

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

SUBMISSION
TO THE
MINISTRY OF ECONOMIC DEVELOPMENT
ON THE
REVIEW OF FINANCIAL PRODUCTS AND
PROVIDERS

Collective Investment Schemes

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Introduction

The Investment Savings and Insurance Association ("ISI") welcomes the opportunity to comment on the Discussion Document *Overview of the Review and Registration of Financial Institutions* issued as part of the Review of Financial Products and Providers ("RFPP"). Our comments are made on behalf of our members who are the issuers and managers of life insurance, superannuation and managed funds listed at the end of this paper. Our members are keenly interested in the proposals put forward for regulation of the financial services industry and we have appreciated the extensive consultation on these issues with officials and advisory groups.

ISI generally supports the overall framework for regulation of the financial services industry and the registration proposal, but we do have some general comments to make on the proposal for collective investment schemes.

General Comments

ISI commends the Ministry of Economic Development for the process followed in the RFPP and the opportunity it presents for the regulation of financial services to be considered in a comprehensive manner. The discussion documents produced by MED together provide a very useful overview of the application of different pieces of legislation to the various products and services available within the industry.

We endorse the approach to financial services regulation from the point of view that comparable products and services should be regulated on a comparable and consistent basis in order to increase the protection and understanding of consumers and reduce the cost of compliance for providers. One of the key outcomes to be hoped for must be an improvement in the environment for saving in New Zealand in order to raise the level of personal saving and increase the pool of local savings available for investment.

As noted above, ISI members are the companies issuing and managing life insurance, superannuation and managed funds in New Zealand. That involves various ISI members in most of the activities reviewed as part of the RFPP: insurance, superannuation, collective investment schemes, platforms and portfolio management services, the offering of securities and consumer dispute resolution and redress. Reinsurance companies (all based offshore) are also members of this association and a key participant in the life insurance industry.

All ISI members have an interest in New Zealand maintaining a robust and efficient financial services system which has the confidence and respect of the New Zealand public and local and international institutions. ISI has taken a leading role for the industry in commenting on law reform issues. Key issues in recent years have been the recommendations for review of the Life Insurance Act 1908 and the review of the Securities Act and Regulations.

We are aware of the need for financial services regulation in New Zealand to take account of responsibilities towards the security of international financial markets and

ISI has provided submissions to recent Ministry of Justice discussion documents on anti-money laundering and countering the financing of terrorism (FATF Recommendations). As most ISI members are trans-Tasman companies, we are also acutely aware of the issues around trans-Tasman mutual recognition.

A holistic approach to regulation of the financial services industry should ensure that the design of a new regime takes into account the need to improve the environment for personal saving in New Zealand while harmonising where possible with Australia and also meeting our international obligations in the area of financial security.

Overview

The RFPP discussion documents propose to apply the same regulatory regime to life insurance products with a savings component, superannuation and managed funds on the basis that they are comparable products and should be regulated on the same basis. ISI supports the general approach involving registration of financial institutions and two main regulators (prudential and market conduct), with collective investment schemes and their issuers being supervised by trustees who are approved and supervised by the Securities Commission. We do not, however, support life insurance policies with a savings component being treated as collective investment schemes.

We support the trustee supervisory model in theory, although we note that it is not entirely clear at this point what the respective roles and responsibilities of the trustees, the Companies Office and the Government Actuary will be. The current trustee model has worked well for unit trusts.

There is still some uncertainty in respect of the proposals for superannuation schemes and whether there is any justification for non-KiwiSaver superannuation schemes being regulated under different legislation from other managed funds.

We do have specific comments to make on the Collective Investment Schemes discussion document. Our comments on the trustee supervisory model are in the ISI submission on the RFPP discussion document *Supervision of Issuers*. This submission covers the application of the trustee supervisory model to collective investment schemes.

Collective Investment Schemes

Definition and scope of CIS

ISI generally agrees with the objectives of the Review set out in paragraph 20. We agree that effective and consistent regulation of comparable financial services should increase investor confidence as well as the ease of doing business for financial services companies.

ISI supports the overall regulatory framework proposed by the RFPP but we have raised some concerns in submissions on other RFPP discussion documents that it may be counter-productive to try to impose a single regulatory model on a wide range of product types.

We support the proposals for the definition of CIS and the proposal that CIS would not be required to take a particular legal form. We agree that allowing a range of product types within the umbrella definition of CIS will provide the flexibility for continuing product innovation. We also agree with the proposal that the Securities Commission have discretion to declare a security a particular type of security as necessary.

Life Insurance

The definition of CIS set out in Appendix 1 includes life insurance policies as defined by section 2 (1) of the Securities Act. While ISI agrees that life insurance as defined does share some of the characteristics of collective investment schemes, we believe that the disadvantages outweigh the benefits of regulating life insurance as a CIS. The sale of life insurance as an investment vehicle is diminishing but there are still many policies in existence which combine risk cover with a savings component. The primary purpose of those policies is life insurance and we recommend that the insurance regime is the appropriate place for them to be regulated.

We recommend that contributory mortgages should be included within the definition of CIS and regulated on the same basis in order to facilitate comparison with other products.

Superannuation

Although the Superannuation Schemes Act requires schemes to be ‘principally for the purpose of providing retirement benefits...’, there are no tax benefits for contributions nor other benefits to distinguish (non-KiwiSaver) superannuation from other long-term savings. The Government has just legislated to allow employer-sponsored superannuation schemes meeting certain criteria (such as lock-in) a limited exemption for SSCWT on employer contributions. Notwithstanding that change, ISI considers that it is appropriate for superannuation schemes to be treated on the same basis as other managed funds and regulated as Collective Investment Schemes.

It would not be appropriate to model the regulation of New Zealand superannuation schemes on the regimes in either Australia (where contribution to superannuation schemes is compulsory) or Britain (where there are tax benefits for pension contributions).

We agree that there is justification for different treatment for existing stand alone employer-sponsored schemes and defined benefit schemes under the Superannuation Schemes Act, with transitional arrangements. However, we do not agree that there is justification for treating workplace superannuation in general differently from other CIS. As long as the Superannuation Schemes Act protections for scheme members, particularly in locked in schemes, are reproduced within the trust deed requirements of a CIS the Superannuation Schemes Act should not apply.

We would expect that most new employer-sponsored superannuation is likely to go into KiwiSaver schemes from July 2007 and thus fall within the definition of CIS. For any new employer sponsored superannuation scheme that is not a KiwiSaver scheme, whether stand-alone or master trust, the trust deed provisions will need to cover the relevant factors such as employer contributions, vesting scales and insured benefits.

Oversight by an Independent Supervisor

Under the proposed trustee supervisory model each CIS will have a trustee to supervise the issuer and the scheme. Trustees will be approved by and supervised by the Securities Commission. ISI supports this framework and our comments on the approval and supervision of trustees, including CIS trustees, are in our submission on the *Supervision of Issuers* discussion document.

Duties and Powers of the CIS Trustee

ISI supports the proposed functions of the CIS trustee set out in paragraph 97 and the powers and rights set out in paragraph 106. We do have concerns with the requirement for the trustee to make the initial ‘fit and proper’ assessment and these concerns are set out in detail below (under ‘Issuer’).

It would be helpful to have a more precise definition of what is envisioned as the legal duties of trustees. At present there is some uncertainty as to whether paragraph 95 c of the discussion document is proposing that trustees should have a responsibility to make a judgement on the merit of the offer being made to investors.

We note the proposal that the CIS trustee be required ‘to act in the best interests of members...’ and recommend that the scope of this requirement is clarified to ensure that trustees are aware of the extent of this responsibility. Paragraph 102 g. proposes that the trustee will not be liable to the investors or the issuer if it refuses to act in the acquisition or disposition of property if it considers it not to be in the best interests of members. It is not clear whether the document intends this independence to extend beyond questions of property.

Breach by CIS Trustee of its Obligations to Investors

ISI supports the proposed remedies for investors where a trustee is not performing its duties or has breached a term of the trust deed. We note, however, that it will be important for trustees to have certainty about the extent of their duties.

In principle, we agree that investors of all CIS (including superannuation) should have the facility to call a meeting and issue a directive to the trustee or take court action and that the Commission should also be able to direct the trustee and/or take court action. However, there needs to be further consideration of the potential conflict between an investor resolution and the trustee’s responsibility to act in the interests of all investors. In particular, the protections for members under section 9 of the Superannuation Schemes Act need to be considered in relation to members’ ability to direct trustees. We recommend that the threshold for the Commission taking such action should be similar to that proposed in the Securities Legislation Bill.

The Issuer

Initial Assessment and Approval

ISI questions the appropriateness of issuers having to demonstrate to the CIS Trustee fit and proper entry requirements. This places the CIS Trustee in a conflict of interest position. To appreciate this it is necessary to understand how the market works. The market works by managers (issuers) wishing to attract funds for investment through a collective investment vehicle. The manager goes to the trustee market, frequently by tender, to appoint a trustee to provide the trustee services. This is competitive, with

the trustees competing with each other to be appointed to the position of trustee of the collective investment vehicle. If the trustee is also required to satisfy themselves as to the issuer's fit and proper entry requirements they would be put in an invidious position. This may compromise the trustee's ability to look at the issuer in a purely subjective manner. We believe that the issuer approval process should be undertaken by the Commission directly. The Commission should determine whether the applicant is competent and has the capacity to perform their functions. It is appropriate for the CIS Trustee to have ongoing monitoring obligation as, once appointed, the trustee will have statutory protection against removal.

ISI supports the criteria that are proposed to be used but we do have some concerns that the approval process may be unnecessarily cumbersome. We recommend that simplicity and ease of operation should be key objectives when designing the details of the process in order to avoid adding unnecessary compliance difficulties and costs.

We agree that issuers who have been declined by the Commission should have the ability to present further information to support an appeal process.

Reporting

ISI supports the proposals for event-based and periodic reporting by the issuer to the CIS trustee, subject to consideration of detailed regulations.

Breach by Issuer of Ongoing Requirements

ISI agrees that the CIS trustee should have a range of mechanisms for dealing with an issuer breach, depending on the severity of the particular breach. We support the options set out in paragraph 142, with the proviso that the issuer should have a facility for providing information in defence of its actions.

Functions, Duties, Powers and Liability of the Issuer

ISI agrees that the general functions of the issuer should be in primary legislation but we recommend that detailed rules should be contained in regulations.

We support the issuer duties set out in paragraph 150, with the same recommendation for clarity around 'acting in the best interests of investors'. We are concerned that there may be considerable variation in the interests of members in a large managed fund and the issuer will not necessarily be privy to them.

ISI supports the additional power for issuers proposed in paragraph 153.

Subject to the need for clarity in the rules, we agree that the issuer should bear the same liability for exercising its powers and duties as if it were a trustee.

Breach by Issuer of Obligations to Investors

ISI supports the proposal in paragraph 155 and we repeat our comments made above regarding breach of ongoing requirements.

Other Protections

We agree that the whistle-blowing provisions be extended across the CIS regulatory framework to provide consistent consumer protection and confidence across the industry

Controls on CISs and Implied Trust Deed Terms

Amendments to the Trust Deed

ISI agrees that trust deeds must include rules for how the trust deed may be amended. If the trustee and Issuer agree on trust deed changes then that should be sufficient to allow for the changes to be implemented (subject to the trustee meeting its fiduciary duties to investors), the amendment lodged with the Companies Office and the Commission notified. If the trustee and issuer cannot reach agreement on a proposed trust deed change then either party should be able to elect to go to the Commission for approval of the change.

We do not support the proposal that full member consent should be required to alter a superannuation scheme trust deed. We recommend consistency across all CIS structures. In the event of a change that would adversely affect member benefits, trustee approval and the approval of the Commission should be required. While the wording of section 9 of the Superannuation Schemes Act is very restrictive in some circumstances, the principle that investors' accrued benefits should be protected is sound and any proposal that could weaken that protection needs to be examined critically.

Transfers to Another Scheme

ISI supports enabling transfers of members to another CIS where the new scheme is equivalent or better than the previous scheme. We recommend that, if the transfer is in the best interest of investors/members, it should be allowed with the approval of the Commission rather than the Trustee who may be compromised by such a transfer.

We agree that there should be some flexibility in transfer provisions. If non-transferability is required by an issuer then that can be specified in the trust deed and clearly specified in the offer document.

Matters to be Addressed in Trust Deeds

ISI agrees that there should be a common standard for clarity and consistency in CIS trust deeds, while maintaining flexibility for variations between different product types. As noted above, any new employer-sponsored superannuation schemes will need to include information on employer contributions, vesting etc. in the trust deed.

We agree that (where appropriate for the product type) a trust deed should cover the matters addressed in paragraphs 203 to 257, although we have some reservations on specific points.

ISI would not support CIS funds that hold themselves out to be superannuation funds having any requirement to lock-in funds, except where there is a tax benefit such as the limited exemption for SSCWT on employer contributions that has just been legislated. In the absence of any tax benefits or other Government incentives we see no justification for superannuation to have a lock-in requirement if unit trusts do not. A CIS that wants to have a lock-in can specify it in the documentation. In addition, we do not consider that a CIS with a lock-in should be required to provide for portability as it may be difficult to implement in practice.

We do not support consistent timing of valuations. Different products may require different timings for valuations such as a multi-manager multi-strategy fund which may be valued on a lesser frequency due to the time and difficulty involved in the valuation.

With regard to winding-up, it is difficult to foresee all possible triggers for a wind up so we do not support having only standard triggers. We recommend retaining the provision for agreement between the Trustee and Manager where it is in the interest of members.

ISI supports replication of the Unit Trusts Act quorum and voting tests in the CIS regime.

ISI considers that some issues, such as fees and returns, will only be able to be covered in general terms in the trust deed and will be covered in more detail in the offer document.

Superannuation Schemes

ISI agrees with the proposals for stand alone superannuation schemes, both the transitional arrangements and non-transitional arrangement for the set up of new stand alone schemes. We have already seen a number of stand alone schemes transferred to master trust arrangements or wound up because of the effort and cost of compliance and some of the proposals in the discussion document may speed this action up. However, the proposed changes are not overly onerous and these schemes should fit reasonably well within the CIS framework.

We recommend that the definition of master trust versus stand alone scheme should be looked at. There are industry based schemes that run as stand alone schemes but have participating employers within their industry. It may be prudent that, rather than legislating the definition, guidelines could be given to the Regulator and schemes could apply to seek exemption on a case by case basis.

ISI supports the proposal for the reversion of assets to a third party to require the approval of the trustee.

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