# Submission

By

Business NZ

To

# Savings Product Working Group

On

# Development of Work-Based Savings Products

**6 July 2004**

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**DEVELOPMENT OF WORK-BASED SAVINGS PRODUCTS**
**SUBMISSION BY BUSINESS NEW ZEALAND**
**6 JULY 2004**

## 1. INTRODUCTION

1.1 Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 56-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

1.2 In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

1.3 Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per capita per year would be required to achieve this goal in the medium term.

1.4 The health of the economy also determines the ability of a nation to deliver on the social and environmental outcomes desired by all. First class social services and a clean and healthy environment are possible only in prosperous, first world economies.

1.5 Business New Zealand therefore welcomes the opportunity to provide comment to the Savings Product Working Group (SPWG) on issues relating to the development of work-based savings products. Ensuring that appropriate retirement income policies are in place is one of the critical issues for New Zealand as the economy comes under increasing pressure from an ageing population.

## 2. SUMMARY AND RECOMMENDATIONS

2.1 Business New Zealand supports initiatives to improve the level of work-based savings, but we are concerned about the potential for significantly increased compliance costs that would arise from any move towards compulsion (such as mandatory offering). This is particularly important to consider when UK and Irish experience with mandatory offering indicates that uptake in work-based savings has not increased to any great extent.

2.2 Business New Zealand recommends that, rather than investigate how to put in place a compulsory regime for work-based savings, the SPWG should focus on how the objective of increased work-based savings can be achieved by improving the existing voluntary regime. It should investigate impediments and disincentives (e.g., compliance costs, tax treatment, issues around portability) to uptake of work-based savings schemes and how they can be satisfactorily addressed. It is also important for the SPWG to consider ways to objectively assess the quality of existing savings schemes and current practices in the savings industry.

2.3 However, we consider that the SPWG should investigate whether employers could be encouraged to do more to educate and advise their employees of issues around work-based savings. Business New Zealand would support the development and promotion of an education campaign targeted at both employers and employees.

2.4 Business New Zealand also recommends that the existing requirement to prepare periodic reports on retirement income policy should be retained in the New Zealand Superannuation Act.

## 3. THE DECLINE OF WORK-BASED SAVINGS SCHEMES

3.1 Work or employment-based savings represents the ‘second tier’ of a three-tier approach to retirement provision. As such it makes a very important contribution to private provision for retirement, particularly for lower and middle-income people who might find it harder to save or harder to decide how to save. However, recent years have seen dramatic falls in both the number of registered employer superannuation schemes and their coverage of the workforce, as shown in Table 1 below.

**Table1: Registered Superannuation Schemes (Government Actuary Newsletter No.56: July 2003, Table 2)**

| Nature of Scheme | Number of Schemes | | Total Assets ($m) | | Total Membership | |
|---|---|---|---|---|---|---|
| | 1990 | 2003 | 1990 | 2003 | 1990 | 2003 |
| ‘Private’ (Set up by individuals for themselves and immediate family) | 508 | 49 | 58 | 29 | 550 | 70 |
| ‘Employer (1)’ (Schemes sponsored by private sector employers and all NPF employer sponsored schemes) | 2,242 | 514 | 9,508 | 9,572 | 310,741 | 246,946 |
| ‘Employer (2)’ (Schemes sponsored by public sector employers and approved under State Sector Act 1988) | 0 | 7 | 0 | 364 | 0 | 16,710 |
| ‘Retail’ (Schemes where membership is open to the general public) | 113 | 125 | 1,466 | 7,350 | 236,042 | 420,205 |
| **TOTAL** | **2,863** | **695** | **11,032** | **17,314** | **547,353** | **683,931** |

3.2 By 2003 less than 14% of those in the workforce were members of either a private sector or a public sector employment-based superannuation scheme. While the decline in the number and membership of employment-based schemes has been dramatic since 1990, the membership of retail schemes has almost doubled and total assets has risen five-fold. As a result, the total membership of all schemes in 2003 was 25% higher in 2003 than in 1990.

3.3 The average size of private sector employment-based schemes has risen from 139 in 1990 to 480 in 2003. This is consistent with the anecdotal evidence we have heard from many employers about increasingly prohibitive costs faced by small schemes and that there are very few, if any, small and medium sized enterprises now offering employment-based schemes.

3.4 The reasons for the decline in employment-based superannuation schemes are well known. Changes to tax treatment and increasingly burdensome compliance costs (e.g., the requirement to produce a prospectus and the auditing of accounts) were a major factor in scheme wind-ups, particularly for small and medium sized employers.

3.5 The Government is clearly concerned about the decline in work-based savings and appears to be determined to reverse the trend. This year it has removed the prospectus requirement for employment-based schemes, introduced progressive SSCWT[1] for contributions to employment-based schemes, and announced the establishment of a new public service superannuation scheme. The Minister of Finance has also announced (in his recent Budget speech) an intention for the Government to improve the tax rules around saving. These rules are currently regarded as being complex, inconsistent and potentially unfair.

3.6 Business New Zealand supports initiatives to improve the uptake of work-based savings schemes. For example, we have applauded the recent legislative changes on prospectuses and SSCWT and we welcome the review of tax rules around saving (although we would not support industry-specific tax incentives).

3.7 While the removal of impediments and disincentives such as those described above should slow the decline in employment-based schemes, on their own they are unlikely to spark a significant revival in such schemes. One of the more significant hurdles is the long-term trend of employers cashing up employees' remuneration packages, a rational response to the removal of tax concessions for superannuation schemes and the impact of compliance costs, most notably fringe benefit tax. Another important issue that is beyond the control of policymakers is the growing level of workforce 'churn' where it is becoming increasingly common for people to have multiple career changes during their working lives (which makes portability an important issue). There is also a view by many that retirement savings is a personal matter and not one in which employers should intervene or be required to intervene in.

3.8 Business New Zealand accepts that an effective way to encourage work-based savings would be for employers to better facilitate retirement savings

[1] SSCWT = Specified Superannuation Contributing Withholding Tax

(i.e., by giving employees an opportunity to have part of their salary invested in an externally managed fund) rather than have them develop their own company-specific schemes. This appears to be exactly what the Government has in mind for the SPWG to consider.

3.9 However, Business New Zealand's support for lifting work-based savings has its limits and we would be opposed to moves that would significantly increase compliance costs, particularly for small and medium sized enterprises. We are therefore unenthusiastic about any move towards compulsion, such as *requiring* employers to offer all their employees access to work-based schemes.

3.10 We are concerned that mandatory offering of access appears to be under active consideration by the SPWG, particularly as we understand that equivalent British ('stakeholder pensions') and Irish ('PRSA') compulsory access schemes have to date failed to result in any significant increase uptake of work-based savings[2].

3.11 There is also a distinct lack of public enthusiasm for a compulsory approach. The referendum held in September 1997 on a compulsory retirement savings scheme resulted in a 92% 'No' vote, an overwhelming rejection. The SPWG should not seek to reintroduce compulsory scheme or anything similar by the back door.

3.12 However, there is still scope to address impediments and disincentives in work-based savings. We understand that, as the law currently stands, as soon as an employee asks their employer for advice on externally managed funds the employer in effect becomes a financial adviser and would become subject to the associated compliance costs this status would involve. This needs to change for employers that are not in the business of offering financial services.

3.13 Business New Zealand submits that there should also be scope for the SPWG to consider issues relating to the savings industry. Practices in the industry around the administration of savings schemes and the associated fee levels, for example, should be able to be assessed to see whether there are impediments or disincentives for their uptake. The quality of the products on offer by the industry might also be an issue.

[2] The UK **Stakeholder Pensions** were introduced in 2001. According to the Association of British Insurers, by August 2003 it was evident that:

- 82% of employer-designated schemes had no members;
- Only 13% of employers were making contributions to schemes on behalf of the employees;
- Sales fell by 15% in the first half of 2003 compared to the first half of 2002;
- Many payments were simply transfers from other schemes, so they did not represent any new provision for retirement; and
- Contributions were highly correlated towards income levels, with very low levels from the targeted group of low-middle income earners.

The Irish **PRSA** scheme was introduced in 2003. Early signs of uptake were not encouraging: we understand that by the end of 2003, 35% of employers had designated a provider, but of these 95% had no members in their schemes.

## 4. BUSINESS NEW ZEALAND'S PREFERRED SOLUTION

4.1 Business New Zealand is concerned that the overall steer in the SPWG Terms of Reference is toward a compulsory solution. While it is certainly important to encourage work-based savings, we are very concerned about the compliance cost implications of requiring all employers to offer access to work-based savings schemes to all employees, particularly for small and medium sized enterprises (we expect the SPWG to consult the Small Business Advisory Group in the course of its deliberations).

4.2 We are also concerned that mandatory offering of savings products to all employees and automatic salary and wage deduction fails to take account of the reality of a modern workforce, for example:

- The nature of many businesses, and the environments in which they operate, mean that many employers have to take on staff on a casual or a seasonal basis;
- Not all workers are paid regular hourly, daily, weekly, fortnightly or monthly amounts – variable rates for shift work, overtime, and work on weekends and public holidays can all add complexity; and
- Even in today's electronic age, there are still a large number of employees that are not paid by direct credit into bank accounts (e.g., by cash or pay cheque).

4.3 While none of these issues are intractable, they would make it difficult and potentially costly to require all employers to offer access to products to all employees and to administer automatic salary and wage deductions.

4.4 Furthermore, as discussed on the previous page, the UK and Irish experience to date suggests that requiring compulsory offering of access is by no means guaranteed to result in any significant uptake in work-based savings. The SPWG should very carefully consider the experience of the UK and Ireland before considering any similar system for New Zealand (we understand that the UK Pensions Policy Institute made a submission to last year's Periodic Report Group warning New Zealand in a diplomatic way that the UK model 'has not been a clear-cut success').

4.5 Business New Zealand submits that at the SPWG should consider how the objective of increased work-based savings can be achieved by improving the existing voluntary regime. It should investigate impediments and disincentives to uptake of work-based savings schemes (e.g., compliance costs and tax treatment) and how they can be satisfactorily addressed. It is also important for the SPWG to consider whether the quality of existing savings schemes and current practices in the savings industry can be objectively assessed.

4.6 Business New Zealand would not support the concept of employers being required to offer access to a work-based savings product to all of their employees. However, we consider that the SPWG should investigate whether employers can be encouraged to do more to educate and advise their employees of issues around work-based savings. This could include providing advice that the employer would, if it is the wish of the employee, deduct an agreed portion of salary and wages as a regular contribution to a personal work-based savings scheme that has been entered into by the employee through a work-based savings 'portal' administered, say, by the Office of the Retirement Commission and funded by either the Government or the retirement savings industry. Business New Zealand would support the development and promotion of an education campaign targeted at both employers and employees.

4.7 By containing compliance costs for employers and ensuring that their obligations are reasonable, we would argue that such an approach is more likely to achieve buy-in and thereby do more to encourage a greater uptake of work-based savings. It would mean that work-based savings becomes a shared responsibility of employers, employees, and the savings industry, assisted by the Government. This would be in contrast to the 'mandatory offering' system suggested in the SPWG Terms of Reference, which places the burden overwhelmingly on the employer.

## 5. Ongoing Review of Retirement Income Policy

5.1 Finally, Business New Zealand considers it critical that there be ongoing review of retirement income policies, including those relating to work-based savings. The best way to provide New Zealanders with certainty on retirement income policy is to build consensus and stability. To achieve consensus and stability requires policies to be built on a sound conceptual framework that can generate informed and objective debate and result in policies that are more likely to withstand intense public and political scrutiny.

5.2 However, Business New Zealand is deeply concerned that the New Zealand Superannuation Amendment Bill, currently before the Social Services Select Committee, proposes to repeal the current requirement in the Retirement Income Act 1993 for an independent group prepare a report on retirement income policy on a periodic basis. We consider the periodic reporting group process to be a critical element to providing a sound conceptual framework as described above.

5.3 Business New Zealand has submitted on the Bill and we have recommended that the requirement to prepare periodic reports should be provided for in the New Zealand Superannuation Act, on a four-yearly basis (rather than the current six-yearly basis).