

## In Confidence

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Economic Growth and Infrastructure Committee

### Improving KiwiSaver Annual Statements

#### Proposal

1. This paper seeks agreement to change the requirements for KiwiSaver annual statements. The key changes would require all KiwiSaver providers to include in their annual statement to investors full disclosure of the fees charged (in dollar values). This will increase transparency and help investors to make better decisions about their KiwiSaver investments.

#### Executive Summary

2. I am proposing a number of changes to the annual statements sent to KiwiSaver investors. The current regulatory requirements are minimal and do not provide investors with enough information to make informed decisions about their retirement savings.
3. There is evidence to suggest that KiwiSaver investors are reading these statements and are interested in receiving more information about their KiwiSaver investment. For this reason, I believe the annual statement presents an opportunity to communicate to KiwiSaver investors and prompt them to take action.
4. The main changes I am proposing are:
  - total fees paid that year (in dollar values);
  - the total amount that the investor's account grew by over the year; and
  - summary transaction figures detailing the money that has gone in and out of the investor's account during the year.
5. The proposal to include dollar fees is to remedy an existing problem whereby, in the absence of regulatory requirements, a number of KiwiSaver providers are only disclosing a fraction of the fees investors are paying. This is unacceptable from a transparency perspective and also may suppress competition amongst KiwiSaver providers in the long term if they are not competing on price.
6. I am still considering whether annual statements should be required to include information about what the investor is on track to receive at retirement, and seek authorisation to decide whether this should be included after considering further advice and evidence.
7. Officials proposed retirement savings and income projections in order to prompt investors to consider whether their current contributions are likely to generate the amount of retirement savings they desire. In 2016, of the 2.6 million New Zealanders who are members of KiwiSaver, 1.1 million were not contributing anything towards their retirement savings.<sup>1</sup> This lack of contributions suggests that many people are not taking action to ensure they will have enough retirement savings. I believe there could be merit in including projected retirement income figures. Subject to Cabinet's agreement, I may decide this should be included if I see further evidence it is likely to spur people to take action and resume or increase their contributions.

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<sup>1</sup> *KiwiSaver Annual Report*, Financial Markets Authority 2016.

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8. The proposals for fee disclosure will impose costs on KiwiSaver providers. These costs will be generated by the need to change their existing IT systems. Despite these costs, I consider that greater fee disclosure will benefit consumers over the long term.

### Background

9. Building the financial capability of New Zealanders is a priority for the Government. Greater financial capability will improve the wellbeing of New Zealand's families and communities, reduce hardship, increase investment, and grow the economy. One of the pillars underpinning this goal is a commitment to help improve investor capability. This focus on investor capability is particularly important, as many New Zealanders are now investing in financial markets through KiwiSaver.
10. KiwiSaver is the most widely held voluntary private retirement savings scheme in New Zealand. Over 2.6 million New Zealanders are members, and for many of these investors, KiwiSaver will be their first, and possibly only, experience with a long-term investment product. The amount invested in KiwiSaver is substantial: in 2016 the Crown contributed \$728 million, employers contributed \$1.6 billion, and members contributed \$3.2 billion. The high level of investment in KiwiSaver by a large number of New Zealanders makes it important that the information provided to investors is complete and helps them make good decisions about their retirement savings.
11. We know that making financial decisions can be difficult, and we know that a large number of New Zealanders fail to make good decisions about their retirement savings. Many New Zealanders stay in KiwiSaver default funds without considering whether another fund might better suit their circumstances, or contribute at only the minimum level even if an increase to their contributions is within their means and would provide them with a better outcome at retirement. These decisions – or, more often, the absence of considered decisions – means that many New Zealanders will end up with less in their KiwiSaver at retirement than if they had taken a more proactive approach.
12. Every KiwiSaver investor receives an annual statement with information about their savings. The regulatory requirements for these annual statements are minimal: the investor must be sent information about their balance in the scheme at the start and at the end of the accounting period, and contributions to their savings during the period.
13. Many KiwiSaver providers also disclose some additional information about KiwiSaver investors' account balances in annual statements. This often includes a savings history, some fee information and the type of fund the investor is in. However, the amount and type of additional information is not consistently provided across the industry.

### *Many consumers read their annual statements*

14. We know, from research conducted by the Financial Markets Authority, that these statements are widely read: nine out of ten people could recall receiving their statement and four out of five had read it.
15. People reported finding all aspects of KiwiSaver annual statements useful, particularly their current balance and contribution amounts. Consumers also had a strong preference to receive additional information about their retirement savings that shows them what they are on track to receive when they retire – in particular, consumers wanted to receive a projected retirement savings lump sum, what that lump sum would convert to as a weekly income, and how long that income would last.
16. The changes I am proposing will create greater transparency and prompt investors to make decisions and take action that will give them a better retirement outcome.

### Comment

17. The high readership of annual statements makes them a good vehicle for information that helps people understand their investments and prompts them to make decisions that will

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improve their retirement outcome. It is important that they contain the key information investors expect and are entitled to, including information about fees.

18. There is currently no requirement to provide information about fees in annual statements. In the absence of regulatory requirements many providers are only disclosing the fixed member fee (average member fee is \$32 per annum) on the annual statement and do not disclose the other fees that are charged to the fund. The partial disclosure of fees in annual statements can lead consumers to assume they are paying fewer fees than in reality. These fees are not insignificant: in the year to 31 March 2016, on average KiwiSaver investors paid \$125 in fees and other expenses.
19. Some KiwiSaver providers do, however, go beyond what is required, and provide information on the total fees the investor has been charged or the total savings they are projected to have at retirement. Some also prompt investors to reconsider their fund choice if they are in a default fund, or to increase their contributions if they are contributing too little to receive the full government contribution.
20. This is positive, and I want to increase the minimum requirements for annual statements while retaining the ability and incentives for providers to innovate in their client communications.

### ***Summary of proposed changes***

21. To ensure that investors are given useful information in their annual statements, I propose that, in addition to the information already required (the balance and summary of contributions) the following information also be required in all KiwiSaver annual statements:
  - total fees paid that year (in dollar values);
  - the total amount that the investor's account grew by over the year; and
  - summary transaction figures detailing the money that has gone in and out of the investor's account during the year.
22. I provide more detail on each of these proposals below.

### *Fees*

23. It is important that KiwiSaver investors understand the fees they are paying. Fees can have a significant impact on total returns over the timeframe of an investment, yet many KiwiSaver members are unaware of that impact as they only see investment returns net of fees. A New Zealand Treasury report last year found that KiwiSaver fee levels appear to be in the upper half of comparator countries and well above the extremely low fees available in some markets, such as, Finland, Israel and the United Kingdom.
24. As described above, most providers include the fixed member fee on their annual statements, but not the management and administration charges, which can lead consumers to assume they are paying fewer fees than in reality.
25. Information about fees is also disclosed in the providers' Product Disclosure Statements and Quarterly Fund Updates but as these are generic sales and information documents, fees are not personalised to the investor and are disclosed as a percentage figure, which consumers do not find as meaningful as a dollar value. Investors would also need to seek out these documents themselves, as the Product Disclosure Statement is only provided at the point of sale, and the Quarterly Fund Update is required to be published online but not sent to investors.
26. There is also evidence KiwiSaver members want more information about fees. The Financial Market Authority's consumer research into KiwiSaver annual statements also showed that there is consumer appetite for information about fees: 39% of those interviewed wanted information about how fees are calculated and 37% wanted to see fees displayed in a dollar amount.

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27. I propose annual statements be required to show each investor the full fee impact in dollar terms. This would be a total fees figure that includes management and administration charges, performance fees and other charges.
28. While a few providers already include this information, there will be implementation costs for the majority that do not. Many providers (or their back-office administrators) will need to build or purchase computer-system upgrades to enable this information to be collected. Feedback from providers indicates that these costs will be approximately \$1 million, subject to final regulatory requirements.
29. While these costs may be passed on to investors, if they take action as a result of the information they receive about their retirement savings there are likely to be net benefits for them over the longer term through increased retirement savings.
30. I also believe that improved transparency about fee disclosure will enhance competition amongst providers, spurring them to communicate more effectively to consumers about the fees they charge and competing on price to a greater extent.

### *Interim solution for fee disclosure*

31. Officials consulted with KiwiSaver providers and firms that provide back-office services to KiwiSaver providers on a proposal to include total fees as a dollar figure in the 2017 annual statements. All the providers who do not currently disclose fees in dollar values indicated that it would be extremely difficult, if not impossible, to calculate this information and include it in 2017 annual statements. In some cases KiwiSaver providers have already begun the processes needed to generate their 2017 annual statements.
32. Nevertheless, I think providers should have to go some way towards addressing insufficient fee disclosure in next year's annual statements. I propose that providers who cannot disclose dollar fees in 2017 annual statements be given one year to comply. In the interim they will be required to include the "total fund charges" in percentage form, and the membership fee in dollars, as they appear in the most recent Quarterly Fund Update. While this figure will not be personalised or expressed as a total dollar figure, it will, in many cases, be an improvement on the existing disclosure of fees.

### *The total amount that the investor's account grew (or decreased) by over the year*

33. This information would be relatively easy for providers to calculate and include, and would help people understand the overall change to their account across the last year.

### *Summary transaction figures*

34. These figures would detail the money that has gone in and out of the investor's account during the year and would include: contributions, returns, fees, tax withdrawals or credits.

### *Timing of additional changes (outside of transitional arrangement for fees in 2017)*

35. My priority for this work in the immediate future is to improve the fee disclosure information for KiwiSaver investors. This will be done in 2017 through the transitional arrangement. All other changes I am proposing will not be required until 2018 annual statements.

### *These changes will apply to KiwiSaver only*

36. Although officials consulted on applying these proposed changes to all KiwiSaver, superannuation and workplace savings schemes, consultation revealed that non-KiwiSaver schemes would have additional compliance difficulties, and additional policy design work would be required. For examples, for schemes that are defined-benefit, rather than defined-contribution, the retirement projection is moot, as the amount the consumer will receive upon retirement is already set. In other schemes the employer pays the fees, rather than the consumer, which would make disclosure of fees more complex.

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37. Given the complexity of applying the changes to non-KiwiSaver schemes, and the fact that KiwiSaver has a wide reach (over 2.6 million New Zealanders are members), I have decided that in the first instance the changes proposed in this paper should only apply to KiwiSaver schemes.

### There may be merit in also requiring annual statements to include information on retirement savings projections

38. New Zealanders do not typically have a clear view of the retirement income they will have, or how long it will last in retirement. While tools exist to help them calculate this, it takes effort for a person to find a tool and enter data. I consider that the high readership of annual statements could present an opportunity to show investors the amount of retirement savings they are projected to have based on their current contributions. This could prompt a 'reality check' for many investors, and lead them to take action if the amount they are projected to receive falls short of what they believe they will need.
39. A number of countries require a personalised projected pension balance to be provided to members. The United Kingdom and Ireland prescribe the method of calculation, while other countries allow providers more flexibility.
40. Officials considered several ways projections could be included in annual statements, and proposed that all providers should have to include projections generated from a government-endorsed set of assumptions. Another option considered was the inclusion of a link to an online retirement calculator. Including a projection on the annual statement would have high implementation costs for providers. During consultation a number of providers also noted the significant investment they had already made into their existing online retirement income calculators. They also expressed concern that part of their unique offering was their bespoke retirement income calculator, which used their own set of assumptions.
41. I am also concerned about the potential for unintended consequences – for example, the potential that a future income projection could dishearten savers and make them less engaged.
42. Nevertheless, I believe there may be merit in requiring annual statements to include information on retirement projections, but I would like to see further investigation and analysis before deciding whether this should be required, and, if so, what form it should take. In particular, I would like to receive further advice on possible unintended consequences.
43. I therefore seek authorisation to decide whether annual statements should be required to include information on retirement savings projections, after considering further advice and evidence.

### Risks and mitigations

44. I have identified the following risks that need to be managed:
- a. **Unintended consequences** (e.g. greater fee disclosure reduces public confidence in KiwiSaver and discourages people from increasing their KiwiSaver contributions)  
Mitigation: The government can provide supporting information at the time the new statements are released. I believe this will also incentivise providers to communicate more effectively to investors about the value they are generating for them for the fee they are charging.
  - b. Overly prescribing the content of annual statements could lead to **check-box compliance** and disincentivise providers from innovating and targeting messaging to their client base.  
Mitigation: My proposals err more on the side of flexibility than prescription.
  - c. The industry is already **fatigued** by regulatory change

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Mitigation: Officials have engaged with industry and will continue to engage with them. Industry is generally supportive of the changes proposed.

### Consultation

45. Officials conducted targeted consultation with KiwiSaver, superannuation and workplace savings schemes, as well as with some companies that provide back-office or registry services and some law firms. They received 35 written submissions and have met with a number of stakeholders.
46. The following departments and agencies have been consulted on the proposals in this paper: The Financial Markets Authority, The Commission for Financial Capability, The Treasury. The Department of Prime Minister and Cabinet has been informed.

### Financial Implications

47. These proposals have no financial implications for the Government.

### Human Rights

48. The proposals outlined in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

### Legislative Implications

49. If agreed by Cabinet, the above proposals will be implemented through regulations made under the Financial Markets Conduct Act 2013.

### Regulatory Impact Analysis

50. The Regulatory Impact Analysis Review Panel has reviewed the attached Regulatory Impact Statement (RIS) prepared by the Ministry of Business, Innovation and Employment. They consider that the information and analysis summarised in the RIS partially meets the criteria necessary for Ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper. This RIS received the rating of 'partially meets' due to a restrained analysis of the problem and uncertainty around the quantification of net benefits for the preferred option.

### Publicity

51. I plan to announce these changes in December 2016. I plan to release this Cabinet paper as part of the announcement so as to give KiwiSaver providers certainty about what is expected of them in 2017 annual statements.

### Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

- 1 **note** that the high readership of KiwiSaver annual statements makes them a good vehicle for supplying key information to consumers about their KiwiSaver;
- 2 **note** that the current requirements for annual statements are minimal, and do not include disclosure of fees paid by the investor;
- 3 **note** that the content of annual statements varies across providers;
- 4 **note** that MBIE officials consulted with KiwiSaver providers on a range of proposals to improve annual statements, and that I have given consideration to their feedback in deciding on the proposals outlined in this paper;

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- 5 **agree** that annual statements should be required to include:
  - 5.1 total fees paid that year (in dollar values)
  - 5.2 the total amount that the investor's account grew (or decreased) by over the year
  - 5.3 summary transaction figures detailing the money that has gone in and out of the investor's account during the year;
- 6 **note** that the method for calculating the total fees figure will be subject to further consultation between the Ministry of Business, Innovation and Employment, the Financial Markets Authority and KiwiSaver providers;
- 7 **agree** that these changes should be required in 2018 annual statements;
- 8 **agree** providers who cannot disclose dollar fees in 2017 annual statements be given a transitional period of one year to comply;
- 9 **agree** that the transitional arrangement for fee disclosure in 2017 annual statements will be the inclusion of the "total fund charges" in percentage form, and the membership fee in dollars, as they appear in the most recent Quarterly Fund Update;
- 10 **note** that there may be merit in requiring annual statements to include information on retirement projections, but that this requires further investigation and analysis;
- 11 **authorise** the Minister of Commerce and Consumer affairs to decide whether annual statements should be required to include information on retirement savings projections, after considering further advice and evidence;
- 12 **note** that, if agreed by Cabinet, these changes will be effected through regulations.

Authorised for lodgement

Hon Paul Goldsmith

**Minister of Commerce and Consumer Affairs**