



Submission to Ministry of Business, Innovation & Employment

in relation to

**Discussion Paper
Review of the KiwiSaver Default Provider Arrangements**

18 September 2019

Introduction

1. This Submission is from Trustee Corporations Association of New Zealand Inc ("TCA" in response to the Ministry of Business, Innovation & Employment ("MBIE") Discussion Paper: Review of the KiwiSaver Default Provider Arrangements (**Discussion Paper**).
2. TCA supports MBIE's initiative to undertake the Review and considers it important that default funds are structured and work well for the members in order to encourage long term savings habits and asset accumulation to provide for retirement benefits. TCA welcomes the opportunity to provide positive input into this core area of NZ retirement savings and the default provider arrangements.
3. TCA would be very happy to meet with MBIE to discuss any aspect of this submission. We can be contacted at:

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About TCA

4. TCA is a long-established association representing licensed supervisors which supervise KiwiSaver Schemes. The Members of TCA are: Public Trust, Trustees Executors Limited, The New Zealand Guardian Trust Company Limited and Covenant Trustee Services Limited. Anchorage Trustee Services Limited is an associate Member of TCA (**TCA Members**).
5. TCA maintains relationships with government ministries, regulatory bodies and financial sector groups.
6. TCA Members also provide prudential supervision for a wide range of investment products and financial arrangements through various legal structures appropriate for the particular product offered. In certain instances, Managed Investment Schemes and Debt Issuers (including NBDTs) must appoint a supervisor to meet regulatory requirements before an offer of a financial product can be made to the market. As at 30 June 2019, TCA Members supervised funds in excess of \$452.9 billion.
7. All TCA Members are licensed under section 16(1) of the Financial Markets Supervisors Act 2011 to provide prudential supervision of a wide range of investment products and financial arrangements. Not all licence holders are Members of TCA.

General comments

8. For this submission, TCA has taken the approach of providing general comments set out below rather than answering each of the Ministry's individual questions. This approach has been taken on the basis that these comments provide a more accurate representation of TCA's view on the issues raised in the Discussion Paper.
9. Supervisors actively supervise KiwiSaver providers' performance of their functions and issuer obligations (which include offering and issuing the product, managing scheme property and administering the scheme). They also monitor the financial position of the provider and the scheme. Irrespective of any potential changes to the default provider settings, supervisors will continue to perform their functions and monitor KiwiSaver providers in accordance with their obligations.
10. Outside the specific areas outlined below, TCA have added the following high-level comments in relation to capital markets, investments and responsible investing which may add value to the MBIE review:
 - 10.1 When considering the KiwiSaver default settings it is important to keep in mind that the objective of KiwiSaver was to encourage long term savings habits, asset accumulation and to provide for retirement benefits. KiwiSaver accounts are transferable between funds and schemes and in certain circumstances members can withdraw their funds. Therefore, when re-assessing the default fund settings, the liquidity of a member's accumulations is paramount as any issues associated with liquidity could have an adverse impact on members.
 - 10.2 Any potential change made to the default settings should consider taking into account whether the default provider has the appropriate structure and processes in place to continue to administer and manage the scheme to a required standard. Having robust procedures and controls in place to correctly value exposures and investments which may not be traded in an active market and are valued without observable market data is also very important as it impacts on member's investments.
 - 10.3 TCA recognises that there is evidence suggesting that certain providers are offering various forms of responsible investing. TCA believes that having clearly defined guidelines would provide for consistency and assist providers and supervisors to monitor ongoing compliance with responsible investment policy. It is also likely to assist with promoting trust and public confidence in KiwiSaver.
 - 10.4 Although there are benefits in having a life-cycle investment strategy in a KiwiSaver Scheme offering, any potential changes to the KiwiSaver mandate should take into account that more and more members are using the first home withdrawal facility.
 - 10.5 Member engagement has been a focus of attention for default KiwiSaver Default Providers in recent times. Providers need to ensure that they continue to actively engage with default members by getting them to obtain an investor profile, and if appropriate encourage members to transfer out of the default option and into an appropriate fund or scheme that better reflects their investor profile. However, this needs to be balanced against the fact that locating and getting some default members to respond to this proactive engagement is not simple and consideration should be given as to whether government agencies can further assist in helping providers to locate members and/or by also engaging with these members directly.

Number of providers

11. Although the number of default providers has increased since the first round of appointments, TCA is of the view that there should not be an unlimited number of providers and that not all KiwiSaver providers should automatically be default providers. TCA recognises that maintaining competition in the market is important but considers that default providers should be required to meet a higher level of thresholds and criteria than currently imposed as part of licencing MIS managers and KiwiSaver providers.
12. TCA believes that it would not be unreasonable to consider, when assessing the financial strength of default providers as part of the selection process, setting the requirement standard at a higher level than the current “positive NTA” requirement set as part of the licensing process. The financial strength of KiwiSaver default providers should be one of the key thresholds and setting this at a higher level may help to ensure that member confidence and the overall success of KiwiSaver is maintained even in very volatile times. The KiwiSaver default providers should have sufficient financial strength and resources to have an effective governance structure and to put in place and maintain the robust controls required in order to perform their function to a very high standard. While default providers should be well placed to prevent poor investor outcomes occurring in the first place, they must also be capable of ensuring that investors are fairly and fully remediated, and in a timely manner, if any issues arise that require member compensation.

While any KiwiSaver provider getting into financial difficulty such that they could not adequately provide member services or remediate members (if that was required) would adversely impact the public’s confidence in KiwiSaver generally, we expect that the confidence impact¹ would be even greater if that occurred in respect of default provider.

13. TCA is of the view that having a limited number of default providers would also likely lead to more competitive tensions around fees. TCA acknowledges that fees and returns have a material impact on scheme effectiveness of providing for member retirement and more competitive fees are likely to enhance outcomes for members. However, it goes without saying that fees should not be assessed in isolation and a range of other variables, including the type of asset management (active versus passive), should also be taken into account.
14. Reducing fees or putting alternative fee structures in place should be balanced against the ability of the default providers to maintain their financial strength and capabilities, even in significant market downturns, as this could materially impact on their profitability. Industry should also be conscious not to drive fees to a minimum level that then stifles innovation and detrimentally impacts service to members.

TCA appreciates that as funds under management have increased over time since the inception of KiwiSaver, fees could have potentially decreased more quickly and more significantly. However, we note that most KiwiSaver default providers will only recently have started to recover their establishment and administration costs. We also note that there is evidence in the market of some default providers now reducing fees to match low cost entrants to the market and passing on the benefits of the increase in funds under management to their members.

¹ Note in this regard we are not referring to members investments being at ‘risk’ as given the bankruptcy remoteness of KiwiSaver schemes from the manager and the powers that the FMA and supervisor has (along with the assets of schemes being held in trust by the supervisor (or via custodians)) this risk is low it is largely an issue of confidence and the timely provision of member services.

Transfer of members

15. TCA does not consider that the transfer of the whole default member base from existing default providers to newly appointed providers would ultimately be in the interest of members, even if a default provider loses its default status. Instead, the default fund should be relabelled, and members informed. It would then be the decision of the member to decide whether to stay in the fund or not.
16. TCA considers automatically transferring members could result in frustration and confusion amongst members. As a result of negative member experience members may lose trust and confidence in the system. It is also very costly to administer large numbers of transfers and it is unclear who will bear the burden of these transfer costs
17. For a provider that loses its default status, TCA believes that members' trust or confidence in KiwiSaver would not be eroded if the same protection and fee guidelines continue to be applied to the non-default fund. By ensuring the same protection guidelines are placed on providers which lose their default status, existing default providers will be encouraged to submit competitive bids during the tender process.
18. TCA considers that the non-automatic transfer and continued application of the same protection and fee guidelines on providers who lose their default status will encourage the provider to invest more in member engagement and move default members out of the default funds.

Conclusion

19. TCA supports the main objective of the review, being to "enhance the financial wellbeing of default members, particularly at retirement". Supervisors will continue to supervise providers and monitor their compliance with default settings whatever they may be. However, members' interests and confidence, together with the complexity of the settings and the ability of default providers to have appropriate structures and processes in place to deliver desired outcomes and objectives, should always be at the forefront of the consideration. As such, it is TCA's intention that our comments will help promote desired and sustainable member outcomes, together with ongoing trust and confidence in the KiwiSaver industry.
20. TCA thanks the Ministry for the opportunity to respond to the consultation and we would be happy to expand on any of the points raised if required.



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18 September 2019