



COVERSHEET

Minister	Hon Kris Faafoi	Portfolio	Commerce and Consumer Affairs
Title of Cabinet paper	Settings for KiwiSaver Default Funds	Date to be published	10 August 2020

List of documents that have been proactively released

Date	Title	Author
4 December 2020	<i>Settings for KiwiSaver Default Funds</i>	<i>Office of the Minister of Commerce and Consumer Affairs</i>
4 December 2020	<i>DEV-19-MIN-0342</i>	<i>Cabinet Office</i>
4 December 2020	<i>Impact Summary: Transfer of Members between providers of default funds</i>	<i>MBIE</i>
22 January 2020	<i>Further advice on settings for KiwiSaver default funds</i>	<i>MBIE</i>

Information redacted

YES

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Some information has been withheld for the reasons of to protect the privacy of natural persons, to maintain legal professional privilege, and to maintain the constitutional conventions for the time being which protect collective and individual Ministerial responsibility.

Impact Summary: Transfer of KiwiSaver members between providers of default funds

Section 1: General information

Purpose
<p>The Ministry of Business, Innovation and Employment (MBIE) and the Treasury are jointly responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing key policy decisions to be taken by the Minister of Finance and the Minister of Commerce and Consumer Affairs.</p> <p>Context</p> <p>When a person starts a new job, they are automatically enrolled in KiwiSaver if they are between the ages of 18 and 65. Unless they opt-out or actively choose a fund, they will be sequentially allocated to a default fund. Approximately 689,000 people remain in default funds. 398,000 of those have not made an active choice to stay there. There are approximately 3 million people in KiwiSaver in total. There are 9 providers of default KiwiSaver funds, and there are 19 non-default providers of KiwiSaver funds.</p> <p>Providers of default funds are appointed by the Minister of Finance and the Minister of Commerce and Consumer Affairs (the Ministers), under the KiwiSaver Act (the Act). The Ministers are also responsible for determining the terms and conditions under which default providers are appointed. Providers are appointed under individual instruments of appointment, which set out the terms, conditions, and settings for default funds. Providers of default funds receive a stream of customers allocated to them. They also enjoy reputational benefits.</p> <p>The Financial Markets Authority (FMA) monitors the performance of KiwiSaver providers against their instruments of appointment.</p> <p>The term for the current providers expires on 30 June 2021. The procurement process for appointing new providers will start in early 2020. A potential outcome of the procurement process is that one or more of the current default providers may not be reappointed as a default provider for another term.</p> <p>Six providers were appointed when KiwiSaver began, after a competitive tendering process. A review of providers occurred in 2013, after which the existing providers were reappointed and new providers were also appointed.</p> <p>The KiwiSaver Act allows regulations to be made to provide for default members of a scheme to be reallocated and transferred at the expiry of the providers' instrument of appointment.</p>

The broader review of KiwiSaver default provider arrangements covers a range of policy decisions, one of which is the reallocation and transfer of members. This Regulatory Impact Statement relates only to options for the reallocation and transfer of members, because this is the only policy decision in the review that requires regulatory change.

Key Limitations or Constraints on Analysis

Evidence limitations

Limited evidence regarding member reaction to being transferred

We have limited evidence about how members would react to being transferred from one provider to another. Some members may feel confused or disrupted, and Inland Revenue (the primary customer-facing agency for KiwiSaver) has advised that some members are likely to be angry. Others may not care about being transferred because they do not actively engage with their KiwiSaver account. However, it is uncertain how many would fall in each category.

We did ask a question in the public consultation process about how consumers might react to being transferred. Unfortunately, many consumers misunderstood the question so we did not get high-quality feedback on this issue as a result of our consultation.

Unknown costs for Government and providers

Inland Revenue has done initial work to quantify its costs for the different options. However, its estimates are in a wide range due to uncertainty about the number of members who would be transferred and the number of members who would approach Inland Revenue with questions and queries.

Due to commercial sensitivity, we have received very little information from providers regarding the costs to them associated with transferring members.

Number of members who would be transferred

We are currently designing policy options for the transfer of members prior to the procurement process for appointing new providers. That is because we think it is desirable for providers to know what will happen post-appointment, before they have to decide on the content of their tenders. It is also to avoid the need to go back to Cabinet prior to issuing drafting instructions for the regulations to enable transfers to take place.

This means there is uncertainty about the number of providers that would be appointed as default providers (including whether all current providers would be reappointed), and therefore the number of members who could potentially be transferred.

Uncertainty regarding strength of incentives

There is a degree of uncertainty as to the strength of incentives providers would face in the options and in the status quo to tender competitively to be a provider of a default KiwiSaver fund. Providers have been generally reluctant to submit on this point. Some providers have told us that the reputational benefits of being a default provider alone would incentivise them to tender competitively.

Consultation

The analysis in this Regulatory Impact Statement is based on public consultation with consumers and the financial sector, as well as desk-based research. We have consulted with individual stakeholders, including all 9 default providers and several non-default providers, as well as Inland Revenue and the Financial Markets Authority.

A discussion document was published in August 2019, and included a discussion of transferring default members. We received 280 submissions.

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27/11/2019

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Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

The counterfactual

The counterfactual is that any member of a current provider of default funds would remain with that provider following the appointment of new default providers. None of those members would be transferred to the newly appointed default providers, even if their provider is not reappointed as a default provider.

Problem 1: default members of non-reappointed providers will no longer have protections under instruments of appointment

Default members receive certain protections (e.g. in relation to fees) under the default providers' instruments of appointment.

In the counterfactual, and assuming that one or more default providers are not reappointed, the obligations on those ex-default providers would lift after the expiry of their instruments of appointment. The members of those providers would remain in funds that are no longer default funds and would therefore not receive protections under the new or former instruments of appointment. For example, there is a risk that ex-default providers would increase their fees above the maximum levels indicated in their instruments, as well as change or remove any other settings mandated by the current instruments. This could result in poorer outcomes for those members.

Aside from those who actively choose to remain in the default fund, default members have not made an active choice regarding their fund and do not engage with their KiwiSaver. This may exacerbate the impacts of protections under the instrument of appointment being removed for members that remain in ex-default funds.

Problem 2: insufficient incentives for new providers to tender

A second potential problem is that there may be insufficient incentives for non-default members to tender competitively to become a default provider in the upcoming procurement round.

In the counterfactual, new providers would enter the default market without any default members, and would only receive new members from the allocation system when new members are automatically enrolled. As over 2 million New Zealanders are in KiwiSaver, the rate of members being allocated through the default allocation has significantly slowed. Based on the current flow of new members, and assuming there are 9 providers (as is currently the case), new providers could expect to receive only approximately 6868 new members a year¹. Those members' accounts will start with low balances that will gradually increase over time.

In comparison, current providers already have sizable funds under management in their default funds and have historically benefited from higher numbers of new members from the

¹ There were 61,811 new members in the annual return year ending 31 March 2019 (FMA KiwiSaver annual report 2019).

sequential allocation system at the outset of KiwiSaver.

In the counterfactual, new providers may feel that they cannot compete with current providers and may refrain from tendering on this basis.

There is some uncertainty about the extent to which this issue is a problem. It may be that the providers who are most likely to tender would tender regardless of the transfer option chosen, due to the ongoing business and reputational benefits of being a default provider.

Problem 3: insufficient incentives for current providers to tender competitively

A third potential problem is that there may be insufficient incentives for current default providers to tender competitively in the upcoming procurement process because they will get to keep their existing members either way.

If no action is taken, existing default providers may make less competitive offers in the procurement process because they would not face any risk of losing their members and because they already have a large portion of the KiwiSaver default market. For example, they may offer higher fees than they would if there was a risk that they would lose their members. This would lead to poorer outcomes for members of default funds.

As with problem 2, there is some uncertainty about the extent to which this issue is a problem given the ongoing business and reputational benefits of being a default provider.

Problem 4: insufficient incentives for default providers to engage with default members

The members of default funds have often not made a choice to be there. Ideally, they would make an active choice of fund (either to remain in the default fund or switch to another fund).

Providers have a key role in encouraging members to make an active choice.

One problem with the status quo is that providers may not have enough incentives to engage with their members to encourage them to make an active choice.

Engaging with members has a cost for providers. Meanwhile, providers are collecting fees from these default members regardless of whether the members make active choices or not.

Given that context, if providers do not face any risk that their default members would be transferred away from them at the end of their appointment, they may have reduced incentives to incur the expense of attempting to engage with members and encouraging them to make an active choice about their fund.

We do accept there are other contributing factors to why providers may not engage with default members, for example, a lack of obligations on default providers to engage with members and practical difficulties faced by providers in contacting members.

2.2 Who is affected and how?

The transfer options would affect current and future providers of default funds and would seek to change the incentives on those providers to tender competitively to be (re)appointed as default providers. The table below provides approximate numbers of allocated default members in each default fund who have not made an active choice to be there:

Provider	Default membership in 2019 ²	Percentage of default market ³
AMP	89,154	22.38%
ANZ	53,874	13.53%
ASB	69,671	17.5%
BNZ	19,749	4.96%
Booster	14,723	3.7%
BT Funds (Westpac)	21,572	5.42%
Fisher	45,496	11.42%
Kiwi Wealth (Kiwibank)	20,307	5.1%
Mercer	63,743	16%
TOTAL	398,289	100%

Default members would also be impacted by the transfer options. Some default members may experience disruption and potential confusion or anger. Others may be disengaged and may not care that they are being transferred. Others still may be prompted through communications from their provider or media reports to engage with their KiwiSaver.

Some of the design choices for transfer options seek to give default members an opportunity to make an active choice if they wish to remain with their current provider.

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

The Act provides for regulations to be made to reallocate and transfer default members to a default KiwiSaver scheme, following the expiry of the current term for default providers.

The regulation-making power covers “default members” only. Default members are defined as members that were allocated to a scheme under sections 50 and 51 of the Act and are in a default investment product of a scheme. That means that regulations cannot be made to transfer “active joiners” – members who have joined a KiwiSaver scheme of their own volition and have selected a default fund for themselves. However, members of default funds who were allocated to a default fund and have made an active decision to stay there are classified as “default members” and can be transferred.

Interdependency with other policy options

The procurement process will be done as a package of policy decisions regarding the desired settings for KiwiSaver default funds, and our broader aim is to improve financial wellbeing of members at retirement. The reallocation and transfer of members is a component part of that broader review and subsequent procurement process, and therefore

² Data obtained from the FMA's Annual KiwiSaver Report 2019.

³ Values rounded to two decimal places.

has interdependency with other policy settings.

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Section 3: Options identification

3.1 What options have been considered?

We have assessed the options against five main criteria, which we have used to assess all the options we have considered as part of the broader review of the settings for default funds:

- ensuring a better financial position for KiwiSaver members, particularly in retirement (highest weighting)
- promoting trust and confidence in KiwiSaver (high weighting)
- ensuring low administration and compliance costs (low to moderate weighting)
- supporting the development of New Zealand's capital markets that contribute to individuals' well-being (low weighting)
- promoting innovation, competition, and value-for-money across KiwiSaver (low to moderate weighting).

Option 1: Existing default providers retain their default members (status quo/counterfactual)

Option 1 is for existing default providers to retain their default members, regardless of whether they are reappointed or not. The most significant part of this option is for non-reappointed providers. Under this option, default members would need to be informed that their default provider is no longer a default provider and given a choice about remaining in their fund. However, if they do not make a choice they would stay with their existing provider. This would mean that providers who are not reappointed would retain their balance of default members. However, the obligations under the instruments of appointment of ex-default providers would end and the fund would be governed as a non-default KiwiSaver fund.

The cons of this option are set out in the problem definition section. The pros of this option as compared with the other options are as follows:

- eliminates the risk of members being transferred potentially against their will, and lessens the risk of operational errors causing erosion in trust and confidence in KiwiSaver as compared to the transfer options,
- no administration costs for providers and Inland Revenue,
- minimises disruption to markets.

Option 2: Weighted transfer to establish an average member balance among default providers

Option 2 is to transfer members from default providers with more members (as well as from those that are not reappointed) to providers with fewer members. This would mean that each provider has a similar number of members.

Legal Professional Privilege

Default members who have actively chosen to remain in the default fund (“active default members”), and default members who have joined a default fund of their own accord, would not be transferred.

Default providers would be required to notify their members of the upcoming transfer and give them an opportunity to make an active choice to remain in the default fund or change to another fund. If a member does not make a choice, they would then be transferred.

Around 120,000 KiwiSaver members would be transferred if there were no changes to the default providers. More members would be transferred if one or more new default providers were appointed or if one or more existing default provider were unsuccessful.

The costs and benefits of this option as compared with the counterfactual (and where applicable with other options) are as follows:

Criterion	Benefits	Costs
Ensuring a better financial position for KiwiSaver members, particularly in retirement	<p>May incentivise providers to help their members make an active fund choice in the short-term.</p> <p>If this results in members being in a more appropriate fund for their circumstances, this is likely to have a positive effect on their financial position at retirement.</p> <p>This benefit applies to Options 2 and 3, but is stronger in relation to Option 2.</p>	<p>If a strong incentive is created, it could lead to emphasis being placed solely on encouraging members to make an active choice, regardless of whether or not that choice is the most appropriate for them. This may result in those members having a worse financial position at retirement than in the counterfactual.</p> <p>May decrease competitive pressure on providers with default membership higher than the average, as this option would result in them losing members even if they are reappointed. This may disincentivise those providers to tender competitively, leading to worse value-for-money for default members.</p>
Promoting trust and confidence in KiwiSaver	<p>In relation to the transfer of members from non-reappointed providers, the option would increase trust and confidence in KiwiSaver because default members would remain under the protections of the instruments of appointment. This benefit applies to Options 2 and 3 equally.</p> <p>In relation to not transferring active choice members, the option would increase trust and confidence in KiwiSaver as active default members would be confident that their choice of fund is being respected.</p> <p>In relation to members being able to opt-out of transfers, the option gives members an opportunity to choose to stay in the providers' fund or choose another fund. This is likely to promote trust and confidence in KiwiSaver because members will have more control over their KiwiSaver.</p> <p>If default providers expect reallocation to happen every 7 years, they may be incentivised to ensure that members make an active choice to remain in the default fund or to move to a non-default fund that is more appropriate for them. We propose that members who make an active choice to remain in the default fund should not be transferred. This increased member engagement may have a positive effect on trust and confidence in KiwiSaver.</p>	<p>Some members would experience disruption and may be unhappy that their provider has changed (for example, those members who like that their provider is also their bank). Some members may be angry or confused. This may have a negative effect on trust and confidence in KiwiSaver. This con applies to Options 2 and 3 but would be more pronounced in relation to Option 2.</p> <p>If default providers expect reallocation to happen every 7 years regardless of whether they have complied with their obligations under the instruments of appointment, they may have lower incentives to invest in building long-term relationships with their default members. If providers are not investing in relationships with members, this could negatively affect trust and confidence in KiwiSaver.</p> <p>There is the risk of members being transferred potentially against their will, and the risk of operational errors causing erosion in trust and confidence in KiwiSaver.</p> <p>However, the design choice to require any transfer option to be opt-out may mitigate this cost if they are made aware of the transfer prior to it occurring.</p> <p>Some members would be transferred away from providers that have legitimately been allocated members through the sequential allocation process and who have kept their default status. This could reduce trust and confidence in KiwiSaver if it is perceived that the Government is interfering with a market unnecessarily.</p>
Ensuring low administration and compliance costs	N/A	<p>There would be administration costs to Inland Revenue, mainly related to the cost of sending out welcome packs to transferred default members, and taking phone calls from concerned members.</p> <p>Inland Revenue have estimated that the cost would be \$14,300 to \$62,700 if around 18,000 members</p>

		<p>are transferred and \$44,800 to \$328,900 if 60,000 to 100,000 members are transferred; and that this number would rise proportionately if more members are transferred. In addition, Inland Revenue would face costs in relation to making system changes to implement the option.</p> <p>There would be a cost on providers to identify the members to be transferred and contact them. This cost applies to Options 2 and 3 but is higher in relation to Option 2.</p> <p>Providers will likely need to be given a longer period of time to transfer members' information and accumulation due to large volumes.</p>
Supporting the development of New Zealand's capital markets	N/A	<p>May increase disruption to markets because providers would need to liquidate underlying funds. This cost applies to Options 2 and 3, but is higher in relation to Option 2.</p>
Promoting innovation, competition, and value-for-money across KiwiSaver	<p>May incentivise new providers to bid for default provider status as they stand to gain a greater share of default members, potentially bringing new and more innovative providers to the market. However, we have heard from some providers that incentives to tender for default membership are already high because of the reputational benefits and customer flow. This means potential providers may tender regardless of there being a reallocation of members.</p> <p>May create more pressure on existing providers in the tendering process by incentivising more competitive offers, leading to better value-for-money for default members. However, given the reputational implications of a current provider losing default status, it may be that there is already sufficient incentive for existing providers to make competitive offers. These benefits apply in relation to Options 2 and 3, but are stronger in relation to Option 2 for current non-providers and providers who have a number of default members below the average.</p>	<p>If default providers expect reallocation to happen every 7 years regardless of whether they have complied with their obligations under the instruments of appointment, they may have reduced certainty and lower incentives to invest in building long-term relationships with their default members. This could decrease value-for-money for default members. However, it is not certain that providers would react in this way and they may instead focus their efforts on ensuring that members make an active choice to remain in the default fund or to move to a more appropriate fund, on the assumption that such members will not be transferred in the future.</p>

Treasury analysis of Option 2

Option 2 is the Treasury's preferred option. The Treasury is of the view that Option 2 creates more pressure in the tendering process. This increased pressure could result in better value-for-money for default members leading to a better financial position for default members.

Option 2 could incentivise new providers to bid for default provider status, as they stand to gain a greater share of default members, potentially bringing new and more innovative providers to the market. As new providers would receive an allocation of members with higher balances at the commencement of their appointment, they may be more able to offer innovative pricing structures (such as low or no fees for members with low balances). Smaller or new entrant providers would receive more members, which may assist them to break even more quickly.

The Treasury considers Option 2 will provide stronger incentives on current default providers than Option 3, particularly those with large numbers of default members, to engage with their members to encourage them to make an active fund choice. Under Option 2, reappointment alone may not be sufficient for providers to ensure that they retain their default members.

The Treasury considers that the positive effects of Option 2 on member engagement and on increased competition in the procurement process outweigh the administration and compliance costs on providers and Inland Revenue. More competitive tenders are likely to lead to better default settings, resulting in a better financial position for default members. The Treasury notes that the costs to providers and Inland Revenue are one-off costs.

The Treasury acknowledges that reallocation could be disruptive for some default members and under Option 2 a larger number of members could be transferred. However, the Treasury also believes the impact is likely to be limited as default members are generally less engaged with their savings. Further, the reallocation process is likely to result in some members engaging with their KiwiSaver and making active choices about their savings, when they would not have done so previously. Members who are unhappy with a transfer also have the option of changing their provider at any time.

The Treasury is aware of concerns that a reallocation of a larger number of members could increase disruption to the markets but considers that this risk could be mitigated by staggering member transfers over a period of time.

Transferring members away from existing providers would be disruptive for those providers. However, while the Treasury accepts that providers may face practical difficulties in contacting members, those providers will have had at least seven years to engage with their default members and to encourage them to make an active choice about their KiwiSaver fund.

Option 3: Default members from default providers not reappointed would be transferred

Option 3 is to reallocate members from existing default providers that are not reappointed. Existing default providers that are reappointed would retain their existing members.

We are considering two options for how members would be allocated:

- The default members that are reallocated would be weighted in a way that increases default membership for providers with the smallest number of default members towards the average number among default providers.
- The default members would be allocated sequentially.

Legal Professional Privilege

Default members who have actively chosen to remain in the default fund (“active default members”), and default members who have joined a default fund of their own accord, would not be transferred.

Default providers would be required to notify their members of the upcoming transfer and give them an opportunity to make an active choice to remain in the default fund or change to another fund. If a member does not make a choice, they would then be transferred.

No members would be transferred if there were no changes to the default providers. Members would be transferred only if an existing default provider was unsuccessful. The costs and benefits of this option as compared with the counterfactual (and where applicable with other options) are as follows:

Criterion	Benefits	Costs
Ensuring a better financial position for KiwiSaver members, particularly in retirement	In relation to the transfer of members from non-reappointed providers, this Option would ensure those default members remained under the protections of the instruments of appointment, and were not subject to any adverse changes to those funds following the expiry of their	If a strong incentive is created, it could lead to emphasis being placed solely on encouraging members to make an active choice, regardless of whether or not that choice is the most appropriate for them. This may result in those members having a worse financial position at

	<p>provider's instrument. This may lead to those members being in a better financial position in retirement.</p> <p>May incentivise providers to help their members make an active fund choice in the short-term.</p> <p>This may result in members being in a more appropriate fund for their circumstances, which is likely to have a positive effect on their financial position at retirement.</p> <p>This benefit applies to Options 2 and 3, but is stronger in relation to Option 2.</p>	<p>retirement than in the counterfactual. This would occur to a lesser degree than in Option 2.</p>
Promoting trust and confidence across KiwiSaver	<p>In relation to the transfer of members from non-reappointed providers, this Option would increase trust and confidence in KiwiSaver because default members would remain under the protections of the instruments of appointment. This benefit applies to Options 2 and 3 equally.</p> <p>In relation to not transferring active choice members, this option would increase trust and confidence in KiwiSaver as active default members would be confident that their choice of fund is being respected.</p> <p>In relation to transfers being opt-out, this option gives members an opportunity to choose to stay in the providers' fund or choose another fund. This is likely to promote trust and confidence in KiwiSaver because members will have more control over their KiwiSaver.</p> <p>If default providers expect reallocation to happen every 7 years, they may be incentivised to ensure that members make an active choice to remain in the default fund or to move to a non-default fund that is more appropriate for them. (We propose that members who make an active choice to remain in the default fund should not be transferred). This increased member engagement may have a positive effect on trust and confidence in KiwiSaver.</p>	<p>Some members would experience disruption and may be unhappy that their provider has changed (for example, those members who like that their provider is also their bank). Some members may be angry or confused. This may have a negative effect on trust and confidence in KiwiSaver. This cost applies to Options 2 and 3 but would be more pronounced in relation to Option 2.</p> <p>There is the risk of members being transferred potentially against their will, and the risk of operational errors causing erosion in trust and confidence in KiwiSaver. However, the design choice to require any transfer option to be opt-out may mitigate this cost if they are made aware of the transfer prior to it occurring.</p>
Ensuring low administration and compliance costs	<p>There would be no administration or compliance costs if all the current providers are reappointed as no members would be transferred.</p>	<p>If one or more of the current providers are not reappointed, there would be administration costs to Inland Revenue, mainly related to the cost of sending out welcome packs to transferred default members and taking phone calls from concerned members.</p> <p>Inland Revenue have estimated that the cost would be between \$14,300 and \$62,700 if around 18,000 members are transferred and between \$44,800 and \$328,900 if 60,000 to 100,000 members are transferred; and that this number would rise proportionately if more members are transferred. In addition, Inland Revenue would face costs in relation to making system changes to implement the option.</p> <p>There would be a cost on providers to identify the members to be transferred and to contact them.</p> <p>Providers will likely need to be given a longer period of time to transfer members' information and accumulation of KiwiSaver fund due to large volumes.</p> <p>The above costs apply in relation to options 2 and 3 but are higher for option 2.</p>
Supporting the development of New Zealand's capital markets	N/A	<p>May increase disruption to markets if one or more providers are not reappointed because providers would need to liquidate underlying funds. This cost applies in relation to options 2 and 3, but is higher in relation to option 2.</p>
Promoting innovation, competition, and value-for-money across KiwiSaver.	<p>May incentivise new providers to bid for default provider status as they stand to gain a greater share of default members, potentially bringing new and more innovative providers to the market. However, we have heard from some providers that incentives to tender for default</p>	N/A

	<p>membership are already high because of the reputational benefits and customer flow. This means potential providers may tender regardless of there being a reallocation of members.</p> <p>May create more pressure on existing providers in the tendering process by incentivising more competitive offers, leading to better value-for-money for default members. However, given the reputational implications of a current provider losing default status, it may be that there is already sufficient incentive for existing providers to make competitive offers.</p> <p>These benefits apply in relation to Options 2 and 3, but are stronger for in relation to Option 2 for current non-default providers and current default providers who have a number of default members below the average.</p>	
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3.2 Which of these options is the proposed approach?

Treasury prefers option 2. MBIE prefers option 3. Option 3 is consistent with the Cabinet paper seeking feedback from Cabinet on the settings for default funds.

How will Option 3 address the problems?

Option 3 will ensure that default members continue to have the protections of default settings if their default provider is not reappointed in 2021, and prevents members from being negatively impacted from any adverse changes to those default funds in the counterfactual. This will contribute to ensuring a better financial position at retirement for default KiwiSaver members.

Option 3 also provides strong incentives for current default providers and non-default providers to tender competitively in the procurement round. Further, the preferred option incentivises current default providers to engage with their default members to encourage them to make active choices about their retirement savings.

Why is Option 3 better than the other options?

Option 3 would solve the problems identified in the problem definition without the risk of the adverse impacts presented by Option 2. It is acknowledged there will be some disruption and impact on consumers and financial markets, but this is necessary to ensure protection for default members whose current default provider is not reappointed. Compared with Option 2, Option 3 also promotes trust and confidence in the KiwiSaver scheme by reducing disruption on members, and has a low level of administration and compliance cost.

Option 3 also reduces the disruption to financial markets caused by a reallocation and transfer of members as compared to Option 2. If a smaller portion of the default KiwiSaver market is reallocated (and subsequently liquidated, transferred, and reinvested), the impact on market pricing will be minimised. This is important for ensuring that members' financial positions are not adversely impacted as a result of the transfer.

The costs of Option 2 would outweigh the benefits, in particular:

- There would be disruption and confusion for members, impacting negatively on trust and confidence in KiwiSaver. While some default members are not engaged and are unlikely to care (or notice) that their provider has changed, other members are likely to be unhappy that their provider has changed. Inland Revenue has advised that the option

risks confusion and even anger in cohorts of the default membership.

- It would be more costly for Inland Revenue and providers, who would face costs to contact members and receive enquiries from affected default members. Inland Revenue has also advised that it would face costs to make additional system changes, and would be administratively complex to implement.
- It would increase disruption to markets (because providers would need to liquidate underlying funds).
- If default providers expect reallocation to happen every 7 years, they may have lower incentives to invest in building long-term relationships with their default members.
- Could lead to emphasis being placed solely on encouraging members to make an active choice so that they are unable to be transferred. This could result in providers incentivising members to actively choose a fund that is not in their best interests.

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Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties (identify)	Comment: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks	Impact <i>\$m present value, for monetised impacts; high, medium or low for non- monetised impacts</i>
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Additional costs of proposed approach, compared to taking no action

Providers of default KiwiSaver schemes	<p><i>Note: the following benefits are nil if all current default providers are reappointed in 2021.</i></p> <p>Providers who are not reappointed will lose default members, leading to reduced income gained from those default members.</p> <p>Losing and gaining providers will face administrative costs associated with the transfer of members.</p>	Medium
Default members subject to transfer	There could be disruption and confusion for default members who are transferred, as a sudden change in provider could be concerning for some.	Low
Inland Revenue	<p>Costs of additional systems to facilitate the transfer of members.</p> <p>Administrative costs to send out welcome information to members and receiving calls from default members.</p>	<p>Administrative costs estimated between \$14,300 and \$62,700 if around 18,000 members are transferred and between \$44,800 and \$328,900 if 60,000 to 100,000 members are transferred; and this number would rise proportionately if more members are transferred.</p> <p>No estimates for system changes, but they are expected to be lower than administrative costs.</p>
Total Monetised Cost		Estimated between \$14,300 and \$328,900 ; potentially rising proportionately if more members are transferred.
Non-monetised costs		Medium

Expected benefits of proposed approach, compared to taking no action		
Default providers appointed in 2021	<p><i>Note: the following benefits are nil if all current default providers are reappointed in 2021.</i></p> <p>Some default providers would gain members, leading to increased income.</p> <p>If allocating default members on a weighted basis is consistent with the Act, smaller or new entrant providers would receive more members, which may assist them to break even more quickly.</p>	Medium
Default KiwiSaver members	<p>Default KiwiSaver members will enjoy the benefits of a more competitive tender process due to the incentives provided from transfer arrangements. More competitive tenders are likely to lead to better default settings, resulting in a better financial position for default members.</p> <p><i>Note: the following benefits are nil if all current default providers are reappointed in 2021.</i></p> <p>Default members who are members of ex-default schemes will be afforded the protections of the new instruments of appointment, rather than in the counterfactual where they will not enjoy those protections, and may be at risk of adverse changes to default funds.</p> <p>Not transferring “active choice” default members will increase members’ trust and confidence in KiwiSaver, as their choice of KiwiSaver fund is being respected. This may lead to more engagement with KiwiSaver from those members in future if they have confidence that their choice of scheme will be respected.</p> <p>Requiring an opt-in member engagement prior to any transfer will lead to increased engagement with members from providers. This is likely to increase member education in regards to their KiwiSaver and could prompt them to choose a KiwiSaver fund that is most appropriate for their personal</p>	Medium

	circumstances. This may have the effect of leading to those members having a better financial position at retirement if they are in a more suitable fund, as a result of required engagement prior to a transfer.	
Non-monetised benefits		Medium

4.2 What other impacts is this approach likely to have?

Disruption to markets

There may potentially be impacts on financial markets. When a member is transferred, their investments are liquidated, and the accumulated funds and data are transferred to the new scheme. During this time, the value of the KiwiSaver fund is taken off the market, transferred to the new provider, and then reinvested into the market.

Subsequently, providers with incoming members will be obligated to invest these funds. There is a risk that if these investments all occur at the same time, the increased demand for investment vehicles could serve to drive up market prices. The result could be a spike in share prices, which may lead to poorer returns for members or higher transactional costs for providers, which may be passed onto members through fees.

However, we note that this impact on the market could be mitigated by staggering transfers.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

Who has been consulted?

MBIE and the Treasury have engaged in a public consultation process with industry, consumers, relevant government agencies and various other stakeholders during the review of default KiwiSaver provider arrangements. This includes:

- Individual consultation with default and non-default KiwiSaver providers, the financial services industry, and other interested parties throughout the review process
- Formal consultation on a discussion document released in August 2019 outlining our proposals, on which 280 submissions were received.

We received submissions from 8 of the 9 current default providers and several non-default providers.

We also received submissions from several representative organizations, including the Financial Services Council (the main provider-facing body), BusinessNZ, and Consumer NZ.

Most of our consumer feedback came from “short-form” submissions through our online portal, of which we received 231. A handful of consumers submitted long-form submissions using our submission template.

Inland Revenue, the Financial Markets Authority, the Reserve Bank and the Commission for financial Capability were consulted throughout the policy process.

This proposal does not have specific impacts on Maori, so targeted consultation with iwi/hapū has not been necessary.

Feedback on proposed approach

Stakeholders generally not supportive of option 2

Most submitters did not support transferring members from reappointed providers. This included all of the default provider submitters that would likely gain membership from the option if reappointed. When discussed, a majority of respondents thought there would be disruption and confusion for members, it would be costly for Inland Revenue and providers, it would have increased disruption on financial markets, and could lead to providers being incentivised to focus on prompting members to actively choose a KiwiSaver fund that may not be in their best interests.

A minority of submitters did not support these arguments. Some respondents questioned the degree to which default members trust in KiwiSaver would be affected by a change in default provider. They stated that if members are given the opportunity to elect to stay with a current provider, this argument is further weakened.

Consumers who provided feedback via the MBIE website generally thought that disruption to members would be small, but many of those submitters appeared not to have understood the question correctly (for instance, some thought that we were referring to a change in other settings for default funds such as the investment mandate or responsible investment

requirements).

Stakeholders supportive of option 3

Several submitters supported option 3. This included a small provider that indicated it will seek to become a default provider. They generally agreed that option 3 would lead to better financial position for default members by giving them protections of the default terms if a provider is not reappointed. Submitters also commented that leaving members with a default provider who has lost their default status may create a cohort of members who feel “left out” of positive industry change. This is inconsistent with members being engaged or even continuing to participate in KiwiSaver (although this applies to option 2 as well).

Several submitters also commented that option 3 is the fairest option and reflects public expectations about government’s stewardship of default members.

Inland Revenue and the Commission for Financial Capability (**CFFC**) supported option 3.

PROACTIVELY RELEASED

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

How is the proposed approach to be given effect?

Section 230(1)(ba) of the Act allows for the making of regulations to providers for default members of a scheme to be reallocated and transferred at the expiry of the provider's instrument of appointment.

Inland Revenue would work with providers to implement the proposals.

Non-reappointed providers (losing providers) would be required to inform their members that they are being switched and give them the opportunity to actively choose to remain, or choose another fund. They would then inform Inland Revenue of the members that are non-active choice members. We could work with Inland Revenue and providers to develop the form of this notice, to ensure default members are adequately informed about the process.

Inland Revenue would determine the provider to which each member is to be transferred (the gaining provider). Confidentiality of advice

Inland Revenue would process the reallocation and send out a welcome pack to transferred members. The losing and gaining providers would then work together to process each switch.

Who will be responsible for ongoing operation and enforcement of the new arrangements?

We do not consider that there will need to be ongoing operation and enforcement of the new arrangements as after a transfer occurs the regulations will be spent.

When will the new arrangements come into effect? Does this allow sufficient preparation time for regulated parties?

These regulations will come into effect following the expiry of the current instruments of appointment on 1 July 2021, and will last for the extent of the transfer period. Providers will be aware of the chosen transfer options from the beginning of 2020, several months before a request for proposal is put to the market. We believe this is sufficient time for providers and Inland Revenue to prepare.

How will the implementation risks be managed or mitigated?

Inland Revenue will develop a plan to mitigate and/or manage any risks arising from the reallocation and transfer of default members. We plan to have appointed default providers at the end of 2020, which provides Inland Revenue and providers with six months to prepare.

We have already consulted on the proposed options with stakeholders. We anticipate that Inland Revenue will engage with providers prior, during, and after the transfer occurs to ensure timelines and processes are adhered to.

Staggering transfers

The plan to mitigate and manage risks could include staggering the processing of transfers over a period of time (for example, each provider could be required to process a percentage of the total required transfers periodically over eg a 3 month period). It may also involve extending the time given to providers to process switches.

Staggering would only apply to the transfer process as between providers (ie the process of a losing provider transferring member information and accumulation to a gaining provider). Inland Revenue's switching process would occur over a short period of time.

Staggering transfers will reduce the logistical and financial costs for providers to complete the transfer in the short-term. It will also avoid a significant one-off disruption in the market through the mass liquidation of KiwiSaver assets. Staggering transfers alleviates some of this effect by spreading the market impacts over a period of time.

PROACTIVELY RELEASED

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

The making of regulations to allow for a reallocation of default members is a one-off exercise carried out by the government, rather than a new set of regulatory arrangements. Accordingly, no system-level monitoring and evaluation measures are required.

We will know the anticipated impacts have materialised if providers tender competitively in the 2020 procurement ahead of appointments being made in 2021.

Inland Revenue will monitor the transfer process as it progresses.

MBIE and Inland Revenue will evaluate the results of the tender process and transfer arrangements with a view to being more informed in the next tender process. In particular, it may be useful to evaluate:

- how many providers tender
- how many (if any) new providers tender
- how many (if any) existing providers do not tender
- The competitiveness of the tenders we receive
- public reaction to the transfer of members
- if there is any increase in member engagement in the short term.

7.2 When and how will the new arrangements be reviewed?

The instruments of appointment for any appointed default providers will expire in June 2028. Ahead of that expiry we expect that there will be another review of default provider arrangements. That review could include a consideration of the transfer arrangements.

We are not anticipating any earlier review of the regulations. That is because once a transfer occurs, the regulations will be spent.