Submission to the Commerce Committee

Financial Markets (Regulators and KiwiSaver) Bill

Kiwibank Limited

10 November 2010

PART 1

INTRODUCTION

1 Introduction

1.1 This submission has been prepared by Kiwibank Limited ("**Kiwibank**") in relation to the Financial Markets (Regulators and KiwiSaver) Bill (the "**Bill**"). Kiwibank welcomes the opportunity to make a submission to the Commerce Committee on the Bill.

1.2 Kiwibank broadly supports the proposals set out in the Bill. New Zealand needs a strong single market regulator, and the establishment of the Financial Markets Authority (the "**FMA**") should go a long way towards restoring public confidence undermined by the Global Financial Crisis and the collapse of local finance companies. We also support proposals to reform KiwiSaver, in particular to shift the role of issuer from the trustee to the manager – in our view this is a more natural reflection of the practical responsibilities of each party.

1.3 We do, however, submit that some areas of the Bill require further refinement. In summary:

(a) We submit that the FMA's new power to exercise a person's right of action requires further refinement, as do provisions relating to the public disclosure of warnings. Part 2 of this submission sets out our comments in relation to this and other aspects of Parts 2, 3 and 4 of the Bill, which relate to the FMA;

(b) We submit that the new "notice and pause" prospectus registration process requires refinement, in particular to accommodate continuously issued securities. Part 3 of this submission sets out our comments on Part 5 of the Bill, which relates to proposed amendments to the Securities Act 1978 (the "**Securities Act**"); and

(c) We submit that further changes are required to align the functions of the manager and trustee of a KiwiSaver scheme with the new role of the manager as issuer, and in relation to the communication of the manager's new role to members. We also comment on the new class of restricted KiwiSaver schemes. Part 4 sets out our comments on Part 7 of the Bill, which relates to proposed amendments to the KiwiSaver Act 2006 (the "**KiwiSaver Act**").

1.4 We hope that the Commerce Committee finds our written submission helpful. We would also welcome the opportunity to make an oral submission to the Committee in relation to the policy aspects of the Bill.

1.5 We appreciate that many of our comments are technical drafting points. We would be more than happy to participate in an industry working group with officials to discuss the more technical aspects of the changes proposed. In this regard we believe we can offer valuable industry expertise in a constructive way to help achieve the best regulatory outcome for New Zealand. We note that this approach has worked well in the past. In any case, we would be grateful to be consulted in relation to any amendments made as a result of our comments.

2 About Kiwibank

2.1 The Government, as the shareholder of New Zealand Post Limited ("**NZ Post**"), granted approval for the establishment of a publicly-funded bank in 2001. Kiwibank was subsequently established and opened for business in early 2002. Kiwibank's ultimate parent company is NZ Post.

2.2 Kiwibank was established as a New Zealand-owned bank, for New Zealanders. At that time, it was intended that Kiwibank:

(a) would have lower fees;

(b) would benefit customers of other banks by keeping the other banks honest, producing lower fees and interest rates at all banks; and

(c) would have more branches than any other bank.

2.3 Today, Kiwibank has the largest branch network in the country, with branches nationwide situated at PostShops around New Zealand. Through a shared cost and host business model, Kiwibank has branches in places that would not otherwise be economically viable. Kiwibank has made local banking accessible to people in areas that would otherwise miss out.

2.4 Kiwibank provides a full range of domestic banking services (retail and business), KiwiSaver and international banking services and investment management services to institutional clients. Kiwibank also provides investment products through AMP Capital Investors, and life insurance through Kiwi Insurance Limited and by way of contractual arrangements with CIGNA Life Insurance New Zealand Limited and TOWER Life respectively.

2.5 Kiwibank maintains a robust customer dispute resolution process for all disputes related to the Kiwibank brand irrespective of where they arise. Kiwibank is also a member of the Banking Ombudsman's Dispute Resolution Scheme which

provides bank customers with an independent avenue of recourse should a dispute prove irresolvable through Kiwibank's internal dispute resolution process.

3 Contact details

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PART 2

FINANCIAL MARKETS AUTHORITY

1 Establishment of the FMA

1.1 Kiwibank supports the establishment of the FMA. Bringing together the regulatory functions of the Securities Commission, NZX, the Government Actuary and the Companies Office into a single regulator will allow the FMA to act in a more cohesive, holistic manner. A strong, active regulator will go some way towards restoring public confidence that was lost during the Global Financial Crisis and the collapse of local finance companies.

Membership of board of FMA

1.2 The Bill provides that the board of the FMA consists of not fewer than five, and not more than nine, members.[1] It does not, however, set out any qualifications for membership or prescribe any particular skills, competencies or experience that the board as a whole must possess. As such, it is unclear whether the board will be comprised of members with a background in policy and Government; or members with industry experience; or both.

1.3 In our view it would be helpful if the Bill set out minimum requirements for the membership of the FMA. In this regard, we note that the Commerce Act 1986 sets out particular requirements for membership of the Commerce Commission,[2] including:

(a) a requirement that at least one member must be a barrister and solicitor of at least five years' standing; and

(b) a provision stating that the Minister must not recommend a person for appointment unless, in the Minister's opinion, that person is qualified for appointment, having regard to the functions of the Commission, by virtue of that person's knowledge or experience in industry, commerce, economics, law, accountancy, public administration or consumer affairs.

In our view it would be helpful to include equivalent provisions in relation to membership of the board of the FMA to ensure that the board has the base level skills, competencies and experience to discharge the functions of the FMA.

1.4 We also note that the Minister may appoint associate members of the FMA, either generally or in relation to a specific matter or class of matters.[3] The

[1] Section 10 of the Bill.
[2] Section 9 of the Commerce Act 1986.
[3] Section 11 of the Bill.

Minister may wish to use this power to appoint "subject matter experts" to the FMA, with specific expertise in certain areas. The appointment of part time experts would bring a depth of expertise to the FMA, helping the FMA perform its functions in relation to more specialised aspects of the financial markets.

1.5 In particular, we note that the FMA would benefit from having an associate member with experience in the banking industry in order to advise on specific issues affecting the banking sector, and to help the FMA quickly understand and deal with new products and services. This would help the FMA understand and effectively regulate a sector that is one of the largest providers and distributors of financial products in New Zealand (if not the largest). It could also help the FMA work effectively with industry stakeholders such as the Reserve Bank and registered banks in New Zealand.

2 FMA may exercise person's right of action

2.1 Kiwibank broadly supports giving the FMA the ability to exercise a person's right of action in certain circumstances. This power would allow the FMA to act as a champion for investors that lack the financial resources or legal standing to commence proceedings on their own. The increased likelihood of civil litigation will also send a strong warning to market participants that the FMA has the power to act even if investors cannot, or directors will not. We do, however, submit that further refinement of the provisions in clauses 34-41 of the Bill is required.

Definition of 'specified person'

2.2 The Bill would allow the FMA to initiate or take over legal proceedings against a 'specified person',[4] including financial markets participants such as issuers and their related companies. The definition of "financial markets participant" in the Bill includes a controlling owner, director *or senior manager* (within the meaning of section 4 of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (the "**FSPA**")) of a financial service provider.[5]

2.3 We question whether it is appropriate for the FMA's power to exercise a person's right of action to extend to include rights of action against senior managers such as the Chief Executive Officer, Chief Financial Officer and General Managers involved in an offer of securities to the public.

2.4 There is a danger that the increased likelihood of civil litigation could deter junior managers from progressing along a natural career path, interrupting succession planning and reducing the quality of senior management in financial markets

[4] Section 34 of the Bill.
[5] Definition of "financial markets participant" in section 4 of the Bill.

participants. It could also influence the behaviour of existing senior managers, who may be more cautious and less willing to play a brave, active role in relation to financial products given the background threat of enforcement action by the FMA.

2.5 The inclusion of senior managers also disregards the primary and ultimate responsibility for an offer of securities to the public, which rests with the directors of the issuer and individual promoters. While senior management may exercise significant influence over the management and administration of the issuer, they are not the ultimate decision makers and their influence falls short of that required to be considered a shadow or de facto director. If a situation arose where their influence was such that they could be deemed to be the ultimate decision maker, then they would be considered a de factor director and be held liable accordingly. In our view only those directly responsible for an offer of securities to the public should be within the scope of the FMA's power to exercise a person's right of action.

2.6 Senior managers, while executive employees of an issuer, do not enjoy the same legislative right to object as directors. In this regard, prospectus (and certain Companies Act 1993 resolution[6]) signoff procedures allow a dissenting director to formally record their disapproval and in some circumstances provide a defence against liability.[7] There is no equivalent for senior managers, leaving them with limited options such as resignation. This supports the argument that it would be inappropriate to subject senior managers to increased risk of civil litigation as they have no practical ability to manage that risk.

2.7 Senior managers have been identified and the term defined in the FSPA for the purpose of identifying individuals required to register as financial service providers. The term is used in the Bill for a very different purpose, namely to extend the general reach of the FMA's power to senior managers. In our view any such extension should be made pursuant to a clear policy decision.

Costs of proceedings

2.8 The High Court must, on application of the FMA, order that some or all of the costs of proceedings must be met by "person A" if the High Court considers that it would be *fair and reasonable* for person A to bear those costs.[8] In our view, the lack of guidance for the High Court as to when it may be "fair and reasonable" to

[6] Clause 5(4) of Schedule 3 of the Companies Act 1993.
[7] Section 56(2) of the Securities Act.
[8] Section 38 of the Bill.

impose a costs order is problematic, and introduces an unacceptable level of uncertainty. For example:

(a) Will the High Court consider whether person A objected to the FMA commencing or controlling proceedings when deciding whether it would be "fair and reasonable" for person A to bear some or all of the costs of those proceedings? If not, investors with strong, principled objections may be called on to help fund proceedings deemed to be "in the public interest" – for example if proceedings were initiated in relation to a failed finance company on behalf of all investors.

(b) Will the High Court consider whether person A considers the costs of proceedings to be reasonable? For example, what may be "reasonable costs" to the High Court and the FMA may be unreasonable for an investor that has already lost money on a failed investment and was reluctant to compound that loss by incurring legal fees to initiate proceedings.

(c) Will the High Court consider whether proceedings were in the interests of person A? For example, it may be consistent with the FMA's objectives to bring a "test case", however person A may operate on the basis of an economic test as opposed to a public interest test.

(d) Will the High Court take into account whether proceedings were successful and/or have resulted in a financial award for person A? For example, will an investor who has already lost money, be called on to bear some or all of the costs of unsuccessful proceedings that they objected to in the first place?

2.9 The foregoing examples illustrate the real potential for conflict between the objectives and motivations of the FMA and the person that actually has the right of action. The FMA's main objective is likely to be of secondary importance to an investor that has lost money, as will other "public interest" factors such as the likely effect of the proceedings on future conduct; and the extent to which the proceedings involve matters of general commercial significance or importance to the financial markets.[9] Whereas the investor is likely to carry out a cost benefit analysis before deciding to commence proceedings, the FMA will be motivated by more than the cost.

2.10 What the above examples also illustrate is the need for statutory guidance on the "fair and reasonable" test to be applied in clause 38. In our view, the Bill should

[9] Section 34(4) of the Bill.

be amended to expressly stipulate the factors the High Court must consider before making an order that some or all of the costs of proceedings be met by person A. In addition, we submit that a costs order should only be made when an action initiated or controlled by the FMA has resulted in a financial award for person A.

Representative actions

2.11 The FMA may represent all or some of the persons having the same or *substantially the same* interest in relation to the subject matter of proceedings against person A commenced or controlled by the FMA.[10] While we appreciate that this wording been modelled on the representative actions provision in the Companies Act 1993,[11] in our view it is inappropriate in this context to group together, without consent, persons that do not have *the same* interest in the subject matter.

2.12 As noted above, the FMA has the ability to not only control (and effectively take away) an investor's private right of action despite their objections; to enforce that right in a manner that is not in the direct financial benefit of the investor; and to apply to the High Court for an order that the investor bear some of the cost of those proceedings. In our view, if private rights are to be eroded as proposed, the quid pro quo is an assurance that any resulting representative action actually champions that investor's actual interests, not interests that are substantially the same, *unless the investor agrees otherwise*. This would be consistent with the provisions of the High Court Rules, which allow one or more persons to sue on behalf of all persons with *the same interest* in the subject matter of a proceeding.[12]

The bigger picture

2.13 We are aware that a draft Class Actions Bill and Rules are under consideration by the Ministry of Justice. We understand that these changes would facilitate class action law suits in New Zealand. It would be helpful if the relationship between the FMA's power to exercise a person's right of action and the proposals in the Class Actions Bill could be clarified.

2.14 We also note the decision of the Court of Appeal in *Colonial Mutual Life Assurance Society Ltd v Wilson Neill Ltd* [1994] 2 NZLR 152, where it was held that where a good reason existed the Court could refuse permission for the shareholders to take over a company's case. It would be helpful if officials could

[10] Section 40 of the Bill.
[11] Section 173 of the Companies Act 1993.
[12] Rule 4.24, High Court Rules, Schedule 2, Judicature Act 1908.

specifically consider the relationship between the FMA's power to exercise a persons' right of action and the decision in *Wilson Neill*.

3 Power to obtain information, documents and evidence

3.1 We have participated in and support the submission of the New Zealand Bankers' Association in relation to the general information-gathering and enforcement powers proposed in the Bill.

4 Warnings

4.1 The FMA's functions include issuing warnings about financial products, providers and other persons dealing in securities in order to promote confident and informed participation in the financial markets.[13] The FMA has the power to require a copy of its warning to be disclosed on relevant websites and incorporated into offer documents.[14] We agree that the FMA should have the power to issue warnings, but would ask that the Committee consider the consequences of the public disclosure of such warnings, and the circumstances in which disclosure will fulfil the function of promoting confident, informed participation in financial markets.[15]

4.2 While a warning could be considered one of the FMA's lesser sanctions, in our view the consequences of the public disclosure of a warning from the FMA are likely to be severe and as such should be carefully considered:

(a) A public warning from the FMA will unnerve investors, and is likely to result in funds outflow and/or a sudden drop in price that could cause remaining investors to suffer loss. The possibility of a public warning may also discourage issuers from developing bold, new products where there is a high possibility that the FMA may see the product as too risky and require a warning to be included in offer documents.

(b) In practice, many issuers will simply suspend allotments and/or pull the offer entirely rather than update the investment statement to include a warning. Issuers that decide to update their investment statement will incur considerable administrative cost and expense, reprinting (and potentially redistributing) the investment statement and addressing investor queries. Many of these costs are likely to be passed on to investors.

[13] Section 9(1)(c) of the Bill.
[14] Section 47(1) of the Bill.
[15] Section 9(1)(c) of the Bill.

(c) A warning would also have a significant adverse affect on the subject's business and reputation. Externally, the trust and confidence investors have in the issuer will be negatively affected. Internally, a warning could undermine the issuer's due diligence process and its right to make commercial decisions.

4.3 Given the disproportionate effect of the public disclosure of a warning, we are surprised that the Bill does not include boundaries or guidelines on the exercise of this power. In our view, the Bill should provide further clarity in this regard, such as a requirement that, prior to requiring public disclosure of a warning, the FMA undertake an enquiry or investigation and/or consider the public interest and whether, in fact, disclosure would fulfil the function of promoting confident, informed participation in financial markets. Requiring the FMA to conduct reasonable due diligence would encourage it to exercise this power in a considered manner, and to balance the likely harm of a warning against the public interest.

4.4 The FMA may require a warning to be disclosed if it has given the subject at least three working days notice, during which the subject has an opportunity to make written submissions and be heard on the matter.[16] In our view three working days is simply not enough time to prepare a coherent response to the FMA, and is unreasonable given the adverse impact a warning may have for the subject and investors. We submit that ten working days would be a more reasonable notice period, unless the issue is significant and it would be materially adverse to investors to allow the full ten working days. Ten working days would give the subject sufficient time to prepare a reasoned response to the FMA while balancing the FMA's need to act swiftly. In this regard we note that the FMA has other powers and can, at any time, prohibit allotment or cancel registration if it considers that it is desirable in the public interest, irrespective of whether it has first issued a warning or not.[17]

4.5 We would also note that there is some uncertainty with regards to the effect of a warning on applications received on the basis of old offer documents that did not include the warning. For example, is a warning a material adverse event such that failure to disclose would render the offer voidable? It would be helpful if the Bill could provide some guidance to issuers in this regard, i.e. whether the warning must be disclosed prior to allotment or whether Australian "cure period" provisions would be appropriate (see paragraph 2.4 of Part 3 below).

[16] Section 47(3) of the Bill.
[17] Section 97 of the Bill, which proposes a new section 43G of the Securities Act.

4.6 Alternatively, a more flexible approach that could achieve the same level of protection for investors would be to warn an issuer, but allow them time to "cure" the issue (whether it be through amending wording in the offer documents agreed with the FMA or altering the structure of a product to satisfy the FMA) and then giving investors a time period in which they can unsubscribe.

5 Levy of financial markets participants Kiwibank supports a strong, adequately resourced FMA and, in principle, a levy on financial markets participants to help fund a portion of the costs of the FMA in performing or exercising its functions, powers and duties.[18] While we appreciate that the shape of the levy will be prescribed by regulations, in our view the levy should be calculated on a "user pays" basis. On this basis, the amount of the base rate levy should reflect the proportion of the FMA's time and resources each class of markets participant consumes. Higher risk market participants will be subject to closer monitoring and supervision, and as such should be subject to a higher levy than lower risk participants. A higher levy would act as a barrier to entry for higher risk market participants, and encourage existing participants to develop the processes and behaviours expected in order to bring the cost of their levy down. Importantly, the Bill should be amended to expressly require that any levy be designed to avoid high-volume low-risk issuers (such as registered banks) subsidising other issuers.

5.2 We would also note that the FMA will require a significant commitment from the Government in terms of funding in order to achieve the regulatory outcomes desired. We endorse comments made by Simon Botherway, Chairman of the Financial Markets Authority Establishment Board to the effect that while the FMA has a very good chance of improving regulatory outcomes, much will depend on its budget.[19] In this regard, the existing regulator, the Securities Commission has received much lower levels of Government funding than other comparable regulators in the past. Whereas the annual operating budget of the Securities Commission is around $15 million,[20] in the year to 30 June 2010 the Commerce Commission received $43.29 million[21] and the Reserve Bank received $46.9 million.[22] The Government must make a firm commitment to increase this level of

[18] Section 63 of the Bill.
[19] Simon Botherway, Chairman of the Financial markets Authority Establishment Board, Double Shot Interview with interest.co.nz on 26 October 2010. Available here: http://www.youtube.com/watch?v=FGAfyrydwAw&feature=related.
[20] Total revenue for the year ended 30 June 2010 was $14.116 million. Securities Commission Annual Report 2010. Available at: http://www.sec-com.govt.nz/downloads/ann-rep-10.pdf.
[21] Commerce Commission 2009/2010 Annual Report, page 52. Available at: http://www.comcom.govt.nz/assets/The-Commission/Accountability/2009-10-Commerce-Commission-Annual-Report.PDF.
[22] Reserve Bank of New Zealand Annual Report 2009 – 2010, page 107. Available at: http://www.rbnz.govt.nz/about/whatwedo/rbnz_2010_ar_financials.pdf. Vaughan, Gareth "Simon Botherway says

funding (not only to close this gap, but also to reflect the additional regulatory functions of the FMA) in order to provide New Zealand with a strong regulator able to discharge the functions prescribed by the Bill.[23]

6 Technical observations

6.1 Section 162 of the Companies Act 1993 allows a company to indemnify and provide insurance for its directors and employees in certain circumstances. This provision may require review in the light of the FMA's power to exercise a person's right of action to ensure that companies are able to sufficiently and appropriately protect their directors and employees so as to encourage participation in the industry.

new regulator needs about twice Securities Commission's budget to boost confidence", 27 October 2010, interest.co.nz Banking & Finance newsletter.

[23] Section 9 of the Bill.

PART 3

AMENDMENTS TO SECURITIES ACT 1978

1 Amendments to the Securities Act 1978 Kiwibank broadly supports the amendments to the Securities Act proposed in Part 5 of the Bill.

2 Prospectus registration process

Prohibition on allotment during consideration period

2.1 The Bill provides for a new "notice and pause" prospectus registration process involving a consideration period, during which no securities may be allotted.[24] The consideration period starts on the date the prospectus is registered (being the "effective date" of the prospectus),[25] and ends five working days later unless the FMA advises otherwise.[26] The consideration period is intended to give the FMA an opportunity to consider whether the new prospectus complies with the Securities Act and regulations; or is false or misleading in a material particular.[27]

2.2 The prohibition on allotment during the consideration period will work well for IPOs, defined term offers and new offers, but will be problematic for continuously issued securities that are already in the market (for example collective investment schemes such as unit trusts and KiwiSaver schemes).

(a) In order to comply with this requirement, continuous issuers will need to either:

(ii) Suspend allotments during the consideration period. This would be artificial and confusing for investors, and potentially unworkable for issuers (see paragraph 2.2(b) below).

(iii) Allot on the basis of an existing prospectus, while the new one goes through the consideration period. This would be misleading on the basis that two "live" and potentially inconsistent prospectuses would be available to the public during the consideration period.

In our view neither outcome is desirable.

(b) We would also note that suspending allotments is just not practicable in relation to some continuously issued securities. For example, the issuer

[24] Section 97 of the Bill, which proposes a new section 43D of the Securities Act.
[25] Section 97 of the Bill, which proposes a new section 42(2)(c) of the Securities Act.
[26] Section 97 of the Bill, which proposes a new section 43D(1) of the Securities Act.
[27] Section 97 of the Bill, which proposes a new section 43C(1) of the Securities Act.

has no control over the automatic enrolment of members into KiwiSaver via participating employers or allocated to default providers pursuant to the KiwiSaver Act. In addition, a compulsory "shut down" period would cause havoc in relation to regular investments and reinvestments of term securities – these investments would need to be suspended pending expiry of the consideration period, which would be confusing for investors and potentially cause an unwanted drag on returns.

2.3 We submit that the prohibition on allotment during the consideration period should not apply to continuously issued securities that are already in the market due to the issues identified above, and on the basis that the FMA is sufficiently empowered to deal with any issues arising in other ways. In this regard, the FMA has the power, at any time, to prohibit allotment or cancel registration on various grounds, including if a registered prospectus does not comply with the Securities Act or the regulations; or is false or misleading in a material particular.[28] These are the same matters the FMA would assess during the consideration period in any case.[29]

Cure period

2.4 The new prospectus registration process proposed in the Bill is based on the Australian model, but unlike the Australian model does not prescribe a "cure period" for issuers. The Australian Corporations Act 2001 sets out choices open to the issuer in respect of applications received that have not resulted in allotment if a condition of the offer is not met (e.g. a minimum number or amount of applications) or the disclosure document is defective.[30] The issuer may either: (a) repay the application monies; (b) give the applicant a supplementary disclosure document and one month to withdraw their application and be repaid; or (c) issue the securities to the applicants, and give the applicant a supplementary disclosure document and one month to withdraw their application and be repaid.[31] The latter two options place the onus on the investor to withdraw their application if they do not wish to proceed.

2.5 In our view, if the new "notice and pause" prospectus registration process taken from the Australian Corporations Act 2001 is adopted, the "cure period" provisions should be adopted as well. This is particularly important for continuously issued securities, as it ensures continuity for the issuer when disclosure documents change while giving investors the opportunity to withdraw

[28] Section 97 of the Bill, which proposes a new section 43G of the Securities Act.
[29] Section 97 of the Bill, which proposes a new section 43C of the Securities Act.
[30] Section 724 of the Australian Corporations Act 2001.
[31] Section 724(2) of the Australian Corporations Act 2001.

their application and be repaid. The Australian "safe harbour" also encourages issuers to acknowledge and communicate defects in their offer documents.

2.6 We also note that the Securities Act already allows the Securities Commission to make a delayed allotment order in certain circumstances in respect of securities offered pursuant to a simplified disclosure prospectus.[32] Adopting the Australian "cure period" provisions would be a natural extension of the existing delayed allotment provisions, and an important corollary to the new "notice and pause" prospectus registration process.

Publication of registration

2.7 An issuer is required to ensure that it advertises the registration of a new prospectus on *its* internet site.[33] This will be problematic for subsidiary issuers such as Kiwibank Investment Management Limited (the issuer of the Kiwibank PIE Unit Trust and the issuer of the Kiwibank KiwiSaver Scheme under the proposed new regime) that do not have stand alone websites. It will also be confusing for investors, who may look to the promoter's (Kiwibank's) website for any such announcements.

2.8 In our view this provision should be amended to allow registration announcements to be published on an internet site maintained by or on behalf of the issuer. This would allow Kiwibank to maintain a part of its existing website (www.kiwibank.co.nz) on behalf of Kiwibank Investment Management Limited, ensuring that the required information is in the first place investors would naturally look for such announcements. This wording would also be consistent with the proposed provision giving the FMA power to order an issuer to disclose a warning on an internet site maintained *by or on behalf of the relevant person*.[34]

2.9 We would also ask that the Committee consider the circumstances in which it would also be appropriate for the distributors of a financial product to include a registration announcement on their websites. We note that many financial products are "white labelled", or repackaged and sold under another brand, and as a result investors may look to the distributor's website in the first instance for notice of registration of a prospectus or prospectus amendment. It may be that the Registrar or the FMA is given the discretion to require disclosure by additional parties where appropriate.

[32] Section 44A(1) of the Securities Act.
[33] Section 97 of the Bill, which proposes a new section 43B of the Securities Act.
[34] Section 47 of the Bill.

2.10 We would also ask that the FMA issues guidelines to clarify what constitutes a "reasonably prominent" statement for the purposes of this requirement.[35] We anticipate some confusion in the industry as to exactly what is required, and what the FMA considers reasonable in this regard.

3 Register of securities

3.1 We support the proposal to create a register of securities and thereby to improve public access to information.[36] In our view it is important that the register is a comprehensive library of information presented in a form that is accessible for the public. In this regard, we submit that the register should operate on the basis that the electronic copy of a document available via the register is exactly the same as the hard copy available from the issuer. Rather than the low quality, black and white scanned copies of documents currently available via the Companies Office online facility, the register should support clear, colour pdfs of registered documents. This is particularly important to maintain the integrity of professionally designed documents such as investment statements, which often use colour and pictures to help with reader comprehension.[37]

4 FMA may grant exemptions

4.1 The Bill proposes that the FMA have the power to grant an exemption from compliance with any provision of Part 2 of the Securities Act or regulations.[38] This power is similar to the existing power of the Securities Commission,[39] but is subject to an additional safeguard in that the FMA must be satisfied that the exemption would not cause significant detriment to investors and the extent of the exemption is not broader than is reasonably necessary.

4.2 We strongly support this proposal, as it will give the FMA the power to ensure that the Securities Act is applied in a sensible, flexible manner that achieves the regulatory outcomes desired. The existing power has worked well for the Securities Commission in the past to "future proof" the legislation, and prevent unintended results.

[35] Section 97 of the Bill, which proposes a new section 43B of the Securities Act.
[36] Section 98 of the Bill, which proposes new sections 43N, 43O and 43P of the Securities Act.
[37] Section 98 of the Bill, which proposes new section 43P(1)(l) of the Securities Act.
[38] Section 120 of the Bill, which proposes new section 70B of the Securities Act.
[39] Section 5(5) of the Securities Act.

5 Technical observations

5.1 We would note the following technical observations in relation to Part 5 of the Bill.

(a) The Bill anticipates some form of issuer continuous disclosure, to be prescribed by way of regulations.[40] On the face of the current wording, this applies to *every* issuer. There is no apparent scope to set different requirements for different types of issuers. In this regard, the requirements for banks will presumably vary from other types of issuers. It may also be that Reserve Bank disclosure requirements obviate the need for any such disclosure, and banks should be outside this regime. In either event, it appears that additional flexibility could be usefully introduced into this power.

(b) The Bill provides that documents for registration must be supplied to the Registrar in the manner specified by the Registrar when the prospectus is delivered to the Registrar for registration.[41] Given the uncertainty around the operation of the new system, we submit that the Registrar issue guidelines in relation to the registration of documents. This is particularly important given that the Registrar must refuse to register a prospectus if these (unspecified) requirements are not complied with.[42]

[40] Section 104 of the Bill, which proposes new section 54C of the Securities Act.
[41] Section 96 of the Bill, which proposes a new section 41(2) of the Securities Act.
[42] Section 97 of the Bill, which proposes a new section 42(2)(a)(iii) of the Securities Act.

PART 4

KIWISAVER

1 Amendments to the KiwiSaver Act 2006

1.1 Kiwibank broadly supports the amendments to the KiwiSaver Act proposed in Part 7 of the Bill.

2 Manager as issuer

2.1 Kiwibank strongly supports the proposal that the issuer of a KiwiSaver scheme for the purposes of the Securities Act be the manager rather than the trustee. This change will result in a more logical division of powers and duties, and will better align the law with the current operational structures of many KiwiSaver schemes.

Statutory indemnity

2.2 The compulsory shift of issuer responsibility from trustee to manager will be a significant (and welcome) change for the industry. We expect that this change will encourage existing trustees and managers to re-evaluate their positions and terms of appointment and, as a result, the managers and trustees of some existing KiwiSaver schemes may change. Existing managers may not be comfortable assuming issuer liability or may be unable to discharge new functions on an economic basis; and it may not be in the best interests of members to retain an existing trustee given the new job description.

2.3 To assist the industry during this period of uncertainty, the Committee may wish to consider whether it would be appropriate to provide a statutory indemnity to clearly allocate responsibility for actions before and after the effective date of transfer from an outgoing manager/trustee to a new manager/trustee. This would create a “clean slate” for the incoming party, facilitate robust negotiation and remove a potential road block to the appointment of a replacement provider where such appointment is in the best interests of members. An indemnity would also be instrumental in clarifying the effective date on which the manager assumes responsibility as issuer.

2.4 An alternative to an indemnity could be a legislative reference to an “effective date” on which the issuer of a KiwiSaver scheme ceases to be the trustee and becomes the manager. In the interests of flexibility (see paragraph 0 below in relation to a transitional period) we would suggest that the effective date is the earlier of a prescribed date (for example, the last day of a 12 month transitional

period) or an alternative date agreed by the trustee and manager. This would allow the trustee and manager to align the change with a natural juncture, for example an accounting reference date.

Trustee as promoter

2.5 As issuers, some trustees will have been instrumental in the formulation of the plan pursuant to which KiwiSaver schemes have been offered to the public. Moving forward the manager will assume this role, however due to their historical involvement the trustee and its directors may still be considered to be promoters of KiwiSaver schemes they established.

2.6 The Committee may wish to consider whether it would be appropriate to expressly provide that the trustee of a KiwiSaver scheme and its directors are not promoters merely because of the trustee's historical role as issuer. In our view this is important given that the KiwiSaver Act requires some KiwiSaver schemes to have at least one independent trustee, i.e. a trustee that is not a promoter of the scheme.[43] This would also help the industry make a clean break with the past and move forward with each party assuming responsibility according to its new role.

Prospectus

2.7 Consideration should be given to consequential amendments to Schedule 6 of the Securities Regulations 2009, which prescribes the contents of a prospectus for a superannuation scheme (including a KiwiSaver scheme), to reflect the new role of the manager as issuer. In particular:

(a) Schedule 6 refers specifically to the trustee in several places and as such will not necessarily require disclosure of the names and past conduct of directors of the issuer[44] or "interested person" disclosures in relation to the issuer or its directors.[45]

(b) Schedule 6 requires the trustee to make a statement in the prospectus as to whether there has been any material or adverse change to the value of the scheme's assets or its ability to pay its debts as they fall due.[46] In our view it would be more appropriate if this statement were made by the manager (as issuer) moving forward.

2.8 Given that the intention is to move non-restricted KiwiSaver schemes towards the legal structure of a unit trust, the Committee may wish to consider whether it

[43] Section 116(1)(e) of the KiwiSaver Act.
[44] See clause 3 of Schedule 6 of the Securities Regulations 2009.
[45] See clause 8 of Schedule 6 of the Securities Regulations 2009.
[46] See clause 15 of Schedule 6 of the Securities Regulations 2009.

would be appropriate to substitute some of the Schedule 6 requirements with the equivalent requirements for a prospectus for a unit trust in Schedule 4 of the Securities Regulations 2009.

3 Trustee's functions

3.1 The main role of the trustee under the new regime (and in the light of the obligations in the Securities Trustees and Statutory Supervisors Bill) will be to monitor the issuer's compliance with the terms of the trust deed and offer of securities, and to step in to protect investors' interests in cases where there has, or may be, a breach of the deed or terms of the offer.[47] Moving forward, the manager will be responsible for the management and administration of the scheme; and as such we would expect the Bill to transfer responsibility for key operational functions from the trustee to the manager.

3.2 In our view, there are a number of operational functions that should be transferred from the trustee to the manager to reflect their new roles. In particular:

(a) The Bill prescribes a new procedure in relation to certain transfers between KiwiSaver schemes.[48] Key operational functions such as giving notice to members, obtaining member consent and liaising with the FMA are the responsibility of the trustee. In our view it would be more appropriate for these functions to be the responsibility of the manager, with performance monitored by the trustee.

(b) The KiwiSaver scheme rules set out a number of operational functions to be performed by the trustee. In particular, the KiwiSaver scheme rules anticipate that the trustee will receive, assess and administer applications for early withdrawal (including for the purposes of buying a first home;[49] on the basis of death;[50] significant financial hardship;[51] and serious illness[52]) as well as applications for withdrawal or transfer to a foreign scheme in the case of permanent emigration;[53] or transfer to another KiwiSaver scheme.[54]

(c) The KiwiSaver Act sets out a number of reporting requirements to be fulfilled by the trustee. In particular, the trustee is responsible for

[47] See also "Securities Trustees and Statutory Supervisors Regulations", Ministry of Economic Development Discussion Document, October 2010.
[48] Section 177 of the Bill, which proposes new sections 119D, 119F, 119H and 119I of the KiwiSaver Act.
[49] Clause 8 of Schedule 1 of the KiwiSaver Act.
[50] Clause 9 of Schedule 1 of the KiwiSaver Act.
[51] Clause 10 of Schedule 1 of the KiwiSaver Act.
[52] Clause 12 of Schedule 1 of the KiwiSaver Act.
[53] Clause 14 of Schedule 1 of the KiwiSaver Act.
[54] Clause 16 of Schedule 1 of the KiwiSaver Act.

preparing an annual report for the scheme and sending it to members;[55] providing an annual return to the Government Actuary;[56] and providing an annual personalised statement of contributions and accumulations to each member.[57]

In our view the manager, as issuer, should bear primary responsibility for making these operational decisions in relation to a non-restricted KiwiSaver scheme, with the trustee monitoring the performance of these functions and acting as an advocate for members in the event of any complaints. We also submit that officials should undertake a thorough audit of the KiwiSaver Act to ensure that all functions are appropriately allocated and aligned to the new roles of trustee and manager under the new regime.

4 Manager's functions

4.1 The Bill expressly requires the manager, when performing its functions, to act in the best interest of members of the scheme.[58] This is a new statutory requirement for the manager of a KiwiSaver scheme; and new in the sense that there is no equivalent obligation placed on the manager of a unit trust.

4.2 While this requirement appears sensible at first glance, in practice there will be a tension between the best interests of members and the commercial interests of the manager as a corporate entity. For example, there are provisions in KiwiSaver scheme trust deeds that are intended to operate for the benefit of the manager, such as the power to charge a reasonable fee or exercise a right of indemnity out of the assets of the scheme. An overarching duty to act in the best interests of members could restrict the ability of the manager to exercise these powers and discretions.

4.3 In our view an amendment is required to enable the manager to exercise powers and discretions set out in the trust deed in a reasonable manner as intended. For example, the Companies Act 1993 (which imposes a similar duty on directors) expressly permits remuneration and other benefits[59] – the corollary here would be permitted deductions from scheme assets.

5 Restricted KiwiSaver schemes

5.1 The Bill creates two kinds of KiwiSaver scheme – restricted KiwiSaver schemes and non-restricted KiwiSaver schemes. Restricted KiwiSaver schemes conform

[55] Sections 122, 123 and 124 of the KiwiSaver Act. See also section 177 of the Bill, which proposes new section 122 of the KiwiSaver Act.
[56] Section 125 of the KiwiSaver Act
[57] Section 125A of the KiwiSaver Act.
[58] Section 206 of the Bill, which proposes a new clause 1C(b) of the KiwiSaver scheme rules.
[59] Sections 161 and 162 of the Companies Act 1993.

to the more traditional structure of a workplace superannuation scheme, with more hands-on trustees and a membership linked by a common employer, profession or community of interest.

Unlicensed trustees

5.2 We understand that it is intended that restricted KiwiSaver schemes will not be required to have a trustee that is licensed under the Securities Trustees and Statutory Supervisors Bill.[60] As you know, the purpose of the Securities Trustees and Statutory Supervisors Bill is to protect the interests of investors and enhance investor confidence in financial markets by requiring trustees to be capable of effectively performing the functions of trustees; requiring trustees to perform their functions effectively; and enabling trustees to be held accountable for any failure to perform their functions effectively.[61] This purpose is achieved through a rigorous licensing, monitoring and reporting regime.

5.3 It will create a significant imbalance (and potential competitive and regulatory distortions) within KiwiSaver if trustees of non-restricted KiwiSaver schemes are required to be licensed and subject to enhanced supervision; and trustees of restricted KiwiSaver schemes fall outside this regime. As a result, the regulator will not have the power to remove the trustee of a restricted scheme for poor performance. It could also undermine the KiwiSaver "brand" if schemes permitted to use the Inland Revenue's KiwiSaver logo are subject to different standards.

5.4 We submit that restricted KiwiSaver schemes that do not have a licensed trustee should be clearly identified to members and prospective members as such. This could be achieved through a requirement to include prescribed wording in the prospectus and investment statement summarising what it means to be a restricted KiwiSaver scheme. This information will help prospective members make an informed investment decision.

Definition

5.5 The list of restricted KiwiSaver schemes is set out in the Bill.[62] Given that each restricted KiwiSaver scheme is unique, and will change over time, it may be more appropriate for each restricted scheme to be designated as such by way of a specific exemption. This would allow the FMA to tailor conditions to specific schemes, and review them individually rather than as a generic "class". A finite exemption would also facilitate regular review and audit.

[60] Explanatory note to the Bill, page 7.
[61] Section 3, Securities Trustees and Statutory Supervisors Bill (as reported from the Commerce Committee).
[62] Sections 211 and 212 of the Bill.

Size

5.6 In our view we are likely to see a growth in the size of restricted KiwiSaver schemes if the proposed changes are implemented. At present there are restricted KiwiSaver schemes that are significantly larger than some non-restricted schemes, both in terms of number of members and funds under management.[63] With the regulatory playing field arguably tilted in favour of these schemes, there is the potential for considerable growth. Membership is likely to grow as restricted schemes become more competitive on price, primarily due to the lower fees expected to be charged by unlicensed trustees.

5.7 In order to prevent competitive distortions developing, limit opportunities for regulatory arbitrage, and limit the number of members in KiwiSaver schemes without a licensed trustee, an additional size requirement should be added to the criteria a KiwiSaver scheme must satisfy in order to qualify as a restricted KiwiSaver scheme. We suggest that any KiwiSaver scheme with over 5,000 members is not eligible to be a restricted KiwiSaver scheme and must have a licensed trustee.

Membership

5.8 A restricted KiwiSaver scheme must restrict membership, in its conditions of entry *and in the way in which those conditions are applied*, to one or more classes of persons who are employed by a particular employer, or who belong to a particular profession, calling, trade, or occupation, or to a particular association, society, or other body having a definable community of interest.[64] We assume that the FMA will monitor the way in which conditions of entry are applied to ensure that members retain a close nexus with a common employer, profession or community of interest. In this regard, an annual confirmation from the issuer may be appropriate.

5.9 We assume that the restricted schemes identified in the Bill[65] have been carefully audited for compliance with the general requirements for restricted KiwiSaver schemes[66] and that, for example, "friends and family" of eligible employees are unable to join; and members that cease to be eligible are promptly transferred to a non-restricted KiwiSaver scheme.

[63] Workplace Savings NZ Quarterly KiwiSaver Survey, as at 30 September 2010.
[64] Section 173 of the Bill, which proposes a new section 116A of the KiwiSaver Act.
[65] Sections 211 and 212 of the Bill.
[66] Section 173 of the Bill, which proposes a new section 116A of the KiwiSaver Act.

6 **Transitional period**We understand that Part 7 of the Bill is not expected to be brought into force until the Securities Trustees and Statutory Supervisors Bill is enacted and fully operational – currently expected to be mid-2011.[67] While it makes sense to enact these changes together, we submit that a 12 month transitional period would be appropriate.

6.2 As you will appreciate, existing KiwiSaver schemes will need to undertake significant project work to reflect the changes proposed in Part 7 of the Bill. Trust Deeds and Establishment Deeds will require review and amendment to reflect the new roles of the manager and trustee. All existing contracts will need to be reviewed to check that the correct contracting parties are represented in the correct capacity, and re-negotiated and amended if required. Offer documents (the prospectus and investment statement) and marketing collateral (flyers, brochures, websites, advertisements etc) will require review and amendment. System generated customer correspondence will require review, and coding changes will be required. In addition, significant back-end systems change will be required, not only by the manager and trustee, but also by third party service providers.

6.3 We submit that a 12 month transitional period would give existing KiwiSaver schemes time to make a smooth, cost-effective transition to the new regime. A reasonable transition period will allow existing KiwiSaver schemes to schedule the required changes to coincide with the next natural scheme juncture, i.e. the next prospectus refresh/reissue; financial year or quarter end; or the date on which the next annual financial statements become available (see also our comments at paragraph 2.4 above in relation to an "effective date").

6.4 A transitional period would also help reduce the cost of implementing the changes, which for some KiwiSaver schemes will be passed on to the members. Allowing existing KiwiSaver schemes to stagger implementation will also reduce the burden on the FMA, which is required to consent to any amendments made to the scheme trust deed in order to comply with the Bill.[68] It will also allow trustees (some of which supervise multiple KiwiSaver schemes) to better manage their workload.

[67] Explanatory note to the Bill, page 7.
[68] Section 215 of the Bill.

7 Investment statement

New investment statement must be sent to existing members

7.1 There may be a requirement to send a new investment statement to existing KiwiSaver scheme members as a result of the changes proposed in the Bill.[69] As noted above, some or all of the cost of complying with any such requirement is likely to be passed on to members. As at 30 June 2010, KiwiSaver membership had reached 1.46 million[70] – even if each investment statement cost around $2 to amend, redesign, reprint and redistribute, this would be a significant cost to the industry in the order of almost $3 million.

7.2 The Committee may wish to consider whether it would achieve a better (and more cost effective) regulatory outcome to allow the manager to communicate the key changes to members by other means, for example:

(a) a letter or flyer setting out the key changes. A brief, targeted communication may result in higher levels of awareness than a blanket investment statement drop. Each communication could refer to the availability of the updated investment statement which would be provided on request and freely available in hard copy at the usual outlets.

(b) a section in the next annual report for the scheme. There is already a requirement that the annual report include a summary of any amendments to the trust deed made in the period[71] – this could be expanded to include a general summary of the changes proposed in the Bill.

(c) a supplement to the existing investment statement. A specific exemption would be required from the ordering requirements in the Securities Regulations 2009,[72] along the lines of that granted in respect of recent tax changes.[73]

The FMA could provide an exemption permitting one or all of the above on a case by case basis if required as part of its review and approval of trust deed amendments to reflect the changes required by the Bill.[74]

New investment statement must be "received"

7.3 We would also note the requirement in the Securities Act that the investment statement is "received" by each existing member.[75] In practice, compliance is

[69] Section 37A of the Securities Act.
[70] Inland Revenue KiwiSaver Evaluation, Annual Report July 2009- June 2010, available here: http://www.ird.govt.nz/resources/d/8/d81556804445319d95669dec1df6e932/ks-ar-2010.pdf.
[71] Section 123(2) of the KiwiSaver Act and paragraph (1)(i) of Schedule 2 of the Superannuation Schemes Act 1989.
[72] Due to the operation of regulations 19(1) and 21 of the Securities Regulations 2009.
[73] See the Securities Act (Taxation Changes Affecting Investment Statement Disclosures) Exemption Notice 2010.
[74] See section 215 of the Bill.

ensured by including the application form within the investment statement. The applicant must detach the form from the investment statement, fill it in and return it to the issuer to enrol – thereby providing the issuer with evidence that an investment statement was actually received prior to enrolment.

7.4 We submit that if an investment statement or supplement must be sent to existing members, an exemption from the requirement that the investment statement be "received" would be appropriate. Similar exemptions already exist in relation to debt securities issued by banks[76] and in relation to specified units in certain cash PIE products.[77] An exemption of this nature would require the issuer to send the investment statement to the member's last known address, but would not require the issuer to obtain confirmation of receipt. In our view an exemption is justified on the basis of the administrative difficulty of compliance (see below) and the serious consequences of non-compliance (voidable irregular allotments and potential liability under the Securities Act).

7.5 One alternative approach may be to ask members to return a signed form confirming receipt. We would expect to have a low success rate with this approach, with many members simply not bothering to return the confirmation. We also note the information gap in relation to KiwiSaver, and recent comments that it appears that as much as 30% or about 200,000 of those in default schemes could not be contacted by their provider because of wrong information.[78] This may make it difficult for providers to obtain confirmation of "receipt" from all members, in particular members that have been automatically enrolled in KiwiSaver.

8 Technical observations

8.1 We would note the following technical observations in relation to Part 7 of the Bill.

(a) The definition of the "administration manager" and "investment manager" of a superannuation scheme (including a KiwiSaver scheme) in the Securities Regulations 2009 cross refer to the definitions in the Superannuation Schemes Act 1989. The definitions in the Superannuation Schemes Act 1989 assume that the trustee has engaged the administration and investment managers – this is not always the case and will be rare for non-restricted KiwiSaver schemes under the new regime where the manager is the issuer.

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[75] Section 37A(1)(a) of the Securities Act.
[76] Clause 5 of the Securities Act (Banks) Exemption Notice 2002.
[77] Clause 5 of the Securities Act (Cash and Term Portfolio Investment Entities) Exemption Notice 2009.
[78] Parker, Tamsyn, "Info gap leaves KiwiSavers in dark", 18 February 2010. Available here: http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10626876.

(b) Proposed new section 116B(1) of the KiwiSaver Act requires that the investments and property of a KiwiSaver scheme be vested in the trustees. In practice, the trustee's nominee may actually hold the assets of the scheme. The nominee may be a wholly owned subsidiary or an external professional custodian. We suggest that section 116B(1) is expanded to refer to the trustee "or its nominee". This would be consistent with the approach taken in the Unit Trusts Act 1960, which expressly recognises nominees.[79]

(c) Proposed new section 120 of the KiwiSaver Act requires that the trustee of a non-restricted KiwiSaver scheme *approve* the audited accounts. If the trustee approves the accounts, it tacitly endorses them as true and correct. In practice, we anticipate that the trustee will demand to be involved in the audit process (which will be problematic from the point of view of the auditor) and/or require an independent review of the audited accounts before it will approve. This will increase costs without providing any additional protection for members. In our view, it should be sufficient for the trustees to simply *receive* a copy of the audited accounts.

(d) Clause 215(1) of the Bill states that the parties to the trust deed may make any amendments that are *necessary or desirable in order to ensure that the trust deed complies* with the requirements of the KiwiSaver Act as amended by the Bill. The Committee may wish to consider whether this provision is wide enough, and whether, for example, it should be extended to include amendments to reflect the new requirements of the KiwiSaver Act or consequential amendment which, when viewed as part of the complete package of amendments, are necessary or desirable to restructure the scheme.

(e) Proposed new clause 1B of the KiwiSaver scheme rules[80] states that, in performing its functions, the trustee must exercise the care, diligence, and skill required of a trustee by sections 13B and 13C of the Trustee Act 1956. These sections relate to the trustee's power of investment, and in particular impose a duty to invest prudently, with professional trustees subject to a higher standard. Proposed new clause 1B is to some extent duplicated in proposed new clause 1F, which states that the trustee must, in exercising the power of investment, exercise the care, diligence and skill required of a trustee by sections 13B and 13C of the Trustee Act 1956.

[79] See the definition of "trustee" and sections 3(3), 6, 6A, 6B and 6C of the Unit Trusts Act 1960.
[80] See section 206 of the Bill.