NEW ZEALAND SUPERANNUATION FUND

25 March 2010

Clerk of the Committee
Commerce Committee Office
Parliament Buildings
WELLINGTON

Dear Sir/Madam

Bill No: 1090-1 Financial Service Providers (Pre-Implementation Adjustments) Bill

1. Background to Crown Financial Institutions

1.1 This submission is made by the following Crown entities[1] :

- Accident Compensation Corporation (ACC)
- Earthquake Commission (EQC)
- Government Superannuation Fund Authority (GSFA)
- Guardians of New Zealand Superannuation (Guardians)

(together, the Crown Financial Institutions (CFIs)).

1.2 The CFIs undertake, in summary, the following roles:

- ACC manages and administers the ACC scheme including the investment of reserves.
- The EQC manages and administers the Natural Disaster Fund.
- The GSFA manages and administers the Government Superannuation Fund.
- The Guardians manage and administer the New Zealand Superannuation Fund.

1.3 The CFIs are each under a statutory duty to invest the investment funds under their management on a prudent, commercial basis and to manage and administer those funds in a manner consistent with:

- Best-practice portfolio management.
- Maximising return without undue risk.
- Avoiding prejudice to New Zealand's reputation as a responsible member of the world community.

[1] Note that the GSFA is making a separate submission in conjunction with the National Provident Fund on account of their particular arrangements for the provision of financial advice and services from their jointly-owned subsidiary Annuitas Management Ltd.

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1.4 As at 28 February 2010, the total investment monies of the CFIs were $38.1 billion. The CFIs work with a number of external investment advisers around the world to execute their respective investment strategies. By way of examples:

- The Guardians ($15.9bn under management) has numerous relationships with offshore fund managers, general partners, derivatives counterparties, custodians and advisers (firms). The number of relationships is expected to rise over time as the Guardians' investment strategies are fully implemented and the total size of the New Zealand Superannuation Fund increases.

- ACC has total funds under management of $13.2 billion. Some of these funds are externally managed. A significant portion of the funds are directly managed by ACC itself and as a result ACC has relationships with numerous firms, many of which are based offshore.

1.5 Partnering with these firms is essential for the CFIs to discharge their respective investment duties referred to above.

2. Request to appear before Select Committee

2.1 The CFIs wish to make oral submissions to the Committee.

3. Executive Summary

3.1 We support a new financial services regime designed to enhance confidence in New Zealand's capital market. We understand the need, particularly, to ensure that protections are put in place to ensure that investors can have some confidence in the calibre of those providing financial advice to them.

3.2 In this regard, though, the CFIs can be considered a special type of investor. Because of their statutory obligations, they each, already, subject their advisers to a very high degree of scrutiny.

3.3 Furthermore, the regime as it currently stands risks the unintended consequence of hampering the CFIs' ability to discharge their investment obligations by reducing the pool of potential overseas firms willing to provide services to the CFIs. Such a consequence would be contrary to the public interest of the CFIs maximising returns to the funds they manage.

3.4 We therefore submit that advice provided to the CFIs should not be considered financial advice for the purposes of the Financial Advisers Act 2008 (FAA). We expand upon the rationale for this in part 4 of this submission.

3.5 In addition, we consider that the following amendments are required for the efficient operation of the regime:

- Directors acting in their capacity as directors, and providing advice to their companies or their fellow directors, should be exempted from the regime (in a similar manner as employees are exempt when providing advice to their employers) This would recognise that directors are not necessarily employees of

the company of which they are a director. The same applies for trustees and partners. Together they are defined as principal officers under the FAA. This issue is addressed in part 5 of our submission.

- We support the amendment to the FAA which exempts employees of Crown organisations from the regime but submit that this be extended to contractors and other agents of the CFIs. This is addressed in part 6 of our submission.

- We submit that employees and agents of CFIs nominated by CFIs to sit on investment committees, investment advisory committees and similar governing or advisory bodies of entities in which the CFI invests should be exempt from the regime. This is addressed in part 7 of our submission.

4. Applying the Financial Advisers Act 2008 (FAA) and Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSPA) to providers to CFIs

Submission

4.1 We **submit** that any person who is providing a financial adviser service[2] or other financial service[3] to a CFI should be excluded from the financial services regime in respect of services to that CFI.

Rationale

4.2 The definition of financial adviser contained in the FAA is very broad, and rightly so for the policy purposes for which that legislation is designed. The CFIs each use a broad range of firms, who might be captured by that definition, to fulfil their statutory duties. A non-exhaustive list of such firms would include:

- Investment managers;
- Investment advisers, both general and across a wide array of specialisations;
- Operational due diligence advisers;
- General partners of limited partnerships;
- Custodians;
- Bankers;
- Derivative counterparties;
- Stock brokers; and
- Peer funds.

4.3 As outlined in 1.3 above, the CFIs are required to invest funds on a prudent and commercial basis and manage and administer those funds in a manner consistent with best practice. Taken together, those requirements compel the CFIs to impose a high standard of due diligence before appointing any investment adviser. By way of example, a decision to invest in a private equity partnership, say, will typically involve due diligence of the offering partnership by CFI staff, private equity advisers, lawyers, tax advisers and operational due diligence experts.

4.4 Furthermore, in order to maximise returns to the funds they invest, the CFIs are often seeking out firms around the world. Very often those firms have no other business in

[2] Section 11 of the FAA.
[3] Defined in section 5 of the FSPA

New Zealand, nor, many times, any interest in pursuing other business opportunities here.

4.5 Although each CFI itself invests considerable sums of money, the amount it trusts to any one firm can often be a small fraction of the total. That amount, too, is often but a small fraction of the total sums invested, or advised upon, by the firm.

4.6 Given these circumstances we consider it likely that many of these firms would decline a CFI's request to provide services to them were they required to comply with the New Zealand financial services regime. They may well see the cost and inconvenience of doing so as outweighing the benefit to them. Should that be the case, the CFI's ability to fulfil their statutory duties would be impaired.

4.7 Should any of the advisers we use wish to seek further business opportunities in New Zealand (outside of relationships with CFIs), and then our proposed amendment would ensure they continued to be captured by the financial services regime.

4.8 Finally, on this issue, the CFIs are exempt[4] from the FAA and FSPA where we are giving advice or making an investment transaction[5] or providing a financial planning service in the course of our functions. It would be consistent with this concept to exempt any person who is providing a financial adviser service[6] or other financial service[7] to the CFIs to be exempt in respect of the provision of services to the CFIs.

Proposed Amendment to Bill

4.9 The following amendments to the FAA and FSPA in the Financial Service Providers (Pre-Implementation Adjustments) Bill (Bill) would implement our Submission:

> **FAA 12: A person does not perform a financial adviser service in the following cases:**
>
> ....
>
> (ma) a person giving advice to, or making an investment management decision on behalf of—
>
> (i) a Crown organisation; or
>
> (ii) the Reserve Bank of New Zealand; or
>
> (iii) an employee, agent, or member of the board of a person listed in any of subparagraphs (i) or (ii) (while acting in that capacity as an employee, agent, or member of the board); or
>
> ....
>
> **FSPA 7(2): The following people are not financial service providers to whom this Act applies:**
>
> .....
>
> (ga) a person providing a financial service to a person listed in any of paragraphs (e) to (g):....

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[4] Section 12(l) of the FAA as amended by the SOP and Section 7(2)(g) of the FSPA

[5] This will refer to 'investment management decision' under clause (1AB) of the Supplementary Order Paper to the Bill (SOP)

[6] Section 11 of the FAA.

[7] Defined in section 5 of the FSPA

5. Internal advice by principal officers

Submission

5.1 We **submit** that the FAA should be amended to exempt principal officers when acting in that capacity and when providing advice to the entities of which they are principal officers, or advice to their fellow principal officers.

Rationale

5.2 The FAA exempts Board members of Crown organisations who are acting in their capacity as a member of the board and in accordance with the Crown Entities Act and the Crown entity's own Act[8].

5.3 However, no similar exemption exists for principal officers when providing advice to the entities of which the person is a principal officer or to their fellow principal officers. This is an issue for all directors and their companies. It is also an issue for trustees and partners.

5.4 Not having such an exemption under the FAA is also inconsistent with the FSPA which includes an exemption for persons who are the principal officers (which in the FSPA is termed "director") of financial service providers[9].

5.5 Occasionally CFIs will seek to install directors on boards of companies in which they invest. If the exemption does not extend to directors when providing advice to fellow directors, or trustees providing advice to fellow trustees, it would potentially have a significant impact on the ability to find people with the right professional expertise to sit on those boards of companies. It would also mean an inconsistency between Board members of the CFIs and where those same members sat on subsidiary companies of the CFIs.

Proposed Amendment to Bill

5.6 The following amendments to the FAA in the Bill would implement our Submission:

....

FAA 12: A person does not perform a financial adviser service in the following cases:

....

(oa) a principal officer, while acting in that capacity, giving advice to—

(i) the entity of which the person is a principal officer; or

(ii) another principal officer of the entity (**A**), provided that A receives that advice while acting in A's capacity as a principal officer of the entity and the advice does not relate to A acquiring or disposing of a financial product.

....

[8] Section 12(l) of the FAA
[9] Section 7(2)(g) of the FSPA

6. Support for exemption of employees of crown organisations

Submission

6.1 We **support** the inclusion of employees of Crown entities to the exemption from the FAA.

7. Exemption for members of investment advisory and investment committees and trustees of investment trusts

Submission

7.1 We **submit** that employees and agents that CFIs appoint to investment advisory and investment committees and similar bodies be exempted from the regime.

Rationale

7.2 As discussed in part 1 of our submission, CFIs must ensure that they discharge their respective mandates. To do that, CFIs will, from time to time, nominate employees or agents to be members of investment advisory committees, investment committees and suchlike bodies in respect of investments the CFIs make.

7.3 Under the FAA (as proposed to be amended by the Bill and SOP), employees of CFIs are exempt where giving advice or making an investment management decision in the course of the Crown entities' functions[10]. Under the FSPA employees of CFIs are exempt while acting as an employee[11].

7.4 We believe that these exemptions should be extended to nominees such as contractors or other agents of the CFIs so that CFIs can more flexibly undertake their duties.

Proposed Amendment to Bill

7.5 The following amendments to the FAA in the Bill would implement our Submission:

> **FAA 12 When advice or transaction by certain persons is not performing a financial adviser service**
>
> ....
>
> (l) A Crown organisation or an employee or agent of a Crown organisation giving advice or making an investment management decision or providing a financial planning service in the course of its functions.
>
> ....

[10] Section 12(l) of the FAA, clause 8(1) of the Bill and clause 1(AB) of the SOP
[11] Clause 7(2)(l) of the FSPA

8. Conclusion

8.1 We support the thrust of financial services reform. As the FAA and FSPA are currently drafted we believe that there will be a number of unintended consequences impacting on the CFIs ability to fulfil their statutory duties. We consider that those unintended consequences can be simply rectified and it is in the public interest to do so.

Yours faithfully

Signed by Adrian Orr, Chief Executive, Guardians of New Zealand Superannuation for:

Dr Jan White, Chief Executive Officer, **Accident Compensation Corporation**
Ian Simpson, Chief Executive, **Earthquake Commission**
Alan Langford, Chief Executive, Annuitas Management Limited
for **Government Superannuation Fund Authority**
Adrian Orr, Chief Executive Officer, **Guardians of New Zealand Superannuation**

cc: Hon Bill English, Minister of Finance
Hon Nick Smith, Minister for ACC
Peter Mellor, The Treasury