

15 November 2010

Dr. Brian McCulloch  
Head of Secretariat  
Savings Working Group  
c/o P O Box 3724  
WELLINGTON

Dear Dr. McCulloch,

**WORKPLACE SAVINGS NZ Submission to the Savings Working Group**

Thank you for your letter dated 9 September 2010.

We wish to submit the attached to the Savings Working Group.

Workplace Savings NZ is a national, not-for-profit, apolitical membership organisation. Our current membership comprises around 100 major workplace superannuation and KiwiSaver schemes and another 50 organisations and individuals representing the various product and service providers for workplace savings arrangements. We have recently reviewed the principal goals and objectives of our organisation and changed name from ASFONZ to better reflect our objectives.

From the perspective of assets under management, the membership of Workplace Savings NZ covers around 90% of retirement savings held through workplace retirement saving arrangements (i.e. Corporate and Master Trust superannuation schemes and KiwiSaver).

Workplace Savings NZ's objective is to be the Voice of Workplace Savings; advancing the sustainable, effective, and efficient delivery of workplace savings outcomes for all involved – including the core workplace superannuation scheme members who remain at the heart of the organisation. We do this through:

- Advocating – advancing legislative and public policy initiatives beneficial to workplace savings and participation in the workplace savings industry, making submissions, engaging with policy-makers and officials and issuing media commentary to advance those causes.
- Education – promoting trustee, employer and member financial and regulatory education through dedicated training programmes, newsletters and special interest seminars.
- Networking – providing trustees, employers and service providers involved in workplace superannuation with a regular forum for sharing ideas and information on industry matters.

- Promotion – publicising the benefits of workplace savings, and helping to improve public confidence in workplace savings.

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I would be pleased to discuss our comments or answer any queries in relation to the submission.

Thank you for the opportunity to make this submission.

Yours sincerely



Bruce Kerr  
**Executive Director**

**Workplace Savings NZ**

**Submission to the**

**Savings Working  
Group**

**November 2010**

# The Workplace Savings NZ Submission

Workplace Savings NZ recognises that there is a divergence of opinion in the country regarding the need for New Zealand and New Zealanders to save, what we should be saving for, the adequacy of current savings and on how to encourage savings where, and if, this is felt to be desirable. We also recognise that individual needs will vary from person to person and that, for any particular individual or household, their needs will not necessarily be the same as the needs of Government or the nation as a whole.

Having said that, we believe that the brief given to the Savings Working Group (SWG) is a timely and essential step in the 'Savings' debate and Workplace Savings NZ is pleased to be part of this debate. The membership of Workplace Savings NZ provides a wealth of knowledge and experience in matters related to retirement savings and investment and believe we can make a valuable contribution.

Workplace Savings NZ provides the following comments on the three areas the Terms of Reference expects the SWG to consider:

- a) **Fiscal policy** – *the role of Government savings as an important component of national savings, including potential long-term savings/debt targets and any offset between Government and private savings.*

The role of Government can simplistically be described as the collector of taxes and other sources of sovereign income, and to then invest or equitably redistribute those monies in line with the fiscal policy priorities that Government determines from time-to-time to be in the best interests of the nation and its people.

An example of this might be for Government to move to a sustainable target level of debt as a percentage of GDP.

With the exception of:

1. Retirement savings policy and regulation;
2. Retirement income adequacy; and
3. Our nation's financial literacy;

Workplace Savings NZ does not have strong views on the policies of the current Government. We believe it is the role of Government to implement economic policy that is most likely to produce the behaviours in individuals, households, or businesses that achieve the intended outcomes of that policy. We acknowledge that all possible consequences cannot always be foreseen.

We do suggest that Government might benefit from taking a step back and asking itself whether there would be benefit in addressing the issues of older New Zealanders in a more holistic manner. When Government comes to review its spending priorities we think there may be a benefit in asking what the nation can realistically and sustainably afford to spend in supplying a range of services to the aged. These services might include; social assistance (NZ Super & other welfare arrangements), Health, Housing etc.

In many areas it may be preferable for Government to provide encouragement to individuals to make arrangements for their own provision. In other areas it may make more sense for services to be provided by central or local Government, either on a universal or targeted basis. We think that it is only when Government is capable of clearly articulating its policies on a holistic basis that New Zealanders will be informed sufficiently to enable them to act rationally.

The following are examples of key decisions New Zealand can only make if there is settled, clearly anticipated, a-political Government policies in place:-

- Should I make savings from current income to support my expenditure expectations in my post employment retired years?
- Does the Government's health policy suggest I should save now so that I can afford health insurance for a longer period of my expected life?

- Which accommodation choices in my post employment retired years are supported by the Government's housing and monetary policies?

A concern that we have is that if statements from Government do not appear to be based on robust research, or otherwise lack credibility, confidence in the position of Government will be undermined. A case in point must be the apparent refusal of either of NZ's major political parties to engage in a debate on the sustainability of NZ Superannuation as presently paid.

Simply maintaining that it will not be changed seems to be at odds with views of various economists and other observers. Experience overseas has seen virtually all other western economies face a similar problem regarding state funded benefits, with most proposing to make changes. Is it credible that NZ is able to avoid making changes in the absence of a debate?

We therefore see formal debate as essential so that all parties' views can be expressed and logical conclusions drawn.

We think that, in many cases, the public will be confused to the extent that they will not know what to believe or what decision to make. This may lead to no decision being made at all. As a result, no improvement in our nation's savings profile will be made.

The practical examples above focus on topics and policies as they affect the welfare of people thinking about retirement as this is the principal interest area of Workplace Savings NZ. Savings at an individual level need not, and we believe should not, be restricted to saving for retirement.

The level of private debt in NZ implies that New Zealanders in general have been living beyond their means for some years and that any value that there may be in saving for life needs is not recognized. This seems to be borne out by disappointing results being recorded in surveys designed to establish the level of financial literacy of respondents.

Workplace Savings NZ has been actively involved in supporting the Retirement Commission's promotion of financial literacy in recent months. We are convinced that this invaluable programme will result in a significant improvement in the levels of financial literacy over time but, at present levels of funding, this process will take many years before it flows through to real action by the population as a whole. A relatively small increase in investment by Government might enable the programme to be expanded such as to produce meaningful results more quickly.

*b) **Taxation** – the impact of the tax system, particularly taxation of capital income, on the level and composition of national saving and investment decisions, and options for improvement. These will include, but are not limited to:*

- *The case for moving to a dual income tax system, whereby labour and capital income might be taxed at separate rates;*
- *Indexation or partial-indexation of the tax system so that real, rather than nominal, income is taxed.*

Workplace Savings NZ accepts that Government has the ability to use tax as a lever to encourage desired behaviours, and we recognise that moving to a dual tax system whereby labour and capital income might be taxed at separate rates, might produce the desired savings outcomes. However we also recognise that such a choice surely has revenue implications which the Government will need to manage in terms of competing priorities and long-run budgeting.

We support the case for moving to a dual income tax system, whereby labour and capital income might be taxed at separate rates, on the assumption that capital income would be taxed at a lower rate than labour as a step change incentive to increase the national savings rate. To contain costs we suggest that such a move would need to be tightly focussed around the desired behavioural outcomes for targeted groups (individuals & households), and that such treatment should be contained to 'locked-in' Workplace Savings products including KiwiSaver.

Additionally, on the grounds of equity, we would also support the indexation or partial-indexation of the tax system (both labour and capital income) so that real, rather than nominal, income is taxed.

That said, the question that remains is how Government might achieve these changes given the current stance on fiscal neutrality and Government cost savings?

The papers released by the Savings Working Group on 11 November 2010 indicate that much work has been done in this area, and we welcome that analysis. However, we do not think the focus of the debate should be unduly dominated by tax considerations. Having a system for taxation that is conducive to enhancing national savings is simply part of the overall equation.

- c) **KiwiSaver** – *the role of KiwiSaver in improving national savings outcomes. This will include, but is not limited to:*
- *Considering options to improve the operation and outcomes of KiwiSaver. This will include options where KiwiSaver is both voluntary and compulsory; and*
  - *The fairness and effectiveness of current KiwiSaver subsidies.*

Workplace Savings NZ puts forward the following observations and suggestions regarding options which might improve KiwiSaver's operation and outcomes:-

We consider the following attributes of KiwiSaver design are positives:-

- Just as Government will recognise that collection of employment related taxes at source (i.e. PAYE) is efficient, we can attest that collection of savings at source is also very efficient as is evidenced by collection of KiwiSaver member & employer contributions by employers;
- Central administration of KiwiSaver contributions via Inland Revenue also creates a very efficient channel between employers and product providers; and
- Auto-enrolment of new employees is a very efficient way of capturing workers into KiwiSaver.

We consider the following attributes of KiwiSaver design may be considered negatives:-

- Under 18's who are in the workforce are making member contributions where employer contributions are not compulsory and no tax credits are payable, which is inequitable;
- Under 18's who contribute get no tax credits to enhance their savings;
- The design feature which allows member withdrawal applications, on the grounds of significant financial hardship and serious illness, to be assessed at the individual product providers/trustees level instead of having a central body responsible for delivering consistency of process and decision making means we have potential for a multiplicity of approaches, and the risk of members shopping around for the 'easiest' provider.

KiwiSaver scheme providers have made it clear that the constant 'tinkering' with scheme rules and provisions that has been such a feature of the early days of KiwiSaver has been counterproductive, confusing and very expensive. Further changes should therefore not be introduced unless there is agreement that the changes will produce meaningful beneficial results.

Workplace Savings NZ suggests the following changes be considered in the broader context of KiwiSaver design and retirement incomes:-

- Government prescription for an increase in member & employer contribution rates to, say, 5% of earnings by each. If it is considered that this cannot be achieved currently, or in a single move, a phased approach could be adopted at, say 0.5% per annum lifting the overall member and employer contribution rates from 2.0% to 5.0% over a 6 year period (completion by say 2018). We strongly suggest that policy be developed to enshrine a realistic schedule of contribution increases over an agreed timeframe;

- Government prescribes that under 18s in the workforce who are contributing to KiwiSaver are treated in the same manner as those of 18 or more;
- Government introduces legislative change which mandates (or at least permits delegation of) either a Government agency (e.g. Inland Revenue), or some other capable & competent commercial organisation or industry body, the responsibility for managing the process around significant financial hardship and serious illness withdrawal processing and decision making. Workplace Savings NZ believes that this change will reduce the current burden placed on the many product providers/trustees, and remove the risk of variability of decisions. This step would also remove the resulting provider changes, currently being made by KiwiSavers, expressly to farm the application outcome.
- New Zealand currently has only one commercial provider of annuities (an income stream product). In our view, this is the result of annuity products being tax inefficient for the purchaser, risk capital demanding for the provider, and historically, there being little or no demand for products such as these.  
Investor behaviour has been brought under the spot light by recent financial market events, and this might suggest that ordinary New Zealanders are ill-equipped or ill-prepared to manage their accumulated retirement nest eggs (e.g. rate chasers losing their money in finance company collapses).  
KiwiSaver is still in its toddler phase so it will be some time before KiwiSavers are faced with decisions about how to manage their accumulated retirement lump sums. We acknowledge that both the industry and Government has time to prepare the landscape for future retiree needs in this arena, however we believe that there are a number of potential decumulation policies that the Government could be currently researching/considering.
- Workplace Savings NZ would like to see Government facilitate a range of choices for KiwiSavers attaining the age of NZ Super eligibility and hence able to access their lump sum savings. Choices should focus on investment management and decumulation product options, and the choice might be enhanced if:-
  1. Government created public/private partnerships to underwrite the tail of longevity risk borne by commercial product providers offering income stream products, such as fixed term or lifetime annuities;
  2. Government created public/private partnerships to inflation protect fixed term or lifetime annuities in payment. Such a product might operate on the basis that the commercial product provider builds in a fixed annual inflation allowance of say 2%, and the Government underwrites any inflation "blow-out" in excess of the fixed allowance. Such an approach could dovetail well with the Reserve Bank's responsibility to manage inflation within the band negotiated with Government;
  3. Government became a provider of low cost reverse mortgages. Such an initiative might assist in delivering certainty of accessibility and cost for a large number of asset rich but cash poor people living in retirement. This might be achieved by utilising the expertise within the Housing Corporation of NZ and by pricing the product at say the UOMI rate or OCR plus a margin and, for example, limiting availability to specific expenditure related with either accommodation or health 'shocks'..

### **Options for KiwiSaver; both voluntary and compulsory?**

While we support ongoing and first class research examining the link between individuals (or household) savings and national savings/GDP growth, we submit that the focus should clearly be on helping New Zealanders understand, at their individual (or household) level what "Retirement Income Adequacy" means.

We would like to demonstrate our point with the following examples:-

- Consider how an ordinary New Zealand household with a single bread winner who receives the national average weekly wage (around \$45,000 p.a. gross; \$37,200 after tax) is expected to move to NZ Superannuation payments, which for a couple living together is about \$26,600. That's a drop in net, after tax, household income of \$10,600 per annum, or 28.5%. How is that household expected to change its lifestyle in retirement? What will they have to stop buying/paying to bring their household expenditure down to the level of NZ Super? Is this a realistic expectation?

Workplace Savings NZ has looked to Australia to see what is happening in the area of living costs for people in retirement. Our sister organisation, the Association of Superannuation Funds of Australia ("ASFA"), in conjunction with a leading financial services provider conducts and publishes regular research on the household expenditures of people in retirement.

The "Westpac ASFA Retirement Standard" benchmarks the annual budget needed by Australians to fund either a "comfortable" or "modest" standard of living in the post-work years. It is updated quarterly to reflect inflation, and provides detailed budgets of what singles and couples would need to spend to support their chosen lifestyle.

- On the other hand, a significant number of working New Zealanders currently receive incomes that are at, or below, the level of NZ Superannuation. Is there any point in these people saving during their working lives to supplement income in retirement? This would be a consequence of making KiwiSaver compulsory, unless it is compulsory only where income exceeds a certain level.

We raise the above discussion under this topic because Workplace Savings NZ believes that while KiwiSaver, under current settings, is showing itself to be a valuable retirement savings tool; New Zealanders are generally saving without adequate information about what their retirement savings goal should be.

We strongly believe that regardless of whether we have the voluntary/compulsory debate, we MUST put in place tools that assist New Zealanders to understand what living costs they might expect in their retired years. They can then make informed choices about adequately preparing for any gap between the state funded universal NZ Superannuation and the actual living costs they are likely to face in their retired years.

All that said Workplace Savings NZ supports:-

1. ongoing improvements in the effective and efficient delivery of KiwiSaver, along with its current incentive settings, on a voluntary membership basis;
2. the establishment, over the next 3/5 years, of research based tools (such as the Westpac ASFA Retirement Standard) which assist and inform the saving public about what savings might be required to support their aspirational retirement life style;
3. that, as a nation, we again review the question/debate on voluntary versus compulsory KiwiSaver membership

### **The fairness and effectiveness of current KiwiSaver subsidies?**

Superannuation<sup>1</sup> statistics for non KiwiSaver schemes show:-

#### **Employer Sponsored Superannuation Schemes**

	No. of Schemes	FUM	Member Nos.
2006	320	\$13.3b	288.7k
2008	258	\$12.2b	283.3k

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<sup>1</sup> Annual report from the Government Actuary

#### Retail Superannuation Schemes

	No. of Schemes	FUM	Member Nos.
2006	115	\$7.3b	313.8k
2008	104	\$6.3b	267.5k

KiwiSaver<sup>2</sup> statistics show that:-

Since its launch in 2007 KiwiSaver has attracted over 1.5 million investors and about \$6b of accumulated savings.

Of this number around 37% (or 550,000) became members through the Auto-Enrolment provisions via their employer. The balance, around 950,000, have voluntarily joined (or Opted-In). Of this number we know that about one third (or 300,000) are under 18s not in the workforce.

So what can we assume about KiwiSaver growth and the effect of the Government subsidies?

- The jury is out on whether KiwiSaver has produced savings substitution, but the above Superannuation Scheme numbers suggest that existing "Workplace" super schemes have largely been unaffected by the introduction of KiwiSaver;
- Of course, KiwiSaver and other compliance costs continue to be contributors to the decrease in the number of traditional workplace super schemes;
- We know that about two thirds of all KiwiSavers have joined voluntarily, and that Inland Revenues research shows that many were attracted by the employer and Government contributions;
- 83% of parents who signed-up their children to KiwiSaver have told Inland Revenue that they were motivated to do so because of the \$1,000 kick-start.
- 38% of KiwiSaver households have told Inland Revenue they were unlikely to save for retirement had it not been for KiwiSaver.

Are the taxpayer funded subsidies equitable?

- Clearly they will not be seen as equitable to an individual (or household) if the individual is not in a position to take advantage of them (e.g. not able to save);
- However, it is fair to assume that no individual taxpayer is able to take advantage of all the concessions and/or services made available by Government. Any tax concession available to KiwiSavers is, therefore, just one of a whole range of targeted incentives or services provided and needs to be considered in that light;
- If generally it is accepted that KiwiSaver subsidies are positively influencing saving behaviour, and this is considered to be in the nation's best interest, they are no more inequitable than any other targeted incentive or service, apart from the distortion created by limiting incentives to those aged 18 or over.

Lastly Workplace Savings NZ would like the Savings Working Group to consider the following issues:-

1. New Zealand Superannuation; and
2. Encouraging Employers to facilitate Savings

#### **New Zealand Superannuation**

We appreciate that the parameters of New Zealand Superannuation are not within the scope of the Group's terms of reference.

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<sup>2</sup> Inland Revenue review of KiwiSaver

However, as noted earlier, Workplace Savings NZ feels strongly that the following issues should be raised:-

- There has been considerable public discussion and concern expressed about the unsustainability of New Zealand Superannuation, as it currently stands. Workplace Savings NZ welcomes an open and robust public debate on this subject.
- As indicated previously, in the absence of that debate taking place, we believe that the unsustainability discussion is creating a tsunami of uncertainty around the future of state retirement income support. For many New Zealanders, the level of uncertainty is working as a distraction, with individuals (and households) doing nothing about personal provision.
- We repeat our earlier point that Government needs to articulate clear policies that give foreseeable certainty, so that New Zealanders can make informed choices in planning for their futures.

### **Encouraging Employers to facilitate Savings**

For many years employers have been assisting their employees to make savings for retirement, to provide insurance benefits when sick or disabled and to make provision for their dependents should they die. While employee and employer contributions to superannuation schemes are probably the best known method of facilitating savings, deductions from pay for credit to savings accounts and the like have also featured. These have generally been on a voluntary basis.

KiwiSaver has led to a resurgence of saving through employers. Source deductions have been shown to be one of the most efficient and effective methods of transferring funds in to the employees' savings, as well as being the most painless to the employee. It is commonly acknowledged that people find it easier to save if the amounts involved never reach the person's personal accounts – it never becomes disposable income.

We believe that providing employers with some encouragement to facilitate savings for their employees, or at least minimise any regulatory and liability risk impediments to doing so, could prove to be very helpful if it is considered that savings overall are to be encouraged. A registered superannuation scheme to sit alongside a company KiwiSaver scheme is an obvious practical example.

Measures to encourage employers need not necessarily be financial. A reduction in compliance requirements would be equally valid. We believe that there is scope for such reductions without compromising the security of the employees' investments.

A couple of examples would be:-

1. the current situation whereby an employer who provides access to a superannuation scheme (non-KiwiSaver) through a master trust is often considered to be a 'promoter' of the scheme under the Securities Act. This has cost and risk implications for the employer and provider without providing any additional value or safeguards to employees. This requirement could, and should in our view, be removed;
2. encouraging employers to assist their employees "close to retirement" to improve their financial literacy, by providing access to Authorised Financial Advisers who could help the employees with their financial planning/preparedness for post employment retirement. Such encouragement by Government should make the employers' expenditure in this area a fully deductible expense, and not subject to Fringe Benefits Tax.

**Submission Ends**