Review of KiwiSaver default provider arrangements

Response from: PIE Funds Management Limited as Manager of the JUNO KiwiSaver Scheme

Section 1: Our details

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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 support the proposed objective for the review "to enhance the financial well-being of default members – particularly at retirement".

Helping default members make good financial and investment decisions is a key objective for KiwiSaver as a whole. Collectively, default KiwiSaver members are a 'floor' indicator of New Zealanders' capability for confident, informed participation in financial markets. Efforts to improve financial capability at this level should therefore be regarded as critical system improvement – default requirements should set the bar to enhanced financial wellbeing for all KiwiSaver members. This is a shared interest for New Zealanders, financial services providers and the Government. So, all providers of default schemes are responsible for ensuring their default members receive adequate financial education from the outset of their KiwiSaver lifecycle.

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

The criteria are appropriate, but we have three comments. First, consistent with the above response, we believe the key contribution default arrangements make to New Zealand's capital markets is enabling confident, informed participation by New Zealand investors. We deal more with this criterion in our responses to questions 28-30. Interpreted this way, however, there is significant overlap between this criterion (fourth in the table) and most of the others. Second, a 'better financial position' (first in the table) is materially dependent on financial markets which are beyond Government or providers' control. So, we have interpreted, and weighted, that criterion as meaning KiwiSaver default members have the necessary capability to make good decisions – which again overlaps with other criteria. Finally, we regard 'Trust and confidence in KiwiSaver' (second in the table) as beginning with default members but having significance for KiwiSaver as a whole. Accordingly, we have under-weighted the 'support development of ...capital markets' criterion and equal-weighted the remainder.

Criteria	Weighting
Better financial position for KiwiSaver default members, particularly at retirement	22.5%
Trust and confidence in KiwiSaver	22.5%
Low administration and compliance costs	22.5%
Support development of New Zealand's capital markets that contribute to individuals' well-being	10%
Promote innovation, competition, and value-for-money across KiwiSaver	22.5%

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

Yes. In our view the conception of default status as a 'parking space' has always been unhelpful. In reality, as New Zealanders' introduction to the concept and practise of KiwiSaver and investing in general, it should have been one of the most active stages in their KiwiSaver journey.

Elsewhere in the paper is a discussion of the concept of a 'nursery period'. We believe this is a far more useful conception of default status, carrying an appropriate sense of nurturing, engagement and learning. We believe automatically enrolled members must be nurtured through a "nursery period" focussed on education and removing as many barriers as possible to 'new' investors forming and sustaining an investment habit.

In our view, the default 'nursery period' should be brief, high-touch and sharply focussed on driving sound fund choice, correct PIR and contributing at least enough to receive the Government tax credit. We have included providing accurate electronic contact details as an active decision because lack of this information complicates everything else. This shapes the minimum standards we believe should be applied to all default arrangements, discussed at **question 17**.

Note the JUNO Scheme would deliver at least the minimum standards and our application to become a default KiwiSaver provider will reflect this.

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?**

Default members only. If the provider's work to get the default members to make an active choice has been competent, the member has chosen a product on its features (risk, fees etc.), not its default label. So, they should not be forced into a different product, with a different provider, just because it does have the default label. Note, we believe the default 'migration' process should check how each provider has assured itself its active default members have made an active choice. Persistent non-response, for example, should not be upheld as an active choice.

Providers who lose, or choose to drop, default status should communicate this to their active default members, however. This should include enough information for the member to make another active choice, if:

- it turns out the default label does matter, for whatever reason, to the member; and/or
- the features (risk, fees etc.) of the product they chose, have changed through losing default status (or otherwise). Particularly if the change is for the worse e.g. if fees increase.

Note we believe this communication should go to all the providers' members. We discussed this further at question 35.

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

First, nursery period is a very useful concept which in our view should be more broadly applied to the entire Default mechanism. See our response to question 3.

However, we don't believe it is necessary to require a life stages product if the engagement and product-set capabilities of the provider are up to achieving the same outcome i.e. communicating with members at significant ages and stages and allocating them to different funds accordingly. This would be enabled, and usefully standardised across the KiwiSaver membership, if (as in section 47 of the discussion paper), the government determines the 'investment mandate of each stage and the ages at which the stages would apply.'

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

We believe a Balanced mandate is best (for the initial 'nursery period') and the growth assets range (35% – 63%) is appropriate. Managers should have discretion to increase the defensive allocation (e.g. cash) beyond maximums if they believe it is in members' interests (for example, in periods of significant market upheaval).

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

We do not believe a Growth mandate is appropriate. The default stage should be a short, education-focussed nursery period. Even with low fees the higher probability of volatility is contrary to the nursery concept. The 'educative' value of a big dip in capital would certainly be instructive, but most likely in a counterproductive way, especially for older people joining KiwiSaver.

Following the nursery period, allocations to Growth products for suitable members will be possible.

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

We do not believe a Conservative mandate is appropriate, particularly for younger New Zealanders joining KiwiSaver. Low, possibly no, returns within the nursery period also have limited constructive educational value.

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?**

First-home buyers are more likely to engage with their KiwiSaver accounts as for them the investment period is shorter, and the value proposition of investing is closer. Also, new members must be in KiwiSaver for at least three years before withdrawing to purchase a first home. Assisted by appropriate education, this is enough time to understand market cycles and make good decisions about what fund to choose and how to use it.

Additionally, at JUNO sub-$5k balances are exempt from fees. So, the impact of market downturns will not be compounded by fee erosion. We note this also encourages first home buyers to leave a minimal sum behind as the basis for resuming saving for their retirement (and to re-engage with KiwiSaver post house purchase).

Other early withdrawal types present more of a risk to investors, given these redemptions are not planned for and typically requested during financial stress. Again, in an environment where low balances are not charged for, the erosion of these accounts can be mitigated, and a balanced mandate is still likely to be appropriate.

We note financial hardship withdrawals are a small, but growing, proportion of all withdrawals. We're aware dealing with financial hardship withdrawal requests can be stressful for staff at providers – and supervisors – who are not trained for conversations with members who may be in acutely distressing situations. As such, there may come a point when hardship should be dealt with outside the KiwiSaver system and it is arguably already a material enough issue to be outside the scope of the default arrangements to satisfactorily resolve.

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

We agree there will be set-up costs for providers, although ongoing costs should be moderate. Regardless, we do not believe a life-stages option is necessary, as discussed at question 5.

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?**

Life-stages: Not necessary. Also, disincentivises providers from actively improving financial literacy and members from engaging. Life Stages is a set-and-forget approach when circumstances change for all members. We believe default arrangements should encourage active engagement, not less harmful inertia.

Balanced: Most appropriate setting for any default product. We reiterate the importance of a nursery phase with an intense focus on education so that members may make an investment decision most suitable to their specific financial needs.

Growth: Not appropriate for a default product. While the investment timeframe of most investors is enough to warrant a growth mandate, the volatility which could be experienced by novice investors within the 'nursery period' is likely to be counterproductive and erode trust and confidence in KiwiSaver.

Conservative: The discussion paper recognises the shortcomings of a default conservative setting. We do not believe it is consistent with any of the review criteria. Choosing this setting means a significant portion of KiwiSaver members will be financially disadvantaged at retirement, regardless of who the providers are or decisions on other default settings.

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?**

"Value" would be returns enough to compensate default members for their fees and, potentially, additional benefits otherwise valued by the member. We don't think it's possible to say KiwiSaver default members as a group get value for their fees, because:

- FMA KiwiSaver Tracker data shows default fund/schemes have not systematically outperformed their market indices after fees (for active approaches) nor delivered market index performance after fees (for passive approaches) over the past five years. There is no returns argument for value.
- We cannot attempt to argue for value on service or other factors because it is subjective, determined by individual perspective and impossible to quantify.

Our view is supported by looking at the numbers. In Table 1 of the discussion document, the annual cost for default members ranges from $96 to $146 with a $20k balance. Of course, the non-default funds for each provider have higher fees. This is why new players have entered the market and are demonstrating low fee options also provide good service and quality performance. At JUNO, all members with a $20k balance pay $60 (or nothing, if under 18). We're an active manager, we integrate ESG, early performance is pleasing; we're demonstrably committed to member education and engagement; and we have a full, digital, high-touch service.

We believe the combined picture of what current defaults provide for the fees they charge, relative to what JUNO provides for our fees, does not support KiwiSaver members currently getting value for their fees. The inescapable conclusion is yes, fees are too high (*across* KiwiSaver, as supported by FMA work in its 2018 KiwiSaver Report showing no relationship between higher fees and higher returns).

In our view all costs are within a provider's control. Both in terms of what costs they incur, and what of those costs they pass on to their members (and it is not evident the benefits of scale, where they exist, are being passed on to members other than through small reductions in manager operating costs). Some providers may argue they charge what their parent companies require them to charge. This should not be persuasive – and in fact should disqualify a provider from being considered for default status, in our view.

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

Yes. Getting hit with fees as a young person starting their KiwiSaver journey and/or someone with a low balance, dissuades them from starting and forming an investment habit. Paying fees, especially higher fees, has an obvious, practical financial impact. But it also has a psychological one. The *size* of the fee may push a new investor away from a product. The *existence* of it may push them away from the concept of investing at all.

As FMA consumer research has shown, starting early is an important success factor for feeling – and being – prepared for meeting investment goals. Starting *at all* is critical. That is why we charge no fees for balances under $5000 and for anyone under 18, across the JUNO scheme.

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?**

Fees should be simple and transparent for all KiwiSaver members but especially for default members. The best option is a flat fee in $, which is consistent with other policy and regulatory changes to KiwiSaver Annual Statements effected by MBIE and the FMA.

We've already advocated, through our public fee 'pledge', for fees across KiwiSaver to be changed – willingly by providers, or otherwise – to average 60bps (half the current average, according to Sorted Fund Finder). This effectively caps fees.

Applied to the $20k balance in Table 1 of the discussion paper, that's $120 annually. But we believe the average default fee should be lower, so we propose a flat $100 annual maximum (total, all-in cost) for Default products.

Finally, we agree (per 93 in the paper) the process assess each providers' non-default fees to ensure they are not unreasonable. To that end, we believe:

- no provider should charge under 18s or people with balances under $5000 regardless of fund, for the reasons described in our response to question 13;
- consistent with our public fee 'pledge', fees across KiwiSaver should be capped to average 60bps (total fees). Where a provider wishes to charge more than 60bps, the process should require the provider to convincingly explain how they are comfortable the fee is 'not unreasonable'.

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?**

As above, we propose a flat annual maximum of $100 (total cost) for default products and a capped, average 60bps fee across all non-default products

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?**

In the default market, it hasn't. Default members are still concentrated with the large, first-round default providers. They had and kept the first mover advantage (in reality, more a "deepest-inertia" advantage). Table 1 of the discussion paper shows this quite clearly. The fee range is still very tight.

In the broader market, that complacency has driven innovation and – still fledgling – competition on value, from *new* players such as JUNO. So, competition has been 'observed in the breach'. For the benefits of new players to truly impact the market, however, their approach should be incorporated within and shape the default sector and by extension the entire market. The incumbents have had more than a decade to be innovative and to demonstrate value. It hasn't happened.

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 believe robust minimum requirements are more important than the number of providers for the default sector. We have already said under question 15 the maximum all-in fee for default members should be $100 annually. We believe the full set of minimum standards should be:

- A Balanced product (questions 6 and 11)
- Maximum annual fee of $100 per member, all-in, and a 'not unreasonable' broader fee structure consistent with an average 60bps total fee across all other funds (question 14)
- Concrete educational/engagement offering with specific, enforced educational outcomes (as per question 3)
- Minimum ESG exclusions and compliant, standardised ESG disclosure (question 21)
- Appropriate MIS and KiwiSaver regulatory status and other operational / hygiene requirements

JUNO's application for default provider status will at least meet these standards and any applicant's proposal which can, should be considered for default status. If incumbent default providers find the standards unattractive or, for whatever reason, unachievable – perhaps because their parent won't accept them – that usefully provides scale for existing/aspiring providers who can deliver (or are already delivering).

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

Period requirements to minimise the risk of member disruption. There are existing provisions in the Instrument of Appointment for a provider wanting to exit default status (or if the Minister wants to terminate providers). If an appropriate minimum standards approach is adopted, we support a period of 7 – 10 years.

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

Yes, there are costs such as paying for research and in some periods the opportunity cost of not having invested in sectors, such as tobacco, which outperforms other sectors. However, given responsible investment is fundamentally about recognising and managing a more complete range of financial risk, they are costs a competent fiduciary should be incurring anyway. Especially over a KiwiSaver horizon.

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

Research[1] is increasingly showing a competent ESG programme focussed on companies with good – or at least improving – ESG performance:

- reduces portfolio risk; and
- for investing in positive 'ESG momentum' (poor performers getting better), improves return.

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

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[1] For example, 'Weighing the Evidence, ESG and Equity Returns' (MSCI, April 2019) see https://www.msci.com/www/research-paper/weighing-the-evidence-esg-and/01315636760?utm_source=esg&utm_medium=email&utm_campaign=esg_financial_performance_04_2019 **also** 'ESG's Evolving Performance' (Axioma Solutions, July 2018) see http://go.axioma.com/rs/240-ASI-005/images/WP_ESG_2018.07.pdf

Yes. As a minimum standard (part of the overall minimum standard for a default fund or scheme), default providers should:

- Exclude companies involved in activities illegal in New Zealand (e.g. cluster munitions, anti-personnel mines). We can't imagine a satisfactory argument for wanting to invest in them
- Disclose their ESG policy / integration approach (if any) in a standard form.
- Disclose full portfolio holdings monthly

Beyond that, we don't believe default providers should be *required* to integrate ESG. We don't believe it's the Government's role to take that scale of risk decision on behalf of providers and their members. We also believe the market will continue to push the ESG evolution which has already started in New Zealand. So, the standard disclosure form should require providers:

- To confirm if they have an ESG policy/approach, and if not why not
- If they do have an ESG approach, they disclose details including:
    - How *their own* organisational governance/operations reflect ESG (for example, our fee structure is a critical part of Pie Funds own ESG approach)
    - What they exclude, why and how (if any, in addition to the required exclusions)
    - If they do positive/impact investing, why and how
    - Their voting approach (and voting record, if appropriate)
    - Company engagements they are involved in
    - Standards they follow and use (e.g. RIAA. UNPRI)
    - Awards or recognition for their approach/results
    - How they report the results of their ESG approach

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?**

As per our response to question 20, we don't believe it does mean limiting future returns.

We believe all default members should want to know:

- what they're invested in;
- they're not invested in any activity illegal in New Zealand, and;
- their provider's approach to ESG, why they have that approach, and its results.

Not all members will have a firm view about responsible investment beyond that. If they do, they will gravitate toward providers whose approach best fits their own (which can be determined from the standardised disclosure and from the increasing number of tools and platforms – such as Mindful Money – serving that need).

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?**

Members will not have the same view and should not be required to accept a 'one size fits all' approach. But they all require information (see our response above). Having standardised, comparable information will change their behaviour and choices if they have, or develop, a deeper sense of their values and how they want them reflected in their investments.

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

No, as per response to 22, because members do not know (or it's hard to find out):

- what they’re invested in
- if they’re invested in activities illegal in New Zealand
- if their provider has an ESG approach and, if so, what it is (or if not, why not).

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?**

Exclusions should be as per response to question 20 (exclude what is illegal in New Zealand). This means the Government remains in control of the minimum standard exclusion ‘list’, because it is a direct function of their own policy. So, no monitoring is necessary to determine exclusions and the cost is zero.

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?**

See our response to question 21.:

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?**

As we said at question 19, given responsible investment is about managing a more complete range of financial risks, it’s a cost a competent fiduciary should be incurring anyway.

Our preferred option is as stated in question 21 – a minimum standard comprising:

- Excluding companies involved in activities illegal in New Zealand (e.g. cluster munitions, anti-personnel mines). We can’t imagine a satisfactory argument for wanting to invest in them
- Disclosing any ESG policy / integration approach in a standard form (and if the provider does not have an approach, explaining why).
- Disclose full portfolio holdings monthly

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?**

We have dealt with these three questions together. The biggest impact KiwiSaver can have on New Zealand’s capital markets, is education, engagement, fee and other settings helping New Zealanders to make confident, informed investment decisions. The most critical ingredient of capital market health is informed participation. Reducing the ‘missing million’ and pivoting the membership base toward funds better suited to their goals is of far greater and enduring benefit to New Zealand capital markets than dictating what investments are made. This is true across KiwiSaver, but especially for default members in a ‘nursery’ context. Additionally, if the default and broader KiwiSaver settings work, New Zealand markets will benefit through property purchase and expenditure of retirement savings.

Investment in any market is a risk decision which should not be made on behalf of investors or providers’ professional investment teams by Government policy. Especially where, on any rational appreciation of investment risk and global diversification, the appropriate target allocation to New Zealand is zero. It’s likely nearly all New Zealanders’ other assets will be local – KiwiSaver may be their only access to much-needed global diversification.

Even if New Zealand alternatives such as early-stage companies are seen as diversifiers and sources of long-term return (and we accept that's plausible), the illiquidity and idiosyncratic risk of those investments is not a good match for the purpose of the default concept. If, as suggested, the mandated percent is so low it does not affect risk or liquidity, its value is not obvious.

If Government is keen to drive KiwiSaver investment in NZ alternatives, the liquidity and transfer rules should be relaxed for appropriately focussed mandates. Then, willing and able providers can create product which targets enough of that exposure to shift the risk and return dial sufficiently for those members who understand and are themselves willing to accept the risk/return equation.

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 have dealt with these two questions together. The location of investing resource should be driven entirely by investment strategy and the most effective, efficient way to execute it. For example, we are an active manager and have globally invested KiwiSaver fund, so:

- we internally manage every aspect of the investment process because it is more effective and efficient than using investment managers (especially for a low-cost active product); but

- we make decisions on investments as close as possible to the markets where the investments are located, which we believe is in our members' best interests. So, we have an office in London, for example, and a member of our team is in Australia. They contribute to investment decision-making.

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

We do not believe a minimum investment requirement is appropriate for default KiwiSaver products or members (as per our response to question 28).

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?**

See response to question 28. Note our view is not the status quo. Focussing provider effort on displaying a minimum standard of competence at building the capabilities of their members, not on meeting a minimum asset class target, is in our view a far more ambitious and effective option than either of those 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?**

Default members have, by definition, made no choice and should be transferred to default settings – products and providers. As per our response to question 4, active default members should not be transferred, as they have 'chosen'. Their providers must still communicate with all their members – not just default members – about their change of status (they certainly communicated to all members about getting default status believing it, rightly, to be reputation-enhancing).

This communication should provide enough information for all members, but particularly default members, to make another active choice if:

- any member values the provider's default status (for whatever reason);
- for active default members the settings are altered, to their detriment, for the fund they have actively chosen, or

there is doubt, because of the process used by the provider, the active default members genuinely made an 'active choice' to stay in the fund (e.g. "three non-responses equal a decision" is not an active choice)

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

Option 2. All default members from providers not reappointed, should be allocated equally among new default providers. If an existing provider is prepared to meet the new minimum requirements we propose, it's unnecessary for their existing default member base to be transferred. If, in practise, they cannot meet the requirements there is existing ability under the Instrument of Appointment for the Minister to require prompt remedial action or to dismiss them and reallocate their members.

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?**

In our view, they should not be given the choice. Their existing provider has been unable or unwilling to get them to make an active choice to that point. An option to remain is the same as an ongoing 'non choice' making the member's situation worse – by prolonging it – and rewarding the provider for continuing to do nothing.

Any provider effort to prompt an active choice at the eleventh hour should be regarded sceptically, closely examined and, in fact, should probably be banned past a certain date in advance of transfer day.

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?**

Option 2 for the reasons described in response to question 36.

Costs and Benefits

Better financial position for default members, particularly at retirement.

We agree with the costs and benefits as set out in the paper, in particular, not transferring current default members to a new fund meeting our specified minimum requirements will almost certainly lead to worse retirement outcomes for these members.

Trust and confidence in KiwiSaver

We agree there will be short-term discomfort as a result of moving default members to a new provider – although we note, given inertia to date, many may still be unaware of who their provider is. However, if minimum standards are robust and enforced, member trust and confidence should build over time, as these members become confident and informed about their retirement savings.

Leaving members with a default provider who has lost their default status, may create a cohort of members who feel "left out" of positive industry change. This is inconsistent with members being engaged or even continuing to participate in KiwiSaver.

There is an important role for the Government to support changes agreed through this review, by communicating why the changes are in members' best interests and consistent with KiwiSaver's intended purpose.

Low administration and compliance costs

There may be additional costs incurred in any situation where a large volume of members is transferred, although KiwiSaver is 14 years old and the system is largely automated and scalable. Accordingly, we believe transfer costs should be borne by providers, as they are for any other transfer. Additional costs arising from onboarding large numbers of new members is part of a significant overall net benefit to the provider.

There is the possibility that in selecting option 2, active default members remaining in a fund formerly with default status, and which has lost most of its members, will unfairly meet the cost of a significant percentage of the portfolio being liquidated. In this case, the affected provider should have three options with the objective of minimising the cost to members of its own decision not to maintain default status:

- Include their active defaults in the 'default migration'
- Create/amend products to match the fee etc. characteristics of the former 'default' fund and switch active default members to that fund
- Switch active default members to another existing fund which may or may not have the same characteristics of the former 'default' fund.

In all scenarios the provider must clearly communicate the option chosen to their active default members.

This may be an argument for moving all members out of existing default funds that do not retain their default status so that all wind-up costs incurred by the fund are distributed equally across the membership.

Support development of New Zealand's capital markets that contribute to New Zealander's well-being

We do not agree KiwiSaver providers should be required to invest a target allocation in New Zealand. As per our response to question 28 we believe facilitating confident, informed participation in financial markets is a far better, more effective goal for default funds, which will flow on to NZ capital markets.

Promote innovation, competition and value-for-money

We agree with the points set out in the paper. We don't believe re-tendering the entire default membership is desirable because of the disruption caused to the membership.

Choosing option three greatly reduces any incentive and most of any ability to compete. Incumbents are rewarded for doing nothing.

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

Two considerations in our view:

- depending on how many members will be transferred (i.e. under option 1 or option 2), how long will it take for the receiving providers to onboard their new members in an appropriate way, giving the new members a positive experience
- the existing limits on transferring default members (~10 days).

There is no reason for transfers to take longer than 10 days, unless the receiving providers require more time for a satisfactory onboarding process (which would be requested as part of their tendering process).

If option two is implemented it will be necessary to consider the effect on "last members standing", which we discuss in our response to question 38.

Market conditions may also influence timing. We understand transfer deadlines cannot be altered last minute for market corrections. But if markets appear in a sustained period of underperformance, transfer deadline could be reviewed accordingly.

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?**

Our view is in our response to question 35.

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?**

Two main views:

First - Engagement must have clear intended outcomes in the member's interest. The paper covers these. As summarised at question 3, any engagement programme, and how its results are reported to the FMA, must be focussed on:

- Members providing accurate electronic contact details
- Members making an active fund choice
- Members choosing a contribution rate at least enough to attract the Government tax credit
- Members choosing the correct tax rate
- Any other outcomes the provider believes demonstrably assist members to make and benefit from good financial and investment decisions.

Second – if a provider claims to educate members (or any audience), the relevant programme must be delivered by a registered teacher with formal, suitably robust desired educational outcomes.

Enforcement

If a provider is not making enough effort to deliver its engagement outcomes; or its efforts are persistently unsuccessful; the Minister can and should remove its default status as is permitted by the rules of the Instrument of Appointment. Especially, if other providers *are* demonstrably succeeding.

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

We believe the assessment criteria should comprise:

1. Provider will or does meet minimum standards set out in our response to question 17
2. Provider meets regulatory requirements for MIS and KiwiSaver
3. Provider meets other operational / hygiene requirements
4. Provider has KiwiSaver and New Zealand 'good standing' in respect of KiwiSaver and elsewhere
5. Provider can demonstrate existing and previous effort to educate members, and New Zealanders more broadly, about KiwiSaver.

43. **Any other feedback?**

We are happy to discuss our submission in person if required.