

Submission on discussion document: Enabling KiwiSaver investment in private assets

Your name and organisation

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Responses to discussion document questions

Please enter your responses in the space provided below each question.

Liquidity management tools – questions for KiwiSaver providers or other industry	
1	For KiwiSaver managers: Please describe your current practice around investing in private assets, including levels of exposure you have to these types of assets, how you invest in these assets, and your management of liquidity risk.
2	Do you think that the current legislative framework for KiwiSaver effectively allows for the use of liquidity risk management tools that may impact transfer or withdrawal times (e.g. suspending redemptions or side-pocketing)?
3	For KiwiSaver managers: If you cannot use these tools, can you please explain the reasons for this and the impacts in terms of: <ul style="list-style-type: none"> a. your ability to increase investment in private assets b. risks associated with your current allocation of private assets.
4	Please provide any other comments on the availability of liquidity management tools.
5	Do you support the proposed approach? Why/why not?
6	If redemption gates were allowed, would you consider developing new products more focussed on private assets?
7	Will you face implementation costs if this change is made? If yes how much will they be and will they be one-off or ongoing?
8	Do you have any comments on the detailed design considerations noted above?
9	Please provide any further comments on this issue of liquidity management tools.
Liquidity management tools—questions for the public	
10	Do you support more investment by KiwiSaver funds into private assets? Why / why not?

	<p>We support this, for two reasons:</p> <p>Firstly, investing in private assets offers investors significantly higher returns (at lower volatility and lower correlation with markets) than other asset classes. Asset consultant Cambridge Associates has researched this subject for many years, and concluded that both private equity and venture capital asset classes offer a premium level of return which easily justifies their relative lack of liquidity. This overperformance is consistent over both longer (10-20 years) and shorter (1-5 year) periods.</p> <p>Secondly, KiwiSaver funds should play a pivotal role in supporting innovation, powering GDP and export earnings and growth, much like their Australian and UK counterparts. Australia's pension funds play a huge role in driving Australian innovation. The Mansion House reforms encouraged UK pension funds to commit <u>5% of their assets into domestic high-growth businesses</u>.</p> <p>As the discussion document notes, Australia has a much larger pool of superannuation funds than New Zealand (A\$3.6 trillion versus NZ\$110 billion), and a much higher proportion of these funds invested into private assets (16% versus ~2.5%). New Zealand, of course, has a much smaller population, but this still means the average Australian has over 40 times more invested into private assets than the average New Zealander. This obviously contributes to the lack of capital investment which affects many New Zealand businesses.</p>
11	<p>Do you support the use of liquidity management tools like 'side pockets', if they may have an impact on the availability of your KiwiSaver funds? Please explain.</p> <p>We consider that the liquidity question is not a material issue.</p> <p>Most Kiwisaver funds are growing, with new contributions being made by account holders on a regular basis. Therefore, if a given account holder wants to switch to another Kiwisaver fund, their funds can be redeemed from the proceeds of new account holders or other liquid assets - there is no need for the Kiwisaver to sell out of any illiquid assets. The only real risk is if a fund loses its government mandate, but that is an edge case, and can be solved through the transition process accounting for illiquid assets (e.g. they might be transferred).</p> <p>KiwiSaver's current high liquidity requirements prevent allocation to the long-term, illiquid, but lower volatility and higher return, private assets such as venture capital investments. These requirements need to be relaxed for higher-risk, higher-reward KiwiSaver funds. We note that many younger Kiwisaver account holders do not expect to redeem their Kiwisaver funds within the typical lifespan of private asset investments, such as venture capital funds which often have a 10-year lifecycle. This may be a matter of a perceived barrier: while savers can switch their funds between KiwiSaver funds, few do.</p>
12	<p>Please provide any further comments on the proposed approach.</p>
Private asset categories – questions for KiwiSaver providers or other industry	
13	<p>Do you consider that the current asset classes in the Financial Markets Conduct Regulations 2014 are problematic as they relate to private assets? If yes, please explain.</p>

14	<p>How do think the categories should be described?</p>
15	<p>Please provide any other comments on the lack of private asset categories.</p>
16	<p>Which option do you think is best and why?</p>
17	<p>Will you face implementation costs if this change is made, if yes how much will they be and will they be one-off or ongoing?</p>
18	<p>Please provide any further comments on this issue of including private assets in asset categories.</p>
<p>Private asset categories—question for the public</p>	
19	<p>Do you think it would be useful to have better visibility over how much KiwiSaver funds are investing into private assets?</p> <p>Yes.</p> <p>We have funds that have made small investments into domestic venture capital (e.g. Booster, Simplicity, Fisher Funds, Generate, etc). They are investing locally so that their customers know that their money is being used to benefit New Zealand and they promote their contribution to our local economy.</p> <p>Customers have both a right and an interest to know how and where their money is invested. We support better visibility and clarity of disclosure of investments into all asset categories, including unlisted PE & VC in New Zealand.</p>
<p>Valuation requirements – questions for KiwiSaver providers or other industry</p>	

20	<p>For KiwiSaver managers: Do your governing document(s) include a valuation methodology which is challenging to apply to valuing private asset? If you do, can you please explain the impact in terms of:</p> <ul style="list-style-type: none"> a. the extent to which your governing documents require amendments to allow for the inclusion and pricings of private assets within your funds. b. whether you have tried to amend the valuation provisions in the past or not, and why. Include examples of where the supervisor has or has not approved a valuation methodology.
21	<p>Please provide any other comments on the valuation methodologies in governing documents.</p>
22	<p>Do you agree that this is an issue that needs addressing?</p>
23	<p>Do you have views on how it should be addressed?</p>
24	<p>Will you face implementation costs if this change is made, if yes how much will they be and will they be one-off or ongoing?</p>
25	<p>Please provide any further comments on this issue of valuation requirements.</p>

One of the reasons people cite for not investing in private assets is the difficulty of valuing the assets which are held. We do not see this as a substantial barrier.

All VC funds provide ongoing valuations to their Limited Partners. 2040 Ventures follows internationally accepted best practice approaches to develop the Fair Market Value for all of our funds and portfolio companies, guided by the 2022 International Private Equity and Venture Capital [Valuation Guidelines](#).

At 2040 Ventures, we have very high standards for valuation and disclosure, with monthly NAV reports provided to our shareholders and auditors, and quarterly NAV reports for our Climate VC Fund investors. Our Punakaiki Fund accounts are prepared to the top IFRS standard.

Normally a valuation will change when:

- A capital raising round has been completed, with third parties providing a view of the value of the company. This is infrequent.
- A major change in the company performance or market multiples warrants a material change in value.
- Annually, when we complete a full revaluation of the portfolio with our auditors as part of the process of finalising audited accounts.

Venture capital as an asset class is about long-term capital growth, and thus valuations do not materially change very frequently, and this lowers volatility for investors. We see that it is important that funds react to market conditions, as we saw in the last few years where poor listed market multiples reduced local valuations.

Total Expense Ratio—questions for KiwiSaver providers or other industry

26

Do you currently outsource fund management for private assets?

27

Do you see any issues with the current TER calculation and if so, what are they?

28

Does the current TER calculation impact your decision to invest in private assets, or to utilise third-party fund management?

Our position is that the question of fees is a key to the success of the proposed changes.

The current emphasis on KiwiSaver fund fees needs to be correctly reframed. Right now, KiwiSaver managers are driven towards asset classes with low fees because of the FMA's test for "reasonable" fees. High fees for high-return asset classes should be justified by performance. The focus should be on net value and returns after management and performance fees, rather than management fees alone.

29

Are there any other issues you would like to draw attention to on the TER?

Total Expense Ratio—questions for the public

30	Do you look at KiwiSaver scheme fees when deciding which KiwiSaver scheme to put your money with?
31	What do you think should be included in any figure that is called “KiwiSaver scheme fees”?
32	Please share any thoughts you have around the TER (total expense ratio) and its function to inform the public of the expenses involved in KiwiSaver management.

Final comments—question for KiwiSaver providers or other industry

33	Please provide any further comment on barriers to KiwiSaver investment in private assets that you see (including any comments in relation to issues identified in paragraph 18b-f).
	<p>We note that the discussion paper says:</p> <p>“Other issues that arose in discussions that the government is not addressing in this discussion document (some of which may be more appropriate for the industry to respond to)</p> <p>b. KiwiSaver managers’ operational capacity and capability – providers may not have the~specialised skillset required to invest in private assets, and outsourcing increases fees and reduces returns.”</p> <p>This is critical to the success of the changes proposed in this paper. Investments will not succeed without skilled management, but that requires funds to be of a certain size before they can firstly assess external managers, and even before performing their own direct investments. We are concerned that Kiwisaver managers’ need the confidence and incentives to be able to allocate assets rather than “pick stocks”, and outsource investment capacity to specialist external managers (as with the Yale Model). Resolving this will produce superior returns versus generalist investing. Expanding specialist investment capability should be a priority for both industry and government to correct.</p>

Final comments—question for all respondents

34	Please use this question to provide any further information you would like that has not been covered in the other questions.
	<p>About 2040 Ventures</p> <p>2040 Ventures Limited is one of New Zealand’s most experienced venture capital fund managers.</p>

launching their first fund in early 2014. Since then, the growing team has made over 130 investments across two flagship funds: Punakaiki Fund and Climate Venture Capital Fund.

Our team of seasoned investment professionals bring global multi-sector experience, and have advised hundreds of NZ technology companies and invested in them for over 20 years. We've invested in and received returns from Kiwi tech companies, including Vend, Timely, and Moxion, and partner Lance Wiggs acted as advisor on the initial Trade Me exit to Fairfax Media. The founding principals also have education and experience in asset allocation, including Chris Humphreys being a CFA Charterholder, and Lance studying the Yale Model and being a Yale Summer Associate, placed by the Yale Investment Office.

Context

The level of investment into private asset classes in Kiwisaver is low, compared to comparable countries like Australia, and extremely low compared to world class investment entities such as US endowments. Moreover the levels of Kiwisaver (and other local fund) investment into high-growth private assets, including those managed through venture capital fund managers, is extremely low.

We agree with the paper's position that increasing Kiwisaver investment into high-growth private assets will benefit Kiwisaver members through better returns and improve the productivity and competitiveness of high-growth New Zealand businesses. We see that as self-evident, and backed by performance of international funds, in particular the US-based endowment funds such as Yale Investment Office. These funds produce higher returns for lower risk.

We support the recommendations made by the Centre for Sustainable Finance Toitū Tahua (CSF) in their report "Investing in Private Assets".

Our position is that fees are a key concern of Kiwisaver providers, and specifically that fees for outsourced investment expertise naturally detract from the fees for the providers themselves. This creates a barrier for Kiwisaver funds to invest in any assets needing specialised fund management, public or private.