Boutique Investment Group submission on MBIE Income Insurance Scheme Consultation

April 2022

Introduction and summary

1. This is a submission by the **Boutique Investment Group (B.I.G.)** on behalf of Nikko Asset Management New Zealand Limited, AMP Wealth Management New Zealand Limited, Mint Asset Management Limited and Kernal Wealth Limited.

2. We are commenting as employers concerned about our staff and communities, as entities with expertise in financial products, and as asset managers. No part of this submission is confidential.

Topping up KiwiSaver would be a better spend to benefit New Zealand

3. If Government believes that an additional 2.8% cost (shared between employers and employees) is an acceptable burden to impose on society (at this point in time) then topping up KiwiSaver would be a better use of the money than creating an income insurance scheme.

4. The Retirement Commission's 2019 "Review of Retirement Income Policies" draws attention to the impending retirement crisis that our aging population faces:

Consider this:

- Between now and 2060 the number of people aged 65+ will double.
- 1 in 4 New Zealanders will be over 65.
- As soon as 2028, those aged 65+ will outnumber children aged 0-14 for the first time.
- This is because we're living longer, and having fewer babies.
- Since the 1960s, the life expectancy for men has increased from 68 to 79; for women it's gone up from 73 to 83.
- A child born today can expect to live to their 90s.
- At the same the time, the number of babies born has declined from a high of 4.3 per woman in the 1960s, to 1.8 today.

That means fewer workers paying tax to support the elderly in the future.

- In 20 years, the ratio of people aged 15-64 to those aged 65+ will decline from 4 to 1, to about 3 to 1, and in 50 years will be 2 to 1. *(1)*

- In the same time, the cost of NZ Super will triple from $39 million a day now, to $120 million a day.
- The Government's Super Fund will only cover a fraction of that - 0.5% in 2035 rising to a maximum of 12% in 2078.

Today's Super is paid out of today's taxes – the same taxes that pay for health, education, law and order and everything else the government funds.

Will our economy grow enough to cover the rising cost of Super? Or does the government need to find a way to cover the cost – raise taxes? Spend less in other areas like health and education? Borrow more?

https://retirement.govt.nz/policy-and-research/retirement-income-policy-review/2019-review-of-retirement-income-policies/who-gets-what-who-pays/

5. The implication of the demographic trend that the Retirement Commission has highlighted is that something will have to give or change as far as superannuation is concerned. Relying on the Government Superannuation status quo will become untenable as the population pyramid becomes more weighted toward the elderly end of the spectrum.

6. The theory that we currently live by is that Government Superannuation will always be there to provide a basic standard of living and that KiwiSaver will then upgrade that basic standard of living to provide a good retirement. However, we all know that current KiwiSaver contribution levels will not be enough provide New Zealanders with a standard of living that they would reasonably want to enjoy in retirement, even if we were to naively assume that the Government Superannuation levels and retirement age will remain unchanged. Many also believe that Government Superannuation will not meet people's basic needs in the future.

7. We note that the discussion paper places a focus on 100,000 New Zealanders being made redundant every year. However, that number is very small against the approximately 1 in 4 of our population who will be in retirement in the not-too-distant future; many of whom will not have saved enough to have dignity and an acceptable quality of life in their old age.

8. It is also worth noting that one dimension of KiwiSaver is the ability to make a financial hardship withdrawal. While this is not the same as income protection insurance, putting additional money into KiwiSaver does create some additional resource for redundancy eventualities. The KiwiSaver rules could also easily be tweaked to expressly allow for some form of withdrawal on redundancy (up to a capped amount).

9. Therefore, while providing redundancy insurance may be a nice to have in an ideal world, addressing future superannuation needs is critical. If we are going to be taking money away from people, it should be put to its greatest value use, which is building up the long-term wealth of the people who would be sacrificing the money.

<u>Timing could not be worse for such a scheme</u>

10. We have submitted above that a top up of KiwiSaver would be a better way to use the money **<u>if</u>** society is in a position to carry that burden. However, we query whether this is the case.

11. The immediate effect of implementing the scheme could be that the price of locally sourced goods and services increase as there would be an additional input cost relating to all employees. In other words, the scheme could have an immediate supply side inflationary effect at a time when inflation is already running at its highest levels for 30 years.

12. We note that the inflationary effect will be on top of a number of other new input costs on businesses that will also likely have a further supply side inflationary effect:

    a. costs of employees being off work far more than they normally would be as a result of the pandemic (and the costs of additional sick leave);
    b. costs of an additional paid public holiday;
    c. potentially increased costs and complexity from changes to the Holiday's Act; and
    d. increased input costs from the supply chain issues (e.g. an approximately 400% uplift in shipping costs with massively increased delays).

13. Simultaneously, it is worth thinking about what impact imposing a defacto 1.4% pay cut on all employees will have on general confidence given that; consumer confidence is already lower

than during the GFC, asset values (including house prices) are falling, and all public sector workers are subject to a freeze on wage increases.

14. The actual cost to employees will end up being the full 2.8% because employers will have to recoup their 1.4% cost which will come out of what would otherwise be future pay increases, resulting in lower pay rises going forward than would otherwise be the case.

15. Ironically, the only part of New Zealand's global economic backdrop that currently seems healthy, against a very bleak economic backdrop is the tight labour market. And with the world now opening up New Zealand will likely suffer a further "brain drain" to the workforce, which will tighten labour conditions further.

16. This point in time arguably presents the worst set of circumstances for taking money out of the economy to fund redundancy cover.

<u>The scheme as proposed is fraught with perverse incentives and unfairness, and hasn't given any thought to sourcing cover using existing insurance providers</u>

A blanket levy that ignores risk will result in some workers unfairly cross-subsidising others and will create perverse incentives

17. Part of the reason why people go into certain careers like; teaching, nursing, working for the police (i.e. the essential workforce that we are now more reliant on than ever before) and working in Government departments is because those kinds of job offer good security despite not necessarily being as highly paid as many other roles.

18. Conversely other people choose to go into roles where the money is a lot better in the good times but the risk of redundancy is higher in the bad times, like marketing or sales roles.

19. We do not think it is fair to make the people who choose to work in relatively low paid but stable roles cross subsidise people in higher paid, but potentially less secure roles. This is especially true for the core public sector workers who will make up the bulk of those in high job security roles who are currently already subject to wage increase freezes.

20. We also think that giving everyone equal cover, for an equal premium ,irrespective of risk is open to abuse and will create perverse incentives:

- Why temper entrepreneurial risk taking with a degree of prudence if you know that Government will pay you 80% of your income if your risk taking doesn't come off? – The scheme will promote moral hazard in weighing up risk taking in business.
- If you are self-employed, why not pay yourself (or your spouse) an unsustainably high salary to then claim 80% of that when you make one person redundant ?
- Why wouldn't businesses exposed to climate risk simply carry on without adapting if they know that Government will pick up the costs of their work force if/when they become hit by weather events or regulatory change?
- What would be the point of going into a stable career so that you can pay for someone else to enjoy taking risk?

21. These wealth destroying outcomes would be the inevitable consequence of decoupling premium from risk.

For businesses where employment conditions are more predictable, the scheme seems expensive

22. Many businesses, including some of the signatories to this submission, already provide income protection insurance (often bundled with life insurance) to their staff.

23. Based on the existing income protection insurance products that we are aware of, businesses in our sector are able to arrange better coverage through existing private sector providers than the cover that citizens would receive under the proposed scheme, and at a cost that is lower than 2.8% of all employee cost. For example, someone on $100,000 salary would be paying $2,800 under the scheme (between employer and employee contributions). That is a lot of money to be spending on a specialised kind of insurance each year.

24. The obvious reason why the Government's scheme would appear to cost so much more than the cover than we are able to arrange for our employees could well be due to the premium created from all the perverse incentives and moral hazards that would arise from decoupling of premium from risk.

25. This is not a good foundation for cover and points to the scheme being not properly costed, understood, or desirable from an actuarial perspective.

There is an absence of any exploration of coverage by private insurers

26. Coming back to the point that our sector (and probably most others if looked at individually) can obtain better coverage that is right priced and right risked by going through a private provider than would be the case under this Government scheme, we query why there doesn't seem to be any discussion of how compulsory coverage might work using existing products by existing providers.

27. This is quite a strange oversight given that, using existing providers would be such an obvious counterfactual to creating a new state-run insurance body.

28. Therefore the scheme formulation thus far does not seem to have drawn from the expertise of the right people, which would include actuaries and other insurance experts, and as noted above wouldn't be as good a use of money as topping up kiwiSaver, and the timing could not be worse.

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