

NEWSLETTER NO. 41: DECEMBER 1997

This newsletter contains:

Part A: Annual Report & related matters

1. Annual Report to the Minister of Finance
2. Security of benefits of defined benefit schemes
3. Request for comment on operation of the Superannuation Schemes Act 1989
4. New name for "Master Schemes"

Part B: General matters

5. Lodgement of prospectuses
6. Clarification of requirements for continued registration
7. Reversions of surplus to employers
8. Lodgement of section 9B communication material
9. Definitions of total and permanent disability
10. Specification of benefits

Part C: Housekeeping

11. Office move
12. Internet site
13. Office closure: Christmas and New Year

1. Annual Report to the Minister of Finance

- 1.1 A copy of my Annual Report under section 28 of the Superannuation Schemes Act 1989 for the year ended 30 June 1997 is enclosed.
- 1.2 The report follows the same format as the report prepared last year, except that Appendix 4, Analysis by Regions, has been discontinued; the address for a substantial number of schemes is the head office of the scheme administrator, and hence the information is of doubtful value.

2. Security of benefits of defined benefit schemes

- 2.1 In my Annual Report, I noted that the number of defined benefit schemes showing actuarial deficits has increased, and that others may have shown a deficit with a more conservative view of future investment return. I noted that there does not appear to be a standard practice for addressing the effect on the financial security of such schemes, and I indicated that I plan to develop a paper on the subject, including consideration of the application of minimum funding requirements.
- 2.2 To expand further on this issue, it is usually seen as a fundamental feature of occupational superannuation that benefits promised by an employer are secured in a manner which does not rely on the continued support of the employer in respect of benefits accrued to date. An employer can become insolvent, cease to trade, or simply decide not to continue to support superannuation; but as at the date on which that occurs, member accrued benefits are expected to be secured by assets held in a trust fund for their benefit.
- 2.3 The particular matters I wish to address are
 - Whether the present powers of the Government Actuary are adequate to ensure that member accrued benefits are fully secured;

- Whether a standard practice for amortising any actuarial deficiency should be set down in regulations;
- Whether a minimum funding requirement should be required, possibly including specification of such matters as projected investment return.

2.4 I would welcome comments from interested parties before I commence work on this paper; I would also expect to distribute it in draft form for comment before publication.

3. Request for comment on operation of the Superannuation Schemes Act 1989

3.1 It is now some eight years since the introduction of the 1989 Act, and although there has been some fine-tuning, it is probably time to consider whether there are any changes which may assist the administration of superannuation schemes without compromising member protection.

3.2 One point in particular is the treatment of persons who have left a scheme (or suspended membership) with some form of entitlement remaining, and who can not be located. If this situation has not been anticipated in the trust deed, it may not be possible to deal with the matter without expensive recourse to Court action. Obtaining member consents to a change in deed provisions also becomes extremely difficult.

3.3 We have an undertaking that changes to the Act will be considered next year. We would earnestly invite practitioners to make written submissions to us in the first instance, so that we can provide Ministry policy analysts with sound and practicable suggestions.

4. New name for "Master Schemes"

4.1 This office has been in the habit of referring to registered schemes for which the members are exclusively the trustees of other registered schemes, as "Master Schemes". This has caused some confusion for readers of the Annual Report to the Minister, particularly since multi-employer schemes are sometimes described within the industry in the same manner, or as master trusts. Clearly we need a better way of referring to these "Master Schemes", and we are open to suggestions.

5. Lodgement of prospectuses

5.1 For superannuation schemes with 31 March balance dates, a number of advisers suggested that prospectuses needed to be registered prior to 31 December 1997, or else the schemes should close to new members from 31 March 1998 until 31 March 1998 accounts are prepared under the Financial Reporting Act. A different reading of the requirements has however been proposed, which suggests that a prospectus can be registered at 31 March 1998 and gain a six month window for provision of accounts prepared under the Financial Reporting Act.

5.2 We have referred this matter to the the Securities Commission for their view, and are pleased to be able to attach their comments as an appendix.

6. Clarification of requirements for continued registration

6.1 I have been asked to clarify whether there has been any change in office policy from that set out in Newsletter No. 32, May 1995, under the heading "Registration of New Superannuation Schemes".

6.2 The short answer is "No." In Newsletter No. 32, we said:

Accordingly, to maintain registration under the Act, we would expect trustees of "short-term" schemes to be able to demonstrate that payments are being made to persons who are retiring (or who have retired); or persons who, by reason of their age (for example) can reasonably be said to be retiring - rather than to persons aged 30 (say) who are not likely to be retiring at the date the payment is made.

In this context, "short-term" schemes refers to those where the provisions of the trust deed place no or little restriction on a member's ability to access savings, or where the nature of the assets is essentially short term.

6.3 The office has from time to time, since the publication of Newsletter No. 32, sought that demonstration from certain schemes, and has received information to confirm that the schemes in question should continue to be registered. This practice will continue.

6.4 I note that while the policy has not altered, the forthcoming removal of the superannuation surcharge tax may affect investor behaviour, and that this in turn may cause some difficulties for some schemes. I note also that the introduction of the requirement for prospectuses and investment statements removes certain possible advantages for superannuation schemes in respect of regulatory compliance.

7. Reversion of surplus to employers

7.1 Where the trust deed of a registered superannuation scheme permits, a company which sponsors the scheme for its employees may apply to the Government Actuary for consent for part or all of any surplus funds in the scheme to revert to the company. In many cases the trust deed needs to be amended before this can happen, and hence members consent is required. In the past few years we have therefore seen a process develop whereby existing members are given a share of the current surplus in return for their consent to a deed change permitting reversion.

7.2 This office has received enquiries from advisers and Trustees as to current market practice in respect to the sharing of surplus. In order that there may be a full appreciation as to how market practice has developed, I have reviewed our files on such cases. In the 11 cases where reversion in excess of \$250,000 has been procured or made available, and the scheme not wound up, I have found that:

7.2.1 Members have received an average 37% share of the calculated surplus, varying from 25% to 49%, and with lower and upper quartiles of 29% and 43% respectively;

7.2.2 Weighting by total surplus gives a slightly lower result of an average of 36%;

7.2.3 Scheme sponsors have taken an average 43% of the calculated surplus by way of a reversionary payment, varying from 0% to 60%;

7.2.4 Excluding the one case of a nil reversion, the average increases to 48%, and the range becomes 32% to 60%, with lower and upper quartiles at 42% and 55%;

7.2.5 Weighting by total surplus reduces the average reversion to 39% of calculated surplus, excluding the nil reversion instance;

7.2.6 The proportion of calculated surplus retained in the scheme varied from 0% to 55%, with 3 instances less than 5% and a further 2 between 5% and 15%. The average, weighted by total surplus and excluding the nil reversion case, was 30% of calculated surplus retained in the scheme;

- 7.2.7 Where the proportion of calculated surplus left in the scheme was less than 15%, the average proportion distributed to members increased from 37% to 44%;
- 7.2.8 The average amount of a reversion payment, excluding the nil reversion case, was \$4.3 million, with a range from \$312,000 to \$10.8 million;
- 7.2.9 The two schemes that did not have a requirement for members to contribute had 26% and 41% going to members, 42% and 41% reverting to the scheme sponsor, and 32% and 18% retained in the scheme respectively.
- 7.3 Reference to "calculated surplus" is to surplus calculated on the actuarial projection basis accepted by the trustees.
- 7.4 In general terms it would seem that the market average is about one third of calculated surplus distributed to members, either in cash, or by way of benefit improvements, or a combination of each. It would appear that the greater the calculated surplus, the greater the proportion retained in the scheme and the smaller the proportion taken as a cash reversion by the employer. This may or may not reflect an intention to apply for a further reversion at a later stage; in one case out of the eleven, a further reversion has been applied for and consent given.
- 7.5 I note that the factual circumstances in any one case may well lead to development of proportions different from the market averages that are indicated by the above analysis, and I have not taken into account any differences as between cases where a cash offer is made to members and cases where benefits are enhanced. Nonetheless, I would expect the above figures to be borne in mind by trustees in assessing any proposal put forward by a scheme sponsor, particularly in regard to what may be reasonable expectations as to a share of calculated surplus for the members of the scheme, and the levels of calculated surplus to be retained in the scheme.

8. Lodgement of section 9B communication material

- 8.1 Section 9B(2) of the Act requires trustees of registered superannuation schemes to notify members in writing of any proposals to transfer all or a substantial number of members and/or beneficiaries from one scheme to another, or between sections of the same scheme; and to forward a copy of such notification to the Government Actuary. Members have to be given the notification at least one month in advance of the proposed transfer date.
- 8.2 Our interpretation of the Act is that we should receive that copy of the notification as soon as members do, but we have found in some instances we are getting the notification late, or even some time after the effective date of the proposal. We would like to impress on consultants and trustees that notification to us should be given promptly.

9. Definitions of total and permanent disability

- 9.1 On the principle that the benefits of a scheme are specified in the trust deed governing the scheme, the definition of the factual situation that will give rise to a claim for total and permanent disability ("TPD") needs to be in the trust deed itself.
- 9.2 The TPD benefit is often insured through a life insurance company. I have become aware that a practice exists of defining the TPD benefit by reference to the definition used by the present insurer, on the grounds that different insurers have different conditions, and that if a scheme changes insurers, this practice ensures that coverage is as currently insured.
- 9.3 While I appreciate the practical difficulties, I consider the practice to have certain dangers. Firstly, as noted above, it offends the principle that a member can refer to the trust deed and find out what benefit entitlement he or she has. Secondly, while the member may be

advised on entry of the then current definition as advised by the insurer, a change in insurer may lead to a change in definition without members being informed.

- 9.4 At this point I would invite comment from interested parties as to why this office should not be insisting upon the definition being incorporated in the trust deed directly.

10. Specification of benefits

- 10.1 The office is occasionally approached by consultants and asked as to the acceptability of generalised benefit clauses, effectively giving the trustees wide-ranging discretionary powers to determine benefits for one particular group of members, or even for individual members. For example, it has been seen as useful to be able to have benefits determined by separate agreement between member and trustee, rather than specified in the trust deed.
- 10.2 It is my view that section 7(d) of the Act does not permit such generalised benefit clauses. The office has accepted deed amendments which allow individual adjustment of benefits in a manner that specifies how benefits are to be adjusted and for whom, subject to member consent, but not amendments which confer on trustees or the scheme sponsor a general power. Nor do I find acceptable any provision which refers to some agreement outside the trust deed; I consider that the deed itself is to be the reference document.
- 10.3 I am aware that some existing deeds have a generalised benefit augmentation clause. It is my intention, when or if I come across them, to discuss their suitability with the scheme trustees. Where a proposal arises for any such clause to be applied in a manner which could be considered not to be equitable as across all members of a scheme, then I would expect the "whistle-blowing" provisions of section 18A of the Act to apply to any administration manager, investment manager, actuary or auditor who became aware of the proposal. Please note however that provisions in defined benefit schemes which are used to augment benefits by addition of past service in return for consideration are not likely to cause me any concern.

11. Office move

- 11.1 The Insurance and Superannuation Unit is a business unit of the Business and Registries Branch (formerly Commercial Affairs Division) of the Ministry of Commerce. As part of the reorganisation of the Ministry into a Branch structure, the Business and Registries Branch head office, including our unit, is moving into the Ministry of Commerce building from 15 December 1997.
- 11.2 Our new location is on the 11th floor of the Ministry of Commerce, 33 Bowen Street, Wellington. Our fax and post office box numbers are not altered by the move and remain as fax (04) 472 5388, and PO Box 10 843, Wellington. Our Direct Dial phone numbers will also remain the same, namely Lesley Carrig 470 2532, Paula Gillespie 470 2531, Alan Leahey 470 2527, Gavin Quigan 470 2526, and Geoff Rashbrooke 470 2528.
- 11.3 However, the main switchboard telephone number is going to change, to **(04) 472 0030**.
- 11.4 A consequence of the shift is that some current files will now be held offsite. In the short term this may cause some slight delays in responding to telephone enquiries. However, we expect no more than a 24 hour delay in accessing such files when the need arises. Please also note that we have arranged that the files will be held on a confidential basis, with no access available to third parties.

12. Internet site

- 12.1 A home page for the ISU is currently being developed within the Ministry of Commerce site. We intend to have available past annual reports to the Minister, Newsletters, the most recent Insurance Company Ratings Schedule, and a list of currently registered superannuation schemes.
- 12.2 We would be very happy to receive suggestions as to other material that might usefully be incorporated in due course.

13. Office closure: Christmas and New Year

- 13.1 The office will be closed from 25 December 1997 to 2 January 1998 (both inclusive).
- 13.2 On behalf of all the staff of the Insurance and Superannuation Unit, I wish you Seasons Greetings and a Happy New Year.

G D Rashbrooke
Government Actuary

APPENDIX

The following comment has been supplied by the Securities Commission

SUPERANNUATION SCHEME PROSPECTUSES AND THE FINANCIAL REPORTING ACT 1993

On 1 October 1997 superannuation schemes became subject to the disclosure requirements of the Securities Act 1978. Prior to this superannuation schemes were exempted from much of the Act and had their own regulatory regime under the Superannuation Schemes Act 1989. Trustees of superannuation schemes are now required to register prospectuses and to issue investment statements when offering interests in superannuation schemes to the public.

The information required to be contained in a registered prospectus for a superannuation scheme is prescribed in Schedule 3C to the Securities Regulations 1983. Clause 12 of this prescription requires the prospectus to contain a reference to “*the latest Financial statements of the superannuation scheme that comply with, and have been registered under, the Financial Reporting Act 1993, the accounting period covered by those statements, and the date of registration*”. We understand that there is presently some uncertainty within the superannuation industry concerning the application of this requirement to the first prospectus of some schemes.

The source of this uncertainty is the application of the requirements of the Financial Reporting Act 1993 to superannuation schemes. By virtue of section 5 of the Financial Reporting Amendment Act (No.2) 1996, a requirement under the Financial Reporting Act on the trustees of a superannuation scheme to prepare and register financial statements shall be construed as a requirement to prepare and register -

- (a) If the liabilities of the trustee and the scheme are not limited to a separate fund, financial statements in respect of the scheme; or
- (b) If the liabilities of the trustee or the scheme are limited to a separate fund, financial statements in respect of both the scheme and that fund.

This amendment came into force on 1 October 1997. It would appear that the practical application of the amendment requires that it only apply in respect of accounting periods which are completed after 1 October 1997. Because of this, it would appear that a superannuation scheme with a financial year of, say, 31 March, will, in respect of the financial year ended 31 March 1997, not be required to have financial statements that comply with, and have been registered under, the Financial Reporting Act. The requirements of the Financial Reporting Act will apply in respect of the financial year ended 31 March 1998 so that the financial statements should be registered under the Act no later than 20 September 1998 (having regard to sections 10 and 18 of the Act which require the financial statements to be registered within 5 months and 20 days of the financial year end). A similar position arises in respect of schemes with financial year ends of 30 June and 30 September. The question therefore arises as to how the prescription in clause 12 of Schedule 3C to the Regulations will apply in respect of superannuation schemes in this situation.

We understand that some members of the legal profession have reached a similar view having regard to section 21 of the Financial Reporting Act. We are unsure as to the extent to which this provision relates to the initial application of the requirements of the Act to superannuation schemes generally.

We understand that some superannuation scheme trustees have received legal advice that the prescription in clause 12 only applies in situations where the trustees are required to prepare financial statements which comply with and have been registered under, the Financial Reporting Act. This is because the Securities Regulations state that the information prescriptions in the Regulations only apply to the extent that they are applicable.

Clearly, it is the policy of the law that superannuation scheme prospectuses should contain or refer to financial statements which comply with and have been registered under the Financial Reporting Act. However, we accept the view that, by virtue of the provisions of the Financial Reporting Act concerning the application of the Act to superannuation schemes, when read together with the Securities Regulations, there may be an exception to this policy in these particular circumstances. We have the following comments:

- Clause 18 of Schedule 3D to the Regulations requires the investment statement for the scheme to state where a copy of the most recent financial statements of the scheme prepared in accordance with the requirements of the Superannuation Schemes Act can be obtained, free of charge.
- Regulation 23A of the Securities Regulations requires a copy of the most recent financial statements of the scheme required to be registered under the Financial Reporting Act, together with all documents that are required to be registered with those financial statements, to be provided to a security holder upon request.
- The exception will only be temporary. During the course of 1998 all superannuation trustees will become subject to the requirements of the Financial Reporting Act and will be required to comply with the prescription in clause 12 of Schedule 3C.
- If superannuation schemes are entitled to register a prospectus without providing the information prescribed by clause 12, it would appear that they will not have the benefit of the provision in the Securities Act which allows the life of a registered prospectus to be extended to up to 18 months. This is because it will not be possible for the registered prospectus to “refer to a balance sheet in accordance with the regulations” which is a precondition for the application for the provision. Moreover, for the same reason, the registered prospectus will only have a life of 6 months.

It seems unsatisfactory that the life of initial prospectuses for superannuation schemes under the new investment product disclosure regime should be limited to 6 months. We think a practical way for the Commission to address the matter might be to grant an exemption from the 6 month restriction on the condition that the prospectus includes up to date financial statements which comply with GAAP and all applicable requirements of the law including, in particular, the relevant provisions of the Superannuation Schemes Act.