

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. <i>Mercer believes there can be return and portfolio diversification benefits gained from investing in private assets. Mercer adopts a manager of managers investment approach, and through this its KiwiSaver Funds have exposure to unlisted assets such as property, fixed interest and infrastructure. Holdings are limited to those that are considered to be relatively liquid.</i>
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)? <i>In theory these tools are available for use within a 10-business day period; however, in practice the current legislative framework prohibits their use.</i> <i>Consideration also needs to be given to future transfer regulations, where these are made in relation to the transfer of default members and their accumulation balances. Such regulations should provide for liquidity management tools to be utilised if required, to enable the orderly transfer between KiwiSaver providers. This may mean a more flexible transfer arrangement than has historically been allowed for.</i>
3	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. <i>The Discussion Paper outlines the key reasons.</i> <u><i>Side-pocketing:</i></u> <i>s56(4) of the KiwiSaver Act – We are of the view the legislation needs amending to enable the existing manager to decide whether funds can be side-pocketed, rather than for both the existing and new manager to agree. The current setting creates too much uncertainty whether side-pocketing could ever be used.</i> <i>s53 of the KiwiSaver Act – It is noted (paragraph 30) MBIE do not believe side-pocketing would result in a breach of the requirement that members can only be a member in one scheme. Our view is greater clarification is required within legislation.</i> <u><i>Redemption gates</i></u> <i>The issues relating to side-pocketing above may also apply to redemption gates.</i> <i>These legislative settings limit the type and quantum of private assets managers are willing to invest into.</i>
4	Please provide any other comments on the availability of liquidity management tools. <i>The discussion about private assets aside, in general, permitting more tools to be available should they ever be required to manage stressed liquidity events is arguably in all investors' best interests. Their availability would make managing such events more orderly.</i>
5	Do you support the proposed approach? Why/why not?

	<i>We support the proposed approach as outlined under paragraph 47. We believe this is a practical solution, and importantly requires any override of scheme transfer and withdrawal requirements to be clearly disclosed to investors. However, consideration needs to be given to word limits within PDS' when drafting the requirements for the extent of disclosure.</i>
6	If redemption gates were allowed, would you consider developing new products more focussed on private assets? <i>For KiwiSaver members, we see inclusion of private assets as a component of a well-diversified portfolio. Whether this would result in a separate diversified fund, allowing investors to build their own asset allocations, or inclusion in existing KiwiSaver portfolios would require further consideration.</i>
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? <i>We would require changes to the trust deed to allow for side-pocketing, and a change to the offer documentation, including as they relate to the proposed conditions for the use of redemption gates and side-pocketing. We also expect changes to systems to be required.</i> <i>There would also be costs in portfolio set up where new private assets are included.</i>
8	Do you have any comments on the detailed design considerations noted above? <i>We agree with the expectation that use of liquidity management tools such as side-pocketing or redemption gates be clearly explained to investors. This will require managers to educate investors what it would mean in practice to the accessibility of their funds should such tools be deployed. This should go beyond disclosures in SIPOs and PDS' to areas that investors are more likely to routinely access such as a manager's website.</i>
9	Please provide any further comments on this issue of liquidity management tools. <i>The inclusion of redemption gates and side-pocketing would also provide additional tools for managing illiquid assets where KiwiSaver members wished to move between investment options within the same scheme. This would also likely assist product development. At the moment, these situations are unlikely to be provided for within trust deeds due to the reasons outlined within question 3.</i>
Liquidity management tools—questions for the public	
10	Do you support more investment by KiwiSaver funds into private assets? Why / why not?
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.
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.
	<i>Whether they are currently problematic depends upon the nature of each fund. However, in many cases we believe amending the categories will provide better information for investors.</i> <i>For example, listed property and unlisted property currently separately exist as categories, but the same unlisted/listed distinction does not apply to equities. This means assets such as listed and unlisted infrastructure, and other private equity opportunities are lost in the 'other' bucket or within equities. As noted above, different assets have different risk characteristics. We would expect investors would benefit from more transparency.</i>
14	How do you think the categories should be described?
	<i>In principle we believe it is better to provide as much transparency about where funds are invested as possible; however, this needs to be balanced against materiality and logistical requirements when presenting information within Fund Updates. For example, being too granular will present difficulties creating pie charts as required by clause 68 of Schedule 4 of the FMC Regulations.</i> <i>It would be helpful for agreed terminology for inclusion of assets under the categories used.</i>
15	Please provide any other comments on the lack of private asset categories.
16	Which option do you think is best and why?
	<i>Assuming the option includes the sub-categories included with the brackets of each asset class, we believe Option 2 is the best. This provides investors with:</i> <i>the asset classes their fund invests into and whether this is global or domestic</i> <i>information about some liquidity characteristics of these assets</i> <i>Under fixed interest, we recommend the 'unlisted' be relabelled or at least clarified. For example, what is more important in this context is the assets liquidity rather than to reflect whether it is listed on an exchange.</i>
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?
	<i>While we expect any implementation costs to be manageable and one-off, as there are other parties involved in the source data (e.g. custodians, third party systems), we suggest further consultation prior to any final decision on asset class classifications.</i>
18	Please provide any further comments on this issue of including private assets in asset categories.
	<i>There is a significant risk spectrum when investing into private assets e.g. Unlevered Core Real Estate is low risk, Venture Capital is very high risk. Bucketing all assets together may not provide investors with an appreciation of the risks being taken. Diversification and transparency around 'single asset' risks are important, particularly if standalone investment options are made available within KiwiSaver.</i> <i>Leverage can significantly alter the risk of a private market asset. Investors should therefore be able to assess the 'look-through' leverage of a fund/investment.</i> <i>In relation to option 4, under paragraph 59, please see our comment below within question 33.</i>

Private asset categories—question for the public

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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

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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.

We do not anticipate a need to amend our trust deed as it relates to valuation methodology. We expect other disclosure documentation will require updates.

21

Please provide any other comments on the valuation methodologies in governing documents.

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Do you agree that this is an issue that needs addressing?

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Do you have views on how it should be addressed?

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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?

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Please provide any further comments on this issue of valuation requirements.

The FMA issued a guidance sheet in 2018, "MIS manager valuation and pricing practices". In the context of the discussion on private assets, it may be useful to update this guidance to further consider types of private assets (such as private debt, private equity, and unlisted real assets). Unlike listed assets that have observable market prices, private assets valuations are subject to different methodologies. Different valuation methods could have a significant impact on the recorded asset value; this could lead to difficulties for investors fairly comparing returns amongst funds. Industry accepted guidelines could be considered within FMA guidance, such as the International Private Equity and Venture Capital Valuation Guidelines (IPEV) for private equity.

Total Expense Ratio—questions for KiwiSaver providers or other industry

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Do you currently outsource fund management for private assets?

Yes. Mercer uses a multi-manager investment approach.

	Do you see any issues with the current TER calculation and if so, what are they?
27	<i>Our view is transparency is important for investors, regardless of whether private assets are included or not.</i> <i>If managers have concerns about higher fees discouraging investors investing into funds with private assets, they will need to be able to provide additional education and communication about the rationale for allocation to such assets. To assist with this, consideration could be given to separating the fee components of a TER based upon private assets and listed assets. This would then disclose the fees attributed to private assets.</i>
28	Does the current TER calculation impact your decision to invest in private assets, or to utilise third-party fund management? <i>No. Asset allocation decisions are made, after consideration of fees, on what will provide the optimal risk/return outcome for investors given the objective of each investment option.</i>
29	Are there any other issues you would like to draw attention to on the TER? <i>Default KiwiSaver funds are assessed to have a number of features, with one of them being low fees (https://www.fma.govt.nz/consumer/kiwisaver-and-superannuation/about-kiwisaver/kiwisaver-default-funds/). Default fund members by definition are not active in their investment choice, and often remain long-term in the defaulted investment option. Notwithstanding the potential transfer problems we mentioned under question 2, default members are likely to benefit from private assets exposure within their portfolio, and consequently may be at a long-term disadvantage if excessive weight is placed on fees when selecting default providers. It will also either discourage default providers from including private assets within their balanced portfolios, or alternatively will mean two balanced funds will be offered side-by-side, which is neither efficient nor likely to be in default members' best interests.</i> <i>Related to this focus on fees, is the requirement under Schedule 1 of the KiwiSaver Act 2006 that fees must not be "unreasonable". Managers must continue to make decisions in the best interests of investors, and consequently should only include private assets within a portfolio should there be expected benefits. However, what constitutes "unreasonable" is open to interpretation and could be judged improperly if value is viewed backward looking and over short time periods. More guidance or a definition of the term "unreasonable" within the Act would provide clarification and therefore further confidence to invest in private assets.</i>
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).
	<i>Paragraph 18(e)</i> <i>The discussion document generally refers to private asset opportunities, without making a distinction whether this is within New Zealand or overseas. However, we understand one policy motivation is to make capital available for New Zealand businesses (paragraph 6). It is important that fund managers are able to pursue the best opportunities available for investors, regardless of the domicile of the investment.</i>

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.
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