

KiwiSaver: Investment Statements and Small Balances

Purpose

The purpose of this report is to draw to your attention two areas relating to the current KiwiSaver scheme that have raised concerns with providers, employers and others in consultation meetings with officials. The report also suggests some options for addressing these that could be discussed at the meeting of Ministers and officials at 10am on Thursday 15 December 2005.

Date:	13 December 2005	Priority:	High
Security Level:	Confidential	File Number:	RCP 3.9.7

Action Sought

	Action Sought	Deadline
Minister of Finance	To note the contents of this report and recommendations for discussion at the meeting on 15 December 2005	Thursday 15 December 2005
Minister of Commerce	To note the contents of this report and recommendations for discussion at the meeting on 15 December 2005	Thursday 15 December 2005
Minister of Revenue	To note the contents of this report and recommendations for the meeting on 15 December 2005	Thursday, 15 December 2005

Ministry Contacts

Principal Author

Name	Position and Unit	Telephone	
		Work	After Hours
Kirstie Hewlett	Manager, Financial Sector		

Responsible Manager

Name	Position and Unit	Telephone	
		Work	After Hours
Kirstie Hewlett *	Manager, Financial Sector Team		

* Suggested First Contact

File: RCP 3.9.7

13 December 2005

Minister of Finance
Minister of Commerce

CC: Minister of Revenue

KiwiSaver: Investment Statements and Small Balances

Executive Summary

Officials have been conducting a number of meetings over the last few weeks with employer groups, providers, industry organisations and crown entities on KiwiSaver. As a result of these meetings concerns have been raised about, among other things, two key aspects of the current KiwiSaver scheme design- the current mechanism for the provision of investment statements and how to deal with potential small balances.

In relation to investment statements, the current option of providing all default investment statements in the information pack, has raised concerns for providers (in relation to costs of providing the large number of investment statements, and that these are provided through employers); employers (in relation to storing large packs, being held responsible for giving up-to-date investment statements, and the risks of employees asking for investment advice); consumer groups (in relation to the amount of information and the fact that they do not know which default they will be allocated to and therefore cannot make an informed decision about whether to opt out or go to another provider); and IRD (who has recognised that in order for them to be able to effectively carry out their central administration role they need to collect name and address information from employees).

Officials are proposing an option that addresses the concerns raised. This would involve employers notifying IRD of a new employee starting and providing address information, IRD then allocating the employee to a default provider and sending out the investment statement for that default provider only. The option would necessitate the opt out period being extended from 2-3 weeks to 2-6 weeks. This option would also include a requirement that the investment statement be concise and understandable, which would be vetted. This option would place a cost on employers in providing some additional information to IRD (however this is likely to be necessary under any option), but the costs are likely to be small and there are more benefits and less risks for employers under this option than the current proposal.

While there are some risks to extending the opt out period by 3 weeks, officials consider that the benefits of the change outweigh the costs. Inertia may mean that people who would not have opted out in the initial 2 week period may not do so if provided with an additional three weeks. In addition, any people that would opt out would probably have taken a contribution holiday anyway after 3 months contributions, exacerbating problems with small balances and costs for IRD and employers. The additional 2-3 weeks could also address concerns with the current opt out period, including giving potential savers time to get advice from a number of sources (i.e. investment statements, the internet, and advisors), a role providers felt that they would not be in a position to carry out alone.

Under the new proposed option the period at which deductions would be taken out of employees' accounts would also need to be extended by three weeks from week 8 to week 11. Under the current agreed position employees must wait for 5 weeks from the final week of opt out (week 3) until deductions are made from their account (week 8). Under the proposed new option employees would have to wait 6 weeks, only one week more. Under either option the fact that there is a delay between opt out and deductions will need to be managed through communications around the scheme. Further, officials believe that there is a benefit in extending the deduction period as employers are concerned about the costs of dealing with casual employees who only work for them for 2-3 months (particularly over Christmas). An extended deduction period addresses employers concerns to a large extent.

Officials would like to discuss this new option with Ministers at the meeting at 10am on Thursday 15 December.

Providers are still raising concerns about the potential for there to be a number of small and inactivate balances, and that this may make becoming a default provider unattractive as providers normally make a loss on small balances. This paper outlines some options for making small balances less of an issue for providers: extending the timeframe for the first contribution holiday; a central holding place and relief from reporting requirements for small and inactive balances.

Officials would like to discuss these options with Ministers to get an indication as to whether you would like officials to undertake more work on any of the options.

Officials believe that if the issues will the provision of investment statements and small balances are not adequately addressed there may be risks for the viability and support for KiwiSaver, and that these issues need to be considered prior to introduction. If the changes are introduced later at Select Committee, the timeframe for the default selection process may be compromised and delayed which may mean the 1 April 2007 commencement date becomes unachievable.

Officials do not believe that if Ministers agree to the changes or work agreed to in this report that the timeframe for introduction of the Bill or the implementation date for KiwiSaver will be impacted in any way. This is because any drafting changes would be minimal.

KiwiSaver: Investment Statements and Small Balances

Purpose of Report

- 1 The purpose of this report is to draw to your attention two areas relating to the current KiwiSaver scheme that have raised concerns with providers, employers and others in consultation meetings with officials. The report also suggests some options for addressing these that could be discussed at the meeting of Ministers and officials at 10am on Thursday 15 December 2005.

Analysis

Background

- 2 Officials have been conducting a number of meetings over the last few weeks with employer groups, providers, industry organisations and crown entities (i.e. the Securities Commission and Retirement Commission). These meetings have provided useful feedback on elements of the current design of the scheme that may cause problems or concerns for stakeholders and which are likely to, if not resolved, result in these concerns being raised at the point of introduction or during the Select Committee process of the Bill.
- 3 Many of these issues can be addressed through minor amendments to the regime or Bill, however, this report discusses two issues relating to investment statements and small balances which would require more substantive changes to scheme design.
- 4 Officials believe that it is important that Ministers consider these issues now for three reasons. First, the desire to ensure that KiwiSaver Bill is as effective as possible in achieving its outcomes when introduced. Second, in order to mitigate the risks of negative comment being made in relation to the KiwiSaver Bill when it is introduced, which may be difficult to counter or to reverse. Finally, now that the selection process for default providers is being undertaken at the same time as the legislation is progressing, we need to minimise as many changes to the scheme during the passage of the legislation as possible, particularly those that may impact on the viability of being a default provider. The reason for this is that if concerns are raised during Select Committee that result in changes to the regime (in particular changes that mean that some providers who may either not have tendered or who were not considered but could now be considered as a result of the changes) then revised Expressions of Interest or Requests for Proposal would have to be issued, potentially slowing down the Selection process and putting pressure on the April 2007 implementation date.
- 5 The concerns raised in relation to investment schemes and small balances, as well as some possible options to address these are outlined below. Officials also intend to provide Ministers with a report which outlines some of the other issues raised as a result of the consultation meetings.

Provision of Investment Statements to New and Potential Members

Current Model

- 6 In a report dated 29 July 2005 officials reported to you on how to get investment statements (IS) to potential KiwiSaver members [T2005/1532]. You agreed that the ISs for all of the default providers would be provided in the information pack handed to new employees by the employer. This was in recognition that it is important that potential new members receive a copy of information specific to the default investment to which they will be allocated to enable them to be informed about where their money is going to be allocated if they remain in the scheme and make no active choice.
- 7 Under the current agreed model ISs for all default providers will be included in the information packs for KiwiSaver. These information packs will be provided to employers by IRD. Employers have the responsibility for giving employees an information pack with the up to date default ISs when they start a new job. If employees do not opt-out of KiwiSaver in weeks 2-3 of a new job then they would subsequently be allocated to one of the default providers by IRD. This means that while employees would have all of the default provider ISs, they would not know, until IRD notified them, which default they were allocated to.
- 8 Employers will be required to begin deductions for new employees subject to automatic enrolment on the first pay day after the employee has been in the job for eight weeks unless advised that the employee has opted out by IRD.
- 9 The following concerns have been raised by stakeholders with the existing option for providing ISs to employees:
 - Under the existing option all default providers would have to print and provide an IS for every person (who is not already a KiwiSaver member), who changes jobs each year, as opposed to only those people who may be allocated to that default. The number of people changing jobs per year is around 700,000 according to IRD and the number of new jobs per year is over a million. Providers have told us that the approximate cost of printing one IS is \$1 and that the cost of the existing option would be prohibitive, as this would involve a commitment of up to \$1m in printing costs alone. Providers were not willing to commit this amount of money given, among other things, the uncertainty over the uptake of KiwiSaver and also what they see as a lack of incentives on members to make ongoing contributions (as profitability for providers of long term savings only occurs if the balance is growing). It should also be recognised that on top of this providers will need to provide IS to anyone who requests them including other new employees and existing employees that wish to consider opting in.
 - The current option may also have implications for the fiscal cost. Providers might set their fees to cover the costs of the fund, which would include covering these administration costs.

- Employers were concerned about the size of the packs if they contained multiple IS, as the storage space needed would significantly increase. Employers were also concerned about how the packs would be kept up to date, and that as employers were handing out the IS confused employees would look to their employer for advice about which default IS was relevant to them or ask them for investment advice. There is also a risk that if employers forget to give employees an IS or give them an out-of-date IS that employees may hold employers accountable for anything that goes wrong in relation to KiwiSaver. Providers were also concerned about the risks that employers may not give current ISs to employees at all or within the correct time period.
- From the perspective of the consumer there were concerns that new employees would be overwhelmed by the amount of information provided to them if all default ISs were included. Further the fact that they do not know which default they will be allocated to makes it difficult for them to have the ability to be informed about where their money is going to be allocated if they remain in the scheme and don't make an active choice.
- Providers also informed us that the minimum information they need to create a new member account is the name, address, date of birth and a unique identifier (such as an IRD number). KiwiSaver members that join a default fund will not complete an application form and so providers will have to obtain this basic information off IRD. However, as not all wage and salary earners are required to complete an annual tax return IRD does not have up to date address information on many people. Without this address information the default provider cannot keep track of the member and communicate with them (such as sending the annual statement). In order for IRD to provide an effective central administration system they need a mechanism to collect accurate, complete information for providers about new members. If IRD performs this role then there will be good reconciliation processes and data integrity and this will keep costs down for providers, and manage better people's unclaimed money and identification of which schemes employees' money are in.

Potential Alternative Option

- 10 Officials have considered the concerns raised above, and developed an option which we believe best manages some of these issues for providers, employers and employees. The option would involve:
 - a Employee starts a new job, employer gives them an information pack (which does not contain ISs) and then within a three week period (consistent with existing dates for the provision of employee details to IRD)¹ notifies IRD of the new employee starting and passes on to IRD the name, date of birth, IRD number and address of the employee.

¹ Officials believe that we should use existing dates for the provision of employee details, that is the 5th (covering the 16th of the previous month to the last day of the month) and the 20th covering the first date of the month to the 15th). This allows the provision of information to be tied in with existing process and dates, notwithstanding that small employers will have an additional filing requirement.

- b IRD receives the information, allocates the employee to a default provider and sends them the IS for the default provider they are allocated to, if they have not already opted out (this would occur during weeks 1-5).
- c Employee cannot opt out of KiwiSaver in week 1 of a new job, but has the ability to opt out in weeks 2-6. This enables employees to have knowledge of which default they have been allocated to and information about the default product.
- d In weeks 7-11 any opt out forms would need to be sent to IRD (one week allowed), IRD would process the forms (one week allowed), IRD would notify employers (one week allowed), employers would make changes to their payroll (one week allowed) and deductions would start in week 11. This would be an extension to the time that the first deductions would be made from employees pay from week 8 to week 11.
- e In order to ensure that ISs are more useful and less daunting for consumers, a requirement would be included in the legislation that any IS relating to default products must be easy to understand and concise. The group selecting and monitoring default providers could check this requirement or the Securities Commission.

11 The benefits of this approach include:

- lower compliance costs for providers as they would only have to provide an IS for people that were allocated to them, if those people did not make an active choice. This would significantly reduce the number of IS required to be printed as, for example, if there are 5 default providers, the number of IS required from each provider will be reduced to a fifth of that required under the current option. In addition, where a person is clear that they wish to opt out from the start and does in week 2, under this option the opt out form will, in many cases, reach IRD in time to ensure an IS not sent out at all. Providers have indicated that they would prefer this model.
- greater reassurance that the employee received the IS and that it is up-to-date, as the IS is sent directly from IRD to the employee². It also significantly reduces the responsibility placed on employers for the operation of the scheme. This will be of benefit to providers and employees.
- lower compliance costs for employers as they would not have to store large packs and ensure that ISs are kept up-to-date. Further, where an employee is sent only one IS they are less likely to ask their employer questions about which provider to choose, so the risks that they will be asked for investment advice or are blamed if something goes wrong with KiwiSaver will be minimised. The member also has a provider to which the employer can direct them with questions about the investment itself. The relationship with the provider is established from the start of the process. This was seen by providers and employers as an advantage.

² A legislative provision will be needed to treat employees as having received the IS if issued by IRD for Securities Act purposes.

- a further lowering of compliance costs for employers by an extension of the deduction period. Employers have expressed concerns during consultation about casual employees that are employed for one-three months (particularly over Christmas), and the costs involved. The extension of the date on which deductions start will address many of these concerns.
- required information that providers and IRD need for new members would be collected. This could potentially reduce the number of accounts that are treated as unclaimed because the member cannot be found (a problem in Australia), and make the scheme more viable for providers as they have the base information they require to be able to handle new members.
- more informed decision making by employees about whether to opt out or whether to choose another provider as employees would have information about where their contributions would go. They would also be able to be better held accountable for this decision (i.e. they could not say that they were confused about their investment because they were provided with the relevant information on the default and not information about other providers). In addition, they would not be overwhelmed by receiving a number of default ISs and may be more likely to use the IS. Experience with the State Sector Retirement Scheme indicated that the provision of multiple IS produced confusion. In addition, as the information would be in a form that was easily understood, there could be positive spin offs in improving people's financial literacy and potentially encouraging them to think more astutely about savings and financial products.
- There is likely to be greater buy-in to KiwiSaver under this model by industry as it has benefits for providers, consumers and employers.

12 There would be a cost on employers in collecting and passing on employee details. Employers already generally collect names and address information about their employees but this is not provided to IRD. Larger employers currently provide information to IRD twice a month (i.e. PAYE) and the employer monthly schedule is provided monthly. Small employers only provide information to IRD monthly. This model would require large employers to include in the information they provide to IRD twice a month any new employee's name, date of birth, IRD number and address that started in that two week period. For small employers it would mean that if a new employee started that month, it may potentially require the employer to provide information to IRD twice that month, where they currently are required to provide it only once. They still would have to only provide it once a month, if the employee started in the two week period that they are due to provide information to IRD. It is likely that a small employer will on average only get one or two new employees starting in a year, and many of these new employees may start in the two week period that fits in with their current monthly reporting. For these reasons it is likely on average that they only would be required to make this additional disclosure once or twice a year so the costs would not be onerous. In addition, this option has substantially less risks and more benefits for employers over the current model.

- 13 *It should be noted that some of this cost is not simply attached to this proposed option. IRD will need to receive name and address information that they currently do not receive under any option. The only difference with this option is in order to keep the opt out period down to 2-5 or 2-6 weeks it has the potential to require small employers to have to provide information to IRD twice in one month if a new employee starts, but as stated in the paragraph above this should not be onerous.*
- 14 This option does extend the opt out period for the regime by 3 weeks. Instead of employees only being able to opt out in weeks 2-3, they would be able to opt out in weeks 2-6. Officials believe that the risk that more people would opt out if you extend the period by 3 weeks is probably minimal (i.e. If people do not opt out because of inertia it is unlikely that they will opt out if the period is extended 3 weeks) and that those that would opt out would probably have taken a contribution holiday anyway after 3 months contributions, exacerbating problems with small balances and costs for IRD and employers.
- 15 There has been some feedback from stakeholders about the opt-out period being too short and this would mitigate these concerns to some degree. Providers would like potential savers to have the ability to get advice from a number of sources- i.e. IS, the internet and financial advisors, as they did not see themselves as being able to carry out all of this role (this role is currently played by the employer if it is an employer based scheme or a financial intermediary if it is a retail scheme). Extending the opt-out period by 3 weeks would give people the opportunity to talk to financial intermediaries or to look on the internet, and remove some of this pressure on providers.
- 16 Under the proposed new option the period at which deductions would be taken out of employees' accounts would need to be extended by three weeks from week 8 to week 11. Under the current agreed approach employees must wait for 5 weeks from the final week of opt out until deductions are made from their account. Under the proposed new option employees would have to wait 6 weeks, only one week more. Under either option the fact that there is a delay between opt out and deductions will need to be managed through communications around the scheme. Further, as stated above, officials believe that there is a benefit in extending the period as employers are concerned about the costs of dealing with casual employees who only work for them for 2-3 months (particularly over Christmas). An extended deduction period addresses employers concerns to a large extent.
- 17 As this option produces benefits for all parties, with minimal costs, and only extends the opt out period by 3 weeks officials are recommending that this option be adopted.

Other Options

Consolidated Investment Statement

- 18 Officials also tested out with providers whether a consolidated investment statement would be a better approach as a way of reducing the need for multiple IS. Feedback suggested that this option did not address all of the concerns

raised with the current model and that it would raise further issues for providers. For example, it does not address the concerns raised above in relation to: the need to collect information for providers and IRD; some of the risks in relation to employers having to provide ISs; and the overload of information for the employee and their ability to make an informed decision and to take accountability for that decision.

- 19 Providers also did not support a consolidated investment statement approach because this option would still incur similar costs, as each provider would attempt to include their entire investment statement in the consolidated one and have to subsidise the information being provided to all new employees. Providers claimed that if the government mandated a form for a consolidated default investment statement, their competitive advantage would be lost and that this would disincentivise providers from applying to be defaults. It was also thought (after the experience with the SSRSS) that the time and effort required to agree on the contents of the consolidated investment scheme would be large considering that each provider would have different schemes and would want to somehow differentiate their underlying products or brand. As the scheme is already operating to a tight timeframe for implementation, particularly for default providers, it was not considered useful to add to risks around this timeframe. Finally, this option would also create complexity around how to attach Securities Act liabilities and remedies for misleading information.

Providing the Investment Statement after the Opt Out Period

- 20 One proposal identified was to give the IS to employees after the opt out period. Under this option basic information about investing would be contained in the information pack, if a person did not opt out then they would be allocated to a default by IRD and receive an IS for the default fund they were allocated to.
- 21 Officials have concerns about this option for the following reasons:
- Beside buying a home, KiwiSaver may well be the most important investment decision people make. Ensuring that an employee has an IS which provides them with the relevant information about where their money is going to go if they do not opt out or choose an alternative KiwiSaver product ensures that the responsibility for making the decision rests on the employee. If no information about the particular product they are defaulted into is made available then we believe this greatly increases the moral hazard for government and also raises questions about whether if the government is removing employees' ability to make an informed decision about where their money is going there should be greater government guarantees placed around the default schemes.
 - As most of the Securities Act liabilities and remedies, including the Securities Commission's powers under the Act, are based on the fact that people rely on the disclosure statements required by the Act, then it appears hard to justify how these provisions could apply when employees are not making a decision based on any such required disclosures. For example, the current Securities Act regime relies on the contractual idea that an IS is an invitation to treat by the provider and the signing of an application form is a contractual

offer by the investor on the terms disclosed, which is then accepted by allotment of securities. While we believe we could say that an employee is deemed to offer to subscribe by not opting out, it is difficult to say if an IS is not provided by a provider or received by an employee that this is a contract and difficult to see why the remedies under the Act should apply. Officials believe that we would want all of the protections and the oversight of the Commission that the Securities Act provides both to minimise the risk of moral hazard for government and to offer real protections for investors. If the burden of informing investors about the risks and benefits of investing, even on a generic basis, falls solely on the Crown, there would appear to be a significant moral hazard risk associated with this, and potentially legal liability in the event of loss following reliance on these statements.

- Some investors do read the investment statement. For example, the Securities Commission undertook two surveys of investors in 1998 and 1999. Although these involved only a small sample of investors, it did reflect that 76% of investors who responded spent more than 15 minutes reading the document and the majority found the statements useful. If the issue is that they are not as easy to understand as they could be the requirement described above in the officials recommended option that the default product IS be concise and understandable should address this.
- Providers would not like this option as they would have less ability to brand and market their product before the end of the opt out period, and thereby it may result in less people being in their scheme.
- Cabinet agreed that officials should develop initiatives to increase the level of financial literacy for New Zealanders for consideration [CAB Min (05) 13/9]. Officials are proposing to report to Ministers on this early in the 2006. However, in any campaign to raise financial awareness or capability, one of the main messages for potential investors is that should be given key information about an investment; (its costs, its risks, its timeframe, and its potential return) that should be used in making financial decisions. It would run counter to any savings education efforts to reduce the chance that eligible employees will receive this investment information prior to making their choices
- MED is leading a review of non-bank financial products and providers (RFPP), this includes a review of the disclosure documents under the Securities Act and how they can be enhanced. As part of that review over the last few months MED has held a number of one-on-one meetings with a range of people (including providers, consumer groups and other market participants) and set up advisory groups made up of stakeholders to test problems and options through. The feedback from this has been that the investment statement for managed funds is not fundamentally flawed, although there could be better disclosure around the costs of managed funds and some of the information could be more appropriately targeted. As some of the key outcomes of the RFPP are to improve financial capability and savings over time by giving effective disclosure and thereby encouraging the prudent non-expert investor to read these documents and make informed

decisions, and to use disclosure to encourage more competition in fee pricing and market efficiency, removing the key disclosure tool from KiwiSaver would make it difficult to achieve these outcomes.

- The IS was designed with long-term savings vehicles in mind. It not only contains information relevant to an initial investment decision, but information that will be relevant during the term of the investment. This includes contacts and procedures for making complaints or enquiries, whether there is any ombudsmen scheme available for disputes, how a person can transfer from the scheme, and the circumstances under which a person can redeem their investment. Given the very limited circumstances under which employees can leave the KiwiSaver scheme officials consider it is important that this information, in particular, is clearly available to potential investors.

Putting the Investment Statement on a Website

- 22 A suggestion has also been made that it should be sufficient to include a website address where the IS can be accessed. While this would clearly decrease publishing costs and enable people to access information quickly, it would not address the concerns raised above. For example it would not resolve the need to collect information for providers and IRD. Nor would it address the concerns that consumers should be able to know where their money is going before they choose to opt out or go to another provider, as an employee would need to know which default they are allocated to and this could not happen until IRD had information from employers and allocated and informed the employee, which would still necessitate an extension to the opt out period.
- 23 The option would also raise the risk that employers are asked to provide information or advice on employees' options. In addition, it may unduly penalise many of the people who are a target demographic for KiwiSaver who will not have easy access to the internet and a printer.
- 24 This option would also appear to be incompatible with a system which relies on inertia, as this would require a member to do something active in order to access the relevant investment information. It is likely that very few people will go to a website and look at the information if the onus is on them to collect. This onus is incompatible with the consumer protection focus of securities law, and also with the promoting investor responsibility in circumstances where a person may subscribe without having taken any active steps. In these circumstances officials believe that responsibility can only be placed on an employee for not opting out of the scheme if that employee has been given every opportunity to make an informed decision about participation

Small Balances

- 25 The design of KiwiSaver includes several mechanisms to encourage ongoing savings and to minimise small balances. These mechanisms include the upfront government contribution, the ongoing fee subsidy and IRD holding small balances until they are large enough to be accepted by providers.

- 26 Some providers are of the view that balances under \$5,000 are not profitable and result in other members subsidising these accounts. In respect of inactive or unclaimed balances, value may be destroyed (i.e. if negative returns).
- 27 Providers were of the view that the small balances issue is compounded by:
- Allowing members to take a contribution holiday after only 3 months; and
 - As some participants will be attracted by the housing subsidy (withdrawing all saved funds at this point leaving only the \$1,000) there could be a timeframe of 20-25 years where the balances remain dormant.
- 28 In addition, concerns were also raised by employers about employees being able to take a contribution holiday after three months of contributions, as there was a view held that people may simply opt in to get the sweetener, and then take a 3 month contribution holiday at the end of that three month period. This would increase administration costs for employers of having to set up an employee on their payroll for KiwiSaver and then remove shortly after.
- 29 A number of options have been suggested or dealing with this issue:
- Extending the timeframe for the first contribution holiday: Initially 3 months was recommended for the contribution holiday as there was a short period for opting out of the scheme, and a concern because of this and the need to “opt out” that many people may unintentionally end up in the scheme who could not afford to. If the opt out period is extended to weeks 2-6 as suggested above, and there is a definition of “hardship” that is flexible enough to deal with this situation then the arguments for the 3 month period may not hold as much weight and the timeframe for when people could take a contribution holiday extended. If people could only take a contribution holiday after say a year- this may build up balances for providers, get people better used to a pattern of saving, and potentially reduce some of the costs for employers.
 - Central Holding Place: providers suggested that providers be given the option of transferring small (or inactive balances) to a central holding point in order to reduce the costs for providers. An alternative may be that one provider could be given all of these balances, if pooling of the balances is more efficient, and to give them greater government subsidies to manage these.
 - Relief from Reporting Requirements: providers have suggested that relief could be provided from the ongoing reporting requirements (i.e. providing annual report to members) in respect of small or inactive balances. This would need to be weighed against a desire to keep people alerted to the fact they have the account in order to encourage people to re-start contributions.
- 30 Officials understand small balances is one of the key issues in relation to the scheme and one which has the most potential to discourage providers from coming forward to be defaults, we would like to discuss the options above with Ministers on the 15th of December to get an indication about whether you would like officials to undertake more work on any of these options.

- 31 If you agree to officials developing further options for dealing with small and inactive balances then officials will report to you in late January 2006 with options.

Risks

- 32 As stated above officials believe that there are risks for the support and viability of KiwiSaver if these issues are not adequately addressed. Further, we believe that these issues need to be considered now, so that there is not negative publicity around the Bill, and the default selection timeframe is not compromised.
- 33 Officials do not believe that if Ministers agree to the changes or work agreed to in this report that the timeframe for introduction of the Bill or the implementation date for KiwiSaver will be impacted in any way. This is because any drafting changes would be minimal.

Consultation

- 34 The Inland Revenue Department has been consulted on this paper and supports the proposed option in relation to the provision of investment statements.

Treasury Comment

- 35 The Treasury supports the central proposal in this report that investment statements be delivered by Inland Revenue rather than through employers, and that providers not be obliged to provide all new employees with their investment statement, in order to reduce compliance costs (although this may increase fiscal costs). The Treasury also supports the proposal to shorten and increase the usefulness of the investment statement.
- 36 There are a number of options Ministers can proceed with in addition to those proposed in the report, while keeping the central proposal. Two key issues are the length of the opt-out period and the number of investment statements received by an individual.
- 37 The Treasury considers that is important that employees have access to adequate information about the nature of the investment and options available and adequate time to make an informed decision and to reduce the perception of a government guarantee. Investment statements provide key information to inform potential existing investors so may play an important role in this process. Nevertheless, it is not clear how useful investment statements would be considered in a decision to join KiwiSaver (as opposed to selecting a specific KiwiSaver scheme). Any extension to the opt-out period to allow individuals to read an investment statement prior to deciding whether to join KiwiSaver will extend the time period before contributions to KiwiSaver could begin. However, it is not clear whether this will have a material impact on participation in KiwiSaver.
- 38 Ministers may also have views on the number of investment statements received. The appropriate number may be a function of the number of default providers, the length of the investment statement and usefulness of the material

contained. If it were determined that they were useful to general decision-making then sending more than one statement could further reduce risk of implied government guarantee of a particular provider and highlight individual responsibility by allowing for meaningful comparisons to be made between schemes. Default providers could be given the option of providing their investment statement to a wider group of employees.

- 39 The report also discusses whether officials should develop additional options to deal with small balances. There are already some measures in place to reduce the small balance problem - such as providing government contributions to individuals accounts, and a prompt to restart contributions each time a contribution holiday expires. There are likely to be trade-offs involved with additional measures. For example, extending the timeframe for the first contribution holiday may lead to more savings of those who choose to join KiwiSaver, but may reduce overall participation by deterring those who are unsure of whether they will be able to commit to saving.

Recommended Action

We recommend you:

- 40 **Note** that stakeholders in meetings with officials have raised a number of concerns about the current mechanism for the provision of investment statements and how to deal with potential small balances;
- 41 **Agree to** the option proposed by officials to address these concerns which contains the following features:
- 41.1 Employers notify IRD within a three week period of a new employee starting and provides IRD with the employees name, date of birth, IRD Number and address information;
- agree/disagree
- 41.2 IRD allocates the employee to a default provider and sends the employee the investment statement for the default product;
- agree/disagree
- 41.3 The employee can opt out of KiwiSaver in weeks 2-6 of starting a new job;
- agree/disagree
- 41.4 Unless an employee has opted-out, contributions start after 11 weeks from starting a new job;
- agree/disagree
- 41.5 That a requirement be included in legislation to ensure that the investment statement for default funds is concise and understandable; and
- agree/disagree

41.6 That a requirement be included in the legislation that provides an employee is treated as having received an Investment Statement for the allocated default fund if IRD has issued one.

agree/disagree

42 **Note** that if you agree to the proposed option in paragraph 36 above then Cabinet approval will be necessary, this could be obtained at the end of January 2006;

43 **Agree to** officials undertaking more work on an option to mitigate some of the issues raised by providers about potential small balances and that these options include:

43.1 Extending the timeframe before a contribution holiday can be granted; and/or

agree/disagree

43.2 Options for a central holding place; and/or

agree/disagree

43.3 Relief from reporting requirements; and/or

agree/disagree

43.4 That the fee subsidy should apply to these small or inactive balances.

agree/disagree

44 **Note** that none of the above decisions would delay the introduction of legislation in early 2006.

Kirstie Hewlett
Manager, Financial Sector Team
Regulatory and Competition Policy Branch

Hon Dr Michael Cullen
Minister of Finance

Hon Lianne Dalziel
Minister of Commerce

