

NEWSLETTER NO. 39 : AUGUST 1997

Government Actuary guidelines in terms of integration of existing superannuation schemes into the proposed RSS

Please find attached a paper setting out a draft of the proposed guidelines. I would draw your attention to this comment at the beginning of the paper:

This paper is an indicative draft of the guidelines. The final form of the guidelines will be dependent on legislation which has as yet to be prepared, and hence their final content may differ in some respects from that presented here. It should be appreciated that if the RSS proposal proceeds, the guidelines are not expected to be static, but to evolve as needed, through ongoing consultation with interested parties; subject always to the broad outline as given in the White Paper.

Some very welcome comments from persons involved in the superannuation industry have been received on earlier drafts of this paper, and further comment is equally welcome. The statement on page 64 of the White Paper relating to integration has been mostly (but not universally) interpreted as requiring a markedly more prescriptive approach than at present applies under the Superannuation Schemes Act 1989, in view of the compulsion element incorporated in the RSS proposal. Any suggestions as to how the proposed guidelines could operate effectively with less prescription will be carefully considered.

Nonetheless, I consider that this draft, given the time constraints that all involved with design of the RSS are working under, gives a good sense of what would be required, and the matters that would need to be addressed. While I am more than happy to discuss the paper with anybody who wishes to comment, I note that I may find written submissions more useful.

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INTEGRATION OF EXISTING REGISTERED SUPERANNUATION SCHEMES INTO THE RSS

Background

On page 64 of the White Paper setting out the RSS proposal, it is stated:

"The Government intends to make it as easy as possible for existing funds to offer RSS options to their members, while maintaining the right of each individual to choose whether or not to pick up such an option.

The Government Actuary will publish guidelines as to the principles to be followed by funds utilising this procedure, which will:

- *allow the individual circumstances of each fund to be recognised. For instance, some funds may want to introduce an RSS fund without making any changes to their existing scheme, and other funds may wish to permit members to redirect some of their existing contributions to the RSS, reducing their existing contribution obligations and benefit obligations accordingly*
- *not force members to change from an existing scheme to an RSS scheme created under the special rules*
- *protect members' existing interests and rights*
- *ensure that the aims of the compulsory scheme are not compromised.*

In respect of defined benefit schemes, any reduction in benefits as a result of the switching of contributions from the existing scheme to the RSS will be subject to approval of the Government Actuary, including ongoing approval of such matters as the technical approach and assumptions used."

This paper is an indicative draft of the guidelines. The final form of the guidelines will be dependent on legislation which has as yet to be prepared, and hence their final content may differ in some respects from that presented here. It should be appreciated that if the RSS proposal proceeds, the guidelines are not expected to be static, but to evolve as needed, through ongoing consultation with interested parties; subject always to the broad outline as given in the White Paper.

Framework

The Government intends to legislate to facilitate changes to existing superannuation schemes registered under the Superannuation Schemes Act 1989 (ESS), so that:

- A new RSS compliant section of the ESS can be established;

and/or members of the ESS can be offered one or more of the following:

- The opportunity to meet the compulsory contribution requirements of the RSS regime by making contributions to the RSS compliant section of the ESS in addition to normal contributions to the ESS;
- The opportunity to divert part or the whole of normal ESS contributions into the RSS compliant section of the ESS, so as to meet the compulsory contributions required by the RSS regime;
- The opportunity to suspend part or the whole of normal ESS contributions, in order that members can make their own arrangements to meet the compulsory contributions required by the RSS regime;
- The opportunity to convert part or all of existing ESS entitlements into RSS contributions; this may involve a partial winding up of the ESS in respect of members wishing to convert all their existing entitlements.

In the case of employer-sponsored schemes, the opportunity to divert, suspend and/or convert may extend to the employer subsidy element, subject to compliance with the legislation and guidelines.

There will be no requirement for any ESS to make any change, and the RSS legislation will permit changes only for the purposes listed above. Amendments would be made in accordance with trust deed requirements, except that member consent to amendments would not be required. Legislation is expected to address:

1. The ability to insert a new RSS section, including changing the winding-up priorities, and the treatment of costs incurred in setting up and promoting an RSS section within an ESS
2. Reductions in contribution obligations and/or reductions in benefits commensurate with diversion, suspension and/or conversion, and improvements in vesting scales in employer-subsidised schemes
3. Partial winding-up to enable transfer of entitlements to an RSS section or scheme
4. Replacement of references to New Zealand Superannuation in scheme rules
5. Imposition of disclosure requirements for amendments to the ESS, additional to those required under the Superannuation Schemes Act 1989, improved investment disclosure regulations, and any disclosure generally required in respect of RSS arrangements.

In addition to the above, there is a risk that the aims of the compulsory scheme could be compromised if any ESS could provide for reductions in contributions and benefits under existing superannuation legislation, bypassing the RSS legislation. Consideration is therefore being given to enacting legislation which will allow the Government Actuary to refuse to accept amendments which permit reduction of contributions and benefits (even where those amendments are allowed by Section 9 of the Superannuation Schemes Act 1989), unless either member consents are obtained, or the Government Actuary is satisfied that the proposed amendment is independent of the introduction of the RSS regime.

The following sections expand on the five points set out above.

Features of an RSS compliant section within an ESS

Whether or not an RSS compliant section is established for RSS savings in addition to existing contribution levels, or so as to incorporate existing member contributions and/or entitlements in part or wholly, the new section to be established in the governing instrument should cover the following matters:

- Who can become a member of the RSS section;
- The procedure to be followed for a person to become a member under the RSS section and for one or more scheme RSS Accounts to be established for the member, including the process of giving the necessary advices as required for RSS schemes generally in addition to those under the Superannuation Schemes Act 1989;
- The basis on which contributions may be made to a member's scheme RSS Account, including what happens when a member meets his or her RSS target, and any other event which may affect the basis on which contributions are made;
- The basis on which RSS scheme credits from an external RSS scheme may be accepted and credited to a member's scheme RSS Account;
- The basis for determining charges that may be made to a member's RSS Account, subject to the regulations affecting RSS schemes generally;
- The basis on which investment policy for the assets in respect of the RSS section of the scheme is to be determined and monitored in respect of diversification requirements under the RSS rules and the overall scheme investment policy;
- Where investment policy and strategy is different from the ESS, the basis on which investment earnings are to be determined and allocated, subject to the regulations affecting RSS schemes generally;
- The circumstances in which payment of the amount standing in a member's RSS Account may be made, subject to the regulations affecting RSS schemes generally, including compliance with portability requirements;
- Any additional reporting requirements that may be required for RSS compliance, over and above that which applies for the scheme as a whole;
- Any other matters as may be required for the administration of the RSS section

Some of the above will be no more than is laid down for RSS schemes generally. Given that the requirements of RSS compliance may change from time to time, reference to "RSS rules in force from time to time" may be acceptable, as long as clarity is not compromised.

It is anticipated that in addition to the above, legislation will:

- Prohibit the costs associated with establishing and promoting an RSS compliant section from being charged to the ESS, unless consent is obtained from all members whose ESS benefit might be thereby reduced; however, where the costs are to be met from unallocated reserves, and the costs are not unreasonable in the context of the ESS and comparable with the cost of establishing external RSS schemes, then member consent will not be required;
- Prohibit any restriction on portability or draw-down contrary to the general RSS regime on amounts built up in RSS accounts, whether or not such amounts include employer subsidy in the case of employer-subsidised schemes;

- Require the winding-up priorities of the ESS to be altered in order that the benefits under the RSS section rank above all other benefits for payment;
- Permit the transfer of RSS entitlements to a 'default' RSS scheme in the event that a member ceases to be eligible for continued membership of the RSS section and fails to nominate an RSS scheme for transfer within a reasonable time.

An RSS section within a scheme registered under the Superannuation Schemes Act 1989 will not be exempt from any surveillance and monitoring generally applicable to RSS schemes, and will be treated as if it were an external RSS scheme for such purposes.

Reduction of ESS contributions and benefits

General

It is anticipated legislation will require Government Actuary approval of any deed amendment to reduce contribution obligations to the ESS, and/or to allow conversion of existing ESS entitlements, with consequential changes to ESS benefits. The amendment is to be made in accordance with the amendment powers in the trust deed, but will not be subject to Section 9 or Section 9B of the Superannuation Schemes Act 1989, or any other member consent requirements. Approval will have regard to the following principles:

- The amendment will have to be accompanied by a copy of the explanatory material to be given to members when an offer is made to them to participate in diversion, suspension and/or conversion, and the material will have to comply with the guidelines on such material;
- No member will be under any compulsion to participate in diversion, suspension and/or conversion as a result of the amendment;
- Any improvement in benefits for RSS participating members which will reduce the benefits of ESS members who do not participate will not be approved; with the exception of improvements in vesting scales under employer-subsidised schemes, where the improvement is for the purposes of facilitating members ability to comply with compulsory RSS contribution requirements in respect of remuneration from that employer;
- Permit benefits to be reduced where a member invokes the legal right to stop contributions being deducted from salary or wages and the deed is otherwise silent, subject to approval by the Government Actuary;
- Any reduction in benefits will be no more than necessary to ensure that the financial position of the ESS is maintained; and where contributions are diverted to an RSS section of an employer-subsidised scheme, employer contributions overall in respect of a member's benefits should not be materially affected;

- There will be no restrictions on the extent and method of diversion or suspension of contributions or conversion of existing entitlements, except that the consequences must be capable of being explained clearly and simply to members;
- The eligibility of a member to participate in diversion, suspension and/or conversion may be subject to such restrictions as wished, such as for example a requirement in an employer-subsidised scheme that all compulsory RSS contributions relating to remuneration in that employment be diverted to the RSS section; or that RSS contributions from other sources will not be allowed; provided only that such restrictions and the consequences thereof are capable of being explained clearly and simply to members;
- In employer-subsidised schemes, any reduction in overall employer contributions in respect of members who participate in diversion, suspension and/or conversion and who do not contribute to an RSS section of the scheme, and the reason for such reduction, will need to be adequately explained in the accompanying material.

In addition, it is anticipated that legislation will require that any actuarial calculations that may be needed will be made in compliance with guidelines set out from time to time by the Government Actuary, such calculations to be monitored by the Government Actuary as seen fit by him or her, and to provide for monetary penalties when such guidelines are not complied with, as well as immediate re-calculation.

Some examples of the approaches that it is anticipated may be taken when an ESS benefit is to be reduced as a result of diversion, suspension or conversion, are set out below. The examples are not intended to be exhaustive, but rather to give an indication of how it is expected various scheme design characteristics may be dealt with.

Examples

Case 1: *Benefit at present expressed as the accumulation of member contributions (and/or, if applicable, employer contributions)*

Diversion of future contributions, in whole or in part, will leave the ESS accumulation expressed as the accumulation of what remains being contributed to the ESS after the diversion.

Conversion, in whole or part, of existing entitlements by transfer into an RSS, should reduce the existing ESS accumulation by the amount transferred.

Case 2: *Benefit at present expressed as a defined amount such as a multiple of salary less the accumulation of member contributions (and/or, if applicable, employer contributions)*

For the purposes of calculating the defined amount, reference may be made to the accumulation in the RSS account as well as to the ESS accumulation, irrespective of whether or not the RSS account is payable in the circumstances. Where there is no RSS account, contributions having been diverted to an external RSS or suspended, or part or the whole of the RSS account has been transferred or drawn out, then the scheme may provide for the keeping of notional accounts (recording the accumulation of RSS contributions) for benefit calculation purposes. Where an internal RSS section accepts voluntary additional contributions, or amounts relating

to the proceeds from investments, balances relating to such amounts would be expected to be excluded.

Case 3: Benefit at present defined as a multiple of the accumulation of member contributions

Provided that members contribute to an RSS section, and do not avail themselves of transfer or draw-down facilities provided by the RSS regime, then the definition of member contributions should include RSS accumulations to the extent that these are attributable to diverted ESS contributions. Conversion of existing entitlements in the ESS to RSS accounts should be treated in the same manner. In the event of transfer or draw-down, or of suspension of member contributions, the use of notional accounts is accepted as being optional but not necessary.

Case 4: Benefit at present expressed as a defined lump sum amount dependent on factors such as membership and salary or final average salary

Two approaches are seen as suitable for such cases. The first is an **offset** method, whereby the benefit from the ESS is reduced by the amount accumulated under the RSS account in respect of member contributions that would otherwise have been allocated to meet the cost of the benefit being provided. The second is a **reduced multiple** method, whereby a reduction in the defined benefit is applied commensurate with the extent of contributions diverted.

The offset method is likely to be the most straightforward, although it may require establishing notional accounts where members transfer or draw down on their RSS account, or divert contributions externally, or suspend contributions. Conversion of existing entitlements, subject to compliance with guidelines below for evaluating existing entitlements in such cases, can also be allowed for in the same way.

The reduced multiple method will generally be considered appropriate only where a member permanently suspends further contributions, and the reduced multiple applied in respect of membership or service from the date of suspension. Other approaches will be acceptable only if they can be clearly explained to members. For example, a reduced multiple for a period of past membership or service where conversion of existing entitlements has occurred may be acceptable. The reduced multiple will have to be justified on actuarial grounds, and may be age dependent (ie a 40 year old suspending contributions permanently may have a different reduction from a 50 year old doing likewise).

Case 5: As for Case 4, but with the benefit expressed as a pension entitlement

The same considerations apply as for Case 4, but with the extra step under the offset method of placing a value on the pension entitlement. The value to be so ascribed will be subject to the guidelines for evaluating existing entitlements.

Evaluation of existing entitlements

In Cases 4 and 5 above, and in any other instance where evaluation requires projections, actuarial calculations will be required. The approach of leaving the matter to the actuaries of the schemes concerned has been considered, but the differences in approach taken by different

actuaries would lead to some lack of consistency over different schemes, despite such differences being generally within the bounds of acceptable professional judgement.

It is presently anticipated therefore that the Government Actuary will establish assumptions for the key factors of:

1. Investment return, net of tax and expenses of investment and administration;
2. Salary growth
3. Price inflation
4. Pensioner mortality
5. In service mortality

Items 1, 2 and 3 will be expressed by reference to key indicators, so that at any particular time they should be relevant without the Government Actuary having to issue continuous advices every time a key indicator changes. The key indicators for investment return are likely to make broad reference to investment profile; and those for salary growth to dominant occupational characteristics. From time to time, the Government Actuary will review the relationship to the key indicators, after consultation with the New Zealand Society of Actuaries and financial economists.

Other assumptions that may be required, such as rates of withdrawal and disablement, will be left to the judgement of the scheme actuaries, but will have to be capable of being justified to the Government Actuary.

In respect of pension schemes, the allowance for pension increases is generally to be in accordance with present practice in the scheme.

In schemes with material levels of surplus or deficit calculated in accordance with the assumptions set by the Government Actuary, the explanatory material given to members contemplating diversion, suspension and/or conversion will be required to identify the presence of such surplus or deficit, quantify the amount attributable to the member's own entitlements, and explain the consequences of diversion, suspension and/or conversion.

Partial winding up

It is anticipated that legislation will permit deeds to be amended to allow for partial winding up, where the proceeds are to be credited to an RSS section of the scheme or to an external RSS arrangement. This is intended to permit some members of a scheme to elect to convert the whole of their entitlements to RSS savings, while leaving other members unaffected. Invocation of this process may involve the proportional allocation of any scheme unallocated reserves to the transferring members.

Consideration is being given to have the legislation require that any conversion of the whole of existing entitlements be effected in the same fashion.

References to New Zealand Superannuation

Some schemes define benefits by reference to "New Zealand Superannuation". Although New Zealand Superannuation will continue to exist until the RSS is fully mature, it is seen as desirable that those schemes can change the reference through the RSS legislation to a proxy for the concept.

Information to be given to members

When an RSS compliant section is added to an ESS without affecting ESS contributions and benefits - ie for voluntary extra contributions - then the information to be given to members will be basically "how to" information. That is, it will advise on how to make contributions, and provide the usual RSS and general investment product disclosure information, including the basis on which costs will be charged and investment return allocated. Where member consents are needed for set-up charges to be met from the ESS, if this is the approach taken, then all members that may be adversely affected or whose benefits will be reduced will have to consent, not just those who choose to make contributions to the RSS section.

Where the opportunity is going to be given to divert and/or suspend contributions and/or convert existing entitlements, there may be far-reaching consequences. The amendment giving effect to the opportunity will have to be accompanied by a copy of the explanatory information to be given to members. Topics to be discussed are to include:

- The member's right to remain in the ESS with benefits and contributions unaltered, unaffected by the introduction of the opportunity to divert and/or suspend and/or convert;
- What will happen, in all foreseeable circumstances, if a member does take that opportunity, to existing and future levels of ESS benefits; and to levels of future employer subsidy, if the scheme is employer-subsidised;
- What rights the member has (if any) to re-commence full or part ESS contributions, and the effect this will have on ESS benefits;
- The rights the member will have to transfer and/or draw-down RSS savings as per general RSS rules;
- Any compulsory transfer of RSS savings when they cease to be eligible for continued membership and are paid out their ESS benefit;
- Any other matters which it would be reasonable for members to be advised on before they commit themselves to taking up the opportunity to divert and/or suspend and/or convert.

The information given should be as matter of fact as possible, balanced, and present both the possible positive and negative effects of any decision a member may be called on to make. In the event that it proves impossible to explain the consequences of a proposed amendment with a reasonable degree of clarity, then the amendment will not be approved.

It is anticipated that in order to have amendments in place by 1 April 1999, preliminary discussions will be needed some months earlier as to the acceptability of amendments and explanatory material. It may well be that timing requirements will need some further consideration, but it is also clear that simple, straightforward approaches have a greater chance of being approved on time if deadlines remain tight.