FinancialServicesCouncil.
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Workplace Savings NZ
Te māngai penapena ā-mahi

Financial Services Council of New Zealand
Level 33, ANZ Centre,
23-29 Albert St, Auckland 1010
P: +64 9 985 5762
E: fsc@fsc.org.nz
www.fsc.org.nz

13 April 2018
To the Economic Development, Science and Innovation Committee

Submission: KiwiFund Bill (Bill)

This submission is from the Financial Services Council of New Zealand Incorporated (**FSC**) and Workplace Savings NZ (**WSNZ**).

We wish to appear before the committee to speak to our submission, being represented by:

- Richard Klipin, FSC Chief Executive Officer
- and members, based on availability

The FSC represents New Zealand's financial services industry having 33 members at 31 March 2018. Companies represented in the FSC include the major insurers in life, disability, income, and trauma insurance, and some fund managers and KiwiSaver providers plus law firms, audit firms, and other providers to the financial services sector.

The broad themes of this submission are supported by the Workplace Savings NZ Council. WSNZ represents the interests of employers who offer workplace retirement savings schemes, their trustees and their members, other retirement scheme managers and supervisors, 18 KiwiSaver providers, retirement savings industry service providers and professional advisers.

Our submission has been developed through consultation with FSC members, and represents the views of our members and our industry. We acknowledge the time and input of our members in contributing to this submission.

The FSC's guiding vision is to be the voice of New Zealand's financial services industry and we strongly support initiatives that are designed to deliver:

1. Strong and sustainable consumer outcomes;
2. Sustainability of the financial services sector; and
3. Increasing professionalism and trust of the industry.

Background
The Bill's *Explanatory Note* outlines its intent: *This Bill establishes an independent working group with the objective to set up a government-owned and operated KiwiSaver provider, known as KiwiFund. It is intended that the working group would first examine the accountability of current KiwiSaver providers relating to complaints of charging exorbitant fees, unethical investments, and profiteering in the trading of Kiwisaver [sic] providers. The working group would be made up of 4–5 specialists across banking, savings, and retirement fields. The working group would advise on setting up KiwiFund based on broad principles such as:*

- *a lower and transparent fee structure;*
- *a government owned and operated KiwiSaver scheme;*
- *a requirement that profits stay in New Zealand;*
- *preferential treatment given to New Zealand based investments;*
- *a requirement that funds are invested in socially and ethically responsible ways; and*
- *the new provider be supported by a government guarantee.*

KiwiFund would provide an option for people to choose a KiwiSaver provider that is ultimately accountable to New Zealand taxpayers.

Executive summary

The FSC welcomes the opportunity for a discussion on KiwiSaver and the issues the KiwiFund Bill raises, but we question whether the measures in the Bill are needed.

The broad principles, intended to create a basis for setting up KiwiFund, are already fulfilled by options available to Kiwis today i.e.

- Fees have been progressively dropping and, with recent market-wide changes, are already transparent.
- A government owned and operated KiwiSaver scheme, which retains its profits in New Zealand, already exists.
- Nearly 50% of KiwiSaver funds are already invested domestically.
- Many providers already offer funds invested in socially and ethically responsible ways.

We are concerned that, a government guaranteed scheme would potentially distort the market, create a moral hazard and create a new and unjustified burden on tax payers.

We therefore do not support the Bill in its current form and consider that, should the Bill proceed, there are several areas where the Bill can be improved. Our nine areas for consideration and further debate are set out in greater detail below.

If the Bill passes, we look forward to an opportunity to engage in the working group and constructively address the issues raised in the Bill. We recommend that the industry is engaged in the finalisation of the Working Group report (Clause 9(1)) by being consulted on the report before it is presented to the Minister.

I can be contacted on 021 0233 5414 or richard.klipin@fsc.org.nz to discuss any element of our submission.

Yours sincerely

Richard Klipin

Chief Executive Officer, Financial Services Council

Observations

1. The KiwiSaver market is already competitive and well-served today

The KiwiSaver industry is competitive and New Zealanders are well-served by a wide variety of providers, which offer a range of investment options, business models and fee levels, including low cost providers. There are 25 providers today[1] already offering myriad investment approaches, demonstrating the diversity of the market, with low barriers to entry. Overall enrolment numbers remain strong[2] and the market continues to evolve and innovate without government intervention, illustrated by examples: 1) a relatively recent new low-cost provider entrant, and 2) providers working towards expanding their methods of engaging their customers by using digital tools. Member transfer numbers commonly sit around 15,000 monthly,[3] demonstrating the liquid nature and ability for New Zealanders to choose a provider better suited to their needs. These points, when considered in the context of those that follow, demonstrate that there is no need for an additional government-owned provider.

2. Statutory review of providers

Claims that "exorbitant fees, unethical investments, and profiteering" are generally applicable across the industry issues are incorrect. On the contrary, the FMA's media releases, recent KiwiSaver report and tracker present a picture of an actively regulated, maturing, and reasonably well functioning KiwiSaver regime, while noting that improvement by a number of providers is required in some areas, for example, by increasing the number of active choices made by default members. Issues are handled well within the current framework, being addressed by the industry with FMA shepherding – e.g. fee transparency has been enhanced by disclosure to members of the actual cost of fees. Another example is responsible investing improvements. It is not clear what specific provider issues the Working Group would be tasked with solving.

3. Reduces investor confidence and undermines the FMA.

Passing the Bill would signal to the New Zealand public that the government considers that something is seriously wrong with the current KiwiSaver regime, and that these matters are the most important in relation to the success of KiwiSaver. Such a message would not only be, in our view, untrue, but it would likely have a negative impact on the public's view of KiwiSaver and ultimately its ability to meet its objectives, as well as distract the industry and government from the need to ensure that New Zealanders are effectively using KiwiSaver to save for a more comfortable retirement.

While not a compulsory regime, one of the key objectives of KiwiSaver is full scale participation. An industry wide review, in the manner proposed by the Bill, is likely to negatively impact participation in KiwiSaver.

KiwiSaver has been, and remains, a key priority area for the FMA, with monitoring, surveillance and regular guidance being issued. Establishing a Working Group risks questioning the quality and veracity of the regulator's activities. Perceived deficiencies of the current framework should, in the first instance, be channelled to the FMA for consideration as part of its overall programme of work. If the Government believes that the FMA has failed to adequately regulate and supervise KiwiSaver, this should be stated and addressed.

[1] http://www.kiwisaver.govt.nz/providers/ks-providers.html
[2] http://www.kiwisaver.govt.nz/statistics/monthly/joining/
[3] http://www.kiwisaver.govt.nz/statistics/monthly/schemes/

4. Government guarantee: risks of market distortion and consumer confusion.

The FSC opposes the establishment of a government guaranteed scheme because:

- No reason has been provided for why a government guarantee is necessary or desirable.
- It creates moral hazard (i.e. investors are not required to take responsibility for the investment choice they have made).
- It would establish a significant competitive advantage for KiwiFund and disrupt a functioning and competitive market.
- There is no reason why all New Zealanders should be required to guarantee the returns of one group of KiwiSaver investors, or any KiwiSaver investors at all.
- Many consumers already mistakenly believe that KiwiSaver is government guaranteed, so having one Scheme with that status would add to that misconception/confusion.

The nature of a government guarantee is also potentially fraught with challenges. For example, will the fund invest wholly in government-backed investments (such as Kiwi Bonds), or will it also invest in international investments. If it is the latter, providing a government guarantee would be akin to underwriting international investment managers, creating market distortions – e.g. members could invest with the knowledge that their worst-case outcome is capital preservation, distorting the risk-return trade off, which is inherent in any non-guaranteed investment.

History has shown that government guarantees of financial institutions in New Zealand tend to result in extremely high costs to the New Zealand taxpayer (e.g. South Canterbury Finance).

5. New Zealand-based investment

The Bill's general policy statement suggests that "preferential treatment [be] given to New Zealand based investments". The latest KiwiSaver Morningstar report[4] indicates that existing KiwiSaver providers already invest ~47% of their funds in New Zealand assets (NB: this compares to ~14% for the NZ Super Fund,[5] a government-owned entity. Increasing the proportion of domestic investment is not necessarily positive for investors. NZ Super Fund states "*A significant proportion of the NZ Super Fund is invested offshore. This strategy is consistent with global best practice. Investing globally gives us diversification and access to investment opportunities that are not available domestically*."). The current figures demonstrate the incumbent providers' very strong commitment to New Zealand investment (without compulsion). Legally mandating a bias towards New Zealand investments (especially if narrowly or directed towards sectors such as regional investment) could:

- Increase market risk, including market concentration and currency risk.
- Affect NZ asset values.
- Create illiquidity in the market.

6. Scale might have a limited impact on delivering low cost outcomes/economies

A significant proportion of fund costs are composed of underlying fund managers' fees (who charge as a percentage of total funds under their management) or, where directly invested in securities, broker fees. This is standard practice globally. Consequently, scale will have, in many cases, only a limited impact on lowering fees, because much of the cost involved is inelastic. For example, Australia's largest MySuper fund, through AustralianSuper, charges an annual administration fee of $78 and investment fees of 75 basis points and has over $103 billion in funds under management.

[4] https://www.morningstar.com.au/s/documents/KiwiSaver_Survey_Q4_2017_Final.pdf
[5] https://www.nzsuperfund.co.nz/sites/default/files/documents-sys/NZSF%20Annual%20Report%202017.pdf

7. A holistic view of fees, service and performance is required

The Bill proposes a Government owned scheme, with a low cost and transparent fee structure. Much media commentary also focuses on fees. KiwiSaver already operates in a competitive market where providers offer a range of investment options, business models and fee levels, including low cost providers. It is also important to contextualise 'low cost' to determine the overall merit of a scheme, assessing value, rather than simply fees paid.

New Zealanders should be encouraged to consider potential returns net of fees, and especially the most appropriate fund type for them.

There is a misconception too that fees have not been dropping. This is incorrect. For example, one of our member's data shows that a default KiwiSaver member is now paying one third less in fees in real dollar terms (for the same investment) versus 10 years ago. Another member has stated publicly that fees across its funds have been cut by about 20% since 2009.

It is our expectation that fees will continue to decrease over time due to the combined effects of a competitive market and growing asset scale (but see point 6 above) as well as default selection where the selection process has a significant weighting to fees.

We strongly support the move to improve transparency over how fees are charged. We note that significant work is already underway across the industry to increase fees' transparency and help members better understand the fees they pay, including new fee statement requirements. There is market transparency too.[6]

For Kiwis to understand better the holistic view of fees, service and performance, public education and better media reporting are required. We consider that the energy and cost proposed for KiwiFund and the Working Group would be better deployed by the Government and through the FMA and the Council of Financial Capability to advance Kiwis' financial literacy generally.

8. Government owned and ethically invested

The Bill proposes a Government owned and operated KiwiSaver scheme, with funds that are invested in socially and ethically responsible ways, and where the scheme manager's profits would stay in New Zealand.

However, Kiwi Wealth is 100% New Zealand owned (by Kiwibank, which is partly Government-owned) and we understand that Kiwi Wealth's profits remain in New Zealand. Likewise, Kiwi Wealth's funds are already being invested in socially and ethically responsible ways, and have been certified by the Responsible Investment Association Australasia.

The industry has made significant progress with regards to responsible investment practices since 2016. There are a range of responsible and ethical investing options currently available through individual KiwiSaver schemes. Transparency has improved greatly also (KiwiSaver providers must make a statement in their product disclosure statements about whether the scheme takes responsible investing into account in its investment policies and procedures).

Nonetheless, our members' experience with overtly "Responsible Investment" funds, is muted. It is generally accepted that many New Zealanders are concerned that their investments are not invested in the more extremely morally challenged investments, such as munitions and nuclear weaponry manufacturers, notwithstanding they are illegal regardless. However, the demand for explicitly-focused ethical investments, which exclude sectors that are legal but, for some people, morally challenged (e.g.

[6] https://public.tableau.com/profile/fmaadmin#!/vizhome/FMAKiwiSaverTracker/Story1

tobacco)), is very subdued. This is illustrated by some of our largest members' schemes where there is less than 0.01% invested in their specific responsible investment offerings.

We understand that the Government has now separately proposed that responsible investing will be a relevant factor in awarding default provider status when the current arrangements expire.

As a result, all points considered, the benefit of introducing another scheme with a socially and ethically responsible investment mandate is not clear.

9. Default members frequently do make active choices of their preferred fund

At the Bill's first reading, significant concerns were raised regarding the number of investors who have stayed with their default provider (it has been suggested that 95% of people who are auto enrolled stay in default KiwiSaver schemes). Our data questions this premise: for example, one of our larger members has seen more than 20% of their default members' funds switched to active choice in the last three years alone (largely prompted by active efforts to engage with its default members and help them switch to the 'right' fund for them). Further, evidence shows default schemes membership has been progressively declining versus active choice membership[7] The FMA is monitoring this area to ensure that default providers increase the numbers of activating members.

Default members are not representative of the market (i.e. they are approximately 20% of current member numbers). MBIE will be reviewing default providers in its upcoming default provider review, so we question the usefulness of a Working Group that places unnecessary focus on default providers.

[7] http://www.kiwisaver.govt.nz/statistics/monthly/schemes/