APRIL 2021

Submissions report:

Managed fund fees and value for money

Summary of key themes from feedback on our proposed guidance on managed fund fees and value for money, along with individual submissions

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

Contents

Background 2

Themes 3

Theme 1 – Guidance or intervention is unnecessary 3

Theme 2 – Value for money is not just low fees 4

Theme 3 – Investment managers are entitled to make a profit 4

Theme 4 – Statutory responsibilities should not be conflated with expectations 5

Theme 5 – Advice is necessary and valuable 5

Theme 6 – There should not be too much focus on performance 6

Additional specific points 7

Appendix: Submissions received 10

Background

In December 2020 we published a consultation paper seeking input from KiwiSaver managers, KiwiSaver supervisors, other MIS managers, and other interested parties, on the regulatory approach to the statutory requirement that KiwiSaver fees must not be unreasonable and the related overarching statutory duties.

We received 26 submissions from a range of industry participants. This feedback has been used to help us refine and finalise our guidance for managers and supervisors of managed funds.

This report summarises the feedback we received, along with our responses, under the following key themes:

1. Guidance or intervention is unnecessary
2. Value for money is not just low fees
3. Investment managers are entitled to make a profit
4. Statutory responsibilities should not be conflated with expectations
5. Advice is necessary and valuable
6. There should not be too much focus on performance

We have also included an overview of some additional specific points raised by submitters.

The individual submissions we received are included in the appendix of this document.

Themes

Theme 1 – Guidance or intervention is unnecessary

> *Guidance or any FMA intervention is unnecessary because there is no market failure or, if there is, the market will punish it – not the FMA.*

No market failure (and so no need for guidance)

Many submitters said the large and growing number of KiwiSaver providers showed the market was working as it should. However, that number of providers in a market of this size, with a solid pipeline of new entrants yet to come, is better evidence that from an investor perspective the market *isn't* – yet – working as it should. New market entrants, and innovation by them and existing players, are a result of them identifying opportunities to take market share from incumbents by charging less, doing better, or both.

This is a logical response to an inefficient market, not an efficient one – inefficient because:

- where scale exists, its benefits are typically not shared with members
- there is no systematic relationship between fees charged and returns received
- there is no systematic relationship between fees charged and degree of active management
- active funds typically do not outperform their market index after fees over meaningful periods (i.e. their recommended minimum investment period, and longer). Similarly, passive funds typically do not closely replicate their market index after fees

A key, hard-to-shift feature of this inefficiency is the prevailing inertia of KiwiSaver members. Even moderately engaged members continue to tell the FMA, *Consumer NZ* and others who conduct surveys that they are unaware of, confused or mistaken about what they pay and what they receive in return. The provider perspective may be that lots of competition and a wide range of offers, pricing and value propositions are encouraging hallmarks of a vibrant market achieving maturity. But from a member and FMA perspective, a maturing, still-inefficient market means risk of investor harm. Intervention is required.

If there is market failure, the market – not the FMA – will punish it

- Investors can be seriously, and perhaps irretrievably, 'punished' by a poor-value KiwiSaver or other managed investment product throughout the entirety of whatever time it takes waiting for the market to punish the provider. This was starkly shown by the impact on many New Zealanders of the collapse of almost the entire second tier of New Zealand's financial services sector in the global financial crisis.
- While certainly it *will* ultimately be the market, not the FMA, which eliminates unreasonable fees, the FMA can, should and will do what we can so the market does it *sooner.* Requiring more disciplined thought, action and transparency from investment managers – assisted by supervisors – about their fees and value for money is the way to do this. First, because more and better-quality information drives

true, merit-based competition (a more efficient market). Second, because it properly informs members' decisions to transfer between schemes.

Theme 2 – Value for money is not just low fees

> *Value for money is not just low fees; services provided to members are also part of the value provided to members.*

The guidance explicitly accepts value for money does not necessarily mean 'cheapest', and services can provide value to investors. However, providers can confuse offering a service with it having value. The guidance differentiates between advice or other services that help investors make better investment decisions (advice is dealt with separately under theme 5), and services or features which demonstrably benefit the investor's account.

For example, if a provider claims their investment research adds value to investors, they should be able to substantiate that by showing how the research benefits investment outcomes, such as reducing risk or enhancing return (or both). As such, a service genuinely representing value for members will typically have a financial benefit. However, the guidance also recognises that investors' accounts can benefit from services or features – such as integrated financial products that have quantifiable social or environmental outcomes – with a primarily non-financial value, or which simply are clearly consistent with the investor's values.

Theme 3 – Investment managers are entitled to make a profit

> *Investment managers profiting from their work is not inconsistent with acting in members' interests. Guidance should not prescribe what managers can charge.*

We agree. The guidance does not prohibit or prescribe any fee structure, size, or type (other than reiterating existing controls on performance fees, and fees not being unreasonable). The guidance is intended to ensure there is a disciplined approach for boards and management of KiwiSaver or other managed fund providers to, with their supervisors, evaluate what they are charging their investors and why – and what value their investors are receiving in return.

The guidance also recognises that competent investment management is valuable and managers profiting from it is not inconsistent with acting in their members' interests. However, profit should be shared appropriately with investors who are paying the cost and taking the risk. If the cost of accessing a manager's capabilities outweighs the benefits of those capabilities, the capabilities become less relevant and the investor should go elsewhere.

Theme 4 – Statutory responsibilities should not be conflated with expectations

> *FMA should not conflate KiwiSaver providers' statutory responsibility not to charge unreasonable fees with a broader conduct expectation to provide value for money. Also, there is no statutory responsibility for non-KiwiSaver managed investment schemes not to charge unreasonable fees and any attempt to require this is likely to be unenforceable.*

It is illogical – or disingenuous – to argue unreasonable fees should be considered without considering value for money. This, presumably, is why some submitters strongly urged the FMA to consider them together.

Not charging unreasonable fees, and providing value for money, are surely among the most fundamental elements of all managers' overarching statutory duties to act in their members' interests. Alternately, we look forward to managers explaining to us and their investors why they *shouldn't* have reasonable fees and provide value for money; or why having unreasonable fees and not providing value for money *is* in their members' interests.

Finally, we note managers readily apply exactly these tests, without querying the statutory basis for doing so, to their underlying managers.

Theme 5 – Advice is necessary and valuable

> *Advice is necessary and valuable. Forcing managers to charge members advice fees directly is likely to dissuade many members – especially KiwiSaver members with low balances – from getting help they need. This is a far greater cost to the member than the financial impact of paying advice fees embedded within the overall scheme fee.*

We have long emphasised the importance of New Zealanders getting the help they need to make good investment decisions. Research by the FMA and others has shown that New Zealanders who get this help – from financial advisers but also from other sources – feel better prepared to achieve their financial goals and, importantly, this is reflected in their investment behaviour.

From a value for money perspective, we want to ensure there are as few barriers as possible to New Zealanders getting the help they need to make good investment decisions, while avoiding a situation where fees for advice are embedded within broader fees and are not transparent to members, resulting in schemes competing to make the best offers to advisers to 'buy' members from them.

We prefer that fees for advice are charged to the member, not the scheme, or are otherwise optional. We acknowledge, however, that the KiwiSaver market is still maturing – balances tend to be lower than for other managed funds, and even a moderate, optional fee for advice may dissuade KiwiSaver members from using or seeking it.

Consistent with our principles-based approach, we are not prescribing how fees for advice are charged (subject to them not being unreasonable). We expect, however, that schemes not already charging members directly for advice will do so as balances increase, the value of advice is established, and the industry matures as a whole.

Regardless of how fees are charged for advice, managers doing so should show that:

- the advice is received – engaged with and acted upon – not just offered
- the advice is ongoing, not just given at onboarding
- the fee charged is not unreasonable, relative to a reasonable expectation of how much advice will be necessary for a member over time (and reflecting KiwiSaver advice requirements are typically straightforward)
- there has been appropriate disclosure to, and discussion with, members about what fee is charged, who it is paid to, and what members receive in return.

We note schemes contacting members during times of volatility to advise them against switching, redeeming, or other panic-fuelled behaviour, are meeting a basic statutory requirement to act in their members' best interests. This is not advice and cannot constitute justification for an advice fee, however charged.

Theme 6 – There should not be too much focus on performance

> *Caution against overemphasising performance as part of the value proposition and in how it is considered (as backward-looking information) alongside consideration of unreasonable fees (which is forward looking). Also, focusing too much on performance, which can be volatile over shorter periods, risks pushing the market toward passive investing.*

Broadly, performance must be a material part of any value for money assessment because it is why people use investment managers and, unlike service, convenience or other factors, is quantifiable, transparent and benchmarked. Performance is what providers' institutional clients expect of them and is what they expect in turn of their underlying managers (if they use them). While some submitters expressed caution about including performance in a value for money assessment, most providers are very happy to advertise performance ahead of any other factor when trying to attract members.

Nevertheless, we accept performance can be volatile over shorter periods, but believe that is addressed by focusing the value assessment on periods meaningful to the member – such as the minimum suggested timeframe for holding the investment – and by the manager competently explaining the causes of and any responses to short-term poor performance.

We don't accept a focus on performance may push providers toward passive investing. Delivering a market return will inevitably involve periods of poor performance as the market dips. So, a shift to passive does not solve the volatility issue. Plus, if the provider of a serially underperforming active product shifts it to passive (and charges less) because they fear value for money scrutiny – or closes the product, so its investors can go somewhere better – that is a positive outcome from our and the investors' perspective.

One submitter cautioned against focusing on performance without accounting for the risk taken, suggesting performance relative to the relevant product's market index was a more complete measure of value than absolute performance. We agree and the guidance reflects this.

Additional specific points

No such thing as fixed costs, some costs are not scalable e.g. costs of underlying managers which are charged in percentages

We don't accept there is no such thing as fixed costs – audit and other fees are fixed, if potentially of marginal impact on overall costs and the resultant fee charged to investors. More importantly, saying underlying investment management fees are not scalable because they are charged in percentages is nonsense. Any institutional mandate will have fee tiers which reduce (as far as a low, single-digit basis point cost) as the funds under management increase. So while there will still be a percentage fee, on a weighted basis it will decline as assets under management (AUM) grows. The manager will (or should) have negotiated it that way. As the manager benefits financially from this, they should pass the benefit to members – or have a good reason for not doing so, which may include showing how the benefit is offset by costs that do increase with scale, such as supervision and administration. We note one submitter acknowledged the tiered structure of underlying investment mandates and said the FMA and supervisors should take into account the timing of when the net financial effect for the manager of declining underlying investment fees was actually positive, which is reasonable.

Managers must be able to charge members with low balances fees which, as a percentage of their balance, may look unreasonable, but are not; in fact, members with low balances require cross-subsidies from other investors with higher balances

We accept both points. But providers should be transparent about where cross-subsidies exist, why, how they influence fees for members, and when and how they expect the cross-subsidies to cease (for example, at a specific balance point). Note we expect this is mainly an issue in KiwiSaver, as non-KiwiSaver managed funds typically have minimum investment requirements. However, should cross-subsidies exist outside of KiwiSaver, we would expect them to be explained and justified in the same way.

Performance fees are not appropriate for long-term superannuation products (i.e. KiwiSaver)

The submitter expressing this view explained having performance fees on KiwiSaver products led to misalignment of the interests of members, who typically benefit over a longer period, and the manager, who is generally paid annually for short-term performance. Conversely, other submitters wanted an express statement that performance fees are acceptable.

We do not intend to prescribe or prohibit any fee amount, structure or type (subject to fees not being unreasonable), but there are existing constraints on performance fees. Additionally, by following our guidance we expect managers and their supervisors to examine if the performance fee structure rewards managers for periods not meaningful to members (a meaningful period being the product's minimum suggested timeframe, or longer). If the performance fee period is shorter than the product's minimum suggested timeframe, the manager should explain and demonstrate how the performance fee is in members' interests. We also expect managers to similarly examine the performance fee structures of any underlying managers.

Annual membership charges are no longer necessary (for scale providers) and should be reduced/eliminated

There is variable maturity and scale in KiwiSaver. Membership fees were intended to cover costs when scale was low. As scale and member balances increase, we see little justification for schemes to charge both a fixed membership fee and a base management fee (which is typically percentage-based). Accordingly, we expect to see KiwiSaver schemes move toward eliminating membership fees from their fee structures. As such, we also expect managers' and supervisors' reviews of fees and value for money to include consideration of whether the existence and size of membership fees is reasonable. This assessment should be evidenced, in accordance with our expectations for fee and value for money reviews in general.

Tax leakage and transaction costs should be disclosed

Tax reduces returns for members but, as it is not charged by the manager, it is substantially not in the manager's control. Some investment approaches do attract more tax (e.g. investing in underlying funds domiciled in other countries). Where a manager's chosen style involves significant 'tax leakage', this should be identified as part of a fee review. The manager should explain to the supervisor why 'leakage' exists and the extent to which it can be mitigated, or why the manager chooses not to mitigate it and why that is in members' best interests. The manager and supervisor should also consider whether this feature should be disclosed – e.g. in the Other Material Information document and website – to ensure investors are aware.

Transaction costs are typically not charged directly to members (and are more common in non-KiwiSaver managed schemes). However, they typically impact unit price, which ultimately does affect investors in all managed funds. Accordingly, where a manager's chosen style involves high turnover, or other causes of material trading costs, the manager should explain and substantiate how this is in members' best interests. Again, the manager and supervisor should consider whether this feature should be disclosed to ensure investors are aware.

Use of spreads, exit and entry fees

Where spreads are used, managers should demonstrate they are for the intended purpose of minimising the impact of investors transacting in a fund. If a scheme charges spreads and entry and exit fees, the manager should explain and substantiate how they fulfil different purposes. If a scheme does not charge spreads, the manager should explain how investors are not adversely impacted by transactions from new, ongoing, or exiting investors.

Default KiwiSaver providers are not a useful/appropriate reference point for fees

One submitter made the point that default schemes' fees must be considered in isolation because their pricing is the result of a 'commercial bargain between default providers and the Crown with default providers gaining a regulatory advantage as a trade-off for charging lower fees and committing to particular service levels'.

That is true. But, as the My Fiduciary report into the investment management styles of KiwiSaver providers explicitly noted, providers with default schemes tend to reduce any adverse financial impact of that 'bargain' in how they then price their non-default schemes and products (which tend to have higher fees than comparable products offered by competitors without default status).

So, our view is default schemes are absolutely a valid pricing reference point for the non-default schemes of those providers. Additionally, better understanding how each default provider calibrated its ‘bargain’ trade-off is a useful input when considering the pricing approach used by other providers who do not offer default schemes but do offer similar products and service levels.

Appendix: Submissions received

1. AMP Wealth Management New Zealand
2. Booster Investment Management Limited
3. Consilium NZ Limited
4. Consumer NZ
5. Dentons Kensington Swan
6. Financial Advice New Zealand
7. Financial Services Council of New Zealand
8. Fisher Funds Management Limited
9. Foresight Financial Planning
10. Generate Investment Management Ltd
11. Implemented Investment Solutions Limited
12. Individual submission
13. KASPANZ Incorporated
14. Kernel Wealth Limited
15. Kiwi Wealth Investments Limited Partnership
16. Lifetime
17. Mercer (N.Z.) Limited
18. Milford
19. Mint Asset Management
20. New Zealand Air Line Pilots' Association
21. New Zealand Shareholders Association Inc
22. Nikko Asset Management New Zealand Limited
23. Pie Funds Management Limited
24. Private Asset Management
25. Smartshares Limited
26. Trustee Corporations Association of New Zealand Inc

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date: 14 December 2020 Number of pages: 2

Name of submitter: [redacted]

Company or entity: AMP Wealth Management New Zealand ("AMP")

Organisation type: MIS provider (including KiwiSaver) and QFE

Contact name (if different):

Contact email and phone: [redacted]

Feedback summary – AMP is broadly supportive of the submission lodged by the Financial Services Council (FSC). However, there are a number of points made in that submission that we wish to reinforce or take a specific position on.

Question number	Response
Q1: Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable?	As the FSC's submission identifies, there can be many different costs incurred by a KiwiSaver scheme provider, with the most obvious items such as investment management costs and registry costs not necessarily accounting for the largest components of the total cost and with different degrees of scalability available. We believe it is important for any guidance around fees and value for money to acknowledge that the KiwiSaver product/offer is actually a wide-ranging bundle of services with multiple components and multiple cost inputs and only limited opportunities for scalability. Without this we believe there is a risk of unrealistic expectations being created in terms of how low KiwiSaver fees could and should go and what might drive any reductions in fees. We also support the FSC's views that: • fund performance is a more relevant factor for fund selection than it is for reasonableness of fees, and linking fees to performance may have unintended negative consequences; and • the guidance should expressly acknowledge that it is not seeking to prohibit or restrict any particular types of fees or fee models (for example, performances fees). We do, however, believe that further guidance on performance fees in the context of assessing value for money would be beneficial.
Q5: Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money?	We agree with the FSC that this is already generally understood in the market but that more detailed guidance will be required to assist participants with making "unreasonable" vs "not unreasonable" determinations in practice, particularly given that the draft guidance is not limited to the statutory framework but also incorporates broader conduct expectations. This merging of statutory obligations and conduct expectations raises two further concerns for us: (1) Some of the descriptions of the effect of statutory provisions appear questionable and potentially coloured by conduct expectations. By way of example, the relevance of s143 of the FMCA to fees and pricing appears

	to be overstated from a legal perspective given that the duty to act in members' best interests is framed in the FMCA as a general, high-level duty. (2) The section on Enforcement appears to blur the distinction between statutory obligations and conduct expectations in that it seems to suggest the various enforcement options referred to are available to the FMA even where the FMA's view that a fee is unreasonable relies, wholly or partly, on conduct expectations. This is particularly concerning given the reference in the guidance to summary options such as stop orders, which we would not consider to be appropriate enforcement options in relation to pricing issues/disputes in any event.
Q7: Are there any additional matters that you think the guidance should address?	We share some of the FSC's concerns in relation to advice fees, particularly in relation to maintaining access to advice. However, there are a number of different adviser remuneration models in the market and we believe a common approach to these is justified, namely that all such remuneration in relation to KiwiSaver customers should be charged and disclosed separately, with customers having the choice as to whether to contract for the relevant adviser services or not. However, if this idea was adopted, the FMA would need to issue further guidance: (1) as to how it should be implemented, given the range of different remuneration models/arrangements currently in place; and (2) as to the respective roles and responsibilities of manufacturers and FAPs in relation to the oversight of delivery of contracted adviser services.

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date: 14 December 2020 Number of pages: 3

Name of submitter: [redacted]

Company or entity: Booster Investment Management Limited

Organisation type: MIS License holder

Contact name (if different): [redacted]

Contact email and phone: [redacted]

Question number	Response
1	We submit there is one highly relevant factor which has been significantly understated in determining whether KiwiSaver fees are unreasonable - the value of easily accessible and affordable financial advice. The extent of the lack of recognition attributed to the inclusion of an advice component in KiwiSaver fees was reinforced in the terms of reference and conclusions reached in the MyFiduciary Report dated 14 August 2020. In that report, there was no allowance made in the total annual percentage-based fees for the inclusion of an ongoing financial advice payment. As further evidence, we note in the **Introduction** to the Draft Guidance, that the MyFiduciary report was commissioned to focus on the investment management style, "because KiwiSaver providers told us that the investment management cost was the largest component of the fee they charge and the investment management style is generally the main point of differentiation between schemes." However, in the Booster KiwiSaver Scheme, the adviser servicing fee component represents up to 0.50% of the total fee, similar in magnitude to the ongoing cost of delivering our active/passive management style and a significant point of differentiation between our Scheme and others. This is also significant because there is actually stronger evidence to support the value of financial advice than there is to support the value of active management. For example, the Financial Services Council of NZ have recently published updated research[1] in which one of their major findings was that "Investment returns over the last five years were 3% pa better on average under advice compared to no advice", and that "advised clients have approximately 52% more in their KiwiSaver". Numerous overseas studies[2] have also concluded that financial advice can add anywhere between 1% and 4% per annum in value to those investors who use a financial adviser, compared to those who do not. The recent market volatility during March of this year also clearly illustrated the value of advice, particularly where this is embedded in KiwiSaver. Booster's switch rate (<1%) from Growth funds to Conservative funds during the March quarter was significantly lower than the industry average switch rate (~4%) and those big providers (with ~7% switch rates) who do not provide access to advice as part of their fee.

	Booster's lower switch rate is directly attributable to members having good access to financial advice, either directly with a nominated financial adviser, or through Booster's in-house advisers. We estimated that those KiwiSaver investors who received good, objective and appropriate financial advice in March not to switch, benefited by around $4,000 each on average. With the average balance switched of around $35,000, this represents around 11% of value. If these members were paying just 0.50% pa to have access to advice when they needed it, this is equivalent to over 20 years of advice value delivered in just a few days. We therefore submit that access to financial advice is specifically acknowledged as a significant factor in the provision of value in KiwiSaver fees and a key point of differentiation between schemes. [1] Money & You 3 - Breaking Through The Advice Barrier - Financial Services Council - December 2020.pdf (fsc.org.nz) [2] The Value of Financial Advice (forbes.com)
2	Page 7 of the Draft Guidance includes a heading **Advice fees and trail commissions**. We do not agree with some of the strong wording used in this section. Unlike a weekly gym membership, which if not used regularly, provides no value, an advice fee CAN be paid regularly for quite some time (i.e. years) and still provide significant value at a single point in time in the future, e.g. during periods of significant market volatility. Unfortunately, there is overwhelming evidence, both here and overseas, that members are generally reluctant to seek or pay directly for advice – see Page 8 of Money & You 3 from FSC. We therefore believe there is significant value in charging all members of the scheme, as it becomes a form of advice 'retainer' payment for when they will actually need it. This was again amply demonstrated during the March market volatility, when we fielded enquiries from members who were looking for advice, and we were able to refer them to a qualified Financial Adviser, at no extra cost. They appreciated that the advice had been available to them when they needed it and that they hadn't fully appreciated it until then. This also reinforced that whilst it's important that there is an ongoing service delivered, the <u>full</u> value cannot be measured in discrete annual time periods. There is a significant risk of undervaluing the effectiveness of embedding a modest and very reasonably priced advice/retainer within a KiwiSaver fee structure, as a means of providing broad and cost-effective access to a large number of members with small to moderate balances. With an average KiwiSaver balance of ~$20,000, paying a 0.50% advice 'retainer' amounts to just $100 per annum. Not only does this $100 represent excellent value, but it would also be almost impossible for someone to source this type of advice for $100 if it was provided as a discrete and separate service. We understand that the UK authorities, who banned all commissions in 2012, including for advice, are now reconsidering this. Their recent findings have shown that due to the emphasis on overall percentage fees and removing the embedded advice component, they created an unintended consequence of effectively making advice unavailable for lower balance investors. These are arguably the very investors who need it the most. A similar problem has occurred across the Tasman, with ASIC having recently completed a review of financial

	planning and advice and noted how the rising cost of advice has priced most Australians out of the market. We therefore submit that it is not unreasonable to continue to charge a modest ongoing advice fee on the basis that it may in some cases represent a retainer for the periods in which it is most needed, whilst acknowledging that this should still require a dedicated adviser to be available to respond to queries as and when required. The alternative of charging members directly and discretely when they think they need it, carries the risk that demand for financial advice drops off significantly, as they have found in both the UK and Australia.

Feedback summary – *if you wish to highlight anything in particular*

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date: 11 December 2020 Number of pages: 3

Name of submitter: [redacted]

Company or entity: Consilium NZ Limited

Organisation type: Company – MIS issuer

Contact name (if different):

Contact email and phone: [redacted]

Question number	Response
1	In general, we agree the factors you have identified are relevant to an assessment of fee reasonability.
2	An emerging factor to consider is whether schemes separately identify and charge advice fees. Schemes that offer a fixed total fee and state that advice is available on request, are effectively charging all members for the same service, whether or not that service is supplied or received. Some schemes provide a trail fee to advisers. These trail fees are often not disclosed in the KiwiSaver scheme documents, but are generally highlighted in the advisers' disclosure documents. Most schemes offer no genuine personalised advice. There is a significant difference between a genuine advice fee and a trail fee. In many of the current KiwiSaver schemes, advisers are paid a trail fee of between 0.25% and 0.50%. However, this fee has been determined by the product provider (not the member) and is focused on product placement, risk tolerance and on-call services. Within this framework, advisers are simply not incentivised to provide more value-adding services because they are restricted from being paid a reasonable fee for this additional work. An advice fee is entirely different. This fee is subject to negotiation between the individual member and the adviser and will be set at level that reflects an agreed amount of ongoing services and support. The adviser is then totally accountable to the member to deliver those agreed services or be subject to being replaced. Critically, the advice fee is not tied to the use of any specific products. In an advice-based model, the adviser is not only incentivised to deliver value in the adviser services they provide, but also to continually identify the most appropriate and cost-effective investment solutions for the member to help keep down overall costs. This includes identifying and allocating to

	lower cost funds when they become available, negotiating fee reductions (where possible) due to economies of scale, implementing appropriate and cost effective portfolio rebalancing practices, and reviewing asset allocation settings in accordance with life cycle and needs.
3	Assessing fees to subjective thresholds like 'reasonable' or 'value for money' is open to interpretation. However, in general, we agree that where economies of scale allow and where fund input costs have fallen, it is more likely that fee reductions can and should be achievable. Where actual costs may be unreasonable, this might imply a structural inefficiency within a particular scheme (or a lack of scale). If this can't be resolved by fee subsidisation by the provider (whilst building scale), adopting cost-saving practices, or cost renegotiation, then the scheme may be unsuitable for a public offering. We agree that fixed minimum monthly membership fees do have the potential to erode members' balances and have a disproportionate effect on members with low balances. For the hundreds of thousands of scheme members currently holding low balances, we believe many of these fixed monthly membership fees are already unreasonable. We agree that where a scheme charges or facilitates a fee to be charged that relates to financial advice, such a fee should be separately disclosed and charged to the member's account benefiting from that advice. It should not be incurred by the scheme itself and consequently all members of that scheme whether or not advice is being provided to each member. We agree that if members are charged a trail fee, advisers must be able to demonstrate a level of ongoing engagement with the member. If an engagement only occurs when the initial sale is made but the fee continues to be charged, we agree that fee is likely to be unreasonable.
4	No
5	This guidance should serve as a reminder to managers and supervisors about their overarching statutory duties, but it generally falls short as an outright call to action. For example, the guidance highlights that "a membership fee that erodes a member's low balance is likely inconsistent with these (statutory) duties". However, this observation relates to an issue already prevalent within KiwiSaver. We believe this guidance should ideally provide a clearer framework for addressing this issue.
6	We believe it is unreasonable to pay a fee for no service. Where a trail fee is paid, this fee is often not clearly identified within fund documents, which gives members little or no ability to determine value for money. There is also no clear requirement for an adviser receiving a trail fee to provide any specific service, and they will be generally get paid the trail whether or not they provide a service at all.

7	**Page four, the statement "reducing fees and refunding members who have been overcharged" could discourage managers from discounting fees when economies of scale might allow it out of a concern for having to pay a historical refund when the discounting was not due to the previous fee being unreasonable. As one intention of the guidance is generally to encourage the passing on of scale benefits to members, we believe this specific aspect could benefit from a little more clarity.** **The paper also has little focus on supervisor, investment or administration fees which are a key component of the overall fee and how managers should determine if those costs are reasonable.**

Feedback summary – *if you wish to highlight anything in particular*

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.

14 December 2020

Financial Markets Authority
PO Box 1179
Wellington 6140

By email: consultation@fma.govt.nz

Submission on "Proposed guidance on KiwiSaver fees and value for money" Consultation Paper

1. Introduction

Thank you for the opportunity to make a submission on the "Proposed guidance on KiwiSaver fees and value for money" consultation paper. This submission is from Consumer NZ, an independent, non-profit organisation dedicated to advocating on behalf of New Zealand consumers. Consumer NZ has a reputation for being fair, impartial, and providing comprehensive consumer information and advice.

Contact: [redacted]

2. General comments

Consumer NZ supports measures aimed at ensuring providers' fees are reasonable, and we therefore welcome the introduction of guidance for managers and supervisors of KiwiSaver schemes.

We're concerned KiwiSaver fees have not decreased as the total value of funds under management has increased. We're also concerned fees for some passive funds are well above the market average.

Our annual satisfaction surveys show consumers lack good information about both KiwiSaver fees and fund performance. Our 2020 survey found just 24 percent knew what they paid in annual fees and two-thirds were unsure how their fund performed relative to the rest of the market.[1]

Overall, only 54 percent were happy with the service they were getting from their provider.

[1] Our survey was a nationally representative survey of 2114 New Zealanders aged 18 and over, carried out in February and March 2020.

3. Answers to questions

Our answers to specific questions in the consultation paper are set out in the feedback form below.

Thank you for the opportunity to make a submission. If you require any further information, please do not hesitate to contact me.

Yours sincerely

[redacted]

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you. **Submissions close on Monday 14 December 2020.**

Date: 14 December 2020 Number of pages: 4

Name of submitter: [redacted]

Company or entity: Consumer NZ

Organisation type: Consumer advocacy

Contact name (if different):

Contact email and phone: [redacted]

Question number	Response
1. Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable? If not, please outline your reasons.	In general, we agree with the factors identified. As noted in our covering letter, our 2020 survey found only 24 percent of KiwiSavers knew what they paid in annual fees so we're pleased to see fee disclosure included in the list of matters that should be considered.
2. Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable, or inconsistent with the related overarching statutory duties?	We consider the FMA should publish fee "benchmarks" to make it easier for consumers to gauge whether the amount they're paying is reasonable.
3. Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If so, please provide details.	In general, we agree with the examples of when fees may be unreasonable or inconsistent with statutory duties. In our view, consumers should be benefitting from the drop in fees charged by offshore fund managers but this hasn't happened. Consumers should also be benefitting from economies of scale, given the significant growth of funds being managed. We would also expect consumers in passive funds to be paying significantly lower fees.
4. Are you aware of any other example of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If so, please provide details.	We're concerned about the fees being charged by some funds that are promoted as "responsible" or "ethical". Consumers may sign up to these funds believing higher fees are justified on the basis of the fund's responsible investment strategies. However, in practice, the level of investment in responsible funds may be minimal.
5. Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money? Please outline the reasons for your answer.	We consider the guidance is likely to help managers and supervisors understand their obligations. However, we consider monitoring and enforcement is crucial to ensure managers and supervisors are meeting their obligations not to charge unreasonable fees. Without market monitoring, we're concerned providers will continue to charge unreasonable fees.
6. Do you have any examples of any costs or fee	See comments above in question 4 about ethical funds.

levels that you think are unreasonable/reasonable? If so, please provide details.	
7. Are there any additional matters that you think the guidance should address? If so, please provide details.	
Feedback summary – see covering letter	
Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.	
Thank you for your feedback – we appreciate your time and input.	

DENTONS KENSINGTON SWAN

[redacted]

Dentons Kensington Swan
89 The Terrace
PO Box 10246
Wellington 6143
New Zealand

dentons.co.nz

Financial Markets Authority
Level 2, 1 Grey Street
PO Box 1179
Wellington 6140
New Zealand

14 December 2020

Submission on Consultation Paper – Proposed guidance on KiwiSaver fees and value for money

1 This is a submission by Dentons Kensington Swan on the Financial Markets Authority ('**FMA**') *Proposed guidance on KiwiSaver fees and value for money* consultation paper dated 2 November 2020 ('**Consultation Paper**').

About Dentons Kensington Swan

2 Dentons Kensington Swan is one of New Zealand's premier law firms with a legal team comprising over 100 lawyers acting on government, commercial, and financial markets projects from our offices in Wellington and Auckland. We are part of Dentons, the world's largest law firm, with over 10,500 lawyers in 193 locations.

3 We have extensive experience in financial services law issues, with a specialist financial markets team acting for established major players as well as niche providers and new entrants to the market.

4 We advise a range of financial markets participants, including a number of providers of KiwiSaver schemes and other managed funds. We frequently assist managers, trustees, supervisors, and custodians of schemes in meeting their regulatory compliance obligations under the Financial Markets Conduct Act 2013 and the KiwiSaver Act 2006. Our experience extends to advising existing and prospective providers on the design, establishment, and ongoing operation of their schemes.

General comments

5 Our responses to the questions set out in the Consultation Paper are attached.

6 In brief, we welcome the FMA's initiative in producing guidance and formally articulating its views as to the factors it will take into account in determining whether or not a fee charged in relation to the provision of a KiwiSaver scheme is unreasonable. Doing so is consistent with the FMA's function of promoting the confident and informed participation of businesses, investors, and consumers in the financial markets.

7 In our view, however, the guidance proposed in the Consultation Paper goes beyond the FMA's regulatory remit. The proposed guidance risks stifling innovation and limiting the range of services

and types of portfolios KiwiSaver providers are willing or able to offer. This would not promote positive consumer outcomes. In particular:

- The discussion of reasonableness is not balanced, with insufficient emphasis placed upon providers' commercial considerations.
- The proposed guidance also fails to reference one of the key features of KiwiSaver, being its portability, and the ability of members to 'vote with their feet' if they consider a scheme's fees are unreasonable. The informed participation of consumers is a key consideration.
- The emphasis placed on 'fair value' is primarily a good conduct consideration. While it is useful to have the FMA articulate its thinking in that regard, it is unhelpful to combine the discussion of unreasonableness and fair value of fees. They are different concepts. One is a prescribed legal condition, the other is a broad 'soft law' objective that is yet to be tightly legislated. The two concepts should be clearly distinguished, with greater clarity provided in the discussion in the guidance.
- There is no regulatory basis for expecting statutory supervisors to monitor fair value.
- The proposed guidance is likely to result in providers offering less access to financial advice for KiwiSaver members than might otherwise be the case, contrary to one of the key objectives of the new financial advice regime.

Further information

8 We are happy to discuss any aspect of our feedback on the Consultation Paper. Thank you for the opportunity to submit.

Yours faithfully

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Specific responses to Consultation Paper questions

1 **Question 1: Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable? If not, please outline your reasons.**

1.1 In our view, when considering the unreasonableness of fees the FMA should be wary of interfering with the commercial operation of schemes beyond the regulatory requirement to not charge unreasonable fees. The regulator plays a key role in ensuring the protection of consumers in financial markets, but it does not have a regulatory mandate to dictate commercial terms that go to the heart of market functionality. The KiwiSaver constraint on charging unreasonable fees does not equate to a requirement to deliver fair value. Those concepts are not synonymous. A number of the factors within the Consultation Paper appear to overextend the FMA's jurisdiction in relation to assessing the unreasonableness of fees.

1.2 The main purposes of the Financial Markets Conduct Act 2013 ('**FMCA**') are to promote the confident and informed participation of businesses, investors, and consumers in the financial markets, and to promote and facilitate the development of fair, efficient, and transparent financial markets. It is not the purpose of the FMCA to dictate what rates an independent business can charge its customers, beyond ensuring fees are not unreasonable. That is a specific consideration in relation to KiwiSaver only. Customers have the ability to choose their own scheme. Provided fees are transparently disclosed and reported on, and are not unreasonable, the FMA should not interfere with and individuals financial decisions.

1.3 Page 5 of the Consultation Paper provides a list of matters the FMA believes are relevant to assessing whether a scheme is providing '*value for money*'. Clause 2 of the KiwiSaver rules is solely concerned with unreasonable fees, and that should be the touchstone consideration. Value for money is a good conduct consideration that should be addressed separately under a good conduct heading, not intermingled or confused with the prescribed regulatory assessment.

1.4 Of the factors listed on page 5:

- A review of the cost of services to ensure the scheme is providing value for money is primarily a good conduct consideration, and should not factor into an assessment of unreasonableness. Regulation 12(b)(i) of the KiwiSaver Regulations 2006 ('**Regulations**') makes it clear that consideration of the costs of services is to be undertaken where a scheme's fee or fees are significantly higher than the fees charged in relation to other comparable schemes or classes of schemes. In that situation, the costs of relevant services are intended to be considered in order to determine whether differences in those costs between schemes mean that it is reasonable for the fee or fees charged by the scheme in question to be higher. That is not the same thing as needing to ensure a scheme is providing value for money based on the cost of services.

- Requiring fees to be 'reflective' of costs is too blunt a consideration. The cost of services is a factor identified in the Regulations, and the relevant matter to assess should be left at that. Alternatively, the consideration should be whether the fee's profit margin over those costs is unreasonable.

- Comparing fees to a default KiwiSaver fund is inappropriate. Fees charged in default funds reflect a commercial bargain, between default providers and the Crown, with default providers gaining a regulatory advantage as a trade-off for charging lower fees and committing to particular service levels. Such a comparison is , not relevant to unreasonableness.

2 **Question 2: Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable, or inconsistent with the related overarching statutory duties?**

2.1 In our view, the factors identified in the Consultation Paper as being relevant to determining whether or not fees are unreasonable are not balanced. In particular, reasonableness should be approached as a two-way street. There is no regulatory imperative for KiwiSaver to be provided as a social good or on sacrificial terms, with a provider's commercial considerations a relevant aspect to take into account.

2.2 Additional factors we consider appropriate to feed into the mix on page 5 of the Consultation Paper include:

- The start-up costs or the sunk costs incurred by a provider in establishing a scheme – to do otherwise might operate as a barrier to entry, with it being reasonable for providers to expect to be able to recoup their costs of investing in the provision of KiwiSaver within a reasonable period of time.
- The level of service and 'value-adds' provided for members – otherwise, there is a risk that providers would be discouraged from innovating or offering additional services for their members. The reasonableness of any fee charged should properly be assessed against the level of services provided. The greater the level of services and/or the greater the degree of personalisation, the more reasonable it is to charge a higher fee.
- The regulatory burden and other environmental factors impacting on the provider's commercial position – in order to encourage providers to participate in the market, it is reasonable to expect them to be fairly rewarded for the regulatory and commercial risk that they take on, and ensure that the ever-increasing extent of the resources required to address regulatory obligations are adequately compensated.

3 **Question 3: Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If not, please outline your reasons.**

3.1 Dentons Kensington Swan disagrees with the proposed guidance in the Consultation Paper in respect of advice fees and trail commissions. By separating out the cost of financial advice provided to individuals from costs that may be shared amongst the scheme members collectively, the FMA risks suppressing access to financial advice, contrary to a key objective of the new regime for financial advice services.

3.2 We consider a more effective proposition is to encourage providers to make available advisory services which are charged collectively, provided they are offered transparently and made freely available. Or at least, it should be open to providers to offer that model, rather than force them to unbundle advice fees and only provide access to advice for those members prepared to pay extra for it. With financial advice made available for all, it is the reasonableness of the fee charged for having that financial advice support available that then needs to be assessed, rather than individual fees.

3.3 This methodology ensures all members have access to financial advice (or at least, ensures providers can offer that model) even if members can't afford or are unwilling to pay for advice individually. This promotes the purposes of the FMCA. Such an approach increases the likelihood that consumers will utilise advice mechanisms, ensuring more complete decision making and creating a more efficient marketplace. A key aspect to take into account when assessing reasonableness in this context is the clarity with which the availability of advice is disclosed, and its take-up rate.

4 **Question 4: Are you aware of any other examples of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If so, please provide details.**

4.1 We have no additional examples to suggest.

5 **Question 5: Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money? Please outline the reasons for your answer.**

5.1 Producing formal guidance will certainly assist KiwiSaver managers and supervisors understand the FMA's views as to the relevant factors in assessing the reasonableness of fees and their related statutory duties. However, the conflation of the discussion of unreasonable fees (in respect of which there is a statutory prohibition) and the discussion of value for money (in respect of which there is no specific express statutory duty, but there is a broader conduct-based expectation of market participants) is likely to add further confusion for market participants.

5.2 In our view, it is important for the finalised guidance to clearly separate out the discussion of the approach the FMA recommends in relation to the practical application of clause 2 of the KiwiSaver rules dealing with unreasonable fees, from the separate conduct-related discussion of value for money. This is particularly important for the statutory supervisors involved. In our view, while the charging of unreasonable fees in relation to the provision of KiwiSaver is something that would breach an issuer obligation and is therefore something that supervisors need to monitor, a broader conduct consideration of value for money is outside of the reasonable scope of a supervisor's monitoring obligation.

6 **Question 6: Do you have any examples of any costs or fee levels that you think are unreasonable/reasonable? If so, please provide details.**

6.1 We have no examples to suggest.

7 **Question 7: Are there any additional matters that you think the guidance should address? If so, please provide details.**

7.1 In our view, the guidance should factor in the importance of transparency around KiwiSaver scheme fees. It should be clear to consumers what they are paying for. The fact that a member chooses to meet a particular fee is relevant to the reasonableness of those fees, in the context of the portability of KiwiSaver scheme membership and the extent of market competition.

7.2 Promoting transparency in fee disclosure achieves a key purpose of the FMCA, being to promote the confident and informed participation of businesses, investors, and consumers in the financial markets. We do not believe it is appropriate for the FMA to regard itself as the sole judge of reasonableness. In a market where investors are free to change schemes at any time, the fact that members perceive value in a clearly disclosed fee position is indicative of its reasonableness, even if not determinative.

7.3 An objective of the FMCA is to promote fair, efficient, and transparent financial markets. In our view, the FMA should focus on ensuring consumers are equipped with accurate and transparent information enabling them to make their own informed decisions.

Feedback to FMA: Proposed guidance on KiwiSaver fees and value for money

DATE:	10 DECEMBER 2020
NUMBER OF PAGES:	4
NAME OF SUBMITTER:	[redacted]
ENTITY:	FINANCIAL ADVICE NEW ZEALAND
ORGANISATION TYPE:	INCORPORATED SOCIETY WITH AROUND 1600 FINANCIAL ADVISER MEMBERS
CONTACT NAME:	[redacted]
CONTACT EMAIL	[redacted]
CONTACT PHONE:	[redacted]

QUESTION	**COMMENT**
1	Yes.
2	No comment to make.
3	Concerns about unintended consequences of advice fees and trail commission changes. See discussion over.
4	No comment to make.
5	Yes. See comments over.
6	No comment to make.
7	No.

Financial Advice New Zealand is a professional membership body for financial advisers in New Zealand. It represents around 1600 members, of which roughly a third offer KiwiSaver advice as part of their core business.

Financial Advice New Zealand has no direct involvement with the provision of KiwiSaver products. However, one of our mandates under our Constitution is to work with financial service providers, and their industry bodies, to promote consumer focused products and services.

We support the goals of providing guidance to KiwiSaver managers and supervisors to ensure KiwiSaver fees are not unreasonable and provide value for money to consumers.

Whilst financial advisers can and do make their own assessment of product suitability for their clients based on their assessment of value, we recognise that currently only a small portion of consumers access advice (independent or otherwise) before determining their KiwiSaver product and provider. For these consumers in particular, the focus on reasonable fund fees and value for money is supported.

We recognise that fees can make a big difference to retirement balances for KiwiSaver members and have a compounding effect over time, especially for people with low balances. We support initiatives which seek to minimise this negative effect.

We encourage more people to gain independent advice around what for many is their second largest investment after their home. KiwiSaver is not a set and forget product and ongoing advice should be encouraged. Therefore we don't support initiatives which may increase barriers to people seeking this advice when they first join KiwiSaver and throughout their lives.

Our feedback is primarily in these areas; advice fees and commissions.

3. Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If not, please outline your reasons.

We do not support the inclusion of shared advice fees and trail commissions as examples of costs which may cause fund fees to be deemed unreasonable – unless those fees and commissions are themselves unreasonable.

Unintended consequences for little value
We believe this guidance's spotlight on trail commissions and advice fees may have the unintended consequence of a reduction in the availability and seeking of KiwiSaver advice which over the long-term would have a much bigger negative consumer impact.

With so few KiwiSaver members seeking advice at the moment, the scale of a fund fee reduction by removing shared advice fees and commissions would be inconsequential. Their inclusion or exclusion would not take a fund fee from being unreasonable to reasonable.

Cost of being unadvised
On balance, we believe the much bigger "cost" to a KiwiSaver member is not seeking advice and ending up in the wrong product or fund for their age and stage. This "cost" at retirement is likely to be much greater than the small cost of shared advice fees and commissions being included in their fund fees over that period.

The example of KiwiSaver movements from growth and balanced funds to conservative funds during the first phase of Covid-19 is a good example of the "cost" of being unadvised.

Research supports the value of advice

Independent research Financial Advice NZ commissioned this year of 2000 New Zealanders, "Trust in Advice[i]" showed the value of gaining financial advice:

- Only 53% of unadvised Kiwis in the survey said they had a good understanding of how much investment risk they can afford to take at their age and in their circumstances, this figure increased to over 80% for people who had received financial planning or investment advice.
- People who received financial advice are twice as likely as unadvised New Zealanders to feel at least reasonably prepared for retirement (50.1% vs 26.4%).
- 69.3% of people who received advice from a financial planner saying their financial security has increased as a result of that advice.
- Whilst only 52% of unadvised Kiwis in the survey said they had at least a good understanding of how much money they needed in retirement, this figure increased to over 70% for people who had received financial planning or investment advice.

These are statistics we must listen to – financial advice is worthwhile and valuable and leads to good consumer outcomes. Non advised respondents in the survey said their main barriers to seeking advice were affordability (29.1%), circumstances (37.5%), and an overestimation of their own abilities (37.0%).

If KiwiSaver members have to choose to pay directly to access KiwiSaver advice, we are concerned that will put up a barrier to accessing advice and those members will miss the opportunity of maximising their long term returns. This "cost" is significant.

Unadvised don't see the value - yet

Our research showed that 45.8% of advised clients felt better prepared for the financial impact of Covid-19 because they received financial advice. When the non-advised were asked if they thought they would have been better prepared if they had received advice, only 19.9% agreed. This highlights that unadvised consumers are yet to fully understand the value of advice, therefore they aren't likely to choose to pay their KiwiSaver provider, or other adviser, directly for that advice.

Advice should be encouraged – it is value for money

KiwiSaver is not a lock and leave product and we should be encouraging people to seek advice throughout their lives as their life stage changes and their balances build up.

We strongly believe that the cost of advice and commissions does provide value for money and improves long term consumer outcomes. Consumers who have gained independent financial advice, which commissions directly support, are more likely to be in the right KiwiSaver fund and contributing the right amount in order to reach their retirement, or first home, goals.

Trail commissions support KiwiSaver advice

The provision of trail commission has allowed KiwiSaver members access to professional advice in a low-cost manner. If KiwiSaver providers reduce or remove trail commission through concerns around this guidance, even less consumers will have access to independent KiwiSaver advice as advisers are likely to be less willing to offer the service and/or consumers will be unwilling to pay for it.

KiwiSaver advice is already a loss-making product for most financial advisers. Consumers are often not charged for the advice, with advisers gaining remuneration only through trail commissions. As an example, the cost to a financial planner to give advice to a KiwiSaver client falls in the range $500 to $1,000. The average KiwiSaver balance at close to $20,000 would provide a trail commission on a per annum basis of $50. It takes a long time to amortise this cost recovery from receiving a trail, even before the cost of providing ongoing advice is factored in.

We do however agree that trail commission without some aspect of ongoing support is unreasonable. At a minimum, these consumers should be supported ongoing through regular newsletters, access to their financial adviser and the offer of a regular review.

Solution – wait for the market to mature
As the KiwiSaver market matures and more people seek advice, and fees and commission increase to the extent that their removal would make a material impact on fund fees, then this would be the time to consider direct fees.

Right now, however, the market is not mature enough and the negative consequences run the risk of creating negative consumer outcomes for KiwiSaver members.

5. Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money? Please outline the reasons for your answer.

Yes, the examples are clear.

---

[i] https://financialadvice.nz/wp-content/uploads/2020/10/Financial-Advice-NZ-Trust-in-Advice-Double-page.pdf

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

Financial Services Council.
Growing and protecting the wealth of New Zealanders

Monday 14 December 2020

Financial Markets Authority
Level 2 1 Grey Street
Wellington

Financial Markets Authority
Level 5 Ernst & Young Building
2 Takutai Square
Britomart
Auckland

By email: consultation@fma.govt.nz

Submission: Proposed guidance on KiwiSaver fees and value for money

This submission on the Financial Markets Authority (FMA) consultation paper, Proposed guidance on KiwiSaver fees and value for money, 2 November 2020 (the Paper) is from the Financial Services Council of New Zealand Incorporated (FSC).

The FSC is a non-profit member organisation and the voice of the financial services sector in New Zealand. Our 86 members comprise 95% of the life insurance market in New Zealand and manage funds of more than $83bn. Members include the major insurers in life, health, disability and income insurance, fund managers, KiwiSaver and workplace savings schemes (including restricted schemes), professional service providers, and technology providers to the financial services sector.

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:

- strong and sustainable customer outcomes
- sustainability of the financial services sector
- increasing professionalism and trust of the industry.

We welcome the opportunity to provide feedback on KiwiSaver fees in New Zealand and the related overarching statutory duties in order to ensure that the resulting guidance for managers and supervisors of KiwiSaver schemes is valuable for the industry and fair to customers. KiwiSaver fees are important. Whilst we recognise the significance of setting KiwiSaver fees that are reasonable and offer value for money to consumers, we have the following general points to make on this consultation:

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

Financial Services Council.
Growing and protecting the wealth of New Zealanders

- A strong focus on fees including cost cutting, potentially leading to significantly less active management across the industry, does not appear to align with the Government's objectives to develop New Zealand's capital markets.
- There appears to be an over emphasis on investment management costs as a component of fees. In addition to costs associated with investment management, KiwiSaver fees cover the operational costs associated with the day to day management of member funds which include, but are not limited to, registry administration, member servicing, and the provision of digital tools for investors.
- With an emphasis on cost inputs, we also encourage balancing considerations to include wider elements of "value for money" in determining whether a fee is unreasonable.
- There are a range of ways to provide benefits to members aside from reducing fees, which can be evidenced by the significant improvements that have been made to offerings when compared to initial KiwiSaver services.
- Whilst we acknowledge the importance of fees being reasonable, it is equally important that the regulatory approach accommodates a range of investment styles to ensure continued choice for investors. Rather than imposing a prescriptive approach to fees, full and transparent disclosure of fees so that members can easily compare those fees across different providers will achieve the objectives of competition in the market and member awareness.
- With many of the FSC's KiwiSaver providers involved in the default RFP process, there have been concerns expressed on the timing of this consultation. We also have concerns that these default providers may feel restricted in commenting as it may impact their RFP process and they are fettered in their feedback due to commercially sensitive information at this time. We recommend further consultation and engagement with the industry following the completion of the default RFP process and perhaps consideration could be given to an industry workshop in the new year which the FSC would be happy to help facilitate.
- We acknowledge that there will be a benefit in ensuring that fund managers and supervisors have processes in place to review the fees and determine that they are not unreasonable. However, when considering and determining whether fees might be unreasonable the industry will require more detailed guidance and input from the FMA.

[redacted]

[redacted]

[redacted]

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

Financial Services Council.
Growing and protecting the wealth of New Zealanders

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**
Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you. Submissions close on Monday 14 December 2020.
Date: 14 December 2020 **Number of pages:** 10 **Name of submitter:** [redacted] **Company or entity:** Financial Services Council of New Zealand **Organisation type:** Non-profit member organisation **Contact email and phone:** [redacted]

1.	Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable? If not, please outline your reasons.

We would like to provide feedback on the following factors identified in the Paper as being relevant to an assessment of whether KiwiSaver fees are unreasonable.

How fees are calculated, charged, disclosed and reviewed
It is acknowledged that fees and expenses should be reasonable, accurate and consistent with the governing documents and with information given to members. Full and transparent disclosure of fees so that members can easily compare those fees across different providers will help achieve the objectives of competition in the market and member awareness.

The role of KiwiSaver supervisors includes oversight of managers to ensure they have processes in place to review the fees and determine that they are not unreasonable. One of the factors when considering whether a fee is unreasonable is to assess it against other schemes with comparable investment mandates, and managers offering comparable services. Supervisors are unlikely to have all the specific detail on the comparable schemes or fee components as they do not have the visibility across the whole market. Some aspects may also be commercially sensitive and not made public. We therefore recommend more detailed guidance for supervisors and input from the FMA to better enable these assessments to be undertaken.

In addition, we note that the obligation to not charge an unreasonable fee is a "market services licensee obligation" and any contravention, or likely contravention of such in a material respect is also directly reportable to the FMA by the manager. We encourage the FMA and supervisors to continue to work together and share information, including assessments as part of initial registration of the scheme, when determining when the fees might be unreasonable.

The cost of the services to which the fees relate and whether the fees are reflective of costs
Fees are not the same as costs. Costs will make up an element of a fee determination, however healthy and vigorous competition in the market will assist to keep fees at an appropriate level for members.

We suggest that the guidance expressly clarifies that the FMA is not seeking to prohibit or restrict any particular type of fee model and stresses the importance of full transparent disclosure of whatever model adopted. We are aware that some managers use performance fee or flat fee structures, both of which are examples of fees not related to costs, and appropriate for the schemes they manage. Performance fees may allow managers to be compensated for additional skills and services, whereas other managers may charge a one-stop fee that covers supervisor, custodial, regulatory fees and other fund/scheme expenses. We consider that all fee models should continue to be permitted under the FMA's proposed guidance and this is in line with the supporting documents referenced in the draft guidance.

Whether the cost of the services has been reviewed to ensure the scheme is providing value for money, review of the performance of underlying managers to consider whether they are providing value for money and how the fund has performed, with a focus on any underperformance over time
We consider these factors to be quite broadly phrased. We encourage further clarity on what should be considered here. We also note that the focus on performance as a factor by which to assess the reasonableness of fees, may inadvertently lead to riskier behaviours, and the narrowing of investment mandates to exclude growth assets.

Generally, fees are made up of the operational costs associated with the day to day management of member funds, such as advice, education, giving customers the right products for the risk profile, compliance and technology costs, supervisory services, as well as costs associated with investment management strategies which link to performance.

We consider that fund performance is a more relevant factor for fund selection than the reasonableness of fees. An element of fees will be reflective of a fund or fund manager's investment strategy and style and the extent to which investments are actively or passively managed and the costs associated with that strategy. In addition, the task of standardising performance is complicated by two key factors, time and risk. Returns can vary significantly depending on the period used, and the risks undertaken are dependent upon the concentration and type of assets held. A simple analysis of returns without considering these factors may promote misleading conclusions.

Performance depends on the asset class (the type of fund), the time period and investment style. In addition, it is difficult to separate the market volatility of the type of assets that a fund invests in from the manager's performance given the changing nature of the markets. It is inherent when employing any management style that there could be periods where a fund underperforms compared to the benchmark or other funds.

From a practical perspective, linking fees to performance is backward looking, where as a fee review should be forward looking. We have concerns that linking reasonableness to performance could imply that a manager should refund an amount of fees if a fund has underperformed, for example, due to market factors outside of the manager's control. We also note that where a manager has performed well, it may not be considered appropriate for a manager to implement a fee increase. This results in managers being unduly penalised by the use of performance as an assessment criterion.

How scheme assets are invested – whether fees reflect the degree of active or passive management employed

We agree that this should be a factor, however, we reiterate that fees are made up of the operational costs associated with the day to day management of member funds, and costs associated with investment management and other services provided. We also note that, with the clear emphasis for fees to trend downward, an outcome of the guidance may be that more providers move from active to passive management models as a result. This in turn could negatively impact on market efficiency of the New Zealand capital market and result in market mispricing of assets.

How fees compare to any restricted workplace savings scheme or other KiwiSaver schemes, how particular fees (such as advice fees) compare to other managed investment schemes with such fees and how fees compare to a default KiwiSaver fund with a comparable level of growth assets

Comparing fees to workplace savings and a default KiwiSaver fund with a comparable level of growth assets is not considered to be a reliable basis for comparison. It does not take into consideration the compared schemes' different assets, asset classes within those, the liquidity within the schemes, the management styles and the fact that often employers pay fees on behalf of employee members of workplace saving schemes. Therefore, we suggest the addition of *investment approach* and *similar service models* to these factors in the final guidance as this would help to clarify that the evaluation is made on schemes which are comparable, taking into consideration the factors mentioned above.

In order to achieve a lower fee for a default fund, a different investment strategy may be employed (such as more passive) compared to a more active fund with a similar level of growth assets that a provider also offers. Default fund fee pricing takes account of factors unique to being a default fund, such as volume acquisition, which can contribute to economies of scale, and in some cases differing management styles, so its fee pricing is distinguishable on that basis and therefore not a reflective benchmark for the fee pricing of other funds.

We understand this point is aimed at comparing to other New Zealand schemes. However, it is hard to accurately compare to other international schemes (as noted below in relation to the United Kingdom) due to the lack of availability of comparable data and relative size differences.

The structure of the scheme

We encourage further clarification on this factor and what is meant by structure, for example, is it intended to refer to asset structure or business model?

The number of members

We suggest value of scheme assets is a more reliable indicator when looking at passing on economies of scale. A large number of members with low balances will have a higher average service cost to fee ratio per member compared to the same number of members with high balances. In addition, there does need to be a critical mass of members before some operational costs reduce. We also note that with more members comes additional costs such as increasing the capacity of registry systems, or of outsourced administration costs.

The value of scheme assets and whether the value has increased over time so that benefits of scale are passed on to members

We generally agree with this point, however we note some of the more significant costs may not be scalable such as the underlying investment management fees charged by third party or international managers and commission, both of which are generally percentage based fees. In addition, timing will be a factor as fees are usually linked to tiered funds under management arrangements with the underlying investment managers. The number and size of tiers will be influenced by a range of manager specific factors as well as decisions around the number of underlying investment managers used.

There are a range of ways to provide benefits to members aside from reducing fees. These include, for example, reinvesting the scale benefits into innovating and improving service offerings for members. This can be evidenced by the significant improvements that have been made to offerings when compared to initial KiwiSaver services.

We also note that there may be an assumption that funds under management will continue to grow, however with an aging population it is expected that we will reach a saturation point. At such time, we could reasonably expect to see movement in KiwiSaver members between fund managers, which can lead to a reduction in members for certain schemes. If fund managers are reducing fees to the lower end of profitability, any negative movement in member balances and member numbers risks unduly impacting the managers' ability to maintain a profitable business, thereby potentially impacting the stability of the New Zealand KiwiSaver market.

The consultation paper referred to the Melville Jessup Weaver report that compares fees between the New Zealand KiwiSaver and United Kingdom (UK) superannuation fund markets, to reinforce the view that the benefits of scale have are not being passed onto KiwiSaver members. We consider that reference to funds in the UK seems inappropriate when the UK is a global financial centre and New Zealand superannuation, in particular KiwiSaver, is in its infancy in comparison.

The proportion of returns eroded by fees

We suggest that this factor be removed. Returns could move materially in times of market volatility and when this occurs the erosion in return is only capturing market volatility which is not directly related to the manager's fee or performance and the question of the value being provided for that fee. Linking fee reasonableness to the level of returns may drive riskier behaviour, or encourage managers to move away from investment in volatile assets removing this as an investment option for members' (particularly younger investors) whose risk profile is suited to growth assets.

As noted above in addressing the factor *whether the cost of the services has been reviewed to ensure the scheme is providing value for money*, managing funds comes with fixed costs such as compliance and paying for supervisory services, irrespective of the returns achieved.

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

Financial Services Council.
Growing and protecting the wealth of New Zealanders

Any other costs of the scheme

As noted above, there are a range of costs inherently incurred by providers in running KiwiSaver schemes, that are distinguishable from investment management costs. These include day to day running costs, such as compliance costs which incur both base costs and the costs of responding to regulatory change. There are also risks associated with operating an investment business which result in further costs for a scheme. For example, risk premium required to keep operating, that is if the business is no longer or less profitable, then shareholders can wind up operations and reallocate capital to investments where a higher return can be made.

We note that many KiwiSaver providers will have made significant past investments such as major system improvements, which may not be apparent when looking at current operating costs. The guidance recognises and expects schemes to adopt cost saving practices, technologies, or structures where it is reasonable to do so, however investment is required to put these in place.

Administration services, which are often outsourced, require a material investment to set up an operational foundation of systems, processes and people to ensure robust and scalable administration services, irrespective of the number of members or level of funds under management. Administration costs may increase with scale as membership grows and what is needed to support that growth, and this inevitably links to additional administration costs irrespective of the management fees charged.

It is important to acknowledge this so that the goal of reducing fees does not come at the cost of member education, access to advice or digital tools which in turn could serve the interests of members better and lead to better investor outcome over time.

Members' Interests

We note the Paper states managers of KiwiSaver schemes should be reviewing fees with members' best interests as the overarching consideration. We are concerned that the guidance does not expressly reference that managers and supervisors are permitted to make a margin notwithstanding their obligation to act in the members' best interests. Members' best interests may not best served via lowest possible fees, but by a range of factors such as providers' costs of capital and adequate margins all of which ensure stability is maintained during periods of volatility. This is also important to ensure investor confidence in the financial markets, that a range of investment products are available and to encourage new providers to enter the market to increase competition and innovation. We are also concerned that unbalanced guidance could lead to unintended perverse outcomes for members, for example managers stripping valuable diversification out of portfolios, a fundamental principle of investment, because diversification carries a cost and therefore possibly higher fees.

The more detailed aspects of the guidance, such as relating performance with value for money, do raise concerns about unintentionally driving outcomes that are not in a members' best interests. We encourage further consideration of the guidance in this light to ensure that results are beneficial for members and to reduce possible risks, such as providers employing a passive strategy which would reduce variety across the market.

2.	Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable, or inconsistent with the related overarching statutory duties?

Services being provided should be a consideration
A fee that is higher in relation to other funds with a similar investment approach, may not be unreasonable if material additional services were being provided by a scheme manager, for example, additional member communication, digital capability/tools, financial advice and member education. While the cost of services is a listed consideration, the services being provided are not expressly stated in the list of factors.

Other requirements for default KiwiSaver providers
We would suggest that the list of factors include additional requirements placed on default KiwiSaver providers as this can result in increased compliance costs. For example, default KiwiSaver providers will have obligations to engage with members to help them make informed decisions about their retirement savings as well as prohibited areas of investment. Higher costs can also be incurred for default providers when seeking to engage with default members who have been allocated by Inland Revenue (IR). The IR's contact information for these members can be out of date and they can be less engaged making them harder to contact compared to members who have made an active scheme choice. We acknowledge that these additional costs to default providers may be offset by the volume acquisition of default members, however as the distribution of members is relatively even across default providers and subject to fluctuation, we encourage further consideration of costs incurred for default providers specifically.

3.	Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If not, please outline your reasons.

We would like to clarify the following two examples:

Funds under management increase – fees should reduce to reflect reduction in fixed costs due to economies of scale
As noted above, we generally agree with this point, however we note that some of the more significant costs may not be scalable, such as the underlying investment management fees charged by third party or international managers and commission, both of which are generally percentage based fees. We note that the fixed costs of schemes would not necessarily reduce relative to the increase in funds under management (FUM). There are also costs incurred as a result of an increase in FUM, for example, the need to improve registry capacity.

A membership fee that erodes a member's low balance is likely inconsistent with the duty to put members' best interests first and treat them equitably
Each provider will likely take their own stance depending on their own scale, fee structure and margins. Providers should be able to cover their costs for members with low balances. There is a

minimum servicing cost per member, for example to open and maintain a member's account, process transactions such as withdrawal requests, and this does not change in accordance with the balance amount.

4.	Are you aware of any other examples of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If so, please provide details.

We are not aware of any other examples of unreasonable KiwiSaver fees.

5.	Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money? Please outline the reasons for your answer.

Whilst this is generally understood in the market, it is helpful as it lays out all the different pieces of legislation and then weaves in FMA expectations on conduct to make their position clear.

6.	Do you have any examples of any costs or fee levels that you think are unreasonable/reasonable? If so, please provide details.

We do not believe it would be appropriate for FMA to state specific fee levels as unreasonable in the Guidance.

7.	Are there any additional matters that you think the guidance should address? If so, please provide details.

Having guidance that mandates fee level and fee structures may discourage new competitors. It may also stifle creativity and variety in member offerings. We note the consultation paper states, "*in the event that fees are unreasonable we expect managers and supervisors to take action to ensure compliance, including reducing fees and refunding members who have been overcharged*". This wording may discourage providers from reducing their fees as it may look like an admission that their fees were unreasonable. Scheme providers should be able to reduce their fees without having to worry about subsequent compensation, and the way this is drafted may have the opposite effect of not encouraging providers to reduce fees.

Many of the factors relevant in reviewing fees are relatively long term such as growth in funds under management (including in relation to underlying investment managers), investment in systems and member services, and additionally require time to determine and implement fee reductions. As a result, it can be very difficult to determine conclusively if, and when members had been overcharged.

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

We note the consultation paper states, "*If any scheme changes require updates to the Statement of Investment Policy and Objectives (SIPO) or other governing documents and such changes impact costs, then fees should be reviewed at the same time*". We would like to highlight that not all changes result in a reduction in cost. We suggest the paragraph is updated to note this applies to changes that result in a material cost reduction.

It is important that we have a stable financial services industry which can maintain longstanding financial services organisations able to offer differentiated services to members. KiwiSaver providers who are profitable are more likely to be stable. Ability to meet all costs, for example relating to addressing risks, insurance, remediation, cost of capital and compliance should also be considered as reasonable components that make up the fee structure.

We suggest that more flexibility is provided within the guidance in relation to advice fees. In particular, managers should be permitted to wrap advice fees within their chosen fee model, so long as the manager is able to demonstrate that the fees incurred are reasonable for both unadvised and advised members.

Feedback summary

We agree that providers should be regularly reviewing their fees with the view to passing on savings to members as scale increases. We believe the fee should be reflective of the investment style employed and the costs incurred in administering the scheme, rather than performance, which can be volatile and depend on the timeframe chosen.

Passive managers generally have lower costs than active managers. A focus on reducing fees may result in more managers utilising passive management to help reduce their costs, which may result in less diversity of offerings in the market and possibly reduced investment options available for members. The FMA may not consider this compatible either in terms of its neutral stance on active or passive management, or in light of its objective to promote and facilitate the development of fair, efficient and transparent financial markets.

A focus on fees, must not restrict innovation in KiwiSaver or the ability of KiwiSaver members to choose from a variety of providers offering different styles and structures for investment. Providers may feel the guidance restricts flexibility to offer all the types of investments they might like to provide, if they feel that to do so may mean the fees they would need to charge appear unreasonable. We also note that when the New Zealand Government is emphasising the need for a focus on NZ capital markets, and supporting local companies in earlier stages, there is more cost associated with these types of investments which is inevitably reflected in fee structures.

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date: 14 December 2020   Number of pages: 6

Name of submitter: [redacted]

Company or entity: Fisher Funds Management Limited

Organisation type: Managed Investment Scheme Manager

Contact name (if different):

Contact email and phone: [redacted]

	Introduction
	Fisher Funds endorses the statement in the Financial Markets Authority's (FMA) Annual KiwiSaver Report 2020 that "*While battered by the first few months of 2020, KiwiSaver has weathered the challenges well, remains in good health, and is delivering on its core objective to help New Zealanders save for their retirement.*" With 35 schemes on offer and a key tenet of KiwiSaver being unfettered portability, the 3 million+ New Zealanders invested in KiwiSaver schemes have a competitive market to choose from and an on-going opportunity to change schemes to one that best aligns with their personal, social and economic objectives. Fisher Funds agrees with the conclusion of the independent research referenced in the FMA's consultation paper that the "global trend is a decrease in fees for passive funds" and would generally expect KiwiSaver schemes which are exclusively or predominately index based to have lower fees than an active investment manager. Inasmuch as the consultation references MyFiduciary's finding that some KiwiSaver managers' actual investment style is not what they are claiming, Fisher Funds wishes to place on record our proven history of active investment management. In further support of our value proposition, Fisher Funds delivers on a key objective of investor education with easy, multi-channel access to financial advice, provided by a wholly New Zealand based corps of advisers and supported by one of the largest KiwiSaver contact centres, domiciled in NZ. We support FMA's position that the importance of fees in determining good outcomes for KiwiSaver warrants industry guidance and further agree with FMA that fees are not the sole determinant of good client outcomes but must be viewed in the context of the overall value proposition of the particular KiwiSaver scheme.
Question	Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable? If not, please outline your reasons.
No. 1	**Value for money (p.5)** Fisher Funds agrees with the statement (p.4) that any assessment of a scheme's fee "*should take into account not only traditional aspects such as underlying costs, but also whether the fee (and the product overall) offers value for money to members.*" This statement represents regulatory recognition that a simple cost-plus approach to the issue of reasonableness of fees has the potential to suppress development of the differing value propositions currently on offer to KiwiSaver clients and ignores the overlay of market competitiveness, which is generally regarded as a key driver of improved client outcomes in any market. Having regard to the above, any framework for assessing reasonableness needs to be flexible enough to accommodate the different KiwiSaver providers' business models, as for example, some providers: • are vertically integrated and may not assign discrete costs throughout their value chain • are not the product manufacturer and are effectively distributors of a single badged product

- manage their schemes' investments on a fully passive basis
- offer a full range of financial advice services
- offer only a digital client service

From a competition perspective, KiwiSaver scheme providers will want to position themselves in the marketplace in a way which differentiates them from the rest of the market; enables them to be competitive; and reflects their individual value proposition.

Regular review of scheme fees

Fisher Funds agrees that managers and supervisors should be able to demonstrate that fees are subject to at least an annual review, assuming no other material changes are made to the product, the service proposition, or distribution arrangements during the course of the year.

We consider that the factors identified by FMA as being relevant to an assessment of whether the KiwiSaver scheme is providing value for money are in the main appropriate. Our comments on the matters identified as relevant by FMA (p.5) are as follows:

- <u>How fees are calculated, charged, disclosed and reviewed</u>

We agree that it is appropriate to consider this matter, in conjunction with the other matters, when assessing whether the scheme is providing value for money.

- <u>The cost of the services to which the fees relate and whether the fees are reflective of those costs</u>

We agree that it is appropriate to consider this matter, in conjunction with the other matters, when assessing whether the scheme is providing value for money but see our earlier comments regarding value and competition.

- <u>Whether the cost of the services has been reviewed to ensure the scheme is providing value for money</u>

We agree that it is appropriate to consider this matter when assessing whether the scheme is providing value for money.

- <u>Review of the performance of underlying managers to consider whether they are providing value for money</u>

We agree that it is appropriate to consider this matter, in conjunction with the other matters, when assessing whether the scheme is providing value for money.

- <u>How the fund has performed, with a focus on any underperformance over time</u>

It would be useful if the guidance specified what the underperformance should be measured against.

Our view is the performance of the fund should be measured against the fund's benchmark as identified in the scheme's Statement of Investment Policy and Objectives (SIPO), and also on an after-fees but before-tax basis. This would be consistent with the reporting in the quarterly fund updates and provide clients with easier fund comparability.

The minimum timeframe for this assessment could be the minimum investment time period for the fund recommended in the SIPO.

<u>How scheme assets are invested – whether fees reflect the degree of active or passive management employed</u>

Fisher Funds would expect KiwiSaver schemes which are exclusively or predominately index based to have lower fees than actively managed schemes. However, following MyFiduciary's findings that some schemes may be mi-representing their activeness, there should be some independent assessment matrix to substantiate such statements.

- <u>How fees compare to any restricted Workplace Savings Scheme or other KiwiSaver schemes</u>

We do not believe that restricted Workplace Savings Schemes are particularly comparable with KiwiSaver schemes.

They not infrequently contain insurances and other features which differentiate them from KiwiSaver schemes. Additionally, in some restricted Workplace Savings schemes, fees and costs are met by the employer or paid out of reserves.

Whilst it would seem appropriate to compare fees with other KiwiSaver schemes, the consultation paper itself notes the limitations of this approach in stating that "the scheme's own fees are the critical consideration."

- <u>How particular fees (such as advice fees) compare to other managed investment schemes with such fees</u>

Fisher Funds offers advice across our product range, including KiwiSaver, and does not charge any additional fees for this service.

Australian experience tends to suggest that investors typically are not prepared to pay for advice until their balances reach circa $100,000.

Elsewhere in the industry, advice fees charged by advisers directly to clients are generally subject to regulatory disclosures by the adviser and written agreements with clients.

- <u>How fees compare to a default KiwiSaver fund with a comparable level of growth assets</u>

Default funds may be priced differently from a fund managers' other funds for reasons which relate to:

- the servicing expectations on default fund providers; and
- the fact that default funds are typically intended as a landing fund for default clients, pending the KiwiSaver provider engaging with default clients to confirm the suitability of the default fund for their particular situation or to advise the client to re-direct their investment to a more suitable fund.

This engagement activity by KiwiSaver managers is heavily dependent on being provided with up-to-date and/or accurate information from Inland Revenue when the default client is allocated.

Given the potential for the default fund to be a landing fund and where the provider's outreach programme of engagement with the client determines a more appropriate fund, that fund would be priced (and disclosed) in a manner aligned with the standard pricing model of the relevant fund manager.

- The structure of the scheme

We agree that it is appropriate to consider this matter, in conjunction with the other matters, when assessing whether the scheme is providing value for money.

- The number of members

We agree that it is appropriate to consider this matter, in conjunction with the other matters, when assessing whether the scheme is providing value for money.

- The value of scheme assets and whether the value has increased over time so that benefits of scale are passed on to clients

Scale within the New Zealand market is not necessarily reflective of what would commonly be thought of as 'scale' in many international markets.

Whilst the number of KiwiSaver providers thought to have 'scale' is generally limited to a very small number within the banking industry, for most other providers any 'scale' increase is generally more incremental in nature or, as is the case for newer or smaller entrants, some providers could be considered sub-scale.

On this basis, there are some limits to the proposition that benefits of scale should be passed on.

Investment Management, Supervisor and certain other expenses of a fund are percentage based. As a result, the quantum of those fees and expenses increases as the value of the scheme assets increases. Conversely the quantum decreases when scheme asset value decreases. It is therefore important that this factor is measured over the longer-term to account for fluctuations in the value of assets due to, amongst other things, market volatility.

Additionally, while fees will increase with an increase in the value of scheme assets, this increase is usually accompanied by an increase in clients. The regulators' conduct expectations of their supervised populations have steadily increased including the identification and development of appropriate responses to vulnerable clients, who typically are drawn from the ranks of KiwiSaver clients.

This approach can require new and more intensive forms of engagement with a commensurate increase in staff and systems.

Accordingly, fee reductions may not automatically flow from an increase in scheme assets as providers' services and service levels continue to increase and add to the value clients are receiving.

At a certain point, managers will have the ability to pass on the benefits of scale. However, this is dependent on the manager's value for money proposition and reinvestment back into the business in support of good client outcomes.

- The proportion of returns eroded by fees

This matter is expressed in the consultation document in unnecessarily emotive language i.e. it reflects only the cost side of the equation and implies that any fee deduction necessarily derogates from the value that accrues to the client as a consequence of their membership of a KiwiSaver scheme.

In our view, a fee charged is not necessarily unreasonable solely on account of its quantum but must also be considered in the context of the particular fund's return, as well as its broader value proposition.

For example, if a passively managed fund has an after-fees return of 1% versus the current benchmark return of 1.5%, a fee of 0.5% is not necessarily unreasonable even though it is 50% of the return.

Similarly, if an actively managed fund returns 2% versus the current benchmark return of -5%, the fact a 1% fee is 50% of the return also does not make that fee unreasonable.

The challenges inherent in applying this factor tend to make it less reliable as a proxy for (un)reasonableness.

Unreasonable fees (p.6)

Our comments below relate to the factors identified in the consultation paper as being relevant to an assessment of whether KiwiSaver fees are unreasonable.

Whilst we generally support the factors identified in the paper, we re-iterate our comment (p.1) regarding the effect of providers' differing business models resulting in different value propositions being available to KiwiSaver clients.

- Economies of scale

Fisher Funds agrees with the general proposition that fees levels should take into account any reduction in fixed costs that occur as funds under management increase but see our earlier comments in this section and further comments in response to Q.3 below.

- Actual costs

Fisher Funds agrees with the general proposition that KiwiSaver managers need to take steps to ensure that actual costs are reasonable, particularly where costs are significantly above the commercial norm.

However, as referenced earlier, the measure of reasonableness is not a simple cost-plus exercise.

Additionally, the calculation of actual costs may also differ as between, for example, a vertically integrated KiwiSaver provider (where discrete fee elements may not be separately calculated) and a rebadged fund where costs are predominately related to distribution.

- Membership fees

Fisher Funds agrees that KiwiSaver providers must have systems and processes in place to regularly review fees having regard to the numbers, types and behaviours of clients investing with them.

However, as expressed above, a fee charged is not necessarily unreasonable solely on account of its quantum but must also be considered in the context of the particular fund's value proposition, in particular the performance of the fund.

We note also that some registry providers charge a fixed cost on a per client basis, regardless of the client's balance.

Notwithstanding registry providers' practices, Fisher Funds acknowledges the point made in the consultation paper that membership fees can have a disproportionate effect on members with low balances.

However, there could be a distinction between KiwiSaver clients who are in the accumulation phase, slowly but purposefully building their low balance retirement savings versus client-driven actions which result in (temporary) low balances e.g. a first home withdrawal from an otherwise high-value account (which account values may be quickly restored) or a client who joins KiwiSaver post-age 65 and is in a decumulation phase, with the intention of using their KiwiSaver scheme account akin to a current account, esp. in an era of local bank branch closures.

Provider initiatives aimed at achieving better outcomes for vulnerable clients, some of whom may have low balances, can also put pressure on fee levels.

- Re-badged funds

Fisher Funds does not currently offer rebadged funds.

- Buy/sell spreads

Fisher Funds does not currently charge buy/sell spreads in our KiwiSaver schemes.

- Advice fees and trail commissions

Greater clarity is sought with reference to the use of the word 'facilitates' so that there is a common industry understanding of the principle which the consultation is intended to address.

Generally, Fisher Funds agrees that where a fee is charged to a KiwiSaver client for financial advice, that fee should be disclosed to and represent a cost to the client benefiting from the advice and not be a direct charge on the scheme.

Fisher Funds offers financial advice on our financial products at no additional cost to the client and with no direct charge to the scheme.

Fisher Funds pays commissions in varying circumstances, not all of which relate to the provision of financial advice e.g. commissions payable for distribution efforts such as display of disclosure materials, hosting on websites, advertising etc.

These one-off and/or trail commissions to third parties are generally chargeable to the fund manager and are not payable by either the scheme or the client.

As the industry approaches the commencement of the new financial advice regime, fund managers paying fees to advisers in respect of their products will be taking action to ensure that the adviser is firstly licensed to provide the relevant advice and secondly that their continued receipt of any payment from the fund manager is accompanied by an on-going advice relationship with the client.

We would expect that in any other circumstances where advice fees are deducted from scheme assets, this would be disclosed to clients in fund and/or adviser disclosure documents as well included in the client's regular transaction reporting.

Question No. 2	Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable, or inconsistent with the related overarching statutory duties?
	Other factors we consider relevant in any assessment of reasonableness include: • direct and indirect client feedback; and • the differing KiwiSaver providers' business models (see our answer to question 1). Fisher Funds seeks direct feedback from clients on their engagement with our financial advisers to provide a range of information pertaining to our client service proposition and product range. Fisher Funds participates in an industry survey which, amongst other things, explores clients' understanding and perception of value for money from their providers, including fees and costs. Fisher Funds also contracts with an Independent research company - SuperRatings - and receives regular reporting on SuperRatings' assessment of schemes' value for money. These mechanisms make an important contribution to our assessment of the reasonableness of KiwiSaver fees from a client perspective. We have commented above on the effects of KiwiSaver providers' differing value propositions.
Question No. 3	Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If not, please outline your reasons. • Funds under management increase – fees should reduce to reflect reduction in fixed costs due to economies of scale • Moving from active to passive investment management • Fund input costs have fallen due to a decrease in third-party manager fees • Scheme amalgamations where economies of scale are an end result
	<u>Funds under management</u> Fisher Funds agrees with the general proposition that fees levels should take into account any reduction in fixed costs that occurs as funds under management increase. Fixed costs (such as audit, unit pricing, fund accounting) as a proportion of funds under management typically reduce as funds under management increase and this has been reflected in a consistent fall in the annual fund charges over time. However, these fixed costs tend to make up a relatively small percentage of the overall annual fund charge compared to Supervisor and Management fees. In terms of the Supervisor fee, we note that as funds under management (FUM) increase so too does the Supervisor's liability and, where the increase is a result of additional client numbers, the monitoring component of the Supervisor's activity may also increase. Accordingly, an increase in funds under management may not automatically result in the Supervisor reducing fees. With respect to management fees where FUM is increasing, KiwiSaver providers such as Fisher Funds will likely consider a range of factors including (in no particular order): sustainability of the increase in funds under management; market volatility; opportunity for a cost reduction; investment in the business; and the scope to increase services to KiwiSaver clients. For example, Fisher Funds is progressively increasing financial adviser numbers as well as investing in on-line tools and other functionality for the benefit of our KiwiSaver clients. We therefore see these situations as needing to be incorporated in the overall assessment of fees in terms of their value for money rather than automatically assuming fees will drop as FUM increases. <u>Active to passive management</u> Fisher Funds has proven competence in active investment management with a consistent record of competitive fund performance. All other things being equal, we would expect passive KiwiSaver managers to charge lower fees than active managers. <u>Third party managers</u> We agree with the principle that where input costs fall due to a decrease in third party managers' fees, the KiwiSaver provider should re-visit their value proposition and cost structure. However, depending on the size of the funds managed by the third manager relative to the size of the overall fund, any diminution of the third party's costs may be immaterial in the context of overall fees. <u>Scheme amalgamations</u> Fisher Funds generally supports the principle of fee reductions where amalgamations result in economies of scale, but this would still need to be considered on a case-by-case basis.

Question No. 4	Are you aware of any other examples of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If so, please provide details.
	Fisher Funds is not aware of any other examples of where KiwiSaver fees may be unreasonable or inconsistent with the related overarching statutory duties.
Question No. 5	Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money? Please outline the reasons for your answer.
	Fisher Funds is of the view that managers and supervisors of managed investment schemes, particularly KiwiSaver schemes, are generally cognizant of their on-going obligations with respect to fees as well as their statutory duties and that their differing value propositions reflect this. With the amendments and additional clarifications proposed in our response, we believe that the guidance will be useful to managers and supervisors in applying a broadly consistent approach to managing their obligations and duties. Aligning the industry in its assessment of the reasonableness of their fees is key to enabling supervisors and the FMA to treat providers fairly while also allowing for a range of approaches in investment management styles, fees, costs and differing client propositions. Key to the success of the guidance is recognition of the fact that value for money is broader than a simple fees /cost calculation exercise. We recommend against taking a prescriptive approach to the guidance so that the number and type of KiwiSaver schemes available to New Zealanders is not unreasonably or unnecessarily constrained.
Question No. 6	Do you have any examples of any costs or fee levels that you think are unreasonable/reasonable? If so, please provide details.
	Fisher Funds is not able to comment on the reasonableness or otherwise of costs or fee levels of other KiwiSaver providers without conducting an in-depth comparative analysis of their fees, costs, investment management style and value propositions.
Question No. 7	Are there any additional matters that you think the guidance should address? If so, please provide details
	Fisher Funds is of the view that well-reasoned and clearly articulated regulatory guidance operates to the benefit of the industry and contributes in a meaningful way to good client outcomes.

Feedback summary – *if you wish to highlight anything in particular*

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.

Feedback form — Consultation paper: Proposed guidance on KiwiSaver fees and value for money

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date: 10/11/20 Number of pages: 1

Name of submitter: [redacted]

Company or entity: Foresight Financial Planning

Organisation type: AFA

Contact name (if different):

Contact email and phone: [redacted]

Question number	Response
1	Mostly but some K/S providers
	charge a transfer fee or a
	closing fee (such as Booster and
	SuperLife) which needs addressing
2	Transfer and withdrawal fees
	on K/Saver should be abolished.
3	Yes but advisers should
	be allowed to earn a fee for
	providing advice
4	As per question 1 and 2
5	No - I think the FMA should
	impose a capping of K/Saver fees
6	No

Feedback summary – *if you wish to highlight anything in particular*

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.

7 Clients who have KS need advice so it is important that they can have access to AFA's at no cost to them. KS Providers should be encouraged to provide renewal commission from their management fees to provide this

Monday 14 December 2020

Financial Markets Authority

Level 2 1 Grey Street

Wellington

Financial Markets Authority

Level 5 Ernst & Young Building

2 Takutai Square

Britomart

Auckland

By email: consultation@fma.govt.nz

Submission: Proposed guidance on KiwiSaver fees and value for money

This submission on the Financial Markets Authority (FMA) consultation paper, proposed guidance on KiwiSaver fees and value for money, 2 November 2020 (the Paper) is from Generate Investment Management Limited (Generate), the manager of the Generate KiwiSaver Scheme.

The Generate KiwiSaver Scheme has over 93,000 members which is the tenth largest membership. We have provided KiwiSaver advice to over 90,000 New Zealanders since inception.

We welcome the opportunity to provide feedback on KiwiSaver fees in New Zealand and the related overarching statutory duties to ensure that the resulting guidance for managers and supervisors of KiwiSaver schemes is valuable for the industry and fair to customers. Whilst we recognise the key importance of setting KiwiSaver fees that reasonable and fair, we have the following general points to make on this consultation:

- Separating our advice fees will create two classes of members, advised and unadvised. Asking members to pay a higher fee for advice will result in many choosing to be unadvised. The unintended consequence of separating out advice fees will therefore be large numbers of KiwiSaver members go without advice. This goes against the Government's stated objectives of greater access to quality advice and improving the financial literacy and capability of KiwiSaver members.
- Managers should be permitted to wrap advice fees within a flat-fee model, so long as the manager is able to demonstrate that the fees incurred are reasonable for both unadvised and advised members.

- A strong focus on fees including cost cutting, potentially leading to significantly less active management across the industry, does not appear to align with the Government's objectives to develop New Zealand's capital markets.

- There appears to be an over emphasis on investment management costs as a component of fees. KiwiSaver fees cover the operational costs associated with the day-to-day management of member funds, and costs associated with investment management which include, but are not limited to, registry administration, member servicing, and the provision of digital tools for investors.
- With an emphasis on cost inputs, we also encourage balancing considerations to include wider elements of "value for money" in determining whether a fee is unreasonable.
- Whilst we acknowledge the importance of fees being reasonable, it is equally important that the regulatory approach accommodates a range of investment styles to ensure continued choice for investors. Rather than imposing a prescriptive approach to fees, full and transparent disclosure of fees so that members can easily compare those fees across different providers will achieve the objectives of competition in the market and member awareness.
- We acknowledge that there will be a benefit in ensuring that fund managers and supervisors have processes in place to review the fees and determine that they are not unreasonable. However, when considering and determining whether fees might be unreasonable the industry will require more detailed guidance and input from the FMA.

[redacted]

[redacted]

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you. Submissions close on Monday 14 December 2020.

Date: 14 December 2020

Number of pages:

Name of submitter: [redacted]

Company or entity: Generate Investment Management Ltd (Manager of Generate KiwiSaver Scheme)

Organisation type: KiwiSaver provider and fund manager.

Contact email and phone: [redacted]

1. Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable? If not, please outline your reasons.

How fees are calculated, charged, disclosed, and reviewed

It is acknowledged that fees and expenses should be reasonable, accurate and consistent with the governing documents and with information given to members. Full and transparent disclosure of fees so that members can easily compare those fees across different providers will help achieve the objectives of competition in the market and member awareness.

The role of KiwiSaver supervisors includes oversight of managers to ensure they have processes in place to review the fees and determine that they are not unreasonable. One of the factors when considering whether a fee is unreasonable is to assess it against other schemes with comparable investment mandates, and managers offering comparable services. Supervisors are unlikely to have all the specific detail on the comparable schemes or fee components as they do not have the visibility across the whole market. Some aspects may also be commercially sensitive and not made public. We therefore recommend more detailed guidance for supervisors and input from the FMA to better enable these assessments to be undertaken.

In addition, we note that the obligation to not charge an unreasonable fee is a "market services licensee obligation" and any contravention, or likely contravention of such in a material respect is also directly reportable to the FMA by the manager. We encourage the FMA and supervisors to continue to work together and share information, including assessments as part of initial registration of the scheme, when determining when the fees might be unreasonable.

The cost of the services to which the fees relate and whether the fees are reflective of costs

Fees are not the same as costs. Costs will make up an element of a fee determination, however healthy and vigorous competition in the market will assist to keep fees at an appropriate level for members.

A performance fee is a payment made to an investment manager for exceeding a set benchmark or hurdle rate of return. This is opposed to a management fee, which is charged without regard to returns. The above factor may be interpreted to mean that performance fees would not be permitted, as the performance fee is not immediately linked to actual costs. If this is the FMA's intention, we suggest that this be expressly stated or amended accordingly.

There are some areas where performance fees are common, such as private equity. A restriction on performance fees may curb investment in New Zealand private equity by KiwiSaver schemes, which runs contrary to the Government's commitment to investing in New Zealand's early-stage capital markets.

We suggest that the guidance expressly clarifies that the FMA is not seeking to prohibit or restrict any particular type of fee model and stresses the importance of full transparent disclosure of whatever model adopted. We are aware that some managers use performance fee or flat fee structures which are appropriate for the schemes they manage. Performance fees may allow managers to be compensated for additional skills and services, whereas managers who charge a one-stop fee, that then covers supervisor, custodial, regulatory fees, and other fund/scheme expenses. The benefit of this approach is it is easier for members to understand and provides certainty to members. The flat fee model allows the member to transfer the risk of additional costs to the manager, while in some year's fees may be less correlated to the actual costs of the scheme (although not unreasonably so), in other years the manager may well reimburse the scheme for costs incurred out of its own profit. We consider that all fee models should continue to be permitted under the FMA's proposed guidance.

Whether the cost of the services has been reviewed to ensure the scheme is providing value for money, review of the performance of underlying managers to consider whether they are providing value for money and how the fund has performed, with a focus on any underperformance over time

We consider these factors to be quite broadly phrased. We encourage further clarity on what should be considered here. We also note that the focus on performance as a factor by which to assess the reasonableness of fees, may inadvertently lead to riskier behaviours, and the narrowing of investment mandates to exclude growth assets.

Generally, fees are made up of the operational costs associated with the day-to-day management of member funds, such as advice, education, giving customers the right products for the risk profile, compliance and technology costs, supervisory services, as well as costs associated with investment management strategies which link to performance.

We consider that fund performance is a more relevant factor for fund selection than the reasonableness of fees. An element of fees will be reflective of a fund or fund manager's investment strategy and style and the extent to which investments are actively or passively managed and the costs associated with that strategy. In addition, the task of standardising performance is complicated by two key factors, time, and risk. Returns can vary significantly depending on the period used, and the risks undertaken are dependent upon the concentration and type of assets held. A simple analysis of returns without considering these factors may promote misleading conclusions.

Performance depends on the asset class (the type of fund), the time period and investment style. In addition, it is not considered practical to separate the market volatility of the type of assets that a fund invests in from the manager's performance. It is inherent when employing any management style that there could be periods where a fund underperforms compared to the benchmark or other funds.

From a practical perspective, linking fees to performance is backward looking, where as a fee review should be forward looking. We have concerns that linking reasonableness to performance could imply that a manager should refund an amount of fees if a fund has underperformed, for example, due to market factors outside of the manager's control. We also note that where a manager has performed well, it may not be considered appropriate for a manager to implement a fee increase. This results in mangers being unduly penalised by the use of performance as an assessment criterion.

How scheme assets are invested – whether fees reflect the degree of active or passive management employed

We agree that this should be a factor, however, we reiterate that fees are made up of the operational costs associated with the day-to-day management of member funds, and costs associated with investment management and other services provided. We also note that, with the clear emphasis for fees to trend downward, an outcome of the guidance may be that more providers move from active to passive management models as a result. This in turn could negatively impact on market efficiency of the New Zealand capital market and result in market mispricing of assets.

How fees compare to any restricted workplace savings scheme or other KiwiSaver schemes, how particular fees (such as advice fees) compare to other managed investment schemes with such fees and how fees compare to a default KiwiSaver fund with a comparable level of growth assets

Comparing fees to workplace savings and a default KiwiSaver fund with a comparable level of growth assets is not considered to be a reliable basis for comparison. It does not take into consideration the compared schemes' different assets, asset classes within those, the liquidity within the schemes, the management styles, and the fact that often employers pay fees on behalf of employee members of workplace saving schemes. Therefore, we suggest the addition of *investment approach* and *similar service models* to these factors in the final guidance as this would help to clarify that the evaluation is made on schemes which are comparable, taking into consideration the factors mentioned above.

In order to achieve a lower fee for a default fund, a different investment strategy may be employed (such as more passive) compared to a more active fund with a similar level of growth assets that a provider also offers. Default fund fee pricing takes account of factors unique to being a default fund, such as volume acquisition, which can contribute to economies of scale and the reduced need for marketing, and in some cases differing management styles, so its fee pricing is distinguishable on that basis and therefore not a reflective benchmark for the fee pricing of other funds.

We understand this point is aimed at comparing to other New Zealand schemes. However, it is hard to accurately compare to other international schemes (as noted below in relation to the United Kingdom) due to the lack of availability of comparable data and relative size differences.

The structure of the scheme

We encourage further clarification on this factor and what is meant by structure, for example, is it intended to refer to asset structure or business model?

The number of members

We suggest value of scheme assets is a more reliable indicator when looking at passing on economies of scale. A large number of members with low balances will have a higher average service cost to fee ratio per member compared to the same number of members with high balances. In addition, there does need to be a critical mass of members before some operational costs reduce. We also note that with more members comes additional costs such as increasing the capacity of registry systems.

The value of scheme assets and whether the value has increased over time so that benefits of scale are passed on to members

We generally agree with this point, however we note some of the more significant costs may not be scalable, such as the underlying investment management fees charged by third party or international managers and commission, both of which are generally percentage-based fees.

There are a range of ways to provide benefits to members aside from reducing fees. These include, for example, reinvesting the scale benefits into innovating and improving service offerings for members. This can be evidenced by the significant improvements that have been made to offerings when compared to initial KiwiSaver services.

We also note that there may be an assumption that funds under management will continue to grow, however with an aging population it is expected that we will reach a saturation point. At such time, we could reasonably expect to see movement in KiwiSaver members between fund managers, which can lead to a reduction in members for certain schemes. If fund managers are reducing fees to the lower end of profitability, any negative movement in member balances and member numbers risks unduly impacting the managers' ability to maintain a profitable business, thereby potentially impacting the stability of the New Zealand KiwiSaver market.

The consultation paper referred to the Melville Jessup Weaver report that compares fees between the New Zealand KiwiSaver and United Kingdom (UK) superannuation fund markets, to reinforce the view that the benefits of scale have are not being passed onto KiwiSaver members. We consider that reference to funds in the UK seems inappropriate when the UK is a global financial centre and New Zealand superannuation, in particular KiwiSaver, is in its infancy in comparison.

The proportion of returns eroded by fees

We suggest that this factor be removed. Returns could move materially in times of market volatility and when this occurs the erosion in return is only capturing market volatility which is not directly related to the manager's fee or performance and the question of the value being provided for that fee. Linking fee reasonableness to the level of returns may drive riskier behaviour or encourage managers to move away from investment in volatile assets removing this as an investment option for members' (particularly younger investors) whose risk profile is suited to growth assets.

As noted above in addressing the factor *whether the cost of the services has been reviewed to ensure the scheme is providing value for money*, managing funds comes with fixed costs such as compliance and paying for supervisory services, irrespective of the returns achieved.

Any other costs of the scheme

As noted above, there are a range of costs inherently incurred by providers in running KiwiSaver schemes, that are distinguishable from investment management costs. These include day to day running costs, such as compliance costs which incur both base costs and the costs of responding to regulatory change. There are also risks associated with operating an investment business which result in further costs for a scheme. For example, risk premium required to keep operating, that is if the business is no longer or less profitable, then shareholders can wind up operations and reallocate capital to investments where a higher return can be made.

We note that many KiwiSaver providers will have made significant past investments such as major system improvements, which may not be apparent when looking at current operating costs. The guidance recognises and expects schemes to adopt cost saving practices, technologies, or structures where it is reasonable to do so, however investment is required to put these in place.

Administration services, which are often outsourced, require a material investment to set up an operational foundation of systems, processes, and people to ensure robust and scalable administration services, irrespective of the number of members or level of funds under management. Administration costs increase with scale as membership grows and what is needed to support that growth, and this inevitably links to additional administration costs irrespective of the management fees charged. It is important to acknowledge this so that the goal of reducing fees does not come at the cost of member education, access to advice or digital tools which in turn could serve the interests of members better and lead to better investor outcome over time.

Members' Interests

We note the Paper states managers of KiwiSaver schemes should be reviewing fees with members' best interests as the overarching consideration. We are concerned that the guidance does not expressly reference that managers and supervisors are permitted to make a margin notwithstanding their obligation to act in the members' best interests. Members' best interests are not best served via lowest possible fees, but by a range of factors such as providers' costs of capital and adequate margins all of which ensure stability is maintained during periods of volatility. This is also important to ensure investor confidence in the financial markets, that a range of investment products are available and to encourage new providers to enter the market to increase competition and innovation. We are also concerned that unbalanced guidance could lead to unintended perverse outcomes for members, for example managers stripping valuable diversification out of portfolios, a fundamental principle of investment, because diversification carries a cost and therefore possibly higher fees.

The more detailed aspects of the guidance, such as relating performance with value for money, do raise concerns about unintentionally driving outcomes that are not in a members' best interests. We encourage further consideration of the guidance in this light to ensure that results are beneficial for members and to reduce possible risks, such as providers employing a passive strategy which would reduce variety across the market.

2.	Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable, or inconsistent with the related overarching statutory duties?

Services being provided should be a consideration

A fee that is higher in relation to other funds with a similar investment approach, may not be unreasonable if material additional services were being provided by a scheme manager, for example, additional member communication, digital capability/tools, financial advice, and member education. While the cost of services is a listed consideration, the services being provided are not expressly stated in the list of factors.

3.	Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If not, please outline your reasons.

Separating out advice fees will have negative unintended consequences for members

We suggest that more flexibility is provided within the guidance in relation to advice fees. In particular, managers should be permitted to wrap advice fees within a flat-fee model, so long as the manager is able to demonstrate that the fees incurred are reasonable for both unadvised and advised members.

Separating out advice fees will create two classes of KiwiSaver members, advised and unadvised. Asking members to pay a higher fee for advice will result in many choosing to be unadvised. The unintended consequence of separating out advice fees will therefore be large numbers of KiwiSaver members go without advice. This goes against the Government's stated objectives of greater access to quality advice and improving the financial literacy and capability of KiwiSaver members.

Further, separating out advised and unadvised members means the provider would be unable to give an unadvised member advice at any time during the KiwiSaver lifecycle without charging them an advice fee. This may not be achievable or practical, such as in times of high volatility when advice needs to be delivered in timely fashion, but the member is unwillingly or unable to pay for advice. Perversely, this may create an unreasonable fee for the advised member (if the provider gives advice to an unadvised member without charging an advice fee) and a potential conduct issue for the provider (if they did not give timely advice and that creates a poor outcome for member).

Funds under management increase – fees should reduce to reflect reduction in fixed costs due to economies of scale

As noted above, we generally agree with this point, however we note that some of the more significant costs may not be scalable, such as the underlying investment management fees charged by third party or international managers and commission, both of which are generally percentage-based fees. We note that the fixed costs of schemes would not necessarily reduce relative to the increase in funds under management (FUM). There are also costs incurred as a result of an increase in FUM, for example, the need to improve registry capacity.

A membership fee that erodes a member's low balance is likely inconsistent with the duty to put members best interests first and treat them equitably

Each provider will likely take their own stance depending on their own scale, fee structure and margins. Providers should be able to cover their costs for members with low balances. There is a minimum servicing cost per member, for example to open and maintain a member's account, process transactions such as withdrawal requests, and this does not change in accordance with the balance amount.

4.	Are you aware of any other examples of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If so, please provide details.

We are not aware of any other examples of unreasonable KiwiSaver fees.

5.	Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money? Please outline the reasons for your answer.

Whilst this is generally understood in the market, it is helpful as it lays out all the different pieces of legislation and then weaves in FMA expectations on conduct to make their position clear.

6.	Do you have any examples of any costs or fee levels that you think are unreasonable/reasonable? If so, please provide details.

We do not believe it would be appropriate for FMA to state specific fee levels as unreasonable in the Guidance.

7.	Are there any additional matters that you think the guidance should address? If so, please provide details.

Having guidance that mandates fee level and fee structures may discourage new competitors. It may also stifle creativity and variety in member offerings. We note the consultation paper states, "*in the event that fees are unreasonable we expect managers and supervisors to take action to ensure compliance, including reducing fees and refunding members who have been overcharged*". This wording may discourage providers from reducing their fees as it may look like an admission that their fees were unreasonable. Scheme providers should be able to reduce their fees without having to worry about subsequent compensation, and the way this is drafted may have the opposite effect of not encouraging providers to reduce fees.

We note the consultation paper states, "*If any scheme changes require updates to the Statement of Investment Policy and Objectives (SIPO) or other governing documents and such changes impact costs, then fees should be reviewed at the same time*". We would like to highlight that not all changes result in a reduction in cost. We suggest the paragraph is updated to note this applies to changes that result in a material cost reduction.

It is important that we have a stable financial services industry which can maintain longstanding financial services organisations able to offer differentiated services to members. KiwiSaver providers who are profitable are more likely to be stable. Ability to meet all costs, for example relating to addressing risks, insurance, remediation, cost of capital and compliance should also be considered as reasonable components that make up the fee structure.

Feedback summary

We suggest that more flexibility is provided within the guidance in relation to advice fees. Managers should be permitted to wrap advice fees within a flat-fee model, so long as the manager is able to demonstrate that the fees incurred are reasonable for both unadvised and advised members.

Separating out advice fees will create two classes of KiwiSaver members, advised and unadvised. Asking members to pay a higher fee for advice will result in many choosing to be unadvised. The unintended consequence of separating out advice fees will therefore be large numbers of KiwiSaver members go without advice. This goes against the Government's stated objectives of greater access to quality advice and improving the financial literacy and capability of KiwiSaver members.

Feedback form — Consultation paper: Proposed guidance on KiwiSaver fees and value for money

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date: December 2020 Number of pages: 6

Name of submitter: [redacted]

Company or entity: Implemented Investment Solutions Limited

Organisation type: MIS. Issuer and manager of the InvestNow KiwiSaver Scheme

Contact name (if different): n/a

Contact email and phone: [redacted]

Question Number and Response

1. Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable? If not, please outline your reasons.

We think to date the FMA's approach to assessing KiwiSaver scheme fee reasonableness has been pragmatic and appropriate. Our concern is this consultation paper indicates the FMA intends taking a considerably more aggressive approach with an objective of driving down KiwiSaver scheme fees.

Our preference is that normal market factors shape and drive fees. We think that as the KiwiSaver market grows investors will naturally benefit from lower fees, better service, and enhanced product offerings. This in part is a function of the unique characteristics of the KiwiSaver landscape, where an individual can only be a member of one KiwiSaver scheme at a time. As KiwiSaver balances grow, we will naturally see increased competition to attract and retain members. Against this backdrop fees will naturally fall.

Factors we think that the FMA needs to consider relating to fees include:

- The possible implications of fees being driven down by FMA intervention rather than market forces. For example, we could end up with a small number of providers and therefore limited investor choice. Innovation could be stifled as new entrants will struggle to compete or even enter the market. Remaining large players may opt for cheaper and potentially lower quality offers. The FMA needs to give careful consideration to the policy implications of market intervention.

- Whether in fact fees should reduce as funds under management increase.

  Consideration needs to be given to what is a reasonable risk adjusted return for the manager/issuer (i.e. profit) on capital employed. There are considerable costs and risks associated with entering the KiwiSaver market. As a new entrant to this market we are keenly aware of this, and expect to be rewarded financially (and considerably) if we grow our KiwiSaver scheme. While we agree fees should always be reasonable, we believe the FMA is taking an aggressive stance by effectively mandating that managers reduce their fees as funds under management increase.

Also note if very large KiwiSaver schemes (like ANZ) took this approach, smaller players (like us) could simply not compete . This would effectively be monopolistic behaviour by large market participants.

While we believe the FMA should continue to review fee appropriateness, we don't think this extends to proactively driving fees down across the industry.

It is important note a large number of KiwiSaver schemes have existed for a long time without obtaining significant scale/profitability. This highlights the market segment's risks and challenges.

- While the InvestNow KiwiSaver Scheme does not have annual/monthly fund administration fees, we think these are appropriate for the KiwiSaver market, especially where members have small balances.

  This reflects high fixed costs of setting up and managing a KiwiSaver investor account. Costs include: AML and onboarding costs; registry costs; reporting costs; as well as fixed costs of providing client support (like call centres etc.). We think fixed administration fees are appropriate in the KiwiSaver market.

- We think that the FMA's position on advice fees is reasonable – being that investors who are not receiving advice should not inadvertently be paying for it by virtue of this being embedded into a KiwiSaver scheme's fees.

- We believe having buy/sell spreads (and other mechanisms like swing prices) is good practice, and agree with the FMA's comments regarding reviewing these regularly.

  We strongly believe the FMA needs to focus on inequities stemming from <u>not</u> having spreads. Where managers do not have spreads they should have to quantify the drag on long term fund performance.

  We do not understand the FMA's reluctance to take the position that it is poor practice to not have spreads.

Other factors we think are important to consider include:

- The ever-growing compliance costs of operating a KiwiSaver scheme.

- Whether a comparison to KiwiSaver default funds is relevant. The current review of KiwiSaver default providers puts a significant weighting on fees (or having low fees), with a risk being that managers will lower their fees to unsustainable levels to try and obtain or retain default status. We think this will result in a large number of default providers having homogeneous funds with large index fund exposures.

- Whether a comparison with work place superannuation schemes is relevant. Workplace superannuation schemes tend to only recover direct investment costs. In addition, workplace superannuation schemes would not "pass-the-muster" in terms of becoming licenced MIS managers.

- Whether a comparison with the UK market is relevant, given the substantial difference in the scale of the two markets. We note that the reference to the UK only relates to passive funds.

- There is a significant potential benefit from KiwiSaver schemes investing in sectors like infrastructure and private capital in the future. These sectors naturally have high costs and fees. The FMA needs to be careful that its focus on driving down fees doesn't limit the investment opportunities available to KiwiSaver investors.

2. Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable, or inconsistent with the related overarching statutory duties?

In addition to the factors the FMA has identified as being relevant to the assessment of whether KiwiSaver fees are reasonable, IIS thinks consideration should be given to:

- Determining how a fund without a spread (or similar mechanisms like swing pricing) can meet the requirements of s 143 (1)(b)(ii) of the FMC Act. This reflects that tools like spreads, and swing pricing, exist to ensure that scheme participants are treated equitably.

  We cannot understand how funds without mechanisms like spreads or swing pricing achieve this outcome. However, until the FMA provides guidance stating that not having these sorts of mechanisms is poor practice, we do not think they will become commonplace. This reflects that on the face of it, funds without this type of mechanism appear (falsely) to be lower cost to consumers. Obviously, not having a mechanism like a spread simply hides these costs, and creates inequities between fund investors .

- Where a KiwiSaver scheme (or any PIE fund) invests in global shares through offshore funds, like Vanguard's Australian unit trusts, then Kiwi investors (including KiwiSaver members) are unable to get a tax credit for the non-resident withholding tax deducted from dividends. We estimate the current tax leakage associated with this to be approximately 0.30% per annum for someone investing in global shares. In contrast, where a NZ PIE fund holds global shares directly, investors obtain an offset for this tax.

  IIS strongly believes this type of tax leakage should be disclosed, just like any fee or cost within a fund. We think some KiwiSaver providers pay low fees to the operators of Australian funds (and other offshore vehicles), but don't correctly disclose the true cost of doing this to their end investors.

- Consideration needs to be given as to whether fees are tax deductible for participants. Where KiwiSaver schemes invest in global shares through offshore funds, members don't get a tax deduction for fees or costs embedded in the offshore fund. This is a function of how FDR tax calculation works. Managers should have to disclose if fees are not tax deductible as this makes a material difference to investor cost.

- Tax is a significant cost to scheme participants. The FMA should engage with the New Zealand Government to ensure tax collected within funds is reasonable. In particular, we believe that there is a strong argument for reducing the FDR rate from 5% to 3%.

We think poor disclosure of the items above makes it difficult for investors to compare fund costs. This is a bigger issue for the FMA to focus on for the here and now. For example, on the face of it a KiwiSaver scheme could appear extremely compelling if you only looked at the headline management fees. However, when you take into account the tax drag relating to investing through funds like Vanguard's Australian unit trusts (for global and Australian shares), as well as the impact of not having buy/sell spreads, the true costs to investors would be significantly higher than what is being disclosed.

3. Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If not, please outline your reasons.

As outlined earlier, we do not think fees should necessarily fall as funds under management increase. We believe there is considerable risk and effort associated with setting up and growing a KiwiSaver scheme, and the reward associated with this should flow to the manager. The manager should be free to determine whether they want to pass any of this benefit back to investors (rather than this being driven by the FMA). We believe fees should largely be driven by market forces rather than government intervention.

We think it is reasonable to expect that if a fund moves from active to passive management there is a change in fees. Key within this though is that the manager clearly explains in their disclosure material how any fund is being managed.

4. Are you aware of any other examples of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If so, please provide details.

We believe not having buy/sell spreads (or other mechanisms like swing prices) is "unreasonable". This results in hidden investor costs and potential inequity.

Also, as outlined earlier, we believe not disclosing factors like tax leakage due to inefficient product structuring should be considered "unreasonable". Again this results in hidden costs.

We also think not disclosing whether fees are tax deductible is "unreasonable".

5. Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money? Please outline the reasons for your answer.

We think that any guidance the FMA provides is helpful for managers and supervisors.

6. Do you have any examples of any costs or fee levels that you think are unreasonable/reasonable? If so, please provide details.

See our earlier responses about spreads, tax leakage, and non-tax deductibility of fees.

7. Are there any additional matters that you think the guidance should address? If so, please provide details.

As stated earlier, we think that the FMA should consider its position on spreads. We believe it is poor practice to not have spreads (or a similar mechanism like swing pricing).

Note our comments throughout this feedback regarding disclosure of tax leakage.

We also highlight our point regarding KiwiSaver schemes investing in sectors like private capital and infrastructure. We think the FMA's focus on driving fees down will stop schemes investing in these sectors in future.

Feedback summary – if you wish to highlight anything in particular

In summary:

- The FMA's approach to ensuring fees are reasonable has been suitable to date. Going forward, we do not think that the FMA's focus should be on proactively trying to drive fees down. Market forces should ultimately drive pricing in this market segment.

  Consideration needs to be given to what is a reasonable risk adjusted return for the manager/issuer (i.e. profit) on capital employed. There are considerable costs and risks associated with entering the KiwiSaver market. As a new entrant to this market we are keenly aware of this, and expect to be rewarded financially (and considerably) if we grow our KiwiSaver scheme. While we agree the fees should always be reasonable, we believe that the FMA is taking an aggressive stance by effectively mandating that managers should reduce their fees as funds under management increase.

- The nature of the KiwiSaver market means member administration fees are in fact suitable for this type of product.

- We think it is good practice to have spreads. Not having spreads can lead to inequity between investors in a fund, as well as hidden costs. We think that the FMA should adopt this stance and say not having spreads is poor practice.

- There should be greater focus on all costs including tax slippage. It is ridiculous we have managers championing their "low" fees, while using low-cost tax-inefficient Australian unit trusts to get exposure to global and Australian shares. The true costs of using these vehicles need to be disclosed to investors.

- We think that the FMA's position on advice fees is reasonable – being that investors who are not receiving advice should not inadvertently be paying for it by virtue of this being embedded into a KiwiSaver scheme's fees.

- The FMA should lobby the Government to get the FDR tax rate reduced, reflecting the significant drag this has on investor returns.

- Consideration needs to be given to the possible implications of fees being driven down by FMA intervention rather than market forces. For example, we could end up with a small number of providers and therefore limited investor choice. Innovation could be stifled as

new entrants will struggle to compete or even enter the market. Remaining large players may opt for cheaper and potentially lower quality offers. The FMA needs to give careful consideration to the policy implications of market intervention.
Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.
Thank you for your feedback – we appreciate your time and input.

Feedback form — Consultation paper: Proposed guidance on KiwiSaver fees and value for money

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date: 16 November 2020 Number of pages: 1

Name of submitter: [redacted]

Company or entity: n/a (private)

Organisation type: n/a

Contact name (if different):

Contact email and phone: [redacted]

Question number	Response
1.	Broadly yes, however the "matters" to be considered in assessing whether the scheme is providing value for money need some work. In particular, I make the following comments: (a) "The cost of the services to which the fees relate and whether the fees are reflective of those costs" – I suggest this be changed to "The cost **to the provider** of the services to which the fees relate and whether the fees are reflective of those costs. (b) "Whether the cost of the services has been reviewed to ensure the scheme is providing value for money" – This appears circular and should be reworded. (c) "Review of the performance of underlying managers to consider whether they are providing value for money" – Past performance is no predictor of future results (see Kahn, R. N. and Rudd, A (1995) *Does Historical Performance Predict Future Performance?* and similar articles). The reasonableness of Kiwisaver fees really comes down to (i) the types of assets the fund offers (including the level of diversification) and (ii) the amount charged for providing access to those assets. Those two things aside, the actual return of any fund is then due largely to luck. For instance, if the Vanguard Total Stock Market Index Fund were to be down while other funds were up, that would say nothing about how good an investment VTSAX is or whether its fees were reasonable. An analogy can be drawn to the game of poker: if a good player loses a hand, they may still have played the hand exactly as they should have done – ie they may have had an 80% chance of winning, but simply have gotten unlucky. There will be a number of funds that are outperforming the market and others that are underperforming the market purely as a matter of chance. While there will almost certainly be a correlation between funds with high (ie unfair) fees and those that underperform the market, it is dangerous to use past returns to assess value for money because the two concepts are so detached. (d) "The value of scheme assets and whether the value has increased over time so that benefits of scale are passed on to members" – I would separate this out to: "The value of scheme assets" and "If the value of scheme assets has increased significantly over time, whether the benefits of scale are being passed on to members" (e) Significant statistical anomalies will be the easiest way to determine whether a fee is reasonable – ie plotting level of active management against fee, and looking for outliers. Perhaps there should be a factor which takes this into account.
2.	No.
3.	Yes.
4.	Level of diversification is also relevant.
5.	Generally yes, but only if changes are made as outlined as 1.
6.	No.
7.	No

Feedback summary – *if you wish to highlight anything in particular*

No.

KASPANZ INCORPORATED: KIWI SAVER ANNUITIES, NEW ZEALAND SUPERANNUATION PROTECTION SOCIETY

Since our inception in 2013, we have drawn attention to what we have called "the golden mile" of excessive fees for Kiwi Saver management fund schemes, suggested from the outset that active funds fees should be no more than

0 .50-1.0%a and passive range 05-0.50%.

Over the last few years, we have seen increasing interest and reflection on fees, including from the FMA, and we applaud this focus. As a voluntary consumer group our resources are limited, indeed like most New Zealand individuals we feel powerless to change the excess fee's regimes. We support and applaud comparative analysis e.g. UK/Aussie markets, NZ should mirror or beat such markets.

Our concern is "*what can be done about it".* Education, Government comment and legislation, the Retirement Commission (Commission for Financial Capability) playing a role along with other industry groups, and we would like to see more academic research within NZ universities, focusing on the issue.

We strongly support your comments below

> **Examples of when we expect fees to decrease** • *Funds under management increase – fees should reduce to reflect reduction in fixed costs due to economies of scale* • *Moving from active to passive investment management* • *Fund input costs have fallen due to a decrease in third-party fund manager fees* • *Scheme amalgamations where economies of scale are an end result.*

Published fee scales annually in a reader friendly form would be helpful.

Individual member reports stating management fees are also helpful, any fee associated with the scheme involved must be shown in total costs (recent improvements noted, but continuing improvement and refinement required) with the Authority closely monitoring this area, we suggest you adopt the Kiss principal.

[redacted]

[redacted]

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date: Number of pages:

Name of submitter: [redacted]

Company or entity: Kernel Wealth Limited

Organisation type: MIS Manager

Contact name (if different):

Contact email and phone: [redacted]

Question number	Response
1	*We agree broadly with the factors identified. The challenge is balancing unreasonable profitability with that of the level of service and education required. Smaller/New providers would become untenable if fees are seen as the predominant factor. Membership fees for no real service offering, and trails and commission not aligned to the review/oversight/advice provided are a misalignment of incentives. Fees certainly do matter, but are not the only factor as we have seen inappropriate risk profile, range of investment options and poor quality systems and processes affect the members experience and outcome. Providers in our experienced opinion should have a larger obligation to communicate, educate and interact with customers to improve the customer outcomes. Providers who are reactive rather than proactive with their explanations and support during March this year, we feel saw larger derisking and switching than those would were proactive. This would have a much greater impact reducing fees by 01.% or 0.2% per annum.* *Further to this, we especially agree with the consultation statements around fees and commission. It is a significant problem that financial advice is delivered in New Zealand as an inside service (i.e. paid by the provider) as a trail, commission or rebate. This misalignment of incentives, comes under particular stress during time of market stress. We feel while fee for service is more appropriate, our mortgage and investment advice practices lead to an expectation that the customer doesn't pay. Therefore a disclosure of the fee based to an adviser should be a minimum and that this should be outside the quoted fund management fee and we would like to see the FMA go further in this area.* *Finally we agree that in most circumstances, spreads are used as scaremongering and that swing pricing is a more appropriate technique for institutional trades, or for retail customers as a disincentive to excessive switching or excessive investment strategy changes*
2	*The size of the scheme is a relevant factor unless the FMA wishes to force consolidation and wrap platform like consolidation for those outside the top 10.* *There needs to be a consideration of quality rather than just price. We are concerned that price may be seen as an indication of quality, and that the member experience, services provided, and surveyed satisfaction should be considered rather than the current assumption that the only differentiating aspect is whether the fund manager needs to pay analysts and investment managers for their attempts to obtain above-market returns.*
3	*The argument that member fees erode value for investors is not aligned with the stance that fair fees deliver better customer outcomes. While member fees have a greater proportional impact on small investment balances, these balances are by in large rising at a material rate and subsequently member fees become increasingly immaterial to the investor outcome. At the same time, member fees do not tend to increase over time. We are supportive of member fees if it results in lower variable fees, which has a greater impact on investor returns, thereby seeing investment fees get closer to a fixed fee per member model.*

Feedback summary – *if you wish to highlight anything in particular*

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date: 16 December 2020 Number of pages: 5

Name of submitter: [redacted]

Company or entity: Kiwi Wealth Investments Limited Partnership

Organisation type: Limited Partnership

Contact name (if different):

Contact email and phone: [redacted]

Question number	Response
Question 1 - Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable? If not, please outline your reasons.	We do not believe that government intervention is required to regulate fees in the KiwiSaver market. We agree that providers should not charge unreasonable fees for their products. However, we do not agree that the fact that average KiwiSaver fees have not dropped as FUM has increased is a sign that fees are unreasonable. Further, we believe that fees in New Zealand are low by global standards. The KiwiSaver market currently has more than 30 participants and new ones are added with reasonable regularity (by way of comparison, that is more than the total number of registered banks, and more than three times the number of national retail banks in New Zealand). Those providers offer a range of different products, with a range of different features, at a range of different price points. That is evidence of a properly-functioning market. No member is locked into a single provider's products, and the ability to switch between providers is enshrined in law (and has recently been streamlined through legislative change). We do not believe that the MJW report cited in the consultation document tells the full story. In particular, we note that the MJW report does not appear to assess the level of fees by reference to the size of balances – it does so based on total FUM. Our view is that this gives a misleading picture. FUM is certainly a measure of size, but a more important measure when it comes to the level of fees is average balance. Put simply, the cost profile of a scheme with 100,000 members with balances of $10,000 is very different to one with 10,000 members with balances of $100,000, despite each scheme having the same FUM. Our own analysis of comparable jurisdictions places New Zealand at the lower end of the fee range by reference to balance size. In particular, New Zealand is cheaper than Australia, which, given the closeness of the two countries, is the best point of comparison in our view. KiwiSaver is a relatively low balance retirement savings scheme and the average member may not spend long inside KiwiSaver with a large balance on which fees comparable with other countries are charged in dollar terms. The average balance of approximately $20,000 is low by comparison to the comparable jurisdictions we have analysed (certainly much lower than Australia, where the average balance is $107,000). Further, KiwiSaver is

	structurally designed to largely stay that way. The first home withdrawal facility allows members to withdraw almost all their balance. Given that the average age to purchase a first home is in the mid-30s, while members might have built up sizeable balances to that point, they will essentially start from scratch again. Accordingly, a member earning the median salary in New Zealand may well be in their 40s before they have the average KiwiSaver balance again. This results in balances that are low by global standards. According to Sorted's retirement calculator, a person on the median wage will not have a balance equivalent to the Australian average until they are in their 50s. Ultimately, the KiwiSaver industry generally operates through higher balance members subsidising lower balance ones, in a similar way to the tax system. Members should have periods of being in both camps – where they are subsidised by other members, and where it is them doing the subsidising. We consider that this results in an overall fairer outcome for all KiwiSaver members generally (albeit not necessarily for any given individual member – again, not unlike the tax system). Turning to the specific factors identified in the consultation, we consider that there is too great a focus on performance as the measure of value in KiwiSaver fees. We are also concerned that default funds are being used as the benchmark for fees, and that there is a perception that additional FUM comes at zero (or close to it) marginal cost to the provider. Measuring value by reference to performance without taking into account risk only works if there has been an opportunity to properly test performance in both bull and bear markets. We agree that performance is a measure of value, but it is far from the only measure. We also think it is a potentially dangerous measure to give outsized weight to (particularly in the context of the extended bull market over the last decade). The amount of money invested in term deposits in New Zealand, along with the panic switching behaviour that many KiwiSaver members displayed during the Covid market crash show that a very large number of New Zealanders are risk averse when it comes to investments. In those circumstances, protection of capital is likely to be of fundamental importance. As a general rule, outsized returns in bull markets result in outsized losses in bear markets. This is because the risk assets held that enable high returns in good times also generally suffer the greatest losses in bad times. Portfolios designed to weather downturns are more likely to produce average, but not outsized, returns in bull markets. However, the capital protection focus is certainly valuable to risk averse investors in a downturn. We suspect that if markets had not re-bounded in the second half of 2020 as they have, the perception of value from a performance perspective could be quite different. To illustrate this point, two KiwiSaver providers who have actively promoted their 'market-leading' performance figures in the past were among the worst performing funds in March and April this year. We also think that default funds are a poor measure of what true value is in the KiwiSaver market. The default provider RFP closing this week requires respondents to offer their lowest possible price for default funds. Many of those respondents may well treat default status as a loss-leader in order to be guaranteed a large number of new members. From a fees perspective, a fund that has artificially low fees, risks setting a market expectation of fees in other funds that simply may not be sustainable. As noted above, New Zealand is not expensive on a global level if you look at comparable data.

	The principle of economies of scale suggests that each additional dollar of FUM comes at zero (or near zero) marginal cost, but that does not reflect how FUM is acquired. While it is true that the marginal cost of additional FUM for any individual member has a lower marginal cost (although certainly not zero, because additional FUM will incur additional charges like statutory supervisor fees, registry and fund administration charges and possibly underlying fund manager costs), the cost of FUM from new members (whether new to KiwiSaver entirely, or acquired from another provider) does not. Those members all require onboarding, which requires account set-up, AML checks and welcome correspondence. All of that comes at a cost. In addition, anyone other than a default member is also likely to have been acquired through advertising spend. The totality of those costs can be quite significant, and many members may be unprofitable until their balance reaches a certain level. As noted above, due to the nature of the first home withdrawal facility, many members will revert to being unprofitable for a period after their balance has increased. As a scheme grows, providers need to employ, inter alia, more people in areas like customer services, compliance, operations and IT. With more people comes the need for more office space and more equipment to enable staff to do their jobs. Accordingly, a growing membership necessarily increases the cost base of a provider. Further, the costs of any business increase year on year with inflation (including salary increases). Because there are statutory and commercial barriers to raising fees, and regulator pressure to reduce fees, providers face expectations to reduce fees while their costs increase. A provider's FUM can fluctuate wildly in a way that is not easy to predict. For example, during March and April, providers would have seen their FUM drop dramatically. Had that continued, providers could have faced a lengthy period with reduced revenue but many fixed costs. While revenue generated by fund managers might be increasing, these business also have a high cost base – in addition to the factors we have already mentioned, providers are required to pay levies to the FMA, and statutory supervisor fees. There are also other costs such as those paid to underlying fund managers and providers of administration and registry services. As we say above, most of those fees are charged on a percentage of FUM basis, so the costs of providers also increase when FUM does. Finally, we agree that it is important for providers to understand the nature of their profitability, for example so that they can establish when a member becomes profitable, and whether the profits they are making are reasonable. As such it makes sense that providers should be able to make a reasonable profit (but not super-profits).
Question 2 - Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable, or inconsistent with the related overarching statutory duties?	Please see our answer to question 1 for our thoughts on how to determine reasonableness.
Question 3 -Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If not, please outline your reasons.	We disagree that economies of scale are as significant as the FMA contends. As we set out in our response to question 1, simply increasing FUM does not mean that the additional fees charged come at zero marginal cost. Our view is that, until KiwiSaver becomes a high-balance retirement savings scheme, it will be difficult for the industry to reduce fees significantly. However, we do agree that moving from active to passive management is a reason for fees to decrease. In this regard, we note the MyFiduciary report that comments that some passive managers in the New Zealand market charge high fees for their service.

Question 4 - Are you aware of any other examples of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If so, please provide details.	It is ultimately for the market to determine whose fees are reasonable and whose aren't. That said, for those members who are defaulted in we believe it is appropriate that there is regulatory input into the fees as the market is not at play and it makes sense for the regulator to negotiate on behalf of these members. However, the default provider RFP ingrains an unsustainable approach to fees if it is used to baseline fees in other funds or investment approaches. Providers can choose to engage in the default process, or not, and the nature of that relationship is understood when bidding. We do note that the RFP says that providers are not allowed to charge any individual fees to members (including anti-dilution levies), and that any buy/sell spreads should be included in the unit price of the fund. However, this creates an unfair situation where all members pay for the transactions of those who deposit or withdraw funds. We believe that if systems are in place to more fairly pass on these costs it should be encouraged as being in the best interests of all members. As the FMA points out in its FAQs on spreads, a buy/sell spread or anti-dilution levy works by charging the transacting members so that they pay the costs that the fund incurs on their behalf. However, by the RFP requiring spreads to be included in the unit price (rather than added to it), all members will end up paying the spread and it will cease to be an anti-dilution mechanism at all. A fee charged to all investors to cover the transaction costs of specific, and identifiable, members is, in our view, not the best customer outcome. We also note that there is inconsistency around how the tax position of different funds is disclosed. For example, certain investments in Australian unit trusts are subject to tax leakage that can be quite considerable. This tax inefficiency is a drain on performance, but is not disclosed in the same way that fees are. As such, a provider who has lower fees but less tax optimization than another provider might be able to promote their low fees as a performance enhancement without telling the full story that there are other, hidden, costs that detract from performance. We would welcome the opportunity to discuss this with the FMA.
Question 5 - Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money? Please outline the reasons for your answer.	We think that the guidance makes the position around fees more confusing. We also disagree that the guidance is necessary at all. However, it should focus all providers on how much each member actually costs them.
Question 6 - Do you have any examples of any costs or fee levels that you think are unreasonable/reasonable? If so, please provide details.	It is ultimately for the market to determine what is reasonable and what isn't, aside from in the instance of Default members as outlined in our response to Question 4.
Question 7 - Are there any additional matters that you think the guidance should address? If so, please provide details.	We would observe that higher fees do not necessarily equate to unreasonableness. Just because one thing is more expensive than another, comparable, thing does not mean that it is overpriced, or does not provide value for money. Value is in the eye of the consumer (in the absence of illegal price fixing behaviour). By way of example (and without intending to imply that KiwiSaver is a luxury brand), the entire luxury goods industry relies on the fact that consumers are willing to pay more for a product that serves the same fundamental purpose as a cheaper alternative. Put simply, Toyota wouldn't bother with selling its Lexus brand if it thought that people just wanted a car with four wheels and an engine. Tesla sells electric cars that are far from the only, or the cheapest, in the market, but it has become one of the most valuable companies in the world (possibly making a number of KiwiSaver members a lot of money along the way). It is clear that, for whatever reason, people are willing to pay more for some products than they are for other, similar ones. Their reasons for doing that are personal and the market will

	ultimately punish manufacturers who produce products that nobody considers are value for money. KiwiSaver providers provide significant other services beyond simply managing KiwiSaver balances. Many providers provide financial advice and retirement planning tools. Others have enabled wealth management to be more accessible through digitizing the investment process. Still others have opened up other investment opportunities (for example, Hatch, Investnow and Sharesies are all either at least part owned by, or affiliated with, KiwiSaver providers). These are all valuable, and these services and innovations should also be factored into whether what KiwiSaver providers are charging is reasonable. On that basis, we do not think this guidance is required. There are statutory prohibitions on charging unreasonable fees in KiwiSaver schemes, and the FMA can enforce those. However, as we say above, in the context of a competitive industry like KiwiSaver, the market will eliminate unreasonable fees long before the FMA will. Finally, in relation to the comment on page 5 of the consultation document that the guidance applies to other managed investment products - we agree that fees in other managed investment products (and other financial services) should not be unreasonable, however we disagree that there is a reliable *statutory* basis to extend the guidance outside KiwiSaver, notwithstanding the duties to act in the best interests of members. There is a specific legislative prohibition on unreasonable fees inside KiwiSaver schemes that does not appear anywhere for other managed investment schemes. If a *statutory* prohibition on unreasonable fees is a natural consequence of the duty to act in the best interests of members, parliament would not have thought it necessary to retain the prohibition on unreasonable fees in the KiwiSaver Act (or would have included an equivalent requirement in the FMC Act). As such, our view is that an amendment to the FMC Act would be necessary to enforce a 'not unreasonable fees' test for all MIPs.
Feedback summary – *if you wish to highlight anything in particular*	
Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.	
Thank you for your feedback – we appreciate your time and input.	

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date: Number of pages:

Name of submitter: [redacted]

Company or entity: Lifetime

Organisation type: Financial Service Company

Contact name (if different): [redacted]

Contact email and phone: [redacted]

Question number	Response
	Since KiwiSaver started I have given advice and ongoing service to new members to the plan and changed no fee. The hours of work done to help these people was essentially done for no cost to them up front with the knowledge that over time the trail commission would reimburse me for the time advice given and cover ongoing review and service costs. *This has saved these members a lot of money and this needs to recognized in the ongoing trail commission that we are receiving.* *The paper does not take this into account*

Feedback summary – *if you wish to highlight anything in particular*

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date: 14 December 2020 Number of pages: 4

Name of submitter: [redacted]

Company or entity: Mercer (N.Z.) Limited

Organisation type: Managed fund provider

Contact name (if different):

Contact email and phone: [redacted] [redacted]

Question number	Response
Q1. Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable? If not, please outline your reasons.	We are supportive of the FMA providing guidance and we are heartened by the title of this Consultation paper "Proposed guidance on KiwiSaver fees and value for money", we appreciate that the paper has a focus on both value for money in KiwiSaver and reasonable fees. As it relates to our business, the list of factors appear to be relevant and we make the following additional comments: 1. Not all of the factors identified are of equal importance but we agree that a range of factors should be considered when assessing whether KiwiSaver fees are reasonable or not. 2. We agree that it is important that fees and expenses are reasonable, disclosed in a transparent way and reviewed on a regular basis. However, we note that comparing fees between schemes may only be possible for certain schemes to a certain degree (it could be problematic to compare fees for different types of schemes e.g. comparison of a restricted workplace savings schemes to a KiwiSaver scheme). 3. We agree that the cost of services and the level of services should be taken into account when considering whether the scheme is providing value for money. 4. In regard to reviewing the performance of underlying managers to consider whether they are providing value for money. As a manager of managers Mercer reviews underlying fund manager performance regularly. It is therefore likely that an underperforming manager would be removed from a portfolio rather than being retained with a reduced fee. The cost of an underlying manager is more a factor of the funds they are managing than how they are performing. 5. In relation to whether the fees reflect the degree of active or passive management. An additional observation is; what underlying assets classes are included in a portfolio can impact fees as certain underlying asset classes may be more expensive but would be included in a portfolio for the benefits they provide. It would not be desirable to exclude an asset class, simply because it may make a fee higher where it may well still be adding value to the portfolio. This is why the focus on value

	for money is important and the benefits of active management, and other asset allocation calls need to be taken into account. 6. We generally agree with including the factor of 'Benefits of scale', however, we note some of the more significant costs for a scheme may not be scalable, such as underlying investment management fees (which is generally a percentage based fee). 7. We note that there are a range of ways to provide value for money or benefits to members aside from reducing fees. This includes reinvesting the scale benefits into innovating and improving service offerings for members. This can be evidenced by the significant improvements that have been made to offerings when compared to initial KiwiSaver services, such as the provision of tools that assist members to have better customer outcomes e.g. smart phone apps, chat bot, online advice tools etc. It is very important that member education is part of the value proposition. 8. The proportion of returns eroded by fees - Mercer believes this factor could be problematic in certain years due to market volatility. A fee in one year could be reasonable and in a future year seen as unreasonable based on a percentage of a member's balance. We note the comment in the guidance in relation to fees becoming unreasonable <u>over time</u> (page 5). We agree that these factors are not something to be looked at annually in isolation as this could lead to the wrong conclusion. This factor is one of those that needs to be monitored over time. In addition, this factor does not take into account the many fixed fee costs which are paid regardless of returns or performance of the fund. These costs are often not in the control of the Manager (for example, regulatory levies and costs in relation to regulatory changes). In summary, looking at all of the factors together, they are helpful in setting out areas to consider when performing a regular review in relation to the reasonableness of fees.
Q2. Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable, or inconsistent with the related overarching statutory duties?	As noted in our response above, we consider it is important to take into account the services being provided by a Manager. If additional services are being provided by a Manager (for example digital tools and promoting member education) this will be relevant when comparing fees. This is partially noted on page 4 of the Consultation paper under "Value for money" where it states that the product overall should be offering value for money to members but could be added as another relevant factor. Further in support of Q1, paragraph 3, there are other contributing factors that should be taken into account when assessing value for money. For example the provision of financial advice to members. Mercer does not charge members, or prospective members, for financial advice provided by our advice team (as distinct to advice tools, such as a risk profiler or retirement income simulator). Other KiwiSaver providers do not provide this service, and suggest that members seek their own financial advice. Value for money As noted in our submission to MBIE in September 2019 (Review of KiwiSaver default provider arrangements), question 2 *"With regard to value for money we agree with the point made by MBIE (para 26) that value for money suggests a connection between the quality of a product and its price. Value for money is more important than a singular focus on*

	fees and takes into account the totality of fees, quality of offering and the risk and return outcomes for members. Focusing solely on fees may reduce innovation, choice for members and total net return outcomes. It's conceivable that the majority of product offerings would become indistinguishable from each other i.e. predominantly passive products. We believe there is a place for both active and passive management when value is the priority. A focus on fees (in isolation) ahead of value or net member outcomes may compromise the achievement of both criterion 1 and 5. Linked with that we agree with the MBIE view (para 27) that the value for money component of criterion 5 has some overlap with criterion 1. *With regard to innovation, we note that this is an ongoing process and not a one-off exercise. To continually innovate requires continual investment. If there is a disproportionate focus on fees the ability to innovate will be compromised somewhat."*
Q3. Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If not, please outline your reasons.	As noted above in Q 1, paragraph 6, some costs may not be scalable as funds under management increase. One example is the cost of investment management, which is generally charged by underlying managers on a percentage basis fee. . In addition, sometimes extra costs or an increase in costs tend to be absorbed by the Manager as funds under management increase. It is important to note that while there may be an increase in scale, there is an increased compliance cost, extra capacity needed and an increase in cost of regulation. Further, in our submission to MBIE in September 2019 (Review of KiwiSaver default provider arrangements), we noted at question 12: *"We agree with MBIE that there are economies of scale in the provision of KiwiSaver services. The high fixed costs of providing these services include both the costs of initial set-up and the ongoing operation of KiwiSaver products. However, while MBIE notes that these economies of scale have not been passed through in the form of lower fees, there are two studies that suggest this may not necessarily be the case.* • *In a 2015 Treasury paper, Heuser et al find that total fees as a percentage of funds under management for KiwiSaver providers fell from around 2.2% in 2009 to 1.95% in 2014;[1] and* • *A study by Auckland University of Technology economists Gilbert, Scott and Xu find that, from 2013 to 2017 total fees as a percentage of funds under management have fallen for all fund types. For Default Conservative funds in particular, these fees have fallen by nearly 30% over the period 2013 to 2017.[2]* *Furthermore, there are other ways in which scale advantages can be passed through to members, rather than solely through fees. For example, providers may have passed through benefits in the form of:* • *Investment in new services provided to members; one recent example for Mercer KiwiSaver scheme includes a new member website;*

[1] Andreas Heuser, Jack Kwok, Daniel Snethlage and Dillon Watts (2015), "Review of KiwiSaver Fund Manager Market Dynamics and Allocation of Assets", New Zealand Treasury, September.

[2] Aaron Gilbert, Ayesha Scott, and Shuohan Xu (undated), "Economies of Scale: The Case of KiwiSaver Fees", Auckland University of Technology, available at: https://www.nzfc.ac.nz/papers/updated/4.pdf

	• *Active management and increased diversification by asset class, investment manager and style leading to better risk adjusted returns;* • *Offshore securities held in mandate form under NZ custody, enabling pass through of foreign tax credits to members; and* • *Investment into private markets.* *We may also see pass-through of economies of scale in the form of fee rebalancing in ways that are beneficial to members. Examples include Mercer's proposed reduction in the fixed monthly fee and fee exemptions for low balance members and those under 18."*
Q4. Are you aware of any other examples of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If so, please provide details.	We are not aware of any other examples of unreasonable KiwiSaver fees.
Q5. Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money? Please outline the reasons for your answer.	This guidance appears appropriate to achieve the stated objectives and will add further clarification to Managers.
Q6. Do you have any examples of any costs or fee levels that you think are unreasonable/reasonable? If so, please provide details.	We cannot comment on any costs or fee levels that are unreasonable.
Q7. Are there any additional matters that you think the guidance should address? If so, please provide details.	The guidance needs to ensure that innovative solutions are not restricted. In addition, KiwiSaver members need to continue to be able to choose from a variety of providers with different styles and structures. FMCA itself includes among its purposes the enhancement of innovation and flexibility in financial markets. Some structures and styles cost more for the manager to implement. Members are able to easily change scheme or provider, and can do so at any time and as often as they like. We believe it is therefore important that fees and expenses are disclosed in a transparent way so that members can get a full picture of what services are being provided (with an emphasis on value for money not just low fees). Having said that members are easily able to change providers, KiwiSaver is a long term business and Managers want their members to remain in their funds so having a product that offers value for money is important. It would be helpful to add some clarity to the guidance in relation to the regular review process, timing of reviews and what is reasonable in relation to increases and decreases to fees (for example when a new Investment Manager is appointed and there is a cost change). The draft guidance is helpful and we appreciate that it focusses on value for money as well as reasonable fees.

Feedback summary – *if you wish to highlight anything in particular*

In addition to this submission, we refer to and generally support the Financial Services Council of New Zealand Incorporated submission and reiterate its key comments. We appreciate the opportunity to provide input to the Consultation process.

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.

SUMMARY

There are a number of aspects that we would like to hight light before addressing the specific questions

We are very supportive of the principle of not having unreasonable fees and any appropriate challenges to providers on fees so long as that is in the context of overall value for money. Competition is important and any loss of recent new entrants with different business models would be an unwelcomed side-effect of any final guidance.

A/ The Draft Guidance is, in our view, overly focussed on cost inputs. We recommend that the assessment of whether the scheme is providing value for money be broadened and re-shaped to consider the quality and types of services that the manager provides, as well as the costs of those services, with a focus on 'value for money' as opposed to a specific focus on fees.

B/ Competition is a key element in helping keep markets competitive and prices fair. The best approach to enhancing competition is to ensure that there is full and transparent disclosure of fees, that investors can easily compare those fees across different providers, and that there is no barrier to switching KiwiSaver provider.

C/ There are potential pitfalls with an overly prescriptive approach to the unreasonable fees obligation under the KiwiSaver Scheme rules. It is important that the regulatory approach accommodates a range of investment styles to ensure continued choice for investors. A range of investment styles is also essential to the effective functioning of the New Zealand capital markets.

D) Constant referral to fixed costs is factually incorrect. We have raised this before. Costs have significantly increased for providers in the last decade. Significant regulation, compliance, licencing and reporting, technology, insurance, capability and additional headcount as the business grows are just a few examples.

E) Constantly referring to overseas markets and similar sized funds is a false comparison. Scale can only be looked at on an overall manager level, as opposed to any particular fund. Most managers being compared to, have multiples of our total market FUM let alone any one individual firm.

F) How fees compare to default KiwiSaver funds of a similar growth/income split is a false comparison. Those default providers are given client flow for little upfront work. This would significantly reduce your cost base if this was your only business model. Providers that do not want to participate in the default arrangements will need to operate different and more costly business models to attract clients. A non-standard market arrangement will not provide a fair comparison.

G) The consultation paper ignores the critical point that businesses and especially growth businesses invest back into their businesses to improve capability, services, features and foundations. New Zealand scale on an international level is small and by simplistically looking to mature international markets on fees very early on, may not encourage providers to employ the right capability and develop services and standards that are world class. Simply assuming that any additional margin immediately goes to reducing fees will lead to poor services and standards and not allow New Zealand to have wealth managers with world class capability and service.

CONSULTATION QUESTIONS

Q1. Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable? If not, please outline your reasons?

In answering this question, we divide it into two parts.

Part 1 comments on the section 'When fees may be unreasonable' in the Consultation paper as the initial factors identified.

Part 2 comments on the "following matters" identified in the Consultation paper as those factors to consider when a scheme is providing value for money.

Part 1 – 'When fees are unreasonable'

Factor 1: Economies of Scale

At face value this would seem sensible but is not necessarily the case. As FUM grows, managers need to find more diversity and capacity (outgrow local markets) to invest KiwiSaver funds. This includes a wider range of investments globally, including private equity and alternative investments for some providers, which involves either employing offshore expert managers and or adding investment research and analyst capability to existing investment teams. The latter has been Milford's approach.

In addition, the consultation document refers to fixed costs reducing as FUM increases. We have already requested to you in prior submissions what fixed costs are being referred to? However, there is no mention of what these fixed costs might be. There are no fixed costs in managing KiwiSaver funds. As FUM and number of members increases each year, the cost to service and administer members increases in dollar terms as many of the fees charged by outsource providers are charged as a percentage of FUM. In addition, regulation, compliance, licencing costs, technology, insurance, additional resources and increased services have meant costs have increased significantly.

In addition to this, as membership grows managers are also investing in new and additional systems, technology, access to advice and people to service more members. At Milford we have made it a priority to invest in our services to clients – our experience is that as KiwiSaver balances increase, members become more engaged with their investment and want to be able to interact and transact with ease. This is a natural evolution of what we think KiwiSaver members will want and need and by design goes to the heart of providing a good member outcome. All of these services contribute to whether a member is receiving value for money (e.g. client portal, online transactions, smartphone app, digital (online) personalised, goals-based KiwiSaver Advice).

Factor 2: Moving from active to passive investment management

We agree costs should decrease with such a move in investment style.

Factor 3: Fund input costs have fallen due to a decrease in third party manager fees

In theory we agree this should lead to a reduction in fees as those cost reductions should be passed directly through to underlying investors. Although we don't use external managers now, this does imply NZ managers have scale to reduce these third-party manager costs. From our experience that is very limited given the scale of our own market at present.

Factor 4: Scheme amalgamations where economies of scale are an end result

This may lead to reduced fees if economies of scale can be achieved, however we note our comments in Factor 1 above; more funds under management (FUM) does not necessarily lead to a proportionate reduction in costs.

Factor 5: Actual costs may be unreasonable

We work in a commercial environment and contract on an arms-length basis, seeking the best commercial outcome we can achieve and actively seek to find cost-saving practices along with investing in technology to be more efficient and provide a better client experience which may reduce certain costs, but comes itself with “new” costs to maintain, upgrade and enhance. Milford doesn’t pass on costs to investors (e.g. supervisor, registry, administration costs), rather we pay these costs directly. Therefore, we have a commercial incentive to ensure we get value for money from the services we utilise.

Our own experience would suggest that KiwiSaver providers do a good job on behalf of their members to ensure costs incurred in managing and servicing their schemes are not excessive and ensure suppliers are charging fees which are reasonable and reflect a fair cost recovery plus a fair margin as commercial entities. Comparisons to overseas jurisdictions are not helpful given the relative size and maturity considerations.

We note that in certain places the Draft Guidance could be read as implying that costs are the sole criterion for determining whether fees are unreasonable (for example, the statement that “We expect supervisors to be regularly challenging the manager to ensure fees are not unreasonable and are reflective of actual costs”). To avoid confusion in the market, the guidance should make it clear that an assessment as to whether a fee is not unreasonable, is not limited to cost recovery only.

Factor 6: Membership fees

The membership fee is a legacy from the launch of KiwiSaver in New Zealand, when balances were low, and as a percentage of FUM fee might not cover the costs fully. Where KiwiSaver managers have scale, consideration should be given to passing on this scale benefit in the form of a lower member fee. As we have already seen across providers, member fees are coming down. We would expect this to continue as providers grow their membership. Member fees are not a feature of unit trust investment vehicles, where the base management fee covers all costs and a margin. KiwiSaver should and is evolving in the same way.

Factor 7: Buy/sell spreads

It is not a buy/sell spread if the manager benefits in any way; those are entry and exit fees. We agree, spreads should be reflective of the costs of trading and actively reviewed to ensure they continue to result in the fair treatment of members. Care should be taken this is not always positioned as a cost, as to most it is protecting their value. The question should be aimed at those who do not imply a spread, as to how they get comfortable in their approach to protecting existing unit holders, especially in a growing market.

Factor 8: Advice fee and commissions

Financial Advisers provide both advice and servicing support to KiwSaver members. This consultation paper assumes Financial Advisers only provide advice however an Advisers role can often be broader than just providing advice (i.e. administrative changes, client queries, client education). As with all KiwiSaver fees, it is important payments received by advisers are periodically reviewed to ensure they remain reasonable. Whilst the advice and service received by the client will vary from year to year, depending on market and client circumstances, the payment needs to be reasonable in comparison to the service received over the longer term.

<u>Part 2 – “Matters to consider when a scheme is providing value for money”</u>

(i) How fees are calculated, charged, disclosed and reviewed

From a disclosure perspective, we think full and transparent disclosure is the key to enabling informed consumers and allowing the competitive dynamic of the market to operate for the benefit of KiwiSaver members. We believe that existing disclosure requirements mandate an appropriate approach. In contrast, substantive regulation of fee levels may introduce market distortions with negative effects on investor choice and the functioning of a competitive market and the benefits that brings.

(ii) The cost of the services to which the fees relate and whether the fees are reflective of costs

Fees are not the same as costs. Costs will make up an element of fee determination, however ultimately it is competition and the approach to service (e.g. low cost-no frills or alternatively a premium service) that determine if fees are set at the right level. When a firm or group of firms compete successfully, we might expect their profitability to be high, while less successful firms will make less money. This is part of the competitive process.

With the high number of providers, increased presence of boutiques and increasing number of new entrants in recent years with differential offerings, there is good cause to believe competition is strong in the KiwiSaver landscape. The transfer market operates well, which would imply it is easy for members to research various providers and move if they are unhappy with their current provider, based on a number of factors including fees, service and performance.

In addition, given the size of this industry compared with other industries in New Zealand, this is a highly competitive market and one which is evolving from being dominated by just a few major corporates.

(iii) Whether the cost of the services has been reviewed to ensure the scheme is providing value for money

We agree.

(iv) Review of the performance of underlying managers to consider whether they are providing value for money; (v) how the fund has performed, with a focus on any underperformance over time

In our view there is not a direct link between performance and costs.

(vi) How scheme assets are invested – whether fees reflect the degree of active or passive management employed

See our response to 'Factor 2' above.

(vii) How fees compare to any restricted workplace savings scheme or other KiwiSaver schemes; (viii) how particular fees (such as advice fees) compare to other managed investment schemes with such fees; (ix) how fees compare to a default KiwiSaver fund with a comparable level of growth assets

Comparing fees to workplace savings and a default KiwiSaver fund with a comparable level of growth assets is not comparing like-for-like. Different structures have different cost structures.

- Workplace savings schemes typically have multiple participation agreements and dedicated servicing costs.
- Default schemes have a high-volume model with members defaulted to their scheme with less need for marketing spend, amongst a range of other differences. As highlighted earlier, this would significantly reduce your cost base if this was your only business model. Providers that do not want to participate in the default arrangements will need to operate different and more costly business models, including requiring distribution resources necessary to attract clients.

In particular, fees for default funds are set directly by the Instrument of Appointment for the default Scheme and many of the default schemes use either a passive or a hybrid passive/active approach and rely on the volume of members allocated to them to cover their costs. The current Default Provider RFP expressly states that "Fees Proposals are sought that achieve the lowest fees for Default Members and other relevant members." That is only likely to reinforce the passive approach to management of KiwiSaver default funds.

In terms of comparing against other MIS, as with all industries, competitor pricing will always be a factor in determining fee levels, but only one factor amongst many and not one which determines whether KiwiSaver members are receiving value for money. By saying your fees are comparable to another competitor, does not indicate value for money. Comparing what it is that the KiwiSaver member receives for what they pay is a more compelling and valuable way to compare oneself against the marketplace and importantly whether what the client receives is deemed "good value" (e.g. strong performance, a range of services such as mobile app, ease of transacting, regular and innovative reporting/investment insights, people to talk to when markets have a downturn, financial advice, investment and advice tools).

Further to this, comparing funds does not in itself mean you are comparing the same size and scale of an organisation. Cost savings will likely be dependent more on the overall size of an organisation, and any cross-subsidising that may occur from other parts of the business etc. Therefore, a fee comparison of one fund against another is not a comparison of cost structures. Further, the types of cost components in largely hidden services incurred by the KiwiSaver provider (e.g. cyber security) can also vary widely depending in the quality of service obtained by the KiwiSaver provider.

(x) The number of members

The number of members is not a specific key factor in determining "value for money", albeit it does to some extent drive the cost to service model for those KiwiSaver providers who are direct to client models. The consideration on number of members (assuming FUM is growing) is more around investment capacity and being able to achieve the fund objective for scheme members in the face of increasing member numbers. As membership grows you also need to add more resources (people and or technology) to maintain the same service levels.

(xi) The value of scheme assets and whether the value has increased over time so that benefits of scale are passed on to members

See response above to 'Factor 1'.

(xii) The proportion of returns eroded by fees

We think the critical component is the 'net after fee return' to the investor that needs to be considered, rather than the fee itself. Therefore, intrinsically the proportion of fees should already be being considered as this will ultimately determine a fund's net return. In a low return environment such as now this becomes even more relevant and providers are very conscious of this. The percentage of return eroded should be considered over a reasonable timeframe e.g. 10 yrs + rather than any one year to avoid a very strong year or very weak year skewing the result.

(xiii) Any other costs of the scheme

To reiterate, scheme costs go beyond the typical registry, fund accounting, audit, legal, investment management costs. As firms look to innovate more and then resource up/spend on maintaining new tools, systems and client servicing and protecting client data, costs are always evolving (to sit alongside any scale benefits in traditional scheme costs).

Q2. Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable, or inconsistent with the related overarching statutory duties?

We think the FMA's draft guidance is overly focussed on cost inputs and should consider wider elements of "value for money" in determining whether a fee is unreasonable.

We acknowledge that the matters (particularly relating to costs) that the FMA has highlighted as being relevant to an assessment of scheme largely correspond with the matters listed for consideration in Regulation 12 of the KiwiSaver Regulations 2006 (KiwiSaver Regulations). However, as is noted in the Draft Guidance, under Regulation 10 of the KiwiSaver Regulations, FMA may consider any other matter that it considers to be relevant. In our view, the approach to the assessment of whether fees are unreasonable needs to be broadened to consider the quality of the services that the manager provides, as well as the costs of those services.

In our view, the assessment of the quality of a manager's services would include consideration of the following (non-exhaustive) factors:

(a) the quality and robustness of the manager's investment processes and demonstrable track record;

(b) the extent and scope of the research the manager undertakes (proprietary or outsourced), and how it is integrated into the investment process;

(c) the extent to which the manager actively engages with management and boards of the companies in which a fund invests, both to drive improved performance for investors, and to ensure that companies are responding appropriately to the ESG concerns of investors;

(d) the extent to which ESG factors are integrated into decision making processes;

(e) the provision of access to personalised financial advice to help members make the right choices about their investor risk profile, fund choice, contribution rates and planning for the decumulation stage of their KiwiSaver;

(f) investor education and insights which assist them to make good choices and not make poor decisions which could significantly impact the quality of their retirement e.g. switching funds at the wrong time in reaction to a short-term market event; and

(g) digital services via the client portal/app providing easy access to information regarding funds held, unit holdings, transactions, contributions, fund performance, key holdings, and the ability to transact online at the members convenience (24/7).

An approach which recognises quality of services would be consistent with overseas regulatory approached. For example, the FCA recently adopted changes to its Collective Investment Schemes sourcebook (prescribing a requirement for authorised fund managers to annually assess whether payments out of the scheme property are justified in the context of the overall value delivered to investors) which expressly recognise *that an assessment of value should include "the range and quality of the services provided to unitholders"*. Further, it is provided that the assessment of quality of service is not confined to services provided directly to investors*, but may include services* *undertaken on their behalf by the authorised fund manager, such as consideration of the quality of the investment process used to make investment decisions.*[1]

3. Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If not, please outline your reasons.

See our response in 1 above, Factors 1-4.

4. Are you aware of any other examples of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If so, please provide details.

Transfer out fees. A provider should not charge a member to transfer out. There have been examples of this to date.

5. Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money? Please outline the reasons for your answer.

It has the opportunity to, however suggest it be broadened and re-framed to include considerations on the quality and types of services that the manager provides, as well as the costs of those services, with a focus on 'value for money' as opposed to a specific focus on fees.

6. Do you have any examples of any costs or fee levels that you think are unreasonable/reasonable? If so, please provide details.

See above.

7. Are there any additional matters that you think the guidance should address? If so, please provide details.

No further comment

[1] Asset Management Market Study remedies and changes to the handbook – Feedback and final rules to CP17/18, Policy Statement PS18/8, April 2018 https://www.fca.org.uk/publication/policy/ps18-08.pdf

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**	
Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you. **Submissions close on Monday 14 December 2020.**	
Date:14th December 22020 Number of pages: 3 Name of submitter: [redacted] Company or entity: Mint Asset Management Organisation type: Fund Manager Contact name (if different): Contact email and phone [redacted]	
Question number	**Response**
Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable? If not, please outline your reasons	*Mint believes that the current factors that the FMA have identified are important; however, there are some areas that we believe require greater clarity particularly around "value for money" before determining what is not an unreasonable fee. The guidance focuses on "value for money" but this is not a defined term.* *Another key question which is more of a legal one is whether the unreasonable fee is implied into the schemes governing documents.*
Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable, or inconsistent with the related overarching statutory duties?	*If the FMA's focus is on value for money then Mint believes that the guidelines from the Financial Conduct Authority (FCA) on the topic of value could be a very good place to start and one that looks at value on a more holistic level.* *The FCA have identified 7 criteria of which 6 could be used to assist the FMA* *They are:* • *Range of quality of Service* • *Performance net of charges* • *Cost of providing services-* • *Comparable rates for other products* • *Comparable market rates* • *Economies of scale* *We feel that these elements capture most of what the FMA is seeking in their current proposal but incorporates one important factor that needs to be included and that is around performance after fee not the level of fees per se..*
Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If not, please outline your reasons.	*We agree with the examples given in the document under the headings of economies of scale ,actual costs, membership fees, rebadged funds, buy sell spreads etc. Specifically we agree on membership fees (please see response to question 6. We agree on buy/sell spreads and their sole purpose of ensuring equitable participation by unit holders buying, selling or staying in a fund. Specifically we need to be realistic on economies of scale in New Zealand. Comparisons with the UK and Australia are not representative of the still very small ownership of financial assets in NZ compared to savings held in business and property assets. In particular,*

	there is very little to be gleaned by comparing pools of retirement assets in NZ with those held overseas. Margins are much slimmer for the overall sector here because of limited scale. *On advice and trail commissions, Mint would like to see a level playing field so that consumers understand what they are paying for. Globally there is a move to get rid of bundled fees that include part of the AMC being paid to an adviser as trail or an introductory fee. Separate share classes in OEICS for example are being closed which means that even though the investors know they are in a specific share class (in other words it is clearly disclosed) on which an advice fee will be paid , this is not sufficient to meet a value for money test. So at the moment in New Zealand, Managers offer various "work arounds "rebating a bundled trail fee back to client's accounts , paying a trail outside the product or paying distribution incentives.* *So removing these practices without a replacement will drive consumers to the banks and vertically integrated businesses. In our view, we need a solution to access to advice which is clean and simple to understand. An agreed fee for simple product specific advice, which consumers can see value in and for which advisers will actually get paid.* *We believe that the industry is unlikely to self regulate in this area given the variety of business models currently in use. The regulator has a role to play promoting low cost INDEPENDENT advice so that consumers understand that this is the gold standard. As we know from previous discussions, simply banning commissions without a replacement solution will reduce the access to advice even further.*
Are you aware of any other examples of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If so, please provide details.	*In Mints view, it is philosophically inappropriate to have any performance fees with long term locked in pensions/superannuation funds. This approach is consistent with international best practice for work place schemes. It creates misaligned incentives between client and manager in terms of performance timeframes and risk taking.*
Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money? Please outline the reasons for your answer.	*No, we do not think it does. Firstly, there is no statutory duty in relation to value for money. As stated earlier there needs to be a clearer understanding on what the FMA means by value and more importantly how they would look to measure it. For example how would the supervisor be able to ascertain from what is in the draft guidance note if fees are unreasonable? Will they need to peer review other providers to see if the clients fees are appropriate? How will they be able to measure the value of fees based on the current paper? Who will pay for the extra administration to monitor this and collect the data that will assist with this level of monitoring?* *The independent re view by "My Fiduciary" focused on "activeness" relative to fees. This is only one potential measure of a strategy that could be consistent with value for money or more accurately a true to label test.* *In our view, this is narrow and not particularly useful as a measure for consumers of these products to understand or to evaluate value for money.*
Do you have any examples of any costs or fee levels that you think are unreasonable/reasonable? If so, please provide details.	*Regarding fees for advice Mint believes that there should be transparency of that fee, and how that advice is going to be provided to the member.* *We think access to advice is incredibly important but it has to be affordable and paid in a way that is suitable to the member. It's not just the advice they got when they joined but the on-going access to advice in the future that the fee is likely to cover.* *However, regarding KiwiSaver we do not think there needs to be a dollar member fee anymore. This adds complexity and cost to members.*

	NZ still lacks significant scale compared to international counterparts in retirement products. This lack of scale affects custody fees, fund accounting costs and registry fees. The drive to reduce overall fees must include consideration of these costs as well as the AMC. These fees are also charged on an ad valorum basis rather than as a fixed dollar amount, which we believe, is more appropriate.
Are there any additional matters that you think the guidance should address? If so, please provide details.	*Based on the current draft guidance Mint is very concerned that there is little detail on what constitutes value for money and the ability to access quality advice. While we appreciate that this paper relates only to KiwiSaver it is clear that this note will in time cascade to all financial service providers and financial advisers.*
Feedback summary – *if you wish to highlight anything in particular*	
Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.	
Thank you for your feedback – we appreciate your time and input.	

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date:	11/12/2020
Number of pages:	2
Name of submitter:	[redacted]
Company or entity:	New Zealand Air Line Pilots' Association
Organisation type:	Incorporated Society
Contact name (if different):	
Contact email and phone:	[redacted]

Question number	Response
1.	*Yes.*
2.	*From the results of the FMA's independent research (as mentioned in the draft guidance), it has shown the global trend in fees for passive funds is decreasing, and the current KiwiSaver fees are higher than similar funds in UK. Has the FMA reviewed, or is the FMA planning to review, the fee structure of other NZ and/or Australian Investment Funds which are similar in size but are not KiwiSaver (or similar funds) providers? The fees those Investment Funds charge may be a good indicator of the "market price".*
2.	*Also, what is the definition of "unreasonable" used by the FMA in this fee review? When assessing if a fee is "unreasonable", what will the FMA be focusing on? Will it be the "$ value of Fees" or "Net Investment Return"? When the FMA compared the fees that NZ KiwiSaver providers charged with similar Fund managers in UK, has the FMA compared the net investment return of these funds?*
3.	*Yes, in general.*
4.	*When assessing if the KiwiSaver fees are reasonable or not, we believe the assessment should cover both:* *- The trend of fees charged by a KiwiSaver provider year on year* *- Fees charged by different individual KiwiSaver providers in the same year/period* *1. While assessing the trend of fees charged, it would be unreasonable if the cost savings achieved by a KiwiSaver provider (as a result of the 3 examples mentioned in the draft guidance) are not passed on to KiwiSaver members.* *2. While comparing fees charged by different individual KiwiSaver providers the same year/period, it would also be unreasonable if the fees charged by these providers are at the same level, but the net investment return is significantly different.*
5.	*Yes*
6.	*Regarding the trend of fees charged by KiwiSaver providers year on year:* *Market research on 24 KiwiSaver fund providers and over 267 individual funds (across five risk groups) between 2013 and 2018 showed that:* • *A 1% increase in the $ value of the KiwiSaver funds under management results in about a 1% increase in fees*

	This suggests that those KiwiSaver providers have either not achieved any cost savings while the funds under management increased or they have not passed the savings onto KiwiSaver members. *The latest 2019 & 2020 stats also confirmed the above findings, details are as follows:* *The FMA annual reports on KiwiSaver for the year ended 31 Mar 2019 have shown the KiwiSaver Funds under management have increased by 17% from $48.6 billion (2018) to $57 billion (2019), while the total fees have increased by 15% from $418 million (2018) to $480 million (2019).* *The 31 Mar 2020 KiwiSaver annual reports have shown the funds have increased by another 8% to $62 billion while the combined total fee has increased by a dramatic 12.3% to $539 million.*
7.	*What should a KiwiSaver member focus on, "Net Investment Return" or "Fees"?* *For an example, both Fund A and Fund B are "Balanced Funds" and each manage $100,000 funds for one member. Fund A achieved 10% investment return in one year (i.e. total value of fund increased to $110,000 at year end, before fees) and charged 1% fees annually. Fund B achieved a slightly lower investment return at 9.5% (total value of the fund increased to $109,500 at year end before fees) and charged an annual fee of 0.9% fees.* *If purely looking at fee level, the total annual fee charged by Fund A over the $100,000 fund is $1,136 ($36 + (1%*$110,000)), and the total fee charged by Fund B is $1,021.50($36 + (0.9%*$109,500)). The annual fee charged by Fund A is $114.50 or 11% higher than Fund B, which may seem to be unreasonable given both Funds are in the same risk group (Balanced Funds) and are similar in size.* *However, when you calculate the net investment return, Fund A has a total of $8,864 ((10%*$100,000) - $1,136) net investment return for the year and Fund B has only a total of $8,478.50 ((9.5%*$100,000) - $1,021.50) net investment return for the year. It suggests that Fund A achieved higher net investment return for the year for the member ($385.50 or 4.6% higher).* *So, the question is which Fund's fees are more likely to be unreasonable? From a KiwiSaver member's point of view, I'd prefer to choose Fund A to be my Fund manager and pay them a higher fee for the higher net investment return.*
7.	*None*

Feedback summary – *if you wish to highlight anything in particular*

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.

Feedback form — Consultation paper: Proposed guidance on KiwiSaver fees and value for money

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you. Submissions close on Monday 14 December 2020.

Date: **Number of pages:**

Name of submitter: [redacted]

Company or entity: New Zealand Shareholders Association Inc

Organisation type: Membership

Contact name (if different):

Contact email and phone: [redacted] [redacted]

Question number	Response
1.	We agree that the factors outlined to determine whether KiwiSaver fees are unreasonable are appropriate. However, we also believe that other factors should be considered when examining different types of registered schemes, such as non-KiwiSaver fund or Managed Investment Schemes (including those associated with NZX-listed entities). In this context, we note the FMA's Guidance Note relating to MIS issued in September 2014 contains little guidance on fees or fee structure.
2.	We consider that there may be further economies of scale relating to the number of funds managed by a single provider (ie, an additional economy of scale not just related to total funds under management in an individual fund). When examining different types of registered schemes, we note a significant inconsistency in methodologies between different funds and/or MIS. This may create confusion amongst investors or hinder effective comparison. An additional factor that may be considered in the case of MIS would be the "alternative management cost"; ie, the next best alternative compared with an externally managed arrangement. For example, the former Kiwi Income Property Trust (KIP) unitholders chose to insource their management contract in 2014, at a cost of $74.5m, forming Kiwi Property Group (KPG). This implies that the benefits accruing from a lower internal management cost over time amount to at least that amount.
3.	We agree with the examples where fees may be considered unreasonable.
4.	We are not aware of any examples where fees may be considered unreasonable – although a **lack of consistency** amongst MIS fees and **complexity** of fee structures can make this difficult to assess. For example, Northwest Healthcare Properties Mgmt changed their fee structure related to the Vital Healthcare Property Trust in early 2019, a proposal ultimately accepted by unitholders. The management fee changed from a %age of Gross Asset Value to a tiered fee coupled with a complex schedule of service-based fees. 01.04.19 Vital Fee & Governance & Chair Announcement Final.pdf (vitalhealthcareproperty.co.nz)

	While this appears to have created some value for unitholders, it was not initially clear as to whether this would be the case. We also note that the change in fee structure was tied to more effective governance outcomes for unitholders.
5.	We believe this guidance should help managers and supervisors understand their obligations not to charge unreasonable fees. For non-KiwiSaver funds or MIS, effective guidance as to fee structure will serve to encourage consistency between providers and remind external managers of their obligations to unitholders.
6.	We do not have any examples of reasonable or unreasonable fees.
7.	Other Matters: • NZSA believes that clear guidelines on fee structures and 'reasonableness' should be provided to **all** fund managers – not just KiwiSaver. This recognises that investors maintain a diverse portfolio of investment products, including KiwiSaver, MIS and Managed Funds. • NZSA believes percentage and well as dollar fees should be disclosed to ensure transparency and easy comparison to other similar funds. • NZSA believes that membership fees should not be charged. For KiwiSaver, there should only be one fee based on a percentage of funds under management. Funds are now of a size where membership fees cannot be justified. • We also note that the application of performance-based fees can be confusing for investors, especially when the performance is relative to a benchmark. If the benchmark lost money and the investor's fund also lost (less) money, this can result in the payment of a performance fee. • Fund Managers should have to provide every new member to a fund a schedule prepared by FMA of all the current fees for each fund of that type. This will ensure new members are aware of comparable funds fees. *We are aware of industry reluctance, seemingly relating to definition issues of different fund types. This may be overcome with the provision of appropriate regulatory support or guidelines.* • Fund Managers should have to provide members the same schedule annually when they send details of the members account for the previous year. This will ensure members are aware of comparable funds fees. • NZSA shares the concern of the FMA that as total KiwiSaver funds under management have increased there has been no significant reduction in fees. It would appear that there has been no application of competitive pressure. • NZSA is concerned that fees charged do not reflect the actual work undertaken as regards managing a fund. For example, we would expect that the fees for managing a passive fund to be significantly lower than for managing an active fund and in both cases significantly lower than the funds currently charged by many funds. • NZSA would also like to see some standards for what constitutes an 'active fund' – to avoid the situation where a fund claims it is active, but is acting more in line with passive investment strategies.
Feedback summary – *if you wish to highlight anything in particular*	
Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.	
Thank you for your feedback – we appreciate your time and input.	

Consultation on: Proposed guidance on KiwiSaver fees and value for money

14 December 2020

<u>Introduction</u>

1. This is a submission on behalf of **Nikko Asset Management New Zealand Limited (Nikko AM)**.

2. In summary:

    a. We agree that KiwiSaver providers should be capable of describing their value proposition in a transparent way; However

    b. The FMA's public messaging to the effect that KwiSaver is overpriced and/or not delivering value to investors could have a chilling effect on markets and is not supported by reliable evidence;

    c. There needs to be more thought given to issues of cross subsidisation and how these should be dealt with in KiwiSaver policy; and

    d. The guidance paper extrapolates some of the legal obligations on managers to an extent that is surprising and problematic.

Part A – The need for product providers to be able to explain their value proposition

3. On 26 November 2020, industry participants met with the FMA to gain clarity on aspects of the draft guidance discussion paper.

4. Nikko AM's main take-out was that the FMA is not seeking to use the prohibition on charging unreasonable fees to outright ban any specific business model or pricing structure.

5. Instead, what the FMA is seeking to do is to require KiwiSaver providers to be able to clearly set out what customers are getting for their money. The point that FMA made during the meeting was that if we cannot see what a customer is getting for their money, how can we know if the fees are reasonable?

6. Nikko AM supports the FMA's line of thinking. In addition, even if there was no obligation on providers not to charge unreasonable fees:

    a. Any reputable business should be able to articulate what its value proposition is to its customers; and

b. Markets only operate efficiently if there is sufficient transparency of information to enable true merit-based competition.

7. Therefore we would support a redrafting of the guidance to provide greater clarity that its thrust is about ensuring that providers are required to be able to demonstrate their value proposition, rather than being directly banned from adopting certain pricing levels.

8. If we have misunderstood the thrust of the FMA comments, we request a further opportunity to submit.

Financial advice and distribution models

9. As a subset of the discussion on being transparent about value proposition, it is worth making some specific observations about advice and distribution models.

10. Our four key points are:

    a. That it would be a better outcome for the market to compete by providing the best value proposition to customers, rather than competing on the basis of providing the best value proposition to advisers;

    b. We believe that the market is more likely to operate as it should (and less opportunity for poor conduct) if there was better visibility as to what 'independent' advisers are being paid and by whom;

    c. There is a much stronger argument that any distribution/advice fees are not unreasonable if the end customer has; clear visibility of what they are, and has a free choice as to whether or not they wish to incur those costs; and

    d. We acknowledge that advisers do need to be properly remunerated for their work and there are challenges for that to occur with low balance customers.

11. From our perspective, the business model that bundles advice/distribution costs together with product / management costs and then also cross subsidises the costs advice against the full customer base (whether or not the full customer base is receiving advice) would have the following problems:

    a. Customers do not have a clear view of how much of the overall value of what they are paying is being transferred to advisers; and

    b. They have no ability to opt out if they consider their advice charges to be excessive.

12. If the industry were to operate on this basis generally, then there would be very little check on the market becoming one in which all the providers are competing to make the best offer to advisers rather than one in which, providers compete to offer the best products to customers.

13. Therefore we would support further work to understand who is paying what to advisers. If a bias toward highest paying provider is apparent, then this raises a question about adviser conduct that should be addressed either with further regulation, or enforcement against adviser codes of professional conduct. We note that this is in principle no different from the work that the FMA has already carried out in terms of internal adviser remuneration models in banks and insurers.

14. Turning to the specific relationship between adviser fees and "not unreasonable" KiwiSaver fees, our business is of the view that it is much easier to show that advice fee is "not unreasonable" if the customer has a clear choice as to whether they incur it or not.

15. Some providers have asserted that industry would not have been able to make calls to customers during the drop in the market earlier this year if they had been required to separate out customers who had payed for advice and customers who did not. We disagree. How payments to external advice providers are funded across the client base, has no bearing on whether staff in the fund manager office could call up the customer and give basic class advice to not switch[1].

16. Even if the point were true, the value of the one-off contact, does not justify making the entire market vulnerable to customers being directed to products that are sub optimal for them, but which pay the most to the adviser.

17. We believe that there is value in looking deeper into whether consumers benefit from providers that focus on using their fees to buy customers from advisors and delivering value to advisers, rather than spending it on providing a quality product and delivering value to customers. We also believe that it is really important to provide customers with a choice as to whether they receive an advice service or not in order to create the right dynamic for consumers to be the winners of competitive pressure.

18. We would support guidance that requires fund managers to explicitly state and split out any trail commissions paid to advisors; further we would support and encourage an approach that enables investors to opt-out of paying a trail fee component. We note that New Zealand is out of step with many other jurisdictions, including Australia, for allowing trail commissions at all because of the inherent conflicts in that model. Taking the step of requiring greater transparency would still leave New Zealand as being one of the more liberal jurisdictions on this point.

19. Notwithstanding everything we have said above, we stress that we also believe that it is important to ensure that advisers are properly remunerated for the work that they do and this is not always possible in kiwiSaver. We comment on this further below in our cross subsidisation commentary.

---

[1] We note that under the FSLAA regime the FMA would need to create a no action policy in order to replicate the class advice messages that were given to deter panic switching, if there was a market event in the future.

Part B – Response to broad suggestions that KiwiSaver is overpriced or not delivering value for money

<u>The KiwiSaver Market is generally exhibiting characteristics of workable competition….</u>

20. FMA's "KiwiSaver Report 2020" summarises the KiwiSaver market as follows:

    "*KiwiSaver has weathered the challenges well, remains in good health, and is delivering on its core objective to help New Zealanders save for their retirement."*

21. We agree with this assessment and observe that against most objective indicators of competition, the market is performing as it should.

22. **The KiwiSaver market is a growing market:** FMA's "KiwiSaver Report 2020" records that the FUM for the market has grown to approximately $62 bn and has in total 3,026,064 members, of which 2,645,030 are active members.

23. **There are a large number of competitors in the KiwiSaver market and there is a wide diversity of offerings to suit whatever a member is looking for**: On the supply side there are over 25 KiwiSaver providers, including several disruptive new entrants (whereas many New Zealand markets will have a maximum of 5 players). The market is generating a diverse range of different offerings to choose from including; ultra-low cost offerings, passive or active options, tiered pricing, climate friendly funds and special interest funds such as Sharia compliant funds.

24. **Barriers to switching are low**: On the demand side, switching between funds is easy thanks to the IRD mechanism. Over the last five years we have also seen some new entrants grow from almost nothing, to forming part of a strong respectable second tier behind the major institutions. They have done this by winning customers from incumbents in many instances.

25. **Large players are being forced to respond to the market pressures:** For example, BNZ has made a commitment to being the lowest cost KiwiSaver provider and AMP has recently made a decision to go passive and is in the process of major restructuring of its wealth offering. While seeing such a formerly strong player struggle is in some ways saddening, it does tend to prove that the market is working.

26. **Even very small players in KiwiSaver, have incentives to differentiate and innovate, which creates value for the market over the long term**: To use our own business as an example, we are a very small provider of KiwiSaver but:

    a. We have rolled out New Zealand's first true digital advice tool to help customers select funds that are right for them. The evolution of tools of this nature could have a transformative effect on financial services over the next five to ten years, and we have started that ball rolling; and

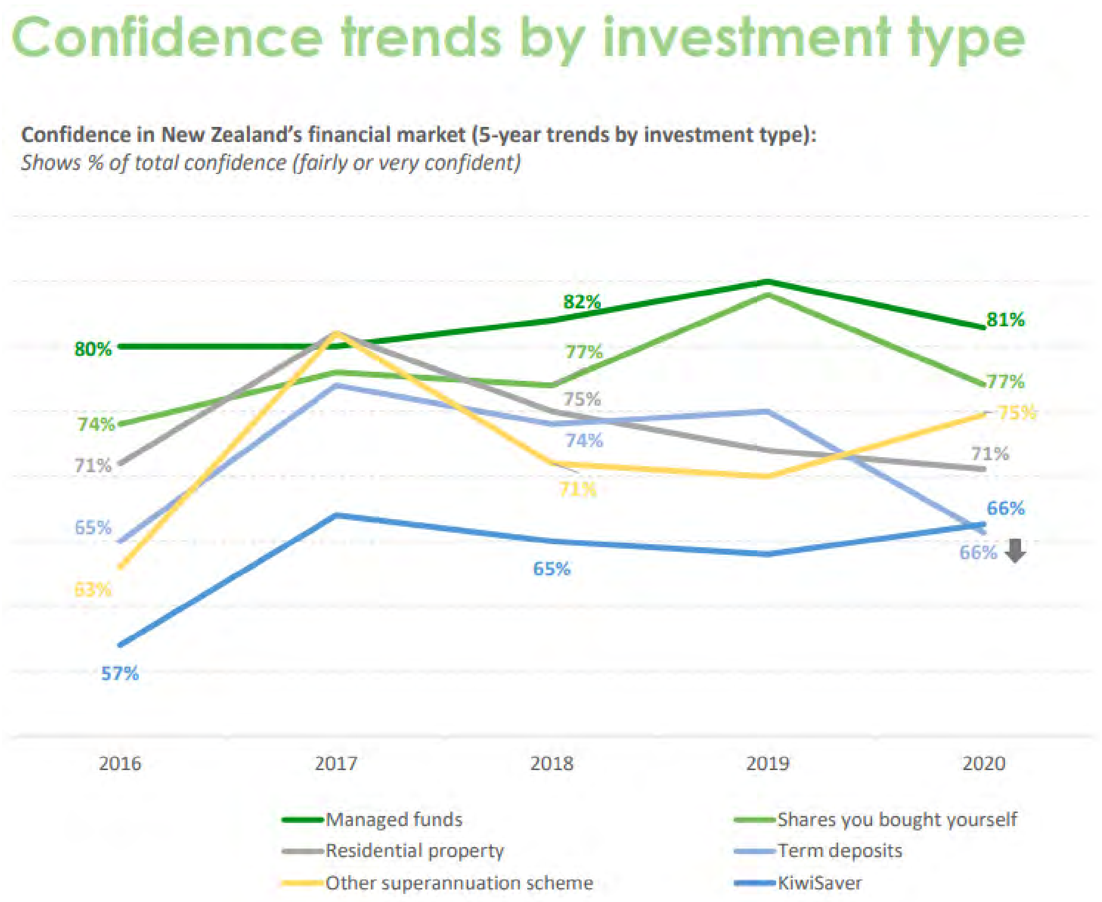
b. We have very recently added the Nikko AM ARK Disruptive Innovation Fund to our KiwiSaver, which offers a totally different investment proposition to the vanilla offers that are in the market.

27. Returns have been high over the last 12 years in general. While there was a decline in March owing to Covid, markets rapidly recovered and the industry worked hard to attempt to reduce panic induced switching.

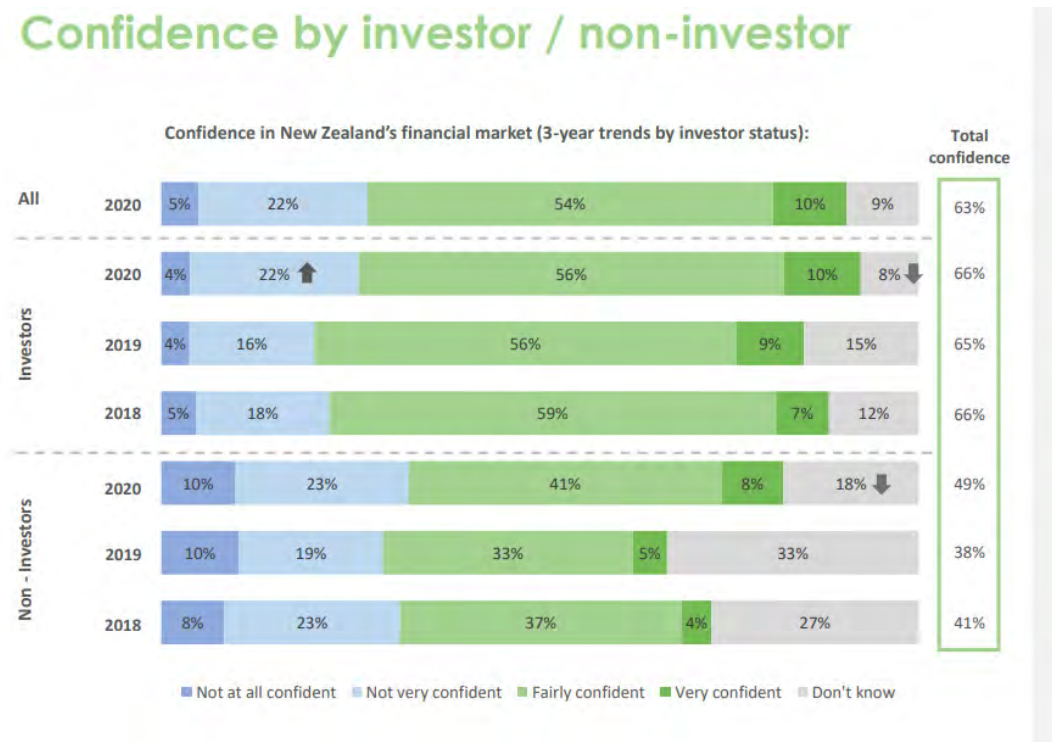
28. Overall, the KiwiSaver market is relatively positive in terms of how it is evolving.

<u>…….But the market is fragile in terms of investor confidence/engagement and that is having some detrimental impacts</u>

29. As the FMA will be aware, page 22 of "Attitudes towards New Zealand's Financial markets – Investor confidence research June 2020" shows that levels of confidence in KiwiSaver have consistently been lower than for any other type of investment, except for in 2020 when term deposits came as low as for KiwiSaver.



30. Further, page 30 of FMA's, shows a consistent correlation between lack of confidence and disengagement in financial markets and not investing:



31. The logical implication of these statistical observations is that if the FMA takes action that causes confusion, doubt or lack of confidence in the market, then the likely consequence will be a reduction in investment, or at least more conservative investment in mainstream vanilla offerings by vanilla providers like banks, potentially less willingness to engage , and potentially less openness to consider alternative offerings (like ours).

32. One aspect of the market that has arguably not served the public is the extent to which people who are in an overly conservative fund kind have effectively lost out on strong growth over the last twelve years. Being in overly conservative funds is in some ways the natural consequence of disengagement (and thus being in a default fund) or being overly sensitive to risks due to lack of confidence.

33. Against such a risk, we believe that they FMA should be very cautious about putting out strong messages in the market about perceived deficiencies in KiwiSaver that could have a further chilling effect on confidence. The potential value of shaving a few basis points off the fees of some providers would clearly be outweighed by the downside of increased disengagement and lack of investment. Vague claims of lack of value for money is potentially even more problematic, especially if unfounded.

Why the finding in the MyFiduciary Report that there is no correlation between fees and "activeness" should not be relied upon to assert lack of value for money

34. The FMA has asserted that customers may not be receiving value for money based on the finding that there is no correlation between what MyFiduciary calls "activeness" and fees in the "MyFiduciary Analysis of Active versus Passive Management in KiwiSaver" (14 August 2020).

35. Our overall view is that the "activeness" score:

    a. Would provide a crude high-level screening mechanism to indicate whether the FMA should ask further questions about how active certain providers are, but it is wrong to draw conclusions about whether provider A is more active than provider B based just on those scores. we provide the example of our cash fund below to explain why the "activeness" score can misrepresent the situation; and
    b. When we consider the "activeness" rankings in aggregate, they bear little relation to how a number of participants would intuitively rank managers based on what we know about their active management approaches. They also do not appear to correlate with how other consultants or institutional investors would rank the fund managers. Therefore we consider that the "activeness" score is relatively arbitrary if it is used for any purpose other than that for which it was commissioned i.e. to make a crude assessment of whether fund managers are true to label or not.

36. It is worth remembering that the MyFiduciary report was commissioned to determine whether some participants were claiming to be active managers when they are not. The test that MyFiduciary developed was appropriate for answering that basic question; in that if a manager is departing from index significantly then it is reasonable to conclude that whatever else is going on it is not hugging an index. Having determined that everyone claiming to be an active manager was departing from the indices to some extent, the job was done.

37. However, the fundamental fallacy of the paper is to conclude that because Manager A is departing further from an index than Manager B this means that Manager A is a more true active manager than Manager B, or doing more work than Manager B in terms of active management.

38. We use as a case study, the scoring of the Nikko AM NZ Cash Fund as a worked example of why "MyFiduciary's" concept of 'level of activeness' is not a reliable proxy for whether a particular fund manager is in fact a good/ active/ delivering value for money:

    a. The KiwiSaver version of the Nikko AM NZ Cash Fund, is essentially a KiwiSaver wrapper to invest in the Nikko AM wholesale NZ Cash Fund. We have a high degree of confidence that this is an excellent actively managed and high value for money fund because:
        i. It has been selected by some significant institutional investors against tough competition; and
        ii. Two top consultant businesses have ranked this fund against peers as; 2/6 and 1/5 over 1 year; and 2/6 and 1/4 over 5 years.

Yet according to table 5 of the the MyFiduciary report, the fund has the second lowest score for “activeness” within its group. This is because the fund consistently outperforms the index in a highly efficient way with an extraordinary information ratio (often used as a measure of the quality of active management).

b. Therefore the first point to note is that the way the MyFiduciary Report ranks funds does not correlate with how reputable commentators or informed purchasers would normally rank funds and managers.

c. The reason why the Nikko AM NZ Cash Fund has a lower level of “activeness” against most of the funds listed in table 5 is nothing to do with how the fund is managed, and everything to do with the fact our fund invests in different asset classes to those other funds. More specifically, most of the cash funds in table 5 hold short- term bonds, whereas the mandate for our cash fund does not allow us to hold short terms bonds. When we are then measured for “activeness” against a cash index, we inevitably will not show as much variance as the “cash” funds that hold assets other than cash. Accordingly we came out close to the bottom of the pack on the “activeness” ranking.

d. Therefore one of the main factors that may drive the activeness rankings throughout the report is how a given fund’s actual asset mix correlates with the index they have been assessed against.

e. A further but related factor that may have impacted a firm’s apparent activeness is whether any given growth fund happened to have been holding cash during a significant market movement. Whether a fund manager made a shrewd tactical call to move to cash, or was asleep at the wheel and was just slow to invest after receiving a build up of deposits, the outcome would be to make that particular fund manager look very active.

f. If we were asked to prove that we were a genuine active manager and a more “true” active manager than others, it would not be on the basis that our fund’s performance looks less in step with indices than other fund managers. What we would do is provide evidence of all the research that went into the positions being taken, the meetings that we have had with issuers, the risks we sought to address and the questions we have asked. Ultimately a terrible fund manager would have no problem departing from index by making poor and/or uninformed choices or by being slow to react. It is what sits behind the positions that identifies the genuine active manager. Therefore the “activeness” score means very little beyond the fact that we are doing something that departs from passive. The fact that Manager A achieves a higher “activeness” score than fund Manager B but charges lower fess, in fact says nothing about which is the more true active manager or which provides more value for money. To determine those issues it is necessary to look deeper.

39. Overall, because the rankings do not mean much at all in themselves, then the fact that there is no correlation between activeness rankings and fees also does not mean much and the FMA is wrong to spook the market on the basis of those findings.

Why it is incorrect to conclude the MJW Report found that fees are too high

40. The FMA has used the "KiwiSaver Fees Comparison for the Financial Markets Authority" (11 July 2019) MJW to make public assertions that KiwiSaver fees are too high.

41. First, we believe that FMA's position is a misreading of the MJW report. The MJW report is limited to saying that certain specific funds in New Zealand are more expensive than certain specific UK funds. This does not mean that the market as a whole is under or over-priced.

42. Second, the things being compared are subject to key differences, that should cause you to expect the UK fees to be lower if both markets are operating correctly:

    a. the report looks at fees for all-of-business tenders worth between 5 to 50 million pounds in the UK, against rack-rates on the KiwiSaver Fund Finder. We believe that you should expect a fund manager to offer a better rate to an entity bringing a $100 million of FUM to a fund, than it would to individuals who may have only a few thousand dollars to bring. Apart from anything else, a dedicated block of millions of dollars obtained through one tender would save very significant distribution costs, enabling a significant discount;
    b. We note that the KiwiSaver businesses that rely heavily on trail would normally pay between 0.25 and 0.5% to advisers. Interestingly, the overall difference in fees observed in the MJW report between NZ and UK funds is 0.3%, which correlates very well with the distribution cost difference;
    c. The quality of the customer base of a book of customers from a solid employer would also be much higher than that of random members of the public in that they will all be contributing members and probability of hardship withdrawals will be much lower. This would also justify a reduction;
    d. Fees on the KiwiSaver Fund Finder are not necessarily representative of the true average amounts charged in New Zealand in that they will not take into account rebates and discounts that might be passed through e.g. through platform arrangements, advisor groups or indeed employer choice discounts; and
    e. A better comparator of rates to the UK providers might be default providers after the MBIE tender process is concluded because in both cases we would be comparing the outputs of tender processes for large numbers of customers.

43. Based on those important differences, we believe that KiwiSaver Fund Finder Fees should be higher than UK tender fees in our view, which is exactly what MJW observes. Turning to the legal tests in regulation 12 of the KiwiSaver Regulations, the pertinent questions to ask before anything can be concluded are:
    a. Are these fees "significantly" higher than the funds being compared with; and even if they are
    b. Is that difference justified by the obvious commercial differences we have identified above – in this case the answer is "yes".

44. Our overall point is that in order to place any weight on the MJW report, you have to believe that there should be no difference in pricing between customers who come to a provider as

individuals off the street versus customers that come as a combined multimillion dollar block. We know that if a major employer came to us and offered us $100 million in FUM if we provided a discount on our normal rates to its staff, we would do it. This is because we would immediately get scale for our funds and there would be no distribution costs, so there is obvious headroom to provide a discount in that scenario. We would challenge the FMA to find any provider in New Zealand that would not behave the same way. Therefore we know that the MJW comparison is simply untrue.

<u>What is at the root of our concerns about fees</u>

45. Our biggest concern is that this guidance together with MBIE's approach to default KiwiSaver is placing an over emphasis on fees that will ultimately lead to a market consisting of a small number of low cost, vanilla scale players, that will squeeze out most other participants.

46. Not only would this be detrimental to businesses like ours that wish to carve out a small role as a genuine active manager, but also to all of New Zealand in the long run. This is because innovation will naturally tend to be driven by disruptors at the fringes, rather than by the organisations at the centre that naturally benefit from the status quo of things continuing. By driving out the disruptors, the FMA is undervaluing innovation and diversity of offering, in order to gain small reductions in fees today – not a good trade off.

47. Further as noted above, we also see a possible consequence of the FMA putting strong messages out into the market about insufficient value for money and excessive charging could be that customers withdraw, invest less and flee to perceived safe havens of banks, rather than consider more alternative offerings.

48. Because New Zealand is such a small economy once a sector has been consolidated down, it is very difficult to reverse that trend. We also note that the FMA and MBIE's treatment of the market as in effect a market failure is not supported by any economic analysis, so what we are seeing are some big market interventions but without utilising the intellectual discipline that is required to accurately diagnose the market condition and to respond appropriately.

Part C – The need to give greater acknowledgement and consideration to cross subsidisation in KiwiSaver

49. There is an incremental cost to serve every individual customer, regardless of balance size. For example, every individual customer needs to be subject to AML checks. As customer numbers increase, registry costs increase, supervisor costs increase, levies increase and staff numbers need to increase to on board and off board customers and to manage queries and communicate.

50. Customers with low balances are unlikely to cover these incremental costs to serve, let alone contribute to the common costs of managing a KiwiSaver fund. Further, low balance customers can be more service intensive than average customers (e.g. on average they more mobile and therefore harder to communicate with and are also more likely to request hardship withdrawals, which is a labour intensive exercise as it requires liaison with a Supervisor).

51. Against that commercial reality, there needs to be a way to reconcile the following:

    a. From the public sector side, KiwiSaver is intended to be universally available and we need to ensure that vulnerable customers and low balance customers are not prevented from growing their wealth; however

    b. Private businesses need a commercial rationale for serving all customers.

52. Ultimately the only way to square these differences may be by way of cross subsidisation; either across the customer base, or over time (unders today are offset by overs many years into the future). This has implications for two things:
    a. The point at which it is appropriate to reduce fees when a business scales up. If a business has many years of losses to make up for from a customer it may need to extend the duration of the upside to make up for it; and
    b. It goes to the political rhetoric in relation to low balance customers. The discussion is often framed to suggest that low balance members are somehow being treated unfairly, being overcharged or not getting value for money. Technically the reverse is true. Low balance customers are not covering their basic costs to serve. Higher balance clients are the ones that are technically being treated inequitably as they are in effect paying for the low balance customers as well as themselves. To be clear we are not arguing against the settings remaining tilted to ensure that low balance customers are able to grow their wealth effectively, we simply consider that it is important to acknowledge that there is always a tilt in their favour.

53. The cost of advice is also worth considering in the context of low balance customers.

54. Providing a person with proper financial advice and a statement of advice would be worth between $300-$900 (an hourly rate of $100-150 per hour multiplied by 3-6 hours work). If an advisor receives a 0.25% fee on a customer with $20K balance what the advisor receives will be $50. It is easy to see against this example that recouping the cost of advice may take many years, if at all for some customers. This reality needs to be factored into FMA thinking about adviser remuneration.

Part D - Instances where we consider the FMA to be overstating its legal powers

<u>Legally there is a high bar before a fee can be found to be unreasonable</u>

55. The obligation on KiwiSaver managers in clause 2 of the KiwiSaver Scheme rules to “not charge a fee that is unreasonable” is a rule that on its face could mean any number of things to any number of people.

56. However, clause 12 of the KiwiSaver Regulations 2006, clarifies that the bar is in fact high before a fee can be found to be “unreasonable”. Regulation 12 directs the Court or FMA:

    a. To consider whether a proposed fee is “**significantly higher**” than comparable classes of scheme; and even if it is
    b. Consider whether there are other factors that could justify the “significantly higher” fee.

57. It is right and proper that the bar be set high because:

a. It is extremely rare in a liberal democracy for a regulator or Government agency to have a power to intervene in relation to the pricing of private services, particularly a competitive market with a diverse range of different offerings ; and

b. Normally where regulators do have a power to set prices in a market (such as in the Commerce Act 1986 or the Telecommunications Act 2001) there are extremely detailed processes that have to be followed along with very specific pricing principles that must be applied because; first it is acknowledged that immense economic harm can flow from a regulator setting prices incorrectly, and second respect for private property rights is a central pillar of western democracy. The fact that that regulation 12 does not introduce significant process or complexity suggests when held up against the general canon of law pertaining to pricing interventions that the intent is that it is only there to address egregious overcharging.

<u>The FMA is over-extending the general duty to act in members interests in section 143 of the FMC Act</u>

58. In this instance, not only does the FMA's guidance not properly acknowledge the limitations in rule 2 of the KiwiSaver scheme rules but it also appears to be attempting to reframe the duty in section 143 of the FMC Act "to act in the best interest of scheme participants" as a general duty on all MIS managers to reset their pricing i.e. the FMA is pushing pricing obligations out beyond KiwiSaver.

59. We disagree with the FMA's interpretation of section 143 of the FMC Act.

60. The law is littered with many similar instances where Party A has to act in the best interests of Party B. For example in the Companies Act 1993 section 131 the wording is very similar to section 143 of the FMC Act:

    …a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company…

    At no point have such provisions ever been interpreted along the lines that directors are required to self review their remuneration. In every case these obligations are taken to mean that person A has to act in Part B's interest when exercising the functions of their role.

    Section 143 of the FMC Act is no different and immediately follows and speaks to section 142 of the FMC Act which sets out the general management and administration functions of the manager:

Role of manager

142 Management and administration functions of manager

(1) The manager of a registered scheme is responsible for performing the following functions:

(a) offering the managed investment products; and

(b) issuing the managed investment products; and

(c) managing the scheme property and investments; and

(d) administering the scheme.

<u>It is difficult to see how use of a stop order or a direction could be a reasonable response to a pricing dispute – The FMA's discussion of remedies is concerning</u>

61. The consultation paper discusses potential use of stop orders and direction orders in the context of deciding that a fee, which used to be reasonable has now become unreasonable, e.g. because of scale.

62. A stop order issued for an established fund with possibly hundreds of thousands of customers (because the discussion is in relation to funds with scale) would have an immensely problematic impact:

    a. Vast numbers of employer contributions that would normally automatically added to a fund would be halted with nowhere to go;
    b. Such an impact would likely precipitate withdrawals among the customer base;
    c. The reputational damage to the fund manager would be immense; and
    d. The broader market itself may be adversely shocked by such a strange intervention.

63. It is difficult to see how such an exercise of power could ever be justifiable as against the purpose statement of the FMC Act, when any dispute over pricing could just as easily be settled without any impact on customers; either by negotiation or in Court if the FMA and the participant cannot reach agreement.

64. Our comments in respect of a stop order are also largely true for a direction order. If the FMA and a manger disagreed as to whether a fee was "not unreasonable" (and the meaning of "unreasonable" is ambiguous enough that two reasonable parties could disagree) then Court is the appropriate remedy, rather than use of a direction order with its impact on reputation.

65. It is a troubling to us that the FMA would suggest nuclear operational intervention in respect of a fund that is essentially functioning as it should, except for a concern that its pricing may be too high.

66. It may be that the regulatory intent of the FMA to simply list all the remedies that are technically available in any situation. However, given that the FMA has raised the possibility of using these powers, it is important for us to respond by observing that the exercise of any power should be proportionate to the nature of the harm that it is seeking to address and in keeping with the purpose statement of the FMC Act.

Part E – Concluding comments

67. Nikko AM's view overall is that:

- It agrees with the focus on requiring managers to be able to show the value they are providing for the fees they charge.

- We agree that the FMA is required to police the obligation on providers to not charge unreasonable fees. However, we see the bar before fees are deemed to be unreasonable to be higher than the FMA sees it.

- There are issues around adviser remuneration and cross subsidisation that require further careful thought. We would support the requirement that trail commissions are explicitly stated and optional to the investor.

- The discussion of using nuclear interventions such as stop orders as remedies to resolve pricing disputes seems disproportionate, adverse to the customer base and concerning.

- Above all we are concerned to preserve the place of genuine boutique offerings in the market both for ourselves and for New Zealand. Our fear is that we may become collateral damage in what seems like frustration towards scale players.

- We believe that true enduring value to KiwiSaver members will arise as a result of disruption, change and innovation that brings new ingredients to offerings that were not there previously. Change on these matters will inevitably be introduced from the fringes of the market not the centre. It is the fringe that has the incentive to change things, it is the centre that has the incentive to keep things the same. Therefore the fringe should be preserved as an important part of the market.

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you.
Submissions close on Monday 14 December 2020.

Date: 30 November 2020 Number of pages: 2

Name of submitter: [redacted]

Company or entity: Pie Funds Management Limited

Organisation type: Managed investment scheme manager

Contact name (if different):

Contact email and phone: [redacted]

Question number	Response
1. *Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable?*	*Pie Funds considers that the factors set out in the consultation paper are fair and appropriate.*
2. *Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable, or inconsistent with the related overarching statutory duties?*	*Pie Funds suggests that the FMA consider including a further factor for assessment, being whether fees are simple, transparent and clearly communicated. This is because how fees are structured, and how this is made clear to consumers, is an important factor that allows consumers to make informed choices when selecting their KiwiSaver provider.* *Pie Funds considers this deserves to be specifically addressed as a factor in the assessment of whether KiwiSaver fees are unreasonable or inconsistent with the related overarching statutory duties (noting that fee structure has already been lightly touched on in the consultation paper on page 5).* *We think it is relevant that the recent MBIE RFP process for selecting Default KiwiSaver providers requires a 'simple and transparent' fee structure (generally limited to a percentage-based fee and/or an annual or monthly fee).* *Further, given the potential for poor disclosure or lack of upfront transparency (leading to member confusion), we also suggest that the existence of multiple and/or complex fees should be specifically considered a factor counting against the reasonableness of KiwiSaver fees.*
3. *Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties?*	*Generally, Pie Funds agrees with the examples identified.* *We note that the simple example given of membership fees having the ability to erode balances (on page 6 of the consultation paper) does not address the related issue of multiple fees. The effect of multiple fees (such as a percentage-based fee in combination with other fees) can have an outsized negative impact on members with lower balances, especially if poorly understood.* *Further, Pie Funds considers that multiple fees not only increase the likelihood of member confusion as to the overall fee charged but they potentially (i) raise the risk of overlapping-recovery of internal costs and (ii) increase the complexity of fee structure reviews.* *We suggest that a worked example involving multiple fees could clarify how they may impact a member with a low balance. Such an example*

	could also make clear to managers the level of clarity around costs the FMA is looking for to understand the value provided to members paying multiple fees.
4. Are you aware of any other examples of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties?	*Only in relation to multiple or complex fees as set out above.*
5. Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money?	*Generally speaking, yes. The provision of specific examples is helpful.*
6. Do you have any examples of any costs or fee levels that you think are unreasonable/reasonable? If so, please provide details.	*No.*
7. Are there any additional matters that you think the guidance should address? If so, please provide details.	*As set out above, Pie Funds would like to encourage the FMA to focus on disclosure and transparency around multiple or complex fees.*
Feedback summary – *if you wish to highlight anything in particular*	
Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.	
Thank you for your feedback – we appreciate your time and input.	

WEEKLY REPORT 17 November 2020

Private Asset Management Ltd

[redacted] is an Authorised Financial Adviser and a personal finance and investments writer.

ARE KIWISAVER FEES FAIR AND VALUE FOR MONEY?

Earlier this month the FMA published a consultation paper entitled "Proposed guidance on KiwiSaver fees and value for money". Introducing the paper the FMA said "fees have a significant impact on the overall returns that KiwiSaver members receive" and "for the last few years the FMA has focussed on fees in the context of whether KiwiSaver schemes are providing good value for money for NZers". Then came the bit that made the KiwiSaver managers hearts miss a beat: "despite expectations of competitive pressure on fees there has been little movement when compared to the amount invested in funds". The FMA had, in my view naively, expected that average fees would reduce as funds under management increased. It was a naive view for a number of reasons:

- "The NZ Kiwisaver fund industry enjoys a near monopoly situation with no exposure to international competition", according to a report by Professors Bart Frijns and Alireza Tourani-Rad of AUT. Monopolies aren't known for passing on economies of scale to their customers and are frequently regulated for just this reason. Fees have fallen overseas but this is due to the increased popularity of index funds. Within Kiwisaver active funds and closet trackers dominate.

- The MBIE and the FMA have primarily relied on disclosure as a means of ensuring retail investors focus on the impact of fees and value for money. However lots of research shows that disclosure, even if it is read, doesn't work - in fact it can have the reverse effect. Even the FMA's own research has shown that only a minority of KiwiSavers are engaged and many don't know who manages their money and whether they are in a balanced/growth or conservative fund let alone the fees they are being charged, and the significance of those fees. The FMA made much of its requirement to require fund managers to disclose the dollar value of their fees however this was never going to work. It would have been far better to require fund managers to prominently set out a realistic forecast return and display, by way of a pie chart, the manager's share, tax and what was left over for the investor.

- The economics of KiwiSaver, whereby employers match contributions dollar for dollar up to 3% of salaries mean that fees, even if they are high, don't fundamentally make KiwiSaver unattractive. Fund managers know that too and, as they have done overseas, appropriate some of that subsidy for themselves.

Reading the consultation paper however it looks like the FMA may have finally lost patience with KiwiSaver managers and might be about to actually do something but there have been a number of false dawns in this space over the years so it is easy to be sceptical. This week we answer the question as to whether KiwiSaver fees are fair and whether they represent value for money. No prizes for guessing the conclusion but how we get there might be of interest.

First off let's have a look some specifics as regards fees. One of the most popular types of KS funds are the so called balanced funds which are typically invested about 40% in bonds with the remainder in property and shares. According to the Sorted website the average annual fee here is 1.14%. Unfortunately, due to a lack of knowledge on behalf of the MBIE, and despite the Sorted website maintaining that their figures represent total fees paid, 1.14% does not in fact represent total fees because it doesn't include the transaction costs which KiwiSavers pay when the manager buys and sells investments on their behalf. Whilst this might only represent an additional 0.1% or 0.2 % for a passive fund, transaction costs are often material for active funds as, as their name suggests, they transact more frequently. Recently I looked at an actively managed fund which incurred transaction costs on behalf of its unitholders of 1.05% pa. A Vanguard study suggested that turnover costs in the average US managed fund typically reduced investor returns by 0.6% pa. In contrast to the very poor decision by MBIE to exclude transaction costs the UK regulator, the FCA, compels fund managers to include transaction costs as part of a one number estimate of total fees. Despite excluding transaction costs the FMA and the Commission for Financial Capability have both drunk the Kool-Aid and continue to maintain that NZ's managed funds disclosure regime works for retail investors.

To see whether KS fees are fair and good value for money I looked at the Sorted website which advises that the average fee for a balance fund is 1.14%. If we add another 0.4% for transaction costs that totals 1.5%. Given their asset allocation and forecast returns from unconflicted experts a balanced fund should return about 4.0% per year, pre-tax, pre-fees. Fees therefore reduce returns by 38%. That doesn't seem fair or value for money. We can derive another estimation of what fair and reasonable fees look like by observing the fees that professional investors like the NZ Super Fund are prepared to pay. In 2020 the Super Fund incurred average management fees of just 9 basis points on it's portfolio ie less than 1/10th the level of the typical balanced Kiwisaver fund. Fees at this low level are readily available to retail investors via overseas listed ETF's. Relative to these fees KS fees are clearly not fair and certainly not good value for money. An example of a 20-year old, earning $40,000 per year and saving via a higher cost balanced Kiwisaver fund illustrates how significant fees are – our model estimates a terminal sum of $430,000 made up of savings of $250,000 and investment returns, after fees, of $180,000. Total fees are estimated at $127,000 ie fees going to fund managers represent more than half of investment returns accuring to the Kiwisaver. That doesn't seem fair either.

To be quite frank the FMA and MBIE have to accept some of the blame for the high fee structures impacting retail investor outcomes and enriching the finance sector because government and regulators permit vertically integrated organisations to exist. Vertically integration here refers to the fact that most organisations i.e. the banks, are vertically integrated in that they provide both the fund management service and the advice to the client as to what funds to buy. The FMA requires that advisors must put their client's interests first (PCIF) but, to accommodate the banks and other vertically integrated institutions which only sell a limited range of products, the regulator has watered down the PCIF requirement by determining that institutions that only sell their own high cost products, so as to maximize their profits, are putting client's interest first if they choose the least inappropriate high cost product from their suite of inappropriate high cost products. Rather than putting client's interests first in reality we have a "its ok to sell high cost products if that's all you have got" regime. The reality on the frontline of KiwiSaver sales is that any bank employee that actually offered impartial advice and said "don't buy our product this other one is much cheaper" would find themselves either unemployed or detained at one of the re-education camps rumoured to be in Northern Queensland. Furthermore whilst there are a number of ostensibly "independent financial advisors" advising on KiwiSaver most of these do so to earn trailing fees and, obviously, only the higher cost providers pay trailing fees.

A common sense approach would be to separate the advice and fund management functions so that there is a tension between advice and the providers of financial instruments, and ban commission and trailing fees. In that scenario retail investors may be able to rely on independent advisors to pick the best funds for them. In practice this frequently means the lowest cost funds.

[redacted]

Level 7, Zurich House, 21 Queen Street,
PO Box 105262, Auckland,
New Zealand
smartshares@smartshares.co.nz

14 December 2020

Financial Markets Authority
Level 2, 1 Grey Street,
Wellington, New Zealand
by email only: consultation@fma.govt.nz

Smartshares submission on proposed guidance on KiwiSaver fees and value for money

Smartshares Limited (**Smartshares**) submits this response to the FMA's consultation regarding the 'Proposed guidance on KiwiSaver fees and value for money' (**Draft Guidance**).

We support the FMA's proposal to provide guidance in relation to the statutory requirement that KiwiSaver fees not be unreasonable, and the related statutory duties that are contained in the KiwiSaver Act 2006 (**KiwiSaver Act**) and Financial Markets Conduct Act 2013 (**FMC Act**). We agree with the principle that members should be equitably charged for their participation in KiwiSaver schemes.

We understand that the FMA is not intending to prohibit or restrict particular fee models (such as an all-infee, or performance fee models), but is wishing to ensure that fees are transparent and that managers regularly assess whether fees are reasonable. We endorse this approach.

We suggest that care is taken with the recommendation in the Draft Guidance, that performance over time is a relevant criterion by which to assess whether members have received value for money. We consider that a comparative assessment of relative performance against a scheme with an equivalent investment mandate managed by a manager offering equivalent services may be an appropriate consideration. However, a simple assessment of whether a fee is reasonable based on a scheme's performance may discourage managers from offering investment in volatile assets, reducing optionality for investors and negatively affecting participation in the broader capital markets.

We have included additional matters for the FMA's consideration in our submission. We thank the FMA for meeting with the boutique asset management group to discuss the Draft Guidance and for the opportunity to make this submission, and we note that nothing in this submission is confidential. We would welcome the opportunity to meet with you to discuss any aspect of this submission.

Yours faithfully,

[redacted]

[redacted]
Chief Executive Officer
Smartshares Limited

Feedback form — **Consultation paper: Proposed guidance on KiwiSaver fees and value for money**

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed guidance on KiwiSaver fees and value for money: [your organisation's name]' in the subject line. Thank you. Submissions close on Monday 14 December 2020.

Date: 14 December 2020

Number of pages: **5**

Name of submitter: [redacted]

Company or entity: Smartshares Limited

Organisation type: Licensed Manager

Contact email and phone: [redacted]

Question 1:

Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable? If not, please outline your reasons.

1. The Draft Guidance includes potential factors that may be relevant to a manager's determination of whether a fee is unreasonable, as well as whether a scheme is providing value for money. We support the approach taken in the Draft Guidance that allows for a manager to consider a range of factors together when determining the reasonableness of the quantum and structure of its fee arrangements

2. We understand that the FMA does not intend to restrict the nature of the fee models adopted by managers in relation to KiwiSaver and other schemes through the Draft Guidance, and that one of the FMA's primary concerns is that disclosure of fees should be clear, concise and effective. We suggest that this is expressly stated in the Draft Guidance.

Cost of services

3. We consider that while the costs of the services to which the fees relate are a legitimate consideration for assessing the reasonableness of fees, that the inclusion of this factor should not be interpreted as prohibiting managers from adopting a performance fee or all-in fee model.

4. We submit that it will be important that the Draft Guidance does not over-emphasize the consideration of costs as a criterion by which to assess the reasonableness of fees, or recommend the use of a cost-plus service fee model. We note that an over-emphasis on costs will disadvantage smaller providers who are not able to take advantage of economies of scale, causing further consolidation of providers and

investment products, reducing innovation and flexibility which is contrary to the stated purposes of the FMCA.

Performance

5. As noted in our introductory comments, we submit that the Draft Guidance should more carefully articulate the basis on which performance should be used as a basis for assessing the reasonableness of fees. We suggest that if performance is to be retained as an assessment criterion, that its use as a measure by which to assess value for money, should be limited to a comparative review by a manager of past performance of schemes with an equivalent investment mandate and managed by a manager offering equivalent services. Otherwise, the requirement to assess fees based on the performance of a KiwiSaver fund may incentivise fund managers to become more risk averse and invest in predominantly conservative investments to secure current fee levels.

6. We also suggest that the FMA further consider the practical aspects of using performance as an assessment measure, given that it is often difficult to separate the services provided by a manager and the value of those services to members, from the performance of the fund's assets. In addition, a fee assessment based on performance is necessarily retrospective in nature, and we query the relevance of past performance as a measure of future value of the services provided to members. We also suggest the removal of the 'proportion of returns eroded by fees' as a factor, for these reasons. We note that neither performance nor erosion of returns are expressly prescribed as relevant matters for the FMA's consideration of the reasonableness of fees under regulation 12 of the KiwiSaver Regulations 2006.

Comparison to workplace savings scheme and default KiwiSaver scheme fees

7. The Draft Guidance suggests that a comparison with the fees of workplace savings schemes and other KiwiSaver schemes may be an appropriate factor by which to assess value for money. We note our comment above in relation to the use of the performance criterion, that to be meaningful any such comparison would need to be conducted against schemes that have similar investment mandates.

8. In the context of workplace savings schemes, it is often the employer who will pay the fees of the employee members. Managers may be incentivised to offer lower fees to an employer in recognition of the economies of scale resulting from attracting a group of employee members (for example: reduced distribution, anti-money laundering and other administrative costs). Similarly, default KiwiSaver schemes will enable economies of scale for certain fixed costs. This may reduce the utility of assessing reasonableness by comparing KiwiSaver scheme fees against those payable under a workplace savings scheme or default KiwiSaver scheme, in particular for smaller KiwiSaver schemes who have proportionally higher costs.

Advice fees

9. We strongly agree that where a scheme charges or facilitates a fee in relation to financial advice that this should be disclosed separately. We consider that such an approach ensures the equitable treatment of members based on whether or not they receive a service to which the fee relates, and allows members to elect whether or not they require a financial advice service relative to their needs and financial literacy.

Question 2:

Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable or inconsistent with the related overarching statutory duties?

10. We note the inclusion of 'how fees are calculated, charged, disclosed and reviewed' as a factor that may be relevant to the assessment of whether a member is receiving value for money. We query whether the FMA intends that the nature of a manager's fee model may be considered within this factor. We consider that this should be a relevant consideration, particularly in the context of managers who adopt an all-in fee structure, who will sometimes be required to absorb scheme costs themselves. We also note that the Government's KiwiSaver Default Provider Request for Proposal appears to accept that an all-infee model provides the additional benefit of providing certainty for members. This could be another relevant factor for managers to consider whether fees are reasonable.

11. Some managers may charge additional fees for communication with members, for example: generating and mailing monthly paper statements, or providing access to digital tools. We suggest that it would be appropriate for managers to be able to consider the extent to which members have actively elected to pay voluntary fees for these types of additional services.

Question 5:

Do you think the guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money?

12. As noted in our introductory comments, we support the FMA's proposal to provide guidance in this area which will provide greater certainty for managers of the FMA's conduct expectations.

13. We note that commentary in the Guidance that the FMA expects that all managers should regularly review scheme fees to assess whether managers are providing good value for money to members, including for non-KiwiSaver schemes. We suggest that if the FMA's intention it to apply this as a specific obligation for non-KiwiSaver schemes that this would be better imposed as a managed investment scheme manager licence condition, rather than a conduct expectation within the overarching statutory duty to act in member's best interests. Such an approach would provide greater clarity for managers and supervisors.

Question 7:

Are there any additional matters that you think the guidance should address?

14. The Draft Guidance proposes that managers should review fees whenever a SIPO is updated. We submit that the Draft Guidance clarifies that a fee review should be conducted when a SIPO update relates to a matter affecting costs, as SIPOs are often updated in relation to changing regulations, or for other reasons that should not affect fees.

15. The Draft Guidance notes the FMA's expectation that managers refund members who have been overcharged unreasonable fees. While such action may be appropriate in some cases, we suggest that this statement is removed from the Draft Guidance. We are concerned that this could create an unreasonable expectation from members that they are entitled to reimbursement whenever a manager reduces fees, which will not be the case where the initial fee was reasonable. In addition, we note that neither the KiwiSaver Act nor the FMC Act expressly require a manager to reimburse unreasonable fees as a default remedy.

Monday 14 December 2020

Financial Markets Authority
Level 2 1 Grey Street
Wellington

Financial Markets Authority
Level 5 Ernst & Young Building
2 Takutai Square
Britomart
Auckland

By email: consultation@fma.govt.nz

Submission: Proposed guidance on KiwiSaver fees and value for money

This Submission on the Financial Markets Authority (FMA) consultation paper, proposed guidance on KiwiSaver fees and value for money, 2 November 2020 (the Paper) is from the Trustee Corporations Association of New Zealand Inc (**TCA**).

The TCA is a long-established association representing Licensed Supervisors. The members of the TCA are: Public Trust, Trustees Executors Limited, The New Zealand Guardian Trust Company Limited and Covenant Trustee Services Limited. Anchorage Trustee Services Limited is an associate member of the TCA.

General comments

The TCA supports work that enhances the promotion and facilitation of the development of fair, efficient and transparent financial markets in New Zealand, and that all customers are receiving good outcomes from the financial sector. This includes ensuring that KiwiSaver Scheme providers are performing their duties and obligations in accordance with their legislative requirements.

We agree that fees and expenses should be reasonable, accurate and consistent with the governing documents and information given to members and that both managers and supervisors of KiwiSaver schemes should have processes in place to regularly review fees.

We note that across the market, supervisor's fees have been reviewed on a number of occasions since the inception of KiwiSaver and as the funds under supervision have increased, the benefits of scale have been taken into account with supervisors fees being reduced considerably over the years.

We acknowledge that supervising the manager's performance of its functions includes challenging them to ensure they have process in place to review the fees and determine they are not unreasonable. However, when considering and determining whether fees might be unreasonable supervisors are likely to require more detailed guidance and input from the FMA.

One of the factors when considering whether a fee is unreasonable, as set out in the KiwiSaver Regulations, is to assess whether the fee is significantly higher than fees charged in relation to another scheme. When considering this, supervisors are unlikely to have all the specific detail on the comparable schemes or fee components, as they do not have the visibility across the whole market. For example, we note that some managers pay fees & expenses themselves from a grossed up management fee, while other managers charge all fees to the scheme directly. This can make it difficult for Supervisors to compare and determine as to whether or not the fees charged are unreasonable.

Therefore, when assessing what is or might constitute “unreasonable” and how to benchmark this, a more detailed guidance will likely be required to assist the relevant parties when undertaking required reviews.

In addition, we note that the obligation not to charge an unreasonable fee is a “market services licensee obligation” and any contravention, or likely contravention of a market services licensee obligation in a material respect is also directly reportable to the FMA by the manager. As such we consider that the FMA and supervisors will need to work together and share information, including assessments as part of initial registration of the scheme, when determining when the fees might be unreasonable.

Consultation Questions

1. <u>Do you agree with the factors we have identified as being relevant to an assessment of whether KiwiSaver fees are unreasonable? If not, please outline your reasons.</u>

We generally agree with the factors identified however there are some areas that will require further clarification. We note the guidance note issued in 2012 in relation KiwiSaver performance fee, however we are not clear what is meant by criteria relating to “*How the fund has performed, with a focus on any* underperformance”, and assume this doesn’t relate to performance fees.

We also note that linking the reasonableness of fees to performance is highly subjective and standardising this can be quite complicated. Whether fund managers employ active or passive investment strategy and style, there will be periods where funds underperform due to market factors which are outside of the fund manager’s control. This can also lead to behaviours that might expose investors to higher risks.

Some of the factors have been quite broadly phrased and some of the considerations might be applicable across a number of factors. We suggest potentially simplifying and providing further clarity, with additional context or examples, on what should be considered on each of those factors.

2. <u>Are there any other factors you consider relevant to an assessment of whether KiwiSaver fees are unreasonable, or inconsistent with the related overarching statutory duties?</u>

Any additional servicers that are included in the fees and provided by the managers should be considered and taken into account. For example if a particular fee (like advice, or other additional service’s Manager might provide) is included the supervisors should be enquiring and monitoring whether the manager is providing that service to members. Appropriate consideration needs to be given as to whether or not the fees charged represent value for money.

3. Do you agree with the examples we have identified of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If not, please outline your reasons

As Supervisors, we would expect licensed MIS Managers to have the right mix of people with the right skills and experience in the right roles to manage their licensed business properly and effectively. This means that, as the size of the business increases, there would likely need to be a requisite increase in resourcing to manage the growing demands of the business, which would include compliance, operations & investment management. When looking at funds under management and the benefits of scale, we consider that managers should also consider those factors when reviewing their fees.

We agree that moving from an active to passive management style should see fees reduce.

4. Are you aware of any other examples of when KiwiSaver fees may be unreasonable, or inconsistent with the related overarching statutory duties? If so, please provide details.

Not at this time.

5. Do you think this guidance will help managers and supervisors to understand their ongoing obligation not to charge unreasonable fees and their statutory duties that relate to fees and value for money? Please outline the reasons for your answer.

We consider that guidance will be helpful, however as indicated earlier more detail and clarity is likely to be required. The TCA can work closely with the FMA to come with some further guidelines on how to supervise and monitor fees, which can be incorporated in the existing TCA supervision guidelines.

6. Do you have any examples of any costs or fee levels that you think are unreasonable/reasonable? If so, please provide details.

Not at this time.

7. Are there any additional matters that you think the guidance should address? If so, please provide details

TCA considers that at the same time as providing value for money to members, managers and supervisors should have sufficient financial strength and resources to have an effective governance structure and to put in place and maintain the robust controls required in order to perform their function to a very high standard. While managers should be well placed to prevent poor investor outcomes occurring in the first place, they must also be capable of ensuring that investors are fairly and fully remediated, and in a timely manner, if any issues arise that require member compensation.

If a KiwiSaver provider was to get into financial difficulty such that they could not adequately provide member services or remediate members (if that was required) this could adversely impact[1] the public's confidence in KiwiSaver generally. In addition, the industry should also be conscious of the impact on innovation (including the type of investment products and range of funds), continuous improvement, and investment into technology, all of which will benefit members.

Kind regards,

[redacted]

[redacted]

[redacted]

[redacted]

[1] Note in this regard we are not referring to members investments being at 'risk' as given the bankruptcy remoteness of KiwiSaver schemes from the manager and the powers that the FMA and supervisor has (along with the assets of schemes being held in trust by the supervisor (or via custodians)) this risk is low it is largely an issue of confidence and the timely provision of member services.

AUCKLAND – Level 5, Ernst & Young Building | 2 Takutai Square, Britomart | PO Box 106 672 | Auckland 1143
WELLINGTON – Level 2 | 1 Grey Street | PO Box 1179 | Wellington 6140