# Financial Intermediaries Task Force

## Response to Initial Issues Paper

**from**

**The Association of Superannuation Funds of New Zealand Inc.**

**18 February 2005.**

## 1. Introduction

1.1 As a rule, ASFONZ is not directly involved in issues relating to financial intermediaries in the context of the Task Force's enquiry. Many of those who are members of the association, however, will have a direct interest and will no doubt be making detailed submissions on all or many of the questions raised in the Initial Issues paper.

1.2 Our response is deliberately limited in scope. The comments below focus attention on what we consider to be an issue of paramount importance to the majority of ASFONZ members.

1.3 The issue relates to the position of an employer who makes membership of a superannuation scheme available to its employees. Should that employer, or officers of that employer, be included under a general definition of "financial intermediary"?

1.4 For the purposes of this response, we define the term "employer superannuation scheme" as a registered superannuation scheme established by an employer that the employees of that employer may join. This would include a registered scheme established solely for the employees of a single employer or group (with its own trust deed and trustees), and a registered scheme established as a "master trusts" where a number of non-associated employers each become participants in respect of their own employees. Contributions to the scheme might be made by both employer and employee, or by one or other of those parties.

1.5 Employees' contributions will almost always be by payroll deduction and, in terms of the Wages Protection Act 1983, in accordance with the employees' written consent. The schemes themselves will be registered under the Superannuation Schemes 1989 and have the regulatory oversight of the Government Actuary. That Act has many registration requirements concerning the establishment, promotion, management and communication of benefits. Schemes are also subject to a number of other regulatory requirements including the Human Rights Act, the Income Tax Act, the Privacy Act, the Property (Relationships) Act, the Financial Reporting Act, the Securities Act and Regulations, and the Trustee Act, among others.

## 2. Background

2.1 By way of background, members of the Task Force will be aware that the number of stand-alone employer superannuation schemes has diminished significantly over the last 15 years or so. We believe that, in simple terms, there are two prime perceived reasons for this:

(i) superannuation schemes over this period have been seen as tax-ineffective savings vehicles – most members pay a higher rate of tax than if they invested directly (though in fact, this might not be the case if effective tax rates are taken into account); and

(ii) compliance costs and risks to employers who provide such schemes have tended to increase over this period.

2.2 In recent months the government has made some positive moves to improve the position of employer superannuation schemes and has indicated that it is considering further moves. These moves include:

(i) the introduction of progressive SSCWT rates on employer contributions. This has removed one element of over taxation;

(ii) removing the need for most free standing employer superannuation schemes to file a prospectus – this has reduced compliance costs for such schemes; and

(iii) the commissioning of the "Stobo" report on taxation of collective investment vehicles. The recommendations in this report would, if adopted, result in many members paying tax at a rate which is similar to (or lower than) that if they invested directly.

2.3 A further initiative that the government is currently considering is the "Harris" report. It is possible that the future of employer superannuation schemes could be enhanced or further threatened, depending on the features adopted as a result of this initiative (if any). If specific "promotional" measures are not made available to existing schemes in any resulting legislation, it is quite possible that employer superannuation schemes as we currently know them will become even more unattractive to the majority of employers.

## 3. Financial Advice and Employer Superannuation Schemes

3.1 Amendments to the securities legislation in 1996 had a significant impact on employers offering stand-alone employer superannuation schemes in that compliance costs and risks increased.

3.2 One of the risks associated with these changes came from the question – "Am I, as an employer offering an employer superannuation scheme, considered to be an investment adviser under the Investment Advisers (Disclosure) Act?"

3.3 Many schemes have been discontinued, or did not commence, because the employer was not prepared to accept the risk that staff of the employer would fall within the definition. We do not have good information on this but anecdotally, it could be said to be the straw that broke the camel's back.

3.4 We recognise that one of the most difficult tasks faced by the Task Force in completing this review will be in defining terms. We commend the approach taken in the Issues Paper to tackle the definitions in the first section of the paper, as this serves to highlight the critical nature of these definitions.

3.5 It may be helpful to the Task Force in its consideration of the definition of Financial Intermediary to consider the different parties involved in the operation of an employer superannuation scheme and the roles that they take. These are:

- *The Employer*: The employer is responsible for establishing the scheme. If the scheme is a stand alone trust then the employer is likely to have an ongoing role as a promoter in terms of the Securities Act. If the scheme is part of a master trust

then the employer, in addition to establishing the design characteristics of the scheme, is likely to have decided which master trust or trusts to offer to its employees;

- *The Trustees*: The trustees are responsible for the ongoing administration of the scheme. It is the trustees who are most likely to be responsible for managing the investments of the scheme and setting and monitoring the investment strategy. Investment management is likely to be outsourced to a professional manager or managers. The trustees may be involved in the preparation of marketing material and planning tools (e.g. projection and budgeting models) and may, in some cases, be directly involved in the scheme's promotion to employees. If the trustees are also employees of the sponsoring employer, they will usually not be paid for the role. However, if a trustee is "independent" of the employer, there will usually be some form of remuneration paid;

- *The HR and Management Team*: These people are responsible for advising employees about the scheme and for providing enrolment material to those eligible to join; and

- *The Providers*: This group includes master trust promoters, investment managers, financial advisers, actuaries, consultants, insurers, and administration managers. These companies are in the business of providing financial and related services. They may be directly involved in the establishment of a scheme and /or in its ongoing management.

3.6 It is important that the definition of Financial Intermediary, and the associated obligations and penalties that will ultimately accompany that designation, treats the various parties in a fashion that reflects the role that they play in the operation of the scheme. An overly stringent definition, with onerous obligations and harsh penalties will be a major impediment to the successful operation of employer superannuation schemes.

3.7 In considering the initial proposals contained in the Issues Paper, ASFONZ offers the following observations and suggestions (where possible, these follow the same order as appearing in the Issues Paper):

## 4. Definition of Financial Intermediary:

4.1 We believe that the term *"a person who provides financial advice .."* will, itself, need to be defined if it is to be of use. The current Investment Advisers (Disclosure) Act 1996(*the Act*) defines *"investment advice*" and this could be used as a base reference. If advice is being provided it should be with the aim of influencing the recipient into doing, or not doing, something. It is important that any definition is not so wide as to be capable of encompassing virtually any statement.

4.2 We also believe it is important that the person giving the "advice" should be doing so knowingly, or at least that the person receiving the advice should be required to reasonably assume that this is the case. To be included in the term Financial Intermediary, there needs to be some *motivation* for the person to be giving the advice. In the majority of cases we expect that this motivation is likely to be some form of

financial reward and we suggest that this be a critical component of any definition that imposes regulatory requirements in an area that is already covered by, among others, the following Acts and common law requirements:

- the Trustee Act;
- the Superannuation Schemes Act;
- the Securities Act;
- the Employment Relations Act;
- the Fair Trading Act;
- the Secret Commissions Act;
- the general law of equity;
- the general laws relating to contracts; and
- the general laws relating to torts.

4.3 In an ideal world we could perhaps consider the giving of financial advice in the same light as we might consider the giving of other professional advice. For example, people frequently discuss and comment on the application of various aspects of law but most would not consider that they were giving or receiving legal advice unless the adviser was qualified in law or unless the adviser knew (or expected) that, the recipient of the advice would act on that information.

4.4 Finally, from section 1.2 of the paper, we believe that a clear meaning of *"promotes"* is also essential. For example, is this activity something that only a *"promoter"*, as defined in the Securities Act, is involved in? Or could this term include, for example, a mention in a job vacancy notice that a staff superannuation scheme is available?

4.5 In this regard we believe that, to be seen as promoting a product or service, a person would need to be actively involved in encouraging another person to buy that product or service. Also, as already suggested, we think there should be an underlying pecuniary motive with respect to that particular service. It would not be good enough, in this regard, for the employer's general pecuniary motive (to make a profit) to be sufficient qualification. It is the particular saving or insurance service offered that must be the focus of attention.

4.6 While we can see that the provision of information or analysis about a product could be part of the advice process, we question whether it is helpful to include these in this definition. There will be many instances where the provision of information and/or analysis will not constitute the giving of advice. We have already suggested some of those.

## 5. The position of Employers

5.1 The list of those who could possibly be considered to be Financial Intermediaries, at paragraph 1.7, is all-encompassing. In general terms we do not believe that it is helpful to include *"employers in relation to superannuation schemes"* in the working definition.

5.2 Employers that offer superannuation to their employees will, as a matter of course, provide information to employees in relation to the scheme being offered. However such employers can be distinguished from other types of financial advisers in that not only is there no financial incentive to the employer if the employee acts on the advice

given but the employer is also likely to itself incur a cost. Employers in the main are not “in the business” of offering financial services.

5.3 We suggest that it is not helpful in encouraging the establishment or retention of employer superannuation schemes to imply that the employer is a Financial Intermediary.

5.4 On the contrary, we suggest that it would be helpful to confirm that the establishment of such a scheme, inviting employees to join, providing the employee with factual information regarding the scheme and giving the employee the scheme’s Investment Statement will not result in the employer being regarded as a Financial Intermediary for the reasons set out above.

**6. Some wider observations**

6.1 We think there is a very useful analogy to be drawn here from the history of prospectuses as they applied to employer-sponsored superannuation schemes. The original drafters believed that, because they were being issued to the “public” and because there were “participatory securities” that they should be subject to the same disclosure rules as things like property syndicates and contributory mortgages. The drafters did not appreciate that employment-related superannuation schemes are different because of the absence, as between the employer “promoter” and employee “investors” of the profit motive. In our view much damage was done to employment-related superannuation. Until the recent prospectus exemption was implemented, schemes produced information that was not wanted, that duplicated information already produced in more “friendly” formats and at great expense. Many of our members did not have a single request for a prospectus in the six years that they were required to produce them. Even commercial providers do not get asked – one of our members (a commercial master trust provider) has had two requests in six years for a prospectus.

6.2 We think that regulation of Financial Intermediaries that suits commercial promoters and advisers with a pecuniary interest is highly unlikely to suit the employment-related superannuation environment.

6.3 We therefore recommend that the Task Force undertakes specific research in this area of financial services before proposing any further regulation than currently applies. On behalf of our members, we really want to understand the “mischief” that requires attention. Once we have that understanding, we are happy to work with the Task Force to implement the spirit of its responsibilities.

Thank you for the opportunity to comment on these initial issues. We will be happy to discuss, clarify or elaborate on any of the points made above.

# Our organisation

## The Association of Superannuation Funds of New Zealand Inc. ("ASFONZ")

ASFONZ is an independent national, non-profit organisation founded in 1969. Its current membership comprises around 100 major workplace superannuation schemes and around 50 organisations and individuals representing the various product and service providers for workplace superannuation.

The mission of ASFONZ is to promote workplace superannuation in New Zealand.

ASFONZ seeks to achieve that mission through:

1. **Advocacy** – being the recognised voice for all employers and trustees involved in workplace superannuation, through:
   - (i) advocating legislative and public policy initiatives beneficial to the industry;
   - (ii) making submissions and commentary on existing legislative and public policy initiatives;
   - (iii) issuing regular press releases and other public commentary on matters of wider concern or interest to members; and
   - (iv) staying in regular contact with responsible Ministers, regulatory and industry bodies, the Retirement Commissioner and Government Departments to project, promote and advance members' interests.

2. **Education** – promoting trustee, employer and member education through dedicated training programmes, newsletters and special interest seminars.

3. **Networking** – providing trustees, employers and service providers involved in workplace superannuation with a regular forum for sharing ideas and information on industry matters.

Contact:

Bruce Kerr
Executive Director, ASFONZ
PO Box 3761, Wellington, NZ
Ph. (04) 499 6556
Fax (04) 499 0884
Mob. (027) 284 0481
Email asfonz@xtra.co.nz
Web Site www.asfonz.org.nz