

The Treasury

KiwiSaver Default Provider Arrangements: Release of Discussion Paper Information Release

September 2019

This document has been proactively released by the Treasury on the Treasury website at
<https://treasury.govt.nz/publications/information-release/finance-portfolio-cabinet-material>

Cabinet Document Details

Title: **Cabinet Paper DEV-19-SUB-0200: KiwiSaver Default Provider Arrangements: Release of Discussion Paper**

Date: **31 July 2019**

Creator: Office of the Minister of Finance and Office of the Minister of Commerce and Consumer Affairs

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[36] 9(2)(h) - to maintain legal professional privilege

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [33] appearing where information has been withheld in a release document refers to section 9(2)(f)(iv).

Copyright and Licensing

Cabinet material and advice to Ministers from the Treasury and other public service departments are © **Crown copyright** but are licensed for re-use under **Creative Commons Attribution 4.0 International (CC BY 4.0)** [<https://creativecommons.org/licenses/by/4.0/>].

For material created by other parties, copyright is held by them and they must be consulted on the licensing terms that they apply to their material.

Accessibility

The Treasury can provide an alternate HTML version of this material if requested. Please cite this document's title or PDF file name when you email a request to information@treasury.govt.nz.

Office of the Minister of Finance
Office of the Minister of Commerce and Consumer Affairs
Chair, Cabinet Economic Development Committee

RELEASE OF DISCUSSION PAPER ON KIWISAVER DEFAULT PROVIDER ARRANGEMENTS

Proposal

- 1 This paper seeks agreement to release a discussion paper for public consultation on the review of the KiwiSaver default provider arrangements.

Executive summary

- 2 KiwiSaver members who do not choose their own fund and are between 18 and 65 years of age are automatically enrolled in a “default fund”. The terms of appointment for the existing nine providers of default funds expire on 30 June 2021. We are the Ministers responsible for appointing new default fund providers.
- 3 After 10 years of KiwiSaver, we now know that many KiwiSaver default members are not engaging with their KiwiSaver accounts in the way that had been expected. A significant number of people (around 430,000) have stayed in default funds without making an active choice to do so.
- 4 The settings for default funds can make a significant difference to a person’s retirement income, so it is important that the default funds work well for people.
- 5 The discussion paper seeks feedback on what, if any, changes should be made to the terms of appointment for providers of default funds. The paper seeks feedback on the investment approach for default funds and options for reducing fees charged to default members. The paper also seeks feedback on responsible investment and whether default settings should be used to support the development of New Zealand’s capital markets.
- 6 There may be strong stakeholder responses to some of the options presented in the discussion paper. We expect that the release of the discussion paper will provide a positive opportunity for full and rigorous debate on the default provider arrangements. In terms of mitigating the risk of strong stakeholder responses, the discussion paper makes it clear that we are consulting on all options, and invites submitters to put forward options not set out in the discussion paper.
- 7 The discussion paper will be released for public consultation following Cabinet approval. The Ministry of Business, Innovation and Employment (MBIE) and the Treasury will then analyse the submissions and provide us with further advice. We intend to seek Cabinet policy decisions on the settings for the KiwiSaver default provider arrangements by November 2019, ahead of a procurement process beginning in 2020.

Background

- 8 KiwiSaver members who do not choose their own fund and are between 18 and 65 years of age are automatically enrolled in a “default fund”. The government appoints providers that can provide default funds and sets the requirements that default funds must meet.
- 9 The terms of appointment for the existing nine default KiwiSaver providers expire on 30 June 2021. We are the Ministers responsible for appointing new default providers, after seeking advice from the Financial Markets Authority.
- 10 Ahead of that appointment process, we are reviewing the arrangements for the default providers. The review is an opportunity to improve the wellbeing of default members, for example, by reducing fees, changing the investment mandate, and changing a range of other settings for default funds.
- 11 The discussion paper seeks feedback on what, if any, changes should be made to the terms of appointment for providers of default funds.

Key issues and content in the discussion paper

Investment mandate

- 12 Default funds currently have a conservative investment mandate, which means that they have a low proportion of assets invested in growth assets.
- 13 The current conservative investment mandate reflects that the default funds were initially envisaged as a “parking space” for default members. It was assumed that an ability to earn higher returns in a more growth-oriented fund would encourage members to actively choose the best fund for them.
- 14 However, we now have information to show that individuals are staying in default funds and are not making active decisions about their retirement savings in the way that had been expected. Approximately 430,000 people remain in default funds who have not made an active choice to stay there. This is approximately 34% of all automatically enrolled members.
- 15 This has a significant impact on a person’s KiwiSaver balance. For an 18 year old who earns an average salary of \$42,500 a year and contributes 3% a year to KiwiSaver, a conservative investment mandate would result in a KiwiSaver balance at retirement (age 65) that is about \$135,000 lower than if a growth investment mandate was chosen and about \$56,000 lower than if a balanced fund was chosen. Assuming a life expectancy of 90 years, this equates to \$358 a week in retirement with a growth fund, compared with \$242 a week from a balanced fund and only \$166 a week from a conservative fund.
- 16 The discussion paper seeks views on the following investment mandate options: life-stages, balanced, growth and conservative. A life-stages option would have a higher proportion of assets invested in growth assets for younger members, with the proportion of growth assets reducing in stages as members get older. A balanced option would have a moderate proportion of assets invested in growth assets. A

growth option would have a relatively high proportion of assets invested in growth assets.

- 17 The discussion paper states that a change to the investment mandate may be warranted and sets out the costs and benefits of each option.
- 18 One potential issue with growth and life-stages approaches (and to a lesser extent, a balanced approach) is that first home buyers (and others making early withdrawals) could be exposed to losses if they withdraw funds when the market is in a down-cycle. In relation to first-home buyers, this issue is small in scale: less than 11% of first home buyer withdrawals are made from default funds. The paper seeks feedback on ways to mitigate this issue if a life-stages, balanced, or growth investment mandate is adopted.

Fees

- 19 Fees can have a significant impact on a person's KiwiSaver balance.
- 20 With percentage-based fees, total fees increase as funds under management increase, despite the same service being provided. We would have expected that percentage fees would have decreased significantly as overall funds under management increase, but this has not occurred.
- 21 The paper states a clear expectation that default fees will reduce as an outcome of this review, and seeks feedback on a range of options for encouraging reductions in fees, particularly for low-income default members.

Ethical/responsible investment

- 22 There has been significant media and public interest in the extent to which KiwiSaver providers invest in a responsible manner.
- 23 The discussion paper sets out options for requiring default providers to invest responsibly, and the costs and benefits of those options. The options presented are:
 - 23.1 Requiring mandatory exclusions of certain industries or companies. This option could require KiwiSaver providers to either follow a particular international standard or framework of responsible investing, or to obtain certification from an external responsible investment authority.
 - 23.2 Requiring providers to follow a standard method of disclosing responsible investment practices to members. This may take the form of an exclusion list organised by sector, which is a practice already observed by several default providers.

Developing New Zealand's capital markets

- 24 We have been considering whether it would be desirable or appropriate to use the KiwiSaver default arrangements to support the development of New Zealand's capital markets.

- 25 Accordingly, the discussion paper seeks feedback on the role that default funds could play in the development of New Zealand's capital markets, and potential options. The options presented are:
- 25.1 Require default providers to conduct some of the activities associated with the management of their default funds in New Zealand. The discussion paper seeks feedback on the scope of this requirement.
 - 25.2 Requiring investment (for example, up to 0.5% of funds under management) in specific parts of New Zealand's capital markets, for example, in early stage New Zealand companies.
- 26 The paper also seeks suggestions from submitters on other options that could assist in developing New Zealand's capital markets.

Transfer of default members

- 27 The discussion paper consults on the extent to which the government should transfer existing default members to appointed default providers, once those providers have been appointed following the procurement process. One option is to transfer only those default members from default providers that are not reappointed. Another option would be to transfer all default members. The discussion paper also seeks feedback on whether to transfer "active default" members (members who have actively chosen to remain in a default fund).

Connections with other regulatory reviews

- 28 The Commission for Financial Capability is currently carrying out its three-yearly Review of Retirement Income Policies. That review is likely to include consideration of issues relevant to the default provider arrangements, including responsible investment. We will continue to engage with the Commission throughout the process to ensure that insights and research from their review is taken into account.
- 29 NZX and the Financial Markets Authority have initiated an industry-led review of New Zealand's capital markets, "Capital Markets 2029". The review has sought stakeholder feedback on how KiwiSaver could improve its contribution to New Zealand's capital markets, both for issuers and investors. The review's final report is scheduled to be released in August or September 2019. We will continue to engage with the review's Steering Group.

Likely public and industry reaction to discussion paper

- 30 There may be strong stakeholder responses to some of the options presented in the discussion paper. In particular:
- 30.1 There has been some public debate already about the choice of investment mandate and fees and we expect this to continue once the discussion paper is released.

30.2 Some stakeholders will be strongly supportive of requiring providers to invest more responsibly. Other stakeholders will be strongly of the view that this would not be desirable, effective, or appropriate.

[33]

31 We expect that the release of the discussion paper will provide a positive opportunity for full and rigorous debate on the default provider arrangements. In terms of mitigating the risk of strong stakeholder responses, the discussion paper makes it clear that we are consulting on all options, and invites submitters to put forward options not set out in the discussion paper.

Legal advice

[36]

34 The consultation process is an opportunity to get more information from stakeholders on whether the particular requirements under consideration support the purpose of the Act or frustrate it. Once we have received submissions from stakeholders, we will consider further whether there are legal issues with any option that cannot be resolved in the detailed design and seek guidance from Ministers accordingly.

Process and timing

35 The discussion paper will be released for public consultation following Cabinet approval. The Prime Minister's Business Advisory Council will be consulted during that time.

36 MBIE and the Treasury will then analyse the submissions and provide us with further advice. We intend to seek Cabinet policy decisions on the settings for the KiwiSaver default provider arrangements by November 2019, ahead of a procurement process beginning in 2020.

Consultation

37 Inland Revenue and the Financial Markets Authority were consulted on this paper. The Department of the Prime Minister and Cabinet has been informed.

Financial implications

38 There are no financial implications of the proposals in the paper.

Legislative implications

39 There are no legislative implications of the proposals in the paper.

Impact analysis

40 An impact analysis is not required because no regulatory changes are sought at this stage.

[33]

Publicity

44 We will issue a press release along with the release of the discussion paper. It is likely that there will be significant media interest in the options presented.

Proactive release

45 This paper will be published on MBIE's and Treasury's websites, subject to withholdings that are consistent with the Official Information Act 1982.

Recommendations

The Ministers of Finance and Commerce and Consumer Affairs recommends that the Committee:

- 1 **note** that the discussion paper titled Review of the KiwiSaver Default Provider Arrangements sets out options for changing the settings of the KiwiSaver default provider arrangements, and the costs and benefits of those options;
- 2 **agree** to the release of the discussion paper Review of the KiwiSaver Default Provider Arrangements; and
- 3 **authorise** the Ministers of Finance and Commerce and Consumer Affairs to make minor or technical changes to the discussion paper prior to its release.

Authorised for lodgement

Hon Grant Robertson

Minister of Finance

Hon Kris Faafoi

**Minister of Commerce and Consumer
Affairs**