6 July 2001

By courier

Ms Marian Kljakovic
Ministry of Economic Development
33 Bowen Street
WELLINGTON

BUSINESS LAW REFORM BILL 2001

1 We refer to the letter dated 25 May 2001 from the Ministry to David Stevens, inviting comment on the May 2001 *Discussion Document* relating to the proposed Bill.

2 The Association of Superannuation Funds of New Zealand (*ASFONZ*) is an independent national, non-profit organisation founded in 1969. Its current membership comprises 122 major employer-based superannuation schemes (17 of them having over 1500 members) and around 60 organisations and individuals representing the various service providers for employer-based schemes.

3 The main objective of ASFONZ is to promote employment-related superannuation in New Zealand, by (among other things) being the recognised voice on employment-related superannuation industry matters.

4 An employer-based scheme is undoubtedly the most simple and cost-effective means for an employee to save for retirement, and as such employer-based schemes deserve from the Government a clear message of support.

5 In that regard, the most significant and welcome aspect of the proposed Bill is the intended removal of the prospectus requirement for employer-based schemes. Over the last three years, that requirement has proved extremely costly, produced no discernible member benefits and contributed materially to a continuing decline in the number of employer-based schemes.

6 The **attached** paper sets out ASFONZ's comments on those parts of the proposed Bill which are of particular relevance for employer-based schemes. Those comments can be summarised as follows:

- Financial Reporting Act 1993, section 9A(2) – both the existing effect of that section and the purpose of the proposed amendments require clarification, and until that occurs it is difficult to comment further;

- Securities Act 1978, section 2 – ASFONZ supports the proposal that the "*issuer*" definition be amended to include the directors of any corporate issuer;

- ASFONZ strongly endorses the removal of the prospectus requirement for employer-based superannuation schemes, for the reasons given;

- In relation to Investment Statements, ASFONZ recommends prescribing that employer-based schemes:

  (i) can replace the *Choosing an Investment Adviser* section with briefer and more appropriate wording; and

  (ii) need only state that no prospectus is required (without including any "Restricted Disclosure" warning);

- Superannuation Schemes Act 1989 (*SSA*) section 12 certificates –

  (i) ASFONZ supports the proposal that section 12 certificates should be able to be signed either before amendments are made or within 14 days afterwards;

  (ii) ASFONZ does not support the proposal that a section 12 certificate should extend to stating that the method of amendment complies with the Act; and

  (iii) ASFONZ recommends a further amendment to section 12(1), clarifying that a section 12 certificate relates exclusively to the relevant amending deed;

- SSA section 20A – ASFONZ does not support requiring at least one independent trustee for an employer-based scheme whenever a receiver or liquidator is appointed. ASFONZ recommends either:

  (i) extending section 20A to the situation where an employer has the power to appoint all or any of the scheme's trustees (requiring those trustees to be replaced with independent persons when the employer enters receivership or liquidation); or

  (ii) replacing section 20A with a provision whereby if a principal employer enters receivership or liquidation, then an independent person must be appointed to exercise all the employer's rights and perform all its duties under the scheme's trust deed;

- ASFONZ recommends expanding the "*independent person*" definition in section 20A of the SSA, to prevent the appointment of any person associated with a scheme's administration or investment manager or any service provider;

- ASFONZ supports allowing abridged accounts for annual reports, but disagrees with some of the suggested consequential amendments to the SSA;

- ASFONZ has no objection to requiring the inclusion in a corporate trustee's annual report of a list of its directors;

- ASFONZ considers that employer-based schemes should, for obvious reasons, be exempt from any requirement to advise in annual reports the registration date of the most recent prospectus; and

- ASFONZ recommends an amendment to section 9(a) of the SSA, clarifying that amendments prescribing benefit improvements able to be funded from surplus are valid notwithstanding their possible adverse effects on contingent wind-up benefit entitlements.

7 Thank you for the opportunity to comment on the proposed Bill, and to contribute to the legislative process. I would be more than happy to meet with you, or others involved in developing the Bill, to discuss or develop any of the matters dealt with in this paper if you consider that would be helpful.

Yours sincerely

David Stevens
Executive Director

COMMENTARY ON

PROPOSED BUSINESS LAW REFORM BILL 2001

(Provisions relating to Financial Reporting Act 1993, Securities Act 1978 and Superannuation Schemes Act 1989)

by

THE ASSOCIATION OF SUPERANNUATION FUNDS OF NEW ZEALAND INCORPORATED (ASFONZ)

6 July 2001

FINANCIAL REPORTING ACT 1993

Section 9A(2): Application of the Act to Superannuation Schemes

1 Section 9A(2) is redundant for superannuation schemes. Trustees' liabilities cannot be limited to a separate fund, and trustees are personally liable for certain breaches of trust.

2 If properly interpreted, section 9A(2) is unlikely to have ever applied. The Ministry may have never received financial statements for a separate fund to which superannuation trustees' liabilities are limited.

3 We understand the rationale for section 9A(3), as the liabilities of a life insurer are often limited to a separate fund. However, that is more a result of the peculiarities of life insurance legislation, and does not sit easily with superannuation schemes, unit trusts or group investment funds.

4 ASFONZ understands that there is a high level of confusion about section 9A(2). Some think that the section is targeted at schemes offering a number of investment fund options, and requires that separate financial statements be provided for each investment fund. That appears incorrect. Financial statements for a separate fund are required only if the *liabilities* of the trustees or the scheme are limited to that fund. Where a range of investment funds is offered, it does not necessarily follow that the liabilities for each fund will be limited to that fund. In fact, in many cases the opposite will be true.

5 Both the existing effect of section 9A(2) and the purpose of the proposed amendments require considerable clarification. It is difficult to comment further until then.

SECURITIES ACT 1978 - DEFINITION OF "ISSUER"

6 ASFONZ supports the proposal that, for consistency with the definition of "*promoter*", the definition of "*issuer*" in section 2 of the Act be amended to include the directors of any body corporate which is an issuer.

7 ASFONZ has previously recommended that the "*superannuation trustee*" definition be extended to include the directors of a corporate trustee, to ensure that the same disclosure information is provided irrespective of the trustee structure.

8 The proposed amendment to the "*issuer*" definition will achieve the same practical result, and is therefore desirable.

9 Minor consequential amendments will be required to several provisions in the Act, such as:

9.1 sections 37 and 37A which refer, throughout, to both an issuer and its directors; and

9.2 sections 41(b)(i) and 43(2)(i), which require a prospectus and any amendments to be signed by "*The issuer of the prospectus (if an individual) and every person who is a director of the issuer*" (those words will need replacing with "*Every issuer of the prospectus*", or similar).

SECURITIES ACT 1978 - EMPLOYER SUPERANNUATION SCHEMES – REMOVAL OF PROSPECTUS REQUIREMENT

Introduction

10 ASFONZ strongly endorses the proposal to amend section 5(2E) (and presumably delete section 5(2F)) so that an exemption from the prospectus requirement is prescribed for all employer-based superannuation schemes. This is an extremely important legislative change for employer-based schemes.

11 ASFONZ has long been lobbying for the removal of the prospectus requirement. We recently joined with the Investment Savings and Insurance Association, the Office of the Retirement Commissioner, the Council of Trade Unions and the Employers' Federation in recommending unanimously to the Ministerial Panel on Business Compliance Costs that the prospectus requirement be removed, on the basis that:

11.1 it is expensive;

11.2 it is of no benefit to members;

11.3 it has resulted in a decline in the number of employer-based schemes; and

11.4 it sends the wrong messages to savers, employers and business.

12 It is pleasing that those representations have been positively acknowledged by the proposed law change.

Defining an employer-based scheme

13 The options include:

13.1 incorporating into the Act an "*employer-based superannuation scheme*" definition along the lines set out in the **attached** Appendix (which is based on the criteria for a "*qualifying superannuation scheme*", set out in section GD 8(4) of the Income Tax Act 1994); or

13.2 prescribing simply that a scheme with qualifying superannuation scheme status is exempt from the prospectus requirement (on the basis that it is most unlikely, by definition, that any scheme given qualifying status under section GD 8 of the Income Tax 1994 could ever be anything other than a genuine employer-based superannuation scheme).

14 Whichever option is adopted, the Government Actuary could have the ability to exclude any scheme which is not genuinely an employer-based, non-retail superannuation scheme.

15 ASFONZ expects that the former option (adding a new definition into the Securities Act) will probably be the preferred alternative because in that event, the Securities Commission will retain the ability to query the status of particular schemes.

Effects of existing prospectus requirement

16 In ASFONZ's view, the extension of the prospectus regime to employer-based schemes has been both misguided and destructive. The resulting heavy compliance costs were never justified with logical argument. There have been no discernible benefits.

17 On any analysis, the prospectus regime surely fails whatever efficacy or cost/benefit test is currently being applied by the current Ministerial Panel on Business Compliance Costs.

(i) Costs/level of prospectus requests

18 In a 1998 survey conducted jointly by ASFONZ and the Retirement Commissioner, the average overall cost for employer-based schemes of producing a prospectus was estimated at $10,800. On average, it had taken 79 hours to prepare a prospectus. Employers paid an average of $7,800 in professional fees for prospectuses, while schemes themselves paid an average of $9,300 in fees. Almost all employers surveyed described prospectuses as being of nil or negligible value.

19 A 1999 ASFONZ survey then showed that the total cost of preparing prospectuses had by that date already amounted to an average *$37,000 per request for a copy*. The survey covered 45 schemes, with 33,000 members and $2.4 billion in assets. 26 members (fewer than 1 in 1000) had asked for a prospectus. 84% of schemes rated the prospectus as having absolutely no value. The remaining 16% rated it of minimal value. A copy of the relevant press statement is **attached**.

20 The 1999 survey was conducted shortly after the introduction of the prospectus regime. The new disclosure requirements had been given a very high level of publicity, so it could be expected that requests for prospectuses were temporarily far more likely than would be the case going forward.

21 Since then, only a derisory number of prospectuses have ever been requested, across the entire employer-based superannuation industry. It is the norm for ASFONZ member schemes (even 1,000 member-plus schemes) never to have

received a request for a prospectus. That is despite overall costs (in terms of advisers' fees, management time and other expenses) that have in some cases approached, or even exceeded, six figures.

22 Compounding this is the fact that, in many cases, the costs associated with prospectuses are being borne by schemes themselves rather than employers. In such cases, the prospectus requirement comes at a direct cost to existing members, in the form of reduced net earnings, for no discernible benefit.

23 The costs of the prospectus requirement are exacerbated by the use of the very word "prospectus", a word typically associated with major equity or debt raising exercises. For New Zealand subsidiaries of multi-national companies, that has often meant (in terms of an express world-wide policy relating to prospectuses) liaison with overseas Boards before each successive prospectus can be signed and registered. Some schemes have chose or seriously contemplated winding up, rather than having to incur the trouble and expense of referring a staff scheme's prospectus to the Board of Directors of an overseas parent every time it is rolled over.

(ii) Wider effects on the industry

24 In its 5 November 1995 submission on the proposed extension of the prospectus requirement to employer-based schemes, ASFONZ commented that:

> "*The current regime allows [employers] to provide customised schemes for employees at an acceptable cost even allowing for no financial or tax advantages. The danger of the proposed new regime is that it will encourage employers to opt out of providing superannuation. This in turn will lead to employers paying their employees on a total remuneration basis at the expense of employees actually saving for their retirement.*"

25 ASFONZ then repeatedly submitted that:

25.1 prospectuses would be of limited benefit to members;

25.2 the costs and time involved in preparing a prospectus would be onerous for employers, would discourage offers of employer-based schemes, and would lead to the demise of some smaller schemes; and

25.3 the prospectus disclosure requirements were largely irrelevant to employer-based schemes.

26 Despite such warnings, the prospectus regime was then extended to employer-based schemes effective 30 June 1998.

27 The prospectus requirement has materially contributed to the wind-ups not only of numerous smaller employer-based schemes, but also of several larger ones. This is reflected in the accelerating rate of decline in the number of such schemes. As at 31 December 1997, six months before the prospectus requirement took effect, there were 1,047 private sector employer-based schemes. The Government Actuary's latest statistics show that:

27.1 only 818 such schemes remained in existence as at 31 December 1999; and

27.2 of those, 109 had informed the Government Actuary that they would wind up during the next calendar year.

28 The extent to which the prospectus requirement has led to scheme wind-ups may have been exaggerated by those who intended to wind up anyway; but there is no doubt it is often a contributing factor. Retail providers marketing to employers and employer schemes use the prospectus exemption enjoyed by participants in a multi-employer scheme as a key marketing tool.

29 The wind-up of an employer-based scheme also does not mean that the relevant employer will necessarily cease providing superannuation to its employees. The continuing reduction in the number of stand alone employer-based schemes has helped drive the strong growth of retail schemes offered by life insurers, as many employers move to participation in multi-employer or "master trust" arrangements.

30 However, whenever an employer-based scheme is wound up, there is inevitably considerable savings leakage. When given the opportunity of either transferring to a retail scheme or taking cash, members choose cash more often than not. This further reduces New Zealand's overall direct savings rate.

The prospectus requirement is wrong in principle

31 The prospectus regime, as it relates to employer-based superannuation schemes, is a solution looking for a problem. To ASFONZ's knowledge, no one has ever seriously suggested (to date) that the prospectus requirement provides any added protection for members or intending members of employer-based schemes.

32 The prospectus requirement was extended to employer-based schemes effectively by default, because of an inflexible "level playing field" ideology within the Securities Commission and an unwillingness to accept that employer-based schemes are not (in any meaningful sense) offered to the public.

33 ASFONZ considers it incorrect to regard an employer who offers membership of a superannuation scheme to its employees as making an "offer to the public".

Even if its employees are technically the public, they are only a minute subset of the general public. Retail scheme promoters would never consider incurring the costs of a prospectus for a new member "market" as small as that available to most employer schemes – perhaps a few dozen new employees each year.

34 Proponents of the "level playing field" approach overlook the fact that there are two quite different types of superannuation scheme operating in New Zealand, namely:

34.1 retail schemes offered to the general public, the products offered being profit-motivated and for general savings; and

34.2 employer-based schemes, which are offered only by employers to their employees and are not run for profit. In those, the promoter (the employer) is often *worse off* financially if an employee chooses to join the scheme.

35 In employer-based schemes, a decision to join benefits only the employee. No one makes a commission on contributions. There is no competition for market share – indeed, there is no "market". In most cases, the employer is acting economically irrationally in offering a scheme because cash-only remuneration is cheaper.

Are there any counter-arguments?

36 ASFONZ understands that some interest groups may well oppose the Ministry's sensible and practical proposal to remove the prospectus requirement for employer-based schemes. We expect there will be three main arguments raised:

36.1 that removing the prospectus requirement for employer-based schemes will somehow provide those schemes with a competitive advantage;

36.2 that investment vehicles which are not genuine employer-based superannuation schemes may be established, or utilised, purely to obtain the prospectus exemption; and

36.3 that removing the prospectus requirement for employer-based schemes will make inappropriate related party investments less "visible" and somehow more likely.

37 ASFONZ considers each argument unfounded. We elaborate below.

(i) The "competitive advantage"

38 Removing the prospectus requirement will eliminate a distinct competitive *dis*advantage for employer-based schemes. Employer-based and retail schemes

are governed by equivalent, equally prescriptive, prospectus requirements, and yet employers can "market" only to a minute subset of the general public (namely their own non-member employees). Retail schemes, by contrast, can market to all employed persons nationally.

39 As noted above, a retail scheme provider would never produce a prospectus for so small a group as a single employer's workforce. The argument that employer-based schemes will derive any meaningful "competitive advantage" from a prospectus exemption is therefore invalid.

40 ASFONZ acknowledges that prospectuses are probably requested almost as rarely in the retail scheme context as for employer-based schemes. What that means though is that even for the very largest retail schemes, prospectuses are now beginning to be resourced accordingly - i.e. they are produced on plain paper with no marketing content, typesetting or imagery, and are confined to the legal essentials.

41 The result of that approach is that the cost of producing a prospectus will not differ greatly as between the very biggest retail scheme and an employer-based scheme which falls just outside the existing "small scheme" exemption. However, that cost will of course be disproportionately significant and totally unjustifiable for the smaller scheme.

(ii) Vehicles defeating the purpose of the exemption

42 The argument here is that prescribing a prospectus exemption for employer-based schemes might somehow lead to vehicles which are not genuine retirement schemes for employees (such as contributory mortgage schemes) being established or utilised purely in order to obtain the exemption.

43 That argument is not well-founded.

44 Section 2(1) of the Superannuation Schemes Act 1989 prevents *any* vehicle other than a *"trust … established by its trust deed principally for the purpose of providing retirement benefits to beneficiaries who are natural persons"* from obtaining, or retaining, registration as a superannuation scheme. The Government Actuary can deregister any scheme which does not operate in accordance with that requirement.

45 An employer-based superannuation scheme can be easily (and exhaustively) defined using either the *"qualifying superannuation scheme"* concept in the Income Tax Act 1994, or incorporating a corresponding definition into the Securities Act.

46 Under Section GD 8(4)(f) of the Income Tax Act, qualifying superannuation scheme status depends on a superannuation fund not having been, in the Government Actuary's view:

> *"... established or utilised in a manner which has the effect of defeating the intent and application of the life insurance rules."*

ASFONZ suggests the inclusion of similar qualifications in any definition incorporated into the Securities Act, to the effect that:

46.1 there is a genuine nexus between the fund and the employment relationship; and

46.2 the fund has not been structured principally for the purpose of complying with the exemption (refer clause 1(f) of the **attached** Appendix).

(iii) Disclosure of related party investments

47 Advocates of the supposed "level playing field" approach might seek to argue that if an employer-based superannuation scheme is not required to produce a prospectus, then that might make it easier for trustees appointed by a sponsoring employer to invest inappropriately in related parties.

48 That is incorrect.

49 Annual reports (including summary accounts) relating to employer-based schemes must be filed with the Government Actuary and distributed to all members each year. Schemes must also file audited accounts with both the Government Actuary and the Companies Office, which must be made available to members on request.

50 Item (g) in the Second Schedule to the Superannuation Schemes Act 1989 requires notification by the trustees of an employer-based scheme in their annual report if more than 10% of the market value of a scheme's assets was invested directly or indirectly at any time during the year (in a way in which it was reasonable for the trustees to be aware):

> "*...in any employer who was a party to the scheme or in any company or entity associated with any such employer and if so, details of all such investments held during the year.*"

51 Item (g) is materially very similar to the corresponding disclosure requirement for a prospectus, prescribed in clause 8(3) of Schedule 3C to the Securities Regulations 1983.

52 If it needs saying, members and the Office of the Government Actuary actually read annual reports. Prospectuses, practically speaking, are never seen by anyone other than the signatories, their own advisers and a Companies Office reviewer who looks at formal compliance.

53 Financial Reporting Standard No. 32 (*Financial Reporting by Superannuation Schemes*), which was approved in April 1998 by the Accounting Standards Review Board under the Financial Reporting Act 1993, and applies to all employer-based schemes:

53.1 requires the inclusion in each scheme's statement of financial position, or net assets, of :

> "*…details of investments in securities issued by the scheme's sponsor or by related parties of the sponsor*"; and

53.2 defines a "*related party*" very broadly – parties are considered to be related if one party has the ability, directly or indirectly, to control or exercise significant influence over the other party in making operating, investing and financing decisions to the extent that one of the parties might be prevented from fully pursuing its own separate interests.

Parties are also considered to be related when they are subject to common outside control or significant influence, and the approach adopted must be one of substance (not legal form).

Conclusion

54 ASFONZ reiterates its strong endorsement for the proposed removal of the prospectus requirement for employer-based schemes.

55 It also reiterates that in the unanimous view of ASFONZ, The Retirement Commissioner, the CTU, the Employers' Federation and the Investment Savings and Insurance Association, the prospectus requirement has had a detrimental effect on employer-based schemes and is of no benefit to members.

SECURITIES ACT 1978 : ADDITIONAL AMENDING SUGGESTIONS

Investment Statement - *"Choosing an Investment Adviser"*

56 ASFONZ considers that the required wording for the opening section of an Investment Statement, headed "*Choosing an Investment Adviser*", is suitable only for retail schemes and should be modified for employer-based schemes. The current wording is:

> ***"Choosing an Investment Adviser***
> *You have the right to request from any investment adviser a written disclosure statement stating his or her experience and qualifications to give advice. That document will tell you –*
>
> - *Whether the adviser gives advice only about particular types of investments; and*
> - *Whether the advice is limited to the investments offered by 1 or more particular financial organisations; and*
> - *Whether the adviser will receive a commission or other benefit from advising you.*
>
> *You are strongly encouraged to request this statement. An investment adviser commits an offence if he or she does not provide you with a written disclosure statement within 5 working days of your request. You must make the request at the time the advice is given or within 1 month of receiving the advice.*
>
> *In addition-*
>
> - *If an investment adviser has any conviction for dishonesty or has been adjudged bankrupt, he or she must tell you this in writing; and*
> - *If an investment adviser receives any money or assets on your behalf, he or she must tell you in writing the methods employed for this purpose.*
>
> *Tell the adviser what the purpose of your investment is. This is important because different investments are suitable for different purposes."*

57 An investment adviser will not usually be involved with an employer-based scheme, making those paragraphs in most cases meaningless.

58 In its 1995 and 1996 submissions on the disclosure requirements, ASFONZ suggested permitting employer-based schemes to replace those paragraphs with brief wording as follows:

> "***Receiving additional advice on the scheme***
> *In addition to the advice you will receive on the scheme from your employer or his/her adviser, you may need to discuss your potential membership with an investment adviser."*

59 Any means of shortening disclosure documents (without sacrificing clarity or comprehensibility) should be encouraged by the legislature as it will, hopefully, lead to disclosure documents which are more meaningful and likely to be read.

Investment Statement - *"Restricted Disclosure"* warning

60 Schedule 3D to the Securities Regulations 1983 currently requires the inclusion in an Investment Statement of a strongly worded warning, with respect to schemes covered by the "*small employer superannuation scheme*" exemption prescribed in regulation 2C, to the effect that (in the absence of a prospectus available on request) members are receiving only restricted disclosure.

61 Obviously, that warning will now be redundant if all employer-based schemes are exempted from the prospectus requirement.

62 More importantly, no such warning should now be required for employer-based schemes. To require such wording would be unfair in comparison with the treatment of other securities which do not require a prospectus, and are required to modify the Investment Statement only to state that a prospectus is not required.

SUPERANNUATION SCHEMES ACT 1989

(1) Section 12: certificates

(i) Timing of certificates

63 ASFONZ supports the proposal that section 12 certificates relating to trust deed amendments should be able to be signed either before the amendments are made or within 14 days afterwards. We do not accept the counter arguments that the proposal:

63.1 would weaken the protection given to members; or

63.2 would create pressure to defend a decision that has already been made, rather than having the compliance issue addressed without that pressure before the decision is made.

64 We consider that, if anything, certifying amendments after their execution is preferable for member protection and ensuring certainty of compliance. For example, one professional adviser has had the experience of a consultant amending a deed after certification, but before its execution. These problems will be removed if the deed is received and certified after it has been executed. Trustees will often require a sign-off before execution, but that will be a matter for them.

65 Certifying compliance after the event is the norm in other contexts, such as conveyancing and the provision of audit certificates. Amendments to superannuation schemes' trust deeds should be no exception.

66 Concerning pressure to defend a decision already made, the reality is that trustees will already have obtained professional advice and formed a view on compliance issues well before the content of a deed of amendment is finalised.

(ii) Certifying method of amendment

67 ASFONZ does *not* support the proposal that a section 12 certificate should extend to stating that the method of amendment complies with the Act. While we are conscious of the technical arguments raised by some people that section 12 does not deal with the amendment process itself, but merely the state of the scheme post-amendment, we see no justification for imposing this onerous additional requirement.

68 The key protection given to scheme members in this context is that prescribed by section 9 of the Act, which invalidates certain deed amendments if they are made without unanimous member consents. Under section 11(2), compliance with section 9 is enforceable by the trustees or any scheme member. Those protections

apply irrespective of whether or not a section 12 certificate has been provided with respect to a particular deed amendment.

69 Where member consents were needed and have been obtained, requiring the provider of a section 12 certificate to certify that the method (as opposed to the content) of an amendment complies with the Act would require a detailed audit, or very close supervision, of every single step in the ballot process. It would be impracticable (or, at the very least, extremely expensive) for a solicitor ever to provide a certificate in that context.

70 If the scheme's administrator or the trustees gave the certificate, on the basis that they had conducted the member consent exercise, then they would effectively be certifying the propriety of their own conduct, which is of no real value.

71 Certifying that the *method* used to amend a trust deed has complied with the Act can only serve a useful purpose following a unanimous member consent exercise. Practically speaking, it is redundant in other contexts.

72 There can hardly be said to be any real risk of non-compliance in that area. If trustees or an administrator seek, and then fail, to obtain unanimous consents they can hardly pretend otherwise. All a dissenter (or a non-respondent) need do to defeat the amendment under sections 9 and 11(2) is point out that they did not consent, and that will be the end of the matter.

73 The proposal to require certification as to the method of an amendment is unnecessary. It would potentially add expense and complexity, for no discernible added benefit to members.

(2) Sections 20A and 25: Independent trustee where a receiver or liquidator is appointed in respect of an employer

74 ASFONZ does not support the proposal that section 20A be amended to require at least one independent trustee for an employer-based scheme *whenever* a receiver or liquidator is appointed for *any* contributing employer (i.e. irrespective of whether or not the employer is also trustee).

75 An amendment of some sort is important for the credibility of employer-based superannuation because, as matters stand, section 20A is all but irrelevant. It can only apply where an employer acts as trustee of a scheme, and that is very much the exception. In a 1998 ASFONZ survey, only *2.7%* of respondent schemes (down from 9.4% in 1997) had the employer as trustee.

76 However, the proposed amendment would go much too far, by repeatedly triggering the "default" application of section 20A in inappropriate circumstances.

77 Liquidation is not synonymous with business failure. Many employer-based schemes have small subsidiaries participating in them, and one or more of those could well be placed in liquidation from time to time in the ordinary course of business (for example as part of a restructuring, or following the sale of a business unit within the group). Under the proposed amendment, that would trigger a requirement on each occasion for an independent trustee, which is surely unintended.

78 Where the trustees of a scheme are individuals, appointing *only one* independent trustee will achieve little (if anything) in the name of member protection anyway, as that trustee will be continually outvoted. Dissenting trustees are usually required by trust deeds to abide by majority decisions, making it very difficult for them to communicate concerns to either members or the Government Actuary without first resigning.

79 ASFONZ considers that an appropriate compromise would be to amend section 20A by extending it to an employer which has the power to appoint all or any of the scheme's trustees. If that employer (usually the principal employer) was then placed in receivership or liquidation, the trustees appointed by the employer would leave office and be replaced by independent persons.

80 Better still, ASFONZ considers that section 20A would be of much more value to members if it provided that where a principal company is placed in receivership or liquidation, an independent person must be appointed to exercise all the company's rights and perform its duties under the relevant scheme's trust deed. That person would then be able to ensure that members' interests were adequately protected.

81 There seems little point doing no more than requiring an independent trustee if the company (i.e. the receiver or liquidator) still retains significant discretions under the relevant trust deed that can vitally affect members in a much more dramatic way.

82 An example is the ability to trigger or control the timing of a wind-up. The timing of a wind-up can be very important, as there can be a substantial difference between the amount a member is entitled to when made redundant and the amount received as a result of winding up.

Second Schedule: Paragraph (b)

83 ASFONZ supports the proposal concerning the inclusion of abridged accounts in annual reports. We understand that, with the acquiescence of the Government Actuary, some annual reports already contain abridged accounts anyway. This is

on the basis that paragraph (b) of the Second Schedule to the Act does not expressly prevent that occurring.

84 ASFONZ also supports the proposed consequential amendments to sections 14 and 17(1)(b). However, we would regard any consequential amendment to section 13(2)(d), or requiring abridged statements to comply with GAAP, as unnecessarily over-prescription where the accounts themselves are already fully compliant.

Second Schedule: Additional Clauses

85 ASFONZ has no objection to proposal (a).

86 Proposal (b) is unclear, in terms of both what is proposed and the reasoning behind it, so we cannot make specific comment. If it relates to specifying in an annual report the assumed long-term earning rate for a defined benefit scheme's investments (which will in turn drive the calculation of that scheme's funding position) then ASFONZ has no strong objection, other than to query why the report should highlight that particular assumption but not others.

87 Employer-based schemes should be exempted from proposal (c). If trustees were required to advise, in all successive annual reports, the registration date of the most recent prospectus then (given the pending removal of the prospectus requirement) that information would very soon become "stale" and meaningless.

SUPERANNUATION SCHEMES ACT 1989: ADDITIONAL AMENDING SUGGESTIONS

Amendments prescribing benefit improvements – clarifying effect of section 9(a)

88 While professional advisers are divided on the point, the apparent effect of section 9(a) of the Act is that no amendment prescribing benefit improvements can proceed without unanimous beneficiary consents if the amendment will (or even might) reduce the possible amount of surplus that existing beneficiaries might receive if the scheme is ever wound up while they remain beneficiaries.

89 The argument is that such amendments adversely affect existing beneficiaries' contingent interest in surplus in breach of section 9(a), necessitating their written consents unless each of them will directly benefit from the amendments.

90 To talk of practical "adverse effects" on contingent wind-up benefits is typically a nonsense in the case of an ongoing scheme, particularly one which is over-funded. The employer will have every intention of keeping the scheme alive and, in the meantime, using whatever surplus is available to continue funding members' benefits.

91 The potential interests of current beneficiaries in the surplus available if the scheme is ever wound up are in most cases so remote and uncertain that they should not be allowed to stand in the way of benefit improvements funded from surplus in the meantime. The contingencies giving rise to entitlements are not within the control of the beneficiaries, so requiring consent elevates their status inappropriately.

92 It appears that most schemes, and indeed the Government Actuary, currently observe section 9(a) "in the breach" where trust deed amendments prescribe benefit improvements such as the acceleration or removal of a vesting scale. In other words, member consents are neither sought nor insisted upon. That is understandable, because the alternative is almost total paralysis.

93 However, the resulting legal uncertainty, and the risk of invalidation if amendments are later challenged, are highly undesirable.

94 ASFONZ would like to work with the Ministry and its advisers to develop appropriate wording for a clarificatory amendment to section 9, enabling benefit improvements funded from surplus to proceed notwithstanding their technically "adverse" effects on contingent wind-up benefit entitlements. The current uncertainty is preventing some inherently good amendments from proceeding, solely in the name of member "protection" which is illusory.

Section 12 – the "cumulative certification" problem

95 Section 12(1) of the Act contains a significant logical flaw, which is particularly troubling for the current trustees and advisers of long standing employer-based schemes (some of which have been in place for generations).

96 Section 12(1) currently requires trustees, an administration manager or a solicitor to certify in relation to any amendment (however simple or mechanical) that *the entire trust deed*, when amended as proposed, will comply with section 7 of the Act and will not contain any provision that is contrary to those implied by sections 8 to 10.

97 Logically, that requires current trustees and advisers (some of whom will be new to the scheme, and will have been completely uninvolved in prior amendments) to certify that every amendment ever made, cumulatively, meets those requirements. In many cases that will be impossible.

98 Practically speaking, a series of section 12(1) certificates has cumulative effect anyway, so the provider of such a certificate should be able to rely upon the validity of all the certificates already given with respect to prior amendments. However, the wording of section 12(1) does not reflect that reality.

99 ASFONZ suggests that section 12(1)(a) be further amended to make clear that a section 12 certificate relates exclusively to the relevant amending deed, not every amendment that has ever been made since the inception of the Act. Appropriate replacement wording for paragraph (a) would be:

> "*Give a certificate that the amendment does not breach sections 7 or 9 of this Act, or introduce into the trust deed any provision that is contrary to those implied by sections 8 to 10 of this Act; or*".

Section 20A – *"Independent person" definition*

100 ASFONZ suggests amending the definition of "*an independent person*" in section 20(2) of the Act, by adding a new paragraph (c) as follows:

> "*Is not, and is not associated with, the administration manager, investment manager, insurer, actuary, auditor, solicitor or any other adviser to the scheme.*"

This is important, because of the actual ownership of trustee companies in New Zealand.

APPENDIX

DEFINITION OF AN EMPLOYER-BASED SCHEME

1 An employer-based superannuation scheme is a superannuation fund which meets all of the following criteria:

(a) The superannuation fund is registered by the Government Actuary under the Superannuation Schemes Act 1989.

(b) No trustee of the superannuation fund is a company carrying on the business of providing life insurance to which the Life Insurance Act 1908 applies.

(c) The superannuation fund was established by an employer, or a group of employers, to provide benefits only to persons who are:

(i) Employees; or

(ii) In the case of benefits relating to a previous period of employment, former employees; or

(iii) In the case of benefits arising in respect of membership of the superannuation fund by those employees or former employees, relatives or dependants or nominated beneficiaries of those employees or former employees –

of any employer who agrees to or is required to make contributions to the fund, or is accepted as a contributor to the fund, or on whose behalf contributions are made to the fund.

(d) The only beneficiaries of the superannuation fund are natural persons to whom any of subparagraphs (i) to (iii) of paragraph (c) applies, except to the extent that an employer of employees who are members of the superannuation fund may have a contingent interest in any surplus in the superannuation fund.

(e) Each employer is required by the trust deed of the superannuation fund or any Act under which the superannuation fund is constituted to make contributions to the superannuation fund that are not merely nominal.

(f) The Government Actuary is satisfied that there is a genuine nexus between the superannuation fund and the employment relationship and that the fund

has not been structured principally for the purpose of complying with this section.

2 Where the Government Actuary ceases to be satisfied that any superannuation fund is a fund to which subsection (1) applies, that superannuation fund shall cease to be an employer-based superannuation scheme from such date as the Government Actuary may specify.

3 Where in respect of any income year a superannuation fund fails to meet the requirements of paragraph (e) of subsection (1), that fund shall nevertheless be treated as complying with that paragraph if the Government Actuary is satisfied that each employer would be required by the trust deed of the superannuation fund, or by an Act under which the superannuation fund is constituted, to make superannuation contributions to the superannuation fund to provide to a significant extent the benefits payable by the superannuation fund, not being merely nominal contributions or contributions only to meet the costs of administration and management of investments of the superannuation fund, were it not that the assets of the fund exceed the accrued benefits of all members and other beneficiaries of the fund.