



NEW ZEALAND COUNCIL OF TRADE UNIONS
Te Kauae Kaimahi

SUBMISSION

by

**New Zealand Council of Trade Unions –
Te Kauae Kaimahi**

on the

**Periodic Reporting Regulations for Retail
KiwiSaver Schemes**

11 March 2011

Contents

1. Introduction.....	2
2. Summary	2
3. General approach.....	4
4. Responses to specific questions	6
5. Conclusion.....	12

1. Introduction

- 1.1. The New Zealand Council of Trade Unions – Te Kauae Kaimahi (CTU) is the internationally recognised trade union body in New Zealand. The CTU represents 39 affiliated trade unions with a membership of over 350,000 workers.
- 1.2. The CTU acknowledges Te Tiriti o Waitangi as the founding document of Aotearoa New Zealand and formally acknowledges this through Te Runanga o Nga Kaimahi Māori o Aotearoa (Te Runanga) the Māori arm of Te Kauae Kaimahi (CTU) which represents approximately 60,000 Māori workers.

2. Summary

- 2.1. The CTU strongly supports the Kiwisaver scheme, and any practical steps taken to enhance its attractiveness. The global financial crisis and the local crisis among finance companies add to the nervousness many New Zealanders feel in entrusting another party with their savings.

- 2.2. Clear and informative reporting is one element of this, and therefore we support most of the suggestions in the November 2010 discussion paper, with a preference to providing as much information as possible, subject only to it being presented in an easily understood form and having regard to the costs of providing that information.
- 2.3. However costs should not be the overwhelming concern, and some information can be routinely provided relatively cheaply following a one-off cost in setting up systems to collect and publish it.
- 2.4. Where preferences are sought in the paper between several choices, we suggest a useful approach would often be to require some or all of them because they give different views, each of which has some value.
- 2.5. However there needs to be realism regarding the benefits of this information. Most savers will not read even well presented information in detail, let alone have the skills to make sound judgements on the performance and security of their fund as a result. The main intensive users of the information are likely to be financial analysts and journalists who will in turn provide advice or analyses to the public.
- 2.6. This means greater emphasis is required on regulatory protections and in some cases government guarantees. In terms of reporting, we should consider mandatory credit rating of the Kiwisaver funds and suggest an independent rating agency paid for by the Kiwisaver funds, but funded indirectly so that no pressure can be brought to bear to bias individual fund ratings.
- 2.7. We have responded to many but not all questions in the discussion paper, and where we do not respond it can be taken as an indication of support for as much information to be made available as possible.

2.8. There should be full disclosure of all charges made against a member's account.

3. General approach

3.1. The CTU strongly supports the Kiwisaver scheme, and any practical steps taken to enhance its attractiveness. We are very aware of the New Zealand history of financial institutions including the share market and the record of savings. The global financial crisis and the local crisis among finance companies add to the nervousness many New Zealanders feel in entrusting another party with their savings.

3.2. The financial impacts of the performance of Kiwisaver funds, including aspects such as management fees, are large and will be increasing over the lifetime of a scheme. Many people will have tens of thousands of dollars at stake. With compulsory membership and/or automatic enrolment possible policy options, these matters become even more important, both as to public acceptance of such changes and the financial impacts should the changes be made.

3.3. Savers need plain English comparative information available to them, firstly to determine whether what they are paying is fair or not and secondly so that financial analysts and journalists can present advice and more detailed analyses. That information is not currently available for all schemes. Fund contributors also have a right to know how profitable their fund is to its managers and what financial interests and incentives they have.

3.4. KiwiSaver funds are one way in which New Zealanders have shown a degree of confidence investing in other than bank deposits. However their conservative choice of schemes is another sign of their lack of confidence. A major attraction of KiwiSaver undoubtedly lies with the employer contributions and

government subsidy, but concerns regarding security are likely to rise as investment returns begin to dominate the change in value of their funds, rather than contributions which dominate while accumulated funds (per individual saver) are at their present low values. The managers of the funds are after all the same as those of funds which were stressed by the global crisis, and often found wanting. It is possible that the government involvement in the scheme means savers feel safer investing in it despite any significant difference in the security of their savings. It is therefore important that consideration is given to the prudential aspects of these funds.

- 3.5. Clear and informative reporting is one element of this, and therefore we support most of the suggestions in the November 2010 discussion paper, with a preference to providing as much information as possible, subject only to it being presented in an easily understood form and having regard to the costs of providing that information. Where preferences are sought in the paper between several choices, we suggest a useful approach would often be to require some or all of them because they give different views, each of which has some value. In many cases, after the initial setup to allow the information to be collected and recorded, provision of the additional information should not be a significant ongoing cost.
- 3.6. However there needs to be realism regarding the benefits of this information. Most savers will not read even well presented information in detail, let alone have the skills to make sound judgements on the performance and security of their fund as a result. While financial education to increase the use and understanding of this kind of information is valuable, the fact remains that even professional investment managers frequently get it wrong, and some did so disastrously prior to the two financial storms New Zealand has experienced in the last three

to four years. This demonstrates how difficult it is for amateurs (i.e. most savers) to safeguard their savings. The main intensive users of the information are likely to be financial analysts and journalists who will in turn provide advice or analyses to the public, but this may be uneven both in regularity and coverage – smaller schemes are likely to get less attention.

- 3.7. This means greater emphasis is required on regulatory protections and in some cases government guarantees. In terms of reporting, we should consider mandatory credit rating of the Kiwisaver funds. In advocating this, we are very aware of the corruption of credit ratings paid for by the managers of funds (or other financial instruments) in the US. Consideration should therefore be given to an independent rating agency paid for by the Kiwisaver funds, but funded indirectly so that no pressure can be brought to bear to bias individual fund ratings.

4. Responses to specific questions

- 4.1. We do not respond to all questions, but where we do not respond, it can be taken as an indication of support for as much information to be made available as possible, including worked examples, with multiple options provided where practicable. (For example question 37 asks for a choice between money-weighted and time-weighted calculations. Both have value for different reasons and both could be provided.)

3. Should New Zealand prescribe its own set of terms and definitions (based on what is in common use already) or should we adopt an overseas standard, to ensure international portability?

- 4.2. There is a balance between the advantages of comparability and the advantages of flexibility to adapt terminology to local and changing needs. An international standard for terms and definitions should therefore be adopted if (a) there is widespread

use of the standard so that there are strong and clear benefits of comparability; and (b) local flexibility is not lost. In particular, the use of standard terminology should not in itself imply constraints on the way a fund is regulated.

5. What would be the advantages and disadvantages of prescribing a single percentage fee to cover all transaction costs?

4.3. A single percentage fee would be simple and hence easier to understand. A percentage fee is an advantage for savers with small amounts of funds, which is very common. It is less clear whether a single fee covering all transaction costs has cost or transparency advantages over fees for every type of transaction. It is likely there will be gaming and unintended consequences of either option.

10. Do you agree with the Ministry's view that performance fees should be disclosed? If not, why not?

11. What benefits are there in disclosing a performance fee as a percentage of the net asset value of the fund?

4.4. We strongly agree that performance fees should be disclosed. Reporting as a percentage of the returns of the fund as well as a percentage of the net asset value of the fund would be valuable.

13. Do you consider the requirement that trail commissions be deducted at source (i.e. from individual investor accounts) and not fund assets worthy of consideration? If yes, why? If no, why not?

14. Do you consider the requirement that all payments made from a fund to financial advisers should be reported quarterly? What are the likely costs and/or benefits?

4.5. We see little benefit to savers in trail commissions, and considerable dangers in conflicts of interest. We consider that they should not be permitted.

4.6. If however they are permitted, they should not be deducted at source. The costs of doing this would be large and would outweigh any benefit. All payments from a fund to financial advisers should be disclosed quarterly and reported to fund members.

17. Do you consider the Ministry's table of three categories appropriate? What should be included and/or excluded? Why? Do you prefer broad categories more closely aligned to the ISI standard, or to the IOSCO standard?

4.7. We prefer the IOSCO standard as we consider it important that management remuneration be reported on clearly and separately. This is a lesson of the global financial crisis.

24. Are there issues of commercial sensitivity relating to disclosure of sub-fund charges? If so, please clarify.

4.8. We do not believe that there should be issues of commercial sensitivity. If there are, the interests of savers/investors should be paramount. The wider the adoption of these standards, the less such considerations matter.

31. Do you consider the method of recovering fees from an investor to be material to the investor's return? If so, why? If not, why not?

4.9. We agree that the method of recovering fees from an investor is material. For example deductions by cashing in investment units potentially can affect returns depending on the timing of their sale, whereas a deduction from returns, contributions etc are simply a cash transaction.

49. Should funds be required to compare their returns with a portfolio of market indexes previously selected by the fund? Are there any alternative ways of benchmarking performance?

50. Are there any other issues related to returns that should be considered?

4.10. We consider that funds should be required to compare their returns with a portfolio of market indexes previously selected by the fund. In particular, comparison with comparable risk Kiwisaver funds could be a useful requirement which would be easily understood.

51. What should be disclosed for the purposes of periodic reporting? Should all individual asset holdings be disclosed? Or should the asset mix plus top 10 holdings be disclosed? Please provide reasons for answer.

52. Do you consider that it would be appropriate to require disclosure of the top 10 portfolio holdings every quarter and the full disclosure of all assets on an annual basis?

53. What are the costs and benefits of requiring disclosure of the underlying assets rather than merely the sub-funds the fund invests in?

54. What information in relation to the assets do you consider should be disclosed?

4.11. We agree that all individual asset holdings should be disclosed annually with the asset mix plus top 10 holdings disclosed on a more frequent basis (e.g. quarterly).

4.12. A benefit of requiring disclosure of underlying assets is that there is increasing interest in ethical considerations and this would provide relevant information. Consideration should also be given to classifications of investments along those lines.

56. What are the benefits of including credit ratings for debt securities in periodic reports?

57. Do you consider disclosure of a liquidity ratio should be required? If so, why? If not, why not?

4.13. See our comments in paragraph 3.7. If credit ratings for such securities can be trusted, we consider the benefits of including them are high. It is very difficult for most savers, and indeed many professionals, to make the crucial judgement of how secure an investment is. The level of trust is an issue. As we commented above, we would support credit rating of Kiwisaver funds. The credit rater could investigate or estimate the ratings of debt securities as part of that task.

4.14. We also support disclosure of a liquidity ratio. This and other more technical disclosures provide essential information to analysts who in turn provide advice to existing and intending savers.

60. Do you consider it sufficient that funds disclose all soft dollar commissions? If not, then what should be required of funds in this regard?

61. Would mandatory disclosure of trading costs help address this issue? If not, why not? If yes, then why?

4.15. Ideally the existence of all soft dollar commissions should be both disclosed and reported as part of trading costs. However, because of the nature of soft commissions, valuing them is highly problematic. Without an agreed and independent valuation process, including them in trading costs may tell savers little and can easily be gamed to hide their real value. However valuation is likely to be very difficult due to the variety of forms these commissions can take. On balance we consider soft commissions should be made illegal.

63. Do you consider there to be merit in requiring periodic reporting on proxy voting? If so, why? If not, why not?

4.16. Funds like Kiwisaver historically were largely passive and did not take an active part in governance or management of their investments. It is of interest to savers if this is changing and if their savings are being used to gain influence over another company. This activity could be both positive and negative from a saver's viewpoint, but is also of interest to those concerned about ethical investing.

66. For the purposes of periodic reporting, do you consider disclosure of names and tenures of key personnel to be sufficient? If not, why not?

4.17. No, we do not consider disclosure of only names and tenures of key personnel to be sufficient and would support annual disclosure similar to that required by the Australian Accounting Standards Board outlined in your paragraph 188. This is part of the increased awareness of conflicting interests that key personnel may have in the light of the experience of the global financial crisis. Knowing who is in control of their fund and what their incentives and behaviour are is crucial to the understanding that fund members have of the security of their savings.

71. What are the advantages and disadvantages of adopting a standardised worked example to illustrate returns after fees and taxes?

4.18. Such examples would be useful. Perhaps an additional element could be "At Age 65 on your current contribution rates you would have ...". It could also include how much has been lost in management fees to date.

5. Conclusion

- 5.1. The CTU supports greater disclosure of fund information, and at the individual level there should be full disclosure of all charges made against a member's account.
- 5.2. Disclosure is just one element of a more rigorous approach to increasing the confidence savers can justifiably feel in the funds which are entrusted with their life savings. We have suggested some others.
- 5.3. We have supported most of the suggestions in the discussion paper, with a preference to providing as much information as possible, while recognising the costs of providing that information. However costs should not be the overwhelming concern and some information can be routinely provided relatively cheaply following a one-off cost in setting up systems to collect and publish it.
- 5.4. We appreciate the effort going into considering these matters and thank you for the opportunity to comment. We are available to answer further questions.