TO: COMMERCE SELECT COMMITTEE

ON: FINANCIAL MARKETS (REGULATORS AND KIWISAVER) BILL

(KIWISAVER SCHEMES AMENDMENTS)

10 NOVEMBER 2010

INTRODUCTION

1 This submission is from Chapman Tripp, PO Box 993, Wellington 6140.

2 We wish to be heard or (if the Committee would prefer it) to talk directly with officials. Our contact for this submission is Mike Woodbury.

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ABOUT CHAPMAN TRIPP

3 Chapman Tripp is a leading law firm with a strong specialist practice in Funds, KiwiSaver and Superannuation. The KiwiSaver-related matters covered in the Financial Markets (Regulators and KiwiSaver) Bill (**the Bill**) are of direct interest to us as specialist legal practitioners and to our KiwiSaver and superannuation clients.

This is the second of two submissions Chapman Tripp is presenting on the Bill. It has a more technical focus and deals principally with those provisions in the Bill which will affect the governance of retail KiwiSaver schemes.

SUMMARY OF MAIN ISSUES

4 We support the proposed changes in principle. However, we consider that the downstream effects on the detail of the KiwiSaver Act, and on the Securities Regulations which govern KiwiSaver schemes, have not been fully thought through.

The decision to change the trustee's role from issuer to statutory supervisor is the right one, but in our view it requires that certain of the powers and duties which are currently held by trustees be transferred to managers.

Managers and trustees will also need compliance relief from certain Securities Act provisions, and the changes encompassed in the Bill will need to be better integrated into the Securities Act itself.

SCOPE OF TRUSTEES' DUTIES UNDER KIWISAVER ACT

5 The KiwiSaver Act 2006 requires comprehensive amending in order to ensure that it appropriately reflects the fundamental change of governance structure contemplated by the Bill (whereby retail scheme managers will replace schemes' trustees as issuers).

Currently, under the Bill as drafted a number of core powers and duties will remain with retail schemes' trustees. Given that trustees will become mere statutory supervisors, those powers and duties should pass instead to scheme managers

as providers. In outline terms - and non-exhaustively - the relevant provisions in the KiwiSaver Act include:

- proposed sections 119D, 119F and 119H, relating to transfers between KiwiSaver schemes - these provisions will continue requiring trustees to issue transfer notices to members and the Financial Markets Authority (**FMA**), that members must provide certain details direct to trustees and that trustees must notify the Commissioner and apply for FMA consents to non-consensual bulk transfers – these are all obligations which should be imposed on the provider (for a retail KiwiSaver scheme, this will mean the scheme manager)

- proposed section 119I, which currently contemplates that trustees (not providers) must obtain members' consents to transfers and certain trust deed amendments

- proposed section 122 and section 123, which will still have annual reports being issued by trustees and require a detailed series of statements and certifications from (or relating to) trustees, when in principle the relevant provisions (including subsections 122(1)(a), 123(1) and 123(3)(b), (4) and (6)) should now refer instead to providers

- subsection 123(2), importing into the KiwiSaver Act without modification a series of reporting and certification requirements from the Second Schedule to the Superannuation Schemes Act 1989 - in our view these should now be modified so that "*trustees*" means "*provider*" for KiwiSaver Act purposes (the relevant provisions here comprise all of paragraphs (d) to (g) and (i) to (l) of that Second Schedule)

- sections 125 and 125A, which will continue requiring trustees (not providers) to issue both annual returns to the FMA and annual statements to members

- subsections 129(1) and 129(3), which currently continue contemplating that trustees will originate trust deed amendment proposals and lodge amending deeds with the FMA (we agree though that trustee *certification* of original and all amending deeds, as contemplated by section 129(2) and paragraph 11 of Part 1 of Schedule 2, is entirely consistent with a retail KiwiSaver scheme trustee's role as statutory supervisor)

- sections 158, 160 and 164, which will still require the inclusion of trustee (not provider) contact and other details on the KiwiSaver Schemes Register and that

trustees (not providers) must notify the FMA of changes

- section 169(4), under which the FMA will be permitted to direct trustees (but not providers) to supply information to members and to direct a trustee to "*operate*" a scheme in a specified manner

- section 174(c), under which the requirements to distribute wind-up accounts and provide wind-up related information to the FMA and members should in our view be provider duties

- section 195(2)(b), under which the provider (not the trustee) should be required to use reasonable endeavours to locate a missing member

- section 197(2), under which duties to receive and respond to information requests should apply either to providers or to both providers and trustees (but not solely to trustees), and

- KiwiSaver Scheme Rules 5 to 7, 8(7)(b), 9, 10, 12 to 14B and 16, all of which should be amended to grant the relevant powers (and impose the relevant duties) on providers rather than trustees.

To clarify that none of the requisite amendments will affect the operation of restricted KiwiSaver schemes or complying superannuation funds, it will likely be necessary to prescribe for avoidance of doubt that in each of the relevant provisions the word *provider* means:

- for a restricted KiwiSaver scheme or complying superannuation fund, the trustees, and

- for any other KiwiSaver scheme, the manager.

This would appear useful in order to complement sections 5(1) and 5(1A).

The implied provisions referred to in sections 128A to 128D of the KiwiSaver Act should each be expressed as enforceable by managers, as well as by trustees and members.

Section 201 should now protect managers as well as trustees.

KiwiSaver Scheme Rule 17 uses the expression *fund provider*. This is defined in section YA(1) of the Income Tax Act 2007 as the scheme's trustee, and requires amending

accordingly.

We have no issue with section 124 of the KiwiSaver Act (annual report for an umbrella trust) continuing to refer to the trustees of the relevant scheme, as we expect it will now only be invoked for restricted KiwiSaver schemes. Similarly, we have no particular difficulty with any of:

- section 168 (cancelling registration and ordering wind-up)
- section 173 (initial steps in winding up scheme)
- section 178 (trust deed amendments for default KiwiSaver schemes), or
- clause 11 of Part 1 of Schedule 2 (certifying trust deed compliance)

continuing to impose obligations on trustees.

SECURITIES LEGISLATION COMPLIANCE

6 Variations to existing securities

The provision in the Bill under which the manager of a retail KiwiSaver scheme will replace that scheme's trustee as the issuer (for Securities Act purposes) of membership interests will produce a result that:

- better reflects schemes' practical operation (we agree that it "*will align the law with the current structure of the affected KiwiSaver schemes*"), and
- is, in that sense, purely technical.

However, in Securities legislation terms this change will fundamentally alter the nature of a person's membership interest.

A membership interest in a KiwiSaver scheme is a single security for Securities legislation purposes. Typically, when membership terms are to be varied, trustees therefore need only invoke the Securities Act (Renewals and Variations) Exemption Notice 2002 and give existing members brief written statements containing prescribed information. They need not redistribute investment statements.

However, that Exemption Notice cannot be invoked with respect to any variation which changes the issuer. Because of this, as the Bill stands it appears that after managers replace trustees as issuers:

- managers will be issuing new securities (in terms of section 2(1)(g) of the Securities Act 1978), and
- existing members must therefore be given new investment statements.

We consider that the Bill should prescribe a specific Securities legislation exemption, under which existing members need only be given a notice adequately describing the scheme governance changes made by the Bill (by no later than when those changes take effect).

7 Updates for new joiners

We also consider it essential to ensure that (as has already been the case with successive KiwiSaver Act amendments) scheme providers have grace periods following the Bill's enactment during which they are protected against breaches of Securities or consumer protection legislation by reason of continuing to use existing offer documents and advertisements.

For logistical reasons, it will be critically important for providers to be notified well in advance of the "sunset date" by which offer documents and advertisements must be replaced.

We submit that the legislation should prescribe protections both for a prescribed grace period (sensibly to 30 September 2011) and for all prospectuses and investment statements issued before a prescribed date.

We also submit that the Bill should incorporate an exemption from regulation 21 of the Securities Regulation 2009 allowing issuers to supplement existing investment statements with brief descriptions of the changes made by (or pending under) the new legislation if they so wish.

8 Consequential amendments to disclosure requirements

Schedules 6 and 13 to the Securities Regulations 2009, relating to superannuation and KiwiSaver schemes' prospectuses and to investment statements, require careful consequential amending so as to appropriately reflect the changed governance structure of retail KiwiSaver schemes. The provisions which should be revisited include (again non-exhaustively):

- clauses 2 and 3 of Schedule 6 – details in a prospectus regarding (respectively) superannuation trustees and managers, promoters, auditors and advisers
- clause 8(4) of Schedule 6 (the *specified person* definition)
- clause 15 of Schedule 6 (we consider that, by analogy with a unit trust, the statement relating to net asset values and liquidity should be issued by the directors of the manager in the case of a retail KiwiSaver scheme), and
- clause 3(5) of Schedule 13 (persons involved in providing the investment).

We also note clause 22 of Schedule 5 to the Securities Regulations (which relates to unit trusts). Under that provision, the trustee of a unit trust need only state whether or not in its opinion the manager has managed the unit trust during the relevant accounting period "*in accordance with the provisions of the trust deed and the offer of units*".

9 Prospectus registration – notice and pause proposals

We make more detailed observations about these provisions in our corresponding more general submission on the Bill.

For the purpose of this submission we note simply that the concept of recurring periods during which issuers cannot accept new subscriptions will be completely unworkable for retail KiwiSaver schemes.

Default KiwiSaver schemes, and also all schemes which have been chosen by employers as their preferred schemes for auto-enrolment purposes, are required by the KiwiSaver Act 2006 to accept continuous automatic enrolments under the KiwiSaver default allocation rules. Persons who commence new employment, as defined, must be automatically enrolled in KiwiSaver at prescribed times and providers "*must accept*" those persons' deemed membership offers and allot securities accordingly.

TRUST DEED AMENDMENTS

10 We have no objection to the proposal for all trust deed changes that are necessary or desirable in order to ensure that trust deeds comply with the amended legislation to require prior FMA consent. This will ensure certainty of compliance before amendments are prescribed.

It is essential though that the Bill prescribes an adequate grace period, so as to enable providers to ensure (and satisfy trustees) that the relevant changes are appropriately detailed. The proposed section 215 of the KiwiSaver Act must also be extended to those changes that are necessary or desirable in order to ensure that trust deeds correctly reflect the Securities Act and Regulations as amended.

Trust deed amendments will be particularly complex for umbrella trust-based schemes, as the two schemes within each umbrella will have materially different governance structures.

GENERAL

11 Transfers pending wind-ups

Proposed section 56(6)(a) of the KiwiSaver Act will prescribe that where a wind-up is pending, no bulk transfer to a replacement scheme can occur under the Act's elective or non-consensual transfer provisions before scheme assets are in due course distributed at wind-up.

This will force inordinate delays in effecting such transfers, which can currently occur prior to (and in contemplation of) schemes then being wound up with neither members nor assets. It will also require the distribution to all transferring members of both final audited accounts and detailed advice about how scheme assets will be distributed. We query this provision's utility and appropriateness.

12 Restricted KiwiSaver schemes

We have one material concern with the proposed section 116A. If *restricted KiwiSaver scheme* status is confined (relevantly) to schemes offering memberships to persons "*employed by a particular employer*", then that will not be broad enough to cover schemes which offer memberships to persons employed by groups of associated employers (and by their successors in business).

For examples of provisions which appropriately restrict membership offers, but allow all members of an employer group to participate in an employer-based scheme, see clauses 4 and 5 of the Securities Act (Employer Superannuation Schemes) Exemption Notice 2004.

13 Assets vested in trustees

As we understand others have noted, proposed section 116B(1) of the KiwiSaver Act appears unduly restrictive where it prescribes that a KiwiSaver scheme's investments and property "*must be vested in the trustees*".

This provision should be clarified to reflect the widespread industry practice of using nominee companies and custodians to hold scheme assets (which of course ensures that those assets remain in trustees' control).

14 Trustee approval of accounts

We query whether the proposed section 120(d) of the KiwiSaver Act should prescribe simply that (rather than having to be "*approved*" by trustees) retail KiwiSaver schemes' accounts need only be reviewed by trustees before being issued. This seems more consistent with the concept of supervision.

15 Miscellaneous

Some of the following paragraphs concern aspects of the KiwiSaver Act which are outside the scope of this Bill in policy terms, but have latterly caused concern for scheme providers.

Section 35 of the Act (as amended effective 7 September 2010) prescribes procedural requirements - and express relief under the Minors' Contracts Act 1969 - in relation to KiwiSaver opt-ins by minors, but it is confined to opting into the overall KiwiSaver regime. This means that there are no clear rules in the Act – and now no Minors' Contracts Act relief, as was formerly the case under section 35(2) - relating to minors transferring between schemes.

Enrolling in KiwiSaver is a materially more significant decision than transferring between schemes. We consider that a transfer should be treated like the exercise of a membership-related discretion. That said, clear procedural rules and express Minors Contracts Act relief are desirable in relation to transfers as well as initial opt-ins.

The reporting provisions in the KiwiSaver Act as amended will retain several now redundant references to fee subsidies (for example in sections 123(4)(a) and 123(5)(h)). We recommend taking the opportunity to delete these when reworking the relevant aspects of the Act.

In proposed subsection 177(5) we suggest that (for consistency) the words "*an eligible KiwiSaver provider*" be

replaced with "*a manager*".

The application of section 189B would be materially simplified (and, we expect, better reflect what actually occurs in practice) if only *providers* need give the requisite notices of fee increases to the FMA. The corresponding rule 2 in the KiwiSaver Scheme Rules should, of course, retain its current scope.

It may be worthwhile clarifying in proposed subsection 119F(1)(a) that the relevant information concerning a transferring member must be given to the provider of the scheme to which the member has consented to transfer.

Some practical issues have arisen in relation to the home purchase withdrawals facility in rule 8 of the KiwiSaver Scheme Rules, which in our view it would be useful to address. One concerns the recent deletion from rule 8(6) of the reference to a leasehold estate. This has had the welcome effect of clarifying that prior residential tenancies do not prevent home purchase withdrawals. However it also prevents a withdrawal for the purpose of taking out a long-term leasehold interest in land (and this latter result appears unintended).

Another issue concerns rule 8(5)(a), where the meaning of the words *"bare trustee"* seems to have been misunderstood. We think that – for reasons which we are happy to address directly with officials - the words *"trustee but is not a beneficiary under the relevant trust"* will correctly capture the policy intent.

Given the extremely restricted operation of the relevant exemption provision (which, as an aside, is not invoked in practice), the proposed recasting of the *manager* definition in section 5C of the Securities Act is redundant.

The *issuer* definition in the Financial Reporting Act 1993 could usefully be amended as a consequence of the KiwiSaver governance changes to clarify that, for retail KiwiSaver schemes, managers will entirely replace trustees as issuers for the purposes of that Act.

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