Submission template: Review of KiwiSaver default provider arrangements

Kensington Swan

Section 1: Your details

Name of contact person: Catriona Grover / David Ireland

Organisation (if applicable): Kensington Swan

Contact email address: catriona.grover@kensingtonswan.com / david.ireland@kensingtonswan.com

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?**

   We consider that the main objective of the review should be to enhance the financial wellbeing of default members. In our view, the focus for the review should be on default members (and not those that have made an active decision to remain in a default fund).

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

   Criterion 1 (Better financial position for KiwiSaver default members) – We agree with the premise that if default members are in a better financial position, they are more likely to experience financial wellbeing in retirement. This criterion aligns with our recommended objective for the review. Specifically, that the focus of the review should be on default members at any stage. In our view, this criterion should have the highest weighting.

   Criterion 2 (Trust and confidence in KiwiSaver) – We support this proposed criterion for the review. This criterion should be given more weight than that of criteria 4 and 5, but less weight than that of criteria 1 and 3.

   Criterion 3 (Low administration and compliance costs) – We support this proposed criterion for the review. Administration and compliance costs passed through to consumers can have big effect over a long period of time. It is important that any changes from the review can be practically implemented and the costs of administering and complying with such changes are minimised without negatively affecting the quality of services the default KiwiSaver providers provide. This criterion should be given more weight than that of criteria 2, 4, and 5, but less weight than that of criterion 1.

Criterion 4 (Support development of New Zealand's capital markets that contribute to individuals' wellbeing) – In our view, this criterion moves away from the proposed objective for the review. We accept that well-functioning and developed capital markets support a strong and productive New Zealand economy. However, we view this as a benefit to a wider audience than just KiwiSaver default members. We do not think it is appropriate to have this as a criterion for this review. There are other more appropriate initiatives to develop New Zealand's capital markets, including KiwiSaver funds other than the default funds, the Capital Markets 2029 working group and the Venture Capital Fund Bill.   If any weight is to be given to this criterion, it should be the least.

Criterion 5 (Promote innovation, competition, and value-for-money across KiwiSaver) – We agree that this should be a criterion for the review. Any changes arising from the consideration of innovation, competition, and value-for-money across KiwiSaver must ensure they do not have a negative effect on the quality of service provided by KiwiSaver providers or on the administrative costs and compliance burden placed on KiwiSaver providers. Changes in this space should not de-incentivise providers from providing services that represent value for money. This criterion should be given more weight than that of criterion 4, but less weight than that of criteria 1, 2, and 3.

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

We largely agree with the problem definition. While well intentioned, the transitional 'parking space' approach for default members has not operated effectively in practice. The evidence presented in the discussion paper indicates that the ability to earn higher returns under a more growth-oriented approach than the conservative default setting has been insufficient to encourage members to move out of default funds.

A number our clients have invested significant resources in endeavouring to educate their default fund members and encourage them to actively choose a fund option that is suited to their circumstances. The extent of the effort put in by those default provider clients has not been reflected in the number of members actively choosing a replacement fund option. We agree with the suggestion made at paragraph 41 that member engagement alone is not effective in encouraging default members to make an active choice, with member inertia presenting a significant hurdle to overcome.

However, we disagree with the extent of the issue as expressed in the discussion paper. The analysis in this section (and in particular paragraph 35) fails to recognise that it is possible that a number of members who have been placed into a default fund may have made an informed decision to remain in that allocation, for whatever reason. It might be that a member is particularly risk averse, or might have a short-term investment horizon due to factors such as saving for their first home. In those instances, members may well have actively chosen to switch to a conservative fund had they been defaulted into a more growth-oriented option at the outset. The statistical analysis is unable to differentiate between those members that 'actively' choose to remain in a conservative default fund because they have decided that a conservative fund suits them best, and those members that remain in a default fund due to one or more of the limited range of factors identified at paragraph 35.

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?**

The investment mandate options should not apply to members who have made an active choice to stay in the default fund. Adopting such an approach would cut across existing contractual arrangements, and presents an overly paternalistic approach to addressing the problem identified. We strongly disagree with any suggestion that an 'active choice' member should be shifted to a new default investment mandate against their wishes.

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

We disagree with the option of adopting a life-stages default option. At present, each provider offering a life-stages approach has adopted their own criteria and approach to moving from one stage to another. Providing for the Government to set the investment mandate for each stage, and the ages at which stages would apply as contemplated at paragraph 48 of the discussion paper, is diametrically opposed to one of the purposes of the Financial Markets Conduct Act 2013 of promoting innovation and flexibility in financial markets, and criteria 3 and 5 of the discussion paper. Doing so would unreasonably interfere with existing structures, with some providers being placed in the unfortunate position of having one set of life-stages and criteria prescribed by the Government, and a different set aligned with their own philosophies that they feel provide a better option for their 'active choice' life-stages members.

If a life-stages option is chosen as the default mandate, we believe that rather than the Government setting the investment mandate for each stage and the ages at which stages should apply, there should be a permitted range that default providers are able to offer, in order to mitigate against disruption to existing systems and minimise the risk of confusion and distinction between default members and active choice members.

We do not support the option of including a 'nursery' period for the initial period of scheme membership. Imposing such a requirement would pose an unnecessary complication and cost to a life-stages default option. Given the lack of success of the current 'parking space' model, imposing a 'nursery' period is unlikely to be effective.

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

We support the adoption of a balanced mandate. We believe flexibility should be permitted, with FMA's guidance on the description of managed funds providing an appropriate range in this regard. This would minimise the extent to which providers would need to adjust their settings. A more restrictive range may have knock-on effects for other fund options offered by default providers, causing unnecessary disruption and restricting innovation. For this reason we support a retention of the FMA's criterion of balanced funds requiring between 35%-63% invested in growth assets, ensuring consistency with existing regulatory guidance.

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

We do not support a growth investment mandate as the default option. However, if a growth investment mandate were selected, we support a retention of the existing 63%-90% investment in growth assets criterion reflected in the FMA's guidance. This would minimise disruption to existing arrangements.

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

If a conservative investment mandate is retained as the default option, we support a range of between 10%-35% invested in growth assets in accordance with the FMA's guidance. We would not support prescribing a higher range for default conservative funds, given the likely disruption to existing arrangements and the potential knock-on impact on other funds offered by the default provider.

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?**

On balance, we do not support imposing any additional measures to mitigate the potential issues identified in relation to first-home buyers and other people making early withdrawals, if a life-stages, growth, or balanced option was adopted as the new default investment mandate. We believe that reliance must be placed upon early clear, concise, and effective member engagement to alert default members to the nature of the fund in which they have been allocated. However, any such engagement needs to be proportionate, to avoid inadvertently discouraging members from remaining in a more growth-oriented fund when they do not have a short-term investment horizon.

Given that members defaulting into KiwiSaver will initially have a very low balance until their savings are able to accumulate, they should have sufficient time to make a more appropriate active choice before the impact of short-term investment fluctuations becomes material for them. First-home buyers looking to rely upon their KiwiSaver balances to assist with that purchase are likely to be more engaged with their KiwiSaver arrangements, and thus more likely to make an appropriate active choice, without imposing an added administration burden upon default providers in the form of an additional array of mitigation steps.

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

Given the increasing automation of processes, we do not anticipate the costs involved in shifting members from one fund to another would be significant, at least as far as the mechanics of changing the mix of investments is concerned. However, we are concerned about the potential cost implications of imposing prescribed criteria for a life-stages default option, as discussed in our response to Question 5. Some of those concerns are reflected at paragraph 71 of the discussion paper.

In particular, where a default provider already provides a life-stages offering, but that offering does not reflect the prescribed criteria for the default option, the provider will inevitably face costs in changing systems to reflect the new requirements. They will then have to deal with the complication of having existing members who have chosen a life-stages option on different criteria to that prescribed by the Government. Those complications (and likely attendant cost) will be significantly increased should a 'nursery' period be imposed. Providers who do not currently offer a life-stages option will clearly face an additional administrative burden in creating the automated functionality required to be able to offer such an option if they are to participate as a default provider. That additional administrative burden is unlikely to discourage potential default providers from seeking appointment, but may well impact on the cost structure they are able to offer.

We are not in a position to quantify the administrative costs involved in choosing a life-stage default option. However, we believe that doing so would be contrary to criterion 3 of the discussion paper, with a life-stages default option likely to present the highest administrative burden and compliance costs for providers, especially if investment mandates and life-stages are tightly prescribed and a 'nursery' period imposed.

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?**

On balance, we support a shift to adopting a balanced investment mandate as the new default option. In our view, this is the option that strikes the best balance of costs and benefits. We believe the balanced fund default option is most consistent with the criteria identified for the review.

We largely agree with the discussion paper's assessment of the costs and benefits of the various options. However, the discussion at paragraph 74 in relation to Criterion 5 fails to identify the potential constraints on innovation, competition and value for money if a life-stages option were to be introduced. The proposal that Government would prescribe the investment mandate for each stage and the ages at which the stages would apply would stifle innovation and competition, with providers having a regulatory disincentive to further innovate in this area.

Offering an alternative non-prescribed approach to life-stages for 'active choice' members would risk confusion, and would complicate member messaging. Given the recent unfortunate experience with the approach the FMA has taken in relation to the inclusion of prescribed generic projection details in KiwiSaver annual statements, we are also concerned that the FMA might look to insist that KiwiSaver providers only offer life-stages that match the prescribed criteria. This would further stifle innovation and competition. Subject to that risk, there is a possibility that prescribing a life-stages option for default funds might increase competition by non-default providers who would be free to offer alternative approaches to life-stages as providing a better member outcome than the prescribed default options. However, encouraging competition on that basis may undermine Criterion 2 (Trust and Confidence in KiwiSaver).

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?**

As external legal advisers, we are unable to comment on the level of value that KiwiSaver default members receive from their fees or the costs that are within or outside a provider's control. However, in our view it is important that fee levels are maintained at a sustainable level to ensure that providers continue to provide value for service to members. This means that fees must be set at a level to ensure that provider continues to provide a high level of customer service, operational and investment management skills, provide communication materials to members, and play an educative role around financial literacy, fund and scheme differentiating factors and also to incentivise the provider to look to innovate and add additional value. If fees are set too low, such that it discourages providers from continuing to provide these additional customer services to KiwiSaver members, we believe it will have a detrimental effect on the trust and confidence that members have in KiwiSaver.

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

In our view lower fees for those on lower incomes would assist those less financially able to contribute and remain contributing to KiwiSaver. We agree that the fixed fee component charged by most providers has a detrimental impact on those on lower incomes with lower balances. However, as most providers are not aware of the income of their members, fixing fees by reference to income is likely to be problematic. However, we would support a lower fee for KiwiSaver members with lower balances. This would have the effect of assisting those on lower incomes and those who are starting their retirement savings journey (and accordingly incentivise them in the early stages of savings while the habit is formed) and allows these members to build an initial savings balance.

As noted in the consultation paper, those in default funds who are under age 18, have chosen to be in the default fund. Accordingly, we do not necessarily agree that those members require a lower fee based on age alone, in absence of the lower fee for lower account balances which are likely to benefit this group of members in any event.

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?**

We do not support the proposal for the Government to set one fee for all default fund providers. Doing so would be contrary to review criterion 5 (Promote innovation, competition, and value-for-money). Each default provider will have different underlying cost structures, making it hard to set a default fee that is fair to all. There is already an effective control in play with the prohibition on unreasonable fees. Each provider's fee proposition should simply be part of the basis on which their application to become or remain a default provider is assessed. Prescribing a set fee at too low a level may result in providers finding it uneconomic to offer value-add services

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?**

In our view providers should be able to set their own fee for default funds, and whether this is acceptable or not will affect their appointment as a default provider. Each of the default fund providers will offer a different experience to KiwiSaver members and each provider should be able to explain those benefits in their application for appointment as a default provider and have their fees assessed on that basis. We agree that default providers should be asked to present and offer a lower fee for KiwiSaver members with lower balances to encourage those on lower incomes to continue to remain in KiwiSaver and develop a savings habit, and to avoid the large impact of fees on lower balances.

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?**

We believe the increase in the number of default and KiwiSaver providers generally has supported increased innovation, competition, and value-for-money in the default and wider KiwiSaver market. But given that this is a review of default providers, we are of the view that increasing innovation, competition and value for money in the default market are less relevant for these members, and that the focus should be on achieving financial wellbeing for these members.

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?**

While we agree with the overall assessment of the costs and benefits outlined in Tables 2 and 3, we note that the following costs may be overstated:

- **More competitive advantage for default providers as compared to non-default providers because there is competitive pressure** – We are of the view that this is an overstated cost given that any competitive advantage that is gained by a default KiwiSaver provider because of competitive pressure between default providers are minimal (or none). We believe that if a competitive advantage is gained by a default provider, this is due to another reason (and not a product of this 'competitive pressure').

- **Less competitive pressure in the procurement process** – We are of the view that appointing a larger or unlimited number of providers will not significantly reduce competitive pressure given that the nature of the procurement process (i.e. submitting tenders) is competitive. Any loss of competitive pressure can be offset by raising the requirements for default providers.

Can you provide us with evidence that might help us quantify the size of the costs and benefits?

In our view, the preferred approach is to not predetermine the number of default providers to be appointed. Instead, the FMA sets out the criteria that must be met by a default provider and allows all prospective providers to submit their best pitch. The appointment of default providers should be determined by the fulfilment of the criteria determined for the review, and not based on the number of appointments that are available. Accordingly, this means if only a small number of providers meet the criteria, then only those providers are appointed (and vice versa if a larger number of providers meet the criteria). However, we note that the criteria should not be so difficult that it inadvertently creates an exclusive club of default providers.

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

We are of the view that a minimum requirements approach (i.e. an unlimited approach) risks providers 'racing to the bottom'. This means that default fees will be set deliberately low (as a result of the number of the default providers in the market), and there is a risk that default customers will not be provided with a high level of customer service including any communication materials and financial education (i.e. default customers will be provided with a minimal service). This approach is unlikely to achieve the primary criteria of the review, which is having default members being placed in a better financial position at retirement.

If a minimum requirements approach is to be taken, we agree that appointments on a rolling basis would be too difficult given the responsibilities and operations involved in transferring default members to another default provider.

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

We have no comments on this question.

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

We have no comments on this question.

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

The current conservative investment parameters for default schemes restrict investment allocation to growth assets such as equities to no more than 25%. In practise, most default providers limit growth assets to 20% or less. As a result, we consider there is limited scope for default providers to be 'front-runners' in responsible investment practises. In our view it would be overly burdensome and in some respects pointless to impose specific responsible investment requirements or objectives on default providers.

This may differ if default providers are permitted to increase portfolio allocation to growth assets in the future (for example, because default providers are required to adopt a balanced investment mandate instead of a conservative investment mandate).

In our view there may well be a place for requiring KiwiSaver providers to offer some form of responsible investment but we do not consider that the default funds is the right place for this objective.

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?**

It is difficult to provide a blanket response to this question as every member will have differing views. Responsible investment preferences are a very personal choice. Many KiwiSaver members will have a different opinion on what is responsible investment and what is not, and what so-called 'sin stocks' are most undesirable in their own portfolio. In our experience, the difference between so-called 'negative screening' and broader environmental, social and governance ('**ESG**') investing is not well understood by the general public.

We have no specific insight of whether KiwiSaver members would accept lower returns as a trade-off for enhanced responsible investment practises. However, given the primary policy objective of KiwiSaver is to help New Zealanders save for retirement, we think that any risk of lower returns being generated as a result of a responsible investment default setting presents an unacceptable trade-off for enhanced responsible investment practices (although global research suggests it is highly questionable that there is such a causative link). International case law generally supports the view that an investment manager's fiduciary duty owed to investors primarily requires the investment manager to maximise financial returns consistent with criterion 1 of the review, which we believe must be given the greatest weighting.

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?**

We do not believe that there is currently inadequate information in the market relating to default providers' responsible investment practises. A number of providers now publish comprehensive responsible investment policies and lists of exclusions. Our experience is that default providers are highly engaged in informing their members of their responsible investment policies on a voluntary basis.

As a result, we do not support prescriptive requirements for further disclosure of information, although we do support a limited, standardised approach to exclusions disclosure in principle (see our answer to question 26).

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

We don't believe there are currently significant mismatches between default providers' actual exclusion practises and the expectations of members. Legislation already prevents default providers from investing in cluster munitions and landmines, and a large majority of providers have chosen to voluntarily screen out investments in tobacco and nuclear weapons manufacturers.

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?**

We don't support the introduction of mandatory exclusions from default schemes. We think that would be a paternalistic step which is potentially at odds with the fiduciary duties owed by investment managers to investors.

We consider that there is an element of subjectivity around a mandatory exclusion regime that is inappropriate for the Government to implement on behalf of consumers, and it would be very difficult to determine which 'sin-stocks' were appropriate for mandatory exclusions and which were not. KiwiSaver members should be left to make their own investment decisions based on disclosure from the scheme provider (see our answer at question 26 below in relation to standardised disclosure).

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?**

Other than a limited statement in a KiwiSaver scheme product disclosure statement, there is currently no requirement for a KiwiSaver scheme to publish information on its responsible investment policies over and above the requirement for the scheme Statement of Investment Policy and Objectives ('**SIPO**') to be lodged on Disclose.

We support the introduction of a limited, standardised form of responsible investment disclosure. In our view, this would most appropriately be achieved by way of the introduction of a responsible investment section in the scheme's SIPO. Given the inherent subjectivity in broader ESG investment practises, we consider this new disclosure should be limited to details of 'negative screening' or exclusions. This could include a requirement to list exclusions applied on a 'whole sector' approach (such as tobacco manufacturers).

Given the significance of the introduction of such measures, we consider the proposed form of standardised disclosure should be separately consulted on.

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?**

As external legal advisers, we are unable to comment on the costs and benefits of the options identified. We prefer new standardised disclosure requirements over the implementation of additional mandatory exclusions.

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?**

Whilst we are supportive of the development and deepening of NZ's capital markets, in our view it is not appropriate for KiwiSaver default provider settings to be used as a tool to support this objective. A more appropriate method would be to encourage members, through marketing, education and broadening of the of the KiwiSaver offering to take a more active role in the management of their fund so that it is moved from the default setting to one that is more aligned to their investment strategy. This could include funds which settings that invest in more high-growth orientated assets, however in our view this should be the choice of the member themselves rather than imposed through a change to the default setting. Pursuing this objective would also require some form of exception to be made to the liquidity requirements of KiwiSaver, which goes beyond the scope of a review of default provider settings.

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?**

For the reasons given above, we are not supportive of KiwiSaver default settings being used for this specific purpose. We recognise that KiwiSaver generally has an important role, and note the recent recommendations in the Capital Markets 2029 Report. We support the Report's comments in that the default settings should not be used to development of NZ's capital markets and rather their growth should be achieved by "[…] market development via commercial means and investor choice rather than a mandate imposed upon the default funds and their members". We note that this can also be supported by the Government through other legislative frameworks such as the Venture Capital Fund Bill.

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?**

For the reasons given in questions 28 and 29 above, we submit that default funds specifically do not and should not take an active role.

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

We understand the management of most of the investment processes involved in default funds is undertaken by NZ entities, given the current conservative default setting.

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?**

See above comments in questions 28 and 29 in relation to our preference for default funds not taking an active role in the development of NZ Capital Markets. However, if this option was pursued, we would query if a mandatory requirement is necessary if management is largely conducted in New Zealand in any event. Such a mandatory requirement could have an adverse impact on fees which would not be in the members' best interests and lead to distortions in the market. This in turn in our view could contribute to a public lack of confidence in KiwiSaver.

33. **What is your feedback on a targeted investment requirement? If the option is adopted, what market should be targeted by an investment requirement (e.g. early stage companies)?**

For the reasons given in questions 28 and 29 above, we are not supportive of this requirement being imposed on KiwiSaver default settings. In our view a targeted investment requirement in alternative assets is inherently incompatible with default provider settings which are conservative by design. The imposition of such a requirement would create a tension between the duty for providers to act in the best interests of its members and the risks involved in investing in alternative assets. This may be difficult to reconcile in practice. The overall effect of such a requirement may distort the actual value in such assets, increase the fees for members due to higher compliance costs, and in our view generally would have a negative effect on public trust and confidence in KiwiSaver.

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?**

For the reasons given in questions 28 and 29 above, we submit that default funds specifically should not play a role in developing New Zealand's capital markets. We are supportive of further discussions of the recommendations to KiwiSaver generally in The Capital Markets 2029 Report, which cover a wide range of suggested enhancements.

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?**

In our view, the protections under the instrument of appointment are over-stated as all providers are subject to a high degree of regulation (see our response to question 4 for more detail).

While we agree that innovation is important for KiwiSaver generally, we believe it is less relevant in the default context. In our view the focus should be on engaging with default members to ensure they have their basic settings right (for example, level of contributions, fund choice), rather than on developing new and innovative products.

Other problems in relation to the transfer of members are referred to in our responses to questions 2 to 6 below – including the risk of disruption and creating confusion, the risk of imposing compliance costs on providers (which are then passed on to KiwiSaver members), and the need to ensure that any large transfer is managed appropriately to avoid negative impacts on the default member base.

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

We do not support the option of transferring default members from providers with more members to providers with fewer members.

If a default provider with more members is reappointed, having been subject to review as part of the tender process, there is no compelling reason for part of that that provider's default member base to then be reallocated. In our view, such reallocation risks disrupting and creating confusion amongst members, potentially leading to a detrimental effect on the trust and confidence that members have in KiwiSaver. While the consultation paper refers to re-allocation as an opportunity to create more competition and innovation amongst tenderers, we believe any positive benefit gained would be outweighed by the level of disruption and confusion caused.

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?**

We do not support option 1 or 2. However, if option 1 or 2 were adopted, providers should be given a degree of flexibility to notify members and give them a choice to remain with them using the method they decide is most appropriate. The most appropriate method (i.e., phone, email, letter) might vary depending on the member contact details held by the provider. It should be made simple for members to exercise a choice to remain with their provider – for example, via an electronic activation link or a tick box form. Providers should be consulted on any notice requirements to ensure they are workable in practice.

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?**

We prefer option 3 (existing default providers retain their default members, regardless of whether they are reappointed or not) as it minimises disruption while providing default members with an opportunity to move out of a fund that loses its default status.

We do not support option 1 because the disruption and potential confusion it is likely to create outweighs any corresponding competition and innovation benefit that may be gained by reallocating the default member base amongst appointed providers. There are also likely to be substantial administration costs involved for providers in managing such a large transfer of members. Please refer to our response to question 2 for more detail.

We do not support option 2 as, similarly to option 1, it is likely to create disruption and confusion. In addition, the consultation paper refers to the “protections” default members have under the instruments of appointment – particularly in relation to fees.

We believe that the protections under the instruments of appointment are overstated in the context of the highly regulated KiwiSaver sector. Even if a provider loses its default status, it will remain subject to the general KiwiSaver rules and regulations and the requirements of the Financial Markets Conduct Act. In relation to fees, all providers are subject to rule 2 of the KiwiSaver scheme rules, which prohibits them from charging a fee that is unreasonable. Providers must also notify the Financial Markets Authority of any fee increase, ensuring the FMA retains a degree of oversight on any fee increases implemented. In our view, the regulatory framework provides a relatively robust level of protection to members such that loss of default status in itself is not necessarily a valid reason to transfer a provider’s default members to another provider.

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

We do not support options 1 and 2. However, if a transfer option is adopted, the factors set out in the consultation paper seem appropriate to consider in deciding transition timeframes. We expect a staggered approach would be best if a large transfer of members is to occur. However, it will be important to engage with affected providers to ensure any timeframes are workable from their perspective.

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?**

No, active defaults have made an active investment choice and should not be treated as default members for the purposes of transfers. To do so would be to override the autonomy and choice exercised by those members without any proper authority to do so. The only exception to this is in relation to the notice to be given to default members under option 3. In our view, active defaults should also be notified of a provider's loss of default status to ensure they are kept informed of the changes.

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?**

We consider the current position for default providers to report steps taken to address the financial literacy of members is sufficient. It may be useful for the FMA to publicise the member education initiatives in each provider's proposal which have proven successful.

We understand default providers currently provide education so that members may actively choose whether they should stay in or switch out of a default fund. We are unaware of any evidence of default providers not reporting the steps they take. If greater member education requirements are still sought, we consider these should be part of the minimum standard requirements that providers are to meet.

We are unaware of any non-compliance issues with member financial literary obligations. The instruments of appointment contain broad and general powers for termination of appointment (and suspension of default allocations). Default providers can additionally be performance managed and required to provide and action a remedial plan for breach of any relevant requirement. Accordingly, we do not see the need for amendment to the enforcement powers within the instruments of appointment.

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

We have no comments on this question.

43. **Any other feedback?**

We have no other feedback on the discussion paper.