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Retirement Policy and Research Centre

A Briefing from the Retirement Policy and Research Centre

Would Total Remuneration improve KiwiSaver fairness?

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Introduction

Total Remuneration (TR) is the total value of an employee's annual compensation package and includes both basic pay or salary and the financial and non-financial benefits. This means that KiwiSaver or other pension/superannuation plan contributions, bonuses, cash incentives, gym membership, access to counselling services and any other benefits, are included.

Such a summation helps clarify the full picture of employment benefits especially for those associated with higher income employment. Some of the value of the extra benefits may be captured by fringe benefit tax.

This PensionBriefing concentrates on the use of TR packages in wage contracts that incorporate the employer's contribution to KiwiSaver. Some regard this approach as equitable, as everyone in the firm who does the same work is paid the same gross TR regardless of whether they are KiwiSaver members. Others argue that the employer's KiwiSaver contribution should be an addition to gross wages as it is a necessary incentive to encourage employees to participate in KiwiSaver.

While the Retirement Commissioner's 2019 Review of Retirement Incomes Policy recommended phasing out TR, the practice is currently legal. Surprisingly, there has been little research into the use of TR for KiwiSaver and there is a dearth of statistical data around the practice.

A 2015 survey by the Employers and Manufacturers Association found 28% of senior managers and 20% of other staff were affected by TR.[2] A 2018 Commission for Financial Capability (CFFC) survey of 500 companies suggested that 55% of employers were paying the 3% on top of gross wages, some were unclear what they were doing but the implication is that up to 45% of employers were including it as part of TR. The CFFC pointed to an alarming number of KiwiSaver members who were not contributing, well beyond those on savings suspensions or self-employed. Was this only because they could

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[1] PensionBriefings are technical papers published as contributions to public debate that aim to objectively set out the issues of particular aspects of policy. The RPRC acknowledges helpful comments from David Boyle, MINT Asset Management, Michael Chamberlain, MCA NZ Limited and Michael Littlewood- former co-director of the RPRC. The remaining errors are the authors' responsibility.

[2] See https://www.nzherald.co.nz/northern-advocate/lifestyle/kiwisaver-shelley-hanna-total-remuneration-is-legal/UOVYRNM4VCODXZPBMCBBJ2FKCA/.

not afford it or was it also evidence that some employers were 'skimping on KiwiSaver contributions'?

> *More than half a million KiwiSaver members left $270 million of government contributions unclaimed last year, and the Commission said that could be because their workplaces were not upholding their end of the bargain.*[3]

Using a policy analysis framework discussed in St John and Dale (2012), we evaluate a range of options to improve equity, especially, but not only, for lower-paid workers:

- Option 1: Make KiwiSaver compulsory for both employer and employee contributions.
- Option 2: Make the employer KiwiSaver contribution a compulsory, not a matching contribution.
- Option 3: A formal TR policy to rationalise all employment-based contributions to KiwiSaver.

Background

KiwiSaver is best described as a quasi-compulsory, employment-based savings scheme. The employer is obliged in most cases to auto-enrol new employees into KiwiSaver.[4] The employee has a short time frame to opt out if they so choose but once they are a member they cannot opt out and the employer must deduct employee contributions.

Employer contributions are not required for anyone on a savings suspension, paid parental leave, or anyone over 65 years old although employers may choose to contribute. Employers do not have to contribute if they already pay into another complying scheme for the employee. If they offer another scheme but the employee does not join but is a KiwiSaver member then the employer must contribute 3%.

Unless the employee has opted to go on a 'savings suspension' they have the right to a compulsory matching employer contribution up to 3% of gross earnings over and above their gross wage or salary unless they have agreed to a TR contract that includes employer contributions.

Workers on casual contracts and temporary employment such as those employed for fewer than 28 continuous days, are excluded from automatic enrolment, but changes made in 2010 require "*the employer to deduct KiwiSaver contributions from an employee's salary or wages*". This "*ensures that, as long as certain other criteria are met, compulsory employer contributions are made to the employee's KiwiSaver account.*"[5]

In a *pure* TR approach, the employee would decide how to allocate their income and would choose whether to contribute to superannuation and how much to contribute from their TR package. Some argue this is desirable because it emphasises individual responsibility and free choice. High-income earners may use the process of salary sacrifice into superannuation schemes and in principle this could be applied to KiwiSaver. However, KiwiSaver is different to other superannuation schemes as the employer contribution is compulsory for KiwiSaver members, and not compulsory for other

[3] https://www.stuff.co.nz/business/104503731/employers-skimp-on-kiwisaver-contributions
[4] See https://www.kiwisaver.govt.nz/new/situation/.
[5] See https://www.taxtechnical.ird.govt.nz/new-legislation/act-articles/taxation-annual-rates-trans-tasman-savings-portability-kiwisaver-and-remedial-matters-act-2010/kiwisaver/temporary-employment-requirement-to-make-kiwisaver-deductions.

retirement saving schemes. Even if an employee has a TR contract, if they are a member of KiwiSaver the employer must deduct the compulsory contributions.

Who pays for the employer contribution?

New Zealand's KiwiSaver requires a minimum 3%/3% employee/employer contribution. This contrasts with Chile where there is an employee contribution alone and with Australia where there is an employer contribution only. In Australia, while the employer contribution appears to be additional to gross wages, a bonus even, it is in practice factored into the employer's overall costs of employment. Thus, the employer contribution may slow the pace of wage growth, as without the employer contribution, wages may be higher.

The default

In KiwiSaver, the default approach is for employer contributions to be made on top of gross pay. Hence a KiwiSaver employee is effectively paid 3% gross more than a non-KiwiSaver member. There may be a further loss over time in that, if there had been no KiwiSaver, wages may have been higher. In this scenario, non-members subsidise the savings of others through lower wage growth.

The idea that the wage earner pays for their own employer contribution through lower wages is contested, especially by the superannuation industry. Nevertheless, the Australian 2020 Retirement Incomes Review found that increases in employer's compulsory superannuation contributions are financed by reductions in workers' wage growth, calling into question whether a rise in the compulsory rate would be sensible for low-wage earners:

> *A rate of compulsory superannuation that would result in people having an increase in their living standards in retirement may involve an unacceptable reduction in living standards prior to retirement, particularly for lower-income earners. This is based on the view, supported by the weight of evidence that increases in the SG rate result in lower wages growth, and would affect living standards in working life.*[6]

The history of Total Remuneration in New Zealand

The history of the use of TR in KiwiSaver was summarised in RPRC's 2013 *PensionBriefing*.[7] When first announced, KiwiSaver did not mandate employer contributions; the employers were required to enrol employees into KiwiSaver but while they could contribute if they wished, contributions were to come from members and taxpayers. Subsequent changes mandated employer contributions, opening up the possibility of those employees who for whatever reason were not members to be paid less in total remuneration terms.

While the default is pay + KiwiSaver employer contribution, it is clear that some employers prefer TR. Is that because they think it is more equitable, or is it because they perceive it will be easier for them to keep the total wage bill down over time?

There have been several changes to legislation on TR, first, it was possible under the original Act 2006, and then specifically disallowed and then allowed again in 2008.[8] The current situation allows TR if accompanied by good-faith bargaining. Typically, unions

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[6] See https://treasury.gov.au/sites/default/files/2020-11/p2020-100554-complete-report.pdf.
[7] See https://cdn.auckland.ac.nz/assets/business/about/our-research/research-institutes-and-centres/RPRC/PensionBriefing/2013-5%20KiwiSaver,%20employer%20contributions%20and%20remuneration.pdf.
[8] Section 101B(4) of the KiwiSaver Act 2006.

regard TR with suspicion, preferring the transparency of the default where the employer contribution is clearly identified.

How it works

Some of the complexity of the current arrangements stems from the fact that the employee and employer contributions are treated slightly differently for tax purposes.[9] Either an employee contribution alone, or an employer contribution alone would be simpler. A detailed example is set out in Table 1.

Table 1. Comparisons of Default and Total Remuneration.

	Default: Employer on pay plus KiwiSaver		Employer on Total Remuneration	
	Employee **not** in KS	Employee in KS	Employee in KS	Employee **not** in KS
Total remuneration	$100,000	$103,000	$103,000	$103,000
Employer KS contribution	0	$3,000	$3,000	$0
Base salary	$100,000	$100,000	$100,000	$103,000
PAYE/ACC	$25,310	$25,310	$25,310	$26,342
Employee KS	$0	$3,000	$3,000	$0
Net pay	$74,690	$71,690	$71,690	$76,658
Total KS contributions*	$0	$5,010	$5,010	$0
Total net remuneration**	$74,690	$76,700	$76,700	$76,658

* the total KS contributions is the employee contribution plus the employer contribution net of Employer Superannuation Contributions Tax (ESCT).
**The table shows an employee who does not join KS on a pay plus benefits approach misses out on $2,100 net; an employee on TR gets slightly more if in KS because they pay ACC on $100k and not $103k (If they have an accident, they will get slightly less ACC payments).

With some employers using the default and others using TR, it is less transparent that the employer contribution has always been added in full to the TR package. The CFFC also identifies TR as it currently operates as offending the equity principle rather than solving it:[10]

> *There is also unfairness when employees compare their situations with peers in other workplaces, with one receiving a match from their employer while the other does not….*

This argument suggests that the unfairness arises from allowing employers the choice of TR as a way around their obligations and implies that some current contracts may fail to actually include the employer contribution. An example of this has been played out in the courts as set out in Box 1. In this case an employer was paying the minimum wage as a TR package that included the employer contribution. Thus, it was argued successfully by the union, he was effectively paying less than his obligations under the minimum wage legislation. The problem is not so easy to see when the wage paid is above the statutory

[9] Under some conditions the tax is slightly less on the employer's part as explained here: https://www.superlife.co.nz/for-employers2/salary-sacrifice. There are complexities in the determination of the ESCT rate and what is in and not in that rate and that it can be manipulated. It requires past data for people employed for a full tax year and estimated data for others.
[10] See page 7, https://cffc-assets-prod.s3.ap-southeast-2.amazonaws.com/public/Uploads/Retirement-Income-Policy-Review/2019-RRIP/CFFC-RRIP2019-SUMMARY.pdf.

minimum and a TR approach is agreed to by the employee and used for all the employer's employees.

Box 1: The Court of Appeal case involving Terranova Homes and Care Limited

The Court of Appeal case involving Terranova Homes and Care Limited highlighted a different issue arising from TR packages. Some employees were employed under total remuneration packages, and if the employer contribution to KiwiSaver was excluded, these employees' direct pay was less than the minimum hourly wage rate. Thus the Care Limited claim was that the total remuneration packages were unlawful as they breached the Minimum Wage Act. In response, Terranova Homes argued that although some of the money was going to their KiwiSaver schemes, the employees were still receiving at least the minimum wage, so the requirements of the Minimum Wage Act were being met.

The full bench of the Employment Court heard the case and found in favour of the employees. So subsequently did the Court of Appeal. Both courts looked at the purpose of the Minimum Wage Act - which is to ensure that people who work receive a set minimum wage for work done. While it is arguable, and was argued on behalf of Terranova Homes, that a person having money paid into his or her KiwiSaver scheme is still receiving the money, s/he is unable to spend this. It is, in essence, a payment towards the employee's future self, not present self. Thus, it does not accord with the physical quality of "receiving" a minimum wage.[11]

The policy analysis

The first question to ask in any evaluation of policy is "what is the problem to be addressed". Once there is agreement on the nature of the problem, different options to address the problem can be assessed (see Box 2, from Box 1, St John and Dale 2012).

Box 2: Options to address the policy problem

1. Clarify the problem.
2. Set clear objectives (aims) for policy; note trade-offs.
3. Make aims measurable or quantifiable.
4. Select policy criteria: e.g. cost-effectiveness, economic efficiency, equity, administrative simplicity; outline theories or models that inform policy development.
5. Assess a full range of policies that might achieve the objectives.
6. Select and design the best policy; project expected costs and outcomes.
7. Implement policy.
8. Measure outcomes against clearly stated, measurable objectives.
9. Review unintended consequences.
10. Evaluate policy against criteria; confirm that the problems and the underlying economic model have been properly conceived; and suggest improvements.

The problem could be described as one where those who cannot afford to be in KiwiSaver or are outside of the compulsory employer contribution (eg over 65 or under 18), are paid less than those who do save and are covered by compulsory contributions. The question is: Is this unfair, or a natural side-effect of a policy designed to change behaviour, ie incentivise saving?

[11] See http://www.stuff.co.nz/southland-times/business/9354470/Total-remuneration-packages.

The incentive argument underpins the recommendation in the 2019 CFFC Review of Retirement Incomes Policies, to *phase out the inclusion of KiwiSaver in 'Total Remuneration' packages.* The rationale behind the recommendation is to separate the KiwiSaver employer contribution from agreed wages or salaries so it is more clearly identifiable as a savings incentive:

> *[T]he employer contribution is probably the strongest incentive for many employees to participate in KiwiSaver. But under total remuneration, employees effectively pay their own employer contribution The absence of a genuine employer contribution incentive weakens the effectiveness of the scheme, increasing the risk that the demands of the day will drown out the demands of the future… Total remuneration can be appropriate in senior management roles, where the employee has far more bargaining power… We recommend amending legislation to prevent total remuneration applying to KiwiSaver, or to restrict it to employees in senior management roles with higher salaries.*[12]

Nevertheless, the government contribution already provides an incentive to members of KiwiSaver to contribute at least up to $1,043 per annum in order to receive the additional 50% subsidy up to a max of $$521.43, yet the data suggest that many fail to respond even to this incentive.[13] This suggests the unaffordability of contribution in the default may be the bigger issue. If the issue is mere myopia about the future, then reducing access to a savings suspension may be a more effective tool.

If it is accepted that the default arrangement is 'unfair', there is both a horizontal equity aspect (equals are treated unequally) and a vertical equity aspect (low income people, people who can't afford to save are disproportionately disadvantaged).

Gender and COVID-19

The issue of equity in both senses has particular relevance for the current COVID-19 recession. There is an unfortunate dearth of data on a gender basis around noncontributors and why they are not contributing or are simply not members.

Women in particular, may find that it is their KiwiSaver that is viewed as most expendable in their household. They may too readily withdraw for hardship reasons or go on indefinite savings suspensions if they or their household feel they can't afford to continue contributions. In doing so they forego the 3% of their total wages that the employer contributes as well as the Government's contribution. In the longer term, especially if the contribution rate is increased, the increase in their wage rate may be lower than it otherwise would be so that they are effectively subsidising the savings of others (Dale and St John, 2020).[14]

Under current default settings, employer contributions are not mandatory after the age of 65.[15] Applying a gender lens to policy, women who spend maybe 10 or more years out of the workforce raising children or other unpaid duties forego the opportunity to have the employer subsidy for the same number of years it is available to others (usually men). Thus, many women continue to work past 65 and need to do so to make up for

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[12] See https://cffc-assets-prod.s3.ap-southeast-2.amazonaws.com/public/Uploads/Retirement-Income-Policy-Review/2019-RRIP/CFFC-RRIP2019-SUMMARY.pdf, p. 9.
[13] The number of KiwiSaver members on savings suspensions in 2020 increased by 5,500 from February to March, to 138,441. See Hardship, hard times and house-hunters drain KiwiSaver | Investment News NZ.
[14] See https://cdn.auckland.ac.nz/assets/business/about/our-research/research-institutes-and-centres/RPRC/OtherPapers/Women%20in%20Super%20September%202020.pdf.
[15] See https://www.rnz.co.nz/national/programmes/ninetonoon/audio/2018710388/kiwisaver-for-over-65s.

lost time: one argument is that they should be able to have the same years of access to the employer contribution, and government contribution, as men have.

The evaluation of options that follows is based on the premise that the problem is a fundamental equity issue that has severe distributional consequences. There are three main options considered against a set of criteria. Suggested criteria are:

- Ability to solve the problem
- Equity
- Efficiency
- Simplicity
- Cost effectiveness
- Political feasibility
- No unintended consequences.

Options for addressing the equity problem

The problem we are trying to solve here is that of fairness to all *employees* whether in KiwiSaver or not. It does not include addressing all the problems of unpaid caregiving or other unpaid work directly. The option of simply phasing out TR entirely would further embed the current inequities in the default and is not considered here.

Option 1. Compulsion

Compulsion would ensure that every employee receives the employer contribution into their KiwiSaver fund on top of their wages, as in Australia. It would make the TR option redundant and is an alternative to a comprehensive TR approach. Compulsion treats each employee on the same gross wage equally. A KiwiSaver member would make a compulsory 3% of gross pay (paid out of net pay) and the employer would contribute 3% of gross, taxed at the appropriate ESCT rate.

The compulsory approach does not solve all the equity problems however as outlined for Australia in Dale and St John (2020). There are concerns that if the contribution rates are 'too high', low-wage contributors may be worse-off because of the wage/rate trade-off that leaves low-income members worse off when working than they will be when retired.

<u>Assessment</u>

- Ability to solve the problem
    - Yes- but may force some into unacceptable working age poverty
- Equity
    - Treats those on equal incomes equally (but employees on the same income may be in different personal circumstances).
    - In principle, improves vertical equity by ensuring that all employees benefit from the employer contribution.
- Efficiency
    - Makes an incentive to belong and contribute redundant so undermining the need for the government contribution
    - Destroys the flexibility of KiwiSaver and responsiveness to changed circumstances as it would not be possible to opt out or go on savings suspensions.
- Simplicity
    - Improves administrative simplicity – no more opt-outs or savings suspensions and it is more transparent and easy to understand.

- Cost effectiveness
    - Some fiscal cost as the government contribution (if it continued) will increase.
- Political feasibility
    - Poor. The last referendum on compulsion in 1997 was decisively defeated
- Unintended consequences
    - May reduce further wage increases or even reduce employment rates as employers seek to cover extra costs.
    - May be the Trojan horse for means-testing NZS (ie, follow the Australian model)

Option 2. Compulsory employer contribution for all in KiwiSaver.

This option is a modification of the status quo. It is attributed to the Financial Market Authorities' (FMA) 2019 Capital Markets Review[16] where it was identified that a significant number of employees were 'missing out'. That Review recommended mandating employer contributions regardless of employees' employment contracts and decisions to opt out or go on a savings suspension. The FMA's review also sought to protect those who were struggling to pay into KiwiSaver by allowing an employee contribution rate lower than 3% but without affecting the employer's 3% rate.

> *Additionally, we recommend requiring employers to continue 3% contributions for low-wage earners who have elected a lower contribution rate (or have suspended their contribution) of their salary or wages. Capital market participants noted the difficulty of saving for low-income households with little disposable income. However, we recognise the importance of instilling a habit of saving and wish to encourage it, particularly in people who are currently struggling financially. We suggest the employees' lower contribution rate could start at 1% and then gradually increase, with stepped contribution path implemented and set at the time of joining. This recommendation will encourage broader participation in KiwiSaver.*

Assessment

- Ability to solve the problem
    - Yes. It helps low-income people who cannot afford to contribute 3%, and improves savings' outcomes for low-income people.
- Equity
    - Treats those on equal incomes equally and takes account of different employee circumstances.
    - Improves vertical equity as low-income people will be able to benefit from the employer contribution.
- Efficiency
    - It maintains the flexibility of KiwiSaver and responsiveness to changed circumstances, as it would be possible to go on savings suspensions or make a lower rate of personal contributions without sacrificing the employer contribution. It may improve the incentive to contribute
- Simplicity
    - It would not greatly increase administrative complexity or compliance costs. But it complicates the employer's payroll system if employees change the contribution level too often. Relatively easy to make transition.
- Cost effectiveness

[16] See https://www.fma.govt.nz/assets/Reports/Growing-New-Zealands-Capital-Markets-2029.pdf.

    - Little fiscal cost - employer contributions are not counted for the government contribution subsidy but higher employees' contributions are.
- Political feasibility
    - May be easy to get political agreement as is not a major change from the status quo.
- Unintended consequences
    - May encourage low-income people to go on savings suspensions or a lower rate when they don't need to.
    - Employees, particularly low-income employees, will probably receive lower future wage increases.

Option 3. Total Remuneration for all

As a rough estimate, currently some 20% of low- to middle-income employees have TR contracts. There is a suspicion that there may be an incentive for employers to take the easy way out and reduce their total costs so that employees who lack bargaining power are worse off than they would be with the default arrangement.

Bearing this in mind, the full TR option considers a compulsory TR for everyone. In effect, it is approximately the same as changing the arrangements from 3% each for employee and employer to an equivalent compulsory employee contribution alone.[17]

To move from where we are currently requires employers using the default to add the current 'on the top' employer contribution to base gross wages. Employer costs would rise because employees not contributing to KiwiSaver would now gain the extra in their TR. However. over time there may be compensating adjustments to future pay increases or even job shedding.

Assessment

- Ability to solve the problem
    - If there is a genuine 3% increase in the gross wage at the time of transition for those employers not currently on TR, it improves outcomes for low-income people not in KiwiSaver who currently miss out on this 3% remuneration.
- Equity
    - Treats those on equal incomes equally whether they are KiwiSaver contributors or not.
    - It also gives them choices as to whether it is taken today for immediate expenditure needs or at retirement for retirement expenditure needs.
    - Improves vertical equity as it is more likely to be low-income employees who gain.
- Efficiency
    - It maintains the flexibility of KiwiSaver and responsiveness to changed circumstances as it still would be possible to go on savings suspensions. The government contribution could be made conditional on not being on a savings suspension to provide an incentive to contribute as an employee.
- Simplicity
    - The transition would be difficult. There would be temptation for employers to reduce normal pay increases to offset costs.

[17] Not quite a simple addition to 6% because of the different tax treatment. In the example in Box 1, it would have to be 4.86% to make it the same.

- There are significant administration issues because of how ESCT is calculated and what happens when employees suspend contributions.
- Cost effectiveness
    - Little fiscal cost.
- Political feasibility
    - This option may be politically unpopular as it may reduce incentives to belong or contribute to KiwiSaver. Unions can be expected to resist. It may appear to give more power to the employers to reduce wage rises over time.
- Unintended consequences
    - May encourage low-income people to go on savings suspensions when they don't need to.
    - May be resisted by low wage employers. May depress wage growth or even reduce employment.

Comments

This briefing began by asking the question "Would Total Remuneration improve KiwiSaver fairness?" The analysis has assumed that unfairness of current default is the main issue.[18] The options discussed all address the problem of the inequity of the current default but differ in their success in meeting the various criteria. This briefing highlights that more research and statistical evidence is urgently needed, including sorely lacking ethnic and gender data.

Full compulsion is a big step from where we are currently, may have unintended consequences and does not appear to be politically feasible. Total Remuneration for all as a policy appears to provide a fair solution, including addressing some of the gender equity issues, by creating remuneration parity between employees doing the same job, including those over 65.[19]

The biggest problem is that TR is a long way from the current default option and that the transition may be contested and difficult. Politically it may be a hard sell, especially as it appears, superficially, to go against the grain of providing an incentive to save in KiwiSaver. The second option of mandating the employer contribution rather than requiring it to be a matching 3% and allowing lower rates of contributions for those who cannot afford 3% may be an easier political solution.

In New Zealand, the Government has yet to respond fully to the 2019 Review of Retirement Income policies. Based on the assessment of the three options discussed in this paper, Option 2 appears to have some clear advantages. Nevertheless, there is a dearth of statistical data and research.

We hope this briefing contributes to the beginning of an informed debate about the future of TR in KiwiSaver policy.

[18] The only incentive to be in KiwiSaver would come from the Government's contribution. This might be made conditional on removal of the savings suspension option.

[19] It is noteworthy that in Australia, since 2013/14, people over 70 who are still employed are eligible for the employers' SG contribution. See https://cffc-assets-prod.s3.ap-southeast-2.amazonaws.com/public/Uploads/Retirement-Income-Policy-Review/Background-papers/International-comparisons/858275a103/RI-Review-2013-Comparison-NZ-Aus-Retirement-Income-Systems.pdf, p 7.

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For comments on this PensionBriefing and for further information please contact:

M.Claire Dale, Research Fellow,
Retirement Policy and Research Centre,
University of Auckland.
Private Bag 92 019
Auckland 1142
m.dale@auckland.ac.nz
http://www.rprc.auckland.ac.nz

Susan St John, Director,
Retirement Policy and Research Centre,
University of Auckland.
Private Bag 92 019
Auckland 1142
s.stjohn@auckland.ac.nz
0275364536

[20] See http://homes.eco.auckland.ac.nz/sstj003/pdf%20journal%20articles/2012%20Evidence_Based_Evaluation_Working_For_Families.pdf.