

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

SUBMISSION
TO THE
MINISTRY OF ECONOMIC DEVELOPMENT
ON THE
REVIEW OF FINANCIAL PRODUCTS AND
PROVIDERS

Review of Securities Offerings

19 December 2006



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Introduction

The Investment Savings and Insurance Association ("ISI") welcomes the opportunity to comment on the Discussion Document *Review of Securities Offerings* issued as part of the Review of Financial Products and Providers ("RFPP"). Our comments are made on behalf of our members who are the issuers and managers of life insurance, superannuation and managed funds listed at the end of this paper. Our members are keenly interested in the proposals put forward for regulation of the financial services industry and we have appreciated the extensive consultation on these issues with officials and advisory groups.

ISI generally supports the overall framework for regulation of the financial services industry and the registration proposal, but we do have some specific comments to make on the securities offerings proposals.

General Comments

ISI commends the Ministry of Economic Development for the process followed in the RFPP and the opportunity it presents for the regulation of financial services to be considered in a comprehensive manner. The discussion documents produced by MED together provide a very useful overview of the application of different pieces of legislation to the various products and services available within the industry.

We endorse the approach to financial services regulation from the point of view that comparable products and services should be regulated on a comparable and consistent basis in order to increase the protection and understanding of consumers and reduce the cost of compliance for providers. One of the key outcomes to be hoped for must be an improvement in the environment for saving in New Zealand in order to raise the level of personal saving and increase the pool of local savings available for investment.

As noted above, ISI members are the companies issuing and managing life insurance, superannuation and managed funds in New Zealand. That involves various ISI members in most of the activities reviewed as part of the RFPP: insurance, superannuation, collective investment schemes, platforms and portfolio management services, the offering of securities and consumer dispute resolution and redress. Reinsurance companies (all based offshore) are also members of this association and a key participant in the life insurance industry.

All ISI members have an interest in New Zealand maintaining a robust and efficient financial services system which has the confidence and respect of the New Zealand public and local and international institutions. ISI has taken a leading role for the industry in commenting on law reform issues. Key issues in recent years have been the recommendations for review of the Life Insurance Act 1908 and the review of the Securities Act and Regulations.

We are aware of the need for financial services regulation in New Zealand to take account of responsibilities towards the security of international financial markets and

ISI has provided submissions to recent Ministry of Justice discussion documents on anti-money laundering and countering the financing of terrorism (FATF Recommendations). As most ISI members are trans-Tasman companies, we are also acutely aware of the issues around trans-Tasman mutual recognition.

A holistic approach to regulation of the financial services industry should ensure that the design of a new regime takes into account the need to improve the environment for personal saving in New Zealand while harmonising where possible with Australia and also meeting our international obligations in the area of financial security.

The RFPP discussion documents propose to apply the same regulatory regime to life insurance products with a savings component, superannuation and managed funds on the basis that they are comparable products and should be regulated on the same basis. ISI supports the general approach involving registration of financial institutions and two main regulators (prudential and market conduct), with collective investment schemes and their issuers being supervised by trustees who are approved and supervised by the Securities Commission. We do not, however, support life insurance policies with a savings component being treated as collective investment schemes.

We support the trustee supervisory model in theory, although we note that it is not entirely clear at this point what the respective roles and responsibilities of the trustees, the Companies Office and the Government Actuary will be. The current trustee model has worked well for unit trusts.

There is still some uncertainty in respect of what is being proposed for superannuation schemes and whether there is any justification for non-KiwiSaver superannuation schemes being regulated under different legislation from other managed funds.

Securities Offerings

Application of the Securities Act 1978

ISI supports the discussion document's intent to clarify the definition of 'the public' and the features of a private investor who should not be regarded as a 'member of the public'. We would welcome clarifying the scope of 'the public' in Section 3 of the Securities Act in order to ensure that unnecessary costs are not incurred in offering securities to institutional investors.

Professional and habitual private investors do not need the same level of additional disclosure and protection as members of the general public. They have the same protections afforded by the existing Fair Trading Act and Securities Markets Act prohibitions on misleading dealing and are more experienced and aware of the information they need to make an investment decision. We support there being a category of 'sophisticated investors' for whom issuers may make more limited disclosure but recommend caution in designing the criteria for that category.

- We support removal of 'for the purposes of' from the definition of habitual investor;
- We support the requirement for 'sophisticated investors' to self-certify and register with the Registrar of Companies. That registration should then remain in force until the investor notifies the Registrar to cancel it. We do not agree that

investors should be required to supply evidence that they meet the criteria, nor that the Registrar should assess their qualification as ‘sophisticated investors’;

- We endorse the four criteria proposed on page 19 of the discussion document for definition of a sophisticated investor and recommend that an investor should be required to meet at least two of the four criteria;
- We recommend that the \$500,000 minimum subscription price in section 3(2)(a)(iia) of the Securities Act should be retained. Lowering the minimum amount would risk including more unsophisticated investors.

We consider that the exemption for wealthy investors will no longer be required. Any wealthy investor who meets one other of the four criteria will be able to self-certify as a ‘sophisticated investor’, otherwise the protections of the Securities Act should apply.

We note that a problem can arise under section 3 (5) of the Securities Act if an issuer issues securities to one member of the public, as well as a number of private investors, without appropriate disclosure. In that case, the securities issued to the private investors are void as well as those offered to the one member of the public. We recommend in that situation that the penalty for breach of the Act should apply only in respect of the one member of the public and the securities allotted to the private investors should be unaffected.

With regard to other exemptions, we recommend that:

- The proposed exemption for small offers should not proceed. We do not consider that the size of the offer gives any justification for a lower level of disclosure in the absence of the ‘sophisticated investor’ criteria.
- There should be no exemption for local authority debt. We do not consider there is any justification for giving local authority debt a comparative advantage over other similar investments.

Definitions

The definition of and exemption for ‘term life insurance policies’ (Securities Regulation 2A) should be clarified to ensure it correctly covers the policies for which it was intended.

The definition of ‘promoter’ also needs clarification to ensure it does not capture people merely giving advice on the offer.

Offer Document Disclosure

ISI supports the proposal to replace the current Investment Statement and Prospectus with a single offer document made up of Part A and Part B. As for the Investment Statement and Prospectus, the content of Part A and Part B should be set out in regulations rather than in primary legislation, to give more flexibility.

We agree that Part A should be a highly prescriptive summary of the key features of the product and that it should have a maximum length of five pages. We agree that issuers should be able to include additional material in Part B, as long as it appears after the information required by regulation, and we endorse the proposal to allow cross-referencing within the offer document.

ISI considers that prescriptive requirements for offer documents are preferable from a compliance cost point of view as prescription provides certainty and reduces the need for expensive legal advice. Prescriptive requirements do, however, also need to be accompanied by the additional item of ‘other material matters’.

Educational Information

ISI would not support a requirement to include educational material in the offer documents. We consider that the purpose of the offer documents is product and issuer disclosure rather than education. In most cases an adviser will be available to assist an investor with any concepts that are unfamiliar and we encourage inexperienced investors to use the services of advisers.

The Office of the Retirement Commissioner has also created a very useful web site (www.sorted.org.nz) to which novice or unconfident investors may be referred for background educative information. We recommend that the offer documents should be required to include a ‘health warning’ for inexperienced investors, advising them to take advice or at least visit the Sorted web site.

Offer Document for CIS and Superannuation

In the years since the current offer document requirements have applied there has been very little demand from investors for prospectuses and, accordingly, we endorse the removal of this requirement. We welcome the proposal that Part A should be a key features summary and Part B should effectively take over and expand the current Investment Statement disclosure.

ISI supports the proposed content for Part A. With regard to the disclosure of fees and charges in a standard format, we would appreciate the opportunity for further discussion on the detailed design issues before the regulations are drafted. It is important that there is consistency between the requirements of Part A and the new requirements in the Securities Markets Act 1988 relating to financial intermediary disclosure. The over-riding requirement is that the information disclosed to consumers should be useful and understandable.

ISI supports the proposal that past performance should not be permitted to be included in Part A but may be included in Part B if issuers choose to do so.

On Request Disclosure

ISI supports continuation of the current requirement that the trust deed and financial statements should be available on request from the issuer. If this information is also to be available on the Companies Office web site it should be up to the issuer to decide whether it is also provided on the issuer’s web site.

The ISI notes paragraph 334 of the Discussion Document and agrees with the view that there are particular benefits to having material contracts made available for debt and equity investors. The ISI considers that the relevance of the concept of material contracts in the context of collective investment schemes should be reconsidered. The schemes are governed by the trust deed and the obligations and of the manager and under the terms of the trust deed the obligations of the manager and trustee to the investors remains, whether or not the manager or trustee utilise the services of third

parties. Any material information contained in the contracts will be encapsulated in the relevant section of the offer document.

If the concept of material contracts is retained, we endorse the proposal that only a summary of the material contracts should be required to be disclosed on the issuer's web site, taking into account their commercial sensitivity.

We question the value of requiring issuers to show past performance on their web sites.

On going Disclosure

Material Changes

ISI recommends that the requirement to update the offer document in the event of material changes to any information should be limited to 'adverse' changes. We note that the discussion document proposes to refer to any material change, on the grounds that what one investor considers adverse may not be regarded as adverse by another investor. We believe that an objective test based on negative rates of return will achieve sufficient unanimity about what constitutes an adverse change to justify limiting the occasions on which an update of the offer document is required.

Registration of Material Changes

ISI supports the proposal to allow amendment of Part B of a CIS by registering a supplement to the offer document with the Registrar of Companies. This will incur significantly less administration cost than the current requirement to reprint an Investment Statement in the event of a material change. We also consider that the requirement to send a copy of the supplement to investors with a letter explaining the change will be substantially better for investor understanding than issuing a revised Investment Statement with no explanation of the revision.

ISI recommends that an offer document for a CIS should have an unlimited life. Material changes to Part B will be dealt with by registering a supplement and a consolidated offer document should be required only after a certain number of supplements have been registered.

Continuous Disclosure

We do not consider that the proposals for a continuous disclosure regime are relevant to CIS and superannuation.

Annual Reporting

Statistical Data

ISI recommends that any increase in the statistical data gathering from CIS and superannuation should be proposed only after careful consideration of the data that is already collected by other agencies and rigorous analysis of the need for extra data.

Annual Reports to the Regulator

ISI accepts the proposals in paragraph 384 for ongoing disclosure to the regulator, with the requirement for an Annual Report applying only to employer-based superannuation schemes (exempted from the trustee supervisory framework). We agree with the continuing reporting requirements of employer-sponsored superannuation schemes, including defined benefit.

Ongoing Disclosure to the Investor

ISI agrees that annual reporting to investors needs to be meaningful information focused on their own investments. We support the proposal for an annual statement to be sent to each investor setting out the value of the investor's interests in the scheme and giving advice of any material changes. This proposal will be particularly useful for members of master trusts.

If the requirement for an annual report for investors is retained, we would support it being provided electronically.

Registration of Disclosure Documents

ISI notes that there has been unnecessary duplication of effort in the requirement for superannuation schemes to file their documents with both the Companies Office and the Government Actuary. The facility to file documents electronically will significantly reduce administration.

Advertising

ISI has previously recommended the deletion of Securities Regulation 17 (Restrictions on Distribution of Certain Advertisements) because of the problems it creates concerning distribution of information that falls within the definition of 'advertisement'.

Given the wide definition of "advertisement", most communications of an issuer will constitute an "advertisement", requiring certification under Regulation 17 by directors. Other provisions are more than sufficient to ensure compliance of advertisements with the law, including compliance with Regulations 8 and 9 of the Securities Regulations.

Remedies available for misleading advertisements include under:

1. Securities Act, section 38B (Commission's powers);
2. Securities Act, section 56 (civil liability on issuer and its directors);
3. Securities Act, section 58 (criminal liability of directors of the issuer); and
4. Securities Act, section 59 (criminal liability of an issuer and its directors).

Accordingly, directors are still personally liable for misleading advertisements, without the need to impose the inefficient, administratively burdensome and costly Regulation 17 procedure. Our recommendation to delete Regulation 17 is consistent with government policy to reduce unnecessary compliance costs.

List of ISI Members

ISI MEMBERS

American International Assurance
AMP Financial Services
Asteron Life Ltd
AXA New Zealand
BNZ Investments and Insurance
CIGNA Life Insurance NZ Ltd
Equitable Group
Fidelity Life Assurance Co Ltd
Gen Re LifeHealth
Hannover Life Re of Australasia Ltd
ING New Zealand Ltd
Medical Assurance Society NZ Ltd
Munich Reinsurance Co of Australasia Ltd
Public Trust
RGA Reinsurance Co. of Australia Ltd
Save and Invest Ltd
Sovereign Ltd
Swiss Re Life & Health Australia Ltd
TOWER Limited
Westpac/ BT Funds Management Ltd

Associate Members

Bell Gully Buddle Weir
Bravura Solutions
Buddle Findlay
Burrowes and Company
Chapman Tripp
Davies Financial & Actuarial Ltd
Deloitte Touche Tohmatsu
Ernst & Young
InvestmentLink (New Zealand) Ltd
KPMG
Kensington Swan
Melville Jessup Weaver
Mercer Human Resource Consulting Ltd
Morningstar Research Ltd
Phillips Fox
PricewaterhouseCoopers
Russell Investment Management
Russell McVeagh
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