

**INVESTMENT SAVINGS & INSURANCE ASSOCIATION OF NZ
INC**

Submission

to

Ministry of Economic Development

on the

Discussion Document:

Changes to the Securities
Regulations

8 May 2009



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Investment Savings and Insurance Association of NZ Inc.

1.0 Introduction

- 1.1 The Investment Savings and Insurance Association ("ISI") is the industry association for the companies that issue and manage life insurance, superannuation and managed funds in New Zealand. ISI members are responsible for approximately \$50 billion funds under management. ISI therefore has a particular interest in regulations applicable to issuers of these types of securities.
- 1.2 ISI members are also the leading providers of KiwiSaver funds and all six default providers are members of ISI.
- 1.3 A list of members is attached.
- 1.4 We appreciate the opportunity to comment on the discussion document covering proposed changes to the Securities Regulations 1983. We have previously commented on a number of these proposals during phase one of the review of Securities Regulations in 2000.
- 1.5 This submission is set out with a summary of the key points on which we have commented, followed by responses to Questions for Submitters, comments on the Appendix – Technical Changes to the Securities Regulations and then additional issues which we recommend that MED consider as part of this review.

2.0 Key Points

- We generally agree with the intention to improve disclosure to investors, modernise the regulations and reduce compliance costs
- We have proposed changes that we believe will assist that intention in respect of:
 - Prospective financial information in a prospectus and an advertisement
 - Cross-referencing information in investment statements (Regulation 7A(4))
 - Up-to-date information to investors on Funds under Management (Regulation 12)
 - Regulation 17 certificates
 - Interpretation of Regulation 20
 - Consequences of extending Regulation 21
 - Interim financial statements (Schedules 3A, 3B and 3C)
 - Disclosure of material contracts (Regulation 7(1)(a)); and
 - Renewal of prospectuses in accordance with Securities Act s.37A(1A)(c).

3.0 General Questions

Q1 Do you agree that the financial statements in the prospectuses for equity, debt, and participatory securities should be prepared in accordance with GAAP? If these financial statements are prepared in accordance with GAAP, are there any additional matters that are not included in GAAP that you think should also be included in these financial statements?

A1. Yes, we agree. We note that GAAP should be interpreted to mean the ‘applicable reporting standard’ where there is not a NZ equivalent to International Financial Reporting Standards (“IFRS”).

Q2 Do you agree that the definition of borrowing group should include guaranteeing parent and sister companies as well as guaranteeing subsidiaries?

A2. No comment.

Q3 Do you agree that the summary financial statements in prospectuses should be prepared in accordance with the applicable financial reporting standard?

A3. Yes, we agree.

Q4 Do you agree that issuers should be required to include a full set of prospective financial statements in their prospectus in circumstances where they are currently required to only include a prospective statement of cash flows?

A4. We recommend a flexible approach that would allow issuers to elect either option. The key requirement is that consumers should have access to information that is easily understandable. We have some concern that the requirement to include a full set of prospective financial statements may increase compliance costs in a manner disproportionate to any disclosure benefit to investors.

The disclosure benefit to investors of prospective data relies on the investor understanding the assumptions underlying the projections and assessing the reasonableness of these assumptions.

The use of full financial statements under FRS42 will increase the amount of assumptions in the material all of which would need to be understood by investors before they can form a balanced view on the reasonableness of the prospective data.

Q5 If issuers are required to include a full set of prospective financial statements in their prospectuses in the circumstances described in question 4, do you agree that these prospective financial statements should be prepared in accordance with the applicable financial reporting standard?

A5. Yes, we agree as it makes sense that all financial information presented throughout a disclosure document be reported on the same basis in order to allow for meaningful comparison.

Q6 Do you agree that the issuers of participatory securities should be required to include the principal terms of their deed of participation in prospectuses, rather than having the option of simply attaching the deed itself?

A6. No comment.

Q7 Do you agree that the requirements for the disclosure of directors/managers' and promoters' interests for issuers of equity and participatory securities should be broadened to aligned with the equivalent requirements for unit trusts, life insurance policies, and superannuation schemes?

A7. Yes, we agree.

Q8 Do you agree that information from interim financial statements about the net assets or the amount of assets and liabilities of an issuer should be able to be cited in an advertisement?

A8. Yes, we agree.

Q9 Do you agree that information from unaudited full or interim financial statements about the net assets or the amount of assets and liabilities of an issuer should be able to be cited in an advertisement, so long as the advertisement makes it clear that the full or interim financial statements have not been audited?

A9. Yes, we agree.

Q10 Do you agree that the consideration to be paid for a security should be able to be determined by reference to a formula, so long as the formula is set out in full and clearly explained?

A10. Yes, we agree, but it should not be mandatory and the 'formula' requirement should follow the same wording as Schedule 3A clause 1(6) for unit trusts, ie: 'If the price or other consideration is not a fixed amount, the manner by which that amount is fixed'.

Q11 Do you agree that an advertisement should be able to contain prospective financial information in the form of commentary or analysis of prospective financial information contained in the registered prospectus, so long as it sets out the principal assumptions and method of calculation of that information? If so, do you also consider that this amendment should apply to all prospective financial information, and not just prospective financial information in the form of commentary or analysis on prospective financial information in the registered prospectus?

A11. No, we do not agree. We consider that the proposed approach would require too many disclaimers and would potentially have a negative effect on market confidence.

Q12 Do you agree that interim financial statements in prospectuses should be prepared in accordance with the applicable financial reporting standard?

A12. Yes, we agree. However, we recommend that the exemption available under the Securities Act (Directors' Certificates – Collective Investment Schemes) Exemption Notice 2008, clause 9(1)(c)(i) should continue to be available in the applicable circumstances. (See page 11 below for additional recommendations relating to the Securities Act requirements for renewing a prospectus with a directors' certificate).

Q13 Do you agree that the current regulation 17(6) should be expanded to make it an offence for a person to post an advertisement on a website without a signed certificate?

A13. Yes, we agree that regulation 17(6) should be expanded to make it an offence for a person to post an advertisement on a website in contravention of sub clause (1), ie: without a certificate under sub clause 1 having been completed.

Q14 Do you have any comment on the intention to undertake a limited rewrite of the regulations?

A14. We have no objection as long as expert guidance is used to ensure that the effect of the Regulations is not changed.

4.0 Technical Changes to the Securities Regulations

Regulation 2(1)

1. We agree.

2. We agree.

5. We agree as long as the industry has the opportunity to review the changes once they have been drafted.

9. We agree as long as the industry is consulted on the proposed expansion of requirements for audit reports.

15. Regulation 2(2)

We agree that the Regulations should be consistent with GAAP.

16. Regulation 2(3)

We agree.

18. Regulation 7A(4)

The Discussion Document proposes that regulation 7A(4) be amended to permit cross-referencing of addresses (but not the corresponding names of individuals or companies) within the investment statement, or to a directory of addresses elsewhere in the investment statement.

Regulation 7A(1) states that every investment statement must contain, in a succinct manner, all of the information, statements and other matters specified in Schedule 3D. However, regulation 7A(4) provides that all information, statements and other matters required to be set out under the italicised questions in Schedule 3D, must be set out together in the investment statement under that italicised question.

The effect of regulation 7A(4) is that certain information may be replicated throughout the investment statement, which is at odds with the requirement that information be succinct in regulation 7A(1).

Given the requirement of regulation 7A(1), we recommend cross-referencing be permitted on a broader scale, for example:

- the names, descriptions, addresses and business telephone numbers for parties that appear more than once in an investment statement ; and
- other information that is required to be produced more than once under different italicised questions such as:
 - the suspension of redemptions from a trust which will likely be addressed under the italicised questions "*What are my risks?*" and "*How do I cash in my investments?*";
 - scaling back redemption requests which will likely be addressed under the italicised questions "*What are my risks?*" and "*How do I cash in my investments?*"; and
 - the winding up of a trust which will likely be addressed in the sections "*What are my risks?*" and "*Can the investment be altered?*".

The proposed Schedule 3D would also require the names of the directors of the issuer to be specified in the investment statement but only for equity securities, life insurance policies and debt securities. From a practical perspective, the directors of some companies can change quite frequently and this change could actually pose additional compliance costs. It would be preferable for the investment statement simply to be cross referenced to the prospectus and Companies Office website for the list of directors of both the issuer and any company treated as a promoter.

Allowing information to be cross-referenced would benefit both investors and issuers as it would reduce unnecessary repetition.

19. New Regulation 7B

We have no objection to the proposal but do not consider it necessary.

20. Regulation 9

We agree.

21. Regulation 11

We agree.

22. Regulation 12

The Discussion Document proposes to clarify that Regulation 12 will apply to unit trusts and superannuation schemes. That would prevent giving up-to-date funds under management (“FUM”) figures and would prevent a trust/scheme from marketing its current FUM level unless that figure is taken from the latest financial statements (which may be expanded under this review to include interims). This restriction is overly restrictive for unit trusts and superannuation schemes as fund values are typically accurate and available daily it would not help ensure that investors are receiving the most up to date information on FUM levels.

23. Regulation 12(1)(c)

We agree.

24. Regulation 13

We agree.

25. Regulation 14

We agree.

26. Regulation 17(2)

We agree that the mechanism to allow persons authorised by directors to sign regulation 17 certificates is desirable from a practical perspective. However, we consider that requiring each director to authorise an agent in writing to sign these certificates creates additional compliance requirements.

We suggest that it would be preferable to adopt an approach similar to the Securities Act (Banks) Exemption Notice, ie: allowing certificates to be signed by 2 persons being, for example:

- directors of the issuer; or
- officers of the issuer authorised by the directors; or
- a director and an officer of the issuer who is authorised by the directors of the issuer to sign the certificates.

The example of the Securities Act (Externally Managed KiwiSaver Schemes and Superannuation Schemes) Exemption Notice 2008 is another alternative that would be

preferable to the mechanism that is proposed. Its approach is similar to that of the Securities Act (Banks) Exemption Notice.

27. Regulation 17(3)(a)(i)

We agree that a non-electronic address should be supplied. However, generally, this regulation should be less prescriptive. Currently, in order to qualify for this ‘exemption’, an advertisement must arguably contain all the types of contact details set out including, for example, a telex number. We suggest that this is no longer relevant. An advertisement should also be permitted to include additional contact details and still qualify for the exemption.

28. Regulation 17(3)(a)

It is not practical to require an advertisement to contain all of the information prescribed in regulation 17(3) in order to be exempt from the certificate requirement. The ability to rely on this exemption should not be lost just because an advertisement does not, for example, refer to a rate of return. We suggest that the exemption should be available where an advertisement is limited to one or more of matters referred to in regulation 17(3)(a).

We understand that the Securities Commission has, in the past, confirmed in writing its view that the purpose and effect of regulation 17(3) is to limit, not prescribe, the kind of information that may be contained in an advertisement in order to take advantage of the exemption.

Additional Proposal

We recommend that references to ‘rate of interest’ in regulation 17(3)(a) and (b) should be amended to include ‘rates of return’.

We also recommend that regulation 17(3)(a)(vii) should be repealed because section 38AA of the Securities Act has already been repealed.

29. Regulation 17(6)

We agree.

30. Regulation 20

We have concerns regarding the proposal to amend Regulation 20 by adding the words ‘or imply’ (ie: “No registered prospectus or advertisement shall state [or imply] that investment in the securities to which it relates is safe or free from risk.”).

The addition of the words ‘or imply’ add a subjective element to the regulation and therefore adds a degree of uncertainty in interpretation.

For example, it could be argued that a reference to a guarantee in a registered prospectus or advertisement for a security implies that the investment to the extent it is covered by such a guarantee is 'safe' (notwithstanding that the description of the guarantee complies with Regulation 11).

In addition, prohibiting any implication of safety could make it difficult to say with certainty how marketing statements such as "A name you can trust" would be treated.

31. Proposed new Regulation 20A

We agree.

32. Regulation 21

The effect of the proposal to extend the scope of Regulation 21 by deleting the references to "interest" and replacing them with "returns" is that issuers of "PIE" funds will be unable to market their product by referring to the "PIE" taxation regime (and thus the "taxation of returns earned by holding securities"). We believe this would be a serious issue for some members of the fund management industry.

In addition, it will raise costs for older life insurance products and non-PIE superannuation schemes which are not actively marketed to new investors but would still be required to update material to bring them into compliance with Regulation 21. As tax is deducted from such funds as a proxy for investors it may also be potentially misleading for them to be unable to state a rate of return adjusted for that tax.

33. Regulation 22

We agree.

34. Regulation 23

The meaning of 'secondary market trading mechanisms' needs to be clarified.

35. Regulation 27

We agree.

36. Regulation 28

We agree.

SCHEDULE 3D CHANGES

51. Clauses 3(1) and 3(2)

We consider that the benefit of requiring this additional disclosure may be outweighed by the compliance costs, such as the cost of updating investment statements when directors change. This will be a significant cost, particularly with mass-membership products such as KiwiSaver.

We suggest as an alternative that investors should be referred elsewhere for this information, for example to the prospectus.

52 to 55.

We agree.

OTHER CHANGES TO SCHEDULE 3A, 3B AND 3C

Interim financial statements and financial statements

In accordance with clause 16(1) of schedule 3A and clause 12(1) of schedules 3B and 3C, a prospectus for a unit trust, life insurance policy or superannuation scheme must contain a reference to the latest registered financial statements that comply with and have been registered under the Financial Reporting Act 1993, **but** a copy of these financial statements does not need to be annexed to the prospectus.

Clause 16(3) of schedule 3A, clause 12(3) of schedule 3B and clause 12(2) of schedule 3C enable interim financial statements to be annexed to the relevant prospectus **provided** that the latest registered financial statements (referred to above) are also attached.

It is not clear:

- why the last full financial statements should also need to be included in the prospectus when, if no interim financial statements are provided, there is no need to attach full financial statements to the prospectus; and
- why the interim financial statements need to be physically annexed to the prospectus at all, given the policy position that full year financial statements need only be referred to.

We recommend that schedules 3A, 3B and 3C should be amended to enable an issuer to refer to interim financial statements without the need to annex a copy of the statements (or full financial statements) to the prospectus. Any reference to interims should, however, provide for investor access to those statements (such as via website and/or telephone request).

Material Contracts

Clause 17 of the first schedule, clause 9 of the second schedule, clause 15 of the third schedule, clause 12 of schedule 3A, clause 9 of schedule 3B and clause 9 of schedule 3C provide that registered prospectuses must disclose the date, names of the contracting parties and the general nature of every material contract (excluding contracts entered into in the ordinary course of business) that was entered into in the two years prior to the date the prospectus is delivered for registration.

Clause 39 of the first schedule, clause 33 of the second schedule, clause 35 of the third schedule, clause 17 of schedule 3A, clause 13 of schedule 3B and clause 13 of schedule 3C provide that registered prospectuses must disclose the times and places where copies of certain documents, including any material contract that is referred to in the prospectus, may, on payment of a fee, be inspected by a person when requested.

Regulation 7(1)(a) provides that every prospectus delivered to the Registrar for registration must have copies of all the material contracts attached.

As the material contracts are made publicly available pursuant to the requirements above, any commercially sensitive information contained in the material contracts will be publicly available. The only alternative open to issuers in these circumstances is to obtain an exemption from the Securities Commission, and the Commission has set a very high threshold for obtaining such an exemption.

We recommend that the issuer should have the option of including in the prospectus a summary of the factors that make the contract material to investors.

RECOMMENDATION RE SECURITIES ACT S.37 (1A)(c)

We have previously recommended that consideration be given to an amendment of section 37A(1A)(c)(i) of the Securities Act to allow (in certain circumstances) for the renewal of a prospectus without the need for interim financial statements.

We consider that the circumstances would apply where a continuous issuer (which tend to renew by means of a directors' certificate rather than by registering a prospectus containing interim financial statements) needs to renew a prospectus in respect of a unit trust or superannuation scheme when there has been a material and adverse change in the financial position shown in the statement of financial position referred to in the prospectus as a result of either a fluctuation in the asset price or a redemption of units.

Unfortunately, the requirements applicable to the 'material and adverse change' condition apply even when it is a result of normal fluctuation in the market price of the assets of the scheme, or the redemption of units. Consequently, unit trusts cannot rely on being able to take advantage of the directors' certificate facility and must incur the compliance costs of producing interim financial statements, despite the fact that they do not assist the 'prudent but non-expert investor'.

We recommend that where the material and adverse change in financial position has resulted solely from a fluctuation in the market price of the assets of the scheme, or the redemption of units, it would be more useful for investors to be given a copy of the refresher certificate containing:

- A statement that, in the opinion of the directors of the issuer after due enquiry by them, the financial position shown in the statement of financial position contained or referred to in the registered prospectus has not materially or adversely changed during the period from the date of the statement of financial position to the date of the certificate, other than a fall in the market price of the assets of the funds or an increase in the redemption of units in the funds;
- A statement that, as a result of the fluctuation in the market price of assets of the funds, the value of the assets may rise and fall over time;
- A description of the investment performance of the funds from balance date to a date not earlier than 1 month before the date of the certificate, calculated on the basis of the best available information;
- A description of the basis upon which the investment performance has been calculated.

List of ISI Members

ISI MEMBERS

AIG Life
AMP Financial Services
Asteron Life Ltd
AXA New Zealand
BNZ Investments and Insurance
CIGNA Life Insurance NZ Ltd
Dorchester Life
Equitable Group
Fidelity Life Assurance Co Ltd
Gen Re LifeHealth
Hannover Life Re of Australasia Ltd
ING New Zealand Ltd
Kiwibank Ltd
Medical Assurance Society NZ Ltd
Munich Reinsurance Co of Australasia Ltd
Public Trust
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Southsure
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PricewaterhouseCoopers
Russell Investment Management
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