Submission template: Review of KiwiSaver default provider arrangements

ANZ New Zealand submission

Section 1: Your details

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Are you requesting that any of this submission be kept confidential? Yes / **No**

If yes, please let us know why the information should be kept confidential in accordance with the Official Information Act. Please also send us a redacted version of your submission for publication.

Reasons for withholding:

Section 2: Feedback on discussion paper

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

We agree that enhancing the financial wellbeing of KiwiSaver default members and optimising their retirement outcomes is a worthy objective.

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

Investment decisions that enhance the financial wellbeing of members should be the highest priority. We think that criteria one '*Better financial position for KiwiSaver default members, particularly at retirement*' should be given the highest weighting.

Following this, returns after fees and adequate oversight of the investment process across a market cycle should be considered. We believe it is important to consider long-term performance and rigorous investment processes. This would retain trust and confidence in KiwiSaver and also demonstrate value for members.

We believe innovation is fostered by competition and, as the number of KiwiSaver providers grow, innovation will develop irrespective of default status.

There is a strong link between the growth of KiwiSaver funds and development of New Zealand capital markets, so we do not believe criteria four '*Support development of New Zealand's capital markets that contribute to individuals' wellbeing*' should be prioritised. As referenced in the review document, 50% of all KiwiSaver default funds under management are invested in New Zealand assets.

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

We agree that despite the best efforts of providers, some members will remain in a default fund and that a move away from the "parking space" purpose and an increase of growth assets is justified.

KiwiSaver's primary objective is a retirement savings vehicle, so improving default members' retirement outcomes and financial wellbeing should be the focus of the investment mandate. A member's future retirement should take priority over other purposes of KiwiSaver, including first home withdrawals, which could be negatively impacted by a shift to a greater allocation of growth assets. We would expect that members looking to make a first home withdrawal are more engaged and open to a discussion about their fund choice and therefore they do not need to be a specific focus.

In our experience, when we are able to contact a default member and have a conversation with them, they are more likely to make a choice about which fund they invest in. In the year to March 2019, 69% of members we spoke to made a choice about their fund. It is important to recognise that the quality of data available to providers such as address, phone numbers and email is sometimes poor, which limits the ability to make contact with default members. If data held by Inland Revenue was improved, we expect engagement rates and the number of members moving out of default funds would also increase.

Member education is still vitally important as no one fund is right for everyone. Currently, default members are put onto a 28% PIR, which may be incorrect for many. By having correct contact information, providers can prompt members to check their tax rate and other important information. Members will also benefit from other initiatives – like checks to find out whether they have contributed enough to receive the Government contribution.

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?**

Any change to an investment mandate should only apply to members who have *not* made a choice about which fund they invest in. This would be a good opportunity to re-engage with those members and educate them about their options.

Applying the mandate change across the board would go against an active member's instructions (reflecting their attitude to risk and goals), if they have decided to stay in a default fund with a conservative setting.

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

The current default asset allocation might be considered too conservative for the majority of members and we agree a life-stages option is a sensible approach. There are a number of models used by the industry, with some more conservative than others. We would support the Government obtaining independent actuarial advice on the most appropriate model.

A “nursery period” adds complexity, which we believe will be confusing to members and add administrative costs for providers. We have not seen any evidence from the field of behavioural economics that this approach better encourages members to make an active choice.

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

The target for growth assets in a balanced mandate should be 50%, with a range between 35–60%.

Allocations will change over time as a result of our asset allocation process. As well as constructing diversified portfolios across different asset classes and regions using a strategic allocation process, ANZ Investments uses tactical allocation to adjust exposure depending on the outlook. This enables us to reduce/increase exposure to asset classes with a less/more favourable outlook, with the aim of increasing members’ long-term risk-adjusted returns.

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

The target should be 80%, with a range from 60–100%.

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

The target should be 20%, with a range from 10–30%. It should be noted within the current ANZ conservative fund, some members have made an active fund choice to remain in this setting. Should the current investment mandate for the conservative fund be changed, the impact of any change – and whether it is material for those active members currently in the conservative fund – would need to be considered.

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?**

KiwiSaver’s main purpose is to increase members’ financial wellbeing in their retirement. With this in mind, asset allocation considerations should focus primarily on retirement, and not early withdrawal types.

Providers should continue to communicate with members that if they are planning to use the first home withdrawal, they should consider their fund choice. For members who do not have a banking relationship with their provider, the only data available that suggests a member is a potential first home buyer is their age and the fact they have not already completed a first home withdrawal. This means tailored engagement is difficult. However, first home buyers are more likely to actively choose their fund and provider – and be more engaged with their account.

In our experience, serious financial hardship and serious illness withdrawals are urgent and unplanned. As such, both members' and the Government's default settings should not attempt to plan for these withdrawals, as it would cause a low risk-and-return approach for all members.

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

In our experience, a life-stages model works best as an overlay across provider funds, not as a separate range of funds. Assuming providers have an appropriate range of funds that would suit each age group, then there is unlikely to be an additional investment management cost, such as running additional investment mandates.

There would be a system implementation cost to ensure the provider's system can analyse a member's age and allocate them to an appropriate fund. Other costs include amending disclosure documents, sending communications to members when they reach a new life-stage, training staff and advisers about the new model and amending online fund choice portals and apps. These costs may be incurred even if a provider currently uses a life-stage model, as any changes to their current model would result in similar costs.

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?**

We support either a life-stages or balanced approach, as a good compromise between returns and risk. A life-stages approach would be a big change for the industry, but would result in better outcomes for members than the current conservative setting. It should be noted that there are limited economies of scale from all default providers adopting a life-stages model. As referenced above, costs relate to an individual provider's system implementation, training and communications.

A growth approach is too aggressive and could negatively impact older members if there is a downturn in the market when they are about to enter into, or are in, retirement. This is not appropriate as it does not meet criteria one or two.

We agree with the assessment of the costs and benefits of each option. However, we note the statement that "it would not be appropriate to take investment risks on behalf of non-consenting participants" in paragraph 65. Although default members do not explicitly agree to the default investment mandate, it is fully disclosed to them and they do have the option of opting out of KiwiSaver, switching funds or suspending their contributions.

Another option is placing members in a particular risk profile based on their age. For instance, this would allocate a younger member into a growth fund and an older member into a conservative fund. While this allocation may have better long-term outcomes than the current conservative setting, the risk remains that these members are unable to be contacted and do not change their risk profile to an appropriate setting for their age and life stage in years to come.

Any changes from the current conservative fund setting would need to be implemented over a transition period. To transfer all current default members to another setting will involve a material number of fund switches, which will in turn require a sell-down of underlying assets in investment markets. To action such moves in a short period of time could distort market liquidity and pricing.

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?**

We believe our fees provide good value for money. We are transparent about what we charge and have reduced fees to reflect scale benefits.

While fees are important, it is more important to look at a provider's ability to deliver long-term investment returns after fees, as this is one of the primary factors that will determine how much money members have when they reach retirement. Other benefits include free advice, tools and digital access that providers may offer.

Primary costs outside of a provider's control relate to the implementation of legislative and regulatory changes. The New Zealand market is competitive and members enjoy a range of options with different fee and service offerings.

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

Fees are likely to disproportionately affect those on lower incomes and under 18s, particularly those who are not working. Fixed monthly or annual fees can erode a member's investment over time. We believe it is important to help Kiwis get into an investing habit, so for example our recent fee reductions were designed to help these members in particular.

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?**

We do not support a fee being set by the government for default funds**.** There is a wide range of offerings in the New Zealand market**,** which encourages innovation and provides choice for members. Fees need to recognise the varying services being provided. However**,** there is the expectation that as a provider grows, economies of scale will be passed onto members. We recommend the ongoing monitoring and assessment of fees. Other items to consider include active versus passive management and the resources required to manage the various asset classes.

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?**

Being a default provider requires investment in considerable infrastructure, processes and training and the allocation of significant resources to meet members' needs and comply with specific regulatory obligations that apply to default providers. It is important that the fee structure is commensurate with the services required of providers.

We broadly agree with the costs and benefits identified, but make a few observations. Firstly, we believe that investment returns after fees is one of the most important considerations when choosing a provider. Fees should not be assessed in isolation. The ability of a default provider to properly meet the needs of the expected volume of default members, given the significant infrastructure investment required, is important.

Were the government to set a fee, the level of service a provider offers may be impacted. This could result in lower engagement efforts by providers.

We agree that members should expect fee reductions as providers achieve scale benefits. However, it is important to note the variable nature of many costs, for instance overseas manager costs. Exposure to offshore markets is a key aspect of a diversified investment strategy.

Another option that should be considered is a total percentage fee cap (taking into account both percentage and dollar fees). That could be monitored by the government to ensure investments, particularly of those of under 18s and low income earners, are not being eroded by fees. However, this would be another investment measure providers would have to disclose, calculate and monitor within relevant systems, with requisite costs and administration implications.

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?**

The number of providers in the **overall** KiwiSaver market, which has grown to 28, has driven innovation, competition and value for money in New Zealand. Default members have considerable choice of KiwiSaver schemes. We welcome competition, but the performance of a provider needs to be viewed across the whole economic cycle to determine whether their strategies are appropriate for a long-term savings vehicle.

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?**

We have not seen evidence that members make a significant association between default provider status and government endorsement. We believe that innovation, competition and value for money across KiwiSaver is being driven by all providers, irrespective of their default or non-default status.

We welcome competition and do not have a firm view on how many default providers should be appointed. There should however be firm accountabilities for default providers in engaging members and also oversight of their performance.

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

A period-based system should be maintained. If a default provider could opt out of the regime at any time, it would create ongoing transfer issues, increase administrative costs and affect the trust and confidence in KiwiSaver.

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

For providers who already take responsible investment (RI) into account within their investment policies and procedures, a continuation of this should not add cost. However, if new standards were imposed and additional reporting and compliance is required, there could be additional costs. These costs could contribute to lower net returns for KiwiSaver members.

It should be noted that community standards and what is deemed ‘irresponsible’ change over time. As such, there will need to be an ongoing and dynamic review process.

As an active manager, we exclude companies that do not fit within our responsible investing philosophy. We also integrate Environmental, Social and Governance (ESG) considerations beyond blanket industry exclusions into our funds, which allows us to actively engage with issuers on ESG concerns and adjust exposures accordingly.

In comparison, passive managers typically hold an index of stocks, with the exception of sectors and industries specifically excluded.

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

Significant research has been undertaken to determine the link between RI and returns (see appendix). On balance, research suggests that responsible investment does not detract from returns over the long term.

However, we believe that we can achieve better risk-adjusted returns, which means higher returns with the same risk or the same returns with less risk, by integrating RI within our investment process. Our process includes exclusions, engagement and evaluating opportunities and risks through an ESG lens.

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

The overriding objective of KiwiSaver is to improve financial wellbeing at retirement and this should be the focus of the industry and government. In our view, intervention to prescribe RI is unnecessary and could create compliance costs and complexity.

Providers have natural and commercial incentives to adapt to evolving customer needs and optimise returns. This means incorporating ESG considerations into the investment management process because those factors can help achieve better risk-adjusted returns.

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?**

In 2018, ANZ commissioned a survey on responsible investing. Of the 1966 respondents, 69% were KiwiSaver members, however the number of default members is unknown. With this in mind, the survey provides general sentiment that could be useful for this review. 80% of respondents said responsible investing was important to them. 59% of respondents stated they were likely or very likely to select a fund that takes responsible investment into account. When asked if they would trade off either returns or fees, 53% of respondents said they do not expect to pay more in fees or accept lower returns. A further 35% would accept lower returns, but not pay more in fees.

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?**

Default member engagement is low compared to non-default, so additional disclosure is unlikely to make a difference to the behaviour of these members.

All members of ANZ's KiwiSaver schemes receive the same information about RI in our product disclosure statement (PDS). Information about our RI philosophy also features on our website, as required by section 129 of the KiwiSaver Act 2006. Any additional disclosure should be on a provider's website, as it can be regularly updated and does not have word count restrictions like the PDS.

Providers should be consistent in how they report on fund holdings, irrespective of fund structure. This would allow members to be better informed about the underlying securities their fund invests in.

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

We do not invest in companies that are involved in manufacturing cluster munitions or anti-personnel landmines, manufacturing or testing nuclear weapons, manufacturing tobacco products and manufacturing automatic and semi-automatic firearms, magazines or parts for civilian use. We have also excluded some companies that have breached global norms or standards, for instance companies that have committed human rights abuses.

Based on our research, we believe this covers the main exclusions that are important to most members today. While there will always be members with more specific needs, we expect that if something is particularly important to them, they will move to the appropriate fund. There is currently enough choice within the market to provide these options.

Providers should engage with companies to advance responsible investing principles alongside an exclusions approach. ANZ is a signatory to the United Nations-supported Principles for Responsible Investment (PRI). As a signatory, we commit to incorporating ESG issues into our decision making processes and reporting on our progress.

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?**

It is likely to be difficult to reach complete consensus over what should be excluded. The UN-supported PRI provides a good broad overview of how to go about RI. However, it does not provide a definition on exclusions that could be used across all funds and no specific list of exclusions.

Flexibility and consensus will be challenged if the government sets a standard, as it removes the opportunity for providers to differentiate. RI is also constantly developing and can mean different things to different people.

Certification is also problematic. We do not see a process currently in use that has set an industry-wide definition of RI, while not being overly onerous or prescriptive.

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?**

Providers should feature exclusions on their website. This has an advantage over the PDS as it can be regularly updated and is easily accessible to members.

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?**

We would prefer to continue with our researched approach to RI, as we believe in ESG integration and see little increase in investment management costs, subject to no additional compliance obligations. We will continue to use RI to maximise long-term risk-adjusted returns for members and continue to survey them about what sectors and behaviours they would like excluded from a fund.

RI is not simply about excluding sectors or securities. We believe best practice requires providers to look at all investments and potential investments through an RI (or ESG) lens.

As referenced earlier, an understanding of what RI can be defined as is difficult to get agreement on. There is no agreed standard for RI investment and we believe a standard would be relatively arbitrary. Using The NZ Super Fund as a template would also be inappropriate, given their specific investment mandate as it differs from that of a default KiwiSaver provider.

Specifically in relation to option two, we support any steps taken that increase transparency around what providers are invested in. This should include transparency on what the fund excludes, industries and at a company-level basis, and more importantly what the fund is invested in.

On the subject of carbon exposures, this is a complex area and there are a number of valid approaches.

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?**

The market capitalisation of NZX-listed companies has grown in recent years. However it is small relative to New Zealand's economy and savings pool. This creates issues in terms of diversification, capacity and liquidity. Similarly, the New Zealand bond market has grown, but it lacks numbers of issuers as there is strong participation from other lenders in New Zealand, often resulting in a high level of competition for available assets.

Market participants have allocated relatively modest amounts of capital towards early stage companies. This suggests investment managers are wary of the risk/reward trade-off. In addition, there has been recent international experience in relation to unlisted investments and the associated issues of valuation and liquidation, for instance the high-profile problems associated with Woodford Funds in the UK.

We acknowledge that an explicit requirement to invest in New Zealand, or indeed certain asset classes, could be helpful in terms of developing New Zealand's capital markets in the very short term. However, this could well be to the detriment of both member returns and the long-term development of New Zealand's capital markets. Hence, we would question the need for a prescribed approach to asset allocation.

In addition, the heavy focus placed on low fees for the default funds makes alternative assets less attractive as these strategies typically have low economies of scale, high fees, and high operational governance requirements.

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?**

Capital markets exist to channel investors' savings into productive use. Any distortions through regulation risks making this allocation process less efficient and the economy less productive. We do not believe that mandating and requiring domestic investment will improve the risk/reward trade-off faced by investors. In this context, we also highlight our fiduciary duty to our investors and are of the view that the desire to develop New Zealand's capital markets must not reduce investors' risk-adjusted returns.

We believe that the parts of the New Zealand capital markets most in need of development include New Zealand's equity market, bond market and early stage companies.

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?**

While the desire to develop New Zealand's capital markets is admirable, we do not believe requiring default funds to have this objective would be in the best interests of investors. It is not appropriate for KiwiSaver investors to bear the risk of developing New Zealand capital markets.

As discussed above, any distortions through regulation risks making asset allocation processes less efficient and the economy less productive. We have a fiduciary duty to our investors and are of the view that the desire to develop New Zealand's capital markets must not reduce investors' risk-adjusted returns.

That said, we note that KiwiSaver has already driven improvements in the New Zealand equity and bond markets in terms of size and liquidity and we expect this to continue to occur going forward.

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

As we understand, all KiwiSaver providers are domiciled in New Zealand and hold a Managed Investment Scheme (MIS) licence. ANZ's investment management team, which consists of around 35 people, is located in Auckland. More important than location is the overall level and experience of the investment team that default fund members benefit from.

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?**

We are wary of any requirement or regulation that enforces the domicile of investment staff and how this might impact the efficient allocation of capital.

Currently, over 40% of our default fund is managed directly by Auckland-based staff on a day-to-day basis. The remainder of the fund is managed by class-leading international fund managers, who are selected and monitored from Auckland. They are chosen for their international experience and expertise, which in many cases includes large global teams.

Any attempt to undertake these activities from New Zealand would need to be very carefully considered against the competitive advantage held by best-in-class international managers. While replication from New Zealand (i.e. competing against large global fund managers – operating 'in market' and with large global teams and a time zone disadvantage from New Zealand) is theoretically possible, we believe this would be unlikely to improve the risk/reward trade-off for our investors.

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)?**

Providers should focus on generating the best possible retirement outcomes for members. While we agree with the intention to develop New Zealand's capital markets, it is not clear how a targeted investment requirement would benefit investors.

Market participants have not allocated much capital to early stage companies markets, which suggests investors are wary of the risk and reward trade-off alongside liquidity considerations. This strategy is also not scalable, so presents challenges for the default market. We also note the recent issues in the UK (Woodford) with unlisted investments and the complexities surrounding this.

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?**

We are reluctant to recommend KiwiSaver default funds be used to improve New Zealand's capital markets with an increased allocation – as discussed above.

There is room for an allocation to New Zealand assets within a balanced portfolio. However, any investments should be based on strategic asset allocation and diversification considerations.

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?**

We agree that if default members are not transferred from ex-default providers to new default providers, they would be disadvantaged. For example, depending on policy settings, they may miss being in a more growth-oriented fund.

The prospect of losing default members could incentivise providers to re-apply as a default provider and increase competition and innovation. Transferring members also ensures that all providers have a sizeable number of default members to incentivise new providers to apply.

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

We do not support this re-allocation because it gives a disproportionate benefit to new default providers, who have not made the considerable investment required to support and grow default member balances over the previous two default arrangement periods.

If it was to proceed, the selection should be done on a random basis. We do not support selecting transfers by member attribute (such as balance, duration with provider or previous attempted contact) as this will create a situation where providers have member bases with different attributes, which is not equitable and may prejudice a provider's ability to engage members.

Any action of this nature should be balanced against member interests. It might be useful for MBIE to consider section 181(1)(a) of the Financial Markets Conduct Act 2013, which states that the FMA may consent to a transfer of members from one scheme to another without member consent if the FMA is satisfied that the terms and conditions of the new scheme are no less favourable to the proposed transferees than the terms and conditions of the old scheme.

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?**

Providing the option for members to stay with their provider could be a good incentive for members to engage with their investment. Experience suggests we should not anticipate a high response rate and this should be balanced with a relatively high cost to implement. Online and pre-populated solutions would encourage the highest response rate, however this would also be the most expensive and single-use only. Paper forms would be the least effective.

The risk of losing default members has already created a strong incentive for providers to engage with members, so this would not change as a result of giving default members 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?**

If all incumbent default providers remain, we support option three. Regardless of whether members have made a fund choice, some default members may consider themselves to have a relationship with their current provider.

Transferring members will cause unnecessary disruption and potential confusion and could contravene criteria two (trust and confidence in KiwiSaver). Also, for members who are considered 'gone no address', communications to advise them of a new provider will not be received, which could make it very difficult for them to re-engage with their provider (if their provider has changed). If default members stay with providers who lose their default status, the providers need to be subject to the same provisions, to ensure members are treated equally.

Options one and two are not equitable, as these options could disproportionately benefit new default providers, who have not made the considerable investment required to support and grow default member balances over the previous two default arrangement periods.

However, if incumbent default providers do not apply or are not re-appointed, we support option two where reallocated default members are distributed evenly across all the appointed default providers.

Whichever option is taken, the FMA's oversight function in respect of member engagement is of paramount importance. Options two and three would result in default member bases that are not comparable in terms of number of members allocated and having members with different attributes (for example default status and age) – therefore this would need to be taken into account in the FMA's reporting of providers' member engagement activities and in the FMA's engagement with providers.

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

We support an orderly transition, with timelines agreed with MBIE. This would be undertaken with the interests of members as the main priority. With this in mind, we are of the opinion that a transition period of a number of months would be appropriate. Factors to take into consideration include the particular asset classes involved, liquidity, size of transactions and operational considerations.

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?**

Default members who have made a choice to stay in a default fund should not be transferred or considered a default member. These members have knowingly made a choice and may have specifically chosen the fund based on their attitude to risk or time horizon, for instance someone who will soon make a first home withdrawal or is heading into retirement.

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?**

Mandated engagement initiatives should focus on simple and easily understood messages, for instance choosing the right fund and the right tax rate. Experience has demonstrated that if more messages or calls to action are added to communication, there are lower response rates.

More complex actions such as changing a contribution rate, or increasing voluntary contributions can be harder both to get traction on and measure. A recent trial with the FMA and MBIE showed that while more informative letters or emails led to a higher number of people taking action, the overall numbers were still low.

Contribution choice is also a much more complex conversation to have with members. A survey ANZ completed with nil-contributors showed that affordability was the main reason for people not contributing (63% of respondents) –because they either did not have an income or could not afford to contribute from their income. While we can give members education on the different contribution options, and what these may do to their balance, we are not aware of their full financial circumstances and what a change in contribution rate could do to their current financial position. This is something that would be better suited to be discussed with a financial adviser.

We support mandated obligations to perform a certain number of outbound calls, emails and letters to members to encourage engagement. This should be measured on its effectiveness and the innovation shown by the provider, not the number of staff involved in the programme. These engagement efforts should be reported quarterly to the FMA.

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

Nil.

43. **Any other feedback?**

Nil.

Appendix:

Research on the link between responsible investment and returns includes:

- Friede, G., Busch, T. & Bassen, A. (2015) ESG and financial performance: aggregated evidence from more than 2000 empirical studies, Journal of Sustainable Finance & Investment, 5:4, 210-233
- Bank of America Merrill Lynch, "ESG: good companies can make good stocks", 18 December 2016
- Bank of America Merrill Lynch, Equity Quant Research, June 2017
- Sakis, K., Pinney, C. & Serafeim. G. (Harvard Business School) ESG Integration in Investment Management: Myths and Realities, Journal of Applied Corporate Finance 28, no. 2 (Spring 2016): 10–16
- Foo, M. (2017) Socially Responsible Investing in Australia, Australian Centre for Financial Studies, June
- O'Brien, A., Lei, L. & Campagna, J. (2017) Responsible Investing: delivering competitive performance, Nuveen TIAA
- BCA Research, Special Report, "ESG Investing: No Harm, Some benefit", 21 November 2018
- MSCI, "Enhancing Economic Value with ESG", Seretis, Eastman: Feb 2018.
- "Quantitative Monographs: Exploring ESG Investing", UBS Global Research, 13 Dec 2017
- Statman and Glushkov, Classifying and Measuring the Performance of Socially Responsible Mutual Funds, Journal of Portfolio Management, Winter 2016