



27 April 2006

SUBMISSION

To the Finance and Expenditure Committee

on the KiwiSaver Bill

Introduction

1. This submission is made by the Superannuation and Savings Committee ("the Committee") of the New Zealand Society of Actuaries ("the Society") in response to the request for submissions on the KiwiSaver Bill.
2. The Society is the professional body in New Zealand for actuaries. The Committee is authorised by the Society to communicate on its behalf on superannuation matters. This submission may not represent the individual views of all members of the actuarial profession in New Zealand.
3. Many of the Society's members are involved on a daily basis in the provision of advice to sponsors and trustees of New Zealand's employer-sponsored superannuation schemes.

General

4. We support the intention of the Bill to provide for employers to be exempt from offering a KiwiSaver product to their employees if they sponsor an existing superannuation scheme. The Bill states that "*KiwiSaver is part of a package of Government initiatives designed to increase the level of savings by New Zealand households....*". In order for KiwiSaver to be effective in increasing the level of savings, it is essential that any changes are not detrimental to existing workplace schemes and their accumulated savings.
5. The purpose of this submission is to comment on the implications of the Bill (mainly) in relation to exempt employers and to set out alternatives that may better achieve the objectives of the Bill.

6. Existing superannuation schemes generally involve employees and employers contributing at a combined rate that is higher than 4% of salary. We agree that it is important that employers sponsoring existing schemes are supported in doing so because, if these schemes were discontinued and replaced by KiwiSaver schemes, this would result in:

- Leakage from the existing savings pool; and
- Lower ongoing contribution rates.

These outcomes would mean that KiwiSaver was responsible for lowering the current level of savings which is the opposite of the desired outcome.

7. We wish to comment on the following issues in relation to a scheme sponsored by an exempt employer:

- 7.1. The minimum contribution rate payable.
- 7.2. Vesting of employer contributions.
- 7.3. Defined Benefit schemes.
- 7.4. Providing encouragement for employers sponsoring existing schemes to continue to do so.

8. We also wish to comment on the definition of **member's accumulation** and **member's interest**, and the requirements relating to the addition of a KiwiSaver scheme under a trust deed that establishes a registered superannuation scheme.

Clause 4

9. There is an anomaly in the definitions of **member's accumulation** and **member's interest**. The amount of any unvested employer contributions and interest and returns on these contributions is included in the definition of **member's accumulation**. The definition of **member's interest** includes both member's accumulation and, once again, any unvested employer contributions and interest and returns on these contributions.
10. The unvested employer contributions and interest and returns on these contributions should be omitted from the definition of **member's accumulation**.

Clause 20

Minimum contribution rate

11. Clause 20(c) requires a minimum contribution rate of 4% of the employee's gross salary or wages. We understand that this basis is desirable as the contributions will be collected through the PAYE tax system. However, the majority of existing employer sponsored superannuation schemes are based on a contribution rate that is a

percentage of Base Salary i.e. salary before tax excluding overtime, bonuses and other additional payments.

12. In order for the Government Actuary to be satisfied that an existing scheme meets the minimum contribution level, it would be easier if the minimum contribution rate is set at 4% of the employee's Base Salary excluding overtime, bonuses and other additional payments.
13. Alternatively the clause could restate the minimum rate as the lower of
 - 4% of gross salary or wages; or
 - 5% of base salary or wages.
14. We note that the minimum contribution rate of 4% of gross salary can be contributed by the employee and/or the employer. However, as the contribution by the employee is after tax and the contribution by the employer is before tax, a 4% of gross salary contribution by the employer will result in the employee having a contribution of only 2.68% of gross salary credited to his or her account (based on a 33% tax rate). It is not clear whether this is the intent. The alternative is to make the minimum contribution requirement after tax.
15. It is not clear what the intent is of the words "the maximum amount that the employer must contribute". They seem to imply that a contribution of less than 4% of gross salary is acceptable provided there is the facility for a 4% of gross salary contribution.

Vesting of employer contributions

16. Clause 20(d) states that the trust deed of the scheme must provide for any employer contribution to vest completely in the employee within 5 years of the employee becoming a member of the scheme.
17. A consequence of this is that a Defined Contribution scheme with no employer contribution will satisfy this criteria but a Defined Contribution scheme with, say, an employer contribution of 10% of salary which vests at 10% per year will not, even though the benefit provided to the employee is better at all times, and after the first couple of years is significantly better.
18. An obvious solution is to remove the requirement for vesting. Alternatively, there could be a requirement for a minimum benefit of, say, 4% of gross salary (or 5% of basic salary if this is introduced) plus credited interest.

Defined Benefit Schemes

19. The Bill does not state what vesting would mean for a scheme that is a Defined Benefit scheme, where employer contributions are not allocated to members, but are pooled to provide benefits for all members.

20. Although many are closed to new members, and new schemes tend to be Defined Contribution in nature, Defined Benefit schemes remain an important part of the superannuation landscape.
21. For example, in the Government Actuary's 2005 Annual Report, Defined Benefit schemes accounted for 70,000 members (25% of the total) and \$4.8 billion of assets (47%).
22. Accordingly, there should be sensible exemption rules for Defined Benefit schemes as well. We suggest that this is achieved by either:
 - 22.1. Incorporating the same amendment suggested for Defined Contribution schemes of removing the vesting requirement, or;
 - 22.2. Introducing an actuarial test (to be approved by the Government Actuary) that the value of benefits accruing is at least 4% of the employee's gross salary. This would cover the situation where the employer is on a contribution holiday and employee contributions are less than 4% of gross salary, but the value of benefits accruing is worth more than the 4% threshold. Obviously this is far more complex and expensive to implement and will require a significant time commitment from the Government Actuary. 5% of basic salary should be an alternative to 4% of gross salary if our suggestion in paragraph 13 is adopted.
23. These changes are purely technical in nature, and are designed to ensure the intent of the exemption criteria is realised for all schemes, not just Defined Contribution schemes.

Clauses 129 and 130

24. These clauses require the trustees of the superannuation scheme to notify all current members of the addition of the KiwiSaver scheme, the option of transferring and the implications of transferring.
25. We believe that it is unlikely that many members will elect to transfer from their existing benefits to the KiwiSaver section because of the requirement for KiwiSaver benefits to be locked in until age 65. Therefore the necessity for the trustees to notify all members of the requirements of Clause 130 before final registration is unduly onerous.
26. We request that the following alternative notification process is instead applied:
 - 26.1. The trustees are required to inform the current members of the change to the trust deed in the next annual report (as would occur anyway under the terms of the Superannuation Schemes Act 1989).
 - 26.2. The annual report includes notice that members may transfer to the KiwiSaver scheme if they wish and that members who wish to consider this option must request written notification of the implications of the proposal.
 - 26.3. The trustees must provide written notification of the implications of the proposal to transfer to the KiwiSaver scheme within the specified time period,

when requested by the member. An appropriate time period would be one month.

The trustees should be able to provide a separate earlier notification to members if they so wish.

Encouragement for existing schemes

27. We believe that employers sponsoring existing schemes should be encouraged to become exempt employers. This would ensure that existing schemes continue and are not wound up because these employers replace their existing schemes with KiwiSaver schemes. The wind up of an existing scheme would mean the loss of existing accumulated assets, which is the opposite of the desired outcome of the Bill.
28. However, it is likely that employers who wish to become exempt employers will incur costs in altering their schemes in order to meet the requirements for obtaining an exemption. Also, these schemes are not eligible for fee subsidies and the one-off \$1000 Government grant. If these were made available to schemes of exempt employers to offset the additional costs that will be incurred, they are less likely to be wound up.

Summary

29. We recommend that:
- 29.1. The definition of member's accumulation is altered to exclude the unvested employer contributions and interest and returns on those contributions.
 - 29.2. The minimum contribution rate required by clause 20(c) be altered to 4% of base salary, or alternatively, either 4% of gross salary or 5% of base salary.
 - 29.3. The requirement for full vesting within five years is removed.
 - 29.4. The exemption criteria are modified slightly (as set out in this submission) to ensure the exemption criteria apply equally to Defined Benefit and Defined Contribution Schemes.
 - 29.5. Schemes provided by exempt employers should be eligible for the fee subsidies or \$1000 grant to offset the cost of altering the scheme to enable it to be eligible for exemption.
 - 29.6. The requirement for trustees to notify current members of the addition of a KiwiSaver scheme to an existing registered superannuation scheme prior to final registration be altered so that this may occur after registration. Notification of the change may be by way of the next annual report and the trustees are only obliged to notify members of the implications of the proposal at the time that this is requested by the member.
- Incorporating these changes will encourage employers sponsoring existing schemes to continue to do so, ensuring that already accumulated savings are not unnecessarily dissipated.
30. We are happy to appear at a select committee meeting (preferably in Auckland) to discuss our submission further.

Contact Details

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