Submission: Review of KiwiSaver default provider arrangements

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Section 1: Your details

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

If yes, please let us know why the information should be kept confidential in accordance with the Official Information Act. Please also send us a redacted version of your submission for publication.

Reasons for withholding:

Section 2: Feedback on discussion paper

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

I agree with the importance and focus on the proposed objective of enhancing the financial well-being of default members, particularly at retirement. The same objective, as a natural extension, should apply to all New Zealanders including non-default KiwiSavers as well as non-KiwiSaver members.

Having said that, the current system of selecting deafult 'providers' is fraught with risks. A major risk has already palyed out over the last 12 years. The Consumer summary refers to 715,000 members in default funds of which 430,000 are alleged to be in those funds without being aware of it. It would be safer to assume that many more than the 430,000 out of the total pool of default members will not have much awareness of what they are invested in. An expression of interest in staying with a 'default' fund may simply be driven by a range of reasons including 'ignorance', 'preference for the status quo rather than a change', the 'stress of having to make a decision' etc. I base this on years of interaction and engagement with retail KiwiSaver members both directly as well as indirectly via financial intermediaries.

The true size of the problem is likely to be much larger than the quoted 430,000.

Issue with a system of default 'providers'

The existence of a default system has partly resulted in the problem today of 715,000 default members.

- Members have an easy way out in not having to make a decision considering they will be allocated (at random) into the pool of (originally 5) 9 providers today. This encourages lazy behaviour in investors, which is in conflict with the objective of building financially capable New Zealanders.
- It provides them a sense of security that somehow the 'default' providers are better to be invested with, than non-default providers (which is just an assumption).
- It also leads to lesser competition in the market as it provides an advantage for a select few providers, which is in confict with the Criterion 5 of the objectives. As a result, it does not work in the favour of the consumer.

A better option

The criterion that applies to default 'providers' should apply to ALL providers. The primary question to ask is whether a provider is 'fit for purpose', or not. If they are not, they shouldn't be allowed to operate in the sector.

If they are fit for purpose they should be allowed to operate conditional to:

- Providing one fund in their suite of products that is a 'default' fund. Members who join their scheme without making a choice should then be allocated to that fund.
- Ensuring that the default member is migrated to a more appropriate product within their suite of products, within a certain timeframe following membership. The obligation to educate and inform rests with the provider and should be a fundamental condition to operate. This should not be an obligation just for a select few default 'providers' who have been 'chosen' on certain assessment criteria.

In summary, a move away from default 'providers' in favour of a default 'fund' across all providers who are fit for purpose is being recommended. It has multiple and far reaching benefits including buliding trust and confidence as well as driving competition. It also puts some responsbiliity back on the member to take a more proactive role but with the majority of the effort coming from the provider.

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

Agree broadly with the Criterion highlighted, but view Criterion 5 should receive a high weighting, if not the highest. Promoting innovation and competition naturally supports a 'value for money' outcome. The focus should not be on achieving high returns in isolation or low fees in isolation. Ultimately, for the individual's long term wellbeing what makes a difference is value for money.

A focus on achieving a competitive market requires market forces to play out - as opposed to making the framework more restrictive. The best shot at achieving the objective of the review is to find the right balance of regulation.

Criterion 4 requires a high weighting as well, as much as it won't return any short term benefits. But, from a longer term perspective the benefits to the New Zealand economy will be significant.

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

Partly agree with a move away from a 'parking space' purpose. An objective of asset maximisation should be in relation to each individual member. To make an assumption either way (i.e., capital preservation vs. growth) is fraught with risks at an individual level and based on assumptions and speculation. On the other hand, given that new members signing up are falling in numbers over time, there maybe an argument to shifting the focus to maximising outcomes for existing default members.

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?**

It should apply to all default members in keeping in line with the intended objective. As stated earlier, the reason why default members choose to actively to stay in those funds may not necessarily be for the right reasons.

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

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

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

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

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?**

A life stage option is not optimal on this basis, given that what matters is not the age of a member but how long their investment timeframe is. But, a nursery period may mitigate this issue as it gives the provider the opportunity to engage with the member and place them in appropriate funds.

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

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?**

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?**

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

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?**

Mandating a fee level should be reserved only for default 'funds' and should be low enough to incentivise providers to move members into more appropriate funds.

Under the proposed system where the approach is appointing providers on the condition of having a default 'fund' as part of their license to operate, the fees become less relevant from a procurement process perspective.

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?**

Of the options listed, Option 3 appears to be the most fair across members and across providers, while driving the objective of longer term fee appropriateness.

Any option that differentiates the cost structure based on age and account balances is fraught with risks and can give rise to unintended consequences. Whether an account balance is low or not, there are costs that accrue to the provider regardless. All members being treated equitably should be an important criteria for selection of the options. To favour one cohort of members over another is unfair to the latter. The benefits of this Option outweigh the risks associated with it as highlighted in the discussion document.

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?**

Refer to response in Question 1. A system of default 'proivders' subdues competition.

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?**

The proposed approach of doing away with default 'providers', eliminates this challenge altogether.

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

The proposed approach of doing away with default 'providers', eliminates this challenge altogether.

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

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

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

If there is an argument that supports applying such a requirement on default funds, then it should be applied to ALL funds. There is no reason to have such a requirement simply on funds – especially if the intention is that members should be moved out of default funds as soon as possible.

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?**

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?**

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

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?**

Responsible investing means different things for different people. Gauging individual appetite for what it means to them comes at a significant cost when implementing.

On the other hand, disclosure of what's in and what's out in a fund is more practical. It is true that given the low level of engagement that members have with KiwiSaver this may still not achieve the intended objective.

But, for those members who are genuinely proactive about being 'responsible' they will know where to look. For those members who are not so inclined they will not be seeking that information any way.

In 2016, I floated an idea at a responsible invesmtent conference that could be quite easily implemented even today. Refer: https://www.stuff.co.nz/business/money/78875952/kiwisaver-should-have-ingredients-labels

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?**

Refer to above.

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?**

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?

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?**

Both default and non default funds should be leveraged to enable funding of early stage New Zealand businesses.

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?**

Both default and non default funds should be leveraged to help develop the New Zealand capital markets.

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

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?**

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)?**

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?**

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?**

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

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?**

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?**

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

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?**

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?**

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

43. **Any other feedback?**

As noted earlier, part of the current issue with a large pool of default members is as a result of a flaw in the original design of 'appointing' default 'providers'. By initiating an arbitrary transfer of existing default members across a new pool creates an additional layer of inefficiencies and unfairness, notwhithstanding costs.

Under the scenario of requiring default 'funds' from all providers, the change in the pool (too ALL providers) will apply only to new members joining KiwiSavers. Point 199 also becomes redundant.

The recommended approach is also also fairer to existing default 'providers' who have invested significantly over the past few years in signing up new members. Doing an arbitrary transfer is grossly unfair to current default providers and provides the receiving provider a free lunch. As such, the proposed options for a tranfer of members on any basis is not an option at all and should not be considered.

I will be happy to expand further on any of the comments in this submission.

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