

**INVESTMENT SAVINGS & INSURANCE ASSOCIATION OF NZ  
INC**

**Submission**  
**to**  
**the**  
**Commerce Select Committee**

**on the**  
**Financial Markets (Regulators and  
KiwiSaver) Bill**

10 November 2010



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# **Investment Savings and Insurance Association of NZ Inc.**

## **1.0 Introduction**

- 1.1 The Investment Savings and Insurance Association ("ISI") is the industry association for the companies that issue and manage life insurance, superannuation and managed funds in New Zealand. ISI members are responsible for approximately \$50 billion funds under management. ISI members are also the leading providers of KiwiSaver funds and all six default providers are members of ISI.

A list of members is attached.

- 1.2 We welcome the opportunity to comment on the Financial Markets (Regulators and KiwiSaver) Bill ("the Bill"). We have set out general comments below, mainly relating to policy issues, followed by more specific comments focusing on the impact of particular parts of the Bill on the collective investments industry. We have not commented on technical drafting issues.

## **2.0 General Comments**

- 2.1 ISI supported the Ministry of Economic Development's Review of Securities Law earlier this year and we recognise that the Bill will have the effect of bringing forward the implementation of certain proposals from that Review.
- 2.2 ISI acknowledges the reasons given by the Minister for fast-tracking some aspects of the Review. While the damage to consumer confidence has been incurred by finance companies rather than the providers of collective investment schemes, we agree that it is in the interests of New Zealand as a whole for the public to have confidence in the financial services industry and that it is appropriate for the Government to take steps to improve the level of confidence.
- 2.3 We do, however, consider that fast-tracking some elements of the Review of Securities Law has the potential to make the process more complicated and confusing than it would otherwise be.
- 2.4 ISI supports the establishment of the Financial Markets Authority ("FMA") and for the FMA to take over the regulatory functions of the Securities Commission and the Government Actuary.
- 2.5 ISI also supports the FMA taking from the Ministry of Economic Development the regulatory functions of prospectus review and the enforcement of rules applicable to financial market participants.
- 2.6 ISI generally supports the amendments to the regulation of KiwiSaver schemes that will transfer the issuer role from the trustee to the manager and bring the trustee within the trustee licensing regime.
- 2.7 ISI supports the Bill's focus on disclosure of information to investors as the appropriate means to engender public confidence in financial markets.

- 2.8 Certain parts of the Bill come into effect on the day after the date on which the Act receives Royal assent while the date that other parts come into effect will be set by Order in Council and could be delayed for some time. Taking that into account, ISI questions whether it would not be more appropriate for some features of the Bill to wait for the completion of the Ministry of Economic Development's Review of Securities Law, which is currently underway, rather than being included in this Bill.
- 2.9 ISI is concerned that the FMA's education objectives may be difficult to achieve unless the FMA is adequately and specifically funded for this function. We note that the Securities Commission has not been able to make much progress in its objective to "promote public understanding of law and practice relating to securities" and we suggest that responsibility for investor education could more usefully be combined with the financial literacy objectives of the Retirement Commissioner.

### **3.0 Specific Comments**

#### **A Single Market Conduct Regulator**

- 3.1 ISI supports the unification of market conduct regulation under the FMA as a single regulator. We support the 'twin peaks' model for the financial services industry, with a prudential regulator (the Reserve Bank) and a market conduct regulator (the FMA). Currently market conduct regulation is divided between several bodies (Securities Commission, Companies Office, Government Actuary etc) with a potential for confusion and duplication of effort.
- 3.2 The ISI submission to the Review of Securities Law in September this year supported the objective of consolidating securities market oversight and regulation under the FMA and providing easy access for retail investors to concise and easily understood key information on potential investments and ongoing disclosure.

#### **Reviewing Offer Documents**

- 3.3 Clause 97 of the Bill proposes a new section 43D of the Securities Act which does not appear to provide for securities that are continuous issues rather than lump sum deposits, such as most collective investments (including KiwiSaver and unit trusts). The effect of this new section as it is currently proposed is that a collective scheme would need to be taken off the market each time its prospectus is renewed or amended.
- 3.4 The Bill replaces the current system of pre-registration review of offer documents by the Companies Office with a process we understand has been based on the Australian regime. Clause 97 amends the Securities Act to prohibit the allotment of securities for 5 days after registration and provides that the FMA may extend the consideration period for an additional 5 days.
- 3.5 However, there are significant differences between the Australian and New Zealand regimes governing disclosure for collective investment schemes. In Australia, issuers of a collective investment scheme are not required to register their offer document and, instead, simply file a notice advising ASIC that they have a current product disclosure statement in use. Consequently, a stand down period does not apply to collective investment schemes in Australia.
- 3.6 In New Zealand the Securities Act 1978 requires issuers of collective investment schemes to register a new prospectus annually and to make amendments to the

current registered prospectus in the event of material changes to the offer. Having a stand down period during which issuers of collective investment schemes are prohibited from allotting securities will be problematic and in some cases unworkable for the following reasons:

- the temporary suspension of a collective investment scheme will have a significant negative impact upon the confidence of both investors in that product and investors generally, particularly as the duration of suspension cannot be certain;
- the suspension of allotments is administratively difficult and in some cases outside the control of the issuer. For example, KiwiSaver schemes would be unable to suspend the allotment of securities to new members who are automatically enrolled under the KiwiSaver Act 2006;
- for some collective investment schemes that offer fixed term investments, many investors opt for their investment to be automatically reinvested upon maturity of the agreed term with units allotted accordingly. Under the proposed regime, there will be a stand down period on registration of each new prospectus where automatic reinvestment upon maturity will not be possible. This will be inconvenient and potentially confusing for investors;
- many investors choose to make regular investments in a collective investment scheme by way of a direct debit or automatic payment initiated on an agreed regular frequency (for example fortnightly or monthly). Under the proposed regime, issuers would be unable to initiate any direct debit or receive any automatic payments during the stand down period. Issuers will be required to give advance notice to all affected regular investors and will require direction from such investors as to how to proceed with respect to the payment. In addition to being both confusing and inconvenient for investors, such a process would impose a costly additional administrative burden on issuers; and
- in practice the stand down period could effectively extend beyond 5-10 days. For example, if there are changes required to a prospectus as a result of the FMA's review, the issuer would be required to cancel and reregister the prospectus, or to file an amended document – presumably thereby restarting the stand down period. Such a scenario would give rise to significant complications in relation to the update, printing and distribution of the investment statement in light of the requirement to ensure consistency between offer documents.

3.7 While we agree that the FMA should be charged with reviewing offer documents we do not accept that the change of process to the new, post-registration vetting model needs to be fast-tracked at the same time that the FMA is established. We would prefer that the current pre-registration review undertaken by the Companies Office be adopted, with the FMA reviewing documents for compliance prior to registration.

3.8 We recommend that further change is deferred to allow time for consultation and that the introduction of any new registration and review procedure for prospectuses should be aligned with the proposal for a single product disclosure statement that was made in the Review of Securities Law

3.9 We also strongly recommend that, if the proposed change is pursued, the consideration period proposed in the Bill should not be applied to collective investment schemes.

### **KiwiSaver Regulation**

- 3.10 ISI generally supports the provisions of clause 166 of the Bill which transfers the issuer role from the trustee to the manager and has the effect of making the manager of the scheme directly liable to investors. This matches the current form of regulation of unit trust investments under the Unit Trusts Act. We agree that it is appropriate also for KiwiSaver schemes and we support the removal of inconsistencies in regulation between similar forms of managed fund.
- 3.11 With regard to KiwiSaver trustees, we recommend some clarification of the trustee's duties in the Bill. We note the requirement of Clause 173 that the investments and property of the KiwiSaver scheme must be vested in the trustees. At present it is common practice for the investments of a KiwiSaver scheme to be held by a nominee, rather than directly by the trustee. We recommend an amendment of the Bill to enable the trustee to delegate custody of the scheme assets to a nominee such as a third party custodian.
- 3.12 It is appropriate for trustees to be subject to the Securities Trustees and Statutory Supervisors Bill (when enacted) and to comply with the requirements of the Trustee Act. The Securities Trustees and Statutory Supervisors Bill will greatly improve the standards of trustees and will also introduce a greater level of independence than is currently found between the trustee and the scheme provider.
- 3.13 However, we note that Clause 206 of the Bill amends Schedule 1 of the KiwiSaver Act to require the trustee to *supervise* the manager's performance of its functions. We consider that this requirement should be reworded to align the extent of the trustee's responsibility with the provisions of the Securities Trustees and Statutory Supervisors Bill (if enacted in its current form).
- 3.14 The clause 206 amendments to Schedule 1 also insert a requirement that the trustee and the manager *must act in the best interests of members of the scheme*. We are concerned that this requirement may create a potential conflict of interest, particularly for the manager where there will be commercial factors to be taken into account. That is likely to include factors such as being able to set fees at a reasonable level and enabling the manager to be indemnified out of scheme assets. We recommend that this clause should be amended to allow a reasonable approach to the requirement.
- 3.15 We also recommend that the Bill should include transitional provisions dealing with some of the compliance requirements of the Securities Act that will create practical difficulties for KiwiSaver schemes in the transition to the new regime. The change from the trustee to the manager being the issuer of the scheme could be interpreted to mean that every KiwiSaver scheme would be required to send each of its members a new investment statement setting out the changes to the scheme. Requiring scheme providers to mail out new investment statements to existing members would involve considerable cost and would not be a meaningful way to present the changes to existing members.
- 3.16 Clause 215 of the Bill allows trust deeds to be amended to reflect the requirements of the Bill without them needing to go through the usual amendment process, subject to the approval of the FMA. We recommend that the Bill should also make it

clear that a new investment statement does not need to be sent to existing scheme members, provided the member receives a letter explaining the changes.

- 3.17 We also recommend that provision should be made to avoid the necessity for issuers to incur the additional cost of reprinting investment statements to reflect the change in the issuer/manager structure. We recommend that the Bill should allow for the information to be provided by means of a supplement to the investment statement until the next required update of the investment statement.
- 3.18 We are concerned about the timescales for compliance with the amendments and recommend that a reasonable period should be allowed for implementation. There will be significant changes to the administration of schemes, including:
- the appointment of a new trustee, where the scheme currently has an in house trustee
  - amendment of the trustee and manager functions and responsibilities
  - amendment of the trust deed to reflect these changes
  - agreement of new service contracts between the trustee and manager
- 3.19 The Bill allows for the provisions of Part 7 relating to KiwiSaver schemes to come into effect on a date to be set by Order in Council. We recommend that the Bill should allow a transitional window of 12 months to effect the change. That would give the trustee and manager the flexibility to implement the change in the most cost effective manner. Taking into account the scope of amendments that will need to be made and the fact that most KiwiSaver schemes will have a prospectus expiring by 30 September 2011, at the very least the new regime should apply no earlier than 1 October 2011.
- 3.20 The approach proposed in paragraph 3.19 above would allow providers to adopt the new structure at any time during the proposed transition period. For example, a provider whose prospectus expires on (say) 22 September 2011 would be able to transition to the new regime on that date, rather than being required to wait until (say) 1 October 2011.
- 3.21 We also recommend that the Bill be amended to provide for relief from the requirement for providers to update their KiwiSaver scheme prospectuses and investment statements to disclose the changes to be effected by the Bill as soon as it becomes law. We suggest that blanket relief be provided until the provider transitions to the new regime or, if this is not acceptable, that relief be based on sections 235 and 236 of the KiwiSaver Act.

#### **Disclosure**

- 3.22 While we support the inclusion in the Bill of amendments to the regulation of KiwiSaver schemes we have some reservations about the need for the additional disclosure requirements to be legislated at this stage rather than waiting for completion of the Review of Securities Law.

ISI is currently drafting standards that will apply to ISI members in respect of:

- Calculation and Disclosure of Fees and Charges
- Investment Performance Reporting, and
- Disclosure of Portfolio Holdings

While we acknowledge that not all KiwiSaver providers are members of ISI, the vast bulk of them are and the standards developed in this process will be available before the completion of the Review of Securities Law. Copies of these draft standards have already been provided to MED officials.

3.23 We do not believe that there is evidence of a problem significant enough to justify fast-tracking clauses 104 and 205.

3.24 Clause 104 inserts new sections 54C to 54 F into the Securities Act, relating to documents, information and other matters that are required to be made publicly available.

Clause 205 allows for regulations to prescribe what information must be included in annualised personal statements and how it should be presented, calculated or prepared. While clause 205 comes into effect on the day after the date the Act receives Royal assent, there is no indication of the likely timing of these regulations.

3.25 We recommend that clauses 104 and 205 be deleted from the Bill and considered in conjunction with the content of point-of-sale product disclosure statements in the Review of Securities Law.

3.26 We have similar concerns in relation to the register of securities in clause 98 of the Bill. While we support the establishment of such a register (and supported it in our comments on the Review of Securities Law), there does not appear to be sufficient justification to include it in this Bill rather than leaving it to be done as part of the considered outcomes of the Review.

3.27 We recommend that clause 98 should be amended in respect of new section 43P(m) to specifically exclude participation deeds for master trusts which should not be open to full public view. The information in any of those participation deeds is relevant only to the employees of the particular participating employer and will be available to them in specific investment statements.

#### **Levies**

3.28 Clause 63 of the Bill allows for an additional levy on financial market participants to be prescribed by regulations in order to fund the costs of the FMA performing its functions, powers and duties under the Act. We do not support this provision.

3.29 Financial Service Providers are potentially subject to levies under both the Financial Service Providers (Registration and Dispute Resolution) Act 2008 and the Financial Advisers Act 2008. We recommend that, other than the levies already provided for in these Acts, the costs of the FMA should be publicly funded on the basis that its main objective is the public good, stated in clause 8 as *to promote fair, efficient and transparent financial markets*.

## **List of ISI Members**

### **ISI MEMBERS**

AIA NZ  
AMP Financial Services  
Asteron Life Ltd  
AXA New Zealand  
BNZ Investments and Insurance  
CIGNA Life Insurance NZ Ltd  
Dorchester Life  
Equitable Group  
Fidelity Life Assurance Co Ltd  
FNZ  
Gen Re LifeHealth  
Hannover Life Re of Australasia Ltd  
ING New Zealand Ltd  
Kiwibank Ltd  
Medical Assurance Society NZ Ltd  
Mercer  
Munich Reinsurance Co of Australasia Ltd  
Pinnacle Life  
Public Trust  
RGA Reinsurance Co. of Australia Ltd  
Sovereign Ltd  
Southsure Assurance  
Swiss Re Life & Health Australia Ltd  
TOWER New Zealand  
Westpac/ BT Funds Management Ltd

### **Associate Members**

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BNP Paribas  
Bravura Solutions  
Burrowes & Co  
Chapman Tripp  
Davies Financial & Actuarial Ltd  
Deloitte  
DLA Phillips Fox  
Ernst & Young  
InvestmentLink (New Zealand) Ltd  
KPMG  
Kensington Swan  
Melville Jessup Weaver  
Minter Ellison Rudd Watts  
Morningstar Research Ltd  
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Russell McVeagh  
Simpson Grierson