

Submission on discussion document: Enabling KiwiSaver investment in private assets

Your name and organisation

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Date	14/02/2025
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Responses to discussion document questions

NOTE: The document has been prepared by staff from a subset of BIG members. While the content has been circulated among all members, it may not reflect the views of all members.

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.
	BIG membership is made up of most non-bank fund managers, many of which are KiwiSaver providers. KiwiSaver providers that are members of BIG (and BIG members generally) have a range of approaches to investing (or not) the KiwiSaver funds they manage into private assets. KiwiSaver fund exposures to private assets subsequently vary across the industry (and we assess that 0-10% would be a reasonable estimate at a fund level, lower at a manager FUM level). Where investment in private assets does feature, both in house and external fund managers are used. Where an in-house management approach is taken, it does not generally cover all private assets, and some external fund management is utilised. An important way that liquidity risk is managed in relation to private asset exposure is via the parameters set for funds that invest in such assets (for example via the SIPO and fund exposure monitoring and management). This includes: • A limitation on the amount a KiwiSaver fund may invest (as a portion of the fund) into less liquid assets such as private assets. Managing actual exposure to be well within ultimate limits. • Having some flexibility in asset mix ranges to ensure that a small redemption request or market movement does not require private assets to be sold to ensure compliance with the SIPO. • Investing in private assets in structures (for example related wholesale funds) that allow the trading of such exposure between funds (where for example one fund is shrinking and one is growing). • Understanding that not all private assets are the same when it comes to liquidity. Some are inherently more sellable than others (for example some unlisted property) or have some certainty around liquidity at a future set date (as is the case for private debt). Some private assets (for example VC investments) are more likely to have no market or buyers potentially for years. • Diversification across assets to ensure that one private asset investment that 'goes wrong' does not cause issues at the fund level.
	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)?
2	Current legislative rules make the implementation of such tools in the KiwiSaver space problematic. We agree with MBIE's assessments in this regard. Because of this industry is proceeding on the basis that suspending redemptions and side pocketing are not options in the KiwiSaver space.

	For KiwiSaver managers: If you cannot use these tools, can you please explain the reasons for this and the impacts in terms of: - your ability to increase investment in private assets - risks associated with your current allocation of private assets.
3	Reasons – the legislative framework issues will be well opined on. Impact on ability to increase investment in private assets – provided that investment in private assets is only undertaken by funds of sufficient scale then the lack of such tools is not seen as prohibiting investment in private assets as large-scale funds should be capable of managing their liquidity requirements provided allocations to direct investments remain right-sized. However, limiting allocations to address circumstances that may never arise may be sub-optimal to investors’ interest. Also, there may be times where private assets are not able to be realised at a price that reflects any reasonable view of their value. The unavailability of the proposed tools clearly puts a limit on the extent to which a KiwiSaver fund may invest into private assets; however, it is not the only limit (prudent fund management practices including around diversification and risk management, and the potential for reputational impact from the use of such tools are two examples of significant factors limiting investment into private assets). If new tools were available, it would remain open for each manager to make its own assessment whether use of them would be appropriate within its funds (or a specialist set of its funds). Impact on risks associated with current allocations of private assets – liquidity risk is primarily managed via other methods. The tools proposed are for more extreme scenarios only and would be expected to be used in very limited circumstances (as it could be anticipated that a manager’s reputation could be affected if it was to use a tool in the absence of conditions that did not affect the market generally). Usual liquidity risk management approaches private asset exposure should not slip because such a ‘backstop’ exists and industry (fund managers, investment managers, regulators, supervisors, auditors and Government) should be mindful of this and any moral hazard that may come with the introduction of such tools. This may be particularly important when considering new entrants to the sector. It is also worth noting that existing liquidity management tools generally work ok whilst KiwiSaver as a whole is growing. Should a demographic tipping point be reached where this is no longer the case (or at least no longer the case absent growth from returns) then the importance of additional liquidity tools such as those proposed may increase.
4	Please provide any other comments on the availability of liquidity management tools. There is a general expectation that fund managers have an effective liquidity risk management framework in place. It is also worth noting that administering side pocketing is likely to have some level of complexity and challenge to it.
5	Do you support the proposed approach? Why/why not?

	There are mixed views on this. If the aim is to encourage private asset investment, then the proposed changes would help support that, though we suspect that any impact would be at the margins. It is likely more to be a tool for those that are involved in private asset investment (to use in extreme scenarios) rather than an encouragement for others to enter into that space. However, there are significant issues with enabling liquidity management tools that gate redemptions or side-pocket assets which include a potential impact on a fund manager's reputation and business from using such a tool, and the fact that such tools are also quite complex for the KiwiSaver investing public to understand – making KiwiSaver more complex to communicate to members and potential members about. Overall KiwiSaver remaining as a trusted investment is a primary concern, as is outcomes for investors.
6	If redemption gates were allowed, would you consider developing new products more focussed on private assets? We are not heard of any comments around the introduction of redemption gate options opening up the launch of new products.
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? For those that look to make changes to enable the use of such tools should legislative changes be made, then yes there will be implementation costs. Significant product changes such as this involve internal costs and often external legal costs. This will not only cover changes to trust deeds, communication to members and updates to disclosures, but also potentially impact on processes. Ongoing costs are likely to be minimal (minor reporting adjustments for example) until such a tool is used. The use of such a tool is likely to require significant management time, heavy engagement with the scheme's supervisor etc. For those that do not make such changes, there is the potential for costs for reviewing and updating processes and training staff as for example some transfer ins may be leaving some assets behind at another provider.
8	Do you have any comments on the detailed design considerations noted above? The design considerations appear to have flagged a number of appropriate questions. As a general comment, tighter / more defined rules may be preferred by a number of providers. A few other comments (noting the commentary in the discussion document): - Any proposal that requires investors to 'opt in' to allowing redemption restrictions or side pocketing is less likely to be supported as there is a view that investors are unlikely to understand the potential long-term impact of what they have signed up for. - The proposed tools should not be available to deal with situations where a private asset has had a significant fall in value. The more appropriate question to ask is can that asset be realised within a range of fair value (noting a fair value range can fall significantly).
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?
	Whilst this question is not aimed specifically at KiwiSaver managers, we think it still warrants a few comments. If required, please take these comments as addressing question 34 instead.
	Private assets do have the potential to add further diversification to an investment strategy and add to the investible universe for a fund – which can be of benefit from a risk management / return perspective. However, it is worth noting that increased investment in private assets raises the probability that something will at some point go wrong in a KiwiSaver fund that cannot be attributed to markets generally. Industry/FMA/Government needs to have its eyes open to and be comfortable with this.
	One issue worth flagging is that we assume that Government's interest lies in encouraging investment into NZ private assets. However, there may be private asset investment options for KiwiSaver funds to also consider that are based overseas and that are as good as or better than local options.
11	It is also worth noting that the extent to which non-KiwiSaver funds invest in private assets is also patchy (many do not invest in private assets, and those that do may be quite restrained).
	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.
12	
	Please provide any further comments on the proposed approach.

Private asset categories – questions for KiwiSaver providers or other industry

13	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.
	We would frame the question more broadly – that current disclosure settings for PDS and fund updates could be improved to require or encourage clearer disclosure around a fund's target / actual exposure (and possibly in some way potential exposure, or limits to such exposure) to private assets.
	Asset categorisation is the obvious initial place to look when raising this problem, however we would caution a narrow focus on increasing the complexity of the currently required graph / table.
14	How do think the categories should be described?

	The current proposals seem quite complicated. We think the current categories could remain unchanged (or even be simplified by combining listed and unlisted property) and that the issue of private assets could be covered in simple, additional disclosure focusing on that topic. Such an approach would better communicate a key aspect of such investment – a fund’s target / actual exposure to private assets. There will be various options for how that additional disclosure could be presented and how detailed it is – it could for example communicate private asset exposure across the fund generally, and/or income and growth assets; or be more detailed e.g. across equities, fixed interest and property / infrastructure. Additional detail should be weighed up against the effectiveness of simple and clear disclosure. Considering the specific classification options posed in the discussion document: • Option 1 – the combination of private debt and private equity to create a new asset class would come at a cost of not distinguishing between debt and equity for those assets. This is not favoured for this reason. • Options 2 and 3 – the additions of categories proposed do make some sense and of the four options presented these are preferred. However, they do add noise / complexity to the disclosure which is why the preferred alternative is noted above. • Option 4 – as with options 2 and 3 however the complexity is at a relatively higher level, and we are not clear that there is evidence that this additional complexity would add value for investors. We also note the use of the ‘other’ bucket for private assets is not ideal as it does not provide information that is as useful as it could be. In summary, combining private and listed assets together in each asset class for reporting, then requiring separate information on a fund’s exposure to private assets is seen as an effective way to communicate the most pertinent points to investors.
	Please provide any other comments on the lack of private asset categories.
15	See our response to question 14 above. One side point to keep in mind is what if any impact on market indices used by fund managers to report return history against will a change in asset category have. We do not expect it to have an impact given composite indices can be used but it is a point for industry to keep in mind.
	Which option do you think is best and why?
16	See our response to question 14 above.
	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?
17	Yes there will be implementation costs. These include updates to disclosure and reporting, but also in reviewing the source of such reporting (for example individual asset categorisations) which may in some cases need to be updated. The proposed approach in 14 would come with similar implementation costs. As with any such changes, one of the most significant costs is likely to be the impact of management time diverted, which is difficult to quantify (relevant to Q7 as well). The costs are likely to mostly be one-off.

18	Please provide any further comments on this issue of including private assets in asset categories. -
Private asset categories—question for the public	
19	Do you think it would be useful to have better visibility over how much KiwiSaver funds are investing into private assets?
Valuation requirements – questions for KiwiSaver providers or other industry	
20	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: 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. Any BIG member that has the issue described is likely to submit individually on this question. As a whole we presume that the issue is somewhat limited in the number of providers it affects. It may also be worth noting that there is a supervisor and auditor dimension to any such change as they would need to understand and accept a particular approach to valuation.
21	Please provide any other comments on the valuation methodologies in governing documents. The question of valuation methodologies and timing in the area of private asset investments is important. We note the lack of FMA guidance for MIS managers on this matter and are unclear on the extent to which government agencies are familiar with market practice relating to private assets including the practices of external managers.
22	Do you agree that this is an issue that needs addressing? We expect that valuation methodologies for any direct (private) investment are stated within constituent investments documents and that if those methodologies are accepted by the fund manager and its supervisor then it should be sufficient that the ongoing focus is on compliance with those methodologies. We submit that there is a false illusion of precision in relying on daily pricing in public markets, where quoted prices reflect limited trading of small parcels of securities between parties with various motives and different levels of information about the full circumstances of the entity involved. If the FMA or government agencies are concerned about the different methodologies adopted within current constituent documents, then this should be a matter for wider industry consultation (including with licensed fund managers, external / wholesale private asset managers, supervisors and auditors).
23	Do you have views on how it should be addressed?

	To the extent that impacted managers cannot resolve this issue in conjunction with their Supervisor and the FMA (preferred approach) then legislative change as a backup option seems reasonable.
24	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?
	Most managers are unlikely to as they do not have this issue.
25	Please provide any further comments on this issue of valuation requirements.
	See comments in Q21.
Total Expense Ratio—questions for KiwiSaver providers or other industry	
	Do you currently outsource fund management for private assets?
26	Of BIG members that are KiwiSaver providers, a number invest in private assets and some do this in house. However, those that do such investments in house usually also invest in external fund manager products / outsource some private asset investment.
	Do you see any issues with the current TER calculation and if so, what are they?
27	Yes, we do see issues around disclosure requirements for fund charges. A key issue is the definition of Fund Charges and what it does and does not capture, as well as what is captured by the synthetic total expense ratio. The current settings on what should be captured in collating fund charges are not sufficiently detailed, and this leads to the potential for disparity between listed and unlisted investments. For example, for an underlying fund that invests in private property should rates, insurance, maintenance costs, property manager costs (covering maintenance and operations rather than investment management) etc. be captured in fund charges when they are not for listed property (noting the <i>FMA guidance note</i> on fee disclosure by managed funds and its discussion on whether an investment is an underlying fund or not).
28	Does the current TER calculation impact your decision to invest in private assets, or to utilise third-party fund management?

	There is an impact from this issue. Considering the traditional private equity fee structure (2% management fee and 20% performance fee, fees charged on a committed vs. invested capital) the impact of a small allocation to private equity to disclosed fund charges can be significant. If an allocation is done inhouse it is likely to still be expensive. It is likely that this is a significant issue that causes fund managers to think twice about such an allocation. There are of course benefits to fee transparency - this is not a suggestion for removing that and third-party fund manager fees should be appropriately captured in disclosure requirements where they are not covered by the licenced manager and its fee. Rather there is clearly a cost / fee barrier to KiwiSaver funds investing in private equity which is potentially exacerbated by the recent focus on low fees and by disclosure requirements. There is also the issue noted in 27 above which may be easier to solve for. This issue is probably felt more for inhouse investment and how such investment is structured (e.g. it may encourage the use of additional complex structures like limited partnerships).
29	Are there any other issues you would like to draw attention to on the TER? We note that some private asset managers charge performance-based fees, and such differences in fee levels / structures should be recognised as a potential feature of private asset investment. It is also worth noting that where regulator expectations land on certain topics will also help shape how expensive private asset investment is – for example a requirement for regular and expensive independent valuations will add to costs. See our comments on question 33 which in part link to this comment. As an aside it may also be time for the \$10k investment figure used in fund charge examples in disclosure to be reviewed, noting the average KiwiSaver balance is significantly higher.
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). There are a number of current barriers to KiwiSaver investment in private assets that are not captured in the consultation document. These include:

- a. Inhouse investment and related party benefit requirements under the FMCA. The current law, combined with the FMA's regulatory approach to this matter (no industry consultation / guidance, enforcement approach without necessarily having a sense of industry views or practice) has recently raised significant uncertainty for fund managers considering inhouse private asset investment and has likely dampened enthusiasm for it. There are a number of interpretation matters that would benefit from industry consultation after which the potential for law reform in this area we suggest could be considered.
- b. Valuation challenges (methodology and frequency) - the valuation of certain private assets includes more requirement for judgement which creates uncertainty and risk. This risk and uncertainty is exacerbated by the lack of FMA guidance on this matter, and the FMA's current tendencies noted in a. above.
- c. Alignment across market participants / supervisors / regulators and Government. There should be a recognition that there will be growing pains in developing or supporting a relatively new industry such as private asset investment in KiwiSaver, and to date this alignment has not existed. As noted in a and b above, there is a lack of guidance on key matters relating to private asset investment and encouraging and supporting consistent understanding and views across all parties in these crucial areas would help. This alignment should also be conscious of fairness for inhouse managed exposure which regulators may more easily get insight into vs. externally managed exposure (including for example around expectations for valuation practices and assurance).
- d. Reporting from investee companies (or from external fund managers). Mixed bag and often needs to be encouraged or developed. Includes financial, climate emissions, other.
- e. Value for Money guidance from the FMA and perceptions within industry that this encourages vanilla, passive, low-cost outsourced model (noting the banks appear to be adopting this model). There is the opportunity to update this guidance to more explicitly acknowledge the legitimacy of different fund management strategies and that different strategies are likely to come at different cost points.
- f. Capability and expertise in private asset investment and management. The management of illiquid assets in a KiwiSaver multi-asset fund is complex and requires higher levels of governance including across liquidity, valuation and operational risk areas, as well as some specific management / operational skillsets. Australia is a good market to learn from in this space, however their compulsory contribution settings do potentially allow for greater liquidity risk tolerances.
- g. Other factors include risk / return considerations; availability of attractive investment options (note that infrastructure as a private asset investment option is essentially non-existent in New Zealand); cost (it can be expensive); increasing complexity - governing and managing that complexity and communicating additional complexity to investors.

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.

One more minor matter to consider is KiwiSaver balance projections that are required to be included in annual member statements (the assumptions for which are set via FMC Regulations) which seem to be overdue for a review anyway. How should these take into account different types of private assets?