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Financial Markets Policy
Building, Resources and Markets
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PO Box 1473
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Submission: Review of KiwiSaver default provider arrangements

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Are you requesting that any of this submission be kept confidential? No

Feedback on discussion paper

Forsyth Barr is a staff and NZ owned firm with an extensive market position advising clients on investments in excess of $20 billion. We operate the Summer KiwiSaver scheme and have a long history of offering superannuation products.

We support the review of the KiwiSaver default provider arrangements and provide our comments to you generally as many of our points are applicable to a number of your specific questions.

With KiwiSaver increasingly becoming the predominant means of retirement savings for most New Zealanders we believe significant change is needed to KiwiSaver to encourage deeper engagement, improve member outcomes, and develop an ecosystem of fund managers providing the innovation, client experience, fee competition and services that are lacking in the current environment (which has been brought about partly by the default regime).

In reviewing default provider arrangements in a maturing (next 10 years) KiwiSaver environment, we suggest the following considerations:

1. Removal of the default provider regime

Given the barriers to entry for a participant to become a KiwiSaver provider including MIS licensing and signing a Service Provider Agreement with the Inland Revenue (IRD), coupled with the ongoing supervision, reporting and compliance requirements, alongside monitoring of ‘reasonable fees,’ we recommend removing the default provider regime.

In its place, providers could elect to participate (for a defined period) in the IRD carousel allocation, by nominating a default fund.

In considering default funds as a transitional parking space, we favour a plain vanilla approach to the structural characteristics of these funds. Parameters can be set around fees, investment mandate, investor education and Socially Responsible Investing (SRI), however competitive tension and market forces around pricing, coupled with an agile response to SRI matters (which in itself may be an increasing motivation to select a fund) is preferable.

Consideration could be given to nomenclature of default funds. A word or phrase that supports the transitional nature of the fund may encourage engagement, for example provisional KiwiSaver account or starter KiwiSaver account.

We see benefits in further leverage of the IRD's central management system and liaison between the core data they hold, employers and providers.

Specifically on **fees**, we are concerned that a Government mandated fee arrangement may lead to the following:

- The potential for cross subsidisation across a scheme membership base comprised of default and non-default members.
- A lower number of participants in the tender process and it will require consideration of average funds under management of all providers.
- Member understanding and engagement grounded in fees alone.

Should a Government mandated fee outcome occur, consideration should be given for apportioned costs in a life stages model.

Specifically on **SRI**, we support transparency and disclosure around responsible investment but flexibility for a provider to communicate their approach and participation in, for example Principles for Responsible Investment (PRI). This enables providers to explain style, create points of difference and allow alignment of members' values and interest against individual fund managers' philosophy and approach.

To avoid member confusion, appropriate **default fund settings** in relation to asset allocation is required. While conservative settings benefit certain groups of members, we favour a balanced investment mandate. (Our experience has been that first home buyers are generally more engaged with their KiwiSaver account).

We are concerned that a default regime which incorporates a life stages approach would serve to further increase apathy and disengagement. Members may consider providers are managing KiwiSaver on their behalf thereby missing opportunities to consider benefits arising from other variables such as increasing employee or maximising Government contributions. The introduction of lifestages will increase costs both for those that need to develop the offering and associated systems alongside disclosure documentation and ongoing communication to support members in a meaningful way. Some providers may not have sufficient scale to deliver this.

2. Historical default member apathy

Subject to careful consideration of market conditions at the allotted time, a one-time highly publicised movement of members in default funds that have not made an active choice, could be reallocated to a new fund within the same default provider. This could be based on an age profile or selecting a single mandate for example balanced. Key to the move would be significant publicity led by a trusted independent party for example Sorted, covering the rationale, matters to be considered (such as those planning a first home withdrawal or nearing retirement and planning to exit) and how to seek advice. In addition such campaign activity should recognise that some default members may in fact have made an active choice to be in the default fund. Providers need to support the activity and take the opportunity to develop ongoing relationships with these members and assist them through their journey towards retirement.

3. Ongoing new default member potential apathy

In order to address ongoing new default member potential apathy, and turn KiwiSaver default arrangements into a transitional parking space as originally intended, we see merit in incentivising new default members to make an active choice of fund in line with their risk profile by utilising a tool from a trusted independent provider for example, Sorted. This develops financial literacy from commencement and paves the way for improved long term financial outcomes.

Subject to an active choice, a $1,000 kick start payment could be applied. We acknowledge consideration could be given to default enrolment (and therefore the kick start applied) above a certain income, however we favour incentivising members to commence their KiwiSaver journey and putting other mechanisms in place for low income earners, for example lower contribution rates or mandatory employer contributions regardless of a saving suspension.

4. Ongoing existing member potential apathy

A means to consider ongoing member apathy for all KiwiSaver members could be by way of implementing an annual warrant of fitness check into a member's KiwiSaver account. This could be three pronged:

A. Contact detail (email, postal address and contact number(s)) confirmation to enable ongoing engagement (via provider)
B. PIR confirmation (via provider as currently exists)
C. Utilising a tool from a trusted independent provider for example, Sorted, undertake a basic risk profile analysis to review fund selection and create a 'what's my number' scenario that can demonstrate the value of correct fund selection over time when aligned to personal risk profile).

Completion of these three actions will turn what might to the member be a complex financial decision into a simple annual action. Specifically, the investment profile tool and associated ancillary resources will be a source of consistent high quality information that sequentially builds financial literacy and capability over time. Associated resources can adapt to topical matters, such as socially responsible investing, changing demographics, investing in retirement and support other key initiatives, for example retirement projections and highlighting impacts of contribution increases.

Consistent with market feedback, the submission paper notes at point 41 that member engagement alone is not effective in encouraging default members to make active choice. Providing an easily accessed financial incentive may drive the desired outcome.

Historically a fee rebate existed. We acknowledge that reinstatement of that as such an incentive is at odds with other messages in markets around fees, however such a warrant of fitness check could be linked to the annual Government contribution. This amount could be increased with the associated portion isolated to reflect the new criteria (recognising 1.2 million did not contribute last year therefore would not be eligible) or be in addition to the current time and money contributed criteria.

We acknowledge the practical challenges with such a proposal in terms of data exchange between the trusted independent entity confirming risk profile completion, but given the data exchanges that occur now, we see technology as an enabler creating an efficient solution for providers, IRD as the central management system and an independent party. Further with the checks around contact details ongoing contact, particularly around completion of basic risk profile but not actioning a fund change can be incorporated into routine follow ups.

5. Critically important structural changes

We support the view in the Capital Markets 2029 report that a KiwiSaver member should be able to have multiple KiwiSaver accounts, thus diversifying across managers and accessing specific features or specialist investment offerings of different providers. This should be on an opt in basis to mitigate the risk of lost funds.

If implementing such a feature we would consider a further step and allow accounts to be held in joint names (on an opt in basis). Treating KiwiSaver as a household asset will serve to further strengthen literacy and deepen understanding of living standards in retirement. Such a change should in no way limit home start grant features.

We are happy to discuss matters raised in this submission directly.

Yours sincerely

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