



TRUSTEE CORPORATIONS ASSOCIATION of NEW ZEALAND INC

Submission
to the
Financial Markets Authority
on the
**Securities Trustees and Statutory Supervisors Licensing
Guidance Note**

October 2011

Background

This Submission is from Trustee Corporations Association of New Zealand Inc ("**TCA**") in response to the request for comment on the proposed Securities Trustees and Statutory Supervisors Guidance Note. We are available to meet with the Financial Markets Authority ("**FMA**") to discuss our Submission. We can be contacted at:

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TCA is a long established association to which all Trustee Corporations belong. The members of the TCA are Public Trust and each of the Trustee Corporations – being Trustees Executors Limited, The New Zealand Guardian Trust Company Limited, New Zealand Permanent Trustees Limited (wholly owned by Public Trust) and Perpetual Trust Limited. The Māori Trustee joined TCA on 1 June 2011. Covenant Trustee Company Limited, although not authorised under the Trustee Companies Act 1967, is an associate member of TCA.

TCA maintains relationships with government ministries, regulatory bodies and financial sector groups. TCA sets minimum standards as practice guidelines for the performance of Corporate Trustees – standards for integrity, competence, financial capacity, internal controls, powers and duties, standards for conflict of interest management and for reports from scheme operators.

Introduction

- 1 Thank you for this further opportunity to comment on the proposed Securities Trustees and Statutory Supervisors Guidance Note ("**the proposed Guidance Note**"). We note our previous discussions with FMA in respect of the proposed Guidance Note and thank FMA for its consideration of TCA's comments.
- 2 TCA also wishes to record its support of the Trustee licensing regime. TCA considers it important that those charged with the responsibility of supervising debt securities, unit trusts, KiwiSaver schemes and retirement villages are appropriately qualified and licensed by FMA.
- 3 However, TCA considers that a number of issues remain with the implementation of the licensing regime and, in particular, the proposed application process for licenses. TCA makes general and specific comments below.

General Comments

Focus of application process

- 4 Under the Securities Trustees and Statutory Supervisors Act 2011 ("**the Act**") the focus of the licensing process is on the entity that will be acting as trustee or statutory supervisor. It is the entity that applies for and is granted the licence and the entity that loses the licence in the event that FMA decides to cancel it. The bulk of the criteria in the Act focus the assessment on the entity rather than the individuals behind it: only one mandatory criterion (being section 16(2)(b)) and one discretionary criterion (being section 16(3)(a)) specifically refer to individuals.
- 5 In light of this statutory backdrop, the proposed Guidance Note appears to focus too much of its attention on the individuals who are involved with the entity, in preference to the entity itself. TCA would suggest refocusing the proposed Guidance Note on the entity, rather than the individuals who happen to be involved in the entity at the time the licence application is made.

Licence duration

- 6 TCA notes that the Act provides for licences to be granted for a period of up to eight years. TCA was concerned that earlier versions of the proposed Guidance Note referred to the default period that FMA would grant a licence as being five years. This has now changed so that the proposed Guidance Note refers to licences being granted for a period of up to eight years, with the actual duration being determined on a case by case basis.
- 7 TCA submits that the default duration of a licence should be eight years unless there are special and very good reasons for a shorter period. As noted in previous discussions, Trustee appointments are long term by their nature and significant expenditure and resources are required to go through the licensing process. Furthermore, if a licensee's performance is inadequate, FMA has the power to cancel its licence. Given this power, there appears to be no reason to grant licences for less than the statutory maximum period.

Protection of sensitive information from disclosure

- 8 The proposed Guidance Note requires disclosure of commercially sensitive information to FMA. It is important that commercially sensitive information is only required to be disclosed

as part of the licensing process where such disclosure is relevant and necessary. Furthermore, because FMA is subject to the Official Information Act 1982, any commercially sensitive information that does end up being disclosed to FMA as part of the licensing process must be protected from disclosure by FMA under that statute. Disclosure could prejudice the commercial position of applicants, undermine the competitive market for Trustee services and thereby increase costs for investors. TCA would therefore like know what robust processes FMA proposes to ensure that commercially sensitive information disclosed to it as part of the licensing process is kept confidential.

Specific Comments

Application guide booklet - paragraph 30

- 9 At paragraph 30, there is a reference to an 'Application guide booklet'. What is this document? There are no other references to it in the proposed Guidance Note or on FMA's website.

Statutory declarations - paragraph 33

- 10 Earlier versions of the proposed Guidance Note anticipated that each director and senior manager of an applicant would have to sign a statutory declaration in respect of certain matters. TCA commented earlier that this was impractical and that instead the corporate entity applicant could provide a single statutory declaration, signed on behalf of the corporate entity applicant by an authorised person such as a director, covering the same matters. Although changes have been made to the proposed Guidance Note in this regard, the requirements are still unclear. TCA therefore suggests an amendment making it absolutely clear that the statutory declaration only needs to be provided by the applicant and that only one statutory declaration needs to be provided.
- 11 The form of the statutory declaration was not attached to the proposed Guidance Note. TCA suggests that it would be appropriate for consultation to be conducted on the proposed form of the statutory declaration in the same manner as consultation has been conducted on the proposed Guidance Note. TCA looks forward to giving its comments on that document in due course.
- 12 TCA notes that its Members have already been through the process of having criminal checks conducted on their directors and senior managers (and paying for those criminal checks) within the last 12 months to comply with the Financial Service Providers (Registration and Dispute Resolution) Act 2008. Any directors or senior managers appointed since the date of initial registration under the Financial Service Provider (Registration and Dispute Resolution) Act 2008 would also have had criminal checks conducted under that legislation. TCA therefore submits that it is unnecessary for FMA to duplicate these criminal checks as part of the Trustee licensing process.

Default events - paragraph 38(b)(ii)

- 13 Under the proposed Guidance Note, applicants must disclose a number of different types of events that have occurred in the last 10 years in their licence applications. These include events of default, moratorium proposals, restructuring proposals and trust deed breaches. TCA previously commented that an element of materiality needs to be present in each case for that information to be relevant to the licence application.

- 14 TCA notes that the proposed Guidance Note has been updated to include a materiality qualifier to the trust deed breach event. However, the materiality qualifier also needs to be added to all the other events listed in that paragraph (other than moratoria and restructuring proposals). The test for materiality should be that the event in question led to the Trustee or statutory supervisor reporting to a regulator in relation to the matter.
- 15 Minor events of default are not uncommon occurrences. An important component of the Trustee oversight function is to ensure that such minor default events are resolved without the need to escalate the matter to investors or to the regulator. It is therefore disproportionately burdensome for an applicant to have to collate and list all such minor default events for the last 10 years as part of the licence application process.
- 16 TCA also questions the extent to which such information is relevant to FMA's consideration of the licence application. The information to be disclosed is historical. It is therefore no firm indicator of future performance. Furthermore, default events by supervised issuers (particularly minor default events) do not appear to have any connection with the licensing criteria, which focus on the experience, skills and qualifications of the applicant.

Business plan and strategy - paragraph 38(c)

- 17 TCA notes that the proposed Guidance Note would require disclosure of the applicant's business plan and strategy in respect of the Trustee business. TCA strongly submits that this requirement should be removed. Business plans and strategies are a highly commercially sensitive part of the Trustee's intellectual property. Furthermore, there is no clear link between the applicant's business plans and strategies and the criteria set out in the Act and regulations which this requirement purports to address.

Curricula Vitae and letters from industry bodies- paragraph 39

- 18 TCA notes the requirement for Curricula Vitae ("**CV**") for each director and senior manager. TCA welcomes the removal of the requirement for CVs for all staff but questions the remaining requirement for a CV for each senior manager. It is the directors who appoint and are responsible for the performance of their senior managers. The focus of the inquiry should be on the directors and the requirement for the CVs of senior managers should be removed.
- 19 It is currently a requirement for a letter from an industry body confirming membership details for the directors and senior managers. This seems redundant given that the applicant will also need to give a statutory declaration that will attest to the same thing. Given the potentially serious consequences of providing a false declaration, TCA submits that the letter unnecessarily duplicates the statutory declaration and inappropriately second-guesses it.

Culture of compliance - paragraph 45

- 20 At paragraph 45, the proposed Guidance Note states that FMA will be looking for evidence of a 'culture of compliance'. TCA Members would like to know what this will mean in practice. How will applicants be able to demonstrate a 'culture of compliance' in their licence applications?

Governing documents - paragraph 45(d)

- 21 TCA commented earlier that the requirement for initial and on-going assessments of governing document terms needs to recognise that Trustees do not necessarily have the power to change the governing document at their discretion. Often, changes to governing documents need to be referred to investors. TCA therefore reiterates that this paragraph should be removed or amended to clarify FMA's expectation of the review process.

Financial information etc - paragraph 49

- 22 TCA has a number of comments on the requirements for disclosure of financial information in paragraph 49.
- 23 At paragraph 49(a), there is a requirement for disclosure of the applicant's ratio of liquid to illiquid assets. The purpose of this disclosure is not clear. The Trustee is not the deposit taker, the fund or the retirement village and the obligation to pay investors does not sit on its balance sheet. The ratio of its liquid to illiquid assets therefore has no relevance to the protection of investors or the applicant's suitability as a licensee.
- 24 Paragraph 49(b) requires disclosure of the applicant's fee structure. TCA strongly submits that this requirement should be removed. An applicant's fee structure is highly confidential information. Trustees operate in a competitive market and that benefits investors by keeping costs down. If fee structure information were disclosed to competitors this would detrimentally affect that market, increasing costs for investors. It should also be noted that Trustees determine fee structures on a case by case basis and practices change over time. It is therefore not possible for an applicant to disclose a single fee structure as being *the* fee structure that it will use in the future.
- 25 The requirement for disclosure of procedures for managing liquidity risk, credit risk and capital risk at paragraph 49(c) is not relevant to the role of a Trustee. As noted above, the Trustee is not the deposit taker, the fund or the retirement village and the obligation to pay investors does not sit on its balance sheet. The Trustee role is to oversee and supervise the relevant manager. Therefore, procedures to manage liquidity risk, credit risk and capital risk are not relevant to an assessment of an applicant's ability to conduct the role of Trustee and should be removed from the proposed Guidance Note.
- 26 At paragraph 49(f), there is a requirement for disclosure of significant funding facilities. TCA submits that the amount of detail here goes too far and suggests that disclosure of the total amount of committed finance available should suffice.
- 27 Paragraph 49(i) requires disclosure of total assets, liabilities and owner equity for each proposed supervised entity. TCA submits that the proposed Guidance Note should be clarified to state that what is required here, as per the regulations, is an *estimate* of the assets and liabilities of each supervised entity. Furthermore, the proposed Guidance Note should also clarify that there is no requirement for these figures to be audited or calculated by reference to IFRS or any other prescribed accounting methodology as this would be hugely costly.

Business succession and growth - paragraph 50(g)

- 28 The requirement for disclosure of the applicant's business succession and growth plans should be removed.
- 29 As noted above, business plans are commercially sensitive and not relevant to the licencing criteria set out in the Act and the regulations. In any event, this duplicates the earlier requirement at paragraph 38(c) of the Guidance Note for disclosure of business plans and strategy.
- 30 Each statutory Trustee Corporation has been in business for at least 125 years. There is no significant likelihood of a change in the business prospects of statutory Trustee Corporations going forward.

'Capture by supervised interest' - paragraph 51(h)

- 31 Paragraph 54(h) requires disclosure of 'Any other policies or processes that safeguard the applicant from capture by its supervised interests'. TCA Members are not entirely sure

what 'capture by its supervised interests' means. The proposed Guidance Note should be amended to clarify what FMA expects to be disclosed here.

Professional indemnity insurance - paragraph 54

- 32 TCA has a number of concerns about the disclosure requirements for professional indemnity insurance.
- 33 A significant problem is that disclosure of professional indemnity insurance terms without the consent of the insurer will invalidate the insurance. Whether the insurer consents to disclosure is not a matter within the applicant's control. The proposed Guidance Note should therefore be amended to take this into account. One alternative is for the applicant to have the insurance broker provide a statement to FMA for licensing purposes that insurance is in place.
- 34 A further problem lies with the new requirement to disclose 'how the amount insured compares with the applicant's overall risk of exposure to liability'. It is unclear what 'the applicant's overall risk of exposure to liability' means or how FMA expects this to be calculated. Even if guidance were issued on this technical point, the calculation would appear to require the services of an actuary. TCA therefore submits that this requirement should be removed. In this regard, TCA notes that the Securities Commission has previously accepted statements from the insurance broker that the level of insurance cover is appropriate for the level of risk.

Previous approvals - paragraph 55

- 35 There is a reference at paragraph 55 of the proposed Guidance Note as to whether the applicant has previously held a licence. It is not clear whether this refers to a licence granted under the Act, or the approvals granted by the Securities Commission and the statutory right of Trustee Corporations to act as trustee under the old regime. The Guidance Note should be amended to clarify this.

We are happy to discuss any of these comments in further detail.

Trustee Corporations Association of New Zealand Inc
6 October 2011