chapman tripp

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FEEDBACK SOUGHT ON POTENTIAL EXEMPTION – CONSOLIDATING DEFINED BENEFIT SCHEMES (*DB SCHEMES*)

Introduction

1 As discussed, we are writing to you on behalf of our client the Financial Services Council of New Zealand Incorporated (*FSC*), which is the key lead industry body for the managed investment schemes sector. The FSC's members in that sector collectively manage funds of over $100 billion.

2 The FSC is a non-profit organisation whose members commit to delivering strong consumer outcomes from a professional and sustainable financial services sector.

3 As well as KiwiSaver and other retail scheme managers, supervisors and service providers, the FSC's members in the managed investment schemes sector include the trustees, sponsors and service providers for a wide range of restricted (single employer, industry or faith-based) "stand-alone" workplace savings schemes.

4 All of these schemes, which include the DB schemes that are the focus of this letter, were established as superannuation schemes under the legislation preceding the Financial Markets Conduct Act 2013 (*FMCA*). They are a small (and dwindling) legacy group because the FMCA does not allow the creation of new restricted schemes.

Purpose of letter

5 This letter is addressed to you at the suggestion of Gavin Quigan, the Principal Adviser, Restricted Managed Investment Schemes at the Financial Markets Authority (*FMA*). Gavin firmly supports and was involved in helping develop the DB schemes consolidation initiative described below.

6 Pursuing the initiative requires enabling exemption relief. Accordingly the purpose of this letter is to seek (at high level) the FMA Regulatory Policy Team's:

6.1 in principle support for the required exemption relief; and

6.2 initial feedback on:

(a) the appropriate exemption type (i.e. class or individual); and

(b) as far as practicable, matters of detail, timing and process (including any additional information that may be required in due course in support of an exemption application).

7 The aim is to simplify and streamline the eventual exemption application process, given in particular:

7.1 the strong support from among the sponsors and trustees of DB schemes for enabling and effecting consolidation as soon as practicable; and

7.2 the consolidation of sub-scale schemes aligning with the FMCA's purposes of:

(a) facilitating and promoting the development of efficient financial markets:

(b) ensuring appropriate governance arrangements; and

(c) avoiding unnecessary compliance costs.

8 In this letter we:

8.1 explain the now pressing need for a DB schemes consolidation solution;

8.2 briefly outline Chapman Tripp's August 2023 report entitled Consolidation of Small Defined Benefit Schemes (*DB Schemes Report*), which addressed the merits and mechanics of such a solution;

8.3 explain the requisite exemption relief; and

8.4 **attach** an illustrative initial draft form of exemption notice (*Draft Exemption Notice*), on which we would be grateful for feedback.

9 We are happy to have a time cost recovery conversation with the FMA in need.

DB schemes in context

10 DB schemes were (with very few exceptions) closed to new members in the early-to-mid-1990s following the removal of tax incentives for pensions-based retirement savings. Despite most now being consequently very small, there remain around 50 employer-based restricted DB schemes on the Register of Managed Investment Schemes.

11 In summary terms, a DB scheme is a workplace savings scheme:

11.1 funded by its members and sponsoring employer(s) on an unallocated basis; and

11.2 whose members are entitled when retiring to lifetime pensions (and in some cases also a pension payable after their death to a surviving spouse or partner, or to another qualifying dependent).

12 Pension entitlements can commonly be exchanged either wholly or partly for lump sums at the point of retirement, or (subject to conditions) subsequently, but only if members so elect.

13 In functional terms a DB scheme operates like a life insurance product. This is because:

13.1 the benefits payable are prescribed in the trust deed, are based principally on each member's age, salary and period of contributory membership and are funded entirely from scheme assets;

13.2 those benefits include pensions payable for life, creating attendant investment and longevity risks; and

13.3 the sponsoring employer underwrites those risks, in the practical sense that if (and to the extent that) the scheme's assets are actuarially assessed as insufficient to meet its liabilities then the employer is responsible for making good that difference by way of additional contributions.

14 The remaining DB schemes are now in effect a closed class – no more restricted schemes can ever be established, because since 1 December 2016 (when the relevant transitional provisions in Schedule 4 to the FMCA were repealed) there has been no legislative facility to establish any new restricted retirement scheme.

15 Most employer sponsors would wind up their DB scheme(s) if practicable, given that those schemes are disproportionately expensive and complex to operate. However, in most cases there are no reliably workable alternatives to leaving the schemes in operation.

16 The principal wind-up impediment is trust deeds requiring the purchase (on winding up) of replacement lifetime annuities for pensioners and in some cases employee members. This requirement, which cannot be modified without unanimous beneficiary consents, operates to prohibit DB scheme wind-ups because:

16.1 there are no longer any New Zealand offerors of the required form of replacement lifetime annuity, for reasons including:

(a) the need for significant insurance reserves invested in fixed interest products; and

(b) the difficult tax treatment of lifetime annuities under the Income Tax Act 2007 (*ITA*); and

16.2 even if annuities were again to become available, it is anticipated that the cost would be highly inhibitive (considerably exceeding the carrying value of the relevant pension liabilities).

17 Put simply, a significant number of DB schemes are in effect "stranded" and operate at disproportionately high cost in terms of trusteeship, service provision and legislative compliance.

DB Schemes Report

18 It was for this reason that the FSC commissioned from Chapman Tripp the DB Schemes Report, released in August 2023 and focussing on creating and giving effect to a robust solution whereby DB schemes could:

18.1 consolidate into one or more multiple participant ("master trust") schemes; and

18.2 thereby capture economies of scale and reduce overhead costs and governance risks, especially as each master trust would have:

(a) one corporate trustee (with a professional board); and

(b) one set of administrative and secretarial, actuarial, legal, audit and investment service providers.

19 The DB Schemes Report concluded that:

19.1 the benefits of consolidation would include significant cost and time efficiency gains from pooling governance, service provision and assets;

19.2 consolidation could also be expected to help drive more effective and efficient investment strategies and improved governance;

19.3 the optimal transition method would be FMA consent-based transfers pursuant to section 181 of the FMCA (requiring all the relevant terms and conditions of any master trust to be no less favourable to transferring members than those of the existing scheme); and

19.4 the appropriate consolidation model would be:

(a) establishing in each master trust a ring-fenced "plan" for each employer participant (funded separately from all the other employer plans); and

(b) giving each employer participant a choice of investment strategy for its plan, from a whole-of-scheme suite of chosen underlying funds.

20 As the DB report explained, each master trust itself would logically be a re-purposed existing DB scheme (so that the consolidating schemes could retain the very significant compliance concessions already applying to them as restricted schemes).

21 The DB Schemes Report and its proposals have met with strong support from DB scheme sponsors and trustees, including those of several larger DB schemes (despite those larger schemes not having been initially our focus). They have also already attracted interest from the first of what it is hoped will be at least two potential master trust providers.

22 As the DB Schemes Report explains though, it is not yet legally practicable to give effect to the desired consolidation solution, as doing so requires:

22.1 an enabling amendment to the ITA; and

22.2 a suite of enabling exemptions from certain FMCA provisions.

23 The required ITA amendment (in practical terms, an amendment ensuring the continuation of each incoming DB scheme's current tax treatment) has Inland Revenue's indicative strong support. We currently anticipate its inclusion in the next omnibus Taxation Bill (in which case it would likely take effect on or about 1 April 2026) but:

23.1 there are efforts to seek its inclusion in the current Taxation Bill; and

23.2 if successful, these might enable its entry into force perhaps as early as 1 April 2025.

24 The FMCA exemption relief which we have recommended seeking is explained below.

Exemption relief needed

25 The DB Schemes Report concluded that in order for the DB schemes consolidation solution to become practicable in cost benefit terms, each master trust would need from the FMA exemptions:

25.1 enabling it to ***admit pensioners*** from other DB schemes, as the workplace savings scheme rules in the FMCA currently prohibit such a scheme from admitting as a member any individual other than (in relation to an entity or industry specified in the trust deed):

(a) an employee or director;

(b) a provider of personal services (other than as an employee) principally to that entity; or

(c) a person employed or engaged in the relevant industry;

25.2 from the ***new member restrictions*** applying to restricted schemes under the FMCA, which prohibit a restricted scheme admitting as members any individuals other than:

(a) persons employed by a particular employer (or a related body corporate of that employer);

(b) persons belonging to a particular profession, calling, trade, occupation or industry;

(c) persons belonging to a particular association, society or other *"entity with a definable community of interest"*; or

(d) immediate family members (or financial dependants) of a person in one or more of the above classes of persons;

25.3 enabling it to satisfy;

(a) its ***actuarial reporting obligations***; and

(b) certain ***annual reporting obligations***;

by reporting not at a "whole of scheme" level (as the FMCA contemplates) but instead at an employer plan-specific level.

26 The report also recommended seeking to exempt a pensioner-only plan within a master trust from the ***3-yearly actuarial review*** requirement in the FMCA (replacing it with a requirement for an annual vested benefits review).

27 Subsequently, based on stakeholder feedback, we have also recommended seeking an exemption allowing employee (i.e. still-active) members to transfer from DB schemes into a master trust without triggering ***FMCA Part 3 disclosure requirements***.

28 We elaborate below.

1) Addressing new membership restrictions

29 As each master trust would admit members from numerous schemes with unrelated sponsors, it would not reliably comply with the new member admission constraints summarised above (and prescribed in sections 131(1)(b)(i) and 131(2) of the FMCA) for a restricted scheme.

30 To enable that master trust to operate as envisaged, its trustee would therefore need an exemption from those constraints.

31 The trustee would also need an exemption enabling it to on-board pensioners, because section 130(1)(d)(i) of the FMCA prescribes that only "*eligible individuals*" as summarised above (and as defined in section 130(2) - relevantly, the current employees of an employer participant) can join a workplace savings scheme. The FMA has already granted exemptions to similar effect in 2018 to the managers of the accounts-based and non-restricted AMP, Mercer and SuperLife master trusts (and again to Mercer this year).

32 We have drafted proposed (suitably conditional) exemption wording to this effect at **clauses 5 to 7** of the Draft Exemption Notice.

2) Exempting master trust from Part 3

33 We consider that if (or to the extent that) the DB master trust solution was offered to DB schemes comprising *only pensioners*, the offer-related disclosure requirements in Part 3 of the FMCA would not apply. This is because:

33.1 pensioners are simply the passive recipients of lifetime pensions already payable (and cannot contribute to the relevant DB scheme); and

33.2 thus a pensioner-only bulk transfer proposal is not an offer of financial products for issue in terms of section 39 of the FMCA.

34 The FMA has accepted this logic in an analogous scheme-specific context.

35 For this reason, the DB Schemes Report recommended offering consolidation solely to pensioner-only schemes (meaning that those still with active members would be unable to transition into a master trust until the last of those had members retired or otherwise left service in due course).

36 However, although most DB schemes with active members now have trivially few persons remaining in that category and can expect to become pensioner-only in the fairly near term, following the publication of the DB Schemes Report we received feedback from a number of sponsors and trustees of those schemes to the effect that:

36.1 they too had a strong appetite to transition as soon as possible; and

36.2 accordingly any master trust solution should cover the on-boarding of active members.

37 As it would be prohibitively expensive to require customised Product Disclosure Statements and Offer Register entries solely to effect the successive one-off on-

boardings of very small groups of employee members, we have recommended seeking for each master trust a full exemption from Part 3 of the FMCA in respect of membership offers made to DB scheme members under (and in accordance with) either:

37.1 section 180 of the FMCA, which applies to the individual consents-based transfer of all, or a substantial number, of the members of one scheme to a new scheme and requires that the FMA and each such member are given a notice (at least one month pre-transfer) setting out:

(a) the transfer proposal and its implications for the proposed transferees;

(b) the date of the proposed transfer and when members' written transfer consents must be received; and

(c) the fact that the notice has also been sent to the FMA; or

37.2 section 181 of the FMCA, which applies to a transfer that is conditional on FMA pre-approval (rather than individual member consents) and requires the FMA to be satisfied that:

(a) the new scheme's terms and conditions are no less favourable to the proposed transferees than those of the old scheme;

(b) the transfer is otherwise reasonable in all the circumstances; and

(c) the transfer applicant has notified every proposed transferee that:

(i) it has applied for FMA consent to transfer that person without their written consent; and

(ii) the person may make submissions to the FMA about the transfer.

38 Established market practice under both section 180 and section 181 is for the transfer offer or notice communication to comprise a suitably descriptive covering letter, a tabular schemes comparison and detailed questions and answers which set out all materially relevant design details and risks, including in relation to:

38.1 governance, management and service provision;

38.2 member and employer contribution obligations; and

38.3 benefit entitlements;

and for that communication to be referred to the FMA in draft for comment before being finalised and issued, so all FMA feedback is addressed before it is distributed.

39 We have drafted proposed exemption wording in this regard at **clause 8** of the Draft Exemption Notice. Though we are confident in our view that (for the above reasons) this exemption need only cover active members, to put beyond doubt the permitted legal treatment of a pensioner transfer this wording would cover pensioners as well.

3) Enabling actuarial reporting at plan (not scheme) level

40 Section 169(2) of the FMCA requires the manager of a DB scheme to ensure that an

actuary examines the financial position of *"the scheme"* not more than 3 yearly. Correspondingly, clause 80(2) of Schedule 4 to the Financial Markets Conduct Regulations 2014 (*FMCR*) requires a DB scheme's annual report to include:

40.1 a statement as to whether the rates or amounts of contributions paid have accorded with the recommendations in the latest section 169 report; and

40.2 a summary of that report.

41 In a master trust scheme (with accounting segregation between employer plans) it will be essential to ensure that the trustee:

41.1 need only obtain actuarial reports for each respective employer plan; and

41.2 need not also obtain whole-of-scheme actuarial reports (which would be complex, expensive and have no added utility).

42 Arguably, if the trustee obtained a full suite of employer plan-specific actuarial reports then, because collectively those would cover the whole scheme, it would have obtained an actuarial examination of the financial position of "*the scheme*" in its entirety, thereby complying with section 169.

43 For certainty's sake though (and consistently with the Australian approach in this context) we have recommended seeking an exemption to the effect that the trustee can satisfy its section 169 obligations by obtaining actuarial reports for each respective employer plan.

44 We have also recommended, for a *pensioner-only* plan in the master trust, seeking an exemption from the 3-yearly actuarial review requirement in section 169, conditional on the trustee obtaining an annual vested benefits review for that plan.

45 This is because in a pensioner-only scheme or plan:

45.1 all benefits are already fully vested, meaning none have yet to accrue (and thus there is no need to conduct either an accrued or a future service benefits valuation); and

45.2 determining the financial position of that scheme or plan accordingly requires only a simple "vested benefits" calculation, which measures the value of the pensions already payable from the scheme.

46 By contrast, if a scheme or plan still has active members then determining its financial position necessitates calculating the value not only of the current pensioners' benefit entitlements but also of:

46.1 the active members' "accrued" benefit entitlements, being the present value of that part of their benefits which relates to past membership (based on their projected final earnings, and an assumed age at and reason for leaving service); and

46.2 the scheme's assumed "future service" benefit liabilities in relation to those members (being the value of its projected benefit liabilities in respect of each member's anticipated future active membership after the valuation date); and

46.3 the future contributions anticipated to be paid by and in respect of those members;

and these calculations necessitate using both a complex valuation methodology and a detailed suite of actuarial assumptions.

47 The exemption wording and exemption conditions which we propose in this regard are set out at **clauses 9 and 10** of the Draft Exemption Notice.

48 Requiring an annual (not triennial) vested benefits calculation for a pensioner-only plan would produce a more robust minimum frequency of funding assessments, and highlight potential underfunding in a timelier manner, than section 169 requires.

4) Enabling annual reporting at plan level

49 Lastly we have recommended seeking an exemption enabling each master trustee to satisfy certain of its annual reporting obligations by reporting to the relevant members at an employer plan-specific (not whole-of-scheme) level, which in practice would involve preparing and distributing employer plan-specific supplements to the master trust's main annual report.

50 This is because many of the annual reporting requirements prescribed in Part 5 of Schedule 4 to the FMCR would not be meaningful (or appropriate) unless made employer plan-specific, including for example the statements required:

50.1 under clause 80(2) about the sponsoring employer's conformity with (and a summary of) the latest actuarial report; and

50.2 under clause 80(6)(b) about the funding position as at the balance date.

51 The exemption wording (and exemption conditions) which we propose in this regard are set out at **clauses 11 and 12** of the Draft Exemption Notice.

Exemptions' consistency with FMCA's purposes

52 We consider that exemptions along the above lines would serve each of the following stated purposes in sections 3 and 4 of the FMCA:

52.1 section 3(b): to promote and facilitate the development of efficient financial markets;

52.2 section 4(b): to ensure that appropriate governance arrangements apply to financial products that allow for effective monitoring and reduce governance risks;

52.3 section 4(c): to avoid unnecessary compliance costs; and

52.4 section 4(d): to promote innovation and flexibility in the financial markets.

53 The exemptions would also be no broader than was reasonably necessary to address the matters giving rise to them, as their impact would be restricted to small member groups undergoing elective or FMA-approved transfers from legacy DB schemes to a master trust in full conformity with (as applicable) section 180 or section 181 of the FMCA.

Feedback sought

54 As noted in paragraph 7, to simplify and streamline the exemption application process in due course, this letter seeks on the industry's behalf the FMA Regulatory Policy Team's in principle support for the proposed exemptions and its feedback on:

54.1 the appropriate exemption type (class or individual – the Draft Exemption Notice assumes the latter for the time being);

54.2 the proposed exemption details; and

54.3 the optimal application timing and process.

55 The writer would be happy to meet with FMA Regulatory Policy Team representatives at their earliest convenience to discuss the content of this letter.

56 Please let us know if you have any initial comments or queries in the meantime.

Yours faithfully

Mike Woodbury
Consultant

SCHEDULE

Proposed Form of Draft Exemption Notice

Financial Markets Conduct ([Name of Master Trust]) Exemption Notice 2025

This exemption is granted by the Financial Markets Authority under section 556 of the Financial Markets Conduct Act 2013 after being satisfied of the matters set out in section 557 of that Act.

Contents

Notice

1. Title

This notice is the Financial Markets Conduct ([Name of Master Trust]) Exemption Notice 2025.

2. Commencement

This notice comes into force on [date] 2025.

3. Revocation

This notice is revoked on the close of [date] 2030.

4. Interpretation

(1) In this notice, unless the context otherwise requires:

Act means the Financial Markets Conduct Act 2013

defined benefit scheme means a defined benefit scheme designated as a restricted workplace savings scheme as identified in Column 7 of the Schedule to the Financial Markets Conduct (Designation of Restricted Schemes) Order 2016 (or, if that scheme is identified as a defined benefit scheme in respect of only a section of the scheme, the scheme in respect of that section)

eligible individual, in relation to a person specified in the trust deed for the specified scheme, has the same meaning as in section 130(2) of the Act

participating employer plan means an employer plan established within the specified scheme under a participation deed entered into by a specified employer with the manager of the specified scheme

Regulations mean the Financial Markets Conduct Regulations 2014

relevant supplement, in relation to a scheme participant to whom it is given along with the annual report for the specified scheme, means a document containing the information referred to in clause 11(2) that applies in connection with the particular participating employer plan

specified employer means an entity that is a participating employer in the specified scheme

specified individual means:

a. a member of a defined benefit scheme who was previously employed or otherwise engaged by a specified employer, or by an entity that was previously a participating employer in that scheme and whose business or undertaking was succeeded to by a specified employer

b. a person who is an immediate family member or dependant of a person who either falls within paragraph (a) or would have fallen within paragraph (a) had they not died, and as a result is or was entitled to become a member or beneficiary of the relevant defined benefit scheme

c. a person who was otherwise eligible to become a member of or receive a benefit from a defined benefit scheme as a result of any other relationship with a person who either falls within paragraph (a) or would have fallen within paragraph (a) had they not died

specified manager means [ ] Limited

specified scheme means [Name of Master Trust], a restricted workplace savings scheme registered under the Act (scheme number SCH[ ]).

(2) Any term or expression that is defined in the Act or the Regulations and used, but not defined, in this notice has the same meaning as in the Act or the Regulations (as applicable).

5. Exemption from workplace savings scheme registration requirement

The specified manager is exempted, in relation to the specified scheme, from section 130(1)(d) of the Act to the extent that it requires admissions to membership of the specified scheme to be restricted to eligible individuals.

6. Exemption from restricted scheme registration requirement

The specified manager is exempted, in relation to the specified scheme, from section 131(1)(b)(i) of the Act to the extent that it requires admissions to membership of the specified scheme to be restricted to only 1 or more of the classes of persons referred to in section 131(2) of the Act.

7. Conditions of exemptions in clauses 5 and 6

The exemptions in clauses 5 and 6 are subject to the conditions that –

a. the specified scheme must admit as members (both in its conditions of entry of scheme participants and in the way those conditions are applied on entry) only one or more of the following:

(i) eligible individuals who are members of a defined benefit scheme; and

(ii) specified individuals;

b. each new member referred to in paragraph (a) is admitted to membership of the specified scheme by way of transferring from the relevant defined benefit scheme to a participating employer plan pursuant to either section 180 or section 181 of the Act; and

c. the governing document for the specified scheme reflects the conditions set out in paragraphs (a) and (b).

8. Exemption from Part 3 disclosure requirements

The specified manager is exempted from Part 3 of the Act in respect of all offers of membership of a participating employer plan that are made to persons referred to in clause 7(a) pursuant to (and otherwise in accordance with) section 180 or section 181 of the Act.

9. Exemption from actuarial examination requirement

The specified manager is exempted from the requirement in section 169 of the Act to ensure that a suitably qualified actuary examines the financial position of the specified scheme as at dates no more than 3 years apart.

10. Conditions of exemption in clause 9

The exemption in clause 9 is subject to the conditions that the specified manager must ensure that:

a. if a participating employer plan has members who are eligible individuals:

   (i) a suitably qualified actuary examines the financial position of the participating employer plan as at dates no more than 3 years apart;

   (ii) the report of the actuary is received no later than 7 months after the date as at which the financial position of the participating employer plan was examined; and

   (iii) the specified manager gives a copy of the report to the FMA as soon as practicable; and

b. if a participating employer plan has no members who are eligible individuals:

   (i) a suitably qualified actuary examines the vested benefits funding position of that participating employer plan as at dates no more than 1 year apart;

   (ii) the report of the actuary is received no later than 4 months after the date as at which the vested benefits funding position of the participating employer plan was examined; and

   (iii) the specified manager gives a copy of the report to the FMA as soon as practicable.

11. Exemption from annual reporting requirements

(1) The annual report prepared for the specified scheme pursuant to Part 5 of Schedule 4 to the Regulations is not required to contain the information specified in subclause (2) if:

a. each copy of the annual report that is given to a scheme participant is accompanied by a relevant supplement; and

b. the annual report incorporates that information by reference to the relevant supplements that are given to scheme participants.

(2) The information is information relating only to a particular participating employer plan that would otherwise be required to be contained in the annual report.

Dated at Wellington this day of 2025

[NAME]
[TITLE]
Financial Markets Authority