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DLA Piper submission: Enabling KiwiSaver investment in private assets

This is DLA Piper's submission on the Ministry of Business, Innovation and Employment's (**MBIE**) *Enabling KiwiSaver investment in private assets* discussion document (**Discussion Document**). DLA Piper is a global business law firm with offices in over 40 countries. In New Zealand, DLA Piper operates out of Wellington and Auckland. Contributing authors were Rachel Taylor, Tom Barnes, David Johnston, Boston Flanagan-Connors, Maggie Chen and Aniston Inger-Holland.

Thank you for the opportunity to submit on the Discussion Document. We would welcome the opportunity to discuss our submission with MBIE. For this purpose, we can be contacted at tom.barnes@dlapiper.com.

General comments

KiwiSaver investment in private (or unlisted) assets is not prohibited. Several KiwiSaver providers already invest a proportion of their KiwiSaver funds in private assets — either through their own "in-house" private asset investment vehicles or by investing in externally managed private asset funds.

However, the current regulatory framework (i.e., the KiwiSaver Act 2006 (**KiwiSaver Act**) and Financial Markets Conduct Act 2013 (**FMC Act**)) and regulatory environment (i.e., regulator expectations and perceived risk) act as barriers disincentivising KiwiSaver investment in private assets. We have heard that for some providers, these are so significant that investment in private assets is not considered feasible. We expect that this, together with the relative youth of KiwiSaver, is the reason KiwiSaver funds invest in private assets at relatively lower rates than superannuation and pension funds in comparable overseas jurisdictions, such as Australia and the United Kingdom.

The Discussion Document identifies some of the key concerns preventing more KiwiSaver investment in private assets, namely liquidity and valuation. The Discussion Document also makes several proposals to address these barriers, which we generally support.

While addressing regulatory barriers is important, to effectively encourage KiwiSaver investment in private assets (and so maximise the opportunity this presents for New Zealand), we think it would be helpful to consider it within a broader programme of capital markets, revenue and fiscal policy work. For example, the alignment and support of the relevant regulatory bodies, including the Financial Markets Authority (**FMA**) and the Inland Revenue, is important. Targeted technical tax changes may also be desirable. In our view, this initiative is an opportunity to strengthen other aspects of our capital markets. While these additional matters are outside the scope of the Discussion Document per se, we would encourage a "joined up" approach to embracing the opportunity across different portfolios.

We also acknowledge the discourse highlighting other concerns with KiwiSaver investment in private assets, particularly regarding fees and maintaining KiwiSaver's lauded simplicity. While these are valid concerns, they can (and should) be addressed through effective regulation. We discuss this further in our submission below.

Responses to Discussion Document questions

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.
	N/A.
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)?
	No. Although not explicitly prohibited, we do not think the KiwiSaver Act allows for the effective use of high impact liquidity risk management (**LRM**) tools such as suspensions or side-pocketing. This is primarily because of the obligation in the KiwiSaver Act for providers to transfer members' KiwiSaver accumulations upon request. Under s 56(4), KiwiSaver providers must transfer member KiwiSaver accumulations to the new provider within 10 working days of receiving the member's request, unless otherwise agreed between the providers of the old and new schemes. As the Discussion Document notes, there is no incentive for the new provider to agree to a longer timeframe. As a result, all KiwiSaver schemes effectively have an ongoing contingent liability to fund transfer requests within 10 working days. This is exacerbated by obligations to fund permitted withdrawals contained in the KiwiSaver rules in Schedule 1 of the KiwiSaver Act (such as upon reaching superannuation qualification age or for first home purchases). Although, unlike transfers, permitted withdrawals do not have an explicit timeframe for payment, there is an expectation they will be paid as soon as reasonably practicable. Together, the transfer and withdrawal rules require ongoing liquidity, effectively disallowing suspensions and side-pocketing. For completeness, we note that while s 53 of the KiwiSaver Act prohibits persons belonging to more than one KiwiSaver scheme, the KiwiSaver Act states that this does not limit subpart 3 (transfers between KiwiSaver schemes) (see s 53(2)). Therefore, we do not consider that the prohibition on belonging to multiple KiwiSaver schemes prevents the use of LRM tools and we were attracted to the analysis at paragraph 30 of the Discussion Document in relation to side-pocketing. We think it would be useful if this were set out more explicitly in the KiwiSaver Act.
3	For KiwiSaver managers: If you cannot use these tools, can you please explain the reasons for this and the impacts in terms of: a. your ability to increase investment in private assets b. risks associated with your current allocation of private assets.

	N/A.
4	Please provide any other comments on the availability of liquidity management tools.
	The FMA's *Liquidity risk management guide* sets out the FMA's expectations that managed funds (including KiwiSaver) have appropriate LRM-related policies, processes and tools as a means of meeting their statutory duties (including in ss 143 and 153 of the FMC Act). There is a perception, at least by some, that this emphasis on liquidity makes investment in less liquid investments (such as private assets) more risky from a regulatory perspective. Given providers are highly motivated to avoid adverse regulatory attention, this may have had a cooling effect on enthusiasm for investment in such assets. Therefore, while we support the proposed amendments to the KiwiSaver Act to explicitly allow for the use of LRM tools (see our answer to question 5 below), we think it would also be helpful to review the broader regulatory environment to more positively acknowledge and align with private asset investment in a KiwiSaver context.
5	Do you support the proposed approach? Why/why not?
	Yes, we support the proposed approach to leave most of the current KiwiSaver settings in place (e.g., the 10-working day transfer timeframe and withdrawal settings), but explicitly enable all KiwiSaver managers to override the scheme transfer and withdrawal requirements when it is a necessary step for them to manage liquidity risk of investments. In our view, this is a simple amendment to clarify that LRM tools may be used. This has the benefit of retaining the features of KiwiSaver which give it its simplicity (e.g., members can belong to only one scheme, and retaining mandatory transfers), while introducing some flexibility for KiwiSaver providers to manage assets in distress. This will enable providers to preserve the value of distressed assets (e.g., through side pocketing, redemption gates, suspensions or deferrals) until they are realisable. Ultimately, this will preserve the value of KiwiSaver members' retirement savings. We note that these LRM tools will be used rarely and only in times of extreme market (or asset) distress. Whenever an LRM tool is engaged, the KiwiSaver manager will continue to be subject to its fiduciary and statutory obligations to act in members' best interests, and subject to the oversight of its statutory supervisor and / or the FMA.
6	If redemption gates were allowed, would you consider developing new products more focussed on private assets?
	N/A.
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?
	N/A.
8	Do you have any comments on the detailed design considerations noted above?
	We do not have any specific comment on the detailed design considerations at this time but think it would be helpful to engage further with these as the policy development process progresses. See our other responses for more general comments on design considerations.

9	Please provide any further comments on this issue of liquidity management tools.
	N/A.
Liquidity management tools—questions for the public	
10	Do you support more investment by KiwiSaver funds into private assets? Why / why not?
	N/A.
11	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.
	N/A.
12	Please provide any further comments on the proposed approach.
	N/A.
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.
	Although we do not consider the current asset classes in the Financial Markets Conduct Regulations 2014 (**FMC Regulations**) to be problematic per se, we would support a review of the categories as part of this workstream. There would be implementation costs for those providers that allocate to private assets, but a more explicit recognition of private asset classes in the FMC Regulations' disclosure rules could help KiwiSaver members better understand providers' allocation to those asset classes.
14	How do think the categories should be described?
	We do not have a strong view on how the asset classes should be described but note the following: • **Number of categories**: Fund updates must include an actual asset allocations PIE graph, broken down by these categories.[1] Too many categories will make the PIE graph difficult to read. We suggest that either: the categories should not be significantly increased (to keep the PIE graph readable); or table disclosure is permitted in the alternative to a PIE graph. • **Geographical / country information:** Fund updates must disclose a fund's top 10 investments, including the "country" of each asset. This means that if the holding in a private asset fund / investment is significant enough to make the fund's top 10 investments, the

[1] PIE graphs tend also to be used for the fund updates' target asset allocation, although the FMC Regulations allow a table to be used instead.

	location of that fund / investment will be already disclosed under the existing rules. This may render the need / desirability of including additional geographic information in the categories unnecessary. • **Look-through of related underlying funds:** The top 10 investment disclosure rules currently require a "look through" of "related underlying funds" i.e., those managed by an associated person of the manager. This has a potentially anomalous result in that there is a "look through" of private asset funds managed "in-house" but not those that are externally managed. In the private asset context, we are not sure there is a good policy reason for this difference in treatment. • **Avoid driving asset allocation decisions:** Although the use of the FMC Regulations' categories to set a fund's asset allocation targets and ranges is not mandated by the law, it is a tidy and convenient way of describing those ranges (e.g., in the SIPO and for limit break purposes). In our experience, it is not unusual for managers to use the categories in this way. In making any changes to the categories, or adding new categories, it may be wise to be mindful that this may affect how asset allocations are set and described.
15	Please provide any other comments on the lack of private asset categories.
	N/A.
16	Which option do you think is best and why?
	See our response to question 14 above.
17	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?
	N/A.
18	Please provide any further comments on this issue of including private assets in asset categories.
	N/A.
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?
	N/A.

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.
	N/A.
21	Please provide any other comments on the valuation methodologies in governing documents.
	Trust deeds – valuation rules and amendments In our experience, most modern trust deeds have the facility for the manager to agree an alternative valuation methodology with the supervisor for any given asset or asset class. We would expect this facility to be available and used for most private asset types where the default valuation methodology hard-coded into trust deed (e.g., a market price for listed securities) is not suitable. Where that facility is not already available, we would be surprised if amending the trust deed to introduce it would be considered to have a "material adverse effect" on members.[2] The amendment would simply introduce flexibility to allow an appropriate valuation methodology to be agreed. It would not mandate any particular methodology be adopted or necessarily result in the fund then being invested in any particular way. To the extent there is a residual concern about the ability to amend trust deeds to introduce appropriate valuation methodologies for private assets, one way this could be addressed is through regulatory guidance clarifying that such amendments do not have a "material adverse effect" on members and so are permissible. Alternatively, the power to make FMA-approved deed amendments[3] could be liberalised to allow changes to be sought and approved in a broader range of circumstances. **An acceptable / safe way to value private asset investments** We see the potentially more challenging issue as being the absence of sufficient certainty about what valuation methodologies (or range of valuation methodologies) for private assets are acceptable and safe from a legal and regulatory perspective. Without that certainty, a manager could see too much risk investing in private assets and avoid the asset class. The solution may be valuation methodologies or principles that have regulatory endorsement. Given valuation is a highly technical area, the details may be best developed by industry and expert valuers, in consultation with the supervisors.

[2] For the purpose of supervisor consent to the deed amendment under s 139(2)(a)(ii), FMC Act.
[3] Under s 140(1)(a), FMC Act.

	We note that private assets valuation has received focus because of concerns about "incorrect" valuations transferring value (e.g., between transacting vs. non-transacting members). We agree valuation is an important issue, but we think any such concerns about private asset valuations need to be viewed against the following context: • **Valuation uncertainty exists for all kinds of assets:** All assets are subject to valuation uncertainty. Market prices for listed assets are subject to market liquidity and change daily. Fixed-income securities can fluctuate based on movements in interest rates and changes in credit quality. Written down investments in failed or distressed businesses can generate windfall gains if assets are sold. KiwiSaver members are exposed to these risks today and the regulatory environment appears to consider them acceptable. There is no perfect valuation — only one that is reasonable in the circumstances. • **Private assets will only comprise a portion of a portfolio:** Even for the most aggressive KiwiSaver investment strategy, private assets would only comprise a portion of a fund's portfolio. Any valuation uncertainty in that private asset allocation would therefore only have a proportional effect on overall portfolio value. For example, for a 10% allocation to private assets, a 20% fluctuation of the value of the private asset allocation would have a 2% effect on overall portfolio value (which, for context, is approximately the change in the value of the S&P 500 index over the last month). • **KiwiSaver is a long-term investment:** KiwiSaver is a long-term investment vehicle, with a specific retirement purpose. It follows that emphasis might be better placed on a long-term view on financial performance rather than a focus on daily pricing "accuracy".
22	Do you agree that this is an issue that needs addressing?
	See above.
23	Do you have views on how it should be addressed?
	See above.
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?
	N/A.
25	Please provide any further comments on this issue of valuation requirements.
	See above.
Total Expense Ratio—questions for KiwiSaver providers or other industry	
26	Do you currently outsource fund management for private assets?
	N/A.
27	Do you see any issues with the current TER calculation and if so, what are they?

	See below.
28	Does the current TER calculation impact your decision to invest in private assets, or to utilise third-party fund management?
	N/A.
29	Are there any other issues you would like to draw attention to on the TER?
	Operating costs The TER[4] rules create some uncertainty about the need to include the operating costs of private assets (e.g., maintenance costs) in the calculation. This is undesirable because it could disincentivise private asset investment due of the risk of needing to increase reported TER, lead to inconsistent approaches between providers, incur additional structuring costs to add certainty or result in providers taking on unnecessary regulatory risk. The TER rules or regulatory guidance about those rules could helpfully be reviewed to add certainty and remove this potential distortion. The components of the TER include "*management and administration charges*",[5] defined as "*fees and costs charged by any person in respect of the fund or an underlying fund that affect investors in proportion to their interest in the fund*". Private assets (e.g., infrastructure, direct real property or operating businesses) can incur operating costs (e.g., development, maintenance and general operating costs). There is an argument that those are "*costs charged by [a] person in respect of the fund or an underlying fund that affect investors in proportion to their interest in the fund*" so need to be included in the TER, making the fund look relatively more expensive. The FMA has issued guidance[6] on what "*management and administration charges*" are, and what an "*underlying fund*" is. This is helpful and goes some way to addressing the issue. However, the guidance obviously predates the current initiatives to encourage private asset investments. There could be benefit in reviewing that guidance to deal with private assets investment more explicitly or reviewing the rules to ensure that the inclusion of asset operating costs in the TER is dealt with more clearly. **Carried interest** For most private equity and venture capital funds, it is typical for the investment managers to be paid a performance fee in the form of "carried interest" on returns above a hurdle "preferred" rate. That will either be a "*performance-based fee*"[7] or form part of the "*management and administration charges*" under the FMC Regulations (depending on whether investment management is conducted in-house). In either case, it will form part of the TER that needs to be disclosed in the PDS and a "best estimate" of expected carried interest would need to be assessed.[8]

[4] We assume the Discussion Document uses TER to reference the FMC Regulations' concept of "fund charges" (cl 2(1), Sch 4, FMC Regulations) rather than "synthetic total expense ratio" (cl 53(3), Sch 4, FMC Regulations) given fund charges are used as the headline fee figure in public facing disclosures (PDS, fund updates, Sorted's fund finder).
[5] Defined at cl 2, Sch 4, FMC Regulations.
[6] FMA Guidance note: Fee disclosure by managed funds (May 2016 as amended July 2017).
[7] Defined at cl 2, Sch 4, FMC Regulations.
[8] Or, more accurately, the "annual fund charges"; per cl 32(2)(b), Sch 4, FMC Regulations.

	Although the FMC Regulations does provide for how the best estimate of performance-based fees can be calculated,[9] that provision is unlikely to be helpful for estimating carried interest given the uncertainties in estimating future carried interest. It might be useful to give consideration to how carried interest should be treated for the purposes of complying the FMC Regulations' fee disclosure rules.
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?
	N/A.
31	What do you think should be included in any figure that is called "KiwiSaver scheme fees"?
	N/A.
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.
	N/A.
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).
	In order to enable a KiwiSaver scheme to invest directly in private assets it will also be necessary to review the relevant tax settings. In particular, even if regulatory changes are made to enhance the ability for KiwiSaver funds to invest in private companies, the current tax framework may still restrict them from doing so. KiwiSaver schemes are almost always Portfolio Investment Entities (**PIEs**), including all of the default Kiwisaver schemes. Compliance with the PIE tax rules is critical for their continued operation. One of the requirements to qualify as a PIE is that the scheme must not have a shareholding in an underlying company that exceeds 20% of the value of an underlying company. Specifically, section HM 13 of the Income Tax Act 2007 (**ITA**) states that where a PIE has an investment consisting of shares in a company (other than shares in a PIE, a foreign PIE or land investment company) the investment must not carry voting interests or market value interests of more than 20%. This may present a problem for a KiwiSaver scheme that makes investments in private assets. It is generally necessary for a private investor to have the ability to hold more than 20% of the voting rights or market value interests. This is partly because, in order to maximise value or obtain an exit, an investor will want some control over liquidity, usually a controlling interest in a

[9] Clause 32(4), Sch 4, FMC Regulations provides that performance-based fees can be calculated on the assumption the fund will achieve the long term average returns of the market index against which fund performance is benchmarked in fund updates.

	company (i.e., 50% or more). In addition, corporate actions (such as capital raises or share buy-backs) can inadvertently result in a private investor holding more than 20% of the shares. Even if two or more KiwiSaver funds invest in an underlying company or investments are made into private equity funds that hold the underlying investments, this may still present an issue. In order to resolve this issue, we would recommend the relevant 20% threshold in the PIE tax rules is lifted to something above 50% ownership. This will no doubt require consultation with the Inland Revenue.
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.
	Eliminate barriers; but no compulsion We do not think there should be any compulsion of KiwiSaver investment in private assets. Managers should be free to make their own decision about whether to allocate to private assets in accordance with their duties to investors. Members should be free to choose to invest with manager and in funds that have those allocations. We think the objective of any reforms should be to identify and eliminate the barriers to that occurring so that the decision to allocate (or not) is based, as far as possible, on genuine investment / commercial judgment — rather than being influenced by regulatory factors. **Insourcing vs. outsourcing – neutrality** A manager allocating to private assets might either choose to invest with an (external) third party private asset manager or might establish their own (internal) in-house capability. Both models operate in the market. We would suggest that, to the extent possible, any changes to the regime should seek neutral treatment between those two models i.e., one should not be subject to materially greater regulatory impediments than the other. In this respect, we note the FMC Act's related party transaction rules[10] would generally apply to the insourced but not outsourced models. Those rules are not clear and have been the subject of significant debate within the industry over the last 6–12 months given the regulatory risk attached to non-compliance. This creates a potential distortion between the insourced and outsourced models. While the related party transaction rules are out of the scope of the Discussion Document, we do think considering these rules would, in time, be a useful (and potentially necessary) extension of the policy work on private assets investment. **Supporting NZX listings (or other secondary markets)** Pricing and liquidity are the most significant issues raised by private asset investment. They are also issues markets solve elegantly. We note and commend the policy work underway on other aspects of strengthening New Zealand's capital markets, including reforms that could benefit the NZX,[11] and see there is opportunity to link the two workstreams. Listing a private asset on a secondary market, such as the NZX, could have a number of benefits. The market could help provide price discovery (valuation) and liquidity (market depth, especially

[10] Sections 172-177, FMC Act and regs 100-106B, FMC Regulations.
[11] MBIE's [2024-25 Capital Markets Reforms | Ministry of Business, Innovation & Employment](#).

	with the assistance of market makers). The listing would extend the options available to investors on the market and potentially strengthen the reputation of the market more generally. Listing a private asset fund that raises capital and deploys it into multiple underlying investments could be a further step which would help with the diversification of risk and the concentration of expertise (addressing the "capability" issue mentioned in the Discussion Document). An issue that has been mentioned is that even with facilitative regulatory settings, providers would still need to voluntarily enter the sector. They might not do so, or might not do so at sufficient scale to justify the initiatives, without the right incentives. Looking overseas, the United Kingdom has had a series of tax schemes in place since the mid-1990s to encourage investment in listed venture capital funds (the Venture Capital Trust regime[12]). We understand that scheme has been a success. While the right settings for incentives in the New Zealand environment (if any) would need careful consideration, there could be merit in considering a broader range of policy work to support the proposals set out in the Discussion Document.

Yours sincerely

DLA Piper New Zealand

[12] For an overview see: Venture Capital Trusts: Introduction to National and Official Statistics - GOV.UK.