

KiwiSaver - Applicable Regulatory Regime

Purpose

This report seeks agreement from you on further details of the regulatory regime applicable to KiwiSaver to discuss at your meeting with officials on Wednesday 8 June at 8am.

Date:	7 June 2005	Priority:	High
Security Level:	Confidential	File Number:	RCP 3.9.7 T2005/1099

Action Sought

	Action Sought	Deadline
Minister of Finance	Agree recommendations and refer to Ministers of Housing and Education	8 June, 2005
Minister of Commerce	Agree recommendations	8 June, 2005
Associate Minister of Finance (Hon Trevor Mallard)	Note	None
Associate Minister of Finance (Hon David Cunliffe)	Note	None

Ministry Contacts

Principal Author

Name	Position and Unit	Telephone	
		Work	After Hours
	Senior Analyst, Business Law, MED		
	Senior Analyst, Markets, Infrastructure and Government, Treasury		

Responsible Signatory (* Suggested First Contact)

Name	Position and Unit	Telephone	
		Work	After Hours
Kirstie Hewlett	Manager, Business Law, MED		
	Senior Analyst, Tax Policy, Treasury		

File: RCP 3.9.7

7 June 2005

Minister of Finance
Minister of Commerce

KiwiSaver - Applicable Regulatory Regime

Executive Summary

We are due to meet with the Minister of Commerce and you on 8 June at 8am to discuss the appropriate regulatory regime for KiwiSaver.

This paper proposes a regulatory regime for KiwiSaver which draws on existing legislation but acknowledges that changes to that regime are necessary. This report outlines that regime, and the proposed changes. The aim is to tailor the regulation to suit the characteristics of KiwiSaver (such as the lock in) and to minimise compliance costs on employers and providers as far as possible, without compromising investor protection. In some areas we signal that further work is needed.

You should note that the general regulatory regime we are proposing can also accommodate interest-only bearing products, with minor modification. Indeed, similar products already operate as registered superannuation schemes (RSS).

Officials have investigated various options for ensuring that a minimum level of basic information about the scheme is provided to potential new members. Options include utilising the existing distribution mechanism of the information packs to provide the investment statement, providing the investment statement to only those people who do not opt out and not providing copies of the investment statement but requiring employers to make copies accessible to employees.

All the options have various advantages and risks and there is a trade off between ensuring investors have some information on which to base their investment decision and ensuring they take responsibility for the decision, and minimising compliance costs for providers and/or IRD.

For example, not providing investment statements to individual investors has the lowest compliance costs for providers but poses the greatest risk in terms of moral hazard for the government. It also reduces the likelihood of a person actually seeing basic information about a scheme before investing. The other options increase compliance costs for providers in that they will, in some cases, provide copies of investment statements to people who end up opting out and consequently will need to print more investment statements. To some extent this cost may be off-set by decreased distribution costs for providers if an investment statement is included in an information pack as part of the broader KiwiSaver promotion.

We will need to do further work, including working with officials from IRD, and the Securities Commission, to develop a workable mechanism that provides appropriate investor protection without unduly increasing compliance costs.

In relation to the annual report that is currently provided to members, officials plan to investigate options that do not involve every member receiving an annual report. This may be relevant to non-active members for example. This should also reduce provider's compliance costs.

In relation to the prospectus requirement officials do not recommend that this requirement be removed specifically for KiwiSaver, however officials plan to review disclosure, and the prospectus requirement in particular, across all investments in the Review of Financial Products and Providers. This Review has been commenced and will enable a consistent and coherent approach to financial products and providers to be taken. The results of the Review will be implemented in 2008.

Recommended Action

We recommend you:

- 1 **Note** that Cabinet has agreed that there will be no government guarantee of products or providers, that the KiwiSaver investments will be regulated consistently with other investment products and that the Superannuation Schemes Act 1989 framework will apply to regulate KiwiSaver;

Minister of Finance

- 2 **Note** that you are required to consult with the Ministers of Education and Housing in making detailed design decisions;

- 3 **Refer** this report to the Ministers of Education and Housing;

yes/no

- 4 **Agree** that the Superannuation Schemes Act 1989 (and associated Acts) will apply to regulate KiwiSaver with the modifications proposed in the table at paragraph 7 of the report;

agree/disagree

- 5 **Note** that interest only bearing products could be offered under the same regime as other KiwiSaver products;

- 6 **Agree-in-principle** that interest only bearing accounts be regulated using the same framework as other KiwiSaver products, subject to consultation with industry;

agree/disagree

- 7 **Agree** that if an interest only bearing account is permitted under the same regime, that trustees be protected from any potential liability arising from their duties as trustees in operating an account that is non-diversified;
agree/disagree
- 8 **Note** that there is no obvious mechanism for providing information about an investment where a member joins a default scheme as they do not fill out an application form or otherwise take any active steps;
- 9 **Note** that there are various options for providing basic information to members who join a default scheme and that these options balance in various ways provision of information against reducing compliance costs for employers and providers;
- 10 **Agree** that officials do further work in consultation with IRD to develop a workable mechanism that provides appropriate investor protection without unduly increasing compliance costs;
agree/disagree
- 11 **Agree** that if an amendment is necessary, KiwiSaver members be exempt from the requirement in the Securities Act 1978 that they receive an investment statement *before* joining a superannuation scheme;
agree/disagree
- 12 **Note** that the Review of Financial Products and Providers will provide an opportunity to increase the consistency and coherence of the regulation of financial products and providers and that it will consider wider issues of disclosure across all financial products;
- 13 **Agree** that that all members can withdraw their own contributions in full once they reach the age of eligibility for NZ Super, even if the \$1000 contribution is locked in past that point;
agree/disagree
- OR**
- 14 **Agree** to imposing an upper age limit of 60 on joining KiwiSaver;
agree/disagree
- 15 **Agree** that the employer exemption from the automatic enrolment provision criteria for the coverage of all permanent employees should be limited to all new permanent employees;
agree/disagree
- 16 **Agree** that the “open to all permanent employees” condition in the exemption from automatic enrolment criteria be qualified to exclude persons who are

already contributing to another employer related scheme offered by that employer (such as a scheme that is closed to new members, like GSF);

agree/disagree

- 17 **Indicate** whether you wish officials to further consider and consult with industry on the criteria for the employer exemption from the automatic enrolment provisions given concerns that few, if any, employers will be eligible for this exemption;

Yes/No

- 18 **Note** that officials will work to develop consistency where possible in the definitions “first home”, “hardship”, “permanent emigration” and any related definitions to be applied to KiwiSaver;

- 19 **Agree** that a withdrawal of funds due to hardship does not include the withdrawal of the \$1000 government contribution;

agree/disagree

- 20 **Agree** that a withdrawal of funds due to permanent emigration does include the \$1000 government contribution;

agree/disagree

- 21 **Agree** that, if necessary, the definition of promoter in the Securities Act 1978 be amended to include an avoidance of doubt provision and to clarify that employers who merely select a KiwiSaver default scheme for their employees are not a promoter;

agree/disagree

- 22 **Agree** that prior to an impending wind up members be required to transfer to a replacement KiwiSaver scheme and that the original scheme then be wound up without assets or members;

agree/disagree

- 23 **Agree** that any funds in KiwiSaver cannot be used as security for a loan.

agree/disagree

Minister of Commerce

- 24 **Agree** that the Superannuation Schemes Act 1989 (and associated Acts) will apply to regulate KiwiSaver with the modifications proposed in the table at paragraph 7 of the report;

agree/disagree

25 **Note** that interest only bearing products could be offered under the same regime as other KiwiSaver products;

26 **Agree-in-principle** that interest only bearing accounts be regulated using the same framework as other KiwiSaver products, subject to consultation with industry;

agree/disagree

27 **Agree** that if an interest only bearing account is permitted under the same regime, that trustees be protected from any potential liability arising from their duties as trustees in operating an account that is non-diversified;

agree/disagree

28 **Note** that there is no obvious mechanism for providing information about an investment where a member joins a default scheme as they do not fill out an application form or otherwise take any active steps;

29 **Note** that there are various options for providing basic information to members who join a default scheme and that these options balance in various ways provision of information against reducing compliance costs for employers and providers;

30 **Agree** that officials do further work in consultation with IRD to develop a workable mechanism that provides appropriate investor protection without unduly increasing compliance costs;

agree/disagree

31 **Agree** that if an amendment is necessary, KiwiSaver members be exempt from the requirement in the Securities Act 1978 that they receive an investment statement *before* joining a superannuation scheme;

agree/disagree

32 **Note** that the Review of Financial Products and Providers will provide an opportunity to increase the consistency and coherence of the regulation of financial products and providers and that it will consider wider issues of disclosure across all financial products;

33 **Agree** that that all members can withdraw their own contributions in full once they reach the age of eligibility for NZ Super, even if the \$1000 contribution is locked in past that point;

agree/disagree

OR

34 **Agree** to imposing an upper age limit of 60 on joining KiwiSaver;

agree/disagree

- 35 **Agree** that the employer exemption from the automatic enrolment provision criteria for the coverage of all permanent employees should be limited to all new permanent employees;
agree/disagree
- 36 **Agree** that the “open to all permanent employees” condition in the exemption from automatic enrolment criteria be qualified to exclude persons who are already contributing to another employer related scheme offered by that employer (such as a scheme that is closed to new members, like GSF);
agree/disagree
- 37 **Indicate** whether you wish officials to further consider and consult with industry on the criteria for the employer exemption from the automatic enrolment provisions given concerns that few, if any, employers will be eligible for this exemption;
Yes/No
- 38 **Note** that officials will work to develop consistency where possible in the definitions “first home”, “hardship”, “permanent emigration” and any related definitions to be applied to KiwiSaver;
- 39 **Agree** that a withdrawal of funds due to hardship does not include the withdrawal of the \$1000 government contribution;
agree/disagree
- 40 **Agree** that a withdrawal of funds due to permanent emigration does include the \$1000 government contribution;
agree/disagree
- 41 **Agree** that, if necessary, the definition of promoter in the Securities Act 1978 be amended to include an avoidance of doubt provision and to clarify that employers who merely select a KiwiSaver default scheme for their employees are not a promoter;
agree/disagree
- 42 **Agree** that prior to an impending wind up members be required to transfer to a replacement KiwiSaver scheme and that the original scheme then be wound up without assets or members;
agree/disagree
- 43 **Agree** that any funds in KiwiSaver cannot be used as security for a loan.
agree/disagree

Senior Analyst, Tax Policy
for Secretary to the Treasury

Kirstie Hewlett
Manager, Business Law
Regulatory and Competition Policy Branch

Hon Dr Michael Cullen
Minister of Finance

Hon Pete Hodgson
Minister of Commerce

KiwiSaver - Applicable Regulatory Regime

Purpose of Report

- 44 This report seeks your agreement on further details of the regulatory regime applicable to KiwiSaver and where modification to the framework applicable to registered superannuation schemes is necessary. Officials are due to discuss these matters with the Minister of Commerce and you on Wednesday 8 June at 8am.
- 45 This report does not deal with the issue of whether there will be any additional ongoing *performance* monitoring of default providers (which would be additional to the financial reporting and reporting on relevant aspects of the scheme to members), or the administration of the fee subsidy. You may want ongoing performance monitoring to ensure that default funds continue to perform and provide reasonable returns, although any such reporting could exacerbate any implication of a government guarantee of the scheme. Additional monitoring is also unlikely to be necessary for some products, such as interest only products if these were defaults. Officials are still working on these issues but you should note that the approach taken in these areas may have further implications for the regulatory regime.

Previous Decisions

- 46 Cabinet has previously agreed [CAB Min (05) 13/9 refers] that:
- the Government will provide a conversion mechanism for existing registered superannuation schemes that want to migrate to KiwiSaver (recommendation 3.21);
 - there will be no government guarantee of products or providers (recommendation 3.23);
 - the KiwiSaver investments will be regulated consistently with other investment products and the Superannuation Schemes Act 1989 (SSA) framework will apply to regulate KiwiSaver (recommendation 3.24);
 - the Minister of Finance, in consultation with the Ministers of Housing and Education, is authorised to make decisions on detailed design issues (recommendation 7).
- 47 In addition, we have previously sought your feedback on how KiwiSaver should be regulated [T2005/82 refers]. You have agreed that:
- the regulation of KiwiSaver should rely on disclosure of information to investors;
 - regulation should make provision for investor protection where appropriate;
 - the disclosure and reporting requirements of the Securities Act 1978 and the Financial Reporting Act 1993 would apply to KiwiSaver (modified where necessary);

- the regulatory requirements for KiwiSaver would be similar to those applicable to registered superannuation schemes (modified where necessary);
- all KiwiSaver products should be registered; and
- KiwiSaver products would be required to comply with a set of minimum criteria as a condition of registration.

Analysis

Regulatory Regime Applicable to Superannuation

- 48 The regulation of superannuation products raises particular regulatory issues. The main issues are:
- Protecting investor's funds where they are locked in;
 - Ensuring investors make informed decisions and take responsibility for the risk associated with their investment;
 - Ensuring that financial institutions are sound.
- 49 There is a particular need to protect investors where their funds are locked in, as in many cases under the existing regime investors cannot switch between products or providers easily. In addition, their money may be being held for a long time and managed by a third party. The SSA provides various mechanisms for protecting investors, which include the use of a trust structure, registration of schemes, and oversight by the Government Actuary.
- 50 When designing regulation it is also important that there is no government guarantee of investments, as investments can fail even where institutions are sound. Any implicit guarantee undermines the investor's responsibility for their investment decision. There is also a need to have some oversight of institutions as the value of the superannuation product relies on the institution remaining solvent over very long time periods. The existing regime uses a combination of tools to achieve this which includes providing initial and ongoing information to individual members about the investment and the provider, and regular reporting to, and oversight by, the Government Actuary.
- 51 Disclosure and other requirements under the Securities Act are also part of the regulatory framework applicable to superannuation. Disclosure is the fundamental basis of New Zealand's regulatory regime in relation to investment. Individuals are provided with information about the investment on the basis that they are in the best position to assess the information and decide upon whether the investment is right for them. This allows individuals to make choices and to be responsible for those investment decisions.

Regulation of KiwiSaver

- 52 The table below sets out the main regulatory issues that arise when regulating superannuation products. It then sets out how those issues are dealt with by the

current regulatory regime, whether that regulatory solution could be applied to KiwiSaver, and whether any modifications of the regulation are desirable given the characteristics of KiwiSaver.

	Purpose of Regulation	Regulatory Solution that Applies to Registered Superannuation Schemes	Application of the Regulatory Solution to KiwiSaver
Registration	Investor protection	Registration of schemes with the Government Actuary (“GA”)	<p>KiwiSaver schemes will have additional registration requirements:</p> <p><i>Portability between KiwiSaver schemes;</i></p> <p><i>Lock in of funds until the age of eligibility for NZ Super;</i></p> <p><i>Lock in of the \$1000 contribution until the age of eligibility for NZ Super or for 5 years, whichever is greater;</i></p> <p><i>Withdrawal of funds except the \$1000 government contribution for the purchase of a first home; and</i></p> <p><i>Withdrawal of funds upon death, hardship and permanent emigration.</i></p>
Trustees and Trust Deed	Investor protection, accountability	<p>To register, a scheme must be a trust with at least one resident trustee being a NZ resident</p> <p>Trust deed must be lodged with the GA (or alternative procedure applies where a scheme is constituted under an Act or Parliament)</p> <p>Duty of care, diligence and skill plus fiduciary duties imposed on the trustee when investing the scheme</p>	<p>Apply in full</p> <p>Apply in full</p> <p>Apply in full</p>

Oversight by Government Actuary	Investor protection, accountability	members' money	
		GA has powers to obtain information from registered schemes	Apply in full
		GA has powers to cancel registration, direct the trustees or order the scheme be wound up in certain circumstances (breach of the SSA, financial position or management inadequate)	Apply in full
		Whistle blowing provisions (for auditors, managers and actuaries)	Apply in full
	Ensuring providers are financially sound	Appeals process from GA decisions	Apply in full
		A registered scheme must lodge a set of annual, audited accounts with the GA which the GA reviews	Apply in full
	GA must produce an annual report on registered super schemes based on annual accounts which are lodged with the GA	Require the GA to report on registered KiwiSaver schemes on at least the same matters upon which he currently reports in relation to RSS. These typically cover statistics about the industry, commentary on legislative amendments and relevant cases, and material issues encountered during the year.	

53 There are also a number of other areas where the general regulatory framework might be adapted for KiwiSaver. These are discussed below.

Non-Managed Fund Interest Bearing Product

- 54 You expressed an interest in officials doing further work on how to allow interest only bearing products that have the characteristics of a term deposit account to be part of KiwiSaver [T2005/708 refers].
- 55 UDC and the Bank of New Zealand offer similar products as registered superannuation schemes, although these products are closed to new members. These schemes were created to exploit a loophole where investments in superannuation schemes were excluded from other income that was used to partially reduce the level of benefit payable under New Zealand Superannuation (NZS) between 1984 and 1990. Hence, these types of schemes were tailored for people eligible for NZS and were offered by banks, finance companies and insurers.
- 56
- We advise that an interest only bearing product could be offered, subject to provider interest, using the same regulatory regime as other KiwiSaver schemes from 1 April 2007. Using the same regime would have the benefit of providing consistent levels of investment protection across all KiwiSaver products. It would also allow for regulatory consistency and simplicity of implementation. Compliance costs for providers would also be reduced, as they are already familiar with the SSA regime.
- 57 There is some uncertainty over whether interest only bearing accounts would fit the “prudent person” test for long-term retirement savings in the SSA for all savers, given these products will not benefit from capital growth or diversification. Hence, an exclusion from these trustee obligations may be needed.
- 58 An alternative option would be to consider a different regulatory approach for interest only bearing accounts, such as the Australian approach on retirement savings accounts. Officials do not favour this approach as it may diminish the level of investor protection provided for these products, introduce inconsistent treatment between KiwiSaver members and would put at risk official’s ability to meet the proposed timeline for developing legislation.
- 59 Further consultation with providers will be necessary on the inclusion of an interest only bearing product to ascertain provider interest in offering this type of product.

Compliance Costs

- 60 The focus of the existing regime is on achieving the aims of regulation without imposing compliance costs that are overly onerous. We understand that concerns have been raised about the compliance costs associated with the SSA framework.
- 61 The main compliance costs of the SSA framework are the prospectus, the investment statement and the annual report. Our ongoing work in this area focuses on how we might reduce the compliance costs associated with these

requirements while still addressing the underlying objectives of regulation outlined above.

- 62 The prospectus is a detailed document which outlines financial and other information about the investment and the provider. One copy of the prospectus must be lodged with the Registrar of Companies and copies must be provided to investors upon request. The prospectus is a snap shot in time as it is a one-off disclosure document that must be produced only when a superannuation scheme is offered.¹ The main compliance costs associated with the prospectus is compiling the information.
- 63 The investment statement is a short document aimed a non-expert investor which answers questions about what type of investment it is and what it will cost the investor. Investment statements must be provided to all members of a superannuation scheme prior to joining a scheme and so the main compliance cost is printing and distribution.
- 64 The annual report provides members with details of the scheme of which they are a member and also includes audited financial accounts. Unlike the prospectus, the annual report is aimed at ongoing disclosure.
- 65 Officials are working on proposals to alter how several of these requirements apply to KiwiSaver in order to address some of the concerns about compliance costs. We outline below our proposed approach.

Investment Statement for Default Schemes

- 66 There are different options for providing an investment statement to members who join a default scheme Because these members do not fill out an application form, providing these members with information is a challenge. There appear to be several approaches to resolving this issue. We have highlighted a few approaches below to highlight the trade offs in this area. We would need to do further work, including officials from Treasury, MED, IRD, and the Securities Commission, to develop a workable mechanism that provided appropriate investor protection without unduly increasing compliance costs.
- 67 One option is including an investment statement for either one of or all of the default schemes in the information pack that goes to all new employees. A second option is to only give an investment statement to members who do not opt out of the scheme after the initial 3 week decision period. A third option is not to provide copies of investment statements but to require employers to make a copy of the investment statement accessible to employees. All of the options have different advantages and risks. While the third option would impose the lowest compliance costs on providers it would introduce the highest risks to the government and investors, as outlined below.
- 68 Currently a person must receive a copy of an investment statement prior to joining an RSS. The investment statement provides the minimum information necessary for a person to make a decision about an investment. The fact that an

¹ The Securities Act also imposes ongoing disclosure obligations.

individual must actually receive an investment statement also forms the basis of the provider's liability for any misleading or false statements about the investment in the investment statement.

- 69 There are a number of options to ensure that this statement is delivered to individuals. A copy of each investment statement could be provided to all potential new members by including them in the information pack that is provided to all new employees. This approach would best ensure statements are seen by those who join, but would have higher compliance costs (note that the higher printing costs for providers would be off set by the lower distribution costs if the investment statement is included in the core KiwiSaver information pack).
- 70 The information pack could include only one investment statement. This could be the investment statement for the default fund to which that person is to be randomly allocated. The advantage of this option is that the provision of unnecessary information packs is reduced. The disadvantage is that it would require the person to be allocated to a default prior to or at the same time as the provision of the information pack. Inland Revenue has concerns about the workability of this option that we would need to explore further with them.
- 71 Another option is to require IRD, the employer or the provider to provide an investment statement after the initial opt out decision has been made, to those people who have chosen to remain in the scheme. This would reduce the distribution of any unnecessary investment statements but would introduce a new step in the process for which there is no obvious mechanism. Again, if Inland Revenue were to play a bridging role, we would have to work more with them to determine how this would be undertaken. Employers are likely to resist being asked to give out a second stage of information but it might be possible for the information to go from the provider directly to the investor for example.
- 72 A final option is to require employers to ensure that a copy of the investment statement for the default schemes is accessible to all employees rather than including an investment statement for all default providers in the information pack given to all new employees. This could include making copies available in the tea room, posting copies on a notice board, and/or providing a website link on an intranet. Thus the requirement would be that every new employee (or existing employee who was considering opting in) had access to the investment statement, rather than requiring that they receive a hard copy. We note that compliance with this obligation would be difficult to monitor.
- 73 This would reduce provider costs as it would reduce distribution and printing costs. However it also greatly increases the chances that an individual members does not see any investment specific information prior to joining the scheme. Officials are tending towards providing all investment statements in the information pack as providing the best balance between the different trade-offs but will need to consult further, particularly with IRD.
- 74 The Securities Commission, which is responsible for enforcing the laws relating to investments, have serious concerns with the final option. In summary, the Securities Commission's concerns are as follows:

- Potential investors may not receive core information about their choice and the impact of their choice if they do not receive a copy of an investment statement;
- Allowing an exemption from the requirement to provide an investment statement could have a negative precedential effect in respect of exemption applications made to the Commission by other issuers who seek competitive neutrality with KiwiSaver providers;
- Not providing copies of the investment statement may run counter to the financial literacy campaign which will encourage people to consider the investment and make the right choice for their own circumstances;
- That removing the compulsory provision of investment statements may affect investor's rights against issuers in the event the information in the investment statement is false or misleading; and
- That even a decision to do nothing and to stay in the scheme and invest with the default provider should be an informed decision.

75 MED shares these concerns but believes that workable solutions can be developed that minimise compliance costs as far as possible while still ensuring KiwiSaver members have the information necessary to make an informed decision.

76 The options included above are merely examples of approaches that could be taken. We intend to do further work in this area to determine the best way to manage compliance costs while still providing the core protections offered by applicable regulation.

77 Given the structure of automatic enrolment, it may not be possible to provide the investment statement prior to many members joining the scheme. For example, in relation to active members the member is enrolled in the scheme and then has 8 weeks to choose a provider. They will receive the investment statement from the provider during this 8 week period, after they have joined the scheme. As a consequence there may need to be minor amendments to the Securities Act to accommodate the different timing of the provision of the investment statement.

Investment Statement for non-Default Schemes

78 For non-default providers, individuals could be supplied with a copy of an investment statement along with the application form for that provider. This would enable these people to obtain adequate information to be informed about their investment, and take responsibility for their investment decision, while not imposing unnecessary compliance costs on providers, as the investment statement is usually appended to the application form. In addition, while the number of default providers is likely to be limited there may be many active choice providers and it would not be practical to require employers to make these investments statements available and keep them up to date. This is especially the case where some providers may be niche providers and may have a small target audience.

Annual Report

- 79 In relation to the annual report it does not make sense for a hard copy to be provided to all members every year, such as inactive members who have taken a 5 year contribution holiday. We also note that receiving some form of information from a provider may remind a non-active member to reassess their financial situation and to consider beginning saving again. Officials will develop options for ensuring that active and inactive KiwiSaver members obtain appropriate levels of information but that do not necessarily involve every member receiving an annual report so as to minimise provider compliance costs.
- 80 Note that similar issues arise in relation to the question as to what information is provided to individuals about the balance of their individual account (such as what information to give inactive members and how to define inactive members) but we would prefer to leave this flexible for the tender, as there is a trade off between requiring providers to provide more information and negotiating fees down.

Prospectus

- 81 Every RSS is required to register a prospectus before members join the scheme (although there is an exemption for employers operating their own RSS). The prospectus provides financial information about scheme providers and the investment that is not easily available otherwise. The directors of a scheme provider must sign the prospectus and are liable if it is false and/or misleading. The GA can also look at a scheme's prospectus when assessing whether to intervene on the basis of the financial position of the scheme.
- 82 One of the compliance issues identified that causes complaint may be that there is some duplication in the financial information that is required to be provided:
- in the annual report (required for RSS only); and
 - the initial and ongoing disclosure requirements of the Securities Act 1978 (which includes the prospectus).
- 83 Officials are aware of this issue. Officials do not recommend exempting KiwiSaver from the prospectus requirement and propose to address any wider issues around disclosure within the Review of Financial Products and Providers which has been commenced. The Review will allow issues of disclosure to be assessed across all financial products, and not just superannuation schemes. This will allow us to take a coherent approach to the regulation of financial products and to potentially reduce compliance costs without introducing distortionary effects between different types of investments. We set out the timing for the Review below.
- 84 The prospectus is important for providing financial information about the investment and the provider of the investment. This information is used by the GA in his role of overseeing RSS and the Securities Commission in their role overseeing the regulation of investments more generally. The GA and Securities

Commission's ability to undertake these roles would be weakened if a prospectus was not required.

- 85 In addition, the directors of a provider are required to certify that the information in the prospectus is correct and they are liable if anything is false or misleading. This increases the accountability of directors and the reliability of the information published. This accountability is even more important in the KiwiSaver context where there may be a perception that the government guarantees providers or returns. It is also likely to lead to more robust financial reporting systems being established within institutions, which can contribute to their strength over time.

Review of Financial Products and Providers

- 86 As you will be aware officials in MED have now commenced the Review of Financial Products and Providers. This work will consider, in a holistic way, and across the financial sector any broader issues around disclosure as well as the regulation of superannuation. The Review will also take into account the recommendations of the Financial Intermediaries Task Force and the results of the Financial Capability survey, when these two streams of work are completed later in this year. Officials believe that any broader issues around the regulation of superannuation as a whole, or disclosure for example, that are not specific to KiwiSaver should be considered within the context of this Review.
- 87 The Review will consider issues of disclosure, prudential regulation and supervision, governance, merit regulation, and occupational regulation across financial products and institutions. This will allow for consistency of regulation where appropriate, and for regulatory issues that are common to different financial products to be considered together. In addition, the RFPP will specifically consider proposals for regulatory co-ordination with Australia..
- 88 The problem definition and key directions for reform for the Review will be developed by July 2005, with options for reform being developed by the end of 2005. These options will be released in the form of a discussion paper early in 2006 with the aim of getting policy decisions in mid-2006 and implementing the reforms in 2008. The reforms arising from the Review will further strengthen the regulation of financial products and providers.

Other Regulatory Issues

Lock in of Government Contribution Where Member is Close to Retirement

- 89 When we sought your agreement to the upfront government \$1000 contribution being locked in until the age of eligibility for New Zealand Super, or for five years, whichever is greater (subject only to the death, permanent emigration and hardship withdrawal conditions), we did not seek your views on whether the five year condition should also apply to a saver's own contributions [recommendation 3.16 of CAB Min (05) 13/9 refers]. Officials understand this to mean that a member who joins the scheme 3 years out from retirement, and contributes throughout that time, can withdraw their contributions at age 65, whereas the \$1000 contribution would be locked in for another 2 years (making 5 years in total). Officials recommend that the 5 year lock in only apply to the government

contribution, as agreed by Cabinet, because it may be difficult to justify locking in a member's individual contributions past the point at which they retire. Thus, officials are seeking a decision on whether the five year condition applies to the period since the first contributions.

- 90 Alternatively, you could consider imposing an upper age limit of 60 on joining KiwiSaver. There is special provision in the Human Rights Act 1993 allowing upper age limits to be imposed on superannuation schemes. This would have the advantage of simplicity.

Conversion

- 91 Currently, trust deeds of RSS cannot be amended without the written consent of every beneficiary and member if they would be adversely affected by the amendment (e.g. where the change would postpone benefit entitlements or increase contributions). Existing RSS that wish to convert to a KiwiSaver scheme as a whole would need to amend their trust deeds. Getting the consent of every member is likely to be expensive and impossible.
- 92 One option may be to deem some or all of the KiwiSaver conditions to apply to a discrete section of a scheme and permit members individually to elect to opt in or out of the KiwiSaver section of the scheme. Officials will need to consult to determine how best to deal with issues around altering members' benefits without consent, and what can be accommodated within provider's existing systems, among other things.
- 93 Employers that convert schemes would obtain the general exemption from promoter status available to employers as part of the regulatory environment for KiwiSaver. This would generate a need for such converted schemes to again offer a prospectus.² Alternatively, the current prospectus exemption could apply where a KiwiSaver scheme is offered by an employer for their employees, but promoter status, as exists at present, should remain if this were the case.

Exemption from Automatic Enrolment

- 94 Cabinet agreed that employers with existing registered superannuation schemes that meet certain characteristics could apply for an exemption from the automatic enrolment provisions [CAB Min (05) 15/2 para 5 refers]. We envisage that employers with existing schemes would need to apply to obtain this exemption.
- 95 Employers are often operating numerous schemes. This happens where a scheme is closed to new members and a new scheme opened. The old scheme is then run in parallel with only the existing members contributing. We have identified a problem with requiring RSS to be open to all permanent employees as members of old schemes, such as the GSF which are closed, may not be eligible to join more recent employer sponsored schemes. Hence, officials

² This is appropriate as the scheme will shift from having been the employer's own scheme (where the exemption is justifiable) to being a KiwiSaver scheme here the employer will not have the same level of involvement in the scheme. We do not anticipate that employers will be concerned about the loss of this exemption where the government is paying the fees of the scheme, as these will previously have been being paid by the employer and thus the overall costs for the employer will be reduced.

suggest that the exemption be limited to those schemes open to all *new* permanent employees. We also recommend that that the “open to all employees” condition be qualified to exclude persons who are already contributing to another employer related scheme offered by that employer (such as a scheme that is closed to new members, like GSF) .

- 96 In addition, our consultation has indicated that very few employer based schemes would meet the conditions for exemption agreed to. We understand for example that these conditions are still a key concern about the scheme for ASFONZ, ISI and the Retirement Commissioner. This is a concern particularly as it is not envisaged that many schemes will take advantage of the full conversion mechanism.
- 97 Officials believe that employers who currently operate schemes may have reacted negatively because they feel that KiwiSaver may undermine participation on their own schemes. This may cause resentment due to the high level of cost and employer time that is involved in providing many of these schemes. Employers also seem concerned about the compliance costs of operating parallel schemes. To some extent employer reaction may be a result of changes to the regulation of superannuation over the last 5-10 years (removal of tax advantages etc) rather than just being confined to this scheme. However, the success of the KiwiSaver scheme will depend upon buy-in from existing savings champions. This means that the concerns expressed to date are important and that it may be worth investigating options for addressing them.
- 98 Hence, there may be merit in considering the scope to make the criteria slightly easier. If you are interested in this, officials will continue to explore this matter further with industry.

Withdrawals for Financial Hardship and Permanent Emigration

- 99 Currently, RSS are able to specify and administer separate withdrawal conditions, such as in the event of “financial hardship”, and “permanent emigration”. Some of the finance industry have noted that it would be preferable if all KiwiSaver products were subject to the same withdrawal conditions for the housing, financial hardship and “permanent emigration” withdrawals. Officials agree that common criteria may be desirable to reduce the risk that funds are transferred between schemes solely to access funds, however we are also keen to ensure that there is sufficient flexibility in the scheme. Officials will work when developing legislation to ensure that there is consistency across different KiwiSaver products as far as possible. Officials also need to consider further who will determine whether the tests for hardship and permanent emigration are satisfied.
- 100 There is also a question as to which portion of a person’s funds can be withdrawn where financial hardship is established or a person permanently emigrates. Officials do not recommend that the \$1000 government contribution be able to be withdrawn in the case of hardship as this was not the purpose of the contribution. In addition, leaving the \$1000 contribution in the KiwiSaver account may increase the likelihood that the person resumes saving after the financial hardship has passed, because they are not starting with a nil balance.

- 101 Where a KiwiSaver member applies to withdraw their funds on the grounds of permanent emigration, leaving the \$1000 behind in a KiwiSaver account would serve no purpose. If the \$1000 remained locked in, it would become an inactive balance in relation to which the government would be required to continue paying fees. In addition, the balance may impose significant unnecessary costs for providers, potentially increasing their fees. However, to avoid people permanently emigrating to access the \$1000 a minimum contribution period, of say two years, could be required before it could be withdrawn.
- 102 Officials recommend that that KiwiSaver members be able to withdraw the total amount in their fund, including the \$1000 government contribution upon permanent emigration.

Employer Liability

- 103 Previously you have agreed that employer concerns about their liability as an investment adviser or promoter of KiwiSaver should be handled through education and legislative amendments, if necessary [T2005/779 refers].
- 104 It is not yet clear whether the level of employer involvement would be sufficient to mean they were a promoter of the scheme. This uncertainty exists both where the employer chooses a default provider and where they make no election. Given the uncertainty, an avoidance of doubt provision could be included in the Securities Act if necessary. Officials intend to investigate the legal position further as well as discuss the issue with Parliamentary Counsel.

Wind Up of Schemes

- 105 Currently when a scheme is wound up the assets are usually disbursed to individual members in the form of a lump sum. This can result in a decrease in funds available for retirement savings as individuals do not always reinvest the lump sum in a new superannuation scheme. We recommend that prior to an impending wind up members be required to transfer to a replacement KiwiSaver scheme and that the original scheme then be wound up without assets or members.

KiwiSaver as Security for Borrowing

- 106 In order to avoid savers borrowing against the funds in KiwiSaver, officials suggest that an explicit legislative provision be included to prevent the funds being used as security for a loan. Officials will work to ensure that this provision does not interfere with the ability of the saver to use the funds for the purchase of their first home.