

16 September 2019

Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140

By email: defaultkiwisaver@mbie.govt.nz

Dear Sir/Madam

REVIEW OF KIWISAVER DEFAULT PROVIDER ARRANGEMENTS: SUBMISSION

Thank you for the opportunity to provide feedback on the review of KiwiSaver default provider arrangements.

In addition to our answers to your specific questions, we want to highlight the **three most important considerations**, in our opinion, for this review:

1. Investment mandate

The decision to select a conservative asset allocation for KiwiSaver default funds over 12 years ago has had a devastating impact on members.

Our research indicates that, using return rate data from the past 20 plus years, a **balanced** asset allocation is the most appropriate option for default funds.

We have graphically shown the financial outcomes over a member's working lifetime, comparing the different fund types of conservative, balanced, growth and lifestages. . The balanced fund outcome (or "Master" is shown by the bars, the other types by the lines) The assumptions and data tables used are detailed separately. We have used median income information by age groups from Statistics NZ dated 2017. The graph does not take into account return variability as they are based on long-run averages. Volatility analysis would further demonstrate why lifestages (or growth) are unsuitable options.

There are numerous other issues with a lifestages approach which make it unsuitable for the Government to use for default funds, including:

- Very few KiwiSaver providers currently offer lifestages options, and there is a large level of disparity between the asset allocations and age stages used;
- The starting asset allocation for lifestages options is typically either aggressive or growth, which are entirely unsuitable for members who may wish to utilise the first home withdrawal option

after three years of membership. In addition, KiwiSaver is likely to be a default member's first non-bank financial asset and with limited financial literacy/education provided to school-leavers it is incorrect to assume that these choices are appropriate for such a large group of people that are likely to withdraw within a few years;

- There will inevitably be a need for the Government to make arbitrary decisions about how lifestages will be applied in default funds both in terms of timing and fund types. It is simply an inappropriate decision for the Government to make, as there is no industry consensus and no average right answers. It is important to note that the relative importance of default funds to the total KiwiSaver market has been trending downward and is now around 13%. Members' knowledge and engagement with KiwiSaver has been constantly improving, which is likely to drive this percentage lower, so it does not warrant the additional confusion, complexity and regulation in attempting to implement that in the default funds.
- It is extremely difficult for members to compare lifestages options with any other fund type or option, or even other lifestages fund. This removes transparency and manager accountability which would suit the industry but not the members;
- Lifestages is an attempt by fund managers to add value by purporting to make adjustments that will assist the member. These adjustments do not add value to the member, who needs to be educated about the relative merits of the particular fund type they should use given their circumstances. As long-established financial advisers, we find that over time, clients acquire knowledge and resilience to financial events. With an aging population, the concept that value is added as members approach retirement by shifting to more conservative allocations is often completely inappropriate given their life expectancy.
- Default funds are designed as 'temporary' holding spaces, not a lifetime plan. We want New Zealanders to take responsibility for their own retirement. Lifestages implies that the default manager has a good solution for the member throughout their lifetime, when in most cases, they do not.

2. Over-taxation

Since the commencement of KiwiSaver and as at right now, auto-enrolled KiwiSaver members are generally over-taxed. The reason for this is that they are taxed at the default rate of 28% and not their own rate (10.5% or 17.5% based on their previous two years income). This has adversely affected the youngest and the least financially literate New Zealanders.

The IRD failed in the auto-enrolment process to advise members or employers in all its documentation about PIR rates and the need for members to adjust these after the auto-enrolment process was complete. Not a single comment about PIR rates or the need to change them, despite the guides talking about future responsibilities. The documents are:

KS1 (the employer form sent to the IRD for enrolment)

KS2 (the authority given by the employee to the employer to start KiwiSaver contributions)

KS3 (information for employees about KiwiSaver)

KS4 (guide for employers about KiwiSaver)

Welcome letter to members

The default KiwiSaver providers' inability to engage with and transfer members out of default funds means that this problem persisted.

3. Failure by default providers to meet contractual obligations

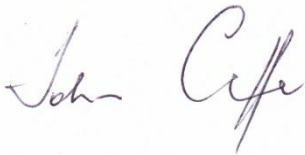
Default KiwiSaver providers have generally failed to meet their contractual obligations to move clients out of the 'temporary' default funds. This because many are deeply conflicted, particularly the Australian-owned banks, which are some of the biggest default funds. Our analysis of their default fund portfolios in July 2018 showed oligopoly behaviour with significant placement of funds in bank term deposits.

There has been no set performance standard. The review needs to set for a default provider very specific performance standards in terms of shifting members out of their default funds. To this must be added automatic consequences for non-performance, such as stopping the flow of new default members to their fund. This could be done on a quarterly basis to rapidly correct underperforming default funds. If the member exit performance target is set significantly higher than their inflows, inevitably this would lead to a decline in default fund membership, exactly the outcome the Government desires. The exit rates could be set higher for the existing largest default fund providers, who have not performed, being AMP, ANZ, ASB, Fisher Funds and Mercer. The failure to perform to the quarterly target automatically results in the loss of new default members for the following quarter. Such a mechanism would ensure results with minimal regulation or oversight from the FMA.


This concept would achieve better outcomes for a large number of New Zealanders provided the performance standard required was strong. It could be supplemented by automatic withdrawals of the longest members in their funds, if the underperformance continued for two or three consecutive quarters.

We would be delighted to support our submission in person in front of the committee, and to answer any questions that members might have.

Kind regards



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Comparison of financial outcomes for KiwiSaver default members

Planning Assumptions

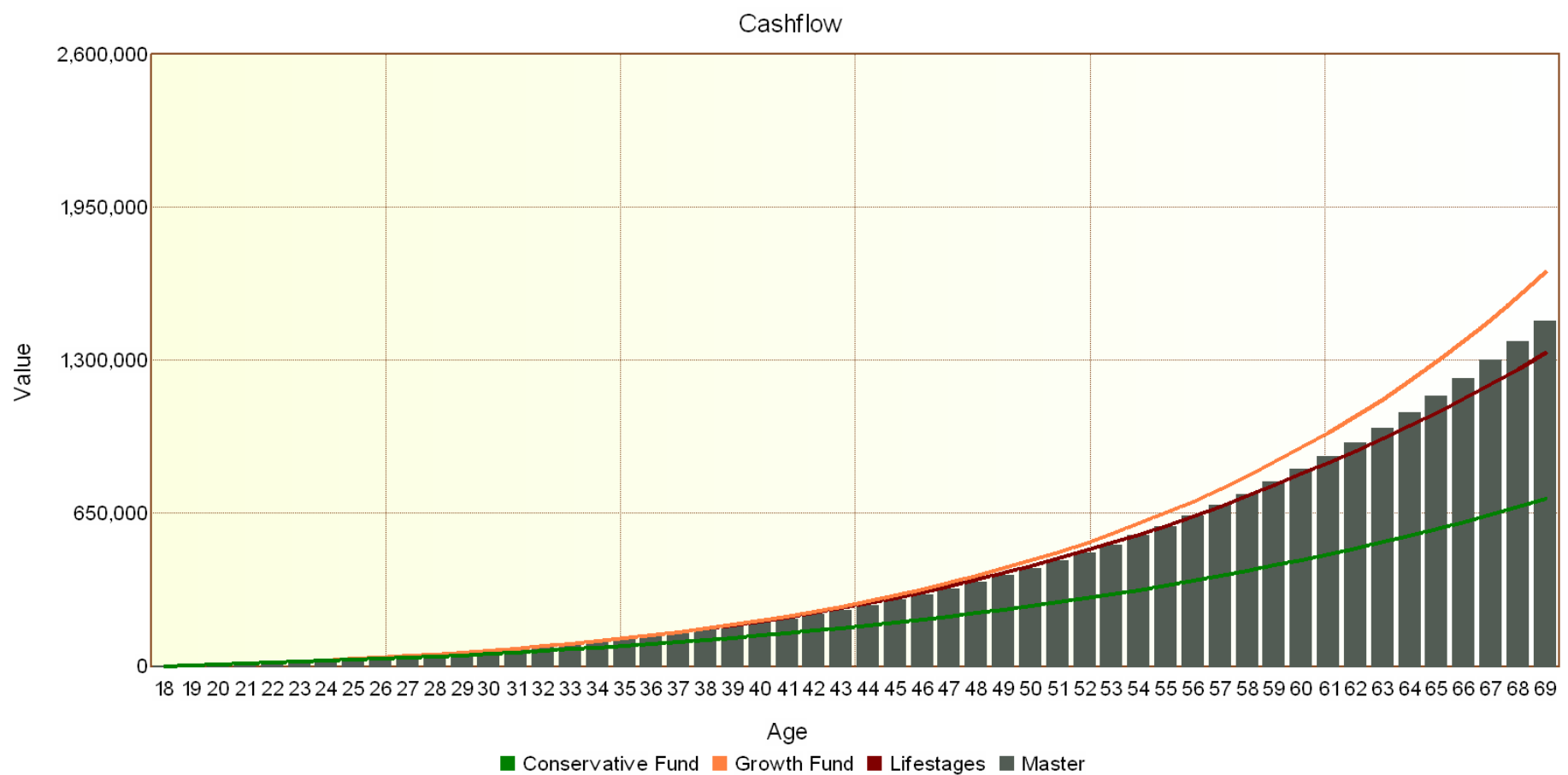
Age range (years)	Weekly gross earning 1, 4	PIR rate	Member contributions (monthly) 2	Employer contributions (monthly) 2	Government contribution (annual) 4	Fund type used for Lifestages
18 -29	\$864	17.5%	112.63	92.92	521.43	Growth
30-39	\$1,193	28%	155.52	111.97	521.43	Balanced Growth
40-49	\$1,312	28%	171.03	123.14	521.43	Balanced
50-59	\$1,293	28%	168.55	121.36	521.43	Moderate
60+	\$1,026	28%	133.75	96.30	521.43	Conservative

- 1 Based on median earnings from 2017, Statistics NZ
- 2 Assumes 3% member contribution, and 3% employer contribution (less Employer Superannuation Contribution Tax)
- 3 Assumes earnings, member and employer contributions increase by the rate of inflation at 2.5%, Government contributions are not inflation adjusted.
- 4 We have not added any additional fee costs in lifestages for the costs involved in implementing the changing asset allocation.

Return Rate Assumptions

Long-run, linear return rates for different fund types have been used as follows:

Fund Type	Annual Return Rates (after manager fees)			Indicative Asset Allocation
	Gross	After tax at 17.5%	After tax at 28%	
Conservative	6.20%	5.1%	4.5%	20% Growth, 80% Defensive
Moderate	6.80%	5.6%	4.9%	40% Growth, 60% Defensive
Balanced (Master)	7.5%	6.2%	5.4%	60% Growth, 40% Defensive
Balanced Growth	7.75%	6.4%	5.6%	70% Growth, 30% Defensive
Growth	8.00%	6.6%	5.8%	80% Growth, 20% Defensive



Master (Balanced)

Yearly

Year	Opening Balance	Contributions	Withdrawals ¹	Earnings	Balance	Weighted Return Rate
2019	0	2,993	0	101	3,094	6.20%
2020	0	3,056	0	300	6,450	6.20%
2021	0	3,120	0	517	10,086	6.20%
2022	0	3,185	0	751	14,023	6.20%
2023	0	3,253	0	1,004	18,280	6.20%
2024	0	3,322	0	1,278	22,880	6.20%
2025	0	3,393	0	1,574	27,847	6.20%
2026	0	3,465	0	1,894	33,206	6.20%
2027	0	3,540	0	2,238	38,983	6.20%
2028	0	3,616	0	2,609	45,208	6.20%
2029	0	3,694	0	3,009	51,911	6.20%
2030	0	3,774	0	3,439	59,125	6.20%
2031	0	3,857	0	3,902	66,884	6.20%
2032	0	71,317	66,884	3,834	75,151	5.40%
2033	0	5,066	0	4,310	84,527	5.40%
2034	0	5,181	0	4,832	94,539	5.40%
2035	0	5,299	0	5,390	105,228	5.40%
2036	0	5,420	0	5,985	116,632	5.40%
2037	0	5,543	0	6,620	128,796	5.40%
2038	0	5,670	0	7,297	141,764	5.40%
2039	0	5,801	0	8,019	155,583	5.40%
2040	0	5,934	0	8,788	170,305	5.40%
2041	0	6,071	0	9,607	185,983	5.40%
2042	0	6,787	0	10,496	203,266	5.40%
2043	0	6,945	0	11,457	221,669	5.40%
2044	0	7,108	0	12,481	241,258	5.40%
2045	0	7,274	0	13,570	262,102	5.40%
2046	0	7,445	0	14,729	284,277	5.40%
2047	0	7,620	0	15,962	307,859	5.40%
2048	0	7,800	0	17,273	332,932	5.40%
2049	0	7,984	0	18,666	359,582	5.40%
2050	0	8,173	0	20,147	387,902	5.40%
2051	0	8,366	0	21,721	417,988	5.40%
2052	0	8,455	0	23,389	449,832	5.40%
2053	0	8,655	0	25,157	483,644	5.40%
2054	0	8,861	0	27,035	519,541	5.40%
2055	0	9,072	0	29,029	557,642	5.40%
2056	0	9,288	0	31,144	598,074	5.40%
2057	0	9,510	0	33,389	640,973	5.40%
2058	0	9,737	0	35,770	686,481	5.40%
2059	0	9,970	0	38,297	734,748	5.40%
2060	0	10,209	0	40,976	785,933	5.40%
2061	0	10,454	0	43,816	840,203	5.40%
2062	0	8,598	0	46,765	895,567	5.40%
2063	0	8,803	0	49,836	954,206	5.40%
2064	0	9,012	0	53,088	1,016,307	5.40%
2065	0	9,227	0	56,533	1,082,066	5.40%
2066	0	9,447	0	60,179	1,151,692	5.40%
2067	0	9,152	0	64,026	1,224,870	5.40%
2068	0	9,383	0	68,084	1,302,337	5.40%
2069	0	9,620	0	72,379	1,384,337	5.40%
2070	0	9,864	0	76,926	1,471,126	5.40%
2071	0	10,113	0	81,738	1,562,977	5.40%

1 To adjust return rate

Scenario One (Conservative)

Yearly

Year	Opening Balance	Contributions	Withdrawals ¹	Earnings	Balance	Weighted Return Rate
2019	0	2,993	0	83	3,076	5.10%
2020	0	2,993	0	243	6,312	5.10%
2021	0	2,993	0	412	9,718	5.10%
2022	0	2,993	0	590	13,301	5.10%
2023	0	2,993	0	777	17,071	5.10%
2024	0	2,993	0	974	21,038	5.10%
2025	0	2,993	0	1,181	25,212	5.10%
2026	0	2,993	0	1,399	29,604	5.10%
2027	0	2,993	0	1,628	34,226	5.10%
2028	0	2,993	0	1,870	39,088	5.10%
2029	0	2,993	0	2,124	44,205	5.10%
2030	0	2,993	0	2,391	49,589	5.10%
2031	0	2,993	0	2,672	55,253	5.10%
2032	0	65,257	61,532	2,590	61,568	4.43%
2033	0	3,725	0	2,878	68,172	4.44%
2034	0	3,725	0	3,180	75,077	4.44%
2035	0	3,725	0	3,495	82,297	4.44%
2036	0	3,725	0	3,825	89,847	4.45%
2037	0	3,725	0	4,170	97,741	4.45%
2038	0	3,725	0	4,530	105,996	4.45%
2039	0	3,725	0	4,907	114,628	4.45%
2040	0	3,725	0	5,301	123,654	4.45%
2041	0	3,725	0	5,713	133,093	4.46%
2042	0	4,049	0	6,152	143,294	4.46%
2043	0	4,049	0	6,618	153,961	4.46%
2044	0	4,049	0	7,105	165,115	4.46%
2045	0	4,049	0	7,614	176,778	4.46%
2046	0	4,049	0	8,147	188,974	4.46%
2047	0	4,049	0	8,704	201,727	4.46%
2048	0	4,049	0	9,286	215,063	4.46%
2049	0	4,049	0	9,895	229,007	4.46%
2050	0	4,049	0	10,532	243,588	4.46%
2051	0	4,049	0	11,198	258,835	4.46%
2052	0	4,001	0	11,893	274,730	4.46%
2053	0	4,001	0	12,619	291,350	4.47%
2054	0	4,001	0	13,378	308,729	4.47%
2055	0	4,001	0	14,172	326,901	4.47%
2056	0	4,001	0	15,002	345,904	4.47%
2057	0	4,001	0	15,869	365,774	4.47%
2058	0	4,001	0	16,777	386,552	4.47%
2059	0	4,001	0	17,725	408,278	4.47%
2060	0	4,001	0	18,718	430,997	4.47%
2061	0	4,001	0	19,755	454,753	4.47%
2062	0	3,281	0	20,822	478,856	4.47%
2063	0	3,281	0	21,923	504,060	4.47%
2064	0	3,281	0	23,073	530,414	4.47%
2065	0	3,281	0	24,277	557,972	4.47%
2066	0	3,281	0	25,535	586,788	4.47%
2067	0	2,760	0	26,839	616,386	4.47%
2068	0	2,760	0	28,190	647,336	4.47%
2069	0	2,760	0	29,603	679,699	4.47%
2070	0	2,760	0	31,080	713,540	4.47%
2071	0	2,760	0	32,625	748,925	4.47%

1 To adjust return rate

Scenario Two (Growth)

Yearly

Year	Opening Balance	Contributions	Withdrawals ¹	Earnings	Balance	Weighted Return Rate
2019	0	2,993	0	108	3,101	6.60%
2020	0	3,056	0	321	6,477	6.60%
2021	0	3,120	0	553	10,149	6.60%
2022	0	3,185	0	805	14,140	6.60%
2023	0	3,253	0	1,079	18,472	6.60%
2024	0	3,322	0	1,376	23,170	6.60%
2025	0	3,393	0	1,699	28,261	6.60%
2026	0	3,465	0	2,048	33,774	6.60%
2027	0	3,540	0	2,425	39,739	6.60%
2028	0	3,616	0	2,834	46,188	6.60%
2029	0	3,694	0	3,276	53,158	6.60%
2030	0	3,774	0	3,753	60,685	6.60%
2031	0	3,857	0	4,268	68,810	6.60%
2032	0	73,764	68,810	4,256	78,019	5.80%
2033	0	5,066	0	4,808	87,893	5.80%
2034	0	5,181	0	5,400	98,474	5.80%
2035	0	5,299	0	6,034	109,807	5.80%
2036	0	5,420	0	6,713	121,939	5.80%
2037	0	5,543	0	7,439	134,922	5.80%
2038	0	5,670	0	8,217	148,810	5.80%
2039	0	5,801	0	9,048	163,659	5.80%
2040	0	5,934	0	9,937	179,530	5.80%
2041	0	6,071	0	10,887	196,488	5.80%
2042	0	6,787	0	11,920	215,195	5.80%
2043	0	6,945	0	13,039	235,179	5.80%
2044	0	7,108	0	14,235	256,522	5.80%
2045	0	7,274	0	15,512	279,308	5.80%
2046	0	7,445	0	16,874	303,628	5.80%
2047	0	7,620	0	18,329	329,576	5.80%
2048	0	7,800	0	19,880	357,256	5.80%
2049	0	7,984	0	21,535	386,775	5.80%
2050	0	8,173	0	23,299	418,246	5.80%
2051	0	8,366	0	25,180	451,792	5.80%
2052	0	8,455	0	27,181	487,428	5.80%
2053	0	8,655	0	29,310	525,394	5.80%
2054	0	8,861	0	31,578	565,833	5.80%
2055	0	9,072	0	33,994	608,898	5.80%
2056	0	9,288	0	36,566	654,753	5.80%
2057	0	9,510	0	39,304	703,567	5.80%
2058	0	9,737	0	42,219	755,524	5.80%
2059	0	9,970	0	45,322	810,816	5.80%
2060	0	10,209	0	48,623	869,648	5.80%
2061	0	10,454	0	52,135	932,238	5.80%
2062	0	8,598	0	55,804	996,640	5.80%
2063	0	8,803	0	59,647	1,065,090	5.80%
2064	0	9,012	0	63,731	1,137,833	5.80%
2065	0	9,227	0	68,071	1,215,131	5.80%
2066	0	9,447	0	72,682	1,297,260	5.80%
2067	0	9,152	0	77,566	1,383,978	5.80%
2068	0	9,383	0	82,739	1,476,101	5.80%
2069	0	9,620	0	88,234	1,573,956	5.80%
2070	0	9,864	0	94,071	1,677,891	5.80%
2071	0	10,113	0	100,270	1,788,274	5.80%

1 To adjust return rate

Scenario Three (Lifestages)

Yearly

Year	Opening Balance	Contributions	Withdrawals ¹	Earnings	Balance	Weighted Return Rate
2019	0	2,993	0	108	3,101	6.60%
2020	0	3,056	0	321	6,477	6.60%
2021	0	3,120	0	553	10,149	6.60%
2022	0	3,185	0	805	14,140	6.60%
2023	0	3,253	0	1,079	18,472	6.60%
2024	0	3,322	0	1,376	23,170	6.60%
2025	0	3,393	0	1,699	28,261	6.60%
2026	0	3,465	0	2,048	33,774	6.60%
2027	0	3,540	0	2,425	39,739	6.60%
2028	0	3,616	0	2,834	46,188	6.60%
2029	0	3,694	0	3,276	53,158	6.60%
2030	0	3,774	0	3,753	60,685	6.60%
2031	0	3,857	0	4,268	68,810	6.60%
2032	0	73,764	68,810	4,105	77,869	5.60%
2033	0	5,066	0	4,629	87,564	5.60%
2034	0	5,181	0	5,190	97,935	5.60%
2035	0	5,299	0	5,790	109,024	5.60%
2036	0	5,420	0	6,430	120,874	5.60%
2037	0	5,543	0	7,115	133,532	5.60%
2038	0	5,670	0	7,846	147,049	5.60%
2039	0	5,801	0	8,627	161,477	5.60%
2040	0	5,934	0	9,460	176,871	5.60%
2041	0	6,071	0	10,349	193,292	5.60%
2042	0	200,079	193,292	10,901	210,979	5.40%
2043	0	6,945	0	11,884	229,809	5.40%
2044	0	7,108	0	12,932	249,848	5.40%
2045	0	7,274	0	14,046	271,169	5.40%
2046	0	7,445	0	15,231	293,845	5.40%
2047	0	7,620	0	16,492	317,957	5.40%
2048	0	7,800	0	17,832	343,589	5.40%
2049	0	7,984	0	19,256	370,829	5.40%
2050	0	8,173	0	20,770	399,771	5.40%
2051	0	8,366	0	22,378	430,515	5.40%
2052	0	438,970	430,515	21,802	460,772	4.90%
2053	0	8,655	0	23,324	492,751	4.90%
2054	0	8,861	0	24,932	526,544	4.90%
2055	0	9,072	0	26,631	562,248	4.90%
2056	0	9,288	0	28,426	599,962	4.90%
2057	0	9,510	0	30,323	639,795	4.90%
2058	0	9,737	0	32,325	681,857	4.90%
2059	0	9,970	0	34,439	726,267	4.90%
2060	0	10,209	0	36,671	773,147	4.90%
2061	0	10,454	0	39,027	822,629	4.90%
2062	0	831,227	822,629	38,003	869,230	4.50%
2063	0	8,803	0	40,149	918,182	4.50%
2064	0	9,012	0	42,403	969,597	4.50%
2065	0	9,227	0	44,770	1,023,593	4.50%
2066	0	9,447	0	47,256	1,080,296	4.50%
2067	0	9,152	0	49,855	1,139,303	4.50%
2068	0	9,383	0	52,571	1,201,257	4.50%
2069	0	9,620	0	55,423	1,266,301	4.50%
2070	0	9,864	0	58,417	1,334,582	4.50%
2071	0	10,113	0	61,560	1,406,255	4.50%

1 To adjust return rate

Submission template: Review of KiwiSaver default provider arrangements

Cliffe Consulting Limited

Section 1: Your details

Name of contact person: John Cliffe

Organisation (if applicable): Cliffe Consulting Limited

Contact email address: john@cliffeconsulting.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:

Section 2: Feedback on discussion paper

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

The objectives are excellent

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

Criteria should be weighted as follows:

- 60% Better financial position for KiwiSaver default members, particularly at retirement
- 20% Trust and confidence in KiwiSaver
- 15% Support development of NZ's capital markets that contribute to individuals' well-being
- 5% Low administration and compliance costs
- 0% Promote innovation, competition and value-for-money across KiwiSaver

Yes, competition and value for money are important, but innovation in investments is a negative, as the industry has a history of failing fads in investment strategies. Some of the currently fashionable themes are likely to fade. For example, life stages – because this makes no makes flawed assumptions about individuals' risk tolerance, education levels and needs. There have been many investment styles that have proved failures such as contrarian, absolute return strategies, capital guaranteed strategies, annuities have a checkered or failed history, momentum investing.

We think default KiwiSaver schemes should invest in a proven methodology and not attempt to be innovative in an attempt to enhance returns as these do not withstand academic scrutiny. Rather if individuals wish to be innovative, they take that risk and actively elect to use to do that, rather than by a Government-selected default scheme.

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

The “parking space” concept has totally failed, to the detriment of hundreds of thousands of KiwiSaver members, largely because the main KiwiSaver suppliers (trading banks and AMP) were completely conflicted with regard to their contractual obligations. They had no incentive to move KiwiSaver members out of their default funds because under the Conservative mandate and the oligopoly relationships between these parties, they could make substantially higher profits retaining funds in default KiwiSaver funds than moving members out. As set out in our open letter to the regulators in July 2018, the cross-holdings in bank term deposits meant about on average about 1/3rd of the funds invested in those default funds was simply invested in themselves, i.e. the banks were charging a management fee to invest in their own term deposits.

The fundamental reason why the “parking space” is wrong is because the number one objective of KiwiSaver is to achieve a better financial position for default KiwiSaver members, particularly at retirement and a conservative fund is one of the worst ways to achieve that goal.

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?

KiwiSaver members who make an active choice should not be able to stay in a default fund. Many KiwiSaver members have been led to believe that being in a default fund is actually a good choice because the Government has selected it and marketing by some of parties involved has been designed to deliberately confuse KiwiSaver members around this point e.g. ASB promotes its Conservative (default) Fund as the biggest KiwiSaver fund. The same institution in its 2012 submission to the default provider review claimed a study they conducted said that New Zealanders were more conservative and wanted conservative funds. This is illustrative of how motivated providers can be to manipulate or persuade customers and the Government. Interesting, though that OnePath (subsidiary of ANZ), in their submission said that a “traditional life-cycle approach is the most appropriate investment option for a default fund”.

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

A lifestages option is an utterly wrong choice for default funds for the following reasons:

- a. On a weight adjusted basis, it will give lower average returns to the member than either Growth or Balanced. The primary reason for this is that when member balances are low, there is little capital in the member’s account to capitalise on the potentially higher returning strategy, but in later life, when member balances are large, lower returns are achieved because of the lower return, when conservative strategies dominate.
- b. Lifestages makes no allowance for the increasing investment knowledge of the member. It implies the opposite. As a firm which has dealt with this for more than 20 years, we believe

that with investment experience, clients become unconcerned by short term volatility and do not become risk adverse just because they are getting older.

- c. For a person joining KiwiSaver when starting their first job, the aggressive nature of a Lifestages option is not appropriate. KiwiSaver is likely to be their first non-bank account financial asset. These members have low levels of financial literacy and in many cases do not immediately engage with their KiwiSaver, so it is important over the first few years, that the account balance is seen to grow, to build confidence in KiwiSaver and to allow opportunity for further education and engagement.
- d. For a person wanting to use KiwiSaver for a first home withdrawal and/or Housing NZ grants, they have a minimum timeframe of three years before being eligible. This timeframe does not support the aggressive nature of a Lifestages option for someone who is aged less than 30. An aggressive investment has a 10+ year timeframe and a large number of KiwiSaver members wanting to use this option will access their KiwiSaver balance within ten years of joining.
- e. Lifestages is a marketing ploy designed to suggest that the manager is adding value by making these changes when in fact all they are doing is adding cost and implying that they know better than the KiwiSaver member what is best for them at whatever age they are (which as a model is regularly at odds with the truth).
- f. Few members will draw out all their KiwiSaver funds when they turn 65. Most will aim to spread out withdrawals over their lifetime. At age 65, that is at least 15-20 years on average. This does not support having a Conservative fund which a lifestages option would long since put in place.
- g. It is impossible to accurately compare lifestages funds available, because the KiwiSaver providers all use different starting points, age brackets and funds used. The performance of any of the lifestages funds is very much more opaque. There are too many variables to facilitate accurate comparisons. This may well suit the fund managers, but definitely does not benefit the member. It also implies that the fund managers have a crystal ball about what is going to happen in markets in the immediate and coming years, which has been proven time and again to be a false assumption.
- h. Surely it is not the role of the Government or this committee to decide on what the lifestage bands and fund allocations should be. It puts an inappropriate responsibility on the Government when the industry itself shows no consensus at all about what the appropriate choices are. To illustrate:

NZ Funds runs a 85% Growth/15% Defensive allocation until age 55

AMP runs an Aggressive Fund until age 31, a Growth Fund until 39, a Balanced Fund until 47, a Moderate Balanced Fund until 56, a Moderate Fund until 64 and a Conservative Fund thereafter.

ANZ runs a Growth Fund until age 35, a Balanced Growth Fund until 45, a Balanced Fund until 55, a Conservative Balanced Fund until 60, a Conservative Fund until 64 and a Cash Fund thereafter.

Generate have two lifestage options. Stepping Stones (their more aggressive option) is 100% in two growth funds until age 35, 70% Growth/30% Conservative until age 45,

40% Growth/60% Conservative until age 55, 20% Growth/80% Conservative until 60, and 10% Growth/90% Conservative until 64, 100% Conservative from 65+.

To compound matters, there are no required asset allocation conventions when using such names as 'Conservative', 'Moderate', 'Growth' etc. This would be required if a lifestages approach was used.

Adoption of lifestages would destroy KiwiSaver fund comparisons because there are too many variables, and too much manager self-interest. The notion that a person at age 65 should be in a Conservative or a Cash Fund is generally not in members best interests, given average life expectancies.

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

We agree with an allocation of between 50- 60% in growth assets.

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

We do not support this as an option for default KiwiSaver funds

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

We categorically do not support this as an option for default KiwiSaver funds

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?

We only support the use of a balanced fund for default KiwiSaver members.

If market conditions are poor and performance has been poor over or leading up to the minimum timeframe (three years for first home withdrawal), the Balanced Fund will still have a worthwhile balance. The home that the first home purchaser is seeking to buy is, in these market conditions, highly likely to be depressed as well, effectively still giving the member the same real assistance required to purchase the property.

The Government cannot be expected to protect investors from short term market conditions.

A lifestages option would have by far the biggest potential downside for first home buyers and other people making early withdrawals.

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

These would be more than a Balanced option. But, this is a minor disadvantage compared with the big structural problems of the lifestages approach.

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?

Disagree with Point 55. It demonstrates how unproven and unsuitable the lifestages approach is for default KiwiSaver funds. In your footnote 9, this is a repudiation of the normal lifestages approach. It is lifestages with racing stripes. It also shows the high level of variability in such options, which would require further definition by the Government. Why should the Government take on the responsibility of selecting the various aspects of a lifestages approach/models? Not just for the type of fund, but also for the age brackets used. What the Government needs is for members to become engaged. The most fundamental reason why a member would become engaged is to determine what type of fund suits their preferences and situation. This empowers the member over the choices they make. With a Balanced option, they start from a middle ground. Using a lifestages approach implies that the investment manager knows better than the member what type of fund they should be invested in all times during their life, removing the responsibility from the member to take ownership of his/her own investment strategy. The economy needs educated, informed citizens not dependents who do not understand investments.

Points 56 and 65 assume that members totally withdraw their KiwiSaver at the age of eligibility (currently age 65). Our experience is that this is most definitely not the case, and in fact, the switching to a more conservative approach would more likely undermine their confidence in the lead up to age 65 because of the low returns they are receiving visa-vie the market generally, encouraging them to exit KiwiSaver at their earliest convenience, particularly as they have not been engaged prior to this with the nature of their investment and most importantly, the difference between risk and volatility. Retirement is not a point in time, it could last 25+ years and KiwiSaver is a perfectly good investment vehicle for a retiree for the rest of their life, especially an informed, educated investor.

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?

The problem isn't fees, it is the conflict of interest with the major KiwiSaver default providers, who fundamentally benefit from members remaining in their default fund.

More significant than fees is the PIR tax issue, which is the second biggest scandal in the twelve years that KiwiSaver has operated, where auto-enrolling members (which includes all default members) and employers are not informed or educated about PIR rates and the requirements associated with them, by the IRD and the industry generally. When auto-enrolling members are being taxed at the highest possible PIR rate, it inevitably has a major impact on the value received by the member from the default fund. The biggest scandal being the use of conservatively invested default funds.

The majority of default KiwiSaver members are invested with some of New Zealand's largest financial institutions, who have demonstrated an inability to complete their contractual obligations as default providers.

What the fee comparison in point 75 ignores is that the cost for the bank-based default fund providers to place investments in themselves is pure revenue for the parent company. This is a non-level playing field for the non-bank default providers, and means that for the Australian-owned managers, their fees are too high.

AMP, ANZ, ASB, BNZ and BT (Westpac) effectively run a cartel of cross-investing in each others' bank term deposits so that on average, at least 30% or more of their default funds are effectively invested in themselves. We have separately written and detailed this, based on the default fund portfolio holdings in June 2018.

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

Yes, but the PIR rate scandal matters more.

The fixed monthly fees disproportionately impact members with low balances. These should be eliminated for all default fund members.

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?**

A fee ceiling should be set, taking into account our comments in Point 12 above.

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?**

There is an over-emphasis on fees. Refer attached chart which clearly demonstrates that fund type matters significantly more than fees, in the main.

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?**

Increasing the number of default funds to nine was a very positive step in terms of allowing non-bank providers and increasing the flow of funds to NZ owned providers and NZ investments.

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 categorically disagree in Point 118 that having nine providers has resulted in a lack of economics of scale, higher monitoring costs and wide variation between providers. This is likely to be a self-serving statement. We believe that the initial six providers received significant incumbency benefits and they have abused that position by not engaging adequately with members to move them into more appropriate funds. To remedy the mis-allocation of default funds, a reallocation of default members should be considered after a specific time. To illustrate, after two years' membership in a default fund, a member could be automatically reallocated to another default fund provider that is meeting the performance guidelines in terms of member engagement and transfers out. There is no valid reason why there could not be more than nine providers if there are credible options.

The big advantage for New Zealand for more default providers outside the banks is the potential flow of investment funds directly into New Zealand investments, such as Government and commercial bonds, and the NZX.

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

Given the failure to monitor and effectively regulate most of the existing nine providers to adequately move their members out of default funds, it is appropriate that some more credible providers be added to the default list. This would assist to reduce the flow of members to non-

performing default providers, which would compliment the reallocation of default members as discussed in Point 17 above.

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 higher costs. To date the data shows that lower net returns have not resulted.

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

See Point 19 and separate submissions from specialist in this area (Matthew Mimms).

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

-

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?**

-

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?**

-

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

-

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?**

-

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?**

-

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?**

-

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?

The original Australian-owned default providers have shown little inclination to invest in New Zealand outside investing in their own institutions.

We do not believe the statement in Point 163 is correct, based on our own research into default fund portfolio composition.

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?**

Yes they should, particularly assisting with the funding of local and central Government through bonds, infrastructure funds and the NZX capital market.

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

It is a reach too far for this default fund review to consider this as there are many complex factors.

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?**

Disagree with the adoption of this option.

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)?**

Leave it to the managers to make those decisions.

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?**

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?**

Agree. All members of an ex-default fund should be reallocated to the other 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?**

All members of an ex-default fund should be transferred out. No selection process is required, use the same process as that used now for auto-enrolling KiwiSaver members. You may consider allocating to any new default provider a higher weighting of these transferring members to assist the new funds to reach critical mass (e.g. 2 or 3 times the number than for an existing 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?**

No choice should be provided.

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 one is too disruptive and penalises members and the remaining default fund providers.

Option two is our preferred option.

Option three rewards non-performance and locks default members in a potentially unsatisfactory arrangement.

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

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?**

No they should not. But, they should not be allowed to make an active choice to remain in a default fund at all.

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?**

When default member engagement levels are so low, focusing on education requirements is ineffective, as has been demonstrated to date. This expectation needs to be addressed through other avenues, such as financial literacy in educational institutions.

Employers should be encouraged to have a preferred provider agreement for KiwiSaver and to run for their staff, financial literacy courses.

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

43. **Any other feedback?**

Get the PIR rate problem for auto-enrolling KiwiSaver members FIXED URGENTLY. Twelve years of misrepresentation and misapplication of the tax laws is long enough. This is a Government-led failure and is easily remedied.

It is inappropriate for any default fund to have charitable status or be owned by a Charitable Trust. Default fund providers should not be exempt from paying income tax. Giving a KiwiSaver licence to a provider that operates as a Charitable Trust with undefined membership and undefined charitable

causes was a major mistake, because it created an uneven playing field amongst all KiwiSaver providers and does not contribute to the Government tax take.