

INTEGRATION IN NEW ZEALAND

by John Elliott (New Zealand)

1. INTRODUCTION

- 1.1 Since the late 1930's, New Zealand residents have enjoyed in old age a universal, non-means tested state pension, financed on a pay-as-you-go basis (originally out of a specific social security tax but more recently from general taxation revenue). Notwithstanding that the amount of this state pension has been relatively substantial since the middle 1950's, few occupational retirement plans had considered, let alone implemented, integration of retirement benefits prior to 1972.
- 1.2 The emergence of state superannuation as a major political issue in the 1972 and 1975 General Elections, followed by rapid structural changes to the state system between February 1977 and August 1978 (50% increase in pension, residential prerequisite reduced from 20 years to 10 years, qualifying age reduced from 65 to 60) focussed media attention on retirement provision and increased public, employer, employee and union awareness of:
 - (a) the taxation cost of the state age pension,
 - (b) the relatively high level of the state age pension, by comparison with other countries,
 - (c) the generosity of better level occupational schemes,
 - (d) the inadequacy of low level occupational schemes.
- 1.3 Despite this greater awareness, subsequent moves to integrate existing occupational schemes have been few and reluctant, for reasons which may not have emerged so clearly in other countries.
- 1.4 The simple basis of the state age pension allows simple, easily understood, methods of integration and facilitates the insulation of employers from any implicit obligation to underwrite future structural changes in the state system.
- 1.5 In 1979, within three years of the statutory enactment introducing the new state age system (indeed within 12 months of its coming into full force),
 - (a) the government appointed New Zealand Planning Council has called publicly for reductions in the level of the state age pension and for increases in the qualifying age,
 - (b) the same political party that promoted the new scheme vigorously in 1975 as an election issue and introduced it in 1976 has implemented a small reduction in the effective pension level.These moves have drawn attention to the non-permanence of state arrangements and to the desirability of insulating employers from the potential financial exposure of an integrated occupational scheme to reductions in the state age pension.
- 1.6 The statutory establishment in 1974 of the Accident Compensation Commission providing a compulsory 80% earnings-related cover against accident (but not sickness) on a 24 hours, no-fault, basis has

drawn attention to the need to integrate occupational plans in wider areas than retirement. Recent increases in the rates of compulsory employer levy by which the Commission is financed (along with levies on motor vehicle owners and a small contribution from general Government revenue) have increased awareness of this point but as in the case of retirement benefits, few occupational plans have yet integrated disablement benefits. (An overlap of state accident and age pensions between ages 60 and 65 draws attention to the need to integrate state plans against each other).

2. THE STATE AGE PENSION

- 2.1 The state age pension (termed the National Superannuation Benefit) is payable to all New Zealand residents of 10 years standing who are aged 60 or more, regardless of property or of other income earned or unearned.
- 2.2 The amount of the age pension, which is taxable in the hands of the beneficiary on the same basis as other income, was originally set by statute in 1976 as being not less than:
 - (a) for a married couple, 80% of the Average Ordinary-Time Wage (as determined by the Department of Labour's six-monthly survey of the entire employed workforce),
 - (b) for an unmarried person, 60% of the married couple rate i.e. 48% of the Average Ordinary-Time Wage.The married couple rate is paid and taxed half to each spouse.
- 2.3 Because of the progressive nature of the personal income tax scale, this half to each tax approach (which is not available to a working couple) resulted not unexpectedly in the net rate of state pension to a married couple with no other income being more than 80% of the net wages received by an "average" worker whose spouse did not work. Public awareness of the difference between net and gross comparisons, following publicity of the distinction by the Planning Council, resulted in the 1979 statutory revision of the age pension/Average Wage linkage.
- 2.4 The revised definition of the age pension is broadly (in simple English) not less than:
 - (a) for a married couple, such gross amount as, after deduction of tax at the primary (no other income) rate, gives to each spouse 40% of the amount received after tax at the married non-working spouse rate, by a worker on the Average Ordinary-Time Wage,
 - (b) for an unmarried person, a gross pension equal to 60% of the married couple gross rate.

The gross pensions continue to be taxable to the recipients; in particular, a married age beneficiary who has other taxable income receives net, less than the 40% net described in (a)

2.5 The Average Ordinary-Time Wage used as a reference point includes males and females without distinction and incorporates the earnings of part-timers on an arbitrary half-count basis. Thus the state age pension is potentially subject to fluctuations against, or on top of, the general trend of wage movement, when large numbers of female and/or part-time workers move in or out of the workforce quickly i.e. at times of economic upturn or downturn.

3. RESISTANCE AGAINST INTEGRATION

3.1 The case for integration in New Zealand includes the usual points of over-provision, re-distribution of benefits from the lower paid towards the higher paid, control over the slope of combined (occupational plus state) pension versus salary, conformity of a local subsidiary with the global practice of its multinational parent company.

3.2 Some employers who are under cost pressures in other directions are seeing integration as a one time opportunity to reduce the cost of an occupational scheme.

3.3 One interesting feature to emerge has been the experience of employers operating a single scheme open on the same basis to all levels of employee. In the past, such across-the-board schemes working on a full salary basis have typically experienced a poor entry rate by the lower paid, who apparently viewed the arrangements as being "too good" in requiring member contributions on full salary which those employees could not afford and in providing benefits on full salary which for them were too large when combined with state benefits. The integration of such schemes appears likely, by reduction of salary base for both purposes, to enable a more effective utilisation by all levels of employee; the results to date indicate a much improved entry rate in the blue collar area.

3.4 Despite the appropriateness in New Zealand of the usual points in favour of integrating occupational schemes, a determined resistance to the concept is apparent. Without disclosing my own stance for or against, I repeat below a number of arguments against integration which have emerged.

(1) The occupational scheme which covers governmental employees (about 20% of the total workforce) and which has always been regarded as the bench mark for the better level of private occupational scheme, is not, and shows no signs of becoming, integrated.

(2) Employees and unions evidence much unhappiness at the prospect of an apparent "taking away", via integration, of a state provided age benefit which they regard as being a citizen's deserved right (especially having regard to the absence of integration in the occupational scheme for state employees).

(3) Integrated schemes are regarded as being more complex than full salary schemes; occupational retirement provision has been poorly understood by employees in the past and any increase in the effort required to enable member understanding of benefit entitlements is viewed with alarm.

(4) Because of increasing mobility in the workforce and because many better level schemes have been established (or upgraded) only recently, the typical current member will retire with only short or medium service credit for pension. The usual methods of integration are seen to be designed around the circumstances of employees retiring after long service and are criticised as imposing, almost as an unforeseen by-product, automatic pro-rata reductions to the already too small pensions of these typical short/medium term members.

(5) Because the state age pension is an age, and not a retirement, benefit and commences at age 60 in contrast to the retirement age of 65 usual in many occupations, employees may be in receipt of both salary and the state pension during their final years of employment. If the state age pension received during that time is used to support a higher standard of living (in contrast to being saved) integration is seen to impose a double reduction of retirement, below earning, income.

(6) New Zealand citizens have enjoyed for very many years a high (by international standards) level of state provided age pension yet very few occupational schemes have chosen to integrate. Existing members of non-integrated better level occupational schemes question whether the 1977/78 increase in the state age pension was in fact large enough in effective real terms to trigger current integration proposals. For some individuals the after-tax increase in state benefit has been small and has been accompanied by the removal of a number of non-cash fringe benefits e.g. telephone rental, television licence, municipal rating, concessions.

(7) There are growing doubts in the New Zealand community whether the new system of state age benefit is financially viable in the long (or even the medium) term, especially since the 1979 statutory reduction in the effective pension level. These doubts are used by some as an argument not to integrate against a state system which may not persist for very long. (The alternative argument is that it is this same possibility of future, perhaps frequent, changes in the real level of state provision that adds to the arguments for integration.)

(8) The over-provision argument for integration is said to be non-realistic,

(a) as being centred on the circumstances of low-salaried long-service employees whereas better level occupational schemes are generally open only to the medium/highly paid and include many short/middle service employees,

(b) as fixing only on the retirement-day situation and ignoring the indexing/non-indexing of the state/occupational pensions; a later analysis in the middle of the retirement period may indicate a more necessitous situation,

- (c) as glossing over the shortfall of final average, below final retirement day, salary,
- (d) as ignoring the common practice of commuting for cash the allowable 25% of occupational pension.

Point (c) is a particularly contentious issue in the scheme for governmental employees which has a 5 year averaging period.

- (9) It is said to be unreasonable to integrate against a state age pension, the entitlement to which is not fully secure because it ceases if the beneficiary is absent overseas for more than 13 weeks and is substantially reduced in the eventuality of a long term stay in a public hospital or other state institution.
 - (10) The arguments in favour of integration are usually put forward in terms of an occupational scheme providing retirement pensions on a benefit-promise basis. A large number of New Zealand schemes provide wholly lump sum retirement benefits and/or are structured on a contribution-promise basis. Integration is widely regarded as being not relevant to such types of scheme.
- 3.5 One conclusion that can be drawn from all of the above arguments against, is that the concept of integration is best suited to an occupational scheme which has been in existence for a long time, which provides generous pensions on a benefit-promise basis, which includes long service members retiring on low salaries, whose retirement pensions are fully inflation-proofed after retirement.
- 3.6 It is paradoxical that the only occupational scheme in New Zealand which fits the specifications of 3.5 above, is the scheme for governmental employees which for reasons of union pressure, of its members' electoral strength and of political inertia, seems likely to be the last scheme in the country to integrate.
- 3.7 The slow acceptance of integration in New Zealand is not due solely to the above resistances and arguments against the concept. Many employers and scheme trustees are reluctant to think about integration in the face of pressures to effect other amendments to occupational schemes before the 1 April 1980 deadlines for full compliance with the tax approval requirements of the new Superannuation Schemes Act and with the nondiscrimination rules of the Human Rights Commission Act. Past political uncertainties as to the future of the new state age pension system has caused many employers to defer consideration of integration. The major political parties appear to be nearing a consensus and the political campaigns leading up to the next General Election, due for end 1981, may stabilise the system's immediate future and thus encourage the making of decisions either way on integration.

4. INTEGRATION METHODS

- 4.1 The only integration methods under general discussion in New Zealand appear to be the straight forward benefit-offset and salary-base (i.e. excess) approaches. Because the state age pension is simple in

form and in no way dependent on a citizen's prior contributon or salary history, complex studies of replacement ratios do not typically enter into considerations of what method of integration to adopt.

- 4.2 The revenue and other governmental authorities with supervisory responsibilities over occupational schemes do not impose any rules or restrictions on integration. In particular there is no maximum allowable offset nor is there any requirement that salary base integration must provide pension accrual both below and above the salary break-point. The direction in which employer tax savings should be distributed to employee members has not emerged as a matter of supervisory nor of public interest.
- 4.3 The only requirement of the supervisory authorities which could be termed an "integration rule" is that a scheme which requires contributions from members and which is integrated on the benefit-offset method must be seen to provide a minimum benefit of value not less than employee contributions. (The majority of occupational schemes in New Zealand, including the scheme for governmental employees, require contributions from members, typically of the order of 5% or 6% of pensionable salary.)
- 4.4 From the limited number of occupational schemes which have considered integration, indications are that the *benefit-offset* approach will not become the commonly used method. At this early stage, that approach appears likely to create employee dissatisfaction at too visible a taking away of the state age pension, to lack an obvious base on which to reckon member contributions, and to be regarded as too highly susceptible to abrupt changes in employer cost if there continue to be further structural changes, particularly reductions, in the real level of the state age pension.
- 4.5 Early indications are that those schemes which choose to integrate will do so on a *salary-base (excess)* method with nil accrual below a salary break-point set at about 1½ times the unmarried rate of state age pension. The salary-base approach appears to be viewed favourably for the following reasons:
 - (a) There is no visible deduction from members' benefits at the time of retirement.
 - (b) Members' contributions are easily tailored to the level of prospective benefit by being based on the same upper portion of salary as is the pension.
 - (c) The system seems to be easily understood by members and by employers, both of whom appear to accept readily the concept of a state pension as a continuing provision for the bottom slice of salary, leaving continuation of only the upper slice as the employer's responsibility.
 - (d) Because such a scheme operates throughout on the basis of a special definition of salary and not on a visible deduction from benefit, no question arises to whether or not special treatment should be afforded retired persons who are not in receipt of the state age pension (e.g. early retirements before age 60, persons who journey overseas, long term stays in state institutions).

- (e) The salary-base method can be adapted more readily than the benefit-offset method, to the technique of employer insulation discussed in the next section as a means of reducing the susceptibility of employer cost to the possibility of structural changes in the state system.
- 4.6 Because even the simplest concepts of integration are widely (but wrongly) considered to be unduly complex and are viewed with suspicion, few schemes have considered anything other than the simplest on/off systems of integration i.e. schemes either integrate on a simplistic "flat slope" benefit-offset approach or on a salary-base "excess only" method or do not integrate at all. Scheme trustees and sponsoring employers appear reluctant to consider detailed studies of suitable slopes with service/salary of combined (state plus occupational) pensions. Accordingly, there has been little interest in the systems of "*cap integration*" or of salary-base integration with different rates of pension accrual below and above the salary break-point. I suspect that such studies will be a second phase area of scheme design development at some future time when the general notion of integration has been more widely accepted by the community.
- 4.7 Notwithstanding the widely held view that integration is not relevant to wholly lump sum nor to contribution-promise schemes, I detect indications that some employers sponsoring such schemes may accept the salary-base approach. The split salary responsibility outlined in 4.5 (c) above is just as valid (or invalid) to these types of scheme as it is to benefit-promise pension arrangements.
- 4.8 One interesting trend to emerge quite strongly so far has been the concept of "one-third integration". A number of large, better level, defined pension schemes made a conscious decision some years ago not to integrate against the former level of state age pension, on the grounds that the combined (non-integrated occupational plus then state) pension provided a suitable slope with salary. For such schemes, it is easy to gain employee and employer acceptance of the notion of continuing in the future the real level of that former combined arrangement by integrating against the one-third of the new state pension which represents its effective 50% or so increase over the former state arrangements.
- ## 5. EMPLOYER INSULATION
- 5.1 One of the most important questions to be faced in occupational scheme design in New Zealand at present is whether it should be the employee or the employer who is "insulated" against the potential financial effect of structural changes to the state age pension system.
- 5.2 The new state system is generous by international standards, commences at a low age and is thought by many to be not viable. In designing any integrated form of occupational scheme, it is important to keep in mind the possibility that the real level of the state pension (i.e. the link with Average Ordinary-Time Wage) may alter. The obvious testing point is what automatic flow-effect such a structural change would have on a member's combined (occupational plus state) pension and/or on the finances of the occupational scheme.
- 5.3 While corrective action can always be taken subsequent to a structural change, via amendments to the governing documents of the occupational scheme, a better protection is to build into the occupational scheme itself a faster and involuntary protection and to leave visible, initiative, "after the event", trust deed reaction as a measure of last, and discretionary, resort.
- 5.4 1979 has seen a small effective reduction in the real level of the state pension. Furthermore speculation as to the state system's future invariably envisages a future downgrading; the following comments are framed accordingly.
- 5.5 Because the *benefit-offset* method of integration operates via a visible and direct deduction linked typically to a multiple of the state age pension, the combined (occupational plus state) pension received by the employee member would not be affected by a reduction in the real level of the state pension. Thus, under that approach to integration, it is the employee who is insulated and the company which must involuntarily make up the additional cost of the integrated occupational scheme unless it is prepared to initiate a visible downgrading of expectations via a formal trust deed amendment.
- 5.6 However under the *salary-base* method of integration it is possible, because of the simple way in which the New Zealand state pension is statutorily defined, to document the salary break-point in either of two available ways (which give a choice as to which party is insulated);
- (a) *directly*, as a multiple of the amount of the state age pension e.g. 1½ times the unmarried rate or
 - (b) *indirectly*, as a percentage of the wage index on which the state pension is based e.g. 72% of the Average Ordinary-Time Wage.
- So long as the gross unmarried rate of state pension was 48% of the Average Ordinary-Time Wage, either of the above example definitions of salary break-point produced the same arithmetic result. It is only when a government changes the structural relationship that the definition alternatives have different implications.
- 5.7 Definition (a), by operating directly in terms of the state pension, makes the occupational scheme susceptible to state structural changes; reductions in the state pension clearly increase involuntarily the occupational scheme's benefit obligations most of which (and especially unfunded past service accruals) is typically financed by the employer. Thus definition (a) insulates the employee, in the first instance.
- 5.8 On the other hand, definition (b) by defining the salary breakpoint indirectly in terms of the Average Ordinary-Time Wage makes the occupational scheme independent of political action. Reductions in the state pension cannot have an involuntary effect on the employer's financial obligation. Definition (b) insulates the employer in the first instance and maintains freedom by way of subsequent voluntary action to initiate trust deed amendments to restore the former benefit expectation.

5.9 Thus there is clearly available in New Zealand, now, an option between insulating the employee or the employer against the flow-on financial effect of future political decisions on the structure of the state pension system. In designing integrated occupational schemes it is essentially necessary to know whether the sponsoring employer considers the personnel or the financial considerations to be paramount.

5.10 In weighing up these alternative possibilities, employers are unlikely to balance the tax savings consequent upon a reduction in the state scheme against higher employer cost in the occupational scheme. The financing of social security out of general taxation revenue obscures both the source of the "contributions" and the extent and the trend of total costs. It is also pertinent that recent changes in taxation-take, up and down, have been effected via changes to the personal, and not the company, scale of income tax.

6. REWARDS FROM ROUNDING

6.1 Prior to the 1979 change in the statutory linkage between state age pension and Average Ordinary-Time Wage, it was not unusual to see integration salary break-points of the indirect type described as very precise percentages, e.g. 80.0% or 72.0% or 68.6% of Average Ordinary-Time Wage as representing respectively direct multiples of 1.2/3 or 1.1/2 or 1.3/7 of unmarried state age pension i.e. corresponding benefit targets of 60% or 66.2/3% or 70% of final average salary after 40 years service.

6.2 The 1979 statutory change caused consideration of two problems,

- (a) whether, and how, to accommodate the approximately 8% real reduction in gross state pension which resulted from the change to a net after tax linkage,
- (b) how to deal with the prospect that the gross level of the state age pension will fluctuate every time there is a change in the personal income tax scale.

6.3 One obvious solution, for schemes operating on indirect salary break-points, is to move away from precise percentages and to use a rounded percentage approximating to the desired degree of integration. I expect to see a change to break-point levels of 80%, 75%, 70%, 65% etc. of Average Ordinary-Time Wage which will remain unchanged through minor fluctuations in effective real level of state age pension, especially where due only to changes in personal tax scale.

6.4 The use of rounded break-points that are clearly only approximations would also be helpful as reminders that systems of integration can be no more than crude attempts to share available occupational scheme monies in a broad pattern of relative need. The few examples of sophisticated integration systems established in the past appear to me to rely unwisely on the premise that some arbitrary slope of combined (occupational plus state) pension against salary can be demonstrated to be especially suitable to the nature of a particular industry, that this should then be followed through in mathematical benefit formula

to the nth degree and fast become a magic device to be held to steadfast for all time through hell and high water.

7. THE WIDER INTEGRATION AREA

7.1 The integration controversy in New Zealand, so far, has been waged almost exclusively in the field of retirement provision. In my view, the arguments for integration apply equally to death and disablement provision.

7.2 The state age pension is a flat moderate benefit, is payable for the most part to all persons over age 60, and is not seen to be financed by the employer.

7.3 By contrast, the statutory provision of disablement pensions, via the Accident Compensation Commission, is a high level 80% individual earnings-related pension, draws an on/off distinction between accident and sickness, is clearly seen to be financed in large measure by employer levies on published rates dependent on nature of industrial activity.

7.4 Accordingly, the case for integrating an occupational scheme's disablement provisions is even clearer than for retirement; however so far little acted upon. Many occupational schemes continue to pay identical benefits to members disabled through sickness as through accident, notwithstanding the very different levels of state provision and the massive overprovision enjoyed by the latter.

7.5 The Accident Compensation Commission pays a 40% "widow's" pension (i.e. 50% of 80%) to a surviving dependant spouse where death follows accidental disablement or is a result of an accident. Sickness is excluded. Accordingly there is scope for integration of the death in service benefits provided by occupational schemes.

7.6 The social security system provides low level flat benefits (smaller than the state age pension) to sickness invalids and to widows where death was not the result of an accident but these are means tested and barely within the scope of integration considerations.

7.7 The Accident Compensation Commission was established in 1974 when the state age pension was at its former level and payable on a non-means tested basis only from age 65. Accordingly the Commission's statute provided for accident disablement pensions to cease at age 65. Notwithstanding the extension as long ago as 1977 of the state age pension qualification down to 60, the Accident Compensation Commission's statute has not been amended and there is an overlap of state benefits between ages 60 and 65. If the failure to remove this anomaly is due to political inertia that could be an unfortunate pointer to the slowness with which the occupational scheme for governmental employees might be integrated.

7.8 The rates of compulsory employer levy to the Accident Compensation Commission have recently been increased by about 7% (but with a doubling of the leisure-time component and thus of the minimum "clean occupation" rate) and the operation of the Commission's statute is currently under consideration by a caucus committee of the govern-

ing political party. It appears possible that changes could emerge in the areas of

- (a) restrictions on cover where sporting and hobby pursuits are particularly hazardous
- (b) removal of cover where accident occurs in the course of criminal activities
- (c) extension of cover to disablement caused by sickness

(d) extension of cover to death caused by sickness.

Publication of the caucus committee's report and knowledge of the future direction and scope of the statutory disablement benefits should quicken interest in the extension of occupational scheme integration to include death and disablement provision.