

The Savings Product Working Group

- report released 15th September 2004

In May this year, the government appointed a “Savings Product Working Group” (SPWG) to investigate the role of workplace superannuation. In summary, the SPWG was asked to...

“... provide advice to the government on the detailed design and implementation issues to be resolved in delivering widely adopted generic work-based savings products.”

The SPWG released its report (*A Future for Work-based Savings in New Zealand*) on 15th September¹. It described a standard government-designed scheme for everyone.

It is important to recognise that the SPWG was not asked **whether** we should have government-initiated workplace saving arrangements. The question it addressed was that, if the government decided to have generic arrangements, what should they look like and how might they best operate?

Key findings

The report describes increasing levels of possible government intervention in workplace superannuation, along a ‘pathway’ that starts with improvements to the current voluntary regime and runs right up to a fully regulated, “generic” scheme.

The five steps identified by the SPWG along the pathway were:

- (a) Education and information

- (b) “Streamlined regulation”
- (c) “Generic processes” for work-based savings
- (d) Design features of a common template
- (e) Specific “sweeteners” for work-based savings.

It’s not too difficult to imagine natural extensions along the pathway for:

- (f) A compulsory scheme, and finally,
- (g) A compulsory and employer-paid scheme, like the Australian arrangements.

The report says that it leaves open the question of just how far along its suggested pathway New Zealand might travel. The SPWG said this was for the government to decide.

Steps (a) and (b) suggest improvements to the current regime without intervening in the decisions that either employers or employees make about retirement saving provision. Implementing steps (a) and (b) should result in better and more accessible information, making it easier for employees to choose what arrangements might be best for them and to help employers decide what they should do.

Steps (c), (d) and (e) are all about the “compulsory, opt-out” scheme that has received most of the publicity on the SPWG’s report. The compulsory provisions will

We say

There are advantages for an employer to offer a workplace saving facility.

If someone wants to save for retirement, doing that through a workplace scheme should be cheaper, even without any employer subsidy. Lower costs normally mean higher net returns. Workplace saving is also usually more convenient. So, facilitating employees to save through a workplace superannuation scheme is generally a good idea.

However, we think an employer should make this decision based on what’s appropriate for its business and the management of its employees. It may not always be the right business decision for an employer to automatically offer such a facility. And it may not always be the right decision for an employee to save in a workplace scheme.

require an employer to provide the scheme and the opt-out provisions will let an individual employee choose not to participate.

¹ The full report can be downloaded at <http://www.beehive.govt.nz/Documents/Files/WorkplaceSavings.pdf>

Government response

From the government's initial reactions, it seems that we might travel all the way to (d) from the outset and may even arrive at one or more of the "sweeteners" mentioned in (e). The "sweetener" possibilities suggested by the SPWG include the payment by taxpayers of administration costs, fund management fees, basic life insurance cover, "kick starts" reward payments and "top ups".

Whether we then move on to the potential steps (f) (a compulsory employee-paid scheme) or (g) (a compulsory employer-paid scheme) will probably depend on the perceived success of the "compulsory, opt-out" model described by the SPWG and the political climate at the time.

Compulsory, opt-out scheme

What follows summarises the SPWG's proposed compulsory, opt-out scheme – many of the details are only suggestions by the SPWG and could change when the government makes its final decisions. For the moment, we will assume that the employer does not have its own superannuation scheme (more on that later) or, in response, chooses to wind it up.

Employers affected

All employers with more than five employees have to participate. According to the SPWG, that will cover about 78% of employees. Smaller employers could participate if they wished.

Membership

All new employees (part-time, full-time and casual) over age 18, hired after the new scheme starts and earning more than

\$27,112² a year have to join, unless they individually decide to opt-out. The SPWG suggested that they can opt-out only after 30 days from starting work. Contributions will be required during the 30 days and may attract interest (presumably taxable) payable by the central "clearing-house". If no interest were to be payable, opt-out would be available immediately on becoming an employee.

Contributions

Employees must contribute 5% of pay above \$16,712 a year with a minimum of \$10 a week (but not if they are paying for a student loan). This is similar to the current student loan payment arrangements but is 5% rather than the student loan scheme's 10%.

The employer is not obliged to contribute directly. There will be indirect costs, given the employer's involvement in the selection of both a default manager and default fund, promotion, management of the opt-out process and administration of the contribution process.

Administration

The employer will collect the contributions and remit them to the IRD along with tax and other deductions, as part of the normal PAYE process.

The IRD will pass the contributions to a central administrator. The central administrator will be chosen by tender.

The administrator will pass the contributions on to the chosen approved manager. All managers will be approved by the "provider approvals panel". The SPWG did not say what the conditions for those approvals might be.

Default manager

The employer will have to choose a default manager from the approved list. If the employer does not do that, the compulsory opt-out scheme as a whole will have a default manager, chosen after "competitive tender" by the "provider approvals panel".

Default investment option

Each approved provider must have a default investment option based on what would usually be described as a "capital stable" investment strategy (something like 70% cash/bonds; 30% shares/property).

Fees disclosure

Approved providers must conform to a standard fees disclosure model, but there is no suggested maximum fee.

Limited access

Members have access to their savings but only on a restricted basis. The SPWG has suggested for example that, after five years' membership and on giving three months' notice, a member can withdraw 50% and a further 50% every three years thereafter. The member can withdraw the full amount after age 55.

Employee can switch

Employees can switch providers - the overall central administrator would handle the change.

Existing superannuation schemes

An employer can be relieved from the requirement to offer the compulsory opt-out scheme if it has an existing superannuation scheme. The SPWG said that:

"Any new generic scheme would build contribution numbers and member

² At this pay level, the suggested minimum weekly (trigger) contribution of \$10 would be collected.

balances slowly, and those gains would be rapidly and materially counteracted if the design features gave either incentive or excuse to close existing schemes and distribute fund balances. Our first building block in any solution is therefore to protect the base of the pathway”.

So, the SPWG suggested minimum requirements before the **employer** can opt-out of having to offer the compulsory scheme:

- (a) Eligibility conditions can (but need not) be aligned to those required by the compulsory opt-out scheme itself.
- (b) If not so aligned, any ineligible employee must be offered the compulsory opt-out scheme.
- (c) The employer must pay a subsidy to the “exempt” scheme of at least the scheme’s administration costs.

A decision by an eligible employee not to join the employer’s scheme will satisfy the opt-out requirements.

The devil in the detail

If the SPWG’s compulsory opt-out regime were implemented, there are many areas of detail that may cause unintended consequences. Below are some issues that will arise.

From 5 to 6 employees

If an employer with five employees proposes to hire a sixth, it may have to comply with the compulsory opt-out provisions for all employees from the moment the sixth employee starts work. That may put the employer off hiring the extra person, certainly as an “employee”.

From 6 to 5 employees

If an employer down-sizes and falls to five or fewer employees, can it stop providing the compulsory opt-out provisions for new employees and possibly even for existing employees?

The IRD’s role

The SPWG assumes that the IRD is a low cost collector of contributions. However, the contributions may be deducted but don’t have to be paid to the IRD for between 2-7 weeks. Even then, it will take further time for the contributions to reach their destination and be invested. All this means lost investment income for members and that’s a cost. And then, what say the member owes some back tax or child support payments? Will the contributions be protected from deduction in those regards? If the employer is late in paying the contributions by a few days, must the employer pay penalties and interest? If so, will the employee benefit by the penalties or will they go to the consolidated fund?

Extra payments and allowances:

We assume that contributions will be required only on taxable pay. That will include bonuses, penal rates and back pay but presumably, not tax-free allowances. Pay systems will need to cope with such subtleties.

Parental leave

When an employee is on parental (or any other) leave, presumably contributions must continue if there is any taxable pay. Will the contributions apply to government-provided, taxpayer-funded parental benefits?

Disability income

The contribution requirement will presumably not apply to a taxable disability income benefit if that comes from an insurance arrangement or ACC rather than from the employer. But what if

that benefit were administered through the employer’s payroll?

Expatriates

Will employees who are not resident in New Zealand have to contribute, if they are paid by a New Zealand employer? There are no details on this.

Emigration

Will schemes be allowed to transfer balances for members who emigrate on some kind of “permanent” basis? Again, there are no details.

The “30 days rule”

If the scheme requires employees to contribute for 30 days before they can opt-out, there will presumably be rules to prevent employers from withholding pay, even with the employee’s agreement, until the 30 days is up.

When student loan stops

There will need to be good communication between the student loan administrator and the employer because the employee’s opt-out period may start when student loan payments stop. Or perhaps there won’t be an opt-out period here again, no details.

Overpayments

Where an employee who works part-time and/or with multiple employers moves in and out of the contribution “trigger”, who will be responsible for either activating the trigger and/or recovering overpayments? There is no detail on this.

Voluntary contributions

The lock-in provisions will discourage employees from contributing on a voluntary basis. Contributions above the minimum will be subject to the same rules as the compulsory contributions.

Employees at the minimum

If an employee earns \$27,111 a year (presumably converted to an equivalent weekly, fortnightly, four weekly or

monthly amount) no contributions are payable. An increase of only \$1 a year (for example, from overtime) means that \$10 a week must now be contributed if the employee has not opted-out. However, if annual pay then falls by a dollar, the contribution is no longer payable. This will not be easy to administer and will be even more difficult to explain. Again, what if regular pay is about \$520 a week (less than the minimum) but overtime or a Christmas bonus adds an extra \$72 for the year? Having made no contributions during the year, is the employee now faced with finding the \$520 in compulsory contributions for the full year?

Employees below the minimum

Will employees who earn less than \$27,112 a year (which will include most part-timers) have to make the opt-out decision when first hired? That's despite the fact that no contributions will be payable. If they don't opt-out, will the compulsory contributions start as soon as annual pay (or the weekly equivalent?) exceeds \$27,112?

Multiple employers

Managing the minimum will potentially be very complicated where an employee has more than one employer. As far as an employer is concerned, will the test be "employer by employer"? Or, will there be an overall test across total pay that, like tax, may require an end of year payment? Who, then, will administer the opt-out options?

Payroll systems

It can't be assumed that payroll systems can cope given the required contribution is not a straight 5% but rather 5% of pay above a minimum and with a minimum weekly/monthly amount. This is not the same as the student loan scheme where there is no minimum.

Employer not liable

The SPWG has suggested that the employer will not be either a "promoter" or an "adviser". However, if the employer picks a default provider from the approved list, the employer will also, presumably, be relieved from any legal liability if the provider loses members' money through either mistakes or theft. On the other hand, where will the employer's relationship with employees stand if the default provider chosen proves to be the worst performer?

Property relationship settlements

When a couple separates, part of the scheme's benefit will be relationship property. Each provider will have to supply information on benefit accruals during the relationship. Will withdrawals be allowed to settle relationship property claims?

De minimis rule

Presumably, providers will not be obliged to administer small balances and can pay them to members regardless of the lock-in rule.

Unique identifier

Privacy requirements prohibit a superannuation scheme from using a member's IRD number as a unique ID. We wonder if that might change for the compulsory opt-out scheme, given the IRD's role in collecting contributions. Every employee must have a unique number that will apply across approved providers. Schemes will need either all members' IRD numbers or a new national ID number (and ID card?) for every employee.

Salary sacrifice

If an employee sacrifices taxable pay for an employer contribution to a superannuation scheme, the reduction may also affect ACC premiums and benefits as well as student loan payments, income-tested state benefits, Family Support and maintenance payments for a

previous partner and children. Now it will also affect compulsory superannuation contributions.

Financial difficulties

As a rule, a person is better off reducing debt before saving for retirement in an unsubsidised superannuation scheme. What will happen if an employee gets into financial difficulty and is about to lose the family home? What say the employee needs a medical operation to continue working? The SPWG was against allowing a "hardship" provision of this kind. That could easily lead to perverse outcomes.

There will be more such issues.

Our thoughts on the report

In assessing the potential implications of the SPWG's recommendations, we thought that it might be helpful to line up the arguments under the general headings of "positive" and "negative". The last two pages of this newsletter do that. Some of the points comment on the principles of the proposal and could be used to form an employer's submission on the issues. Other comments relate to the details of the "pathway" described by the SPWG.

If the SPWG's proposals have a sound policy foundation (because there is a real and justified need for a pseudo-compulsory, workplace savings regime), then the proposals have merit. The government seems to think that saving by deduction from pay can be an effective way of enticing people to save. Many successful employer-based schemes have proven this to be the case.

However the question remains; should government intervention in this way be necessary and should a regime that relies on individuals making decisions

through inertia be viewed as a reasonable position in which to place employees and employers?

In New Zealand, there is a wide variety of ways in which an individual can save for retirement. The government's proposal is really aimed at the small employers that generally do not provide an employer-based superannuation scheme. It is also aimed at the lower paid and the "mobile" worker who moves from job to job, in and out of employment and who may be a seasonal worker. The proposal also seeks to manage the problem of short-term savings being consumed before they accumulate to a worthwhile amount.

As an industry provider, we are intuitively supportive of any proposal that encourages retirement savings. On that basis, we suggest the proposals have some merit. They introduce another saving option for employees; one that tries to simplify the collection and recording processes.

However, we have some concerns as well.

We question the fundamental need for such a wide ranging and all encompassing workplace arrangement. We see the proposal as potentially distorting saving patterns. Debt (mortgage) reduction as a first priority seems to have taken a back seat. Will directed contributions finish up in a small number of large (offshore?) providers? Will the significant cost of establishing the infrastructure required to operate the plan be in the end justified by the savings eventuating? If the savings do not reach the "justification" level will the rules change, i.e. require a matching employer contribution?

There will need to be detailed regulations that prescribe the obligations of employees, employers, the IRD, the central administrator and the approved providers. Those will come at a considerable cost, both to set up and maintain.

On balance, we think that a well-designed, employer specific, tailored plan is more likely to provide a better solution to the long-term mutual interests of an employer and their employees than a government controlled pseudo-compulsory vehicle. Our own SuperLife plan has the requisite simplicity and low cost basic options. Using SuperLife, an employer can meet employees' needs in ways that best suit their circumstances.

Submissions sought

Although the report calls for submissions and the government says that it hasn't made its mind up, it's clear that something might happen relatively soon. The government said that the 2005 Budget is the earliest opportunity for implementing the report's recommendations. Those recommendations do not, however, seem to involve Budget issues unless the government is thinking about taxpayers generally meeting the administration costs or for there to be a "sweetener" of the kind proposed by the SPWG.

Submissions on the SPWG's recommendations must be with the Minister of Finance by 31st October. However, the SPWG has suggested that there is no point in making submissions on its terms of reference. The government set those so, if employers have any thoughts on the basic concept of the generic compulsory opt-out scheme, they would have to be addressed directly to the government.

We think that employers should make submissions and say what they think to both the SPWG and the government about the report's proposals.

This whole subject deserves a proper, evidence-based national debate.

The arguments for

General

For many individuals, saving a standard rate of pay, in a standard product, with a standard investment option throughout their career, will be an efficient way to build up a retirement nest egg, minimise hassles and reduce the costs that come out of the saver's return. For those who want to save more or adopt a different strategy or do their own thing, they can opt out.

The proposed compulsory opt-out scheme provides a framework for the average employee. A standard set of rules will let most individuals satisfy their needs, cost effectively and be comforted by the knowledge that they are not alone.

Also, employers, particularly small employers, will not be faced with deciding how to put in a scheme for employees. From an employer's perspective, the payment of contributions by pay deductions through the tax system is convenient. The whole structure means that the employer doesn't have to be part of an individual employee's decisions.

Specifically

- The default provisions will provide an acceptable "middle ground solution" for a "typical" employee if the employee allows the compulsory opt-out scheme to take effect.
- The proposed standard plan is a way in which an employer can make workplace

superannuation as easy as possible.

- If an employer wants to do something more than the minimum (by having its own scheme), the requirements that a separate scheme must satisfy are relatively modest and not restrictive.
- A government commitment to the "first level" intervention along the SPWG's "pathway" (education and information) will also help to improve employees' knowledge of the issues.
- The suggested "second level" intervention (streamlined regulation) along the "pathway" should remove some of the problems with the current regime.
- Attaching the contribution collection process to the PAYE tax procedures should be a relatively low cost mechanism.
- Having "default" investment options and contribution rates should make the employees' initial decisions less complex.
- Having a "provider approvals panel" should reduce the possible risks to the employer of low quality providers.
- Requiring providers to identify fees on a common basis should illuminate comparative costs and, possibly, reduce them.
- The access provisions (no access for 5 years and restricted after that)

balances flexibility with costs and will get employees used to the idea of medium to long term saving.

The arguments against

General

The arguments in principle against the proposals concern the extra costs and risks imposed on employers in an area that, for most employers, has not been an area of their responsibility.

Also, there is no evidence produced that New Zealand needs an intervention of this nature. That evidence should be produced and discussed. The Treasury itself has reported that, despite the fall in workplace saving schemes, New Zealanders seem to be behaving rationally in saving for retirement. See “Saving for Retirement New Evidence for New Zealand” Grant Scobie and others, New Zealand Treasury Working Paper. It can be downloaded at www.treasury.govt.nz/workingpapers/2004/04-12.asp.

Specifically

- Employers may think that whether employees save for retirement is a personal issue for them to resolve, depending on their individual circumstances, as those change over time.
- Although the SPWG’s proposals try to reduce the employer’s involvement, the employer will be drawn into this issue. It must choose a default scheme and default investment option. It may help employees to decide on a default scheme or even, perhaps, help employees to decide whether to opt-out. It probably can’t avoid those issues.

- Employers’ direct and indirect costs of administration will rise. Payroll systems will need to be changed.
- Forcing employees to behave “appropriately”, even on an opt-out basis, will require a considerable body of regulation and regulatory oversight. This will add to costs nationally and will involve a considerable time in coming to terms with it.
- Financially, employees with debt are better off reducing debt rather than saving in a scheme like the compulsory opt-out scheme suggested by the SPWG. Someone will need to explain this.
- Employees may decide that the compulsory opt-out scheme is all they need and may reduce their other savings.
- From the government’s initial reaction, we may not first try the less intrusive options along the SPWG’s suggested “pathway”. We may move straight to the compulsory opt-out scheme with “sweeteners”. Lower levels of intervention (and costs) for employers may be the better long-term strategy.
- Overseas evidence shows that “sweeteners” tend to reward high earners at the expense of lower earners. They affect significantly where people save but not how much they save.
- A major Statistics New Zealand Survey (*Survey of Family Incomes and Employment*) is now under way. Perhaps we should wait until the evidence from that starts becoming available to see if New Zealand actually has a problem.
- If the overall arrangements don’t work, it would be a small step to make the scheme compulsory just by removing the opt-out provision.
- Employers that already have workplace superannuation may now decide that there is no competitive advantage in being involved. That may lead to further reductions in workplace superannuation, particularly for subsidised schemes.
- For employees, restricting access to their savings means less flexibility especially if their financial circumstances change. Limiting access to what is essentially a voluntary scheme seems inconsistent.
- While the employer’s role might be reduced as far as practicable, the employer is the “gateway” to the scheme and will be blamed for errors, poor selection of the default provider etc.