Impact Summary: KiwiSaver enhancements resulting from the Retirement Commissioner's review

Section 1: General information

Purpose
Inland Revenue is solely responsible for the analysis and advice set out in this Regulatory Impact Assessment, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with changes to be taken by Cabinet.

Key Limitations or Constraints on Analysis

Scoping of the problems

The problems were identified as part of the Retirement Commissioner's December 2016 review of retirement income policies (the Review) – which was prepared by the Commission for Financial Capability. Therefore, the problems were effectively already identified before Inland Revenue began work on the proposed regulatory approaches.

Range of options considered

As the problems were identified as part of the Review, the options considered were also based on the recommendations made in the Review.

The Retirement Commissioner has a legislative mandate to review retirement income policies every three years, as a result the Commission for Financial Capability is experienced in considering ways to improve the effectiveness of retirement income policies (including KiwiSaver). The recommendations in the Review were made after problem definitions and solutions had been tested with the public, the private sector and Government agencies during 2016. (This consultation involved interviews with the public, a range of online surveys taken by approximately 11,200 members of the public and consideration of substantive written submissions).[1] The nature of the Commission for Financial Capability's expertise and the significant scoping done as part of the Review indicates that the recommendations it proposed are likely to be the most viable options to address the problems it had identified.

Quality of data used for impact analysis

It is not possible to accurately determine how many KiwiSaver members will be encouraged by the proposed approaches to increase their contributions and therefore their long-term

[1] Surveys were available on the Commission for Financial Capability's website.

KiwiSaver savings. However, results of a public survey undertaken as part of the Review generally signalled support for the recommendations.[2]

The estimated impacts of the proposed options are dependent on the behavioural response of KiwiSaver members. Previous changes to the scheme have been more restrictive in nature, so cannot be used as a basis for predicting responses to the proposals.

Assumptions underpinning impact analysis

Both proposals assume KiwiSaver members would be responsive when presented with voluntary (rather than compulsory) options that increase their long-term savings.

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1 March 2018

[2] Out of 1,830 survey responses, 85.4 percent of respondents were in support of more flexible contribution rates while 51.6 percent of respondents supported reducing the maximum period of a contributions holiday from five years to one year.

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

The KiwiSaver Act 2006 sets out the requirements for KiwiSaver members and their employers. Under the KiwiSaver policy framework, although KiwiSaver remains voluntary, contributions are encouraged in several ways. For example, employees' contributions are facilitated by being deducted directly from their pay (if the employer receives a deduction notice from the member or Inland Revenue), and members are incentivised to make contributions to their KiwiSaver account so they receive the Government subsidised member tax credit (an annual maximum payment of $521.43, to members who contribute upwards of $1,042.86).

This regulatory impact analysis deals with two specific problems:

Part A problem – low employee contribution rates

Currently, KiwiSaver members have contributions deducted at a rate of 3% (the minimum default rate), 4% or 8% from their salary and wages. Approximately 90 percent of members were contributing at the lowest 3% or 4% employee contribution rates in the 2016-17 year.

Population demographics are changing, with New Zealander's living longer into retirement. Life expectancy for New Zealand females is 83.2 years and 79.5 years for males,[3] with these numbers expected to continue to rise. The Review signalled that KiwiSaver members contributing at a low rate, may not have accumulated sufficient savings to financially support themselves during the entire duration of their retirement, in a way that meets their individual retirement needs and preferences.

Part B problem – long contributions holidays

For the year ending 31 June 2017 131,710 members were on a contributions holiday, with 84 percent of these contribution holidays being five years in duration (contribution holidays can be for any period between three months and five years, five years is the default period). This means these members were not making contributions, or were only making minimal voluntary lump sum contributions during this period (voluntary contributions are generally not at the level the member would have saved were they not on a contributions holiday).

Stopping contributions for five years has a significant impact on members' savings, and also means members generally do not receive the member tax credit or employer contributions during this period.

The purpose of the contributions holiday is to ensure members can take a break from making contributions when they are not in a financial position to do so. However, having a default five year contributions holiday period is likely to be longer than necessary for many members (whose financial position is likely to improve in the interim period).

[3] *Statistics New Zealand* 'New Zealand Period Life Tables: 2012-14'

Who should address the problems and when?

KiwiSaver is the only Government subsided retirement savings scheme offered to the public. Therefore, the Government has a responsibility to ensure it is fit for purpose. This should include making sure members are given as many options as possible to effectively save.

These problems should be addressed now. They were identified as part of the December 2016 Review. It would be prudent for the Government to respond to problems identified in the Review within a reasonable timeframe, because the longer that nothing is done to address the problems, the more savings KiwiSaver members potentially lose out on.

The problem definitions and recommendations in the Review were formed after consultation with the public, the private sector and Government agencies, meaning there is agreement across a variety of sectors that the problems are an issue.

2.2 Who is affected and how?

Part A problem – low employee contribution rates

KiwiSaver members (who are salary and wage earners) who are not contributing enough to their KiwiSaver account to meet their specific retirement preferences would be affected. The aim of this change is to get these members to start contributing at a higher rate, in a manner that is still flexible enough to respond to changes in their financial circumstances. The purpose of this is to increase KiwiSaver members' retirement savings, so that they can achieve retirement outcomes aligned with their specific retirement needs.

The proposed option would address this problem by introducing additional 6% and 10% employee contribution rates.

KiwiSaver scheme providers and other Government agencies jointly responsible for KiwiSaver (MBIE and the Treasury) support this option. This approach should not have financial implications for the Government.

Part B problem – long contributions holidays

KiwiSaver members (who are salary and wage earners) who are taking breaks due to contributions holidays would be affected. The aim of this change being to prompt members to resume making contributions sooner, so that they increase their savings and maximise their member tax credit entitlement (which they would not receive while contributions are paused).

The proposed option would reduce the maximum period of the contributions holiday from five years to one year. This would limit the time during which members make no contributions (it would still be possible for members to indefinitely renew contributions holidays, but they will have to do so more frequently, ensuring they actively consider the matter).

KiwiSaver scheme providers and other Government agencies jointly responsible for KiwiSaver also support this option. There may be some cost to the Government. If reducing the contributions holiday has the desired effect and results in members resuming contributions earlier, this would result in an increase in the aggregate amount of member tax credits payable.

The majority of the administrative costs for implementing the proposed approaches to address the problems would be borne by Inland Revenue and could be accommodated in existing baselines. There would not be any significant compliance cost for scheme providers or employers.

There is not known to be any group that does not support the proposed approaches.

2.3 Are there any constraints on the scope for decision making?

Constraints

As the problems were identified by the Review, the options in scope to address them have been limited to the recommendations made in the Review. However, the Retirement Commissioner's experience in considering the effectiveness of retirement income policies, as well as the consultation process undertaken as part of the Review to identify problems and solutions (as outlined in more detail above), suggest the recommendations made in the Review are likely to be the most appropriate options to address the problems.

The previous Government approved its letter of response to the Review for public release in May 2017. As part of the process of inputting into this letter of response Inland Revenue officials considered how effectively the options outlined below would address the problems.

When it approved the release of the letter of response to the Review, the previous Government also invited the Minister of Revenue to report back to Cabinet specifically on implementation details for:

- providing additional optional employee contribution rates;
- reducing the maximum permitted renewal time of the contributions holiday; and
- changing the name of the "contributions holiday" to "savings suspension".

Connections to other existing issues

At the time of writing this regulatory impact analysis Cabinet were also considering:

- a change to the name of the contributions holiday;
- a change to the name of the member tax credit; and
- consequential issues related to the previous Government's decision that over 65 year olds should be eligible to join KiwiSaver.

Section 3: Options identification

3.1 What options have been considered?

Part A deals with low employee contribution rates and aims to get these members to start contributing at a higher rate, in a manner that is still flexible enough to respond to changes in their financial circumstances.

Part B aims to prompt members to resume making contributions sooner, so that they increase their savings.

In contributing to the Government response to the 2016 Review Inland Revenue conducted a high-level assessment of the options to the two problems using the following criteria:

- *Effectiveness*: the option must address the problems in a manner that is appropriate within wider KiwiSaver policy settings.
- *Compliance*: compliance cost for employers and KiwiSaver members should be minimised.
- *Administration:* implementation and administration costs for Government departments should be minimised.
- *Equity:* as far as practical the option should be available to all KiwiSaver members.

Part A problem

Four options are considered for dealing with low employee contribution rates.

Option one: Add additional employee contribution rates of 6% and 10%

Effectiveness

Additional 6% and 10% employee contribution rates are likely to have a positive impact on savings, and would give members greater flexibility to achieve retirement outcomes aligned with their specific retirement savings needs and to adjust their contribution rate to suit their current financial circumstances. The additional 6% rate would also address the gap between the current 4% and 8% contribution rates, which the Review indicated many members think is too large. This view is supported by the fact that 24 percent of members contribute at the 4% rate, but only 9 percent of members contribute at the 8% rate.[4]

Compliance

Members would have to self-select onto one of the new employee contribution rates (as members wanting to contribute at 4% or 8% currently have to). Employee deductions would continue to be made out of members' salary or wages, meaning there would be no on-going additional compliance costs for employees.

The range of rates at which employers would be required to deduct contributions from employees' salary or wages would increase. This could result in a small increase in compliance costs for employers not using a commercial payroll system.

Administration

This option would require building additional employee contribution rates into Inland

[4] The other 67 percent of members contribute at the minimum 3% rate.

Revenue's administrative system. However, this impact would be a one-off cost.

Equity

Members on a higher salary or wage are more likely to be in a financial position to self-select onto a high rate than lower salary and wage earners. As the additional contribution rates are voluntary their introduction would not result in lower income earners being financially worse off as a result of them.

Option two: Add automated option to allow members to increase their contribution rate over time

Under this option members would choose an automated annual increase in their contribution rate of 0.25%, 0.5% or 1% up to a capped maximum rate.

Effectiveness

This option would provide more flexible contribution rates. This could have a positive impact on savings, as well as allowing members to personalise their contribution rate more specifically to their retirement savings needs.

Compliance

As contribution rates would automatically increase members would not be required to self-select onto a higher contributions rate which could be seen as a reduction in compliance costs. However, this option would significantly increase compliance costs for employers, and could require them to modify their payroll systems. The automated contribution rates could also be complex for payroll and software providers to implement in the first instance.

The automated rates would also add complexity to KiwiSaver rules, which could be difficult for scheme providers to explain to members.

Administration

Introducing increasing contribution rates which are not whole numbers would require changes to Inland Revenue systems and could be difficult to administer.

Equity

There is a possible inequity, in that members on a higher salary or wage are more likely to be in a financial position to choose to annually increase their contribution rate. However, as the automated annual increases would be voluntary their introduction would not result in lower income earners being financially worse off.

Option three: Increase the minimum employer and employee contribution rate from 3% to 4%

Effectiveness

This option would result in a compulsory increase in costs for KiwiSaver members and employers contributing to KiwiSaver. This could detrimentally impact on members and employers' current financial position and short-term savings. We note there is limited evidence this recommendation would raise savings rates (as it may result in KiwiSaver members substituting away from other savings).

Compliance

Employee deductions would continue to be made out of members' salary or wages, meaning there would be no additional compliance costs for employees.

The minimum rate employers would be required to deduct contributions from employees' salary and wages would increase. This could result in a one-off increase in compliance costs for employers not using a commercial payroll system.

Administrative

This option would require changes to Inland Revenue's administrative processes for validating minimum contribution rates. However, these impacts are likely to be small and one-off in nature.

Equity

This option would make it more difficult for low-income earners to contribute to KiwiSaver. This could adversely impact whether they are in a financial position to adequately support themselves in the short term or alternatively it could force members to go on a contributions holiday (and therefore negatively impact on their long-term savings).

Option four: Status quo

Effectiveness

The status quo does not address the problem, as it does not give members the opportunity to self-select onto new higher contributions rates and therefore it is unlikely to have any positive impact on members' long term savings. It also does not give members more flexibility to personalise the amount they contribute to align with their retirement savings needs.

Compliance

There would be no additional compliance costs.

Administration

There would be no additional administrative costs.

Equity

Members on a higher salary or wage are more likely to be in a financial position to self-select onto a high rate than lower salary and wage earners. Notably the gap in affordability between the 4% and 8% rate is a financial obstacle preventing many members from contributing at a higher rate. If members are not in a financial position to opt onto a higher contribution rate, it would mean these members would not have the opportunity to save more for their retirement.

Part B problem

Two options are considered for dealing with long contributions holidays.

Option One: Reduce the maximum contributions holiday period from five years to one year

Under this option the maximum length of a contributions holiday would be one year. Contributions would automatically resume after the one year, unless the member renewed their contributions holiday for another year.

Effectiveness

Although some members on a contribution holiday continue to make lump sum contributions, stopping regular contributions for five years is likely to significantly impact on members' long-term savings. Reducing the maximum period from five years to one year encourages members to more frequently re-engage with KiwiSaver and to assess whether they are in a position to resume making contributions.

Compliance

Members wanting to remain on a contribution holiday would have to renew their holiday each year rather than every five years, resulting in a small increase in compliance costs.

Administration

This option would require Inland Revenue to contact members on a contributions holiday more frequently. This would result in an on-going increase in the resources Inland Revenue would need to allocate to processing contribution holiday renewals. This impact would be manageable, and the on-going administrative cost of renewing contributions holidays could be reduced once KiwiSaver is transferred into the new START system, as part of Inland Revenue's business transformation programme.

Equity

Members on a contributions holiday because of financial hardship are unlikely to be in a position to resume contributions after a year. Therefore, this option would only benefit members whose financial position had improved since going on a contributions holiday. If, at the expiry of the shortened holiday period the member's financial situation has not improved they could still renew their holiday, but this option would ensure that they actively consider their financial position on a more regular basis.

As part of the detailed design of this option, transitional arrangements would be put in place for members on a contributions holiday longer than a year when the reduced period comes into effect. This would ensure these members would be entitled to complete the duration of their existing contributions holiday under the rules that applied when they opted to go on a holiday.

The proposal potentially creates an equity issue between members (in otherwise identical situations) applying for a contributions holiday prior to this change being enacted and those applying after this change is enacted. However, as transitional arrangements would only apply until members completed an existing contributions holiday there would not be an on-going equity concern (beyond five years).

Option two: Status quo

Effectiveness

The status quo does not address the problem. Going on a five year contributions holiday is likely to significantly impact on members' savings. As members are not prompted to reconsider the length of their holiday during the five year period, it also means they could stay on a contributions holiday for longer than is financially necessary.

Compliance

There would be no additional compliance costs.

Administration

There would be no additional administrative impacts.

Equity

If members do not select a duration end date for their contributions holiday, the default five year period applies. As they are not prompted to reconsider whether they are in a financial position to resume making contributions during the five year period, they could continue to be on a contributions holiday when their current circumstances do not require it. Therefore, the long term savings of a member on a five year contributions holiday are more likely to be negatively impacted, than members on a contributions holiday who select a (shorter) duration end date.

3.2 Which of these options is the proposed approach?

Part A problem

The proposed approach to address the problem of low contribution rates is to introduce additional 6% and 10% optional employee contribution rates. These additional rates would give members more flexibility to meet their specific retirement savings needs and have the potential to positively impact KiwiSaver members' long term savings. A member with an annual gross income of $50,000 gains an additional $1,000 in savings by increasing their contribution rate from 4% to 6% or from 8% to 10% each year.

As the additional rates are voluntary the current financial needs of low-income earners will not be adversely affected.

Part B problem

The proposed approach to address the problem of long contributions holidays is to reduce the maximum period of the contributions holiday from five years to one year. This approach would prompt members to reassess whether they were in a position to resume making contributions after one year rather than five years. For every additional year a member contributing at the default 3% rate with an annual gross income of $50,000 resumes contributions, they gain up to $3,258.93 in savings (including the full member tax credit and compulsory employer contributions).

Members would still be able to renew their holiday if their financial circumstances continue to require it and members who do not use KiwiSaver as their primary retirement savings vehicle would not have to substitute away from their other savings.

The proposed approaches are not incompatible with the Government's '*Expectations for the design of regulatory systems'*.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties	Comment:	Impact
Additional costs of proposed approach, compared to taking no action		
Regulated parties (*KiwiSaver members, employers*)	**Part A** Employers could see a marginal rise in compliance costs, as there would be additional rates at which employee contributions are made. It is estimated between 38 percent to 55 percent of employers use commercial payroll systems,[5] therefore it is anticipated these employers should not have difficulty with this. The additional rates would be a low level change for payroll system providers and should not be difficult for them to implement. Previous changes in contribution rates (such as the movement in the minimum rate from 4% to 2% and then 3%) have not caused significant issues for employers or payroll system providers. **Part B** Additional on-going compliance costs for members wanting to renew a contributions holiday, as they would have to actively consider renewal of their holiday each year, rather than every five years.	Low Low
Regulators (*Inland Revenue)*	Communicating the proposed approaches to the public, employers and scheme providers would have an estimated one-off cost of up to $300,000. **Part A** Changes to Inland Revenue's operational systems would have an estimated one-off cost of up to $90,000. **Part B** Changes to Inland Revenue's operational systems would have an estimated one-off cost of up to $18,000. Having to renew members' contributions holidays each year, rather than every five years, would also result in an increase in estimated on-going administrative cost	One-off communication cost of up to $300,000. One-off implementation cost of up to $90,000. One-off implementation cost of up to $18,000. Administrative cost of up to $71,000 for 2019-20 and $184,000 for 2020-21. KiwiSaver is scheduled to

[5] Based on the 198,000 employers who filed with Inland Revenue in 2016. The 38 percent using a file transfer filing method use commercial payroll software, it is anticipated over half of the 34 percent of employers using an onscreen filing method also use commercial payroll software.

	for Inland Revenue of up to $71,000 for 2019-20 and $184,000 for 2020-21.	be transferred into Inland Revenue's new computer system (START) in 2020, which may reduce on-going delivery costs.
Wider government	**Part A** The additional rates should not have a fiscal impact (members earning an annual gross income of $26,071.50 contributing at the existing 4% rate contribute enough to receive the full member tax credit). **Part B** Assuming the proposed approach encourages members to come off contributions holidays earlier more members would be entitled to the member tax credit.	Low If all members currently on a contributions holiday resumed making contributions the fiscal cost would be approximately $30 million. If only members on a five year holiday resumed contributions the fiscal cost would be approximately $23million.[6] Actual fiscal costs are likely to be significantly less, as costs would consistently decline based on the members on a contributions holiday that decided to renew their holiday.
Other parties	No other parties are impacted.	No impact.
Total Monetised Cost	*Administrative costs for Inland Revenue.*	*One-off cost of $408,000, on-going cost of up to $71,000 for 2019-20 and $184,000 for 2020-21 period.*
Non-monetised costs	*Compliance costs on KiwiSaver members and employers and increase in member tax credit payable by the Government.*	*Low*

Expected benefits of proposed approach, compared to taking no action		
Regulated parties (*KiwiSaver members*)	**Part A** Additional 6% and 10% employee contribution rates could encourage members to self-select a higher rate and increase their savings.	Low (as both Part A and Part B would be voluntary, the aggregate increase in members' savings is difficult to predict).

[6] Based on number of people on a contributions holiday at 30 June 2017 and assumes each person would receive a member tax credit payment of $380.00 – the average member tax credit amount claimed by members on a contributions holiday (who were making voluntary contributions).

	Part B Reducing the maximum contributions holiday period to one year prompts members to reassess whether they are in a financial position to resume contributions. Resuming contributions earlier would increase members' savings.	
Regulators (*Inland Revenue*)	N/A	N/A
Wider government	N/A	N/A
Other parties	N/A	N/A
Total Monetised Benefit	*N/A*	N/A
Non-monetised benefits	*Increase in KiwiSaver members long-term retirement savings*.	*Low*

4.2 What other impacts is this approach likely to have?
The exact impact the proposed approaches would have on KiwiSaver member's contribution behaviour cannot be anticipated. As the proposed changes are voluntary there is the risk they might not have the desired effect of increasing the amount KiwiSaver members are contributing. However, consultation and surveys undertaken as part of the Review suggested there was public support for the proposed approaches: • 85.6 percent of respondents were in support of more flexible contribution rates (the proposed approach to address low employee contribution rates); and • 51.6 percent of respondents supported reducing the maximum contributions holiday period (the proposed approach to address long contributions holidays). This suggests there should be a notable group of KiwiSaver members who would be responsive to the proposed approaches (particularly in respect of the approach to address low employee contribution rates).

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?
As part of the previous Government's response to the Review (which was co-ordinated by MBIE) the Treasury, MBIE, and MSD had the opportunity to express their views on the proposed approaches. Inland Revenue has also separately consulted with the agencies jointly responsible for KiwiSaver – MBIE and the Treasury, who agreed with the proposed approaches. Inland Revenue has consulted with KiwiSaver scheme providers, and they generally support the proposed approaches. A working group made up of representatives from 11 KiwiSaver scheme providers also made a written submission as part of the Review consultation process. Inland Revenue have not consulted further with employers or KiwiSaver members, relying instead on the public consultation which was undertaken as part of the Review - in the form of interviews, written submissions and surveys (approximately 11,200 surveys were completed on retirement income policy, with 1,830 of those being specifically on KiwiSaver). Members and employers would also have had the opportunity to provide feedback on the proposed changes after the Government's letter of response to the Review was released publicly.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?
The proposals will require amendment to the KiwiSaver Act 2006. Amendments would be included in the next available omnibus tax bill, currently scheduled for introduction in May 2018. The changes would come into effect once this bill has been enacted into law. It is anticipated this would be in early 2019. We are proposing that transitional arrangements be put in place for KiwiSaver members on contributions holidays of longer than a year, when the changes are enacted. These members would not be subject to the reduced maximum contribution holiday period, until their current contribution holiday expires. Inland Revenue would be responsible for the on-going administration of the new arrangements. Inland Revenue officials have assessed the magnitude of these administrative impacts, and consider that they would be manageable to implement in the proposed timeframe. The Minister of Revenue would make an announcement, on the contents of the proposed omnibus tax bill (including these proposals) when it is introduced in the House.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?
Inland Revenue would monitor the outcomes pursuant to the Generic Tax Policy Process (GTTP) to confirm that they match the policy objectives. The GTPP is a multi-stage policy process that has been used to design tax policy in New Zealand since 1995. Inland Revenue also currently collects data on members' employee contribution rates and contributions holiday duration periods. This data could help inform an assessment of how many members' contributions behaviour has changed as a result of the proposed approaches.

7.2 When and how will the new arrangements be reviewed?
The final step in the GTPP is the implementation and review stage, which involves post-implementation review of legislation, and the identification of remedial issues. Post-implementation review is expected to occur around 12 months after implementation. Opportunities for external consultation are built into this stage. Any necessary changes identified as a result of the review would be recommended for addition to the Government's tax policy work programme. As the Retirement Commissioner's review of retirement income policies is conducted every three years, the next review in 2019 would also provide an opportunity to reflect on the level of support for the proposed approaches.