Ministry of Economic Development
Manatū Ōhanga

THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: KiwiSaver - Investment Statements

Date:	29 July 2005	**Treasury Priority:**	MEDIUM
Security Level:	IN-CONFIDENCE	**Report No:**	T2005/1532

Action Sought

	Action Sought	Deadline
Minister of Finance	**Agree** to the recommendations **Refer** to Ministers of Housing and Education	2 August
Minister of Commerce	**Agree** to the recommendations, once the paper is referred to you by the Minister of Finance	3 August
Associate Minister of Finance (Hon Trevor Mallard)	Note	None
Associate Minister of Finance (Hon David Cunliffe)	Note	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
	Senior Analyst, Markets, Infrastructure & Government, Treasury			✓
	Senior Policy Analyst, Regulatory & Competition Policy Branch, MED			

Enclosure: **No**

29 July 2005 SH-13-0-7

Treasury Report: KiwiSaver - Investment Statements

Executive Summary

This report provides you further advice on the timing of the provision of investment statements to employees as part of KiwiSaver and seeks to confirm your view on imposing an upper age limit on joining KiwiSaver, in light of feedback from other agencies.

You previously agreed to officials doing more work on how to get basic investment information to KiwiSaver members within the framework of automatic enrolment (report T2005/1099 refers).

Investment statements provide basic investment information to KiwiSaver members to help them decide whether to save or not, choose the appropriate investment product (default or active choice product) and take responsibility for their investment.

Officials considered a range of possible options for how and when investment statements can be provided to members. Given practical difficulties and a desire to reduce compliance cost, there are two broad options:

- multiple investment statements for each default provider provided with the information pack on a new employee starting work (upfront option); or

- single investment statement sent direct to the employee after the employee is allocated a default provider (cooling off period option).

Multiple Investment Statements – Upfront Option

In the upfront option, the information pack would provide new employees with all the default investment statements. Based on this information, the employee would be able to notify Inland Revenue in weeks two to three after commencing a job that they wished to opt out of KiwiSaver before any contributions are deducted from their pay. New employees would be notified of their default provider after the opt out period but would still be able to choose an alternative provider, if they wished.

Single Investment Statement – Cooling Off Period Option

In the cooling off period option, the Inland Revenue would post out an investment statement for the default provider to which the member has been allocated as soon as practical after the first saving deduction is made from their salary. Members who had not opted out initially would be provided with a short cooling off period, for example, a two week period, within which they could effectively opt out after having received and considered their investment statement. This period would be in addition to the opt out period provided in weeks two to three of their new job, which would be for people who know they do not want to save or cannot afford to save.

If Inland Revenue has been advised that a member has already made an active choice then no investment statement would need to be provided. Where an employer has selected a default provider for its employees the employer will be responsible for ensuring employees receive an investment statement.

Choice between Investment Statement Options

In deciding between the options, you will need to consider:

- the impact on participation;
- the likelihood that employees receive and consider the necessary basic financial information upon which to make choices, including on whether to opt out or not;
- the perception of any government guarantee of the scheme;
- the risk that people that are unable to save fail to opt out; and
- the costs imposed on providers and employers.

The main benefits of the upfront option are that there is a single opt out period and it utilises an existing distribution mechanism in the form of the information pack. However, employees may not fully consider or understand the implications of KiwiSaver and fail to opt out, even where it is appropriate for them to do so, given the short opt out period, the amount of information to digest and limited time for seeking advice. In addition, the investment information may be out of date as employers are likely to store this material.

The main benefits of the cooling off period option are employees may be more likely to consider the information in a single investment statement rather than multiple statements, the employee has an opportunity to reconsider opting out once the first contribution is deducted from their pay (i.e. when employees may be more aware of the full impact that contributing to KiwiSaver has) and providers would have lower costs as investments statements would only be provided to a subset of new employees (i.e. only a proportion of those who have not opted out or made an active choice). In addition, employees are more likely to receive the relevant information if it is posted directly to them by IRD, as employers are taken out of the distribution loop. The other benefits of the cooling off period option are discussed in the main body of this report.

The main disadvantage of the cooling off period is it may increase the number of people who opt out. It is uncertain how much difference an additional opt out period would have to overall participation given inertia will still apply. However, people who would have opted out in the cooling off period are not likely to be as committed to making ongoing contributions and hence are likely to take a contribution holiday, possibly at the first opportunity.

Officials recommend a single investment statement is sent direct to the employee after the employee is allocated a default provider and employees have a two week cooling off period in which to opt out.

Inland Revenue Discretion

Inland Revenue has the discretion to process opt out forms for employees that opt out of the scheme in the first eight weeks. Officials consider this discretion is only intended to cover situations where, for example, a person's opt out form was lost, not processed in time or in cases of genuine hardship. If an additional opt out period is agreed to, officials consider it would be appropriate to extend the period of Inland Revenue’s discretion so that it aligns with the initial period of time IRD holds an employee’s funds.

Point Upfront Government Contribution Received

In addition, officials recommend aligning the point where savers receive the upfront government contribution and IRD passes funds on to providers, which would be three months after the first contribution is received by IRD. This would avoid the potential situation of an employee ceasing to make contributions after receiving the government upfront contribution and prior to being eligible to take a contribution holiday.

Upper Age Limit

Several agencies have expressed strong concerns about excluding people close to retirement age from being able to join KiwiSaver given that many people continue in the labour force for a considerable period after 60, there is a real appetite for savings by older age groups and the gaming risk (opening an account and not contributing beyond the initial three month period) is not limited to this group. For example, in the State Sector Retirement Savings Scheme (SSRSS) about 35% of those aged over 60 years in the public sector joined. Many of these individuals contributed more than the minimum employee contribution rate.

According to Statistics New Zealand, there were 104 700 people aged 60 to 64 years old in the labour force in the March quarter 2005. It would be possible to allow this group to participate while not allowing them to withdraw their funds until after a minimal period. For example, the member's funds could be locked in until the later of five years after the first contribution and the age of eligibility for New Zealand Superannuation. Hence, officials wish to check whether you still want to exclude those aged over 60 years from joining KiwiSaver.

Employer Exemption from the Automatic Enrolment Provision

The State Services Commission (SSC) has advised that the government, as employer, would be unable to qualify for the employer exemption from the automatic enrolment provision given that members of the Government Superannuation Fund are able to contribute to SSRSS but are not entitled to any matching government contribution. SSC has suggested that the exemption provision not be modified to address this problem given it would increase complexity. In our view, it is not necessary to resolve this issue now.

IRD was consulted in the preparation of this report.

Recommended Action

We recommend that you:

Minister of Finance

a **note** that you are required to consult with the Ministers of Education and Housing in making KiwiSaver design decisions;

b **refer** this report to the Ministers of Education and Housing;

Yes/no.

c **note** that it would be desirable for you to consult with the Minister of Commerce before making any decision on investment statements;

d **agree** that investment statements are provided in the information pack upon a new employee starting work;

Agree/disagree.

OR

e **agree** that a single investment statement be sent direct to new employees after the first saving contribution is deducted from their salary and the employee is allocated a default provider. New employees have a cooling off period of two weeks after receiving the investment statement during which they can opt out (in addition to the opt out period in weeks two and three);

Agree/disagree.

f **agree**, if you agree to recommendation e, that Inland Revenue would post out investment statements, if Inland Revenue has not been advised that these members have already chosen a provider or their employer has selected a default provider for their employees (and Inland Revenue has been informed of the employer's selection);

Agree/disagree.

g **agree** that the upfront government contribution will be provided to an individual's account three months after the first contribution is received;

Agree/disagree.

h **agree**, if you agree to recommendation g, that Inland Revenue has the discretion to consider requests to opt out up until three months after the first contribution is received;

Agree/disagree.

i **agree** that you want to exclude those within five years of eligibility for New Zealand Superannuation from being able to open a KiwiSaver account;

Agree/disagree.

OR

j **agree** that employee funds should be locked in for the later of five years from the first contribution and the age of eligibility for New Zealand Superannuation;

Agree/disagree.

k **indicate** whether you would like to discuss these matters with officials given the complexity and practical issues;

yes/no

l **refer** a copy of this report with your decisions to the Minister of Commerce;

yes/no

Minister of Commerce

m **agree** that investment statements are provided in the information pack upon a new employee starting work;

Agree/disagree.

OR

n **agree** that a single investment statement be sent direct to new employees after the first saving contribution is deducted from their salary and the employee is allocated a default provider. New employees have a cooling off period of two weeks after receiving the investment statement during which they can opt out (in addition to the opt out period in weeks two and three);

Agree/disagree.

o **agree**, if you agree to recommendation n, that Inland Revenue would post out investment statements, if Inland Revenue has not been advised that these members have already chosen a provider or their employer has selected a default provider for their employees;

Agree/disagree.

p **agree** that the upfront government contribution will be provided to an individual's account three months after the first contribution is received;

Agree/disagree.

q **agree**, if you agree to recommendation p, that the Inland Revenue has the discretion to consider requests to opt out up until three months after the first contribution is received;

Agree/disagree.

r **agree** that you want to exclude those within five years of eligibility for New Zealand Superannuation from being able to open a KiwiSaver account;

Agree/disagree.

OR

s **agree** that employee funds should be locked in for the later of five years from the first contribution and the age of eligibility for New Zealand Superannuation.

Agree/disagree.

Senior Analyst, Markets, Infrastructure & Government
for Secretary to the Treasury

Kirstie Hewlett
Manager, Business Law
Regulatory and Competition Policy Branch
Ministry of Economic Development

Hon Dr Michael Cullen
Minister of Finance

Hon Pete Hodgson
Minister of Commerce

Treasury Report: **KiwiSaver - Investment Statements**

Purpose of Report

1. This report seeks your decision on how and when investment statements are provided to new employees.

Analysis

2. You have previously agreed to officials doing more work on how to get basic investment information to KiwiSaver members within the framework of automatic enrolment (report RCP 3.9.7, T2005/1099 refers).

3. If a significant number of people do not see any information about the scheme before joining, there may be a perception that the scheme is guaranteed by the government.

4. Officials have explored various options for providing basic investment information to KiwiSaver members. The objectives in providing this information are:

   - to ensure that members take responsibility for their investment, even if they join a default product;
   - to facilitate a member's decision to stay in or opt out by providing information about default products;
   - to facilitate a member's decision as to whether to stay with a default or to choose an active choice product; and
   - to minimise compliance costs for employers and providers.

5. Officials consider there are a range of options for providing basic information about the default products to potential new KiwiSaver members. These include:

   - putting an investment statement or multiple investment statements in the information pack given out by employers (upfront option); and
   - requiring IRD to send out default investment statements direct to potential new members once an employee has been allocated to a default provider (cooling off period option).

Multiple Investment Statements – Upfront Option

6. It is important that new KiwiSaver members have information about their potential investment, the risk and the fees that will be charged prior to being committed to being in the scheme. This will likely be provided in the form of an investment statement, which is a document which answers set questions written for the non-expert investor. It may be possible to include either one consolidated investment statement or the investment statements for all the defaults in the information pack that gets handed to employees by employers when they start a new job. Officials would need to do further work, including consulting providers, if a consolidated investment statement were to be used as there may be significant practical and legal liability issues raised by a consolidated statement.

7. Potential KiwiSaver members would be able to consider the investment information and decide whether to opt out of the scheme. Employees would not know which default they are allocated to at this point as IRD will not have allocated them a default. Due to the operation of the PAYE cycles it is approximately 8 weeks after a new employee starts that IRD is aware that they exist. Thus, the allocation to a default will not occur until after this point. Once they have been allocated to a default IRD will notify them and they would have an opportunity to make an active choice or remain with the default they have been allocated to.

8. An advantage of this option is that it utilises an existing distribution mechanism in the form of the information pack in order to get the investment information to potential new KiwiSaver members. In addition, the single opt out period is simple for employees to understand.

9. A disadvantage of this approach is that employees will receive information about multiple defaults which will likely be confusing to them. At this point they will not know which default is relevant to them. In addition, novice investors will probably not have seen an investment statement before and will likely be overwhelmed if they are faced with multiple investment statements. In addition, when a person has just begun a new job they are likely being provided with a lot of new job related information. It is unlikely that providing 2 weeks to consider investment information for multiple defaults is likely to be sufficient time. The short opt out period combined with the provision of investment information so close to beginning a new job may mean that people opt out rather than take the time to make a decision due to feeling that there is not time to figure out what is best for them.

10. Providing investment information through the information packs would increase compliance costs on employers and still risk employees not receiving the information compared to other options. Although legislation can require that employers provide all new employees with information packs this obligation would be very difficult to enforce. In addition, employers will run out of packs and there may be delays before new packs are obtained. Under current law, the allocation of a security is voidable if a person does not receive an investment statement prior to the allotment, which indicates the importance which is currently placed upon all investors receiving this information prior to investing. Thus, a further disadvantage is that there will be greater inconsistency in the provision of investment information.

11. There were also concerns about how the investment statement would be kept up to date once information packs had already been distributed to employers. Including three or more investment statements in the information packs would also make the information packs long, which adds to distribution costs and introduces storage issues for some employers. It would also add to the cost for providers who would have to print a significant number of investment statements, as a copy would go to everyone, including people who always intended to opt out.

12. The final disadvantage is that some people will not realise the impact of KiwiSaver on them until they see the first deductions made for their pay. At this point some people will become aware that they cannot afford to save or for other reasons wish to opt out. Not allowing opt outs at this point will result in many small balances as these people are highly likely to take a contribution holiday as soon as possible (after 3 months of contributions). Consultations with industry has already highlighted that small balances is one of the key issues.

Single Investment Statement - Cooling Off Period Option

13. Using IRD to post investment statements rather than providers would get the investment information to the new member as quickly as possible after the member has been allocated to a default. Default providers would be automatically allocated to a new employee after the first saving contribution deducted from their pay is received by Inland Revenue if no active choice or opt-out decision has been made. This option allows IRD to post only information that is relevant to the default product to which the new member has been allocated to the individual's last known address held by Inland Revenue. It also allows for the investment statement to be kept up to date. As with notices given by the commissioner of IRD by post, the investment statement will be deemed to have been received when, in the normal course of post, it would have been delivered.

14. The provision of investment information is not meaningful unless potential members have an opportunity to opt out of the scheme after considering the information. However, it will be some weeks before IRD knows that a new employee has commenced employment with an employer. Thus, officials recommend that a two week cooling off period be introduced after the investment statement is dispatched within which a person can effectively opt out. Officials do not believe that this cooling off period will undermine the operation of automatic enrolment, as those people that are disinclined to do anything active will still be unlikely to opt out. This is due to the fact that some people find financial decisions particularly difficult and intimidating, however long they have to consider it.

15. Nevertheless, the cooling off period would assist the KiwiSaver scheme to operate more smoothly. For example, people who only realise they cannot afford to save after the first deduction have been made would be able to opt out during the cooling off period. This will reduce the small balance issue. Another advantage of this option is that, by not relying on employers for distribution, there is a greater chance that individuals actually receive the investment information.

16. The disadvantage of this option is that it may be more confusing for people to have two periods within which they can opt out. It may also mean that more people opt out (although the people who remain may be more likely to be those who make ongoing contributions to the scheme). It is uncertain how many more people will opt out under this option given that inertia will still operate.

17. The proposed timeline would align the point where savers receive the upfront government contribution and IRD passes funds on to providers at three months after the first contribution is received by IRD.

18. Officials are recommending the following timeline for automatic enrolment:

    - Week 1: employee starts a new job, is given an information pack and automatically enrolled in KiwiSaver.

    - Weeks 2 to 3: period where the employee can opt out, prior to any deductions from pay being made.

    - Weeks 4 to 6: IRD processes opt out forms and advises employers when an employee has opted out. Employee cannot opt out in this period.

    - Weeks 7 to 8: Employer makes changes to payroll system to begin deductions at the first pay day after eight weeks at a new job, unless advised otherwise by IRD.

- Week 9 onwards: deductions begin at the next pay day for those people who have not opted out. If not advised that member has already made an active choice or their employer has selected a default provider for its employees, IRD posts out an investment statement for the default provider to which the member has been allocated as soon as practical after the first saving deduction is made from their salary.

- 2 weeks after being advised of allocated default: the member considers whether the default provider is right for them, whether they need to make an active choice or whether they should opt out. The employee has a **two week** cooling off period during which he or she can seek to opt out through IRD and IRD refunds any contributions made. IRD actions any active choice made by the member.

- 3 months after first contribution is received: IRD passes contributions to relevant provider, along with the $1000 upfront government contribution. Employees are able to take a contribution holiday but are not able to opt out.

Other Options Considered but Dismissed

19. Officials also considered but dismissed the following options:

- IRD allocates new employees to a default provider in the first week of an employee starting their new job (default upfront option);

- IRD assigns default providers by employer (not employee) and information statements specific to that provider would be supplied to the employer for distribution to new employees, possibly with information packs (employer assigned default option);

- IRD would advise providers of which employees had been allocated to them as a default provider, that is, after IRD has become aware that a new employee has commenced. These providers would distribute their investment statements direct to employees (provider issued default option).

Default upfront option

20. IRD is not aware that a new employee has commenced until approximately week 8 so this option would require employers to notify IRD directly when a new employee first starts. Therefore, this option would increase compliance costs on employers.

Employer assigned default option

21. Inland Revenue would have needed to develop a process to assign default providers to employers. The process would need to be transparent and appear to be fair from the point of view of each default provider.

22. It would have been difficult to design a mechanism to allocated defaults to employers given that large employers constitute a significant share of total employment and some employers would be more lucrative than others, for example, employers with higher paid workers.

23. In addition, using employers to provide investment statements would increase compliance costs on employers and still risk employees not receiving the information compared to the other options. Under current law, the allocation of a security is voidable if a person does not receive an investment statement prior to the allotment,

which indicates the importance which is currently placed upon all investors receiving this information prior to investing.

Provider issued statements option

24. This option is a variant of the cooling off period option with providers instead of IRD sending out the information but with higher compliance costs on providers.

25. Requiring providers to send investment statements to potential new members allows for the investment statement to be kept up to date. However, where a member joins a default scheme they will not complete an application form and so providers will not have basic details, such as a mailing address for new members. This address information for new members will have to come from IRD.

26. If providers were to post out investment statements there would be delay caused by the provider having to wait for address information to be supplied by IRD. There is already delay in the system associated with IRD's receipt of the employer monthly schedules. It is important that any investment information is sent out as soon as possible to allow the new employee time to consider the details of the default product, and decide whether to opt out of the scheme, stay in a default, or make an active choice.

27. There is also a risk that a default provider does not send out the relevant investment statement.