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Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
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By email: defaultkiwisaver@mbie.govt.nz

Review of the KiwiSaver default provider arrangements – Discussion paper

Thank you for the opportunity to provide feedback on the discussion paper of August 2019. Attached is our submission.

Aon New Zealand is New Zealand's largest insurance broker and a major force in New Zealand for insurance broking, risk management, employee benefits and claims management. We continually strive to improve and extend our services to corporate business, small and medium businesses, groups and individuals.

Aon's history with KiwiSaver commenced in 2006 when we made submissions to Government on the KiwiSaver Bill and started engaging with and educating employers about KiwiSaver.

In 2007 we established and registered two KiwiSaver schemes, AonSaver and AonSaver(AMT). AonSaver (now the Aon KiwiSaver Scheme) was aimed at the general public and AonSaver(AMT) was established for employers to sit alongside existing superannuation arrangements.

In 2007 and 2008 we worked closely with clients who sponsor superannuation schemes to add KiwiSaver benefits to their existing superannuation benefits under an umbrella trust arrangement. At various times we have administered up to 20 KiwiSaver schemes, including these umbrella trusts. We also have considerable experience in administering workplace savings schemes, although we no longer offer this service as we have outsourced this service for our two schemes to Link Market Services Limited.

We are committed to the long term savings industry and continue to work in the industry by offering the Aon KiwiSaver Scheme, Aon Master Trust and supporting employer and industry superannuation schemes through consulting services, actuarial advice and investment consulting services.

We are happy to meet in person to discuss any aspects of the discussion paper and our submission.

Yours sincerely

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Principal, Head of Retirement Products – Aon New Zealand

Attachment: Aon submission – Review of KiwiSaver default provider arrangements

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Submission: Review of KiwiSaver default provider arrangements

Amanda Beeslaar

Section 1: Your details

Name of contact person: Amanda Beeslaar

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

Section 2: Feedback on discussion paper

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

   We agree with the main objective of the review, which is to enhance the financial well-being of default members, particularly at retirement.

   However, we note that the financial well-being in the consultation seems to be focussed on account balances and investment return. In other markets Aon has defined financial well-being more broadly to address member behaviours. What can government do to encourage good member behaviours?

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

   We agree with most of the points included in the criteria of the review, however we believe that supporting the development of the New Zealand's capital markets (Criterion 4) should not be included in the criteria of the review as the growth of KiwiSaver will naturally contribute to its growth over time.

   Improving the investment returns for the default funds is of importance, as this will have a big impact on achieving the goal of being in a better financial position at retirement. However, contribution rates and savings behaviours are as important as investment returns.

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

   The parking space approach assumed member engagement would come. It has not so the default option should be adjusted to reflect the strategy most likely to be consistent with the financial well-being objective. We think a "life stages" approach is the best for this purpose.

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?

We do not believe that the active choice members in the current default funds should be moved as the members have made an active decision to be in this fund for various reasons. However, we believe active choice members should be engaged with and given the opportunity to change if they wish.

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

We don't believe there should be a "nursery" period as this might result in the exact same situation we are in now with the conservative default funds and members not making active decisions. However, we do believe that consideration should be given to including the question around whether the member intends to use KiwiSaver funds to buy their first home in the current KS2. A "first home withdrawal fund" should be the default fund for members that indicate that they will be using KiwiSaver to buy their first home. Once a member has made their first home withdrawal they should be moved to the appropriate "life stages" fund.

"Life Stages" can be educated, communicated and administered relatively easy. Members that are engaged might choose to change their asset allocation the closer they get to retirement but for those that haven't their capital should be preserved for retirement.

The following "stages" could be considered – high growth, de-risk to retirement and point of retirement. Another alternative could be to set up "retirement date target" funds i.e. 2025, 2035, 2045 etc.

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

To be considered a balanced fund, we would expect that between 40% to 60% is allocated to growth assets.

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

To be considered a growth fund, we would expect at least 60% to be allocated to growth assets.

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

To be considered a conservative fund, we would expect that at most 40% to be allocated to growth assets.

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?**

See point 5 above. Both of these, while reasonable reasons to withdraw, are likely to be detrimental to the members financial well-being at retirement. We therefore recommend requiring members to understand the consequence of their withdrawal decision. This requirement could be fulfilled via provision of financial advice by a suitable institution not related to the KiwiSaver provider. In the case of a first home buyer, this advice could be part of the lender's mortgage approval process.

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

The ongoing administration costs should be relatively limited, depending on how the life-stages (or other method resulting in a similar glidepath) option is implemented. However, although the overall fees for a life-stages approach would likely be higher than e.g. a balanced or conservative fund, the expected additional investment return over the member's participation period until retirement would be expected to more than offset the additional fees.

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 the life stages options as we believe it can be managed relatively easily and cost effectively and should be relatively easy to educate and communicate on. This option will support the objective of the review.

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 don't have a view on default members getting value for the fees they pay overall as some providers are providing a better member experience than others. We also don't believe that the current fees structure is too high as the overall costs for KiwiSaver have increased over the last decade. However, we agree that fees should reduce with economies of scale.

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

We do not believe it is a problem. Given the fixed fee component, total fees are proportionally higher for default members with lower balances, such as those on low income or under 18. However, there is an element of fixed per-member cost in administering KiwiSaver benefits, regardless of the balance size or what investment is held. As such, any reduction in fees for members with lower balances could lead to a cross subsidy, so that default members with larger balances are in effect subsidising costs for members with low balances.

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?**

Setting a fee may reduce innovation / competition between default providers as the main incentive from providers would become to manage assets at the lowest possible cost, while complying with legal requirements. While fees are an important consideration, it is more important for members to get value for money, in terms of retirement outcomes and level of service.

Restrictions on fees may force providers towards a passive investment strategy. Since passive investment follows the net decisions of active managers, higher fees should be allowed for active managers to avoid an excess of passive management which could cause significant distortions in the market.

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?**

    Alternatives could include the Government contributing a fixed amount toward administration costs for under 18s and/or members on low incomes.

    Another alternative option to avoid reduce cross-subsidies might be to apply lower fixed fees to under 18's but for the reduction in fees to be recovered over a period of time once their balance increases beyond a certain level, such as $5,000 (although this would be administratively more complex and consideration would need to be given as to what happens if a member were to change KiwiSaver providers before the expenses have been recovered).

    While management of fees is an important consideration, the value that default members get from the fees they pay is more important. Consideration could be given to setting maximum fees chargeable (depending on asset allocation) but allowing other factors to be incorporated into the fee structure, such as a performance based element to encourage a focus on maximising investment returns, or even a measure of member satisfaction if assessed independently.

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?**

    There is a significant amount of effective fixed cost as a KiwiSaver provider. This includes compliance costs, governance and maintaining relevant scheme documentation (such as the SIPO and PDS). Default providers have a scale advantage, meaning that the fixed costs of operating a KiwiSaver scheme can be spread across more members. While non-default providers can bring innovation to the KiwiSaver market and offer members increased choice, non-default providers are at a comparative disadvantage to the scale that long-established default providers have achieved.

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?**

Responsible investing if done correctly, must incur additional cost through the requirement to undertake additional research when investment managers make asset selections (or additional cost in the use of a provider to do so). However, given sufficient scale, these additional costs should be marginal. In the long run, we believe that responsible investment is likely to lead to higher returns to members, even after allowing for additional research costs. For example, businesses which are better placed for resilience against climate change should benefit from this in the long run.

We would, however, also clarify that what is considered as responsible investing is open to interpretation and different investors may have different views on what responsible investment means to them.

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

As long as the fund is well diversified the return versus those funds that do not adopt this policy should be marginal.

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

Some element of responsible investment should be required from default funds but given that what responsible investment means to different investors may be significantly different, any restrictions imposed should be based on an industry agreed understanding developed through consultation and engagement with KiwiSaver providers.

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?**

There appears to be a general desire for some level of responsible investment in the New Zealand market, although different members are likely to have significantly different views on what is meant by responsible investment. It is not clear to us how much potential future returns members would be willing to sacrifice if net returns were expected to be lower due to responsible investment (if indeed any returns were to be sacrificed).

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?**

Given the generally challenges of engaging with members, especially default members who have not made an active KiwiSaver provider or fund selection, we would see that it is not currently a significant issue for default members to not have deep information on responsible investment and do not believe it is likely to change member behaviour in the near term. We do not believe that there should be a requirement for default providers to disclose additional information on responsible investment beyond a declaration that they meet an agreed industry standard. However, we support members being given access to the right level of information, including in relation to responsible investment, to enable them to make informed decisions about their KiwiSaver investments.

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?**

We support the international responsible-investing exclusion standard such as the United Nations-supported Principles for Responsible Investment.

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?**

A declaration that the default fund meets the agreed industry standard.

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 support Option 1, the use of mandatory exclusions, but would recommend that this is based on an agreed KiwiSaver industry standard, rather than being purely for default funds.

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?**

We do not believe that the settings for KiwiSaver default providers should be influenced by an objective in relation to New Zealand's capital markets.

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?**

If consideration were given to requiring a proportion of the default fund to be invested in the New Zealand market, care should be taken as given the scale of default assets, and the size of the domestic market, if the requirement to invest locally were set too high, it may not be in members' best interests and it could impact on the quality of investments available in which to invest, or lead to a concentration of risk. For example, there are a limited number of bond issuers in the New Zealand market, which could prove restrictive.

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?**

No

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?

We don't believe this option should be selected.

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)?**

    We believe that this requirement may not be in members' best interests. Any significant allocation to alternatives could impact on the overall risk/return profile and potentially have issues on liquidity. If the requirement is set at a low level e.g. 0.5%, it may be of insufficient scale to be effective.

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?**

    Maintain the status quo.

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 do not support the transfer of existing default members to new providers. The existing default providers have already incurred the capital outlay to support and develop the infrastructure required. This approach will result in a lot of confusion and will not be a good member experience overall. It might even result in a break of trust and confidence in the KiwiSaver process.

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?**

43. **Any other feedback?**