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Review of the KiwiSaver Default Provider Arrangements
Financial Markets Policy
Ministry of Business, Innovation & Employment
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Review of the KiwiSaver Default Provider Arrangements

ASB Bank Limited (**ASB**) welcomes the opportunity to provide feedback to the Ministry of Business, Innovation & Employment on the Review of the KiwiSaver Default Provider Arrangements (the **Review**). Our submissions on the Review generally are set out in Section 1, and in Section 2 we set out our submission on the Review focus areas.

We acknowledge that ASB's submission may be published on the Ministry of Business, Innovation & Employment website, and may be released in response to a request under the Official Information Act. ASB does not seek confidentiality for any aspect of this submission, other than my direct contact details below.

ASB looks forward to ongoing engagement as the Review progresses. If you require any further information in relation to this submission, please do not hesitate to contact me.

Yours sincerely,

Sam Kelly
Head of Regulatory Affairs (Acting)
ASB Bank Limited
[redacted]

SECTION 1: THEMATIC COMMENTS

ASB is proudly committed to its purpose of accelerating the financial progress of all New Zealanders. KiwiSaver plays a critical role in this regard given for many New Zealanders this is the only form of long-term savings that will provide for their retirement. However, for those many default members that are not actively engaged with their KiwiSaver accounts, we share the Government and industry's concern that their needs are not being best served by the current default settings, in particular the conservative investment mandate.

We strongly support the objectives of this Review and we look forward to further engagement as the policy is finalised.

ASB's key submission points are noted below:

1. **Investment option:** ASB firmly believes that members should be responsible for their fund choice and we have been supporters of the parking space concept since the inception of KiwiSaver. Our preferred approach is to see good customer outcomes achieved through high quality engagement strategies where members actively choose a fund suitable to their risk profile and situation.

   However, we do accept that there is difficulty in engaging a substantial group of default members. Accepting this and that the Government may have to assist funding any shortfall for these members at retirement, we believe it is justified to move away from the view that a default fund is a short-term 'parking space'. Therefore, we support a less-conservative investment mandate for the default investment product. We consider that a balanced mandate best meets the needs of the largest cohort of default members. It has the potential to earn higher returns over the long-term, without taking as much risk as would be taken if the growth fund option, or in certain age groups, if the life-stages option was chosen (particularly for default members that may be First Home Buyers).

2. **Fees:** Fees are important, however we believe fees should not be considered in isolation. There is an inherent link between fee, investment approach, fund type, services and innovation. Over the long-term the net benefit to members (in particular, investment performance after fees) is crucial to a better financial position at retirement.

3. **Transfer of members:** We do not support any option that results in the transferring of default members among providers and we do not agree that unsuccessful existing default applicants should automatically lose their current default members. Transferring default members could result in poor customer outcomes, with a high propensity to affect trust and confidence in KiwiSaver.

4. **Capital market development:** This objective could conflict with a provider's overarching fiduciary duties to members of achieving the best possible risk adjusted returns. Therefore, we do not support an objective to use KiwiSaver or Default arrangements to develop New Zealand capital markets.

SECTION 2: FEEDBACK ON DISCUSSION PAPER

1. **What is your feedback on the proposed objective for the review?**

We strongly support the main objective of the review to "enhance the financial well-being of default members, particularly at retirement." It aligns strongly with ASB's purpose of accelerating the financial progress of all New Zealanders.

2. **What is your feedback on the proposed criteria for the review? How should the criteria be weighted?**

Our order of preference for the proposed criteria for the review is:

1. Better financial position for KiwiSaver default members, particularly at retirement
2. Trust and confidence in KiwiSaver
3. Promote innovation, competition, and value-for-money across KiwiSaver
4. Low administration and compliance costs

We do not agree that the criterion "Support development of NZ's capital markets that contribute to individuals' well-being" aligns with the purpose of the default fund settings or to the purpose of KiwiSaver.

Investment option

3. **What is your feedback on the problem definition for the investment mandate? Is a move away from a "parking space" purpose justified?**

ASB firmly believes that members should be responsible for their fund choice and we have been supporters of the parking space concept since the inception of KiwiSaver. Our preferred approach is to see good customer outcomes by using effective engagement strategies, which result in all members actively choosing a fund suitable to their risk profile and situation.

However, we do accept that there is difficulty in engaging a substantial group of default members. We agree with MBIE's view that past experience with member engagement suggests that it alone is not effective in encouraging default members to make an active choice about their KiwiSaver investment. Our experience is that member engagement is difficult to achieve and after concerted engagement efforts by us, and other current default providers, the highest levels of member activation are generally around 15%[1].

Accepting that there will be a cohort of long term members that will not make a choice and that the Government may have to assist funding any shortfall for these members at retirement, we believe it is justified to move away from the view that a default fund is a short-term 'parking space'.

The question is what is the most appropriate strategy? Conservative is attractive as a default investment mandate as it has the least downside risk, but inherently this leaves the younger members with the least retirement capital and the Government potentially needing to fill retirement shortfalls. If the majority of the default cohort is young, then the best strategy is Growth, which is appropriate until age 54. However, after this age, Balanced (and then Moderate from age 62) would generally be ASB's recommendations. Overall, a balanced investment strategy is suitable for a customer who makes no fund choice as it is closest to the

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[1] FMA KiwiSaver Annual Report 2018

average of a life-stages option. The challenge remains that this is not the best option for First Home Buyers. However, we expect a First Home Buyer member is more likely to engage at some point and with enough time to gain an understanding around the different fund choices and importance of choosing the right fund for your situation.

The idea of a nursery period discussed under the life stages option has merit for any default investment mandate other than the conservative option. We think it provides a period for default member to engage including potential First Home Buyers, and to select an appropriate fund for their situation. After this nursery period then they would be transferred into the chosen default investment mandate, which ensures over the long-term if they continue to not engage with their KiwiSaver fund choice, then they still achieve a better financial position at retirement.

On this basis, we support a balanced investment mandate for the default investment product. A balanced mandate best meets the needs of the largest cohort of default members. It has the potential to earn higher returns over the long-term, than a conservative fund, but without taking as much risk as would be taken if the growth fund option or in certain age groups, life-stages option was chosen.

4. **Should the investment mandate options (and other options, for example in relation to fees) apply only to default members who have not made an active choice, or should they also apply to members who have made an active choice to stay in the default fund? Why or why not?**

We strongly believe that investment mandate options and other default settings should apply only to default members who have not made an active choice. Additionally, we query whether shifting default members who have made an active choice to the investment mandate is a viable option, given that default members who have made an active choice are excluded from the definition of 'default member' under the Instrument of Appointment.

In principle, an investment manager should not materially override a member's investment election without first gaining their consent. We consider a default member who has elected to remain in the conservative default fund has made an investment decision, which is as legally binding as any other investment decision made by default members into non-default funds.

It would be confusing to a member if, after making an investment decision, they were shifted to another investment option, meaning their investment decision had been overridden.

Aside from the potential confusion, this treatment would create large inconsistencies in member treatment, even where members had taken substantially similar actions. For example, consider the treatment of the following members, "Member A" elects 80% remains in the conservative default fund and 20% is invested in a growth fund, while "Member B" elects 100% remains in the conservative default fund. If, as suggested, default providers were required to shift members who had elected to remain in the conservative default fund, it would create an inconsistent outcome as Member A will be shifted to the new default investment option but Member B won't be.

The result of creating inconsistent outcomes would likely result in a poor customer outcome and could undermine trust and confidence in KiwiSaver and the default settings. This is inconsistent with criterion two of the Review's objectives.

Finally, there are significant practical issues in implementing a transfer of members. For example, around $1 billion of default member assets invested in the ASB KiwiSaver Scheme would need to be traded. The sale and purchase of $1 billion in assets has the potential to significantly distort the New Zealand and Australian equity and bond markets and would impose the trading cost on the existing default members. Default members across providers would get different outcomes. We would also need to ensure the transaction costs of the default members transferring are not passed onto other KiwiSaver members in conservative funds.

5. **If a life-stages option is adopted, what "stages" should apply and to which age groups? Should there be a "nursery" period?**

   We do not recommend a life-stages option should be adopted as noted below. However, if a life stages option were to be adopted we agree the idea of a nursey period and suggest a one year period would be appropriate. In terms of stages, ASB's glide path is Growth (80 growth/20 income) to age 54, Balanced (60 growth/40 income) to age 62, and Moderate (40 growth/60 income) thereafter. Our model also recommends shifting to a Conservative fund (20 growth/80 income) once the member is within three years of completely exhausting their funds.

6. **If a balanced investment mandate is adopted, what range for growth assets should be applied?**

   We recommend the adoption of a balanced investment mandate. If a balanced investment mandate is selected, there should be a tighter range for growth assets than the FMA's guidance of 35%-63%. A mandate as wide as the FMA's guidance could produce a wide range of retirement outcomes and wide range of outcomes across default providers, which would be inconsistent with criterion one and two[2] of the proposed default review objectives. To create consistency amongst default providers we believe a narrow range of +/-5% around the benchmark as is currently the case for the default investment mandate and a balanced fund benchmark should be 60% growth and 40% income assets.

7. **If a growth investment mandate is adopted, what range for growth assets should be applied?**

   We do not recommend a growth option should be adopted. If a growth investment mandate is selected, there should be a tighter range for growth assets than the FMA's guidance of 63%-90%. A mandate as wide as the FMA's guidance could produce a wide range of retirement outcomes and wide range of outcomes across default providers, which would be inconsistent with criterion one and two[3] of the proposed default review objectives. To create consistency amongst default providers we believe a narrow range of +/-5% around the benchmark and a growth fund benchmark should be 80% growth and 20% income assets.

8. **If a conservative investment mandate is adopted, what range for growth assets should be applied?**

   We do not recommend a conservative option should be adopted. However, if a conservative mandate were adopted the current settings are appropriate.

9. **If a life-stages, growth, or balanced option was adopted, how should we mitigate the potential issue in relation to first-home buyers and other people making early withdrawals?**

[2,3] Criterion 1: Better financial position for KiwiSaver default members, particularly at retirement, and Criterion 2: Trust and confidence in KiwiSaver.

In order to mitigate the potential issue in relation to First Home Buyers, Government could work with default providers to create a targeted engagement strategy. This could be achieved by identifying attributes common to First Home Buyers, for example, age, certain behaviours such as asking for a balance or increasing their contribution rate.

In terms of other early withdrawal types, these are typically unexpected circumstances and by their very nature would be difficult to design communication strategies for.

10. **What would be the administrative costs to providers of choosing a life-stages option?**

There are one-off and ongoing systems and administrative costs to setting up a life-stages option that are greater than a single fund option. The business readiness activities to launch a life-stages option are also significant and would take a number of months to implement.

11. **What is your feedback on the different options? Do you agree with our assessment of the costs and benefits of the option? Which option do you think is best and why? Is there another option that we have not considered that would be better than the options discussed?**

Broadly we agree with the Review's assessments of the costs and benefits of each option and we do not believe there are other better options than those discussed.

As stated above, we consider that a balanced investment option best meets the needs of the largest cohort of default members.

A growth or life-stages option results in too much risk for members who are the most likely cohort to make an early first home withdrawal.

ASB recognises the merits of life-stages option as it attempts to match a member's investment timeframe to the appropriate fund. However, we see issues with life-stages as a default investment option, which run contrary to the criteria of the Review's objective:

1. The life-stages option assigns young default members, that is, those members who are most likely to make a first home withdrawal in the short-term, in the fund suitable for long-term saving. This introduces the risk that when a member comes to withdraw that the market is in a downturn, which could be significant and prolonged. This risk if it manifests, has the potential to undermine trust and confidence in KiwiSaver, and create significant issues for providers and members.
2. We consider that a life-stages option will be more expensive for providers to offer than a single fund, and therefore will be more expensive for members.
3. Life-stages depends on provider's having accurate information as to a member's date of birth. The default member is not required to give this information to their employer and our experience is that this data is missing for some members and may not be reliable for others. Therefore, we could not apply a life-stages mandate to some members or accurately to others.
4. The life-stages option is an intuitive investment solution that makes sense to members if it is well explained. However, it could add complexity and length to conversations that explain fund choice to default members. This could undermine goals around improving the financial literacy of default members, and mean more time is spent explaining fund options. This will leave less (or no) time to explain the importance of other KiwiSaver features such as, contribution rates, PIRs and fees.
5. When measured over the long-term, the life-stages option results in a substantially similar investment outcome to being in a balanced fund. We consider a balanced fund

mitigates the issues above, whilst still seeking to enhance the financial outcome for the majority of members with a reasonable approach to risk and return.

Fees

12. **What is your feedback on the level of value that KiwiSaver default members get for their fees? What are the costs that are within and outside a provider's control? To what extent are fees too high?**

We consider that default members who are part of the ASB KiwiSaver Scheme receive excellent value for money. This is evidenced by our top value for money ratings from agencies such as Canstar and SuperRatings. ASB believes returns after fees are more important than the fees charged. Default members in the ASB KiwiSaver Scheme have received returns of 4.53% pa for the last 5 years, which was the top performance of a default fund over that period[4].

Enhancing the financial wellbeing of default members is a complex problem that requires a holistic solution including:

- access to digital tools
- knowledgeable staff
- regular and targeted communications
- an outbound calling programme.

Since the launch of the ASB KiwiSaver Scheme we have continued to invest in increasing and enhancing the services we offer to default members. We expect to continually expand and enhance our services to members, which require significant reinvestment.

Most of the costs incurred in managing KiwiSaver funds are inside a provider's control. However the level of costs can vary substantially, depending on the provider's approach. The main costs relate to a provider's approach to the following areas:

- investment approach (passive vs active)
- fund structure (investment mandates vs fund of fund)
- dedicated staff and services; and
- levels of compliance costs (Audit, Supervisor, Custody)

The main costs outside a provider's control are:

- trading and brokerage costs
- compliance costs (Audit, Supervisor, Custody) these costs can be reduced but not removed entirely.

Fees should not be considered as a single factor in isolation. Fees are important, however there is an inherent link between fee, fund type, services and innovation. There are examples of high fees in market, with corresponding high levels of consistent investment performance and services. However, there are also examples of relatively high fee levels, poor investment performance and medium levels of service.

[4] Return quoted is annualised and after the deduction of annual fund charges and tax at the highest PIR (28%) as at 30 June 2019, source of comparison Smart Investor tool smartinvestor.sorted.org.nz.

Over the long-term the net benefit (which is investment performance after fees) to members is one of the most important factors in achieving good customer outcomes. Members should have options within a competitive market place in which to invest.

13. **Is it a problem that fees disproportionately affect those on low income and under 18s? Why/why not?**

ASB believes that fee structures should be competitive and equitable across all members. We do not believe that any group of members (i.e. those with low or high account balances) should be cross-subsidised by another group of members.

Administration fees cover some of the fixed services required of a KiwiSaver scheme, such as maintaining the registry, providing each member with an Annual Statement and Annual Report. These types of services cost the same for all members regardless of their account balance. If administration fees were prohibited, members with medium and high account balances would cross-subsidise these services for those with low account balances.

Other KiwiSaver features could instead be considered to improve outcomes for employed under 18s and low balance members, such as easing the ability for these members to qualify for Government contributions or a Government fee subsidy. Government contributions are proportionately a greater benefit to those on lower incomes due to their maximum cap.

14. **If the government sets a fee, what should the fee be set at for the different investment mandate options? What considerations, methods or models could be used to determine the fee? What should be the balance between fixed and percentage fees?**

Setting fees will conflict with the criteria of promoting innovation, competition, and value for money across KiwiSaver. A set fee level may mean reduced services or lower quality investment structures, both of which would negatively impact the objective of enhancing the financial well-being of default members at retirement.

It should be unnecessary to set fees, as KiwiSaver providers:

- are commercial entities subject to healthy competition;
- have members who can transfer easily; and
- are required to have reasonable fees.

Setting fees could impact the number of providers who tender and it may reduce competition with the effect that a number of providers will tender at/near the set fee. Tenders may reduce if costs to service default members increase, coupled with uncertainty around the number of providers. Therefore the opportunity being tendered for, a fixed price, may make default status commercially unviable.

Providers should be able to determine the balance between fixed and percentage fees. This ensures fees can be structured in a balanced way that is fair for all members, as considered as part of our conduct obligations.

15. **What fee arrangements would best promote the objectives of the review? What is your feedback on the fee options? Do you agree with the costs and benefits identified? Which option (or the status quo) do you prefer and why? What other approaches or models could be used to reduce fees?**

Low fees that do not compromise service or quality best achieve the objectives of the review.

Our feedback on each of the fee options is below.

Option 1- Government sets a fee: Government should not set fees as this could be counterproductive to a number of key objectives as outlined in our answer to question 14.

Option 2 - Two-stage assessment of fees in procurement: As per our answer to question 12, fees should not be considered in isolation because there is an inherent link between fees, investment approach, fund type and potential after fee returns, services and innovation. Also this option would likely result in all default funds being passively managed.

Option 3 - Percentage-based fees reduce as provider's funds under management increase: This would limit a provider's incentive to reinvest in its business potentially to adopt the best investment strategy. It is possible that a manager could be passive (and therefore with lower costs) and then conclude that an active strategy (at a higher cost) would provide better retirement outcomes for members. Active strategies are typically more expensive. Equally a provider might feel restricted in their ability to add more expensive asset classes (such as alternative hedge funds) in future.

Option 4 - No fees for under 18 year olds: Setting 'no fees' for under 18s who chose the default investment option should be outside the scope of this review as they are not default members. In any case, we do not support cross-subsidising across membership groups, as outlined in our answer to question 13. We do not consider that lowering fees would incentivise members to contribute more to their KiwiSaver, however, changing the government contribution eligibility may, as referred to in our answer to question 13.

Option 5 (No fees for low balances) and Option 6 (No annual fees): Setting 'no fees' for low balances and setting 'no annual fees' should be outside the scope of this review. These options are broader than the requirements for default members. Again, in any case, we do not support cross-subsidising across membership groups, as per our answer to question 13.

In order to ensure providers can tender with their best fee levels and structures the default opportunity must be clearly defined during the procurement process. This will allow the provider to accurately price their tender. If the opportunity is vague and costs to service default members are not clearly defined, then providers will price higher to cover this uncertainty, or they may not tender at all.

Number of providers

16. **How has the number of providers in the default market affected innovation, competition and value-for-money in the default market and in KiwiSaver more generally?**

    The number of default providers has not significantly affected innovation, competition and value for money. This is because most default members and funds are incorporated in a provider's overall scheme and have benefitted as providers have continually improved their offerings, whilst keeping a focus on costs and fees in a very competitive market.

17. **Do you agree with our assessment of the costs and benefits of the different approaches for the number of providers? Can you provide us with evidence that might help us quantify the size of the costs and benefits? What option do you prefer and why?**

We broadly agree with MBIE's assessment of the costs and benefits of the different approaches for the number of providers. However, we note that the general public is now largely unaware of the ASB KiwiSaver Scheme's default status.

MBIE's assessment correctly captures that the number of providers is directly related to the size of the default opportunity and to the ability to attract high quality tenders from providers at the best possible fee.

Therefore, we encourage MBIE to consider setting a range of estimated appointments at the beginning of the procurement process. This will enable providers to assess the opportunity and to tender accurately.

18. **If a "minimum requirements" approach is taken should this be on a period-based or rolling system, and why?**

A minimum requirements approach should be avoided as this will make it unattractive for providers to tender. If the number of default providers change on a rolling or periodic basis, then providers cannot establish what the commercial opportunity for being a default provider is. This means that those providers either won't tender, or that competitive fee pressure during the tender process cannot be applied.

Practically this approach would be difficult for the IR administer (on either a rolling or periodic basis). IR's default allocation PDS distribution and update process is cumbersome with long lead in times. Unlimited providers would exacerbate these problems, making PDS updates extremely difficult.

Responsible investment

19. **Are there higher investment costs for responsible investing? If so, how likely are these costs to contribute to lower net returns?**

Yes there are higher costs for responsible investing. The lowest cost investing is index tracking and any variation from this has an increased cost from the lowest cost position.

Responsible investing can mean a range of different investment structures and approaches being applied to funds management. There are a variety of models employed by providers. Models can include some or all of:

- negative screening – controversial sectors are excluded, this may include following the NZ Super exclusions list
- positive screening – through ESG criteria that are a measure of sustainability and social impact and include:
    - environmental considerations - Policies and practices to address climate change, waste and pollution.
    - social considerations - The promotion of diversity and inclusion. Positive human and animal rights practices.
    - governance considerations - Corporate practices that create fair and transparent work places.
- prioritising responsible investment – to the extent that the risk/return profile is secondary

- engaging with companies to influence them to change policies, and actively voting proxies are another aspect of responsible investing, and it requires resource and thus adds cost

Responsible investing increases in cost as you increase the layers of approach. Negative screening to exclude certain controversial sectors is relatively affordable, but the administrative cost to members increases as buying and selling assets are increased. Each shift in approach can take some time to implement.

20. **How does responsible investment affect returns? Does it increase or decrease returns, and to what extent?**

ASB recognises that this is a rapidly evolving area, and as such the understanding about relative costs and performance of responsible investment is fluid. We are aware that several industry commentators believe that a skew towards more environmental investments will ensure greater resilience against climate and reputational risk, and therefore position the fund for stronger long-term performance.

However, it is ASB's view that there is not yet sufficient evidence to support the conclusion that responsible investing adds value. To gain certainty about this would require good quality data through at least one, but better many, market cycles. The approach has simply not been around for long enough, to enable this level of analysis.

ASB launched its own ASB KiwiSaver Scheme Positive Impact Fund and ASB Investment Funds Positive Impact Fund in July 2019; so this is an area that we are actively engaged in. We will be monitoring the funds' performance closely to inform our understanding in this area.

Currently, investing with a preference for investments that make a positive impact on society or the environment means a fund will be less diversified in the investments it can pursue. This means it may forego some potentially profitable opportunities on ethical grounds. This preference can impact on the fund's risk/return characteristics.

Responsible investing increasingly affects returns as you increase the layers of approach. Negative screening only decreases the investable universe slightly, so this is unlikely to have a large impact on returns. However, if the negative screens are increased substantially then they will certainly impact returns.

21. **Should the default provider arrangements be used to achieve objectives in relation to responsible investment?**

We do not consider that the Government should seek to achieve its policy goals in this way. The funds in KiwiSaver belong to its members and we do not consider it is appropriate for the Government to direct the manner in which the funds should be invested. It is the choice of the member as to how the funds are invested, and they will select a provider and fund based on what the disclosure tells them and how that aligns with their beliefs and circumstances.

With the default fund however, the Government may have to assist funding any shortfall for default members at retirement. It is plausible that they may be more directive with the overall investment strategy. However, it is important to distinguish that these funds belong to default members through KiwiSaver and are not Government funds equivalent to the New Zealand Super Fund or ACC funds. The funds are personal retirement funds held in trust, in the member's name, for the benefit of the member.

Responsible investing means various things to different people and to providers. What is responsible or ethical to one person may not be to another. Further to this, generally when people are asked to consider if they would invest responsibly if the financial outcome was potentially lower, attitudes diverge further. Trying to meet the views of all default members, or even the majority of default members, with a managed fund investment option, is very unlikely.

Therefore, we support that all KiwiSaver funds should invest legally, and responsible investing which goes further than this, should be left to consumer choices and competitive pressures. For example, we have recently launched the ASB KiwiSaver Scheme Positive Impact Fund to enable our members to invest with a preference to investments that have a positive impact on society or the environment. Clear, consistent and easy disclosure will enable consumers to make choices and apply this competitive pressure. It is not appropriate to use KiwiSaver default settings to dictate levels of responsible investing.

22. **Would default members want their funds to be invested more responsibly? If yes, is the same true if responsible investment means potentially limiting future returns?**

It is possible to conclude that default members do want their funds to be invested more responsibly, by extrapolating research results on this topic[5] and considering the broad membership base of default members. However, there is often no common approach to responsible investing shared across broad membership bases and most do not want to potentially limit returns as a result.

23. **To what extent is it a problem that default members do not have information about whether their investments are made responsibly? Would having more information make a difference to the behaviour of default members? What alternatives might there be to more/standardised information to address responsible investment concerns?**

The main problem with default members is that they have not engaged with their KiwiSaver overall. This means very significant settings such as the right fund, PIR and contact details may not be correct, which will have a major impact on their outcomes in retirement. We believe responsible investing is a lesser concern for default members, and that base levels of responsible investing will inherently lift with competition. Fund settings, where responsible investing is prioritised to the extent that it is likely to affect the risk/return profile of a fund, should remain as a choice that investors are free to make.

24. **Do providers' current responsible investment exclusions meet what default members would expect?**

In the absence of research on this particular topic, we consider default members are likely to have a very broad range of expectations. It is unlikely that the current default settings meet the expectations of all default members. Due to the range of expectations, we believe responsible investing should be an individual's choice rather than a default setting. As there are risk/return differences with different responsible investment approaches, a member should weigh up their individual beliefs with the potential benefits that an active choice investment option offers.

[5] For example, see this survey where 93% of KiwiWealth customers who were surveyed expected their KiwiSaver funds to be invested responsibly: www.kiwiwealth.co.nz/blog/kiwisaver-members-attitudes-to-responsible-investing-are-changing-according-to-large-scale-survey

25. **If this option is adopted, what industries or sectors should be excluded? Should the government instead adopt an international exclusion standard or certification regime? What would be the costs associated with an exclusion or certification regime?**

As above, we believe responsible investing should be an investor's choice and all KiwiSaver providers should be required to invest legally, with exclusions applied at their competitive discretion.

If an international exclusion standard or certification regime was adopted, there are inherent costs of ongoing management to these standards as well as subscription costs, which are in the tens of thousands.

26. **If this option is adopted, what form should standard disclosure take? For example, should all providers be required to provide a statement listing all excluded companies by sector?**

Even if this option is not adopted, further guidance could be issued by the FMA on the disclosure of responsible investing policies. A central comparison tool where providers input details could be a good way to achieve effective disclosure. This could be achieved by enhancing the smart investor tool[6].

27. **What is your feedback on our assessment of the costs and benefits of the responsible investment options identified? Which option (or the status quo) do you prefer and why?**

Large scale and widespread shifts towards more responsible investing practices will impact returns as the investable universe shrinks. This could artificially drive up the prices of responsible investments and will concentrate investment risks in funds.

Capital market development

28. **What limitations or problems exist in relation to New Zealand's capital markets? How could the settings for KiwiSaver default providers be amended to support the development of New Zealand's capital markets? How do the liquidity and pricing rules affect default provider investment in alternative New Zealand investments?**

We acknowledge that there are challenges in New Zealand's capital markets that have limited its growth. In particular, limitations related to New Zealand's capital markets include low liquidity and poor quality.

KiwiSaver investment managers prefer liquid daily priced investments because of the right to transfer, withdraw, or make an early withdrawal at any time by an investor. To allow a withdrawal that is equitable to all investors in a fund, its assets must be liquid and priced accurately each day. There are not enough New Zealand capital market investment opportunities available currently. The solution is to facilitate more options, or in other words to increase the supply, rather than forcing funds into potentially illiquid risky investments. Forcing funds into illiquid and potentially risky assets will increase the risk on the individual members and their private retirement savings, for the greater good of New Zealand. KiwiSaver should make use of the New Zealand Capital markets where it is the right thing to do for members. An investment decision is made based on the expectation of an acceptable return for the risk taken. This allows us to ensure that we are achieving the best possible outcome for

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[6] smartinvestor.sorted.org.nz

members over the long-term. Forcing a set allocation to any asset class undermines the integrity of this process.

If the Government have a policy objective around this we consider this should fall outside the scope of this review as it conflicts with the purpose of the KiwiSaver Act and our overarching fiduciary duties to members.

This discussion cannot be limited to default KiwiSaver. The majority of default KiwiSaver providers use common wholesale fund pools that are used by all their funds and not just the default fund. The problems of the New Zealand Capital markets apply to KiwiSaver generally not default KiwiSaver

29. **How could the default settings be used to develop New Zealand's capital markets? What parts of New Zealand's capital markets are most in need of development?**

    See our answer to question 28.

30. **Should default funds take an active role in helping develop the New Zealand capital markets? Would this support the purpose of the KiwiSaver Act and the accumulation of retirement savings by default members?**

    See our answer to question 28.

31. **To what extent is the management of default funds currently located in New Zealand or carried out by New Zealand entities?**

    The manager of the ASB KiwiSaver Scheme, ASB Group Investments NZ Limited, is New Zealand based. The directors of the manager and members of our investment committee are all New Zealand residents who are based in New Zealand. The member administration, call centre and registry systems are all based in New Zealand. However, certain business functions, including some of our investment management activities, are located offshore, where the expertise and scale to perform that function well and at low cost, resides.

32. **What is your feedback on a New Zealand-based management option? If this option is adopted, which part of the investment process do you think should be based in New Zealand to help develop New Zealand's capital markets? What type of mechanism would best give effect to this requirement?**

    If a New Zealand-based management option were adopted, it makes sense to us that member administration and investment administration should be able to be New Zealand based. Equally, it should be the case that investment management of New Zealand assets should be able to be New Zealand based. The investment management of offshore assets would be most likely to be based offshore. In reality not all investment administration is conducted in New Zealand as it is strongly linked with the custody of the assets, which is a scale based function dominated by very large international banks. Equally not all New Zealand assets are managed domestically. This is a function of scale and competency.

    We think a domestic manager could struggle to compete on price with existing large global managers for the management of some types of New Zealand assets and to force KiwiSaver provider's to use local managers at higher prices would be inconsistent with the objective of achieving better financial positions for KiwiSaver default members, particularly at retirement.

Government could encourage or incentivise those existing large offshore managers to set up local operations, as most currently operate out of Australia.

33. **What is your feedback on a targeted investment requirement? If the option is adopted, what market should be targeted by an investment requirement (eg early stage companies)?**

See our answer to question 28.

34. **What is your feedback on our assessment of the costs and benefits of the options to develop New Zealand's capital markets? Which option (or the status quo) is best and why? Is there another option that would be better than the options discussed?**

We have not sought to assess the costs and benefits of the options here as we do not consider this to be within the scope of the default providers arrangements. Currently we do not invest in New Zealand venture capital as an asset class because its illiquid assets create risks around member equity due to the difficulties in accurately pricing these assets on a daily basis. However, ASB is happy to be involved in further discussions as to how KiwiSaver more generally could help facilitate these policy objectives in future.

Transfer of members

35. **What is your feedback on the problem definition for the transfer of members? What other problems are there in relation to the transfer of members?**

We encourage MBIE to clearly outline if there will be a transfer of members at the beginning of the procurement process. This will enable providers to assess the opportunity and to accurately tender.

We agree that default members should not be maintained by providers who are no longer default providers and who no longer continue to meet the standards required of a default provider. We think a good option to minimise member disruption, would be to allow an incumbent provider to lose default status, or decide not to re-tender, but to retain their existing default members with continued oversight. In both of the past default procurement processes, newly appointed providers started with a zero allocation of members and had to build up membership and funds under management over time. It would seem unfair if during this procurement process, new providers were handed a windfall of customers. If a new default provider does not have the size or strength to absorb the initial costs of default status, then it should be questionable if they have all of the required features to be a default provider.

Transferring default members among providers has a high propensity to affect trust and confidence in KiwiSaver. Additionally any option that involves the transfer of members will incur significant risks and costs. See further detail in our answer to question 38.

36. **If default members are transferred from providers with more members to providers with fewer members, how should we decide which members are transferred?**

Existing default providers should not to be forced to forfeit default members if they are not reappointed. We consider default members have been well serviced and that we have done a good job of managing members' money during our two terms as a default provider. Giving our default members to a new, unproven, provider could result in poor customer outcomes, with a high propensity to affect trust and confidence in KiwiSaver and does not represent good faith business arrangements on behalf of the Government.

Furthermore, this option creates a disincentive and disadvantage for incumbent default providers to reapply. Therefore, it may have the unintended consequence of high quality providers deciding not to retender.

37. **If transfer option 1 or 2 were adopted, how should default members be given a choice to remain with their current provider for this option?**

We do not believe there is an ideal way to communicate a choice for default members to remain with their current providers without:

- being unable to engage a large portion of the default membership base on this matter;
- causing confusion to members who do engage with the communication diligently and try to do the right thing;
- incurring significant costs; and
- undermining trust and confidence in KiwiSaver as a result.

This adds to the reasons why we believe existing default providers should retain their existing membership base.

38. **What is your feedback on the transfer options and the costs and benefits of the options? Which option (or not transferring at all) do you prefer and why? Is there another better option we have not considered?**

Not transferring at all is the most pragmatic option. However, we do not believe an existing default provider, who does not regain status (by failing to be selected or by its own election) should continue to manage default members without any form of oversight.

Any option that involves the transfer of members will incur significant risks and costs.

However, if a transfer of members were undertaken this should be staggered. The risks of moving members can be reduced, but not removed, with a staggered implementation. Staggering could also help minimise costs and limit the potential for the transfer to distort markets.

The cost of a transfer is largely fixed in the base preparation costs of a transfer (communications, IT costs and business readiness), and only small economies of scale are gained if a larger numbers of members are transferred.

Option one if implemented in a single transfer, would almost certainly distort the market and this could cost members more than necessary. Also, a single asset transfer concentrates the risk of losses if the market drops during that period. If the asset transfer occurs gradually for all members over a period of months, then the cost of buying and selling assets is smoothed with less potential to distort markets.

39. **What factors should the review consider in deciding transition timeframes?**

There are a number of factors to consider that are summarised along with some additional factors below:

1. Risks of transfer, and considering a staggered implementation (staggered implementation has a number of disclosure and member equity considerations, which

we have not covered in this submission, due to our belief it is best not to transfer members[7] - if a transfer option becomes a preferred option we would wish to meet with you to discuss these issues in further detail)
2. Timeframe to communicate in a comprehensive way so as to minimise confusion for members
3. Timeframe to allow providers to undertake an IT build for bulk transfer facilities
4. Co-ordination of business readiness activities by KiwiSaver providers, IR etc.
5. Cost of transferring members – this is more a factor to consider as to whether there should be any transfers at all.

40. **Should active defaults be considered default members for the purposes of transfers? How should active defaults be treated and notified of any changes to default provider settings?**

Members who have chosen their fund should not be considered default members for the purposes of transfers. They have made an active choice to remain in the default fund and should therefore no longer be considered a default member for transfer purposes. Also see our answer at question 4.

Member engagement

41. **What is your feedback on the member education requirements that default providers should have in relation to default members, and how these should be enforced in the instruments of appointment?**

Default providers should continue to have financial literacy requirements; these remain best practice. However, a provider should have flexibility as to how to best achieve the requirements. Therefore we do not support a set number of calls, emails, staff, etc. Instead, a set number of active conversions could be considered and activity by default providers monitored. As we know some members are very difficult to engage. Any activation metric should be monitored in context with the provider's overall attempts and effort to engage default members.

Where a default provider is failing to stay on track for active conversions, enforcement could involve a quarterly performance review. Ongoing non-performance could be enforced by a suspension of their ongoing new default member allocation.

Other

42. **What is your feedback on the other requirements that should apply to default members?**

No comment

43. **Any other feedback?**

No comment

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[7] Unless a provider wishes to forfeit their default members and no longer be subject to ongoing governance. See our answer to question 35.