Submission template: Review of KiwiSaver default provider arrangements

Kiwi Wealth Limited

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?**

We agree with the proposed objective for the review

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

We agree with the proposed criteria for the review. Our order of priority in relation to the criteria is as follows:

1 Better financial position for KiwiSaver default members, particularly at retirement

2 Trust and confidence in KiwiSaver

3 Low administration and compliance costs

4 Promote innovation, competition, and value-for-money across KiwiSaver

5 Support development of NZ's capital markets that contribute to individuals' well-being

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

KiwiSaver has been in existence for long enough for there to be substantial data collected on the behaviours of its Default members. Evidence suggests that despite continuous efforts to engage members and get them to make an active fund choice, many members choose not to do so, and even when they do engage, many still make an active choice to remain in a Default fund.

Whilst the intent may have been for the Default fund to be a parking space, this is not how it is being used or viewed by members who are not actively choosing funds that are better suited to their risk appetites and investment timeframes. This places a large number of members in a low growth option with decades to run until retirement eligibility.

Although a conservative option may benefit some members who intend to utilise their KiwiSaver balances for first home purchase withdrawals, we do not support a conservative fund remaining the default option as this applies to a relatively small number of members. Only 0.22% of our Default Fund members made a first home withdrawal in the year to 30 June 2019.

For these reasons we believe a move away from a "parking space" purpose is justified and indeed beneficial for the majority of 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?**

Mandate and fees should be applied at a fund level, and not split within a fund. In our opinion having a split fee mandate and fees within a fund is against the objective of low administration and compliance costs as it will require increased monitoring and disclosure. This concept also appears to be inconsistent with one of the purposes of the FMC Act and messaging from the FMA as the arrangement has a higher chance of confusing investors. Active choice members should have the ability to benefit from options applied to Default members, should they choose to.

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

Refer to our response to question 11.

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

A growth target of between 50%-60% seems appropriate for a Default balanced investment mandate, providing a suitable allocation for growth but not so much that a Default member's portfolio is heavily impacted by market volatility should they be required to make an early withdrawal.

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

Refer to our response to question 11.

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

Refer to our response to question 11.

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?**

Member education to promote active fund choice will remain a focus for the Default member group, irrespective of which investment mandate is selected. This is particularly important for those that may fit into the first home withdrawal category. It is important to note, however, that the average age of Default members has decreased since the launch of KiwiSaver. New Default members are primarily members who are commencing employment and even this age group is unlikely to make a first home purchase withdrawal within the first few years of joining KiwiSaver, and as such will benefit from a higher growth fund. Those that are looking to utilise their KiwiSaver for a first home purchase withdrawal are also more likely to have engaged with their provider.

Based on our experience, only a small number of members within the Default fund make a first home purchase withdrawal, as stated above we had 0.22% of Default members complete a first home withdrawal in the year ending June 2019. This is proportionately lower when compared to active choice members who make a first home withdrawal.

Default members also make proportionately fewer withdrawals for serious financial hardship and serious illness, although this could be because of a lack of awareness about the KiwiSaver options available to them.

With specific regard to serious illness and financial hardship this is no different to active choice members in higher growth funds who find themselves needing to withdraw for these reasons. These are often not situations that a member can plan for and de-risk their holdings accordingly.

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

Costs will vary depending upon whether providers already offer a life-stages option, as those that do not will likely require significant technological changes and/or new funds to be able to offer life-stages.

If providers choose to use their existing funds for a life-stages offering, they may well need to amend their asset allocations to meet the criteria for the mandated funds. This will impact existing, active choice members.

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?**

<u>Balanced mandate</u>

We support a balanced investment mandate. This should allow Default members adequate growth over the long term, thereby providing members with a better financial position at retirement, whilst still benefiting from the stability of fixed interest assets. We agree with your statement that a Balanced Fund would have about the same long term returns as a Lifestages option.

We also agree with your analysis of the options as they relate to first home withdrawals. As noted above we have found that the proportion of Default members withdrawing for a first home purchase is low enough for this to be rejected in favour of benefitting the majority.

We also find that many members still have a relatively long term investment horizon at 65 and as such are not certain that being automatically moved to conservative would be in the best interests of the majority.

Life-stages

We believe in Lifestages as an active choice option for members who wish to delegate management of their retirement fund choices over their path to retirement. However, as a default option we consider that lifestages is detrimental to member engagement. It is more likely to encourage members to ignore their investments, knowing that they will automatically adjust with a member's age. It does not, however, factor in a member's risk appetite, member's looking to make a first home withdrawal in the near future, or when members will begin to withdraw their funds in retirement. A conservative option, as the last option, may be suitable to many, however, for those who intend to continue working and may not commence withdrawals until after age 65, this may not be a suitable option.

There are also few providers offering a life-stages option and the costs associated with establishing a new product offering may impact the number of providers that apply for Default status. At the very least, those members who do not currently offer a life-stages product would need to amend the asset allocations of existing funds to comply with any government set mandates.

Establishing a Default life-stages offering with a nursery period within a conservative fund still doesn't address the issues related to risk appetite and withdrawal ages at retirement.

Growth mandate

We do not support a growth investment mandate. A growth investment mandate, while likely to provide a good retirement outcome for members through asset maximisation, may not be appropriate for the risk appetite of many investors. In addition, the volatility associated with growth funds may have a detrimental impact on those members who need to withdraw their funds on short notice as a result of unforeseen circumstances. Market shock events may also erode trust of members who do not understand, and have not explicitly signed up for, the potential for large drops in value.

Conservative mandate

We do not support a conservative investment mandate. Given the number of members who do not engage with their KiwiSaver accounts or elect to remain in their Default fund through apathy, procrastination or other, conservative investment mandates may not provide a suitable retirement outcome over the long term and could negatively impact a member's standard of living. This is also likely to erode trust and confidence in KiwiSaver. We would want investment returns to outstrip inflation at the very least.

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?**

Fees on default funds are very good value. From an active management investment perspective, Default members appear to be receiving a similar level of service as their active choice counterparts, who are often being charged more for investing in funds with similar asset allocations. Continued pressure on fees could possibly lead to more passive Default options in the market.

There is likely to be a level of cross-subsidisation for Default funds, despite the additional resourcing and administrative requirements associated with Default members. Specifically, member education, locating members with no current address and additional reporting are additional costs associated with the Default fund.

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

We consider this to be more of an issue for those on low incomes, however, the purpose of percentage-based fees is to ensure fairness across balances. Low income earners are less likely to join KiwiSaver, not because of fees, but because of the mandatory 3% contribution amount. To combat this, the industry ought to consider alternatives to the minimum employee contribution.

All members receive the same investment management services, irrespective of how much they earn, so it would be unfair to reduce management fees for one group over another. In addition to this, Default fund fees are already low.

It is arguable that there is any urgency for under 18s to join KiwiSaver and as such, we do not support a fee reduction for this age group.

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 idea of the government setting fees. There are too many variations of how KiwiSaver default providers manage funds for one size to fit all. As the providers know their business best it would make more sense for providers to continue to be responsible for setting their fees. KiwiSaver schemes are also monitored by licensed supervisors, the media and a number of other channels such as Sorted.org, which appears to be ample scrutiny that the Government should not need to also step in. Having the Government set the fee also comes with the risk of impeding innovation as increased prescription leads to reduced flexibility.

We do think the government should ensure that fees represented by Sorted and Smart Investor represent accurate fee information from providers. As it is currently backward looking, fee reductions are not reflected in this, widely promoted and used, information until up to a year after the fact.

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?**

<u>Option 1</u>

As noted above, we do not agree with the government setting a fee. Although this could increase trust and confidence in the KiwiSaver, setting a fee range or capping fees is likely to drive providers to the maximum fee and could also limit the number of tenders received, even though some providers who may not tender, may offer a better retirement outcome because of their investment performance.

<u>Option 2 & 3</u>

Although this may provide a better retirement outcome for Default members, continuing to focus on reducing Default fund fees means further cross subsidisation of Default members, which negatively impacts active choice members.

We think under option 3 it would be difficult to establish at what point in time a provider must reduce its fees. As member numbers grow so do compliance costs, so it is not a simple economies of scale argument. As FUM grows, so to do levies, again showing that it is not a simple economies of scale argument. Costs associated with operating a fund are not consistent across providers and a point in time reduction in fees would not address this. We support the status quo whereby individual providers regularly review fees and can determine when and how they amend their fees.

<u>Option 2 variation</u>

Only Default fund fees ought to be assessed as part of the Default Provider review. We do not consider that it is up to any governmental body to assess what providers are charging active choice members as these members have chosen to be in these funds.

<u>Option 4</u>

Rather than prohibiting providers from charging fees to under 18 year olds, there should be more emphasis on ensuring that under 18 year olds are not auto enrolled, with a mechanism allowing IRD to stop these enrolments from being processed.

We do not consider a locked-in retirement savings product to be the most appropriate means to encourage under 18s to develop a savings habit.

<u>Option 5</u>

We do not support this option. Given the majority of our Default members have balances under $10,000, and we do not charge a member fee, this is akin to suggesting a free Default option, which will result in cross subsidisation by active choice members.

<u>Option 6</u>

Eliminating or reducing Default member fees may be a viable option for both members and providers, however, this is also likely to result in further cross-subsidisation.

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?**

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?**

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

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

Yes, there are additional costs associated with implementing a responsible investing policy, however, these costs vary depending on the level of responsible investing. Costs should be minimal for basic responsible investing implementation, such as exclusions.

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

Responsible investing should lead to an improved return or lower risk if implemented in the right way.

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

We do not consider that the Default provider arrangements should be used to achieve responsible investment objectives. There is too much variance in responsible investing to determine what is a suitable minimum.

There are different approaches to responsible investing with exclusions being the most basic and not necessarily the most effective form of responsible investing. Responsible investing means different things to different people. To put this into effect industry, investors and regulators would all need to agree on what responsible investing is and how to best deliver responsible outcomes.

We consider that providers should be able to determine the level of responsible investing in their funds and ensure adequate disclosure so that members are aware of their approach to responsible investing.

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?**

As noted above, there is no consistent view of responsible investing. There is also a disconnect between what members say they want and what they do, as was evidenced in the 2018 Colmar Brunton survey.

Assuming that some responsible investing is required within the Default product, it shouldn't necessarily negatively impact 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?**

The very nature of a Default investor is that they do not engage or make active choices. It's unlikely that making more information available about the responsible investing status of their fund will impact the behaviour of Default members. As noted by Colmar Brunton, the two biggest barriers to investing responsibly were a lack of independent information and lack of time to compare all of the options. Assuming that providers did make more information available to Default members, it would not be independent and it is unlikely that most Default members would take the time to evaluate this information.

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

It's difficult to gauge what a disengaged member may expect from their KiwiSaver provider, assuming they've given any thought to their KiwiSaver.

Also, exclusions are not the only aspect of responsible investing, and there is a strong focus on exclusions within the discussion paper. Responsible investing also includes positive screening, best-in-class screening, ESG integration and corporate engagement and shareholder action. Although exclusions may be a more familiar concept to members, these elements are equally important to responsible investing.

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?**

This is not an option we support. It is implied that exclusions are the defining aspect of responsible investing, which we do not believe to be the case. The government should look at processes which drive improvements in underlying issues. Excluding sectors is a weak driver of change.

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?**

Although we are happy to support this option, it is more difficult to identify how this information should be presented to members. The product disclosure statement, although provided to all members, is rarely read, with information incorporated by reference being even more unlikely to be read. A statement could be provided together with the annual member statements.

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?**

Our preference is Option 2 despite the increase in costs associated with any additional disclosure.

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?**

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?**

The primary purpose of KiwiSaver is to encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement. It is focussed on the individual and not on supporting the development of New Zealand's capital markets as these two objectives are not necessarily aligned.

Investment managers have an obligation to consider the risk and return characteristics of all investments. Given the size of the opportunity, a mandated level of investment in New Zealand capital markets is likely to result in the acquisition of some inferior investments, which would not be in the best interests of members. We would also have concerns about the liquidity and pricing associated with unlisted investments, as well as the lack of returns in the short to medium term.

Irrespective of the size of the mandate, it would be difficult for investment managers to make these investments knowing that under normal circumstances, they would not meet investment criteria. Mandated investments into unlisted markets will also increase administration costs associated with research and monitoring.

We do not consider that investments to boost New Zealand capital markets should be mandated. Rather individual providers should be able to select investments they consider to be appropriate for their funds.

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?**

We are uncertain whether having a New Zealand based management team is likely to have much of an impact on New Zealand capital markets.

All parts of our investment process relating to the Default fund are located in New Zealand.

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?**

We agree with the problem definition as stated in the discussion paper. We would note that, even if Default members are notified in writing prior to any transfer taking place, there is still a significant percentage of Default members that providers won't be able to contact because they don't hold up-to-date contact information. This will result in members being transferred with no idea who their new provider is.

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 this option as unnecessary movement of members is likely to negatively impact confidence and trust in KiwiSaver.

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?**

Providers will need to contact members to request their confirmation to remain in the Scheme (whether this means remaining in the Default fund or switching to another fund). How providers do this should be determined by individual providers because the providers know their businesses best. The providers are in the best position to determine the most cost-efficient method to contact their members to avoid unnecessary regulatory burden.

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?**

Moving members from one Default provider to another, when their existing Default provider has not lost their Default provider status makes for a poor member experience and could negatively impact trust and confidence in KiwiSaver. It would also result in unnecessary administrative costs.

We support option 2 provided that existing Default members are given the option to remain with their current provider. Option 2 will ensure that those existing Default members who are truly disengaged or cannot be located, will continue to be protected under an instrument of appointment.

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

Timeframes will need to allow existing providers an opportunity to contact their Default member base to give them an opportunity to remain in the provider's scheme.

Assuming that members will be transferred from ex Default providers to new or existing Default providers, it would be preferable to stagger the transfer of members after 1 July 2021 to allow providers time to process new Default members and properly onboard them.

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?**

If a Default member has chosen to remain in the Default fund, they are no longer a Default member. Members in this category can be notified of the changes occurring, but shouldn't be required to take any action.

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?**