REVIEW OF FINANCIAL PRODUCTS AND PROVIDERS:
COLLECTIVE INVESTMENT SCHEMES

Discussion Document

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1. Executive Summary

1. Investment in collective investment schemes ("CISs") contributes to the economy by facilitating household wealth accumulation and risk management (through the ability to mitigate and pool risk), while at the same time providing a mechanism for investment which encourages business innovation and growth.

2. Collective investment scheme ("CIS") products, including superannuation schemes and participatory securities, are currently regulated under a number of different pieces of legislation.

3. The problem definition work on the RFPP undertaken last year concluded that the current regulation of CISs is fundamentally sound. However, because investors in CISs generally do not have the knowledge or the time to make their own investment decisions they therefore place their reliance on and trust in the skill, knowledge and experience of professional managers. Investors in CISs are also generally inactive in monitoring the manager and rely on managers acting with integrity. These characteristics of CIS investors, together with the fact that CISs generally tend to be medium- to long-term investment vehicles, raise issues around the information and power imbalance between investors in CISs and issuers, and leave investors in CISs vulnerable to opportunistic behaviour. We do not consider that the current regulatory settings for CISs are adequate to address the information and power imbalances between investors in CISs and issuers, or to achieve the objectives specified for the regulation of CISs (see paragraph 20). In particular:

   - The various pieces of regulation applying to different CISs create inconsistent and complex obligations for CISs which are difficult for investors to differentiate and understand. This creates both inefficiencies and costs for providers and the potential for regulatory arbitrage;

   - There is inconsistent supervision of CISs and insufficient assurance that current supervisory structures are adequate (these issues are identified and expanded upon in the *Supervision of Issuers* discussion document);

   - There are inconsistent regulatory controls and trust deed requirements across CISs, resulting in inconsistent, and in some areas insufficient, investor protections;

   - Current disclosure requirements for CISs do not provide meaningful disclosure to CIS investors. These issues are identified and considered in the "Disclosure" part of the *Securities Offerings* discussion document;

   - The governance arrangements for different CISs are inconsistent and do not adequately meet the objectives for regulation of CISs. There is the potential for conflicts of interest to arise for the trustee in superannuation schemes and there are no standardised checks on the competency or capacity of issuers of CIS products.

4. This discussion document proposes a consistent framework for governance and supervision of all CISs except for existing employer stand-alone and defined benefit superannuation schemes. Specifically, the framework will apply to current unit trusts, other superannuation schemes and all KiwiSaver schemes, most participatory

securities and life insurance policies with an investment component. The framework is based on the trustee supervisory model which is outlined in the *Supervision of Issuers* discussion document.

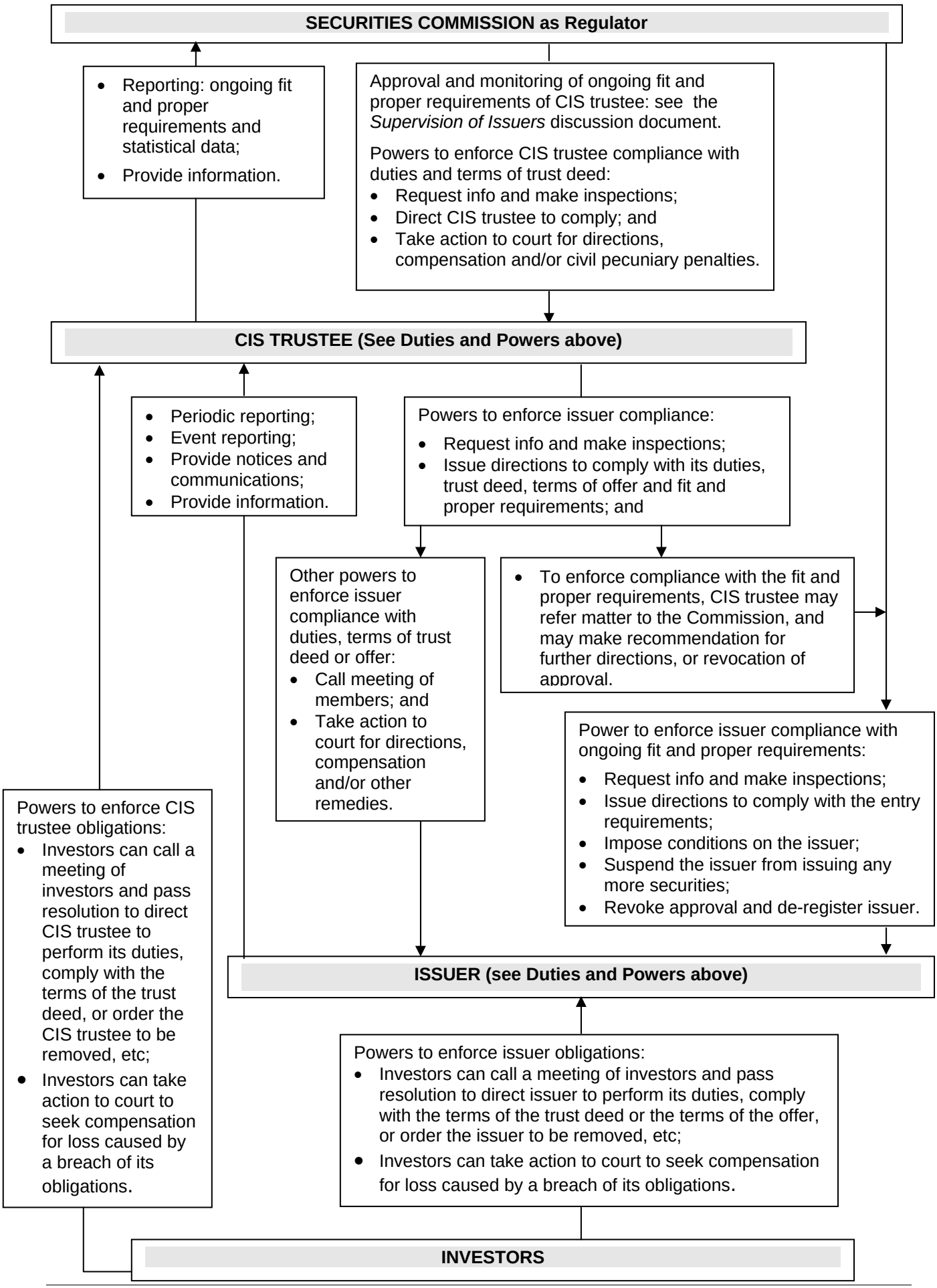
5. Under the proposed framework, every CIS that offers to the public will be required to have an issuer and an independent CIS trustee who are approved by the Securities Commission (the "Commission"), as regulator, in accordance with "fit and proper" entry criteria. The CIS trustee will be the first-level supervisor of the scheme and the Commission will have oversight of the CIS trustee, primarily to ensure that the CIS trustee is effectively undertaking its role as supervisor.

6. The following tables and diagram set out the proposed powers and duties of the Commission, the CIS trustee and the issuer under this framework. The powers and duties reflect the roles of the various parties within the supervisory framework. The diagram does not focus on the roles of the Commission, CIS trustees or issuers in relation to disclosure: see the "Disclosure" part of the *Securities Offerings* discussion document.

Duties of the CIS Trustee	**Powers and Rights of the CIS Trustee**
• To consider whether an issuer meets fit and proper entry requirements and is registered before accepting appointment as the CIS trustee; • To monitor issuer compliance with ongoing fit and proper requirements; • To monitor and enforce issuer compliance with duties, the terms of the trust deed and the terms of the offer; • To report to the regulator regarding ongoing fit and proper entry requirements and statistical data; • To comply with requests for information and to allow the Commission, or a person appointed by the Commission, to make inspections; • To hold scheme property in the name of the CIS trustee or a nominee; • To not act on any direction of the issuer in relation to scheme property if they consider the proposed acquisition or disposal is manifestly not in the interests of the investors; • To act on the directions of investors; • To notify the appropriate regulatory authority when appointed as a new CIS trustee; and • To hold personal profits and/or	• To nominate one or more persons to hold the scheme property on trust; • To receive all notices and other communications relating to the scheme; • To reasonably request information relating to the scheme or the issuer and to inspect or review, or appoint a person to inspect or review, the issuer's books and papers and the books and papers relating to the scheme; • To require periodic reporting from the issuer; • To require the issuer to summon a meeting of members; • To attend and be heard at a meeting of members of the scheme and to nominate a person to chair a meeting of members; • To apply to the High Court for directions where the CIS trustee is of the opinion that any direction given to it by the members conflicts with the trusts or any rule of law or is otherwise objectionable; • To direct the issuer to comply with the terms and conditions of its approval, fit and proper requirements, its duties, the terms of the trust deed or of the offer; • To take an action to the High Court on behalf of members for breach by the issuer of its duties, the terms of the trust deed or of the offer; • Where an issuer has failed to comply with a direction in relation to ongoing fit and proper requirements, to recommend to the Commission that it make

Duties of the CIS Trustee	Powers and Rights of the CIS Trustee
benefits (except remuneration) on trust.	directions to ensure issuer compliance or for issuer removal; • To apply to the High Court in certain circumstances for additional powers of management or administration in relation to scheme property; • To apply to the High Court to assess damages against a delinquent director or other officer of the issuer if, in the course of winding up the issuer, it appears that the issuer has misapplied or retained or become liable or accountable for any money or property of the scheme, or committed any misfeasance or breach of trust in relation to the scheme; and • To amend the trust deed in certain circumstances.

Duties of the Issuer	
• To appoint a registered CIS trustee; • To use its best endeavours and skill to ensure that the scheme is carried on in a proper and efficient manner; • To use the same care and diligence in the exercise and performance of its functions, powers and duties as it would if it exercised those functions, duties and powers as a CIS trustee; • To pay out, invest and apply scheme property in accordance with the terms of the trust deed or the constitutional document; • To provide information relating to the affairs of the scheme to members at a meeting of the scheme; • To ensure reporting requirements specified in the legislation are met; • To register any documents required to be registered with the regulator; • To maintain a website; • To pay or pass to the CIS trustee all money and other scheme property received by the issuer in respect of purchases of or subscriptions for interests in the securities.	• To hold personal profits and/or benefits (except remuneration) on trust; • To provide the CIS trustee with a copy of all notices and such other communications relating to the scheme; • To provide the CIS trustee with information and to allow the CIS trustee, or a person appointed by the CIS trustee, to make inspections; • To call a meeting of members; • To report to the CIS trustee; • To report statistical data to the Commission; • To report to investors; • To comply with the law and any requests or directions from the CIS trustee and/or the Commission. **Power of the Issuer** • The proposed power of the issuer is to apply to the High Court in certain circumstances for additional powers of management or administration in relation to scheme property.


SECURITIES COMMISSION as Regulator
Reporting: ongoing fit and proper requirements and statistical data;
Provide information.
Approval and monitoring of ongoing fit and proper requirements of CIS trustee: see the Supervision of Issuers discussion document.
Powers to enforce CIS trustee compliance with duties and terms of trust deed:
Request info and make inspections;
Direct CIS trustee to comply; and
Take action to court for directions, compensation and/or civil pecuniary penalties.
CIS TRUSTEE (See Duties and Powers above)
Periodic reporting;
Event reporting;
Provide notices and communications;
Provide information.
Powers to enforce issuer compliance:
Request info and make inspections;
Issue directions to comply with its duties, trust deed, terms of offer and fit and proper requirements; and
Other powers to enforce issuer compliance with duties, terms of trust deed or offer:
Call meeting of members; and
Take action to court for directions, compensation and/or other remedies.
To enforce compliance with the fit and proper requirements, CIS trustee may refer matter to the Commission, and may make recommendation for further directions, or revocation of approval.
Power to enforce issuer compliance with ongoing fit and proper requirements:
Request info and make inspections;
Issue directions to comply with the entry requirements;
Impose conditions on the issuer;
Suspend the issuer from issuing any more securities;
Revoke approval and de-register issuer.
Powers to enforce CIS trustee obligations:
Investors can call a meeting of investors and pass resolution to direct CIS trustee to perform its duties, comply with the terms of the trust deed, or order the CIS trustee to be removed, etc;
Investors can take action to court to seek compensation for loss caused by a breach of its obligations.
ISSUER (see Duties and Powers above)
Powers to enforce issuer obligations:
Investors can call a meeting of investors and pass resolution to direct issuer to perform its duties, comply with the terms of the trust deed or the terms of the offer, or order the issuer to be removed, etc;
Investors can take action to court to seek compensation for loss caused by a breach of its obligations.
INVESTORS

7. This discussion document proposes standard regulatory controls for CISs and requirements for certain matters to be addressed in all CIS trust deeds. This will establish a minimum set of rights for investors in CISs and obligations by CIS trustees in relation to the operation of schemes. The proposals balance the objective of adequate investor protection with the desire to maintain flexibility for schemes to operate on an efficient commercial basis. The proposed regulatory controls relate to:

   - A procedure for amendments to trust deeds;
   - A procedure for transfers of members to other schemes in limited circumstances;
   - Assignment of interests or units in a scheme; and
   - Benefits in schemes linked to employment status.

8. This discussion document discusses whether the following matters should be required to be addressed in trust deeds, and the specificity with which they should be addressed:

   - Scheme objectives;
   - Conditions of scheme entry and exit;
   - Contribution levels and rates;
   - Authorised investments;
   - Benefits, returns, redemptions and pricing;
   - Discretions regarding benefit payments;
   - Fees;
   - Appointment and removal of the trustee and issuer;
   - Winding up; and
   - Meetings.

9. In applying the framework to superannuation schemes, the proposals reflect the common features between superannuation schemes and other CISs. They also take account of the fact that superannuation schemes are evolving towards master trust structures. The proposals are neutral in that while structurally superannuation schemes will be subject to the same governance and supervisory framework as other CISs, the framework is sufficiently flexible to enable savings in superannuation products to be incentivised. For example, it is envisaged that the governance and supervisory framework for KiwiSaver schemes would be the same as for other superannuation CISs.

10. An additional transitional structure is proposed which would apply to all existing employer stand-alone superannuation schemes, to reflect concern that the imposition of new governance structures on these schemes would facilitate scheme wind-up. The transitional structure will also apply to all existing defined benefit superannuation schemes. Generally, the structure is:

    - The roles, powers and duties of the trustee and issuer will be combined within the trustee of the scheme (this approximates the current governance arrangements for superannuation schemes where the trustee is the scheme issuer);

    - The regulator will be the primary supervisor of the scheme and will have powers to gather information from schemes and enforce compliance with trust deed and regulatory requirements;

    - Fit and proper entry requirements will apply to these schemes, but may be adapted to reflect the composition of their boards of trustees;

    - Defined benefit schemes will continue to be required to undertake actuarial assessments. This document queries whether other changes to improve the current regime for defined benefit schemes are also necessary; and

    - The regulator will have the powers and expertise to assess actuarial assessments and enforce trust deed and regulatory requirements for defined benefit schemes.

11. This discussion document also seeks feedback on whether the governance and supervisory structures proposed should be applicable to all participatory securities, or whether some changes to the structure should be made to reflect the features of those securities. It addition, it asks whether additional provisions are required to cover securities that do not fit within the definition of CIS, equity or debt securities, or whether the regulator should have the flexibility to apply appropriate requirements to those securities taking account of the objectives of the regulation.

2. Introduction

2.1 OUTCOMES SOUGHT FOR CISs

12. There are a significant number and variety of collective savings products that are currently offered in the New Zealand market. The December 2005 Reserve Bank's Managed Funds Survey estimated approximately $57.5 billion in funds management in New Zealand, with approximately $17.8 billion in unit trusts and group investment funds.

13. Investment in collective savings products can contribute to sustainable economic development by encouraging household wealth accumulation and investment which encourages business innovation and growth. CISs also facilitate effective risk management (i.e. the ability to mitigate and pool risk).

14. Adequate regulation of CISs is crucial to both supporting investment in CISs and building and maintaining consumer and industry confidence in the non-bank financial sector.

2.2 REASONS FOR REGULATORY INTERVENTION

15. The need for Government to intervene in relation to CISs arises as a result of market failure, in particular, information and power asymmetries that exist between the investor and the CIS.

16. CISs are fundamentally based around the concept that an investor is deferring investment decisions to the scheme, rather than making his or her own investment decision. Because of this, the investor is placing significant reliance on and trust in the competence and integrity of the issuer. Issues of trust in the issuer are compounded by the characteristics of investors in CISs. Investors may defer their investment decisions to the CIS at least in part because they do not feel they have the necessary knowledge or experience to undertake these investments.

17. These characteristics of CIS investors, in combination with the nature of CISs, exacerbate issues of information asymmetry between investors in CISs and issuers. In a CIS, substantial assets are owned by a dispersed group of investors with incomplete information. At the same time, the assets are under the control of institutions that can control flows of information. Information is costly for an individual investor to gather and, if that barrier is overcome, could be very difficult for them to understand. This can lead to an inefficient allocation of resources through adverse selection, and may also stifle innovation and efficient operation of business.

18. The characteristics of investors who invest in CISs, and the fact that CISs tend to be medium- to long-term investment vehicles, also mean they are particularly reliant on issuers acting with integrity. However, because investors in CISs may be less financially savvy than investors in other financial products, they are not well placed to make an assessment of the scheme provider, leaving them vulnerable to opportunistic behaviour. For example, investors rely on the integrity of issuers and effective supervision to provide legally compliant disclosure documents, as investors are often unable to assess compliance for themselves.

19. Information and power asymmetries can be addressed through both appropriate disclosure and governance requirements. Issues related to disclosure for CISs are addressed in the "Disclosure" part of the *Securities Offerings* discussion document. Given the nature of CISs and the particular characteristics of CIS investors, it is particularly important that the governance arrangements for, and supervision of, CISs are sufficiently robust. These issues are addressed in this discussion document.

2.3 OBJECTIVES FOR REGULATING CISs

20. The following objectives have been identified for the regulation of CISs:

- Investors in CISs are adequately informed about the characteristics of CISs and the risks associated with investment in CISs. This can occur through relevant disclosure, enabling investors to make informed decisions, so they are able to take responsibility for their investment decisions. This also enables investors and market commentators to make meaningful comparisons between CISs;

- The application of minimum consistent regulatory standards to all CISs that help to ensure that investors' interests are adequately protected;

- Effective governance of CISs to facilitate issuer compliance with minimum standards. This should minimise the risk of unfair or fraudulent conduct by helping to ensure that there is honest and competent management effectively managing risks;

- Effective supervision of CISs, that allows the CIS trustee and the regulator to hold an issuer accountable for things it undertakes to do, is required by law to do, and for promises it fails to deliver on. Such supervision should be independent and free from conflicts of interests with the people or entities it supervises; and

- Flexibility to enable CISs to operate efficiently and encourage the availability of a wide range of investment products and services, so investors are able to choose the products/services that will best suit their investment or savings needs.

21. The following regulatory design principles also apply in considering the appropriate framework for the regulation of CISs:

- A consistent and common regulatory framework for all CISs which is transparent and clear and which:

    - provides certainty to providers and investors about their rights and obligations so that those affected by the regulation can easily access and understand the processes and requirements imposed on them;

    - minimises the potential for regulatory arbitrage; and

    - is fair and treats those affected by the regulation equitably;

- Regulation is cost-effective. Regulation should go no further than necessary to meet the defined objectives. The regulatory regime for CISs should aim to

minimise compliance and transaction costs and should not impose unnecessary barriers to entry;

- Enhanced coordination with Australia. The regulatory regime is developed within the framework for the Memorandum of Understanding on Business Law Coordination between New Zealand and Australia. There is a presumption in favour of coordination; however, this presumption will be overturned where there are good reasons for the laws to be different between the two countries; and

- Regulation that recognises and complies with international principles and standards, unless there are good reasons not to apply those principles and standards.

2.4 ADEQUACY OF CURRENT REGULATION IN MEETING OBJECTIVES

22. Currently different types of CISs are regulated by different pieces of legislation with the overlay of the provisions of the Securities Act 1978 (the "Securities Act") and the common law. The legislation for each type of CIS prescribes a different regulatory framework, with varied duties and obligations for trustees, statutory supervisors and managers.

23. There are five key areas where the current regulation does not adequately meet the objectives identified for the regulation of CISs.

- The various pieces of regulation applying to different CISs create inconsistent and complex obligations for CISs which are difficult for investors to differentiate and understand. This creates both inefficiencies and costs for providers and the potential for regulatory arbitrage.

- There is inconsistent supervision of CISs and insufficient assurance that current supervisory structures are adequate to ensure that supervision is being undertaken in a way that achieves the objectives for CISs (these issues are identified and expanded upon in the *Supervision of Issuers* discussion document).

- There are inconsistent regulatory controls and trust deed requirements across CISs. This means there are inconsistent investor protections across CISs, which are not necessarily understood by investors in those products. It also means that for some CIS products investors may not currently have the level of minimum protections necessary for achieving the objectives for CISs.

- Current disclosure requirements for CISs do not provide meaningful disclosure to CIS investors. These issues are identified and considered in the "Disclosure" part of the *Securities Offerings* discussion document.

- The governance arrangements for different CISs are inconsistent and do not adequately meet the objectives for regulation of CISs. In particular, there is the potential for conflicts of interest to arise for the trustee in superannuation schemes and there are no standardised checks on the competency or capacity of issuers of CIS products.

24. Through our consultation with industry and our work with the various Auckland and Wellington CIS and superannuation advisory groups we have noted there is general agreement that, from a principled basis, regulatory intervention is necessary to ensure that similar products are regulated similarly, and that investors with similar characteristics who invest in CIS products have the same protections.

3. Proposed Framework for the Regulation of CISs

3.1 OFFERS TO THE PUBLIC

25. The proposed framework for the regulation of CISs applies only to funds that are offered to the public as defined by the Securities Act. This is discussed further in the "Disclosure" part of the *Securities Offerings* discussion document.

3.2 PROPOSED OPTION FOR REGULATING CISs: A REGULATORY FRAMEWORK APPLICABLE TO ALL CISs

26. CISs allow investors (generally non-expert retail investors) to pool their funds together under professional management and supervision. We consider that these commonalities in CISs, together with the similar characteristics that investors in CISs share (see paragraph 3), justify a similar regulatory framework for CISs with similar regulatory protections for investors in CISs.

27. To meet the objectives for regulating CISs (refer paragraph 20), and subject to a few exceptions,[1] we therefore propose regulating all CISs consistently.

28. That is, one piece of legislation will prescribe requirements across each of the different types of CISs, regardless of the form of the CIS.

29. We propose that the following regulatory protections/requirements will apply across each of the different types of CISs:

- Oversight by an independent supervisor;
- Issuer requirements;
- Regulatory supervision;
- Regulatory controls (including trust deed/constitutional document provisions);
- Disclosure; and
- A consumer dispute resolution and redress mechanism.

3.2.1 How the Proposed Regulatory Framework for CISs Fits with the Trustee Supervisory Model

30. The proposed framework for the regulation of CISs operates within the proposed new trustee supervisory model. The trustee supervisory model is a form of prudential supervision and is discussed in the *Supervision of Issuers* discussion document.

31. Briefly, the trustee supervisory model requires the Securities Commission (the "Commission"), as market conduct regulator, to approve and supervise CIS trustees, and the proposed framework for the regulation of CISs requires the CIS trustee to supervise the issuer and the scheme.

[1] For example, see the sections on stand-alone employer superannuation schemes, defined benefit schemes and some participatory schemes.

32. There will therefore be two layers of supervision within the trustee supervisory model. Whilst the two layers of supervision add increased protections for investors, the integrity of the trustee supervisory model is based on the principle that each layer of supervision has its separate sphere of operation, and functions independently of the other. It is intended that the two layers of supervision will overlap in very limited and prescribed circumstances, but a tenet of the trustee supervisory model is that, in general, trustees will provide the front line supervision role, with the Commission providing checks and balances and holding trustees accountable.

33. The proposed framework for CISs will apply to those securities that fit within the proposed definition of CIS (except for a transitional framework that will apply to existing employer stand-alone and defined benefit superannuation schemes – see paragraph 282). This discussion document discusses and seeks your opinion on the proposed definition of CIS, the duties and powers of the CIS trustee, issuer requirements, regulatory supervision and the regulatory controls for CISs. The proposed reform in respect of:

- Disclosure for CISs is discussed in the "Disclosure" part of the *Securities Offerings* discussion document;
- Supervision of trustees is discussed in the *Supervision of Issuers* discussion document;
- Registration of financial institutions, including issuers and CIS trustees, is discussed in the *Oversight of the Review and Registration of Financial Institutions* discussion document; and
- Addressing consumer disputes is discussed in the *Consumer Dispute Resolution and Redress* discussion document.

3.3 PROPOSED DEFINITION OF CIS

34. The current definitions of group investment fund, superannuation scheme, unit trust, life insurance policy and participatory security are set out in Appendix 1.

35. Currently, these securities are defined in different pieces of legislation, with each prescribing different manager and trustee/statutory supervisor duties and powers, and different levels of investor protections.

36. We consider these products have broadly similar characteristics, in that they allow investors (generally non-expert retail investors) to pool their funds together under professional management and supervision.

37. One of the objectives for regulating CISs is that similar products are regulated similarly, such that CIS issuers comply with the same requirements, supervisors comply with the same requirements, and that both issuers and supervisors operate fairly and with transparency.

38. Consistent regulation will also ensure investors receive similar protections. Investors will also more likely understand the protections they have if they apply consistently across similar products. Such consistency will promote investor confidence in the financial sector and, in particular, in CISs.

39. We consider the definition of CIS should be similar to paragraph (a) of the section 9 Corporations Act 2001 (Australia) (the "Corporations Act") definition of "managed investment scheme", as that definition appropriately encompasses the similar characteristics that all these types of products share. The Corporations Act defines "managed investment scheme" to mean:

> *A scheme that has the following features:*
>
> *(i) People contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not);*
>
> *(ii) Any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders);*
>
> *(iii) The members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions)…*

40. The proposed definition of CIS will include:

- A unit in a unit trust;
- An interest in a superannuation scheme, including KiwiSaver[2] (but see paragraph 56);
- Participatory securities (but see paragraph 76); and
- Life insurance policies with an investment component (but see paragraph 79).

41. We consider the proposed definition will capture a wide range of offers of securities to the public that allow investors to pool their contributions. It is intended to look at the substance of an investment scheme, rather than simply the legal form. Indeed, we consider that very few securities will not be able to be categorised as an equity security, a debt security or a CIS. For the proposed regulation of those securities that are not equity securities, debt securities or CISs, please see the *Participatory Securities* part of this discussion document.

42. We consider the proposed umbrella definition of CIS, covering a wide range of similar products, meets the regulatory objectives for CISs by providing consistent regulation across similar products, by reducing regulatory arbitrage between the different types of CISs, and by facilitating contestability, competitiveness and innovation.

3.3.1 Should the Legal Form for CISs be Prescribed?

43. One issue that arises in relation to the proposed regulatory framework for CISs is whether there should only be one legal form for CISs. Currently, CISs include trusts

[2] This document refers to KiwiSaver schemes. These will be schemes established under the KiwiSaver Bill when it is passed. At the time of writing this document, the KiwiSaver Bill was under consideration by the Finance and Expenditure Select Committee. The Bill is due to be reported back to Parliament in early September 2006.

(for example, superannuation schemes and unit trusts), partnerships, corporates and contractual arrangements (for example, some participatory schemes).

44. Provided issuers comply with the requirements for CISs we do not propose requiring CISs to take a particular legal form as we consider that issuers should have the flexibility to develop new and innovative products based on the legal form that they consider most beneficial. Encouraging innovative products will increase investment products and opportunities available to investors and will increase competition among issuers. Prescribing legal form may unnecessarily hinder the development of new and innovative products.

45. The OECD White Paper on Governance of Collective Investment Schemes[3] noted that "In nearly all OECD countries, basic laws specify the legal forms in which CIS may be offered to the public and also specify that an internal governance system must be established for each CIS. A number of legal forms for CIS are found in major OECD countries. These legal forms reflect each country's legal system and its own history. Some jurisdictions permit only one legal form of organisation for CIS while others allow more than one form… No legal form or governance regime for CIS has been accepted as inherently superior to other systems." We consider that the objectives for regulating CISs (see paragraph 20) can be achieved without prescribing the legal form of CISs and without limiting the availability of the several different legal forms that have developed over time in New Zealand.

46. Further, if the legal form (or forms) of CISs were to be prescribed issuers who offer CISs that fall outside of the prescribed legal forms would eventually be required to transition to the prescribed forms. This may create advantages for those already operating CISs in the prescribed forms, and disadvantage those issuers who would be required to transition into the prescribed forms. Such transition may result in the issuer determining that the costs of restructuring to the prescribed legal form outweigh the benefits, and it may therefore cease to operate and offer investment products. This may reduce competition and reduce the wide range of investment products on offer to investors.

3.3.2 Exclusions from the Definition

3.3.2.1 Specific Exclusions Prescribed in the Definition

47. The Corporations Act definition of "managed investment scheme" also prescribes that some types of entities that fit within the definition are specifically excluded from the definition. Amongst others, the Corporations Act's definition of "managed investment scheme" does not include a partnership that has more than 20 members, a body corporate, a regulated superannuation fund, or a retirement village scheme operating within or outside Australia.

48. Like the Australian definition, we also propose prescribing in legislation that some entities be excluded from the proposed definition of CIS. For example, we propose prescribing that retirement villages (within the section 6 Retirement Villages Act 2003 definition) be excluded from the definition of CIS as they are regulated under other legislation.

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[3] OECD White Paper on Governance of Collective Investment Schemes, *Financial Market Trends*, No 88, (March 2005) pp 141-142.

49. Unlike the Australian definition, we will not be excluding superannuation schemes from the definition of collective investment scheme. This is discussed further from paragraph 56 of this discussion document.

50. We also see no justification for excluding partnerships from the proposed definition of CIS.

3.3.2.2 Regulations Declaring Certain Types of Schemes not to be CISs

51. The Corporations Act definition of "managed investment scheme" also prescribes that a scheme will not be a managed investment scheme where it is "a scheme of a kind declared by the regulations not to be a managed investment scheme".

52. We also propose adopting the Australian approach, such that regulations can declare that certain types or kinds of schemes are not CISs.

3.3.2.3 Securities Commission's Discretion

53. It is proposed that in addition to the definition of CIS the Commission will have the power to make an order declaring a security a particular type of security (that is, a substance over form approach).

54. The proposed definition of CIS would therefore provide certainty so that most issuers will know what law applies to them in advance. However the Commission's discretionary powers would provide flexibility so that securities on the boundaries will be regulated appropriately. For further discussion on this issue, see the paragraphs under the heading "Product declaration power" in the *Supervision of Issuers* discussion document.

3.3.3 Group Investment Funds and Contributory Mortgages

55. Group investment funds and contributory mortgages would both fit within the proposed definition of CIS. However, we propose that, in respect of:

    a. ***Group investment funds***, the Trustee Companies Act 1967 be amended, such that the Trustee Companies Act cannot be used as a means for third parties (for example, commercial fund managers) or for trustee companies to offer pooled or unitised funds to the public. Instead, the offering of funds under the Trustee Companies Act will be limited to its original purposes, for example, the investment of estate and trust funds where the trustee company is trustee or co-trustee, or for a client who is mentally incapable where the trustee company either jointly or severally holds an enduring power of attorney. When group investment funds revert to their original purposes they will not come within the proposed definition of CIS (as they are internally managed by the trustee and are not offers to the public). It is proposed that existing group investment funds will continue to exist under the current provisions until wind-up; and

    b. ***Contributory mortgages***, the Securities Act (Contributory Mortgage) Regulations 1988 be repealed, such that contributory mortgages would then be classed as debt securities and would be required to comply with the provisions of the Securities Act relating to debt securities. They would therefore not come within the proposed definition of CIS. Contributory mortgages are considered in

more detail in the "Disclosure" part of the *Securities Offerings* discussion document.

3.3.4 Superannuation Schemes

56. Many superannuation schemes are likely to fall within the definition of CIS. Defined contribution superannuation schemes in particular have similar characteristics to other CIS products in that contributions are pooled, the scheme invests those contributions into other products and provides returns back to the member. Day-to-day operations are carried out by the manager of the superannuation scheme.

57. All KiwiSaver schemes will also fall within the definition of CIS (KiwiSaver schemes are defined contribution superannuation schemes). The KiwiSaver Bill is both based on, and applies many provisions of, the Superannuation Schemes Act. There are two exceptions to this: the Bill contains some provisions that strengthen governance requirements for KiwiSaver schemes (such as the requirement for an independent trustee); it also contains provisions which specify the design of KiwiSaver schemes (such as lock-in requirements). It is anticipated that any changes to the governance and supervision of superannuation schemes that are agreed as part of the RFPP will flow through to the regulation of KiwiSaver schemes. Other provisions in the KiwiSaver Bill that specify the design features of KiwiSaver schemes would continue to apply to KiwiSaver schemes.

58. Three key issues to be considered in bringing superannuation products within the definition of CIS are:

- Whether the CIS framework is appropriate for superannuation schemes generally;
- Whether the involvement of an employer in superannuation schemes means those schemes should be regulated differently to other CISs; and
- Whether defined benefit superannuation schemes could or should be brought within the definition.

3.3.5 CISs and Superannuation

59. Currently registered superannuation schemes are required to be "principally for the purpose of providing retirement benefits…".[4] Because of the focus of superannuation schemes on providing benefits to members for their retirement, the regulation of superannuation schemes links strongly to the Government's objectives for the promotion of saving for retirement. This is potentially more so than with other CIS savings and investment vehicles, which may link more squarely into the objectives of investment for wealth accumulation, growth and innovation.

60. A number of members of the Wellington and Auckland superannuation advisory groups suggested that the retirement focus of superannuation means there is a case for differentiating superannuation from other CISs. It was also suggested that there was no need to change the current regulatory structures for superannuation, which were considered to be working effectively. There was concern that changing the

[4] Section 2 definition of "superannuation scheme" Superannuation Schemes Act 1989.

regulatory structure would add costs to superannuation schemes but bring little additional benefit over and above the current regulatory arrangements.

61. Other members of the Wellington and Auckland superannuation advisory groups, most members of the Wellington and Auckland CIS advisory groups, and we, disagree with the assessment made by those members of the superannuation advisory groups. We consider that the retirement focus of superannuation products is not a reason to differentiate those products from the general CIS governance arrangements. We also have a concern about the potential for conflicts to arise within the current governance structures (this is discussed in more detail at section 6.3.2.2 of the *Supervision of Issuers* discussion document) and a more general concern that maintaining different regulatory requirements for superannuation schemes will not meet the identified objectives for regulation of CISs, in particular those objectives relating to effective governance and supervision of CISs. We do, however, agree that there is a case for providing a transitional structure for stand-alone employer superannuation schemes (including defined benefit schemes), to avoid imposing significant costs on those schemes and forcing scheme wind-up. This structure is discussed further in the "Employer Stand-Alone Schemes" part of this discussion document.

62. A further concern raised by some members of the superannuation advisory group was that the lock-in of funds in many superannuation schemes (this is linked to their retirement focus) meant that additional protections were required for investors in superannuation schemes. We consider that lock-in is not in itself a significant differentiating factor that requires different governance or supervisory structures. Many CIS schemes are long-term in nature (some unit trusts also have lock-in of funds for a specified period), and the governance and supervisory requirements and regulatory restrictions on all CIS schemes need to reflect this. Particular issues that arise with locked-in funds for any CIS scheme and protections for investors that may be required in relation to those funds are addressed in the "Regulatory Controls" part of this discussion document.

63. It has also been suggested that other jurisdictions regulate superannuation products differently from other CISs, and that there may be a case for taking a similar approach in New Zealand. In Australia, superannuation schemes are specifically excluded from the definition of managed investment scheme and are subject to their own regulatory and supervision requirements. Most Australian superannuation schemes are prudentially regulated by the Australian Prudential Regulation Authority ("APRA"). APRA develops and enforces prudential requirements for superannuation schemes. The objective of APRA's supervision is to ensure that, under all reasonable circumstances, financial promises made by supervised institutions are met within a stable, efficient and competitive financial system. The Australian Securities and Investment Commission ("ASIC") regulates the market conduct of superannuation industry participants.

64. Supervision of schemes by APRA is risk-based, and the level of supervisory activity is related to APRA's Probability Rating and Impact Rating for each rated institution. APRA has four supervisory stances: "Normal", "Oversight", "Mandated Improvement" and "Restructure".

    - A "Normal" mode means APRA collects and analyses data and makes routine on-site visits.

- "Oversight" means a significant step-up in information collection and inspection intensity. APRA may increase minimum capital requirements for "Oversight" institutions.

- "Mandated Improvement" means the institution is operating in an unsustainable way. APRA will direct these institutions to present and execute a remediation plan that addresses the area of identified weakness and restores financial stability. At this level, APRA allows the regulated institution to retain control of its destiny, but clearly signals that improvements must be made. APRA may issue directions and take other enforcement actions at this level.

- "Restructure" institutions are in serious danger of failure. To these institutions, APRA applies its full enforcement powers, including issuing directions to replace persons and service providers and/or to restrict business activities. APRA's paramount concern in this situation is to quarantine the entity from further deterioration and minimise losses to depositors, policyholders and superannuation fund members.

65. The approach to supervision reflects the role of superannuation schemes in Australia. In particular:

- There is a compulsory regime for superannuation savings; and

- There are tax incentives provided for savings in superannuation schemes.

66. The Australian Financial System Inquiry which reported in March 1997 stated that: [5]

> *The compulsory nature of some superannuation savings, … the mandatory long-term nature of superannuation and the contribution to superannuation of tax revenue forgone provide a case for prudential regulation of all superannuation funds, even where investors have knowingly accepted market risk.*

67. In this context, we consider there are a number of features of the New Zealand environment which make this sort of prudential regulation of superannuation schemes inappropriate in New Zealand, in particular the voluntary nature of superannuation in New Zealand. While it is noted that the Government will be facilitating individuals into private superannuation schemes through KiwiSaver, membership of a KiwiSaver scheme will be voluntary.

68. There will, however, still be regulatory requirements proposed for superannuation schemes that are designed to ensure effective prudential supervision of those schemes. The proposals in this discussion document link to issues identified such as the potential for information and power asymmetries given the characteristics of superannuation consumers. The proposals will ensure good governance of schemes and that issuers and CIS trustees have the capacity and capability to undertake their roles. They will also include some prudential regulation of defined benefit superannuation schemes. These concerns are common to all CISs and we consider they should be addressed in a consistent way for all CISs.

69. The application of the trustee supervisory model will be a significant change for current registered superannuation schemes. In particular, the trustee of a

[5] *Financial System Inquiry Final Report*, Australian Government Publishing Service, March 1997, p 305.

superannuation scheme is currently the issuer of securities in the scheme and this would change under the proposed model. The implications of this change are discussed in further detail in both the *Supervision of Issuers* discussion document and in subsequent places within this document.

3.3.5.1 Employer-Sponsored Superannuation Schemes

70. A number of members of the Wellington and Auckland superannuation advisory groups also considered that the involvement of employers in superannuation schemes made these schemes distinct both from other CISs, and other retail superannuation schemes. Particular issues raised were that:

- The employment contract between the sponsoring employer and the employee member places an additional overlay on the superannuation scheme, which gives these schemes a distinctive character;
- The employer provides an additional check and balance on the scheme, which may give the employee member greater assurance about the scheme;
- Employer-sponsored schemes often provide substantial benefits to the employee member, and that it is important to continue to encourage employers to sponsor and participate in these schemes; and
- Employers can sometimes exercise discretions in an employer-sponsored superannuation scheme that may not be in the employee member's best interests, and that there should be some controls on the exercise of these discretions.

71. It is recognised that these features of employer-sponsored schemes raise some particular issues in terms of how they should be regulated. However, we consider that the issues raised are not, in themselves, reasons for defining all employer-sponsored schemes differently from other CISs. We are therefore proposing that all employer-sponsored superannuation schemes should be regulated within the same framework as other CISs, with the exception of existing employer stand-alone superannuation schemes (in recognition that imposing a new structure on these schemes would impose some costs and could lead to scheme wind-up). Master trust employer superannuation schemes would not fall within this exception.

72. Issues relating to employer (and other third party) involvement in superannuation schemes and the proposed transitional structure for existing employer stand-alone superannuation schemes are addressed further in the "Employer Stand-Alone Schemes" part of this discussion document.

3.3.5.2 Defined Benefit Superannuation Schemes

73. Defined benefit superannuation schemes[6] are employer schemes which do not allocate contributions, or returns on those contributions, to particular members of the scheme. Instead, the scheme provides the promise of a benefit upon a specified event (generally retirement). Because of the unallocated nature of defined benefit

[6] For a definition of defined benefit superannuation schemes, please refer to paragraphs 315 and 316 in the "Defined Benefit Superannuation Schemes" part of this document.

superannuation schemes, it is arguable that they would not fall within the definition of a CIS outlined above.

74. The Wellington and Auckland superannuation advisory groups considered that there are a number of distinct issues raised with these schemes, including the need for an actuarial assessment of the funding of the scheme and the risks to members associated with their wind-up.

75. We agree that there is a case for treating defined benefit superannuation schemes differently to other CISs in a number of respects. For this reason we propose a transitional structure that would continue to apply to all existing defined benefit superannuation schemes in the "Defined Benefit Superannuation Schemes" part of this discussion document. Various features of that structure would also apply to any new defined benefit superannuation scheme.

3.3.6 Participatory Securities

76. We consider that most schemes that offer participatory securities to the public will fit within the proposed definition of CIS.

77. However, we recognise that:

- Not all of the requirements for CISs will be appropriate to all schemes that currently come within the definition of "participatory security"; and
- products may be developed in the future, or there may be some existing products, that are not equity securities, debt securities or CISs.

78. The regulation of participatory securities that fall within those two categories is discussed in the "Participatory Securities" part of this discussion document.

3.3.7 Life Insurance Policies with an Investment Component

79. The Law Commission's discussion paper on life insurance calls traditional whole of life and endowment policies and insurance bonds "savings policies" because they combine a savings arrangement and risk protection.[7]

80. The Commission's discussion paper on life insurance notes that:[8]

> *traditional whole of life and endowment policies have some similarity with superannuation schemes, where savings are often locked up for many decades before the product matures;*
>
> *insurance bonds have some similarity with superannuation schemes, unit trusts and group investment funds, each being a kind of managed fund;*

81. The Commission's discussion paper on life insurance states that the Investment Savings and Insurance Association of New Zealand observed a decline in new business written for whole of life and endowment policies over the 10 years between 30 June 1992 and 30 June 2002. Consultation with the Wellington and Auckland CIS

[7] Law Commission *Life Insurance: A discussion paper*, Preliminary Paper 53, December 2003, Wellington, New Zealand, p 5.
[8] Above n 7, pp 5 and 6.

and superannuation advisory groups confirmed that such policies were still declining, with virtually no new business being written.

82. Due to these types of schemes being in decline we propose regulating existing policies and new policies separately.

3.3.7.1 Existing Policies

83. The following proposals for regulating life insurance policies with an investment component, and CISs with an insurance component, are based on how the offer was made to investors, and the relevant disclosures necessary for investors to make informed decisions.

84. We have received feedback from members of the insurance industry that life insurance policies with an investment component can be classified into two separate categories:

    a. where the life insurance policy and the investment component are offered by a life insurance company within one policy; or

    b. where the life insurance policy is a separate contract from the investment contract (whether this is offered by one company, a group of related companies, or unrelated companies).

85. In relation to existing policies with an investment component, we propose that where the products are:

    a. governed by one policy, that the regulatory requirements for life insurance (see the *Insurance* discussion document) apply, but that disclosure of the investment component of the life insurance policy must comply with the disclosure requirements prescribed for CISs (see the “Disclosure” part of the *Securities Offerings* discussion document); and

    b. governed by two separate contracts (one insurance and one investment), the requirements will depend on the structure/s of the entity offering the two separate contracts:

        - Where separate entities offer the separate contracts (whether related or not), that is, where the issuer of the life insurance policy is a separate entity from the issuer of the investment contract, the life insurance component will be subject to the regulatory requirements for life insurance (see the *Insurance* discussion document) and the investment component will be subject to the regulatory requirements for CISs (that is, the requirements set out in this document); and

        - Where one company offers both contracts, it is proposed that those contracts will be regulated in accordance with the requirements in paragraph 85(a) above, so that those existing companies are not put to the expense of setting up separate entities to govern each contract.

3.3.7.2 New Policies

86. Going forward, we propose that any new life insurance policies that have an investment component will be regulated in the same manner as set out in the first

bullet point of paragraph 85(b), that is, as if they were two separate contracts – one insurance and one investment, requiring the issuer of the insurance policy to be a separate entity from the issuer of the investment contract.

87. These policies will still be able to be bundled and sold together; however, as the interests of policyholders in life insurance and the interests of investors in CISs are different, they require different regulatory protections. Separating the two discrete products and entities will not only ensure accounting separation of product, but will also ensure that the separate interests of policyholders and investors are looked after through the appropriate supervisory framework, that is, prudential supervision by the supervisor for the insurance component, and trustee supervision by a CIS trustee/Commission for the investment component.

88. In light of the proposed new definitions for insurance and CIS it will almost always be clear what category most products or policies will fall within. However, for those products/policies designed in future that do not clearly come within the insurance or CIS definitions, it is proposed that the Commission, in conjunction with the prudential regulator, will have the power to declare with which regulatory regime a scheme or a policy must comply (see paragraph 53). Such a power will enable any products/policies designed in the future to be regulated appropriately (that is: the regulators will adopt a substance over form approach). However, because of the proposed new definitions, we consider this power will not be used very frequently.

Questions for Submission

Proposed definition of CIS

1. Do you consider the proposed definition of CIS meets the objectives for regulating CIS (refer paragraph 20)?

2. Do you consider the proposed definition captures the range of securities, schemes and policies that should be regulated similarly? That is, can you identify any securities, schemes or policies that would fall outside this definition that should be regulated the same as other CISs and therefore included in the definition?

3. Is there any part of the definition that you consider inappropriate? If yes, what part and why is it inappropriate?

4. Is the definition missing any elements? If so, what elements is it missing, and how would the missing element assist in defining CISs?

5. What securities, entities or schemes do you think currently come within the proposed definition of CIS, but should specifically be excluded from the definition of CIS, and why?

6. Do you consider the legal form or forms for CISs should be prescribed? Why/why not?

Superannuation schemes

7. Do you consider superannuation schemes should fall within the general definition of CIS or should they be regulated differently? What are the reasons for your view?

8. Do you consider employer-sponsored superannuation schemes should generally be regulated in the same way as other CISs? In particular, do you consider that employer

master trusts should be treated the same way as other CISs? Why?

9. What are the implications (including both benefits and costs) of regulating superannuation schemes in the same way as other CISs?

Life insurance with an investment component

10. In relation to existing policies:

    - In your experience, how many life insurance policies where the investment component is a separate contract are offered by (a) one company and (b) separate entities?

    - Do you consider the proposed regulatory treatment for existing policies/contracts is appropriate? Why/why not? If not, how should existing policies/contracts be regulated?

11. Considering the objectives for regulating CISs (see paragraph 20) and the objectives for regulating life insurance (see the *Insurance* discussion document), do you consider the proposed framework for regulating new policies is appropriate? Why/why not?

3.4 OVERSIGHT BY AN INDEPENDENT SUPERVISOR

3.4.1 Each CIS will have an Independent CIS Trustee as its Supervisor

89. We propose requiring every CIS to have an independent supervisory governance structure to supervise and monitor the scheme and the issuer.

90. We use the term “CIS trustee” to describe the entity that provides the supervision proposed under this structure.

91. This feature of the regulatory regime is discussed in the *Supervision of Issuers* discussion document.

3.4.2 The CIS Trustee will be Approved by the Commission and must Satisfy Entry Requirements

92. It is proposed that CIS trustees will be approved by the Commission upon satisfaction of entry requirements.

93. Approvals, entry and ongoing requirements of CIS trustees are discussed in the *Supervision of Issuers* discussion document.

3.4.3 Functions of the CIS Trustee

3.4.3.1 Current Functions of Trustees and Statutory Supervisors

94. Currently, trustees of superannuation schemes and unit trusts, and statutory supervisors of participatory schemes perform slightly different functions, although all are required to act in the best interests of members. The principal differences arise in the following aspects of supervision:

- In superannuation schemes, the trustee's other functions are to issue interests in a superannuation scheme,[9] to be responsible for administration and investment management;[10] and to hold scheme property on trust;
- For unit trusts, the trustee's other function is to hold scheme property on trust;[11] and
- For participatory schemes, the trust property is not vested in the statutory supervisor.

3.4.3.2 Proposed Functions of the CIS Trustee

95. The purpose of imposing supervision over CISs is to ensure there is appropriate supervision of the issuer and the scheme and, because investors are distant from the management of the scheme, to ensure that someone without an interest in the scheme and who is unrelated to the issuer is looking after the best interests of investors.

96. The proposed functions of the CIS trustee set out under this part are based on how the functions link into the role of the CIS trustee outlined under the trustee supervisory model.

97. As well as its functions under the trustee supervisory model,[12] it is proposed that the CIS trustee will have the following functions as part of its role to monitor and supervise issuers:

a. To act in the best interests of members, to act on their behalf and to fulfil all of the other duties of a trustee contained in the Trustee Act 1956 (the "Trustee Act") and at law;

b. To make the initial assessment whether an issuer meets the fit and proper entry requirements and, if it does, to recommend to the Commission that an issuer be approved (see paragraph 118(b)), and to monitor the issuer's ongoing compliance with the fit and proper requirements;

c. To negotiate the terms of the trust deed and the offer of securities with the issuer;

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[9] Section 2 definition of "Issuer" Securities Act 1978.
[10] Section 2 definition of "Trustees" and s 8 Superannuation Schemes Act 1989.
[11] Section 3(3) Unit Trusts Act 1960.
[12] The CIS trustee's supervisory role is discussed in the *Supervision of Issuers* discussion document.

d. To hold scheme property on trust separately from the other property of the CIS trustee or the issuer; and

e. To supervise the issuer and the scheme to ensure compliance with the terms of the trust deed and the terms of the offer and to seek appropriate remedies on behalf of investors for breaches by the issuer.

98. We propose that the CIS trustee will be a trustee in legal terms for every type of CIS, that is, that the CIS trustee will have the same liabilities for its acts and omissions in the performance of its functions and duties and the exercise of its powers as it would if it performed those functions and duties and exercised those powers as a trustee. This may raise some issues for CIS trustees of participatory schemes (that is, for those schemes currently supervised by a statutory supervisor): see paragraph 354 of the "Participatory Securities" part of this discussion document.

99. Note: we are not proposing to prescribe legal form or require CISs to have a trust structure: see paragraph 44. For those CISs that are not structured as a trust it is proposed the Commission will be able to grant an exemption from the requirement to hold scheme property on trust: see "The Commission's Power to Exempt a Person from Compliance with the Proposed CIS Regulatory Framework" at paragraph 355.

Questions for Submission

12. Do you consider the CIS trustee should be required to perform any other functions in addition to those set out above, or are there any that are inappropriate? Why?

13. Do you consider the CIS trustee should be liable for its acts and omissions in the performance of its functions as a trustee? Why/why not?

14. Will any of the proposed functions raise issues for the CIS trustee of a participatory scheme? If so, what are those issues and how do you consider those issues should be addressed?

3.4.4 Duties of the CIS Trustee

3.4.4.1 Current Duties of Trustees and Statutory Supervisors

100. The duties of a superannuation scheme trustee, unit trustee and statutory supervisor are contained in the common law, in legislation and in the express and implied terms of the deed. The current duties prescribed in the Unit Trusts Act and the Superannuation Schemes Act for trustees, and the 7th Schedule to the Securities Regulations for statutory supervisors are set out in Appendix 2.

3.4.4.2 Proposed Duties of the CIS Trustee

101. Imposing duties on the CIS trustee will ensure that the CIS trustee carries out its primary functions to monitor and supervise the scheme and the issuer and to act in the best interests of investors. We consider the proposed duties in paragraph 102 will meet the objectives for regulating CISs because they promote robust governance arrangements for CISs and ensure effective supervision of issuers by CIS trustees, thus reducing the risk of unfair or fraudulent conduct and ensuring the best interests of investors are looked after.

102. In addition to the duties at law preserved by section 13F of the Trustee Act (including, for example, the duties to exercise the diligence and care in managing the trust property as people of ordinary prudence and vigilance would use in managing their own affairs, and to act in good faith and in the best interests of all members) and the duties under the Trustee Act, it is proposed the CIS trustee will have the following duties:

    a. To ensure that, before it accepts an appointment to act as the CIS trustee, the CIS trustee has considered whether the issuer meets the fit and proper entry requirements and is registered or will be registered at the same time as the CIS trustee (see paragraph 127);

    b. To monitor and enforce issuer compliance with the ongoing fit and proper requirements, that is, to ensure that after initial approval the issuer continues to be competent and have the appropriate capacity to perform its functions and duties prudently (see paragraph 131);

    c. To monitor and enforce issuer compliance with its duties, the terms of the trust deed and the terms of the offer;

    d. To report to the Commission that it continues to satisfy the ongoing fit and proper entry requirements and to report statistical data (the CIS trustee's reporting requirements are discussed in the *Supervision of Issuers* discussion document);

    e. To comply with any reasonable requests for information about the scheme and/or the CIS trustee for the purposes of the proposed legislation from the Commission and to allow the Commission, or a person appointed by the Commission, to make inspections for the purposes of the proposed legislation;

    f. To hold scheme property in the name of the CIS trustee or a nominee. Any nominee would not be able to be the issuer of the scheme or under the control of the issuer of the scheme. Currently, the trustee of a superannuation scheme and the trustee of a unit trust are required to hold the scheme's property on trust.[13] However, where a trust deed permits, the unit trustee may nominate in writing one or more persons in whom the assets of the trust may be vested.[14] In respect of participatory schemes, the manager of the scheme is required to establish a bank account to be kept in the name of the scheme, and to ensure that all money received on behalf of the scheme is paid into that bank account as soon as practicable.[15] We consider that requiring the CIS trustee to hold scheme property on trust will meet the regulatory objectives because it will ensure consistent regulation applies across similar products. This duty will also ensure that scheme property is ring-fenced and therefore adequately protected, as it will be held separately from the property of the CIS trustee and the property of the issuer. The separation of scheme property reduces the scope for fraudulent activity to occur and increases protections for investors. However, we recognise that this requirement may not be practical for all types of CISs. For example, there may be some participatory schemes which have a

[13] Sections 43 and 47 Superannuation Schemes Act 1989 and s 3(3) Unit Trusts Act 1960.
[14] Section 6(1) Unit Trusts Act 1960.
[15] Clause 3(2), 7th Schedule, Securities Regulations 1983.

variety of assets and other scheme property which may not appropriately fit within the trust structure. It is proposed that this duty will be similar to that contained in section 3(3) of the Unit Trusts Act;

g. To not act on any direction of the issuer to acquire any property for the scheme or dispose of any property of the scheme if, in the CIS trustee's opinion, the proposed acquisition or disposal is manifestly not in the interests of the investors (see question 17 as to whether "manifestly not in the interests of investors" is the appropriate threshold). It is proposed that the CIS trustee will not be liable to the investors or to the issuer if it so refuses to act. This duty is another mechanism to ensure independence of the CIS trustee from the issuer, and to ensure that checks are placed on the issuer and that the scheme property and interests of investors are protected. It is proposed that CIS trustees are exempt from any liability for such decisions, so that, when necessary, they can make the "hard call" to protect scheme property and investors' interests, and they are not concerned that they may be held responsible if, in hindsight, their judgement was incorrect. It is proposed that this duty will be similar to that contained in section 12(1)(c) of the Unit Trusts Act;

h. To act on the directions of investors. This duty will be a change for current trustees of superannuation schemes. Under the Superannuation Schemes Act members do not have the ability to call a meeting of members or direct the trustee. We consider it is essential that, where sufficient numbers can be raised at a meeting of investors and, subject to the terms of the trust deed and the law, investors be given the right to say how the scheme is run. That includes requiring CIS trustees to act on the directions of investors. However, the CIS trustee will not always be required to act on the direction of investors – it is proposed that they will still have the power to apply to the court for directions where the CIS trustee is of the opinion that any direction given to it by investors conflicts with the trusts or any rule of law or is otherwise objectionable (see paragraph 106(h)). It is proposed that the duty to act on the directions of investors will be similar to that contained in section 18(2) of the Unit Trusts Act;

i. To notify the appropriate regulatory authority when appointed as a new CIS trustee. It is proposed that this duty will be similar to that contained in section 20(3) of the Unit Trusts Act; and

j. To hold personal profits and/or benefits (except remuneration) by the CIS trustee or principals/directors of the CIS trustee on trust for the benefit of members. It is proposed that this duty will be similar to that contained in section 26 of the Unit Trusts Act.

103. Under the Superannuation Schemes Act the trustee, as issuer, is responsible for the investment management of the scheme. It is not proposed that the CIS trustee will be required to assess investment manager performance, for example, whether an investment manager is meeting its benchmark – that will be one of the duties of the issuer. Under the trustee supervisory model, the CIS trustee supervises the issuer and the issuer is responsible for the management of the scheme. In the separation of functions between issuer and CIS trustee, it is therefore more appropriate for the issuer to assess investment manager performance. However, part of the CIS trustee's duty to monitor the terms of the trust deed and the terms of the offer will be to supervise the scheme to ensure that it is "true to label", that is, that the scheme's

assets are invested in accordance with the terms of the trust deed and the terms of the offer – including, for example, the scheme's objective. Where it is not, the CIS trustee will have a range of powers (see paragraph 155(d)) to ensure the scheme is "true to label".

- For example, an investor invests his/her money in a CIS on the basis that it is a low risk investment, and the investment manager then invests the scheme's assets in, for example, global equities. In that example, if the issuer did not ensure the investment manager's compliance with the investment strategy and the terms of the trust deed and of the offer, the CIS trustee would have a duty to enforce compliance, for example, by directing the issuer to ensure the investment manager complied with the terms of the trust deed and the terms of the offer. It is acknowledged that, especially for participatory schemes, it may not always be clear whether the scheme is performing in accordance with the investment strategy and objective for the scheme and therefore whether the issuer is complying with the terms of the trust deed and the terms of the offer. For the discussion on how investment performance of the scheme can be measured, see the paragraphs under the heading "Authorised investments" in the "Regulatory Controls" part of this discussion document.

Questions for Submission

15. Do you consider the CIS trustee should be required to perform any other duties in addition to those set out above, or are there any that you consider are inappropriate?

16. Do you consider the CIS trustee should be liable for its acts and omissions in the performance of its duties as a trustee? Why/why not?

    - Will any of the proposed duties raise issues for the CIS trustee of a participatory scheme? If so, what are those issues and how do you consider those issues should be addressed? For example, will the duty to hold scheme property on trust cause any issues or will all participatory schemes be able to hold scheme property on trust? If not, how should this be regulated to ensure the objectives for regulating CISs are met?

17. The CIS trustee's duty to not act on any direction of the issuer to acquire any property for the scheme or dispose of any property of the scheme is dependent on the CIS trustee's assessment of whether the proposed acquisition or disposal is "manifestly not in the interests of investors". A duty to not act only where the proposed acquisition or disposal is not "manifestly not in the interests of investors" is considerably less of a duty than its duty to act in the best interests of investors. However, on the other hand, issuers also need flexibility to manage the scheme and the investments, and should be allowed to operate without the CIS trustee challenging every acquisition or disposal of scheme property.

    - Is "manifestly" the appropriate threshold to trigger this duty? If not, what should be the appropriate threshold?

    - Is it clear what "manifestly not in the interests of investors" means? If not (and you consider "manifestly" is the appropriate threshold), how would you provide guidance on how to interpret the provision?

18. Do you consider investors should be able to call a meeting and require the CIS trustee to act on their directions? Why/why not?

3.4.5 Powers of the CIS Trustee

3.4.5.1 Current Powers and Rights of Trustees and Statutory Supervisors

104. The current powers and rights of a trustee of a superannuation scheme, unit trustee and statutory supervisor are contained in legislation (for example, the power to invest is prescribed in section 13A of the Trustee Act 1956) and in the express and implied terms of the deed.

105. The current powers and rights prescribed in the Unit Trusts Act and the Superannuation Schemes Act for trustees, and the 7th Schedule to the Securities Regulations for statutory supervisors are set out in Appendix 3.

3.4.5.2 Proposed Powers and Rights of the CIS Trustee

106. It is proposed that, in addition to all the powers at law in the Trustee Act and those negotiated and expressly stated in the trust deed, the powers of the CIS trustee will be:

a. To nominate one or more persons to hold the scheme property on trust. It is proposed that the CIS trustee would be jointly and severally liable with the nominated person for the performance of the duties and obligations imposed on the nominated person. This power gives the CIS trustee the flexibility to delegate its duty to hold the property to a nominated person, whilst either or both the CIS trustee and the nominated person could be held responsible for the performance of the nominated person's duties. Any nominee would not be able to be the issuer of the scheme or under the control of the issuer of the scheme. The requirement that the nominee is not the issuer or under the control of the issuer is another means of segregating the scheme property from the person managing the property, and therefore reducing the risk of fraudulent conduct. It is proposed that this power will be similar to that contained in sections 6 and 6A of the Unit Trusts Act;

b. To receive all notices and other communications relating to the scheme which investors are entitled to. This information is necessary for the CIS trustee so that it is kept informed about the activities of the issuer and the scheme, and assists the CIS trustee in its monitoring and supervisory role. It is proposed that this right will be similar to that contained in clause 2(1) of the 7th Schedule to the Securities Regulations;

c. To reasonably request information relating to the scheme, or to the business, property or the affairs of the issuer and to inspect or review, or appoint a person to inspect or review, the issuer's books and papers and all books and papers relating to the scheme. Apart from the reporting requirements from the issuer to the CIS trustee, this will be the main tool the CIS trustee uses to monitor the issuer and the scheme. This power may be used by the CIS trustee to examine whether the issuer is complying with ongoing fit and proper requirements and complying with its duties and the terms of the trust deed and of the offer. The

CIS trustee may, for example, use such a power to gather evidence to present to a meeting of members so that members are adequately informed about the scheme and can then make appropriate decisions about what actions to take, or the power may be used by the CIS trustee to gather information to use as the basis for its recommendation to the Commission that the issuer should be removed. It is proposed that the rights to request information and to make inspections will be similar to those contained in section 12(1)(b)(i) and (ii) of the Unit Trusts Act;

d. To require periodic reporting from the issuer to the CIS trustee. Currently periodic reporting requirements are not a statutory requirement, nor are they a term implied into trust deeds. Instead, it is a term that is generally negotiated between the trustee and issuer and set out in the trust deed or the deed of participation. The advantage of requiring the issuer to report periodically to the CIS trustee is that it would provide assurance to investors that issuers are subject to reporting requirements. It would also give CIS trustees an additional lever to obtain information from issuers. We do not propose prescribing a minimum reporting frequency. While minimum requirements would ensure that all issuers are subject to consistent minimum periodic reporting, it may result in a "one size fits all" approach, which may reduce the flexibility of each CIS trustee's supervision, and may make it more difficult for CIS trustees to negotiate higher (that is, more frequent than the statutory minimum) reporting standards. The appropriate periodic reporting obligations may differ for different products and issuers and may need to be dynamic to cope with changing circumstances and risks. By not prescribing the minimum reporting frequency each CIS trustee will be required to positively consider the appropriate minimum reporting frequency in the circumstances of a particular scheme and its issuer. We consider the CIS trustee will be able to specify a reporting regime for each issuer or scheme upon approval of the issuer and over time, as risks change. Further, the trustee supervisory model should provide assurance that there is regular reporting from issuers to trustees, as the appropriateness of each CIS trustee's monitoring systems, including minimum reporting systems, will be considered by the Commission when considering whether the CIS trustee meets the fit and proper entry requirements. The entry requirements for CIS trustees are discussed further in the *Supervision of Issuers* discussion document;

e. To require the issuer to summon a meeting of members. For example, the CIS trustee may wish to use this power to obtain directions from the members, or to get the members to vote on a resolution to remove the issuer. What will constitute a quorum at a meeting of members and the majorities that are required to pass a resolution (for example, to direct the CIS trustee) at a meeting are discussed in the "Regulatory Controls" part of this discussion document. Under the Unit Trusts Act the unit trustee has the power to "request" the issuer to summon a meeting. However, we consider that a stronger obligation is required if the CIS trustee, who acts on behalf of members and in their best interests, wishes to call a meeting of members. Where the matter to be raised at the meeting concerns, for example, breach by the issuer and/or a resolution to remove the issuer, we do not consider the issuer should be allowed to decline the CIS trustee's request to summon a meeting of members. It is proposed that the power of a CIS trustee to summon a meeting will be

similar to that implied into all unit trust trust deeds by section 12(1)(d)(i) of the Unit Trusts Act;

f. To attend and be heard at a meeting of members of the scheme. This is a fundamental right which allows the CIS trustee to communicate with the members of the scheme – for example, by keeping the members informed about relevant matters. It is proposed that this right will be similar to that contained in clause 2(2) of the 7th Schedule to the Securities Regulations;

g. To nominate a person to chair a meeting of members, where that meeting was requested by the CIS trustee or members. This power is essential to ensure a meeting, which was not initiated by the issuer and therefore may be contentious by nature, is run fairly. It is proposed that this power will be similar to that contained in section 18(1) of the Unit Trusts Act;

h. To apply to the High Court for directions where the CIS trustee is of the opinion that any direction given to it by the members conflicts with the trusts or any rule of law or is otherwise objectionable. It is proposed that this power will be similar to that contained in section 18(4) of the Unit Trusts Act;

i. To direct or order the issuer to comply with the terms and conditions of its approval or the fit and proper requirements, or to comply with its duties or with the terms of the trust deed or of the offer, within a specified time frame. For example, a direction to act, an order prohibiting the issuer from acting, an order imposing terms or conditions on the issuer or on the operation of the scheme, or an order that no more members be accepted into the scheme. Such a direction may be in greater or lesser degrees of specificity – for example, the CIS trustee may, if it sees fit, direct the issuer as to *how* to fix the breach. As the supervisor of the issuer and of the scheme this power will be one of many the CIS trustee has to enforce the issuer's compliance with the ongoing fit and proper requirements (see paragraph 142(b)) or with its duties (see paragraph 155(d));

j. To take an action to the High Court on behalf of members to seek a remedy for breach by the issuer of any of its duties or the terms of the trust deed or of the offer. For example, the court may order the issuer to pay compensation for loss arising from the breach, direct or order the issuer to comply with its obligations, or make other orders. Currently, section 49 of the Securities Act permits a trustee or statutory supervisor to apply to court for orders where it is of the opinion that "the provisions of any deed relating to the securities are no longer adequate to give proper protection to the security holders". In this situation, amongst other orders, the court may order that the provisions of the deed be amended; that restrictions be imposed on the issuer; direct the issuer or the trustee or statutory supervisor to convene a meeting of security holders; or give such other directions as the court considers necessary to protect the interests of security holders, other holders of securities of the issuer, any guarantor of the securities or the public.[16] We seek your comment on the orders that the court should be able to make against an issuer for breach by the issuer of its duties, or the terms of the trust deed or of the offer;

[16] Section 49(3) Securities Act 1978.

k. To recommend to the Commission that further directions are necessary to ensure issuer compliance with the ongoing fit and proper requirements, or to recommend that the issuer should be removed, where an issuer has failed to comply with any direction or order given by the CIS trustee in relation to its satisfaction of the ongoing fit and proper requirements. It is proposed the CIS trustee would only be able to recommend that the issuer should be removed where the issuer has breached (and has not remedied within the given timeframe) the ongoing fit and proper requirements;

l. To apply to the High Court in certain circumstances (for example, where it is inexpedient or difficult or impracticable to manage or administer the scheme property) for additional powers of management or administration in relation to scheme property. This power allows the CIS trustee to apply to the court so that it can have the powers necessary to carry out its functions. Whilst any additional powers should have been negotiated in the trust deed, it is often hard to predict in advance all the powers a CIS trustee may need to carry out its functions. This power does allow the CIS trustee to circumvent the consent of members to what would otherwise be an amendment to the trust deed, however, in this case the court will be able to consider the best interests of members and the necessity of having the additional power granted to the CIS trustee. The ability to apply to the High Court for certain powers of management would not be a means of circumventing the normal process for increasing its powers, rather it is intended to be used for the limited purposes set out in the provision. It is proposed that this power will be similar to that contained in section 22(1) of the Unit Trusts Act;

m. To apply to the High Court to assess damages against a delinquent director or other officer of the issuer if, in the course of winding up the issuer, it appears that the issuer has misapplied or retained or become liable or accountable for any money or property of the scheme, or committed any misfeasance or breach of trust in relation to the scheme. It is proposed that this power will be similar to that contained in section 27 of the Unit Trusts Act; and

n. To amend the trust deed. See the discussion on “Amendments to the Trust Deed” in the “Regulatory Controls” part of this discussion document.

107. The proposed powers for CIS trustees are those that we consider are the minimum powers a CIS trustee needs to perform its supervisory role. CIS trustees and issuers will also be able to negotiate other additional or greater powers as they consider necessary for the particular scheme. These powers will be stated in the trust deed.

Questions for Submission

19. Do you consider the CIS trustee should have any other powers in addition to those set out above, or are there any that you consider inappropriate?

20. Do you consider the CIS trustee should be liable for its acts and omissions in the exercise of its powers as a trustee? Why/why not?

- Will any of the proposed powers raise issues for the CIS trustee of a participatory scheme? If so, what are those issues and how do you consider those issues should be addressed?

21. Do you consider CIS trustees should have a statutory power to require periodic reporting from the issuer? If no, why?

22. What directions or orders do you consider the court should be able to make for breach by the issuer of its duties, the terms of the trust deed or the terms of the offer (refer paragraph 106(j))?

3.4.6 Breach by the CIS Trustee of its Obligations Owed to Investors

108. This section discusses what happens if the CIS trustee is not performing its duties or has breached a term of the trust deed. It discusses who can enforce the performance of the CIS trustee's obligations and the proposed remedies available. This section does not cover the CIS trustee's breach of its obligations as a supervised entity under the trustee supervisory model (for example, the CIS trustee's breach of the ongoing fit and proper requirements). Instead, that is discussed in the *Supervision of Issuers* discussion document.

109. In the event the CIS trustee breaches any of its duties owed to investors or the terms of the trust deed the CIS trustee will be liable to investors. The proposed remedies are in addition to those available under general trust law and the Trustee Act for breach by the CIS trustee of its duties. It is proposed that:

a. Investors will be able to call a meeting of investors to consider what actions to take against the CIS trustee for breach of its duties or for breach of the terms of the trust deed (see the discussion on "Meetings" in the "Regulatory Controls" part of this discussion document as to the numbers required to call a meetings);

b. Investors will be able to direct the CIS trustee (for example, to perform its duties or other obligations) or order the CIS trustee to be removed if the members obtain the appropriate threshold at a meeting of members (see the discussion on "Meetings" in the "Regulatory Controls" part of this discussion document as to quorum and the thresholds for investor resolutions). We consider it is essential that, where sufficient numbers can be raised at a meeting of investors, investors be given the right to have some control over the scheme and the CIS trustee to ensure the CIS trustee performs its duties;

c. Investors will be able to take an action to court to seek compensation for loss caused by a breach by the CIS trustee of any of its duties or the terms of the trust deed. However, this may be extremely costly for an individual investor to pursue or difficult for individual investors to get the numbers required at a meeting of members to take a collective action against the CIS trustee;

d. The Commission will have the power to request information from the CIS trustee for the purposes of the proposed legislation and inspect or review the records and books of the CIS trustee or the scheme for the purposes of the proposed legislation. These powers are necessary to ensure the Commission has sufficient information to carry out its supervisory function effectively;

e. The Commission will have the power to direct or order the CIS trustee to comply with the terms of the trust deed or its duties owed to investors. It is proposed that the Commission will exercise this power where the Commission is of the

opinion that the CIS trustee has breached or may breach any of its obligations owed to investors. We consider the Commission should only be able to exercise its power to direct the CIS trustee to comply with the terms of the trust deed or its duties if it is in the public interest and to do so is necessary for the protection of investors:

- It is proposed that where a CIS trustee acts on the directions of the Commission it will be indemnified against any liabilities in complying with those directions. This will give protection to the CIS trustee who would otherwise be acting against its will;

f. The Commission will be able to take an action to court against the CIS trustee to seek compensation for investors, to seek civil pecuniary penalties or to order or direct the CIS trustee (for example, to comply with its obligations). In light of the fact that investors may find it difficult to get the numbers to call a meeting or pass a resolution, or expensive or inequitable for an individual or several members to take an action against the CIS trustee (it may be inequitable, for example, if one or a handful of investors bear the cost of litigating against the CIS trustee, but the successful result of such litigation will benefit all members of the scheme) we consider there may be some public interest in the Commission taking an action to court. Currently, there is no ability for the Commission to take a collective action against a trustee. However, there is precedent for this in the Securities Legislation Bill. If implemented, the Bill will permit the Commission, where appropriate, to apply to the court for a civil pecuniary penalty order if an event materially prejudices the interests of subscribers for the securities involved; is likely to materially damage the integrity or reputation of any of New Zealand's securities markets; or is otherwise serious.[17] We consider a high threshold is necessary for the protection of CIS trustees, and propose that the Commission should only be able to take an action to court to seek a civil pecuniary order or other orders/directions against a CIS trustee for similar circumstances to those proposed in the Securities Legislation Bill: that is, for a serious breach. We seek your comment on the directions and/or orders that the court should be able to make against the CIS trustee for breach by the CIS trustee of its duties or the terms of the trust deed. In addition, there is precedent for the Commission to apply for compensatory orders in the Securities Legislation Bill. It is proposed that the court will have the power to order the CIS trustee to pay compensation to all investors who have suffered loss or damage by reason of the CIS trustee's breach of the terms of the trust deed or for breach of duty.

110. Under paragraphs 109(c) and 109(f) it is proposed that the High Court, on the application of either an investor or the Commission, will have the ability to grant a remedy for breach by the CIS trustee of its obligations owed to investors. In addition to the remedies set out in those paragraphs, we seek your comment on what other remedies may be appropriate for the court to grant where the CIS trustee has breached its duties owed to investors or the terms of the trust deed. For example, should the court also be able to grant an injunction or specific performance, or remove the CIS trustee? For example, the court may give an order that the CIS trustee be removed where the Commission proves the CIS trustee acted in bad faith or was grossly negligent.

[17] Clause 4, Securities Legislation Bill.

Questions for Submission

23. Do you consider the proposed remedies for breach by the CIS trustee of its duties are appropriate? Why/why not?

24. Currently, members of a superannuation scheme do not have the ability to call meetings and/or direct trustees. Do you consider members should have the ability to call meetings and/or direct CIS trustees? Why/why not?

25. What directions or orders do you consider the court should be able to make for breach by the CIS trustee of its duties or the terms of the trust deed?

3.5 THE ISSUER

111. This part discusses registration of the issuer and the fit and proper entry and ongoing requirements that issuers of CISs will be required to meet. This section then discusses the proposed functions, duties and powers of the issuer, and the remedies for breach of the issuer's duties owed to investors.

3.5.1 Issuers will be Registered

112. New Zealand is a signatory to the Financial Action Task Force ("FATF") Recommendations.[18] Recommendation 23 of the FATF Recommendations requires that directors and senior management of financial institutions subject to the Core Principles (the banking, insurance and securities sectors) should be evaluated on the basis of "fit and proper" criteria, including those relating to expertise and integrity. A CIS issuer is a financial institution for the purposes of the FATF Recommendations.

113. In order to comply with FATF Recommendation 23, New Zealand is required to have a comprehensive supervisory framework for financial institutions. To have such a framework we need to be able to identify the financial institutions. Currently some financial institutions do not have to be registered or may only have to register a prospectus.

114. In relation to registration of financial institutions, it is being proposed that the Companies Office would receive registration information from financial services providers (including issuers of CISs), carry out negative assurance checks and liaise with the Commission. It is proposed that issuers of CISs will be subject to a qualitative "fit and proper" assessment by the CIS trustee (see paragraph 127). The CIS trustee will then provide a recommendation to the Commission that the applicant should be approved as an issuer. The Commission will then have the discretion to determine whether or not to approve an issuer.

115. An applicant would not be registered as an issuer until it has completed both processes: that is, until the Registrar of Companies is satisfied with the negative assurances provided by the issuer and the Commission has approved the applicant as an issuer. For the objectives of the registration system and the preferred

[18] New Zealand is a signatory to (and must ensure compliance with) the FATF Recommendations. The Financial Sector Assessment Programme ("FSAP") report on compliance with FATF Recommendation 23 is attached at Appendix 4.

registration option, see the *Overview of the Review and Registration of Financial Institutions* discussion document.

3.5.2 The Issuer must Satisfy Fit and Proper Entry and Ongoing Requirements

116. As part of the registration process, issuers will be required to satisfy fit and proper entry requirements and continue to satisfy them on an ongoing basis.

117. The purposes of the fit and proper entry and ongoing requirements include:

a. The application of minimum regulatory and governance standards to issuers of CISs which promotes the protection of investors' interests;

b. They provide a "hygiene test" such that issuers of CISs are required to have honest and competent management who are held accountable, thus helping to reduce the risk of fraudulent conduct and to reduce the possibility of breach by an issuer of its duties and obligations;

c. They require issuers to be competent and have capacity to carry out their functions; and

d. They will enable New Zealand to comply with international standards and its international obligations, namely, Recommendation 23 of the FATF Recommendations (above) and Principle 17 of the International Organisation of Securities Commission ("IOSCO") Principles.[19] The Financial Sector Assessment Programme ("FSAP") considered New Zealand's compliance with IOSCO's Principles. Principle 17 states that the regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme. The FSAP report commented that Principle 17 was "Not Implemented" in New Zealand. The FSAP report noted:

> *Several commentators advised the mission team that the operation of CIS in New Zealand is an area of concern, and that reform is needed. Reliance to some extent on supervision of CIS operators by trustees can be a cost-effective regulatory method. Certain improvements to the scheme, however, could reduce risks and enhance compliance. Possible reforms could include:*
>
> *…*
>
> *(2) high level minimum entry and ongoing standards concerning CIS operators' honesty and integrity, competence, financial capacity, internal controls, powers and duties.*

3.5.3 The Commission will Approve Issuers

118. In relation to entry requirements, it is proposed that:

a. An issuer will provide information to the CIS trustee demonstrating how it meets the fit and proper requirements (set out at paragraph 127) and will provide negative assurances to the Registrar of Companies;

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[19] The FSAP report on compliance with IOSCO Principles 17 to 20 (relating to collective investment schemes) is attached at Appendix 4.

b. The CIS trustee will make the initial assessment as to whether an issuer satisfies the qualitative fit and proper entry requirements and, if it does not meet all of the requirements, inform the issuer of the particular fit and proper entry requirements that it does not meet. The issuer will be able to present further information to the CIS trustee demonstrating the requirements that it initially failed;

c. Upon the CIS trustee's satisfaction that the issuer meets the entry requirements, the CIS trustee will recommend to the Commission that the issuer be approved; and

d. The Commission will exercise its discretion and provide a final determination of whether or not to approve the issuer. The Commission's final determination is another check which ensures that CIS trustees take a consistent approach in applying the entry requirements to issuers. It will also reduce the risk that:

- Issuers will attempt to "trustee shop" to find a trustee to supervise the issuer where other potential CIS trustees have considered that the issuer does not meet the entry requirements and refused the appointment; or

- Where issuers do "trustee shop" that there is a final independent check to ensure that consistent standards apply to all issuers.

119. The fit and proper entry requirements (see paragraph 127) will not limit the scope of the Commission's approval process. That is, the Commission will be able to place terms and conditions on an issuer's approval as it sees fit.

120. Given the consequence of failing to meet the fit and proper requirements (that is, an applicant will not be approved as an issuer and will not be able to offer securities to the public), it is important that applicants have some protections. However, it must also be borne in mind that we do not want undesirable issuers or issuers without the necessary competence and capacity offering securities to the public and there should be some degree of finality in a determination made by the Commission. If the Commission determines that the applicant does not meet the entry requirements the Commission must give the applicant its reasons for making that determination. We seek your comments on the process that you consider should be followed in the event an applicant is declined approval by the Commission. Should it be able to present further information to the CIS trustee or to the Commission, or should the applicant be allowed to appeal the decision to the High Court?

3.5.3.1 How Registration and Approval Work Together

121. To illustrate how registration and approval will work together in practice, an issuer will apply to register the first offer document in respect of a product. If the issuer is not already registered as a financial institution, this would trigger the Companies Office to seek the necessary information on the issuer, and carry out negative assurance checks. Once these checks are completed, the Companies Office would refer the information to the Commission to carry out the qualitative fit and proper checks: see paragraph 127. As part of the approval process, the Commission will be required to seek a recommendation from the CIS trustee selected by the issuer as to whether, in its opinion, the issuer satisfies the fit and proper entry requirements. Where the Commission was satisfied that the issuer satisfied the fit and proper entry requirements it would advise the Companies Office that the issuer was approved and

the Companies Office would register the issuer under the relevant category of financial services provider.

122. To retain flexibility in the registration regime, an issuer may first wish to approach the CIS trustee and the Commission for pre-approval of the qualitative fit and proper requirements to give it certainty before it applies to register the offer document and as a financial institution.

3.5.4 Fit and Proper Requirements: Issuers must be Competent and have Capacity

123. To gain and maintain its approval an issuer will need to demonstrate to the CIS trustee that it satisfies the fit and proper entry requirements, that is, that it is competent and has the appropriate capacity to perform its functions.

124. The proposed entry requirements will need to be flexible so that they can be tailored to suit the particular type of issue or scheme. Issuers will be required to demonstrate to the CIS trustee the particular competency and capacity requirements necessary to issue interests in and manage a particular type of issue or scheme. For example, the issuer of a racehorse syndicate may be required to have different knowledge and experience than would the issuer of a unit trust. Ultimately the Commission will exercise its discretion to determine whether a particular applicant is competent and has the appropriate capacity to offer and issue interests in a CIS to the public and to perform its other functions.

125. The proposed requirements are based on the current criteria that the Commission uses to decide whether to approve a trustee or a statutory supervisor under section 48(3) of the Securities Act[20] and from our discussions with the Wellington and Auckland CIS advisory groups.

126. We need to consider what requirements should be prescribed in the primary legislation, what (if any) should be in regulations, and what (if any) should be left to the CIS trustee's discretion. In order to fulfil FATF obligations, a certain level of detail around the fit and proper requirements will be need to be prescribed in legislation. However, there needs to be a balance between certainty and flexibility – to have all requirements in primary legislation would provide the greatest level of certainty, but would be inflexible and more difficult to change. An approval system which gave total discretion to the CIS trustee and the Commission would be flexible and adaptable, but would lack transparency for issuers. It may also mean that the bar would be set too high, as the CIS trustee may be too risk-averse and may not recommend approval to the Commission, at the expense of a competitive market.

127. To ensure issuers have the competency and capacity to perform their functions and duties prudently, we propose requiring an issuer to demonstrate to the CIS trustee the following fit and proper entry and ongoing requirements:

    a. The appropriate skills, qualifications and experience of management (at both the individual director/board member level, and the entity (for example, company) level);

[20] A copy of the Securities Commission's policy for approval of trustees and statutory supervisors can be found at http://www.sec-com.govt.nz/notices/trustees/index.shtml#policy.

b. Ensuring that adequate infrastructure and organisational (including governance), accounting, computer and operating systems are in place; and

c. Ensuring appropriate levels of capital to enable the issuer to carry out its functions (i.e. administration and investment management) and to manage an orderly wind-down of its services and the scheme should it face financial difficulty.

128. It is proposed that the issuer's competence and capacity requirements could be outsourced to other parties (for example, to an administration or investment manager). In that case, the issuer would be required to confirm to the CIS trustee/Commission that the agent has the relevant competence and capacity to perform the outsourced component of the issuer's functions. It would also be a term of the issuer's approval that the issuer monitored the agent.

129. It should be noted that as part of the trustee supervisory model the CIS trustee is required to be independent of the issuer. This is not a requirement that the issuer must prove. However, as part of its approval a CIS trustee would not be able to take on an appointment where it was not independent from the issuer.

130. The fit and proper requirements in paragraph 127 are in addition to the negative assurances an issuer must provide to the Companies Office as part of the registration process (see paragraph 114).

Questions for Submission

26. Do you consider any of the fit and proper entry and ongoing requirements are inappropriate? Why?

27. Do you consider issuers should be required to comply with any other fit and proper entry and ongoing requirements? Why?

3.5.4.1 CIS Trustees will Monitor Issuers' Compliance with the Ongoing Fit and Proper Requirements

131. We consider that, once approved, and to maintain the integrity of the trustee supervisory model, the CIS trustee will be in the best position to receive information from the issuer and monitor its compliance with the ongoing fit and proper requirements. It is the CIS trustee who has the primary relationship with the issuer, both initially in relation to the setting up of the offer and trust deed, and then on an ongoing basis. Many trustees already carry out such fit and proper person vetting before they take on an appointment.

132. It is therefore proposed that the issuer will be responsible for informing the CIS trustee if there has been a change in circumstances which may result in the issuer no longer meeting the fit and proper requirements (see the fit and proper requirements at paragraph 127 and the reporting requirements at paragraph 136).

133. If the CIS trustee determines that the issuer no longer meets the fit and proper requirements, the CIS trustee will have a range of powers (set out at paragraph 142) to ensure the issuer's compliance with the fit and proper requirements and the terms and conditions on which the issuer was approved.

134. If the issuer ignores the CIS trustee and is still in default the CIS trustee must report that determination to the Commission.

135. The Commission will have a range of powers (set out at paragraph 143) to ensure issuer compliance with the ongoing fit and proper requirements, and it will provide a final determination of whether the issuer continues to meet the fit and proper requirements. If the Commission determines that the issuer does not, then the issuer's approval will be revoked and the issuer will be de-registered. See paragraph 144 for discussion on whether issuers should be allowed to appeal to the High Court the Commission's decision to revoke its approval.

Questions for Submission

Approval

28. Do you agree the CIS trustee should recommend approval of a particular issuer to the Commission, with the final determination resting with the Commission? Why/why not?

29. What process do you consider should be followed in the event an issuer is declined approval by the Commission? Should it be able to present further information to the CIS trustee or to the Commission, or should the issuer only be allowed to appeal the decision to the High Court? If the latter, on what grounds should an appeal be provided? What other process do you consider would be appropriate?

Ongoing monitoring

30. Do you agree the CIS trustee should monitor the ongoing fit and proper requirements of the issuer, and report to the Commission where the CIS trustee determines that the issuer no longer meets the fit and proper requirements? Why/why not?

31. Do you agree the final determination as to whether the issuer continues to meet the fit and proper requirements should lie with the Commission? Why/why not?

3.5.4.2 The Issuer will be Required to Report to the CIS Trustee

136. This section discusses the issuer's requirement to report to the CIS trustee to ensure the ongoing fit and proper requirements are met. The issuer will also be required to report to investors and the CIS trustee regarding the performance of its duties and powers and the affairs of the scheme, and report statistical data to the Commission. These requirements to report are discussed at paragraphs 150(n) to (p).

137. To ensure that the CIS trustee has sufficient information to monitor the fit and proper requirements of the issuer, the issuer will be required to report to the CIS trustee:

    a. When any matter material to its approval changes (event based reporting); and

    b. On a periodic basis, to confirm the fit and proper requirements continue to be met (i.e. that it continues to be competent and have the appropriate capacity to perform its functions and duties prudently) and that it is actually performing its functions and duties (periodic reporting).

Event based reporting

138. There will be a requirement that the issuer self-report to the CIS trustee upon the occurrence of any breach of the issuer's particular approval requirements, and how the issuer is addressing the breach.

139. Any material changes to the issuer's approval that falls short of a breach of an entry requirement will also need to be reported to the CIS trustee.

Periodic reporting

140. The periodic reports will provide the CIS trustee with information demonstrating that the issuer continues to satisfy the fit and proper entry requirements: see the CIS trustee's proposed power to require periodic reporting at paragraph 106(d).

Question for Submission:

32. Do consider the proposed reporting requirements are appropriate? Why/why not?

3.5.5 Breach by the Issuer of the Ongoing Fit and Proper Requirements

141. An issuer will be found in breach if it breaches the fit and proper requirements after its initial approval, or if it breaches the terms and conditions attached to its approval. For example, if an issuer was approved on the basis of one director's specialist area of experience, and that director resigned, there may be a breach of the fit and proper requirements if the replacement director does not have (or other directors between them do not have) that specialist area of experience. Another example of a breach of the fit and proper requirements would be where an issuer failed to comply with reporting obligations (for example, if the issuer was late with its reporting obligations to the CIS trustee).

142. It is proposed that the CIS trustee will have a range of powers to deal with the issuer's breach of the ongoing fit and proper requirements. The response necessitated will depend on the severity of the breach – being a week late with a periodic report should not incur the same penalty as, in an extreme example, failure of an issuer to report to the CIS trustee that it no longer had the capacity to carry out any of its functions. We consider there needs to be a graduated system of mechanisms and penalties for dealing with breaches. It is proposed that the CIS trustee will have the powers to:

    a. Request information from the issuer and, where necessary, to carry out, or appoint a person to carry out, inspections or reviews. For example, if a report is late the CIS trustee would be able to seek an explanation from the issuer. If the CIS trustee was not satisfied with the explanation, it could question the issuer about it: see paragraph 106(c);

    b. Issue directions or order the issuer to comply with the terms and conditions of its approval or the fit and proper requirements: see paragraph 106(i); and

    c. Refer the matter to the Commission, and recommend to the Commission that the Commission issue further directions or that the issuer's approval be revoked

where the issuer continues to be non-compliant with the fit and proper requirements: see paragraph 106(k).

143. In the event the issuer does not comply with the directions or orders of the CIS trustee, the Commission will have the powers to:

    a. Request information from the CIS trustee and/or the issuer and make inspections;

    b. Issue directions or order the issuer to comply with the terms and conditions of its approval or the entry requirements;

    c. Impose conditions on the issuer;

    d. Suspend the issuer from issuing any more securities; and

    e. Revoke the issuer's approval and de-register it. In practice, this will result in the removal of the issuer and will require the scheme to be wound up, unless another issuer steps into the shoes of the removed issuer. We seek your comments on what will happen in the event an issuer's approval is revoked.

144. Given the consequence of failing to continue to satisfy the fit and proper requirements (that is, revocation of the issuer's approval and deregistration), it is important that issuers have some protections and avenues for redress. If the Commission determines that the issuer does not meet or no longer meets the fit and proper requirements, it must give the issuer its reasons for making that determination. While the Commission's actions will be subject to judicial review, further protection could be afforded by an appeal process to the High Court. We seek your feedback on the appeal processes that an issuer can pursue if it is unhappy with a decision of the Commission.

Questions for Submission

33. Do you consider the proposed options for remedying a breach by the issuer of the fit and proper entry requirement are appropriate, or are there any that are inappropriate?

34. What appeal rights do you consider the issuer should have if the Commission determines that it no longer meets the fit and proper requirements? If you consider an issuer should be allowed to appeal a determination that it no longer satisfies the fit and proper requirements to the High Court, on what grounds should the issuer be entitled to appeal? What are your reasons?

35. Will there ever be a situation where another issuer will step in and take over as issuer where the issuer's approval has been revoked and it has been removed?

    - If so, what should happen?

    - If not, should the scheme be wound up?

3.5.6 Functions of the Issuer

145. The proposed functions set the scope for the issuer's duties and powers. They provide a general overview of the role of the issuer, and what we expect the issuer will do and will be responsible for.

146. It is proposed that the functions will be prescribed in the primary legislation.

147. Based on our discussions with the Wellington and Auckland CIS advisory groups, the proposed functions of the issuer will be:

    a. To offer and issue securities in the CIS (this is the same function as currently prescribed in section 3(2)(b) of the Unit Trusts Act);

    b. To adhere to the terms of the trust deed;

    c. Responsibility for investment management in accordance with the trust deed, and monitoring any investment manager. Although the issuer will be able to contract out the investment management function, the issuer will ultimately remain responsible for investment management;

    d. Administration and management of the scheme, and monitoring any administration or any other agents appointed by the issuer (again, the issuer will be able to contract out the administration management function, but will ultimately remain responsible for this function);

    e. To maintain robust systems and controls and to appropriately manage risk;

    f. Asset pricing; and

    g. To report to the CIS trustee (see paragraph 136) and to members of the scheme.

Question for Submission

36. Do you consider there should be any other functions for issuers in addition to those set out above, or are there any that you consider inappropriate? Why?

3.5.7 Duties of the Issuer

148. The current duties of issuers prescribed in the Unit Trusts Act, the Superannuation Schemes Act and the 7th Schedule to the Securities Regulations are set out in Appendix 5. The duties prescribed in these Acts are in addition to the duties negotiated with the trustee/statutory supervisory and which are stated in each scheme's trust deed/deed of participation.

3.5.7.1 Proposed Duties and Liability of the Issuer

149. In respect of CISs, we propose that the issuer will have the same liability for its acts and omissions in the exercise of its functions, duties and powers as it would if it

exercised those functions, duties and powers as a CIS trustee. We propose that this provision will be similar to the liability of the manager of a unit trust under section 24(1) of the Unit Trusts Act 1960.

150. The proposed duties of the issuer will be:

a. To appoint a CIS trustee who is registered or will be registered at the same time as the issuer;

b. To use its best endeavours and skill to ensure that the scheme is carried on in a proper and efficient manner. Because investors do not have day-to-day control over the operation of the scheme or of the issuer, it is important that issuers observe a high standard when operating the scheme. This duty focuses the issuer's mind that it must actually use its best endeavours and skill. Without such a duty it could be easy for an issuer to be negligent or reckless in operating the scheme or dealing with scheme property. (This provision is the same as the manager's duty implied in every unit trust trust deed by section 12(1)(a) of the Unit Trusts Act, and similar to the manager of a participatory scheme's duty implied by clause 3(1)(a) of the 7th Schedule to the Securities Regulations);

c. To use the same care and diligence in the exercise and performance of its functions, powers and duties as it would if it exercised those functions, duties and powers as a CIS trustee. This is similar to the liability imposed on the manager of a unit trust and the manager of a participatory scheme.[21] This imposes a higher duty on the issuer. We consider that this higher duty is justified because of the characteristics of investors in CISs and because they do not have any day-to-day control of the scheme or the issuer. Investors are therefore entirely reliant on issuers acting in the best interests of investors when they make decisions that concern the scheme or scheme property. Without such a duty an issuer may be inclined to act in its own best interests, take risks that it may not take if it was investing its own money, make decisions that could adversely affect investors or become passive in monitoring the investment manager such that it is negligent in the performance of its duties;

d. To pay out, invest and apply scheme property in accordance with the terms of the trust deed or the constitutional document. It is proposed that this will be a similar provision to that currently contained in clause 3(1)(d) of the 7th Schedule to the Securities Regulations. This is discussed in the "Regulatory Controls" part of this discussion document;

e. To provide information relating to the affairs of the scheme to members at a meeting of the scheme, where a member has given reasonable notice requesting such information. This duty allows members to be provided with relevant information about the scheme and the issuer, and enables investors to make informed decisions about the scheme (for example, to direct the issuer to act) or for themselves individually (for example, to exit the scheme). It is proposed that this duty will be similar to that contained in clause 3(1)(e) of the 7th Schedule to the Securities Regulations;

[21] Clause 3(3), 7th Schedule, Securities Regulations 1983 and s 24(1) Unit Trusts Act 1960.

f. To ensure reporting requirements specified in the legislation are met (for example, keeping proper books of account and having them audited periodically). It is proposed that this duty will be similar to that contained in section 13 of the Superannuation Schemes Act;

g. To register any documents required to be registered with the regulator (for example, the prospectus and the financial statements of the scheme);

h. To maintain a website, containing the information required to be uploaded on its website. We acknowledge that not all issuers would have websites to promote their products, however the CIS and superannuation advisory groups did not consider it unreasonable to require issuers to have a website (see the paragraphs in section 4.2.5.1 under the heading "Internet Access – on Issuer's Website" in the "Disclosure" part of the *Securities Offerings* discussion document);

i. To pay or pass to the CIS trustee all money and other scheme property received by the issuer in respect of purchases of or subscriptions for interests in the securities. This duty ensures the issuer is accountable for any monies and other scheme property it receives from investors. It is proposed that this will be a similar provision to that currently set out in section 14 of the Unit Trusts Act. Upon receipt by the issuer, scheme property will be subject to the trusts governing the security. It is proposed that this will be a similar provision to that currently set out in section 15 of the Unit Trusts Act;

j. To hold personal profits and/or benefits (except remuneration) by directors of the issuer on trust for the benefit of members. Even where an action is in the best interests of investors an issuer cannot profit from the use of the scheme property. Instead, it must hold any profits on trust for the benefit of investors. It is proposed that this will be a similar provision to that currently set out in section 26 of the Unit Trusts Act;

k. To provide the CIS trustee with a copy of all notices and such other communications relating to the scheme as any member is entitled to receive. It is proposed that this will be a similar provision to that currently set out in clause 2(1) of the 7th Schedule to the Securities Regulations;

l. To provide the CIS trustee with such information as it reasonably requests relating to the scheme, or to the business, property or the affairs of the manager or its compliance with the ongoing fit and proper requirements, and to allow the CIS trustee, or a person appointed by the CIS trustee, to inspect or review the issuer's books and papers and all books and papers relating to the scheme. This information is necessary for the CIS trustee so that it can inquire into particular matters where periodic reporting may not address an issue or may not go far enough. It also ensures the CIS trustee is kept informed about the activities of the issuer and the scheme, and assists the CIS trustee in its monitoring and supervisory role. It is proposed that this will be a similar provision to that currently set out in section 12(1)(b)(i) and (ii) of the Unit Trusts Act;

m. To call a meeting of members when so requested by the CIS trustee or the members. It is proposed that this will be a similar provision to that currently set out in section 12(1)(d)(i) of the Unit Trusts Act;

n. To report to the CIS trustee that the ongoing fit and proper requirements continue to be met and on the performance of its duties and powers and the affairs of the scheme as specified in the trust deed;

o. To report statistical data to the Commission. Such a requirement is based on the requirement under the Superannuation Schemes Act to provide statistical data contained in superannuation schemes' current annual reports to the Government Actuary. Such statistical data contributes to a high-level overview of the financial sector, which is of interest to both the industry and government policy-makers. We received feedback from the CIS and superannuation advisory groups that statistical information is in fact currently at the managers' fingertips and readily extracted from their system at any given month or quarter end. However, it is recognised that the gathering of statistical data is not without cost, so any requirement needs to be put in place only after careful consideration of, for example, the necessity of the information, and who is the best source of the information. It is proposed that the statistical data would be collated and made publicly available on the Companies Office website. It is likely that there will be a distinction between data that will be made public and data (particularly commercial data) given in confidence that will be kept private. The data that is made public will generally be amalgamated with that of other issuers to provide an overview of the whole sector;

p. To report to investors. To keep investors informed about their investments and so that investors can monitor the management of their investments it is proposed that issuers send an annual statement to members. Amongst other things, the statement would contain information about the investor's opening and closing value of investment, any contributions made by the investor (or a third party), all fees deducted, investment earnings, any withdrawals, benefits payments, redemptions and the value of the investment on withdrawal or redemption (see the paragraphs in section 4.4.6.3 under the heading "Requirement to Send Annual Statement to Investors" in the "Disclosure" part of the *Securities Offerings* discussion document for further discussion and questions on the content of the annual statement); and

q. To comply with the law and any requests or directions from the CIS trustee and/or the Commission.

151. We consider the proposed duties are the minimum obligations that should be imposed on issuers so that they are appropriately able to carry out their functions (including administering and managing the scheme). CIS trustees and issuers will also be able to negotiate other or higher duties as they consider necessary for the particular scheme (for example, the additional obligations imposed on issuers of a listed unit trust). These duties will be stated in the trust deed for the scheme.

Questions for Submission

37. Do you consider there should be any other issuer duties in addition to those set out above, or are there any that you consider inappropriate? Why?

38. Do you consider the issuer should have the same liability for exercising its functions and powers as if it were a trustee? That is, do you consider a higher duty should be imposed on issuers? Why/why not?

39. In relation to the requirement to report statistical data to the Commission what information should be included in any statistical data return?

    - What data do you think should be kept confidential, and what should be made publicly available?

3.5.8 Powers of the Issuer

152. The current powers and rights of issuers prescribed in the Unit Trusts Act, the Superannuation Schemes Act and the 7th Schedule to the Securities Regulations are set out in Appendix 6.

3.5.8.1 Proposed Power of the Issuer

153. In addition to the powers specified in the trust deed to enable the issuer to carry out its functions and duties, it is proposed that the following power of the issuer will be prescribed in the primary legislation:

    a. The power to apply to the High Court in certain circumstances (for example, where it is inexpedient or difficult or impracticable to manage or administer the scheme property) for additional powers of management or administration in relation to scheme property. This power will enable an issuer to effectively undertake its functions and duties, with the court's approval, if something is hindering the issuer or if the issuer does not have the power to perform its duties at law or under the trust deed. This power would be the same as that proposed for the CIS trustee at paragraph 106(k) and will be similar to the power contained in section 22(1) of the Unit Trusts Act.

Question for Submission

40. Do you consider the issuer requires any other powers in addition to that set out above, or do you consider the proposed power is inappropriate?

3.5.9 Breach by the Issuer of its Obligations Owed to Investors

154. This section discusses what happens if the issuer is not performing its duties or has breached a term of the trust deed or of the offer. It discusses who can enforce the performance of the issuer's obligations and the proposed remedies available.

155. In the event the issuer breaches any of its duties owed to investors, or the terms of the trust deed or the terms of the offer, the issuer will be liable to investors. It is proposed that:

    a. Investors will be able to call a meeting of investors to consider what actions to take against the issuer for breach of its duties, the terms of the trust deed or the terms of the offer (see the discussion on "Meetings" in the "Regulatory Controls" part of this discussion document as to the numbers required to call a meeting);

    b. Investors will be able to give directions or orders to the issuer (for example, a direction to perform its duties, comply with the terms of the trust deed or the

terms of the offer, or order the issuer to be removed) if the members obtain the appropriate threshold at a meeting of members (see the discussion on "Meetings" in the "Regulatory Controls" part of this discussion document as to quorum and the thresholds for investor resolutions);

c. Investors will be able to take an action to Court to seek compensation for loss caused by a breach by the issuer of any of its duties, the terms of the trust deed or the terms of the offer. However, this may be extremely costly for an individual investor to pursue or difficult for individual investors to get the numbers required at a meeting of members to take a collective action against the issuer;

d. The CIS trustee will have a spectrum of powers to deal with the issuer's breach of its duties or breach of a term of the trust deed or of the offer. The response necessitated will depend on the severity of the breach. It is proposed that the CIS trustee will be able to:

- Request information from the issuer and carry out, or appoint another person to carry out, inspections or reviews (see paragraph 106(c));
- Issue directions or orders to the issuer to comply with its duties or with the terms of the trust deed or the offer (see paragraph 106(i));
- Call a meeting of members to consider what actions to take against the issuer (see paragraph 106(e)); and
- Take an action to the High Court on behalf of investors for directions, compensation or other orders (see paragraph 106(j)).

Question for Submission

41. Do you consider the proposed options for remedying a breach by the issuer of its obligations owed to investors are appropriate, or are there any that are inappropriate?

3.6 OTHER PROTECTIONS

3.6.1 Whistle-blowing Provisions

3.6.1.1 Current Whistle-blowing Provisions

156. Section 18A of the Superannuation Schemes Act requires any administration manager, investment manager, actuary or auditor of a registered superannuation scheme who forms an opinion that there is a serious problem with the scheme to disclose to the Government Actuary information relating to the affairs of the scheme that they obtained in the course of holding that office.

157. Section 18A of the Superannuation Schemes Act provides an associated protection against any liability for such disclosure where the disclosure was made in good faith to the Government Actuary.

3.6.1.2 Proposed Whistle-blowing Provisions

158. We consider that whistle-blowing provisions, similar to sections 18A and 18B of the Superannuation Schemes Act, should be incorporated in the regulatory framework for CISs.

159. The proposed provision would allow an administration manager, investment manager, actuary or auditor of a CIS, who forms an opinion in the course of, or in connection with, the performance of the functions of that office that there is a serious problem with the scheme, to disclose that information to the CIS trustee.

160. However, where the information directly related to the actions or omissions of the CIS trustee, the relevant party (including the issuer) would instead be required to disclose that information directly to the Commission. This is to avoid a conflict where the CIS trustee receives information about itself (that is, the CIS trustee will have a limited incentive to remedy the problem with the scheme where the problem is related to the actions or omissions of the CIS trustee) and is consistent with the trustee supervisory model where the Commission supervises and monitors CIS trustees.

161. It is considered that the definition of "serious problem" in section 18A(2) of the Superannuation Schemes Act is a good starting point. The proposed definition of "serious problem" will mean:

> *(a) The scheme is not operating in accordance with the primary legislation, and any regulations made under the primary legislation, or fails to meet any requirements of the primary legislation or any such regulations; or*
>
> *(b) The financial position of the scheme, or the security of benefits, or the management of the scheme, is inadequate.*

162. It is proposed that any persons who disclose information in good faith under the provision would be protected from any liability for such disclosure. The "exemption" from liability will encourage those parties with knowledge to come forward with the information, without fear of reprisal.

163. Such a duty and corresponding exemption from liability will encourage those parties who have knowledge about any serious problems with the CIS to give that information to the CIS trustee or, if the information directly relates to the actions or omissions of the CIS trustee – to the Commission. The CIS trustee (or, where relevant, the Commission) can then examine the CIS and will be able to take any necessary actions, including passing information to the Commission (for example, if the serious problem with the scheme related to the issuer's compliance with the ongoing fit and proper requirements or if it related to potential or actual money laundering activities). Provided the information is disclosed in good faith, no liability will attach to any person who alerts the Commission of any serious problem in relation to the CIS.

164. Inclusion of a whistle-blowing provision will minimise the risk of unfair and fraudulent conduct as it provides another check and balance on the issuer and the CIS trustee, and enhances investor protections.

Question for Submission

42. Do you consider the proposed whistle-blowing provision meets the regulatory objectives for CISs? Why/why not?

3.7 REGULATORY SUPERVISION

3.7.1 Functions of the Commission

165. The Commission will be the regulator and it will have three distinct functions. It will be responsible for:

a. Enforcing compliance with the proposed disclosure requirements (discussed in the "Disclosure" part of the *Securities Offerings* discussion document);

b. Approving and monitoring the fit and proper entry and ongoing requirements for CIS trustees (discussed in paragraphs 92 and 93 and the *Supervision of Issuers* discussion document) and, on the recommendation of the CIS trustee, approving the entry requirements for issuers (discussed in paragraph 118); and

c. Enforcement where there is non-compliance by:

- The CIS trustee, for breach of its obligations owed to investors (see paragraph 109(f)); and

- The issuer, for breach of the ongoing fit and proper requirements, where initial measures by the CIS trustee have failed (discussed in paragraph 143).

3.8 REGULATORY CONTROLS

3.8.1 Introduction

166. CISs are currently subject to a variety of different regulatory controls. These controls place constraints on how a scheme is able to operate. Some controls are prescriptive in that they specify how a scheme must operate in relation to a particular matter. Others are more discretionary in that they require the trust deed of a scheme to deal with certain matters, but how these matters are dealt with is specific to each trust deed.

167. There are several objectives that need to be considered in placing restrictions on the way a scheme is able to operate:

- Ensuring that there are certain minimum protections so that the interests of the investor are preserved and that investors have confidence in investing in the scheme;

- Common standards can help ensure there is a clear understanding amongst investors and providers about the rules that apply to schemes, which assists in providing clarity about the nature of the product and the rights and obligations of both investors and providers and provides a basis for comparison between different products; and

- Schemes need to have sufficient flexibility to be able to innovate and develop products that reflect both the characteristics and needs of their clients and their own business over time.

168. The Unit Trusts Act and Superannuation Schemes Act currently imply some provisions into trust deeds for unit trusts and superannuation schemes. The Securities Act also currently implies some provisions into deeds of participation for participatory securities. The Unit Trusts Act, Superannuation Schemes Act and Securities Act also specify matters that must be dealt with in trust deeds and deeds of participation, but are not prescriptive as to the content of those provisions. In addition to the requirements around trust deeds, the various pieces of legislation that currently regulate CISs also contain some other controls on how CISs operate.

169. Because the proposed CIS regime brings in a new common framework for all CISs, there is a need to consider which controls are necessary and appropriate to apply to CISs generally. In addition, some particular concerns were raised by the CIS advisory group about the general lack of clarity and consistency in CIS trust deeds, which meant that investors did not know what the protections were, that there was an inadequate basis for comparison between products and that some important minimum protections did not apply to some CIS products. The group raised particular issues about the adequacy of some current CIS controls, including a lack of consistency in standards around:

- Specification of fee levels;
- Clarity around pricing of units and benefits;
- Wind-ups, including triggers for wind-up; and
- Meeting provisions.

170. The superannuation advisory group also raised concerns that some current superannuation scheme trust deed provisions were either inflexible or were not adequately addressed in the regulation.

171. FSAP considered New Zealand's compliance with Principle 20 of the International Organisation of Securities Commission's Principles, which states that regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme. FSAP commented that:

> *In respect of most CIS, the trustee or statutory supervisor negotiates with the CIS operator the terms relating to asset valuation, NAV calculations, and pricing and redemption of CIS units. The broad obligations of the trustee or statutory supervisor to act with due care in the best interests of unit-holders provide some assurance that these matters will be properly addressed. This broad discretion could result, however, in significant variations in investor protections across different schemes. It is recommended, therefore, that consideration be given to adopting consistent, minimum regulatory standards regarding asset valuation, pricing and redemption.*

172. FSAP also commented, in relation to compliance with Principle 19, that if significant concerns arise with respect to the terms negotiated by trustees and statutory supervisors for the protection of CIS unitholders in trust deeds and deeds of participation it may be appropriate to specify minimum standards in the legislative

framework (while making it clear that the trustee or statutory supervisor is free to establish higher standards through negotiation).

173. Many of the provisions applying to specific CIS products in current legislation, and some additional provisions, will be important to ensure that CISs operate in a way that achieves the objectives identified. This part sets out the proposed controls on CISs, including requirements that may be specified in legislation, those that may be implied into trust deeds and matters that must be dealt with in trust deeds.

3.8.2 Controls on CISs and Implied Trust Deed Terms

174. It is proposed that the matters in the following section be dealt with by prescribing requirements for CISs.

175. These requirements could either be contained in a specific legislative provision or prohibition, or could be implied into trust deeds for CISs.

3.8.2.1 Amendments to the Trust Deed

176. The Superannuation Schemes Act contains restrictions on how amendments to a superannuation scheme trust deed can be made. In particular, any amendment to a superannuation scheme trust deed that has any of the following impacts can only be made with the written consent of any affected member or beneficiary of the trust:

- Reduces, postpones or otherwise adversely affects accrued member benefits; or
- Removes a right to participate in the management of the scheme; or
- Increases the contributions, fees or charges payable; or
- If the scheme enables reversion of assets to a third party, increases the level of that reversion.

177. The rules applying to amendments to unit trust deeds are not prescribed by law but instead, are generally stated in each trust deed, which are negotiated between the issuer and the unit trustee. Some of the provisions included in trust deeds permit the unit trustee to amend the trust deed if:

- In the unit trustee's opinion, it is made to correct a manifest error or is of a formal or technical nature;
- In the unit trustee's opinion, it is necessary or desirable for the working management of the trust fund, or to obtain NZX listing, or for safeguarding or enhancing the interests of the fund or unit holders;
- In the unit trustee's opinion, it is necessary or desirable in view of legislation or requirements imposed by any lawful authority affecting the trust;
- It is authorised by an extraordinary resolution;
- It is considered by the unit trustee not to be likely to become prejudicial to the interests of unit holders.

178. It is important to have some restrictions on how CISs and CIS trust deeds can be amended, so that members of a CIS have some assurance that they will not be adversely affected by any change, and that any change to the CIS does not fundamentally alter the nature of the scheme that they have subscribed to. However, situations can also occur which mean that trust deeds need to be changed for the member's benefit or to reflect a change in the environment within which the trust operates. In such circumstances, there may be good reasons to have flexibility to amend trust deeds, but this does need to be balanced against member rights. The CIS advisory group considered that there was a case for introducing more flexibility to amend CIS trust deeds in certain circumstances.

179. Amendments to the trust deed may be necessary for a number of reasons. For example, if there has been a change in legislation or best practice guidelines which impact on the trust deed provisions or if there has been a change in market conditions that has changed the risk profile of the issuer. If market changes are favourable to the issuer, the issuer may want the trust deed provisions relaxed. If market changes are not favourable to the issuer, the trustee may want the trust deed provisions tightened.

180. It is proposed that in order to ensure this balance can be achieved, specific provisions should be included in the primary legislation which specify the conditions under which, and the procedure for, changes to be made to the trust deed. There are two possible scenarios where there may be a push for a change to the trust deed (outside of a situation where a resolution of members is obtained):

- Where the issuer and the trustee agree that a change is necessary; and
- Where one of either the issuer or the trustee proposes a change to the trust deed, but the other party does not agree.

181. Where both the issuer and the trustee agree to a change in these circumstances, and the amendment does not adversely affect the interests of the investor, nor materially change the nature of the investor's investment, we propose that the amendment should be allowed without recourse to investors. In this situation, the regulator could play a role in pre-approving the amendment, which could give greater assurance that the rights of the investors have not been adversely affected, nor the nature of their investment materially changed.

182. We also propose that if one party to the trust deed wants to amend the trust deed and the amendment does not adversely affect the interests of the investor, nor materially change the nature of the investor's investment, the other party to the trust deed should not unreasonably withhold their consent to the amendment. If the issuer and trustee cannot agree to an amendment, the regulator could play a role in determining whether the consent to the amendment was reasonably withheld.

183. The proposal for deed amendments to be made by negotiation between the trustee and the issuer represents a change for superannuation schemes. This is because currently a superannuation scheme trustee is the issuer of securities in the scheme. As a result, it is not proposed that this provision will apply to stand-alone employer superannuation schemes (see the discussion on transitional structure in the "Employer Stand-Alone Schemes" part of this discussion document). However, within an environment where the CIS trustee is the independent supervisor of a CIS,

it is suggested that there will be a sufficient check and balance on the discretion of the issuer, along with the proposal for regulator sign-off.

184. There is a further question as to whether the Superannuation Schemes Act procedure which enables changes to the trust deed which adversely affect accrued member benefits to be made with full member consent should be maintained. While there are limited circumstances in which changes to trust deeds can be effectively made under this provision (it is generally very difficult in practice to obtain full member consent), this provision potentially provides a useful mechanism for changes to be made to trust deeds, particularly for small schemes.

185. An alternative option that would address concerns related to changes to trust deeds required as a result of legislative change is to make case-by-case amendments to trust deeds only within any legislation that impacts on trust deeds. However, case by case legislative amendment does not necessarily address concerns about changes that are necessary as a result of non-legislative changes. In addition, it may be an inefficient approach to address changes required by legislation, because there may be flow-on impacts that arise after legislation has been passed that could not have been initially contemplated.

Questions for Submission

43. Do you support the proposed provisions relating to amendments to CIS trust deeds or would you prefer changes were made in legislation on a case-by-case basis? Are there any additional issues raised with applying this framework to all CISs?

44. Do you consider that the Regulator should approve changes to trust deeds where the issuer and the trustee agree to the change? Why?

45. Should the Regulator have a similar power where, in the opinion of one party, consent to a trust deed change has been unreasonably withheld? What are your reasons?

46. Should the Superannuation Schemes Act procedure for obtaining full member consent to adverse trust deed changes be maintained?

3.8.2.2 Transfers of Members to Another Scheme

186. There are several reasons why it may be desirable for a scheme to be able to transfer its members to another scheme:

- During the last 10 to 15 years, relatively low-cost master trust structures have developed for superannuation schemes. Employers with existing stand-alone schemes may wish to continue to provide a superannuation facility for their employees, but at a lower cost and with less onerous responsibilities/liabilities. The ability to transfer members to a new scheme enables the employer to maintain continuity between schemes. It also helps maintain competition within the industry. Inefficiencies within current schemes can be maintained or supported if provisions around transfer of members create a barrier to an employer switching scheme providers.

- The proposed KiwiSaver scheme could accentuate the trend for employers to seek to switch providers. This is because employers can leverage off the KiwiSaver infrastructure and provide a scheme for their employees by simply choosing a preferred provider.

- There may also be situations where CISs other than superannuation schemes may wish to transfer members to another CIS. This could happen if, for example, a scheme is to be wound up or needs to be moved to a newer more active scheme that an issuer has initiated. The CIS advisory group commented that there were a large number of people in inactive schemes that had not been wound up simply because it is too difficult. Transferring members to a new scheme could enable schemes to consolidate and evolve over time and may be in the best interests of members.

- If there is no provision for transfer of members, winding-up of a scheme may be the only alternative. Where a scheme is wound up, there is disruption to members, and funds are released back to those members (except in the case of KiwiSaver schemes, where funds are transferred to another KiwiSaver scheme). Wind-up of CISs can be difficult and time-consuming and there is a risk, particularly with superannuation schemes, that on the release of funds, the funds are diverted into spending rather than savings. This runs counter to the Government's objective of encouraging private savings.

187. While there may be some real advantages to enabling transfer of members, it is also important that transfer provisions take into account the potential impact on members of a transfer. If members have subscribed to a scheme on the basis of the terms and conditions offered by that scheme, it is important that these terms and conditions are not undermined by enabling transfer of members.

188. The Superannuation Schemes Act currently provides that a member cannot be transferred to another scheme without the written consent of the member and the option for a member to cash up. It also provides a procedure for transfer of all or a substantial number of members to another superannuation scheme, requiring the consent of all members and beneficiaries except those that the regulator considers will not be materially affected by the proposed transfer (in practice this is "lost" members only).

189. It is proposed that the superannuation scheme provisions relating to transfer should be used as the basis of a provision that will apply to all CISs. Under the proposed trustee supervisory model, it would be more in line with the trustee's role as first-level supervisor of the scheme than the regulator's role to determine which members would not be materially affected. However, given that transfers can fundamentally impact on a member's interest, there is a question as to whether trustee sign-off would achieve the objectives of CIS regulation in this instance.

190. Some concern has been expressed, however, that the New Zealand Superannuation Schemes Act transfer provision should be extended to better facilitate transfers while maintaining the position of members of the schemes. In Australia, the Superannuation Industry (Supervision) Act 1993 addresses these issues by permitting the transfer of members and assets from one superannuation fund to another without the need to obtain member consent, provided the members in the new fund receive rights equivalent to the original fund.

191. To address the concerns about the difficulty of seeking member consent to a transfer, it is proposed that there should be an additional provision, similar to the Australian legislation, to facilitate transfer of members in circumstances where the terms of the scheme that they would be transferred to would be equivalent to or better than those relating to their current scheme.

192. There is a question about whether, under the trustee supervisory model, the trustee or the regulator should have the power to make a final assessment about the equivalence of the CISs. The trustee is the primary supervisor of the scheme. However, the assessment potentially has significant implications for a member of a scheme, and the judgment about equivalence will often be a finely balanced one. Because of this, it may be very difficult for a trustee to effectively make such a decision in practice. There is also the potential for a trustee to be conflicted in making the decision if it is paid by the scheme that is seeking to transfer its members and it is not the trustee of the scheme that the members will be transferred to. It is therefore proposed that the trustee of the CIS that the members will be transferred to should be required to certify the equivalence of the terms, conditions and benefits of the new CIS. In addition, the risks of conflict could be further reduced by requiring the regulator to make an overall decision based on its assessment of the certification and any other matters.

Questions for Submission

47. Do you support a provision equivalent to the current Superannuation Schemes Act provision enabling transfers of members to another scheme for all CISs? Why? If so, should the trustee or regulator determine which members would not be materially affected by the transfer?

48. Do you agree that the Superannuation Schemes Act transfer provision should be extended to all CISs to enable transfers where the new scheme is equivalent or better than the previous scheme? If so, do you consider that the trustee or the regulator (or both) should make that assessment?

3.8.2.3 Assignment of Interests/Units in a Scheme

193. The Unit Trusts Act specifically provides that interests in a unit trust are transferable (i.e. assignable to another person by a unit-holder in the trust). The trust deed is required to state how transfers will be made and recorded.

194. The Superannuation Schemes Act does not contain specific provisions relating to assignment of interests, however clause 174 of the KiwiSaver Bill does specifically prohibit the assignment of a member's interest to another person. There are reasons why transferability of benefits would not be supported for superannuation schemes. The requirement for registered superannuation schemes to be principally for the purpose of retirement links to the concept that superannuation schemes are vehicles for members to save for their own retirement. There is an expectation that the benefit is personal to the member of the scheme. In addition, if a third party is providing some benefit to a member that is linked to their membership of a particular superannuation scheme (e.g. insurance), an ability to assign interests or benefits in the superannuation scheme is likely to undermine this arrangement.

195. Generally, it is likely that different types of CISs would want to have different provisions around, and restrictions on, the transferability of units or interests in the scheme. Members of superannuation schemes, particularly those linked to a third party (e.g. employer) should arguably be restricted from assigning their interest in the scheme, but other CISs may see some value in enabling transfer of units.

196. It is considered important to enable schemes to develop rules around transferability that link to the preferences of those involved in and offering the CIS and the specified objectives of the CIS. However, it is also important for the member of a scheme to have clarity about the transferability of interests or units, as it can affect the liquidity and price of their unit. To balance these objectives, it is proposed that:

- The primary legislation specify that an interest in a unit is transferable, subject to the provisions of the trust deed; but
- Those schemes that hold themselves out to be superannuation schemes (and therefore have an objective linked to long-term retirement savings), should be restricted from enabling transfer of units.

Questions for Submission

49. Do you agree that transfer provisions should be flexible for CISs generally? Why?

50. Do you support restrictions on assignment of interests in superannuation schemes? What are your reasons?

3.8.2.4 Benefits in Schemes Linked to Employment Status

197. The Superannuation Schemes Act requires that a beneficiary who continues to be employed after their expected age or date of retirement may defer receipt of a benefit that they are eligible for until they cease to be employed by the employer offering the superannuation scheme.

198. This provision resulted from changes to the age of eligibility for New Zealand Superannuation, and enabled members to retain their benefit in the superannuation scheme until the end of their employment (as earlier trust deeds may have reflected a retirement age of 60). It is proposed that this provision continue to apply to all existing superannuation schemes.

Question for Submission

51. Do you agree that the provision on benefits in schemes linked to employment status should be retained for all existing superannuation schemes?

3.8.3 Matters to be Addressed in Trust Deeds

199. In addition to the general protections discussed above which would apply to all CIS schemes, there are a number of matters that we consider should be specifically addressed in trust deeds. Trust deeds are essentially a constitutional document for the trust and requiring matters to be specified in trust deeds provides clarity to

investors about their rights and can ensure that there are minimum protections for investors that can be enforced the investor and/or the regulator against the trustee.

200. There is a question as to whether certain matters are better contained in the terms of the offer of the security (and disclosed to the investor in offer documents) than in trust deeds. There are several implications of the distinction between terms of the offer and terms in a trust deed. Where terms are contained in a trust deed, it is simpler for the trustee to monitor those terms and they are enforceable by the investor against both the trustee of the scheme and the issuer of securities in a scheme. Terms of the offer of securities are only enforceable by the investor against the issuer. In addition, terms of a trust deed are more difficult to change than terms of an offer. While offer documentation generally states that the terms of the offer can change over time, there are more limited situations where the terms of a trust deed can change (see discussion above). As a result, where it is important for investor protection that terms continue to be applied to the scheme on an ongoing basis, this can be more effectively achieved through requiring those terms to be specified in the trust deed.

201. In considering requirements that should be contained within trust deeds, we need to balance the objectives of flexibility and while ensuring ongoing minimum protections are available for investors in CISs. In some cases, this could be achieved by requiring that matters be addressed, rather than specific provisions about how these matters must be addressed. However, to ensure there are minimum protections for investors in some areas, there may be a need for greater specification. The questions below consider the level of specification that may be required in relation to the matters identified.

202. Taking account of these objectives, it is proposed that the following matters should be required to be addressed in CIS trust deeds. Note, however, that where a matter is not applicable to a particular CIS, the trust deed would not be required to address it.

3.8.3.1 Objectives of the Scheme

203. Currently a deed of participation for participatory securities is required to specify the business or other activities in which the assets of the scheme may be used. A superannuation scheme is specifically defined as being “principally for the purpose of providing retirement benefits”.

204. This raises two issues:

- Whether trust deeds should be required to contain an objective; and
- The level of specificity of that objective.

Objectives in Trust Deeds

205. Where a CIS does have a high-level objective that imposes a constitutional limitation on the activities and strategies of the scheme, it is important this be specified in the trust deed so that members can have certainty that the objective or strategy will be applied by the trustee and the issuer on an ongoing basis. It is therefore proposed that where a scheme has an objective or business strategy, this should be specified in the trust deed.

206. For CISs that are marketed as, or hold themselves out as being, superannuation schemes, potential investors in the scheme are likely to consider that the scheme is for retirement purposes. It is therefore proposed that any CIS that describes itself as a superannuation scheme should have a provision implied in its trust deed that links to its objective of being for the purpose of providing retirement benefits.

207. There may also be some value in requiring all other CISs to set out clear investment objectives in the trust deed, so that investors have certainty about the focus of the scheme on an ongoing basis and so trustees can adequately monitor compliance with the objective. However, such a requirement would potentially restrict the activity of a scheme that had very broad objectives. There may also be difficulty in determining the level of specificity that would be required for objectives (this is discussed in further detail below).

Specificity of the Objective

208. Some concern was raised by the CIS advisory group that where a scheme objective is contained in a trust deed, but is too broad, it does not give sufficient clarity to the trustee or the investor about what the objective means in practice and may be difficult for a trustee to enforce. In addition, some participants in the superannuation industry have raised concerns about the lack of clarity in the current test for registration of superannuation schemes, i.e., that they be "principally for the purpose of providing retirement benefits". In practice, this has generally been interpreted as requiring some kind of lock-in of funds in the scheme.

209. Greater specificity will enable CISs, CIS trustees and investors to have sufficient certainty about the objective and its enforceability. This could be achieved, for example, by requiring the deed to set out the investment objectives of the fund in sufficient detail to allow the trustee to monitor the manager's activities and to determine whether any investment accords with those objectives.

Questions for Submission

52. Do you agree that a CIS's objectives should be included in the trust deed? Should all CISs be required to specify an objective? `What are your reasons?

53. Do you support the proposal that CISs that hold themselves out to be superannuation schemes should have an implied provision that is linked to its purpose of providing retirement benefits? Should this test be more specific, e.g. should it require funds to be locked in, or the statement of an investment strategy in the trust deed that is consistent with a long-term savings vehicle, or would it be better to achieve clarity for investors through disclosure?

54. Is greater specification of objectives required in CIS trust deeds generally? What sorts of matters could or should be required to be stated in relation to the scheme objective? Could this reduce some of the flexibility that the new regulatory regime is intended to introduce?

3.8.3.2 Conditions of Scheme Entry and Exit

210. Superannuation scheme trust deeds are required to specify the conditions of entry of members to the scheme and conditions as to termination of membership of the scheme. This reflects the fact that membership in employer superannuation schemes is often conditional on continued employment with a particular employer, because the employer has provided the scheme as part of an incentive package for the employee. It also reflects the fact that registered superannuation schemes are required to be "principally for the purposes of providing retirement benefits".

211. A further relevant factor is the proposed introduction of KiwiSaver. Funds in KiwiSaver schemes are required to be locked in until the age of eligibility for New Zealand Superannuation. However, all funds are required to be transferable – so that funds can be transferred freely between any KiwiSaver scheme. Other CISs may also want to place conditions on scheme membership, for example, some unit trusts have limited lock-in provisions.

212. Having conditions of entry and exit specified in the trust deed is important for giving members and potential members certainty about their rights to join, remain in and exit the scheme, as they can significantly impact on the value of a member's interest in the scheme (e.g. if members cannot readily access their funds). It is therefore proposed that all CIS trust deeds should be required to include any conditions of entry, continuance in or exit of a scheme.

213. A further issue arises as to whether any additional requirements should be imposed where there are lock-in provisions in scheme trust deeds that are unrelated to the term of employment. Trust deeds that specify lock-in often have some provision to enable transfer of funds to a scheme with equivalent lock-in provisions. This sort of portability enables the member to switch schemes if they have concerns about the operation of the scheme or its performance. This can help to encourage competition between schemes, which could otherwise operate on the basis that they have a captured market.

214. It has been proposed that CISs with lock-in provisions unrelated to the term of employment should be required to enable portability of funds to schemes with similar lock-in provisions. This requirement would be consistent with the KiwiSaver requirements. However, there is a question about how such a requirement could work in practice. CISs that have locked-in funds are likely to charge fees and/or other penalties to a member seeking to transfer funds out of the scheme. Therefore, a requirement for portability may only be effective in practice if some constraints (e.g. a fee cap or restriction) are placed upon the penalties or fees charged on transfer. Such a restriction could, however, facilitate transfers between schemes where a transfer is not in the member's best interest and costly for the scheme.

215. There is a further question about when such a portability requirement could or should be required where funds are locked in for a relatively short period of time (for example, 5 years). There may be less of an argument that portability is necessary for these schemes than if funds were locked in for a substantially longer period, such as in KiwiSaver.

216. An alternative mechanism to deal with the impact on investors of lock-in is to ensure that where a locked-in scheme does not provide portability, that there are very clear warnings for investors on accessing the scheme that they will not be able to access

their funds for the specified period of time. However, this would not address the competition constraints of lock-in identified above.

Questions for Submission

55. Do you agree that any conditions of entry and exit into a CIS should be specified in the trust deed? Do you have any comments on the practical effect of such a provision? What are your reasons?

56. Do you consider that trust deeds that contain lock-in provisions that are not related to a term of employment should be required to have provision for portability of funds? If so, how can this be practically achieved?

57. What would be an effective mechanism for balancing the concern around allowing effective portability between schemes but preventing unnecessary churn which is costly for schemes that may have priced the lock-in into their offer? How long would a period of lock-in need to be for a portability requirement to apply?

58. Would clear disclosure of lock-in be an effective way of dealing with the concerns raised?

Contribution Levels and Rates

217. Superannuation scheme trust deeds are currently required to specify the level of contributions payable. This requirement reflects the general nature of superannuation schemes, i.e., that a member generally makes regular small contributions to the scheme rather than a lump sum investment. While other CIS vehicles are generally not used in this way, where they are, it will be important for the investor to have ongoing certainty about the regular contribution levels (for the same reasons discussed above in relation to conditions of entry into and exit from a scheme).

218. It is therefore proposed that where a scheme requires minimum contribution levels, these should be specified in the trust deed. In order to retain some flexibility around how those levels are set, it should be sufficient for this provision to describe a process around how those minimum contribution levels will be established and revised.

Question for Submission

59. Do you agree with the proposal that any minimum contribution levels, or a process through which these are established and/or amended, should be included in the trust deed? Why?

3.8.3.3 Authorised Investments

219. A CIS may specify limits on the nature or type of its investments. There is a question as to whether these limits or restrictions should be contained in trust deeds or whether it is better to include this information in disclosure documents. The ability for a member to have certainty that the scheme will adhere to these limits is important,

because a member may often have based their decision to subscribe to a particular scheme on the basis of those limits. However, it is important that a scheme is not unnecessarily restricted in terms of its investments. There may be good reasons why a scheme should alter its investment strategy, for example, as a result of a shift in economic conditions. If authorised investments are specified too prescriptively in the trust deed, it may inhibit the ability of the issuer and trustee to amend the investment strategy in line with their duties under the Trustee Act to invest prudently.

220. The CIS advisory group also considered that it was important to include provisions in trust deeds which specified how a CIS's performance against investment criteria would be measured. Where authorised investments are specified, a mechanism for measurement of the performance of those investments would provide greater clarity for CIS trustees, issuers and investors about whether the investments adequately conformed to the investment strategy. This would also make it easier for investors and trustees to enforce the requirements.

221. As a way of balancing the objectives identified, it is proposed that the trust deed should be required to contain a methodology for how the investment strategy can be developed, amended and measured. At its broadest, this could potentially state that the investment strategy would be reviewed from time to time by the issuer and changes will be approved by the trustee. However, there is a question as to whether this would effectively achieve the objectives identified, and hence whether specification of a discretion on the part of the CIS trustee would be sufficient.

222. An alternative approach is to require that if a fund markets itself as being limited in the investments it is undertaking, or to having a specific investment strategy that is likely to be material to investors (in terms of the scope or nature of the investments being undertaken), then this should be set out in the trust deed in addition to the requirements for it to be in an offer document. This sort of provision would link the trust deed requirement to the stated investment strategy of the scheme, but would not limit the flexibility of the scheme by requiring an investment strategy if the scheme did not want to market itself or be confined to a particular strategy. This would, however, mean the scheme would have a significant discretion in terms of the nature of investments that it undertook and we query whether this would provide sufficient certainty for any investors in the scheme.

Questions for Submission

60. Do you agree that a methodology for determining and amending a scheme's investment strategy should be included in the trust deed, or is this information better placed in disclosure documents? What are your reasons?

61. Should this only be a requirement where the scheme has a material investment strategy? What are your reasons?

3.8.3.4 Benefits, Returns, Redemptions and Pricing

223. Superannuation schemes are currently required to specify the conditions under which benefits become payable and the way in which the benefits are to be determined. A unit trust deed is required to specify whether the manager has an obligation to buy back interests in a unit trust if they are requested to do so. If there is such an

obligation, the deed must also specify the conditions of redemption, including the method of calculating the minimum price. Deeds of participation are required to specify the terms relating to redemption of the participatory security.

224. Benefits from unit trusts can take the form of income distributions or capital appreciation. The precise value of the latter benefit depends on the trust's approach to unit pricing. Various factors impact on the way that unit pricing is undertaken. It should be noted that the Taxation (Annual Rates, Savings Investments and Miscellaneous Provisions) Bill currently before Parliament, which contains opt-in tax rules for Portfolio Investment Entities (PIEs – these entities will generally be Collective Investment Schemes), requires PIEs to pay tax on their income at investors' tax rates at least quarterly. It is envisaged that PIEs will report a unit price that does not include a provision for tax, so the tax calculation will be performed outside of the unit price. Tax will, for most PIEs, be sourced from selling investors' units in the PIE.

225. Generally, the terms and conditions associated with the benefits or returns that a CIS member obtains, the pricing of those benefits and the way in which they can be realised can all be critical to the value of the member's financial interest. It is important that they are clear to the investor and that the investor has some protection against unilateral changes to these provisions. For these reasons, it is important that these issues are effectively addressed by CISs and clear for investors. However, this does need to be balanced against the objective that CISs should not be unnecessarily constrained in the way that they operate in these matters. The CIS advisory group recognised these competing objectives, but did not have a unanimous view on where the balance between these objectives should lie.

226. FSAP specifically recommended that, given the ability for broad variance between provisions in different CIS trust deeds around asset valuation, pricing and redemption of units, there could be significant variations in investor protections across different schemes and that consideration should be given to adopting consistent minimum regulatory standards regarding asset valuation, pricing and redemption.

227. By way of comparison, the Australian Corporations Act 2001 requires the responsible entity of a managed investment scheme to comply with several obligations which are relevant to asset valuation and pricing, including:

- Treating members who hold interests in the same class equally and members who hold interests in different classes fairly;
- Ensuring that scheme property is valued at regular intervals;
- Ensuring that all payments out of the scheme property are made in accordance with the scheme's constitution and with the Corporations Act; and
- Ensuring that the constitution of a registered scheme makes adequate provision for matters including consideration to be paid to acquire interests in a scheme, withdrawal from a scheme and dealing with complaints.

228. On balance, we consider there is a case for requiring CIS trust deeds to specify the conditions of the scheme in relation to allocations, withdrawals, redemptions (including when they can be withheld) and distributions.

229. It is also proposed that trust deeds should be required to specify a methodology for valuation of assets. This could be at either the fund or individual investor level. There are, however, some particular questions that arise with the detail of such a requirement. These are discussed below.

Timing of Valuations

230. Some CIS advisory group members considered that the trust deed should specify the timing of the valuation, e.g. daily, or on the last business day of the week. Requiring a specified time is beneficial for both the scheme and the investor because it prevents either party gaming the market by timing valuations around known transactions.

231. This raises a further question as to whether each scheme should be free to choose the timing of the valuation, or whether a standard time should be specified for all schemes.[22] A standard time could potentially provide greater comparability of pricing between different products, which may be a benefit for investors, however it may also be a considerable constraint on a CIS's flexibility. This could be particularly so for a scheme that has an overseas parent, and that times its pricing on a consistent basis with that parent. An alternative approach to address issues of comparability of pricing could be to require a standard time for currency conversion (which has previously been discussed within the industry).[23] However, because of the potential for this to inhibit flexibility, there is a question about whether government should prescribe a particular time, or whether it is better for industry to develop consistent standards around timing itself.

232. The major threat in terms of enforcing market timing provisions come where a manager or a trustee permits one investor to trade after a pricing cut-off time. The only way that this can be guarded against is to have strictly enforced cut-off times for redemptions and purchases. This raises the question about whether the trustee should be given any discretion for such redemptions or purchases, or whether they should simply be prohibited.

233. A further concern relates to the effectiveness of any regulatory controls around timing. Because a majority of managed funds in New Zealand have high overseas exposure, overseas markets timing points are likely to be more influential in practice than domestic timing. Because of this, a specific valuation timing point for a New Zealand fund may not in fact achieve the comparability in pricing that the provision is intended to achieve.

Process for Valuing Assets

234. Some practical issues arise when considering how the process for valuation of assets may be specified in a trust deed. One issue is to ensure that the process specified addresses whether expenses are covered within asset valuation. There is currently the potential for schemes to include expenses in the valuation of units, rather than separate expenses out as an administrative cost of the scheme. Where this occurs, we would anticipate that the trust deed should specify that expenses are included

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[22] An example of how this could be done is that for those schemes that choose to value on a daily basis, the time is set at 5pm each day, and that for schemes that choose to value on a weekly basis, the time is set at 5pm on each Wednesday.

[23] An example of this could be that currency conversions occur at 5pm each day, New Zealand time.

within the asset valuation, and what those expenses are (e.g. trustee fees, custodian fees, brokerage).

235. A further issue that has been raised is the pricing process around allotment of units to investors. Again, it is important for investors to have clarity about this process, because the timing and process of pricing can have an impact on the value of their interest in the scheme. It is therefore proposed that the process specified for valuation of assets include the process of allotment of units to investors.

236. Some questions were raised by the CIS advisory group about the variability of entry and exit spreads within different schemes, and whether this could be addressed through a requirement to specify spreads as part of the process for valuing assets. Clarifying spreads in the trust deed would give investors greater information about the cost to them of buying and selling units. However, specification of spreads in offer documents arguably gives investors sufficient certainty. In addition, spreads tend to vary depending on the fund manager and asset class. There is therefore a question about whether requiring specification of spreads within the trust deed would unnecessarily restrict the operation of a scheme, e.g. in terms of their ability to change fund managers.

237. A particular issue that has gained relevance since the widespread fund losses in 2002-2003 is the treatment of tax losses. There are different ways that tax losses can be dealt with in unit pricing and this can have a real impact on the value of the unit. For this reason, some CIS advisory group members considered that a clear mechanism for dealing with tax losses should be specified in the trust deed. However, the way that tax losses are dealt with is a balance between the rights of existing members, the rights of new members and the rights of those who are seeking to redeem units. Because of this balance of interests, the way that pricing reflects tax losses is likely to need to change over time. It should also be noted that the PIE Bill would require funds that elect to be PIEs to flow losses through to investors at the end of each tax year. This will mean that losses will no longer have to be provisioned for in the unit price from year to year.

238. As a result of these factors, it is unclear whether a consistent mechanism for dealing with tax losses could be specified in trust deeds, whether such a provision would be needed in the medium term in any event as a result of the PIE changes, and whether requiring a mechanism would potentially derogate from the issuers' and trustees' overall duty to act in the best interests of members.

3.8.3.5 Discretions Regarding Benefit Payments

239. Within a superannuation scheme, the trustee often has a discretion in relation to the payment of particular benefits. For example, there is usually a trustee discretion to enable a member to withdraw a benefit in circumstances of serious financial hardship (this is specifically required to be contained in KiwiSaver trust deeds). Some concern was raised within the superannuation advisory group that these discretions can be delegated to a third party (i.e. an employer). Given the significance of the discretion about payment of benefits in terms of its impact on both the member who is the subject of the discretion and all other members of the scheme, we propose that any discretions about benefit payments should be contained in the trust deed, and that these discretions should only be exercisable by the CIS trustee.

Questions for Submission

62. Do you agree that trust deeds for CISs should be required to specify the conditions of the scheme in relation to pricing, withdrawals, redemptions (including when they can be withheld) and distributions? What are your reasons?

63. Do you support the proposal for a general requirement to specify a process for valuation of assets in the trust deed? If so, should there be any qualitative requirements around the provision, e.g. the Australian requirement for "adequate" provision to be made for these matters?

64. Do you agree that it would be beneficial to require consistent timing of valuations? Should this be consistent across all schemes? Would standardisation of the timing of currency conversion be a better approach? How could this best be achieved – by government or by the industry? Please state your reasons.

65. Do you have any comments on the issues identified relating to the process for valuing assets? If a process is required, how prescriptive should this requirement be?

66. Do you agree that any discretions around payment of benefits should be contained in the trust deed and should only be exercisable by the trustee? Why?

3.8.3.6 Fees

240. As with other factors that influence the level of an investor's interest in a scheme, it is important for investors to have certainty about the way in which fees are charged by a scheme. However, the level of fees charged is likely to change over time, and it is also important that scheme providers have the ability to revise fees that are charged, particularly if cost structures change.

241. As a way of balancing these objectives, trust deeds could be required to specify the types of fees that are or could be deducted and how they would be calculated but that they should not be required to specify particular fee levels. These sorts of provisions are relatively common in superannuation scheme trust deeds. However, we also query whether more meaningful information could better be given to investors through offer documentation, and whether there are sufficient benefits in having such a provision in trust deeds to balance the costs to providers in terms of limitations on their flexibility to determine future fee levels.

Question for Submission

67. Do you agree that trust deeds should specify the types of fees that are or could be deducted and how they would be calculated, or is this information better contained in offer documents? What are your reasons?

3.8.3.7 Appointment and Removal of Trustee and Issuer

242. The Superannuation Schemes Act currently requires superannuation scheme trust deeds to specify the number of trustees and provision for their appointment and retirement. The Securities Act requires deeds of participation to set out the

procedure to be adopted in the event of a vacancy in the office of statutory supervisor, the terms relating to remuneration and costs of the statutory supervisor, the terms relating to the appointment, remuneration and removal from office of the manager and the powers and duties of the manager.

243. Provisions around the appointment and removal of the CIS trustee and the issuer are largely dealt with under the duties and powers of CIS trustees and issuers in this discussion document. In particular, the requirements for the regulator to assess that the CIS trustee is "fit and proper", and for the CIS trustee to make a similar assessment of the issuer, will limit the degree to which provisions around appointment and removal of the CIS trustee can be dealt with in the trust deed.

244. However, it is recognised that within the overall discretion of the regulator in relation to the performance of the CIS trustee and the issuer, there is still likely to be some room for provisions in trust deeds, particularly around appointment of the CIS trustee and the issuer. It is therefore proposed that subject to the overall powers and duties of the regulator, CIS trustees and issuers that will be specified in the primary legislation, where there is specific provision around the appointment and removal of CIS trustees or issuers, these should be contained in the trust deed. There are potentially some practical issues about how the appointment and removal provisions may work within the regulator's powers in practice. These are addressed in paragraphs 295 to 300 of the "Employer Stand-Alone Schemes" part of this discussion document.

Question for Submission

68. Do you support the proposal that trust deeds should contain any provisions around appointment and removal of trustees and issuers, subject to the powers of the regulator, trustee and issuer that will be contained in the legislation?

3.8.3.8 Winding-up

245. The Superannuation Schemes Act currently requires superannuation scheme trust deeds to specify the circumstances in which the scheme may be wound up and the way that the assets of the scheme are to be distributed in the event of a winding-up. The Securities Act requires deeds of participation to state the circumstances in which the scheme shall be wound up and the procedure for a wind-up. It also requires the rights and liabilities of security holders on winding-up to be specified. There are no specific provisions in the Unit Trusts Act which govern wind up, this is dealt with through general trust law.

246. Both the trigger and procedure for wind-up are significant for investors. Whether and when wind-up may occur could impact on the level of the member's investment in the scheme. For example, a scheme that is closed to new members may become expensive to administer over time if it does not have sufficient members. In this situation, the CIS advisory group considered that there may be real benefit in the scheme winding up. In addition, the procedure for distribution of assets on wind-up will be important for particular investors, particularly if they are considering whether to continue with a scheme or redeem their units.

247. It is proposed that trust deeds should be required to contain the circumstances which will trigger a wind-up and the procedure for wind-up and the distribution of assets of the scheme.

248. There is a further issue of whether the legislation should include standard trigger-points which could initiate a wind-up. Two suggested trigger points are:

- When the trustee considers that the total cost of running the scheme is disproportionate to the benefits of the scheme; or
- Where there is significant impairment to a major asset.

249. Specifying trigger-points for wind-up would give investors greater clarity about when wind-up would occur for all schemes. However, there is a question as to whether these sorts of triggers would add anything to the issuers' and trustees' existing duties in terms of investing in the interests of the members. It is arguable that on the events specified in either of these trigger-points, the issuer and trustee would be under a duty to consider the best interests of the investor, which may result in the initiation of a wind-up.

Questions for Submission

69. Do you agree that the circumstances which will trigger a wind-up and the procedure for winding up and the distribution of assets should be included in trust deeds? What are your reasons?

70. Do you consider that there should be standard triggers for wind-up for all schemes? If so, what would those triggers be and how would they interact with the issuer's and trustee's duty to act in the interests of members?

3.8.3.9 Meetings

250. The powers of CIS trustees and issuers to call meetings, and the powers of CIS trustees, issuers and members of the scheme at a meeting are addressed in the "Oversight by an Independent Supervisor" and "The Issuer" parts of this discussion document. There are three other aspects of meetings that need to be addressed to give all parties sufficient certainty about how meetings can be conducted, and the rights of members at meetings: the ability of members to initiate a meeting, what will constitute a quorum at a meeting and the majorities that are required to pass a resolution at a meeting.

Initiation of a meeting

251. The Unit Trusts Act currently enables unit holders to call a meeting on the request of either one-tenth of the number of unit holders, or of unit holders with over 10 percent of value of units in the scheme. The Securities Act enables participatory security holders with over one-tenth of the value of securities to summon a meeting.

252. It is important to have some restrictions on the ability of members to call meetings, as meetings are generally held at some cost to the scheme. However, the CIS advisory group considered that it can be difficult for members to effectively co-ordinate a large number of members in order to call a meeting. A suggested approach is to reduce

the Unit Trusts Act threshold to one-twentieth of the number of unit holders or of unit holders with over 5 percent of the value of units in the scheme. A minimum actual number of unit holders (for example, 100) could also be used as a threshold. This could address some of the concerns about the difficulties of very large schemes to meet the percentage thresholds in the Act, while ensuring that there is a significant threshold to deter vexatious meeting requests.

253. An additional issue for Superannuation Schemes is the current restriction on the availability of registry information about other members of the scheme, which is contained in section 51 of the Securities Act. Currently members of superannuation schemes are not able to access registry information about who the other members of the scheme are. This could constrain members' ability to organise with other members to call a meeting. However, it is also important to maintain the privacy of individual investors unless there is a good reason why this information should be disclosed. Providing open access to details of CIS membership could, for example, enable competitors to access those details for marketing purposes. As a way of balancing these considerations, it is proposed that the register requirements should enable members of all CISs to access the name and address details of other members of the scheme, and potentially for legitimate access by other market participants. This could be achieved, for example, by linking access to a proper purpose in keeping with the purpose of the register.

Quorum and Voting Requirements

254. The Unit Trusts Act provides that a resolution to direct the trustee can be passed by unit holders with three-quarters of the value of interests in the unit trust, which are held by unit holders who are present (in person or by proxy) or making written votes, and who hold not less than one-quarter of the value of all the interests in the unit trust.

255. In contrast, the Companies Act requires a quorum of shareholders who are between them able to exercise a majority of the votes to be cast on the business to be transacted by the meeting. Depending on the nature of the resolution, it can then be passed by either an ordinary resolution (a simple majority) or a special resolution (75% majority).

256. If a low quorum is required, there is the potential for very few members to dominate the voting on a particular issue. Conversely, if the size of the quorum required is too large, there is a risk that it will be very difficult to convene the numbers necessary for a resolution to be passed. It should also be noted that there may be different considerations around requirements for CIS quorums than for company quorums. As described above in paragraphs 15 to 19, CISs are characterised by the lack of direct control by members over the scheme. For example, members of a CIS are not able to change the requirements of a trust deed through a vote at a meeting. This is in contrast to shareholders in a company, who are able to exercise considerable control over the direction of the company by resolutions at meetings. In addition, because investors in a CIS are only given authority to vote on relatively significant issues, the high threshold better aligns with the Companies Act extraordinary resolution threshold.

257. Given the relatively restricted nature of CIS members' powers at meetings, it is proposed that the quorum and voting tests in the Unit Trusts Act are most appropriate and should be retained for CISs generally.

Questions for Submission

71. Do you support the proposals for initiation of meetings? Please give reasons for your answer.

72. Do you agree that the proposed quorum and voting procedures will be effective for CIS schemes? What are your reasons?

73. How much would a meeting constituted under these provisions be likely to cost?

3.8.4 Other Trust Deed Provisions

258. Under the proposed powers of the CIS trustee (see paragraph 106) the trustee is able to enforce the provisions of the trust deed. The trustee will, therefore, have powers to act in relation to the matters that are covered by the trust deed as discussed in this section of the discussion document.

Question for Submission

74. Given this link between provisions in the trust deed and the trustee's power to act, do you consider there are any other matters that should be included in the trust deed so the trustee has the power to act in relation to those matters? Why?

3.8.5 Other Requirements from the Unit Trusts Act, the Superannuation Schemes Act and the 7th Schedule to the Securities Regulations

259. In proposing the new framework for the regulation of CISs we consider we have taken the "best elements" from the Unit Trusts Act, the Superannuation Schemes Act and the 7th Schedule to the Securities Regulations.

Question for Submission

75. Are there any other requirements (for example, duties, rights, powers, etc) contained in any of the Unit Trusts Act, the Superannuation Schemes Act or the 7th Schedule to the Securities Regulations that you consider may be appropriate to apply to the framework for CISs? What are your reasons?

4. Superannuation Schemes

4.1 INTRODUCTION

260. Superannuation schemes have traditionally been provided through the workplace. Many employers use superannuation schemes as both a recruitment and a retention tool for their employees. According to statistical information produced by the Government Actuary[24], of the 625 superannuation schemes in force with scheme balance dates in 2004, 463 were employer schemes. However, membership in employer schemes has declined from 22.6% of the labour force in 1990 to 13.89% of the labour force in 2003. Membership of retail schemes has remained relatively static in proportion to the population, with numbers of members increasing from 236,062 in 1990 to 364,029 in 2004.

261. There are various ways in which an employer can be involved in their employees' superannuation scheme. Traditionally, employers took a very active role in the development of superannuation schemes. This generally involved an employer approaching and contracting with an administration and investment manager to provide services for the scheme, and coordinating a board of trustees to oversee the scheme. In these employer stand-alone schemes, the employer is almost always represented on the board of trustees and in some schemes there is also an employee representative and/or an independent trustee.

262. More recently, the nature of the employer's involvement has evolved with the development of master trust structures. An employer can approach a provider of a master trust scheme and negotiate a participation agreement with that provider to supply a superannuation scheme to their employees. The Government Actuary has estimated that of the approximate 300 employer-defined contribution schemes, at least 30-40 of these are employer master trust arrangements, although only approximately 15 of those schemes are actively marketed to new members. Another 100 of those 300 schemes are small private schemes (often one-person schemes). The transition of schemes towards master trust structures can be seen in part through the sharp decline in the number of defined contribution employer schemes, but consistency in the numbers of members of those schemes between 1990 and 2004.[25] Some superannuation advisory group members suggested that almost all new employer superannuation schemes would be likely to be master trust arrangements, because these can generally be both less expensive and more straightforward for employers to arrange and be less onerous in terms of responsibility and potential liability.

263. Employer superannuation schemes can also be distinguished on the basis of whether they are defined contribution or defined benefit schemes. Generally, defined contribution schemes are schemes that define precise contribution rates for the employer and the employee and allocate the member's and any employer contribution to that member's account. The benefit the member ultimately receives is directly linked to the earnings of those contributions in the scheme. In a defined

[24] Report of the Government Actuary for the year ended 30 June 2005

[25] In the 14 years from 1990 to 2004, the number of defined contribution schemes declined from 1,790 to 307. At the same time, however, the total number of members in defined contribution schemes remained static. There were 209,524 members in defined contribution schemes in 1990 and 210,275 members in these schemes in 2004 .

benefit scheme, the member's benefit is defined at the outset. Contributions from the member and employer and returns on those contributions are used to fund the benefits payable. The particular features of defined benefit schemes, and issues arising with those schemes, are described in more detail in the "Defined Benefit Superannuation Schemes" part of this discussion document.

264. The proposed introduction of KiwiSaver is also likely to have an impact on the role of employers in the provision of superannuation schemes. Under KiwiSaver, all new employees will be required to be automatically enrolled in a KiwiSaver scheme when they start a new job, unless they opt out.

265. While KiwiSaver is a work-based scheme, employers will not need to become involved with a particular KiwiSaver scheme unless they wish to. Under the KiwiSaver Bill, an employer is able to choose an employer-preferred KiwiSaver scheme. If they do so, their employees would be automatically enrolled in that preferred scheme. The ability for, and ease with which employers are able to leverage off the KiwiSaver infrastructure, may lead to employers choosing a preferred KiwiSaver scheme or negotiating a participation agreement with a KiwiSaver scheme within a master trust arrangement, rather than maintaining a separate stand-alone scheme.

266. Another possible trend is the involvement of third parties, who are not employers, in superannuation and other savings schemes; for example, community organisations may be interested in contributing to, or supporting members' contributions to, a superannuation scheme. These sorts of schemes can make a positive contribution towards the development of a savings habit, and it is important that the regulatory regime is sufficiently flexible to support these initiatives.

267. The regulatory framework for superannuation schemes has, in the past, reflected tax and other advantages that have applied specifically to savings in superannuation schemes. The decline of these incentives is likely to have been a contributing factor to the decline in numbers of members in superannuation schemes. Because the proposed framework for CISs does not differentiate the supervision and governance requirements for superannuation schemes, it is effectively neutral. The regulatory structure will not, in itself, provide incentives for investments in superannuation schemes. However, it will be possible to link other incentives into the regulatory framework if governments wish to provide incentives for superannuation savings. The regulatory structure will, for example, apply to KiwiSaver schemes.

4.2 ROLE OF EMPLOYERS AND OTHER THIRD PARTIES

268. The superannuation advisory group considered that employer support of and contributions to savings schemes can have a positive impact. Key benefits arise through the negotiation and development of the scheme and its benefits, ongoing contributions to the scheme and ongoing monitoring of the scheme.

269. In the development of a scheme, or negotiation of participation in a scheme (through a master trust), a third party can have a significant role. For example, an employer may be able to negotiate discounted fees, or linked insurance products, in return for the bulk business the provider receives through offering the scheme to that employer's employees.

270. In addition, employers or other third parties who have arranged a scheme for particular savers will usually provide some ongoing contribution towards the scheme. This may be in the form of a fee subsidy or an ongoing contribution, which may be matched to the members' contribution.

271. Third party contributors will also often feel a level of investment in the scheme, in the sense that they, as well as the member, will be concerned to ensure the success of the scheme. Because of this, third parties can have a positive and constructive role in monitoring the scheme on an ongoing basis.

272. Because the trustee of a superannuation scheme is also the issuer of securities in the scheme under current law, and at least in employer stand-alone schemes the employer is generally represented on the board of trustees of the scheme, employees who belong to these schemes may currently perceive that their primary relationship with the scheme is through their employer. This perception can contribute to the feelings of ownership and responsibility over the scheme by employers, and employees may feel that superannuation is an intrinsic part of the employment relationship. Separation of the trustee and issuer could facilitate a change in employees' perception of the relationship in employer stand-alone schemes so that is more consistent with the nature of the relationships in current retail and employer master trust schemes. This change could have both positive and negative consequences – an employee may have greater clarity about their rights, have greater certainty that they will be treated impartially by the scheme and may feel more prepared to dispute the actions of a trustee that is not their employer. However, where superannuation is less linked to the employment relationship, the employer and/or employee may perceive that they have less of an investment in the scheme.

273. Generally, because of the benefit to savers from third party participation, it is considered important that the regulatory regime adequately takes account of the role of third parties and effectively manages any potential risks that arise with their involvement. The proposed general CIS structure specifically addresses the roles of the member of the scheme, the provider of that scheme and the scheme trustee. However, given the benefits of third party representation, there is a question about how their involvement or participation in CIS schemes should be addressed within the regulatory regime.

4.2.1 Employer Discretions

274. Some concern was raised within the superannuation advisory group that without specific controls on the role of an employer, situations can arise where an employer is able to make decisions that are more appropriately dealt with by a scheme trustee, for example, requests for withdrawal of funds for financial hardship. This may occur particularly in master trust arrangements, where participation agreements often defer responsibility for decision-making to the employer, or where the trustee often acts on the recommendation of the employer.

275. Some of these concerns are potentially addressed through the proposals to standardise and clarify the roles, responsibilities and obligations of the trustee and the manager. See in particular the proposal at paragraph 239 to require discretions around the payment of benefits to members to be specified in the trust deed and only exercisable with the consent of the trustee. This, coupled with the requirement for independence of the trustee, should reduce the extent to which an employer is able

to exercise discretion in relation to issues that are more properly the role of the trustee.

276. A further issue is the ability for assets of a scheme to revert to an employer or any other third party. Assets may be allocated to members of the scheme or employers in accordance with the trust deed, or allocation may be at the discretion of the trustee. In that case, there may be particular risks arising where the trustee includes representatives of the employer. In the past, reversions have tended to be confined to defined benefit schemes, but more recently some defined contribution scheme trust deeds have made provision for reversion of assets to the employer.

277. The Government Actuary must currently give consent to the reversion of assets to an employer and may only do so where there are sufficient assets which remain to support the accrued benefits of all members and other beneficiaries, and where the reversion is fair and equitable to the members and other beneficiaries, taking into account the manner in which the scheme acquired those assets.

278. Under the trustee supervisory model, it would be consistent for the requirement for this consent to be given by the trustee rather than the regulator. However, where there are employer representatives on the board of trustees the potential for conflicts of interest to arise means that it may be more appropriate for the regulator to retain a role in approving the reversion.

Questions for Submission

76. Do you think there is a need to further specify the sorts of matters that should not be left to the discretion of an employer or third party? If so, which matters should this prohibition apply to?

77. Do you agree that the trustee should be required to give consent to the reversion of assets to a third party? Should this decision rest with the regulator where there is an employer representative on the board of trustees? Are there any problems with the current reversion provisions in the Superannuation Schemes Act?

4.3 EMPLOYER STAND-ALONE SCHEMES

4.3.1 Issues Arising for Employer Stand-Alone Schemes

279. Particular issues arise when considering how current employer stand-alone superannuation schemes fit within the proposed CIS structure. A particular concern is that given the potential higher costs to employers associated with these schemes over master trust arrangements, and the relative ease with which an employer may contribute to an employee's scheme through KiwiSaver, any additional costs imposed through a change in structure would push these schemes to seek to either transfer the members in the scheme to a scheme with a lower-cost structure, or to wind up.

280. If funds are withdrawn, as a result of either member withdrawal or wind-up of the scheme, funds within the scheme will be released back to the member. There is a risk that these funds will be spent rather than reinvested. This means that if a change in regulatory structures pushes a number of these schemes to wind-up, there is a risk of a moderate decline in the aggregate level of funds in savings.

281. A further distinctive feature of these schemes is the nature and composition of their boards of trustees. Where a board of trustees has both employer and employee representation, this broad range of interests can enable the board as a whole to have effective independence. However, there is a potential risk that the employer could unduly influence the board in the exercise of its trustee functions. There is also a risk that trustees on these boards do not have the same level of experience or knowledge of trustee duties that a professional trustee would have.

4.3.2 Proposed Exception from CIS Framework for Existing Stand-Alone Schemes

4.3.2.1 Application of the Exception – Definition

282. As a result of the concerns about scheme wind-up, and because the trustee of an employer scheme is generally separate from the management of the scheme (hence some of the concerns relating to the potential for conflicts of interest may not be as significant for these schemes), we are proposing a transitional structure that would apply to existing stand-alone employer schemes on a continuing basis (i.e. until the scheme is wound up).

283. The transitional structure would not apply to employer master trust schemes. The concerns about the impact of increased costs and the potential for scheme wind-up do not apply to those schemes – rather, wind-up of employer stand-alone schemes is in part linked to the availability of lower-cost master trust structures. In addition, concerns about the potential for conflicts of interest are more significant in employer master trust schemes because the trustee in these schemes is generally much more closely linked to the scheme provider.

284. Because this is a transitional framework only, any new employer stand-alone schemes that are established will not fall within the transitional framework. The application of the framework to new stand-alone employer schemes is discussed below.

285. The transitional framework is complemented by the proposed transfer provisions outlined from paragraph 186 of this discussion document, which would enable a stand-alone scheme to transfer its members to a new scheme if the benefits provided by the new scheme are equivalent to, or better than, the current benefits provided to members.

286. For the purpose of applying this transitional framework, there will need to be a definition of a stand-alone employer scheme. We intend that the definition will cover schemes that have a single trust structure, but that it would exclude master trust arrangements where there is a single trust deed with multiple employer participation agreements. We also propose that the regulator should have the power to declare that a scheme does or does not fall within the definition of employer stand-alone scheme for the purposes of this exemption.

4.3.2.2 Transitional Framework for Existing Stand-Alone Superannuation Schemes

287. The transitional provision proposed is that the current trustee structure of the Superannuation Schemes Act will continue to apply for existing stand-alone superannuation schemes. The trustee will therefore have a similar role to the current

superannuation scheme trustee. The requirement in the *Supervision of Issuers* discussion document that a board of trustees of a scheme be "fit and proper" will apply to existing stand-alone superannuation schemes that fall within the transitional framework, with some changes: see the *Supervision of Issuers* discussion document and the paragraphs under the heading "Fit and Proper Entry Requirements" in part 4.3.3.1 of this discussion document.

288. The powers and duties of the CIS trustee will also apply to the trustee of a stand-alone superannuation scheme, with some amendments, to take account of the fact that there will be no independent supervisor of these schemes and no separation of the trustee and issuer. The following table sets out the proposed powers and duties of the trustee of a stand-alone superannuation scheme within the transitional framework.

Powers of trustee of a stand-alone superannuation scheme	**Duties of trustee of a stand-alone superannuation scheme**
• To nominate another person or entity to hold the scheme property on trust; • Investment management; • To summon a meeting of members; • To attend and be heard at a meeting of members; • To nominate a person to chair a meeting of members; • To apply to the High Court for direction where a resolution from a meeting of members conflicts with the trust deed or law; and • To apply to the High Court for necessary powers in relation to scheme property.	• To hold scheme property on trust; • To pay out, invest and apply scheme property in accordance with the terms of the trust deed; • Report statistical information and information about the scheme to the regulator; • To report to scheme members about the scheme; • Comply with reasonable requests for information from the regulator; • To call a meeting on the direction of members; • To provide information of the affairs of a scheme at a meeting of members; • To act on the direction of investors at a meeting; • To hold any personal profits or benefits on trust on behalf of members; • To ensure reporting requirements in legislation are met; • To register documents with the regulator and/or Registrar; and • To maintain a website.

289. It is also proposed that the regulatory controls contained in the "Regulatory Controls" part of this discussion document should, in general, apply to transitional stand-alone employer schemes. However, given concerns about the potential wind-up of schemes if additional costs are imposed, it is important to consider the impact of the proposed changes to controls and whether the benefits of change would justify the costs of change. Taking account of these objectives, there may be a case for providing exceptions in relation to the following issues:

- Provisions around changes to trust deeds (the existing Superannuation Schemes Act provisions would continue to apply);
- Specification of the number of units in the scheme;
- Meetings.

290. In each of these areas, there are no current equivalent requirements applying to superannuation schemes. The provisions relating to changes to trust deeds and meetings are closely linked to the roles of the trustee and issuer within the trustee supervision model and it is not proposed that they should apply where there is no separation of functions in existing schemes. Specification of the number of units in a scheme will not be relevant for schemes that do not currently operate on a unitised basis and it may be both unnecessary and costly to place this requirement on them.

291. Other matters that are not currently required to be specified in superannuation trust deeds are:

- Specification of a methodology for determining and amending a scheme's investment strategy;
- Valuation of assets including timing and process; and
- Specification of the types of fees that are or could be deducted and how they would be calculated.

292. As a matter of practice, these matters are relevant for superannuation schemes and many superannuation trust deeds do address them in some way. In addition, these matters will be significant for members because they directly impact on the benefits payable. However, there are likely to be some costs to current schemes if they are required to develop and include provisions in the trust deed to deal with these matters where they are not already covered. This could exacerbate the potential for stand-alone superannuation schemes to wind-up.

4.3.2.3 New Stand-Alone Employer Schemes

293. For new stand-alone employer schemes, it is proposed that the general CIS structure set out in this discussion document should apply. However, there are particular questions about how the fit and proper entry requirements may apply to the board of trustees of a stand-alone employer scheme, given that these schemes are often constituted by representatives of the employer and sometimes by representatives of the employees. These issues are discussed in the section on fit and proper entry requirements below.

Questions for Submission

78. Do you agree that the proposed transitional framework should be applied to existing stand-alone employer schemes? How could stand-alone employer schemes be defined for the purposes of the exception?

79. More specifically, do you agree with the proposals for amended powers and duties of the trustee and manager and regulatory controls?

80. What do you consider are likely to be the costs imposed by the additional trust deed requirements to existing stand-alone schemes, and do you consider that these costs would outweigh the benefits of including the requirements?

81. More generally, what would be the additional costs of applying this transitional framework to existing stand-alone employer schemes? How would this compare to the costs of applying the proposed general CIS structure to existing schemes (i.e. if no exception was made for existing stand-alone schemes)?

4.3.3 Role of the Regulator

294. Under the proposed transitional framework, the regulator's role would need to be adjusted to take account of the lack of independence of the trustee from the scheme. In this case, rather than supervising the trustee who is the front-line supervisor, the regulator will need sufficient powers to supervise the scheme itself. In that way, the role of the regulator will be similar to the current role of the Government Actuary under the Superannuation Schemes Act, but could include a broader range of powers. The key proposed powers of the regulator (in addition to those powers under the "Regulatory Supervision" part of this document) are:

- A duty on the regulator to review documentation (e.g. disclosure and reporting documentation provided by the scheme to determine compliance with regulatory requirements, the trust deed and the terms of the offer;

- A power for the regulator to question the trustee and seek responses/assurances in relation to any matter. This power could be similar to the powers that the Securities Commission currently has to summon witnesses;

- A power for the regulator to make inspections of the scheme and require the scheme to produce any documents. This power could be similar to the powers that the Securities Commission currently has to inspect documents, or request the Registrar of Companies or any other authorised person to inspect documents; and

- A power for the regulator to direct trustees to undertake any action in order to comply with regulatory requirements, the trust deed or the terms of the offer.

Question for Submission

82. Do you agree that the proposed powers of the regulator would effectively address

concerns arising from the lack of independent monitoring by the trustee in these transitional schemes?

4.3.3.1 Fit and Proper Entry Requirements

295. There is a further issue about how the fit and proper entry requirements for trustees could be applied in the case of stand-alone employer schemes. In particular, it may be difficult to apply a test of independence to a board with representatives from the employer or the employee, although as a group the board may be able to achieve effective independence. We are proposing that a board of trustees with representation from both the employer and employees should satisfy the independence test in these circumstances. There is also a question as to whether these boards should be required to have at least one individual trustee that is independent of the other parties involved in the scheme.

296. The advantage of requiring representatives from both the employer and the employee on the board is that it helps to ensures that the board takes adequate account of the interests of all parties, although there is also the potential for an employee representative to be effectively bullied by an employer representative. While currently there is often employer representation on boards, employee representation is less common. Requiring this representation may impose some additional costs on schemes where there is currently no representation (a member election process can be both expensive and time consuming) and some smaller schemes may have difficulty establishing interest amongst the employees for a member to seek election to the board. The concerns about cost could be alleviated by requiring schemes above a specified size to have member representation on the Board.

297. Requiring an independent trustee is likely to bring a number of benefits. An independent trustee brings someone to the board who is able to provide an impartial view – this may be useful where the other representatives on the board have an employment relationship which sits alongside, but outside of, the superannuation scheme. However, anecdotal evidence suggests that only a minority of stand-alone superannuation schemes currently have an independent trustee. Some superannuation advisory group members also considered that there were no problems currently arising with conflicts of interest in relation to boards of trustees of stand-alone employer schemes. An independent trustee would also be likely to require a fee for their services, which would increase the costs of the scheme.

298. Another issue is how the competence requirements of the fit and proper test may be satisfied for stand-alone employer schemes. Requiring a professional trustee can bring a level of expertise and experience to the board that it may not otherwise have if it is comprised of representatives of the employer and employee. This could help to ensure that the board as a whole is both aware of, and complies with, its obligations under the Trustee Act. However, it has also been suggested that the benefits of a professional trustee could be achieved through other mechanisms, such as a professional secretary or an advisory trustee. Rather than focusing only on the composition of the board of the trustees, the Regulator could consider the capacity of the board to outsource professional advice and expertise.

299. If the independence requirements for the fit and proper test are applied to the board as a whole, there is a further question as to whether this should be a transitional requirement only (in that it would only apply to existing schemes), or whether it should also apply to all new stand-alone employer schemes. There are benefits in having employer and member representation on a board of trustees, as these representatives are both likely to have a real interest in ensuring the scheme operates in the interests of members. However, any issues of professionalism may be exacerbated where the trustee has a supervisory role, rather than its current role under the Superannuation Schemes Act. Because the trustee is effectively the front-line supervisor under the CIS framework, it will be particularly important that the trustee is aware of its duties and both responsive and effective in fulfilling those duties.

300. A further issue that arises with stand-alone schemes is that they often have procedures in the trust deed for the appointment and dismissal of trustees. There is a question about how these trust deed provisions would sit with the requirement for the regulator to assess whether the trustee is "fit and proper". Because appointment processes can be costly, there is the potential for a scheme to be put to some cost if an appointment is made subject to the approval of the regulator. However, in practice the board could go through a negative assurance process in relation to the candidates put forward for election prior to the election taking place. The board may also be able to seek some guidance from the regulator prior to the election process about the mix of expertise on the board and possible criteria that could be applied to candidates for election.

Questions for Submission

83. Do you agree that fit and proper entry requirements around independence should apply to the board of trustees as a whole in a stand-alone scheme, and that this should enable the board to have representatives from the employer and the employee?

84. If the independence requirements do apply to the board as a whole, should there be a requirement for broad representation on the board, i.e. representation from the employer, employee and or an independent trustee? What would be the costs of imposing this requirement on current schemes?

85. Should the proposals relating to independence of the board for a stand-alone scheme apply only to existing schemes, or should they apply more broadly to any new stand-alone employer scheme?

86. How could or should the regulator's approval of the trustee fit with procedures that may be contained in the trust deed for appointment of trustees to the board?

4.4 DEFINED BENEFIT SUPERANNUATION SCHEMES

4.4.1 Introduction

301. A defined benefit superannuation scheme guarantees a defined benefit for a member upon a specified event (this is often when he or she retires, leaves service, dies or becomes disabled). The benefit is often expressed as a percentage of the member's average salary or salary upon retirement or leaving and often relates to length of

membership. These schemes are distinguished from defined contribution superannuation schemes in that the contributions a member makes to a defined benefit scheme are not allocated on a defined basis to that member until a specific event (e.g. retirement) or withdrawal.

302. This part describes the features and profile of defined benefit schemes, and outlines proposed amendments to address concerns raised with the current regulatory environment.

4.4.2 Features of Defined Benefit Schemes

303. A distinctive feature of defined benefit superannuation schemes is the nature of the employer's involvement in the scheme. In most schemes the employer bears the liability for funding the promised benefit. Because of this, the employer also bears the risk of low or negative returns. Two further risks are wage and salary escalation (because benefits are tied to salaries), and longevity of the member (because the employer has guaranteed the payment of the pension). The employer also generally meets some or all of the costs of the scheme operation. Historically, employers have been represented on the board of trustees of defined benefit schemes, with very little employee or member involvement. Traditionally, schemes have also not had an independent trustee.

304. Because defined benefit schemes are centred around a promise of a future benefit upon a defined event, and the assets of the scheme are not allocated to a member until that event, these schemes do not easily fit with the concepts of portability or transferability of benefits. Most defined benefit schemes enable a member to withdraw from the scheme, but the benefit that the member receives on withdrawal is generally significantly less than the member would receive if they were able to access the benefit upon a specified event.

305. Benefits that a member receives on wind-up are also generally less than the member would receive on the defined event, and will depend on the level of funding of the scheme. Scheme wind-up will also stop the accrual of future benefits to a scheme member. A particular objective with these schemes is, therefore, to minimise any incentives for scheme wind-up.

306. Another feature of defined benefit schemes is that because funding is not allocated to particular members, there is no choice of investment fund to suit individual members' profiles. Rather, as with all superannuation schemes, the funds must be invested in accordance with the trustee's general duty to exercise their powers in the best interests of all present and future beneficiaries of the trust.

307. The nature of the benefit received by a member under a defined benefit scheme has historically often been paid as a pension or annuity on retirement. Again, this differs from most defined contribution schemes, where benefits are generally paid as a lump sum to members. This may, however, be in part symptomatic of the limited market for annuities in New Zealand. Currently there is only one provider offering annuity products within the New Zealand market.

308. There are a further category of defined benefit schemes that can be described as "hybrid" defined benefit and defined contribution schemes. These schemes can arise when an historical defined benefit scheme sets up a defined contribution section within the scheme. In many cases the defined benefit section is closed to new

members (to limit the employer's liabilities) although new members may be able to join the defined contribution section.

309. Another example of a hybrid scheme is where a defined benefit scheme sets up a defined contribution section that sets the contribution rates for the employee members and the employer promises a benefit to the member that is based on their level of contribution. For example, this may be two times their accumulation on retirement. The employer in this case would fund the scheme to meet that benefit.

4.4.2.1 Profile of Defined Benefit Schemes

310. There has been a decline in the number of defined benefit schemes in New Zealand over the last 15 years, from 452 schemes in 1990 to 156 schemes in 2004. New defined benefit schemes are rarely established, only three new defined benefit schemes have been registered with the Government Actuary in the last five years (these have been the result of mergers of existing schemes rather than the creation of new schemes). However, defined benefit schemes still have assets of $4.935 billion (49.6% of employer schemes assets) and there are 69,442 defined benefit scheme members out of a total of 270,490 employer scheme members.

311. A shift from membership of defined benefit to defined contribution schemes has also been observed internationally. The OECD has noted that:

> *The shift from defined benefit to defined contribution pension plans is a phenomenon spread throughout most of the OECD. The changing design of pension plans has led to the growth of a new type of pension funds that has much in common with investment funds and other collective investment schemes. The pension fund in the Czech republic, Hungary, Italy, Poland, Portugal, the Slovak Republic and Spain are all largely or solely supporting defined contribution arrangements.*[26]

312. The Government Actuary's Office has commented that of the 140 defined benefit schemes registered in New Zealand, 64 schemes (approximately 45% of all defined benefit schemes) are still open to, and accepting, new members. There were 5,500 new members into these schemes in the last year. The majority of the open schemes are likely to be hybrid schemes, and it may be fair to assume that the new members are joining the defined contribution sections of those schemes.

313. One of the reasons employers may want to establish a defined benefit scheme would be as a result of a company split or sale where a defined benefit scheme was in existence and offered to employees. Due to employment conditions, the new employer might be legally required to offer similar superannuation provisions and may accordingly establish mirror schemes in to order to avoid any liability. International companies operating in New Zealand may also wish to offer benefits to expatriate employees.

314. There are various possible explanations for the decline in the number of defined benefit superannuation schemes, including:

- As discussed above in relation to employer stand-alone schemes more generally, the development of lower cost master trust structures has provided

[26] OECD – Pension Markets in Focus – June 2005 Issue 1, p8.

an alternative for employers seeking to establish a superannuation scheme for their employees;

- Employees are less likely to stay with the same employer over the length of their career than they may have been in the past and defined benefit schemes are generally designed to reward long-term service; and

- Employers may be increasingly reluctant to take on the open-ended liability and cost of a defined benefit scheme. Historically, however, defined benefit schemes were seen as stronger retention mechanisms given the security of benefit that they offer to members. In the shift from defined benefit to defined contribution schemes, the risks of salary escalation and longevity are passed from the employer to the employee.

4.4.3 Defined Benefit Schemes – Key Regulatory Issues

4.4.3.1 Regulatory Framework for Defined Benefit Schemes

315. There is currently no definition of a "defined benefit scheme". However, the Superannuation Schemes Act currently applies requirements for actuarial examinations to any scheme that:

> *operates on the principle of unallocated funding; or provides benefits that are dependent upon the contingencies of human life, and the risks associated with those benefits are not fully insured with a company engaged in the business of life insurance.*

316. This definition picks up on the key areas of difference and risk with defined benefit schemes, i.e. that funds are not allocated specifically to the member and that benefits received are based on the longevity of the member. There are some concerns, however, that this definition may not include a scheme that operates as a defined benefit scheme but allocates funds to specific member accounts. This concern has been addressed for KiwiSaver schemes (which are required to be defined contribution schemes), by specifying that a member's interest in the scheme must be fully funded at all times. The converse approach could be taken in a definition of a defined benefit scheme, i.e. specifying that a scheme that is not fully funded (aside from unvested employer contributions) will be a defined benefit scheme. This discussion document will use the Superannuation Schemes Act definition as a base working definition for the schemes to which the proposals relating to defined benefit schemes will apply, but we would value comment on whether the definition of defined benefit scheme should be expanded to include concepts of funding.

317. Defined benefit superannuation schemes are invariably also stand-alone employer schemes. We are therefore proposing that the transitional structure (identified in the "Employer Stand-Alone Schemes" part of this document) would apply to existing defined benefit schemes. We are also proposing that the current checks and balances in the Superannuation Schemes Act which apply specifically to defined benefit schemes should, in general, continue to apply to all defined benefit schemes (i.e. both existing schemes and any new schemes). These checks and balances are:

- A requirement that an actuary examines the financial position of the scheme as at dates that are no more than three years apart;

- A duty on the trustee to ensure that the actuarial report is received no later than seven months after the date at which the financial position of the scheme was examined;

- A duty on the trustee to send a copy of the report to the Government Actuary within 28 days after the date on which it is received by the trustees;

- A right for a member to receive on request a statement of the specific interest, mortality and other assumptions and bases of calculation applied in determining the value of the assets and liabilities of the scheme for the purposes of the actuarial examination required under the Act;

- Where a member is considering a proposed change to their benefits (e.g. an election to convert a benefit to a lump sum, an election to defer receipt of a benefit or an election to transfer the benefit), a right for a member to receive on request a statement of the specific interest, mortality and other assumptions and bases of calculation applied in determining the benefits under consideration and, where different assumptions and bases of calculation have been applied in the last 12 months to determine benefits similar to those under consideration, a statement of the reasons why the different assumptions and bases were applied; and

- Where a scheme is wound up, a right for a member to request a copy of the actuarial examination of the scheme, a statement of the specific interest, mortality and other assumptions and bases of calculation applied in determining the value of the assets and liabilities of the scheme for the actuarial examination and a statement of the specific interest, mortality and other assumptions and bases of calculation applied in determining the person's benefits.

318. There are, however, some further features of defined benefit schemes that raise particular issues for the way that these schemes should be regulated, and there are some further measures which could be taken to address concerns that have been identified with the current regulation. These are outlined below.

Questions for Submission

87. How should defined benefit schemes be defined in legislation?

88. Do you agree that the proposed transitional structure for defined benefit schemes will be effective? Are there sufficient checks and balances within this structure to address the risks that are inherent in defined benefit schemes?

4.4.4 Funding of Defined Benefit Schemes

319. As noted above, defined benefit schemes are funded on an unallocated basis. In practice, these schemes are funded to a particular level, which may or may not be sufficient (at a specified point) to fund all benefits due to members either on withdrawal or on an event specified in the trust deed.

320. Schemes are generally funded through a combination of the employee's contribution and a contribution by the employer. The level of the employer's contribution may

vary, depending on the level of existing funding of the scheme and estimates of the level of funding required to adequately pay benefits to members. An employer generally has a discretion to take a contributions holiday (i.e. make no contributions to the scheme) at any time.

321. Currently there are no specified levels of funding required for superannuation schemes. Unless the trust deed governing a scheme has specific provisions, the level of funding of defined benefit schemes is discretionary. However, the current Superannuation Schemes Act reporting requirements require the trustees to certify in the annual report that the market value of the assets at the close of the financial year equalled or exceeded the total value of benefits that would have been payable if all members had ceased to be members and if provision been made for the continued payment of all benefits being paid to members and other beneficiaries. Note that there are proposals for changes to this reporting requirement contained in section 4.4.6 of the "Disclosure" part of the *Securities Offerings* discussion document.

322. The Government Actuary's office has previously commented that in the 2003 year a relatively high number of defined benefit schemes were under-funded as result of the 2000-03 period of negative investment performance. The Government Actuary's office estimates that 15-20 percent of defined benefit schemes are currently under-funded. However, other industry participants have commented that they do not consider there is a significant problem with under-funding of defined benefit schemes.

323. The introduction of International Financial Reporting Standards may also have a potential impact on the way that defined benefit schemes are valued and funded. It is unclear at this point what the impact is likely to be, but it has been suggested that one effect could be that schemes become more risk averse and that employer companies may pay more attention to defined benefit schemes. This could potentially flow through to increased funding levels for defined benefit schemes, or scheme wind-up.

324. It has been suggested that concerns about funding levels of defined benefit schemes could be addressed through establishing a target level of funding for these schemes. A target level of funding may help give greater assurance to members, however, there are issues associated with setting target levels. The level of funding required may differ depending on the particular circumstances of the scheme and economic conditions. It may be very difficult to specify a target that can apply effectively to all schemes. This concern can be alleviated by providing a target range, which may act as a trigger for some remedial action by the regulator. However, it is arguable that even a target range may not be sufficiently flexible.

325. There is a further question about whether ensuring funding levels within the scheme is the best mechanism for addressing concerns about the ability of a scheme to pay promised benefits. If an employer is required to pay funds into a scheme, they will not be able to use those funds for their business. In situations where there are concerns about funding levels, the employer may not be in a financial position to be able to increase funding levels. It may ultimately be better for both the employer and the scheme if the employer uses those funds to sustain or grow its business, rather than diverting them into the superannuation scheme.

Questions for Submission

89. Do you agree that there is currently a problem with under-funding of defined benefit schemes? If so, what is the extent of this problem?

90. If there is a problem, can it be effectively addressed by specifying target funding levels for schemes? How could these levels be designed to take retain some flexibility to take account of the circumstances of different schemes?

4.4.5 Actuarial Assessments, Valuations and Standard

326. The current three-yearly actuarial examination required under the Superannuation Schemes Act must be conducted by a fellow of the New Zealand Society of Actuaries. The standards that are used for actuarial examinations are set by the New Zealand Society of Actuaries, but are loosely based on United Kingdom and Australian standards. The New Zealand actuarial standard on reporting for superannuation schemes is contained in Professional Standard No. 2.

327. Aspects of determining the funding levels of defined benefit schemes are not straightforward. Future benefits payable are, among other things, dependent on future income growth, the life expectancy of the members and market fluctuations in investment performance. Therefore, the funding levels necessary to maintain an assurance that promised benefits are able to be paid may vary depending on the profile of members in the scheme and predicted investment performance.

328. Actuarial examinations of funding levels are made on the basis of actuarial assumptions. These assumptions are not specified as such in the actuarial standard. Actuaries are instead required to rely on their professional opinion. However, the standard does require the actuary to specify particular information about the assumptions that he or she has used in their actuarial report. The focus of the actuarial standards reflects the discretionary nature of funding levels for defined benefit schemes in New Zealand.

329. In addition, while the method of valuation and funding levels are also related to the professional opinion of the actuary, the current standard requires actuaries to report on:

- An explanation of the funding objectives and the valuation method used to achieve those objectives;
- An explanation of the implications of the funding objectives and the valuation method in terms of the stability of future contribution rates and future funding levels; and
- A statement as to whether or not there has been any change in the funding objectives, or the valuation method, or both, since the date of the report on the immediately preceding investigation, and, if so, an explanation of the effect of such changes.

330. Some concerns have been raised about the variety of assumptions that can be used for actuarial examinations, and the potential for lack of consistency between or clarity in how those assumptions may be applied. It has been suggested that the lack of prescription to ensure consistency between assumptions does not provide sufficient

certainty for members about the basis on which actuarial examinations are undertaken.

331. Greater clarity and consistency of actuarial assumptions could provide a more transparent basis for actuarial examinations, and help provide an assurance for members that there is a standard and robust basis for the valuation of their scheme. However, it may be difficult to prescribe assumptions that will be applicable to all schemes and assumptions may need to change over time to reflect changes in the environment.

332. An option that may provide members with a better assurance that the standards used by actuaries are sufficiently robust is to amend the governance arrangements for approval of actuarial standards. Proposals have been developed for governance arrangements for the development and approval of actuarial standards in the insurance context. These proposals are discussed in the "Licensing and Prudential Requirements" part of the *Insurance* discussion document. This structure could be equally applied to the standards for superannuation examinations.

333. A further issue is the frequency with which actuarial examinations are undertaken. Because examinations are undertaken every three years, it has been suggested that there is a risk that the financial position of the scheme could deteriorate during that period without an opportunity for either the regulator or scheme members to question the scheme trustees or intervene. This risk is mitigated, however, by the requirement for scheme trustees to certify that the market value of the assets equalled or exceeded the total value of benefits (see paragraph 321). In addition, it has been suggested that as actuarial recommendations are generally long-term in nature, more frequent examinations are unlikely to have a significant impact on funding levels of a scheme over the medium term.

334. More frequent actuarial examinations are also likely to be at some cost to the scheme. Examinations can cost between $5,000 and $20,000, depending on the nature and characteristics of the scheme. There is a risk that the additional cost of these examinations could further impact on the viability of some schemes (particularly smaller schemes) and provide an impetus for them to effect wind-up, which may be to the overall detriment of members.

Questions for Submission

91. Do you agree with the contention that actuarial assumptions that are used in valuations should be more consistent and transparent? Do you see any risks with greater prescription of assumptions?

92. What is your view on whether the governance arrangements for actuarial standard setting are sufficiently robust? Do you support the proposal for using the same governance structures for superannuation actuarial standard setting as for insurance actuarial standard setting?

93. Do you support more frequent actuarial examinations than are currently required under the Superannuation Schemes Act? How frequent do you consider that these examinations should be and why? Are you able to provide an estimate of the cost of an actuarial examination?

94. Do you agree that there is a need for more prescription in trust deeds around how

withdrawals should be valued? What provisions do you think should be required?

4.4.5.1 Valuation of Members' Benefit on Wind-up

335. Further issues potentially arise with the valuation of a members' benefit upon wind-up of a scheme. The formula for valuation of these benefits is generally contained in the trust deed. However, there are currently no regulatory requirements or restrictions on how these formulae are constructed. In practice, many trust deeds require that priority is given to the payment of pensions prior to payment of contributing members. This may be in recognition of the fact that a retired person will not be in a position to replace their retirement provision, whereas a younger person may be.

336. It has been suggested that these types of trust deed provisions can result in significant inequity between members of the same scheme who may have made similar contributions and be entitled to the same retirement benefits. A mechanism to reduce this inequity for any new defined benefit schemes may be to require a formula for paying wind-up benefits to be specified in the trust deed. There could be an additional requirement that the formula be equitable to all members of the scheme, taking account of matters such as levels of contributions paid and length of service.

337. However, placing restrictions in new trust deeds around wind-up benefits will not address problems of inequity that arise within current schemes. It has been suggested that concerns around wind-up benefits for these schemes could be addressed through a discretion by the regulator to approve an equitable distribution proposed by the trustee that differs from the requirements in the trust deed.

338. Such a provision may be difficult to administer in practice. Members will have entered into the scheme on the basis that they have certain rights to benefits and that they are to be paid those benefits according to a specified priority on wind-up of the scheme. Those members who may be entitled to an ongoing pension in priority to a payment to a contributing member are likely to feel that any subsequent change to that priority would be denying them of their legitimate right to the benefit. This sort of provision would also run counter to the trustee's general obligations under the Trustee Act to act in the best interests of all members. Because of these concerns, it may be very difficult for both the trustee and the regulator to effectively make a determination about the equity of a redistribution of priorities.

339. It has also been suggested that the lack of an annuities market in New Zealand is a contributing factor to the inequity of distributions upon wind-up. Because of the limited market, the price of annuities is relatively high. This, in turn, leaves fewer funds for distribution to contributing members.

Questions for Submission

95. Do you consider that current trust deed provisions can be inequitable in their treatment of different members upon wind-up?

96. Do you think that these issues can be effectively addressed for new schemes by restricting the type of wind-up provisions that can be included in trust deeds for defined benefit schemes? What sort of restrictions should apply?

97. Do you agree that trustees and the regulator should be given a discretion to amend priorities on wind-up provisions in current trust deeds? What would be the implications of such a provision, and could it be administered fairly in practice?

98. Could the limited annuities market in New Zealand be contributing to the perceived inequity of distributions on wind-up of schemes? If so, how could the annuities market be bolstered to address these issues?

4.4.5.2 Regulator Powers

340. Because the transitional framework for stand-alone employer schemes will be used as a base for defined benefit schemes regulation, it follows that the powers of the regulator (see paragraph 294) will also apply to existing defined benefit schemes.

341. However, the requirement for actuarial assessments in defined benefit schemes means that some additional regulator powers are likely to be required for all defined benefit schemes (i.e. both existing and any new schemes). The Superannuation Schemes Act currently requires that actuarial reports be submitted to the Government Actuary. However, the only powers the Government Actuary has in respect of schemes is the power to cancel the registration of the scheme, direct the trustees, administration manager or investment manager to operate the scheme in a specified way, or order that the scheme be wound up.

342. A particular concern is that there are currently no powers for the Government Actuary in relation to third party contributors to the scheme. This may be particularly important for defined benefit schemes, where funding is contingent on employer participation and contributions.

343. It is proposed that the regulator will need to have some additional powers to deal with concerns around the nature of defined benefit schemes and the employer's participation. In particular:

- The regulator will need to have the ability to monitor and take action in respect of actuarial assessments that are provided to it;
- The regulator could have the ability and discretion to work with the scheme trustee and employer to create and enforce a plan for dealing with issues that arise in relation to the operation of the scheme;
- As part of this, the regulator could have a power to direct a trustee, or the employer, in relation to funding levels; and
- The regulator may also need the power to contract expertise to support its monitoring activity, for example, it could contract actuarial expertise to assist with considering actuarial assessments of defined benefit schemes.

344. If these powers are given to the regulator, it will be important that these regulator discretions are exercised fairly in the interests of the scheme, the member and the employer. There may be a need to develop a set of principles to guide how the regulator may exercise the discretion.

Questions for Submission

99. Do you agree that there is a need for greater regulator powers to deal with issues that arise in relation to defined benefit schemes?

100. Do you support mechanisms that would empower the regulator to work with schemes to require them to address concerns about funding levels, which may include the ability to direct an employer in relation to the scheme?

101. If the regulator is given the sorts of powers that are proposed, do you consider that principles should be developed to guide that discretion? Should these principles be developed by the regulator or an independent body? What could these principles cover?

102. Do you consider that it is appropriate for the regulator to have an ability to direct an employer in relation to funding levels? What would be the implications of such a provision for employers?

5. Participatory Securities

5.1 INTRODUCTION

345. This part of the discussion document considers how to regulate those participatory securities that either:

    a. Come within the proposed definition of CIS, but may not appropriately be able to meet all of the requirements of the regulatory framework for CISs; or

    b. Do not come within the proposed definition of equity security, debt security or CIS.

5.1.1 The Current Regulatory Regime

346. Currently, a participatory security is any security that is not an equity security, a debt security, a unit in a unit trust, an interest in a superannuation scheme; or a life insurance policy.[27] A "security" is defined as any interest or right to participate in any capital, assets, earnings, royalties, or other property of any person.[28]

347. Property proportionate ownership schemes, income-pooling schemes attached to property developments, incorporated societies, marina schemes, forestry ventures/syndicates, racehorse syndicates, ostrich schemes, schemes offered in New Zealand by overseas issuers, some derivative products, and partnerships are some examples of schemes offering participatory securities to the public.

348. Some of those schemes will now come within the proposed definition of CIS (see paragraph 39 for the proposed definition of CIS), but it is likely there are some that will not.

349. In addition, considering the broad range of interests that come within the definition of "participatory security", some schemes offering participatory securities may not appropriately fit all of the proposed regulatory requirements applicable to CISs.

350. We also note that in the future, products may be designed that are not equity securities, debt securities or CISs.

351. At present the broad "catch-all" definitions of "security" and "participatory security" work to bring most such interests within the securities regulatory regime. Those that do not fit appropriately within the basic regime for participatory securities are generally granted exemptions by the Commission, which allows for a level and mode of regulation that is tailored to the needs of participants in these schemes. As the proposed reforms to CISs will create a more structured regime for these securities, it is likely there will continue to be schemes that do not fit well into the regulatory regime set out in the primary legislation.

352. One group of products that increasingly falls into the category of "participatory securities" are derivatives. It is proposed that derivatives and futures contracts be dealt with under a separate regulatory regime more suited to the complex nature of

[27] Definition of "participatory security", section 2(1) Securities Act 1978.
[28] Section 2D Securities Act 1978.

these products. Accordingly derivatives are not addressed in this discussion document. For a discussion on derivatives see the "Application" part of the *Securities Offerings* discussion document.

5.2 PROPOSED OPTION FOR REGULATING PARTICIPATORY SECURITIES

5.2.1 A CIS Trustee will be a Trustee in Legal Terms

353. We have proposed that the CIS trustee will be a trustee in legal terms for every type of CIS and will therefore have the same liabilities for its acts and omissions in the performance of its functions and duties and the exercise of its powers as it would if it were a trustee: see paragraph 98. This requirement may however raise some issues for CIS trustees of some participatory schemes (that is, for some schemes that are currently supervised by a statutory supervisor). Currently, it is not clear whether statutory supervisors are subject to trustee obligations and liable as if they were trustees, although there may be an argument that these obligations are already inferred on them.

354. We have considered the functions, duties and powers that CIS trustees will be required to perform and consider that trustee obligations and powers should also be imposed on the CIS trustee of a participatory scheme to ensure that the supervisors of those schemes are subject to the same regulation as other CIS trustees and that investors' interests are protected. We seek your comments on whether this proposal meets the objectives for regulating CISs or whether the imposition of trustee obligations and liabilities on CIS trustees of participatory schemes will be a considerable departure from their current obligations and will require them to be unjustifiably subjected to more onerous duties.

Question for Submission

103. Do you consider the CIS trustee should be a trustee in legal terms and, in particular, do you consider that trustee obligations and liabilities should be imposed on statutory supervisors? Why/why not?

5.2.2 Commission's Power to Exempt a Person from Compliance with the Proposed CIS Regulatory Framework

355. Where a security comes within the proposed definition of CIS, but is not appropriately able to meet all of the requirements of the regulatory framework for CISs, it is proposed that the Commission will have the power to exempt an issuer or a CIS trustee from that or those requirements, as it can at present.[29] For example, in respect of the CIS trustee for some participatory schemes the Commission may exempt a CIS trustee from the requirement to hold scheme property on trust.

356. Any exemptions will be subject to such terms and conditions as the Commission thinks fit.

[29] Section 5(5) Securities Act 1978.

5.2.3 A Back-stop Class of Securities

357. Where a security does not come within the proposed definitions of derivative, equity security, debt security or CIS, it is proposed that this be dealt with by retaining a "back-stop" class of securities.

358. This back-stop class of securities could be defined in the same way that "participatory security" is currently defined – that is, as a security that is not an equity security, a debt security, a CIS or a derivative. The current definition of "security" would be retained.

359. A potential difficulty with this is that the definition of "security" is, arguably, dependent on legal form rather than economic substance. It can also catch certain products or rights that are not ordinarily considered to be financial products or investments. This latter problem is addressed, in respect of certain land-based products, by reference to the term "contributory scheme". Section 2 of the Securities Act defines contributory scheme to mean:

> *Any scheme or arrangement that, in substance and irrespective of the form thereof, involves the investment of money in such circumstances that-*
>
> *(a) the investor acquires or may acquire an interest in or right in respect of property; and*
>
> *(b) pursuant to the terms of investment that interest or right will or may be exercised in conjunction with any other interest in or right in respect of property acquired in like circumstances, whether at the same time or not;*
>
> *but does not include such a scheme or arrangement if the number of investors therein does not exceed 5, and neither a manager of the scheme or any associated person is a manager of any other such scheme or arrangement.*

360. At present the term "contributory scheme" is used only as the test to ascertain whether an interest in real estate should be subject to the Securities Act. We seek your comments on whether this term should be used, in conjunction with the present definition of "security" to ensure that present and future products that have the characteristics of securities are given like regulatory treatment.

5.2.4 Proposed Regulatory Treatment

361. In practice there are only a small number of participatory securities that have required extensive exemptions from the Securities Act. For the most part these have been schemes that do not appear to require ongoing monitoring by a statutory supervisor, either because investors have greater security regarding the basic assets of the investment (such as for income pooling schemes associated with real estate) or because the right that comprises the security is not generally acquired in circumstances that fit well with the investment-directed structure of Securities Act regulation (such as many memberships of incorporated societies).

362. The exemptions that have been granted to accommodate these types of scheme vary significantly in the degree to which they alleviate the regulation applying to the product. This variance reflects the degree to which the Commission has considered that subscribers to these schemes require the protections offered by the Securities Act, balanced against the costs of compliance.

363. We seek your comment on what types of securities would not be declared to be an equity security, a debt security, a CIS or a derivative by the Commission and would fall within the back-stop class of securities. If those securities in the back-stop class have similar features, we will be able to design a regulatory framework applicable to the features of those securities (for example, a framework could be based on the current framework for the regulation of participatory securities: the requirement to have a supervisor, a constitutional document and disclosure to investors).

364. However, it may be the case that the securities in the back-stop class do not have similar features or investors with similar characteristics justifying similar regulatory treatment and similar investor protections. If this is the case, it is proposed that the Commission be given the flexibility to regulate these securities as it considers appropriate. Such a regime will not only catch those securities in the back-stop class that require separate regulatory treatment, but will also allow new and innovative products developed in the future to be appropriately regulated.

365. The use of this regime will be limited to those schemes that do not fit within the proposed statutory definition of an equity security, a debt security, a derivative and a CIS, or which are designated by the Commission as participatory schemes, rather than as CISs. This designation power will also allow the Commission to require an issuer to adopt the more formalised CIS structure where this does appropriately fit with the scheme and its objectives.

Questions for Submission

104. Are there any products that currently come within the definition of "participatory security" that you consider should not be regulated as securities under securities legislation?

105. Are there any products that currently do not come within the definition of "participatory security" that you consider should be regulated as securities under securities legislation?

106. Are there any products that currently come within the definition of "participatory security" that you consider may not appropriately fit all of the proposed regulatory requirements applicable to CISs?

- If so, what requirements would not work for that particular offer of securities?

107. Do you consider that the definition of "contributory scheme" should be used in conjunction with the current definition of "security" to ensure that present and future products that might not ordinarily be considered to be financial products or investments, but which have the characteristics of securities, are given like regulatory treatment?

108. We consider there will be only a small number of securities that are not derivatives, equity securities, debt securities or CISs. Can you provide any examples of the types of products and features of those products that will fall in the back-stop class of securities?

109. If the back-stop class of securities does not have similar features or investors with similar characteristics justifying similar regulatory treatment, do you agree or disagree with that the Commission should be given the flexibility to determine the most appropriate way to regulate these securities? What are your reasons for your opinion?

6. Other Issues

6.1 TRANSITIONAL PROVISIONS

366. We do not expect to implement the proposed framework for the regulation of CISs overnight. Introducing the framework will be complex – some aspects of the framework could be introduced as soon as the legislation is drafted, however other aspects will need to be transitioned in.

367. We will do more consultation on the implementation of CIS regulatory framework and any necessary transitional provisions when we have a clearer idea of what the regulatory framework will look like.

Question for Submission

110. Do you have any comments or ideas about transitional provisions in general or how particular transitional provisions should work?

6.2 CONSUMER DISPUTE RESOLUTION

368. A consumer disputes resolution and redress mechanism is one part of the regulatory framework for CISs. The problems and proposed options for consumer disputes resolution are discussed in the *Consumer Dispute Resolution and Redress* discussion document.

6.3 DISCLOSURE

369. Disclosure is one part of the regulatory framework for CISs. The problems and proposed option for CIS disclosure are discussed in the "Disclosure" part of the *Securities Offerings* discussion document.

APPENDIX 1: CURRENT DEFINITIONS

Current Definitions

370. Section 2 of the Trustee Companies Act defines *group investment fund* to mean:

> *a Group Investment Fund established under section 29 of [the Trustee Companies] Act. Section 29(1) of the Trustee Companies Act states "a trustee company may from time to time establish and keep in its books one or more Funds, each of which shall be called a Group Investment Fund. Where more than one Group Investment Fund is so established, each such Fund shall be given an appropriate distinguishing number.*

371. Section 2(1) of the Superannuation Schemes Act defines *superannuation scheme* to mean:

> *(a) Any trust established by its trust deed principally for the purpose of providing retirement benefits to beneficiaries who are natural persons [or paying benefits to persons who are the trustees of a registered superannuation scheme; or*
>
> *(b) Any arrangement constituted under an Act of the Parliament of New Zealand, other than the Social Security Act 1964, principally for the purpose of providing retirement benefits to natural persons.*

372. Section 2(1) of the Unit Trusts Act defines *unit trust* to mean:

> *any scheme or arrangement, whether made before or after the commencement of this Act, that is established under New Zealand law and that is made for the purpose or has the effect of providing facilities for the participation, as beneficiaries under a trust, by subscribers or purchasers as members of the public and not as an association, in income and gains (whether in the nature of capital or income) arising from the money, investments, and other property that are for the time being subject to the trust; but does not include—*
>
> *(a) A trust for the benefit of debenture holders; or*
>
> *(b) The Common Fund of [Public Trust]; or*
>
> *(c) The Common Fund of the Maori Trustee; or*
>
> *(d) Any Group Investment Fund established under the Trustee Companies Act 1960; or*
>
> *(da) any group investment fund established under the Public Trust Office Act 1957 or the Public Trust Act 2001; or*
>
> *(e) Any friendly society or credit union registered or deemed to be registered under the Friendly Societies and Credit Unions Act 1982; or*
>
> *(f) Any superannuation scheme which is registered under the Superannuation Schemes Act 1989; or*
>
> *(g) a share purchase scheme as defined in section OB 1 of the Income Tax Act 2004; or*
>
> *(h) Any trust fund or global asset trust or GAT subsidiary or pool within the meaning of the National Provident Fund Restructuring Act 1990.*

373. Section 2(1) of the Securities Act defines:

373.1. *life insurance policy* to mean:

> *a policy of life or endowment insurance, or a policy securing an annuity; and includes—*
>
> *(a) A policy of insurance that is declared by regulations to be a life insurance policy for the purposes of this Act; and*
>
> *(b) A renewal or variation of the terms or conditions of any such policy or a security referred to in paragraph (a) of this definition;—*
>
> *but does not include any such policy, or a security referred to in paragraph (b) of this definition, or a term life insurance policy (within the meaning of regulations) that is declared by regulations not to be a life insurance policy for the purposes of this Act.*

374. *Participatory security*. It is the current “catch-all” security. That is, the definition is phrased in the negative to capture any security that is not an equity security, a debt security, a unit in a unit trust, an interest in a superannuation scheme, or a life insurance policy.

APPENDIX 2: CURRENT DUTIES OF TRUSTEES AND STATUTORY SUPERVISORS

375. Amongst other common law duties, the primary duty of all trustees is to use the same diligence and care in managing the trust as people of ordinary prudence and vigilance would use in managing their own affairs.[30] Trustees must act at all times in good faith and in the best interests of all the members.

376. The following is a summary of the duties currently prescribed in the Unit Trusts Act for unit trustees, the Superannuation Schemes Act for superannuation scheme trustees, and the 7th Schedule to the Securities Regulations for statutory supervisors of participatory schemes.

Unit Trustees

The unit trustee's duties under the Unit Trusts Act include:

a. holding the investments and other property that are subject to the trusts governing the unit trust in the name of the unit trustee or in 1 or more nominees: section 3(3);

b. not acting on any direction of the manager to acquire any property for the unit trust or dispose of any property of the unit trust if, in the trustee's opinion, the proposed acquisition or disposal is manifestly not in the interests of the unit holders; and the trustee shall not be liable to the unit holders or to the manager for so refusing to act on any direction of the manager. This is implied into all unit trust trust deeds by section 12(1)(c);

c. acting on the directions of unit holders: section 18(2);

d. notifying the District Registrar of being appointed as a new unit trustee: section 20(3);

e. observing the care and diligence in the performance of its duties as any other trustee: section 24; and

f. holding personal profits and/or benefits (except remuneration) on trust for the benefit of members: section 26.

Superannuation Scheme Trustees

377. The "trustee" position in superannuation schemes is different to that in the other securities issues discussed, as the trustee itself is the issuer under the Securities Act.[31]

378. The trustee of a superannuation scheme's duties under the Superannuation Schemes Act include:

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[30] *Brice v Stokes* (1805) 11 Ves 319; 32 ER 1111; [1803-13] All ER Rep 401; *In re Speight* (1883) 22 Ch D 727, 739 per Sir George Jessel MR. Quoted in *Re Mulligan* [1998] 1 NZLR 481, 500.
[31] Section 2 definition of "issuer" Superannuation Schemes Act 1989.

a. Responsibility for administering the trusts governing the superannuation scheme: section 2 definition of “trustees”;

b. Investing all money in accordance with the provisions of the Trustee Act as to the investment of trust funds. This is implied into trust deeds by section 8(a);

c. When exercising the power of investment, exercising the care, diligence, and skill required of it by section 13B or section 13C of the Trustee Act. This is implied into trust deeds by section 8(b);

d. Notifying members, beneficiaries and the Government Actuary of a proposed transfer of members or beneficiaries to a new superannuation scheme: section 9B;

e. Certifying that any amendments made to a trust deed will comply with the requirements for the content of trust deeds and are not contrary to implied provisions in the trust deed nor contrary to the provisions of the Act. The trustee must lodge that certificate and a copy of the amendment with the Government Actuary: section 12;

f. Ensuring proper books of account are kept, that they are prepared in accordance with GAAP, and that they are audited annually (unless the scheme is fully managed by an administration manager which provides annual audited accounts in respect of its total business to the regulator, and the trustees certify that all contributions were passed to and paid by the administration manager and the trustees hold no funds): section 13;

g. Preparing an annual report, and sending the completed annual report to the Government Actuary: section 14;

h. For defined benefit schemes, ensuring that an actuary examines the financial position of the scheme as at dates no more that three years apart, ensuring that the actuary’s report is received no later than 7 months after the date as at which the financial position of the scheme was examined, and sending a copy of the actuary’s report to the Government Actuary: section 15;

i. Meeting all disclosure requirements and rights to information for prospective members: sections 15A and 16;

j. Providing all information required as of right or on request by all members on an ongoing basis: section 17;

k. Notifying the Government Actuary as soon as possible if the superannuation scheme ceases to have a trustee who is a New Zealand resident: section 18; and

l. Where a superannuation scheme is wound up, lodging a copy of the resolution with the Government Actuary, ensuring final accounts are prepared and audited (unless there is no need according to Act), sending a copy of final accounts to the Government Actuary and to every member of the scheme before it was wound up, advising the Government Actuary and members how assets of the scheme will be distributed, and informing the Government Actuary of the date on which the final distribution of assets is completed: section 21.

379. It should be noted that some of the above duties are often delegated to a third party administration or investment manager as appropriate.

Statutory Supervisors

380. The statutory supervisor's statutory duty in respect of participatory schemes is prescribed in the 7th Schedule to the Securities Regulations 1983.

381. The statutory supervisor's duty is to exercise reasonable diligence to ascertain whether any breach of the terms of the deed of participation or of the offer of the participatory securities has occurred and, except where satisfied that the breach will not materially prejudice the interests of the holders of the participatory securities, it must do all things it is empowered to do to remedy any such breach: clause 1, 7th Schedule to the Securities Regulations.

APPENDIX 3: CURRENT POWERS OF TRUSTEES AND STATUTORY SUPERVISORS

382. The following is a summary of the powers and rights currently prescribed in the Unit Trusts Act for unit trustees, the Superannuation Schemes Act for superannuation scheme trustees, and the 7th Schedule to the Securities Regulations for statutory supervisors of participatory schemes.

Unit Trustees

383. The unit trustee has the following powers and rights under the Unit Trusts Act:

a. To nominate one or more persons in which are vested any of the investments and other property that are subject to the trusts governing the unit trust: section 6(1);

b. To inspect the manager's books and papers and all books and papers relating to the unit trust, and to be provided with such information as the unit trustee requests relating to the unit trust, or to the business, property or the affairs of the manager: section 12(1)(b)(i) and (ii);

c. To request the manager to summon a meeting of unit holders. This is implied into all unit trust trust deeds by section 12(1)(d)(i);

d. To nominate a person to chair a meeting of unit holders, where that meeting was requested by the unit trustee or unit holders: section 18(1);

e. To apply to the High Court for directions where unit trustee is of the opinion that any direction given to it by the unit holders conflicts with the trusts or any rule of law or is otherwise objectionable: section 18(4);

f. To apply to the High Court for an order to remove the manager: section 19(1);

g. To remove the manager where the unit trustee certifies that to do so is in the interest of unit holders: section 19(2);

h. To apply to the High Court in certain circumstances for additional powers of management: section 22(1);

i. To appoint a temporary manager upon the resignation or removal of the manager: section 23; and

j. To apply to the High Court to assess damages against a delinquent director or other officer of the manager if, in the course of winding up the manager, it appears that the manager has misapplied or retained or become liable or accountable for any money or property of the unit trust, or committed any misfeasance or breach of trust in relation to the unit trust: section 27.

Superannuation Scheme Trustees

384. The trustee of a superannuation scheme has the following powers and rights under the Superannuation Schemes Act:

a. To contract some or all of the investment management and administration of the scheme to an investment manager or administration manager: section 2(1) definitions of “administration manager” and “investment manager”;

b. To apply to the Government Actuary for registration of a superannuation scheme: section 3;

c. To amend the trust deed, within the limitations of the Act: sections 7 to 10; and

d. To apply to the Government Actuary to cancel the registration of a superannuation scheme: section 19(2).

Statutory Supervisors

385. A statutory supervisor of a participatory scheme has the following powers and rights under the 7th Schedule to the Securities Regulations:

a. To obtain information about the scheme, attend and be heard at a meeting of security holders, and require the manager of the scheme to make available all financial and other records: clause 2;

b. To summon a meeting of security holders: clause 4(1)(b); and

c. To appoint the chairman of a meeting of security holders: clause 4(3).

APPENDIX 4: EXCERPTS FROM THE FSAP REPORT RELATING TO CISS

Excerpts from the Financial Sector Assessment Programme ("FSAP") report on New Zealand's compliance with the International Organisation of Securities Commission Principles and the Financial Action Task Force ("FATF") Recommendations

FSAP made the following assessments in relation to IOSCO Principles 17 to 20.

Principle 17. The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.

Description

There are six types of CIS in New Zealand: (1) unit trusts; (2) superannuation schemes; (3) contributory mortgages; (4) life insurance policies; (5) group investment schemes; and (6) participatory schemes.

All marketing of CIS to the public must be done in accordance with the Securities Act (i.e. the provisions applying generally to offerors of securities and offers).

Although operators (or supervisors of operators) of CIS are subject to various duties (e.g. to act with due care and in the best interests of CIS unitholders), only the statutory supervisors of operators of participatory schemes are subject to comprehensive eligibility criteria. In respect of other types of CIS, certain arrangements intended to protect the interests of unitholders are required. In very general terms, there usually are requirements: (1) to segregate the assets of the CIS from those of the operator (e.g. through trust accounts, arrangements to have independent nominee companies or trustee companies to hold assets, etc.); and (2) to have a trust deed or similar document executed by the issuer/operator and a trustee, who will supervise the fulfilment by the issuer/operator of its obligations under this document. In respect of some CIS, there are basic criteria relating to the fitness and integrity of the operator (or supervisor of the operator).

For example, it is a criminal offence for any person who has been convicted of a crime involving dishonesty to act as a director, officer or responsible employee of a manager of a unit trust, except with the consent of the relevant Minister.

It is a criminal offence to make materially misleading statements in offer documents or advertisements and/or to offer, distribute or allot securities in contravention of the Securities Act. Likewise, it is a criminal offence to offer an interest in a unit trust in contravention of the Unit Trusts Act 1960. The Securities Commission's powers in respect of prospectuses, investment statements and advertisements are described above in relation to Principle 14.

The Court can remove managers of unit trusts on application by the responsible Minister, a unit trustee or a unitholder. The Government Actuary has certain powers to direct the operation of a superannuation scheme if he believes that it is operating in contravention of the governing legislation, and it is a criminal offence not to comply with such a direction. The Securities Commission can make certain orders in respect of contributory mortgage brokers (e.g. to prohibit a broker from continuing to act in respect of existing mortgages and appoint another broker in its place, and to replace the directors of the broker's

nominee company). The Securities Commission can also revoke the authorisation of a participatory scheme's statutory supervisor.

CIS operators and/or the supervisor of CIS operators are subject to certain ongoing obligations (e.g. to keep offer documents accurate and up-to-date). Failure to do so may mean that allotments of securities are voidable. Among other things, material changes in respect of the operator, trustee or statutory supervisor may be considered material information in respect of the offer (e.g. where the quality of the management or organization was mentioned in offer documents), requiring an amendment or reissue of the prospectus. The general duty of companies to report changes in directorship or ownership to the Registrar of Companies applies to corporate entities involved in the operation or supervision of CIS. Operators generally must (pursuant to the trust deed or a statutory requirement) report material changes in their affairs to the trustee or statutory supervisor. Statutory supervisors must report material changes in their management or organisation to the Securities Commission. All issuers must keep proper accounting records, and must prepare and file audited annual financial statements under the Financial Reporting Act 1993. CIS' annual audited statements must be filed with the Registrar of Companies, who is required to refer all qualified audit reports to the Securities Commission and the Accounting Standards Review Board. The accounting records and legal compliance of contributory mortgage brokers must be audited quarterly. There is no program of routine inspections by a securities regulator. However, the Securities Commission has the power to inspect the affairs of a CIS (e.g., where the financial statements, offer documents or other sources of information suggest that there may be compliance or investor protection issues). More detailed provisions apply in respect of superannuation schemes, involving the Government Actuary and the scheme's own independent auditor or actuary.

In addition to a general obligation (e.g. to act with due care and in the best interests of CIS unitholders), a CIS operator other than a contributory mortgage broker usually is required to comply with specific obligations specified in the trust deed or deed of participation, some of which are prescribed by law. Its compliance with these obligations is supervised by the trustee or an appointed supervisor. In order to fulfil their fiduciary obligations of care to CIS unitholders, trustees for unit trusts, group investment funds and superannuation schemes implement compliance and monitoring programs. There is no specific requirement to do so, but carrying out such programs reduces the trustee's risk of liability to CIS unitholders. Securities and companies law of general application requires disclosure of interests, material transactions and related party transactions. Unit trustees, statutory supervisors and CIS operators are subject to the general obligations to act honestly with due care in the best interests of CIS unitholders. In addition, statutory supervisors are required to ensure that the CIS operator maintains appropriate operating procedures. Listed CIS are subject to additional requirements under the NZX Listing Rules. In respect of most CIS regulated in New Zealand, all contributions received by operators must be transferred to a trust account and held on trust by an independent person. This reduces the risk that an operator will misuse the CIS unitholders' property.

In general terms, a CIS operator can delegate its functions in relation to the CIS but not its legal obligations or liabilities. If a delegate assumes sufficient core functions of an operator, it is likely to meet the definition of "issuer" under the securities laws, in which case it will also become directly liable to the investors (as will the original operator). Delegation arrangements will be reviewed and monitored by trustees of unit trusts, group investment funds and superannuation schemes and by statutory supervisors for participatory schemes.

Part 5 of the Securities Act allows for mutual recognition and application of overseas securities regimes in New Zealand and for New Zealand's regime to be extended to overseas offers under application and regulation regulations.

Assessment

Not Implemented

Comments

Although the Securities Act provides a common regulatory framework for the regulation of the various types of CIS in their capacity as issuers and regarding the disclosure documents provided to prospective and/or continuing investors, the regulation of CIS operators/managers and their conduct varies according to the type of product. The various categories of CIS operators are regulated under different statutes and obtain authorisation from different regulators and authorities. General responsibilities, standards for performance and duties may be defined by general principles of trust law, while the more detailed requirements may be specified in contracts.

Accordingly, the regulatory scheme for CIS operators is relatively complex, and somewhat less transparent than some other aspects of the securities regulatory regime. The regulatory scheme does not prescribe in detail eligibility criteria for CIS operators, and there is no program for ongoing regulatory oversight of CIS operators.

The operation of CIS has been identified as a risk area by the Securities Commission and Ministry of Economic Development representatives have indicated that the regulatory scheme for CIS will be considered in the fourth stage of the securities law reform process. Several commentators advised the mission team that the operation of CIS in New Zealand is an area of concern, and that reform is needed. Reliance to some extent on supervision of CIS operators by trustees can be a cost-effective regulatory method. Certain improvements to the scheme, however, could reduce risks and enhance compliance. Possible reforms could include:

(1) the appointment of a trustee or statutory supervisor to oversee the conduct of contributory mortgage brokers (or provide for direct regulatory oversight);

(2) high level minimum entry and ongoing standards concerning CIS operators' honesty and integrity, competence, financial capacity, internal controls, powers and duties;

(3) general conflict of interest standards for CIS operators and their trustees or supervisors;

(4) minimum standards for CIS operators to provide periodic and timely reports to trustees or statutory supervisors (or to the appropriate regulator, if directly supervised by a regulator), including a requirement to immediately report material contraventions of any regulatory requirement or requirement specified in a trust deed or similar document;

(5) minimum requirements for trustees or statutory supervisors to conduct periodic inspections of CIS operators and make timely reports to the Securities Commission of any material contraventions by CIS operators of regulator requirements or requirements under the trust deed or similar document;

(6) the suspension or prohibition of any CIS operator by the Securities Commission; and

(7) the issuance of directions by the Securities Commission to a trustee or statutory supervisor that does not appear to be fulfilling its responsibilities and, in more serious situations where investor protection is jeopardised, to remove a trustee or statutory supervisor and replace such person with the Securities Commission's appointee.

Principle 18. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.

Description

For most CIS, the participants' rights are derived from a combination of statutory provisions, general legal principles governing trust relationships and the provisions of a trust deed or deed of participation. The CIS operator has some discretion to define these rights through negotiation of the trust deed or deed of participation with the trustee or statutory supervisor, but the trustee or statutory supervisor, due to its own obligations to act with due care in the best interests of unitholders, will insist that the deed contain certain protections. The Securities Regulations require all material matters to be disclosed in the registered prospectus for an offer of CIS units. This includes summaries of trust deeds or deeds of participation, material contracts, managers' and promoters' interests. Risks of the proposed investment must be set out in an investment statement, which must be given to all prospective investors.

The Registrar of Companies is responsible for registering trust deeds and deeds of participation for unit trusts, group investment funds and participatory schemes, for registration of contributory mortgage brokers and for ensuring that the form and structure requirements for these CIS are observed. The Government Actuary performs the same function for superannuation schemes.

In general terms, investors' rights form part of the investment contract and, therefore, cannot be changed without unanimous consent. In some cases the regulatory scheme provides for prior approval by the trustee or statutory supervisor on behalf of unitholders. However, any change that adversely affects investors' rights will have to be notified, and generally will require prior consent.

Some changes will be material and, therefore, the issuer/operator would have to file an amended prospectus with the Registrar of Companies before making further allotments of securities.

Segregation of assets is maintained in respect of unit trusts, group investment funds and superannuation schemes. A contributory mortgage broker must have a nominee company that operates a trust account in which contributions are held in the name of the nominee or the individual names of all contributors. For CIS that require a deed of participation, a deemed term of the deed is that the operator must ensure that all money received on behalf of the scheme is paid into the scheme's bank account. However, the manager is not required to establish a trust and there is no obligation to segregate scheme assets from scheme money.

Except for contributory mortgage schemes, the Securities Act provides that a CIS operator must keep a register of all shares/units and maintain proper accounting records of transactions in the scheme. The Unit Trusts Act imposes additional obligations on unit

trust operators. Contributory mortgage brokers must keep registers and maintain accounting records in relation to transactions involving the scheme. CIS operators must have their financial statements audited at least annually.

Provisions for the winding-up and/liquidation of CIS exist in legislation (for some CIS) or deeds of participation (for participatory schemes). The Government Actuary can issue directions to superannuation schemes in some circumstances. A statutory supervisor can apply to the High Court if it believes that the winding-up provisions may not give adequate protections to investors in the circumstances. As noted above, the Securities Commission can order a contributory mortgage broker to cease acting as such and to appoint a replacement broker.

Assessment

Partly Implemented

Comments

A Partly Implemented rating is assigned to this Principle, principally because: the regulatory scheme does not appear to provide for: (1) adequate assurance, through regulatory oversight, that standards relating to the legal form and structure of all CIS are enforced; (2) notification to the regulator of proposed changes to investors' rights; or (3) segregation of assets in relation to participatory schemes. It is recognised, however, that in respect of most CIS (except contributory mortgage schemes), the trustee or statutory supervisor has obligations to ensure that CIS unitholders are adequately protected. If some or all of the recommendations set out above in respect of Principle 17 were implemented, there would be greater assurance that the underlying objectives of Principle 18 were achieved.

In connection with the upcoming review of the Securities Act, the Securities Commission and/or the Registrar of Companies should consider reviewing a sample of trust deeds and deeds of participation to determine whether any significant concerns arise with respect to the terms negotiated by trustees and statutory supervisors for the protection of CIS unitholders. If problems are identified, it may be appropriate to specify minimum standards in the legislative framework (while making it clear that the trustee or statutory supervisor is free to establish higher standards through negotiation).

Principle 19. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.

Description

Public offers of CIS units are subject to the same disclosure requirements as public offers of any other types of securities (see the discussion in relation to Principle 14). In addition, in respect of offers of CIS units, prospectuses and/or investment statements must include, among other things, information regarding:

(1) the legal constitution of the CIS;

(2) investors' rights in the CIS;

(3) the asset valuation methodology;

(4) procedures for the purchase, redemption and pricing of units;

(5) relevant audited financial information;

(6) information about the custodian, if any;

(7) the CIS' investment policies;

(8) risk disclosure;

(9) the appointment of any external administrators, investment advisers or managers who have a significant and independent role in relation to the CIS; and

(10) fees and expenses in relation to the CIS.

Annual audited financial statements prepared in accordance with and registered under the Financial Reporting Act must be prepared for all CIS. The Unit Trusts Act requires the manager of a unit trust to send to unitholders each year an audited statement of accounts, together with a summary of any amendments to the trust deed made since the date of the last statement. An annual meeting is optional. For most other CIS, the operator is required to hold an annual meeting within six months after the end of the financial year to consider the previous year's financial statements.

Assessment

Broadly Implemented

Comments

CIS are subject to prospectus disclosure requirements as well as annual reporting requirements sufficient to provide the investor with the information needed to evaluate a fund's suitability and value. There is a concern, however, that unitholders do not receive annual reports in a timely manner, since such reports need not be made publicly available for almost six months after the end of the financial year (and only listed CIS disclose preliminary results at an earlier date).

Principle 20. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.

Description

There are asset valuation requirements for some types of CIS, but not all CIS are required to have net asset value calculations conducted on a regular basis in accordance with NZ GAAP. Financial statements for CIS must be prepared and audited annually. The statements must be prepared in accordance with NZ GAAP by a qualified independent auditor. There are specific regulatory requirements in respect of the fair valuation of assets where market prices are not available in respect of group investment funds but not other types of CIS.

All information relating to the circumstances of valuation, pricing and redemption is required to be contained in the deed of participation or trust deed, and material information

must be disclosed in the offer documents. Information relating to the purchase and redemption of units, the realisation of assets for the purposes of redemption, pricing of interests on redemption and circumstances in which redemption might be suspended would constitute material information. Material changes in such information would have to be disclosed in an amended prospectus. While regulatory requirements do not address the circumstances in which redemptions can be suspended, the scheme documentation usually permits suspensions of redemption, e.g. where the level of redemptions requested could be contrary to the interests of remaining unitholders.

There are no prescriptive requirements with respect to pricing errors.

The Securities Commission can intervene in an ongoing offer (e.g. by cancelling or suspending a registered prospectus) if, for example, the descriptions of the operator's practices in the offer documents are false or misleading. The statutory supervisor can apply to the High Court for directions if it appears that the terms of a deed of participation are insufficient to protect investors. The Government Actuary has certain powers to direct the operation of a superannuation scheme if he believes it is operating in contravention of the Act.

Assessment

Not Implemented

Comments

In respect of most CIS, the trustee or statutory supervisor negotiates with the CIS operator the terms relating to asset valuation, NAV calculations, and pricing and redemption of CIS units. The broad obligations of the trustee or statutory supervisor to act with due care in the best interests of unitholders provide some assurance that these matters will be properly addressed. This broad discretion could result, however, in significant variations in investor protections across different schemes. It is recommended, therefore, that consideration be given to adopting consistent, minimum regulatory standards regarding asset valuation, pricing and redemption.

Overall recommendations on IOSCO principles 17-20 (that is, those relating to collective investment schemes):

Amend the securities legislation to provide for:

(1) greater oversight of contributory mortgage brokers;

(2) high level entry and ongoing standards concerning CIS operators' honesty and integrity, competence, financial capacity, internal controls, powers and duties;

(3) general conflict of interest standards for CIS operators and their trustees or supervisors;

(4) minimum standards for CIS operators to provide periodic and timely reports to trustees or supervisors (or to the appropriate regulator);

(5) minimum requirements for trustees or statutory supervisors to conduct periodic inspections of CIS operators and make timely reports to the Securities Commission of any material contraventions by CIS operators of applicable standards.

FATF Recommendations

Following is Recommendation 23 of the FATF Recommendations, followed by the FSAP report on New Zealand's compliance with the Recommendation.

Recommendation 23

Countries should ensure that financial institutions are subject to adequate regulation and supervision and are effectively implementing the FATF Recommendations. Competent authorities should take the necessary legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function in a financial institution.

For financial institutions subject to the Core Principles, the regulatory and supervisory measures that apply for prudential purposes and which are also relevant to money laundering, should apply in a similar manner for anti-money laundering and terrorist financing purposes.

Other financial institutions should be licensed or registered and appropriately regulated, and subject to supervision or oversight for anti-money laundering purposes, having regard to the risk of money laundering or terrorist financing in that sector. At a minimum, businesses providing a service of money or value transfer, or of money or currency changing should be licensed or registered, and subject to effective systems for monitoring and ensuring compliance with national requirements to combat money laundering and terrorist financing.

FSAP response

There are reasonably comprehensive measures to prevent criminals taking control or acquiring a significant participation in a registered bank, and there are also some requirements, though less comprehensive, for sharebrokers. However, there are no requirements for other types of financial institutions, and this deficiency should be rectified.

As noted above, in order to ensure compliance with the anti-money laundering and countering the financing of terrorism ("AML/CFT") measures, New Zealand relies on framework based on industry discipline. There is no programme of supervision or monitoring. The Financial Transactions Reporting Act 1996 contains sanctions for failing to comply with the different provisions of the Act, and the New Zealand Police can conduct an investigation for such offences in the same way as for other offences. Both the Reserve Bank and the Securities Commission have the ability to conduct on-site inspections in banks and sharebrokers respectively, but AML/CFT requirements do not fall within the scope of the supervision. Otherwise there are effectively no oversight or monitoring mechanisms.

APPENDIX 5: CURRENT DUTIES OF ISSUERS

Manager of a Unit Trust

386. Under the Unit Trusts Act, the manager of a unit trust is required to:

a. Pay a bond to the Crown securing the due discharge by the manager of its obligations: section 4(2);

b. Lodge a copy of the trust deed with the District Registrar: section 9(1);

c. Send the audited accounts/financial statements and any amendments to the trust deed to unitholders annually: section 11(1) and (2);

d. Use its best endeavours to ensure that the unit trust is carried on in a proper and efficient manner. This is implied into all unit trust trust deeds by section 12(1)(a);

e. Make its books and papers available to the unit trustee for inspection. This is implied into all unit trust trust deeds by section 12(1)(b)(i);

f. Give information relating to the unit trust or to any business of the manager, or to any property of the manager, or otherwise relating to the affairs of the manager to the unit trustee. This is implied into all unit trust trust deeds by section 12(1)(b)(ii);

g. Summon a meeting of unit holders when so requested by the unit trustee or the specified number of unit holders. This is implied into all unit trust trust deeds by section 12(1)(d)(i);

h. Furnish the meeting of unit holders with copies of the last statements and summaries of accounts. This is implied into all unit trust trust deeds by section 12(1)(d)(ii);

i. Pay into a separate bank account any money received by it in respect of that unit trust, and pay that money (less any amount it is entitled to deduct or retain) within 7 days to the unit trustee or a nominated person: section 14;

j. File the relevant accounts: section 20;

k. Observe care and diligence in the performance of its duties as any other trustee: section 24; and

l. To hold personal profits and/or benefits (except remuneration) on trust for the benefit of members: section 26.

Issuer of a Superannuation Scheme

387. The issuer of a superannuation scheme is the trustee. The current duties of the superannuation scheme trustee under the Superannuation Schemes Act are set out at paragraph 378 in Appendix 2.

Manager of a Participatory Scheme

388. The 7th Schedule to the Securities Regulations deems the following duties of the manager of a participatory scheme to be contained in deeds of participation:[32]

a. To use his best endeavours and skill to ensure that the affairs of the scheme are conducted in a proper and efficient manner;

b. To use due diligence and vigilance in the exercise and performance of his functions, powers, and duties as a manager;

c. To account to the members of the scheme for all money that he receives on behalf of the scheme;

d. Not to pay out or invest or apply any money belonging to the scheme for any purpose that is not directed by or authorised in the deed;

e. To supply to the members of the scheme, in general meeting, such information relating to the affairs of the scheme as any member has given him reasonable notice to supply; and

f. To establish a bank account to be kept in the name of the scheme; and the manager shall ensure that all money received on behalf of the scheme is paid into such bank account as soon as practicable.

[32] Clause 3, 7th Schedule to the Securities Regulations 1983.

APPENDIX 6: CURRENT POWERS AND RIGHTS OF ISSUERS

Manager of a Unit Trust

389. The manager of a unit trust has the following powers and rights under the Unit Trusts Act:

a. to apply to the court for an order removing the unit trustee: section 10(1);

b. to apply to the court in certain circumstances for additional powers of management: section 22(1).

Trustee of a Superannuation Scheme

390. The powers and rights of the trustee of a superannuation scheme and rights under the Superannuation Schemes Act are set out at paragraph 384.

Manager of a Participatory Scheme

391. Under clause 4(2) of the 7th Schedule to the Securities Regulations, the manager of a participatory scheme has the right to request the statutory supervisor to summon a meeting of the holders of the issued participatory securities for the purpose of giving to the statutory supervisor their opinions or directions in relation to the exercise of its powers.

APPENDIX 7: SUMMARY OF QUESTIONS FOR SUBMISSION

1. Do you consider the proposed definition of CIS meets the objectives for regulating CIS (refer paragraph 20)?

2. Do you consider the proposed definition captures the range of securities, schemes and policies that should be regulated similarly? That is, can you identify any securities, schemes or policies that would fall outside this definition that should be regulated the same as other CISs and therefore included in the definition?

3. Is there any part of the definition that you consider inappropriate? If yes, what part and why is it inappropriate?

4. Is the definition missing any elements? If so, what elements is it missing, and how would the missing element assist in defining CISs?

5. What securities, entities or schemes do you think currently come within the proposed definition of CIS, but should specifically be excluded from the definition of CIS, and why?

6. Do you consider the legal form or forms for CISs should be prescribed? Why/why not?

7. Do you consider superannuation schemes should fall within the general definition of CIS or should they be regulated differently? What are the reasons for your view?

8. Do you consider employer-sponsored superannuation schemes should generally be regulated in the same way as other CISs? In particular, do you consider that employer master trusts should be treated the same way as other CISs? Why?

9. What are the implications (including both benefits and costs) of regulating superannuation schemes in the same way as other CISs?

10. In relation to existing policies:

    - In your experience, how many life insurance policies where the investment component is a separate contract are offered by (a) one company and (b) separate entities?

    - Do you consider the proposed regulatory treatment for existing policies/contracts is appropriate? Why/why not? If not, how should existing policies/contracts be regulated?

11. Considering the objectives for regulating CISs (see paragraph 20) and the objectives for regulating life insurance (see the *Insurance* discussion document), do you consider the proposed framework for regulating new policies is appropriate? Why/why not?

12. Do you consider the CIS trustee should be required to perform any other functions in addition to those set out above, or are there any that are inappropriate? Why?

13. Do you consider the CIS trustee should be liable for its acts and omissions in the performance of its functions as a trustee? Why/why not?

14. Will any of the proposed functions raise issues for the CIS trustee of a participatory scheme? If so, what are those issues and how do you consider those issues should be addressed?

15. Do you consider the CIS trustee should be required to perform any other duties in addition to those set out above, or are there any that you consider are inappropriate?

16. Do you consider the CIS trustee should be liable for its acts and omissions in the performance of its duties as a trustee? Why/why not?

    - Will any of the proposed duties raise issues for the CIS trustee of a participatory scheme? If so, what are those issues and how do you consider those issues should be addressed? For example, will the duty to hold scheme property on trust cause any issues or will all participatory schemes be able to hold scheme property on trust? If not, how should this be regulated to ensure the objectives for regulating CISs are met?

17. The CIS trustee's duty to not act on any direction of the issuer to acquire any property for the scheme or dispose of any property of the scheme is dependent on the CIS trustee's assessment of whether the proposed acquisition or disposal is "manifestly not in the interests of investors". A duty to not act only where the proposed acquisition or disposal is not "manifestly not in the interests of investors" is considerably less of a duty than its duty to act in the best interests of investors. However, on the other hand, issuers also need flexibility to manage the scheme and the investments, and should be allowed to operate without the CIS trustee challenging every acquisition or disposal of scheme property.

    - Is "manifestly" the appropriate threshold to trigger this duty? If not, what should be the appropriate threshold?

    - Is it clear what "manifestly not in the interests of investors" means? If not (and you consider "manifestly" is the appropriate threshold), how would you provide guidance on how to interpret the provision?

18. Do you consider investors should be able to call a meeting and require the CIS trustee to act on their directions? Why/why not?

19. Do you consider the CIS trustee should have any other powers in addition to those set out above, or are there any that you consider inappropriate?

20. Do you consider the CIS trustee should be liable for its acts and omissions in the exercise of its powers as a trustee? Why/why not?

    - Will any of the proposed powers raise issues for the CIS trustee of a participatory scheme? If so, what are those issues and how do you consider those issues should be addressed?

21. Do you consider CIS trustees should have a statutory power to require periodic reporting from the issuer? If no, why?

22. What directions or orders do you consider the court should be able to make for breach by the issuer of its duties, the terms of the trust deed or the terms of the offer?

23. Do you consider the proposed remedies for breach by the CIS trustee of its duties are appropriate? Why/why not?

24. Currently, members of a superannuation scheme do not have the ability to call meetings and/or direct trustees. Do you consider members should have the ability to call meetings and/or direct CIS trustees? Why/why not?

25. What directions or orders do you consider the court should be able to make for breach by the CIS trustee of its duties or the terms of the trust deed?

26. Do you consider any of the fit and proper entry and ongoing requirements are inappropriate? Why?

27. Do you consider issuers should be required to comply with any other fit and proper entry and ongoing requirements? Why?

28. Do you agree the CIS trustee should recommend approval of a particular issuer to the Commission, with the final determination resting with the Commission? Why/why not?

29. What process do you consider should be followed in the event an issuer is declined approval by the Commission? Should it be able to present further information to the CIS trustee or to the Commission, or should the issuer only be allowed to appeal the decision to the High Court? If the latter, on what grounds should an appeal be provided? What other process do you consider would be appropriate?

30. Do you agree the CIS trustee should monitor the ongoing fit and proper requirements of the issuer, and report to the Commission where the CIS trustee determines that the issuer no longer meets the fit and proper requirements? Why/why not?

31. Do you agree the final determination as to whether the issuer continues to meet the fit and proper requirements should lie with the Commission? Why/why not?

32. Do consider the proposed reporting requirements are appropriate? Why/why not?

33. Do you consider the proposed options for remedying a breach by the issuer of the fit and proper entry requirement are appropriate, or are there any that are inappropriate?

34. What appeal rights do you consider the issuer should have if the Commission determines that it no longer meets the fit and proper requirements? If you consider an issuer should be allowed to appeal a determination that it no longer satisfies the fit and proper requirements to the High Court, on what grounds should the issuer be entitled to appeal? What are your reasons?

35. Will there ever be a situation where another issuer will step in and take over as issuer where the issuer's approval has been revoked and it has been removed?

    - If so, what should happen?

    - If not, should the scheme be wound up?

36. Do you consider there should be any other functions for issuers in addition to those set out above, or are there any that you consider inappropriate? Why?

37. Do you consider there should be any other issuer duties in addition to those set out above, or are there any that you consider inappropriate? Why?

38. Do you consider the issuer should have the same liability for exercising its functions and powers as if it were a trustee? That is, do you consider a higher duty should be imposed on issuers? Why/why not?

39. In relation to the requirement to report statistical data to the Commission what information should be included in any statistical data return?

    - What data do you think should be kept confidential, and what should be made publicly available?

40. Do you consider the issuer requires any other powers in addition to that set out above, or do you consider the proposed power is inappropriate?

41. Do you consider the proposed options for remedying a breach by the issuer of its obligations owed to investors are appropriate, or are there any that are inappropriate?

42. Do you consider the proposed whistle-blowing provision meets the regulatory objectives for CISs? Why/why not?

43. Do you support the proposed provisions relating to amendments to CIS trust deeds or would you prefer changes were made in legislation on a case-by-case basis? Are there any additional issues raised with applying this framework to all CISs?

44. Do you consider that the Regulator should approve changes to trust deeds where the issuer and the trustee agree to the change? Why?

45. Should the Regulator have a similar power where, in the opinion of one party, consent to a trust deed change has been unreasonably withheld? What are your reasons?

46. Should the Superannuation Schemes Act procedure for obtaining full member consent to adverse trust deed changes be maintained?

47. Do you support a provision equivalent to the current Superannuation Schemes Act provision enabling transfers of members to another scheme for all CISs? Why? If so, should the trustee or regulator determine which members would not be materially affected by the transfer?

48. Do you agree that the Superannuation Schemes Act transfer provision should be extended to all CISs to enable transfers where the new scheme is equivalent or better than the previous scheme? If so, do you consider that the trustee or the regulator (or both) should make that assessment?

49. Do you agree that transfer provisions should be flexible for CISs generally? Why?

50. Do you support restrictions on assignment of interests in superannuation schemes? What are your reasons?

51. Do you agree that the provision on benefits in schemes linked to employment status should be retained for all existing superannuation schemes?

52. Do you agree that a CIS's objectives should be included in the trust deed? Should all CISs be required to specify an objective? `What are your reasons?

53. Do you support the proposal that CISs that hold themselves out to be superannuation schemes should have an implied provision that is linked to its purpose of providing retirement benefits? Should this test be more specific, e.g. should it require funds to be locked in, or the statement of an investment strategy in the trust deed that is consistent with a long-term savings vehicle, or would it be better to achieve clarity for investors through disclosure?

54. Is greater specification of objectives required in CIS trust deeds generally? What sorts of matters could or should be required to be stated in relation to the scheme objective? Could this reduce some of the flexibility that the new regulatory regime is intended to introduce?

55. Do you agree that any conditions of entry and exit into a CIS should be specified in the trust deed? Do you have any comments on the practical effect of such a provision? What are your reasons?

56. Do you consider that trust deeds that contain lock-in provisions that are not related to a term of employment should be required to have provision for portability of funds? If so, how can this be practically achieved?

57. What would be an effective mechanism for balancing the concern around allowing effective portability between schemes but preventing unnecessary churn which is costly for schemes that may have priced the lock-in into their offer? How long would a period of lock-in need to be for a portability requirement to apply?

58. Would clear disclosure of lock-in be an effective way of dealing with the concerns raised?

59. Do you agree with the proposal that any minimum contribution levels, or a process through which these are established and/or amended, should be included in the trust deed? Why?

60. Do you agree that a methodology for determining and amending a scheme's investment strategy should be included in the trust deed, or is this information better placed in disclosure documents? What are your reasons?

61. Should this only be a requirement where the scheme has a material investment strategy? What are your reasons?

62. Do you agree that trust deeds for CISs should be required to specify the conditions of the scheme in relation to pricing, withdrawals, redemptions (including when they can be withheld) and distributions? What are your reasons?

63. Do you support the proposal for a general requirement to specify a process for valuation of assets in the trust deed? If so, should there be any qualitative requirements around the provision, e.g. the Australian requirement for "adequate" provision to be made for these matters?

64. Do you agree that it would be beneficial to require consistent timing of valuations? Should this be consistent across all schemes? Would standardisation of the timing of

currency conversion be a better approach? How could this best be achieved – by government or by the industry? Please state your reasons.

65. Do you have any comments on the issues identified relating to the process for valuing assets? If a process is required, how prescriptive should this requirement be?

66. Do you agree that any discretions around payment of benefits should be contained in the trust deed and should only be exercisable by the trustee? Why?

67. Do you agree that trust deeds should specify the types of fees that are or could be deducted and how they would be calculated, or is this information better contained in offer documents? What are your reasons?

68. Do you support the proposal that trust deeds should contain any provisions around appointment and removal of trustees and issuers, subject to the powers of the regulator, trustee and issuer that will be contained in the legislation?

69. Do you agree that the circumstances which will trigger a wind-up and the procedure for winding up and the distribution of assets should be included in trust deeds? What are your reasons?

70. Do you consider that there should be standard triggers for wind-up for all schemes? If so, what would those triggers be and how would they interact with the issuer's and trustee's duty to act in the interests of members?

71. Do you support the proposals for initiation of meetings? Please give reasons for your answer.

72. Do you agree that the proposed quorum and voting procedures will be effective for CIS schemes? What are your reasons?

73. How much would a meeting constituted under these provisions be likely to cost?

74. Given this link between provisions in the trust deed and the trustee's power to act, do you consider there are any other matters that should be included in the trust deed so the trustee has the power to act in relation to those matters? Why?

75. Are there any other requirements (for example, duties, rights, powers, etc) contained in any of the Unit Trusts Act, the Superannuation Schemes Act or the 7th Schedule to the Securities Regulations that you consider may be appropriate to apply to the framework for CISs? What are your reasons?

76. Do you think there is a need to further specify the sorts of matters that should not be left to the discretion of an employer or third party? If so, which matters should this prohibition apply to?

77. Do you agree that the trustee should be required to give consent to the reversion of assets to a third party? Should this decision rest with the regulator where there is an employer representative on the board of trustees? Are there any problems with the current reversion provisions in the Superannuation Schemes Act?

78. Do you agree that the proposed transitional framework should be applied to existing stand-alone employer schemes? How could stand-alone employer schemes be defined for the purposes of the exception?

79. More specifically, do you agree with the proposals for amended powers and duties of the trustee and manager and regulatory controls?

80. What do you consider are likely to be the costs imposed by the additional trust deed requirements to existing stand-alone schemes, and do you consider that these costs would outweigh the benefits of including the requirements?

81. More generally, what would be the additional costs of applying this transitional framework to existing stand-alone employer schemes? How would this compare to the costs of applying the proposed general CIS structure to existing schemes (i.e. if no exception was made for existing stand-alone schemes)?

82. Do you agree that the proposed powers of the regulator would effectively address concerns arising from the lack of independent monitoring by the trustee in these transitional schemes?

83. Do you agree that fit and proper entry requirements around independence should apply to the board of trustees as a whole in a stand-alone scheme, and that this should enable the board to have representatives from the employer and the employee?

84. If the independence requirements do apply to the board as a whole, should there be a requirement for broad representation on the board, i.e. representation from the employer, employee and or an independent trustee? What would be the costs of imposing this requirement on current schemes?

85. Should the proposals relating to independence of the board for a stand-alone scheme apply only to existing schemes, or should they apply more broadly to any new stand-alone employer scheme?

86. How could or should the regulator's approval of the trustee fit with procedures that may be contained in the trust deed for appointment of trustees to the board?

87. How should defined benefit schemes be defined in legislation?

88. Do you agree that the proposed transitional structure for defined benefit schemes will be effective? Are there sufficient checks and balances within this structure to address the risks that are inherent in defined benefit schemes?

89. Do you agree that there is currently a problem with under-funding of defined benefit schemes? If so, what is the extent of this problem?

90. If there is a problem, can it be effectively addressed by specifying target funding levels for schemes? How could these levels be designed to take retain some flexibility to take account of the circumstances of different schemes?

91. Do you agree with the contention that actuarial assumptions that are used in valuations should be more consistent and transparent? Do you see any risks with greater prescription of assumptions?

92. What is your view on whether the governance arrangements for actuarial standard setting are sufficiently robust? Do you support the proposal for using the same governance structures for superannuation actuarial standard setting as for insurance actuarial standard setting?

93. Do you support more frequent actuarial examinations than are currently required under the Superannuation Schemes Act? How frequent do you consider that these examinations should be and why? Are you able to provide an estimate of the cost of an actuarial examination?

94. Do you agree that there is a need for more prescription in trust deeds around how withdrawals should be valued? What provisions do you think should be required?

95. Do you consider that current trust deed provisions can be inequitable in their treatment of different members upon wind-up?

96. Do you think that these issues can be effectively addressed for new any schemes by restricting the type of wind-up provisions that can be included in trust deeds for defined benefit schemes? What sort of restrictions should apply?

97. Do you agree that trustees and the regulator should be given a discretion to amend priorities on wind-up provisions in current trust deeds? What would be the implications of such a provision, and could it be administered fairly in practice?

98. Could the limited annuities market in New Zealand be contributing to the perceived inequity of distributions on wind-up of schemes? If so, how could the annuities market be bolstered to address these issues?

99. Do you agree that there is a need for greater regulator powers to deal with issues that arise in relation to defined benefit schemes?

100. Do you support mechanisms that would empower the regulator to work with schemes to require them to address concerns about funding levels, which may include the ability to direct an employer in relation to the scheme?

101. If the regulator is given the sorts of powers that are proposed, do you consider that principles should be developed to guide that discretion? Should these principles be developed by the regulator or an independent body? What could these principles cover?

102. Do you consider that it is appropriate for the regulator to have an ability to direct an employer in relation to funding levels? What would be the implications of such a provision for employers?

103. Do you consider the CIS trustee should be a trustee in legal terms and, in particular, do you consider that trustee obligations and liabilities should be imposed on statutory supervisors? Why/why not?

104. Are there any products that currently come within the definition of “participatory security” that you consider should not be regulated as securities under securities legislation?

105. Are there any products that currently do not come within the definition of “participatory security” that you consider should be regulated as securities under securities legislation?

106. Are there any products that currently come within the definition of “participatory security” that you consider may not appropriately fit all of the proposed regulatory requirements applicable to CISs?

- If so, what requirements would not work for that particular offer of securities?

107. Do you consider that the definition of “contributory scheme” should be used in conjunction with the current definition of “security” to ensure that present and future products that might not ordinarily be considered to be financial products or investments, but which have the characteristics of securities, are given like regulatory treatment?

108. We consider there will be only a small number of securities that are not derivatives, equity securities, debt securities or CISs. Can you provide any examples of the types of products and features of those products that will fall in the back-stop class of securities?

109. If the back-stop class of securities does not have similar features or investors with similar characteristics justifying similar regulatory treatment, do you agree or disagree with that the Commission should be given the flexibility to determine the most appropriate way to regulate these securities? What are your reasons for your opinion?

110. Do you have any comments or ideas about transitional provisions in general or how particular transitional provisions should work?