

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	
	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. Mindful Money is a charity providing transparency on KiwiSaver and other investments. We undertake research, public education and provision of information to promote ethical and sustainable patterns of investment. We are responding to questions for KiwiSaver managers drawing on a project based on a survey and forum undertaken with 13 leading KiwiSaver managers on boosting investment that has a positive impact on the New Zealand economy. Increasing KiwiSaver investment in private capital was an important focus for the report, Mainstreaming Impact Investment, published last year.
1	The survey included the KiwiSaver providers with the highest proportion of investment in private capital. They were confident in managing liquidity, using stress testing and sound liquidity management, but were unsure what level of private capital would be acceptable to the regulator. They were apprehensive about being picked out for regulatory action, and wanted greater clarity in guidelines for acceptable levels of private capital. Other fund managers with little or no investments in private capital were interested in making investments but were wary about potential regulatory risk, as well as constraints around capacity, capability and costs. The FMAs guidance on liquidity management was considered helpful, but not sufficiently clear about the acceptable level for illiquid or partially illiquid investments. They were seeking greater clarity around the threshold for regulatory action.
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)? There was uncertainty about the scope for liquidity management tools such as side pocketing. Generally, it was considered that the use of these tools would need changes in legislation.
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.

a). A lack of familiarity with private capital is a constraint for both smaller and larger providers. The terminology, concepts and cultures are different between the worlds of listed securities and private capital, with differences between early stage financing, private equity/debt and direct investment in SMEs.

Investment management skills required for portfolios of listed securities are different to unlisted securities, requiring capabilities in areas such as business development, early stage capital raising, balance sheet structuring, valuation and cash management. A major difference is also in the level of quantified information available on listed securities, primarily through the major research providers such as MSCI, Sustainalytics and S&P Global - the same level of quantified information is not available for unlisted companies..

In addition, the dynamics of early stage financing, with initial losses followed by the potential of higher returns, is challenging for fund managers that operate in listed markets.

Outsourcing management to private equity managers or venture capital managers is an option, but it introduces a new layer of costs, and there is still a need to manage those investments, with requirements for expertise in investment evaluation, valuation, liquidity management and ongoing monitoring and management.

Most KiwiSaver providers will be able to overcome these barriers, but support and greater regulatory certainty would help.

b). While such legislative changes were considered potentially helpful, it was recognised that there are opportunities to significantly increase private capital investment if there was greater clarity and certainty about the acceptable thresholds from the regulator.

For some fund managers using sound liquidity management, there was confidence that investments in illiquid or partially illiquid assets of up to 20% of KiwiSaver portfolios would pose only minor risks, and they could be managed.

It was also recognised that the level of liquidity is changing with new initiatives to create secondary markets for private assets, such as through the Catalist platform. There was support for extending the opportunities to provide exit opportunities through forms of trading in unlisted assets.

Please provide any other comments on the availability of liquidity management tools.

4

Liquidity management tools are available but are complex in their design and use. Guidance and greater regulatory certainty are essential.

5

Do you support the proposed approach? Why/why not?

	We support in principle, but with provisos. • A heavy reliance on technical information disclosure, as is proposed, is not likely to be an effective way to protect the interests of investors, particularly individuals with low levels of financial literacy and experience. Already, few individual investors read PDS documents and even fewer understand the disclosure documents sufficiently to enable them to make informed investment decisions. Rather than technical information in investment documentation, there should be visible, easily accessible information displayed prominently on offers, website and applications forms, specifically pointing out that the product may not be available on short notice to those withdrawing funds for hardship reasons, first home purchase or retirement. • More information by itself will not be sufficient to protect them from adverse outcomes, particularly on issues like side pocketing that are not well understood by many finance professionals, let alone members of the public. There need to be clear boundaries around the provision to “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.” This provision has the potential to be misused, for example to allow side pocketing where a valuation of a private investment was low. The provision should only be used for liquidity management, not to avoid losses in private investments. A system of monitoring the use of side pocketing, with clear conditions, criteria and boundaries, will be essential. This may require a detailed process for opting in to the use of side pocketing.
6	If redemption gates were allowed, would you consider developing new products more focussed on private assets? The feedback received from the survey undertaken by Mindful Money supported flexibility around withdrawals. This is not unfamiliar to many fund providers. Varying periods for withdrawal from certain funds is already a part of some non-KiwiSaver managed investment schemes. These generally provide for longer periods in unusual circumstances or periods of extreme market volatility. Clear conditions, criteria and boundaries would be required to protect KiwiSaver investors, many of whom are less knowledgeable and experienced, and with smaller fund balances than investors in non-KiwiSaver managed funds.
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? Not discussed.
8	Do you have any comments on the detailed design considerations noted above? see above comments.

9	Please provide any further comments on this issue of liquidity management tools.
	Support for fund providers and the broader financial sector through clear information, training and guidance will be essential. Simple and accessible information for retail investors is also essential. Dense financial information in PDS and other documentation is not sufficient.
Liquidity management tools—questions for the public	
10	Do you support more investment by KiwiSaver funds into private assets? Why / why not?
	Yes, for the following reasons: - As noted in the UK's Mansion House initiative, the incorporation of private assets in long term investment portfolios will, on average, increase financial returns. Currently KiwiSaver investors are missing out on returns from the inclusion of private capital as an asset class in their investments. - Private capital investments have the potential to contribute onwards positive outcomes for New Zealand's economy, society and environment, as outlined in Mindful Money's report. There is generally a more direct contribution to positive outcomes from investment in early stage, innovative and smaller companies than from investments in listed securities.
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.
	Yes, if they enable private capital investment. The proviso is that they are well-regulated, managed and monitored to protect the interests of KiwiSaver investors. The addition of more technical information in PDSs and other investment documentation is not effective in informing and educating the public. Any introduction of liquidity management tools must be accompanied by clear, simple and accessible public information.
12	Please provide any further comments on the proposed approach.
	The aim of regulation should be to ensure good outcomes, such as protection of the small investor, not compliance for its own sake.
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.
	They are problematic because they do not provide adequate information to investors on an important distinction between asset classes.
14	How do think the categories should be described?

	There should be identification of investment in private capital, and specifically private capital investment in NZ. Terminology will be difficult, given the range of different forms of listing of financial assets. Listed generally refers to listing on the NZX, but over time there is likely to be alternative exchanges with less onerous requirements, but with opportunities for regular trading. The Catalist platform is an example. Consideration should be given to recognising other categories than listed or unlisted.
	Please provide any other comments on the lack of private asset categories.
15	This is becoming more of an urgent issue with the growth of private capital investment in KiwiSaver funds.
	Which option do you think is best and why?
16	Some variant of option 4 that provides the identification of investment in private capital, and specifically private capital investment in NZ.
	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	This issue was not discussed in Miindful Money's research, but we would expect that costs are likely to be low.
18	Please provide any further comments on this issue of including private assets in asset categories.

Private asset categories—question for the public

	Do you think it would be useful to have better visibility over how much KiwiSaver funds are investing into private assets?
19	Yes. The information is important for a range of reasons, including for those investors that may have concerns over risks to their ability to immediately withdraw their funds, and to those wishing to invest more in 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: - the extent to which your governing documents require amendments to allow for the inclusion and pricings of private assets within your funds. - 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.
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	This was raised as an issue in our survey only by a few fund providers.
21	Please provide any other comments on the valuation methodologies in governing documents.
22	Do you agree that this is an issue that needs addressing?
	Do you have views on how it should be addressed?
23	Periodic valuation is already provided by most unlisted companies. Valuations are updated and investors informed where there have been significant events that change the company valuation. There should not be a problem with such a system, provided there are conditions applied that require periodic reporting and valuation updates to KiwiSaver providers.
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?
25	Please provide any further comments on this issue of valuation requirements.
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?

The higher fees associated with investment in private capital was considered a major constraint by fund providers surveyed.

The context is that, in recent years, there has been intense pressure on KiwiSaver fund providers to reduce their fees. This has included criteria in the selection of default KiwiSaver providers, publicity from Sorted, statements from the FMA and media commentary.

The pressure can lower fees, but this is not the same as providing value for money. Low KiwiSaver fees are increasingly achieved by investing in large scale passive funds. But KiwiSaver providers with other approaches to investment are being penalised and by this narrow focus on low fees. It would be helpful if the focus was on value for money.

The low fees mantra is a major reason for low investment in private capital. KiwiSaver providers are wary about increasing the proportion of private capital in their portfolios because it invariably requires higher cost for management and higher fees.

The emphasis on low fees also encourages a lack of research by KiwiSaver providers, including on the real world implications of their investments. It is cheaper for them to invest in simple indexes that include harmful companies than to choose portfolios that avoid those companies. Most New Zealanders want to avoid harmful investments such as weapons, gambling, companies that violate human rights and fossil fuel producers, but the drive for low cost indexes means there are fewer options available to them.

It is also cheaper to take shortcuts on their corporate governance responsibilities. KiwiSaver providers should engage with companies in their portfolio on ESG issues as part of their investment management role. The drive for low fees means few investment providers have the capacity to fulfil their responsibilities.

The solution is not to amend the fees calculation, as a way to hide fees for private capital. Full disclosure of fees is essential for transparency and accountability. There is a responsibility for agencies such as the FMA, Sorted and others, as well as KiwiSaver providers, to contextualise their advice to investors and focus on value for money rather than low fees. It is the level of after fee returns that are important to consumers, not the level of fees.

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

Total Expense Ratio—questions for the public

Do you look at KiwiSaver scheme fees when deciding which KiwiSaver scheme to put your money with?

30 Mindful Money informs, educates and engages with retail investors. Over 400,000 Kiwis have used our research. We provide information on fees on our website, as well as returns after fees and risks. We note that past returns after fees are not always an indicator of future returns, but it is information that many investors find helpful.

	We encourage investors to consider a range of factors in their investment decision, including the ethical and sustainability impacts and long-term returns after fees. These are part of the value of the investment, rather than just a focus on fees.
31	What do you think should be included in any figure that is called “KiwiSaver scheme fees”? The full costs of managing and operating an investment scheme, including costs such as management fees, including staffing, outsourced services and overhead costs, marketing and distribution costs, including commissions, and additional expenses, such as trading fees, legal fees, auditor fees, and other operational expenses.
	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. The full disclosure of fees, such as provided in the TER, is essential for transparency and accountability.
Final comments—question for KiwiSaver providers or other industry	
32	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).
	See comments above on other issues, including capability and capacity, the role of the regulator and financial literacy.
Final comments—question for all respondents	
33	Please use this question to provide any further information you would like that has not been covered in the other questions. Mindful Money’s primary interests in promoting private capital investment in KiwiSaver is to increase risk adjusted returns for KiwiSaver members, and to expand the pool of capital available for investment in meeting the challenges we face - such as investing in renewable energy and other climate solutions, in social housing, and in nature regeneration. Many of these assets, such as infrastructure and social housing, have the potential to provide stable and predictable returns over the long term, providing ideal investments for retirement funds. The use of private capital for public good would be enhanced by accompanying policies such as electricity market reform, government guarantees for community Housing Providers and biodiversity credits. However, we have concerns that the promotion of private capital in KiwiSaver funds will become a tool for financing the privatisation of state assets. We consider that most retail investors would be concerned if their investments were used for this

purpose, and we would oppose any legislation or regulations that aim to promote private capital for privatisation.

International experience with privatised state assets shows that a large number of projects that have been subject to a high degree of regulatory and political risk, making them unsuitable for retirement savings.