

14 February 2025

Financial Markets
Building, Resources and Markets
Ministry of Business, Innovation & Employment
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Dear Sir/Madam

Re: Enabling KiwiSaver Investment in Private Assets

1. Background

I am writing to you regarding the discussion document entitled *Enabling KiwiSaver Investment in Private Assets* (referred to as 'the Discussion Document').

BusinessNZ supports having deep and liquid capital markets in New Zealand to further the growth of New Zealand businesses and the wider New Zealand economy. We have consistently advocated for an improvement in the quality of regulation across all facets of the economy, to help reduce barriers and facilitate better opportunities for capital market development. Therefore, we are open to options being explored to develop New Zealand's capital markets, particularly where the KiwiSaver legislation has regulatory barriers prohibiting investment in a broader range of assets, including investment in private assets.

BusinessNZ believes that investing in private assets offers several advantages. These assets, such as private equity and real estate, provide diversification due to their lower correlation with public markets and can offer higher returns by accessing unique opportunities. They typically involve long-term investments, allowing managers to focus on growth without short-term market pressures, making them attractive to institutional investors seeking stability.

However, investing in these assets also requires investors to enter these markets with eyes wide open, particularly from a KiwiSaver setting. Private assets are generally illiquid, making it harder to access funds quickly, especially during times of financial stress. Also, higher fees, complex due diligence, and limited transparency increase the cost and difficulty of investing.

Overall, BusinessNZ welcomes the discussion around the best ways in which KiwiSaver investment can include private assets.

Recommendation: That the Government undertakes further work regarding how to best enable KiwiSaver investment in private assets.

Looking beyond KiwiSaver investment in private assets

While BusinessNZ will outline its views on various aspects of the Discussion Document below, we would also like to outline our broader considerations regarding the future of KiwiSaver.

At the time when KiwiSaver was developed in 2004/2005, BusinessNZ expressed strong concern to the Government that there was little research undertaken to show New Zealand had a savings problem, and if it did, whether KiwiSaver was the optimal policy going forward. Subsequent research by Treasury in 2011 and 2014 showed that KiwiSaver had not been associated with greater accumulation of net wealth by its members and hence had not improved retirement income outcomes.

Nevertheless, taking into account the fact that the policy is now embedded in New Zealand's structure with high numbers of New Zealanders signed up and with over \$110 billion now in KiwiSaver accounts, it is clear that it has become fundamental to the way a large proportion of New Zealanders think about their retirement savings. The total pool of funds already in KiwiSaver, as well as contributions that continue to be made, send the signal that the regulatory settings for the scheme within the full context of New Zealand's policies around savings are becoming increasingly important.

BusinessNZ has previously submitted on various issues relating to KiwiSaver over time, including a number of targeted reviews into specific aspects of the Act. However, while we have specific views on a number of the proposal outlined, we are also highly cognisant of the need to examine what the scheme means going forward, given it is approaching 20 years in existence.

The Discussion Document provides a useful outline of the issues associated with KiwiSaver investment in private assets, as well as the focus of the Document and current Government work. However, paragraph 18 of the Discussion Document also outlines a number of areas which are deemed not to be relevant to the discussion on KiwiSaver investing in private assets. While BusinessNZ understands that this is a targeted review concerning one element of KiwiSaver policy, ideally, we believe the Government needs to undertake a full root and branch review of KiwiSaver in the near future given the increasing part it is now playing for many New Zealanders regarding their retirement savings.

The review could examine a broad range of issues, ranging from details such as the default KiwiSaver ban on investing in fossil fuel-related investments, the contribution rates that are currently available, the need for withdrawals for a first home purchase, through to the broader macro role of KiwiSaver in relation to other retirement savings policies, including the New Zealand Superannuation Fund and New Zealand Super.

Recommendation: Government undertakes a comprehensive root and branch review of KiwiSaver policy.

2. Discussion Document proposals

The Discussion Document outlines four proposals in relation to KiwiSaver investment in private assets. While we provide our views on three of them, the Government will need to look at what the full package of changes could look like, rather than viewing each proposal in isolation. Investment in certain categories of private assets typically follows a J-curve effect, where an investment initially experiences negative or low returns before generating higher, positive returns over time. This typically means upfront costs, fees, and early-stage inefficiencies that can lead to losses initially, followed by improved performance as the underlying assets mature, generate income, or appreciate in value. While more sophisticated investors understand and recognise this situation, other New Zealanders may need to be prepared for this initial period of underperformance and adopt a long-term perspective to benefit from the eventual upside.

Proposal 1: Enabling KiwiSaver providers to use liquidity risk management tools

In principle, BusinessNZ supports further exploration into this area to encourage increased KiwiSaver investment in private assets. However, we also strongly urge caution around the pathway towards the introduction or enhanced use of the options discussed, given the need to ensure the KiwiSaver scheme is well understood by the bulk of the population who are signed up to it.

The Discussion Document outlines a need for clarity on rules for side pocketing, as well as on the possible introduction of redemption gates, given both have been suggested as being capable of lifting fund managers' ability to invest in private assets. On face value, providing a more practical pathway for side pocketing along with better clarity in the relevant legislation and guidance could lead to a more homogeneous interpretation and action by different KiwiSaver providers. Likewise, redemption gates could potentially facilitate the KiwiSaver industry developing new products with increased focus on private assets, thereby enabling a *'fund manager to carefully control withdrawals from a fund over a period of time, including by slowing or halting withdrawals'*.

However, as stated in the Discussion Document, they *"have heard concern from the sector about complicating the KiwiSaver Scheme and confusing KiwiSaver members in a manner that undermines its brand reliability."* From BusinessNZ's perspective,

overcomplication could potentially undo much of the ongoing work towards New Zealanders having KiwiSaver as a primary tool to save for their retirement.

One of the reasons why KiwiSaver has been successful has been its easy opt-in, minimal complications around choosing a provider, and the ability for members to make consistent contributions over a long period of time. We believe consideration should still be given to the majority of New Zealanders who simply seek to save funds for their retirement in a simple and consistent manner. Therefore, it is essential to clearly communicate the investment conditions to KiwiSaver members, especially if more complex schemes are introduced.

When looking at the broader proposed approach that is outlined in the Discussion Document to clarify availability of LMT's, we agree that *"further development of this approach would need to consider more detailed design considerations, policy questions and technical matters."* The best interests of KiwiSaver members need to be foremost in the minds of policy makers when providing more detailed information on the proposal as a whole.

Discussions around liquidity risk management tools should also take into account the broader issue regarding what KiwiSaver providers are realistically capable of doing, given the relatively shallow pool of KiwiSaver investments compared with investments overseas. While New Zealand's total KiwiSaver savings amount to around \$110 billion, this is small in comparison with savings in a number of countries we typically compare ourselves to. For instance, the Australian Superannuation Scheme has been running since 1992 and has now amassed a total of \$4.1 trillion saved. Because of New Zealand's relatively shallow pool of funds, options around side pocketing or other LMT's could lead to questions regarding the liquidity options for KiwiSaver providers. Side pocketing can reduce the overall liquidity of the fund, making it challenging for some KiwiSaver providers to meet withdrawal demands, especially during periods of high market stress or volatility. This could affect the fund's operational flexibility and reputation.

Given the Discussion Document states that *"LMTs like side pockets and gating are tools of last resort and would only be used if in the best interests of KiwiSaver members,"* BusinessNZ would want any option of last resort to have the most safeguards, being a high-stakes option carrying significant risks and consequences.

Recommendation: KiwiSaver managers are enabled to override KiwiSaver's scheme transfer and withdrawal requirements when necessary to manage liquidity risk, as long as the process to undertake this includes sufficient safeguards and efforts towards a clear understanding by KiwiSaver members.

Proposal 2: Improving private asset visibility in disclosure requirements

If KiwiSaver investment in private assets were to be enabled, then the asset categories outlined in Schedule 4 should be made more visible, in terms of exposure.

The Discussion Document states that the absence of appropriate private asset categories may hamper investment in private and illiquid assets, noting that this may be a problem from the perspective of KiwiSaver managers in relation to the 'reasonableness' of fees, given investing in private assets has proportionally higher costs than other asset classes due to the administrative costs of private asset management and the specialist skillsets required.

To remedy this situation, four options have been identified, namely:

1. Creating a new category for private assets;
2. Modifying existing categories to better include private assets and jurisdictions (so they do not all get listed in 'other');
3. Modifying existing categories and apply categories to the underlying assets; and
4. Adding sub-categories to current categories.

BusinessNZ has no strong views on what option would provide the most optimal outcome. However, when making this assessment we note that the Discussion Document states that the *"options around change ... relate only to the information that is available to KiwiSaver members about their KiwiSaver investments in reports that KiwiSaver providers publish four times a year."* We believe three matters should be safeguarded: ensuring clarity about which private assets the fund is investing in; ensuring the scheme remains easy to understand for KiwiSaver members, and ensuring any changes do not lead to excessive ongoing costs for KiwiSaver managers.

With these safeguards in mind, view option 1 could be seen as potentially not providing enough change, and option 4 could be seen as unnecessarily complicating matters for KiwiSaver members. BusinessNZ believes options 2 and 3 are the best starting point for more consideration.

Recommendation: Government continues working on changes to improve private asset visibility in disclosure requirements.

Proposal 3: Ensuring valuation requirements support private asset investment

BusinessNZ has no comments on this proposal.

Proposal 4: Consideration of the total expense ratio formula

Overall, BusinessNZ supports the disclosure of fees charged by KiwiSaver providers as a way in which KiwiSaver members or the public can better understand if they are getting value for money. We also support a competitive market where KiwiSaver policies provide better outcomes for members through lower fees, improved investment performance and better customer service.

We believe the Total Expense Ratio (TER) is an important tool for KiwiSaver members as it provides a clear measure of the total costs associated with managing their investments, helping them assess whether they are receiving value for money. We

agree with the premise of the TER that ensuring fee transparency supports competition among providers and enables investors to make informed decisions about which KiwiSaver scheme best aligns with their financial goals.

The Discussion Document outlines the possible tension between the TER and the increased numbers of KiwiSaver providers investing in private assets, inviting submitters to outline possible solutions. BusinessNZ would like to see a balance found between maintaining transparency for KiwiSaver members while addressing industry concerns about the TER and its impact on investment decisions. Since fee disclosure is essential for informed decision-making and competition, we believe that any changes should ensure that members continue to understand the full costs of their investments. However, concerns from those in the industry regarding the current TER discouraging private asset investment should also be carefully considered to avoid unintended consequences, which could lead to limiting diversification opportunities or stifling private investment growth.

We believe the Government should prioritise enhancing education and communication around TER rather than immediately altering its calculation. There should be clearer explanations about how fees relate to value for money, returns, and different investment strategies. Additionally, other ways to present TER information should be explored, including separate disclosures for third-party management costs, while maintaining transparency.

BusinessNZ strongly advises that further feedback from industry participants, members, and financial experts should be sought, to help ensure that any decisions in this area support both investor protection and a well-functioning investment market.

Recommendation: Government prioritises enhanced education and communication around TER rather than immediately altering its calculation to take into account investing in private assets.

Other issues

Scaling up to handle investing in private funds

While the option to invest in private assets for KiwiSaver providers might in theory be a step toward broadening the investment base, there are practical considerations regarding fund manager capability that providers need to consider. When fund managers invest in private assets, they typically need more specialised knowledge and skills to properly evaluate, buy, and manage these investments. Fund managers must recognise that private assets are long-term and not easy to sell quickly and must be able to handle cash flow to meet investor withdrawals without causing undue stress on the portfolio.

Managing private assets typically involves more time and effort for research and monitoring, as managers need to closely evaluate the private market, partners, and how the assets are performing. While some KiwiSaver providers may be in a position to begin incorporating private investments into their funds once the process has been approved, feedback from BusinessNZ members tends to suggest that this will not be

the case for many others. It may be the case that some KiwiSaver providers would choose not to incorporate such investments into their portfolio at all, once the trade-off between a broader investment base and the additional time and resources for their business is taken into account.

While we believe most KiwiSaver providers will make an informed judgment regarding whether to invest in private assets, BusinessNZ is concerned at the potential for some providers to decide to begin investing in private assets on behalf of their members without doing full due diligence in investigating the time and resources this could involve.

BusinessNZ believes the Government should, in full consultation with KiwiSaver providers, consider some adequate safeguards against this. One option could be some form of one-off establishment process that KiwiSaver providers would go through to assure the Government that they are fully capable of investing members' funds into these assets. Screening providers for this aspect of KiwiSaver investing would help mitigate broader risks to the retirement savings system by ensuring only capable and well-prepared entities engage in such investments.

The process could provide a check on whether providers have the necessary expertise, resources, and systems in place to handle the complexities of private asset investing, to reduce the risk of mismanagement. It could also provide an opportunity for the provider to clearly articulate their investment approach and demonstrate compliance with regulatory standards, fostering greater trust and accountability in the system.

BusinessNZ recently submitted on another Discussion Document, "*Promoting Competition in New Zealand – A Targeted Review of the Commerce Act 1986*," which includes a chapter outlining the possible future use of industry codes and regulations. The widespread use of the word 'code' refers to a range of approaches, from mandatory government regulations through to voluntary self-regulatory codes, but highlights to us the necessity for the public and private sectors to constructively work together to ensure there are the right amount of checks and balances to ensure the most optimal outcome for the wider economy.

Recommendation: Government works with KiwiSaver providers to consider some form of transparency check on KiwiSaver providers' capability to invest members' funds into private assets.

Kind regards,



Katherine Rich
Chief Executive
BusinessNZ