ASFONZ

(The Association of Superannuation Funds of New Zealand)

The KiwiSaver Bill

Submission to the Finance & Expenditure Select Committee

28 April 2006

The KiwiSaver Bill

The Association of Superannuation Funds of New Zealand (ASFONZ) welcomes the opportunity to make this submission on the KiwiSaver Bill ("the Bill"). ASFONZ is an independent non-profit organisation with a membership comprising major workplace superannuation schemes and organisations and individuals representing product and service providers for workplace superannuation.

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Appearance at Select Committee hearing:

We confirm that we wish to have the opportunity to appear in person in support of this submission at the hearings of the Select committee.

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Section 1 Introduction

1.1. Superannuation is about to undergo its third major change in the last 30 years or so:

1.1.1. The first of these occurred in 1975 when the “old” New Zealand Superannuation Scheme was introduced and private schemes were given the opportunity to contract-out of the central government administered scheme.

1.1.2. The second major change occurred in 1987-1990 when the tax changes shifted New Zealand from an EET to a TTE environment. That was a huge task and was completed over a two year period ending on 1 April 1990.

1.1.3. The KiwiSaver Bill is another change of equivalent significance that will have repercussions over decades on workers, employers, existing superannuation schemes and the KiwiSaver providers.

1.2. Savings, and whether or not people in New Zealand are saving “enough” for their retirement years in particular, has been a topic for comment for many years.

1.3. There are those who point to changes in demographics and improving longevity, coupled with declining macro-economic “saving” ratios, as conclusive proof that savings levels are inadequate and that steps must be taken to encourage (or compel) more savings by individuals.

1.4. Others consider that recent research indicates that, overall, Kiwis are rational in making decisions on whether to save, how they save and how much they save. We have more to say on both this and the demographic and savings numbers in Appendix A of this submission.

1.5. ASFONZ acknowledges that the government is in a seemingly difficult position - likely to be damned by some if it takes no action to encourage savings; damned by others if it does! There is a feeling that the population as a whole has become tired of endlessly hearing of the problem while little is done to either fix it or to convince the majority that the problem does not exist.

1.6. Having said that, ASFONZ is concerned that the level of debate surrounding this topic has been superficial with the result that conclusions based on generalities and vague assumptions are being made. While we agree that the provision of easy access to work-based savings arrangements offers an attractive savings option to many, we continue to question the need for legislation in the form of KiwiSaver at this time.

1.7. ASFONZ is similarly concerned that the KiwiSaver scheme as proposed will not achieve the objectives desired. Considerable expense will be involved in establishing the infrastructure required, particularly by the IRD and providers and, to a lesser extent, by employers. We believe that rigorous and informed debate, over a predetermined and relatively short period, would produce some more robust answers that might enable more appropriate targeted solutions to be devised.

1.8. For many years employers and providers have offered excellent benefits to employees through workplace superannuation schemes. We are not sure whether or not it is intended, but some of the commentary surrounding the introduction of the Bill seems to suggest that workplace savings arrangements have generally represented poor value and have not been particularly beneficial to their members. ASFONZ disputes any such assertion.

1.9. ASFONZ believes that achieving the purpose set out in clause 3(1) of the Bill depends on gaining the support of employers. As a component of this it is vital for KiwiSaver schemes and other registered schemes to be able to operate alongside each other with the minimum of restrictive regulation. For these things to happen there will need to be changes to the regime set out in the Bill.

1.10. We recognise however that the government's role is to govern and that the government believes that KiwiSaver, as proposed in the Bill, is the best way to proceed. ASFONZ has considerable expertise in the workplace savings market. We think there are several significant changes to the design of KiwiSaver that might improve its workings. The comments and suggestions made in this submission seek to highlight those areas of the proposal that we believe can be improved such that the desired objectives are more likely to be achieved.

1.11. Finally, we note the OECD's review of regulatory performance. We understand that the Ministry of Economic Development is considering a request to the New Zealand government to participate in that review. We thought that a useful test of the Bill might be to assess it against the OECD's *Guiding Principles*. A note on the *Guiding Principles* as they may be relevant to the Bill can be found in section 4 and a detailed review of the Bill against the eight principles suggested by the OECD is contained in Appendix A to this submission. We conclude that, generally, the Bill fails to meet those *Guiding Principles*. We offer our suggested scorecard on that in paragraph 4.9

Section 2 KiwiSaver – Summary of suggested design improvements

2.1. In this section we assume that KiwiSaver will proceed in much its current form, despite the reservations that we have expressed in section 1 and the shortcomings in policy formation that we describe in section 4 and Appendix A. We therefore draw on our superannuation scheme design experience to suggest ways of making KiwiSaver as good as it can be, thereby improving on the operation of KiwiSaver as proposed in the Bill.

2.2. The principal issue for ASFONZ in considering the Bill is to ensure as far as is possible that the KiwiSaver Scheme will be complementary to other workplace superannuation schemes, operating as registered superannuation schemes. This applies equally to schemes that are already in place and to new schemes that may be started by employers for their own employees.

2.3. To that extent, we believe that it needs to be made as easy as is practicable for employers and their employees to operate and participate in workplace savings arrangements that will facilitate improved standards of living in retirement. Maximum flexibility with a minimum of compliance costs is the desired outcome.

2.4. Before starting this summary, ASFONZ would like to commend the approach taken by the government and the various departmental officials involved in drafting the Bill. The level of consultation by officials, and the clearly genuine desire to draft workable legislation, is unprecedented in our experience. We believe that this has resulted in a Bill that needs no major modifications. We do however regret that this same process was not adopted when the founding principles of the Bill were conceived and developed.

Commencement date

2.5. ASFONZ is greatly concerned about the very compressed timeframe in which this legislation and the accompanying infrastructure are being created. Nearly everyone in the superannuation business, from advisers, providers, employers to organisations such as ASFONZ, believes that the process is being rushed.

2.6. We believe that the proposed date is too soon bearing in mind the potential complexities to be overcome by both the IRD and providers. It is difficult to see that a deferral of one year to 1 April 2008 would materially impact on any individual's savings for retirement and suggest that the date of commencement is deferred until 1 April 2008.

2.7. As an alternative to deferral of the commencement date, we suggest that the initial period for holding contributions in the KiwiSaver's IRD's Holding Account be extended to 12 months. This would improve things in two ways:

2.7.1. It will allow the process of choosing default providers to be deferred until the Bill becomes law. We think it is unusual for that process to proceed when it is authorised only by a draft law, yet to be passed.

2.7.2. It will give providers at least another year to establish their systems infrastructure and upgrade their administration systems to cope with KiwiSaver's special requirements. There is only a limited number of specialist service providers available in New Zealand and we have some concern about their capacity to cope with the huge changes implied by both KiwiSaver and the new QCIV tax regime.

On the basis that KiwiSaver proceeds, we want it to be successful and we think, based on our experience, that the proposed starting date is a significant threat to that.

Number of default providers

2.8. We are concerned about the likelihood of their being a restricted number of default providers. The Bill does not specify a target number stating only (clause 158) that there be at least one and providing for a maximum number to be specified by regulation (clause 194(f)). However, statements made by the Minister indicate that the number will be relatively small – only 4 to 6 default providers. We question the rationale for having a limitation and wonder if this is a means of allowing the government bargaining power to negotiate administration fees down to a level that will provide a barrier to entry to non-default providers. We are further concerned, if this is the case, that driving fees to an uncompetitive level may force default providers to cross-sell aggressively to justify a product that in itself does not meet the necessary return to the providers' shareholders.

2.9. From a competition viewpoint, we think that any provider meeting prescribed conditions should be added to the pool of default providers. This approach would help to reduce the risk to the government of default providers being seen as somehow guaranteed by the government as being the best option simply because they have been selected to provide this service. The Bill acknowledges this risk in the Regulatory Impact Statement (at page 34) and suggests that it will advantage the chosen few at the expense of other providers.

2.10. Another possible reason for such a selection process must be the possibility of a default scheme's failure and the potential negative publicity that may raise a moral regulatory responsibility. On that, we observe:

2.10.1. There has never been a failure of a retail superannuation scheme in New Zealand, despite the relatively relaxed regulatory environment in which they operate. KiwiSaver will operate in the same retail environment but will be subject to additional constraints.

2.10.2. KiwiSaver will operate on defined contribution principles in a well-established superannuation environment. The risks of failure of such arrangements in that environment are relatively small.

2.10.3. The IRD is collecting and remitting contributions. This eliminates another possible area of risk.

2.10.4. Default providers will be subject to much more public scrutiny than is the case for a typical superannuation scheme. Providers will be on their best behaviour to avoid the commercial downside of negative publicity.

2.10.5. Required portability between KiwiSaver schemes means that all providers, including default providers, will be the subject of the best discipline of all – market pressures to perform.

2.10.6. The process of allocating members to default schemes will be automatic and will involve the IRD in no more work if the choice is one among 20 rather than one among six.

Given the constraints imposed in the KiwiSaver environment, giving scale to a chosen few will limit innovation and competition. In the absence of restricted numbers there will be no need to embark on the expensive, time-consuming process of choosing the favoured few. We can see little downside risk in widening the number of default providers to all providers that meet the minimum standards.

First home ownership scheme

2.11. We think that mixing the concepts of retirement saving with saving for a first home is likely to be confusing. It will take the focus off the retirement saving goal. We do not see first home ownership as "superannuation". It should be part of (and remain in) the government's housing policy initiatives. Indeed, we had understood the government was concerned about the over-emphasis on housing as an investment vehicle for retirement.

2.12. We prefer the first home ownership scheme to be operated separately by the IRD or by another agency, such as the Department of Building and Housing by direct grant with an option to transfer any savings to a superannuation scheme through the KiwiSaver contribution facility if not used for housing.

2.13. Additional membership administration will inevitably be involved in managing this incompatible part of "superannuation" policy if it is to remain. We therefore suggest that the annual membership fee subsidy paid by government should be increased from the "superannuation only" amount[1] by 50% for every member (and for each year of membership) who has used the KiwiSaver scheme to help purchase a first home. Alternatively, administration of the first home subsidy and access requests could be the responsibility of the Commissioner. We understand that the targeted nature of the subsidy will include income limitations. If this is the case then the Commissioner will be in the best position to test that eligibility criteria have been met.

[1] We do not yet know what the annual membership fee grant will be but assume it will be about $50 a year for each KiwiSaver member.

“Independent” trustees for KiwiSaver schemes

2.14. The Bill proposes (clause 99) that a KiwiSaver Scheme must have at least one “independent” trustee (essentially someone who is not a member, nor connected with the promoter, any participating employer or related organisation). We see no advantage in that requirement. The duties and responsibilities of a trustee are clearly defined in law and registered superannuation schemes have operated successfully for many decades without such a requirement. There has been no failure of a retail scheme despite the current lack of such a requirement.

2.15. The introduction of this requirement for a superannuation scheme implies that there have been problems with the requirements of the Superannuation Schemes Act 1989 which do not require any trustees of a registered scheme to be “independent” as defined. While we recognise that the current requirements offer the potential for a trustee to have a conflict of interests on occasion, ASFONZ is not aware of any incidents that have been left unresolved. The New Zealand law relating to the conduct of trustees is such that a trustee must act in a particular way regardless of whether they would otherwise be seen as “independent”.

2.16. The most obvious disadvantage of having a separation of duties in the way proposed by the Bill is that an additional layer of fees will be charged. As well as the level of risk that is taken on by the trustee, there is duplication of effort as most of the tasks associated with the independent trustee’s role are also performed naturally by the manager, resulting in additional cost for which there does not seem to be any justification. If the current proposal proceeds, we think the only real effect is likely to be an increase in fees payable by savers with no improvement in the security of savers’ benefits.

2.17. In addition, many investors are confused by the multiplicity of parties providing their investment and generally have no idea of (and, in reality, little interest in) which one is responsible for what. Superannuation schemes have offered the advantage, generally, of having a single party, the trustee, entirely accountable and not able to pass the responsibility to someone else.

2.18. If the supposed additional security provided by a scheme offering an independent trustee is valued by investors, then investors should be free to decide to pay the premium for that additional service. There is no reason to distinguish this feature from, say, the provision of adequate advice to investors considering their investment options which arguably offers better value for the investor’s additional fee.

2.19. ASFONZ does not believe that the requirement for an independent trustee is warranted or desirable. We are not aware that any supposed deficiencies of the current regime have been the subject of any investigation or debate.

“Trustee corporation” for default schemes

2.20. Clause 158 requires that a default scheme have a “trustee corporation” as at least one trustee. We understand that the government might want to see a more public form of governance, but we question the need to have a trustee corporation unless the government is prepared to directly meet the costs involved, quite separately from the administration fee subsidy.

2.21. Other types of similar securities (notably unit trusts) have had a requirement to separate duties between a manager and non-related, or “independent”, trustee for many years, with the trustee being one of the trustee corporations. The question then arises as to whether investors have been better served by the unit trust regime’s requirements compared to those of superannuation schemes. ASFONZ can see no evidence of this.

2.22. We do not think the presence of a trustee corporation will contribute anything to the security of members’ benefits. In fact, we suggest that the presence of trustee corporations can have just the opposite effect. People assume that an investment must be in order because of the presence of a prominent name as trustee. For the reasons listed in paragraph 2.10, we think the risks of failure of a default scheme are so small as not to justify the expense of granting a very small group of available trustee corporations a privileged place in the financial services market. If the members themselves are to pay for this through a reduction in their savings, the justification is further reduced. However, if a particular provider saw value in having such a trustee, we see no harm in allowing the KiwiSaver scheme concerned to have one.

Direct payment of contributions

2.23. ASFONZ would like to see the flexibility of KiwiSaver schemes enhanced by removing the requirement for member contributions to always be paid to providers via the IRD. If an employer offers membership of a KiwiSaver scheme or section of a scheme, it should be able to pay contributions from members direct to the provider.

2.24. That is particularly the case if the KiwiSaver provider is a section of the employer’s own scheme or is offered by the master trust that already provides the employer’s other superannuation services. It would also allow integration with the employer’s existing payroll processes, the immediate investment of contributions for the member’s benefit and would reduce the costs that would otherwise be imposed on taxpayers.

2.25. Employees would also be able to choose another provider if they wished, in which case the normal IRD facilitated process would apply.

Section 9B transfers

2.26. Following the theme adopted for KiwiSaver schemes of being fundamentally about long-term saving, we believe that it would be helpful to incorporate a minor change to section 9B of the Superannuation Schemes Act 1989. This section can have the unfortunate effect of forcing the termination of an employer's scheme if the employer is part of a master trust arrangement and thinks that the employees would be better served if they moved to another provider.

2.27. Termination of participation in a master trust can involve the distribution of accrued benefits to the members at that time. We think this provision should be changed such that the employer could arrange a transfer to a new master trust, without the consent of the members, as long as the provisions of the new master trust are at least as good as those of the existing master trust. There is a model for this kind of arrangement in Australia and we understand that this works well.

2.28. We also suggest that "preferred" KiwiSaver schemes should be required to have such a provision in their trust deeds. If an employer is dissatisfied with the provider's administration or investment performance and wants to nominate a new preferred provider, the employer should be able to shift all current members as well, as long as the "comparable benefits" conditions are satisfied. That would increase competition, improve performance and would be a relatively easy requirement, given the prescriptive nature of the KiwiSaver environment.

Accidental contributors

2.29. In a scheme that is founded on the principles of behavioural economics, we find curious the 12 month minimum contribution period for all who chose to join, or who fail to opt out. We believe this will result in those with a marginal interest in becoming members opting out. However, we think it is reasonable for the Bill to require the 12 months' contributions for savers to be entitled to the $1,000 "sweetener"

2.30. Inevitably, some employees (and even some employers) will fail to observe the opt out rules. On the first pay day after 77 days' employment, the mistake will be discovered but by then, it will be too late for most.

2.31. The Commissioner has a proposed discretion on limited grounds to accept late opt-out notices, but we think there should be another procedure.

2.32. However, if for whatever reason, an employee joined unintentionally, we see no philosophical grounds to prevent an employee from withdrawing from the scheme at any time during the 12 months and losing the entitlement to the "sweetener". If the employee really did not want to be a member, it seems to offend the basic principles of behavioural economics (doing what is in the employees' "best interests") to not allow them to reverse an accidental "decision".

Staged contribution alternative

2.33. The Bill suggests only two contribution rates (4% or 8% of an employee's total taxable pay). There is no explanation given for those particular rates, although the limited choices can be justified on the ground of maintaining a simple structure with few choices. We have no difficulties with the idea of the 4% rate but we think the alternative 8% rate is undesirable.

2.34. If there are to be only two choices (we agree with the logic of limiting options), we think that the alternative should be a staged regime that starts at 1% of pay in 2007 and increases by 1% in each year. That means it will be 2% in 2008, 3% in 2009 and 4% in 2010. From 2009, there will be only one contribution option but members can always pay more on a voluntary basis, if they wish. We believe that this option will find favour with employees and will have a positive savings outcome.

2.35. We suggest that practically no-one will choose the 8% contribution alternative. No financial service provider, including KiwiSaver providers, will recommend that savers use the current 8% alternative for the following reasons:

2.35.1. The voluntary contribution will be locked up until age 65 so reducing considerably the saver's flexibility;

2.35.2. Given KiwiSaver's objective to lower costs, providers' margins on KiwiSaver business will be squeezed and may be loss-leading even for default providers. The same constraints will not apply if the extra 4% were contributed to a KiwiSaver provider's alternative retail product.

2.35.3. Advisers paid by commission probably will not be paid directly for a new KiwiSaver member, certainly not on the basis of KiwiSaver contributions as there will not be the margins on that business to allow advisers to share that directly. Advisers are likely therefore to be recommending that any voluntary contributions are not paid to KiwiSaver.

2.36. Lower paid employees are much more likely to choose the staged contribution option because it will impact more gradually on their immediate standard of living. Allowing the increasing contribution to come out of future pay rises also accords with the principles of behavioural economics on which the Bill claims to be founded.

2.37. There then needs to be a discussion about the way in which the government's $1,000 "sweetener" is paid. We suggest that this should be paid at the outset (as currently proposed) because the "approved" behaviour should be rewarded from the outset. However, we think it should not be the saver's by right until the staged contribution period has ended and only if the saver has contributed for the whole period. To make things simple, given the small amount involved, we suggest that it "vest" at the end of the staged contribution period rather than proportionally during the period.

2.38. Any contribution holiday taken during the four years will add to the period that it will take for the sweetener to be vested. The alternative is not to allow contribution holidays during the staged contribution period.

2.39. “Unvested” sweeteners should be returned by the KiwiSaver scheme to the IRD.

2.40. We think that most employees will choose the staged contribution option and that, overall, more employees will join KiwiSaver schemes with this staged contribution alternative than under the Bill’s suggested design.

2.41. We also think that more employees will remain KiwiSavers at the end of the four years than at the end of the current 12 month period. After four years of contributions, the member’s account balance will be a relatively worthwhile amount and the saving habit better established.

2.42. We also suggest that the staged contribution alternative should be the default contribution option. If an employee does not make an active choice, the less intrusive contribution option should be preferred.

2.43. Under our suggestion, the IRD will still need to manage (with the tax codes) only two contribution rates during the phase-in period. After 2009, there will be only one option (4%).

2.44. There is a case to continue the staged four year period as a permanent feature of KiwiSaver for the reason stated in paragraph 2.36. However, we recognise that managing that through the tax codes would be relatively complex. There would need to be five different codes depending on where a member on the staged contribution programme was up to. We believe our staged contribution option has merit even only as a transitional arrangement as during the intervening years agencies will have established a sound education pathway to support KiwiSaver. By 2009 new entrants to the workforce will be better educated about KiwiSaver and retirement savings.

Exempt employer requirements

2.45. The suggested criteria for an employer to become an “exempt employer” are restrictive and if they remain in their current form, may result in a decline in the participation in and operation of workplace savings arrangements other than KiwiSaver.

2.46. The requirement for contributions to be based on full gross salary and wages is inconsistent with current market practice and will almost universally preclude employers with existing schemes from qualifying. It is unusual for variable amounts to be included in subsidised superannuation arrangements. We note such amounts are excluded in the Australian superannuation legislation for the determination of employer contributions.

2.47. The need for employer contributions to be fully vested within five years may also be inconsistent with the design of many schemes. Enforcing such a short vesting scale could reasonably be expected to result in a reduction in the quantum of the employer subsidy, or at the extreme, the withdrawal of that subsidy.

2.48. The exempt employer requirements do not accommodate defined benefit arrangements. As this type of arrangement is still offered by some employers, legislation needs to make provision for sponsoring employers to become exempt if they have a defined benefit offering. A discretion given to the Government Actuary along with a set of guiding principles may be the best option for such arrangements.

Attracting employer participation

2.49. The KiwiSaver Bill will be more successful in achieving its objectives if employers actively participate.

2.50. Employers may be more inclined to contribute on behalf of members if the obligation to calculate the SSCWT liability is transferred to the IRD (where payments are channelled through the IRD). For KiwiSaver contributions channelled via the IRD it should be possible for the IRD to assume responsibility for the SSCWT calculations.

2.51. Ensuring that exempt employers are able to offer the best terms to their employees may necessitate allowing KiwiSaver members who move to the employment of an exempt employer to commence a contribution holiday even if they have not made contributions for a period of twelve months). This will avoid the situation of a new employee potentially missing out on an employer subsidy as he or she cannot afford to contribute 4% to KiwiSaver and meet the required contributions for the employer scheme.

Summary – suggested design changes

2.52. If the Bill accommodated our design suggestions described in this section 2, we think that KiwiSaver will be a better scheme. That will improve the chances of its success.

Section 3 The KiwiSaver Bill – clause by clause

3.1. As indicated above, this part of the submission considers the specific clauses of the Bill that we wish to highlight. ASFONZ represents many stand alone workplace superannuation schemes. We have drawn on our practical experience in representing those schemes to suggest changes to the specific clauses of the Bill. The comments follow the numbering of the Bill rather than any order of significance.

3.2. Clause 4. The definition "member's accumulation" includes, in sub-paragraph (a), unvested employer contributions. This appears to be an error as they are then included again in sub-paragraph (c) of the "member's interest". Subsequent clauses indicate that these contributions are part of the member's interest but not the member's accumulation. Unvested employer contributions should be excluded from the definition.

3.3. Clause 4. Definition "salary or wages". We think that the definition as stated includes the payment of redundancy pay. While the member may later be able to invoke the hardship provisions to make a withdrawal from the scheme, it does seem illogical to include contributions on payments of this nature to a locked-in scheme. Such payments should be excluded from the definition.

3.4. Clause 10. This would be clearer if sub-clause (2) commenced "Despite sections 8 and 9, .."

3.5. Clause 11. Sub-clause (1)(a)(ii) says that once an employee becomes subject to the automatic enrolment rules under Job A and, before opting-out, starts a new Job B (or an additional Job C) the "automatic deduction of contributions" begins immediately in either Job B or Job C. In other -words, there is no continuation of the opt-out period started in Job A and all the rules about contributions begin without choice. We assume that this is unintentional. We are unsure how Employer B or C might become aware of the opt-out period in Job A.

3.6. Clause 14. Sub-clause (1)(d) gives the Commissioner power to accept a late opt-out notice for a variety of reasons, but only within the time limit specified earlier. We recommend that the Commissioner be empowered to accept a late notice at any time in appropriate circumstances as determined by the Commissioner. There will almost certainly be some good reason for the Commissioner to agree to such a request at some point in the future. This may involve a refund of contributions if they have been paid.

3.7. Clause 17. Given the time frame for an employer to pass the information provided on to the Commissioner under clause 18(2) or (3), it would be helpful for the employee to be required to give the information to the employer within an appropriate prescribed period.

3.8. Clause 17. For clarity, it might be helpful for sub-clause (c) to start "whether or not he .."

3.9. Clause 19. The heading ("Purpose ..") does not seem to tie in with the subsequent wording. Is this more of an effect? Is "Consequence" a better choice?

3.10. Clause 20. The requirements for an employer to become an exempt employer appear to be unnecessarily restrictive. We think that the minimum contribution requirement under sub-clause (c) and the vesting requirement under sub-clause (d) are unhelpful and should be removed. It is not likely that an employer would go to the trouble of establishing itself as an exempt employer merely to circumvent mandatory enrolment of employees in a KiwiSaver scheme.

3.11. Clause 20. We note that the definition of salary and wages in clause 4 is conceptually different from that used by the majority of existing superannuation schemes, where base, regular salary is most common. Very few existing schemes would satisfy this definition and thus be able to qualify as an exempt scheme unless amended to provide an alternative minimum. The amendment would require the consent of 100% of the members, as it could result in higher member contributions. Adoption of our suggestion in paragraph 3.10 overcomes this problem.

3.12. Clause 20. If the minimum contribution requirements are retained, the relevant amount of an employer's contribution to be taken into account for this test under sub-clause (c) is not clear. It would be clearer if the words "maximum" and "or does" are deleted and if "for all employees" is replaced with "for any employee".

3.13. Clause 20. The reference to member's interest ought to be a reference to member's accumulation in part (b).

3.14. Clause 21. There should be a time limit for the Government Actuary to act. For example, clause 113 gives 28 days.

3.15. Clause 25. It would be helpful if the heading and sub-clause (1) stated that this clause applies to persons who are aged 18 years or more, if this is what is intended.

For example:
How a person aged 18 or more may opt in
(1) a person who is aged 18 years or more who wishes to opt in …

3.16. Clause 26. The heading for this clause refers to "Persons under 18 .." whereas clause 26(1) mentions "employees". Is this clause applicable to anyone under age 18?

3.17. Clause 29. To clarify the information to be given by the provider, sub-clause (2)(d) could helpfully commence "if A is an employee and A intends that his or her employer or employers make deductions of contributions from his or her salary or wages, -".

3.18. Clause 32. Is it envisaged that information packs will always be supplied to employers in hard copy form? We suggest that the Commissioner be empowered to agree with any employer that it can use a copy of an electronic version, as supplied by

the Commissioner to the employer, in circumstances deemed appropriate by the Commissioner.

3.19. Clause 34. Sub-clause (b) requires an employer to provide an information pack to an employee who has opted in under clause 25(1)(b). This seems to be unnecessary if the employee has also taken action under clause 25(1)(a), as envisaged in clause 25, as they are already committed to a provider and will have been provided with all appropriate information by that provider.

3.20. Clause 47. Sub-clause (2)(c) would not capture the original start date for contributions where the member had already transferred before this transfer. If this information is needed, the words “started contributing to the old” could be replaced with “first started contributing to a KiwiSaver”.

3.21. Clause 47. Other information might prove useful over time – for example, details of any early withdrawals. It would be helpful to add a further sub-clause to require the provider of an old scheme to also supply the provider of the new scheme with such information as the new scheme provider might reasonably request.

3.22. Clause 55. It is still not really clear why employees and employers cannot be allowed to agree, in sub-clause (2), on any rate in excess of 4%.

3.23. Clause 55. There is, presumably, no restriction on the number of times that an employee can give notices under this clause, either to increase from 4% to 8% or to revert from 8% to 4%? It would be helpful if this right of the employee could be specified as such.

3.24. Clause 55. We note that there does not appear to be any minimum level of contribution requirement for a person who opts in under clause 25(1)(a). Should there be, given that a consequence of opting in would be the crown’s $1,000 contribution?

3.25. Clause 57. The requirement for member contributions to be channelled through to providers via the IRD seems to be unnecessarily restrictive and could be seen as a disincentive to employers to contribute.

3.25.1. Where an employer establishes a KiwiSaver scheme, or a KiwiSaver section of a registered scheme, it appears that contributions by the employer can be paid directly to the provider or paid to the provider via the IRD at the option of the employer. Is there any reason why the contributions by a member, where there is a group arrangement and the member has agreed to use the employer’s provider, could not also be paid directly to the provider, with confirmation to the IRD that this is to happen?

3.25.2. This option would seem to be attractive in that it avoids the double handling of these contributions and the production of additional schedules by the employer and IRD, avoids the potential for confusion on the part of a member as to why

his contributions do not get to the provider for some time after those of the employer and it provides for the contributions to be invested at the earliest opportunity.

3.26. Clause 64. As an alternative to postponing the commencement date for KiwiSaver (if that is found to not be acceptable), we recommend that an additional sub-clause is added to this clause providing for the Commissioner to initially retain contributions in the holding account for a period of twelve months commencing on 1 April 2007. We have covered this point in more detail in section2.7 above.

3.27. Clause 81. It would be helpful if sub-clause (1) made it clear that this is an option for the contributing employer, as an alternative to making payments direct to the provider. This sub-clause could currently be read as specifying that if an employer wishes to make a contribution to an employee's KiwiSaver scheme, payment is to be made via the IRD.

3.28. Clause 83. Similarly (as with clause 81), this clause should be clarified to show that this is an alternative to a direct payment to the provider.

3.29. Clause 86. Sub-clause (1)(b) provides for a minimum contribution period of 12 months, compared to that originally proposed of 3 months. While we agree that 3 months is probably too short a period, we feel that 12 months is too long and may result in the member suffering hardship and subsequently withdrawing all of their accrued benefits by instituting the expensive "financial hardship" provisions (we have more to say on these below). We suggest that 6 months may be more reasonable.

3.30. Clause 87. It would be usual for any request of this nature to be made in writing. It is not obvious why, in sub-clause (2), the Commissioner is unable to specify that a written request is made or that it can be made electronically.

3.31. Clause 89. Sub-clause (1) could usefully specify that the Commissioner will also tell relevant employers and providers the date on which the contribution holiday is due to end.

3.32. Clause 94. The requirement should be for the Commissioner to advise relevant employers, some reasonable time prior to the end of the contribution holiday, that deductions must be restarted on the due date.

3.33. Clause 94. Given that contribution holidays may last up to 5 years, it would be helpful for there to be an obligation on the member to advise the IRD if they leave the employment of a relevant employer during a contribution holiday. Provision for an employer to notify the IRD could also be included.

3.34. Clause 96. Should either or both of the employee and employer be required to advise the Commissioner if either of these events (revocation and reinstatement of contributions holiday) occur?

3.35. Clause 97. Presumably this clause is applicable specifically to a person who has been granted a contributions holiday? Should sub-clause (1) start with "A person who is currently on a contributions holiday may apply ..".

3.36. Clause 99. Sub-clause 99 (1)(d) introduces a requirement that KiwiSaver schemes have an "independent trustee" (unless the scheme predates this Part of the legislation). The term "independent trustee" is defined in clause 4.

3.36.1. For the reasons discussed in paragraphs 2.14 to 2.20 above, ASFONZ does not believe that the requirement for an independent trustee is warranted or desirable. We are not aware that any supposed deficiencies of the current regime have been the subject of any investigation or debate.

3.37. Clause 104. We assume that sub-clause (a) is targeted at those registered superannuation schemes that also offer a KiwiSaver scheme under the same trust deed. However, it is not clear what purpose will be served by insisting on separate reporting on all matters for members using the annual report for the scheme. Surely a summary of key information would suffice, thereby avoiding additional expenses incurred by reporting separately on every aspect?

3.38. Clause 130. Providing the copies of certificates to members and contributing employers as envisaged by sub-clause 130(1)(b) seems unnecessary. It is unlikely that these persons will understand what is being certified and it does not seem to be necessary for them to understand, as the Government Actuary would not have provisionally approved the proposal if they had not been provided.

3.39. Clause 131. The time available to members to make elections under sub-clauses (a) and (b) of this clause is not clear. As currently worded, it appears that an election cannot be made within the first 28 days after notice has been given. Presumably this is meant to say that a period of at least 28 days, commencing on the date on which notice is given, must be allowed for the election to be made.

3.40. Clause 134. In sub-clause (1), the word "proposed" seems to be incorrect and should be deleted as the trust deed was an actual deed?

3.41. Clause 151. Should the Government Actuary also be required to confirm to the trustees of the scheme that the registration has been cancelled?

3.42. Clause 158. As indicated above with respect to clause 99, we cannot see that this requirement is generally in the interests of potential members.

3.43. Clause 176. The identification of a unit trust in sub-clause (1)(g) as an offence seems strange. This suggests that it is somehow not an offence to describe a KiwiSaver

scheme as a debt security for example. Surely it should be an offence to describe it as any kind of security other than an interest in a superannuation scheme?

3.44. Clause 181. It is not obvious why providers in general will be required to attempt to verify a contributor's identity for Financial Transaction Reporting Act purposes. As the vast majority of contributions are expected to be transferred from existing accounts using the PAYE system, this appears to be unnecessary, and we suggest that the requirement is removed.

3.45. Clause 194. Sub-clause (f) provides for the maximum number of default providers to be prescribed by regulations. ASFONZ believes that limiting the number of default providers is not necessary or desirable in that it is likely to lead to reduced competition and unnecessary barriers to entry. We have commented on this in paragraphs 2.8 to 2.10 above.

3.46. Schedule 1, Clause 1. While the power of the Court needs to be preserved, it seems to be unreasonable for a provider not to be able to rely on guidelines published by the Government Actuary to set "reasonable" fees. Sub-clause 1(5)(b) does not give providers sufficient protection in circumstances where they have not deviated from the guidelines to a significant degree.

3.47. Schedule 1, Clause 3. Should the date for accessing funds under sub-clause 3(1)(a) be the date on which the member reaches the New Zealand Superannuation qualification age that was in force on the date on which the person joined the scheme?

3.48. Schedule 1, Clause 3. Employers who establish separate KiwiSaver schemes or a separate KiwiSaver section within a registered scheme, are likely to experience considerable difficulties in keeping track of employees who have left their employment and who have not asked for their locked in benefits to be transferred to another KiwiSaver scheme. Such employees are also likely to lose track of these benefits. It is suggested that the scheme trustees be entitled to transfer accumulated benefits in these circumstances after 12 months from the date that the employee leaves service, to one of the default providers as directed by the IRD.

3.49. Schedule 1, Clause 7. ASFONZ thinks that the combination of a first home deposit scheme with a retirement savings scheme will lead to a loss of focus on the prime aim of the retirement savings scheme. We recommend that these two schemes be operated separately and clause 7 be removed. We have commented on this in paragraphs 2.11 to 2.13 above.

3.50. Schedule 1, Clause 7. If this provision is to continue to apply, should the word "purchaser" in sub-clause 7 (7)(b)(iii) be "vendor"?

3.51. Schedule 1, Clause 11. As a general comment, the amount of time and therefore cost that is likely to be involved in administering this clause ("serious financial hardship") is potentially quite onerous. Reactions to requests from members will inevitably be inconsistent, as the guidelines included will lead to a great degree of subjectivity.

3.51.1. The grounds put forward under sub-clause 11 (a)(i) for example will mean different things to each one of us in two respects. Firstly, the term "minimum living expenses" has no generally accepted meaning. Similarly, the term "normal community standards" will produce differing answers depending on the standards of the person considering the request.

3.51.2. Government advertisements relating to the recently revised qualification criteria for Working For Families demonstrate how difficult this is likely to be. The family shown clearly lives in a house of a reasonably high value with good quality chattels. Communication between family members (albeit in a light hearted way) is via multiple mobile phones. Yet this family is being urged to consider whether they may be entitled to a family support tax credit. Irrespective of the official purpose and justification for this policy, many in the community regard these tax credits as welfare benefits – support of someone in our community who should be financially subsidised by other tax payers.

3.51.3. It could be argued that, for example, payment of the phone bill or the purchase of a new phone could be included in this sub-clause. Some would argue however, that these were excluded under sub-clause 11 (b)(iii) or (iv).

3.51.4. Sub-clause 11 (b)(i) excludes the payment of tax or financial support, but it is not clear why they should be excluded. Such specific exclusions themselves can lead to anomalies arising. For example, members A and B both have significant debts relating to their serious illness and both owe tax. Member A pays his tax and applies for a benefit payment to cover costs associated with the serious illness. This appears to be acceptable. Member B pays for the costs associated with the serious illness and then applies for a benefit to pay his tax. This request must be refused.

3.51.5. ASFONZ recommends that consideration be given to a central body, possibly attached to IRD or the Government Actuary's office, being made responsible for making decisions on all requests under this heading. This will assist in ensuring consistency.

3.52. Schedule 2, Part 2, Clause 3. Sub-clauses 3(g) and (h) should be part of a new sub-clause. The wording does not make sense when read in conjunction with the opening lines of this sub-clause. The requirement to send a copy of the most recent annual report or accounts [in (g)] should not be necessary where one has already been sent to the Government Actuary. In most cases, it will have already been provided, as this is a requirement of the Superannuation Schemes Act for registered schemes.

3.53. Schedule 2, Part 3, Clause 3. We have a similar comment as above relating to Schedule 2, Part 2, Clause 3. The current Clause 4 may not be necessary if the modification suggested above is appropriately worded.

3.54. Schedule 3, Superannuation Schemes Act 1989, Clause 9B. This clause has the effect, essentially, of forcing the termination of an employer's scheme if the employer is part of a "master trust" arrangement and thinks that the employees would be better served if they moved to another provider. We have discussed this issue earlier in section 2.27 to 2.29.

3.54.1. For the reasons described in section 2.27 to 2.29, we recommend that the employer can arrange a transfer, without the consent of the members, as long as the provisions of the new master trust are at least as good as those of the existing master trust.

Section 4 OECD's review of regulatory performance

4.1. The OECD has invited the New Zealand Government to participate in a review of New Zealand regulation against the *OECD Guiding Principles for Regulatory Quality and Performance*[2]. We understand that the Ministry of Economic Development is considering that request.

4.2. We thought that a good test of the KiwiSaver Bill might be to assess it relative to the OECD's *Guiding Principles*. Does the Bill meet the eight broad objectives of "good regulation" that the OECD has suggested? This section describes those principles and summarises our assessment of KiwiSaver against the principles.

OECD Guiding Principles for Regulatory Quality and Performance

4.3. In 1995, OECD Ministers asked the OECD to examine the significance and direction of regulatory reforms in member countries. The 1995 recommendations were the first international statement of regulatory principles common to member countries. In 1997 and again in 2005, the OECD built on those initial recommendations. In 2005 it published the *OECD Guiding Principles for Regulatory Quality and Performance.*

4.4. The *Guiding Principles* presents a framework of regulatory policies against which over 20 member countries have now been assessed. New Zealand has not participated in that review.

4.5. According to the OECD:

> "The goal of regulatory reform is to improve national economies and enhance their ability to adapt to change. Better regulation and structural reforms are necessary complements to sound fiscal and macroeconomic policies."[3]

4.6. The *Guiding Principles* recognises that regulation should be dynamic to create a regulatory environment favourable to the creation and growth of firms, productivity gains, competition, investment, and international trade. The OECD stipulates a number of guiding principles for governments.

4.7. These principles include the adoption at a political level of broad programmes for regulatory reform that establish clear objectives of good regulation. "Good" regulation should, according to the OECD adopt the following eight principles:

1. serve clearly identified policy goals and be effective in achieving those goals;
2. have a sound legal and empirical basis;
3. produce benefits that justify costs, considering the distribution of effects across society and taking economic, environmental and social effects into account;

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[2] This can be seen at http://www.oecd.org/dataoecd/3/51/36328053.pdf.

[3] *Guiding Principles* page 1

4. minimise costs and market distortions;
5. promote innovation through market incentives and goal-based approaches;
6. be clear, simple and practical for users;
7. be consistent as far as possible with other regulations and policies, and
8. be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels.

4.8. The *Guiding Principles* also recommend that regulatory regimes contain an efficient appeal process against individual decisions, and not unduly delay business decisions. In addition, they should be regularly reviewed against the principles of good regulation and from the point of view of those affected rather than from that of the regulator. Regulations should be regularly updated through automatic review procedures such as sunset provisions.

4.9. Our assessment of the Bill and the KiwiSaver initiative against the eight *Guiding Principles* identified by the OECD, results in the following score card:

- Achieved	1
- Partly achieved	2
- Partly (or needlessly) failed	1
- Failed	4

4.10 We believe that this is a disappointing result. The rationale for the scorecard can be found in Appendix A to this submission.

Appendix A - The KiwiSaver Bill in the context of the OECD's principles

A.1 There has been much public discussion about whether New Zealand has a savings problem and what initiatives the government might consider to correct a perceived difficulty with the behaviour of New Zealanders. We thought that it might be useful to examine this issue in the context of the *OECD Guiding Principles for Regulatory Quality and Performance.* We comment in this section on each of the eight principles in the context of:

- the Bill's "Regulatory Impact Statement" (the "RIS")[4];
- the general framework of the legislation, taking account of background statements made about the way in which KiwiSaver is likely to work..

A.2 **Principle 1: serve clearly identified policy goals and be effective in achieving those goals.**

The Bill's stated goals are to achieve a long term savings habit; to increase asset accumulation by people who are unlikely to continue their pre-retirement standard of living once they stop working; to increase individuals' well-being and financial independence, particularly, in retirement and to provide retirement benefits; and "to facilitate individuals' savings, principally through the workplace"[5].

We deal in paragraph A.3 with the evidence cited in support of these goals. While we agree that the goals of promoting a savings habit, increasing well-being, and facilitating, particularly workplace savings are estimable objectives, we note that the Savings Product Working Group's report[6] suggested that less intrusive ways along its "pathway" be tried before the much more intrusive "compulsory, opt-out" KiwiSaver. The report's recommendations have been ignored without explanation. The RIS implied that there were other recommendations ("The final report of the Group contained a number of possible interventions …..") but mentioned specifically only the "work-based saving scheme" that is now KiwiSaver.

We think that the Bill's goals are clearly stated and we support them as far as they go. For reasons that we describe shortly, we think there is a significant risk of the Bill's failing to achieve those goals. We suggest that the Bill has only partly achieved Principle 1.

[4] The Bill, pages 29 to 40.
[5] The Bill, page 31.
[6] *A Future for Work-based Savings in New Zealand*, Savings Product Working Group (2004) – the full report can be seen at www.beehive.govt.nz/ViewDocument.aspx?DocumentID=20918

A.3 Principle 2: have a sound legal and empirical basis

The evidence provided in support of the goals identified in paragraph A.2 (or, more accurately, of the gaps in behaviour that the Bill is intended to fill) is, in summary:

(a) Two surveys by financial service providers with a stake in the issue that give anecdotal, unprompted evidence only of individuals' intentions and clearly inadequate statistical evidence along with an Australian survey that apparently shows that Australians believe their own **compulsory** saving arrangements will fail to reach their retirement saving goals.

(b) Census evidence that has been publicly challenged in some detail about apparently falling home ownership rates.

(c) Misleading extracts from the Government Actuary's statistics that show falling workplace superannuation scheme membership when there is no reference to the quite large rise in retail superannuation membership and other evidence of rising financial assets. The numbers we have are not conclusive but approximately one quarter of all adult New Zealanders belong to a registered superannuation scheme. This is a different picture from the RIS's 14.1% of the labour force.

(d) An inaccurate reference to Treasury research on the relationship between workplace savings and wealth.

From this, the RIS concludes that "there is a risk that some New Zealanders may not own sufficient assets, nor save enough to meet their objectives". In our view, that is an unsupported leap. We suggest that the evidence cited does not support the stated conclusion. We also suggest that the Bill is unlikely to change that "risk".

We have four problems with the RIS's empirical basis:

(A) The RIS ignores the much more extensive and detailed study of New Zealanders' retirement saving behaviour[7] where the conclusion was:

> "Typically we find that the actual saving rates do in fact exceed the rates needed for maintaining living standards in retirement. This reinforces our tentative conclusion that there is no apparent gross under-saving for retirement especially in the older age cohorts.
>
> The results apply to broad groups within which there will be a distribution of people some of whom would likely not be saving at a rate to maintain their real standard of living in retirement. The results in no way imply that every individual is saving "adequately".

We wonder why the evidence of the government's own Treasury officials was ignored in the RIS. It is the best New Zealand (not Australian) evidence we have of New Zealanders' likely retirement income provision, based on

[7] *Saving for Retirement: New Evidence for New Zealand* by Grant Scobie, John Gibson and Trinh Le, New Zealand Treasury Working Paper 04/12.

extensive (though incomplete) research and a continuation of current behaviour.

Statistics New Zealand recently substantially increased the measured rate of productivity growth in industries that account for about 60 percent of the economy. This arose from an upward revision of the level of output. (Output cannot easily be measured separately from inputs for the non-market sectors.) If output has been understated, then it is likely that national saving and investment rates have also been understated. Thus the alleged problem of low national savings may be due, at least in part, to statistical errors.

(B) The RIS assumes that KiwiSaver will achieve the goals summarised in paragraph A.2 above but offers no evidence that each of these apparent deficiencies will be addressed. In fact, we think there is a risk that KiwiSaver may lead to:

(i) Reduced employer-subsidised superannuation provision (including the winding up of current schemes) when anecdotal evidence before the KiwiSaver announcements indicated a growing interest by employers in new schemes for their staff;

(ii) A huge increase in superannuation membership but only to collect the government's "sweetener" – thereafter, providers will be left with the problem of administering thousands of inactive accounts with less than $3,000 to their credit.

(iii) Reduced provider choice as smaller providers that fail to obtain "default" status withdraw from the market.

(iv) Barriers to entry for new providers that will face difficulties in obtaining traction and scale in the face of large, favoured, incumbent "default" providers.

(v) Higher costs for other superannuation-related services (voluntary member savings, employer subsidies, insurance and advisory services) as providers seek to recover costs from loss-making KiwiSaver accounts.

(C) There is no analysis of the costs of current superannuation schemes (particularly those of the so-called master trusts that KiwiSaver will itself use) and no evidence that reducing administration costs for either members or employers (one of the Bill's aims) will encourage more New Zealanders to save for retirement through superannuation. In our experience, fees are relatively unimportant drivers of saving behaviour. The increased focus on fees that KiwiSaver may provoke could change that but the RIS offers no evidence of this or any discussion of possible outcomes (including unintended consequences).

(D) Once the 12 month minimum contribution period has ended, no-one who has debt[8] should continue contributing to a KiwiSaver scheme. Every financial

[8] With the exception, now of student debt given that it is interest-free.

adviser and Budget adviser will urge New Zealanders to stop contributing as soon as they can because they will be measurably worse off for each year they continue to belong. There was no reference to that in the RIS, nor any discussion of this issue in the Savings Product Working Group's 2004 report, on which the design of KiwiSaver is based.

In short, we suggest that the RIS's empirical support is inadequate and misleading, seemingly ignoring well-publicised evidence that fails to support its thesis. We suggest that the Bill fails Principle 2.

A.4 Principle 3: produce benefits that justify costs

The OECD suggests that governments consider the distribution of effects across society, taking economic, environmental and social effects into account. Unfortunately, the RIS offers no evidence of the likely effect of KiwiSaver on retirement saving behaviour across different age groups, ethnic groups, income levels, different types of employee (part-time, fulltime; broken careers etc).

The only evidence we have on these different groups (the Treasury report already referred to) indicates that these groups are, in general, coping reasonably well on their own with their retirement saving projects.

There is, however, no evidence in either the Bill or the 2005 Budget documents that supported the KiwiSaver announcement in 2005 that the significant costs to taxpayers, employers, existing schemes and superannuation providers and their service suppliers will justify the benefits to any of those groups. The only analysis of costs is what the government itself might pay. There are no estimates of benefits from that expenditure other than the generic "motherhood' statements summarised in paragraph A.2 above.

The only non-financial advantages cited in the RIS were, in the words of the RIS itself (paraphrased):

- the financial sector's possibly increased demand for its services;
- the possibly increased use of KiwiSaver vehicles by employers instead of setting up their own, seemingly more expensive arrangements;
- increased access to superannuation by individuals and their increased financial literacy;
- possible increased self-reliance in retirement and that
- economic growth might increase if domestic savings increase if more funds become available for domestic investment.

We suggest that, even though the total of the direct and indirect costs of KiwiSaver were not quantified, the listed advantages (even if true) are unlikely to come close to being justified. We think there are much less intrusive and less expensive ways of achieving those same objectives. These were listed in the Bill's "founding"

document, the report by the Savings Product Working Group, but have subsequently been ignored.

We therefore suggest that the Bill fails Principle 3.

A.5 Principle 4: minimise costs and market distortions

Given the scale of KiwiSaver's intervention, we think that, by using the current superannuation environment coupled with the collection and remission function assumed by the IRD, the Bill does minimise disruption, and therefore compliance costs. We also think the IRD's role is an improvement on the Saving Product Working Group's suggested dedicated central administrator.

However, we suggest that any limitation on the number of default providers that the Bill contemplates will create unnecessary market distortions. Those distortions are in fact acknowledged in the RIS itself (at page 34) and are expected to benefit the chosen providers, making it harder for other providers to compete. We have already discussed this in paragraphs 2.8 to 2.10 of this submission.

We therefore suggest that the first leg of Principle 4 is achieved but the second leg is needlessly failed (but could be achieved if any provider that satisfies minimum requirements could qualify as a "default' provider).

A.6 Principle 5: promote innovation through market incentives and goal-based approaches

KiwiSaver schemes will be prescriptive. In part, that is justified to ensure simplicity but it is mainly because KiwiSaver is about just one form of saving (first home deposit scheme aside). The scheme of the Bill does not recognise that savings might start out as being for retirement but may turn into something else before transforming back to their original purpose. Aside from choices on whether contributions are made and which regulated provider to use, there will be little to choose between the limited "default" and wider "preferred" providers and that is the Bill's intention.

We do think, however, that KiwiSaver will introduce more New Zealanders to the idea of saving for retirement and, to the extent that KiwiSaver providers use KiwiSaver as a platform for marketing other services, may lead to product innovation outside KiwiSaver.

KiwiSaver itself will constrain, rather than promote innovation – apart from investment performance differences, there is unlikely to be anything to choose between alternative providers, particularly the limited number of default providers. The government's stated objective on fees, for example, will ensure a cross-provider uniformity that has led to reduced competition among the AFPs of the Chilean compulsory regime where marketing, rather than product characteristics, drive "fund-hopping". For the reasons already described in paragraph A.3, we also

think that some of KiwiSaver's goals will be compromised by its deliberately inflexible nature.

We think that the Bill fails Principle 5.

A.7 Principle 6: be clear, simple and practical for users

Given KiwiSaver's compulsory nature (albeit with an opt-out arrangement) we think that it is a simple, clearly specified initiative. We think its existence has not been justified but if a decision is made to proceed with a compulsory scheme, we think the principles on which KiwiSaver is founded are reasonably robust. We have already suggested that there is a significant risk of KiwiSaver's failing to achieve its key objectives (while achieving others) and that is probably a more significant issue for us.

Making use of existing frameworks for the collection of contributions, their investment and administration minimises the extent of the new scheme's disruption.

Again, given the decision to proceed, we think that the Bill rates as "achieved" with respect to Principle 6.

A.8 Principle 7: be consistent as far as possible with other regulations and policies

For the last 16 years (since the tax changes of 1987-1990), the government has maintained a relatively level savings playing field for income tax. Unlike all other developed countries, New Zealand has offered no tax incentives for retirement saving[9]. The reasons for New Zealand's policy are clear but are still not generally accepted in New Zealand. Tax incentives are very expensive, favour the rich (largely at the expense of those who can't afford to save) and there is no proof internationally that they increase saving. They do shift savings around – tax-favoured schemes attract large sums from those who *can* afford to save. However, they are expensive to administer and greatly distort saving and investment behaviour. However, the fact that they don't seem to work is their main failing.

There is a tax saving in that KiwiSaver and other managed funds have an upper tax rate of 33% not 39% and income is not taken into account in abating income-related assistance such as Working For Families.

Aside from that the government has generally opposed tax incentives.

KiwiSaver disturbs this principled approach in two ways:

- The so-called "sweetener" of $1,000 is a subsidy to "approved" behaviour. It is intended to have the same effect as deductible contributions but will end up failing to increase saving in much the same way as full-blown incentives in other countries behave.

[9] We acknowledge the minor incentives allowed for "salary sacrifice " arrangements but a very small number of employees have made use of this small tax break for saving.

- The annual fee subsidy is another subsidy and will have unintended consequences (it may raise overall fees charged by providers, given the base cost coverage met by the government). The evidence overseas indicates that providers capture a proportion of the value of such subsidies that were intended for savers. That is rational behaviour on their part.

We think this is a break from the policies of the past and we suggest that the change has not been justified while the risks of the money spent each year being wasted (by failing to secure the required behavioural change) are not insignificant.

We expected a higher standard of analysis in the RIS and in the earlier Budget papers and our concern is mitigated only by the relatively small amounts involved for each member. Despite that, if as we expect, there are hundreds of thousands of accounts that are the result of only 12 months' contributions (on average total contributions of about $3,000), the cost to taxpayers of each account will be the initial $1,000 (one third of all contributions) plus say $50 a year for administration (1.7% of the total contributions). As percentages of the amounts involved, those are relatively significant, taxpayer funded costs.

With respect to superannuation, we think that KiwiSaver breaches a fundamental principle of other government policy on giving "rewards" for particular behaviours that are centrally designated. It therefore fails Principle 7 of the OECD's *Guiding Principles*.

There is another indirect risk from the breach of Principle 7. For the reasons already described, we think there is a risk that KiwiSaver will fail to reach its objectives. That will lead to calls from providers and then by politicians to "switch off" the opt-out facility. That will be a small legislative and administrative change, given that the framework will already be in place. However, it will have large policy repercussions. If change happens in the same manner as KiwiSaver itself was introduced, that risk will be significantly increased. On this ground alone, we can argue a breach of principle 7. However, the indirect behavioural and political risk for future change is lifted by the scheme and specific design of KiwiSaver.

A.9 Principle 8: be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels

While any financial service provider will be able to start a KiwiSaver, the commercial reality is that only "default" providers will be commercial winners in the KiwiSaver environment and that will confer a commercial advantage on those providers with other aspects of their superannuation and advisory businesses.

For the reasons described in section 2 (paragraphs 2.8 to 2.10), we see no reason to confer that advantage on a favoured group. Widening the group of those providers would be "compatible …. with competition and investment facilitating principles".

As drafted, we think that the Bill fails Principle 8 but that could be remedied by widening the potential number of “default” providers as we have recommended..

Appendix B Our organisation

B1. ASFONZ is an independent national, non-profit organisation founded in 1969. Its current membership comprises around 100 major workplace superannuation schemes and around 50 organisations and individuals representing the various product and service providers.

B2. ASFONZ seeks to achieve that mission through:

B2.1 **Advocacy –** being the recognised voice for all employers and trustees involved in workplace superannuation, through:

B2.1.1 advocating legislative and public policy initiatives beneficial to the industry;

B2.1.2 making submissions and commentary on existing legislative and public policy initiatives;

B2.1.3 issuing regular press releases and other public commentary on matters of wider concern or interest to members; and

B2.1.4 staying in regular contact with responsible Ministers, regulatory and industry bodies, the Retirement Commissioner and Government Departments to project, promote and advance members' interests.

B2.2 **Education** – promoting trustee, employer and member education through dedicated training programmes, newsletters and special interest seminars.

B2.3 **Networking** – providing trustees, employers and service providers involved in workplace superannuation with a regular forum for sharing ideas and information on industry matters.