



BRIEFING

Further advice on settings for KiwiSaver default funds

Date:	22 January 2020	Priority:	Medium
Security classification:	In Confidence	Tracking number:	2078 19-20 (MBIE) T2020/7 (TSY)

Action sought		
	Action sought	Deadline
Hon Grant Robertson Minister of Finance	Agree to the recommendations regarding the settings for KiwiSaver default funds.	31 January 2020
Hon Kris Faafoi Minister of Commerce and Consumer Affairs	Forward this briefing to Rt Hon Peters, Hon Parker and Hon Shaw.	

Contact for telephone discussion (if required)			
Name	Position	Telephone	1st contact
Sharon Corbett	Manager, Financial Markets Policy, MBIE	Privacy of natural persons	
Robbie Taylor	Acting Manager, Financial Markets, Treasury		
Susan Ivory	Senior Analyst, Financial Markets, Treasury		✓

The following departments/agencies have been consulted (if required)
Inland Revenue, Financial Markets Authority

Minister's office to complete:

- | | |
|---|--|
| <input type="checkbox"/> Approved | <input type="checkbox"/> Declined |
| <input type="checkbox"/> Noted | <input type="checkbox"/> Needs change |
| <input type="checkbox"/> Seen | <input type="checkbox"/> Overtaken by Events |
| <input type="checkbox"/> See Minister's Notes | <input type="checkbox"/> Withdrawn |

Comments:



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Date:	22 January 2020	Priority:	Medium
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Purpose

To seek your formal agreement to the proposals for the settings for KiwiSaver default funds, including in relation to the two issues discussed at Cabinet Constitutional conventions

To update you on legal advice on whether default members can be transferred on weighted basis from providers who are not reappointed.

Recommended action

The Treasury and the Ministry of Business, Innovation and Employment recommend that you:

- a **agree** to change the investment mandate of KiwiSaver default funds from conservative to balanced.

Agree Disagree

- b Constitutional conventions

c

- d **agree** to the following proposals in relation to the high-level policy settings for KiwiSaver default funds (about which Cabinet was supportive):

- i. to have a two-stage assessment process for tenders in which providers are required to submit their proposals (excluding fees) separately from their fee proposals
- ii. to limit default fees to a single percentage-based fee and a single annual or monthly fee, and prohibit providers from charging fees that consumers would not be able to translate to a percentage or dollar amount, with certain exceptions

- iii. not to seek an unlimited number of default providers or a drastically reduced number of providers
- iv. to require that default providers maintain a responsible investment policy, commit to assessing environmental, social and governance issues in making investment decisions, and report to the Financial Markets Authority regularly on their progress against their commitments
- v. to require providers to disclose, on their websites, their responsible investment practices, including exclusions, a description of the provider's environmental, social and governance policy, and any certifications the provider holds
- vi. to allow reappointed providers to retain their default members, and transfer the default members of any providers who are not reappointed (after those members have been given an opportunity to make an active choice of fund)
- vii. not to transfer default members that have actively chosen to stay in that fund
- viii. to include member engagement requirements as part of the terms and conditions for default providers
- ix. to use the procurement process to encourage providers to come up with initiatives to support New Zealand's capital markets.

Agree / Disagree

e

Legal professional privilege

- f **agree** (subject to Crown Law's peer review of the legal advice) to transfer those members on a sequential basis such that each appointed provider receives approximately the same number of transferred members.

Agree / Disagree

- g **note** that officials will provide you with further advice about the timing of the procurement process and governance arrangements.

Noted

- h **note** that officials will provide you with further recommendations on second-order policy issues ahead of the procurement process starting.

Noted

i forward this briefing to Rt Hon Peters, Hon Parker and Hon Shaw.

Corbett

Sharon Corbett
Manager, Financial Markets Policy, MBIE

22 January 2020

Robbie Taylor

Robbie Taylor
Acting Manager, Financial Markets, Treasury

22 / 01 / 20 20

Hon Grant Robertson
Minister of Finance

..... / /

[Signature]

Hon Kris Faafoi
Minister of Commerce and Consumer Affairs

25 / 1 / 20

Forwarded
Pls write letter
outlining content of
decision re
exclusions. Co-signed to
MoF if possible

PROACTIVELY RELEASED

Background

1. The terms of appointment for the existing nine providers of default KiwiSaver funds expire on 30 June 2021. You are the Ministers responsible under the KiwiSaver Act for appointing new default providers, in consultation with the Financial Markets Authority. You are also responsible for determining the terms and conditions on which the providers are appointed.
2. On 5 November 2019, we provided you with recommendations on the settings for KiwiSaver default funds, which will form the basis for procuring new KiwiSaver default providers. We also provided you with a draft Cabinet paper seeking feedback on those recommendations [Briefing 0743 19-20 (MBIE), T2019/3540 (TSY)].
3. Cabinet considered the proposed settings on 9 December 2019 and provided feedback. A copy of the Cabinet paper is attached as **Annex 1**.
4. We now provide you with further advice, and seek your decisions, on the two settings which the Cabinet Economic Development Committee (DEV) discussed on 4 December 2019. Constitutional conventions

Constitutional conventions

Constitutional conventions

Constitutional conventions

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Responsible investment

11. The Cabinet paper proposed that default providers should be subject to the following three responsible investment requirements:

- to require default providers to exclude illegal weapons and fossil fuel production from default funds
- to require that default providers maintain a responsible investment policy, commit to assessing environmental, social and governance issues in making investment decisions, and report to the Financial Markets Authority regularly on their progress against their commitments
- to require providers to disclose, on their websites, their responsible investment practices, including exclusions, a description of the provider's environmental, social and governance policy, and any certifications the provider holds.

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Constitutional conventions

13. Following DEV, on 5 December 2019 Hon Shaw wrote to you in support of the exclusion of fossil fuels and munitions investments stating that he saw the exclusion as the ethical and economically sensible thing to do. He noted that default provider status is a privilege. Default providers accrue significant commercial benefit as a result of the government's endowment of that status. This is particularly true given the low rate of customers moving away from default providers in the market. Therefore, in his view, default providers should operate in line with government policy. He also wrote that excluding fossil fuel investments would help New Zealand give effect to its commitment under the Paris Agreement to "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development".

14. The exclusion of fossil fuel production is consistent with the Government's commitment to take action on climate change and transition to a low-emissions economy.

15. We have deliberately recommended that the number of exclusions be limited to illegal weapons and fossil fuel production to reduce the risk that returns could be impacted. Although it is not certain how sector exclusions would affect after-fee returns for default members, exclusion of systemic risks (eg excluding coals when coal prices are declining worldwide) could increase returns in the long-run.
16. Worldwide, governments, as well as large pension funds, have started to divest from fossil fuels. For example, on 4 January 2019 the Ireland Strategic Investment Fund, a sovereign development fund, announced that it had divested from all fossil fuel investments (within the meaning of the Fossil Fuel Divestment Act 2018). On 10 January 2018 the Mayor of New York and trustees of the city's \$189 billion pension funds announced a goal to divest city funds from fossil fuel reserve owners within five years.
17. The settings for default funds are reviewed only every seven years. The review of the settings for default funds represents an opportunity to ensure that default funds are invested more responsibly.

Constitutional conventions

18. We recommend that you agree to the following recommendations, which we previously briefed you on [Briefing 0743 19-20 (MBIE), T2019/3540 (TSY)] Constitutional conventions

- to have a two-stage assessment process for tenders in which providers are required to submit their proposals (excluding fees) separately from their fee proposals
- to limit default fees to a single percentage-based fee and a single annual or monthly fee, and prohibit providers from charging fees that consumers would not be able to translate to a percentage or dollar amount, with certain exceptions
- not to seek an unlimited number of default providers or a drastically reduced number of providers
- to require that default providers maintain a responsible investment policy, commit to assessing environmental, social and governance issues in making investment decisions, and report to the Financial Markets Authority regularly on their progress against their commitments
- to require providers to disclose, on their websites, their responsible investment practices, including exclusions, a description of the provider's environmental, social and governance policy, and any certifications the provider holds
- to allow reappointed providers to retain their default members, and transfer the default members of any providers who are not reappointed (after those members have been given an opportunity to make an active choice of fund)
- not to transfer default members that have actively chosen to stay in that fund
- to include member engagement requirements as part of the terms and conditions for default providers
- to use the procurement process to encourage providers to come up with initiatives to support New Zealand's capital markets.

Weighted allocation to transfer default members

19. The Cabinet paper proposed that:
- the default members of default providers that are not reappointed (if any) would be transferred to the default providers appointed for the term beginning 1 July 2021
 - reappointed default providers would retain their members.
20. Members would be informed of the upcoming transfer ahead of time by providers and would be given a chance to make an active choice to stay in their current fund or choose another fund. If no decision was made, the member would be transferred.
21. The Cabinet paper also stated that officials will carry out further work on how transferred members would be allocated but, if feasible and consistent with the KiwiSaver Act, this would be done on a weighted allocation basis so that appointed providers with fewer or no default members would receive a greater proportion of transferred members.

22. Legal professional privilege

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Timelines and next steps

26. We will work with your offices to prepare a press release about the high-level requirements for default funds. Subject to your agreement to the settings, we recommend announcements are made in February 2020 so that KiwiSaver providers can begin preparing for the tender process later this year.
27. There will be mixed views about the decisions. We have engaged with stakeholders throughout the consultation process, so most of the decisions are not likely to be surprising to them. Stakeholders are most likely to be interested in the fees, transfers and responsible investment decisions. We will provide you with key messages in relation to these issues in due course.
28. Officials have started work on the procurement process for appointing new providers. We are aiming for the procurement process to conclude in late 2020. The term of appointment for new providers will start on 1 July 2021. This allows six months for providers and Inland Revenue to arrange transitions and for regulations about transfers to be made (if needed).
29. In March 2020 we expect to provide you with further advice on the procurement process and governance arrangements.
30. We will also provide recommendations on second-order policy issues (for example, the allowable range of growth assets within the balanced investment mandate, and member engagement requirements) ahead of the procurement process starting.