms (and there are existing investment vehicles that allow investors to do this), the question, however, is whether this type of investment, which has the general attributes of venture capital, is appropriate for a scheme where it is highly likely that savers will be assigned to a default scheme. The result could well be exposure to too great a level of risk. Any well diversified fund will spread assets both within New Zealand and internationally. Indeed, this is a prudent course of action given the relatively small size of New Zealand's capital markets.

Home ownership assistance inconsistent with retirement savings

KiwiSaver encourages New Zealanders to save for their retirement by encouraging asset accumulation. This includes both financial assets (via KiwiSaver) and a home (via the home ownership withdrawal and targeted deposit subsidy). Those who own their own home when they retire are generally likely to achieve a higher living standard in retirement.

One of the reasons for combining long-term saving and home ownership is that it is simpler for a saver to have a single rather than multiple accounts. Moreover, it is consistent with encouraging a savings habit over the life cycle. This is because young savers entering the workforce can put money away without deciding how much will be for retirement and how much for a home, with the knowledge that they can access their funds for a home when they are ready. This flexibility is likely to encourage participation.

However, the primary purpose of the scheme is long-term saving, and hence the scheme has been designed with this in mind. Officials acknowledge that the home ownership assistance makes the KiwiSaver scheme different from typical registered superannuation schemes.

The housing assistance is aimed at first home buyers. It may used only once per person, to assist in the purchase of a home to live in (not a rental property).

KiwiSaver is expensive and the level of demand is not clear

KiwiSaver is estimated to cost around $700 million from 2005/06 to 2009/10, based on the assumption that 25% of the eligible population will have joined KiwiSaver by 2014. However, these costs are dependent on take-up – if take-up is lower than assumed, the cost will be lower. It is very difficult to assess the level of demand for a scheme such as KiwiSaver. Internationally, participation rates can vary markedly across different schemes, and there is no clear international experience of schemes with similar design features to KiwiSaver.

While no detailed work has been done to assess the actual level of demand, it is pertinent to note that work-based savings is generally considered a good method to encourage a savings habit and the prevalence of these schemes has fallen over the past 20 years. It is therefore likely that KiwiSaver will fill an important savings niche.

Is there any evidence for the behavioural assumptions, automatic enrolment and inertia?

The study of behavioural and experimental economics has blossomed over recent years with two of the field's leading researchers, Vernon Smith and Daniel Kahnemann, being jointly awarded with the Bank of Sweden Prize in the Memory of Alfred Nobel in 2002. One of the key insights from this literature supports the concept of automatic enrolment as this is a method to overcome inertia in decision making. Although overseas based studies need to be interpreted with a degree of caution because the environment within which automatic enrolment occurs will differ, automatic enrolment is also likely to increase employee participation in the New Zealand context.

Where is the evidence that there is a 'savings problem' and how does KiwiSaver fit with Treasury research by Grant Scobie et al.?

The work by Scobie et al.[1] suggests that the rate of household savings for retirement is broadly appropriate. For those in the lower 40% of the income distribution there is little or no incentive to forego current consumption and save more given the prospect of New Zealand Superannuation. Those in the upper three deciles have typically substantial retirement wealth in any event. There will undoubtedly be some middle income earners who may reach retirement with less accumulation than they would have preferred. Other work by Scobie et al. suggests that individuals and couples holding workplace superannuation schemes do tend to accumulate higher levels of wealth after allowing for as many other factors (such as age and income) as possible.

KiwiSaver is intended to assist people who are not currently saving enough by encouraging a long-term savings habit, rather than address a 'savings problem' per se. Although evidence suggests there does not seem to be any significant under-saving for broad groups within the population, there can be wide variation within such groups, which means some people may be saving adequately while others may not. The evidence also suggests that workplace savings schemes have a positive effect on wealth accumulation. In addition, although New Zealand Superannuation provides a base level of income, many people wish to have more than a basic standard of living in retirement. Therefore KiwiSaver has the potential to benefit many people who may find saving decisions difficult and may wish to save more. The research discussed above suggests it is likely that the take-up of KiwiSaver would be concentrated among middle income earners.

KiwiSaver will not prepare New Zealand for an ageing population

KiwiSaver is part of a suite of policies designed to increase the level of savings by New Zealand households and support New Zealanders in retirement. Other initiatives include the introduction of the State Sector Retirement Savings Scheme, and the establishment of the New Zealand Superannuation Fund, aimed at pre-funding the future cost to the government of New Zealand Superannuation. It is therefore not intended that KiwiSaver be the only policy instrument to address the issue of population ageing.

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1 Scobie, Grant; Gibson, John; Le, Trinh, "Household wealth in New Zealand ", Victoria University. Institute of Policy Studies, 2005.

Recommendations

That the purpose of KiwiSaver, including the home ownership component, be affirmed.

2. KiwiSaver Implementation Timeline

Submissions

The KiwiSaver public submission process has highlighted the implementation timeline as a significant issue. Many potential providers consider that the 1 April 2007 date is difficult to manage when added to the need to implement system changes to accommodate the Portfolio Investment Entity (PIE) rules. Concerns raised in submissions include:

- The timeframe is too short for a successful implementation of the Bill as providers are facing a number of systems and administration changes. There is also concern about the interface with Australian systems and that providers reliant on Australian service providers will be less likely to meet the deadline. Another concern is developing products in absence of final legislation. *(5 Kelvin Prisk – 9 ING - 10 SIL Mutual – 13 KPMG – 20 Mercer – 21 FINSIA – 23 Chatswood Consulting - 24 Business New Zealand – 41W ANZ National Bank - 44W ASB Group, 53W – Commacc, 65, Superlife Aventine);*

- Delay the implementation date until 1 October 2007 (Mercer, ANZ National Bank ASB Group, Meat Industry Association, New Zealand Institute of Chartered Accountants, KPMG), 31 December 2007 (SuperLife Aventine) or 1 April 2008 (ASFONZ, Mercer, ANZ National Bank ASB Group, Meat Industry Association, New Zealand Institute of Chartered Accountants) or alternatively extend Inland Revenue's Holding Account for 6 to 12 months (ASFONZ). (19 – ASFONZ, 20 - Mercer, 41W – ANZ National Bank, 44W – ASB Group, 59 – Meat Industry Association, 60 – New Zealand Institute of Chartered Accountants, 65 - Superlife Aventine);

- The timeframe will be affected by the changes being considered to PIEs, which have the same implementation date as KiwiSaver. This will place further pressure on IT and administration resources. The PIE changes will require complete overhaul of unit pricing systems and investment structures. *(9 – ING, 10 SIL Mutual, 20 – Mercer, 24 – Business New Zealand, 41W – ANZ National Bank, 65 - Superlife Aventine);*

- The tight timeframe will impact on the decision-making of employers selecting preferred providers, on deciding employer contributions, on whether they seek exemption or conversion options (possibly leading to low employer take up). The short timeframe also impacts on the time to amend trust deeds of current schemes for exemption or conversion. There is also concern around a lack of time for the Government to educate employers and employees. Providers have to wait to see how KiwiSaver affects their schemes. *(20 – Mercer, 44W – ASB Group, 65 – Superlife Aventine);* and

- A number of other policy changes are happening at the same time, such as expected changes to investment adviser disclosure laws *(20 – Mercer),* changes to 4 weeks' holiday for the Holidays Act *(53W – Comacc),* and changes to the method of determining the rate of specified superannuation contribution withholding tax (SSCWT) *(20 Mercer).*

Comment

Risks around implementation date of 1 April 2007

Officials consider that the following risks arise from keeping to the timeframe of 1 April 2007:

- **Potential wind-up of existing employer superannuation schemes**

  Employers currently providing access to superannuation schemes and providers will face a number of decisions and be required to go through a number of processes. There is a risk that these employers may not have sufficient time to make an informed decision. In addition, there is a risk that if such decisions and processes are rushed, employers could become frustrated and may seek to wind up their existing schemes. This may have a subsequent consequence that the funds held by those schemes will be released back to members, which in turn may reduce aggregate savings.

  There are different pressures that will apply to providers and employers, and different pressures facing employer stand-alone schemes, Master trusts and New Zealand and overseas-based companies. As an example, the steps required for a large Master Trust with an overseas parent company and many participating employers to make a decision about the most effective method to participate in KiwiSaver could include: presenting business cases with their overseas parent company; consulting with all their participating employers (in some cases this could number to the hundreds); deciding the most appropriate process going forward; notifying members; amending trust deeds; entering into a memorandum of understanding with the Commissioner of Inland Revenue; developing appropriate offer documents; and applying to the Government Actuary's office. Note that with the current timeline, providers will also have to comply with other government reforms, including the reforms in respect to PIEs. Although these pressures are primarily applicable to providers, they are also likely to impact on an employer seeking to participate in KiwiSaver. The process for a smaller, New Zealand-based, employer stand-alone scheme will be simpler, but they will still have to undertake several of these steps.

- **Government Actuary ability to process applications**

  The Government Actuary will likely receive a large number of applications in the months preceding the implementation of KiwiSaver, from employers who either want their existing superannuation schemes to become KiwiSaver compliant or want to become exempt. The Government Actuary is also likely to receive a number of applications from providers either seeking registration, conversion or the establishment of a KiwiSaver scheme under their existing scheme trust deed. This may place significant pressure on the Office of Government Actuary to ensure that all applications are processed in the required time. Inland Revenue will need to also certify that such providers will comply with the operational and electronic capabilities standards.

  It is likely that many applications by employers and providers will be made in the same period of time just before the scheme is implemented, in late February or March 2007. This is because of the time and processes required to make and give effect to any decisions, as outlined above. In addition, many businesses may be closed around the Christmas and New Year's period, which reduces the time that is available to make these decisions further.

  It should be noted that the Government Actuary's Office is aware of the risks with the timeframe and has sought appropriate funding to mitigate these risks. It is, however, difficult to gauge the severity of this risk at present as it is not yet clear how employers and providers may respond to the final KiwiSaver Bill. However, if the Office of the Government Actuary is unable to process all applications by the implementation date, there is a further risk that this may undermine the credibility of KiwiSaver.

- **Loss of credibility**

  The scheme could lose credibility early on if the necessary systems are not in place and running smoothly at the implementation date. This risk is valid for both providers and Inland Revenue. Note that in order for schemes to be registered as KiwiSaver schemes, they will need to enter into a memorandum of understanding with the Commissioner of Inland Revenue, to ensure that their schemes are compatible. This will involve ensuring design compatibility and the testing of systems. This is likely to put a further time strain on providers who may be seeking to register as KiwiSaver providers. Providers will also have to comply with their disclosure obligations under the Securities Act 1978 and publish the requisite disclosure information. There is a risk that if the process is rushed, and unintended errors are made in these documents, that the providers may incur liability, which may further undermine the credibility of the scheme.

  If the systems that are implemented do not function effectively and create difficulties such as the mix up of member accounts, or delays in the channelling of contributions, people may become disincentivised from contributing further to the scheme. Members who may be already contributing may only contribute for a minimum period of time, and new employees may decide to opt out of the scheme.

- **Marketing**

  The timeframes to carry out the necessary marketing are short. Some providers might consider that the time they have between being registered and the commencement date is insufficient to carry out an adequate marketing campaign, leading them to conclude it is not worthwhile for them to be providers, particularly default providers. However, a public education campaign is planned that can mitigate this risk to some degree.

  The objective of allowing KiwiSaver schemes to register as "active choice" KiwiSaver schemes was to encourage and facilitate competition within the KiwiSaver environment. The advent of automatic enrolment and the appointments of default providers are likely to give a competitive edge to default schemes. Active choice schemes will rely heavily on their ability to market themselves better than other providers in order to access the KiwiSaver market. If providers are deterred from registering as KiwiSaver schemes, there is a risk that there could be corresponding disincentives on the default providers to provide optimal high quality services. This will also have the effect of undermining the effectiveness of KiwiSaver as an efficient savings vehicle.

Options to address and mitigate risks

- ***Delay start date until 1 July 2007***

  Officials consider that extending the start date of KiwiSaver by 3 months to 1 July 2007 would reduce the risks outlined above. In particular, this would:

  - give providers and employers additional time to make decisions about KiwiSaver;
  - spread the time over which applications by employers and providers are lodged with the Government Actuary, and allow additional time for the processing of such applications;
  - allow providers additional time to complete marketing; and
  - give Inland Revenue more time to ensure implementation is as effective and efficient as possible for all stakeholders.

  A start date of 1 July will affect employers as they will need to make annual payroll changes as a result of changes in ACC levy rates etc. on 1 April 2007 and then make additional changes to accommodate KiwiSaver on 1 July. At this time, officials have not been able to discuss the magnitude of this issue with employer representatives to gauge their views.

- ***Delay date funds are received by providers until 1 October 2007 [transitional measure]***

  The majority of contributions to KiwiSaver are likely to be paid via Inland Revenue, and these will be held by Inland Revenue for an initial three-month holding period. However, there is the ability for all KiwiSaver members to make direct payments to a KiwiSaver scheme provider if they wish (e.g. the self-employed may take up this option). As a transitional measure, officials consider that all contributions to KiwiSaver should be made via Inland Revenue until 1 October 2007.

  Requiring all payments to be made via Inland Revenue until 1 October 2007could have the following benefits:

  - ensure KiwiSaver providers are ready to accept payments, by extending the date they need to be ready to accept payments by 6 months;
  - allow providers additional time to become PIE compliant, especially default providers who by law will need to be so (PIEs are included in a separate Bill, and additional issues regarding the timeline for PIEs are outside the scope of the KiwiSaver Bill);
  - reduce the impact of a number of policy changes (e.g. expected changes to investment advisor disclosure laws, Holidays Act implications, and changes to progressive SSCWT) occurring at the same time; and
  - allows providers and Inland Revenue to develop their systems with less pressure, and to test their systems and ensure that both systems are compatible.

  However, there are risks of extending the length of time that funds are held by Inland Revenue. In particular, it may increase confusion by members about where their money is being held, and the time until they are effectively a member of an individual KiwiSaver scheme will be delayed.

Recommendations

That KiwiSaver continues to come into force on a date to be appointed by the Governor-General by Order in Council.

Note that the Government is intending that the start date of KiwiSaver be delayed until 1 July 2007. This will largely address the risks outlined above.

That as a transitional measure all contributions to KiwiSaver should be made via Inland Revenue until 1 October 2007.

3. Compulsion

Submissions

(4 – Industry Retirement & Insurance Services Ltd (IRIS), 5 – Kelvin Prisk, 8 – The New Zealand Institute, 10 – MFL Mutual Fund Limited & Superannuation Investments Limited, 12W – First NZ Capital, 16W – ABN-AMRO Craigs, 36 – Investment Savings and Insurance Association of New Zealand (ISI), 38W - Westpac, 54 - Tower, 57W – W T Stevens, 62 – AMP, 68W – NZX)

That the scheme should be compulsory *(MFL Mutual Fund Limited & Superannuation Investments Limited, First NZ Capital, ABN AMRO Craigs, Tower, W T Stevens, NZX, ISI, AMP).*

That a compulsory regime could be phased in over a period of three to five years (*MFL Mutual Fund Limited & Superannuation Investments Limited*). That the scheme should be compulsory for all income earners *(Tower)*, or for all employees *(W T Stevens, NZX)*, with a monthly maximum contribution amount *(ABN AMRO Craigs)*. That all income earners should be required to contribute to either an approved workplace-based scheme or KiwiSaver *(ISI)*. That compulsory contributions should be funded by tax cuts *(First NZ Capital).*

That a compulsory scheme, in combination with policies for raising productivity and real wages, could alter the level of household savings, rather than merely lead to a reallocation of savings by households *(Westpac).*

That a compulsory scheme could alleviate the increasing need to seek offshore funding for development in New Zealand *(Kelvin Prisk).*

That if compulsion is considered unacceptable, instead remove the ability to opt out for the following targeted groups:

- New employees from 1 April 2007;
- Employees who turn 18 from 1 April 2007;
- Employees over 40 years of age from 1 April 2007; or
- New employees over 40 years of age from 1 April 2007 *(MFL Mutual Fund Limited).*

That employer contributions should be compulsory *(IRIS, The New Zealand Institute, MFL Mutual Fund Limited & Superannuation Investments Limited, NZX, First NZ Capital).* They should be immediately vested and portable to another scheme *(IRIS)* and there should be a three-year notice period for introduction *(MFL/SIL)*. That the lack of obligation for employers to contribute is at variance with usual practice for funding retirement *(Kelvin Prisk).*

Comment

A number of submissions raised suggestions about whether the scheme should be more or less compulsory. There are different variants to whether and how the scheme could be compulsory, for example:

- compulsory for all employees to join from day one; or
- automatic enrolment, but no ability to opt out (i.e. compulsory only for new employees).

A compulsory scheme would increase the take-up of KiwiSaver, given that people could not opt out.

However, the key disadvantages of a compulsory scheme include:

- for some people, such as those with other debts, it will be in their best interests to repay debt before they save (particularly if this debt is at a high interest rate); and
- for some people, such as those on low incomes, New Zealand Superannuation may provide an adequate income in retirement.

In addition, compulsion removes individual's choice. Some people may not wish to save, or may wish to save in alternative forms. A number of submissions supported the voluntary nature of KiwiSaver.

Removing the ability of selected employees to opt out would make the scheme compulsory for those employees. Removing the ability to opt out for new employees could have unintended consequences – such as discouraging job turnover. Making the scheme compulsory for only some employees may be perceived as unfair.

The automatic enrolment feature that is central to the design of KiwiSaver is designed to encourage saving while maintaining the flexibility to allow individuals to decide whether or not it is in their best interest to save in KiwiSaver, or whether to save in an alternative vehicle or repay debt.

Officials do not recommend compulsory contributions funded by tax cuts. This could significantly increase the fiscal cost of the scheme. In addition, this is more likely to assist those who are better off, who are in a better position to make ongoing savings contributions and are more likely to already be saving.

It has been suggested that a compulsory scheme could increase the level of household savings, rather than merely lead to a reallocation of savings by households, and could alleviate the increasing need to seek offshore funding for development in New Zealand. 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. This may have some benefits for the economy at large if the changes in individuals' behaviour flows through into increased overall domestic savings. However, this is not the primary objective of KiwiSaver. In any case, it is not clear to what extent a compulsory scheme would achieve such objectives – for example, evidence in Australia suggests that the compulsory scheme has led to some substitution of compulsory savings for voluntary savings.[2]

The Bill permits employers to make contributions to individuals' KiwiSaver accounts over and above the member contribution. Making such contributions compulsory would increase the cost to business and therefore to the economy. It would also be counterproductive as employers may discourage individuals to join KiwiSaver in order to avoid these increased costs. In addition, it is likely that the cost to employers in making employer contributions compulsory will result in employer contributions substituting employees' pay increases.

Recommendation

That the submissions be declined. That participation in KiwiSaver not be made compulsory.

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2 Connolly, E and M Kohler (2004) 'The Impact of Superannuation on Household Saving', RBA Research Discussion Paper 2004-01.

4. When deductions start

Submissions

(1 – Peter Harris, 3 – Fidelity Life, 5 – Kelvin Prisk, 16 – ABN Amro Craigs, 23 – Chatswood Consulting, 39 – AON Consulting, 41 – ANZ, 48 – New Zealand Council of Trade Unions (CTU), 55 – New Zealand Public Service Association (PSA), 65 – SuperLife Aventine)

Deductions do not begin until after 77 days. There should be no delay and deductions should commence with effect from the first pay, so that savers are less likely to opt out, to reduce employees' misunderstandings, and to reduce complaints to employers. If employees decide to opt out, the Bill will need to provide the ability to apply to Inland Revenue for a contribution refund *(Peter Harris, Fidelity Life, Kelvin Prisk, Chatswood Consulting, AON Consulting, ANZ, CTU, PSA, Super Life*). Employers will face backlash from employees when take home pay drops at week 11 when first contributions are deducted from salary *(ABN Amro Craigs).*

Comment

The key advantage of beginning contributions from their first pay at a new job is to maximise the inertia effect (i.e. the notion that 'people don't miss what they've never had'). Therefore employees may be more likely to participate. It will also avoid the potential for confusion when deductions begin after week 11, and for employers to deal with any complaints arising from this confusion.

There are three main disadvantages of beginning deductions from the first pay:

- it may lead to hardship for some people, by reducing the first take-home pay at a new job. This may particularly impact on those who move into a first job having previously been out of the workforce, unemployed, or on a benefit (some of who will already face reasonably high effective marginal tax rates);
- the need to provide refunds to those who opt out after their first pay day may increase compliance costs for employers and employees and administrative costs for Inland Revenue, and there may be delay before the refund is processed (see example below). Inland Revenue would need to collect additional information from the employee such as bank account details to enable the efficient processing of refunds. Sending amounts to Inland Revenue to be refunded creates efficiency costs and the delay may cause annoyance or hardship to people waiting for a refund; and
- it may impact negatively on how the scheme is perceived by both employees and employers. It would make the scheme participation compulsory, at least for a period of time until opt-out can be completed, and may encourage people to opt out sooner. Employer support

is likely to be key for the success of KiwiSaver, but beginning contributions from the first pay day could lead to a situation where employers try to encourage employees to opt out, to avoid the need to deal with disgruntled employees and to avoid any additional compliance costs.

Example:

The following example shows one possibility of the timeframe before refunds may be processed. Note that the exact timeframe depends on when the employee starts in relation to the employer's pay cycle, the frequency of paydays, and how frequently the employer remits the contributions and information to Inland Revenue. In this example, an employee who opts out late in the second week of a new job would have contributions deducted from their pay for the first three weekly paydays, and would receive a refund on 21st May for contributions deducted on April 6th, 13th and 20th.

Assumptions:

- *Employee starts work at a large employer on Monday 2 April 2007;*
- *Employee paid weekly on Fridays (less frequent paydays would result in fewer deductions);*
- *Employee sends opt-out form during second week at new job (sending the opt-out form later would result in additional deductions).*

Date	**Action**
Monday 2 April 2007	Employee starts job and receives information pack
Friday 6 April 2007	Deduction made from employee's first payday
Thursday 12 April 2007	Employee sends opt-out form to Inland Revenue
Friday 13 April 2007	Deduction made from employee's second payday
Monday 16 April 2007	Opt-out form received by Inland Revenue
Friday 20 April 2007	Deduction made from second payday Employer sends deductions from 6/4 and 13/4 to Inland Revenue, but no detail of amount per employee
Monday 23 April 2007	Opt-out form processed by Inland Revenue - employer advised to cease deductions (5 working days from receipt of form)
Monday 7 May	Employer sends deductions from 20/4 to Inland Revenue Last day for large employer to file Employer Monthly Schedule (EMS) containing detail of amount per employee
Monday 21 May	Inland Revenue actions refund to employee for contributions on 6/4, 13/4, and 20/4 (10 working days from receipt of EMS)

On balance, officials recommend beginning deductions from the first payday.

Note that for some employees, their first pay day will occur before they are able to opt out of KiwiSaver. These employees will make a contribution before they are able to opt out, and this will need to be refunded. This could have an impact on the Inland Revenue's current design and processes and as a result may impact on the implementation timetable due to the need to re-engineer processes. However, extending the start date to 1 July 2007 would mitigate the risks to the implementation timetable.   It may also impact on administrative costs due to the potential for a large number of refunds and resulting enquires.

Recommendations

That deductions to KiwiSaver begin from the first payday in a new job.

5. Contribution rates and employer contributions

Submissions

That employer contributions should be supported/required *(NZX, Eriksens Actuarial, NZLS, EPMU, NZEI Te Tiu Roa, PSA, CTU).*

That a more flexible range of contribution rates should be supported, to allow more choice and encourage greater participation *(IRIS, MFL Mutual Fund Limited & Superannuation Investments Limited, ASFONZ, Chatswood consulting, BNZ, Axa, ANZ, EPMU, CTU, Tower, NZ Bankers Association, AMP, Super Life, NZLS).*

That the minimum amount should be lower (e.g. 2%), because 4% may be too high for some people, prompting them to opt out altogether *(Peter Harris, Chatswood consulting, NCWNZ, BNZ, AON, ANZ, EPMU, CTU, NZEI Te Tiu Roa, PSA, EMA, Salvation Army, Eriksens Actuarial).*

That the 8% rate is unnecessary, as it is unlikely to be recommended by financial advisors since alternative schemes with less restrictive lock-in may be preferable *(ASFONZ, Super Life).*

That a dollar amount should be used instead of a percentage of income *(IRIS).*

That a formula for contributions should be used (e.g. with income thresholds, or with a higher default rate for those on higher income) instead of a percentage of income *(Peter Harris, Kelvin Prisk, Finsia).*

That contributions should be stepped up over several years (e.g. in 1% increments or through pay increases), to ease the transition *(MFL Mutual Fund Limited & Superannuation Investments Limited, ASFONZ, Chatswood consulting, ANZ, Super Life).*

Comment

Employer contributions

The Bill allows employers to make voluntary contributions to KiwiSaver over and above the employee's minimum contribution rate of 4%. However, some submissions have suggested that employer contributions should count toward the minimum 4% contribution rate.

The main pros and cons of allowing employer contributions to count towards the 4% rate are summarised below:

Pros	Cons
The main purpose of KiwiSaver is to provide a better standard of living in retirement, suggesting who contributes matters less.	The less individuals save themselves, the less likely it is that they will develop a 'savings culture'.
An individual's savings could potentially be higher, if he or she would join at (say) 2% (with a 2% employer contribution making up the balance), but would otherwise have opted out on the basis that 4% is too high.	An individual's savings could potentially be lower, since the employer may otherwise contribute over and above the 4% level.
Provides flexibility for employers in the range of remuneration options available, and innovative employers may find ways of achieving this anyway.	Could put wage pressure on employers to meet part of the 4%, but this could occur anyway through wage pressure to allow employees to meet the 4%.

Officials consider that the advantages of allowing employer contributions to count towards the 4% rate outweigh the disadvantages. The interaction with a decision on the minimum rate is considered below before reaching a recommendation.

The main aim of allowing employer contributions to count towards the 4% would be to assist those individuals who otherwise cannot afford to meet the 4% rate. However, a relevant question is whether employers would want to make an employer contribution, and what the potential benefit is for employers. Some employers may wish to add a vesting scale to employer contributions, so an employee does not become entitled to the employer contribution until they have remained with the employer for a set period of time, as an employment retention tool. Officials consider that although allowing a vesting scale may encourage employer contributions, the primary aim is to help employees to meet the 4% contribution rate. Therefore we consider that where employer contributions help make up the 4% rate, they should be required to vest in the employee immediately (no vesting scale). We note, however, that this creates a risk that employers would not wish to undertake this option.

There would be two operational issues in allowing employer contributions to count towards the 4% rate:

- to enable integrity checks on whether the 4% contribution level has been met, employers would need to notify Inland Revenue of any employer contributions (since payment of employer contributions need not necessarily go via Inland Revenue); and

- the enforcement of employer contributions would be a matter between employers, providers and employees, unless the government wished to make good on an employer's contributions where the employer does not make the required payment (as will occur with contributions deducted from an employee's salary but not remitted to Inland Revenue by the employer).

This extension would also increase complexity and has the potential to increase both administrative and compliance costs. However, officials do not consider that these additional costs are significant.

Officials consider that the employer's contribution for this purpose should be based on gross salary or wages.

Note that although 2%+2% (employee+employer) has been used as an example, this recommendation would also support 0%+4%, where the employee does not contribute at all (though this situation would probably be rare).

Flexibility

More flexibility could include a greater number of fixed rates, or a fixed default rate and flexibility above that rate.

The main disadvantages to greater flexibility are:

- *greater compliance for the employer.* A greater number of rates (or flexibility to choose any rate) will inevitably impose greater compliance costs on employers. In particular, although large businesses may have sophisticated payroll systems to calculate any given contribution rate, small businesses often use tax tables. Inland Revenue would be able to implement three contribution rates, although it would create issues around incorporation into the current PAYE tables booklet, since the size of the booklet may become cumbersome and it may make the booklet less user-friendly. Inland Revenue considers that if any more than three rates were desired, a preferable approach would be a minimum rate with flexibility above that (such an approach would need an on-line calculator as well as tables); and

- *greater complexity for the employee.* One of the design principles of the KiwiSaver scheme was simplicity, to make saving easy for people who have never saved before. Greater complexity is likely to create a higher hurdle to saving for employees and increase the chances of opt-out or inertia to remain saving at the default rate.

Other relevant considerations are the ability for Inland Revenue to conduct an integrity test on the contribution rate. Inland Revenue will not be collecting the contribution rate from employers or members. Therefore, Inland Revenue will not be able to validate that the correct deductions have been made. However, an integrity test will be applied to ensure that potential employer errors in deduction rates are identified where these are outside a tolerance range. The more rates, the more difficult these integrity tests are. Having a rate less than the default rate does not allow for an integrity check to be adopted to check whether the default rate has been contributed.

The key advantage in offering greater flexibility would be more choice to employees, potentially encouraging participation at higher rates of saving (e.g. older employees may wish to save upwards of 10% of their income for retirement). It should be noted that voluntary contributions above the default rate of 4% can be made via Inland Revenue or direct to the provider, but these would not be deducted at source from salary/wages.

Officials consider that the disadvantages of allowing greater flexibility outweigh the advantages and therefore recommend a maximum of three rates.

This recommendation means that, for example, an additional 6% rate could be introduced to provide 4%/6%/8% options. The trade-off would be between some additional compliance or complexity and potentially higher savings (a jump from 4% to 6% may be more attractive than a jump from 4% to 8%). Officials do not have a strong view so would not recommend any change to the Bill as drafted.

Lower minimum rate

A contribution rate of 4% potentially equates to a reasonably significant portion of disposable income at relatively low income levels and could make participation difficult.

However, it is worth noting that a savings rate of 2% (or even 4%) would be insufficient to provide a 70% replacement income in retirement for a large number of New Zealanders. The following table shows the savings rate required to supplement NZ Superannuation to achieve 70%

income replacement in retirement for different starting ages.[3] For example, with a gross income of $30,000 and starting saving at age 25, 2-5% would need to be saved until retirement to achieve a retirement income of 70% of $30,000 (after tax, including NZ Superannuation). Starting saving later in life or given a higher salary increases the required savings rate considerably: 12-16% would be required starting saving at age 40 with a gross income of $60,000.

Contribution rate required for 70% income replacement in retirement

		Income			
		$30,000	$40,000	$50,000	$60,000
Age	25	2%-5%	4%-7%	5%-8%	6%-8%
	30	3%-6%	5%-8%	7%-10%	8%-10%
	40	4%-10%	9%-14%	11%-15%	12%-16%

Source: Treasury calculation using www.sorted.org.nz information.

The key trade-off is between encouraging participation by a wider group on one hand (specifically, greater participation among low income earners), and encouraging higher rates of savings across the board on the other (specifically, among low to middle income earners). However, the key questions “how much extra participation?” and “how much greater savings?” cannot be answered with any certainty.

Another important downside to reducing the minimum rate would be the greater likelihood of a large number of small savings account balances. Provider fees will be set with regard to the likely number of small account balances, since they would lead to additional overhead cost without significant scope for investment of funds. Consequently, reducing the minimum rate would be likely to increase the fees providers charge.

There is also a risk that with a 2% rate, there would be a greater number of current savers joining KiwiSaver for a year simply to receive the $1,000 lump sum contribution, adding to deadweight costs.

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3 The required rates differ for male/female (due to life expectancy) and single/couple (due to New Zealand Superannuation rate). The assumptions include: retirement at 65, life expectancy 82/85 (male/female), net real rate of return 2.5% (gross rate of return 8%). Note that these calculations do not include the effects of other asset accumulation, such as a house (e.g. the house could be sold and a cheaper house purchased, providing additional income). Also note that the results are sensitive to the rate of return (and other assumptions). For example, an increase in gross rate of return of 2 percentage points would decrease the required contribution rate by around 1-2 percentage points.

Three potential ways to mitigate the downsides to a lower minimum rate would be to:

- maintain the default contribution rate at 4%. The design of KiwiSaver is based heavily on the behavioural literature, which suggests that most employees are likely to select the default contribution rate anyway and be unaffected by a lower contribution rate. *Officials would recommend this approach;*

- apply an income threshold for eligibility for the 2% rate. However, this would add another layer of complexity to what is intended to be a simple design. Further, income is often not a good proxy for affordability. Officials would not recommend this approach; or

- reduce the $1000 government contribution to $500 (raised during oral submissions), allow the $1000 to "vest" only at the end of a particular contribution period if the employee has contributed the whole time *(ASFONZ)*, or increase the minimum contribution period from, say, 12 to 24 months *(CTU)*. The upfront contribution of $1000 per member is intended to encourage people to begin saving, by providing a benefit that is tangible or "something lost" by those who do not participate. It is a flat dollar amount and so will appear larger for those on lower incomes, and smaller for those on higher incomes. The exact dollar amount needs to balance providing incentives for members to join the scheme with the fiscal cost. Reducing this amount to $500 for those joining at 2% may provide less benefit to those on lower incomes (who are more likely to choose a 2% rate) and may provide less incentive to join KiwiSaver. It would also add to the administrative cost of the scheme, as additional verification of a member's contribution rate would be needed. Similar arguments apply for increasing the minimum contribution period or "vesting" the $1000 at the end of a particular contribution period. Officials would not recommend this approach.

An alternative approach that could largely achieve the main benefit of a lower minimum rate without the associated downsides would be to allow employer contributions to count towards the 4% *(PSA, CTU, EPMU, NZEI Te Riu Roa, Eriksens Actuarial)*. For those employees that may not be able to meet 4%, some employers may offer to meet a portion (e.g. 2% employer and 2% employee). This could promote competition among employers to offer an attractive package that includes savings, further building a 'savings culture'. The other advantages and disadvantages of allowing employer contributions to count towards the 4% (mentioned above) would also apply.

The following matrix summarises four potential options, including the status quo:

		Employer contributions	
		Do not count	**Count**
Rates	**4% (default), 8%**	A (status quo)	C
	2%, 4% (default), 8%	B	D

Officials consider that that there is relatively little to choose between options B, C and D. As discussed above, officials consider that the advantages of allowing employer contributions to count towards the 4% outweigh the disadvantages. Officials also consider that, on balance, the risks of a large number of small account balances and reduced savings across the board support maintaining the minimum contribution rate at 4%.

In short, officials recommend option C above – maintaining 4% as the minimum contribution rate, but allowing employer contributions to count towards this amount.

8% unnecessary

A contribution rate of 8% is certainly not too high for many New Zealanders if the goal is to provide income adequacy in retirement. On the other hand, the restrictive lock-in provisions may make alternative savings vehicles more attractive, and it is probably likely that the 8% rate will have low take-up.

On balance, officials consider that designing the KiwiSaver scheme with 4% as the highest contribution rate would be at odds with a stand-alone scheme for retirement savings, and therefore recommend retaining the 8% rate.

Dollar amount approach

Dollar amounts would potentially be easier to understand for employees. On the other hand, a table could be provided to employees (perhaps through the information pack) indicating dollar amounts for different incomes and contribution rates.

Using a dollar amount would also have two significant disadvantages:

- The amount of savings under a percentage gradually rises as income rises, whereas a dollar amount would not. People may only infrequently look at raising this amount (i.e. inertia), meaning savings arelikely to be lower.

- If the dollar amount were set at a low level (e.g. 4% at $30,000, or $23 a week), this same dollar amount would be only 2% of income at $60,000. This rate of savings is likely to be far too low to achieve 70% income replacement in retirement.

Officials do not recommend a change to a dollar amount approach.

Formula approach

The Savings Product Working Group proposed a formula for contributions based on an exempt threshold, and a percent of salary above that threshold, subject to a de minimus contribution level. This would be similar to the formula for the repayment of student loans. Officials considered this approach as part of considering the recommendations of the Savings Product Working Group. However, officials did not recommend a formula approach.

As mentioned above, one of the design principles of the KiwiSaver scheme was simplicity, to make saving easy for people who have never saved before. A formula approach to contributions is potentially harder to understand for first-time savers, especially if the formula involved thresholds and different rate structures at different thresholds. The concern is that if people don't easily understand how much they will be required to contribute, they may be less likely to participate in KiwiSaver.

As an example, student loan repayments use a threshold and a single rate, where repayments are calculated as 10% of income above a certain threshold. The approach means that repayments are equivalent to 4.3% of gross income at $30,000, or 7.1% of gross income at $60,000. This has the benefit that the contribution rate increases as income rises. However, if it is complex for potential first-time savers to understand, it may deter participation. This is less likely to be a concern in the student loan context, because the formula for repayments is unlikely to be a critical factor when students decide whether or not to take out a student loan.

For these reasons, officials do not recommend a change to a formula approach.

Stepped up contributions

Stepped contributions would potentially make starting saving easier. However, such an approach would add complexity and add compliance costs for employers including payroll developers, as they would be responsible for changing the contribution rate each year. Inland Revenue would need to develop systems to monitor the anniversary dates of membership so that it could police that the rate increase occurred (and could notify employers that an increase was due).

The complexity would depend on whether the stepped increase would be a transitional measure and would apply to everyone from 2007 (1%) to 2010 (4%), or would require each member to increase their savings for their own first four years of membership, whenever that may be. The former would be considerably simpler, but would only make starting saving easier for new savers between 2007 and 2010 – it would have no effect on an ongoing basis.

Officials do not recommend a change to stepped up contributions. Officials consider that introducing a 2% rate would be a preferable approach if the concern is for the ability of low income earners to start saving.

Recommendations

That employer contributions count towards the 4% and 8% contribution rates.

That officials do not have a strong view on introducing an additional third contribution rate above 4%, such as 6%, but would recommend only one additional rate be added.

That all other submissions are declined. However, if the Committee favours stepped-up contributions, officials would recommend introducing a 2% rate instead if the concern is for the ability of low income earners to start saving.

6. Employer Exemptions

Clauses 19-23 of the Bill currently set out the grounds and processes by which an employer may apply to be an exempt employer. An exempt employer, if eligible, will be exempt from the automatic enrolment rules. The employer will have to apply to the Government Actuary for an exemption. The Government Actuary will grant the application if the employer satisfies all the requisite criteria. Similarly, the Government Actuary also has the authority to revoke an exemption where an employer ceases to comply with the criteria or where the employer applies for a revocation of the exemption.

Submissions

While many of the submissions support the idea of an exemption for employers, many also suggest that the criteria for exemption, as they are presently constructed in the Bill, are inadequate for several reasons. The predominant concern in the submissions has been that the criteria for the exemption are too narrow. As such, there is concern that they will not accomplish the policy objective of preventing the wind-up of existing KiwiSaver schemes. In fact, some submissions have even claimed that no schemes will currently comply with the criteria for the exemption without some amendment to the trust deed of the scheme. These amendments are likely to be a time consuming and costly option for employers and scheme providers. This may undermine the objective of minimising costs on employers that already provide access to superannuation schemes.

There have been several specific comments made in respect of the criteria for the exemption, including the following key issues. Note that some ancillary issues have not been addressed in this discussion and will be responded to in the clause-by-clause analysis of the submissions:

- The exemption does not appear to include employers that provide access to defined benefit schemes *(Aon Consultants, New Zealand Bankers' Association, ANZ National Bank Ltd, Westpac Corporation, Insurance Savings and Investment Association, Kelvin Prisk, ING (NZ) Ltd, ASFONZ, New Zealand Society of Actuaries, Mercer Human Resource Consulting and Shell);*

- The exemption should also include employers that provide access to superannuation schemes through Master Trusts *(Mutual Fund Limited, Tower Investments, ASB Group, Phillips Fox, Insurance Savings and Investment Association, Kelvin Prisk and ING (NZ) Ltd);*

- The definitions of salary or wages used in the Bill for the exemption are inconsistent with the definitions currently used by schemes *(Westpac Corporation, Insurance Savings and Investment Association, Kelvin Prisk, ASFONZ, New Zealand Society of Actuaries, Mercer Human Resource Consulting, ASB Group, AMP and New Zealand Law Society);*

- The exemption should be available to any employer that has a scheme open to all new employees in practice *(Insurance Savings and Investment Association, ING (NZ) Ltd, Shell, Mutual Fund Limited and ASB Group);* and

- The exemption should be available to any employer irrespective of the vesting scale they may have *(Westpac Corporation, Insurance Savings and Investment Association, Kelvin Prisk, ING (NZ) Ltd, ASFONZ, New Zealand Society of Actuaries, Mercer Human Resource Consulting, ASFONZ, Meat industry Association, Foodstuffs, Tower Investments and Peter Robertson).*

Comment

Policy Objectives

The purpose behind the exemption from automatic enrolment is to provide the employer with a method of avoiding additional costs where that employer is already actively promoting retirement savings. There are several dimensions to these objectives that need to be considered when establishing an appropriate threshold for the exemption, including:

- encouraging individuals to save for their retirement at an appropriate threshold;

- encouraging continued employer participation in saving;

- preventing the wind-up of existing employer-based and sponsored schemes and the subsequent release of funds out of schemes; and

- preventing the exemption becoming a means of regulatory arbitrage.

The following discussion examines the various submissions that were canvassed above against the objectives outlined above.

Defined Benefit Schemes

Defined benefit schemes, as provided for in the Superannuation Schemes Act 1989, are schemes that operate on the principle of unallocated funding.[4] Members contribute towards a scheme in return for a defined benefit on retirement. This may be paid either by way of an annuity or as a lump sum. Employers bear the investment risk in these schemes and will be liable to fund the scheme to ensure that any benefits payable

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4 Note that the definition in the Superannuation Schemes Act 1989 does not explicitly refer to defined benefit schemes, but rather refers to schemes that operate on the principle of unallocated funding.

from the scheme may, in fact, be paid. These schemes are often more generous than defined contributions schemes, in that the member is assured of receiving the predetermined benefit on retirement and does not run the risk of negative returns. The annual retirement benefit is usually calculated on a fraction of final salary multiplied by the numbers of years in service. For example:

Annual Benefit Provided in Retirement = (1/80 x Final Salary) x Years in Service

An example of this formula in practice may be where an employee earns $40,000 in his or her final year of service and has worked for an employer for 40 years, that employee will receive an annual annuity in retirement amounting to $20,000. The fraction used in the calculation of the benefit may change. Another variable between different defined benefit schemes is whether the final salary is used as the basis for calculation or whether average salary is used instead.

It should also be noted that a number of defined benefit schemes are hybrid schemes. The defined benefit sections of many of these schemes are closed to new members, leaving a “cash accumulation” type section open to new members. The sections that are open to new members effectively operate on a defined contribution basis and have a notional member’s account into which all member and employer contributions are deposited. The benefit that is payable on withdrawal would amount to the funds that are held in the notional account.

The Government Actuary’s Office has indicated that there are 139 defined benefit schemes currently in operation. These schemes hold a total of $5.2 billion in assets and currently have 72,464 members. This constitutes approximately 48% of total funds administered by superannuation schemes and 24% of all members currently in superannuation schemes.

While defined benefit schemes have the potential to provide a substantial level of security to pensioners in retirement, there are several risks that need to be considered when determining whether such schemes should be eligible to be used as vehicle for an employer to apply for the exemption from automatic enrolment.

One of the primary complexities is that today’s labour market is highly flexible, with job tenure unlikely to be forty years. Given that the number of years in the employer’s service is a key determinant of the benefit receivable, any assessment of the generosity of the scheme will depend on the number of years that the member is likely to be in service. Discussions with the Association of Superannuation Funds of New Zealand (ASFONZ) however, have suggested that a threshold could be established to ensure that, as a minimum, defined benefit schemes must accrue benefit in the members’ interest at a minimum rate of 4% in order to be used as a vehicle for the exemption. This will ensure that, while an employee may not stay with an employer providing a defined benefit scheme for an extended period of time, the employee will nevertheless be accruing benefits at a rate equivalent to KiwiSaver. To provide greater certainty, there could be a requirement on the actuary of the relevant scheme to provide certification to the Government Actuary to the effect that the benefits provided by the scheme are, in fact, accruing at a minimum rate of 4%.

There are also inherent wind-up risks with defined benefit schemes. Upon the winding up of defined benefit schemes, pensioners are usually paid benefits before any of the active members of the scheme. A member, thus, runs a risk in a defined benefit scheme that if the scheme is wound up prior to their retirement that they would receive a substantially reduced benefit, which could conceivably be less than the amount that the member contributed towards the scheme. There is a further risk with defined benefit schemes that arises from the fact that the employer bears the investment risk. The employer, in defined benefit schemes, is responsible for the ensuring that the scheme is funded to an appropriate level to pay all required benefits. In the event that the employer becomes insolvent, the scheme would generally be forced to wind up. In such cases, the member's benefit is likely to be significantly diminished as well. Submissions, however, have indicated that most of the schemes that are open to new members (of which, there are 76) are run by large and well funded organisations, in which the risk of wind-up is minimised.

One such example is The Shell New Zealand Pension Plan run by Shell New Zealand Limited, which has been open to members since 1947. In their submission to the Committee, Shell indicated that they currently contribute at a rate of 19% of members' base salary. Shell New Zealand Ltd has been in operation in New Zealand for almost 100 years and have a well established corporate profile. One may assume in such an instance, the risk of employer insolvency is low.

Many other defined benefit schemes also provide substantial employer contributions for members. In order to facilitate the savings objective of KiwiSaver, it is desirable that these employers are encouraged to continue their contributions. There is a risk that if employers are forced to incur costs in complying with the KiwiSaver obligations, they may be discouraged from making further contributions. The importance of preserving the funds in such schemes should not be underestimated. The Government Actuary's Annual Report for the year ended 30 June 2005 reported that in 2004 there were 156 such schemes with $4.84 billion in funds. The wind-up of these schemes and the subsequent release of funds could result in a drop in aggregate savings levels.

It should finally be noted that there were 115,606 businesses employing employees in 2001. Given that defined benefit schemes are primarily employer stand-alone superannuation schemes (which are generally offered by singular employers or groups of related employers), and that they only number 156 schemes, the number of employers that will be eligible for the exemption is likely to be negligible. As such, the extension of the exemption criteria to include defined benefit schemes is unlikely to have a substantial impact on participation in KiwiSaver. The failure to extend the criteria for the exemption, however, is likely to exclude a number of employers that currently provide access to defined benefit schemes. This may serve as a disincentive for the employer to continue providing access to these schemes.

Accordingly, officials recommend that employers providing access to defined benefit schemes be able use the defined benefit scheme in an application for an exemption.

Note also that officials will develop an appropriate test to ensure that defined benefit schemes are included without creating opportunity for regulatory arbitrage.

Master Trusts

Employer Master Trust superannuation schemes establish an overarching trust that employers are able to participate in. Often, employers are still able to specify the terms and conditions of their participation, including specifying matters such as the contributions that are payable and the conditions of entry. Such conditions are generally specified in the participation agreement that the employer enters into with the trustees of the scheme. The benefit of Master Trusts is that they centralise the costs of operating the superannuation scheme. They also reap benefits in being able to access larger pools of funds for investments. There are currently 16 Master Trust Schemes with 2,318 participating employers. These schemes hold a total of $1,498 million in net assets.

It was intended that the Bill allow employers that provide access to Master Trust Superannuation Schemes to be exempt from the automatic enrolment rules, if those schemes satisfy the requisite criteria. Submissions have raised concerns that the current construction of the criteria for the exemptions may exclude Master Trust arrangements.

It should also be noted that the application for exemptions has to be made by an employer as defined in the Bill. Accordingly, if there are a number of employers that participate in a Master Trust, each of those employers will need to satisfy the Government Actuary that the scheme they provide access to satisfies the requisite criteria. If a number of employers wish to make a joint application, they will be able to, so long as each employer is able to satisfy the requirements of the exemption. In order to clarify this issue, officials recommend that individual employers be able to apply for an exemption equally through Master Trust Registered Superannuation Schemes as well as stand alone Registered Superannuation Schemes.

Open to all Employees

The submissions have indicated that while some current schemes do not have trust deeds that specify that the schemes are open to all employees, those schemes may *in practice* be open to all new employees. Generally, while the trust deed will provide that employees may join the scheme at the employer's discretion, the offer documents of those schemes will state that they are open to all permanent employees. It is desirable that such schemes become eligible for the exemption as long as, *in practice*, they remain open for new members to join.

Accordingly, officials recommend that an employer be eligible for an exemption if they provide access to a scheme, that is *in practice* open to all new permanent employees. Schemes would have to demonstrate this fact to the Government Actuary.

Definitions of Salary or Wages

In order to satisfy the criteria for exemption, the total of the minimum that employees must contribute and the maximum the employer can contribute must be at least 4% of an employee's *gross* salary or wage. The current test suggests that the scheme must require the amount to be 4% of total remuneration from that employer, inclusive of overtime, bonuses and other additional payments. Submissions have indicated that many schemes will fail this test, as they are not constructed in terms of *gross* salary or wages. The test, submissions have indicated, should be based on the calculation of salary or wage that the scheme currently uses. Most schemes do not include such additional payments and are likely to fail a test based on gross salary or wages, even if they require contributions at 4%. Industry associations have indicated that a test that is based on basic salary or wages will encompass all definitions that are currently used by existing schemes.

Accordingly, officials recommend that the test currently in clause 20(c) be amended to refer to gross *base* salary or wages. Note that this would only apply to schemes where the employer is exempt from automatic enrolment. Deductions to KiwiSaver schemes would still be calculated based on gross salary or wages.

Vesting

Many defined contribution superannuation schemes currently provide for employer contributions to vest over a certain prescribed period of time. Vesting scales are often used by employers as a loyalty tool. It encourages greater retention, as an employee is motivated to stay with the employer for longer periods of time in order to access more of the employer's contributions. Any unvested contributions remaining in a superannuation scheme when an employee leaves the employer generally are transferred into a reserve fund in the scheme. These funds are not able to be transferred or withdrawn by the member. The employer is generally also able to make contributions from the reserve account if the trust deed of a scheme permits it.

Note that defined benefit schemes do not have vesting scales. This requirement should not apply to defined benefit schemes if it is agreed that such schemes should be included within the exemption criteria.

In order to satisfy the criteria for an exemption, a scheme has to provide that any employer contribution has to vest within five years. This ensures that the interest in the employer's contributions would completely pass to the employee at the end of five years. The objective of this requirement is to encourage greater compatibility between registered superannuation schemes and KiwiSaver. In order to ensure that members who are saving through an exempt employer superannuation vehicle are able to save at 4% of their income, it is desirable that the 4% be vested in the employee within a reasonable timeframe. The test as presently drafted in the Bill, however, requires *all* employer contributions to be vested within five years.

This would result in a position where a scheme that requires an employee to contribute 4% and does not require the employer to contribute will be eligible to qualify as a scheme for exemption, but a scheme that provides 17% employer contribution that does not vest by the fifth year of employment will not be eligible. At the same time, however, it is necessary to ensure that employers do not use vesting requirements to prevent the employee accessing the funds for extended periods of time when it contributes towards the 4%. This is especially relevant given that job tenure is relatively short in New Zealand.

In order to balance the employer's need to use vesting as a retention tool and in order to ensure that vesting is not used as a means to avoid payment to the employee, officials recommend that the vesting requirement only apply to the amount of the employer contribution that is considered as part of the 4% of gross base salary or wages requirement.

Recommendations

That the criteria for the exempt employer is amended to allow:

- defined benefit schemes to be permitted under certain conditions;
- master trust schemes to be permitted;
- any scheme that is, *in practice*, open to all permanent employees to be eligible;
- gross base salary or wages to be used as a test (instead of gross salary or wages); and
- clarification that the requirement that employer contributions must be fully vested in the employee at five years only applies to any employer contribution that is required as part of the minimum 4% contribution.

7. Financial advice and education

The ANZ-Retirement Commission Financial Knowledge Survey has recently reported that while New Zealanders generally have reasonable levels of personal financial knowledge, there is some confusion about investment strategies. There has also been an indication that a further, commonly-held view is that New Zealanders have difficulty making complex financial decisions about their retirement. Indeed, this was one of the fundamental premises that the development of KiwiSaver was predicated on. One of the core objectives of the KiwiSaver was to introduce a simple method by which people could begin a savings habit, through automatic enrolment and deductions at the work place.

There are a number of occasions where a person will require information so that they are able to make a financial decision, should they wish to do so. Note that while KiwiSaver has been designed to enable a person to become enrolled without having to make a decision, it nonetheless, remains desirable that people take an active part in their financial decision-making. The financial decisions that need to be made relate to the following:

- whether or not a person should opt out of, or participate in, KiwiSaver;
- the specific KiwiSaver scheme that is most appropriate for that person's circumstances, if that person chooses to participate in KiwiSaver;
- the specific product that is most appropriate for the individual's own risk profile (which may also include accessibility to other products such as insurance); and
- on an ongoing basis, if something has changed and they should review the scheme or product that they are in, or if they should review their participation in KiwiSaver, if they have not already participated.

There are three methods within KiwiSaver that are available to encourage a person to make these financial decisions. These aim to provide the individual with the appropriate tools to enable that person to make an informed decision that is in their own best interests. These methods include:

- disclosure through the provision of investment statements;
- a generic financial education campaign; and
- the involvement of financial advisors.

Submissions

Submissions to the Committee have raised a number of issues with the role of financial advice and education in KiwiSaver. The specific points that have been raised in submissions include:

- that the current level of financial literacy in New Zealand is relatively low;
- that the KiwiSaver information pack should direct an employee to seek financial or professional advice; and
- that the information pack clarifies the role and obligation of employers in KiwiSaver and reduces the risk that people will turn to their employers for advice.

Comment

Disclosure

KiwiSaver requires Inland Revenue to send an investment statement to all employees who are automatically enrolled in a KiwiSaver default scheme, prior to the end of the opt-out period. The aim of this disclosure is to provide the member with information on the scheme and the product into which they will be defaulted.

This information, while valuable in providing information about the specific investment, does not enable a person to compare similar products to determine whether they should opt for another scheme or product. A prospective member may request investment statements for other KiwiSaver products, although there will be search costs associated with this. A member may be unwilling to take the effort to search for further schemes or products, which in turn would inhibit their ability to compare the default KiwiSaver product with other investments.

The usefulness of the investment statement is further limited as the information is not intended to be tailored specifically to the individual circumstances of the prospective member (i.e. the risk/return profile of the member).

Financial Education

The Retirement Commission, in conjunction with other core Crown agencies, has been provided with funding in this year's Budget to undertake a generic financial education campaign around the launch of KiwiSaver. The objectives of the short-term campaign include the following:

- increase consumer knowledge of what information is available to the prospective members;

- reduce confusion and the feeling of being overwhelmed by financial information;
- create and utilise trusted sources of financial information; and
- provide tools to support consumers in making informed and relevant decisions about KiwiSaver.

While this campaign will be a generic campaign, it aims to help people with thinking about their individual financial situations. One of the avenues that will be used for this campaign is the information pack, which will provide generic information about KiwiSaver as prescribed in clause 33 of the Bill. The provision also enables the Commissioner to include any further information that he thinks is necessary in the information pack. This information will be provided in a generic fashion and is not intended to address questions that individuals may have around their particular circumstances.

The Role of Financial Advisors in KiwiSaver

It is desirable that people are able to access financial advice when making financial decisions. Advisors are able to give people advice about all the decisions that will be specific to the individual's circumstances, which may not be as easily accomplished by the other methods outlined above. The Bill is currently silent on the role that financial advisors may play in the KiwiSaver environment. This does not automatically preclude financial advisors having a role in KiwiSaver. An argument has been developed, however, that the automatic enrolment mechanism reduces the likelihood that people will seek financial advice. This is because a person would not have to actively engage in any financial decision making in order to become enrolled in a KiwiSaver scheme. This creates a further difficulty given that it is currently envisaged that the default investment product will be a conservative investment, which may not necessarily be in the best interests of a young person saving for retirement.

It should also be noted that the KiwiSaver environment, however, creates large scope for financial advisors to actively market themselves, and in doing so improve the level of financial understanding and provide advice that will allow the most effective and efficient savings options for the individuals. The design of the KiwiSaver scheme (i.e. the length of time to decide whether to opt out) gives employees time to seek advice before they are defaulted into or make an active choice of KiwiSaver scheme, if they wish. Furthermore, many scheme providers have either in-house or related financial advisors. Where such advisors are attached to default KiwiSaver providers, or employer-preferred KiwiSaver schemes, they are likely to have access to a greater number of members. These advisors would be able to provide members with more relevant information about the types of products that the member should be saving in or to sell these members other products such as insurance.

It should also be noted that financial advisors have a further role in KiwiSaver in marketing employer-preferred schemes to employers. This would be both beneficial for employers who may want to facilitate contributions to a specific provider and the financial advisor industry. Furthermore, as it is more likely that there will be a greater number of people involved in financial products, there is also likely to be greater interest in financial advice, creating greater scope for financial advice to be provided and increased education.

It should be noted that the current environment for financial advisors operates on the basis that the advisors are required to actively market themselves and seek clients. Advisors will be able to continue actively marketing themselves in this manner in the KiwiSaver environment. This should also increase the availability of financial advice for members seeking to make financial decisions in KiwiSaver. Such advisors, however, are more likely to market themselves actively to higher income individuals, simply because the effort is likely to be more warranted. In order to encourage other individuals to consider seeking advice from financial advisors about the product that they should subscribe to, a further intervention may be warranted. The information pack that is provided to all new employees may be an ideal opportunity to encourage people to seek financial advice.

Such advice is likely to be desirable, because the generic information provided in the information pack might not explicitly address some of the concerns that individuals have around their particular circumstances. In addition, the default investment product is currently envisaged to be a conservative investment, which may not necessarily be appropriate for all long-term savers. Accordingly, officials recommend that a statement be included in the KiwiSaver information pack suggesting that an employee should seek financial advice if they want information in relation to their personal financial circumstances or if they need assistance in deciding whether to opt out or not, in selecting an appropriate KiwiSaver scheme or investment product within a KiwiSaver scheme, or do not understand the scheme or financial concepts..

Role of Employers

A further concern with automatic enrolment is that many employees will turn to their employers for financial advice when given the information pack. Employers have submitted that this will place pressure on the employer-employee relationship. Employers may be liable for any advice they provide to employees and will not want to incur such liability. The chances, however, of employers being liable for such advice is slim, as they would have to be negligent or otherwise not acting in good faith when providing the advice to incur any liability. There is also a further ‘avoidance of doubt provision’ in the Bill that states that where the information that they provide to their employee is of a factual nature, they will not be liable for that information. However, if they do not provide such advice there is a concern that undue pressure will be brought to bear on their relationship with their employees. The concern is exacerbated because the Bill, as currently drafted, is silent on whether employers should or should not give financial advice. Employees may have an expectation that their employers will advise them on the best option. It should be noted that where an employee is already enrolled with a KiwiSaver scheme, the employer may refer the employee onto their provider.

This problem could be further alleviated by clarifying in the information pack that if an employee wants advice in respect of KiwiSaver, that employee should seek advice from a professional financial advisor rather than their employer. This is especially so, given that the source of the concern is that the provision of the information pack is likely to create the expectation that the employer will be able to advise the employee on an appropriate course of action. This information will also be provided to all employees in the generic financial education campaign. This will further aid in alleviating any perceptions that the employer ought to be providing financial advice.

Recommendations

That a statement be included in the information pack to be given to new employees that:

- suggests that employees should seek financial advice if they want information in relation to their personal financial circumstances or if they need assistance in deciding whether to opt out or not, in selecting an appropriate KiwiSaver scheme or investment product within a KiwiSaver scheme, or do not understand the scheme or financial concepts; and

- clarifies that employees should seek such advice from a professional financial advisor rather than their employer.

8. Penalties and disputes

Submissions

(26 – National Council of Women of New Zealand (NCW), 60W – New Zealand Institute of Chartered Accountants (NZICA)).

That the legislation should make it clear who would be responsible in the event of errors being made in calculating payments to a savings scheme on a wage sheet. Employers should not be penalised in any way for not participating in KiwiSaver whether or not they have overcome the hurdles to obtain an exemption *(NCW).*

That KiwiSaver deductions are not akin to PAYE. They are not amounts of tax and should not be treated as such. They are not due to the Crown. Therefore, they should not be subject to penalties and use-of-money interest, including when an employer misses the 77 day deadline or fails to provide an information pack on time *(NZICA).*

Comment

Penalties

A policy decision was previously made to apply use-of-money interest and all standard tax penalties (late filing, late payment, shortfall and criminal penalties) to KiwiSaver. This was a result of adopting the existing PAYE system to collect KiwiSaver contributions, with the aim of minimising compliance costs for employers. It was felt that the same penalty rules should apply to both PAYE and KiwiSaver contributions as they would be collected together. However, officials agree that KiwiSaver contributions are not the same as tax payments in that if deductions are not made no-one is out of pocket. As such, we propose the following revised penalty rules to address submitters' concerns.

A KiwiSaver employer offence can fall into three categories:

- failure to provide information (failure to provide information pack, failure to give notice of new employee);
- failure to deduct contributions (failure to commence deductions, failure to commence contributions at the end of a contribution holiday, failure to deduct correct amount of contributions); and
- failure to pass contributions withheld onto Inland Revenue.

Failure to provide information

In relation to the first category of offence, officials consider that there should be a fixed monetary penalty ($50 for small employers and $250 for large employers). Inland Revenue will notify the employer after a first offence has been identified to remind them of their obligations. A penalty will be imposed for a second offence unless the employer can demonstrate that they have been compliant for at least 12 months prior to the offence.

The existing criminal penalties would continue to apply as a backup for employers who knowingly and consistently ignore their KiwiSaver obligations.

Failure to deduct

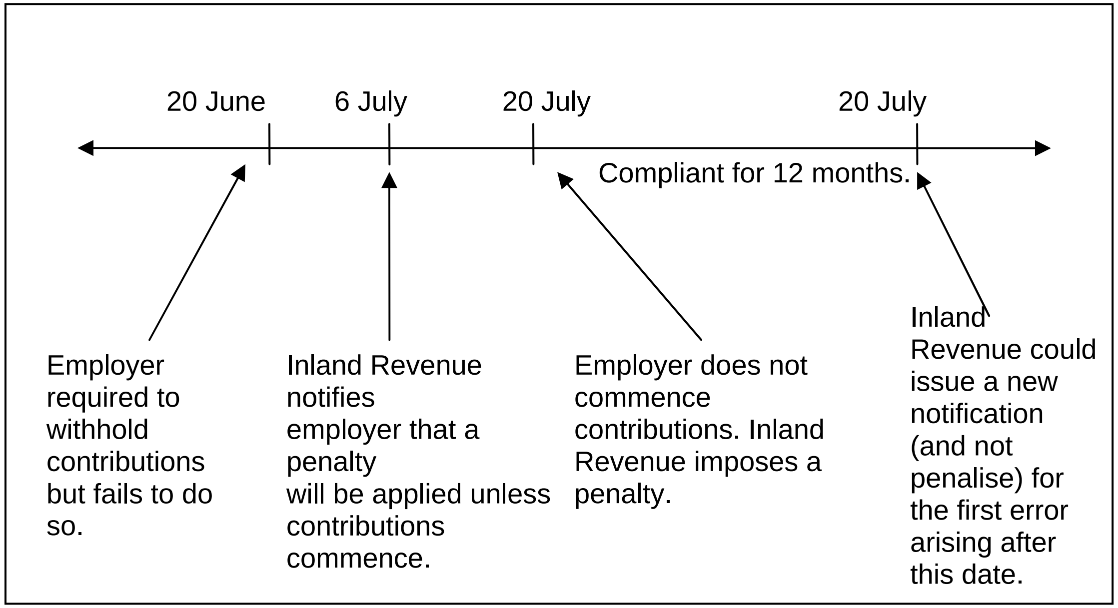
In relation to the second category of offence, officials propose that an employer should not be required to make up any contributions that should have been withheld. This is on the basis that the employee has retained the money that should have been withheld. This would mean that there would be no tax shortfall, and as such, shortfall penalties would not apply. There would also be no late payment penalty or use-of-money interest applied as there would be no late payment of contributions. There should also be no late filing penalty as the employer monthly schedule should have been filed for PAYE generally.

Instead, officials propose applying a set dollar penalty ($50 for small employers and $250 for large employers) for any employer monthly schedule where an employer has failed to deduct contributions (failure to commence deductions, failure to commence contributions at the end of a contribution holiday, or errors in calculating contributions).

This would be applied as follows:

- An employer fails to withhold the correct amount of KiwiSaver contributions.
- Inland Revenue notifies the employer that they have not withheld the correct contributions and that a penalty will be applied if they do not withhold the correct contributions going forward.
- The employer's next employer monthly schedule does not contain the correct KiwiSaver contributions and Inland Revenue applies the penalty.
- A penalty would apply to any subsequent errors made within 12 months of a previous error.
- A new warning notice (with no penalty) would be issued for an error made where the taxpayer has been complaint for at least 12 months.

This is illustrated in the diagram below.



The existing criminal penalties would continue to apply as a backup for employers who knowingly and consistently ignore their KiwiSaver obligations.

Failure to account

The standard tax penalties would continue to apply to employers who withhold contributions but fail to pass these on to Inland Revenue.

Remission

It is proposed that these new penalties would be subject to the existing remission rules with appropriate administrative changes to deal with KiwiSaver. The Commissioner's existing policy on remission of penalties is that certain penalties can be remitted if the Commissioner is satisfied that the non-compliance has been caused by an event or circumstance that provides reasonable justification or excuse for the omission and the omission was rectified as soon as possible.

Disputes

Officials have also reviewed the proposed KiwiSaver disputes process in light of submissions in relation to penalties.

It was intended that a consistent disputes process would apply to PAYE deductions and KiwiSaver contributions. However, as currently drafted, all matters relating to KiwiSaver enrolment and contributions (Parts 1 to 3) and Schedule 3 of the KiwiSaver Bill, including any matters subject to Commissioner discretion, are disputable decisions. This is not consistent with the existing disputes process which applies to the PAYE rules. Under section 138E of the Tax Administration Act 1994, a matter left to Commissioner discretion under the PAYE rules is not a disputable decision and may only be challenged by judicial review.

Officials recommend amending the KiwiSaver Bill so that the disputes process is consistent with the PAYE disputes process. Matters related to KiwiSaver enrolment and contributions would be disputable decisions, excluding those that are subject to the exercise of Commissioner discretion. Instead, officials recommend amending all KiwiSaver Commissioner discretions to give members an additional period of time to supply further information for consideration. In other words, if the Commissioner considers that he is likely to decline any decision that is subject to his discretion, he would be required to inform the person and give them time to provide additional information to support their claim.

This approach would be consistent with section 177 of the Tax Administration Act 1994, which allows the Commissioner to seek further information when considering an application for financial relief. It would also mean that the KiwiSaver disputes process is consistent with the process applying for PAYE, while providing taxpayers with a low cost process for administrative review of KiwiSaver Commissioner discretions. This process will not apply to any disputes arising out of the registration, conversion, exemptions or other processes that are generally dealt with by the Office of the Government Actuary. This will be dealt with under the existing processes that the Government Actuary employs to deal with disputes.

Recommendations

That the submissions on penalties be accepted and that the penalties for KiwiSaver be amended so that the penalty for a failure to provide information and failure to deduct contributions is a fixed monetary penalty ($50 for small employers and $250 for large employers). Inland Revenue will notify the employer after a first offence has been identified to remind them of their obligations. A penalty will be imposed for a second offence unless the employer can demonstrate that they have been compliant for at least twelve months prior to the offence.

That the existing criminal penalties would continue to apply as a backup for employers who knowingly and consistently ignore their KiwiSaver obligations.

That the standard tax penalties would continue to apply to employers who withhold contributions but fail to pass these on to Inland Revenue.

That KiwiSaver penalties would be subject to the existing remission rules with appropriate administrative changes to deal with KiwiSaver.

That the KiwiSaver Bill be amended so that the disputes process is consistent with the PAYE disputes process. Matters related to KiwiSaver enrolment and contributions would be disputable decisions, excluding those that are subject to the exercise of Commissioner discretion. Instead, the Commissioner of Inland Revenue would be required to give members an additional period of time to supply further information when he considers that he is likely to decline any decision that is subject to his discretion.

9. Casual and temporary employees

Submissions

(7 – Employers and Manufacturers Association (EMA), 60W – New Zealand Institute of Chartered Accountants (NZICA), 70W - Tourism Industry Association New Zealand (TIANZ))

Casual employees are going to be a time-consuming category of employee – we expect the majority of them to opt out. Most tend to be employed for less than three months but more than eight weeks. A three month period will vastly reduce the administration in regard to the scheme *(EMA).*

Automatic enrolment rules should not apply to temporary or casual workers *(NZICA).*

Compliance is created around seasonal workers. Many employees are employed for very short periods, perhaps three or four months – the automatic enrolment process will create additional time-consuming tasks at a time when small businesses can least afford the compliance requirements *(TIANZ).*

Comment

With some small exceptions, the automatic enrolment rules in the Bill apply to all employees, whether part or full-time, casual or permanent. This means that people who are employed on a casual, short-term basis (e.g. for one day) are subject to automatic enrolment. It should be noted that currently casual agricultural workers are excluded from the automatic enrolment rules.

While “casual employee” could be defined and such employees excluded from automatic enrolment, the problem with casual employment is that it may describe a wide variety of employment relationships. One submitter gave examples of someone employed on a one-off basis (e.g. for a Super 14 match) and someone who had been with the same employer for 18 years as both being of a casual nature.

“Casual employee” is not a defined term in employment law, although essentially the concept is employment that is “intermittent or irregular”. Using a similar definition for KiwiSaver purposes would potentially exclude permanent casuals from automatic enrolment – those who are employed by the same employer for long periods but who work on an “as and when required basis”. It would also exclude those individuals who have a number of “as and when required” jobs.

Instead, officials consider that employees who are employed for four weeks or less should be excluded from automatic enrolment. A four week period will significantly reduce the compliance burden for employers and short-term employees without undermining the automatic enrolment mechanism. Officials consider that a period of more than eight weeks would undermine the intent of automatic enrolment.

A provision would be required to cover the situation where an employee who initially came within the four week period for exclusion from automatic enrolment had their employment extended beyond four weeks. Officials consider that a "new job" should be deemed to have started on the day on which employment has exceeded four weeks, triggering automatic enrolment. At this stage the employee would become subject to the normal automatic enrolment rules. Given that casual agricultural workers are currently excluded from the automatic enrolment rules a similar rule should apply to them when they cease to be a casual agricultural worker (that is after three months).

Recommendation

That employees who are employed for four weeks or less be excluded from automatic enrolment, and that, for these employees, a 'new job' be deemed to have started on the day employment exceeds four weeks, triggering automatic enrolment.

That in the case of casual agricultural workers a 'new job' be deemed to have started when such employees cease to be a casual agricultural worker for PAYE purposes (after three months).

10 Privacy

Submissions

(7 and 7A – Employers and Manufacturers Association (EMA), 20 – Mercer Human Resource Consulting (Mercer), 39 – AON, 50 – Motor Trade Association (MTA), 70W – Tourism Industry Association of New Zealand (TIANZ))

That the disclosure of information be used only for Inland Revenue administration purposes. For various reasons employees do not want their address to be disclosed and therefore collection by third parties would be inconsistent with privacy principles *(MTA)*.

That some employees may be reluctant to provide their addresses in terms of clause 17. Inland Revenue is the agent for a number of collections that the employee may be trying to avoid, such as child support or student loan repayments. Clause 190, which gives the Inland Revenue the ability to use the names and addresses supplied to help fulfil other statutory functions (and chase other debts), may have the legal effect that employees chose not to comply with their obligations under section 17 *(EMA)*.

That there is a concern that the employee address supplied by the employer may be used by Inland Revenue for other tax purposes *(TIANZ).*

The Commissioner should be required to specify the employee's tax file number in addition to other information *(Mercer).*

That the Privacy Act should be amended to permit KiwiSaver schemes to use a person's IRD number as the member's unique identifier *(Mercer, AON).*

Comment

A number of submissions have been made in relation to the privacy implications of KiwiSaver, both calling for greater and less use of information. The Office of the Privacy Commissioner has also raised a number of privacy issues in relation to KiwiSaver. We address each of the issues below.

Relationship between KiwiSaver and existing Inland Revenue responsibilities

The Office of the Privacy Commissioner has raised the possible conflict between Inland Revenue's existing role in relation to revenue matters and its proposed role as the central administrator for KiwiSaver.

Officials note the concern. However, a high level policy decision was made to use Inland Revenue to administer KiwiSaver. This was based on the benefits of keeping compliance and administration costs down by using existing systems.

KiwiSaver as a Revenue Act

The Office of the Privacy Commissioner has queried whether information collected for KiwiSaver will be collected for "revenue purposes" and is therefore covered by the revenue exception to privacy principles 2, 10, and 11.

Officials consider that, as an Inland Revenue Act, information collected by Inland Revenue for KiwiSaver will be collected for revenue purposes. Therefore, the normal revenue exceptions to privacy principles 2, 10 and 11 apply. Inland Revenue would not rely exclusively on the "protection of the public revenue" exceptions to the information privacy principles when using or disclosing personal information. There will be a statutory override, authorising the use of KiwiSaver and tax administration information (currently clause 190), and other exceptions to the privacy principles may apply in any case.

The Office of the Privacy Commissioner has also noted that making KiwiSaver an Inland Revenue Act will remove access and complaint rights under the Privacy Act. However, Inland Revenue's administrative practice is to exercise Commissioner discretion under section 81(4) of the Tax Administration Act 1994 in line with access rights under the Privacy Act 1993. In respect of complaint rights, KiwiSaver members will have the protection offered by the Ombudsman and the tax disputes process.

Use of information for revenue purposes and vice versa

Submitters and the Office of the Privacy Commissioner are concerned that personal information obtained for KiwiSaver will be used by Inland Revenue for revenue collection purposes.

While using KiwiSaver information for other revenue purposes and vice versa does give rise to potential privacy issues, officials consider that this risk can be managed operationally and that the ability to use information across Inland Revenue is an important power for administrative efficiency. Information collected for KiwiSaver purposes will be another source of information which can be used by Inland Revenue to carry out its many functions. Given the limited contact that many salary and wage earners have with Inland Revenue under self-assessment, officials recommend that information collected for one purpose should be able to be used for any Inland Revenue purpose to ensure that Inland Revenue maintains up-to-date information on taxpayers. However, officials also recommend that employers only be required to pass on those employee details provided. This will mean that employees can choose not to supply certain information.

Although there is the potential that the use of information for revenue purposes could have some impact on perceptions of KiwiSaver, officials consider that this risk is not significant because employees can choose not to supply certain information.

Information matching

The Office of the Privacy Commissioner is concerned that clause 190 permits Inland Revenue to use KiwiSaver information for the comparison and verification of other personal information. This appears to be information matching without the normal protections under Part 10 of the Privacy Act 1993.

Clause 190 of the KiwiSaver Bill allows the Commissioner to compare KiwiSaver information with other information held by Inland Revenue. It is not intended that this be an information matching power. Officials recommend that clause 190 be revised in order to remove any inference to information matching.

Clause 190 could be revised in line with section 240(8) of the Child Support Act 1991:

> *"Notwithstanding anything in any other Act, nothing shall prevent the Commissioner or any officer of the Inland Revenue Department from—*
> *(a)Using information obtained under this Act for the purposes of carrying into effect the provisions of any of the Inland Revenue Acts; or*
> *(b)Using information obtained under any of the Inland Revenue Acts for the purposes of carrying into effect the provisions of this Act."*

Ability to retain KiwiSaver information on non-members

The Office of the Privacy Commissioner has raised the retention of information on individuals who opt-out of KiwiSaver as a privacy concern.

One of the features of KiwiSaver is that an employee to whom the automatic enrolment rules apply may opt out after starting a new job. However, an employer is required to give information (name, address, tax file number) on new employees to Inland Revenue each month. This means that Inland Revenue is likely to receive information on taxpayers who do not become KiwiSaver members.

Officials agree that it would not be appropriate to retain a non-member's KiwiSaver record as an active record longer than is administratively needed. Therefore, officials agree that a change should be made to the KiwiSaver Bill to limit use of this information by Inland Revenue once a KiwiSaver file is effectively closed.

Passing on KiwiSaver information

The Office of the Privacy Commissioner is concerned that personal information obtained for KiwiSaver by Inland Revenue will be disclosed to third parties. They consider that this appears to contradict the tax secrecy provisions.

The KiwiSaver Bill requires Inland Revenue to disclose member information to third parties in certain circumstances and provides specific authority to allow this to occur. Therefore, officials do not consider that this is contrary to the secrecy provisions in section 81 of the Tax Administration Act 1994.

Unique identifiers

The Office of the Privacy Commissioner is concerned about the use of a person's tax file number as a unique identifier, noting that this appears to be a statutory override of privacy principle 12.

Several submitters have raised the importance of being able to use a person's tax file number as a unique identifier.

While allowing the tax file number to be used in this way does raise privacy concerns, officials consider that given the intention for KiwiSaver to be a portable personal savings account, the use of the tax file number as the unique identifier for the scheme makes sense for practical, compliance and administration reasons. Officials therefore recommend including a basic override to privacy principle 12 into the KiwiSaver Bill. This could be based on section 296ZH of the Fisheries Act 1996.

Officials consider that concerns over the use of the tax file number could be addressed by making use of the tax file number as a unique identifier optional for providers and building controls around the use of the tax file number as a unique identifier into the memorandum of understanding between Inland Revenue and providers.

The Office of the Privacy Commissioner has recommended an alternative of providers using their own unique identifier but recording the member's tax file number within the client's record so that this can be used for interactions between the provider and Inland Revenue. While this would provide an audit trail between providers and Inland Revenue, it would appear to result in duplication of information. Each provider would need to use their own unique identifier and each time that a member transferred their scheme (which is likely given the lifetime portable nature of KiwiSaver) they would be allocated a new number. Also, where members interact with Inland Revenue in respect of their KiwiSaver account they would need to remember and quote their provider number rather than being able to use their Inland Revenue number. This seems inconsistent with the fact that Inland Revenue is the central administrator of KiwiSaver.

Other remedial issues

The Office of the Privacy Commissioner has also highlighted an amendment required to schedule 3 of the Bill to remove the consequential amendment which inserts sections 137 to 146 in Schedule 2 of the Privacy Act. Officials agree that this change needs to be made.

Recommendations

That submissions on limiting the use of KiwiSaver information collected by Inland Revenue be declined. Information collected for one purpose should be able to be used for any Inland Revenue purpose for administrative efficiency. However, employers should only be required to pass on those employee details provided. This will mean that employees can choose not to supply certain information.

That clause 190 be revised in order to remove any inference to information matching and to allow two-way flow of information between KiwiSaver and other Inland Revenue functions.

That a change should be made to the Bill to limit the use of KiwiSaver information collected by Inland Revenue from non-members.

That submissions on the unique identifier be accepted and that a basic override to privacy principle 12 be included in the KiwiSaver Bill.

That an amendment be made to Schedule 3 of the Bill to remove the consequential amendment which inserts sections 137 to 146 in Schedule 2 of the Privacy Act 1993.

That the Commissioner does not make a final allocation to a default KiwiSaver scheme when the Commissioner has made a decision that is being disputed.