KiwiSaver – Legislation Passed

Implications for existing schemes and employers

September 2006

1. Introduction

The legislation has gone through the House and is now final. It includes the tax change to SSCWT on employer contributions. The key features are:

- Contributions will start from day 1 of a new employee's employment.
- An employer can make contributions on behalf of an employee to a KiwiSaver scheme.
- An employer contribution to a KiwiSaver scheme will be exempt from SSCWT up to the lessor of the employee's own contribution level and 4% of gross salary/wages.
- After contributing for 12 months members can divert up to 50% of their KiwiSaver contributions (but none of the employer contributions) to repay their mortgage.
- Employers can compulsorily transfer members between registered superannuation schemes provided the new scheme's benefits are as good as those provided by the original scheme.
- The start date has been deferred to July 2007.

In this Topix we ask:

- How will schemes respond to the legislation?
- How valuable is the tax concession available via KiwiSaver?

2. What will the key tax announcement mean for KiwiSaver?

It has to be good news for the take-up rate of KiwiSaver. This move has resolved the simple dilemma posed before, why would people invest and lock their money up till age 65 when they could go into an existing scheme and get it out on leaving their employer.

This was the one major handicap for the KiwiSaver scheme. While the $1,000, the housing incentive, the fee subsidy, the implied Government scheme "approval" were important, the 4% exemption from SSCWT is worth something tangible.

And, with the change allowing employers to meet part of the KiwiSaver mandatory 4% of contributions for an employee, unions may be looking to negotiate this benefit for their members at the next wage round.

However as we explore further, we find that while the tax change is a valuable plus, it is probably worth less than it first seems.

3. What will be the response to the new revised KiwiSaver scheme

Employer response - They will want to ensure that their employees can take advantage of the tax concession. This is a plus and in addition to low fees, $1,000 initial contribution and housing subsidy. They are likely to give employees options on how they are remunerated.

Employee response - Some existing members as well as new employees will want to access the KiwiSaver benefits easily and through their employer. The groups we see as being particularly interested are:

- The younger age group who will be attracted by the chance to receive a Government lump sum of up to $5,000 towards the cost of a first house. For a couple this amounts to $10,000.
- Older employees, for whom a lock in to age 65 is not a long time and who will want to receive all the benefits i.e. the $1,000 and the tax advantages.
- Those employees already on a total remuneration basis who are used to the idea of varying the way they are paid.
- Anyone who was uncertain about investing before may select a default provider scheme and feel more confidence in the provider concerned.
- And possibly, the person with spare disposal income who can afford to put aside 4% of their gross income and take advantage of the tax break and the $1,000 lump sum.

4. Five possible responses from employers

While the greatest interest in the KiwiSaver discussion is currently around existing schemes, it is also valuable to start by considering how an employer with no scheme might approach the subject.

We first note that new employees must be enrolled by their employer into either the employer's own chosen KiwiSaver scheme, a default scheme, or an exempt scheme.

No existing scheme and no interest in employee benefits

- This group will enrol their employees into a default scheme and leave the employee to decide whether to stay in the scheme or opt out. These are likely to be smaller employers and some medium size ones too.

No existing scheme but interested in taking a stance on KiwiSaver

- The employer will select a KiwiSaver provider into which employees will be enrolled. Alongside the KiwiSaver, the employer will also run a standard master trust scheme. Employees will then be given the option to choose how they wish to be remunerated to take advantage of the tax savings. This may include salary sacrifice for the higher rate tax payers. The combination with the master trust offering will allow the employee flexibility to make additional contributions and purchase any insurance benefits they wish, including medical insurance.

Existing defined contribution scheme provided through a master trust

- The master trust provider will establish a KiwiSaver section in the scheme into which new employees will be automatically enrolled. New employees will be given the option to join the existing scheme (if eligible) and continue in the KiwiSaver scheme.
- The total benefits offered will need to be structured to allow employees to arrange their own and the employer's contributions to maximise the tax and other benefits to the employee. Existing members will be offered the same options. This will require changes to any employer's participation agreement.
- The master trust providers will work hard to ensure employees make the right decision. This may include any salary sacrifice arrangements as applicable.
- Contributions to KiwiSaver will still need to be directed through the IRD but once in the scheme the KiwiSaver / master trust provider will structure the reporting back to members to show the member's total position.
- For these employers, the introduction of KiwiSaver will be managed relatively easily.

Existing standalone defined contribution scheme

- Already having an interest in superannuation, this employer will probably look to provide direct access to KiwiSaver for new employees. This will be by either setting up a KiwiSaver section within the existing scheme or selecting a separate KiwiSaver provider. The first option will be cost effective only to the larger schemes. It is not an option for smaller schemes. The alternative which the original Bill contemplated of an employer establishing an exempt scheme no longer looks attractive in comparison with KiwiSaver (see below.)
- The employer will have the issue of contributions going both to its own scheme and also direct to the IRD for KiwiSaver.
- The deed will need to be changed to allow the necessary contribution flexibility.
- Members wanting to put their own 4% and the employer's 4% into KiwiSaver could mean only a low level of contribution going into the existing scheme, leaving the employer questioning why it would want to continue with the existing scheme at all. .
- Some employers in this position may start to ask why not switch the members and their accumulated funds into a master trust, maybe using the new compulsory provisions, and simply close off the standalone scheme

Existing standalone defined benefit scheme

- Employers will select a KiwiSaver scheme. New employees will be offered the option to join the existing scheme or KiwiSaver and will make their decision around the assessed value of the two schemes and the contributions required.
- But it will be difficult to vary the contributions and consequently the benefits of the existing scheme to allow for KiwiSaver contributions. Therefore the flow of new members may drop and existing members may also want access to a KiwiSaver scheme. In this environment employers may need to consider closing the scheme to new members and either run off or wind up.

5. Salary sacrifice

Employees who are keen on joining a KiwiSaver scheme and keen to access the tax advantages from an employer contribution maybe able to arrange to salary sacrifice the necessary employer contribution. It will be expensive though in terms of giving up take home income as employees will need to also make a personal contribution to the scheme.

6. Advice to assist members to make right decision about the split of their contributions

There may be a need for employees to have access to software which will enable them to decide how much to allocate to their existing scheme and how much to KiwiSaver, and also just how much to save in order to reach their own individual goals.

7. How valuable is the tax advantage?

We have looked at a number of different scenarios covering:

- What is the tax position for existing schemes?
- How valuable was the salary sacrifice already possible for the higher rate tax payer?
- What does the picture look like under KiwiSaver?

Consider the following:

Existing scheme – Employer and employee contributions are each 6% of salary.

KiwiSaver – Employee and employer contributions are each 4% of salary.

A member's contributions to the existing scheme reduce by the contributions made to KiwiSaver. We have set up the salary sacrifice basis such that for the existing scheme the net contributions made for the member are the same and the savings are taken as additional tax paid income.

For a member with an $80,000 salary the results show:

- Under the pre-KiwiSaver regime the impact of the salary sacrifice was to increase a member's take home pay from $51,690 to $52,213. The net contribution to superannuation remained the same at $8,016.
- With no salary sacrifice, the diversion of the employer contributions of 4% to KiwiSaver has increased the net contributions to superannuation by $1,056, i.e. 33% of 4% of $80,000.
- The total impact of KiwiSaver for a member with no current salary sacrifice is an increase in total combined net pay and superannuation contributions of $1,211.

Considering now an employee on a salary of $100,000 the results show:

- Under the pre KiwiSaver regime the impact of the salary sacrifice was to increase a member's take home pay by $610, from $62,474 to $63,084. The net contribution to superannuation remained the same at $10,020.
- The impact of the introduction of KiwiSaver and diversion of employer contributions of 4% is to increase the net contribution to superannuation by $1,320 per annum.
- If the member now also introduces salary sacrifice, the introduction of KiwiSaver results in a net overall increase in take home pay and superannuation of $1,472.

The full results are included in the Appendix. In summary we comment:

- The increase due to the KiwiSaver change is not particularly significant.
- For the higher rate tax payer who is already doing salary sacrifice the effect is smaller.
- The members who possibly gain the most in relative terms are the employees on 33% who previously had no use of salary sacrifice but now get the benefit of the SSCWT exemption.

8. Take up rate

So what does the above mean for take up rate for KiwiSaver? If we go back to before 1987, when there was full deductibility on all contributions and members could get their contributions out when they left the employer, we still had less than 30% of employees in super schemes. Will this change now? Maybe it will - if we allow for the increased "marketing" from the Government and the Retirement Commission, and just the greater general awareness around the subject of retirement savings.

9. Resurgence of interest in employee benefits overall

While the tax benefit may not be significant, some employers will want to have their own KiwiSaver scheme and when combined with a master trust we can expect to see a resurgence in interest in employee benefits.

10. Existing standalone schemes - what is required to put them on a level playing field?

The tax concession aspect of the legislation is a blow to existing schemes and the manner in which it was introduced, without consultation, has naturally upset the industry. It would be a good development now if the Minister could respond positively to the proposal being made to him to allow existing schemes to enjoy the same tax benefits subject always to the same basic terms as apply for KiwiSaver. This will then allow Trustees and employers an option to make changes to their own standalone schemes or move to a master trust arrangement. At the moment Trustees are feeling justifiably slighted by the way the tax concession was introduced.

The ideal position would be to allow schemes to offer to lock in contributions made on the same basis as KiwiSaver till age 65 but without having to add a KiwiSaver section. This could include requiring schemes to transfer out the monies to a KiwiSaver scheme when a member leaves.

The provisions for adding a KiwiSaver section to an existing scheme have been simplified, which is a positive development. What would make a big difference would be if all the contributions and not just the employers could be made direct and not through the IRD.

One possible solution for a defined benefit scheme would be to allow the same SSCWT exemption but require the savings to be held in a separate account for individual members.

11. Miscellaneous matters

Mortgage diversion scheme - This will operate as follows:

- After making contributions for 12 months a KiwiSaver member can elect to have 50% of their contributions paid to their mortgage lender.
- Neither a KiwiSaver provider nor a mortgage lender is required to have this facility.

The impact of this facility is to accede to the request from certain parties to have a total 2% contribution rate to KiwiSaver.

Reasonable fees - All KiwiSaver providers will need to have their fees reviewed by the Government Actuary to ensure they are not unreasonable.

Default providers - What are the various changes going to do for the default providers? It will probably be less important to be selected as a default provider as there will now be more real reasons for employers getting involved in superannuation and so happier to make an active choice and select a 'preferred' KiwiSaver provider.

Tax - The date for the introduction of the new tax regime for schemes has been put back to October 2007 which has been welcomed by the industry. However the date for the proposed tax regime for overseas shares is still April 2007.

Compulsory transfer provision - The legislation includes a provision allowing for the automatic transfer of members between KiwiSaver schemes. The provision has general applicability to members of all superannuation schemes.

Future scenario - Having made this change to the original KiwiSaver framework, where might the future take us? Firstly the Minister can increase the level of the contribution allowable for exemption from SSCWT. But this may well depend on the take up rate. If it is less than expected, then compulsion may arrive sooner rather than later. And such a change will pose more issues for existing schemes.

Need for consistent long term investment strategy - The impact of locking in monies to age 65 will open up the opportunity for investment managers to offer funds with a long term time horizon to investors. This will give investors the opportunity to take advantage of the normal premium that can be obtained for forgoing short term liquidity.

Exempt schemes - The attraction of an exempt scheme under the original Bill was that it enabled an employer to enrol new employees into the exempt scheme direct and not have them enrolled into KiwiSaver at all. It would have meant some changes to the existing scheme but the employer might have been happy to make these just to get the benefit of automatic enrolment. But this has now changed. So the question now is will anyone have an exempt scheme?

12. Next steps

Trustees/employers with an existing scheme:

a) Who already have a master trust provider

As in the future it will be possible to move more easily to a new provider, the opportunity could be taken to review the performance of the existing provider. If a change of provider is to be made, it will be easier to do at the same time as the introduction of KiwiSaver rather than later.

Confirm with the provider that they will have a KiwiSaver section and enquire as to their timing on talking to clients on their plans.

Advise employees and current members that there will be a KiwiSaver scheme in place for 1 July 2007, and that options are expected to be available for the allocation of both personal and the employer's contributions.

b) Who already have a small standalone defined contribution scheme

Start to think about whether the scheme has a long term future. Think about why the Company wants a standalone scheme and what advantages it has.

Think about whether a move to a master trust provider with members all transferring on their current terms might be the way forward. Review the offerings from the master trust providers.

Advise employees and members that there will be a KiwiSaver scheme available from 1 July 2007.

c) Who already have a large standalone defined contribution scheme

Confirm that the scheme is expected to continue in the longer term.

Enquire of the current administrator whether they will be able to easily and cost effectively administer a KiwiSaver section for the existing scheme.

Advise employees and members that there will be a KiwiSaver scheme in place on 1 July 2007.

d) Who have no existing scheme

Decide whether they wish to offer their own KiwiSaver scheme to employees or instead just have employees enrolled into a default scheme.

If they do wish to offer their own scheme, then:

- Think about whether any employer contribution will be made directly or via salary sacrifice.
- If a large employer, contact some providers to see what their plans are.
- Advise employees that there will be a KiwiSaver scheme in place on 1 July 2007.

13. Other sources of information on KiwiSaver

IRD has established an interim website that provides information and frequently asked questions relating to KiwiSaver. See http://www.ird.govt.nz/kiwisaver.

A dedicated KiwiSaver website will be launched mid-October.

Treasury has information on the KiwiSaver Bill at http://www.treasury.govt.nz/kiwisaver/.

The Retirement Commission will be developing education programmes to assist New Zealanders to make informed decisions on KiwiSaver in the context of their wider financial situation.

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Appendix

KiwiSaver Tax Impact Examples

Salary: $80,000 per annum.

	No salary sacrifice			With salary sacrifice			Combined
	Existing Scheme	Existing Scheme and KiwiSaver	Change	Existing Scheme	Existing Scheme and KiwiSaver	Change	
	$	$	$	$	$	$	$
Net take home pay	51,690	51,690	0	52,213	51,845	-368	155
Net contributions	8,016	9,072	1,056	8,016	9,072	1,056	1,056
Total	59,706	60,762	1,056	60,229	60,917	688	1,211

Salary: $100,000 per annum

	No salary sacrifice			With salary sacrifice			Combined
	Existing Scheme	Existing Scheme and KiwiSaver	Change	Existing Scheme	Existing Scheme and KiwiSaver	Change	
	$	$	$	$	$	$	$
Net take home pay	62,474	62,474	0	63,084	62,626	-458	152
Net contributions	10,020	11,340	1,320	10,020	11,340	1,320	1,320
Total	72,494	73,814	1,320	73,104	73,966	862	1,472