Submission template: Review of KiwiSaver default provider arrangements

Pathfinder Asset Management Limited

(Pathfinder is manager of the CareSaver KiwiSaver Scheme)

Section 1: Your details

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Section 2: Feedback on discussion paper

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

A move away from the 'parking space' purpose is not justified. The default funds are intended to be a temporary placement, with an obligation on the industry to encourage investors to switch to a solution more suited to them.

Boutique fund managers (not only default providers) are very focused on engaging with default members encouraging a switch from a default setting to a more appropriate fund. A 'more appropriate' fund may mean moving to a growth fund, an actively managed fund, an ethical fund, a fund that includes alternative assets, a lifestages fund etc. If default funds are reconfigured to include some or all of these features, then the incentive for investors to engage (and switch out of their default setting) is reduced.

Rather than a change of investment mandate, thought should be given to reminding investors that default funds are intended as temporary. The term 'default' is unhelpful, and implies that it has been selected or recommended by the Crown. It gives no sense of urgency to consider a switch. The fact it is a 'parking space" should be made clearer through the name – 'default' should be changed to something clearly signalling the 'interim' and 'temporary' nature of a default selection.

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?

We disagree with the suggestion of a life-stages approach for default funds. We believe this will (a) make many investors more comfortable with an investment solution that is intended as a 'parking space' and (b) increase costs for default funds.

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?

Regulatory settings for KiwiSaver should encourage innovation, new entrants and continual product improvement. This promotes higher quality offerings and improves the range of options for investors.

This is achieved by settings providing opportunities for smaller boutique operators – rather than barriers maintaining the status quo of Australian owned banks dominating the KiwiSaver market. For this reason we support appointing an unlimited number of default providers, provided they meet minimum requirements. Smaller providers entering the market need to be competitive on pricing – despite the lower size of funds managed, boutique non-default KiwiSaver providers have already demonstrated they can drive fees lower.

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

No, default provider arrangements should not be used to achieve objectives in relation to responsible investment. This lever is not needed to promote responsible investment – the broader market is achieving this anyway without regulatory intervention.

Responsible investment is undertaken for 2 reasons, being:

a) *firstly* on a values basis it is 'the right thing to do'. Setting a single set of 'values' for all default funds is controversial. Should there be a wide or narrow set of exclusions? Should human rights and animal welfare be considered? Exactly whose value set will be adopted? Regardless of personal beliefs, we should respect the views of investors who want exposure to legal activities/investments, even though others may find them distasteful as investments or harmful to society.
b) *secondly* on a financial basis there is the belief (which we share) that responsible investing can improve returns. The concern is that this discussion is very nuanced – it is not a binary choice of improving or reducing returns. We believe the evidence shows adopting only exclusions (for example avoiding tobacco, gambling etc industries) may increase or reduce returns, but may also increase volatility – there is no clear answer and can depend on the data set chosen. Where responsible investment does increase returns is by focusing investment into companies that manage their ESG risk (ie identifying 'good' companies, rather than simply avoiding 'bad' industries). The 'higher financial returns' argument is unlikely to be achieved by default funds adopting exclusions only. (We are happy to provide research, if requested, to back up our views on returns in this paragraph).

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?

Based on our discussions with hundreds of investors and potential investors, we conclude:

a) More often than not investors want their KiwiSaver to take their personal values into account. But note that this can be best achieved by switching funds to one that suits them (not by imposing ‘one size fits all’ responsible investment settings on default funds).
b) Only a small percentage of investors are comfortable with investing ‘responsibly’ if they perceive it will cost in terms of their returns.

24 Do providers’ current responsible investment exclusions meet what default members would expect?

Yes. If a default scheme is properly explained as a ‘no frills’ parking space for investment, investors have no expectation of responsible investment overlays. If they care deeply about investing ethically, then this provides a motivation for them to move to a more suitable fund for their personal values.

The problem is not whether default funds are meeting their values, the problem is that investors are too often not aware that they can embody their personal values in the way they invest their KiwiSaver (ie the problem is really one of financial education and communication). This is not solved by introducing values-based exclusions into default funds.