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Dear Joanna

Opinion: KiwiSaver investing in private assets

1. Introduction

- 1.1 The Centre for Sustainable Finance: Toitū Tahua (**CSF**) believes KiwiSaver providers should play a bigger role in investing in the sustainable future of New Zealand while delivering better long-term value for KiwiSaver members.
- 1.2 To clarify and remove barriers currently inhibiting this type of investment, CSF convened a working group of senior representatives from KiwiSaver providers together with relevant industry stakeholders to put forth recommendations to encourage investment by KiwiSaver funds and other investors into sustainable long-term assets and infrastructure (otherwise known as private assets).
- 1.3 One of the key purposes of the working group in promoting the proactive consideration of investment in private assets by KiwiSaver providers was to bring better value to KiwiSaver members, while at the same time driving sustainability outcomes for Aotearoa New Zealand.
- 1.4 With this purpose in mind, the CSF-led working group observed that KiwiSaver schemes generally had a very low exposure to private assets compared to pension funds from other jurisdictions. In particular, the working group noted that, internationally, institutional investors from G20 jurisdictions, such as pension funds, were increasingly relying on private investment to deliver “green and transformative infrastructure”, with allocation from this sector to private asset investment expecting to double in the next five years¹.
- 1.5 In developing its recommendations to encourage investment in long-term assets, the working group identified several key barriers and challenges, perceived or otherwise, potentially impeding investment by KiwiSaver funds in private assets. The recommendations, together with the key barriers and challenges, are set out in a paper entitled *Investing in Private Assets: Joint Paper on Key Recommendations to Reduce Barriers and Challenges for KiwiSaver Funds to Invest in Private Assets (CSF Paper)*².
- 1.6 CSF has requested MinterEllisonRuddWatts and Chapman Tripp to provide this opinion advising on whether those impediments are legal in nature, and if so to suggest steps that might be taken by government and/or the Financial Markets Authority (**FMA**) to remove or reduce them. The terms of reference of this opinion are set out in [Appendix 1](#).

2. Executive Summary

- 2.1 There is no outright legal prohibition that prevents KiwiSaver providers investing in private assets in New Zealand.

¹ [Pensions are poised to power an ESG-driven global economy \(github.org\)](#)

² [Investing+in+Private+Assets+WG_Recommendations+Paper_v1.1+FINAL.pdf \(spacespace.com\)](#)

2.2 KiwiSaver providers have a broad discretion to invest KiwiSaver scheme assets, provided it is in accordance with the fundamental requirement to act in the best interests of investors³ and within any asset class or other limits they impose in their schemes' Statements of Investment Policy and Objectives (**SIPOs**)⁴ (which are publicly available documents established and maintained for each scheme containing the scheme's investment objectives and strategies).

2.3 However, there are other features of KiwiSaver's current legal and regulatory environment which may act as disincentives, discouraging providers from investing in private assets, with the result that KiwiSaver schemes as a whole are much less invested in private assets (as compared to the New Zealand Superannuation Fund (**NZ Super Fund**) or private sector retirement savings schemes in comparable jurisdictions). These features include:

(a) **the need for liquidity** to meet:

- (i) the account portability obligations contained in section 56 of the KiwiSaver Act 2006 (**KiwiSaver Act**), which require KiwiSaver providers to transfer members' account balances from one KiwiSaver scheme to another within 10 working days of a request;
- (ii) members' entitlements to various permitted early withdrawals as allowed under Schedule 1 to the KiwiSaver Act (the **KiwiSaver Scheme Rules**) (in addition to members' withdrawals of their funds on and from their 'KiwiSaver end payment date'⁵), and the fact these entitlements cannot be waived (including with member consent); and
- (iii) the increasing expectations of the FMA for liquidity management in light of the duties in sections 143 and 144 of the Financial Markets Conduct Act 2013 (**FMC Act**), as described in the FMA's Liquidity risk management good practice guide for Managed Investment Schemes⁶ (**MIS Manager Liquidity Guidance**),

as well as the need for liquidity to meet switch requests from one KiwiSaver fund to another fund within the same KiwiSaver scheme (which could be partly addressed by KiwiSaver providers imposing a lock-in period or notice period for switches, if palatable to members and permitted by the scheme's governing document);

(b) **the requirements for daily pricing of assets** contained in many existing scheme governing documents (in response to the need for liquidity outlined in paragraphs 2.3(a) above), which are more easily satisfied when investing in assets that are (or can be) priced daily; and

(c) **the requirement that fees not be "unreasonable"** in clause 2, Schedule 1 of the KiwiSaver Act, as interpreted in light of the FMA's Managed Fund Fees and Value for Money guidance from April 2021⁷ (**VfM Guidance**) and the manner in which fees are reported by the FMA and Sorted⁸, which are perceived to encourage 'low service/low fees' products, ahead of those with more costly, complex investment decision processes.

2.4 It is the role of KiwiSaver providers and their expert investment management teams to make investment decisions (including whether to prefer one asset class over another) in members' best interests and in accordance with the relevant SIPO. However, where there are features of the legislative and regulatory environment which may impede or discourage KiwiSaver providers

³ Section 143, FMC Act.

⁴ Section 164, FMC Act

⁵ Clause 4(3) of the KiwiSaver Scheme Rules

⁶ Issued April 2020 <https://www.fma.govt.nz/assets/Guidance/MIS-liquidity-risk-management-guide.pdf>, which is proposed to be updated in new guidance for Managed Investment Scheme (MIS) managers and their supervisors for effective liquidity risk management⁶ (issued September 2023 <https://www.fma.govt.nz/assets/Consultations/Consultation-paper-Proposed-liquidity-risk-management-guidance.pdf>)

⁷ [Managed-fund-fees-and-value-for-money-guidance.pdf](https://www.fma.govt.nz/assets/Guidance/Managed-fund-fees-and-value-for-money-guidance.pdf) (fma.govt.nz)

⁸ Sorted is a free service provided by Te Ara Ahunga Retirements Commission. For more detail on its KiwiSaver fund finder tool, including the assumptions it uses for provider fees, see <http://sorted.org.nz/how-these-calculators-work/kiwisaver-fund-finder>

investing in long term assets in accordance with members' best interests, then these issues should be considered by the Government for reform for those members seeking to invest for the long term.

- 2.5 In our view, amending the legislative and regulatory environment to make it easier for KiwiSaver providers to invest in private assets by mitigating the issues is consistent with (and would aid in furthering) both the main and additional purposes of the FMC Act. As CSF and the working group observed, the relative lack of investment by KiwiSaver in private assets means consumers are not participating in the growth of private markets in New Zealand. This is also limiting investment sector choice.
- 2.6 The main purposes of the FMC Act are to promote the confident and informed participation of businesses (as well as investors and consumers) in financial markets and to promote and facilitate the development of fair, efficient, and transparent financial markets.⁹ An ancillary purpose of the FMC Act is to promote innovation and flexibility in financial markets¹⁰. Modifying the law to allow KiwiSaver providers to invest in private assets, free from all other considerations, when it is in members' best interests, is squarely consistent with these aims.
- 2.7 As set out in section 7 of this opinion below, we consider there are several changes to legislation or regulation that would mitigate the difficulties identified above.

3. The need for liquidity

- 3.1 Sustainable investments, such as infrastructure or carbon sinks, and other private assets often have long investment horizons with very limited liquidity opportunities, meaning that fund flow assessments need to cover long periods through different economic cycles, which increase the investment risks. Accordingly, sustainable investments may not be preferred by managers who have a higher requirement for liquidity, even if those investments have commensurately higher expected returns.
- 3.2 Certain KiwiSaver features encourage KiwiSaver providers to favour highly liquid investments, and anticipate transfer and withdrawal rates conservatively, which may be contrary to the interests of investors with long term investment horizons. We discuss these features below.
- 3.3 Under section 53 of the KiwiSaver Act, a person can (currently) belong to only one KiwiSaver scheme at a time, but a person can change schemes at any time. If a member chooses to change KiwiSaver schemes, the member must apply to the new provider of the scheme they want to join. The new KiwiSaver provider gives notice to the old provider to transfer the member's savings. The KiwiSaver Act requires the old KiwiSaver provider to comply with the notice to transfer a person's account balance to the new scheme within 10 working days of receiving the notice¹¹ by liquidating fund assets to transfer cash to the new KiwiSaver provider within that 10 working days timeframe. A proportion of the relevant KiwiSaver scheme needs to be in liquid assets to meet those requirements.
- 3.4 Permitted early withdrawals are also allowed under the KiwiSaver Scheme Rules (in addition to accessing funds when members reach their 'end payment date'¹²), and both require a proportion of liquid assets to meet withdrawal demands. Permitted early withdrawals are allowed when a member:
- (a) makes a first home withdrawal;
 - (b) dies;

⁹ Section 3 FMC Act.

¹⁰ Section 4(d) FMC Act.

¹¹ Section 56(4) KiwiSaver Act. Before 1 April 2020, providers (other than default providers) were required to comply with a transfer request within 35 days of receiving notice. Default providers have always been required to comply with a transfer request within 10 working days of receiving notice under their Instrument of Appointment.

¹² Being the later of (a) when they reach the New Zealand superannuation qualification age (currently 65) or (b) after they have been a member of KiwiSaver for at least 5 years.

- (c) suffers significant financial hardship;
 - (d) suffers serious illness (including early withdrawal for a life-shortening congenital condition);
 - (e) withdraws or transfers to a foreign scheme in cases of permanent emigration; or
 - (f) withdraws funds to meet foreign superannuation withdrawal tax liabilities.
- 3.5 KiwiSaver members can also switch between funds within a scheme, requiring rebalancing of assets within each fund and consequential sales of some assets to keep within mandated asset class limits of the old fund. Switching rights therefore also contribute to the need to invest a proportion of each KiwiSaver fund in liquid assets.
- 3.6 In addition, if members will be able to invest in more than one scheme or additional early withdrawal rights are allowed (as envisaged by cross reference under the Coalition Agreements¹³ that were entered into to form the current Government), the need for KiwiSaver providers to maintain liquidity to meet permitted early withdrawals under the KiwiSaver Scheme Rules could be exacerbated, unless carefully balanced to avoid having that unintended effect.
- 3.7 The CSF Paper records that KiwiSaver providers report that they find it difficult to predict when members will want to transfer to another provider¹⁴. As a result, some providers have been unwilling to invest in private assets because these assets are generally less liquid, meaning there could be significant challenges for providers to accommodate (and comply with) account transfer requests without impacting the asset allocations authorised within their investment mandates. The perceived need to maintain high levels of liquidity to fund early permitted withdrawals seems to have prompted these KiwiSaver providers to prefer to maintain a large proportion of fund investments in liquid assets. The working group noted this approach was at odds with retirement savings providers in other jurisdictions, as described in the CSF Paper¹⁵.
- 3.8 The scale of the KiwiSaver market suggests that a small proportion of KiwiSaver assets would be an attractive source of funds for private asset investments if the KiwiSaver framework was more conducive to long term investments. The latest Melville Jessop Weaver KiwiSaver Market Review (October 2023)¹⁶ (**MJW Market Study**) indicates the overall size of the KiwiSaver market in the year to March 2023 was \$93.6 billion (of which four of the largest bank-owned providers together managed approximately 50% of the total FUM).
- 3.9 Membership of KiwiSaver for the same period to March 2023 was 3.25 million people, and the average KiwiSaver account balance was \$28,800¹⁷. According to the FMA's KiwiSaver Annual Report 2023¹⁸, 131,260 of those members (approximately 4% of all members) transferred between providers (including movements to different risk types) in the year to 31 March 2023. A corresponding small proportion of total assets were withdrawn in 2023. The total amount withdrawn from KiwiSaver schemes in the year to 31 March 2023 was \$4.2b, with the largest category (by value) being members making retirement withdrawals¹⁹.
- 3.10 The IRD KiwiSaver statistical datasets show that, aside from the increased spike as at 30 June 2022 (due in large part to the number of involuntary transfers that occurred as a result of the outcomes of

¹³The current Government was formed pursuant to two coalition agreements between National and ACT, and National and NZ First (Coalition Agreements). The Coalition Agreements do not refer to KiwiSaver changes but incorporate by cross-reference National's 100-point plan. Point 47 of the 100-point economic plan proposes to "allow KiwiSavers to invest in more than one provider, driving innovation, boosting competition and putting downward pressure on fees."

¹⁴ CSF Paper at page 11.

¹⁵ CSF Paper at page 1.

¹⁶ [KiwiSaver Market Study \(mjw.co.nz\)](https://www.mjw.co.nz)

¹⁷ MJW Market Study at page 1.

¹⁸ [KiwiSaver Annual Report 2022-23 \(fma.govt.nz\)](https://www.fma.govt.nz)

¹⁹ FMA KiwiSaver Annual Report 2023. Retirement withdrawals accounted for \$2.8b of the total \$4.2b (or ~67% of withdrawals for the year ended 31 March 2023).

the default provider review that took place in December 2021) the number of scheme-to-scheme transfers has remained relatively static from June 2013 to June 2023.

- 3.11 Accordingly, intuitively, it should be possible for KiwiSaver providers to predict the likely range of net outflows from a fund (whether due to portability transfers, switching, early withdrawals or retirement age withdrawals), particularly with the benefit of actuarial advice – at least in the ordinary course of events, and so a small proportion of KiwiSaver scheme assets could be invested in long term private assets.
- 3.12 However, the reality remains that the large majority (by FUM) of KiwiSaver providers do not allocate funds' assets to private assets – far less than retirement savings scheme providers in other jurisdictions. The MJW Market Study identified only a number of smaller or niche KiwiSaver providers doing so²⁰. As of March 2023, the Reserve Bank of New Zealand reported that a mere 0.18% of KiwiSaver funds were allocated to unlisted shares²¹. In comparison, private equity makes up approximately 4% of the NZ Super Fund's investment portfolio²².
- 3.13 The reasons why so few KiwiSaver providers actively allocate to private asset investment (compared to retirement savings scheme providers in other jurisdictions), despite the apparent predictability of member outflows in the ordinary course of events and the potential higher returns available for long-term commitments, are not clear.
- 3.14 In our opinion, one of the reasons that many KiwiSaver providers are discouraged from investing in private assets is likely to be that they regard the potential illiquidity of such assets as creating risk given the account portability and permitted early withdrawal rights (along with the permitted withdrawals and switches) are entitlements that must be met in all circumstances.
- 3.15 The possibility of high volumes of transfers, permitted withdrawals or switches due to aging, changes in investor circumstances or preferences, or other factors, could cause KiwiSaver providers to be concerned that their schemes will suffer net outflows. In such cases, asset allocations would need to be reduced, but it may not be possible to liquidate private asset investments, causing the scheme's private asset allocations to be overweight compared to those mandated in its SIPO, potentially causing the KiwiSaver provider to breach its prudent manager duties to the remaining members²³, and leading to potential enforcement action and reputational damage. The significance of these risks could currently reasonably be prompting KiwiSaver providers to take a cautious approach to their scheme's liquidity profiles.
- 3.16 Fund managers have seen the impact of “runs on the bank” in the banking sector, and the speed with which those events can gather momentum as a result of member decisions, whether or not those decisions are based on rational factors.
- 3.17 The liquidity bias could also be exacerbated by the MIS Manager Liquidity Guidance²⁴, in which the FMA encourages MIS managers to have a range of liquidity management tools, including “side-pockets”, redemption gates, withdrawal limits and the ability to suspend redemptions to address liquidity crises.
- 3.18 “Side-pocketing” is a practice used in other managed investment schemes which are not subject to statutory redemption rights, whereby (generally speaking) a manager can set aside illiquid assets in a sub-fund and not permit a member who has exposure to those assets to make withdrawals from those investments.
- 3.19 The ability to side pocket private assets, operate redemption gates, introduce withdrawal limits or suspend redemptions would assist KiwiSaver providers address the liquidity risks associated with

²⁰The MJW Report identified Booster KiwiSaver Scheme, Simplicity KiwiSaver Scheme and Pathfinder KiwiSaver Scheme as having exposure to private assets

²¹ Ministry of Business, Innovation & Employment, Startup Advisers Council *UpStart Nation 2023*, page 32 (available [here](#)).

²² NZ Super Fund Annual Report 2023, page 40 (available [here](#)).

²³ Sections 143 and 144 of the FMCA.

²⁴ [MIS-liquidity-risk-management-guide.pdf \(fma.govt.nz\)](#) (see Principle 7 – liquidity management tools)

holding private assets, if those mechanisms are available. However, in our opinion, the KiwiSaver Act does not allow providers to utilise these types of liquidity management mechanisms to override the entitlement to account portability or permitted withdrawal requirements in the KiwiSaver Scheme Rules. We elaborate on this conclusion in section 6 below. Consequently, KiwiSaver providers are unable to use these types of tools to mitigate the illiquidity risks arising from long-term investments in private assets, potentially fuelling any bias towards more liquid investments.

- 3.20 For the reasons outlined above, the requirement for account portability and early withdrawals, and the FMA's liquidity expectations, may be discouraging KiwiSaver providers from investing in private assets. We set out in section 7 our thoughts on ways in which these factors could be overcome with legislative amendments.

4. Requirements for daily pricing

- 4.1 In parallel with the desire to maintain perceived levels of liquidity to fund account portability, early withdrawal requirements and fund switching, KiwiSaver managers have cited the requirement for daily pricing of assets as a further feature discouraging private asset investment.
- 4.2 Daily valuation of assets is necessary where a fund allows entries, redemptions (or other withdrawals) to occur on a daily basis. Such redemptions (or withdrawals) may be for the purpose of funding balance transfers to other KiwiSaver schemes (as set out above in paragraph 3.3), or to fund switches or permitted withdrawals (whether for retirement or another permitted reason i.e. first home purchase).
- 4.3 Most, if not all, governing documents of KiwiSaver schemes require managers to calculate the net asset value of a KiwiSaver scheme (or fund(s) within that scheme) within a set period e.g. at least once every 5 business days. While daily pricing could still be achieved for KiwiSaver schemes which invest in private assets if long-term values are permitted for price valuation purposes, any amendment to the valuation methodology provisions in a governing document for an existing scheme to mitigate a daily pricing need (or provide for a different method) would be subject to the requirements of the FMC Act (which essentially would require that the change not be materially adverse to members – see paragraph 4.5 below).
- 4.4 Most private assets do not have a traded market from which to derive current market prices and are usually valued by reference to a framework or methodology agreed by the manager. In addition, private assets are usually valued far less frequently than more liquid assets (i.e. valued monthly, quarterly, or even annually). These less frequent valuations can be utilised for unit pricing purposes if the trust deed permits, but it may be necessary to alter a scheme's trust deed to allow for such deferred valuations of private assets if they have not been provided for. The FMC Act requires trust deeds set out the methodology for valuing scheme assets²⁵.
- 4.5 Under section 139 of the FMC Act, a change to a governing document (for example, a change to the pricing methodology reflected in the governing document) for a managed investment scheme is of no effect unless either:
- (a) approved by (or contingent on approval by) a special resolution of scheme participants that are (or may be) adversely impacted by the change; or
 - (b) the supervisor is satisfied that the amendment does not have a material adverse effect on scheme participants, and a solicitor certifies to that effect²⁶.
- 4.6 Some governing documents may be more flexible than others to allow a change to the pricing methodology without requiring an amendment to the governing document. However, for those governing documents which are not as flexible and for which an amendment would be required, it

²⁵ See s 135(1)(d) FMC Act

²⁶ See s 139(2) FMC Act.

may be difficult to characterise an amendment to defer regular assets pricing for unit pricing purposes as not having a material adverse effect on scheme participants.

- 4.7 Even when less frequent asset values can be used for private assets, KiwiSaver providers will still be required to consider the best interests of members and whether the less frequent asset valuations might raise potential equity considerations between investors if the private assets held are not able to be valued sufficiently frequently to be accurately reflected in daily pricing of the fund.
- 4.8 Accordingly, while the valuation of private assets which are not market traded is more cumbersome than for daily pricing of traded assets, it can be accommodated within the relevant scheme trust deed. It should also not be a reason to avoid non-market traded investments, such as private assets, within KiwiSaver schemes, if the inconvenience and cost of arranging regular private asset valuations are outweighed by the benefits of investing in that asset class. Shifting investments into long term, non-traded private assets can therefore be accommodated within unit pricing mechanisms, but would likely require in most cases carefully drafted trust deed changes which would involve following the process prescribed in the FMC Act.
- 5. Requirement for fees not to be “unreasonable” misinterpreted as meaning low fees**
- 5.1 The “intense focus on fees” as a result of the VfM Guidance was highlighted in the CSF Paper as a significant feature discouraging private asset investment, due to the potential cost associated with making such investments, such as hiring experts and outsourcing management²⁷.
- 5.2 Although the FMA clarified in its Value for Money Industry Report²⁸ (**FMA VfM Report**) - a pilot report on funds of several MIS managers in the year following the VfM Guidance - that the VfM Guidance was not designed to push the industry toward being passive and low-fee²⁹, there remains a perception in the industry, as highlighted by the CSF Paper, that the FMA remains heavily focussed on low fees as a primary mechanism to provide “good outcomes” for investors.
- 5.3 This perception may have been exacerbated by the recent KiwiSaver default provider selection/reappointment process in 2021. A key outcome of the competitive tender process run by the Ministry of Business, Innovation and Employment (MBIE) in 2021 was the reduction of KiwiSaver fees. When MBIE assessed applicants as part of the competitive tender, it applied a weighted set of criteria, with a weighting of 60% given to fees alone (with the remaining 40% being an assessment of “qualitative criteria” including member experience, and organisational structure and financial standing).
- 5.4 By comparison, fees were weighted at 30% in the 2014 default provider appointment review. When setting its parameters for the 2021 tender process, MBIE acknowledged the lower weighting in prior years meant “some proposals with significantly higher than average fees [were] assessed favourably and ultimately appointed³⁰”.
- 5.5 Interestingly, none of the default KiwiSaver providers who were appointed as part of the default provider review in 2021, as far as we have been able to determine, invest their default funds in private assets. One reason for this may be the pressure to have low fees has discouraged default KiwiSaver providers from investing in private assets due to their greater management and administration costs.
- 5.6 In our view, despite the FMA’s reassurances that the VfM Guidance was not meant to result in a “race to the bottom” on fees, the VfM Guidance would benefit from express acknowledgement that “value for money” could include delivering better long-term value for KiwiSaver members by investing in private market (VC and PE) and infrastructure assets (where the product positioning and SIPO of the particular KiwiSaver fund allows).

²⁷ CSF Paper at page 12.

²⁸ [Value-for-Money-Industry-Report.pdf \(fma.govt.nz\)](#)

²⁹ Ibid at page 10.

³⁰ [KiwiSaver Default Provider Review – revised evaluation approach \(mbie.govt.nz\)](#)

- 5.7 The VfM Guidance does not currently recognise the fundamentally different nature of private asset investment compared to more liquid assets, for example, the “J-curve” effect³¹ (representing the tendency for private assets to post negative returns in the initial years with a gradual increase to (generally) eventual higher returns at exit).
- 5.8 Instead, the FMA VfM Report states that “fee drag” has “reduced the benefit of [MIS manager] competence” to investors³², serving to reinforce the impression (whether intended or not) that low fees are the primary goal of value for money.
- 5.9 On the face of it, the legislative requirement that KiwiSaver fees not be “unreasonable”³³ does not constrain a provider to any particular fee structure, size or type. However, the KiwiSaver Regulations 2006 give the FMA a framework within which it can consider whether a KiwiSaver provider has met its legislative requirement not to have “unreasonable” fees, including by reference to the fees of other funds or schemes that the FMA considers “comparable”³⁴.
- 5.10 Direct comparison between a fund that has no allocation to private assets to a fund that has a proportion of its investments allocated to private assets may not be possible considering the relative complexity associated with the management of private assets and the specialist nature of these assets. A strict approach to fee ranges may cause KiwiSaver providers to be discouraged from private asset investments if they result in fund fees that are “out of step” with market, and therefore potentially vulnerable to being categorised by the FMA as “unreasonable”.
- 5.11 By their very nature, private assets require more investigation, management and administration given their relative complexity. This takes time and therefore costs more for investors. However, managers should be justified in charging higher fees for the management of funds which allocate to private asset investment compared to those that do not, where the private asset investments are expected, or have the potential, to earn returns that warrant the additional costs.

6. The liquidity risk management toolkit is not available for KiwiSaver schemes

- 6.1 In September 2023, the FMA released a consultation that outlines its expectations of the essential features for liquidity risk management for all managed funds³⁵. It follows the FMA’s earlier MIS Manager Liquidity Guidance.
- 6.2 In the consultation, the FMA refers to the need for a MIS manager (which includes a KiwiSaver manager) to have a “range of appropriate tools readily available to deploy in specific circumstances, including where redemption obligations cannot be met in the ordinary course of business”³⁶.
- 6.3 Specifically, the consultation states:

[The FMA] consider that a careful, skilled and prudent MIS manager (including, for example, managers of KiwiSaver schemes) must have the ability to suspend redemptions and for this ability to be properly disclosed to investors (through the PDS or Other Material Information).

There are situations where the need to delay or suspend redemptions may be acceptable for KiwiSaver and other restricted schemes, providing the manager is acting in the best interests of scheme participants and treating them equitably.

*It is our expectation that such tools are used only in exceptional circumstances, sparingly, and with a view to lifting the suspension as quickly as the circumstances will allow. **Suspending redemptions***

³¹ See page 32 of UpStart Nation Report by the StartUp Advisors Council ([UpStart Nation 2023 \(mbie.govt.nz\)](https://www.mbie.govt.nz/upstart-nation-2023))

³² Ibid at page 3.

³³ See clause 2, Schedule 1, KiwiSaver Act.

³⁴ See clauses 11 and 12, KiwiSaver Regulations 2006.

³⁵ [Consultation paper - Proposed liquidity risk management guidance. \(fma.govt.nz\)](https://www.fma.govt.nz/consultation/paper-proposed-liquidity-risk-management-guidance). This consultation proposes to update and replace the existing liquidity risk management guidance from April 2020.

³⁶ Ibid at page 12.

is highly effective at controlling fund liquidity in a serious market event which, in turn, supports the MIS manager to fulfil their statutory duties (emphasis added).

- 6.4 These liquidity tools would be helpful to address liquidity risk and facilitate investment in long-term private assets, as well as protecting KiwiSaver members in times of a crisis. However, the mandatory KiwiSaver Scheme Rules prevent KiwiSaver providers suspending redemptions or creating 'side-pockets' as a means to deny, for a period of recovery or realisations, transfers or permitted withdrawals, which are mandatory under the KiwiSaver Scheme Rules.
- 6.5 KiwiSaver managers have a statutory duty to carry out functions as a manager in accordance with the governing document, the SIPO, and all other issuer obligations³⁷.
- 6.6 Under section 135 of the FMC Act, a governing document for a KiwiSaver scheme is treated as having in it any provision implied under the KiwiSaver Act³⁸.
- 6.7 The KiwiSaver Scheme Rules are implied in every trust deed that establishes a KiwiSaver scheme³⁹. For the avoidance of doubt, the KiwiSaver Scheme Rules apply despite anything to the contrary in a trust deed, and are enforceable by the manager, the supervisor, and any member, of a scheme⁴⁰.
- 6.8 The KiwiSaver Scheme Rules set out the prescribed permitted withdrawals, which include a mandatory obligation to allow a withdrawal where conditions are met (for example, when a person reaches New Zealand superannuation qualification age⁴¹). As mentioned earlier, they also require transfers are completed within 10 working days.
- 6.9 Accordingly, the legislative duty of a KiwiSaver scheme manager to act in accordance with the terms of the KiwiSaver Scheme Rules (which apply despite any provision to the contrary in a governing deed, including a provision in relation to the suspension of redemptions) will override the FMA's expectation in the consultation that "*careful, skilled and prudent MIS managers (including... managers of KiwiSaver schemes) must have the ability to suspend redemptions*".
- 6.10 "Side-pocketing" (which, as explained above at 3.18, is a localised form of suspension of stressed assets), which is another liquidity risk management tool the FMA has referenced in relation to the guidance, is equally not permitted.
- 6.11 However, switching is not prescribed by the KiwiSaver Scheme Rules and accordingly, it is possible to include suspension and 'side-pocket' rights in a governing document in respect of switching requests. However, in practice, a KiwiSaver member who is denied a switching right is likely to make a mandatory transfer request or, if available to them, a permitted withdrawal request, and so the liquidity benefits of suspensions or side-pocket rights in respect of switching would be limited.

7. Potential solutions to reduce impediments

- 7.1 There are some potential options that could be implemented in order to reduce the impediments for KiwiSaver scheme managers to invest in private assets. Not all of these options are mutually exclusive and a solution could involve a combination of the options set out below.

Liquidity

- 7.2 It is proposed that there be a legislative amendment to the KiwiSaver Scheme Rules allowing schemes to opt out of the portability rules, and/or early and permanent withdrawal requirements in

³⁷ See s 143(2) FMC Act.

³⁸ See s 135(2) FMC Act.

³⁹ See s 116(2) KiwiSaver Act.

⁴⁰ Ibid.

⁴¹ See clause 4, Sch 1, KiwiSaver Act.

circumstances which are prominently disclosed in the scheme's PDS and acknowledged by applicants.

- 7.3 KiwiSaver providers would then be able to:
- (a) have mandatory lock-in periods to allow long-term assets to mature; or
 - (b) include liquidity management tools, including "side-pockets", redemption gates, withdrawal limits and the ability to suspend redemptions to address liquidity crises within their terms and conditions.
- 7.4 It would be possible to go further and amend the KiwiSaver Act to allow for the creation of a specific "private asset" fund type within a KiwiSaver scheme. This "fund type" could have pre-defined qualifying characteristics which, if met, allow it to be exempt from the account portability and withdrawal requirements of the KiwiSaver Act and KiwiSaver Scheme Rules. KiwiSaver members investing in this particular "fund type" would be able to make withdrawals and transfer their account balances only in certain circumstances, which would be clearly disclosed upfront to those investors.
- 7.5 This solution may be more attractive, and potentially easier to administer, if members are allowed to join more than one KiwiSaver scheme at a time. The parameters of any such "fund type" could be carefully prescribed, with consideration given to various factors including the proportion of illiquid assets, adequate disclosure and investor acknowledgment of risk (and corresponding lack of access to those funds), and any investment thresholds (for example, a high minimum subscription amount to target more sophisticated investors). Disclosure of the special features of such fund would need to be transparent so that investors know what they are signing up and agreeing to.
- 7.6 Additionally, when considering submissions on its consultation on the essential features for liquidity risk management for all managed funds, the FMA could address specifically the tension between the legislative duty of a KiwiSaver scheme manager to act in accordance with the terms of the KiwiSaver Scheme Rules and the FMA's expectation that KiwiSaver scheme managers have the ability to suspend redemptions (including "side-pocketing" assets).

Daily pricing

- 7.7 While it is possible for KiwiSaver scheme trust deeds currently to accommodate different valuation methodologies for non-market traded assets (which private assets would typically be), there is additional inconvenience for KiwiSaver providers to invest in assets which are not daily priced and to adapt their scheme's trust deed to accommodate suitable valuation methodologies for such assets. Accordingly, we recommend that:
- (a) private asset promoters (including the Government) who are seeking long term investment establish a means by which private assets can be traded or a market value struck in an administratively efficient manner to facilitate greater attractiveness of their private asset investments to KiwiSaver providers; and
 - (b) the FMA Act trust deed amendment provisions be streamlined to allow supervisors to agree to trust deed changes to permit long-term asset valuation methodologies to be adopted in a more efficient manner.

Greater recognition that the higher fees associated with private assets are not unreasonable and recognition that KiwiSaver default providers could increase agreed fees on a go forward basis by a reasonable amount to allow default funds to invest in private assets

- 7.8 In our view, it would be beneficial to introduce a definition, in the KiwiSaver Scheme Rules, of the term "unreasonable" as it is used in relation to scheme fees, or at least include a "safe harbour" of what should be considered "reasonable" in the context of such fees. Additionally (or alternatively) consideration should be given to reforming those sections of the KiwiSaver Regulations 2006 that set out the process by which the FMA can make a fees assessment, to give more detail regarding what the FMA should consider as "comparable."

- 7.9 It would be helpful for the FMA to clarify that, in terms of its VfM Guidance, fees should be commensurate with the amount of effort exerted by the manager to invest in the assets chosen for a scheme, by reference to private assets. The updated VfM Guidance could ideally give the example of a KiwiSaver manager investing in private assets, illustrating how it could support a management fee commensurate with the relative complexity in managing and administering such investments (including the greater effort required to conduct due diligence before making such investments and then, when the investment has been made, monitoring the investment on a go forward basis).
- 7.10 It would also be helpful for MBIE to clarify in the agreements with default KiwiSaver providers that, should KiwiSaver default providers wish to invest some of their default funds in private assets, having satisfied the best interests of investors test, then those default providers could propose fee increases to their default funds on a go forward basis to account for the greater time and cost incurred investigating and managing private investments in the default fund. MBIE could also clarify that it will consider any such fee increases for default funds on a good faith basis with the KiwiSaver default provider.

8. Final observations

- 8.1 Generally speaking, there is an expectation of higher potential returns for private asset investments in return for their long-term investment commitment. Therefore, for investors with a long investment horizon, it may be in members' best interests to facilitate investment in illiquid assets such as private assets, or at the very least to be given that choice.
- 8.2 It would be advantageous to allow KiwiSaver providers to utilise the liquidity tools identified by the FMA, through KiwiSaver Act exceptions allowing delays from the portability rules and early and permanent withdrawal requirements, with express or implied member consent, to enable long-term investments to mature, either generally or in cases of liquidity crises.
- 8.3 Where these exceptions apply, their potential operation would need to be transparent to investors who would then have the choice of making investments in funds with greater lock-in commitments in return for potentially improved investment returns. The proposition is a familiar concept, evident in the better returns for term deposits over call deposits, or in longer term deposits or other investments that benefit from an upwards sloping yield curve, so the concept should be capable of transparent explanation.
- 8.4 Moreover, modifying the legal and regulatory environment to encourage KiwiSaver providers to invest in private assets will serve a dual purpose: Removing the barriers and challenges identified in the CSF Paper will help enable the delivery of better long-term value to KiwiSaver members, while also acting to deliver on the purposes of the FMC Act.
- 8.5 The CSF Paper observes that the industry could play a bigger role in investing in the sustainable futures of New Zealand whilst delivering better long-term value for KiwiSaver members. Our view is that government and regulators could also play a role, by acknowledging, and addressing, the disincentives to this aim.

Yours sincerely

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Appendix 1: Terms of reference of this opinion

Terms of Reference

- 1 This opinion was commissioned by CSF on 18 October 2023 for the purposes of testing the actuality of the legal and regulatory barriers raised in the CSF Paper.
- 2 The terms of reference for the opinion are:
 - (a) to highlight the core legal and/or regulatory factors that contribute to the existing inhibition of KiwiSaver providers to invest in private assets in New Zealand;
 - (b) to comment on liquidity requirements, in particular, whether the law (as currently drafted) allows for fund suspension or side-pocketing of assets in KiwiSaver schemes;
 - (c) to comment on the requirement for daily pricing in KiwiSaver and whether this is a legitimate limitation;
 - (d) to consider what is meant by the requirement for KiwiSaver fees not to be “unreasonable” in context of investment in private assets in New Zealand with particular regard to Value for Money guidance from the FMA; and
 - (e) to identify scope for legislative and regulatory reform.