MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

TE TAI ŌHANGA
THE TREASURY

BRIEFING

KiwiSaver Default Provider Review – final matters

Date:	5 August 2020	**Priority:**	Medium
Security classification:	**In Confidence**	**Tracking number:**	MBIE 2021-0264 TSY 2020/2633

	Action sought	Deadline
Hon Grant Robertson Minister of Finance	**Agree** to the proposed definition for excluding fossil fuel production from default funds	20 August 2020
Hon Kris Faafoi Minister of Commerce and Consumer Affairs	**Agree** to evaluation criteria and guidance on the value-for-money assessment	

Hon Grant Robertson
ORIGINAL

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)		
Joseph Shannon	Lead, KiwiSaver Default Provider Review (MBIE)		✓
Susan Ivory	Senior Analyst, Financial Markets (Treasury)		

The following departments/agencies have been consulted
Financial Markets Authority

Minister's office to complete:

- ☐ Approved
- ☐ Noted
- ☐ Seen
- ☐ See Minister's Notes
- ☐ Declined
- ☐ Needs change
- ☐ Overtaken by Events
- ☐ Withdrawn

Comments:

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Purpose

To seek your agreement to a definition for excluding investment in fossil fuel production from KiwiSaver default funds and other matters, prior to the release of the request for proposals.

Recommended action

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

a **Agree** that KiwiSaver default funds should be unable to make equity investments in companies that either:

   a. own fossil fuel reserves where those reserves account for at least 15 per cent of revenue; or

   b. have a primary business activity associated with fossil fuel production.

Agree / Disagree

b **Agree** that the fossil fuel reserves in the above definition should not include metallurgical coal.

Agree / Disagree

c **Agree** to the evaluation criteria and weightings provided in the table in paragraph 14.

Agree / Disagree

d **Agree** to the guidance that the evaluation panel should apply when making the value-for-money assessment provided in paragraph 16.

Agree / Disagree

e **Agree** that officials may make minor changes to the evaluation criteria, weightings and value for money guidance as procurement materials are finalised.

Agree / Disagree

f **Note** that officials recommend that you do not discuss the default provider review with KiwiSaver providers and other interested parties due to commercial sensitivity and probity risks.

Noted

g **Forward** this briefing to the Minister of Energy and Resources and the Minister for Climate Change.

Forwarded

S Corbett

Sharon Corbett
Manager, Financial Markets Policy
Ministry of Business, Innovation and Employment

5 August 2020

Robbie Taylor
Acting Manager, Financial Markets
The Treasury

5 August 2020

Hon Kris Faafoi
Minister of Commerce and Consumer Affairs

..... / ...... / ......

Hon Grant Robertson
Minister of Finance

9 / 8 / 20

Background

1. As the current terms for KiwiSaver Default Providers end as of 30 November 2021, it is necessary to re-select default providers. MBIE and the Treasury are planning to formally start the selection process in early September by issuing a request for proposals (RFP).

2. Joint Ministers recently agreed to most outstanding issues related to this process, including two options for a definition of the fossil fuel production exclusion to be consulted on with KiwiSaver providers (ref 3735 19-20 (MBIE), T2020/729 (TSY)).

3. This briefing seeks your agreement to the final two matters that require Ministers' consideration prior to releasing the RFP:

   a. A final decision on a definition of the fossil fuel production exclusion; and

   b. The high-level evaluation criteria and weightings, as well as guidance on a value-for-money assessment that will guide our evaluation panel's assessment and recommendation.

Fossil fuel production exclusion

4. We undertook brief technical consultation on two definitions for the exclusion of investment in fossil fuel production for KiwiSaver default funds. The two options were:

   a. Option A: exclude equity investments in companies with fossil fuel reserves where those reserves account for at least 15% of revenue or

   b. Option B: exclude equity investments in companies that either:

      - own fossil fuel reserves where those reserves account for at least 15% of revenue *or*

      - have a primary business activity in fossil fuel production.

5. The relevant primary business activities (based on international classification standards) in Option 'B' are:

   a. exploration, drilling, and production of oil and gas;

   b. supply of equipment and services to oil fields and offshore platforms;

   c. integrated oil and gas companies; and

   d. exploration for or mining of coal.

6. **Annex 1** provides a description showing which type of companies would be excluded under each definition.

7. We received responses from ten KiwiSaver providers including all but one of the current default providers, and two non-default KiwiSaver providers. The consultation confirmed that both definitions are likely to be practical, workable and unlikely to cause any significant unintended consequences. The majority of providers considered the definitions reasonably straightforward, while a minority found them challenging but implementable.

We recommend Option 'B'

8. We had originally recommended Option 'A' as the definition that appeared to best meet your objectives on the expectation that providers might find Option B more complex, and that this likely outweighed the benefit of the additional companies captured.

9. However, although many respondents did not express a clear preference for an option, of those that did the balance of preference was for Option 'B.' Contrary to our expectations, several respondents considered Option B easier to implement as it reduces the number of companies one has to examine in terms of fossil fuel ownership, which can be more complex. The primary business activity provides a simple 'initial screen.'

10. On this basis, we recommend Option 'B'. This will capture a greater proportion of relevant companies and, based on the consultation responses, does not appear more challenging or costly to implement than Option 'A'.

Changes to the definition based on consultation

11. The only substantive change we propose to the design of Option 'B' based on feedback is to exclude from the fossil fuel reserve definition 'metallurgical' or 'coking' coal. It is a reasonably common practice to not include metallurgical coal from fossil fuel exclusions, as it is necessary for the chemical process of making steel (to provide a source of carbon).

12. Many steel companies own coking coal reserves. Although our revenue threshold would most likely keep them from being excluded anyway, this change will add clarity to the definition and align better with international funds management. This was a feature we had previously considered in drafting the definitions, and the consultation confirmed it is worth excluding.

13. **Annex 2** identifies some of the other issues raised by respondents and how we do or do not intend to address them. We will also make further technical changes in response to feedback.

Decision-making criteria and guidance

14. The RFP will need to provide weighted decision-making criteria as well as guidance on how the panel should approach the value-for-money assessment. This will form the basis of the recommendations for appointing default providers, and we wish to ensure they reflect your priorities for this process.

15. The first component of the value-for-money assessment is a number of non-fee qualitative criteria. Each will be scored, and then an overall weighted-average will be calculated. We are seeking your agreement to the criteria and weightings as presented in the table below:

Criterion	Core Question	Weighting
Provision of default investment product	Does the provider have the capability, approach and systems to effectively deliver the default investment product as required?	35%
Member experience	Will the provider meet our increased member engagement and services standards, and what else will they do to provide a good member experience?	35%
Transition	Is the provider capable of managing the transition to becoming a default provider, in particular the potential for a large one-time influx of members?	15%
Organisational	Does the wider organization have appropriate	15%

Criterion	Core Question	Weighting
structure and financial standing	governance, management systems and financial standing, including in relation to their KiwiSaver business?	
	Total	100%

Value-for-money guidance

16. The most complex judgement the panel will be required to make is balancing the relative performance on the qualitative criteria above with fees, including considering fees for low-balance members. As previously agreed, there is no explicit weighting for fees.

17. To ensure that the panel and potential applicants understand Ministers' intent for this process, we recommend that guidance based on the following principles be applied by the evaluation panel in determining the value-for-money of the respondents' proposals:

   a. Only those applicants who clearly demonstrate that they are capable of meeting the requirements to be a default provider can be considered to provide value-for-money.

   b. Officials understand that you place a strong emphasis on the value that low fees offer to all default members given the impact fees can have on long-term returns.

   c. We also understand that you consider that there is important value to be gained through improved KiwiSaver member engagement to support them making choices that best meet their long-term needs. The updated requirements for default funds, including the new service standards for member engagement, will support this improved experience.

   d. There can be a trade-off between cost and member experience. Over the long-term, fees will have a material effect on members' balances in retirement. Being in the appropriate fund will also have a significant effect. The new service standards for member engagement should result in better fund choices by members.

   e. While somewhat higher fees may be justified for delivering greater value over and above meeting requirements in areas such as member engagement, those proposals with significantly higher fees are unlikely to be considered good value-for-money, irrespective of specific additional offerings.

   f. The inclusion of the average annual fee for low-balance members in the value-for-money assessment is aimed at encouraging fee structures to support members with low balances. Targeting lower fees for low-balance members may mean somewhat higher fees for other members than would otherwise be the case. However, this should not lead to higher fees overall. Therefore, when considering fees as part of the value-for-money assessment, the average annual fees across all members will be prioritised, but where this is very similar between proposals, those that offer lower average annual fees for low balance members will be preferred.

18. The draft member engagement service standards referred to above are provided for your information as **Annex 3**. These are still being finalised.

Engagement with providers

19. As we will soon begin the formal selection process, officials suggest that Ministers avoid discussion of the review with KiwiSaver providers, in light of the commercial sensitivities and probity risks. We recommend you avoid taking meetings specifically focused on the review, and where you are meeting or engaging with providers for other reasons, avoid discussion of

the process. We have advised your offices of this, and will reflect this in meeting advice and notes when relevant. We have communicated similar expectations to KiwiSaver providers.

Next steps

20. The agreements sought in this briefing are the final matters required of Ministers prior to release of the RFP. As previously indicated, we intend to release the RFP in September and we will inform your offices of the final date once confirmed. We will provide regular updates on progress, and advice on preferred providers, in March 2021.

Annexes

Annex 1: Types of companies excluded under each option.

Annex 2: Themes from fossil fuel technical consultation.

Annex 3: Draft member engagement service standards.

Annex 1: Companies excluded under fossil fuel production exclusion options

Types of companies excluded under Option A	Companies with a primary business activity in fossil fuel production, who own reserves (and derive at least 15% of revenue from upstream and mining activities) such as: • ExxonMobil • New Zealand Oil and Gas • Peabody Energy • Gazprom Diversified mining companies where only a minority of activity is fossil fuel mining but which may still have extensive coal mining operations (e.g. BHP Billiton)
Types of companies excluded under option B	All companies excluded under Option A Companies that don't control reserves but have a primary business activity in fossil fuel production such as: • Schulmberger • Halliburton Possibly some integrated Oil and Gas companies where less than 15% of revenue comes from upstream activities.
Types of companies not excluded under any option	a. Oil refining companies (e.g. NZ Refining Company). b. Wholesale gas/oil pipeline companies (e.g. KinderMorgan). c. Companies that are primarily utilities (e.g. Vector or Meridian) or retail (Z Energy). d. Companies with major oil and coal production service arms, but where this is still a minority of overall activity (e.g. General Electric, Siemens). e. Conglomerates where a minority fossil fuel production that control fossil fuels (e.g. Berkshire Hathaway). f. Energy companies where less than 15% of revenue comes from fossil fuel production but who control fossil fuel reserves (e.g. Genesis Energy). g. Industrial firms that control fossil fuel reserves for a specific industrial purpose, primarily steel production (e.g. ArcelorMittal).

Annex 2: Themes from fossil fuel technical consultation

Issue raised by respondents	Our intended approach
Two respondents suggested that the Government provide a definitive list of companies to be excluded. A further respondent suggested that the Government could provide guidance on certain companies where it is difficult to apply the definition.	We do not consider it practical or desirable for the Government to provide a globally complete list of excluded companies that would need to be updated frequently. However, there may be value in issuing guidance with respect to specific companies where it is difficult to apply the definition. The FMA considers that this would be outside the scope of their role and resourcing. Officials will consider this further as issues arise. In general, a provider will always have the discretion to exclude a company 'when in doubt.'
Two respondents suggested that we also exclude debt investments in fossil fuel production companies (in addition to equity). However, a third respondent noted the importance of not including debt investments in the exclusion.	We consider that the basis on which we previously provided for not including debt investments remains sound, in particular the relative lack of bond index funds that exclude fossil fuel companies. The importance of this was noted by one respondent. We note that in our consultation with the NZ Super Fund, they supported our view of not including debt in our definition.
Several respondents noted that their current data service providers provide revenue by source in thresholds from 0-10% and 10-25%. This would mean directly applying the 15% threshold would require some manual analysis or additional data. However, some providers considered procuring the data with a different threshold would not be complicated.	While alignment with existing data provision thresholds would be helpful, neither of the points at which we would need to place the threshold for KiwiSaver default providers (10% or 25%) are desirable. As providers can apply a more restrictive definition if they wish, they would be able to apply a 10% threshold (excluding more companies) and still comply with the definition.
Two respondents sought clarity on the application of the exclusion to unconventional gas and petroleum such as oil sands which may not always be considered 'fossil fuel reserves.'	We will clarify in the definition what 'fossil fuel reserves' does include.

Annex 3: Draft member engagement service standards

Obligations to provide minimum member experience standards

Provider service	Description	Service standard
Onboarding	All new members receive access to an on-boarding advice process covering fund choice, contribution rate and checking contact details.	Within 3 months of being allocated to the provider: - At least 50% of members engage with the onboarding process. For example, opening emails, updating contact details, downloading a provider app. - At least 20% of members complete onboarding via an advice conversation or through engaging with digital tools (for example, completion of a fund profile tool, using a savings calculator).
First home withdrawal checkup	All members who withdraw funds for a first home receive a check-up to discuss the value of continuing contributions (if the member can afford this) and to check fund choice.	Within 3 months of withdrawing funds for a first home: - At least 50% of members engage with the first home withdrawal checkup (for example, opening emails, contacting the provider for personal advice). - At least 20% of members complete the checkup via an advice conversation or through engaging with digital tools (for example, completion of a fund profile tool, using a savings calculator).
Pre-retirement checkup – 10 years out	All members turning 55 receive a 10-year out checkup covering contribution rate, fund choice, and an introduction to the options available when they reach retirement eligibility.	Within 3 months of turning 55: - At least 50% of members engage with the 10-year out checkup, for example opening emails, contacting the provider for personal advice. - At least 20% of members complete the checkup via an advice conversation or through engaging with digital tools (for example, completion of a fund profile tool, using a savings calculator, use of an options tool).

Provider service	Description	Service standard
Pre-retirement checkup – one year out	All members turning 64 receive a one-year out checkup covering contribution rate, fund choice, and an introduction to the options available when they reach retirement eligibility.	Within 3 months of turning age 64: - At least 50% of members engage with the 1-year out checkup for example, opening emails, contacting the provider for personal advice. - At least 20% of members complete the checkup via an advice conversation or through engaging with digital tools (for example, completion of a fund profile tool, use of an options tool).
65-plus support	Delivery of a 65-plus support programme for members.	Results of activities are measured and reported to the FMA.
Engagement prompts at key milestones	A planned series of engagement campaigns and activities at the following key milestones: - Annual member statement time. - Government contribution payments. - During significant market volatility. - As the member nears the end of section 104 savings suspension. - As the member approaches eligibility for First Home withdrawal. - When a non-contributing member not on an approved section 104 savings suspension has not made a contribution within the last 18 months. - When a member reaches eligibility age for withdrawal (65 years).	Results of activities are measured and reported to the FMA.