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Savings Working Group
c/- PO Box 3724
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Attention Brian McCulloch
via email savingsworkinggroup@treasury.govt.nz

Dear Members

I refer to your letter of 9 September 2010 and the invitation to contribute on the issues. I note:

1. I have a general belief that there is no evidence that shows that incentives or compulsion work anywhere in the world to solve long-term retirement income security or savings issues. New Zealand is unlikely to have any different experience.

2. As a country, we should be very careful about increasing incentives or changing the balance of incentives or making savings compulsory. This is particularly important at the current time when the government is in a negative fiscal position. We should focus on evidence-based policy.

3. We also need to agree as a country on what the government's role should be. The government's role, in my view, should be focused on alleviating poverty in retirement and therefore limited to:

   – the provision of New Zealand Superannuation [actually, NZS does a bit more than alleviate poverty – preventing poverty is more accurate], and

   – creating a principles-based framework for individuals (and employers) to accumulate supplementary savings. This framework must remove the barriers to save and tax distortions within the market place.

4. In the context of the government's role, KiwiSaver should play no part. It was a solution looking for a problem. However, we accept that the government is unlikely to wind it up and it is here to stay. Any recommendations of the SWG should therefore look to simplify it and make it less complex.

5. It is a nonsense that the government would set terms of reference for the SWG that exclude consideration of the terms on which New Zealand Superannuation is payable. It is not possible to address retirement savings issues without ensuring long-term stability in New Zealand Superannuation. To do so is to build savings on a shifting foundation. Therefore despite the terms of reference the SWG should comment on New Zealand Superannuation.

6. New Zealand Superannuation operates reasonably well, though we recommend that the SWG encourages the government to address the overseas pension offset issues, and cease to be dogmatic on its details (e.g. age of eligibility) and more dogmatic on the agreed principles. The eventually agreed principles behind New Zealand Superannuation should allow for it to naturally evolve over time. That will require greater flexibility and the shifting of the age of entitlement.

7. New Zealand has a poor savings legislative framework that is about to get worse. The advisor regime will not achieve its goals; the proposed disclosure regime does not achieve its goals; the trustee registration scheme achieves nothing; there are significant tax distortions and inequalities, and the framework does not integrate well with the welfare policies. It would be good if the SWG made recommendations in each of these areas to improve the regime for New Zealanders. While it would be better to scrap most of what has been put in place, we doubt that that would be politically acceptable. However, it is important that there is a better disclosure regime than is currently contemplated which involves disclosure in a meaningful way that is clear, concise and supported by a certificate of accuracy from the promoter/advisor.

8. New Zealand in recent years has adopted a piecemeal approach to regulation and created complexity and inequities. Ideally the work of the group should set a target date of 2020 to eliminate the complexities and inequities and create a true level tax and regulatory playing field. The regulatory playing field should have a high level of transparency, total honesty and material sanctions for poor behaviour. Achieving that before 2020 would be good but to get a comprehensive regime that is internally and externally consistent requires time. It will meet resistance from the industry as it undermines the industries' cash cow.

KiwiSaver

9. Attached is a document written earlier this year on suggested changes to KiwiSaver. Each of these should be implemented. The document was written pre-SWG and assumed KiwiSaver was here to stay and the incentives are to stay.

10. My preference is for the incentives to be removed as they have no role to play in a long-term sustainable savings solution. At best, they can work short-term. Incentives also do not work where "work" means increased savings, greater

retirement security, fairness etc. Incentives favour the industry and the wealthy, at the expense of the poor.

11. We would not have the incentives in their current form, however, if incentives are to stay, we would consider:

- changing $1,042.86 to $1,000 - it is just simpler.
- changing the member tax credit subsidy from $1 to $1 to $2 for $1 so that there is a lower hurdle for the poor to participate. This would encourage greater participation and would also reduce the regressive nature of the current tax break. To the extent that more people join, it will cost the government more. This could be fixed by reducing the $1,042.86 to $900 (say).
- automatically enrolling each new baby, unless there are religious reasons, and give them the kick-start. This is not compulsion but a $1,000 kick-start as no savings are required. It does mean that the child can learn about investing from a practical perspective. Also, they will see first hand the value of investing. If not at birth, then when they get to Year 7, and at the same time make savings part of their education.
- simplify the tax regime and remove the situation where you can get a negative return but pay tax. If simplification involves subsidies, I would reduce the $1,042.86 to $500 to ensure fiscal neutrally. Though if there are cross subsidises, you can be sure that the wealthy will take advantage.

12. An alternative way of encouraging the lower paid to join is to replace the member tax credit with a $500 tax rebate which, if then directed into KiwiSaver, will attract a further $500 into KiwiSaver. This should only be available to those whose income is below the national average wage.

Compulsion

13. Compulsion is unlikely to result in a material amount of increased savings. It will however, increase the moral risks of poor industry behaviour.

14. Compulsion is a political issue and the decision will be made, or not made, for political reasons and not economic or rational reasons. A high level note on the case against compulsion is attached.

Tax

15. You cannot improve the savings regime without improving the tax regime. The current regime with its recent changes is sub-optimal, unless the goal was complexity, increased distortions and abuse (and an increased role for tax planners). We refer you to the paper on the taxation of collective investment

vehicles written earlier this year by Michael Littlewood and me[1]. Until we reduce the distortions, there will always be problems.

16. Improving the tax regime will do more for savings than anything else. Improvement means removing the incentives to save in a particular way.

Treasury background paper

17. Having read the Treasury paper, I am concerned about the quality of the official information in front of the Savings Working Group. The paper is not evidence-based and not consistent or logical. In parts, it notes inadequacies in the data but then ignores inadequacies to reach conclusions. It reads very much like the original Treasury justification for KiwiSaver "we have not tried this and you (the government) wish to do something, so lets give it a go even though the evidence available seems against it." I appreciate that this view will mean that the previous comments may be dismissed, but it needs to be said. New Zealand deserves better information and the SWG has the opportunity to demand or recommend it. The starting point for any savings review should be original Brash review, the Todd Task Force review and the OCR reviews. The issue is, where did these reviews get it wrong?

We have deliberately kept this submission brief. It is inefficient to spend time restating the evidence publicly available or documenting the principles. This is more efficiently done through discussion if the SWG is interested in pursuing any aspect.

We are happy to discuss the above as appropriate.

Yours sincerely

Michael Chamberlain

Michael Chamberlain
for MCA NZ Limited

encl articles

Improving disclosure
Compulsory Super

[1] Towards a more rational tax treatment of collective investment vehicles and their investors. Working Paper 2010-1, Retirement Policy and Research Centre.

If New Zealand introduces compulsory superannuation, for example by making KiwiSaver compulsory, one thing is certain, the changes will be significant. How things change will depend on the detail and there will be short-term and long-term changes and effects. Not all changes are good. It is not as simple as 'everybody starts saving, has a better retirement and lives happily ever after'.

Very few people would argue with the concept that individuals should save for their retirement and take personal responsibility. However, it is a separate issue to force those that are not saving at all, and those who are saving but in a different way, to save via a superannuation scheme like KiwiSaver. For many and therefore, for the country as a whole, it may be better for them to pay off their mortgage, invest in a business or buy a rental property. For many New Zealanders, NZ Superannuation is more than adequate to meet their retirement income needs.

If we force people to save, for example to KiwiSaver, everyone will have to choose how they will respond. There are four immediate responses available to them; substitution, increased debt, non-compliance and increased savings. People will fall in to one or a combination of these groups.

Substitution

An individual may shift money being saved elsewhere, to the compulsory scheme. The net effect may be no change to the total savings and could shift current savings to a less efficient form of savings. It also means less flexibility - not a great outcome for the individual or the country.

Increased debt

An investor may borrow money and save it in the compulsory scheme. In practice, an investor may choose to fund their compulsory saving requirements by reducing their current debt repayments (e.g. their mortgage payments). Effectively therefore, they are borrowing to invest and their debt and risks will be above what they would otherwise have been. Borrowing to invest is probably not something that should be encouraged for the general population.

Non-compliance

Some people will choose to ignore the law and simply not save. We will create a new class of tax avoiders (compulsory super contributions are after all just another form of taxation).

Increased savings

Some people will choose to save extra. They will reduce their current spending and save instead. The consequence is that reduced spending will mean fewer goods bought and therefore manufactured. Producing fewer goods will mean reduced staff levels for retailers and manufacturers and the social consequences of higher unemployment. If the reduced spending is on tobacco and alcohol, this may be positive for the country and its health expenditure but it is more likely to be on other things.

How many people will substitute, borrow, become tax avoiders or choose to save extra is unknown. In practice, many will adopt a combination. Overseas evidence favours the first three[1]. Even though there will be some new savings, the question has to be whether the cost of the compulsory scheme imposed on everyone justifies the increased savings that flow from just a few. It is quite possible also, that these extra institutionalised savings may not create a greater NZ based investment pool. Much of it may be invested overseas!

Given that the best evidence New Zealand has is that most New Zealanders are currently saving adequately[2] for their retirement needs, above what is provided by New Zealand Super, the conclusion has to be that making KiwiSaver compulsory is a political solution looking for a problem.

[1] Australians saved an average $6 a week over the four years to 2009 despite compulsion. In Chile, 60% of Chileans do not contribute to its compulsory scheme.

[2] Scobie & Henderson, 2009

Making KiwiSaver compulsory also raises a number of issues:

1. **Role of the government.** It is important that there is a clear objective for all government policies. Is it to alleviate poverty or subsidise a financial services industry? Few would disagree that the government has a role to play in the provision of a state benefit to alleviate poverty of the elderly. The question is whether the government also has a role to play which forces its citizens to save above this level and through a particular vehicle. Is there international evidence that compulsion might help to resolve that policy objective?

2. **Default providers.** The default providers i.e. the providers who would benefit most from such a decision, are not the best providers. Why should taxpayers subsidise, in an increased way, a section of the industry that is mostly overseas owned and which, in our view, is less than optimal. A shift to compulsory KiwiSaver must involve a rethink of the default providers.

3. **Government guarantee.** If the government forces people to save, should it mean that the government needs to provide a guarantee particularly to those that end up in a default scheme. The behaviour of some finance companies that were given a guarantee raises concerns about the potential behaviour of scheme providers who are given guarantees.

4. **Government subsidies.** If people have no choice but to save, should the current incentives to save (the $1,000 kick-start and the $1 for $1 MTC subsidy) no longer be provided? It does not make economic sense to force someone to save and then reward them with government borrowed money. It's what happens in Australia but Australia seems not to notice that policy flaw. Removing the current incentives will save the government money or redirecting the KiwiSaver tax incentives into increasing the level of New Zealand Superannuation will be more optimal in reducing poverty in retirement, if this is the objective.

5. **What will happen to NZ Superannuation: is Australia a precedent?** Will the age be put back as is happening in Australia? Will the government introduce an income or asset test as applies in Australia? Will the level be reduced? Australia's pension is a bit lower than New Zealand's! It is important that the rules around NZ Superannuation are clearly known and the community has confidence that they will not change over the medium term (15 to 25 years). The government has said that a review of NZ Superannuation is off the agenda on the current prime minister's term. This position is unhelpful as there needs to be long term certainty and sustainability with NZ Superannuation, for further compulsion to work.

6. **Retirement more expensive.** Forcing people to save will actually increase the economic cost of paying for the retirement of the Baby Boomers unless the government decides to introduce an income and/or asset test for NZ Superannuation. Increasing the amount of retirement savings will just add to the amounts that future retirees will want to be paid once they stop working. Because the government has said that it will not touch NZ Superannuation, compulsion will actually make things worse in that regard.

7. **Coverage.** Will the compulsory scheme apply to employees only, or include beneficiaries, children, students and stay-home parents? Do those with student loans also have to save through the compulsory scheme? How does one's earnings-based savings scheme help close the retirement wealth gap between people moving in and out of the workforce and those who work for most of their working lifetime? Will this create a higher maximum NZ Super benefit to bridge this gap? That is, will the "poverty" test move up?

8. **Hardship.** Inevitably some of those who are required to save will not be able to afford to save. The hardship caused will have other immediate social implications.

Also, the impact that compulsion would have on employers in terms of the increased employer contribution costs as suddenly all employees are covered and the compliance, system change and process change costs should not be underestimated.

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10 Suggested changes to KiwiSaver

January 2010

If we were the government, this is how we would change KiwiSaver in 2010. This assumes that the payment of kick-starts and member tax credits will continue to apply. The following are suggested improvements to the current framework.

Early retirement

1. Let members who are over age 60 and have been in KiwiSaver for five years and who genuinely retire before age 65, withdraw up to 20% of their KiwiSaver savings each year. Of course if they withdraw more than they save, they will not get the member tax credit for that year. The members would need to demonstrate that they have retired and provide a statutory declaration to the provider.

Flexible savings

2. Rename member tax credits as "Government KiwiSaver Contribution" and allow unused amounts in one year to be carried forward for up to two years. This would be fairer to those who lose their jobs or who cannot afford to save short-term.
3. Let members save extra, into a voluntary KiwiSaver account, and be allowed to take out such savings before retirement. Such savings wouldn't qualify for the member tax credit but would make it easier to save extra. Most extra savings would end up being saved for the member's long-term future (akin to retirement savings).

Vehicle and security

4. Remove default provider status[1]. Default status reduces the competitiveness of those providers and favours the big overseas banks and insurance companies. There is no evidence that this has reduced costs (they are not the cheapest), increased flexibility (they offer fewer choices) or improved security. It has created an unfair windfall gain to a favoured few at a cost to the taxpayer and affected members. Alternatively, relax the default provider status to allow others to qualify, having met objective requirements, based on their KiwiSaver service to date. It is only required because of auto enrolment (see 8).
5. Require better and simplified disclosure of fees, investment strategies and actual net returns after tax and fees, based on the amounts actually credited to a specified sample member's account (that the auditor certifies).
6. Establish a user friendly central database of information on fees, financial statements and performance. A database where the providers are required to provide monthly financial data and a formal monthly verification that the fee data and financial statements are correct. These would be subject to end of year audit sign-off. As part of this, publish in the press, on a regular basis, comparative fee and after-tax performance data and encourage quality analysis and reporting in the media through a formal peer review process. Not all people are internet savvy.

Other

7. Reduce the age 18 discretionary requirement to age 16. This should apply to both employer contributions and member tax credits. This reduces complexity and encourages employees to save through payroll deduction from first starting work.
8. Remove auto enrolment. It complicates the recruitment and induction process at, mostly, the employers' and providers' expense. Given the large numbers that have already joined, auto-enrolment is no longer cost effective or needed. Placing greater emphasis on more education, clearer communication and increased flexibility would achieve a better outcome.
9. Require a provider who is receiving an existing member from another provider, to provide a statutorily specified template, comparing the key differences of the two providers' schemes.
10. Remove the requirement that KiwiSaver schemes issue a prospectus. The KiwiSaver arrangements as a whole are relatively closely monitored by the IRD and Government Actuary. The current prospectus is a compliance document that few, if any, members see or read.

[1] Note: SuperLife KiwiSaver would benefit from this as it is not a default provider.

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