Standalone super schemes – Options for scheme sponsors under the FMC Act

Retirement

December 2014

Summary

Come December 2016 all existing employer sponsored super schemes will have undergone substantial changes and will be subject to a new regulatory regime in accordance with the Financial Markets Conduct Act (FMCA). Complying with the new regime requires significant work (and cost) for Trustees. In this newsletter we consider the options available to scheme sponsors. Broadly these are:

- Make the necessary changes to comply with the legislation, leaving the scheme broadly unchanged
- Wind up the scheme
- For a defined contribution scheme, transfer into a master trust.

Each option has pluses and minuses and for some schemes an option might be ruled out on the basis of the costs are "too high". Scheme sponsors will want to assess each option and consider which is best placed to deliver the objectives of their superannuation policy.

Existing scheme statistics – as at August 2014

In terms of both the number of schemes (defined benefit (DB) and defined contribution (DC)) and the number of members, the 1980's and early 1990's were clearly the high point. According to an old Government Actuary newsletter, there were no less than 2,863 registered superannuation schemes in 1990 with over 500,000 members and assets of some $11bn.

Scheme size	No schemes		FUM $m's	
by FUM $m's	DB	DC	DB	DC
$100 +	13	20	6,632	10,022
$50 - $100	9	6	655	405
$20 - $50	18	8	570	265
Less $20	55	20	346	174
Total	95	54	8,203	10,866

Since then, whilst overall asset values have increased, the total number of schemes has reduced significantly as shown in the table.

The total funds under management now exceed $19 billion but the number of schemes is now close to 150. The more interesting statistic is perhaps the numbers for the schemes with assets less than $50 million i.e. the ones which may be more likely to change due to the legislation. There are approximately 100 in this category with total FUM of $1.4 billion, 12,000 active members and 21,000 total members. The majority of the 100 or so 'smaller' schemes are defined benefit schemes. The smaller number of defined contribution schemes perhaps reflects the fact that many scheme sponsors have already chosen to move to a master trust arrangement. The $100 million plus category for defined contribution schemes includes the major master trust schemes. A more complete breakdown of the numbers is included in Appendix A.

Overview of the legislation

It is not the intention of this newsletter to go into the legislation in detail; below we have just set out the key points for a scheme to comply with the new legislation are:

- The trust deed must be certified by a solicitor as complying with the new legislation.
- A licensed independent trustee must be appointed.
- The Trustees will need to change to a corporate model, or alternatively could consider employing a corporate trustee.
- The SIPO will need to be updated.
- The investment statement is replaced by a PDS (a product disclosure statement in an agreed format).
- The SIPO and the PDS will need to be uploaded to a public website.
- Annual Fund Updates will need to be prepared
- The new framework must be in place by 1 December 2016.

More information on the transition process can be found by following the link below to the FMA website.

http://fma.govt.nz/assets/Report-and-Papers/Information-Sheets/Information-Sheet-Superannuation-MIS.pdf

Options for DC schemes

The decisions for sponsors of a defined contribution scheme are relatively straightforward, namely:

- Continue the scheme as is, or
- Wind up and switch to a master trust.

The first option will need to follow the process outlined above. For those schemes which handle their own scheme administration this may be a good time to look at the alternative of an external provider.

Master trust option Probably the best solution would be to replicate the existing benefits within a master trust. Providing certain conditions are met, members would be transferred to the master trust in accordance with the compulsory transfer provisions of the legislation. One of the key issues is which master trust to select. There are a small number of providers whose key statistics are included in the table. Each of the providers have their own strengths and weaknesses. A few points we see as important are:

Scheme Provider	FUM $m	Members 000s	Employees
AMP	2,200	30	527
AON	107	2	53
ASB	894	23	100*
Aventine	1,151	15	140
Fisher	416	5	80
Mercer	260	6	95

*estimate

Quality of the investment options. To varying degrees, all master trusts provide a range of investment options which enable scheme members to choose the investment strategy which best suits their specific needs. Some schemes offer options where the risk level (or exposure to growth assets) reduces automatically the older the member; others offer different manager options and some offer index management.

Quality and comprehensive member investment advice. Having a full suite of on-line tools is valuable as is the ability for the provider to put in place regular structured updates to scheme members. While selecting the top investment provider over a 30 year period may help, just having the advice there to enable the member to stay the course is invaluable. The provider needs to be either a QFE or employ AFA's to provide individual member advice.

Retirement A critical time for members is when they retire. Quality advice and meaningful product options are so important at this stage. The market has yet to develop fully but there are already some interesting developments which enable the retirement funds to remain fully invested, with a facility to draw down funds in a structured manner in order to set up a suitable income stream.

Some existing advisers operate their own master trusts and so will naturally have an incentive for the sponsor to switch automatically into their own scheme. Care needs to be taken to ensure that any conflicts of interest are identified.

Options for DB schemes

As shown in the table there are 55 defined benefit schemes with assets less than $20 million and less than 2,500 active members. Almost all of these are closed to new members and the employers will have their own arrangements in place for new employees. The ideal solution for those employers who want to maintain their scheme in place while being managed in an efficient and effective manner would be to join a multi-employer master trust scheme. However it is not possible under current legislation for a DB scheme to be part of a master trust arrangement. So what are the options available?

Option 1 – Winding up and buying annuities The basis of a scheme wind is of course dictated by the terms of the trust deed. In many cases, a common obstacle has been that many trust deeds require the Trustees to buy annuities for the pensioners (and possibly for those active members who are entitled to an early retirement benefit). Up until the end of 2013, there was only one life insurance company (Fidelity Life) selling annuities. However, following Fidelity Life's decision to cease writing annuity business, it is no longer possible for Trustees to purchase annuities on a scheme wind up.

It should be noted that even when annuities were available, cost was a significant barrier. This is because the cost of purchasing annuities was typically 30% to 40% higher than the reserves held by a scheme to fund its liabilities.

Note that the problem for the life insurance companies when offering annuities is that there are no fixed interest securities of sufficient duration to match the liabilities. In addition, the capital required by a life insurance company for RBNZ solvency purposes is significant which results in a poor return being available for prospective annuitants.

It is possible we might see a life company revisit this market.

Options 2 – Amending the existing deed (with consent) and winding up It may be possible to amend the trust deed so as to avoid having to purchase annuities for pensioners and other beneficiaries. However, this will almost certainly mean that the consent of all members and pensioners will have to be obtained. Some trustees have enjoyed success with this approach. The strategy is to offer all members the value of their benefit as assessed by the actuary. If a scheme has a funding deficit then the employer may need to top up the scheme. Where there is a surplus the members would get their share.

Option 3 – Continuing the existing scheme Where the scheme is large enough and the sponsor is committed this is of course possible and the Trustees will need to follow the processes outlined above to comply with the new legislation. Arguably the requirements are not onerous for the larger schemes and, with the possible exception of the cost of appointing the independent trustee; once the changes are made the ongoing additional costs will not be too great.

Hybrid schemes - A number of schemes have both a defined benefit section and a defined contribution section. Where it is decided to continue the existing defined benefit section, the option exists to switch the defined contribution members to a master trust arrangement.

Deciding whether or not to continue the scheme. Some consultants sponsor master trust arrangements. Accordingly when trustees or the scheme sponsor are considering whether to continue or wind up their scheme, the consultant may be all too ready to encourage a switch to their master trust quite reasonably thinking this is in the best interests of the client. An independent perspective on this would add value.

ABOUT MELVILLE JESSUP WEAVER

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Appendix A Scheme statistics

Scheme size	No schemes		FUM $m's		Active members		Total members	
by FUM $m's	DB	DC	DB	DC	DB	DC	DB	DC
$100 +	13	20	6,632	10,022	32,860	154,640	88,840	155,140
$50 - $100	9	6	655	405	2,760	6,080	4,620	6,090
$20 - $50	18	8	570	265	2,350	4,100	9,660	4,280
Less $20	55	20	346	174	2,480	2,700	4,080	2,720
Total	95	54	8,203	10,866	40,450	167,520	107,200	168,230