LEGISLATION CHANGES AFFECTING SUPERANNUATION AND RELEVANT CASE LAW: as at 30 June 2004

1. LEGISLATION

1.1 Superannuation Schemes Act 1989

The Superannuation Schemes Act 1989 provides for the registration of superannuation schemes and governs all registered schemes. Appendix I summarises the Act and all amendments made to it since 1989. Since the date of the previous report, the Superannuation Schemes Amendment Act 2004 has been passed, and took effect on 14 April 2004. The amendment is detailed in Appendix I.

1.2 Superannuation Schemes (Fees) Regulations 1992

The fees payable to the Government Actuary under the Superannuation Schemes Act 1989 remain at the levels which came into force effective 1 January 2002 under the Superannuation Schemes (Fees) Amendment Regulations 2001.

1.3 Securities Amendment Act 2004

Like the Superannuation Schemes Amendment Act 2004, this amendment was originally part of the 2003 Business Law Reform Bill and has also been in force since 14 April 2004.

The significant changes include:

- An offer of securities made to a director of the issuer is no longer considered to be an offer to the public. Nor are offers to persons who are each required to pay a minimum subscription price of at least $500,000 for the securities before the allotment of those securities.
- A new exemption for offers of securities made exclusively to “eligible persons”, being persons who are either wealthy (defined as having net assets of at least $2 million or an annual gross income of at least $200,000 for each of the last two financial years), experienced in investing money, or experienced in the industry or business to which the security relates.
- Relief from the need to have a prospectus before advertising that the issuer is considering making an offer to the public, and is (if applicable) seeking preliminary indications of interest, provided certain conditions relating to advertisement content are met.

However, the Commissioner may still prohibit the advertisement on the basis that it does or may mislead, deceive or confuse the public, or where it is inconsistent with the scheme's eventual prospectus. The issuer also still faces criminal liability if the "pre-prospectus" advertisement contains an untrue statement.

- An issuer must now ensure that subscriptions for securities offered to the public are held in trust for the subscribers until the securities are allotted or until the subscriptions are repaid to the subscribers.
- Issuers may now make an application to the Court for a relief order where void or voidable allotments of securities have been made. As long as the issuer complies with the procedures under the Act, orders are mandatory in respect of allotments made where an issuer has failed to have a registered prospectus for the security at the time of subscription as a result of contravening the terms of an exemption notice. However, only discretionary relief is available in that and other cases, such as where the issuer failed to ensure that a subscriber received an investment statement. The Court may, on the application of a subscriber (i.e, the scheme member) order an issuer to pay compensation to the subscriber for any loss or damage suffered by the subscriber that is caused by the contravention.
- Where an investment statement is suspended, there is now no longer a requirement to hold in trust for subscribers all subscriptions received for securities from the time of the suspension.
- A memorandum of amendments to a registered prospectus no longer needs to be delivered to the Registrar in duplicate.
- Where the registration of a prospectus is suspended, no allotment of securities subscribed for, whether before or after the suspension is made, may be made. Where a registered prospectus is cancelled, all subscriptions which have been received for which no allotment has yet been made must be immediately repaid to the subscribers.
- An issuer must not indemnify, or directly or indirectly effect insurance for, a director, employee, or auditor of an issuer in respect of liability for any negligence, default, breach of duty, or breach of trust in his or her capacity as a director, employee or auditor; or the costs of that person in defending or settling any claim or proceeding relating to that liability.
- The repeal of the previous exemption from prospectus requirements for small employer schemes contained in the Securities Regulations 1983, and its replacement with a new employer superannuation scheme exemption that applies regardless of the size of the scheme. The new exemption is subject to the condition that certain additional information must be included in the scheme's annual report, and that information relating to the scheme's investment objectives and policy must be sent to members on request. As enacted, the employer scheme exemption is quite limited in its application. A wider exemption for employer schemes was subsequently developed in the form of a new Exemption Notice, discussed below.

1.4 Securities Act (Employer Superannuation Schemes) Exemption Notice 2004

The Exemption Notice establishes a further exemption from the requirement under the Securities Act to prepare and register a prospectus for employer superannuation schemes, and came into force on 23 July 2004. These exemptions will only be available if the new exemption under the Securities Act does not apply, and then only if certain requirements are satisfied. The principal application of the Notice is in respect of "employer superannuation schemes", which are registered superannuation schemes promoted by 1 employer only or 1 employer and 1 or more associated persons of that employer, regardless of their size, provided that interests in that scheme are offered only to:

- employees of a person promoting the scheme; or
- employees of any associated person of a promoting person; or
- relatives, spouses, de facto partners, or dependents of those employees.

The Notice also provides a replacement exemption for "small employer superannuation schemes", which was removed in the latest changes to the Securities Act that came into force on 14 April 2004. In effect, the new exemption resurrects the exemption for small employer schemes that qualified under the previous regulatory exemption immediately before its repeal, albeit with some additional requirements to be satisfied.

For either exemption to apply it must be a term of the offer of scheme membership that should there be a "shortfall" for any financial year, the promoter and/or any associated persons of the promoter will incur costs (by way of contributions, expense payments, or both) equal to the amount of the shortfall. A "shortfall" is defined in the Exemption Notice as the amount by which administrative costs exceed any surplus that has been applied during the year to meet contribution obligations or expenses of the scheme (or both).

Additional disclosures of certain matters in the scheme's investment statement and annual report are also required, as is (in most cases) disclosure on request of the scheme's investment objectives and the means by which changes to those objectives may be made.

1.5 New Zealand Superannuation Bill 2004

The Select Committee's report back to the House on the New Zealand Superannuation Amendment Bill is due on 3 November 2004. The Bill proposes to:

- repeal the Retirement Income Act 1993; and
- alter the functions and powers of the Retirement Commissioner to include:
- *developing and promoting methods of improving the effectiveness of the retirement income policies from time to time implemented by the Government in New Zealand, including the promotion of education about retirement income issues and the publication of information about those issues;*
- *monitoring the effects of retirement income policies that are being implemented in New Zealand; and*

- *monitoring the effectiveness of persons (whether referred to as ombudsmen or by any other term) who have been appointed (other than under statutory authority) to consider complaints and disputes about savings and investments; and considering any issues addressed to the Commissioner by any such person and, if appropriate, making recommendations to any person.*

1.6 Government Superannuation Fund Amendment Act (No 2) 2003

The amendments under the No 2 Act for 2003 became effective on 1 July 2004. Formerly, the rate of an employee's contribution was determined to be either 6.5% or 7.0% depending on the section under which their contributions were made. The amendment removes this distinction and the rate is now 6.5% across the board.

1.7 Taxation (Annual Rates, GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003

This Act came into force on 25 November 2003. It contains changes to the taxation of Trans-Tasman investments and the treatment of employer contributions to superannuation funds, the imposition of GST on financial and imported services, and the introduction of new rules tied with mass-marketed schemes. The changes to the treatment of employer contributions involve the introduction of a progressive rate for Superannuation Scheme Contribution Withholding Tax (SSCWT) on employer contributions to registered superannuation schemes.

Key points of the regime include:

- elected rates of SSCWT must be based on the level of the relevant employee's earnings in the previous year, or on the employer's estimate of the employee's earnings where the employee is relatively new;
- the election is made by the 'employer', with no statutory power given to employees (or anyone else) to compel the employer to do so, or prevent an election being made, unless the employer and employee had previously agreed to a higher rate being deducted under section NE 2AA of the Income Tax Act;
- a trustee of a registered scheme cannot elect to apply progressive rates of tax to contributions made to the scheme, or to any particular employee or group of employees. Nor can a trustee refuse an employer's right to make such an election. There is no statutory obligation on an employer to notify the trustee of a scheme of any election made under section NE 2AB; and
- elections are made on a case-by-case basis. An employer may elect that a progressive rate applies to a particular employee, but not to others.

1.8 Income Tax Act 2004

This Act will come into force from 1 April 2005. The amendments it makes in relation to superannuation schemes are largely cosmetic. References to "Income Tax Act 1994" are changed to "Income Tax Act 2004". Similarly, terms which have been changed by the 2004 Act require consequential amendments where they have been used in other legislation.

1.9 Accounting Standards

IAS-26

In December 2002 the Accounting Standards Review Board (ASRB) announced it would recommend to government that New Zealand reporting entities be required to apply International Financial Reporting Standards (IFRS) in general purpose financial reports for periods beginning on or after 1 January 2007 (early adoption is permitted after 1 January 2005).

Earlier this year ED NZ IAS-26*: Accounting and Reporting by Retirement Benefit Plans* was released for comment. ED NZ IAS-26 is the New Zealand exposure draft of the International Standard IAS-26.

ED NZ IAS-26 has a similar scope to FRS-32: *Financial Reporting by Superannuation Schemes* and applies to all retirement benefit plans including plans established by employers to provide benefits to employees and plans where individuals make contributions for their retirement. The objective of the standard is to specify measurement and disclosure principles for the reports of retirement benefit plans.

To ensure ED NZ IAS-26 is broadly consistent with FRS-32, ED NZ IAS-26 details specific FRS 32 disclosures to be made in addition to those of IAS-26. This has resulted in a proposed standard that is similar to FRS 32. Some of the changes are highlighted below.

Review of Changes against Current Practice

Defined Contribution Plans
ED NZ IAS-26 requires the report of the Defined Contribution plan to now contain a statement of net assets available for benefits. This contrasts with the current requirement to prepare a Statement of Financial Position. The disclosure of the information contained within the statement of net assets can be made in the balance sheet format.

Defined Benefit Plans
ED NZ IAS-26 requires the actuarial disclosure to be made on the face of the statement of net assets or in a note to that statement only and not in an accompanying actuarial report as permitted by IAS-26.

Valuation of Plan Assets
Retirement benefit plan investments are to be carried at fair value as opposed to net market value as per FRS-32. The two values differ in that disposal costs are not deducted in obtaining fair value.

Frequency of Actuarial Valuations
IAS-26 does not outline how often actuarial valuations are to occur. ED NZ IAS-26 acknowledges New Zealand legislative requirements in regards to the frequency of valuations (at least every 3 years) and directs New Zealand entities to refer to legislative requirements for guidance.

Disclosure

The following information is required to be disclosed by ED NZ IAS-26:

- A statement of changes in net assets available for benefits;
- A summary of significant accounting policies;
- A description of the plan and the effect of any changes in the plan during the period; and
- A statement of cash flows (not required in IAS-26 but currently required under FRS-32)

In addition to complying with ED NZ IAS-26 superannuation schemes will need to consider the impact of other IFRS, particularly IAS 39: *Financial Instruments: Recognition and Measurement* as it relates to the treatment of any derivative instruments used to hedge currency or investment rate risks.

IAS-19

Attention is also drawn to IAS-19

At the time of writing IAS-19 is under consideration. It will address issues affecting assumptions, including discount rates, as well as topics such as multiemployer plans and hybrid plans.

2. CASE LAW

2.1 Recent New Zealand decisions

Re Foreman v Kingstone [2004] 1 NZLR 841

This case related to the extent of trustees' obligation to disclose information and documents to discretionary beneficiaries. It concerned a complex family situation involving 3 trusts and children from various marriages of the settlor. The plaintiffs in question were discretionary beneficiaries under trusts, and were seeking access to information and documentation relating to the trusts.

The case provides an extensive analysis of the New Zealand application of the leading international case in the area, *Schmidt v Rosewood Trust Limited* [2003] 3 All ER 76 (which was discussed in the report for the 2003 year) as well as related authorities. The case confirms that the right of discretionary beneficiaries to obtain documents and information relating to a trust is not a proprietary right. Rather, beneficiaries are entitled to receive information which will enable them to ensure the accountability of the trustees in terms of the trust deed. A beneficiary's access to trust documents should be approached as an aspect of the Court's inherent jurisdiction to supervise the administration of trusts. The fact that the party establishing a trust may desire confidentiality in relation to the trust's affairs does not, of itself, outweigh the right of beneficiaries to be informed – the fundamental duty of trustees is to be accountable to the beneficiaries, not the party establishing the trust.

That having been said, the judgment confirms that beneficiaries are not entitled to be given the reasons for the exercise by the trustees of their discretions. They must respect the autonomy of the trustees in relation to discretions vested in them by the relevant trust deed. The request for information as to the basis upon which various decisions of the trustees were made was declined.

The plaintiffs in this case had requested access to various categories of information. They were partially successful in the proceedings. In essence, "trust documents" (deeds and financial information) were ordered to be provided.

In the superannuation context this may mean that requests or directions as to confidentiality made by a participating employer ought not to derogate from the members' right to be informed. The fundamental trust law duty of a superannuation scheme trustee is to be accountable to the members, with accountability to participating employers a secondary consideration. In the superannuation context, these rights to disclosure are also prescribed by statute.

Trustees of superannuation schemes will also find the analysis in the case of relevance when considering the implications of recording reasons for the exercise of any discretion, and the extent to which information held must be disclosed to scheme members and beneficiaries.

Hester & Ors v Commissioner of Inland Revenue (CIR) (2004) 21 NZTC 18,421

The plaintiffs were the trustees of the Church of Jesus Christ of Latter Day Saints Deseret Benefit Plan for New Zealand. The plan was a defined benefit and contributory superannuation scheme providing retirement income for employees of the church. The trustees claimed that the plan was exempt from income tax pursuant to the charitable purpose exception under section CB4(1)(c) of the Income Tax Act 1994. Their case was based substantially on the decisions in Presbyterian Church of New Zealand Beneficiary Fund v C of IR (1994) 16 NZTC 11,185; [1994] 3 NZLR 363 and Baptist Union of Ireland (Northern) Corporation Ltd v C of IR (1945) 26 TC 335.
The trustees' case failed because they could not establish that the purpose of the plan was consistent with the charitable purpose of the church. The benefits provided to the employees of the church by the plan were private. In addition, there was an insufficient nexus between those benefits and the charitable activities of the church.
The case was distinguished from the Presbyterian case because the roles undertaken by employees of the church were more transportable to other employment than the role undertaken by specially trained ministers. The lifelong commitment principle which emerged in the Presbyterian case was not applicable in these circumstances.
The trustees had originally also argued that the refusal by the CIR to grant them the exemption was a breach of the Bill of Rights because in treating the plan inconsistently with the treatment of the Presbyterian plan, the assessment was discriminatory. The Court did not accept this submission, stating that the Commissioner is required to make assessments based on the application of the appropriate legal principles to a particular taxpayer. The mere fact that the

Commissioner has made a different assessment because he considers one taxpayer differs from another, does not amount to discrimination and does not affect the assessment.

G v G (High Court, Wellington, 4 August 2003, Neazor J, AP319/02)

This case involved a matrimonial dispute, with the property in question including interests in a superannuation scheme. The husband unsuccessfully appealed against the matrimonial property and spousal maintenance decision in the Family Court. Although the assets were divided equally, he received a considerably smaller monetary sum than his wife on the basis that he would receive a substantial superannuation payment in the future.

The family court judge's decision was upheld by the High Court. The case is illustrative of the approach the courts may take in placing a current cash value on future superannuation benefits.

2.2 Significant Overseas Decisions

Ibekwe v London General Transport Services Ltd [2003] EWCA Civ 1075

This case considered the extent to which an employer had a duty to inform an employee of proposed alterations to his workplace pension arrangements, and in particular the extent of the employer's duty to inform the employee of the availability of a right to transfer of interest to another pension scheme, and the consequences of failing to exercise that right in circumstances where in all the circumstances the employee cannot be expected to be aware of the term unless it is drawn to his attention.

The Court held that there was either an implied term of the contract of employment or an equivalent duty of care in tort on the part of the employers in such circumstances, but went on to say that on the facts there was no implied promise to ensure the information was actually communicated to the employee, only to take reasonable steps to do so.

This case is illustrative of the importance for employers offering superannuation as part of its employees' terms of employment to take reasonable steps to ensure that those employees are adequately informed of their entitlements, regardless of the statutory obligation placed on issuers and promoters. In the New Zealand context, where prospectuses are not routinely provided to members but only the Investment Statement, is it reasonable to rely on the prospectus to disclose the right or entitlement if it is omitted from other disclosure documents? Further, where a scheme trustee is under an obligation to provide information to scheme members (for example, the obligation to notify members in writing of details relating to transfers under section 9B(2B) of the Superannuation Schemes Act) the case supports the argument that in the absence of anything further, the trustee's obligation is satisfied by taking reasonable steps to communicate the information to the members concerned, without needing to be absolutely certain the information had in fact been received.

Fisher & Others v Harrison & Others [2003]

EWCA Civ 1047, [2003] BPIR 1322

This case involved the construction of a forfeiture clause under a pension plan in the context of an agreement to assign a member's benefits. The effect of the forfeiture clause in this case was held to be to forfeit the scheme member's future rights under the scheme, but not any rights that had fallen due for payment. H was absolutely entitled to those rights and free to dispose of them as he saw fit. Any agreement to effect an assignment of future rights was unenforceable by reason of s 91(1)(a) of the Pensions Act 1995 (UK).

The case is illustrative of the principle that forfeiture rules cannot be applied so as to forfeit a benefit entitlement that has already vested in the member concerned.