Review of KiwiSaver default provider arrangements

Mint Asset Management

Section 1: Your details

Name of contact person: David Boyle

Organisation (if applicable): Mint Asset Management

Contact email address: david.boyle@mintasset.co.nz

Are you requesting that any of this submission be kept confidential? 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:

Summary

Mint would like to thank The Ministry of Business, Innovation & Employment for the opportunity to respond to the KiwiSaver default provider review.

Mint is uniquely positioned given we are not a current KiwiSaver provider. Our approach when completing this document, has been to apply a customer lens to the majority of questions with a focus to improve the overall financial outcome for current and future KiwiSaver members.

While Mint is not a current KiwiSaver provider, we are an underlying manager for two KiwiSaver schemes and have contributed to a range of government requests regarding this review. We were a member of the steering group that conducted the Capital Markets 2029 review, and have assisted The Commission for Financial Capability (CFFC) in their work regarding the Retirement Income Policy Review specifically in the KiwiSaver section this year as well.

KiwiSaver has now been going some 12 years with over 2.9m members and over 50bn of funds invested via an array of KiwiSaver providers. While this sounds significant, there are a number of challenges and issues that are affecting its growth and influencing the long-term financial outcomes of New Zealanders when they reach their retirement years.

The thoughts and suggestions that follow we believe will ensure that KiwiSaver continues to grow, help improve New Zealanders financial outcomes in their retirement years and provide greater access for more New Zealanders to help save for their retirement years.

Summary of recommendations

- Remove the default provider status and allow every KiwiSaver provider to "Opt In" and provide a government defined default fund solution
- Have a "Balanced Fund" asset allocation as the default fund for all new KiwiSaver auto enrolled members
- For those default members making no choice, have all their future contributions go to the default balanced fund option
- Pick up and lift all non-active default members and reallocate those members to all KiwiSaver providers that opt in and offer a default fund
- Bring back the $1,000 kick start for any new members when they make an active decision to join a KiwiSaver provider as per the Capital Markets 2029 Review
- Undertake research now to understand the implication of how New Zealanders are being employed and the impact this is having on current and future KiwiSaver members not getting employer contributions
- Allowing KiwiSaver members to invest in another KiwiSaver provider essentially have a truck and two trailer approach. This will allow those members with larger sums to diversify away from a vanilla option and choose more innovative investment options from a specialised KiwiSaver provider

Section 2: Feedback on discussion paper

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

Mint believes that the objectives should look at the overall structure of KiwiSaver not just the default providers. We understand there are a number of challenges and issues facing default members but there are other challenges facing active choice members already in the scheme and barriers to access for low income earners.

These include:

- A large number of KiwiSaver members not making any contributions at all
- A large number of KiwiSaver members are not getting their full Member Tax Credit which means they are contributing less than $20 a week into their fund
- A generally unengaged membership that have ticked the box of KiwiSaver and believe that their retirement is sorted. However current contribution rates are unlikely to meet many members retirement income requirements
- A lack of financial capability around how to get the best out of your KiwiSaver scheme
- Lack of innovation with just a focus of getting fees down rather than looking at return after fees
- Access to KiwiSaver for lower income earners
- Ensuring employer contributions are paid on top of employee's salary
- Severe financial hardship numbers are growing. Work has to be completed to understand the reasons why this is happening.

This review seems a perfect time to take a pause, and not only look at the default member settings, but also take a more holistic view of KiwiSaver overall.

The way New Zealanders are being employed Mint believes is having a negative impact on New Zealanders gaining access to KiwiSaver via the employer. There are a number of reasons including the move to contracts, fixed term employment agreements and employers either not offering this to their staff or getting new employees signing employment agreements that state their KiwiSaver contributions are part of their total employment cost. We think this need to be further investigated now to make sure that all New Zealand employees are getting access to KiwiSaver via their employment.

The first twelve years has had a number of significant changes to the original scheme, many of which have negatively impacted KiwiSaver members from what they had originally signed up to. That said there are a number of “jewels in the crown” with how KiwiSaver has been designed, including the incredibly efficient process of collecting Employer and Employee contributions via the IRD, the truck and trailer approach where your KiwiSaver provider follows the member during their working career.

The next ten years will determine how successful KiwiSaver will be delivering on the promise of providing a nest egg for New Zealanders so they can use their savings as retirement income during those years when they have finally left the workforce.

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

We feel the 1,2,3 and 5 should be of equal weighting however 4 should be of a lower weighting until some of the fundamental issues of KiwiSaver are addressed. The Capital Markets Review 2029 has considered this further and should be considered as part of the review process.

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

The Default Fund was established in 2007 to mitigate the loss of capital for early investors in the scheme that did not make an active choice and were not use to market and capital fluctuations in their savings.

The Financial services industry at the time lobbied for the default fund to be a balanced asset allocation much like the default funds used in the Australian superannuation regime. However this was not adopted and has now created a gap in financial outcomes of KiwiSaver members with higher allocation to growth assets.

Given the financial market environment we were entering into (the Global Financial Crisis) the chosen allocation was one of safety first. It was only in the second default provider review that the “parking space” concept was truly highlighted given the challenges that default providers had in connecting with the default members. There have been a number of reasons for this including, member apathy, mixed approaches by providers to connect with members, and inadequate personal investor details being supplied to providers so they could make make contact with default members.

In a recent meeting with smaller KiwiSaver providers and interested parties John Berry (from Pathfinder) suggested a name change for the default fund. We support this idea. The definition of default is “failure to fulfil an obligation” which in the case for KiwiSaver means a failure to choose the right fund. Highlighting this at the time of employment and or changing the name of the fund could help motivate a more active decision.

Reintroducing the $1,000 kick-start to reward those new members that make an active decision also has merit and should be considered.

We also believe if the appropriate asset allocation of the default fund was balanced then the need to make a more active decision may not be so important unless they were going to be using their funds for buying their first home in the near future. If this was adopted we would agree the “Parking Space” term would not be necessary.

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?**

Those members that have taken an active choice to stay in the default Conservative fund should not be moved. Cleary they have said this is the fund they feel is most appropriate to their personal circumstances and risk tolerance. To shift them I suspect would be against the terms and conditions of the scheme? The new default member setting if changed should only apply to new members and those that have yet to make an active choice.

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

Mint doesn’t consider the Life Steps option as an appropriate vehicle for default members. As discussed already we believe the balanced fund asset allocation is the most appropriate default option. We also suspect that many of the providers would need to make significant structural changes to their scheme to accommodate this option if they had the investment and systems capability. Life Steps/Stages should be an active choice option.

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

If a balanced fund option was adopted we believe that the SAA should be 50 /50 with possible ranges of 40/ 60 income growth to 60/40 income growth allowable to manage for any market changes in the short term.

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

We do not believe that a growth asset allocation is appropriate.

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

We do not believe that a conservative investment mandate should be adopted.

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?**

Regarding members making an early withdrawal this is really out of everyone's control given it is driven by a set of individual circumstances ultimately driven by hardship.

Regarding the risks for first home buyers a requirement of the default fund guidelines would need to ensure providers have connected to all members with very clear communications in all formats as a warning notice that this type of fund may not be suitable for potential first home buyers that might be looking to purchase a property in the next XX number of years.

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

N/A

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?**

As highlighted earlier Mint believes that the balanced fund would be the best option for new default members to be allocated to. For those members in default funds that have not made an active decision a communication should go out to all of these members stating if they do not choose to stay in the conservative fund all future contributions would be allocated to the new default fund setting.

This option ensures that there will be a nationwide level of communication to all non-active default members, it helps those non-active members to move up the risk return spectrum without putting any of their current capital at risk, and may provoke members to take a more active approach to their KiwiSaver investment choice and provider.

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

Fees are an important part of returns after fees but not the only one. If fees are the only driver then passive funds will be the only solution for default funds. As you point out passive funds by their nature cannot outperform a benchmark given costs involved to "match" a benchmark return.

The expected economies of scale have not been achieved because a large part of the fee is an "ad valorum" fee so it rises and falls with the value of the investment. This also applies to "other fees" which relate to administration. These fees should be fixed not ad valorum and should reduce as balances grow. The administration task is the same for larger or smaller balances and manager skill is not being applied to deliver alpha so these fees should be fixed and decline as a fixed dollar amount as balances grow.

Fees charged by overseas managers will be negotiated in the same way as fees for a wholesale mandate. There will be a lower rate for large fund balances and the lead manager (KiwiSaver scheme provider) will negotiate these savings upfront.

Looking at the fees charged relative to those charged for similar (conservative) wholesale mandates. The managers at the upper end look high (0.58%) and the bottom end (0.35%) look about right. However these fees should all be on a sliding scale, declining below 0.30% as balances grow.

Additionally performance based fees are inappropriate for long term locked in savings and should be abolished.

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

KiwiSaver was never designed for children and it was only the $1,000 kick start that motivated many parents to sign up the kids (some 460,000 of them). This was primarily because a number of providers sold KiwiSaver to parents for the "free $1,000" for kids. I would suspect that very few children under the age of 18 are making regular contributions. If they are working under that age 3% of their income should be going into the KiwiSaver scheme. Perhaps this is where employers should have to contribute to KiwiSaver irrespective of the employee's age?

Fees need to be low for all default investors. Differentiating fees is not fair or equitable and would add cost from an administration point of view. Dealing with the "total remuneration" matter where the KiwiSaver contributions are paid on top of salary would probably do more to address the low balances of lower income earners.

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?**

While Mint is not a current KiwiSaver default provider we believe that the Government should set the parameters of the default fund including the fees and other costs. This ensures that all new KiwiSaver members end up in exactly the same type of fund with exactly the same costs and asset allocations. If the default fund is still going to be deemed a parking space then this seems to be the most logical choice.

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?**

Preference is **Option 1** for the reasons above. We don't think the procurement process aligns with the above approach which means all default members will not be treated equally on the proviso that it is still deemed as a parking space.

Option 3 has merit on the basis that all fixed costs do not increase over the same period of time. As mentioned in response to question 12.

Option 4 Mint disagrees with this approach unless the under 18s are actually contributing to their KiwiSaver scheme and some encouragement of a fee reduction helps them start getting into the savings habit. We would be surprised to see any under 18s in the default funds given the legislation states the auto enrolment occurs when employees are 18 years of age or over. That said there could have been some active choice in default funds by their parents.

Option 6 Mint never really understood the rationale for the member fee. Suggest that it gets removed after the member is in the scheme after year one.

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?**

From our observations the number of providers has had no impact on innovation and little by way of competition other than getting management fees down to some degree. Again if this is just a parking space before the member finds the appropriate fund for their personal circumstances then it should be provided as cost effectively as possible. If the Government has an appetite for change around the fund type then this may lead to greater innovation and competition.

In our view there is little doubt that the incumbency advantage from the low number of providers selected in the first round of default providers has resulted in a focus on the protection of these customer bases rather than any focus on innovation or customer benefits.

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?**

Over the last 12 years the number of default providers have changed markedly. Initially there were six providers that met the terms and conditions of default status. Funnily enough by the next review three of those providers had disappeared. There are now currently nine default providers and the same problems are still there today around contribution rates and active member selection.

This review should be seen as a chance to shake up the status quo and change what we have today. If we don't it's very likely we will have these same issues in another seven years still dealing with the same problems and possibly creating an even a great financial gap between those in the default fund and active choice members.

For this reason we believe all KiwiSaver providers should be able to opt in to the default scheme with criteria set by the government.

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

We don't believe that the minimum requirements approach should be applied.

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

As mentioned above lowering fees will likely produce a passive investment approach across most asset classes. This would require providers to be able to access negatively screened passive products at a reasonable price which requires scale. Active management costs more to implement and a positively screened approach is consistent with this. It does not follow that higher costs for active responsible investing would result in lower net returns.

According to a recent study from Morningstar, passive ESG funds are on average one third the cost of active alternatives.

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

Mint believes that its approach to socially responsible investing affects returns positively. This is particularly true in the case in the delivery of above average risk adjusted returns. Mint has a preference for positive engagement as opposed to negative screening to permit investment in a broad range of securities to create alpha opportunities. The weight of academic studies now point to the incorporation of SRI adding alpha to returns or at least not reducing alpha as a minimum.

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

No. Those that want a responsible investment approach are engaged with their investment. They can choose such a fund. The default fund should be low cost and open to all on the same basis. The default fund should be managed in line with the objectives for such a fund which do not include and SRI 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?**

See above.

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?**

The challenge for default members is getting them to understand what fund they are in and how that is expected to perform over the life of their savings. To expect default members to then determine what level of the investments are responsible is a bridge too far in our opinion. These elements should be sought when making an active decision and allowing providers that offer this approach to promote their own specific investment solutions in this area. There are websites already helping KiwiSaver members to find more appropriate investment solutions that suit their specific definition of Responsible Investing.

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

As a minimum yes. But there are strong views around gambling, alcohol, cruelty to animals, and environmental aspects like fossil fuels that could also be considered. The key here is that an appropriate benchmark of measuring performance is also adopted to manage investors' expectations and compare like for like.

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?**

Mints believes that this option should not be adopted for the default fund if the parking space is kept. If there was a willingness to set new default fund guidelines then some of the above should be considered as possible exclusions and again reflected in the default fund guidelines.

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?**

The disclosures should be in the same form as those provided for wholesale investors. A standing list of exclusions is produced and updated as frequently as exclusions of securities are added to the list.

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?**

Mint does not think the default fund should be required to have an SRI overlay however further possible exclusions could be applied for the reasons stated above.

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 the default provider review is the appropriate mechanism for dealing with the issues in New Zealand capital markets. This has been reviewed by Capital Markets 2029 of which Rebecca Thomas CEO of Mint was a steering committee member.

However the long term locked in savings nature of KiwiSaver should be consistent with broadly a long term approach to investing. This is however impacted by the portability requirements of KiwiSaver. Nevertheless, an approach can be found to allow illiquid investments to form a portion of KiwiSaver portfolios and in Mint's view this must take place to allow KiwiSaver investors access to private markets and growth assets.

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?**

N/A

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?**

N/A

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

N/A

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?**

N/A

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)?**

N/A

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?**

N/A

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?**

The key problems have been highlighted. Other aspects that need to be considered include the initial costs of transfers, systems capability and market impacts of assets being sold and purchased in a short period of time. To mitigate this, transfers should be rolled out over a rolling basis (say over six to 12 months) to ensure a smooth transition to the new default fund providers.

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

Mint appreciates that the "lift and shift" has some significant challenges which might mean some would be shifted back to their original provider. Working out a way that allows an appropriate allocation of default members to all providers should be on the basis of having the same percentage of members allocated to each default fund. This way mitigating the risk that default members get reallocated to the same default fund provider.

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

Default members should be given every opportunity to stay with their current provider. However it has to be an active choice and acknowledged by the member that they are happy to stay where they are.

Current default providers who don't have the correct information on the member should be supported by Government and Employers to get the members correct contact details. Thus providing the best possible chance to get the member to make an active decision and mitigate any wastage in communication costs.

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?**

We consider **Option 1** being the best outcome if all providers were able to opt in and offer a default fund. We fully appreciate the challenges associated with this option. However an event like this we think would ignite the change needed to get default members making a more active decision and the positive long term impact for the members financial wellbeing cannot be underestimated. It has been twelve years since KiwiSaver started and to have so many members in the default fund has already significantly impacted their overall financial outcome. To let another seven years go by and be in a similar position this would be simply untenable.

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

We believe that a staggered approach will be the best outcome for all concerned. As mentioned before the logistics and market impacts along with costs to the member and providers could be significant unless there is a slow and meaningful transition over a reasonable period of time.

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?**

We do not believe that active default members should be moved as they have elected to choose the fund they are in. With the probability that a new default fund option will be developed those providers with active members in their current default conservative fund would simply stay there.

There would be no issue on that basis to have to notify them of any change given the fund they have actively chosen would stay the same.

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?**

The terms and conditions that were clearly articulated in the last review are a very good benchmark and should be the foundation for this review. However they need to be monitored more regularly not just reported on. If providers aren't meeting their obligations they should lose their right to offer a default fund.

We also believe that CFFC and the FMA work more closely together in relation to key messages with KiwiSaver and improving the general KiwiSaver membership levels of financial capability. Having an independent source with innovative ideas to get better traction in this very difficult space is incredibly important.

Perhaps one innovative idea is have a **"KiwiSaver Week"** (much like Money Week). A well-structured approach on key messages could be delivered in unity through the FMA CFFC, and KiwiSaver providers. With such a concentrated period of aligned messages we believe that this approach would be far more effective than some of the ad hoc approaches we have seen to date.

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

N/A

43. **Any other feedback?**

N/A