MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HIKINA WHAKATUTUKI

TE TAI ŌHANGA
THE TREASURY

Review of the KiwiSaver Default Provider Arrangements

Discussion paper

August 2019

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The Treasury and the Ministry of Business, Innovation and Employment (MBIE) seek written submissions on the questions raised in this document by **18 September 2019**.

Your submission may respond to any or all of the questions. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

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Financial Markets Policy
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Ministry of Business, Innovation & Employment
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Wellington 6140
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How we will use your submission

The information provided in submissions will be used to inform the Treasury and MBIE's policy development process, and will inform advice to Ministers on the options for the default provider arrangements. We may contact submitters directly if we require clarification of any matters in submissions.

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Contents

Foreword

KiwiSaver helps New Zealanders enjoy the best retirement they can by providing an easy and affordable way to save for their retirement. Many New Zealanders are automatically enrolled in KiwiSaver default funds when they start a new job. After 10 years of KiwiSaver, we now know that many of these default members are not engaging with their KiwiSaver accounts and making active decisions about their retirement savings in the way that had been expected. A significant number of people have stayed in default funds. This means that it is important that default funds work well for people.

There are currently nine default KiwiSaver providers, and their terms of appointment expire on 30 June 2021. Before we start the process next year to appoint new default KiwiSaver providers, we want to make sure that we have the right settings for the default funds.

This discussion paper sets out options for the default fund settings. It seeks your views on how default members' savings should be invested, and whether there should be a change to invest more heavily in growth assets.

We also want to hear about default providers' fees. Fees and returns can make a big difference to how effective the funds are at providing for peoples' retirement, and we want to ensure that default members get a value-for-money service. This paper seeks your views on ways to achieve this.

The review also explores whether there is a role for KiwiSaver default funds in developing healthy capital markets in New Zealand. We also ask whether KiwiSaver default funds should be required to invest ethically, or provide clearer and consistent information to members about their approach to ethical or responsible investment.

The settings for default funds can make a big difference to retirement outcomes. We encourage you to give us your views on the future for KiwiSaver default funds.

Hon Grant Robertson

Minister of Finance

Hon Kris Faafoi

Minister of Commerce and Consumer Affairs

1 Introduction

1. When you start a new job, you are automatically enrolled in KiwiSaver if you are between the ages of 18 and 65. Unless you opt-out or actively choose a fund, you will be randomly allocated to a default fund. Approximately 715,000 people remain in default funds. 430,000 of those have not made an active choice to stay there. This is approximately 15% of all KiwiSaver members and approximately 34% of all automatically enrolled members.[1]

2. The providers are appointed by the Minister of Finance and the Minister of Commerce and Consumer Affairs (the Ministers).[2] The Ministers may make appointments subject to terms and conditions, which are set out in each default provider's instrument of appointment.

3. There are currently nine providers of default funds. The providers are AMP, ANZ, ASB, BNZ, BT Funds (Westpac), Fisher Funds, Booster, Kiwi Wealth (Kiwibank) and Mercer. The term for the current providers expires on 30 June 2021. MBIE and the Treasury anticipate that the procurement process for appointing new providers will start in early 2020.

4. Ahead of that, MBIE and the Treasury are reviewing the default provider settings. The review covers the policy settings that underpin the appointment of new providers and the terms on which those providers are appointed. Other matters (for example, contribution rates, compulsory enrolment in KiwiSaver, membership in more than one scheme) are outside the scope of the review.

Purpose and structure of this paper

5. In this paper, we seek your feedback in relation the current default provider settings. Feedback on this paper will be used to inform recommendations to Ministers in relation to the default settings.

6. This paper first seeks your feedback on a proposed objective and proposed criteria for assessing the options for the review. It then seeks your feedback on the investment mandate that should apply in relation to default funds. Finally, it seeks your feedback on a range of other matters, including fees; number of default providers; responsible investment; development of New Zealand's capital markets; transfer of members after appointments are made; and other requirements for default members (including member education).

1 Approximately 285,000 more people have actively chosen to remain in a default fund. In this paper, the term "default members" does not include people who have made an active choice to remain in a default fund (for example, they told their default provider that they wished to stay in the default fund).

2 Under section 132 of the KiwiSaver Act, the Ministers of Finance and Commerce and Consumer Affairs (the Ministers) may appoint one or more managers (default providers) for a specified term to provide default investment schemes and default investment products. In determining whether to appoint a manager as a default KiwiSaver provider, the Minister must seek the advice of the Financial Markets Authority.

2 Objectives and criteria for the review

7. We seek your feedback on our proposed objectives and criteria for the review.

Objective for the review

8. The purpose of the KiwiSaver Act 2006 provides the starting point for determining the review's objectives. The purpose of the Act is to "to encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement. The Act aims to increase individuals' well-being and financial independence, particularly in retirement, and to provide retirement benefits".

9. The purpose of the Act is focussed on individuals and ensuring their financial well-being. This is particularly important in relation to default members, who have not made financial choices in relation to their default fund status.

10. We propose that the main objective of the review is to enhance the financial well-being of default members, particularly at retirement.

11. This objective is consistent with the Treasury's Living Standards Framework. Meeting the objective would involve growing New Zealand's financial/physical and human capital but could also have impacts for other domains in the Living Standards Framework.

1	What is your feedback on the proposed objective for the review?

Criteria for the review

12. We seek your feedback on criteria for the review, which have been developed from the objective above. The criteria would be used to assess how well each option achieves the objective of the review and whether other important policy objectives can be achieved alongside the overall objective of the review. The criteria would apply to a package of options and not all of the criteria will be applicable to every decision required for the review.

Criterion 1: Better financial position for KiwiSaver default members, particularly at retirement

13. If default members are in a better financial position, they are more likely to experience financial well-being in retirement. Given the criterion's importance in achieving the main objective of the review, we would give this criterion a high weighting.

14. Assessing options against this criterion would involve considering all potential sources of income for default members, for example KiwiSaver balances, other savings, and accumulated assets such as equity in a house. It would focus on an individual's financial position at retirement, but would also consider their financial position at other times in their life.

15. Meeting this criterion could involve improving the investment returns for default funds (thereby increasing KiwiSaver balances at retirement) and lowering default fees. It could also involve considering the impact of options on those seeking to make use of the first-home withdrawal option, as having a mortgage-free home can be an important contributor to financial well-being at retirement.

Criterion 2: Trust and confidence in KiwiSaver

16. If individuals have trust and confidence in KiwiSaver, they are more likely to join KiwiSaver, remain in KiwiSaver, and keep contributing to it. This in turn is likely to support the financial well-being of individuals at retirement.

17. This criterion is also important because default members have not chosen to be in the default fund. This implies a responsibility on the government to ensure that the default provider settings promote high trust and confidence.

18. Increasing financial capability, for example as a result of member engagement, may have a positive effect in relation to this criterion.

Criterion 3: Low administration and compliance costs

19. This criterion is important to ensure a workable solution with positive net benefits. It is important that any changes to the default arrangements can be implemented and that the cost of administering and complying with the default arrangements (by providers, employers and government agencies) are minimised.

20. This criterion is primarily concerned with administration and compliance costs that would be passed through to consumers, and includes initial and ongoing costs.

Criterion 4: Support development of New Zealand's capital markets that contribute to individuals' well-being

21. This criterion considers how options support the development of New Zealand's capital markets, in a way that is consistent with the purpose of the Act.

22. Well-functioning and developed capital markets support a strong and productive New Zealand economy, allow New Zealand organisations to obtain the capital they require, and help savers, and businesses better manage the various risks they face. This will contribute to the objective of enhancing the financial well-being of default members, particularly in retirement.

23. In assessing options against this criterion, decision-makers might consider whether the option would lead to more investment in productive New Zealand assets, contribute to market conditions that would lead to these investments, or support the development of a wider capital markets ecosystem that contributes to individual wellbeing.

Criterion 5: Promote innovation, competition, and value-for-money across KiwiSaver

24. This criterion considers the extent to which the options are likely to increase competition, innovation and value-for-money in the KiwiSaver market. This includes consideration of the default market and the wider KiwiSaver market.

25. This criterion deliberately includes the non-default market because we recognise that the default funds and their appointment process are likely to have impacts across the wider KiwiSaver market.

26. Value-for-money suggests a connection between the quality of a product and its price, and how well this aligns with the preferences of individuals in the default funds.

27. In relation to the value-for-money component of this criterion, we recognise that there is some overlap with criterion 1. We have opted to assess the direct effects of fees on member balances as part of our criterion 1 assessment, and not as part of our criterion 5 assessment.

28. In relation to innovation and value-for-money, we recognise that innovation costs money in the short term, but may lead to greater long-run efficiencies in the markets under consideration.

2	What is your feedback on the proposed criteria for the review? How should the criteria be weighted?

3 Investment mandate

Current situation

29. Default providers are currently required to adopt a conservative investment mandate for their default funds.[3] This approach has a lower short-term risk of losses but is also likely to result in comparatively low long-run returns.

30. The current investment mandate reflects that the default fund has been envisaged as a transitional “parking space” for default members. It was assumed that an ability to earn higher returns under a more growth-oriented approach would encourage members to move out of the default funds. Accordingly, KiwiSaver providers have obligations to educate their members and encourage them to actively choose their KiwiSaver fund.

31. Part of the purpose of KiwiSaver is to encourage long-term saving habits and the accumulation of retirement savings. In that context, the fact that a conservative asset mandate has a lower risk of losses was seen as appropriate at the beginning of KiwiSaver as it built trust in KiwiSaver.

Problem definition

32. A reasonable amount of time has passed since KiwiSaver began. We now have more information to suggest that a change to the investment mandate of default funds may be justified in the circumstances. This would imply a move away from a “parking space” purpose and towards a purpose that focusses more on asset maximisation – which would be in line with the objective of the review.

33. We acknowledge that part of a parking space purpose involves providers engaging with members, because no specific fund will be suitable for everyone. Our view is that member engagement remains important. We discuss member engagement further in section 9 of this paper.

Individuals are staying with default funds

34. A large number of people have been in (conservative) default funds on a long-term basis and are not choosing to move to a fund that better matches their investment needs. Approximately 430,000 people remain in (conservative) default funds who have not made an active choice to stay there. This is approximately 15% of all KiwiSaver membership (2.9 million) and approximately 34% of all automatically enrolled members (1.25 million). A further 285,000 people (approximately) have actively chosen to keep at least some of their funds in a default option.

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3 In relation to default funds, default providers must invest between 15 and 25 per cent of default product assets in growth assets. Conservative funds invest in a high proportion in bank deposits and fixed interest investments, and a lower proportion in growth assets such as shares and property.

35. Factors that encourage individuals to remain in a default option without making an active choice to do so include inertia, procrastination, lack of financial capability, difficulty assessing risks when faced with complex financial decisions, and assumptions that the default is endorsed or recommended by the government. Of course, other factors such as fees may be relevant to members who make an active choice to remain in a default fund.

Lower KiwiSaver balances with current conservative investment mandate

36. The problem with individuals staying in default funds long-term is that, with the current conservative investment mandate, they are likely to end up with lower KiwiSaver balances at retirement than members in higher risk (and higher return) funds. This would likely impact on their quality of life and financial well-being in retirement, and potentially increase the financial burden on government if their retirement savings were inadequate.

37. Assuming an average starting salary of $42,500 a year and a 3% contribution rate, an individual joining KiwiSaver at age 18 today who remains in a conservative fund is estimated to have a KiwiSaver balance that is approximately $135,000 lower at retirement than if a growth fund was chosen, and approximately $56,000 lower at retirement than if a balanced fund was chosen.[4] For a person that retires at 65 and lives to age 90, these returns equate to $358 a week in retirement for a growth fund and $242 a week in retirement for a balanced fund, as compared with only $166 a week in retirement for a conservative fund.

Many people remain in default funds despite member engagement

38. A large number of people remain in default funds despite member engagement by providers. Providers have told us that they have made efforts to encourage members to make active choices, but that those efforts have not been very successful. Providers have said that it is difficult to contact members. When it is possible to contact members, factors such as inertia and the complexity of the decision mean that people often do not make an active choice.

39. Providers are currently required (under their instruments of appointment) to report on the steps taken to address the financial literacy of members. However, there is no express requirement for providers to take such steps.

40. While some providers have had more success than others at member engagement, we recognise that member engagement can be difficult. Member engagement is costly, and this can make member engagement uneconomical, especially in relation to members with low balances.

41. Experience with member engagement suggests that member engagement alone is not effective in encouraging default members to make an active choice about their KiwiSaver investments and that many members will remain in the default fund for a reasonable length of time.

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4 sorted.org.nz/kiwisaver-savings-calculator. The calculator uses assumptions based on those in the Financial Markets Conduct Amendment Regulations 2019.

42. If a less conservative mandate was selected, member education would still be important, and we consider it continues to be appropriate for providers to take responsibility for investor engagement and education.[5] That is because:

a. No fund will be right for everyone.

b. Fund choice is only one component of member education –member education could also incorporate education on contribution rates, decumulation, and general financial capability.

c. Being a default provider provides significant benefits for a KiwiSaver provider because default members are automatically allocated.

d. Providers have conduct obligations and member education helps customers get better outcomes.

3	What is your feedback on the problem definition for the investment mandate? Is a move away from a "parking space" purpose justified?

Options for investment mandate

43. This section sets out options for the default investment mandate to address the problems set out above. The options are life-stages, balanced, growth and conservative (status quo). We have assessed the first three options against the status quo.

44. As a general question, we seek feedback on whether the options for investment mandate should apply only to default members who have not made an active choice, or whether they should also apply to members who have made an active choice to stay in the default fund. For example, if the investment mandate was changed to a balanced approach, should "active choice" members be shifted to that investment mandate?

4	Should the investment mandate options (and other options, for example in relation to fees) apply only to default members who have not made an active choice, or should they also apply to members who have made an active choice to stay in the default fund? Why or why not?

Option 1: Life-stages investment mandate

45. Under a life-stages investment mandate, younger members would have their savings invested mostly in growth assets (such as shares and listed property). As members get older, their savings would be moved more into income assets (such as term deposits and fixed interest products).

46. Only some providers currently offer life-stages options. Typically between three and six stages are offered. Of the nine current default providers, two providers offer a life-stages option, and both offer a six stage option.[6]

5 Member education requirements are discussed further in section 9 of this paper.

6 One default provider currently offers a smoothed option, similar to life-stages, in which asset allocation is gradually changed year-to-year from growth to conservative based on age. This is called a target date

47. The fees for providers' life-stages products are based on the underlying funds. For example, a person in the "balanced" stage of a life-stages product would pay the provider's fee for a balanced fund.

48. If a life-stages option is chosen, we envisage that the government would set the investment mandate of each stage and the ages at which the stages would apply. In this regard, we have received informal feedback that a conservative final stage would be too conservative for those approaching retirement, given average life expectancy is much higher than the retirement age. This could be mitigated by increasing the age at which members are switched to the final stage, or making the stages less conservative (for example, such that the final stage is a balanced approach).

49. Another option for structuring a life-stages approach would be to have an initial, conservative, "nursery" period (for example, six months or a year) when a member starts in life-stages. This could potentially give providers an opportunity to engage with members (for example in relation to first home ownership) and give individuals a chance to make a choice about their investments before they are shifted to a higher-growth fund.

5	If a life-stages option is adopted, what "stages" should apply and to which age groups? Should there be a "nursery" period?

Option 2: Balanced investment mandate

50. Under a balanced investment mandate, an individual's KiwiSaver portfolio would contain a greater proportion of growth assets than a conservative investment mandate. Balanced funds can fall a little in value in the short term but are generally considered to produce mid-range returns over the longer term.

51. According to the Financial Market Authority's (FMA) guidance on the description of managed funds, balanced funds have between 35%-63% invested in growth assets.[7] If this option was adopted, we envisage the government would specify a smaller range for default funds within the FMA's classification (eg that default funds must invest 50-60% in growth assets). We seek feedback on what the appropriate range would be, if a balanced option is chosen.

6	If a balanced investment mandate is adopted, what range for growth assets should be applied?

Option 3: Growth investment mandate

52. Under a growth investment mandate (between 63-90% invested in growth assets according to the FMA's guidance), an individual's KiwiSaver portfolio would contain a higher proportion of growth assets as compared to a balanced or conservative investment mandate. Growth funds can undergo large fluctuations in value in the short term but are

approach. We are not considering adopting a target date approach as we think it would be administratively complex and costly.

7 http://www.fma.govt.nz/assets/Guidance/151124-Guidance-note-on-risk-indicators-and-description-of-managed-funds.pdf

expected to generally produce good returns over the longer term. If this option was adopted, we envisage the government would specify a range for default funds within the FMA's classification.

7	If a growth investment mandate is adopted, what range for growth assets should be applied?

Option 4: Conservative investment mandate

53. This option is to retain a conservative investment mandate (between 10-35% invested in growth assets according to the FMA's guidance). A conservative fund has limited fluctuations in value and generally produces comparatively low long-term returns. As is currently the case, the government could specify a range for default funds within the FMA's conservative classification. For example, the current range for default funds is 15% to 25%.[8] Another feasible option would be to choose a higher range (eg 25%-35%) which would make default funds less conservative without changing the classification.

8	If a conservative investment mandate is adopted, what range for growth assets should be applied?

Costs and benefits of investment mandate options

Criterion 1: Better financial position for KiwiSaver default members, particularly at retirement

Higher balances at retirement for options 1-3

54. The **life-stages, growth, and balanced** options are likely to result in higher KiwiSaver balances at retirement for default members, as compared with a **conservative** option. This is likely to support default members being in a better financial position, particularly at retirement. In contrast, a **conservative investment** mandate is likely to result in poorer returns in the long-run than other options for most people. This would have a negative effect in relation to criterion 1.

55. We have been told by stakeholders that a **life-stages** option would have about the same long-term returns as a balanced fund (though no single investment mandate will be suitable for everyone).[9] We seek feedback on the likely returns of the different options.

56. In the long-run, a **growth** option has a high probability of increased returns as compared to a conservative fund. However, not all default members will be in the fund for the long-term (eg people nearing retirement, people withdrawing under the hardship or first-home provisions). Those people may not get the benefit of a growth fund to the same extent – and may experience their balances reducing if there is a downturn when they withdraw funds. The same could be said for a **balanced fund** (to a lesser extent). However, as the average life expectancy is much higher than the retirement age, even if a person in a balanced fund has a short-term decrease in their balance close to retirement, there is still time for them to regain that loss during their lifetime if they stay in KiwiSaver.

8 In practice, providers tend to remain below 20% in order to maintain a buffer.

9 If a life-stages fund with less conservative settings is chosen (eg a fund whose stages are growth, balanced/growth and balanced), returns are likely to be even higher.

57. **Life-stages, growth, and balanced** options generally have higher fees, though this is not the case for all providers. However, because those funds have higher expected long-term returns, this should not have a negative effect in relation to this criterion.

Potential issue in relation to first-home buyers and people making early withdrawals

58. In relation to the **growth, life-stages and balanced** options, there may be costs in relation to first-home buyers and other people making early withdrawals (for example, under the significant financial hardship grounds). Those individuals could be exposed to negative effects on retirement balances if they withdraw funds when the market is in a down-cycle. However, the chance of actual losses remains fairly low. Of the three options, the magnitude of the issue is greatest for the growth option and smallest for the balanced option.

59. However, for many people, any negative consequences in the short-term would be less significant than the long-term benefits of a higher-growth fund. Broadly speaking, the short-term consequences might be justified in order to ensure better returns long-term.

60. In relation to first-home buyers, this issue is relatively small in scale because first-home buyers are less likely to be in a default fund. From the inception of the first-home programme until mid-April 2019, Inland Revenue received notifications of over 117,500 first home withdrawal purchases. The vast majority (84.1%) of them were made for members who had actively joined with their provider in the first instance. 10.8% were made for members who were in a default fund in the first instance.[10] However, the actual percentage of first home buyers in a default fund is almost certain to be less than 10.8%: some of the 10.8% would have made a subsequent choice to leave the default fund. However, the number of people making first-home withdrawals is increasing over time.

61. We would expect to take steps to mitigate this issue if a life-stages, growth or balanced approach was adopted and seek feedback on the best way to do this. One option would be to apply specific member engagement requirements on providers, targeted at potential first home buyers.

9	If a life-stages, growth, or balanced option was adopted, how should we mitigate the potential issue in relation to first-home buyers and other people making early withdrawals?

Criterion 2: Trust and confidence in KiwiSaver

Better long-term returns likely to promote trust and confidence in KiwiSaver

62. The **life-stages, balanced and growth** options are likely to have better long-term returns, which is likely to in turn promote trust and confidence in KiwiSaver over time as people see the benefits of being in a higher-growth fund.

63. On the other hand, there has been commentary that conservative investment mandates are putting people in poor financial positions at retirement, and continuing with a **conservative** option could degrade trust and confidence in KiwiSaver over time.

10 These figures will not be completely accurate due to Inland Revenue not capturing subsequent active choices to move funds. However, the figures will only move in one direction where this does occur – increasing the percentage in the active choice category.

Less exposure to market shocks at retirement for life-stages and conservative options

64. A benefit of the **life-stages** option is that, assuming that members would be shifted to a conservative fund as they near retirement, there is less chance of exposure to market shocks when assets are withdrawn. This could promote trust and confidence in KiwiSaver.

65. This benefit would also apply in relation to a **conservative** approach. It would also assume that it would not be appropriate to take investment risks on behalf of non-consenting participants. This could safeguard trust and confidence in KiwiSaver in the short-term – though this would need to be balanced against the degrading of trust and confidence identified in paragraph 63.

Engagement

66. A **life-stages** approach would also provide opportunities for providers to engage with members and encourage them to make active choices every time an individual is shifted from one stage to another. This could promote trust and confidence.

Volatility for people withdrawing early

67. For the **growth, life-stages and balanced** options, individuals that withdraw their funds early (for example, for a first home) and are negatively affected by volatility could lose trust and confidence in KiwiSaver as a result of their negative experiences. However, the risk of actual losses remains low. Other members may feel less confident in KiwiSaver when they see volatility in their balances – even if they are not withdrawing their funds.

68. Volatility could result in people deciding to stop participating in KiwiSaver (eg by going on a savings suspension) or switching to a conservative fund if they are concerned about short term losses – even if they are not withdrawing their funds.

69. These issues are most pronounced in relation to the growth option and least pronounced in relation to the balanced option.

Criterion 3: Low administration and compliance costs

70. For the **life-stages** option, providers would be required to shift members from one fund to another for each stage. We think the costs of this would be low, but seek feedback on this.

71. Providers without life-stages offerings, or offerings that do not match the default requirements could face initial costs as they develop their default life-stages offerings.

72. We do not expect there would be significant administration or compliance costs associated with adopting a balanced, growth or conservative option.

10	What would be the administrative costs to providers of choosing a life-stages option?

Criterion 4: Support development of New Zealand’s capital markets that contribute to New Zealanders’ wellbeing

73. The life-**stages, growth and balanced** options would result in increased overall investment in growth assets, as compared with the status quo. This is likely to lead to an increase in investment in productive assets and capital markets in New Zealand and off-shore. The benefit would be most pronounced in relation to the growth option and less pronounced

for a life-stages or balanced option. There would be no benefits in relation to this criterion for the conservative option.

Criterion 5: Promote innovation, competition and value-for-money across KiwiSaver

74. There are potential benefits in relation to this criterion for the **life-stages** option. There are only a few providers that currently offer life-stages options. Choosing a life-stages investment mandate would mean that more providers develop life-stages offerings, which could create economies of scale to support offering life-stages options to KiwiSaver members more generally. We have not identified costs or benefits in relation to this criterion for the other three options.

11	What is your feedback on the different options? Do you agree with our assessment of the costs and benefits of the option? Which option do you think is best and why? Is there another option that we have not considered that would be better than the options discussed?

4 Fees

Current situation

75. All current default providers charge a percentage-based performance fee, and most providers charge a fixed monthly fee. There are also a range of minor additional fees and expenses charged by various providers.

Table 1: Maximum fees that can be charged by default providers to provide default funds, as set out in instruments of appointment

Provider	Percentage-based management fees (p/a)	Fixed monthly fee	Other fees	Annual fee for $20,000 balance[11]
AMP	Max 0.35% (of net asset value)	Up to $1.95	Max 0.04% p/a	$101.40
ANZ	Max 0.45% (of net asset value)	Up to $2.00	0.04% to 0.15% p/a, plus $2.40 p/a	$146.40
ASB	Max 0.40% (of gross asset value)	Up to $2.50	n/a	$110.00
BNZ	Max 0.58% (of gross asset value)	Up to $1.95	Performance-based fees charged by managers of underlying funds	$139.40
BT (Westpac)	Max 0.40% (of gross asset value)	Up to $2.25	-0.03% to 0.14% of gross asset value p/a - Indirect fees/costs. - Up to $500 for inward overseas transfers.	$135.00
Fisher Funds	Max 0.56% (of net asset value)	$2.75 for first 25,000 members, $2.25 for all other members	n/a	$145.00
Booster	Max 0.35% (of net asset value)	$0 on balances up to $10,000, $2.50 on balances $10,001+	0.03% p/a	$106.00
Kiwi Wealth	Max 0.48% (of net asset value), min $40	n/a	Actual fees charged by managers of underlying funds	$96.00
Mercer	Max 0.50% (of net asset value)	Up to $2.50	- Max 0.03% p/a - Actual costs associated with managers of underlying funds. - Costs for ordinary expenses. - Performance-based fees. - Anticipated ordinary expenses.	$136.00

76. Outside of the default arrangements, the market for KiwiSaver is growing. There have been a number of new entrants to the market, some of whom are offering (or contemplating offering) novel low-cost fee models.

11 To the extent this can be calculated from the data presented in this table. We have not taken into account, for example, performance based fees or trustee fees.

What do fees cover?

77. Fees cover asset allocation decisions, customer service, member transfers, withdrawals, and supervisory costs. They also cover costs specific to default providers, such as quarterly reporting to the FMA and targeted member education.

78. We understand that fees cannot be assessed in isolation from the services they cover. If providers are required to provide a range of other services in addition to asset management (for example, extensive member engagement), this may increase the fees they charge.

79. In addition, some default funds have managers that pick investments that they believe will perform well (actively managed funds). For other default funds, investments are automatically selected to match an index or part of the market (passively managed funds). Actively managed funds generally have higher fees than passive funds. One view is that significant reductions in fees would lead to providers ceasing to offer actively managed default schemes. Another view is that passive funds track market indices and actively managed funds do not collectively outperform the index in the long-run.[12]

Problem definition

80. We seek your feedback on the problems and issues that exist in relation to fees. We expect that fees will play a significant part in the procurement criteria for default providers.

Fees have not decreased as expected

81. With percentage-based fees, the fee paid by an individual increases as their balance grows, despite the same service being provided. Accordingly, we would expect to see percentage fees decrease as overall funds under management increase. In relation to KiwiSaver fees in general, the FMA has stated publicly that "we would have hoped that as funds under management grew, we would have seen fees decline faster, and that members would be getting advantages of economies of scale that come with growth."[13]

82. In addition, we have had feedback that some fund managers with active approaches are more active than others, with fees not always justified.

83. While we accept that fees are only one component of a value-for-money service, we want to see reductions in fees for default funds as a result of this review and subsequent procurement process. Default providers get a steady stream of new customers and reputational benefits as a result of being a default provider. Given these benefits, the government expects that providers will offer more competitive fees in order to enhance outcomes for members.

84. The extent to which high fees are a problem is partially dependent on the investment mandate for the default funds. Higher fees are less problematic if long-term returns are higher (for example, if the default fund had a life-stages, balanced or growth approach).

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12 See for example, William Sharpe, The Arithmetic of Active Management, Financial Analysts Journal, 1991.

13 http://www.scoop.co.nz/stories/BU1810/S00269/kiwisaver-providers-warned-on-fees-default-investors.htm

85. We would like your feedback on:

a. The costs that are within and outside providers' control (for example, fees charged by overseas managers).

b. The value that members get from fees.

c. Whether fees for default funds are too high (for example as compared to fees charged to institutional and wholesale investors).

12	What is your feedback on the level of value that KiwiSaver default members get for their fees? What are the costs that are within and outside a provider's control? To what extent are fees too high?

Fees disproportionately affect those on low income and under 18s

86. Fees for default funds disproportionately affect low-income individuals on low incomes and those under the age of 18.

87. People on low income are likely to make lower contributions to their KiwiSaver. As a result, the standard monthly or annual fee charged by most KiwiSaver providers regardless of account balance is a higher proportion of returns. This negatively affects returns over the long run.

88. Individuals are automatically enrolled in a default fund only if they start a new job and are aged 18-65, so the only under 18s in default funds are those who have chosen to be there. Under 18s tend to make smaller contributions towards KiwiSaver, and they are not eligible for employer contributions or the government contribution. This can result in savings being eroded over time and the monthly fee can be more than the return on investment. While under 18s in default funds are not default members, we think that it important that the default fund settings work for younger members.

13	Is it a problem that fees disproportionately affect those on low income and under 18s? Why/why not?

Options for fees

89. We seek your feedback on the options that would be effective in addressing problems and issues in relation to fees. The options presented are not mutually exclusive.

Option 1: Government sets a fee

90. Option 1 is for the government to set the fees that may be charged by default providers (for example, by setting a fee, setting a fee range or capping fees). The fee would be disclosed when tenders are sought. We seek feedback on the level at which the fee should be set and the method that should be used to set the fee (should the option be adopted).

14	If the government sets a fee, what should the fee be set at for the different investment mandate options? What considerations, methods or models could be used to determine the fee? What should be the balance between fixed and percentage fees?

Option 2: Two-stage assessment of fees in procurement

91. Option 2 is to separately consider fees in the procurement process, so that providers can be differentiated on fees. For example, there could be a two-stage assessment process in which any provider that meets the criteria (excluding fees) would then be assessed on fees. The government could set a maximum number of providers (eg five) and the five providers with the lowest fees would be appointed. For further analysis of this option, please refer to the "number of providers" section of this paper (page 25).

92. Another option is to require providers to submit their proposals (excluding fees) in one envelope, and their fee proposals in another envelope. These could be considered separately so as to allow the evaluation panel to focus on fees and value-for-money for the services offered. That is because fees and value-for-money would be a separate consideration, not a weighted criterion that would be balanced against other criteria.

93. **Variation on option:** a variation on this option would be would be to assess, as part of the procurement process, the non-default fees offered by providers, in addition to assessing the fees they are offering for the default fund.

Option 3: Percentage-based fees reduce as provider's funds under management increase

94. Option 3 is to require that percentage-based fees reduce in percentage terms over time as the provider's funds under management increase.

Option 4: No fees for under 18 year olds

95. Option 4 is to prohibit default providers from charging fees for members under 18. This option would apply only to those who have made an active choice to join the default fund.

96. Variation on option: A variation on this option is to require that default providers offer no fees for under 18s across their KiwiSaver funds, not just the default fund. This is likely to have a much bigger impact on balances and much greater impact on savings habits for under 18 year olds.

Option 5: No fees for low balances

97. Option 5 is to prohibit default providers from charging fees for members with low balances (eg under $5000 or $10,000). This could make KiwiSaver more attractive for individuals under 18 and individuals on low incomes, many of whom would have low balances.

Option 6: No annual fees

98. Option 6 is to prohibit fixed (for example, annual or monthly) fees.

Costs and benefits of fee options

Criterion 1: Better financial position for KiwiSaver default members, particularly in retirement

99. A benefit of **option 1** (government sets a fee), **option 2** (two stage procurement), and **option 3** (percentage-based fees must reduce as funds under management increase) is that it could lead to lower fees, which would lead to higher retirement incomes for individuals. In turn, this would support criterion 1, because it would support individuals having a better financial position at retirement.

100. In relation to **option 1,** it may be difficult for the government to determine what an appropriate fee would be. If the fee was set too high, providers may tender higher than they otherwise would and the government might lose the opportunity to receive offers for even lower fees from an open tender process.

101. We seek feedback on how the **option 2 variation** (fees assessed across KiwiSaver) would perform in relation to criterion 1. The variation would be beneficial for default members who make a choice to switch to another fund offered by their provider, because those fees are likely to be lower than they otherwise would be. However, providers may compensate for this by making their default fees higher than they otherwise would. This would have a negative effect in relation to criterion 1.

102. **Option 3** could result in lower fees, but it could also result in higher initial fees as providers compensate for the expected reduction in fees over time. **Option 4** (no fees for under 18s) would result in higher KiwiSaver balances for members of default funds that are under the age of 18, because returns would not be eroded by fees. However, it would not make any difference to default members (that is, members who have not made a choice to be in the default fund). It may even increase fees for those members.

103. **Option 4** would encourage individuals under the age of 18 to contribute to KiwiSaver, thereby building a savings habit. This could have the long-run effect of higher retirement incomes. However, the option could also create perverse incentives for parents to contribute to their children's KiwiSaver funds instead of taking other steps that would result in higher retirement incomes for the parents (for example, paying off debt).

104. **Option 5** (no fees for low balances) would result in higher KiwiSaver balances for default members with low balances, because returns would not be eroded by fees. The option would encourage individuals under the age of 18 to contribute to KiwiSaver, thereby building a savings habit. This could have the long-run effect of higher retirement incomes.

105. On the other hand, **option 5** could lead to higher fees/cross-subsidisation from members with higher balances. This could negatively affect the financial position of those other members in retirement.

106. **Option 5** could also create incentives for providers to move members from the default funds (which have no fees) to other funds (which have fees). This could be detrimental to the financial position of KiwiSaver members if the fund they are switched to is not suitable for their circumstances.

107. **Option 6** would have benefits in relation to this criterion because it could result in higher after-fee returns.. However, providers may compensate for removing fixed fees by increasing percentage-based fees. The total percentage-based fee would increase over time as balances grow, so this option could result in higher fees overall in the long-term.

Criterion 2: Increase trust and confidence in KiwiSaver

108. **Option 1** (government sets a fee) could increase the consistency of outcomes for individuals in default funds. Given that individuals are randomly allocated to default providers, consistency amongst providers could potentially increase trust and confidence in KiwiSaver.

109. **Option 2** (two-stage procurement) could lead to the government receiving a range of fee offers from providers. This could lead to wide variety of fee outcomes for default members, which could reduce trust and confidence slightly.

Criterion 3: Low administration and compliance costs

110. We seek feedback on the impacts of the options in relation to this criterion.

Criterion 4: Support development of New Zealand's capital markets that contribute to New Zealanders' wellbeing

111. We have not identified any costs and benefits of the options in relation to this criterion.

Criterion 5: Promote innovation, competition and value for money across KiwiSaver

112. In relation to **option 1** (government sets a fee), we have already identified that it may be difficult to accurately determine what an appropriate fee would be. If government sets the fee too low, providers may cease to offer some services in the tender process, or may not want to tender at all. This would decrease supply-side competition in the market, and may result in lower value-for-money because default members would not receive a product that matches their preferences.

113. Also in relation to **option 1** (government sets a fee), setting a fee that is too low could impact on the level of service offered by default providers, resulting in sub-optimal value-for-money. If the fee was set low, providers might increase their fees for their non-default products. This could result in lower value-for-money across KiwiSaver in general.

114. The **option 2 variation** (assess fees across KiwiSaver) may increase competition and value-for-money across KiwiSaver, because providers would be incentivised to make their offerings competitive across all of their KiwiSaver products.

115. A potential cost of **option 6** (no annual fees) is in relation to competition in the default KiwiSaver market. Some providers who were contemplating a low-cost fixed-fee offering might be disincentivised from tendering.

116. **Options 1, 3, 4, 5, and 6** could have the effect of decreasing innovation in fee design by providers.

15	What fee arrangements would best promote the objectives of the review? What is your feedback on the fee options? Do you agree with the costs and benefits identified? Which option (or the status quo) do you prefer and why? What other approaches or models could be used to reduce fees?

5 Number of providers

Current situation – feedback sought

117. In the first appointment round, six providers we appointed. In the second appointment round four more providers were appointed bringing the total to nine providers.

118. We have had some feedback on how the number of providers has impacted the default market and the KiwiSaver market more generally. For example, some people have told us that nine providers is a large number and that this had resulted in a lack of economies of scale, higher monitoring costs, and wide variation between providers. Others have said that appointing a lower number of providers (six) in the first round resulted in those providers receiving significant incumbency benefits, and that those providers have been able to grow and maintain large KiwiSaver customer bases.

119. We seek further feedback from submitters on how the number of providers (six and then nine) has so far affected innovation, competition and value-for-money in the default market specifically, and in the wider KiwiSaver market more generally.

120. This section covers issues that overlap with the fees and transfer sections, and should be read in conjunction with those sections.

16	How has the number of providers in the default market affected innovation, competition and value-for-money in the default market and in KiwiSaver more generally?

Feedback sought on approach to number of providers

121. We also seek feedback on whether to appoint a smaller, larger or unlimited number of providers.

122. Under an "unlimited" approach, any licenced public provider that meets minimum requirements would be appointed. This could be done on a rolling basis (providers can enter and exit as default providers at any time) or on a period-based system (providers can join at any time with contracts coming up for review at standardised times).

123. Each of the options would come with costs and benefits. Some of the costs and benefits in relation to these approaches that we have so far identified are:

Table 2: Costs and benefits of appointing a smaller number of providers

Benefits of appointing a smaller number of providers	**Costs of appointing a smaller number of providers**
Providers can achieve economies of scale for members, potentially resulting in lower fees (criterion 1)	Concentrates risk in a few providers, creating a risk for KiwiSaver if an issue arises (criteria 2, 3 and 5)

May be lower monitoring costs, because fewer providers to monitor (criterion 3)	More likely that default members and providers will think that the government has endorsed the providers as they capture a large proportion of the market (criterion 2)
Short-term price benefits because more competitive pressure can be created in the procurement process (criterion 1 and 5)	More competitive advantage for default providers as compared to non-default providers because there is competitive pressure (criterion 5)

Table 3: Costs and benefits of appointing a larger or unlimited number of providers

Benefits of appointing a larger or unlimited number of providers	**Costs of appointing a larger or unlimited number of providers**
Maintain competition in the market and make it easier for smaller/start-up providers to enter the market (criterion 5)	May be higher monitoring costs because more providers to monitor (criterion 3)
	Less competitive pressure in the procurement process (criterion 5)
	Depending on whether there are standardised terms, there may be a wider range of quality and fees charged between providers, leading to differences in outcomes for members (criteria 2 and 5)
	Will take longer for providers to achieve economies of scale for members, potentially resulting in higher fees in the meantime (criteria 1 and 5)
	If default providers can opt-out of the default regime at any time, this could create on-going transfer issues which could negatively affect trust and confidence in KiwiSaver and could increase administration costs. (criteria 2 and 3)

17	Do you agree with our assessment of the costs and benefits of the different approaches for the number of providers? Can you provide us with evidence that might help us quantify the size of the costs and benefits? What option do you prefer and why?
18	If a "minimum requirements" approach is taken should this be on a period-based or rolling system, and why?

6 Responsible investment

Current situation

124. Providers are currently required to include in their product disclosure statements (PDS) a statement of whether or not the scheme takes responsible investment into account in their investment policies and procedures.[14] There are no other responsible investing requirements that apply specifically to KiwiSaver. As a result, there is no standard responsible investment mandate or practice among KiwiSaver providers (or for that matter, among other managed funds).

125. Many KiwiSaver providers employ frameworks to filter out investments that could be considered irresponsible or unethical. This often takes the form of positive screening through Environmental, Social and Governance criteria, or negative screening through sector-exclusion policies. Following public scrutiny of KiwiSaver investment practices, most KiwiSaver funds now exclude several controversial sectors. A few have also adopted the New Zealand Superannuation Fund's blacklist of companies excluded from investment for human rights abuses, poor environmental practices, or other ethical concerns. Sectors excluded by current default providers include tobacco, alcohol, gambling, controversial weapons manufacturing, fossil fuels, and whaling. In addition, some providers offer separate, specific KiwiSaver funds that prioritise responsible investments.

126. However, KiwiSaver providers (including default providers) have faced criticism for their responsible investment performance. Particular points of contention have been not further developing their socially-responsible criteria and poor transparency for members about where their money is invested. Many default KiwiSaver providers invest through index funds – mutual funds designed to track the returns of certain investments and invest accordingly. In many cases this is considered best practice for performance and cost. However, this also reduces the control providers have over where KiwiSaver funds are invested, as investments are not directly made by the KiwiSaver provider.

127. There is ongoing debate about the impact responsible investment has on returns. Some stakeholders have told us that returns from 'responsible' investments are, on average, at least as high as those from conventional investing, and referred us to studies demonstrating this.[15] Others have told us that responsible investment limits returns, pointing to the lasting success of typical investment practices without ethical investment

14 KiwiSaver Act 2006, section 129.

15 Gordon L. Clark, Andreas Feiner, and Michael Viehs, 'From the Stockholder to the Stakeholder', September 2014, accessed at: https://www.smithschool.ox.ac.uk/publications/reports/SSEE_Arabesque_Paper_16Sept14.pdf; Anne-Maree O'Connor, David Rae, and Rishad Sethi, 'Why We Believe Responsible Investing Pays Off', November 2015, accessed at: https://www.nzsuperfund.co.nz/sites/default/files/documents-sys/White-Paper-ESG-Beliefs.pdf

restrictions, and the subjective nature of defining "responsible" leading to the potential exclusion of good investment opportunities.[16]

128. Currently, the information provided to default members about what sectors are excluded from default providers' investment portfolios is not uniform. Some providers issue exclusion lists by company, whilst others list the sectors that are excluded.

19	Are there higher investment costs for responsible investing? If so, how likely are these costs to contribute to lower net returns?
20	How does responsible investment affect returns? Does it increase or decrease returns, and to what extent?

Problem definition

Should default funds be used to promote responsible investment?

129. We seek your feedback on whether the default provider arrangements should be used to promote responsible investment.

130. One view is that there is public interest in responsible investment, and that it is appropriate for the government to change the default provider settings to achieve this. Several stakeholders have said that the current requirements for responsible investing are not robust enough, and that there should be stricter responsible investment criteria in the default provider settings. This could function as a lever to promote responsible investing across all KiwiSaver funds, and indeed, across other investment funds.

131. As the default provider settings are considered infrequently (every seven years), the review could be seen as an opportunity to cater to public concern, particularly if responsible investment continues to be an issue. Given that many of these issues have been raised in the last four years, public concern may grow in the period following the new appointment of default providers. Thus, this review is an opportunity to respond.

132. Another view is that default members are free to choose a more responsible fund, and it would be inappropriate for the government to impose a particular set of investment criteria on the default product, particularly if doing so could limit potential returns.

133. More broadly, there is a question about how responsible investment aligns with the objective of the review. We therefore seek your feedback on the extent to which responsible investment aligns with the purpose of the Act and objective of the review (for example, whether responsible investment would limit returns).

21	Should the default provider arrangements be used to achieve objectives in relation to responsible investment?

16 Peter Jan Trunks and Bert Scholtens, 'The Opportunity Cost of Negative Screening in Socially Responsible Investing', *Journal of Business Ethics, 140*(2), 2015, pp.193-208.

Would default members want their investments to be more responsible?

134. We seek feedback on whether default members would want their investments to be made more responsibly.

135. There is some evidence that KiwiSaver members in general are interested in responsible investment. A Colmar Brunton survey released in 2018 showed that 72% of New Zealanders expect their investments to be made responsibly and ethically, and 62% would move their investments if they discovered their money was being invested in activities inconsistent with their values. This was particularly high among New Zealanders aged under 30 and over 50. According to the same survey, 73% reported they were more likely to invest in a scheme that is certified to be responsible or ethical. However, only 8% of KiwiSaver members chose the provider they thought was best on sustainability.

136. A Consumer NZ survey released in April 2019 showed that 49% of respondents wanted a fund that provides good returns and invests responsibly (as equally important factors). 14% wanted a fund that invests responsibly even if it provides lower returns. However, it is not clear whether these figures accurately reflect the percentage of people who would, in practice, choose a responsible fund if it meant lower returns.

137. According to Colmar Brunton, the two biggest barriers to investing responsibly were a lack of independent information and lack of time to compare all of the options. Reasons cited included uncertainty about the performance of responsible investment funds, whether they are expensive, the availability of credible options, and whether to believe claims of being 'responsible'.

138. Some stakeholders have told us that the low uptake of responsible funds indicates that people are less interested in responsible investing, and that individuals who are interested in a more responsible fund should choose a dedicated responsible investment fund. The low uptake of responsible funds may indicate public disinterest.

139. However, this view may overlook the behavioural factors (for example, inertia, loss aversion, complexity of the decision) that cause default members to stay in a default fund. This means that default members have an interest in responsible investing despite their failure to make an active choice about their fund.

22	Would default members want their funds to be invested more responsibly? If yes, is the same true if responsible investment means potentially limiting future returns?

Do default members have enough information about whether their investments are being made responsibly?

140. Another potential problem is that information regarding responsible investment practices of default providers may not be readily available, or easy to understand.

141. While all nine current default providers provide information to members regarding their responsible investment practices in addition to their limited PDS obligations, there is no standard practice in what information is provided, or in what form. This may make it difficult for members to compare providers, and thus evaluate their current provider's responsible investment performance.

142. We seek your feedback on the extent to which this is a problem. For example, we are interested in hearing from submitters on the extent to which default members would

make different decisions about their investments if they had more information, and how they would like this information to be provided. We are also aware that there are online comparison websites (for example Mindful Money) that help consumers compare the responsible investment practices of their KiwiSaver providers.

143. We are also aware that many default members do not make active choices about their investments because the decisions can be complicated. More information may make decisions even harder to make. We seek your feedback on whether more information is likely to have this effect, and if so, what alternatives there are to providing more information.

23	To what extent is it a problem that default members do not have information about whether their investments are made responsibly? Would having more information make a difference to the behaviour of default members? What alternatives might there be to more/standardised information to address responsible investment concerns?

Options for responsible investment

Option 1: Require mandatory exclusions of certain industries or companies

144. Option 1 would require default providers to exclude particular sectors/industries from their default fund portfolios.

145. There is little common understanding among KiwiSaver providers (or New Zealanders) about what constitutes "responsible" investment. While there are some industry standard options that can be adopted, such as the New Zealand Superannuation Fund exclusion list, there is no established standard. This means providers can offer vastly different investment practices under the same classification of "responsible investing", which may in turn be different to what KiwiSaver members themselves consider responsible. This can be confusing for default members.

146. Thus, if an option is chosen to mandate a particular set of exclusions, it may first require a definition of what constitutes a "responsible investment". The decision about which sectors/industries this applies to could be made by government after consultation with providers and/or the public. The difficulties associated with that decision could be mitigated by the following options:

    a. The government selects an international responsible-investing exclusion standard, such as the United Nations-supported Principles for Responsible Investment (which is followed by the New Zealand Superannuation Fund).

    b. The government requires that KiwiSaver providers obtain a certification from an external responsible investment authority, such as the Responsible Investment Association Australasia.

24	Do providers' current responsible investment exclusions meet what default members would expect?
25	If this option is adopted, what industries or sectors should be excluded? Should the government instead adopt an international exclusion standard or certification regime? What would be the costs associated with an exclusion or certification regime?

Option 2: Standard disclosure for responsible investment

147. This option is to require default providers to follow a standard method of disclosing responsible investment criteria. The aim would be to aid default members with responsible investment concerns to discover the responsible investment practices of their provider. This may further aid default members in actively choosing a non-default KiwiSaver fund on responsible investment grounds, by allowing comparisons to be more easily made to default funds.

148. This may take the form of requiring default providers to issue exclusion statements that lists by sector all companies excluded from the providers' investment portfolios. Alternatively, it may simply require that sector exclusions be listed directly on providers' websites, and in their PDSs. In this case, providers would be given the responsibility to highlight clearly to members exactly how they are adhering to responsible investment criteria.

149. Alternatively, this may take the form of requiring default providers to list what is not excluded from a mandated list of 'unethical/irresponsible' investments or sectors. This may present a more effective form of disclosure.

150. We seek feedback on other options for disclosure that could be desirable, for example, in relation to carbon intensity, or the diversity of the investment portfolios themselves.

26	If this option is adopted, what form should standard disclosure take? For example, should all providers be required to provide a statement listing all excluded companies by sector?

Costs and benefits of responsible investment options

Criterion 1: Better financial position for KiwiSaver default members, particularly at retirement

151. **Option 1** and **option 2** could result in higher fees, which would have negative effects in relation to this criterion.

152. **Option 1** could have positive or negative impacts on a before-fee returns for default funds, depending on whether responsible investment does in fact limit returns. If responsible investment results in better returns, members would have a better financial position, particularly at retirement.

153. If responsible investment limits returns, members would experience a poorer financial position, unless there is a significant market shift towards more responsible investment practices. There is a tension between whether default KiwiSaver providers should focus on members' return on investment over responsible investing considerations, particularly when the default member is not making the choice for themselves.

Criterion 2: Trust and confidence in KiwiSaver

154. **Option 1** would make responsible investments easy to understand, as there would be visible, public exclusions across all default products. This also serves to increase confidence in the KiwiSaver brand, by distancing the default product from controversial investments and thus potential controversies.

155. However, it is difficult to determine what investments are considered "irresponsible", as such a decision is very subjective and may run the risk of inconsistencies with other investment funds such as those of the New Zealand Superannuation Fund and Accident Compensation Corporation. Whilst there may be a significant number of default members who agree that a particular sector should be excluded from investing in, there may be a separate cohort who does not. In this regard, it may be perceived that Government is imposing moral decisions upon KiwiSaver default providers and members.

156. **Option 2** may increase trust and confidence in KiwiSaver by increasing the transparency in relation to responsible investment practices. This option may potentially encourage providers to divest from controversial stocks, as they may not wish to have these assets flagged in their disclosures. Additionally, if responsible investments lead to higher returns, confidence in the KiwiSaver scheme as a vehicle for achieving higher financial capability at retirement may rise. This could serve to raise the overall perception of the KiwiSaver default scheme, as default providers may be seen to engage in responsible investment practices for the benefit of its members.

Criterion 3: Low administration and compliance costs

157. **Options 1 and 2** will likely increase administration and compliance costs. For option 1, providers may need to actively divest investments and would incur ongoing costs to adhere to the responsible investing mandate. There may also be initial costs involved with setting up the appropriate wholesale responsible investment products to meet demand from providers (for example, for providers who passively invest in index funds).

158. For **option 2**, the disclosure process would be likely to result in ongoing costs.

Criterion 4: Support development of New Zealand's capital markets that contribute to New Zealanders' wellbeing

159. We have not identified any costs and benefits of the options in relation to this criterion.

Criterion 5: Promote innovation, competition, and value-for-money across KiwiSaver

160. **Option 1** could increase value-for-money for default members, assuming that default members would want their investments to be made more responsibly. The same is true if responsible investments result in similar, or even higher, returns. The option could also create increased demand from providers for wholesale responsible investment products. This could lead to more choices being available to New Zealand consumers more generally. However, it could also create distortionary effects in the market by affecting capital flows.

161. **Option 2** could lead to increased product offerings on the market, as investment fund managers may offer more responsible funds to cater to the needs of default providers who wish to demonstrate that they have more responsible investment practices. If default providers begin to divest from controversial stocks because of the increased public disclosure, they may be seen as the "most" responsible of all providers across the KiwiSaver scheme. This may encourage non-default providers to similarly divest from controversial stocks, which will raise the responsible profile of the KiwiSaver scheme as a whole.

27	What is your feedback on our assessment of the costs and benefits of the responsible investment options identified? Which option (or the status quo) do you prefer and why?

7 Capital market development

Current situation

162. We seek feedback on how the KiwiSaver default provider settings could be used to develop New Zealand's capital markets. Deep and liquid capital markets help promote long-run economic growth by channelling savings to businesses that want to invest in new capital. Capital markets play a key role in the development of new and innovative businesses, the growth of the New Zealand economy and ultimately in the balances of KiwiSaver members.

163. KiwiSaver currently has $58 billion funds under management, and is experiencing strong year-to-year growth. Over half the value of KiwiSaver default funds is invested in New Zealand, primarily in listed assets.

164. Given the level of KiwiSaver investment in New Zealand assets, limitations or weaknesses in New Zealand's capital markets could have a significant effect on the balances of KiwiSaver default members. The size of KiwiSaver funds under management also means that the KiwiSaver default settings may have a role to play in the health of New Zealand's capital markets.

165. KiwiSaver funds currently have minimal investment in New Zealand unlisted alternative assets (including infrastructure assets, early stage companies and private equity). Exposure to these assets could increase with a more growth oriented investment mandate and as funds under management increase (as fund managers look for more growth assets in which to invest). Globally, two thirds of pension funds invest in domestic early stage companies or in private equity investment strategies. In contrast, only three KiwiSaver funds explicitly invest in these categories.

166. The government has recently announced a $300 million investment in the New Zealand Venture Investment Fund to help boost investment in the early stage market. This investment is intended to be a co-investment with the private sector. We are interested to explore the role of KiwiSaver in this space.

Problem definition

167. We seek your feedback on any current limitations or problems in relation to the development of New Zealand's capital markets.

168. By way of background, successive New Zealand governments have expressed an interest in fostering New Zealand's capital markets, because deep and liquid capital markets support the growth of New Zealand businesses and the wider New Zealand economy. Within this broader context, the Government has a number of particular interests in the development of New Zealand's capital markets:

    a. ensure that early stage New Zealand companies have access to sufficient capital, so that they can grow and compete, both domestically and internationally.

b. ensure that New Zealand companies have the option to list domestically.

c. ensure that advice and research, particularly in fields that require specialist expertise, is available and accessible. This could impact both the availability of capital for alternative investment and early stage companies and the ease with which investors can identify good investment opportunities in such companies.

169. Given that KiwiSaver is already an important player in New Zealand's capital markets, we are interested in exploring whether the KiwiSaver default settings could play more of a role in achieving these interests.

170. We have also received feedback from some KiwiSaver providers that KiwiSaver transfer rules, which require providers to transfer members within 35 days if a member requests to transfer schemes, make alternative New Zealand asset investments unappealing due to difficulties with liquidity and daily pricing. We would appreciate feedback on whether this is the case, and whether there are regulatory reforms that could be made to improve this situation.

28	What limitations or problems exist in relation to New Zealand's capital markets? How could the settings for KiwiSaver default providers be amended to support the development of New Zealand's capital markets? How do the liquidity and pricing rules affect default provider investment in alternative New Zealand investments?

Feedback sought on the role of default funds in New Zealand capital market development

171. Many countries use retirement savings schemes to develop domestic capital markets. The majority of OECD countries have some restrictions on the amount that retirement savings or pension funds can invest outside the country. For example, Canada allows up to 30% of the fund be invested in foreign investments. One of the stated goals for many of these restrictions is to develop domestic capital markets.

172. The KiwiSaver default settings could be used to promote liquidity in New Zealand capital markets and encourage increased flows of capital into under-serviced parts of New Zealand's capital markets ecosystem. This could support KiwiSaver default members to accumulate long-term retirement savings, to achieve their financial goals and to allow them to have a similar standard of living in retirement to what they enjoyed pre-retirement, consistent with the purpose of the KiwiSaver Act.

29	How could the default settings be used to develop New Zealand's capital markets? What parts of New Zealand's capital markets are most in need of development?
30	Should default funds take an active role in helping develop the New Zealand capital markets? Would this support the purpose of the KiwiSaver Act and the accumulation of retirement savings by default members?

Options for developing New Zealand’s capital markets

173. The options in this section could be mandatory or be volunteered by default providers as part of putting together a strong tender offer. We are also interested in your view on other options to develop New Zealand’s capital markets. These options should not detract from the purpose of KiwiSaver and should help ensure default members are in a better financial position, particularly at retirement.

174. We have not included an option to require providers to invest a certain percentage of default funds in New Zealand. We do not think that option would address a problem in New Zealand’s capital markets (as default funds are already heavily invested in New Zealand). In addition the option could lead to over-exposure to the New Zealand economy and/or materially impact on a fund manager’s ability to invest on a prudent financial basis.

175. We note that adopting a less conservative investment mandate may help develop capital markets: default funds would invest more in higher-growth oriented assets, with some of this investment likely to take place in New Zealand.

Option 1: New Zealand-based management requirement

176. Option 1 would require default providers to conduct some of the activities associated with the management of their default funds in New Zealand.

177. We understand that most of the activities associated with the investment process already take place in New Zealand. However, we are interested to know whether there are activities carried out off-shore that could be brought back to New Zealand that would help build a stronger financial ecosystem and support better outcomes for New Zealand firms. It would also be useful to receive information from submitters on the extent to which the management of default funds is currently located in New Zealand or carried out by New Zealand entities.

178. The objective of this option is to help build a wider financial ecosystem. Increased domestic capability in research, ancillary services (eg fund accounting) and specialist investment fields (eg venture capital) could support more activity in New Zealand’s capital markets. The detailed design of this option would need to be considered further following consultation, including ensuring it works for both passive and actively traded funds.

179. We are interested in hearing from submitters about the parts of the investment process that should be based in New Zealand, if this option was adopted. We are also interested in views on what type of mechanism would best give effect to this requirement (for example, providers agreeing in their terms of appointment to have the relevant parts of the investment process based in New Zealand).

180. This option could also take advantage of the fund manager’s home bias (the preference to invest in your own country due to greater familiarity with local market players, compliance costs and opportunities). Conversely, it would also remove bias against growth-oriented New Zealand investments which could be a result of offshore asset management practices by some fund managers.

181. The effect of this option will depend on the investment mandate that is chosen. For example, if the conservative mandate is maintained then the option would have limited effect due to the high proportion of bonds and other low-risk assets in the fund.

182. We would also be interested in any other suggestions that would lead to an increased focus by providers on New Zealand assets that do not currently attract much investment from KiwiSaver providers (eg private equity).

31	To what extent is the management of default funds currently located in New Zealand or carried out by New Zealand entities?
32	What is your feedback on a New Zealand-based management option? If this option is adopted, which part of the investment process do you think should be based in New Zealand to help develop New Zealand's capital markets? What type of mechanism would best give effect to this requirement?

Option 2: Targeted investment requirement

183. Option 2 is to require default providers to invest a certain percentage of default funds with a specific focus - for example, that a small percentage (ie not more than 0.5%) of a default fund must be invested in alternative New Zealand assets. The objective of this option would be to support investment by default funds into alternative New Zealand markets. For example, investment in early stage companies could help develop the wider capital markets, including the expertise available in the wider capital markets ecosystem.

184. The low percentage would allow the fund manager flexibility to maintain an appropriate risk profile across their fund and the liquidity to comply with transfer rules. As a targeted requirement only limits the investment for a small part of the fund the requirement is unlikely to make a material change to the funds overall risk profile, returns or fees.

33	What is your feedback on a targeted investment requirement? If the option is adopted, what market should be targeted by an investment requirement (eg early stage companies)?

Costs and benefits of options to develop New Zealand's capital markets

Criterion 1: Better financial position for KiwiSaver default members, particularly at retirement

185. **Option 1** could have a negative impact on fees as fund managers may not be able to take advantage of economies of scale. This would have a negative effect in relation to this criterion. However, this may be able to be mitigated by the design of the option and enhanced rules on fees.

186. **Option 2** could reduce flexibility for providers to invest in members' best interests. There would also be the risk that investment in alternatives could result in lower short term returns. However, a small targeted investment requirement is unlikely to have a material impact on the financial position of KiwiSaver default members. This is because the higher fees associated with alternative investment and the potential higher return would be small relative to the overall size of the fund.

Criterion 2: Trust and confidence in KiwiSaver

187. For **option 2** default members could feel that their funds are being used to achieve additional government objectives (whether the option actually benefits them in the long run or not). This could reduce trust and confidence in KiwiSaver. However, if the targeted

investment requirement leads to better long term investment return it is likely to in turn promote trust and confidence in KiwiSaver over time as people see the benefits.

Criterion 3: Low administration and compliance costs

188. Both options could create incentives for providers to minimize the effect of the requirement. This could increase compliance costs for providers and monitoring costs for regulators.

189. **Option 1** may be difficult to design in a way that required the desired buildup of expertise in New Zealand, while allowing flexibility in investment approach (eg active versus passive investing).

190. **Option 2** may have higher compliance costs, as investing in alternative markets is more costly than investing in listed markets (for example due to higher research and monitoring costs). There could also be issues with maintaining the required investment percentage given the volatility in value of some alternative investment (eg early stage companies), which would also increase administration costs.

Criterion 4: Support development of New Zealand's capital markets that contribute to individuals' well-being

191. Both options are likely to have a positive effect on the development of New Zealand's capital markets.

192. **Option 1** takes advantage of home bias to increase investment in New Zealand without having to require investment in New Zealand. The option also looks to increase the wider financial ecosystem by encouraging the build-up of expertise in the country, provide ongoing career pathways and avoid hollowing out the financial ecosystem. This may lead to natural growth in the New Zealand capital markets, including both the listed and alternative markets. The market growth in this option is also natural and is unlikely to lead to market distortion created by direct government requirements.

193. **Option 2** would be a direct way for default funds to support New Zealand capital markets. The majority of default funds are unlikely to invest directly into alternative New Zealand assets, as the investments require considerable monitoring and specialist expertise. Therefore, if a targeted requirement is selected, default funds could invest into funds run by specialised managers which could help develop the wider investment ecosystem. The option could also provide a positive signal to international investors about these markets, increasing foreign investments in them.

194. However, **option 2** could also lead to overinvestment in the sector, leading to lower quality investments or distortions in the market. This risk can be mitigated by design options – for example, by setting the requirements very low or phasing them in. The option also runs the risk of these parts of the capital market becoming dependent on government policy settings to maintain the market.

Criterion 5: Promote innovation, competition and value for money across KiwiSaver

195. Both options could promote innovation in the capital markets.

196. **Option 1** may help build an innovative capital market by growing the wider financial ecosystem and encouraging local expertise to stay in the country. This in turn may foster

innovation and competition in the wider KiwiSaver market. We encourage feedback on how the option might do this.

197. **Option 2** may encourage KiwiSaver default providers to build their capacity to invest in New Zealand which in turn may create an environment that fosters innovation and competition in the KiwiSaver market.

34	What is your feedback on our assessment of the costs and benefits of the options to develop New Zealand’s capital markets? Which option (or the status quo) is best and why? Is there another option that would be better than the options discussed?

8 Transfer of members

198. We seek your feedback on the extent to which existing default members should be transferred to any new or reappointed default providers following the procurement process.[17] These decisions will affect the incentives on providers to make competitive tenders during the procurement process.

199. If no default members are transferred, some members would remain in funds that were no longer default funds ('ex-default funds'). The obligations on these former default providers would end after the expiry of their instruments of appointment.

200. The government could choose to appoint more or fewer than nine providers. Some existing providers may not be reappointed and/or new providers may be appointed.[18] **Table 4** sets out the number of default members in each default scheme.

Table 4: default members in each default scheme and percentage of default market

Provider	Default members in 2018[19]	Percentage of default market
AMP	112,620	22.00%
ASB	90,456	17.70%
Mercer	81,861	16.00%
ANZ	72,443	14.20%
Fisher Funds	68,508	13.40%
BT Funds (Westpac)	22,492	4.40%
Kiwi Wealth (Kiwibank)	22,295	4.40%
BNZ	22,172	4.30%
Booster	18,308	3.60%
TOTAL	**511,155**	**100%**

Problem definition

Protections under the instrument of appointment would end

201. Default members who are not transferred out of an ex-default fund would no longer receive protections under the new or former instrument of appointment. For example, the provider would no longer be regulated in relation to fees. This means providers' fees may

17 The Act allows regulations to be made for the transfer of default members. The instruments of appointment also require default providers to comply with directions given to them by the Minister in writing.

18 If a current default provider is re-appointed as part of this review, it will be appointed under a new instrument of appointment, which will set out the additional obligations specific to default providers.

19 The sum of contributing default members at the start of the reporting period, plus all new default members gained during the year, plus all non-contributing default members at the start of the reporting period. Also includes some members who exited during the reporting period. From FMA's *KiwiSaver Report 2018*.

increase. Members that remain in an ex-default fund would also not benefit from any new settings, such as a more growth-oriented investment mandate.

202. Default members are unlikely to have made an active choice regarding their fund and in general do not engage with their KiwiSaver. This may exacerbate the impacts of protections under the instrument of appointment being removed for members that remain in ex-default funds.

Reducing the incentive to tender

203. Default members are assigned automatically, not as a result of efforts by default providers. If no members were transferred, the incentive to tender or to submit competitive bids is likely to be reduced. This is because any new default provider would only benefit from new members. Ex-default providers would retain their existing members.

204. This could be seen as unfair for the newly appointed providers which will not benefit fully from a sizeable existing default membership but which will have to comply with additional obligations. This could also discourage newer or smaller providers from tendering.

205. Setting the appropriate transfer arrangements is an opportunity to create more competition and innovation for KiwiSaver through a procurement process that only occurs once in seven years.

35	What is your feedback on the problem definition for the transfer of members? What other problems are there in relation to the transfer of members?

Options for transfer of members

206. This section sets out options for the transfer of members. Some options may or may not be applicable depending on how many and whether existing default providers are appointed. A key dependency for the merits of these options is the number of providers that are appointed. In general, we are also interested in your views on how to minimise disruption to members and providers across all options.

Option 1: Allocate all default members among appointed default providers

207. **Option 1** is to transfer the whole default member base from the existing default providers to the appointed providers. All default members would be subject to reallocation and not just the default members from providers that were not reappointed. If this option is taken, organisational capability of providers will be an important consideration, as default providers may be required to handle a large influx of members.

208. All existing default members could be pooled together and reallocated amongst the appointed default providers. An alternative would be to transfer members from providers with more members to providers with fewer members such that all appointed providers have a similar number of members. It is important that there is a fair process for determining which members are transferred. We seek your views on the appropriate mechanism for reallocating members for this alternative option.

209. The impact on membership levels will depend on the number of providers appointed. If fewer providers are reappointed, it is possible that all or almost all appointed default providers would still be net recipients of additional default members.

36	If default members are transferred from providers with more members to providers with fewer members, how should we decide which members are transferred?

210. **Member choice to remain**: for this option, we seek your feedback on how existing default members should be notified of any default status changes and how to enable a choice to remain with their current provider. For example, default providers could be required to contact their members (eg by issuing them with a form) in an attempt to determine if they wish to remain with their provider. Those who indicate that they wish to remain would not be transferred. Those who do not respond, or indicate that they wish to be transferred, would be transferred to a new or reappointed default provider. Providers would have incentives to engage with their members to retain them.

Option 2: Default members from default providers not reappointed would be transferred

211. The second option is to reallocate members from existing default providers that are not reappointed to appointed providers. Existing default providers that are reappointed would retain their existing members. The default members that are reallocated could be reallocated evenly amongst all the appointed default providers, or only amongst any new default providers (that were previously not a default provider). We seek your views on how these reallocated members should be distributed.

212. **Member choice to remain:** as with option 1, we also seek your views on how members should be notified and given a choice if they wish to remain with their existing provider.

37	If transfer option 1 or 2 were adopted, how should default members be given a choice to remain with their current provider for this option?

Option 3: Existing default providers retain their default members

213. Option 3 is for existing default providers to retain their default members, regardless of whether they are reappointed or not. The obligations under the instruments of appointment of ex-default providers would end and the fund would be governed as a non-default KiwiSaver fund, subject to any transitional arrangements that were put in place.

214. Under this option, default members would need to be informed that their default provider is no longer a default provider and given a choice about remaining in their fund. However, if they do not make a choice they would stay with their existing provider.

Costs and benefits of transfer options

Criterion 1: Better financial position for default members, particularly at retirement

215. For **options 1 and 2** the impact on the financial position of members at retirement will depend on the decisions made regarding other settings such as the investment mandate

and fees. If the new settings have a more positive impact on the financial position of default members, these options would ensure that default members are transferred and receive those benefits.

216. For **option 3** existing default members who are no longer subject to fee regulation under the provider's instrument of appointment could see fee increases if they are no longer subject to fee regulation as a default provider.

217. If the new settings for default providers result in a better financial position for default members, the members that remain in ex-default funds would have a comparatively worse financial position.

Criterion 2: Trust and confidence in KiwiSaver

218. In the short-term, **option 1 and 2** could lead to a slight decrease in the trust and confidence in KiwiSaver for default members if default members feel disrupted by being moved from their default provider. This would be more so for option 1 than for option 2.

219. Given that default members tend to be disengaged with their KiwiSaver, the disruption to members from these changes may be minimal. However, some default members will know who their provider is and have a relationship with them that they value. Those members could experience more significant disruption and this could affect their trust and confidence in KiwiSaver.

220. In the long-term, **options 1 and 2** are more likely to maintain trust and confidence in KiwiSaver compared to an option that does not transfer any members, because all default members would remain in default funds and continue to receive the protection that comes with them.

221. For the members from a provider that is not reappointed in **option 3**, they may lose trust and confidence in KiwiSaver if they later find out that they were no longer subject to any additional protections that a default fund had provided. Members that are notified that their KiwiSaver provider has lost default provider status may lose trust and confidence in KiwiSaver as losing default provider status may be construed as implying the fund they are now in is of lower quality. However, **option 3** would involve less disruption to members compared to the other options, as there would be no transfers of current members.

Criterion 3: Low administration and compliance costs

222. The more members we transfer the higher the administration and compliance costs for providers and the government could be.

223. **Option 1** could have higher administration and compliance costs because more default members are likely to be transferred. However, if a transfer of members is likely to occur regardless, for example if the review appoints fewer than nine providers or at least one different provider, we believe there could be efficiency gains from tendering the whole default member base at the same time.

224. **Option 2** would have moderate costs due to the transfer as it is likely a smaller number of default members would need to be transferred.

225. **Option 3** would have the lowest administration and compliance costs due to the transfer, as there would be no transfer of members required.

Criterion 4: Support development of New Zealand's capital markets that contribute to New Zealanders' well-being

226. **Options 1 and 2** could help develop the capital markets. By reallocating the default members away from funds that are no longer default funds these options will maximise the effect of the decisions taken in other sections that will help develop capital markets.

227. **Option 3** will have a smaller effect on capital market development by decreasing the number of members, and therefore the pool of funds available to capital market development.

Criterion 5: Promote innovation, competition, and value-for-money

228. **Option 1** is likely to have the strongest positive impacts on innovation, competition and value-for-money. There could be a greater incentive for providers to submit more competitive tender bids, or encourage bids from new providers given they stand to gain a greater a market share of the default members compared to the other options.

229. There is a risk that retendering the whole default member base could reduce the attractiveness of tendering to become a default provider as it would signal the government's willingness to retender default members again in the future. This could lead to fewer providers tendering to become default providers. However, this disincentive may be minimal compared to the benefits of being a default provider.

230. We think that the prospect of losing all existing default members in **option 2** would place significant pressure on existing default providers to submit competitive bids during a tender process. The strength of the incentive on existing default providers would depend on the number of default providers appointed.

231. **Incentives on member engagement:** A benefit of option 1 is that it may encourage default providers to invest more in member engagement and move default members out of the default funds. Any member that makes a choice to move out of a default fund as a result of engagement by default providers with their members would remain with that provider in one of their other funds.

232. **Option 3** may have less impact on innovation, competition, and value-for-money as it would preserve the market share of the existing providers. This may discourage more innovative or competitive bids from being put forward.

38	What is your feedback on the transfer options and the costs and benefits of the options? Which option (or not transferring at all) do you prefer and why? Is there another better option we have not considered?

Transition timeframes

233. We seek your feedback on the transition timeframes for transfer, if a transfer option is adopted. One option would be to transfer members when the terms of the existing default providers expire (1 July 2021). Another option is to transfer members after 1 July 2021. This could involve staggering the transfer over a period of a time (eg six months).

234. Key considerations for determining appropriate transition timeframes include:

- How many default members are to be transferred to the new and reappointed default providers.
- Whether there are significant changes to the settings of existing funds.
- The time needed to notify default members of any changes to a provider's default status and to provide them an opportunity to make active choices whether to remain in their existing fund.
- The effect on the market of moving large numbers of members at once, depending on the investment mandate and the allocation of members to those funds. For example, if the investment mandate changes so that the default funds invest more in New Zealand equities, this could crowd out other investments or create inflationary pressures that distort the market.
- The potential for confusion for default members, if some default providers have both an old and a new default fund during the transition process.

39	What factors should the review consider in deciding transition timeframes?

Transfer of 'active defaults'

235. A decision also needs to be made regarding any transfer of 'active defaults' to new providers. Active defaults are members who have made an active choice to join or remain in default funds. Active defaults are not counted as default members for the purposes of reporting default membership. We seek your views on whether active defaults should be transferred along with default members, or whether they should be treated differently or excluded from any transfers.

236. In terms of the case for treating active defaults as default members, active defaults may have chosen the fund for its default status, and expect to continue receiving the benefits that come from default provider settings. There is also some evidence to suggest that active defaults are not fully engaged with their decision when choosing to remain in the default fund, or choose it because of the relatively lower default fees so it might be appropriate for them to benefit from any default provider settings intended for disengaged members.

237. On the other hand, some providers tell us that these members have in fact been actively recruited as a result of engagement by providers with their members.

238. If active defaults are not transferred, the provider may also choose to maintain a small ex-default fund with old settings just for these members.

40	Should active defaults be considered default members for the purposes of transfers? How should active defaults be treated and notified of any changes to default provider settings?

9 Member engagement

239. Providers are currently required to report on the steps taken to address the financial literacy of members. However, the instruments of appointment do not specify actual steps that providers must take to address the financial literacy/capability of members.

240. As discussed earlier in this paper, we consider that it would be appropriate for providers to have obligations in relation to investor engagement and education. No fund will be right for everyone, so member education is important to ensure that, to the extent possible, default members end up in the right fund for them. In addition, there are other roles that member education can play, for example educating members about investment more generally and ensuring that members are on the contribution rate that is right for them.

241. The FMA's guidance on sales and advice states that providers should talk to their members about the following key points:

    a. **Be in KiwiSaver:** how KiwiSaver works and why it is suitable for many New Zealanders

    b. **Contribute**: advising the member to choose a contribution rate and contribute enough to get the full member tax credit

    c. **Right fund**: helping the member choose the right fund for them

    d. **Right tax rate:** how to choose the correct tax rate.

242. We seek feedback from submitters on the member education requirements that should be imposed and the emphasis that member education requirements should have in the overall criteria for appointment of providers. For example, there could be requirements in line with the above guidance from the FMA. Some structural options could include:

    a. Requirements to report to the FMA regarding steps taken to address the financial capability of members

    b. Obligations to make a certain number of outbound calls or email contacts (to the extent that that contact information is available) to each default member, with the purpose of addressing their financial capability

    c. Obligations to maintain a certain number of full-time staff responsible for member education (pro-rated against the provider's number of default members).

243. We also seek feedback on how the instruments of appointment can best provide for enforcement, and what the appropriate consequences should be for failing to meet the requirements set out in the instruments of appointment.

41	What is your feedback on the member education requirements that default providers should have in relation to default members, and how these should be enforced in the instruments of appointment?

10 Other requirements

244. We seek feedback on other requirements for default providers. Table 5 is a summary of the criteria and weighting from the last appointment process, excluding fees and member education. The weightings assigned to the categories above add to 60%. 10% was assigned to member education and 30% to fees.

245. MBIE and the Treasury are not attached to keeping the same assessment criteria for this review. In particular, some of the criteria in the list would be satisfied if the applicant was a licenced managed investment scheme (MIS), so one option would be to treat being a MIS as a pre-requisite, with focus then being given to criteria in addition to the MIS requirements (for example, fees, member engagement, ability to handle a large influx of members). However, the list provides a useful starting point for discussion.

Table 5: Summary of criteria from last appointment process excluding fees/member education

	Assessment criteria and summary of assessment criteria	Weighting
Organisational background (15%)	**Organisational detail**	N/A
	Summary of the provider's business history	5%
	Financial strength, soundness and stability of their organisation	20%
	History and credibility: how the provider has helped grow personal and superannuation savings, has supported and promoted KiwiSaver, and how their appointment will maintain and promote confidence in KiwiSaver.	15%
	Financial information: risk management and control systems are robust and fit for purpose.	15%
	Compliance and regulatory: provider not subject to regulatory or legal proceedings that bring into question the efficacy of their compliance systems or their suitability to provide a default KiwiSaver scheme.	15%
	Corporate structure and governance: a strong and well-articulated corporate governance regime.	10%
	Portfolio investment entity: that the provider is a portfolio investment entity	N/A
	Trans-Tasman portability: processes for trans-Tasman portability.	5%
	Anti-money laundering: a robust and well-documented anti-money laundering compliance regime.	5%
	Independent statutory (corporate trustee company): Provider is subject to effective oversight by a licenced trustee with the necessary personnel, resources and supervision regime	10%
Organisational capability (15%)	**Organisational experience and knowledge:** capability to effectively operate a default KiwiSaver scheme, including an experienced and qualified senior management team.	60%
	Implementation: resources and plans are in place to accept default members and comply with the default provider requirements	40%
Administration capability (15%)	**Resourcing**: necessary resources to handle a large influx of default members.	20%
	Reporting capability	10%
	Systems and processing: respondents should have all the necessary systems in place to reliably administer a KiwiSaver default scheme	35%
	Client service: respondents should be able to meet and exceed the minimum client service standards.	35%

	Assessment criteria and summary of assessment criteria	Weighting
Investment capability (15%)	**Default investment product, objectives and risk profile:** default investment product aligns with the investment mandate decided by Government. Respondents should have a clear performance strategy, including assessment against relevant benchmarks, and should propose a risk strategy that is consistent with the aim of promoting public confidence in KiwiSaver.	40%
	Asset structures: Appropriate diversification in investment structure. The Statement of Investment Policies and Objectives should be appropriate for a default investment product.	10%
	Investment diversification and risk control: A detailed and convincing strategy for managing risks.	25%
	Investment operations: robust systems and processes to manage operational investment risks. This should include using a custodian that has appropriate controls, systems and procedures to protect client assets.	15%
	Other non-default products: A broad range of non-default investment products of varying risk profiles that are suitable to different groups of KiwiSaver members, with competitive fees.	10%

42	What is your feedback on the other requirements that should apply to default members?

11 List of questions

1. What is your feedback on the proposed objective for the review?

2. What is your feedback on the proposed criteria for the review? How should the criteria be weighted?

3. What is your feedback on the problem definition for the investment mandate? Is a move away from a "parking space" purpose justified?

4. Should the investment mandate options (and other options, for example in relation to fees) apply only to default members who have not made an active choice, or should they also apply to members who have made an active choice to stay in the default fund? Why or why not?

5. If a life-stages option is adopted, what "stages" should apply and to which age groups? Should there be a "nursery" period?

6. If a balanced investment mandate is adopted, what range for growth assets should be applied?

7. If a growth investment mandate is adopted, what range for growth assets should be applied?

8. If a conservative investment mandate is adopted, what range for growth assets should be applied?

9. If a life-stages, growth, or balanced option was adopted, how should we mitigate the potential issue in relation to first-home buyers and other people making early withdrawals?

10. What would be the administrative costs to providers of choosing a life-stages option?

11. What is your feedback on the different options? Do you agree with our assessment of the costs and benefits of the option? Which option do you think is best and why? Is there another option that we have not considered that would be better than the options discussed?

12. What is your feedback on the level of value that KiwiSaver default members get for their fees? What are the costs that are within and outside a provider's control? To what extent are fees too high?

13. Is it a problem that fees disproportionately affect those on low income and under 18s? Why/why not?

14. If the government sets a fee, what should the fee be set at for the different investment mandate options? What considerations, methods or models could be used to determine the fee? What should be the balance between fixed and percentage fees?

15. What fee arrangements would best promote the objectives of the review? What is your feedback on the fee options? Do you agree with the costs and benefits identified? Which option (or the status quo) do you prefer and why? What other approaches or models could be used to reduce fees?

16. How has the number of providers in the default market affected innovation, competition and value-for-money in the default market and in KiwiSaver more generally?

17. Do you agree with our assessment of the costs and benefits of the different approaches for the number of providers? Can you provide us with evidence that might help us quantify the size of the costs and benefits? What option do you prefer and why?

18. If a "minimum requirements" approach is taken should this be on a period-based or rolling system, and why?

19. Are there higher investment costs for responsible investing? If so, how likely are these costs to contribute to lower net returns?

20. How does responsible investment affect returns? Does it increase or decrease returns, and to what extent?

21. Should the default provider arrangements be used to achieve objectives in relation to responsible investment?

22. Would default members want their funds to be invested more responsibly? If yes, is the same true if responsible investment means potentially limiting future returns?

23. To what extent is it a problem that default members do not have information about whether their investments are made responsibly? Would having more information make a difference to the behaviour of default members? What alternatives might there be to more/standardised information to address responsible investment concerns?

24. Do providers' current responsible investment exclusions meet what default members would expect?

25. If this option is adopted, what industries or sectors should be excluded? Should the government instead adopt an international exclusion standard or certification regime? What would be the costs associated with an exclusion or certification regime?

26. If this option is adopted, what form should standard disclosure take? For example, should all providers be required to provide a statement listing all excluded companies by sector?

27. What is your feedback on our assessment of the costs and benefits of the responsible investment options identified? Which option (or the status quo) do you prefer and why?

28. What limitations or problems exist in relation to New Zealand's capital markets? How could the settings for KiwiSaver default providers be amended to support the development of New Zealand's capital markets? How do the liquidity and pricing rules affect default provider investment in alternative New Zealand investments?

29. How could the default settings be used to develop New Zealand's capital markets? What parts of New Zealand's capital markets are most in need of development?

30. Should default funds take an active role in helping develop the New Zealand capital markets? Would this support the purpose of the KiwiSaver Act and the accumulation of retirement savings by default members?

31. To what extent is the management of default funds currently located in New Zealand or carried out by New Zealand entities?

32. What is your feedback on a New Zealand-based management option? If this option is adopted, which part of the investment process do you think should be based in New Zealand to help develop New Zealand's capital markets? What type of mechanism would best give effect to this requirement?

33. What is your feedback on a targeted investment requirement? If the option is adopted, what market should be targeted by an investment requirement (eg early stage companies)?

34. What is your feedback on our assessment of the costs and benefits of the options to develop New Zealand's capital markets? Which option (or the status quo) is best and why? Is there another option that would be better than the options discussed?

35. What is your feedback on the problem definition for the transfer of members? What other problems are there in relation to the transfer of members?

36. If default members are transferred from providers with more members to providers with fewer members, how should we decide which members are transferred?

37. If transfer option 1 or 2 were adopted, how should default members be given a choice to remain with their current provider for this option?

38. What is your feedback on the transfer options and the costs and benefits of the options? Which option (or not transferring at all) do you prefer and why? Is there another better option we have not considered?

39. What factors should the review consider in deciding transition timeframes?

40. Should active defaults be considered default members for the purposes of transfers? How should active defaults be treated and notified of any changes to default provider settings?

41. What is your feedback on the member education requirements that default providers should have in relation to default members, and how these should be enforced in the instruments of appointment?

42. What is your feedback on the other requirements that should apply to default members?