# KiwiSaver Default Changes Have Arrived, but Are They an Improvement?

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**Contents**



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## Executive Summary

KiwiSaver has grown to become the primary retirement savings vehicle for the vast majority of New Zealanders, and the recent changes to the default provider system have created the most significant shakeup of the default market since KiwiSaver's inception. The shift from conservative to balanced default portfolios is undoubtedly a move in the right direction, even if it could have gone further. But are the changes to the default providers, largely driven by fee considerations, in the best interest of KiwiSaver members and in line with the objective of KiwiSaver? Is there empirical evidence to support this in the KiwiSaver setting?

## Key Takeaways

- KiwiSaver's rapid growth, reaching $87.3 billion at the end of September according to Morningstar's KiwiSaver Survey September Quarter 2021, has rightfully come with increased scrutiny from all stakeholders.
- The changes to KiwiSaver default providers, announced by the Ministry of Business, Innovation & Employment on 14 May 2021, were by far the biggest shakeup to the KiwiSaver default scheme since its inception.
- The major changes to the default system included the default investment option being switched from a conservative to a balanced portfolio, a long overdue change for what is supposed to be a long-term savings vehicle and one Morningstar has long called for.
- Several criteria were used in determining the default providers going forward, including "lower fees and higher levels of service", but it is clear from the outcome that low fees were the most important determinant.
- The empirical evidence in the KiwiSaver setting presented here demonstrates that low fees have not historically been predictive of better future performance.
- The KiwiSaver default provider review was to "enhance the financial well-being of default members, particularly at retirement". Given the lack of historical relationship between fees and returns in KiwiSaver, it is difficult to see on what basis the criteria used are best suited to meeting KiwiSaver's objective.
- We would encourage the government to consider a more balanced range of criteria in future default provider reviews.
- Alternatively, the government could consider creating and running one centralised default fund itself.

**Introduction**

KiwiSaver began in 2007 as a voluntary savings vehicle with significant tax and co-contribution incentives to encourage takeup. KiwiSaver is governed by various Acts of Parliament, notably the KiwiSaver Act 2006. The purpose of the act is "to encourage a long-term savings habit and asset accumulation by individuals who are not in a position to enjoy standards of living in retirement similar to those in pre-retirement. The Act aims to increase individuals' wellbeing and financial independence, particularly in retirement, and to provide retirement benefits".

KiwiSaver has grown substantially during that time, reaching $87.3 billion at the end of September, according to Morningstar's KiwiSaver Survey September Quarter 2021, and is now the primary retirement savings vehicle for the vast majority of New Zealanders. With that rapid growth has rightfully come increased scrutiny from all stakeholders – government, asset managers, media, and KiwiSaver members, to name a few.

**The Review of KiwiSaver Default Provider Arrangements**

KiwiSaver members who do not choose a provider are invested in one of the government-appointed default providers. This list of providers is reviewed every seven years, making this the second review of default providers since KiwiSaver started. According to the Ministry of Business, Innovation & Employment discussion paper announcing the review in 2019, "the main objective of the review is to enhance the financial well-being of default members, particularly at retirement". An unnamed independent panel provided advice to the government on the process, according to finance minister Grant Robertson.

The changes announced by the MBIE on 14 May 2021 were by far the biggest shakeup to the KiwiSaver default scheme since its inception. There were two major changes to the default system:

- The default investment option was changed from conservative to balanced; and
- There were a number of changes to the default providers.

The change of the default investment from a conservative to balanced portfolio is long overdue for what is supposed to be a long-term savings vehicle. Morningstar has long called for this change. While KiwiSaver balances can be withdrawn for use in purchasing a property, shortening the investment time frame for some members, as per the objective outlined above, it is predominantly a long-term retirement savings vehicle. So, while the move to balanced funds for the default option is a move in the right direction, it could be questioned if it is a move far enough. Would a growth portfolio have been a more appropriate option for the majority of KiwiSaver members?

However, the changes to the list of default providers were a major shakeup that carried a number of surprises to us. While several criteria were used in determining the default providers going forward, including "lower fees and higher levels of service," according to commerce and consumer affairs minister David Clark, it is clear from the outcome that low fees were the most important determinant.

### The Outcome

Four existing default providers were kept: BNZ, Booster, Kiwi Wealth, and BT/Westpac. Five existing default providers were sacked: AMP, ANZ, ASB, Fisher Funds, and Mercer. Two new default providers were added: Simplicity and SmartShares.

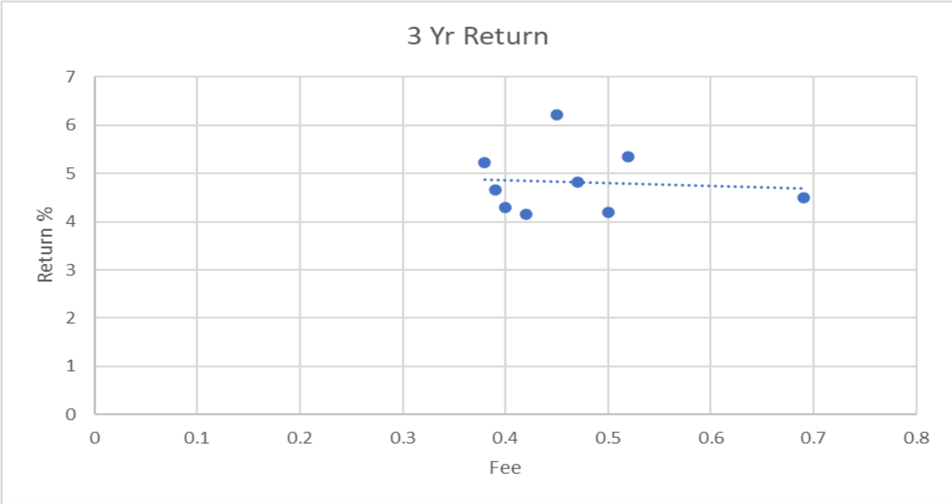
It is not clear how "higher levels of service" was assessed. Member engagement has often been discussed and has been particularly important in a system where the default investment setting to date, a conservative fund, has been inappropriate for most KiwiSaver members, as this review has highlighted. Looking at one objective, observable measure of member engagement—the proportion of members not in the default option—provides some comparison between the existing providers. While the likes of ASB still had a significant proportion of their members in the default option, ANZ had less than 7% of members in its default fund as at 31 March 2021, which by most objective comparisons would appear to be a very successful member engagement program. Combine this with the fact that ANZ's default fund was the best-performing default fund over 10 years, and it's puzzling to understand why it failed the review and lost its default provider status.

Morningstar has written extensively around the world for many years about the importance of fees in fund investing. The rest being equal, of course all investors want to minimise fees where possible. Many studies in large markets with low dispersion of returns, like US equities, have shown the importance of fees in investment decision-making. But does the empirical evidence in New Zealand, and specifically in KiwiSaver, where the conditions for active management are different from other markets, support this myopic focus on fees in selecting default providers?

### Analysis of Existing Default Funds

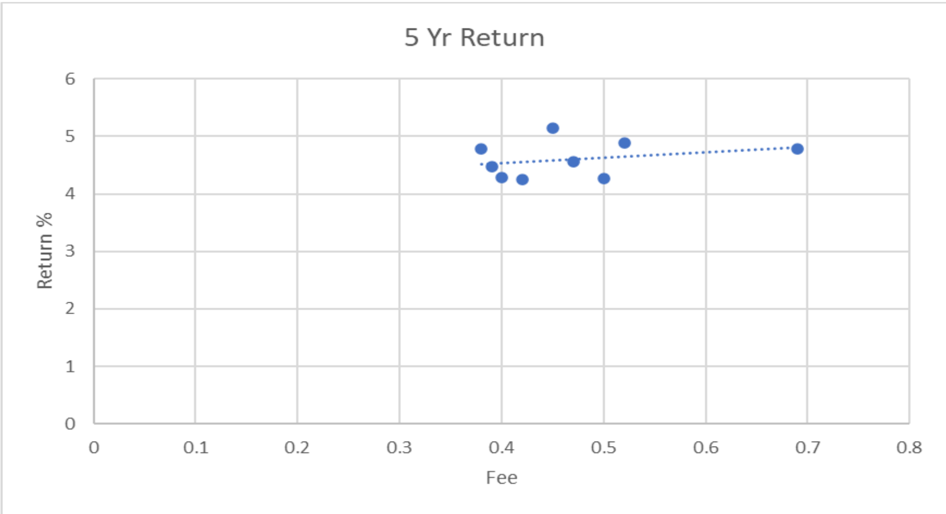
The existing default funds are conservative funds, and while these aren't the default options going forward, it's instructive to assess how well fees have predicted net returns in the existing default provider lineup. We do this by plotting ongoing fees versus net returns over three-year, five-year, seven-year, and 10-year periods in the following charts:

**Exhibit 1** Existing Default Funds Three-Year Return Vs. Fee



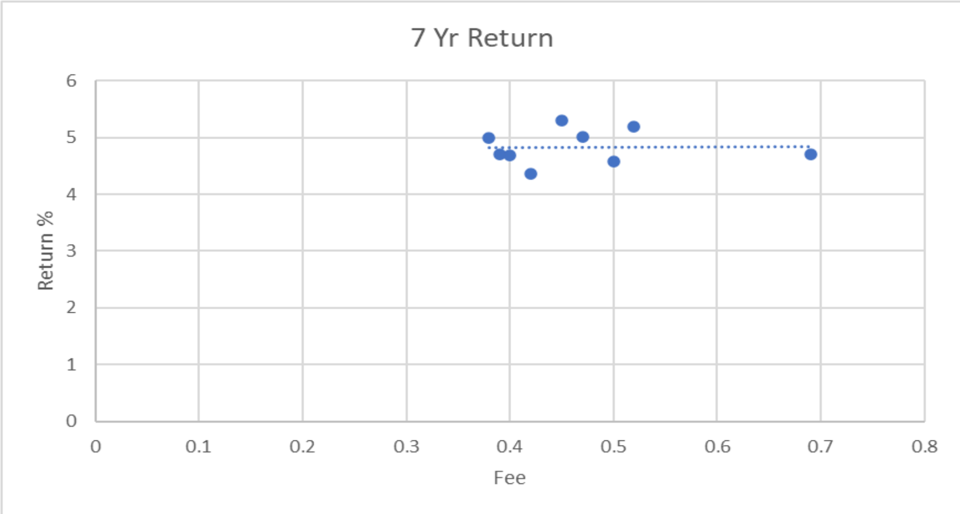

Source: Morningstar Direct. Data as of 31 October 2021.

**Exhibit 2** Existing Default Funds Five-Year Return Vs. Fee



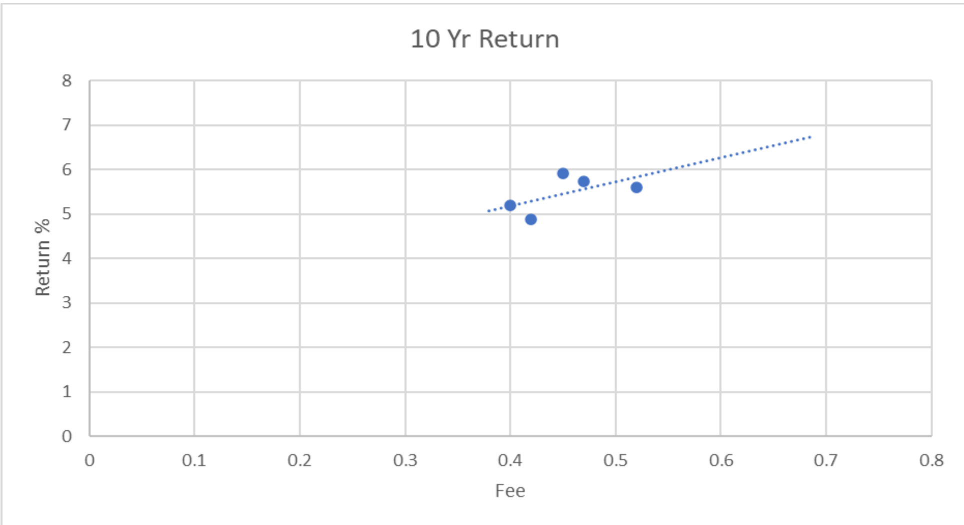

Source: Morningstar Direct. Data as of 31 October 2021.

**Exhibit 3** Existing Default Funds Seven-Year Return Vs. Fee




Source: Morningstar Direct. Data as of 31 October 2021.

**Exhibit 4** Existing Default Funds 10-Year Return Vs. Fee




Source: Morningstar Direct. Data as of 31 October 2021.

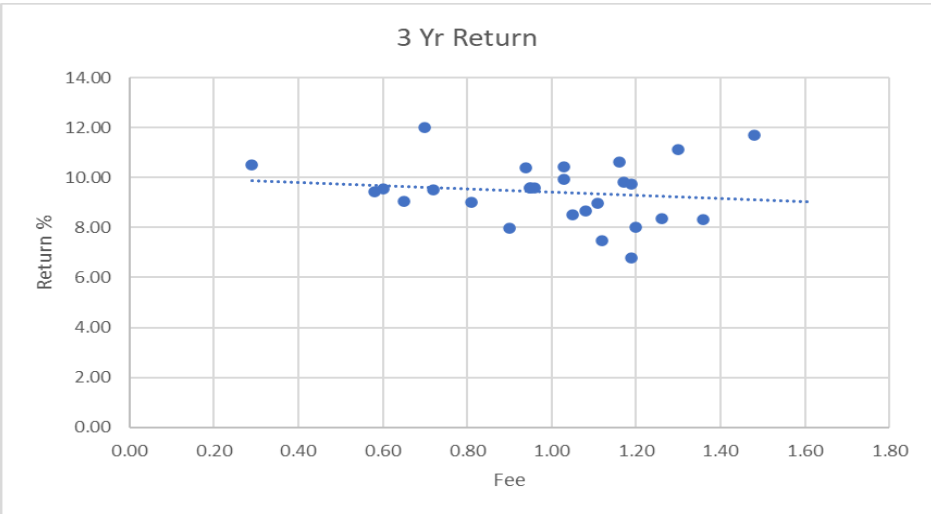
The evidence here for low fees being predictive of future net returns is not strong. In fact, over three years, five years, and seven years, it would be reasonable to conclude that there is no relationship between fees and net returns, while over 10 years, high fees were in fact more conducive to higher returns, albeit in a small sample size.

So, with no empirical evidence to support the myopic focus on fees for default provider selection amongst the existing default options, is there any more compelling evidence in the balanced option category, which is the new default risk profile going forward?

**Balanced Category Returns**

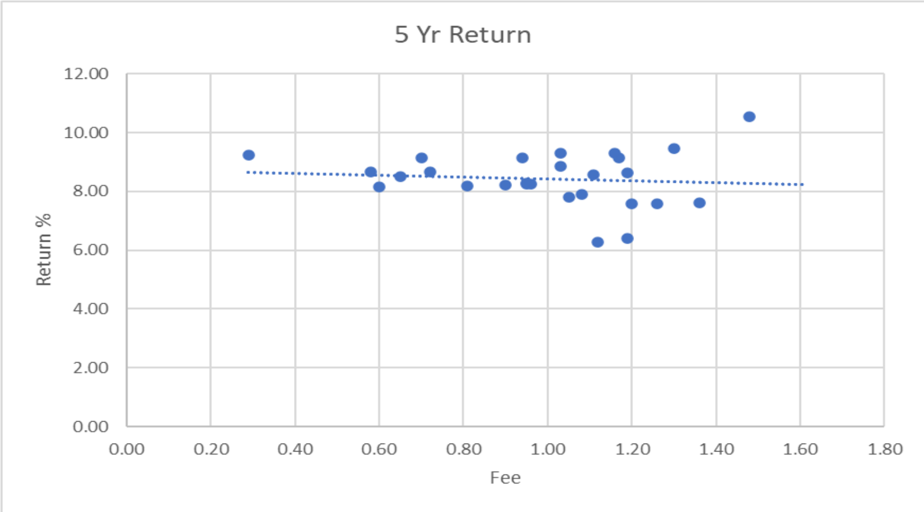
We do the same analysis of the Balanced KiwiSaver category by plotting ongoing fees versus net returns over three-year, five-year, seven-year, and 10-year periods in the following charts:

**Exhibit 5** Balanced Category Funds Three-Year Return Vs. Fee



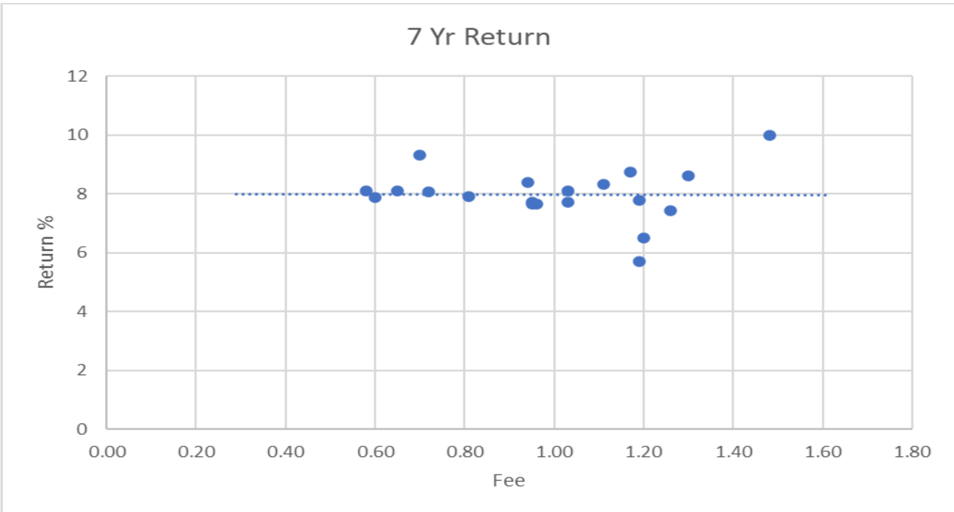

Source: Morningstar Direct. Data as of 31 October 2021.

**Exhibit 6** Balanced Category Funds Five-Year Return Vs. Fee



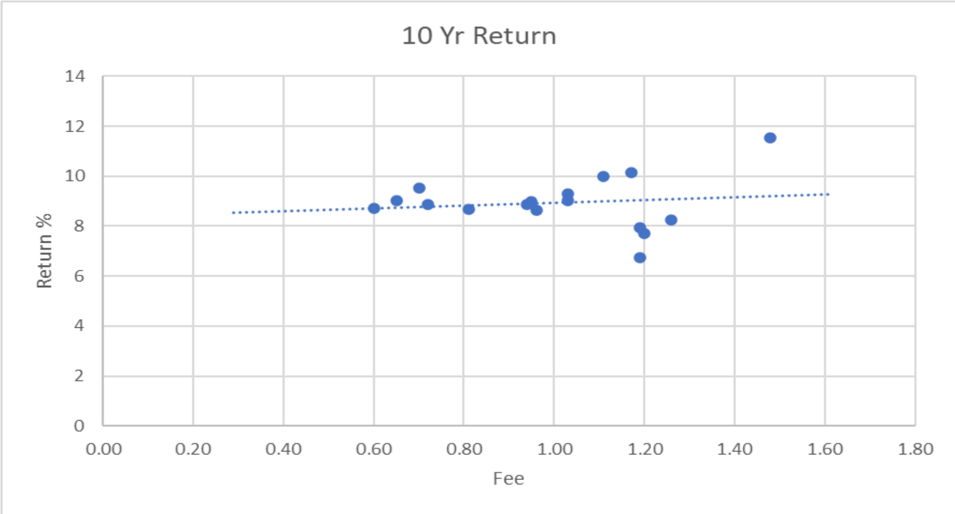

Source: Morningstar Direct. Data as of 31 October 2021.

**Exhibit 7** Balanced Category Funds Seven-Year Return Vs. Fee




Source: Morningstar Direct. Data as of 31 October 2021.

**Exhibit 8** Balanced Category Funds 10-Year Return Vs. Fee

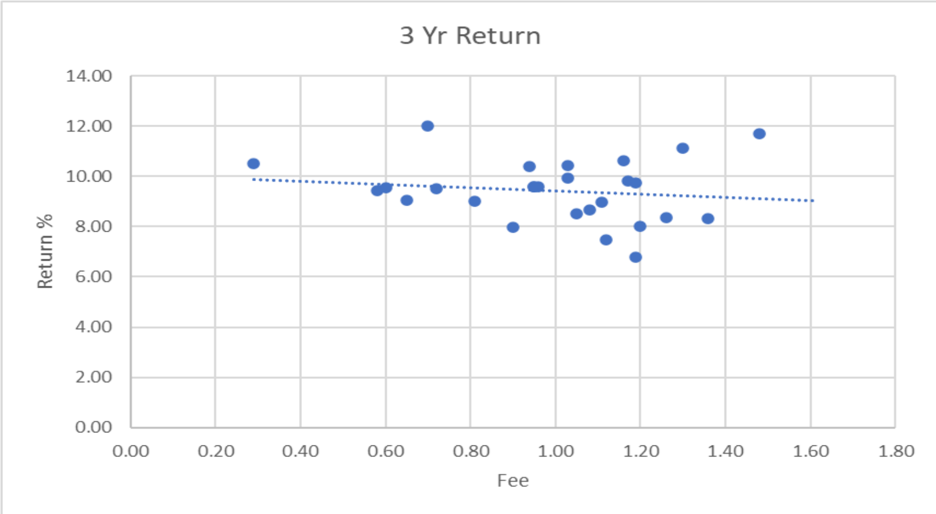



Source: Morningstar Direct. Data as of 31 October 2021.

Over the longer seven-year and 10-year periods, there's again no evidence to support low fees being the primary basis for default provider status leading to better investment outcomes. In fact, over 10 years, the opposite is true, with mild positive correlation between fees and returns, whereas if low fees were predictive of future returns, you would expect to see negative correlation.

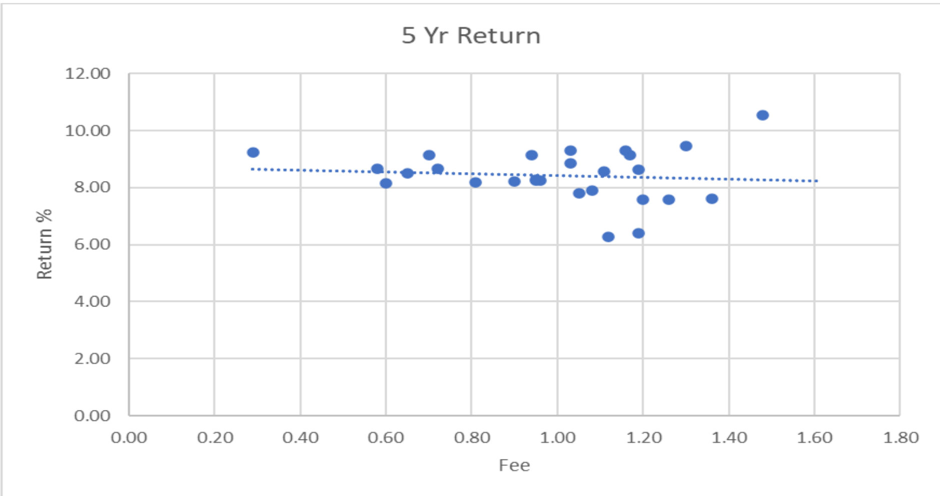
In the shorter-term and more recent three-year and five-year periods, there does appear to be some evidence that lower fees have been mildly correlated with better net of fee outcomes. However, that outcome is skewed by the particularly poor performance of one very small but high-fee fund—AMP Global Multi-Asset—which represents barely 0.05% of assets in the KiwiSaver Balanced Category. If we exclude this fund and run the analysis again, the results look as follows:

**Exhibit 9** Balanced Category Funds Ex. AMP Three-Year Return Vs. Fee




Source: Morningstar Direct. Data as of 31 October 2021.

**Exhibit 10** Balanced Category Funds Ex. AMP Five-Year Return Vs. Fee




Source: Morningstar Direct. Data as of 31 October 2021.

There is still a mildly downward slope between returns and fees, but it is far from a compelling case that fees should be the number-one criteria for selecting go-forward default KiwiSaver options. It brings into question whether the focus on fees in this default provider review is really in the best interest of KiwiSaver members and whether it achieves the objective to "enhance the financial well-being of default members".

**Future Suggestions**

We would never suggest that fees shouldn't be a component of assessment in any fund selection process, but they should be one of several criteria in a more balanced assessment using a range of criteria. It was well flagged by the MBIE before the default tender process that this would be the case, but it is frankly an indictment on the process that it doesn't seek to attract the best-performing funds over the long term, which surely should be the goal if the review wants to "enhance the financial well-being of default members". When the best-performing balanced fund provider over five years, seven years, and 10 years—Milford—doesn't even bother applying for default provider status, knowing it would have little chance of success given that its fees are some of the highest in the market, then the process must surely come into question. Surely any review of default providers should be aiming to attract the best-performing funds over the long term, as that is what will best meet the stated objective "to enhance the financial well-being of default members, particularly at retirement" for the largest cohort of KiwiSaver members rather than a philosophical focus on just one data point—low fees.

With several new entrants to the default space all offering very low fees, it must be asked if being a KiwiSaver default provider is commercially viable in its own right for most firms, which ultimately are commercial organisations, or is it used as a loss leader in order to attract new members and then attempt to upsell them to higher-margin products? Is this dynamic healthy or really likely to "enhance the financial well-being of default members"?

If low fees are the primary philosophical focus the government wants to see in KiwiSaver default funds, one scenario that should be considered is for the government to create and run one central default fund, where it can control fees without commercial considerations and members have a choice to move to another commercially run KiwiSaver fund if they so choose. This would remove the risk of "loss leader" behaviour from commercial operators.

**Conclusion**

The main purpose of this KiwiSaver default provider review was to "enhance the financial well-being of default members, particularly at retirement". As the empirical evidence in KiwiSaver presented here demonstrates, low fees have not historically been predictive of strong future performance in KiwiSaver, so it's difficult to see on what basis the criteria used are best suited to meeting KiwiSaver's objective. We would encourage the government to consider a more balanced range of criteria in future default provider reviews, so that the best-performing funds are part of the default lineup in order to better empower the investment success of New Zealanders. Alternatively, the government may consider creating and running one centralised default fund itself and allowing commercial providers to only operate as actively chosen KiwiSaver providers.

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