

SUBMISSION

To

THE PERIODIC REPORTING GROUP 2003

By

**THE ASSOCIATION OF SUPERANNUATION
FUNDS OF NEW ZEALAND INC.**

30 May 2003

Executive Summary

1. The Association of Superannuation Funds of New Zealand Inc ("ASFONZ") is a national 'not- for-profit' organisation whose membership comprises major employment-related superannuation schemes as well as industry advisors and service providers.
The mission of ASFONZ is to promote employment-related superannuation in New Zealand, by advocating legislative and public policy initiatives beneficial to the industry, by education, and by providing trustees, employers and service providers with a forum for sharing ideas and information.
2. ASFONZ believes that employment related superannuation in New Zealand is at crisis point, and risks extinction without a meaningful "circuit breaker". There has been an absence of objective reasons for establishing or continuing schemes, compounded by the effect on scheme funding levels of 3 consecutive years of negative investment returns.
3. Over the last decade or so there have been a number of major contributors to the steep decline in the level of participation in employment-related schemes: -
 - (i) a significant shift away from the "pay plus benefits" remuneration philosophy to a "total remuneration" or "total cash" philosophy;
 - (ii) lack of tax-neutrality for the lower paid, in the form of both a flat rate of 33 percent for specified superannuation contribution withholding tax and taxing savings returns at the current flat rate of 33 percent;
 - (iii) employers looking to smooth their contribution cost/liability by closing or winding up more expensive "defined benefit" schemes; and
 - (iv) compliance cost increases for employment-related superannuation schemes (notably the prospectus requirement, introduced in 1998).
4. Employment-related superannuation comprises "Tier 2" of the widely recognised three-tier approach to retirement provision. To breathe life into Tier 2, consideration needs to be given to:-

- (i) acknowledging that deduction at source is the simplest means of growing employment-related retirement savings, and that employment-related superannuation may therefore merit differing policy treatment to retail superannuation;
- (ii) emphasising to both employers and unions not just the intrinsic benefits of adequate retirement saving, but also the significant “group discounting” benefits open to participants in employer-sponsored (as opposed to retail) superannuation schemes;
- (iii) rewarding “best practice” behaviour that will contribute to the desired outcome (we note that one possibility advocated by industry participants, which certainly has merit, would be to prescribe either full or partial deferrals of taxation on employer contributions and / or investment earnings);
- (iv) as a corollary to any policy-level advantage given to employment-related retirement savings, limiting the current opportunity for savings leakage by (for example) introducing a “preservation” framework;
- (v) acknowledgment by Government that the current “hands off” approach to employment-related retirement savings has not worked, and that other initiatives are necessary to create a “tipping point” whereby employers will return to providing superannuation in significant numbers; and
- (vi) Government taking a leading role in promotion of employment-related superannuation in the public sector (for example, by extending the excellent Teachers’ Scheme model to other areas of the sector).

ASFONZ SUBMISSION TO THE PERIODIC REPORTING GROUP

The Periodic Reporting Group ("PRG"), set up under the Retirement Income Act 1993, convenes each six years to prepare a report on and suggest adjustments to the retirement income policies of the New Zealand Government.

In 2003 the PRG Terms of Reference state (inter alia) that:

"..... this Periodic Report is to focus on the private provision of retirement income. The 2003 Periodic Report should include:

- A commentary on the interface between private savings for the provision of retirement and other savings undertaken during the life cycle for pre-retirement purposes;
- Suggestions for the adjustment of any of the Government's retirement income and savings policies in order to enhance the provision of private retirement income including those relating to:
 1. Mechanisms for Government, employers and the savings industry to work collaboratively together to promote employer based superannuation;
 2. The impact of the tax system on the private provision of retirement income."

The Association of Superannuation Funds of New Zealand Incorporated ("ASFONZ") welcomes the opportunity to make this submission to the PRG.

The mission of ASFONZ is to promote employment-related superannuation in New Zealand.

ASFONZ will achieve that mission through:

- 1 **Advocacy** – being the recognised voice for all employers and trustees involved in employment-related superannuation, through:
 - (i) advocating legislative and public policy initiatives beneficial to the industry;
 - (ii) making submissions and commentary on existing legislative and public policy initiatives;
 - (iii) issuing regular press releases and other public commentary on matters of wider concern or interest to members; and

- (iv) staying in regular contact with responsible Ministers, regulatory and industry bodies, the Retirement Commissioner and Government Departments to project, promote and advance members' interests.
- 2 **Education** – promoting trustee, employer and member education through dedicated training programmes, newsletters and special interest seminars.
- 3 **Networking** – providing trustees, employers and service providers involved in employment-related superannuation with a regular forum for sharing ideas and information on industry matters.

The retirement income framework is generally categorised as comprising "Tier 1", "Tier 2" and "Tier 3", as follows: -

1. Tier 1 - Public provision of retirement income (currently provided through the universal New Zealand Superannuation, Veterans' Pensions and the operation of the New Zealand Superannuation Fund);
2. Tier 2 - Private provision through employment-related superannuation arrangements; and
3. Tier 3 - All other private provision (including subscription for retail retirement savings products, building a business, directly owning real estate etc.).

The ASFONZ submission will focus only on the inter-relationship between Tier 1 and Tier 2.

What is the current state of “Tier 2” (the employment-related Tier)?

New Zealand employers play a far less significant role in helping employees prepare financially for retirement than is the case with most other developed countries.

According to the Government Actuary's latest annual report (prepared as at 30 June 2002) employer-sponsored schemes covered just 14.6% of the workforce at the end of December 2001, down from 22.5% in 1990 (when the regime had just moved from tax incentives to a “tax neutral” level playing field).

Over this same period the number of employer-sponsored schemes on offer had fallen from 2,242 to just 625. Active membership numbers had fallen by 20% (from 273,065 to 218,284) while accumulated savings had increased by just 10% in aggregate (from \$9.5b to \$10.4b).

We understand from more recent discussions with the Government Actuary's office that the number of employer-sponsored schemes remains in steep decline, with the number of those schemes (after taking into account pending wind-ups) having dropped to 515 - a reduction, since 1 January 2002, of 103 schemes.

So why do some employers continue to help their employees in this way?

Anecdotal evidence – there is no empirical research of which we are aware – suggests that employer motives have historically centered around staff recruitment and retention, competitive positioning within the labour market (given the absence of compulsion, and the fact that most employers do not have schemes) and group buying power. However, in reality, little hard evidence exists about the motives of New Zealand employers.

It does seem that many of New Zealand's employer-sponsored superannuation schemes originated as a part of the "pay plus benefits" framework adopted by an offshore parent. Certainly many overseas-owned businesses, used to an environment of compulsion or quasi-compulsion, provide superannuation for their New Zealand employees.

Some schemes, established as part of the business culture or at a time when tax incentives prevailed, have continued to exist principally because of healthy actuarial surpluses which could be used to meet the employer contribution liability. As those surpluses are exhausted, or are replaced in some cases by an actuarial deficit, those schemes are becoming increasingly "at risk" as employers question their continued commitment.

In summary, given the absence of objective reasons for establishing or continuing schemes,

compounded by the effect on scheme funding levels of three consecutive years of negative investment returns, ASFONZ believes that employment-related superannuation in New Zealand is at crisis point, and in fact risks extinction.

Why has this come about?

As stated above, New Zealanders' level of participation in employment-related superannuation schemes has been in steep decline for the past decade.

ASFONZ contends that over this time there have been a number of major contributors to the decline: -

1. A broad shift away from "pay plus benefits" remuneration philosophy to a "total remuneration" or "total cash" philosophy whereby employers were simply given a pay cheque and the freedom to decide how to spend it.
2. The introduction of a flat rate of 33 percent for Specified Superannuation Contribution Withholding Tax ("SSCWT"), resulting in the over-taxation of employees earning less than \$38,000 p.a. as their marginal income tax rates are much lower than that.
3. Likewise, taxing schemes' investment returns at the current flat rate of 33 percent, which further penalises low-income earners through over-taxation.
4. Employers looking to smooth their contribution liability, and in so doing to eliminate "balance of cost" funding risks, by shifting their employment-related schemes from a "defined benefit" structure (incorporating a salary-based "benefit promise") to a "defined contribution" structure (under which the employer contributes at a fixed rate and members receive a return of contributions plus earnings). This has led to the wind-up of a number of defined benefit schemes, with resultant savings leakage.
5. Lastly, ASFONZ would be errant if we did not attribute some of the decline to Government policies (such as the nonsensical requirement for an employer-sponsored scheme to issue and maintain a prospectus), which have contributed significant compliance costs to the administration of employment-related superannuation schemes.

The continuing decline in the number of employment-related schemes in New Zealand is not simply “rationalisation”, whereby smaller employer scheme participants transfer to multi-employer or “master trust” arrangements. Some employers are “opting out” altogether, but (more particularly) whenever transfers to a master trust are offered there is inevitably savings “leakage” as certain members choose to receive cash rather than transferring. The Government Actuary's statistics confirm that substantial savings leakage occurred during the period of decline in the number of employment-sponsored schemes.

This leakage also arises from scheme wind-ups and conversion from defined benefit schemes to defined contribution schemes. The anecdotal evidence shows leakage is used in debt reduction and/or purchasing consumables.

This leakage has come about partly as a consequence of legislation requiring consents to transfer members from one scheme to another, hence the temptation-led behaviour of choosing to receive cash.

What needs to change to breathe life into Tier 2?

Given the absence of compulsion or tax incentives, ASFONZ recommends the following mechanisms/approaches for Government, employers and the savings industry to bring about renewed growth in employment-related superannuation.

Deduction at source has to be the simplest means of growing employment-related retirement savings, so consider differing policy treatment for employment-related schemes.

Recent research undertaken by AMP shows that the most successful savers are those who put money aside before they see it. Government has long known this to be true. After all, how does Government collect income tax from workers and student debt repayments?

Government should give serious consideration to making its policy treatment of Tier 2 (retirement savings arrangements where contributions are deducted at source) different to

that applied to Tier 3, which represents other forms of voluntary savings products.

We contend that there does not have to be a “level playing field” as between Tier 2 and Tier 3, if the objective is to ensure New Zealanders entering retirement are better prepared financially.

Reward best practice behaviour, which will contribute to the desired outcome.

Gradual accumulations of savings as a form of private provision for one's retirement have the potential not only to benefit individuals in retirement, but also (at the macro economic level) to reduce long-term fiscal risks from spending pressures in social policy areas, especially health and state-funded super.

Employers

The Human Rights Act outlaws a compulsory retirement age. In the case of the "older" employee, employers are reliant either on performance-based measures to determine when the employee "retires", or on the employee having amassed personal savings that allow him or her to be the determinant of their own future lifestyle, and hence initiate their own exit from the workforce.

The Older Workers Employment Transition study, recently conducted by Massey University, revealed that one quarter of manual workers surveyed would need to work beyond age 65 if the eligibility age for New Zealand Superannuation is raised. For many employers this may introduce a heightened level of safety and other health related issues.

It could therefore be argued that it is in the employers' best interests (in terms of succession planning) to ensure their employees financially prepare for retirement. However, little incentive currently exists to ensure employers offer their support by setting up workplace schemes.

Ways need to be found that will reduce ongoing compliance cost for those employers who wish to offer superannuation. For example, administration costs could be significantly reduced with a minor change in the current disclosure requirement regime, namely removing the redundant and inappropriate requirement to prepare and maintain a prospectus.

Employers may also need to consider their remuneration approach. For example, despite only a small employer contribution, the primary teachers' retirement savings scheme has proved more popular than expected, with 42% of teachers signed up by the end of November 2002 (several weeks after the establishment date). The success of that exercise illustrates that the “cash plus benefits” approach to remuneration retains significant appeal among employees, particularly in a relatively low-wage environment.

Unions

Like employers, unions may need encouragement to consider acceptance of employer contributions to retirement savings (in lieu of “bare” salary/wage increases) as an appropriate salary / wage bargaining outcome on behalf of their members.

One way of doing this would be to emphasise to unions not just the intrinsic benefits of adequate retirement saving, but also the significant “group discounting” benefits open to participants in employer-sponsored (as opposed to retail) superannuation schemes in the areas of administration and investment fees and the provision of insured death and disablement benefits.

Unions should also be encouraged to recognise that a business opportunity exists for them if they choose to collaborate with the financial services industry to create and market their own employment-related superannuation product offerings.

Employees

ASFONZ expects that employee take-up of employment-related superannuation would be enhanced if (for example) Government were to accept either full or partial deferrals of

taxation on employer contributions and/or investment earnings, thus providing a behavioural stimulus for employees.

That said, it is important to emphasize that ASFONZ's stance on tax issues is (and always has been) that it is neutral on the question of tax incentives and changes to the current TTE regimes. The objective has been to ensure that ASFONZ is kept fully informed, and also take part in any debate with Government, other political parties, IRD and the Treasury. If the Government introduces or proposes any change then ASFONZ will endeavour to ensure that it is done in such a way that any adverse impact on employers and schemes is minimised.

Move to block “leakage” from employment-related retirement savings.

ASFONZ suggests that there are two areas that need to be explored in this regard.

Current employment trends continue to suggest that few employees remain with a single employer from "cradle to retirement". The "short career" syndrome has two potential impacts in the current employment-related savings environment: -

- (i) the feeling that there is no point joining a scheme (if one is available) because an employee won't be with the employer for very long; and
- (ii) it contributes to the difficulty of focusing on long-term financial savings goals in an economy / marketplace where consumerist behaviour is rewarded (particularly by the media) and financial prudence is not.

The resulting high level of pre-retirement withdrawals from schemes is exacerbated by a lack of benefit portability between schemes.

There is a pressing need for the Government to consider closing down the current opportunity for savings leakage.

While New Zealand rejected the notion of compulsory retirement savings in the 1997

Referendum, perhaps room exists for political accord on a prescriptive approach to workplace retirement savings preservation, as illustrated below: -

1. Introduction of a "preservation" framework, whereby accumulated workplace retirement savings should only be made available when the employee reaches a pre-determined age (but only as a corollary to there being, for example, any policy advantage such as full or a partial deferral of taxation on employer contributions and investment earnings).
2. Creation of specific "transition funds" where savings can be parked while individuals are between periods of paid employment. Such funds would need to offer diversity of investment choice to meet the variable risk profile of savers, and be competitively priced.
3. Granting of limited pre-retirement access to accumulated retirement savings in schemes that involve tax deferrals or any other favourable policy treatment, on such limited bases as significant financial hardship, partial retirement or effecting a relationship property settlement. Availability could also extend to essential housing, tertiary education or healthcare needs.

What does ASFONZ consider Government's role should be?

We didn't get it right, but we are committed to Tier 2!

- After 13 years of the level playing field (e.g.: tax "neutrality", and latterly tax disincentives for the lower paid) Government should acknowledge that the experiment has not driven an outcome of growth in employment-related retirement savings – increased employer spending choice has not led to growth in retirement savings.
- Government should acknowledge that to do nothing is wrong and that, although a perfect solution is not available, it will explore introducing a raft of complementary initiatives, similar to other developed nations best practice models.

Promote, Educate and Lead by Example

- Government should be prepared to "walk the talk" in the public sector (e.g. best employment practice) by contributing, during the employment relationship, to the well being of your people after the employment relationship is over. This would be a tangible outcome of employment-related retirement savings arrangements.
- Increase funding to the Office of the Retirement Commissioner to enable it to properly advocate employment-related superannuation, and re-focus resources on initiatives such as the "Retire @ Work" education / promotional programme.
- Government should lead by example (with more initiatives similar to the Teachers' Retirement Savings Scheme) in setting remuneration policy that respects the importance of employment-related superannuation arrangements in all areas of the public sector.



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