

18 September 2019

The Treasury
1 The Terrace
Wellington
New Zealand

Financial Markets Policy
Ministry of Business, Innovation and Employment
Wellington
New Zealand

By Email: defaultkiwisaver@mbie.govt.nz

NZX Limited – Review of the KiwiSaver Default Provider Arrangements – Discussion Document

1. NZX Limited (**NZX**) is writing to provide a submission in response to the discussion paper 'Review of the KiwiSaver Default Provider Arrangements' (**the Discussion Document**) published by the Ministry of Business, Innovation and Employment (**MBIE**) and The Treasury. We would like to thank MBIE for the opportunity to provide this submission, and for meeting with us on 19 August.
2. NZX is a licensed market operator, and is New Zealand's Exchange. NZX supports vital sectors of New Zealand's economy, and by being an exchange based in New Zealand is estimated to lower the cost of capital for listed New Zealand companies by approximately 1.05%, delivering \$2.4 billion of value to the New Zealand economy.¹ Companies listed on the NZX Main Board within the S&P/NZX 50, in whom many KiwiSaver members invest, contributed \$24.6 billion GDP for the financial year ended 2017.²
3. We endorse the recently published recommendations of Capital Markets 2029, in relation to the default provider regime. We consider that the dis-establishment of the current framework, in favour of a regime that allows all KiwiSaver providers to be eligible to offer default funds, will enhance competition and innovation, and deliver better outcomes for New Zealanders. As these recommendations will need to be considered further by Government, we comment below on the Discussion Document's proposals that impact the capital markets.

Capital Markets Development

4. Healthy capital markets are essential to growing New Zealand's economy, and delivering value for KiwiSaver members. Kiwi companies need access to capital to grow to become successful. New Zealand is a small domestic market and we endorse initiatives to unlock

¹ 'New Zealand's exchange and its role in supporting the New Zealand economy', NZIER report, February 2018, page 21.

² 'New Zealand's exchange and its role in supporting the New Zealand economy', NZIER report, February 2018, page 15.

access to investment, which will provide broader benefits for all New Zealanders through the development of a productive and sustainable economy.

5. However, we do not consider that KiwiSaver default funds are the most appropriate vehicle for mandated investment in alternative New Zealand assets, such as unlisted SMEs. There are also certain practical difficulties with this proposal. Most managers conduct pricing on a daily basis, and would face difficulties in accurately pricing unlisted assets. There could also be tension with the transferability settings under the KiwiSaver Act, which currently require a member's entire investment to be transferred to another provider, on request, within a short time frame.
6. We consider that these concerns are less problematic for alternative assets which are listed on an exchange (where price discovery and transferability are more readily accommodated). We are also conscious that the current default allocation to a conservative portfolio is delivering sub-optimal savings outcomes for members at retirement, and that default members appear to be actively dis-engaged from making an active investment decision³. Therefore, while as a general principle NZX considers that KiwiSaver providers, not the Government, should set the specific investment mandates for funds, we support the general proposals to increase the exposure of default members to growth assets.
7. In particular, we support the Government's introduction of a "life stages" default product, which could mandate asset allocation ranges to ensure an appropriate mix of assets at certain key life stages. We would recommend the Government take actuarial advice when developing these requirements, and that any mandates are flexible enough to allow KiwiSaver providers to deliver investment outcomes that are in the best interests of members.
8. KiwiSaver funds are projected to reach \$200 billion by 2030⁴, representing the largest pool of capital available for domestic investment. The manner in which KiwiSaver is invested therefore has the potential to change the landscape of New Zealand's capital markets, mobilising funds for the benefit of all New Zealanders. We consider that in the default fund context, it will be important for further New Zealand investment products to be made available to absorb this funding pool. In this regard we support the corporatisation of local government assets, and note that if registered banks are required to list financial products as an outcome of the Reserve Bank's capital review, that each of these asset classes would neatly fit within the investment portfolio of a "life stages" product.
9. There is also a role for default providers to facilitate access to alternative New Zealand asset classes, by educating default members as to the options that are available. This will enable a KiwiSaver member to actively opt-into funds which provide exposure to alternative assets, based on the member's investment preferences. This could be supported by the recommendations in the Capital Markets 2029 report in respect of

³ 'Review of the KiwiSaver Fund Manager Market Dynamics and Allocation of Assets', The Treasury (Heuser, Kwok, Snethlage, Watts), September 2015.

⁴ 'Growing New Zealand's Capital Markets 2029,' Capital Markets 2029 Steering Group, September 2019. Extrapolated from 'Review of the KiwiSaver Fund Manager Market Dynamics and Allocation of Assets', The Treasury (Heuser, Kwok, Snethlage, Watts), September 2015.

members' ability to invest with more than one provider, and to self-select their investments.

Number of Fund Providers

10. NZX supports the proposal in the Discussion Document to establish 'a minimum requirements approach' for an unlimited number of default fund providers. By introducing competition and eliminating the monopoly of a few providers, this will result in a fairer system for all.

Requirement for Managers to be based in New Zealand

11. We agree with the proposal to mandate New Zealand based management for KiwiSaver default funds. KiwiSaver is about superannuation run by Kiwis, for Kiwis. It would, in our view, be inappropriate for a manager to be based overseas, sending profit and taxes outside of New Zealand. A New Zealand manager is more likely to invest in New Zealand companies because they are already familiar with them. There are also other advantages, as the physical nexus between the members and a New Zealand manager, may improve the member's engagement with their investment. We also agree that keeping KiwiSaver managers within New Zealand's jurisdiction enables the Government, regulators and other policy makers to maintain a greater degree of sovereignty over New Zealand's capital markets.
12. If KiwiSaver managers are required to be domiciled in New Zealand, we believe that they should be deemed portfolio investors (as proposed in the recent 2019 Overseas Investment Act 2005 (OIA) consultation paper). This will allow New Zealand companies to more easily comply with their statutory obligations when accepting contributions from KiwiSaver schemes.

Responsible Investment

13. NZX actively supports Environmental, Social and Governance initiatives (ESG).⁵ However, we do not believe that responsible investment should be a default fund criterion because it may limit the financial well-being of default members, especially at retirement. There is not enough clear evidence that funds comprised purely of ESG assets would deliver the highest returns for investors over the near term. These funds also may have higher administrative costs.
14. We note the growth of "green bonds" and other green investments. This part of the industry is in its infancy in New Zealand⁶, and there is the opportunity for institutional investment by KiwiSaver providers to act as a catalyst for growth, aligned with the Government's objectives for New Zealand to transition to a low carbon economy. We consider that this may be appropriate in the default fund context, where anecdotal evidence suggests that in New Zealand there is no differential in price, or premium, for a "green bond" compared with a "vanilla bond".

⁵ NZX is a member of the UN Sustainable Stock Exchange Initiative. We require Issuers to voluntarily report non-financial metrics under principle 4 of the NZX Corporate Governance Code, provide ESG guidance to issuers via our ESG Guidance Note and are developing ESG data points for Issuers so that there is greater visibility of ESG compliance.

⁶ 'Green Finance Country Briefing – Australia and New Zealand', Climate Bonds Initiative, August 2018.

15. We also consider that KiwiSaver providers have a role in facilitating access to socially responsible investments by providing visibility to default members that such options are available, and can be actively selected.
16. We agree that default providers should be transparent about their social investment practices, through disclosure requirements that enable access to comparable information. This would aid default members in understanding the implications of responsible investment versus standard investment. If a member can compare their default fund side-by-side against a 'responsible' fund, the member can theoretically better ensure alignment with the member's investment preferences, although we note that most default members appear to be actively disengaged from making investment decisions.
17. We note that there are other opportunities for Government to develop ESG in New Zealand, and support the use of these levers. As the front-line regulator of its market, NZX is taking an active role in promoting ESG disclosure through its Corporate Governance Code that applies to certain issuers listed on its markets.

Member Engagement and Transfer

18. Investing in default member education will provide a natural and meaningful way to increase financial literacy overall. For many New Zealanders, KiwiSaver is the only financial investment for their future. It therefore provides an important opportunity for providers to make contact and educate Kiwis about their investment decisions. A recent report from the FMA found that active fund choice rates rose by 100% when KiwiSaver providers called members to discuss their investments (while written information made little difference).⁷ We therefore support the retention of obligations for default providers to provide meaningful education to default members. We recommend that consideration is given to the most efficient manner in which education initiatives could be conducted, and whether this could be centralized to create economies of scale through a funding pool to be run by a neutral provider such as the Commission for Financial Capability.
19. We would be pleased to discuss the matters raised in this submission with you further.

Yours sincerely,



Kristin Brandon
Head of Policy and Regulatory Affairs

⁷ FMA: Impact of behavioral insights on KiwiSaver enrolment communications – August 2019