REVIEW OF FINANCIAL PRODUCTS AND PROVIDERS:

REVIEW OF SECURITIES OFFERINGS

Discussion Document

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1. Executive Summary

1. The Securities Act 1978 ("Securities Act") is investor protection legislation. The premise underlying the Securities Act is that the best protection of investors lies in full, timely and accurate disclosure of information material to investors' investment decisions. This allows investors to make an informed decision on the potential risks and rewards of their investment choices and to take responsibility for their own investment decisions.

2. The objectives behind the current regulatory regime for securities offerings are sound. However, the Securities Act and the Securities Regulations 1983 have been around for a while now and we have identified, through consultation with regulators, industry and consumers, a number of areas where the regulatory regime could be improved.

3. The improvements proposed below are aimed at reducing compliance costs for market participants and enhancing investor protection. The proposals will provide clarity for issuers as to when the disclosure regime applies and simplify access to capital for those making offers to sophisticated and professional investors. The proposals will also ensure that the disclosure regime is more relevant and more accessible.

Aim: the Securities Act is clearly targeted at those investors who need the protection of regulatory intervention, so that capital can still be raised cost-effectively from private sources

4. The Securities Act only applies to "offers of securities to the public". The Securities Act does not provide a definition of "public". Instead, it defines who is a member of the "public" by setting out those offers that do not constitute offers of securities to the public. These exclusions from the Securities Act are typically referred to as "private offers". The Securities Act does not regulate private offers because these types of investors are deemed to not need the protection of the disclosure regime, as they will already have knowledge of, or the means to access, the type of information that would normally be disclosed under the Securities Act.

5. We recognise that the disclosure regime imposes costs on issuers. We want to ensure that these costs are only imposed if they are outweighed by the benefits the disclosure regime provides to investors. To achieve this, we want to ensure that the Securities Act is clearly targeted at those investors who need the protection of the disclosure regime, so that issuers can raise capital cost-effectively from private sources.

6. To ensure that the Securities Act is clearly and appropriately targeted, we:

    a. Propose to retain the concept of an "offer of securities to the public"; however we seek feedback on whether there are minimum protections that should apply to all offers of securities. Private investors may not need the protection of the disclosure regime; however, they may still need some protection as they are reliant on the honesty and integrity of the issuer to make accurate disclosures. Such protections may include, for example, the power of the Securities Commission to prohibit the distribution of advertisements for securities, and criminal liability for misstatements in an advertisement.

b. Propose to provide greater clarity to the exclusions from the Securities Act. We propose to clarify the existing definitions for "relatives and close business associates", "professional and habitual investors" and seek feedback on whether offers with a "minimum subscription price of $500,000" and to "any other person" should be retained. The proposed definitions aim to ensure that the Securities Act does not apply to those investors who do not need the protection of the disclosure regime, as they will already have knowledge of, or the means to access, the type of information that would normally be disclosed under the Securities Act. The proposed definitions also aim to ensure that issuers can make private offers with more certainty.

c. Consider whether there are additional exemptions from parts of the Securities Act that could be provided for certain types of offers. For example, we consider whether there should be exemptions provided for: small offers, in terms of number of investors, value of issue and the time period for which the offer is open; offers of investment-grade debt, rated as investment grade by an internationally recognised credit rating agency; offers of local authority debt; and offers by listed issuers who are subject to the continuous disclosure regime and who want to issue new securities of a class already listed. Exemptions, where appropriate, are important as they can provide regulatory flexibility.

d. Seek feedback on whether the definitions contained in the Securities Act are working appropriately.

Aim: there are appropriate entry requirements for all issuers who offer securities to public investors.

7. Currently, there is no comprehensive way of identifying or monitoring providers of financial services, which makes it difficult for regulators to collect data in order to identify and monitor risks in the sector or people who are not complying with the law. It also fails to provide assurance that financial service providers have not been convicted of financial crimes or other misconduct or that they are fit to run financial institutions. This increases the risk of unfair, fraudulent or negligent conduct in relation to financial institutions and also means that we are not currently complying with Recommendation 23 of the Financial Action Task Force Recommendations.

8. The *Overview of the Review and Registration of Financial Institutions* discussion document is proposing that the Registrar of Companies register all core financial institutions, carry out negative assurance checks and liaise with the relevant regulator (in relation to the securities sector, this is the Securities Commission), who would carry out a qualitative "fit and proper" assessment, where required.

9. For issuers of equity or corporate debt securities to the public, we propose it is sufficient that these issuers meet the negative assurance requirements for registration. In practice, registration as a financial institution will occur when the issuer registers its offer document, therefore imposing minimal cost on these issuers.

10. For non-bank deposit-takers that issue debt securities to the public, we propose that those financial institutions falling within the definition of "Tier 2 deposit-taking financial institutions" should be subject to a qualitative "fit and proper" assessment. This qualitative assessment may include: additional negative assurance requirements; experience and capability requirements; a minimum capital requirement; and possibly a credit rating. The trustee will undertake the assessment

and provide a recommendation to the Securities Commission, which will provide a final determination. The fit and proper requirements for Tier 2 deposit-taking financial institutions are discussed in the *Non-Bank Deposit-Takers* discussion document.

Aim: investors receive effective disclosure of material information over the life of the security

11. Disclosure is the key tool for securities regulation, and we want to ensure it is as effective as it can be. We also need to ensure that any new proposals bring us closer into line with international principles.

12. We are aiming to ensure that investors receive full, accurate and timely disclosure by issuers of information material to investors' decisions and that the information is delivered to investors in a manner those investors can readily understand.

13. At the same time, we want to ensure that issuers have cost-effective access to capital from the public, so it is important that the disclosure regime does not impose any unnecessary compliance costs. This does, however, need to be balanced against the necessity to hold those disclosing information to investors accountable for the accuracy of the information disclosed. Placing clear requirements on issuers will address this.

14. Through our consultation with regulators, industry and consumer groups, it has become clear that the current disclosure regime does not achieve these aims. We have identified that the investment statement and prospectus are not delivering full, accurate and timely disclosure to investors in a user-friendly manner. We have also identified a number of areas where the disclosure regime imposes unnecessary compliance costs on issuers, for example, through disclosure requirements which are duplicative, ill-targeted, inflexible, and uncertain.

15. To address this and to ensure that the disclosure regime for securities offerings meets our objectives, we:

    a. Propose to remove the investment statement and prospectus and replace it with a single offer document, for all types of securities.

    b. Propose to have a single offer document with a Part A and Part B. Part A will be prescriptive (the prescription will be targeted for each type of security), product specific and concise. Part A is targeted at retail investors and will aim to provide the investor with a summary of the key features of the offer in a short and digestible form. Part B will provide fuller disclosure on the offer and the issuer. This should also make it easier for investors to compare material information relating to similar investment products.

    c. Propose to ensure that disclosure documents are more accessible for consumers, so they are encouraged to read and consider disclosure documents' contents. However, we note that we intend to conduct consumer testing when the new disclosure framework is more fully developed, so we can ensure that the single offer document is targeted appropriately and meets the information needs of investors.

d. Propose to provide educational information either within, or as a supplement to, the offer document. The purpose of the educational material is to make the information disclosed in the offer document easier to understand.

e. Propose to enhance and rationalise the ongoing disclosure requirements for all issuers. For example, ensuring that issuers register and communicate to investors, in a timely fashion, all material changes to both the offer document and trust deed (where applicable). This is facilitated by allowing registered supplements to amend disclosure documents, suggesting clarification of the definition of "material", and requiring issuers to advise material changes at the time of change. We acknowledge that there are issues with the current reporting requirements and it is intended to rationalise the annual reporting to investors for CIS and superannuation. We note that we intend to maintain issuers' reporting obligations under the Financial Reporting Act 1993 and the Companies Act 1993.

f. Propose that offer documents and all additional supplementary information required to be made available to investors (including amendments to this information) be made available by the issuer on request and on the issuer's website. For example, where applicable, this would include the trust deed, material contracts, annual report and financial statements. In addition, the same documents will be registered and made available to the public on the Registrar of Companies' website. This will enable investors to access all registered information on a particular financial institution from a central point.

g. Propose that Tier 2 Non-Bank Deposit-Taking Institutions be subject to additional enhanced ongoing disclosure requirements. For example, a requirement to register six-monthly audited financial statements and a key information summary, which sets out in brief form key financial and risk-related information. This proposal is discussed in detail in the *Non-Bank Deposit-Takers* discussion document.

h. Consider how to address the lack of a high-level overview of, and statistical data on, the financial sector and seek feedback on whether issuers should be required to produce an annual statistical return for all securities offered. This information could be required at a common date in order to facilitate the collection of complete and comparable data – useful to both industry and Government. This is not intended to be an onerous requirement and for some collective investment schemes, could leverage off current reporting requirements to the Government Actuary and information already produced by the financial institutions. We seek feedback on whether this requirement could usefully be extended to issues of debt and equity securities.

i. Consider and seek feedback on whether to extend the continuous disclosure regime to all securities for which the issuer holds out that there is or may be an established secondary market.

16. We recognise that disclosure is not the only tool that can be used. So, as part of the *Review of Financial Products and Providers* and the *Review of Financial Intermediaries*, we are making efforts to improve financial capability by considering how we can educate investors about financial concepts; and for those investors who prefer to rely on financial advice to make their investment decisions, we are ensuring that there is a sound regulatory regime for financial intermediaries.

17. Details on how and when you can make a submission on this discussion document are set out in the *Overview of the Review and Registration of Financial Institutions* discussion document.

2. Introduction

2.1 OUTCOMES

18. The outcome we are seeking from this review of securities offerings is a sound and efficient securities market, which promotes:

    a. confidence in the securities sector to encourage participation by consumers, firms and providers; and

    b. productive resource allocation, economic growth and household wealth accumulation.

19. The ability to access capital is important for business growth and innovation. Businesses can access capital by issuing securities. By issuing a debt security, businesses can access finance from investors on terms that may not be available from banks, and can allow financing for higher-risk ventures. By issuing an equity security, businesses can invite participation by investors as co-owners of the business, rather than as creditors. This can be important for businesses in higher risk sectors of the economy, where debt financing may not be viable.

20. Securities markets also provide opportunities for households to diversify their investments and risks in a cost-efficient way, by investing in a range of businesses and sectors either directly or through a collective investment scheme ("CIS").

2.2 REASONS FOR REGULATORY INTERVENTION

21. The reasons for regulatory intervention in relation to the offering of securities are:

    a. *Information asymmetries.* There is an imbalance of information between issuers of securities and investors. Investors have much less information about the risk profile of a product or issuer than the issuer. This is because investors may not have sufficient expertise, time or information to gather this information. Regulatory intervention is needed to address this information asymmetry and to ensure that all investors have access to the information they need so they can choose which products or providers best suit their needs and risk levels.

    b. *Unfair and fraudulent conduct.* Apart from relying on adequate and accurate information on which to make informed decisions, investors are to a certain degree reliant on providers acting with integrity. Information asymmetries leave investors open to opportunistic behaviour. While disclosure about an issuer may go some way to address this risk, disclosure does not deal comprehensively with the misconduct of those who have an advantage.

2.3 OBJECTIVES

22. The objectives that we see helping us achieve these outcomes are:

    a. *Promoting well-informed investors*. Disclosure is an important regulatory tool that we can use to address information asymmetries. We want to ensure that investors receive effective disclosure over the life of the security, so investors

can make informed investment decisions and take responsibility for the decisions that they make.

b. *Deterring, detecting and enforcing measures against unfair or fraudulent conduct*. We want to ensure there are well-defined and consistent (where appropriate) prohibitions against unfair and fraudulent conduct. In particular, we want to ensure that disclosure is not misleading and that securities are not allotted unless the Securities Act 1978 ("Securities Act") has been complied with.

c. *Promoting accountability*. We want to encourage sound institutional governance and risk-management practices, so that issuers are responsible for, and investors have confidence in, the products provided to the market.

d. *Not impeding contestability, competitiveness and innovation in the financial sector.* We want to ensure that the regulation of the securities sector allows providers to be innovative. We want to ensure that the regulation of the securities sector is sufficiently flexible to cope with change in financial markets and products and so there are no excessive barriers to entry.

23. Disclosure is an important regulatory tool we can use to achieve these objectives. However, we recognise that disclosure alone is insufficient. For this reason, we are taking other measures to ensure that our objectives are met. For example, the Government is already using education as a tool to address the financial literacy needs of the public. We also intend to use occupational regulation to ensure that financial intermediaries provide quality financial information and advice to the public. Additionally, we propose to enhance the model of trustee supervision, so investors can have confidence that debt and CIS issuers are supervised and held accountable for the manner in which they carry out their business.

24. Under the Review of Regulatory Frameworks, the Government is focusing on the removal of unnecessary regulatory constraints on economic growth as well as the continuous quality improvement of regulatory frameworks and processes. An important component of this is ensuring quality process in regulatory design. Consistent with this, our focus for the review of securities offerings is on removing unnecessary compliance costs on participants by ensuring that any regulatory intervention is transparent and commensurate with the needs for regulatory intervention, and that participants in the securities sector can participate cost-effectively and with certainty.

2.4 PROBLEMS IDENTIFIED

25. The objectives behind the current regulatory regime for securities offerings are sound. However, we have identified, through consultation and analysis, a number of areas where the regulatory regime could be improved. These include ensuring that:

a. The Securities Act is targeted at those investors who need the protection of regulatory intervention. This is discussed in more detail in Part 3.1 of this discussion document.

b. There are appropriate entry requirements for all issuers who offer securities to public investors. This is discussed in more detail in Part 3.2 of this discussion document.

c. Investors receive effective disclosure over the life of the security. This is discussed in more detail in Part 4 of this discussion document.

d. The regulator has sufficient and appropriate enforcement powers. This is discussed in more detail in the *Supervision of Issuers* discussion document.

e. Trustee supervision provides appropriate and consistent protections for investors, without reducing the flexibility of trustees and issuers to tailor a trust deed to a particular issue of securities. This is discussed in more detail in the *Supervision of Issuers* discussion document.

2.5 INTERNATIONAL CONSIDERATIONS

26. Financial institutions and financial markets increasingly operate in a global market. New Zealand's regulatory environment for the securities sector needs to recognise this, but at the same time, the regulatory regime needs to be appropriate for New Zealand conditions.

27. This review of securities offerings is being conducted in the context of the Memorandum of Understanding on Business Law Coordination between New Zealand and Australia and the trans-Tasman mutual recognition regime for securities offerings. This means that there will be a presumption in favour of coordination, and any changes to New Zealand's securities regime will aim to achieve outcomes consistent with the Australian regime, unless there are good reasons for the laws to be different.

28. This review is also being conducted in the context of the International Organization of Securities Commissions ("IOSCO") *Objectives and Principles of Securities Regulation*[1] and the IOSCO standards for disclosure.[2] IOSCO is the pre-eminent forum for international cooperation among securities regulators and is recognised as the international standard setter for the securities sector. Compliance with international best practice is important for confidence in our securities sector. Any regulation developed from this review of securities offerings will aim to comply with the IOSCO objectives, principles and standards, where appropriate.

29. New Zealand is a signatory to the Financial Action Task Force ("FATF") Recommendations. As such, part of this review will consider how we can comply with our obligations under those recommendations; in particular, how to comply with Recommendation 23, which requires that directors, senior management and those persons with beneficial control of financial institutions, be evaluated on the basis of "fit and proper" criteria.

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[1] A copy of the IOSCO *Objectives and Principles of Securities Regulation*, 1998 can be found at www.iosco.org/library/pubdocs/pdf/IOSCOPD82.pdf.

[2] IOSCO's *International Disclosure Standards for Cross-Border Offerings and Initial Listings by Foreign Issuers*, 1998, contains detailed disclosure standards applicable to equity securities. IOSCO's *Investor Disclosure and Informed Decisions: Use of simplified prospectuses by Collective Investment Schemes*, 2002, contains detailed disclosure principles applicable to CIS. IOSCO's *International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers,* 2005, contains detailed disclosure principles applicable to public offerings and listings of "plain vanilla" corporate debt securities.

3. Application

3.1 APPLICATION OF THE SECURITIES ACT 1978

3.1.1 Background

30. The Securities Act distinguishes between those investors who need protection, the "public", and those investors who do not need protection, i.e., the "private investor".

31. The Securities Act regulates the issue of securities to the public. The premise underlying the Securities Act is that the best protection of the public lies in full disclosure of information material to investors' decisions. This allows investors to make informed decisions on the potential risks and rewards of their investments and to take responsibility for their own investment decisions.

32. The Securities Act does not regulate the issue of securities to those investors who are not considered to be members of the public, i.e., private investors. Private investors are deemed to not need the protection of the disclosure regime, as they will already have knowledge of, or the means to access, the type of information that would normally be disclosed under the Securities Act. This may be because of their relationship with the issuer, or their experience, position or wealth. It is recognised that the disclosure regime imposes costs on issuers, and these costs cannot be justified if they outweigh the benefits the regime provides these investors.

33. The distinction between public and private investors is important for New Zealand businesses. We want to create an environment that encourages business growth and innovation by providing businesses with cost-efficient access to capital. To do this, we want to ensure that the Securities Act is targeted at offers of securities to those investors who require the protection of regulatory intervention, so that capital can still be raised cost-effectively from private sources. Further, we want to ensure that the Securities Act is user-friendly enough so that businesses are not discouraged from seeking funds from the public.

3.1.2 Current Regulation

34. The Securities Act only applies to offers of securities to the public. Section 3 of the Securities Act defines an offer of securities to the public. Section 3(1) sets out what is considered to be an offer of securities to the public and section 3(2) sets out what is not. Under section 3(2), offers of securities to the following types of investors are considered not to be an offer of securities to the public, and therefore excluded from the application of the Securities Act:

    a. relatives and close business associates of the issuer or of a director of the issuer;

    b. professional and habitual investors;

    c. investors who purchase a minimum subscription of $500,000; and

    d. any other person selected otherwise than as a member of the public.

35. Section 5 of the Securities Act contains a list of the types of offers and investors exempted from various provisions of the Securities Act. Apart from those types of

offers listed in section 5(1) (such as offers of estates or interests in land), section 5 does not exempt those listed from certain basic protections of the Securities Act - for example, criminal liability for misstatements in an advertisement or prospectus and the power of the Securities Commission to prohibit advertisements under section 38B of the Securities Act.

36. While, in general, the Securities Act applies only to primary issues of securities, section 6 of the Securities Act provides two avenues by which the Securities Act may apply to secondary market activities. The first avenue is where securities were originally allotted, to non-public investors, but with a view to being offered for sale to the public.[3] The second avenue is where the original allotter assists the holder or offeror in connection with the offer or sale of the security.[4]

37. Section 6(7) of the Securities Act defines "issuer" as including both the original allotter of the securities and the offeror of the securities. The aim of this provision is to hold the offeror responsible, as if it were the issuer, for the preparation of the offer documents and the conduct of the offer.

38. The principle of section 6 is that while the Securities Act normally only applies to offers in the primary securities market, there are certain situations where the offer in the secondary market is so closely connected to the original offer or the original offeror that it should be brought within the scope of the Securities Act.

39. Section 2D of the Securities Act defines "security". The term "security" is defined as any interest or right to participate in any capital, assets, earnings, royalties, or other property of any person. The definition specifically includes: equity securities; debt securities; units in a unit trust; interests in superannuation schemes; and life insurance policies. All other types of security come within the term "participatory security". Each type of security is also defined under section 2 of the Securities Act.

3.1.3 Problems Identified

40. There are no significant problems with sections 2, 3, 5 or 6 of the Securities Act. However, this review of securities offerings is an opportunity to improve the application of the offering regime. We have received feedback that the application of the offering regime could be improved by:

    a. ensuring that consistent minimum protections apply to offers of securities to private investors;

    b. providing greater certainty around the definitions of private investors;

    c. reviewing the wealthy investor exemption, and the scope of the exemption for offers of an estate or interest in land;

    d. considering the provision of exemptions for small offers, offers by listed issuers, offers of investment grade rated debt, and offers of local authority debt;

[3] Section 6(1), Securities Act 1978.

[4] Section 6(3), Securities Act 1978.

e. reviewing the exemption for contributory mortgage brokers;

f. reviewing the previously allotted securities provisions;

g. reviewing the definitions of equity and debt and determining a line between securities and derivatives; and

h. reviewing the definitions of issuer and promoter.

3.1.4 Minimum Protections for Offers of Securities to Private Investors

41. The Securities Act does not apply to offers of securities to private investors. Therefore a private investor will receive none of the protections and remedies that the Securities Act provides to the public investor.

42. The private investor does have some protection. The private investor is able to pursue a civil remedy under section 9 of the Fair Trading Act for misleading and deceptive conduct in trade. Under the Securities Legislation Bill, an amendment will be made to the Securities Markets Act 1988, which will prohibit misleading or deceptive conduct in relation to any dealings in securities.[5] This prohibition will not apply to conduct in relation to an offer of securities that is regulated under the Securities Act.[6] However, it will apply to conduct in relation to private offers of securities.

43. Under the Securities Legislation Bill, the Securities Commission will be given the ability to make prohibition and corrective orders if a person contravenes the general dealing misconduct prohibition.[7] The general dealing misconduct prohibition is a civil remedy provision, and the court may, on the application of either the Securities Commission or a subscriber, make compensatory orders for breach of that provision.[8]

44. We seek feedback on whether private offers of securities require any of the protections provided to the public investor - for example, the ability of the Securities Commission to prohibit the distribution of advertisements for securities;[9] the ability of the Securities Commission to accept enforceable undertakings from any person and seek court orders to enforce these;[10] and criminal liability for misstatements in an advertisement or prospectus.[11]

45. Private investors may not need disclosure, as they will already have knowledge of, or the means to access, the type of information that would normally be disclosed

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[5] Clause 21, Securities Legislation Bill, inserting new section 13, Securities Markets Act 1988.

[6] Clause 21, Securities Legislation Bill, inserting new section 16, Securities Markets Act 1988.

[7] Clause 27, Securities Legislation Bill, inserting new section 42B(a), Securities Markets Act 1988.

[8] Securities Legislation Bill, inserting new section 42ZB, Securities Markets Act 1988.

[9] Section 38B, Securities Act 1978.

[10] Section 69J, Securities Act 1978.

[11] Section 58, Securities Act 1978.

under the Securities Act. However, they may still need some protection as they are reliant on the honesty and integrity of the issuer to make accurate disclosures. The prohibitions, penalties and remedies described above are designed to provide sufficient incentives to minimise the risk of negligent, unfair or fraudulent conduct.

46. We also seek feedback on whether there is any need to retain the distinction between private offers made under section 3 (offers excluded from the Securities Act) and offers made under section 5 of the Securities Act (offers exempted from parts of the Securities Act). If there are consistent minimum protections for investors applied to all offers, there may be no good reason to retain this distinction. An advantage of removing the distinction is that an issuer could make one offer to investors under both sections 3 and 5.

Questions for Submission

1. What protections, in addition to the prohibition on misleading or deceptive conduct in relation to any dealings in securities, should apply to private offers of securities?

2. Should the distinction between offers made under sections 3 and 5 of the Securities Act be retained?

3.1.5 Definitions of Private Offers

47. We have received feedback that the definitions of private offers in section 3(2) of the Securities Act are uncertain. This makes it difficult for issuers to proceed with private offers and impacts on the cost of access to capital.

3.1.5.1 Relatives and Close Business Associates

48. Under section 3(2)(a)(i) of the Securities Act, an offer of securities made to relatives or close business associates of the issuer or of a director of the issuer is not an offer of securities to the public.

49. This exclusion aims to cover those investors who, by reason of their relationship with the issuer, have knowledge of or have the means to access the type of information that would have been disclosed under the Securities Act. If the relationship between the issuer and investor is sufficient to overcome the problem of information asymmetry, the investor does not need the protection of the disclosure regime. As currently drafted, this exclusion assumes that a familial or close business relationship is sufficient.

50. The feedback that we have received is that relatives may or may not be in a position where they have knowledge of the issuer's business and the security on offer, or the means to obtain this knowledge from the issuer, and that the social restraint of a familial relationship alone is not enough to overcome the information asymmetry that normally exists between an issuer and investor.

51. We have also received feedback that the term "close business associates" is not easily understood by issuers and is often interpreted widely so as to include any business relationship. The correct interpretation of this term is that stated by the

Court of Appeal in *Securities Commission v Kiwi Co-op Dairies Ltd* (1995) 7 NZCLC 260, 228:

> *Although an issuer and a holder of its securities have a relationship through business, the use of the terms 'close' and 'associate' requires more than this: there must be a degree of intimacy or 'business friendship' in the relationship, though not necessarily a friendship away from business.* ***It must be sufficient to overcome any inequality which might otherwise be present in the relationship****.* (Emphasis added)

52. We propose to redraft this exclusion so that it more accurately reflects the policy behind the exclusion: that the investor, by virtue of their relationship with the issuer, has the knowledge or the means to obtain the knowledge of information that would normally be disclosed under the Securities Act. We propose to remove the presumption that "relatives" and "close business associates" will satisfy this exclusion but will consider whether guidance can be given, in legislation or via the Securities Commission, as to the types of relationship which may satisfy this exclusion.

Questions for Submission

3. Do you agree that the exclusion for relatives and close business associates can be improved by focusing on the principle of the exclusion, i.e., that by virtue of his or her relationship with the issuer, the investor has the knowledge of or access to the information that would normally be disclosed by the issuer under the Securities Act?

4. Should we list examples of the types of relationship that might satisfy this exclusion? If yes, where should this list appear? In legislation or in guidance provided by the Securities Commission? What would it cover and why?

3.1.5.2 Sophisticated Investors – Professional, Habitual and Experienced Investors

53. Under section 3(2)(a)(ii) of the Securities Act, an offer of securities made to persons whose principal business is the investment of money (commonly termed "professional investors") or who, in the course of and for the purposes of their business, habitually invest money (commonly termed "habitual investors"), is not an offer of securities to the public.

54. Under section 5(2CB) of the Securities Act, offers of securities only made to "eligible" persons are exempt from Part 2 of the Act (other than sections 38B and 58). Under section 5(2CC), a person who is experienced in investing money or experienced in the industry to which the security relates will qualify as an "eligible person" (commonly termed "experienced investors"). Under section 5(2CE), experience must be determined by an independent financial service provider.

55. Both the professional and habitual investors' exclusion and the experienced persons' exemption are aimed at sophisticated investors. It is assumed that because of their profession or their expertise, sophisticated investors do not need the protections of the Securities Act.

Re-defining Sophisticated Investors

56. We have received feedback that there is no uncertainty as to who is a professional investor. We propose to retain the exclusion for professional investors.

57. However, we have received feedback that the definition of habitual investor is uncertain and does not cover the range of investors who are considered "sophisticated". We have been told that a sophisticated investor may regularly invest money in the course of business, but that investment may not be *for the purposes of* their business. If the investment is not in the course of *and* for the purposes of the business, the investor will not fall under the habitual investor definition.

58. This issue could be addressed by deleting the words *for the purposes of* from the habitual investor definition. This may widen the scope of the habitual investor definition, but it would still be restricted to those who invest in the course of their business.

59. We have also received feedback that the experienced investors' exemption is not often used because of the requirement to obtain certification from a financial service provider. The intention of requiring a financial service provider to make an assessment was that it would add an extra layer of protection for the investor and provide certainty for the issuer in deciding whether an individual falls within the exemption. However, we are told that financial service providers may be reluctant to provide certification and issuers are uncertain whether they are able to rely on the certification at face value.

60. We want to question whether both of these issues can be addressed by re-defining who is a "sophisticated investor" and should therefore be deemed to not need the protections of the Securities Act.

61. The United Kingdom provides an example for how we could define a sophisticated investor, in their exemption for "qualified investors".[12] Qualified investors include, in addition to professional investors, persons who have wealth and experience in securities investment. To be eligible as a qualified investor, the investor must satisfy two of the following three criteria:

    a. The investor has carried out transactions of a significant size on securities markets at an average frequency of, at least, 10 per quarter over the previous four quarters;

    b. The size of the investor's securities portfolio exceeds 0.5 million euros;

    c. The investor works or has worked for at least one year in the financial sector in a professional position which requires knowledge of securities investment.

62. We consider that transaction and professional experience in the securities industry and portfolio size are good indicators of sophistication in securities investment. We note that the levels provided in the United Kingdom example would need to be adapted for the New Zealand market.

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[12] Sections 86(1)(a) and 86(7), Financial Services Markets Act 2000.

63. However, we question whether the definition of a sophisticated investor could be broader than the United Kingdom example. The three criteria would probably cover one arm of the experienced investor exemption – the investor who is experienced in investing money. However, it would not cover the second arm of the experienced investor exemption – i.e., the investor who is experienced in the industry to which the security relates.

64. We propose that "experience in the industry to which the security relates" be added as a fourth criteria, rather than left as a stand-alone exemption. Even if an investor has experience in the industry, he or she may be unsophisticated in investment matters. Requiring the investor to also satisfy one of the other criteria would minimise the risk of that unsophistication being exploited.

Certification and Registration of Sophisticated Investors

65. In the United Kingdom, if they meet the criteria, investors are able to self-certify as qualified investors and then must register as qualified investors with the Financial Services Authority.

66. The advantage of certification and registration of sophisticated investors is that it can provide certainty for issuers that these investors fall outside the scope of the Securities Act. This certainty will make it easier for issuers to proceed with a private offer to sophisticated investors and may reduce the cost of making that offer.

67. The advantage of self-certification is that it allows a sophisticated investor to decide whether or not to avail him or herself of the protection that the Securities Act provides. And, self-certification does not incur the cost of third party certification.

68. We have received feedback that the cost and time involved in obtaining third party certification can discourage some investors. This feedback was received in respect of the wealthy person exemption, which requires certification by a chartered accountant within six months of an offer. Some investors, who qualify for the wealthy person exemption, only make one or two investments per year. This means that in practice investors need to be certified by a chartered accountant before every investment they make. We have also received feedback that the cost of obtaining certification from an independent financial services provider under the experienced person exemption can discourage some investors.

69. There is a risk that investors may be inappropriately encouraged to self-certify as a sophisticated investor. For example, a potential investor may be asked to self-certify as a sophisticated investor without understanding exactly what protections he or she is signing away. The advantage of third party certification is that it provides an independent check for the investor on whether he or she meets the criteria for sophistication, which provides an extra layer of protection for both the investor and the issuer.

70. We propose that investors should be able to self-certify as sophisticated investors. On balance, we consider that the risk of investors being inappropriately encouraged to self-certify can be managed by establishing appropriate criteria that the investor must satisfy to be considered a sophisticated investor, and to require the investor to register as a sophisticated investor with the Registrar of Companies ("Registrar").

71. In order to register as a sophisticated investor, investors would need to provide the Registrar with some evidence that they meet the criteria for sophistication. We seek feedback on what evidence investors should provide. For example, investors could sign a standard form stating that they meet each of the stated criteria. Alternatively, investors could be required to provide proof to the Registrar that they meet the criteria. In either case, we consider that the information provided to the Registrar should not be made publicly available.

72. We also seek feedback on when and how often investors should have to register as sophisticated investors. For example, investors could be required to register once, and notify the Registrar if they no longer meet the criteria. Alternatively, investors could be required to register prior to accepting each offer or on a periodic basis.

Questions for Submission

5. Do you agree to the use of a list of criteria to define a sophisticated investor? If no, why?

6. If yes, should a sophisticated investor be defined by reference to the following criteria:

    - transactions of a significant size on securities markets at a specified frequency over a specified period;
    - the size of the investor's securities portfolio;
    - works or has worked for at least one year in the financial sector in a professional position which requires knowledge of securities investment; and
    - experience in the industry to which a particular investment relates.

7. If you agree with the above criteria, how many of these criteria should an investor satisfy in order to be considered a sophisticated investor? Why?

8. Should investors be able to self-certify as sophisticated investors, or should investors be certified as sophisticated investors by a third party? Why?

9. How often should investors have to certify as sophisticated investors? For example, prior to each offer? Every six months? Every 12 months?

10. What evidence should investors have to provide the Registrar to show that they meet the criteria for sophisticated investors?

3.1.5.3 Minimum Subscription Price of $500,000

73. Under section 3(2)(a)(iia) of the Securities Act, an offer of securities which requires each person to pay a minimum subscription price of at least $500,000 before the allotment of those securities is not an offer of securities to the public.

74. This exclusion is aimed at those investors who have large sums of money to invest and who do not fall within the exemption for professional and sophisticated investors. It is assumed that where an investor contributes $500,000 to a venture, the size of the contribution is such that the investor would have leverage to access the sort of information about the venture that would normally not be available to an investor.

75. We have received feedback that this exclusion is rarely used because the $500,000 threshold is too high for the New Zealand market: investors are unlikely to place such a large sum in one investment; and New Zealand is a country of small businesses that, on average, request $200,000 or less. It has been suggested that a more appropriate threshold is $100,000.

76. A threshold of $500,000 is consistent with the equivalent exemption in Australian legislation.

77. Lowering the threshold to $100,000 may extend section 3(2)(a)(iia) to a number of less sophisticated investors. However, the threshold needs to be of a size such that the investor would have leverage to access the sort of information about the venture that would normally not be available to an investor. We note that setting a threshold is arbitrary, but we are not certain that $100,000 would be sufficient to give an investor that leverage.

78. Alternatively, section 3(2)(a)(iia) could be removed altogether. If an investor does not fall within either the professional or sophisticated investor exclusions, or the wealthy person exemption, then perhaps they should be presumed to need the protection of the Securities Act.

Questions for Submission

11. Is an exclusion for minimum subscription price needed if we have a sophisticated investor exclusion?

12. If yes, what should the minimum subscription price be? And, how would this meet the objectives of the Securities Act?

3.1.5.4 "Any Other Person"

79. Under section 3(2)(a)(iii) of the Securities Act, an offer of securities to any other person who in all the circumstances can properly be regarded as having been selected otherwise than as a member of the public, is not an offer of securities to the public.

80. This exclusion is designed to catch those investors who do not fall within the other exemptions from the Act but who are considered to be able to protect themselves, either by being able to require the issuer to provide them with sufficient information or because of general sophistication in investment matters.

81. The Court of Appeal has provided some guidance on the interpretation of this exclusion.[13] The Court stated that the test is an objective one, and it will be indicative that persons have been selected otherwise than as members of the public "If those selected can objectively be seen to be in a category of persons able to protect

[13] *Lawrence v Registrar of Companies* (2004) 9 NZCLC 263 (CA).

themselves either by being able to require the issuer to provide them with relevant information or because of general sophistication in investment matters".[14]

82. We have received feedback that, despite the guidance provided by the Court of Appeal, this section is rarely used because it is considered so uncertain that it is unworkable.

83. We propose that this section be removed. We consider that the types of investor who do not need the protection of the Securities Act will already be covered by one of the proposed definitions for close associates; professional and sophisticated investors; and offers with a minimum subscription.

Questions for Submission

13. Should the exclusion for "any other person" be removed?

14. If no, which type of investor will it catch that will not already be covered under the proposed definitions for close associates; professional and sophisticated investors; and offers with a minimum subscription?

3.1.6 Section 5

3.1.6.1 Wealthy Investors

84. Under section 5(2CB) of the Securities Act, an offer of securities only made to "eligible" persons are exempt from Part 2 of the Securities Act (other than sections 38B and 58). Under section 5(2CD), a person who is wealthy will qualify as an eligible person (commonly termed "wealthy investors"). Under section 5(2CD), a person is "wealthy" if an independent chartered accountant certifies, no more than six months before the offer is made, that the chartered accountant is satisfied on reasonable grounds that the person either has net assets of at least $2,000,000; or had an annual gross income of at least $200,000 for each of the last two financial years.

85. We seek feedback on whether this exemption should be retained. The policy behind this exemption is the least principled of all the exemptions. This exemption assumes that if an investor is wealthy, then he or she will be able to make an informed investment decision without the aid of the disclosure regime, because he or she will have the ability to seek professional financial advice. Further, in light of the proposed amendments to the section 3 exemptions, a wealthy investor exemption may not be needed.

Question for Submission

15. Should the exemption for wealthy investors be retained? If no, why? If yes, how does this meet the objectives of the Securities Act?

[14] *Lawrence v Registrar of Companies* (2004) 9 NZCLC 263, 480 (CA).

3.1.6.2 Section 5(1)(b)

86. Section 5(1)(b) of the Securities Act exempts from Part II of the Securities Act any estate or interest in land for which a separate certificate of title can be issued under the Land Transfer Act 1952 or the Unit Titles Act 1972, other than any such estate or interest that forms part of a contributory scheme, and does not entitle the holder to a right in respect of a specified part of the land for which a separate certificate of title can be so issued.

87. The policy behind this exemption is that land is good security; it is tangible and, via the land registration system, the investor receives perfect title to the land.

88. We have received feedback that this exemption is being used in circumstances where another security is "tacked onto" the interest in land. For example, an offer of land with a rental guarantee for a specified period. On the face of it, the rental guarantee looks like a debt security, but it is exempted from Part II of the Securities Act because it is part of the offer of land. This creates a situation where products of the same economic effect are regulated differently.

89. We propose to redraft this exemption so that, if there is a security that is "tacked onto" the offer of land, which is not the interest in land itself, it is excluded from this exemption.

Questions for Submission

16. Do you agree that if there is a security that is offered in conjunction with an offer of land, which is not the interest in land itself, it should be excluded from this exemption and subject to Part II of the Securities Act?

17. Is there anything else that should be changed to clarify the scope of this exemption? Do the words in paragraph 5(1)(b)(i) add anything to the provision, or should the exemption simply apply to any estate or interest in land that does not form part of a contributory scheme?

3.1.7 Exemptions to Add

3.1.7.1 Small Offers Exemption

90. New Zealand is a country of small and medium enterprises ("SMEs"). According to research undertaken by MED and Statistics New Zealand in 2004 entitled *Business Finance in New Zealand*, just over 96 percent of all businesses have 19 or fewer employees, and almost 87 percent employ five or less.[15]

91. *Business Finance in New Zealand* suggests that SMEs in New Zealand generally do not have any problems accessing finance, and that the majority of SMEs who want extra funds, will request debt financing from banks and other non-bank financial institutions, and are successful with their requests. Equity is a less preferred form of

[15] *Business Finance in New Zealand*, a copy of this report is available at www.stats.govt.nz/analytical-reports/business-finance-2004.htm.

finance for SMEs. The most common reason for this is that debt financing has so far been sufficient for SMEs. Other, less common, reasons are that a number of SMEs have a poor understanding of equity, the process is too difficult and costly, and the owners typically do not want to lose or dilute control of the business.

92. The research does not, however, break down the results by sector or age of business. So, we do not know whether certain sectors have more problems than others in accessing capital. Nor do we know whether newer businesses have problems in accessing capital, although it is assumed that young businesses can find it more difficult to access capital from traditional sources and are therefore more likely to rely on informal supplies of capital.

93. We want to ensure the Securities Act is user-friendly so that SMEs are able to access capital cost-efficiently. We want to encourage SMEs to seek funds from the public if appropriate, and we want to ensure there are sufficient avenues for SMEs to access capital privately if that is more appropriate. However, any step we take to achieve this must be measured against the policy of the Securities Act: that the Securities Act will regulate offers of securities to those investors who need the protection of regulatory intervention.

94. The Securities Act already goes some way in achieving this via the exclusions from the Securities Act set out in section 3(2), and the wealthy and experienced person exemption. This will be enhanced with the proposed improvements to the current exclusions and exemptions.

95. We have received some feedback that a "small offers" exemption, in terms of number of investors, value of issue and time period, would make it easier for SMEs to raise capital and encourage SMEs to consider such offers as a source of external capital rather than placing such heavy reliance on banks and non-bank financial institutions. A small offers exemption would reduce the costs and administrative burden associated with smaller offers. A small offers exemption would also have the advantage of certainty, through the fixed limits placed on the number of investors, value of issue and time period. An issuer would have no doubt as to whether its offer fell within the exemption.

96. A number of overseas jurisdictions provide various exemptions for small offers in recognition of the needs of SMEs in accessing capital.

97. Both Singapore and Australia exempt "small personal" offers to investors from the prospectus requirements. In Australia, a small offer is one where the offer results in 20 or less investors in any 12 months and is worth Aus$2 million or less in any 12-month period.[16] In Singapore, a small offer is an offer of up to S$5 million (or such other amount as may be prescribed by the Authority) in any 12-month period.[17] Singapore also exempts offers of securities to not more than 50 investors during a 12-month period.[18]

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[16] Section 708(1), Corporations Act 2001.

[17] Section 272A, Securities and Futures Act.

[18] Section 272B, Securities and Futures Act.

98. Both Australia and Singapore require that the small offers be "personal", in that the offer must be directed to persons (and may only be accepted by those persons) who are likely to be interested in the offer given previous contact or relationship with the offeror, or persons who have previously indicated interest in offers of that kind.

99. Singapore goes a step further than Australia by imposing restrictions on the advertising or promotion of the securities and requiring that closely related offers be aggregated when determining whether the prescribed limit has been exceeded.

100. The United Kingdom provides exemptions from the prospectus requirements for offers of securities to 100 or less persons; and for offers of securities where the total consideration for the securities does not exceed 100,000 euros.[19]

101. We do not propose to create a small offers exemption because such an exemption is inconsistent with the policy of the Securities Act. We consider there is a risk that a small offers exemption could be used by fraudulent investment schemes to target the very investors that the Securities Act is trying to protect, the investor whom, because of information asymmetries, needs the protection of the disclosure regime. We note that this risk could be reduced by imposing restrictions similar to those imposed in both Australia and Singapore; however, we are not convinced that these restrictions would provide sufficient protection for public investors.

102. We also consider that SMEs will have sufficient opportunity to access capital privately under the existing and proposed exclusions from the Securities Act, including exemptions (for particular situations) that can be granted by the Securities Commission. If the issuer is unable to raise capital via one of the existing exemptions, the investment should be offered to the public only with the disclosure and other protections that accompany an offer made under the Securities Act. This is particularly relevant to SMEs. New and small businesses are likely to be riskier investments and there may be less publicly available information on these businesses.

Questions for Submission

18. Should we introduce a small offers exemption?

19. Are there any policy considerations that would justify such an exemption?

20. Although it is inconsistent with the policy of the Securities Act, is there sufficient harm in allowing a small offer exemption to justify not doing so?

21. Could sufficient protection be provided to investors by imposing restrictions on:

    - who the offer can be made to?
    - the advertising and promotion of the offer?

[19] Section 86(1), Financial Services and Markets Act 2000.

3.1.7.2 Rated Investment-Grade Debt

103. We have received feedback that there are few opportunities for the public to participate in purchasing investment-grade rated debt and that what debt is available to the public is largely limited to higher-risk debt, such as unrated finance company debt and subordinated corporate debt. We note that there are opportunities for the public to invest in very high-end debt, for example, bank debt securities and Crown debt, but that perhaps there are fewer opportunities to invest in the next tier of debt. We note that prior to 1998 (when local authorities had an exemption from parts of the Securities Act), local authority debt was a predominant source of high-quality debt for the public.

104. We are told that the lack of investment-grade rated debt in the retail market results in a lack of transparency of the risk/return payoff between investment-grade rated debt and low quality debt. It has been maintained that this lack of transparency results in low-quality debt not being priced according to its true level of risk.

105. We have been told that one of the reasons investment-grade debt is predominantly sold to the wholesale market is because of the cost of complying with securities legislation, in particular, the difficulties around listing debt on a stock exchange, and the disclosure regime in the Securities Act. The main compliance costs of the disclosure regime identified were:

a. the cost of preparing the investment statement and prospectus;

b. the scope of the disclosure requirements for debt is too wide. The disclosure regime was initially designed for equity securities and has been adapted to cover debt securities and does not elicit the information most relevant for investors in debt securities;

c. the continuous disclosure regime is off-putting for issuers with quoted debt securities;

d. there is duplication of disclosure requirements for a listed issuer who is subject to the continuous disclosure regime.

106. We are told that if the costs of the disclosure regime in the Securities Act were reduced for investment-grade rated debt, more issuers of investment-grade rated debt may offer to the public, rather than to wholesale. This would increase the range of debt products available to the public and would address the mispricing of low-quality debt.

107. One way of reducing costs would be to provide an exemption for investment-grade rated debt issuers, which substitutes the current investment statement and prospectus with reduced disclosure obligations. The basis of this would be that the ratings report would provide information that is normally produced in the investment statement and prospectus. The reduced obligations would only apply to corporates, state owned enterprises and local authorities issuing debt rated investment-grade from an internationally recognised rating agency, such as Standard and Poor's, Moody's or Fitch.

108. The reduced disclosure requirements would consist of a single offer document, a hybrid of the current investment statement and prospectus, which would not need to

be signed by all directors, though all directors would be liable in relation to it. The offer document would include:

a. the terms of the offer and description of the securities;

b. description of the issuer and guarantors;

c. description of issuer's business and risk factors;

d. description of any financial covenants relating to the securities;

e. description of the circumstances in which repayment of the securities can be accelerated;

f. details of debt ranking;

g. ratings report;

h. the issuer's most recent audited financial statements, and if the securities are guaranteed, the financial statements of the guaranteeing group, including upstream guarantors. Option to allow offer document to refer to where financial statements can be obtained;

i. other matters which the issuer reasonably considers are material to an investor in the relevant debt securities.

109. Under these modified disclosure obligations, there will be no requirement to include prior period financial statements (although the offer document could refer to where these may be obtained), and no requirement to file material contracts. Additionally, the offer document would not have a shelf life, provided it is regularly updated to include the most recent audited financial statements; the most recent ratings report; and details of the debt ranking. These matters would be appended at the back of the offer document so they could be updated without altering the balance of the document.

110. We are not convinced that an exemption for investment-grade rated issuers is necessary or desirable for the following reasons:

a. The issues of compliance costs for investment-grade rated issuers may be adequately dealt with under our proposals to reform the current disclosure regime; a single offer document with disclosure requirements tailored to the type of security offered; an exemption for listed issuers so as to reduce the duplication of disclosure between offer documents and the continuous disclosure regime; and, possibly, an easing in the compliance requirements for local authorities.

b. Reliance on a ratings report to support reduced disclosure obligations creates an issue of accountability. It is true that the market will be provided with information on the issuer via the rating, and that this information may be partially duplicated in the issuer's offer documents. However, it is the rating agency providing this information to market, not the issuer. An important purpose of disclosure is that it provides a mechanism for accountability. If an issuer's disclosure is misleading, that issuer can be held to account for this fact. It is not clear how this accountability could work where the author of the

information is a third party. Who is accountable if the rating is incorrect or the rating agency is too slow to respond to a change in the issuer's position? It is unlikely that the rating agency will take on such responsibility. Would the rating agencies need to be regulated? In contrast, the market may be provided with information on the issuer via the continuous disclosure regime and currently, this information may be partially duplicated in the issuer's offer document. But in that instance, it is the issuer providing the information to the market and it is clear that the issuer is responsible for the information.

c. It is unclear whether the modified disclosure requirements would entice investment grade rated debt issuers to the retail market. There are other reasons issuers choose to offer securities privately. For example, it can be easier to shift large sums of debt quickly.

Question for Submission

22. Should issuers of investment-grade rated debt have reduced disclosure obligations, by virtue of having an investment-grade rating? Why?

3.1.7.3 Local Authorities

Exemption from the Disclosure Regime

111. Until 1996, local authorities were exempted under section 5(3)(b) of the Securities Act from complying with certain requirements under the Securities Act. The basis for the exemption was that local authority borrowing was heavily regulated under the Local Authorities Loans Act 1956 which, in particular, limited to whom local authorities could issue debentures (section 57), and which also provided that a special rate was automatically created as security for the repayment of any loan. In these circumstances the general provisions of the Securities Act were seen as unnecessary and inappropriate.

112. The Local Government Amendment Act (No.3) 1996 significantly reformed the borrowing powers of local authorities. The Local Authorities Loans Act 1956 was repealed and local authorities were generally provided with the same general powers to borrow as companies and other corporate entities, and subject to the same restrictions. The exemption from Securities Act requirements was repealed accordingly.

113. We want to question whether local authorities should again have an exemption from the disclosure regime. We have received feedback that the disclosure regime imposes unnecessary compliance costs on local authorities. We are told that Local Government Act requirements for public financial reporting, prospective annual planning (with a 3-year scope) and prospective long-term financial strategies, make the disclosure requirements in the Securities Act unnecessary and duplicative. If there is sufficient information in the public domain about the local authority, the investor may have less need for the protection of the disclosure regime.

114. We are also told that given that local authorities have the power to rate, grant security over rates and cannot be wound up for financial default, there is low financial risk to the investor. However, we note that while the ability to rate may reduce the

financial risk to investors, it does not provide a guarantee to investors that they will not lose their investments as there is nothing to compel local authorities to rate.

Exemption from the Signature and Liability Provisions

115. We have also received feedback that the requirement for all directors to sign the registered prospectus can create a situation where councillors who are opposed to the issue can have an effective right of veto over the issue by refusing to sign the prospectus. It has been suggested that, if local authorities were to remain subject to the disclosure regime, the signature requirement be replaced with the common seal of the local authority and that liability attach only to those councillors who voted in favour of the issue.

116. Local authorities may be distinguishable from other corporate bodies. They do have the power to rate, but they are also politically elected bodies. Decisions of local authorities are made by majority vote of elected members, and there is no recognised concept of collective responsibility. Councillors may object to particular proposals and have no legal obligation to assist in the implementation of majority decisions.

117. We do not propose to provide local authorities with an exemption from the signature and liability provisions. To only attach liability for the offer documents to those councillors who voted in favour of the issue would undermine the policy objectives of the Securities Act. The policy of the signature and liability provisions is to ensure that directors take collective responsibility for the accuracy of information within an offer document.

118. We do propose that as an alternative, local authorities be exempted from the requirement that all councillors must sign the offer document, but to retain responsibility for that offer document on all councillors. This would avoid the situation where a councillor could effectively veto an issue by refusing to sign the prospectus, but would remain consistent with the policy objectives of the Securities Act.

Questions for Submission

23. Should local authorities have an exemption from the disclosure regime in the Securities Act? Why?

24. If no, should local authorities have an exemption from the requirement for all councillors to sign the offer document, whilst retaining liability on all councillors for the content of the offer document? Why?

3.1.7.4 Listed Securities

119. The disclosure regime in the Securities Act applies when an issuer makes an offer of securities to the public. The purpose of this disclosure regime is to ensure that investors have sufficient information to make informed decisions as to whether to subscribe for the securities on offer.

120. The continuous disclosure regime established in 2002 by amendments to the Securities Markets Act 1988 applies to issuers who have securities listed on a New

Zealand-based stock exchange. The purpose of the continuous disclosure regime is to keep the secondary market informed of materially price-sensitive information (subject to certain exceptions) that is not generally available to the market.

121. There is an overlap of information disclosed under these two regimes. Despite this overlap, there is currently no relief from the Securities Act disclosure regime for a listed issuer who issues new securities, unless an exemption is obtained from the Securities Commission. There are exemptions in place that do provide such relief in recognition of the value of the continuous disclosure regime to inform potential investors in listed companies. For example: the Securities Act (NZX-NZAX Market) Exemption Notice 2005; the Securities Act (Share Purchase Schemes) Exemption Notice 2005; the Securities Act (Employee Share Purchase Schemes) Exemption Notice 2002; the Securities Act (Dividend Reinvestment) Exemption Notice 1998; and the Securities Act (Rights, Options and Convertible Securities) Exemption Notice 2002.

122. The Securities Act (NZX-NZAX Market) Exemption Notice 2005 grants certain exemptions for offers of equity securities made by issuers that have entered into a listing agreement with NZX in respect of its NZAX market. Under the exemption, NZAX issuers only have to produce one offer document, similar to an investment statement, but registered as a prospectus. For subsequent share offers, the issuer must register a new prospectus; however, they are able to raise capital using the prospectus by making an offer announcement to the market, and informing investors that the prospectus is available on the NZAX website as well as on the issuer's website, if it has one.

123. Both Australia and Canada provide concessionary disclosure requirements for further issues of securities by issuers subject to a continuous disclosure regime.

124. In Australia, listed issuers who are subject to the continuous disclosure regime can use a transaction-specific prospectus for further issues of quoted securities. Under the transaction-specific prospectus, the issuer must detail the security being offered and the impact of the offer on the issuer; include material price-sensitive information that had not previously been disclosed as a result of any of the exceptions to the continuous disclosure regime; and refer to the information that has already been disclosed by the issuer under the continuous disclosure provisions since the most recently lodged annual financial report.[20]

125. In Canada, listed issuers are allowed to use a short form prospectus, which incorporates by reference the information contained in their continuous disclosure documents. The issuer is required to: be a SEDAR filer (System for Electronic Document Analysis and Retrieval), to ensure broad accessibility to an issuer's continuous disclosure information; have filed all continuous disclosure documents; and have a current annual information form and current annual financial statements.

126. British Columbia has gone one step further than the rest of Canada. It has introduced a continuous market access system, which has eliminated the need for a

[20] The Corporations Act also contains a provision that allows ASIC to deny a disclosing entity access to these arrangements if the entity has contravened the prospectus or continuous disclosure or periodic reporting provisions in the previous 12-month period.

prospectus at all for subsequent offerings. In British Columbia, the issuer must file a prospectus for its first offering to the public, and comply with the continuous disclosure regime. But the issuer can raise subsequent capital simply by issuing a news release that sets out the material information about the securities being offered. The intent is to put investors on the same footing, whether they buy securities from the issuer or in the secondary market.

127. We propose to allow listed issuers who have been subject to the continuous disclosure for a specified period and who want to issue new securities of a class already listed, to use a transaction-specific offer document, which is to be registered with the Registrar. We seek feedback on whether issuers should be able to use a transaction-specific offer document for debt offers, if they have either listed equity or listed debt securities.

128. Similar to the NZAX exemption, the listed issuer may choose to raise capital using this document by making an offer announcement to the market; and informing investors that the offer document is available on the Companies Office website, the NZX website and also on the issuer's website, if it has one. However, the issuer must provide a printed offer document free of charge to any person who asks for one.

129. In the transaction-specific offer document, the issuer would be required to disclose the following information:

a. any information material to the securities being offered that had not previously been disclosed, including as a result of any of the exceptions to the continuous disclosure regime;

b. reference to the information that has already been disclosed by the issuer under the continuous disclosure provisions since the latest registered statement of financial position, and where that information can be obtained; and

c. a statement by the directors of the issuer as to whether, after due enquiry by them in relation to the period since the date of the latest registered statement of financial position, there have, in their opinion, arisen any circumstances that materially adversely affect: the trading or profitability of the issuing/borrowing group; the value of its assets; or the ability of the issuing/borrowing group to pay its liabilities due within the next 12 months.

130. The transaction-specific offer document would need to be registered with the Registrar, so that there is a degree of vetting of the offer document and to ensure there is a permanent public register of securities offerings.

131. The Securities Commission would have the power to deny an issuer from using the transaction-specific offer document if the issuer has contravened either the Securities Act or the continuous disclosure regime.

132. This proposal will provide listed issuers with significant cost savings while still ensuring that investors have access to sufficient information about the offer of securities. The transaction-specific offer document will avoid duplication between the information a listed issuer must disclose under the Securities Act, and the information the listed issuer has already disclosed to the market via the continuous disclosure regime. This will benefit issuers by removing the cost of preparing, printing and distributing duplicative information.

133. This proposal will not compromise the legislative intent of investor protection. It acknowledges that substantial information on the listed issuer will already be in the market through the continuous disclosure regime and, based on previous disclosures the issuer has made to the market about its activities, the market's view will already be reflected in the price of the securities. The requirement on directors to sign the offer document and the registration process will also provide protection for investors.

134. We note that an issue has been raised regarding the potential overlap between enforcement of the Securities Act disclosure regime and the continuous disclosure regime. We recognise that this issue will also apply to this proposed exemption; however, we do intend to ensure that this exemption is clear as to what falls within the scope of offer disclosure and what falls within the scope of continuous disclosure.

Questions for Submission

25. Should issuers who are subject to the continuous disclosure regime and who want to issue new securities of a class already listed, be able to use a transaction-specific offer document? If no, why?

26. Should issuers who are subject to the continuous disclosure regime and have either listed equity or listed debt securities, be able to use a transaction-specific offer document if it wants to issue new debt securities? If no, why?

27. Should the transaction-specific offer document contain the following:

- any information material to the securities being offered that had not previously been disclosed, including as a result of any of the exceptions to the continuous disclosure regime; and

- reference to the information that has already been disclosed by the issuer under the continuous disclosure provisions since the latest registered statement of financial position, and where that information can be obtained;

- a statement by the directors of the issuer as to whether, after due enquiry by them in relation to the period since the date of the latest registered statement of financial position, there have, in their opinion, arisen any circumstances that materially adversely affect: the trading or profitability of the issuing/borrowing group; the value of its assets; or the ability of the issuing/borrowing group to pay its liabilities due within the next 12 months?

28. If no, what disclosures should the listed issuer make in the transaction-specific offer document?

29. For what time period should a listed issuer have been subject to the continuous disclosure regime before it can use the transaction-specific offer document?

30. Should the transaction-specific offer document be registered with the Registrar?

31. Should the listed issuer have to provide a copy of the registered transaction-specific offer document to any person who requests it?

32. Should the listed issuer be able to raise further capital with the transaction-specific offer document by making an offer announcement to the market and informing investors that the transaction-specific offer document is available on the NZX website, the Companies Office website and the issuer's website (if it has one)?

33. Should the Securities Commission have the power to deny a listed issuer from using the transaction-specific offer document if it has breached any provisions of the Securities Act or the continuous disclosure regime?

3.1.8 Exemptions to Review

3.1.8.1 Contributory Mortgages

135. By virtue of section 5(4) of the Securities Act, an offer to the public of an interest in a contributory mortgage does not need to be made in accordance with sections 33(3), 37, 37A, 38C to 38F, 39 to 44, and 45 to 53 of the Securities Act. Instead, contributory mortgage brokers are required to comply with the Securities Act (Contributory Mortgage) Regulations 1988 ("Contributory Mortgage Regulations").

136. The Contributory Mortgage Regulations require a significantly lower reporting standard than debt and participatory securities. Unlike an issuer of debt or participatory securities, a contributory mortgage broker is not required to register offer documentation with the Registrar before the offer is made. The Contributory Mortgage Regulations do not impose any prudential supervision on contributory mortgage brokers. Unlike an issuer of debt or participatory securities, a contributory mortgage broker is not required to appoint a trustee or statutory supervisor and register a trust deed or a deed of participation with the Registrar.

137. Contributory mortgages were traditionally offered by lawyers. The policy behind the exemption was that gaining an interest in land is good security. Contributory mortgages were subsequently offered by persons other than lawyers and used to raise funds greater than the value of the land for the purposes of funding development, eroding the value of land as good security.

138. The level of compliance with, and understanding of, the contributory mortgage regulations by contributory mortgage brokers (not including lawyers offering contributory mortgages) is low. Since 2000, the Securities Commission and the Registrar have carried out a number of inspections of contributory mortgage schemes. These inspections found a number of breaches of the Contributory Mortgage Regulations by contributory mortgage brokers. Many of the matters were resolved successfully through correspondence with the broker concerned and did not warrant formal enforcement action. However, in other cases, the Registrar considered that formal criminal enforcement action against contributory mortgage brokers was necessary. The Securities Commission has been required to act on several occasions either to prohibit offer documents of contributory mortgage brokers or in some cases to ban companies from continuing to act as contributory mortgage brokers.

139. The following are examples of the types of breaches found:

a. False and/or misleading valuations. Details of valuations are key information that potential investors rely on before investing in a contributory mortgage.

b. Failure to provide prescribed information for investors as set out in the Schedules to the Contributory Mortgage Regulations.

c. Failure to maintain adequate accounting records, in particular, to have an acceptable trust account system in place.

d. Failure to prepare and register financial statements.

e. Failure to inform contributors and take timely or appropriate actions in relation to defaults by borrowers.

f. Serious breaches of the specific provisions in the Contributory Mortgage Regulations about managing development mortgages, which have placed investors' funds at risk. The contributions are paid to the developer either:

    i. before the full amount of the mortgage had been raised;

    ii. when insufficient funds had been raised to complete the project; and

    iii. when the broker knew or ought to have known the valuation report was false or misleading.

140. We propose to remove the exemption for contributory mortgages, so that contributory mortgages are brought back within the disclosure regime for debt securities under the Securities Act. Given the number of inspections carried out and brokers prohibited by the Securities Commission and the number of cases taken by the National Enforcement Unit, it is clear that contributory mortgages pose a significant risk to the public.

141. If the exemption for contributory mortgages is removed, this will impact on solicitors who offer contributory mortgages. Solicitors have an exemption from the Contributory Mortgage Regulations. The Securities Act (Contributory Mortgage) Regulations (Solicitors) Exemption Notice 1996 exempts solicitors from compliance with the Contributory Mortgage Regulations subject to the condition that there are in force (and in a form approved by the Securities Commission) rules made by the Council of the New Zealand Law Society regulating the keeping of trust accounts by solicitors and regulating the formation, operation, management, and liquidation of solicitors' nominee companies.

142. We seek feedback on whether solicitors should continue to have an exemption from the disclosure regime. Solicitors have an exemption from the Contributory Mortgage Regulations because it is considered that the New Zealand Law Society conduct rules provide sufficient protection for the investor. Further protection is provided with the review of this exemption by the Securities Commission every five years.

143. An alternative proposal is to only remove the exemption for contributory mortgages which are used to fund development. As noted above, the policy behind the exemption for contributory mortgages is that gaining an interest in land is good security. The value of this security is eroded and accordingly the risk to investors is

higher in the case of development mortgages, where the funds raised can be significantly greater than the value of the land. If only the exemption for development mortgages were removed, solicitors could continue to have an exemption from the Contributory Mortgage Regulations.

Questions for Submission

34. Should the exemption for all contributory mortgages be removed?

35. Alternatively, should only the exemption for contributory mortgages used for development purposes be removed?

36. If the exemption for all contributory mortgages should be removed, should solicitors who offer contributory mortgages continue to have an exemption from the disclosure regime?

3.1.9 Previously Allotted Securities

144. We have received feedback questioning whether the definition of "issuer" in section 6(7) of the Securities Act should extend to the content of disclosure (so as to include both the original allotter of the securities and the offeror of the securities). The Schedules to the Securities Regulations 1983 ("Securities Regulations") relate primarily to the disclosure of information about the original allotter of the securities. However, the effect of section 6(7) is that an offeror must make disclosures in the offer documents about both itself and the original allotter. Many of the disclosure requirements for the offeror will not be relevant for the investor, for example, the financial statements of the offeror. Further, the offeror must sign off on information about the original allotter, even though the offeror may not be privy to such information and vice-versa.

145. To ensure that appropriate responsibilities are placed on both the original allotter and the offeror, and to ensure that investors receive relevant information and appropriate protections, we propose that the Securities Regulations should state clearly whether they apply to the offeror, the original allotter, or both.

Questions for Submission

37. Should section 6(7) of the Securities Act extend to the content of the disclosure documents?

3.1.10 Definitions

3.1.10.1 Definitions of Types of Security

146. The term "equity security" is defined in section 2 of the Securities Act as:

> *any interest in or right to a share in, or in the share capital of, a company; and includes—*

(a) A preference share, and company stock; and

(b) A security that is declared by regulations to be an equity security for the purposes of this Act; and

(c) A renewal or variation of the terms or conditions of any such interest or right or a security referred to in paragraph (a) or paragraph (b) of this definition;—

but does not include any such interest or right or a security referred to in paragraph (a) or paragraph (c) of this definition that is declared by regulations not to be an equity security for the purposes of this Act.

147. The term “debt security” is defined in section 2 of the Securities Act as:

any interest in or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing by, any person (whether or not the interest or right is secured by a charge over any property); and includes—

(a) A debenture, debenture stock, bond, note, certificate of deposit, and convertible note; and

(b) An interest or right that is declared by regulations to be a debt security for the purposes of this Act; and

(c) A renewal or variation of the terms or conditions of any such interest or right or of a security referred to in paragraph (a) or paragraph (b) of this definition;—

but does not include—

(d) An interest in a contributory mortgage where the interest is offered by a contributory mortgage broker; or

(e) Any such interest or right or a security referred to in paragraph (a) or paragraph (c) of this definition that is declared by regulations not to be a debt security for the purposes of this Act.

148. Since the Securities Act came into force in 1978 and the Securities Regulations in 1983, the types of financial products available for investment have expanded in nature. We consider it timely to review whether the definitions of debt and equity securities are still adequate and appropriate. We note that the *Collective Investment Schemes* discussion document proposes a definition for “collective investment scheme”. This is discussed in section 3.3 of that discussion document.

149. There has been some criticism that the current definitions of the different types of security do not adequately accommodate some products, such as hybrid products and derivatives. However, we note that this criticism will be addressed by giving the Securities Commission the power to declare a product to be a particular type of security. This proposal is discussed in section 4.2.4 of the *Supervision of Issuers* discussion document.

3.1.10.2 Definition of "Derivative"

150. Securities regulation currently makes a distinction between securities, regulated under the Securities Act, and futures contracts, regulated under the Securities Markets Act 1988 ("Securities Markets Act"). Derivatives are not recognised as a distinct category and are regulated differently depending on whether they are classified as a security or a futures contract.

151. Section 2D of the Securities Act defines "security" as:

> *In this Act, unless the context otherwise requires, the term security means any interest or right to participate in any capital, assets, earnings, royalties, or other property of any person; and includes—*
>
> *(a) An equity security; and*
>
> *(b) A debt security; and*
>
> *(c) A unit in a unit trust; and*
>
> *(d) An interest in a superannuation scheme; and*
>
> *(e) A life insurance policy; and*
>
> *(f) Any interest or right that is declared by regulations to be a security for the purposes of this Act; and*
>
> *(g) Any renewal or variation of the terms or conditions of any such interest or right;—*
>
> *but does not include any such interest or right (other than a security referred to in paragraph (f) of this subsection) that is declared by regulations not to be a security for the purposes of this Act.*
>
> *(2) Where the terms of a security require or allow the subscriber to pay separate amounts of money at different times, each such payment shall, for the purposes of this Act, be treated as payment for the same security as each other payment.*

152. Section 37 of the Securities Markets Act defines a futures contract as:

> *(a) An agreement under which one party agrees to deliver to another party at a specified future time a specified commodity or a quantity of a specified commodity at a price which is fixed when the agreement is made but under which it is contemplated or understood that the obligations of the parties may be satisfied by means other than actual delivery:*
>
> *(b) An agreement under which each party has either—*
>
> *(i) An obligation to pay a sum of money to the other or to credit the account of the other with payment of a sum of money; or*
>
> *(ii) A right to receive payment, or a credit, of a sum of money from the other—*

depending on whether at a future date the value or price of a specified commodity calculated in a manner specified by, or in accordance with, the agreement is greater or less than the value or price agreed upon by the parties when the agreement was made:

(c) An agreement under which each party has either—

(i) An obligation to pay a sum of money to the other or to credit the account of the other with payment of a sum of money; or

(ii) A right to receive payment, or a credit, of a sum of money from the other—

depending on whether at a future date the value or level of a specified index calculated in a manner specified by, or in accordance with, the agreement is greater or less than the value or level agreed upon by the parties when the agreement was made:

(d) An option or right to assume, at a specified price or value, or within a specified period, or by a specified date, rights and obligations under an agreement of a kind described in a preceding paragraph:

(e) An agreement, option or right which is declared by the Commission, in accordance with this section, to be an agreement, option or right to which this Part of this Act applies:

(f) An agreement, option or right which is of a class of agreements, options or rights declared by the Commission, in accordance with this section, to be a class to which this Part of this Act applies.

153. We have received feedback that the distinction between securities and futures is challenged by innovative derivative products which exhibit characteristics of both securities and futures contracts.

154. This creates two problems. First, it can be unclear to the issuer which regulatory framework applies. This is a problem because the penalty for breach of either the Securities Act or the Securities Markets Act is severe. To some extent this problem can be dealt with by the Securities Commission's power to declare a product or instrument to be a futures contract.[21] However the Commission's power of declaration to clarify the scope of the definition of futures contracts is limited in that it does not extend to declaring that a product or instrument is not a futures contract.

155. Second, because derivatives are synthetic products that derive their value from the value of an underlying commodity or instrument, the disclosure and other regulatory requirements that are suitable for these products are often different from those for more conventional securities. The vendor of a derivative product may not be the issuer of the underlying commodity or instrument. It is therefore difficult to fit derivatives into a framework of issuer disclosure. So far, the Commission has addressed this, in respect of various types of products, either by a tailored exemption

[21] Section 37(7), Securities Markets Act 1998.

under the Securities Act or by authorisation of the issuer under the Securities Markets Act, subject to terms and conditions.[22]

156. We note that we have proposed to give the Securities Commission the power to declare a product to be a security or a derivative. This proposal is discussed at section 4.2.4 of the *Supervision of Issuers* discussion document.

157. However, we recognise that there needs to be a clear regulatory framework for derivative products. We invite your comments on how to define a derivative and provide a suggestion that a derivative be defined as a financial product that provides either second level or synthetic exposure to the property, rights, capital, or earnings underlying a security, or to any commodity.

Questions for Submission

38. Is the current definition for equity appropriate? If no, how could it be improved?

39. Is the current definition for debt appropriate? If no, how could it be improved? Is there a need for a clearer generic definition, in addition to the indicative list of specific debt security instruments?

40. Where should the line fall between a security and a derivative? For example, should a derivative be defined as a financial product that provides either second level or synthetic exposure to the property, rights, capital, or earnings underlying a security, or to any commodity?

3.1.10.3 Definition of "Promoter"

158. Under section 2 of the Securities Act, "promoter", in relation to securities offered to the public for subscription:

(a) Means a person who is instrumental in the formulation of a plan or programme pursuant to which the securities are offered to the public; and

(b) Where a body corporate is a promoter, includes every person who is a director thereof; but

(c) Does not include a director or officer of the issuer of the securities or a person acting solely in his or her professional capacity.

159. We have received some feedback that there is concern that the definition of "promoter" is too wide in that it captures parent companies that are not actively promoting the scheme. We have been advised by some stakeholders that because of the liability attaching to promoters, this discourages offshore issuers from issuing in New Zealand. Under section 56 of the Securities Act, a promoter is civilly liable (subject to defences) for misstatements in the prospectus and advertisements. Under section 59 of the Securities Act, a promoter is criminally liable (subject to

[22] Securities Commission, Discussion document, 21 April 2006, *Proposal to declare certain foreign exchange contracts to be futures contracts under the Securities Markets Act 1988*, p5.

defences) for offering, distributing or allotting securities in contravention of the Securities Act.

160. We seek feedback on whether the definition of "promoter" and the liabilities attaching to promoters are appropriate.

Questions for Submission

41. Are there any problems with definition of "promoter"?

42. If yes, how might these problems be addressed?

43. Are promoters subject to the appropriate liabilities? If no, what liabilities should promoters be subject to?

3.1.10.4 Definition of "Issuer"

161. Under section 2 of the Securities Act, "issuer" means:

(a) In relation to an equity security or a debt security, or to an advertisement, investment statement, prospectus, or registered prospectus that relates to an equity security or a debt security, or to a trust deed that relates to a debt security, the person on whose behalf any money paid in consideration of the allotment of the security is received;

(b) In relation to a participatory security, or to an advertisement, investment statement, prospectus, or registered prospectus, or to a deed of participation that relates to a participatory security, the manager;

(c) In relation to an interest in a contributory mortgage offered by a contributory mortgage broker, or to an advertisement that relates to such an interest, the contributory mortgage broker;

(d) In relation to a unit in a unit trust, or to an advertisement, investment statement, prospectus, or registered prospectus that relates to such a unit, the manager;

(e) In relation to a life insurance policy, or to an advertisement, investment statement, prospectus, or registered prospectus that relates to a life insurance policy, the life insurance company that is liable under the policy;

(f) In relation to an interest in a superannuation scheme, or to an advertisement, investment statement, prospectus, or registered prospectus that relates to such an interest, the superannuation trustee of the scheme.

162. We are not aware of any problems with the definition of "issuer" in the Securities Act. However, we seek feedback on whether the definitions of "issuer" in respect of each type of security are still appropriate. For example, should "issuer" as it applies to debt securities, include the recipient of conduit funding, as is now intended under the Financial Reporting Act 1993? And, should "issuer" as it applies to debt securities issued by unit trusts, be the trustee (as is currently the case) or the manager? Who is the issuer of a derivative product?

Questions for Submission

44. Are there any problems with the current definitions of "issuer" in respect of each type of security?

45. If yes, how could these problems be addressed?

3.2 ENTRY REQUIREMENTS

3.2.1 Introduction

163. The following discussion relates to the entry requirements for equity and debt issuers. The entry requirements for issuers of collective investment schemes are discussed in section 3.5 the *Collective Investment Schemes* discussion document.

164. The *Non-Bank Deposit Takers* discussion document is proposing to create two tiers of deposit-taking institutions (DTFI) that issue debt securities to the public: Authorised DTFIs, Tier 1, which would be supervised by a single supervisory authority; and Tier 2 DTFIs, which would continue to be supervised by trustees. A distinction is made in the discussion below between Tier 2 DTFIs and corporate debt issuers for the purposes of identifying what entry requirements these two different types of debt issuers should have. The entry requirements for Tier 2 DTFIs are discussed in section 7.2 of the *Non-Bank Deposit Takers* discussion document.

3.2.2 Registration

165. Currently, there is no comprehensive way of identifying or monitoring providers of financial services. A comprehensive database of financial services providers would contribute to the main objective of the RFPP – that is, to promote a sound and efficient financial system. It would achieve this through promoting well-informed investors/consumers, reducing the risk of fraudulent conduct and enabling the appropriate authorities to ensure providers are meeting the relevant regulatory requirements. It would also facilitate the collection of data on the financial sector for monitoring purposes.

166. An additional factor is New Zealand's obligation to comply with the FATF on Money Laundering Recommendations. A number of these recommendations relate to the regulatory and supervisory arrangements for the financial sector. Recommendation 23 of the FATF Recommendations requires that directors and senior management of financial institutions subject to the Core Principles (the banking, insurance and securities sectors) should be evaluated on the basis of "fit and proper" criteria, including those relating to expertise and integrity.

167. In order to comply with the FATF Recommendations, New Zealand is required to have a comprehensive supervisory framework for financial institutions. To have such a framework we need to be able to identify the financial institutions. Currently some financial institutions do not have to be registered or may have to register prospectuses only.

168. In the discussion document relating to registration of financial institutions, it is being proposed that the Companies Office would receive registration information

from financial services providers, carry out negative assurance checks and liaise with the relevant regulator who would carry out a qualitative "fit and proper" assessment where required. For issuers of equity or corporate debt securities, we propose that it is sufficient that these issuers meet the negative assurance requirements for registration as a financial institution. In practice, this will occur when the issuer registers its offer document, therefore imposing minimal cost on the issuer.

169. Tier 2 DTFIs would be subject to a qualitative “fit and proper” assessment by the trustee supervising the Tier 2 DTFI and the Securities Commission. This proposal is discussed further in section 7.2 of the *Non-Bank Deposit Takers* discussion document.

170. The Companies Office would maintain an up-to-date public register of information including names of directors, senior management and major shareholders, with documents such as prospectuses, disclosure statements, and financial statements. The register would also indicate the categories of financial services provided by the entity. The Companies Office would have enforcement responsibility for taking action against financial services providers who provide services without being registered.

4. Disclosure

4.1 AIMS OF DISCLOSURE REGIME

171. We are seeking a disclosure regime that:

a. provides full, accurate and timely disclosure by issuers of information material to investors' decision, so that investors can make informed decisions on the potential risks and rewards, and their rights and obligations of their investments and to take responsibility for their investment decisions;

b. delivers information to investors in a manner that investors can readily understand (using an accessible, concise format and clear plain language) and that encourages investors to read and consider disclosure documents' contents;

c. enables investors to easily compare material information of similar investment products;

d. holds those disclosing information to investors accountable for the accuracy of the information disclosed; and

e. ensures clear requirements are placed on issuers and does not impose unnecessary compliance costs on issuers.

4.2 OFFER DOCUMENT DISCLOSURE

4.2.1 Current Regulation

172. New Zealand has a two-document disclosure regime that issuers must comply with when offering securities to the public. Unless an exemption applies, the issuer must prepare both an investment statement and a prospectus, although only the investment statement must be provided as a matter of course to each investor. The issuer must register the prospectus and make it available to each investor on request.

173. The investment statement is aimed at the prudent but non-expert investor. The purpose of the investment statement is to provide a short form summary of the key information that a prudent but non-expert investor needs when making a decision on whether to invest in a securities offering, and to make investors aware that further information is available in other documents.

174. The Securities Regulations (in particular Schedule 3D to the Securities Regulations) prescribe in detail the matters that must appear in an investment statement.

175. The prospectus is intended to be a more detailed document, directed more at describing the underlying financial status of the issuer. The Securities Regulations prescribe in detail the matters that must appear in a prospectus.

4.2.2 Problems Identified with Current Regulation

176. The general feedback we have received is that the two-document disclosure regime does not achieve the objectives of securities regulation. The investment statement and prospectus have been targeted at all investors (retail investors and intermediaries and institutional investors) but has failed to cater for any one audience adequately. In particular, the two-document disclosure regime:

    a. does not provide investors with the information they need to make an informed choice about which product or issuer best suits their needs and risk levels and, in particular, does not enable investors to understand the risks of a particular product or issuer; and

    b. imposes unnecessary compliance costs on issuers.

177. The feedback that we have received is that this may be because:

    a. both the investment statement and the prospectus are not needed for all types of securities;

    b. the content prescription for the prospectus and investment statement does not cater for the full range of products and issuers;

    c. there is significant overlap between the content of prospectuses and investment statements;

    d. some investors may not read or understand the disclosure documents; and

    e. disclosure documents may not be appropriately targeted for the particular product, or their audience - be it either retail or institutional.

178. Further feedback confirmed that the requirement to produce both an investment statement and prospectus is a significant compliance cost for issuers.

4.2.2.1 Two Offer Documents are not needed for all Securities

179. Feedback received to date has raised the question of whether both an investment statement and prospectus are needed for all types of securities.

180. The content prescription for investment statements was originally designed with CIS in mind, and extended to equity and debt. Likewise, the content prescription for prospectuses was originally designed with equity in mind, and extended to debt and CIS. There is some doubt as to whether this “one size fits all” approach to disclosure provides the best information for investors on each type of security. In particular the following comments were made in relation to particular products.

    a. **CIS and superannuation** - The uniform two-document disclosure regime has not worked for CIS and superannuation products and both an investment statement and prospectus are not needed as very few, if any, CIS and superannuation investors will request a copy of the prospectus. Stakeholders have also questioned whether either document reaches its intended audience. The Superannuation Advisory Group suggested that the previous regime of the members’ booklet for superannuation schemes was more relevant and useful

from an investors' perspective and the investment statement is too complex and lengthy for the average investor.

b. **Equity -** Equity investors generally need to go beyond the investment statement and read both the investment statement and the prospectus to get the information they need. An offer of equity securities is an invitation to the investor to participate as a co-owner of the issuer. An equity investor will be less interested in comparing different types of securities and more focused on finding out more information about the issuer. We are told this is one reason why issuers of equity securities tend to produce a combined investment statement and prospectus.

c. **Debt -** Debt investors will also generally need to go beyond the investment statement to the prospectus. For a debt security, which is a promise to repay funds, the key information for any investor is the ability of the issuer to repay the funds at maturity. This cannot be ascertained in the absence of financial information about the issuer, which is found in the prospectus rather than the investment statement. We are told this is one reason why corporate debt issuers tend to produce a combined investment statement and prospectus. However, we understand that the typical investor in some types of debt products, particularly those issued by finance companies, is less sophisticated and more likely to read an investment statement than a prospectus.

4.2.2.2 Disclosure Requirements not Appropriately Targeted – Prescriptive Schedules are Outdated or Irrelevant for Some Products and Issuers

181. We have received feedback that the prescriptive disclosure requirements in the prospectus do not cater for the full range of products and issuers. It has been suggested that: either, the prescriptive content requirements need to be updated so that they are more appropriately targeted; or, that principle-based disclosure should be considered.

182. This is particularly the case for debt securities. There is a wide range of savings and investment products that fall within the definition of a debt security, and a wide range of debt issuers, all with varying risk profiles. The current disclosure requirements prescribed in the Second Schedule to the Securities Regulations may not be sufficient to bring out the risks specific to these different debt products and issuers.

183. This has been identified as a particular problem with debt securities offered by finance companies. The Securities Commission identified a number of problems with the disclosure made by finance companies and has published guidance on the Commission's expectations for finance company disclosure under the current law.[23] However, a question still remains as to whether the current prescriptive disclosure requirements are flexible enough to bring out the risks specific to finance companies.

184. In respect of CIS and superannuation, there has been some criticism that the current prescriptive regulations on disclosure are inflexible and do not provide investors with the information they need to make informed choices about:

[23] Securities Commission, *Report on Disclosure by Finance Companies*, 22 April 2005.

a. whether the investor should invest in a CIS (that is, it is difficult for investors to assess the level of risk exposure); or

b. which type of CIS (for example: unit trust or GIF or superannuation scheme) or which product (for example: choosing between several unit trusts offered by different issuers), or which issuer best suit the investor's needs and risk levels.

185. At the same time, it has also been suggested for all products (CIS, superannuation, debt and equity) that there is some ambiguity around the interpretation of the content requirements of the investment statement. That is, how the questions should be answered and what information and level of detail is required.

186. Some stakeholders have questioned whether the disclosure requirements schedules should remain prescriptive, or should be principle-based. The advantage of a principle-based disclosure requirement is that it provides flexibility – by focusing the attention of issuers on the outcome to be achieved, a principled approach would be applicable to a wide range of circumstances and financial products, and would be responsive to changes in investors' needs, market expectations and innovation in market practices and products. The disadvantage of a principle-based disclosure requirement without the guidance of prescription is that it increases the cost of preparing an offer document. The cost increases because of the uncertainty for issuers as to what constitutes compliance with the principle. The uncertainty may lead to greater legal input, which will have a greater impact on small issuers who have fewer resources for legal advice. The uncertainty may also lead to issuers erring on the side of caution and disclosing more information than is necessary, resulting in an investment statement that is too long and complex for investors, and too expensive to produce for issuers. This is discussed further as it applies specifically to the debt and equity and CIS and superannuation offer documents under sections 4.3.1.2 and 4.3.2.3 respectively below.

4.2.2.3 Investors May not Read Disclosure Documents

187. While some investors do read disclosure documents,[24] feedback from the Advisory Groups is that many investors are not reading disclosure documents, which may be for a variety of reasons.

a. The retail investor is likely to obtain information from a variety of other sources, e.g., friends and family, employer, bank manager, financial advisors, media, and product issuer advertising and marketing documents. The media and financial intermediaries should (generally) be able to read these disclosure documents in order to properly advise their clients. In this case the disclosure documents are still useful as they are in effect interpreted by others and the relevant information passed on to the investor.

b. Some retail investors do not use or understand the investment statement. This may be because the investment statement is a complex document; and the level of financial literacy of some retail investors is low. This is evidenced by

[24] See Appendix One, which details results of the Securities Commission 1999 survey *Investors' Opinions of Managed Funds' Investment Statements*.

the recent *ANZ - Retirement Commission Financial Knowledge Survey* (conducted in conjunction with MED), which researched the financial knowledge of New Zealanders.[25] This survey and other consumer research are discussed further in Appendix One. It is acknowledged that New Zealanders' financial literacy levels are to be addressed as part of a wider financial literacy education campaign and this should, over the longer term, assist with investors' understanding of offer documents. However, it is noted that the survey results did show that an above-average percentage of investors and potential investors said they obtained written information in advance and of those who obtained an investment statement, 87 percent regarded it as useful or quite useful, and 46-76 percent regarded the investment statement as very useful.

c. Both the investment statement and the prospectus are too long and complex for investors. This may be because issuers are placed in a position where they have to tread a line between providing succinct and key information to the investor whilst ensuring that there are no material omissions and no misleading statements made. As a result, a number of issuers seek extensive legal input into preparing the investment statement and disclose all possible risks, irrespective of materiality. This makes it difficult for investors to assess the true level of risk exposure that an investment in a particular product has. This can be addressed through the review of the disclosure requirements.

4.2.2.4 Cost of Compliance for Issuers

188. The requirement to produce both an investment statement and prospectus is a significant compliance cost for issuers. There are, however, some necessary costs of compliance and some unnecessary costs, while some costs might be avoided without reducing the benefit to investors.

Necessary Costs

189. There is a significant cost to issuers in producing offer documents as it requires a level of detail and information that requires legal review, auditors' sign-off and approval by the trustees and/or directors. Further, the prospectus is required to be updated annually by issuers, which incurs additional costs in seeking legal, auditors', trustees' and directors' sign-off on an annual basis. Such costs are unavoidable and necessary in ensuring issuers' accountability for the accuracy of the information.

Unnecessary Costs

190. There is a large amount of time and cost involved in producing offer documents and maintaining consistency between the two offer documents. These costs cannot be justified if both documents are not needed for all securities and it was generally agreed in consultation that the two documents (the investment statement and prospectus) provide repetitive information. We are told that this repetition is one reason why some issuers will combine the investment statement and prospectus.

191. Further, it is noted that some information is irrelevant and not targeted to the product. If the documents do not provide relevant information for investors in a

[25] A copy of the *ANZ - Retirement Commission Financial Knowledge Survey* can be found at www.retirement.org.nz.

manner that they can read and understand then it is hard to justify the compliance costs. This can be fixed by better targeting more appropriate prescription of the offer document to the product.

192. There is some ambiguity around the definition of what is considered a material change to information the issuer is required to include in the investment statement or prospectus and therefore issuers will take an overly cautious approach to ensure compliance and, as a result, incur significant costs in re-issuing investment statements and prospectuses in light of any changes. Again, this may be fixed by greater and more appropriate prescription.

4.2.3 Proposed Offer Document

193. We propose to:

a. remove the two-document disclosure regime and introduce one offer document for all types of securities;

b. include educational information either within, or as a supplement to, the offer document; and

c. require issuers to make available on their websites other registered disclosure documents, for example, the trust deed, material contracts (as applicable) and financial statements.

194. The purpose of this proposal is to create an offer document that delivers material information in a manner that is user-friendly for the investor; is targeted to the particular product, and which removes any unnecessary compliance costs for the issuer.

195. In formulating a new disclosure framework, we appreciate that the practical reality of what investors will read must be taken into account. We intend to conduct consumer testing when the new disclosure framework is more fully developed, so we can ensure that the offer document is targeted appropriately and meets the information needs of consumers. We are also interested in receiving consumer feedback on what information consumers consider is an absolute prerequisite, what is fairly important, what would be "nice to have" and what is not necessary.

4.2.3.1 One Offer Document for all Securities

196. It is proposed that the offer document will be made up of two parts. Part A will summarise the key features that an investor must know before making a decision on whether to subscribe for the securities offered. Part A is intended as an overview of the offer of securities and as an introduction into Part B, the body of the offer document. Part B will provide fuller disclosure on the offer and the issuer.

197. The offer document will be signed by the directors and promoters of the issuer and be registered with the Companies Office. Issuers will provide the offer document to the investor before the investor subscribes for the securities on offer.

198. In addition, issuers will be required to address information requirements in both parts of the offer document in plain English and in a readable and concise manner. This is in line with IOSCO principles.

Part A: Key Features Summary

199. Part A is intended to be a short and concise summary of the key features of the offer. To achieve this, we propose that:

a. Part A will be highly prescriptive. Like the current investment statement, Part A will be based on answering the types of questions an investor should ask before investing in the securities offered. The questions will be followed by prescriptive content requirements, which will draw out the key features of the offer. Both the questions and the prescription underneath the questions may differ for equity, debt, CIS and superannuation to cater for the inherent differences in the nature of these securities. This is discussed further in section 4.3.1.1 regarding debt and equity securities, and in section 4.3.2.2 regarding CIS and superannuation below.

b. Part A should only cover paramount disclosure items. The paramount items may be different for different securities and this is discussed further below separately for both debt and equity securities and CIS and superannuation.

c. In Part B of the offer document, the issuer will be allowed to expand on the answers it provided in Part A of the offer document. The issuer must cross-reference the investor to the appropriate section in Part B where the more detailed or further information on the key features can be found (particularly for information that cannot easily be stated in a couple of paragraphs, for example, tax), and to any additional information that the issuer is required to make available (for example, the trust deed). This is in contrast to the current requirement for the investment statement, which requires the issuer to set out all information needed to answer the questions in the investment statement under each question,[26] which results in repetition and unnecessary compliance costs for issuers.

d. Part A should have a maximum number of pages. While we have received mixed feedback on how many pages Part A should be, we propose that Part A should be no longer than 5 pages. However, this will depend on the type of product offered and whether educational material is included in Part A. We will review this maximum limit as the review progresses.

200. Part A is not intended as a substitute for reading Part B. Part A will include an introductory (and cautionary) statement which explains to the investor that the offer document is in two parts; that Part A is only a summary of the key features of the offer and that to get a full picture of the offer, and before making any decision to invest, the investor should read both Parts A and B.[27]

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[26] Regulation 7A(4), Securities Regulations 1983.

[27] The CIS and Superannuation Advisory Groups discussed whether Part A should be a stand-alone offer document. It was noted that if so, Part A would need to contain more than an overview of the key features of the offer. The Advisory Group concluded that it would be of greater use to investors if Part A was limited in length and only a summary of the critical information required to enable an investor to make a decision, and supplemented by a Part B which contains fuller disclosure.

Part B: Body of Offer Document

201. Part B is intended to provide the investor with fuller disclosure on the offer and the issuer.

202. For equity and debt securities, it is proposed that Part B will be based on the current prospectus, updated and improved as appropriate. Part B will be governed by a principle-based disclosure requirement, which will be stated in the Securities Act. The principle will be supported by more prescriptive disclosure content requirements, which will be set out in the Securities Regulations. The prescription will be tailored to reflect the nature of the security offered and the issuer offering the security.

203. For CIS and superannuation, it is proposed that Part B will be based on the current investment statement, updated, improved and simplified as appropriate (recognising that they will need to be adapted to suit the various CIS products – e.g. unit trusts and superannuation schemes). Part B would address the information not already set out in Part A through prescribed headings and would provide fuller disclosure describing an investor's rights and obligations and the product's key benefits, rules, risks and fees. Part B will also include a provision for other material matters to be included.

204. To avoid repetition within Part B, we propose to allow for cross-referencing within the offer document. This would address one of the complaints with the current requirements that all of the information that an issuer must disclose in answering the questions in the investment statement must be set out under that question.

205. We have received some feedback that issuers should not have to repeat in Part B the information disclosed in Part A. This issue was debated in the CIS and Superannuation Advisory Groups without an agreed consensus being reached. The advantage of not repeating information between Parts A and B is that it may reduce the length of the entire offer document. However, the disadvantage is that some repetition of Part A information may be needed in Part B to aid understanding and complete the information picture for investors, and to avoid investors having to refer back to Part A to get key information. This issue was not discussed by the Debt and Equity Advisory Group and the usefulness of this, or otherwise, has yet to be tested on consumers. Feedback is also sought on what is considered to be most useful for the investor.

Question for Submission

46. Should the issuer be allowed to repeat information disclosed in Part A of the proposed offer document in Part B?

Cross-reference to other Information Available on Website, or upon Request

206. It is proposed that there will be the facility to allow both Part A and Part B of the offer document to refer to other documentation and information (that is not required to be included in the offer document) available on request and on the issuer's website, as well as being registered on and accessible from the Registrar's website: for example, the trust deed and the financial statements.

207. Such a provision would allow for the cross-referencing of information in other documents and on issuers' websites, which would potentially simplify the offer document, while still ensuring the investor is aware of what other information is available and where they can access it from. However, it is intended that there will be a core of material information that must be *in* the offer document.

208. There is useful reference to the incorporation of cross references in disclosure documents in the Australian Government Treasury paper (April 2006) – *Corporate and Financial Services Regulation Review Consultation Paper*.[28] Clause 1.15 of that paper notes that disclosure documents can be lengthy due to the inclusion of information that is repeated in other disclosure documents or is otherwise available, such as on websites. The recognised objective is that it is desirable to reduce duplication (to avoid ambiguity or confusion from an investor perspective and to minimise compliance costs for issuers). There may be scope to incorporate information by reference into disclosure documents from other sources – such as websites or issuers' other documents, rather than having to set out that material in the disclosure document itself. Australia is also looking to allow for incorporation of standardised and general material prepared by the industry.

209. Where simplified disclosure documents are used, most IOSCO jurisdictions require a more detailed disclosure document be either delivered or made available to investors. This principle has merit and could readily be applied to the New Zealand environment as it is recognised that there is an issue of duplication and that offer documents are currently considered to be too long, repetitious and technical.

Other Voluntary Information can be Included

210. It is proposed that issuers can include additional voluntary information in Part B of the offer document that is not prescribed under the disclosure requirements; that is, as long as that additional information did not underplay or overshadow the statutory required information. However, we question how best to incorporate such additional information without confusing investors. It has been suggested that any such voluntary information should only be included at the end of Part B, so as not to clutter or unnecessarily lengthen the document. An alternative is that if issuers include such information through the main body of the text, the information should be clearly highlighted or differentiated as being additional voluntary information.

211. However, whether these suggestions are appropriate and workable in practice will need to be worked through with issuers, and feedback is sought on this point. Consumer testing will also be important to ensure usefulness from an investor perspective.

Questions for Submission

47. Should issuers be allowed to include additional voluntary information in Part B of the proposed offer document?

48. If yes, how should that voluntary information be incorporated? For example, should the

[28] A copy of the Australian Government Treasury paper *Corporate and Financial Services Regulation Review Consultation Paper,* April 2006 can be found at www.treasury.gov.au.

voluntary information be included in the appropriate section of Part B or, at the end of the document? Should that voluntary information be highlighted as voluntary information or otherwise differentiated from the statutorily required information?

49. Should there be any restrictions on how the issuer may present the voluntary information? For example, should the issuer be restricted from giving the voluntary information greater prominence (e.g. printed in colour or larger font) than the statutorily required information?

50. What requirements, if any, should be placed on the content of the offer documents in terms of readability, conciseness and clear, plain language?

4.2.4 Educational Information

212. As mentioned above, the Retirement Commission, in conjunction with ANZ and the Ministry of Economic Development, recently commissioned research into the financial knowledge of adult New Zealanders (the "Financial Knowledge Survey"). The study concluded that while most New Zealanders have a good basic understanding of financial concepts, there are some topics, such as compound interest, mortgages and investment that are not understood very well. Investing was identified as one of the more complex areas where there was evidence of confusion and lack of knowledge.[29]

213. As noted in the Ministry of Consumer Affairs discussion document *Consumer Dispute Resolution and Redress,* given the disparity in interests among the various financial product providers, it would be difficult to obtain voluntary agreement from industry on the content or style of consumer education programmes needed. There is a risk that if the obligation to provide consumer education falls on industry, providers will have an incentive to focus their education/information efforts on information specific to the products they offer. Therefore, it is suggested that it is not appropriate for individual providers to be required to deliver consumer financial education programmes and because financial information and education has some public good characteristics, it is suggested that financial education programmes should be delivered or coordinated by Government. There are already a number of financial education programmes currently operating in New Zealand, including the Retirement Commission's website, www.sorted.org.nz, as well as work by the Securities Commission through its enforcement and compliance role.

214. We propose that the offer document include some educational material on financial concepts. The purpose of the educational material is to make the information disclosed in the offer document easier for the investor to understand. An added benefit is that it may improve the financial capability of investors. The educational material would be developed by government agencies and may include generic information that applies to the particular type of product or issuer as well as pointers alerting the investor to the types of information that they should look out for when reading the offer document. The educational material may also refer the investor to other educational tools, for example, the Retirement Commission's website, www.sorted.org.nz.

[29] *ANZ-Retirement Commission Financial Knowledge Survey*, March 2006, pp8-9.

215. There is a question over who would meet the cost of producing and distributing such educational material. If the information was produced as a separate brochure it is suggested that the cost of this would be met by Government. However, if the information is to be incorporated into issuers' offer documents there is an argument to suggest that it would just be incorporated into the issuers' own production costs – as it is considered that it would be likely to be a marginal additional cost. This has not been discussed with the various Advisory Groups and feedback is sought on this point.

216. There are two types of generic educational information.

a. An explanation of the various types of investments (e.g. what a superannuation scheme investment is compared to a unit trust or equity) and an explanation of the common features of, and risks associated with, different types of investments. This could include a glossary of defined terms.

b. A guide to product disclosure – that is, information designed to inform the investor about what information and detail an issuer should be providing in its offer document and on an ongoing basis, what investors should look out for and what is important to know/understand. The Advisory Groups agreed that such a guide – "how to read an offer document" – would be very useful. An example of this might be:

> *This Part A is designed simply as an introduction to and summary of the key features and benefits, rules and fees relating to XYZ Product. It should be read in conjunction with the attached Part B which together forms the offer document. More detailed information may also be available on the issuer's website and there is certain information that you are entitled to request and receive. Details of what additional information is available and how you can access and receive copies of it are contained in Part A of this offer document.*

217. Further, it is noted that some current disclosure documents (CIS and superannuation in particular) include a significant amount of information relating to general investment risks that it might be possible, to some extent, to remove from the offer documents – to reduce both length and complexity of the document. This information could then potentially also be provided in the generic educational material. The merits of this are discussed generally below, and the more specific issues related to the issuers' offer documents are discussed in section 4.3.2.3 below as it relates specifically to CIS and superannuation.

218. Educational information could be included within the offer document itself, for example, highlighted in boxes alongside the issuer's disclosure. Alternatively, the educational information could form a separate document that supplements the offer document.

219. As a matter of principle all the information an investor needs to be able to make an informed decision before making an investment should be in the one document.

220. The advantage of including the educational material in the offer document is that it would facilitate the investor's understanding of the offer as he or she reads through the offer document. It would facilitate the prospective investor's understanding of the specific risks of the product on offer, in the context of other generic investment risks.

It would also ensure that the investor has all the information and tools he or she needs to make a decision in one document.

221. The disadvantage is that it would lengthen the offer document. If the educational material is included in Part A, it will make it difficult to keep the key features summary under five pages. There is a risk that the investor's attention would be lost and the investor may not read the offer document at all.

222. This risk could be avoided by putting the educational material in a separate document which supplements the offer document. However, there are also risks with this option. The educational material will be one more piece of paper that the investor needs to read. The documents may get separated, or one or the other lost or discarded, and so might not be read by prospective investors. Or, the investor may only read the educational material. In either case, the investor may not receive enough information or tools to understand the offer.

223. One suggestion made was that the educational information could be online only (for example, on the Retirement Commission and Securities Commission websites) and the offer documents could be required to include reference to the availability of this educational information. However, this suggestion can be discounted on the basis that not all investors have internet access, so this would restrict coverage and accessibility, and the issue of investor inertia which should not be overlooked.

224. It is also important to take note of the recent Financial Knowledge Survey. Further, this is where there will be a need to do some consumer testing to gauge what works best and how important educational material is to consumers.

225. We note that disclosure is only one tool to address the financial literacy needs of New Zealanders. The Government is also taking other measures, for example, addressing the regulation of financial intermediaries to ensure that New Zealanders receive quality financial information and advice.

Questions for Submission

51. What are the benefits and risks of having generic educational information extracted from the offer documents? Would this aid or detract from investor understanding of the information in offer documents?

52. Should the generic educational material be included in the issuer's offer documents? If so, in Part A or Part B or in a separate document (brochure/pamphlet) produced by the Government?

53. If generic educational information is retained in issuers' offer documents should there be stipulated requirements around the wording and how this information is presented (for example, should it be highlighted and identified as not being product specific and being from an independent source)? If so, should the Government provide the required wording for all issuers to use?

54. Is there sufficient standard and common information about features and risks associated with various products to make this information useful?

55. Who should bear the costs of producing educational material?

56. Is it important that educational material is independently sourced?

4.2.5 Additional Required Information – On-request Material

4.2.5.1 Internet Access – on Issuer's Website

226. It is suggested that all of the additional supplementary information required to be available to investors and provided on request should, in the first instance, be available on the issuer's website.

227. Requiring such information to be held on the issuer's website makes the assumption that all issuers would have websites. This was discussed by the Advisory Groups and it was generally agreed that most issuers would have websites to promote their products.

228. It also follows that there would need to be a requirement for issuers to have a website. This would also mean there would need to be a requirement on issuers to ensure continued internet access to their website for the above requirements to be effectively adopted. This was not considered to be an unreasonable expectation by the CIS and Superannuation Advisory Groups.

229. Further, the information would be required to be kept up-to-date. Effectively the website would be an advertisement and there would be a requirement to ensure it contains no false or misleading information.

230. However, it was acknowledged that not all investors have internet access, so not too much reliance should be placed on issuers' websites for investors to view and seek additional information. Hence there would also be a requirement for issuers to provide investors with hard copies of the information on request.

231. To be relevant to investors, and so that investors can make decisions based on the financial information contained in any documents held on the issuer's website, the information would need to be filed and made available on the issuer's website as soon as possible.

4.2.5.2 Internet Access – on Registrar's Website

232. In addition to and to complement the above, it is intended that all of the following information will be required to be registered with the Registrar (refer section 4.5 below), and available on the Registrar's website, which is publicly accessible. The objective of this is to provide a central site for investors to access all publicly available information on issuer's products. For investors, it will mean that there is one easily accessible point for information on a financial institution. For example, an investor could find information about a financial institution's offer document, details of senior management, trust deed and financial reports, all in one place. This also effectively meets the objective of informing consumers, business analysts and intermediaries. This is discussed further in the *Overview of the Review and Registration of Financial Institutions* discussion document.

4.2.5.3 Information Requirements

233. It is proposed that the trust deed, financial statements and material contracts (as appropriate) be required to be available on request from the issuer (as is currently the case), on the issuer's website and also on the Companies Office website. The disclosure of material contracts for CIS issuers is discussed further in section 4.3.2.5 at paragraphs 329 to 334.

Questions for Submission

57. Should the trust deed, financial statements and material contracts be required to be made available on the issuer's website? If not, why not?

58. What, if any, additional information should be required to be held on the issuer's website?

59. Is it sufficient that issuers make their financial statements (full/summary) available on their websites and the Companies Office website, and on request by investors? Or, should issuers be required to provide summary/full financial statements to all investors?

60. Is there any other information that is currently required to be in the offer documents, (for debt and equity or CIS and superannuation) that might be better suited to being provided on request?

4.2.6 Disclosure of Environmental Information

234. There is currently a relatively small amount of environmental information provided to potential investors about securities offered in New Zealand. This information can be important to both protect investors from financial risk and allow investors to make informed investment decisions that reflect their individual preferences. In recognition of the importance of environmental factors to investment decisions, many OECD countries (including Australia, United Kingdom, Sweden, Germany and France) have introduced requirements for various forms of disclosure of environmental information to investors.[30] In New Zealand, there is no specific policy approach or legislation requiring disclosure of environmental information.

Appropriate Disclosure of Environmental Risk

235. Environmental risks and financial risks have a strong and increasingly significant correlation (e.g. climate change may significantly impact investment in the agricultural sector). There is increasing recognition of the materiality of environmental factors to investment decisions.[31] Research into the effect of environmental information on investment decisions indicates that where investors are presented with

[30] Ernst & Young for Environment Australia (2003). *The Materiality of Environmental Risk to Australia's Finance Sector*, May 2003. ISBN 0 642 54906 04. Retrieved March 2006 from http://www.deh.gov.au/settlements/industry/finance/publications/environmental-risk/comparing.html.

[31] Ernst & Young for Environment Australia (2003). The Materiality of Environmental Risk to Australia's Finance Sector, May 2003. ISBN 0 642 54906 04. Retrieved March 2006 from www.deh.gov.au/settlements/industry/finance/publications/environmental-risk/index.html#download.

environmental data to supplement financial data, they may assess risks and opportunities differently and make different decisions about an investment's financial value, than when presented with financial data alone[32]. Disclosure of environmental information is currently not common practice in New Zealand. A recent report by BT Financial Group has found that New Zealand investors are not getting enough environmental information to allow investors to sufficiently assess financial risks and opportunities.[33]

Enabling Informed Consumer Choice About Environmental Impacts

236. Disclosure of environmental information is particularly relevant in an era where investors increasingly wish to achieve both financial and other environmental or socially responsible objectives with their investment funds. The recent Financial Knowledge Survey found that 71 percent of people surveyed agreed that they wanted to take into account ethical, environmental and social factors when deciding where to invest.[34] These investors require information to allow them to differentiate between products that take environmental factors into account, and products that do not. It is important that this information is provided at the time of investment as investors often have no day-to-day control over the use of the money invested. Furthermore, where an investment product claims to take environmental factors into account, detail of which factors and how they are taken into account need to be provided.

237. Feedback is sought regarding options for improving environmental disclosure in New Zealand and the associated benefits and costs of these.

Questions for Submission

61. Do you think relevant environmental information needs to be provided by issuers to provide appropriate disclosure of risk? If so, what type of information is important?

62. Do you think that current disclosure of material environmental information by issuers is adequate? If not, why not?

63. How, if at all, do you currently assess which environmental factors could affect financial returns on an investment?

64. What assistance, if any, do issuers require to ensure that disclosures of material environmental information are high quality, relevant and comparable?

65. Do you think the costs of environmental disclosure are significant, and if so, how significant would they be, and can they be justified?

66. Do you think that current disclosure of material environmental information by issuers is

[32] Sustainable Asset Management, PWC: Sustainability Year Book 2005 www.sam-group.com\

[33] BT Financial Group (2006) *Sustainability - Considerations for the long term investor*, a report by BT Financial Groups Government Advisory Service.

[34] *ANZ-Retirement Commission Financial Knowledge Survey*, March 2006 at www.retirement.org.nz/index.php?currentPage=168

adequate to allow informed consumer choice? If not, why not?

67. To enable informed consumer choice, do you think issuers should disclose whether or not they take environmental factors into account? If so, what information would be important to provide when an issuer did take environmental factors into account?

68. How, if at all, do you currently assess which environmental information is of interest to investors?

69. What assistance, if any, do issuers require to ensure that disclosures of material environmental information are high quality, relevant and comparable?

4.3 APPLICATION OF PROPOSED OFFER DOCUMENT FRAMEWORK

238. The following section addresses the application of the proposed offer document framework across debt, equity, CIS and superannuation products. The discussion with the CIS and Superannuation Advisory Groups reached a greater level of detail than the Debt and Equity Advisory Group and this is reflected in the detail addressed below.

239. It should also be noted that we do not attempt to prescribe the content of disclosure here. The prescription will be developed and consulted on when the Securities Regulations are considered. Instead, the content prescriptions described here are intended to be indicative only and provide an outline for the proposed offer document. We seek feedback on the proposed framework, form and content of disclosure in order to then determine the detailed content of the offer documents.

4.3.1 Offer Document for Debt and Equity

4.3.1.1 Part A – Key Features Summary

240. The 11 questions in the investment statement were designed for investors in CIS but extended to all types of securities. We consider that the questions could be more focused for equity and debt investors. We propose that the following questions are those that an equity or debt investor should ask in order to understand the key features of an offer of equity or debt securities:

a. What are the main terms of the offer?

b. Who is involved in offering it to me?

c. What are the risks to my return?

d. How do I invest?

e. How can I cash in my investment?

f. Who can I speak to if I have a question or complaint about my investment?

g. What other information can I obtain?

241. The questions will be followed by prescriptive content requirements, which will draw out the key features of the offer. As discussed above, we attempt to provide an indication of what that prescription may include.

What are the main terms of the offer?

242. For equity, the prescriptive content requirements may include: the type and class of shares on offer; any qualification on the rights of the shares offered; the price of the shares (including any formula or procedure for pricing, where the offer is open-priced); the issuer's dividend policy; and the maximum amount or value of shares on offer.

243. For debt, the prescriptive content requirements may include: a description of the type and structure of the debt security on offer; the price; the interest rate and term; and the maximum amount or value of debt securities on offer.

Who is involved in offering it to me?

244. The investor needs to know who the issuer is, the issuer's principal activities and how long it has undertaken those activities for. For finance company debt, the investor should be informed about the principal types of financing activities it undertakes, in what sectors, and the levels of concentration in those sectors.

245. The investor needs to know the reasons for the offer and the issuer's intended use of the proceeds of the offer. The investor should be informed of any related party lending.

246. The investor needs to know who the directors and key management of the issuer are and any promoters of the offer. For debt, the investor needs to know who the trustee, auditor and guarantor are.

What are the risks to my return?

247. The investor needs to know the principal risks that apply to: the type of security offered; the industry in which the issuer operates; and the specific issuer. This risk disclosure should be a summary of the principal risks and the impact of those risks on the investor's return.

248. For debt, the prescriptive content requirements may require the issuer to explain whether the debt is secured and if so, against what assets; how the debt security ranks in relation to other existing company debt; if the debt security is "first ranking", that this description relates only to ranking among the securities offered and that prior charges under other legislation may take priority; and whether the issuer is able to issue further debt which may rank higher than the securities on offer.

249. For debt, the prescriptive content requirements may also require the issuer to set out in brief form, key financial and risk-related information, including capital adequacy, exposure concentrations and exposures to related parties, and for debt that has a voluntary rating by a recognised credit rating agency, the issuer should disclose the credit rating agency, the credit rating and what the credit rating means. The issuer should also disclose whether there have been any recent changes to the credit rating.

How do I invest?

250. The investor needs to know the method and timetable for subscription and allotment of the securities.

How can I cash in my investment?

251. The investor needs to know whether he or she is entitled to sell his or her securities and if so, whether there is or is likely to be an established market for those securities, or whether the issuer intends to have the securities quoted for trading on any public market.

252. For debt, the investor also needs to know whether there are rights of early termination, by whom and under what circumstances, whether there are any charges to be paid by the investor, and how early termination will affect the return to the investor.

Who can I speak to if I have a question or complaint about my investment?

253. The investor needs to know the contact details of the persons they can speak to if they have a question or complaint about the investment, e.g., the issuer, the trustee, and the ombudsman. The issuer should not have to restate contact details already stated under one of the other questions.

What other information can I obtain?

254. The investor needs to know whether further information on the offer and the issuer can be obtained and if so, where the information can be obtained from - for example, the annual report, financial statements, or trust deed.

Questions for Submission

70. Are these seven questions appropriate and sufficient to bring out the key features for equity and debt investors?

71. Should any questions be removed or added? If so, what?

72. Are the topics suggested under these questions appropriate and sufficient to bring out the key features for equity and debt investors?

73. Are these key features capable of being summarised meaningfully in less than five pages?

4.3.1.2 Part B – Body of Offer Document

Overriding Principle-Based Disclosure Requirement

255. Part B will be governed by a principle-based disclosure requirement. The basis of the principle will be that an issuer should disclose all information that is likely to be material to an investor's decision to subscribe for the securities offered.

256. The First and Second Schedules to the Securities Regulations already require an issuer to disclose "other material matters". However, we have received feedback that some issuers do not give it due consideration because it is at the end of the schedules. We consider that elevating the principle to the beginning of the disclosure requirements will require issuers to turn their mind to the overriding principle when they go through each prescribed disclosure requirement.

257. An overriding disclosure principle is consistent with international practice. Australia, Singapore and the United Kingdom impose a general disclosure obligation on issuers of prospectuses in primary legislation. The general disclosure requirements are similar and require prospectuses to contain all information that investors and their professional advisers would reasonably require to make an informed assessment of the rights and liabilities attaching to the securities offered; and the assets and liabilities, financial position and performance, profits and losses and prospects of the issuer.

258. Singapore and the United Kingdom supplement the general disclosure obligation with detailed content requirements. In Singapore, the content requirements are detailed in subsidiary legislation.[35] In the United Kingdom, the content requirements are detailed in the Prospectus Rules.[36]

259. Australia does not prescribe detailed content requirements, although there is provision for this to be done under the Corporations Act 2001. Australia relies on principle-based disclosure because it considers that the prescriptive approach is inflexible and not sufficiently responsive to changes in investors' needs, market expectations and development in market practices and products. In contrast, by focusing on the outcome to be achieved, principle-based disclosure is applicable to a wide range of circumstances and financial products.

260. The disadvantage of a principle-based disclosure requirement without the guidance of prescription is that it increases the cost of preparing the offer document. The cost increases because of the uncertainty for issuers as to what constitutes compliance with the principle. The uncertainty may lead to greater legal input, which will have a greater impact on small issuers who have fewer resources for legal advice. The uncertainty may also lead to issuers erring on the side of caution and disclosing more information than is necessary, resulting in a prospectus that is too long and complex for investors, and too expensive to produce for issuers.

Prescriptive Disclosure Requirements

261. The overriding principle-based disclosure requirement will be supported by prescriptive disclosure requirements, which will be set out in the Securities Regulations.

262. The prescription will be tailored to reflect the nature of the security offered and the issuer who offers it. The feedback that we received from the Advisory Group process

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[35] Section 243, Securities and Futures Act; Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2002.

[36] Section 87A Financial Services and Markets Act 2000; United Kingdom Listing Authority Prospectus Rules.

is that the disclosure prescribed in the First Schedule to the Securities Regulations is generally adequate for equity; however, there is an opportunity to update and improve the prescriptive requirements in the Second Schedule so that they cater for different types of debt products and debt issuers. Specific issues relating to the disclosure of risk, prospective financial information, and the trust deed, were raised by the Advisory Groups and are discussed at paragraphs 264 to 280 below.

263. We do not attempt to redraft the Second Schedule to the Securities Regulations here. The prescription will be developed and consulted on when the Securities Regulations are considered. Instead we invite your comment on whether the general headings in both the First and Second Schedules to the Securities Regulations are appropriate:

First Schedule – Matters required in registered prospectus for equity securities	**Second Schedule – Matters required in registered prospectus for debt securities**
General Requirements 1. Main terms of offer 2. Name and address of offeror 3. Details of incorporation of issuer 4. Principal subsidiaries of issuer 5. Directorate and advisers 5A Restrictions on director's powers 6. Substantial equity security holders of issuer 7. Description of activities of issuing group 8. Summary of financial statements 9. Prospects and forecasts 10. Provisions relating to initial flotations 11. Acquisition of business or subsidiary 12. Securities paid up otherwise than in cash 13. Options to subscribe for securities of issuing group 14. Appointment and retirement of directors	*General Requirements* 1. Main terms of offer 2. Name and address of offeror 3. Details of incorporation of issuer 4. Guarantors 5. Directorate and advisers 5A Restrictions on director's powers 6. Description of activities of borrowing group 7. Summary of financial statements 8. Acquisition of business or subsidiary 9. Material contracts 10. Pending proceedings 11. Issue expenses 12. Ranking of securities 13. Provisions of trust deed and other restrictions on borrowing group 14. Other terms of offer and securities *Requirements in respect of Financial Statements*

First Schedule – Matters required in registered prospectus for equity securities	Second Schedule – Matters required in registered prospectus for debt securities
15. Directors' interests 16. Promoters' interests 17. Material contracts 18. Pending proceedings 19. Preliminary and issue expenses 20. Restrictions on issuing group 21. Other terms of offer and securities *Requirements in respect of Financial Statements* 22. Application 23. Statements of financial position 24. Equity 25. Minority interests 26. Deferred taxation 27. Non-current liabilities 28. Current liabilities 29. Commitments and contingent liabilities 30. Fixed assets 31. Investments 32. Current assets 33. Intangible and other assets 34. Statements of financial performance 35. Contents of statement of financial performance 36. Statement of cash flows 37. Other information	15. Application 16. Statements of financial position 17. Equity 18. Minority interests 19. Deferred taxation 20. Non-current liabilities 21. Current liabilities 22. Commitments and contingent liabilities 23. Fixed assets 24. Investments 25. Current assets 26. Intangible and other assets 27. Statements of financial performance 28. Contents of statement of financial performance 29. Statement of cash flows 30. Other information 31. Special provisions relating to financial institutions 32. Equity method of accounting *Miscellaneous Requirements* 33. Places of inspection of documents 34. Other material matters 35. Directors' statement 36. Auditor's report

First Schedule – Matters required in registered prospectus for equity securities	Second Schedule – Matters required in registered prospectus for debt securities
38. Special provisions relating to financial institutions *Miscellaneous Requirements* 39. Places of inspection of documents 40. Other material matters 41. Directors' statement 42. Auditor's report	

Questions for Submission

74. Do you agree with the approach of an overriding principle-based disclosure requirement supported by prescriptive disclosure requirements, which are tailored for different offers and issuers, for Part B of the offer document?

75. If no, do you support a principle-based disclosure requirement only?

76. Are the general headings listed in the First Schedule to the Securities Regulations sufficient and appropriate for equity securities?

77. If no, what headings would you remove or add?

78. Are the general headings listed in the Second Schedule to the Securities Regulations sufficient and appropriate for debt securities?

79. If no, what headings would you remove or add?

Risk Disclosure

264. Feedback we have received from Advisory Groups is that some issuers do not provide meaningful risk disclosure and tend to bury the material risks in legal boilerplate, which makes it difficult for the investor to see and understand the specific risks applicable to the securities on offer.

265. We propose that Part B contains a separate section which is entitled "Risks". To make it clear to investors what risks apply to the offer of securities, we propose that the issuer disclose the material risks that apply: to the type of security offered; to the industry in which the issuer operates; and to the issuer specifically. We propose that, in order for risk disclosure to be meaningful to investors, the issuer explain the consequences of these risks to investors.

266. We have also received feedback that some debt issuers, and in particular finance companies, have provided inadequate disclosure of material risks. For example, we have received feedback that there has been a significant problem with first ranking debentures that are secured over a small amount of assets compared to the debt exposure of the issuer, and that some issuers have failed to adequately explain the impact of the security's ranking in relation to other company debt and, if the debt is secured against assets, the value of those assets. Other issues that have been raised are inadequate disclosures about the principal activities of the issuer and related party lending exposures.

267. *The security's ranking in relation to other company debt and what that means for the issuer.* The issuer should state whether the debt is secured and if so, against what assets and the value of the assets used as security. The issuer should explain how the debt security ranks in relation to other existing company debt. If the debt security is "first ranking", the issuer should explain that this description relates only to ranking among the securities offered and that prior charges under other legislation may take priority. If the debt security is not "first ranking", the issuer should define the value of the higher ranking debt against the available assets. The issuer should also disclose whether it is able to issue further debt which may rank higher than the securities on offer. The issuer should explain the risks associated with ranking behind other lenders. This is in accordance with international disclosure principles for debt offerings.[37]

268. *The principal activities of the issuer.* For example, a finance company that issues debt should inform the investor about the principal types of financing activities it undertakes, in what sectors, and the level of concentration in those sectors. If there is high concentration, the issuer should disclose the risks arising from a lack of diversification. This is in accordance with international disclosure principles for debt offerings.[38]

269. *Related party lending exposures.* The issuer should disclose any possible conflicts of interest in lending to related parties and the risks associated with these transactions. The issuer should explain to the investor any differences in lending procedures and policies between loans to related parties and others; give details of existing loans to related parties; and disclose the risks associated with the lack of diversification that can result from lending mainly to related parties. This is in accordance with international disclosure principles for debt offerings.[39]

Questions for Submission

80. Do you agree that Part B of the offer document should contain a separate section on "Risks"?

81. Do you agree with the proposal to require issuers to split their disclosure on risks into

[37] *International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers*, Technical Committee of the International Organization of Securities Commissions, October 2005.

[38] Above n37.

[39] Above n37.

three sections i.e. risks relating to: the security offered; the industry in which the issuer operates; and the issuer?

82. Do you agree that this proposal will make it easier for the investor to understand what risks apply to the offer of securities?

Prospective Financial Information

270. From 1 June 2006, all entities that produce prospective financial information will be required to prepare that information in accordance with the new *Financial Reporting Standard 42: Prospective Financial Statements* ("FRS42"). FRS42 will replace *Financial Reporting Standard 29: Prospective Financial Information*. The general principle of FRS42 is that prospective financial information should be prepared using best information based on assumptions that are reasonable and supportable.

271. It is mandatory for first-time issuers of equity securities to include a prospective statement of cash flows in their registered prospectus,[40] unless they are exempted by the Securities Commission. The Securities Commission from time to time grants such exemptions. It has done so mainly in the case of offers of equity securities in investment companies, where the investment is in substance more like a managed fund. In such cases, the prospective cashflows of the company depend on the fortunes of the market in which the company's funds will be invested, and any attempt to provide prospective financial information could be of little use to investors.

272. There is also a class exemption for issuers listed on the NZAX market, which allows the directors of a company to certify that, because of the nature or state of their business, they do not consider that they can provide reliable prospective financial information, provided they clearly warn investors of the absence of this information.[41]

273. From 1 June 2006, these issuers will need to prepare their prospective statement of cash flows in accordance with FRS42. The problem is that first-time issuers may find it difficult to meet FRS42, if their business is not well established. This will create a situation where the Securities Regulations require the issuer to produce prospective financial information that does not accord with generally accepted accounting principles. This may cause a problem for those issuers who are members of the Institute of Chartered Accountants New Zealand, which requires members to follow Financial Reporting Standards whenever they prepare financial statements.

274. Requiring first-time issuers to produce prospective financial information is unusual internationally. In the United States, the inclusion of forward-looking information that has a reasonable basis is encouraged but not required. Forward-looking information that is made without a reasonable basis or disclosed in bad faith will be considered fraudulent.

[40] Clause 10, First Schedule to the Securities Regulations 1983.

[41] Securities Act (NZX-NZAX Market) Exemption Notice 2005.

275. In Australia, it is up to the issuer to assess whether it is appropriate to disclose prospective financial information. It is considered appropriate if the prospective financial information is based on reasonable grounds and is not merely speculative. If there are no reasonable grounds, the information will be considered misleading and cannot be disclosed in the prospectus.[42]

276. We propose to remove the requirement that every first-time issuer of equity provide a prospective statement of cashflow. Prospective financial information can be expensive to collate. In the case of relatively new and developing companies, prospective financial information may be less meaningful and reliable for investors. We consider it inappropriate to impose this cost on issuers and to require this information to be provided to investors if the information is so uncertain that it can not be sensibly used by the investor. If it cannot be sensibly used by the investor, it is unlikely to be information material to the investor's decision.

277. We propose that every issuer of equity securities be required to consider whether it should provide prospective financial information, based on whether such information is likely to be material to an investor's decision. As is required under the class exemption for NZAX issuers, we consider that if an issuer does not provide prospective financial information, then the issuer's offer document should carry additional risk warnings to reflect the uncertainty associated with the investment.

Questions for Submission

83. Should it be mandatory for first-time issuers of equity to produce prospective financial information?

84. If no, on what basis should issuers have to produce prospective financial information?

85. Should every issuer of equity securities be required to consider whether it should provide prospective financial information, based on whether such information is likely to be material to an investor's decision?

Trust Deed Summary

278. The Second Schedule to the Securities Regulations requires debt issuers to summarise the principal terms of the trust deed in the prospectus.

279. We have received feedback that the summary of the trust deed is too complex to be understood by investors. We are told that this may be because some issuers summarise the entire trust deed because it is unclear which terms of the trust deed are the principal terms. We are also told that this may be because it is simply too difficult to explain certain trust deed covenants in a manner that the investor can understand. A question has been raised whether the offer document should contain a summary of the trust deed at all.

280. We consider that it is important that the offer document summarise the principal terms of the trust deed. The trust deed covenants are aimed at providing protection

[42] ASIC Policy Statement 170, 2002.

for debt investors and should be disclosed to the investor. This is in line with international principles for debt disclosure.[43] The proposed enhancements to the current requirements for debt trust deeds may provide some clarity for issuers as to what terms of the trust deed are the principal terms and should be summarised in Part B of the offer document. We are proposing to prescribe high-level headings which must be addressed by all trustees and disclosed in the trust deed. These headings include:

a. Corporate governance

b. Terms of the securities

c. Financial covenants (including capital and liquidity ratios)

d. Exposure (restrictions on exposure concentration and related party exposures)

e. Reporting requirements

f. Trustee duties and powers

g. Meeting procedures

h. The procedure for appointment and removal of trustees.

Questions for Submission

86. Should Part B of the offer document include a summary of the principal terms of the trust deed?

87. If yes, should the regulation prescribe what terms of the trust deed must be summarised?

4.3.2 Offer Document for CIS (including superannuation)

4.3.2.1 Application of Proposed Framework for Disclosure for CIS

281. In determining an appropriate disclosure framework it is noted that CIS investors have several common characteristics and that disclosure should be aimed to meet the information needs of those investors (and it was suggested by some in the CIS and Superannuation Advisory Groups that disclosure should be aimed at the least sophisticated investor in the class) who generally are:

- retail investors;
- non-expert investors, who rely on the skill and judgement of others;
- non-active (in that they generally do not wish to take an active role in monitoring the manager); and

[43] Above n37.

- investing for the medium to long term (that is, investors will usually invest their funds for periods over 12 months).

282. For CIS and superannuation it is recognised that there is an added benefit that the prescribed short and concise form and content of Part A of the offer document would facilitate investors making comparisons across like products.

283. Because of the type of investors in CIS and superannuation and the lack of requests for prospectuses, it is proposed that Part B of the offer document should be more like the current investment statement, than like the current prospectus.

284. It is proposed that both Part A and Part B of the offer documents for CIS and superannuation do not have a prescribed life (like the current investment statement, and unlike the current prospectus requirement to be updated annually).

4.3.2.2 Part A – Key Features Summary

285. The following is an outline of the information that is currently proposed to be required to be included in Part A of the offer document - the key features summary. It should be noted that the exact content of Part A has yet to be decided, as well as how the information should sit alongside the information required to be included in Part B. Feedback is sought on how best to practically achieve the right balance of information to ensure full disclosure of relevant information to investors. The prescription of the content will be developed and consulted on when the Securities Regulations are considered. This is an opportunity to test and seek feedback on the current thinking.

286. It is proposed that the format of Part A of the offer document for CIS will be question and answer, and will use the format of questions similar to that currently prescribed for the investment statement (recognising that questions will need to be adapted to suit the various CIS products – e.g. unit trusts and superannuation schemes). The same question format and same questions will be used in Part B of the offer document so that cross references can easily be made by the investor). The questions could be along the lines of:

What type of investment is this?
Who is it right for? Who can join and invest in this scheme?
Who is involved in providing the investment scheme?
How much do I pay? (contribution rates/investment levels)
What are the fees and charges and what are they for?
What are the benefits?
What are the investment risks and what choice do I have? (key product-specific risks)
What returns will I get?
How do I cash in my investment? (access rights)

Who do I contact with questions about my investment? Who can I complain to and where do I go if things go wrong?
What further information can I ask for and obtain?

Explanation of Content and Reasoning

287. The following considerations were given to the content of Part A of the offer document:

a. What type of investment is this?

i. Fund objective. The nature of the CIS including a brief description of the legal status of the CIS, for example, superannuation scheme or unit trust.

ii. The date it was established and how long it will continue.

b. Who is it right for? Who can join and invest in this scheme?

i. Who can join and any key rules that apply to membership which might restrict who is likely to join; for example, an investor joining a superannuation scheme might be locked in to age 65.

ii. A brief description of the typical investor to whom the CIS is targeted.

c. Who is involved in providing the scheme?

i. Who the issuer, trustee, investment manager and auditor are.

d. How much do I pay?

i. Investment or contribution minimums - initial investment, additional investments, withdrawal, balance (levels and frequencies).

e. What are the fees and charges and what are they for?

i. A specific concern raised in consultation and agreed amongst stakeholders was lack of transparency in the disclosure of cost and fee structures.

ii. It was agreed by the CIS and Superannuation Advisory Groups that to address this concern Part A of the offer document should require fees to be disclosed in a standard format. While some members of the CIS Advisory Group preferred to show the total fees of an investor as an MER (management expense ratio), the Superannuation Advisory Group agreed that fees should not be shown as an MER, as this is considered to be meaningless to investors and potentially misleading, and suggested that it would be preferable to show fees as a worked dollar example. There was, however, a difference of opinion about how a generic example could be developed and how this would be applied in practice across various products.

iii. It is noted that issuers often use an MER to produce a single figure of expenses so that advisers and investors can compare products quickly and easily. But while members of the Investment Savings and Insurance Association (ISI) are obliged to give MERs for most of their products many other product providers are not.

iv. Concerns raised with proposing MER disclosure as a requirement are that MERs are not always successful in providing a complete comparison between products, for a number of reasons.

v. It was noted that Australian regulations ("Enhanced Fee Disclosure" regulations introduced on 10 March 2005[44]) require disclosure of fees in a worked example format (to standardise the description and calculation methods for fees and costs to allow for easier comparability and understanding by providing an illustrative example of fees and costs in a balanced investment option for a specified account balance and level of contributions) in their Product Disclosure Statements (PDS). Comment was made by some in the Advisory Groups that it would be useful to follow the Australian example for ease of compliance by those organisations that have Australasian parent companies. In working through the process to establish the most workable model the Australian format will be investigated to see if it is appropriate to apply to New Zealand product disclosure.

vi. In discussions it was acknowledged that the Retirement Commission has done a significant amount of work with industry to look at coming up with an agreed standard worked example to present product fees. It was agreed that there needs to be some commonality between what the Retirement Commission publishes as educational information material on fees (e.g. on www.sorted.org.nz) and what legislation requires product issuers to do - in order to secure industry buy-in and to avoid confusion for investors.

vii. It was suggested that if a worked example was used it should be of what the investor will pay in fees, for example: I have $1,000 to invest – how much will I pay in fees and what will I end up with once the fees have been taken out? This is based on consumer feedback (sourced from both the Retirement Commission and the Consumers Institute) that says that consumers like to think about things from the point of starting with a dollar sum and looking at what they will end up with.

viii. It was noted that any such worked example would need to have all the appropriate qualifiers noted and highlighted to the investor; for example, the fact that the risk profile of the product, return (better or worse than the nominal return used in the example), length of person's membership/investment, amounts invested and how often, and services/transactions utilised – will all impact on the fees paid. It was agreed that it is important not to isolate fees from the risk of the product

[44] See the Australian Treasury website, www.treasury.gov.au for further details.

invested in as investors need to understand the relationship between the two.

ix. There is also debate over what fees should be included in a worked fee example, and the application of this in practice still needs to be worked through. It is also noted that many fees that are not fixed fees will vary from period to period and any fee example is likely to only use the most recent historical fees actually charged, which may not necessarily be indicative of future fees. It is acknowledged that there would be a number of disclaimers that would be required, which potentially could confuse the investor. However, any such qualifiers could be turned into more useful explanations of how to interpret the fee model and any variable expenses could be required to be shown as ranges.

x. Particular concern with the suggestion of a worked dollar example was raised by the CIS Advisory Group with regard to the application to products that are sold through a financial intermediary. In part, the concern relates to the likelihood that variable commissions might be payable to advisers, but could not be factored into a worked dollar example, along with the fact that advisers might negotiate reduced fee structures for clients. The CIS Advisory Group considered that an MER disclosure would better take account of these.

xi. Further suggestions were that financial intermediaries' fees should not be included in the Part A of the offer document worked example, because the disclosure required is at issuer product level, and that intermediaries should then be required to disclose any commissions or remuneration they receive on top of the product-specific fees. The concern expressed by the CIS Advisory Group was that a financial intermediary is often involved in negotiating fees on behalf of investors so the only useful worked example of fees is from the financial intermediary, as it is specific to the individual investor and includes any negotiated fees and all relevant commissions and remuneration payable. Therefore, it was suggested by some that any disclosure at product level of a worked example of fees is irrelevant and that the obligation is then on the financial intermediary to prepare a full fee example for the investor based on the fees they have negotiated. Feedback is sought on these issues and suggestions.

xii. The *Securities Legislation Bill Regulations* discussion document (for which submissions closed on 5 May 2006) discussed the issue of investment advisers' relevant remuneration in relation to fee disclosure, and work is now being done to consider the industry feedback sought. The *Financial Intermediaries* discussion document also provides useful discussion on the question of fee disclosure by intermediaries. The Ministry of Economic Development is conscious of the desirability of designing product and intermediary disclosure to be complementary, so as to be most useful to the investor.

f. What are the benefits?

i. The significant benefits to which an investor will or may become entitled, including detail about the circumstances and times at which these benefits

will or may be provided and the way these benefits will or may be provided.

ii. Ideally this should be in a table format allowing for ease of comparison.

g. What are the investment risks and what choice do I have?

i. The significant risks associated with investing in the particular CIS product.

ii. It is suggested that there needs to be some type of "litmus test" for investors to be able to judge the level of risk and potential returns before they invest, and to then be able to judge over time if the manager/issuer has actually produced the returns that were promised. Internationally, all IOSCO TCSC-5 members require that offer documents contain risk disclosure, but the form of the disclosure varies. [45]

iii. Features of the different investment options (e.g. targets high yield, exposure to growth and/or income assets, type of securities, etc) and risks.

iv. What is the risk that the investor will not get the returns they expected? This should be based on the expectations of investors and needs to describe the risk, including volatility. As an example: the risk of a product could be described as being the risk of a negative return – e.g. low risk might have a risk of a negative return one year in 14 years, with high risk being a negative return one year in five.

h. What returns will I get?

i. The matters the investor needs to be aware of that will impact the return the investor will get on the investment, e.g. term of the investment; tax; frequency of contributions; and/or the risk profile of each of the investment fund options.

i. How do I cash in my investment?

i. How often an investor can access the investment – any limits on level and frequency, along with any rights of suspension.

j. Who do I contact with questions about my investment? Who can I complain to and where do I go if things go wrong?

i. The investor needs to know the contact details of the persons they can contact if they have a question or complaint about the investment, e.g., the issuer, trustee and who to contact in terms of the dispute resolution process i.e. the ombudsman, if applicable. This is where the issuer's and trustee's contact details should be shown.

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[45] Refer to the IOSCO report on *Investor Disclosure and Informed Decisions*, May 2002, which can be found at www.iosco.org/library/pubdocs/pdf/IOSCOPD131.pdf.

k. What further information can I ask for and obtain?

i. The investor needs to know what further information on the offer and the issuer can be obtained (e.g. the financial statements and trust deed), where the information can be obtained from, and whether there is a charge for the information.

ii. There should be references to further information, for example, Part B of the offer document, the issuer's website, generic educational material, and/or the Retirement Commission's website, www.sorted.org.nz. The issuer should not have to restate contact details here if already stated under one of the other questions.

l. Tax

i. A short and simple explanation should be given either separately or under the heading "What returns will I get?" A fuller explanation would then be provided in Part B.

m. Past performance – not Included

i. There was a difference of opinion within the Advisory Groups with regard to whether past performance should be included in Part A of the offer document or not. However, generally it was agreed that it was not a relevant fact that investors should take into consideration when making a decision to invest or not – as past performance is not an indicator of future performance. It was noted that past returns were even less relevant for employer-sponsored superannuation schemes, as the employer contribution subsidy is far more important.

ii. It is also noted that without appropriate full qualifiers and disclaimers there is a potential risk that past performance could create a misleading picture of future performance. Perhaps even more likely, investors could misinterpret performance figures.

iii. Internationally, while some IOSCO jurisdictions do allow past performance information to be given in an offer document, primarily as an indication to investors as to the past volatility of the scheme, such information is normally highly qualified and with appropriate warnings that it is not an indication of future performance.[46]

iv. It is proposed that past performance will not be allowed to be included in Part A of the offer document, for a variety of reasons, including:

- the issues with how to present performance data consistently;
- the potentially lengthy qualifiers that are required in relation to the risk of investors relying on past performance as an indication of future returns, which it is not possible to do justice to in the space available;

[46] Above n45.

- investors should not be focusing on past returns; and
- including past performance would also unnecessarily date Part A of the offer document.

288. Instead, it is suggested that (if included at all) it is more appropriate to include past performance in Part B of the offer document (perhaps voluntarily rather than as a requirement) and on the issuer's website (with relevant and appropriate qualifiers and disclaimers).

Questions for Submission

88. Should all of the above information be included in Part A of the offer document? If not, what information should be excluded and why?

89. Should Part A of the offer document be able to stand alone as an offer document and therefore, be able to be relied upon by the investor without reference to Part B?

90. If Part A of the offer document is the only information that an investor reads before investing – does it tell the investor all the critical information that he or she needs to know? Is there any other information that should be included in Part A of the offer document that is useful or more relevant to investors?

91. What level of detail of the investment risk should be addressed in Part A of the offer document? For example, should the investment options and risk be to a level of detail that includes the asset class weightings? Or should that be addressed in Part B of the offer document?

92. Should Part A of the offer document be limited to a specified number of pages? For example, can the key features, benefits, risk and fees of various products be meaningfully and usefully summarised in fewer than five pages?

93. How should fees be disclosed in a standard format in Part A of the offer document? What is more appropriate for the investor – an MER, a worked dollar example, or both?

94. Should fees be required to be stated either net or gross for consistency and ease of comparison?

95. How could a generic worked example of fees be applied consistently and meaningfully across the various CIS products?

96. Can the Australian standard worked fee example be applied to products in New Zealand? If not, why not? If so, how could it be adapted to better suit New Zealand products?

97. Should past performance be included or excluded from Part A of the offer document? Why?

98. With the removal of the requirement to produce a prospectus is there any additional information from the current prospectus requirements that should be disclosed in Part A of the offer document?

99. Should Part A of the offer document be prescriptive rather than principle-based

disclosure requirements?

4.3.2.3 Part B – Body of Offer Document

289. We do not attempt to redraft Schedule 3D of the Securities Regulations here. The prescription will be developed and consulted on when the Securities Regulations are considered. Instead we invite your comment on whether the general structure of, and headings, in Schedule 3D are appropriate.

290. It is proposed that the format of Part B of the offer document will be question and answer (as is currently required under the Securities Regulations) and will cross-reference to the question and answer format in Part A of the offer document – see above. It is noted that the prescription will need to be tailored to reflect the nature of the security offered and adapted to suit the various CIS products – e.g. unit trusts and superannuation schemes.

Explanation of Content and Reasoning

Prescriptive v Principle-Based Regulation

291. Some stakeholders have questioned whether the disclosure requirements should remain prescriptive, or should be principle-based. The feedback we have received for Part B of the offer document has been clear – in the interests of keeping the document short form, it has to remain prescriptive. Some stakeholders have noted, however, that under the current prescriptive disclosure requirements for the investment statement, there can be inconsistencies (in both form and content) between the investments statements of superannuation and CIS products. These stakeholders noted that clearer prescription is needed so that offer documents are reasonably comparable.

Use Existing Format of Questions

292. The suggestion of using the existing investment statement format of questions and answers is based on feedback from the CIS and Superannuation Advisory Groups that the current questions generally work well, although there is room for improvement to address ambiguity. This is also substantiated by the comments made in Appendix One with regard to the consumer feedback from a Securities Commission survey on investors' opinions of managed funds investment statements.[47] It is noted, however, that some in the Superannuation Advisory Group suggested the previous regime of a members' booklet was more useful and user-friendly.

Remove Non-product-specific Generic Educational Information that is Common to CIS/Superannuation

293. As noted above, current offer disclosure documents include a significant amount of information relating to general investment risks (e.g. bankruptcy provisions, product

[47] A copy of the Securities Commission 1999 survey: *Investors' Opinions of Managed Funds' Investment Statements* can be found on the Securities Commission website www.sec-com.govt.nz/publications

or issuers' insolvency, the Property Relationships Act and general market investment risks), that is useful to the investor, but that is non-product-specific and is generic across similar products.

294. It is suggested by some in the Superannuation Advisory Group that perhaps such generic educational non-product specific information and material could be extracted from the current offer documents and reproduced as a separate document (a pamphlet) by Government as part of their educational material. This standard information would then be developed and distributed by the regulator and the Retirement Commission and would supplement the offer document. It would then be a requirement that this generic information be provided to potential investors along with the offer document.

295. While in general the Advisory Groups agreed that it was a good idea to have supplementary generic information that was produced by the regulator for all CIS, and that this information be provided with the offer document, it was debated at length how this might work in practice. It is acknowledged that a fine line distinguishes financial education information from product disclosure. It was also questioned whether such information should be provided to investors as a separate document, or whether it would be more useful to require it to be contained in issuers' offer documents, in order to aid understanding and complete the information picture for investors, and to avoid investors having to refer to a separate document for further explanation. This is a point that would need to be consumer tested.

296. One of the reasons for looking to exclude or extract some of the generic educational information that is currently contained in all offer documents is to limit the compliance costs of issuers. The other reason is to simplify the readability of offer documents by reducing their length and ensuring only prescriptive product-specific information is included – to better facilitate investors making product comparisons.

297. However, there is an argument to place educational information in the offer document to facilitate the prospective investor's understanding of the specific risk of the product on offer, in the context of other generic investment risks.

298. With separating the generic information from the offer documents, there are also risk and accountability issues that could arise, that is, where an investor suggests down the track that they were not given a full explanation of the relative risks of the investment. Questions could well arise as to where the information gaps were – in the issuer's offer document or because they did not read the generic educational information. This raises questions of who is accountable for the members' misinformed decision – the issuer, or the regulator.

299. The costs and benefits to the investor arising from this issue are discussed further under section 4.2.4 above on Educational Information.

A Provision for other Material Matters to be Included

300. It has been questioned whether there should continue to be a provision for "any other material matters" or for information that will affect the returns to the investor to be required to be disclosed. The CIS and Superannuation Advisory Groups discussed this briefly and questioned the definition of what is considered to be material. It was agreed in principle that there should be a requirement to disclose anything that is material to the investor, that is, anything that would have an impact

on the nature of the risk and return associated with the investment, the investor's likely benefit upon withdrawal, and the investor's decision to invest.

301. An alternative view presented was that the detailed prescription of Part B of the offer document would mean that there is full and adequate disclosure without this additional requirement. However, this suggestion can only work in practice if the prescription settled on is so detailed that there is no conceivable situation in which there may be material information not covered by the prescription. In addition is the question of how the current liability placed on issuers for misleading investors by the omission "of a particular which is material to the statement in the form and context in which it is included" would work in the absence of a requirement for "all material matters" to be disclosed. It is considered to be unpalatable for this to be addressed by simply leaving in the requirement via the back door, with reference only to the liability for material omissions, as such an approach would not be aligned to the objectives of transparent disclosure. This also raises the risk that without an "all material matters" requirement neither the Registrar nor the regulator could act against a misleading document (one that omitted something material) if the missing information was not required by the prescription.

Fees

302. Further work needs to be done here on the most appropriate means of disclosure as it is acknowledged that there are issues at present with the disclosure of fees. As a minimum, any disclosure should include all costs, fees and other charges or expenses associated with an investment in, and redemption from, a CIS product – including a brief description on how they are determined, and whether they are payable directly by investors or at the product level.

303. One suggestion is that fees should be disclosed in a tabulated format along the lines of the requirements of the Australian regulations.[48] This provides for fee disclosure in Product Disclosure Statements for superannuation and managed investment products to include (among other things) a fees and costs template, which is a standardised fee table that details all the fees and charges deducted from the investor's account, with further disclosure of any fees and charges that are deducted indirectly from the returns on the investment or from the assets of the investment product as a whole. The Australian regulations require the type of fee or cost to be described and then the amount of the fee stipulated, along with an explanation as to how and when the fee is paid. The application of such a model across the New Zealand market needs to be worked through in detail and feedback is sought on this point.

Risk Disclosure

304. The key risks should be summarised in Part A of the offer document and should cross- reference the investor to the various sections in Part B of the offer document where further information on risks can be obtained. Risk disclosure needs to be accurate and meaningful. The investor needs to understand the risk and return

[48] Refer to the Australian Treasury website: www.treasury.gov.au for further details.

relationship of the securities offered. Risk disclosure should not contain legal boilerplate as this does not provide investors with concrete information about the specific risks applicable to the securities on offer. All IOSCO TCSC-5 members require that offer documents contain risk disclosure, but the form of the disclosure varies.[49] Most jurisdictions require specific disclosure about the CIS investments, for example where the circumstances are likely to adversely affect net asset value, yield or total return. It is proposed that the issuer disclose the principal (all relevant and appropriate material) risks that apply to the type of security offered; the industry in which the issuer operates; and the issuer itself. We propose that the issuer explain the consequences of these risks to the investor.

Past Performance

305. While a clear view has formed in the CIS and Superannuation Advisory Groups' discussions that past performance should not be included in Part A of the offer document, there is a question about whether past performance should be required to be included in Part B of the offer document or should remain voluntary and only required to be provided on request (and on the issuer's website). Whether required to be disclosed in the offer document, or disclosed on a voluntary basis, it is suggested that there would need to be clear prescription in terms of what qualifiers and disclaimers should be linked to the returns shown. It was acknowledged that for past performance to be most useful to the investor, it would need to be required to be presented in a prescribed format – to ensure consistency across like products and to facilitate and enable consumers/investors to make comparisons. However, it was questioned whether this was practically achievable and this was not discussed in any detail with the Advisory Groups. Further feedback is sought on these points.

Questions for Submission

100. Should the information that is generic to all CIS or particular CIS products (e.g. superannuation schemes) be extracted out of the offer document and be reproduced in a separate generic educational document?

101. What information should be required to be in Part B of the offer document and what information should be on request only?

102. With the removal of the prospectus is there any information that is currently contained in the prospectus that should be included in Part B of the offer document?

103. What level of detail of the investment risk should be addressed in Part B of the offer document? For example, should the investment options and risk be to a level of detail that includes the asset class weightings? Or is it sufficient to require that level of detail to be held on the issuer's website?

104. Should performance over various time periods be required to be provided or available? Is on the issuer's website sufficient, or should it be included in Part B of the offer document? Why? If included, should it be required to be disclosed or be disclosed on a voluntary basis? What prescription, if any, should there be around how performance figures are disclosed, and should they be presented in a consistent

[49] Above n 45.

format? What qualifiers and disclaimers should be included?

105. Should there be a provision for "any other material matters" or information to be disclosed in Part B of the offer document?

106. How should fees be prescribed to be disclosed in order to ensure that the investor gets a complete picture of all fees and charges they could directly or indirectly incur?

107. Can the Australian standard fee template be applied to products in New Zealand?

4.3.2.4 Application of Disclosure to Different Types of CIS

306. Consideration needs to be given as to how the above proposed regime might be applied consistently across all types of CIS and whether there should be any exceptions to the rules to accommodate specific products or whether there should be any additional requirements placed on specific products. Feedback is sought on any such specific issues and the implications for various products.

Unit Trusts

307. No specific issues were raised in discussions with the CIS Advisory Group other than a concern expressed by the Group with regard to how the suggested worked fee example might be applied. These concerns are addressed above under paragraph 287e.

Participatory Securities

308. It is noted that not all questions proposed for Part B of the offer document may be relevant. However, it should be noted that most participatory securities will become CIS, so consistency is important.

Questions for Submission

108. Are there any specific issues that need to be addressed in relation to the proposed offer document disclosure for unit trusts?

109. Are there any specific issues that need to be addressed in relation to the proposed offer document disclosure for participatory securities?

110. How would the application of a standard format fee disclosure apply across all investment product types? What form of fee disclosure is most appropriate for and relevant to the investor?

Master Trust Superannuation Structures

309. It is questioned whether a Part A (of the offer document) should be required for each employer participating scheme in a master trust – just as a supplement to the issuer's generic investment statement is required now – as each employer scheme will be different and the particular employer terms (e.g. benefit design such as resignation benefits, vesting scales and contribution rates) are what are relevant and

important to employees/members. How this will practically be applied has yet to be discussed and feedback is sought on this point.

310. It is also noted that many master trust schemes offer a multitude of investment options and how these could be presented in the summary Part A (of the offer document) is questioned.

311. The Superannuation Advisory Group questioned why the information about an employer's superannuation scheme sponsorship and term and conditions (in the participating agreement to a master trust deed) should be publicly available through the Companies Office. It is information that effectively relates to an employer's offer to their employees, so the Group suggested that it is neither appropriate nor relevant for the information to be publicly available. It was also noted that investors do not in fact seek such information from the Companies Office (only competitor providers/issuers do). It is noted that this issue was addressed in 2004 with the renewal and amendment of the class exemption in clause 8(2) of the Securities Act (Multiple Participants Superannuation Schemes) Exemption Notice 1998. Since 2004 the exemption notice has allowed participants the choice between registering their participating deeds or stating as a term of the offer (in the investment statement or supplement to the investment statement), that a copy of the participating deed and all amendments are available free of charge to all "specified persons" and prospective members of the scheme on request. It is not proposed to change this provision and feedback is sought on this issue.

312. In terms of what should be disclosed to investors in the offer document, it is important that the relevant terms and conditions of the investor's employer's participating agreement under the master trust are clearly and adequately disclosed. It is proposed that this would include the following:

a. Employer contributions payable and any minimum levels of employee contribution required in order to receive the employer's contribution. What fees, if any, the employer has agreed to pay on behalf of the employee's membership.

b. Additional information on benefits payable – e.g. on leaving employment, or redundancy, or insurances offered.

c. Whether there will be a reserve fund and, if so, how the reserves will be utilised and specifically how they will be distributed on wind-up.

d. Whether salary sacrifice is allowed.

e. Why the employer has chosen a particular issuer/manager and what rights they have to change managers.

f. The terms and conditions on which the employer has agreed to sponsor the employee's membership of the scheme and what rights the employer has to cease that sponsorship at any time and/or wind up the scheme.

g. Any employer discretions, as well as when and how the employer will exercise those discretions.

313. The above is not an all-inclusive or exhaustive list, and feedback is sought on what should be disclosed in the offer document for master trust superannuation schemes.

Questions for Submission

111. What would Part A of the offer document disclosure requirements mean in relation to a master trust scheme? That is, where a product/scheme has a number of investment fund options on offer under the one product/scheme – should there be a Part A (of the offer document) for each underlying investment fund, or should all investment funds be included in the one product/scheme Part A of the offer document? What could be achieved within a short summary? What is considered to be the most useful disclosure for consumers and the easiest to understand?

112. Does the class exemption in clause 8(2) of the Securities Act (Multiple Participants Superannuation Schemes) Exemption Notice 1998, as renewed and amended in 2004, adequately address concerns about the confidentiality of employer participating agreements?

113. Should a Part A of the offer document be required for each employer participating scheme in a master trust – just as a supplement to the issuer-generic investment statement is required now? How would this be practically applied?

Employer Stand-alone Superannuation Schemes

314. Based on discussions with the Superannuation Advisory Group it is recognised that employer stand-alone superannuation scheme disclosure will need to be different to the disclosure required for retail superannuation schemes and that the disclosure needs to be more appropriately targeted.

315. It is suggested that employer-based superannuation schemes should include the additional disclosures detailed above for master trust participating schemes.

316. Feedback is sought on whether there is any additional information that should be disclosed in the offer document.

Questions for Submission

114. Is any of the required disclosure information not relevant for employer-sponsored stand-alone superannuation schemes?

115. Will some of the information proposed for the offer document be standard information about all superannuation schemes (and therefore better dealt with through the generic educational information produced by the regulator)? If so, which information?

116. Is it possible to achieve a useful summary of the key features and benefits of an employer-sponsored stand-alone scheme in fewer than five pages?

117. Are there any issues about superannuation schemes, as opposed to general CIS schemes, that would require longer disclosure?

118. Is there any particular additional information that should be required to be disclosed

for employer-sponsored stand-alone schemes – would this differ for master trusts and stand-alone schemes?

Defined Benefit Schemes

317. Some in the Superannuation Advisory Group questioned the value and relevance of the detailed prescribed offer document for defined benefit schemes. It was suggested that the nature of defined benefit schemes meant that a lot of the questions were not as relevant to investors and that the disclosure for defined benefit schemes could be more appropriately targeted and concise.

318. However, it is proposed that the same disclosure requirements (Part A and Part B offer document) should also apply to defined benefit schemes, with the above requirements for additional disclosures for employer standalone and master trusts superannuation schemes equally applying to defined benefit schemes.

319. It is suggested that defined benefit schemes should also be required to disclose, both in the offer document and also in the annual report, (to the regulator and in the annual statement to members) the ongoing position and the wind-up position of the scheme – that is, what it means from the investor's perspective in terms of the actuarial value of members' benefits – upon wind-up, and on an ongoing basis.

320. Related to the above is the question of the hierarchy of the benefits payable on a scheme wind-up – that is, what is the risk to any member that they may not receive their full benefit entitlement on wind-up due to the hierarchy of benefit payments? It is suggested that the process for the payment of benefits on wind-up should be clearly stated in the disclosure documents.

321. We are also proposing that the current disclosure requirements in the Superannuation Schemes Act, which apply specifically to defined benefit schemes should, in general, continue to apply to all defined benefit schemes (in addition to the above new requirements). These disclosure requirements are detailed under the ongoing reporting requirements section, at paragraphs 422 to 431below.

322. The above is not an all-inclusive or exhaustive list, and feedback is sought on what should be included in the offer document for defined benefit schemes.

Questions for Submission

119. What aspects of the suggested disclosure would be appropriate or inappropriate for defined benefit schemes? Is there any information that is useful for investors in other superannuation schemes that is not relevant for investors in defined benefit schemes?

120. What is the key information that needs to be disclosed for defined benefit schemes?

121. Is there any other information that would be useful for and important to investors in defined benefit schemes?

4.3.2.5 Additional Information Required – On-Request Material

323. In light of the fact that there will no longer be a requirement for a prospectus, it is proposed that the following additional information would be required to be available on request from the issuer in respect of CIS and superannuation, as well as on the issuer's website:

a. past performance;

b. any other material information requirements;

c. summary of trust deed; and

d. summary of material contracts.

324. These information requirements are in addition to the trust deed and financial statements.

Past Performance

325. It was agreed by the Advisory Groups that past performance should, as a minimum, be required to be shown on the issuer's website and available in hard copy on request (if not also required to be, or voluntarily provided, in Part B of the offer document).

Any Other Material Information Requirements

326. It is questioned whether there is material information that is currently required to be disclosed in the prospectus that would be of interest and value to an investor and should, therefore, be required to be available on request or included on the issuer's website.

Summary of Trust Deed

327. It is noted that a summary of the trust deed is currently required for the prospectus. While it is agreed that such a summary would be more readily accessible to and understood by investors than the full trust deed, it is suggested that in effect the content of the offer document provides a summary of the provisions of the trust deed. It was suggested, therefore, by the Superannuation Advisory Group that there is no need to also include a separate trust deed summary on the issuer's website.

328. However, it is proposed that there be a requirement for some level of sign-off from the trustees to confirm that the offer document effectively summarises and correctly reflects the terms and conditions of the trust deed that are relevant to an investor's membership. This would also need to be accompanied by a general disclosure obligation for the offer document to set out any material terms of the trust deed that are not otherwise covered specifically in the disclosure requirements of the offer document.

Summary of Material Contracts

329. It is noted that a summary of material contracts is currently required for the prospectus. It is acknowledged that this summary would be more readily accessible to and understood by investors than copies of the contracts and would facilitate

understanding of the material contracts in place, as well as who the key parties are and what their respective responsibilities are to the product offering. It is, therefore, suggested that a summary of the material contracts is included in Part B of the offer document.

330. The CIS and Superannuation Advisory Groups suggested that there should not be a requirement to include copies of the material contracts on the issuer's website or hold the contracts on the Companies Office register. This reflects the view that such contracts are commercially sensitive and should not, therefore, be publicly available, although the implications of such contracts being publicly available were not discussed.

331. This suggestion is also based on the Advisory Groups' view that the material contracts are not likely to be requested by the underlying investor and the belief that investors do not in fact seek such information from the Companies Office; only competitor providers/issuers do (although this point is not proven). Further, it is suggested that the relevant components of the material contracts that impact on an investor's investment are in fact encapsulated in the terms and conditions of the product, are summarised in the offer document and will be reflected in the fees charged to the investor.

332. However, it should be noted that the Securities Commission has the discretion (under published policy guidelines) to approve applications for exemptions for material contracts – for CIS, superannuation, debt, and equity issuers. It is interesting to note though that the majority of applications for exemptions made to the Securities Commission and approved have to date been from equity and debt issuers. Very few CIS and superannuation issuers have sought such exemptions.

333. Officials consider that by definition, a "material" contract is "material" to an investor and is, therefore, likely to influence an investor's decision and should, as such, be accessible. Availability is the prerequisite to use. To suggest that such contracts should not be publicly available on the Companies Office website is an apparent contradiction of the starting point for securities disclosure, which is that investors should have access to all material information. It is, therefore, proposed that the current regime continue to apply with the ability for issuers to seek exemptions from the Securities Commission.

334. It is noted that there are particular benefits to having material contracts made available for debt and equity investors. When an issuer enters into a material contract that is outside its ordinary course of business, the terms of that contract can have a significant impact on the operations and profitability of the business. This information is especially relevant if it has an impact on a debt issuer's ability to fulfil its obligations on the debt securities.

Annual Report – Superannuation Schemes

335. It is noted that section 16 of the Superannuation Schemes Act currently provides for a copy of the most recent annual report to be provided to prospective members before they join a superannuation scheme. In light of the proposal below under section 4.4.6 to remove the requirement for an annual report, it is questioned what additional information should be required to be usefully provided to prospective members before joining. Feedback is sought on this point.

Questions for Submission

122. Should there be a requirement for issuers to summarise the trust deed? If so, what terms should be summarised? Alternatively, is it sufficient to rely on the offer document to, in effect, summarise the trust deed?

123. Are the issuer's material contracts considered to be commercially sensitive? If so, is it appropriate that they be required to be held with the Companies Office and publicly available on the Companies Office or issuer's websites? If not, why not? Or is it sufficient that there is only a requirement to summarise the contracts in the offer document?

124. Does the current provision to apply for an exemption from the Securities Commission work well in practice and adequately deal with the concerns over the commercial sensitivity of material contracts?

125. In light of the proposal to remove the requirement for an annual report, what additional information should be required to be usefully provided to prospective members before joining? Should this information be required to be disclosed or provided on request and on the issuer's website?

126. Is it reasonable to expect issuers to, on request by investors, provide a hard copy of any information that is held on their website (in particular to cater for those people who do not have internet access)?

4.4 ONGOING DISCLOSURE

4.4.1 Financial Reporting

336. The Financial Reporting Act 1993 requires that the directors of every issuer must, within five months after the balance date of the issuer, prepare financial statements for the issuer as at the balance date. The financial statements must comply with Generally Accepted Accounting Practice and present a true and fair view of the matters to which they relate. The financial statements must be audited, and must then be registered with the Registrar of Companies.

337. We are not aware of any issues with this requirement. Accordingly, we do not propose to make any changes. However, we have received feedback that this financial reporting requirement is insufficient for Tier 2 DTFIs. It is proposed that Tier 2 DTFIs be subject to enhanced financial and risk-related disclosure requirements. This proposal is discussed further in the *Non-Bank Deposit Takers* discussion document.

4.4.2 Annual Report – Companies Act 1993

338. The Companies Act 1993 requires the production of an annual report by every company. We are not aware of any issues with this requirement. Accordingly, we do not propose to make any changes.

4.4.3 Material Changes – to Offer Documents and Trust Deeds

339. While an offer of securities is open, the Securities Act requires the issuer to keep both the investment statement and the prospectus up to date. Although there are no specific provisions setting out when an amendment is required, section 34(1)(b) of the Securities Act prohibits a registered prospectus from being distributed if it is false or misleading in any material particular by reason of failing to refer or give proper emphasis to adverse circumstances. Further, section 37A(1)(b) applies the same test and prohibits securities being allotted if the prospectus or investment statement is false or misleading.

340. While the following issues relating to material changes were discussed briefly by the CIS and Superannuation Advisory Groups, they were not discussed by the Disclosure and Debt and Equity Advisory Groups.

The Definition of "Material"

341. The feedback from the CIS and Superannuation Advisory Groups was that there is ambiguity over the interpretation of the term "material" and that this ambiguity increases compliance costs on issuers.

342. It was discussed within the CIS and Superannuation Advisory Groups whether "material" should be limited to "adverse" material changes. It should be noted that this is in fact the effective test at the moment in New Zealand under section 37A(1)(b) of the Securities Act – that is, for changes during the period of an offer, a security cannot be allotted if the investment statement is misleading in a material particular by reason of failing to refer to, or give proper emphasis to, an adverse circumstance. However, some in the Advisory Groups suggested that this could be open to interpretation because what one investor might consider being adverse may not be adverse to another investor. The Groups concluded that if anything "material" was to change then the offer document should be updated.

343. It is proposed that "material" should relate to any information that is likely to influence an investor's decision to invest or retain their investment in a product - that is, any material change to the issuer or to the terms of the offer that affects investors' rights, or to the value of the investment, or their decision to maintain the investment. For example – their rights and obligations, the costs, risk or benefits of the product, the potential return of the investment or any material change to the issuer. We consider that any change to the information in Part A of the proposed offer document would be considered to be material.

344. Feedback is sought on what should be considered to be "material" and how it should be defined.

Registration of Material Changes

345. An issuer may amend a registered prospectus by registering a memorandum of amendment with the Registrar of Companies.[50] We propose to extend this

[50] Section 43(1), Securities Act 1978; Section 9(1), Unit Trusts Act 1960.

requirement to the proposed offer document, so it will apply to the new offer document for debt and equity securities and to the new offer document for CIS.

346. However, it is acknowledged that it is currently difficult to amend an investment statement without reissuing the entire document, because all of the information that an issuer must disclose in answering the questions in the investment statement must be set out under that question. Further, there is no ability to add supplements to the investment statement as information changes. As a result, if information does change, the issuer will incur significant costs in reissuing and reprinting the investment statement. To address this it is proposed that CIS issuers can choose to use supplements to amend Part B of their offer document but, if so, these supplements would need to be registered. This was acknowledged as useful by the CIS and Superannuation Advisory Groups.

347. The offer document for debt and equity securities will continue to incorporate financial statements. As is currently the requirement, the offer document will need to be updated and re-registered annually alongside the requirement to register the annual audited financial statements.

348. The offer document for CIS will not incorporate financial statements; therefore, the offer document for CIS will not be required to be updated annually. It is also proposed that the offer document has no fixed-term life or expiry date. In light of this, the CIS and Superannuation Advisory Groups questioned whether there should be an annual requirement to register the CIS offer document to ensure that directors of the issuer turn their mind to the information and ensure it is up to date. We propose that it will be sufficient for issuers to provide a statement to the regulator (with other reporting requirements) that states the directors have reviewed the offer document and confirmed that the offer document is still up to date, relevant, that nothing material has changed and that it is not misleading, or that a supplement has been registered to disclose any material changes. Several members in the Advisory Groups did comment, however, that as a matter of best practice it was common for issuers to update their offer documents annually anyway.

349. Where any trust deed or deed of participation registered under the Securities Act, or any trust deed registered under the Unit Trusts Act, has been amended, a copy of the amendment must be registered with the Registrar of Companies.[51] Where any trust deed registered under the Superannuation Schemes Act has been amended, a copy of the amendment must be registered with the Government Actuary. We propose to retain these obligations.

Communication of Material Changes to Investors

When

350. We have received feedback that some issuers do not disclose material changes to the offer documents or trust deeds to investors in a timely manner.

351. The question of what advice of any material changes should be given to existing investors, and when it should be required to be given, was debated by the CIS and

[51] Section 47, Securities Act 1978.

Superannuation Advisory Groups. The general view of the Advisory Groups was that current/existing investors should be advised of any material changes (be it to the offer document or trust deed) and it was suggested that this should be required to be done at least annually.

352. We consider that advice on an annual basis is not sufficiently timely. It is proposed that, by definition of being material to an investor's investment, any material change should be required to be advised to investors at the time of the change or within a defined period as it could be too late or irrelevant advising investors at the next annual reporting date. We seek feedback on whether further notice of trust deed amendments or other material changes should also be provided in the issuer's annual statement to investors.

353. In respect of trust deed amendments, it was questioned by the CIS and Superannuation Advisory Groups whether all trust deed amendments should be advised to investors or whether there should only be a requirement to advise investors of material changes. One view from the Advisory Groups was that investors should be advised of all trust deed amendments irrespective of materiality, as is currently required under the Superannuation Schemes Act, because this would avoid any question of whether an amendment is considered material or not. Feedback is sought on this point.[52]

How

354. This then raises the question of how investors should be advised of such material changes.

355. This issue has not been discussed with Advisory Groups. However, it is proposed that formal notice should be sent to investors by way of a letter which provides supplements to amend the offer document, at the time of the change, as well as a notice being provided on the issuer's website. This is in addition to the requirement that such a material change would require an amendment to the offer document or trust deed to be registered and provided on the Registrar's website.

356. We seek feedback on whether the issuer should be able to use supplements for amendments to both Parts A and B of the offer document. Part A of the proposed offer document is intended to be a comprehensible short summary of the key features of the offer. There is a risk that if the issuer were able to use supplements to communicate changes to Part A, as opposed to reissuing Part A, the purpose of Part A could be undermined.

Questions for Submission

127. Should the offer document for CIS have a prescribed and definitive life? For example, should it be updated annually? Or is it appropriate for the life of the offer document to be based on changes to material information? Is there a risk that the information becomes outdated? Should there be a prescribed timeframe for updating the offer document following any such material changes?

[52] The discussion document *Collective Investment Schemes* provides further discussion on trust deed amendments and investor consent required for any adverse changes.

128. If the offer document for CIS does not have a definitive life, how would an investor know that the offer document given to them is the latest version? Should it be dated, and should the issuer be required to state when it will expire?

129. Would it be sufficient for the offer document for CIS to be signed off by the trustee and issuer annually as part of the requirements to report to the regulator – i.e., a confirmation statement provided to the regulator as part of the ongoing annual reporting requirements?

130. For CIS, should any material changes to either Part A or Part B require re-issue and re-registration of the offer document in its entirety, or can supplements adequately deal with any amendments?

131. Should there be a limited number of supplements that can be applied to any one offer document by an issuer – to avoid cluttering the offer document and making it unreadable and confusing for the investor?

132. Should only adverse material changes trigger the updating and re-issue of offer documents, or should any material change trigger a re-issue?

133. Should material changes be advised to investors at the time they are made? Or within a defined time period?

134. How should investors be advised of material changes?

135. Should all trust deed amendments be advised to investors? Or, should the issuer only be required to advise investors of material changes?

136. If the issuer should only be required to advise investors of material changes, what should be defined as "material"? Who should determine what is considered to be "material" – the trustee or the regulator?

4.4.4 Ongoing Disclosure for Unlisted Securities

4.4.4.1 Limited Ongoing Disclosure for Unlisted Securities

357. Principle 14 of the IOSCO Principles for Securities Regulation requires that there should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions. In their assessment of New Zealand securities regulation, FSAP noted that periodic disclosure requirements for listed companies provided for sufficient and timely disclosure, but expressed concern that the periodic disclosure requirements for unlisted issuers did not.

358. Issuers who have listed on a New Zealand-based registered stock exchange are subject to the continuous disclosure regime established in the Securities Markets Act. The continuous disclosure regime is designed to provide investors with price-sensitive information that is material to their decision to transact in the secondary market. It is also useful to company insiders, by providing an avenue to disclose the price-sensitive information in order that the insider may trade.

359. There is no continuous disclosure regime for those issuers who are not listed on a New Zealand-based registered stock exchange. Post-issue disclosure for issuers

who are not listed on NZX is limited to the requirements of the Companies Act (annual reporting), the Financial Reporting Act (audited financial statements within five months after balance date) and the Securities Act (requirement to keep the prospectus up to date). In contrast, by virtue of the continuous disclosure regime, post-issue disclosure for issuers who are listed on NZX is much more extensive and current.

360. As FSAP commented in their assessment of New Zealand's compliance with Principle 14, this is less of a problem in respect of unlisted issuers who are closely held companies and for whose securities there is limited secondary market trading, but it is a problem in respect of larger issuers whose securities are actively traded on a secondary market.[53]

4.4.4.2 Proposed Ongoing Disclosure for Established Markets

361. We question whether a continuous disclosure regime should be extended to all securities for which the issuer holds out that there is, or may be, an established secondary market.

362. In Australia, the continuous disclosure requirements in the Corporations Act 2001 apply to listed issuers and to unlisted issuers where either a disclosure document has been lodged with ASIC under the fundraising provisions or securities have been issued under the disclosure document and those securities have been held by 100 or more persons since issue.

363. The benefit of a continuous disclosure regime is that it provides a mechanism by which price-sensitive information can be disclosed. A continuous disclosure regime provides a source of information for investors which may impact on their decision to transact in the securities of the relevant issuer. This allows the investor to make informed investment decisions. This benefit applies to all securities for which there is a secondary market. If there is no secondary market for the securities, the investor will derive little or no benefit as they will not be able to act on the information.

364. The disadvantage of extending the continuous disclosure regime to all markets for trading of securities may discourage issuers from listing on informal markets. This may prevent the development of smaller, more innovative markets, potentially affecting the ability for small or start-up businesses (whose shares are often traded on less formal systems) to raise capital. It may also encourage issuers to favour private placements over public offerings.

365. It could also be argued that the current regime is clear about which entities that provide trading facilities for securities are regulated by New Zealand law, and that this allows investors to make an informed decision about whether they want to trade through an entity that offers statutory protections or not.

366. If a continuous disclosure regime was imposed on issuers who hold out that there is or may be an established secondary market, it will be necessary to provide a

[53] Nevertheless, FSAP recommended that the periodic disclosure requirements be amended so that all unlisted issuers have to file audited annual financial statements within four months of year end (rather than the current five months) and have to make a preliminary announcement of annual results within 60 days of year end.

mechanism for the disclosure. A possible option is to require the issuer to maintain a publicly available website and to post all information disclosed under the continuous disclosure obligation on that website.

367. An alternative option would be to require unlisted issuers to file their continuous disclosure information with the Registrar of Companies. In Australia, if the issuer is not listed, and the information is not required to be included in a supplementary or replacement disclosure document, the issuer must lodge a document containing the information with ASIC. To enable broad accessibility to the issuer's continuous disclosure information, the Registrar of Companies' electronic database could be expanded to create a disclosure system similar to the Canadian SEDAR (System for Electronic Document Analysis and Retrieval) system.

Questions for Submission

137. What are the benefits of a continuous disclosure regime?

138. Are these benefits manifested for all issuers?

139. Which issuers should be required to comply with a continuous disclosure regime?

140. What are the costs of applying a continuous disclosure regime to these issuers?

141. How should these issuers make their continuous disclosures to the market?

4.4.5 Annual Statistical Data Return – at a Common Date

4.4.5.1 Current Regulation

368. Only the Superannuation Schemes Act currently provides for and requires superannuation schemes to report statistical data to the regulator (the Government Actuary).

4.4.5.2 Proposals

369. The value and use of the statistical data contained in superannuation schemes' current annual reports to the Government Actuary was discussed by the Superannuation Advisory Group. It was noted that such statistical data contributes to a high-level overview of the financial sector, which is of interest to both the industry and Government policy-makers. The Superannuation Advisory Group was receptive to, and saw sense in, schemes producing an annual statistical return to the regulator on a common date which would be standardised across the industry. They could see the value to both the Government and the industry in having such complete and comparable data. The comment was made by some in the Superannuation Advisory Group that this information is in fact at the managers' fingertips and readily extracted from their system at any given month or quarter end.

370. It is proposed under the new regime that there would be a requirement for all other debt, equity and CIS issuers to provide the same statistical data reporting annually, although it is recognised that the information gathered may be slightly different.

371. Such statistical data would then be reported in the regulator's annual report and would become public information.

372. The only qualifier to collecting such information at a common date (rather than producing it at the provider's/issuer's own year end) is that it would, therefore, be unaudited data at that point in time – although it would of course be audited at the product issuer's financial year end.

373. Examples of the headline statistical data suggested to be provided to the regulator once a year would be: investor/member numbers (and number of employers in master trust superannuation schemes), dollars invested (employer and employee contributions for superannuation schemes), dollar value of benefits paid (by category), total opening and closing value of funds invested.

374. This issue has not been discussed with the Debt and Equity or CIS Advisory Groups and further investigation is required to establish the relevance of the above information to the regulator and the application of these information requirements across all debt, equity and CIS products.

375. It is also recognised that the gathering of statistical data is not without cost, so any requirement needs to be put in place only after careful consideration of, for example, the necessity of the information, and who is the best source of the information.

376. It is noted that there are currently other data-gathering mechanisms in place such as those administered by the Reserve Bank under section 36 of the Reserve Bank of New Zealand Act 1999, which requires financial institutions to supply information from time to time. Further, there are additional obligations placed on institutions by Statistics New Zealand. It is acknowledged that there is a need for coordination of the data collection by these various agencies in order to avoid duplication and minimise compliance costs.

377. The above data collected would then by collated and publicly available on the Registrar's website. This is discussed further in the *Overview of the Review and Registration of Financial Institutions* discussion document.

Questions for Submission

142. What information would the regulator need to effectively monitor the issuer? And what should the regulator do with the information?

143. What information should be included in any statistical data return (at a common date) to the regulator? How should this differ from any information required to be reported to the regulator (at the issuer's year end)?

144. How useful would statistical information that is currently produced by superannuation schemes be to the industry if it was applied across all debt and equity and CIS? Would additional or different data be more useful?

145. How accessible is the above statistical data at dates other than the products'/issuers' respective year end?

4.4.6 Annual Reporting – CIS and Superannuation

4.4.6.1 Current Regulation

378. The Superannuation Schemes Act 1989 requires an annual report to be prepared within five months of the end of the financial year and the Second Schedule to that Act sets out what information must be contained in the report. The purpose of the current annual reporting for superannuation schemes is three-fold. It provides the regulator with information to enable it to monitor the schemes. It also provides members of the scheme with information about the operation and performance of the scheme. Finally, it provides statistical information about superannuation schemes more generally, which is of interest to both the industry and government policy-makers. The completed annual report must then be sent to the regulator within 28 days of its completion and must also be sent to members within six months.

4.4.6.2 Problems Identified

379. It has been suggested by some that the current annual report required to be produced for superannuation investors is a waste of time and money, as few investors read it because it does not provide relevant and useful information. What investors are really interested in is the value of their investment in the scheme. Investors want to know: the dollar value of their account; their own and any employer contributions invested; the value of their investment on withdrawal or redemption (e.g. for superannuation schemes the retirement benefit, the death benefit and benefit on resignation); and the investment earnings or return – net of tax and fees.

380. It was also suggested that a lot of the information required to be contained in the annual report was irrelevant to investors and was out of date by the time investors received it. However, other feedback recognised the benefit of investors receiving an annual update on their investment and some issuers viewed it as a valuable opportunity to communicate with investors.

381. Further specific feedback with regard to master trust superannuation schemes is that master trust annual reports are not at all tailored for investors. An issuer is only required to produce an annual report for the master trust scheme as a whole and is not required to produce annual reports for each participating scheme. While there are recognised economies and efficiencies in the application of this, what it means from an investor's perspective is that the annual report is not targeted at their participation in the scheme and is largely irrelevant to their investment or membership. In effect these investors are not getting sufficient information about their specific investment. This was acknowledged as an issue by both the CIS and Superannuation Advisory Groups, but some on the Advisory Groups considered that to require master trusts to produce annual reports for each participating scheme would be excessive and would compromise the efficiencies and cost savings achieved by master trusts for participating employers and members.

382. A suggestion and question that has been raised is whether the obligation to provide annual reports to members could be met by sending a copy electronically to members. This is, however, not currently allowed for under the Superannuation Schemes Act.

4.4.6.3 Proposals

383. It is proposed that ongoing disclosure is required on two fronts – to the regulator, and to the investor.

Ongoing Disclosure to the Regulator

384. It is proposed that the following ongoing disclosure requirements be placed on CIS product issuers:

a. Annual Statistical Data Return at common date (as above).

b. Annual Financial Statements (as above).

c. Trust Deed and any amendments (as above).

d. Amendments to offer document (as above).

e. Other Material Matters.

f. Annual Report at issuer's year end (for employer-based superannuation schemes).

Other Material Matters

385. It is proposed that there be an additional requirement that any other material matters be disclosed. This was only discussed briefly within the CIS and Superannuation Advisory Groups. The question of what is the definition of "material" is discussed in section 4.4.3 above.

Annual Report

386. There is a question about whether there should be a supplementary annual report to complement the above, which addresses all the information that is provided to investors (see below paragraphs 388 to 391). This was discussed with the Superannuation Advisory Group and the proposal to retain the requirement for employer superannuation schemes is addressed below in paragraphs 415 to 421. Again this has not been discussed with the CIS Advisory Group and feedback is sought on this point.

Questions for Submission

146. Should issuers of all CIS products be required to produce an annual report to the regulator? If so, what information should be included in the issuer's annual report to the regulator?

147. Alternatively, should the requirement to produce an annual report to the regulator only apply to existing employer-sponsored stand-alone superannuation schemes, which are exempted from the proposed trustee supervisory model?

148. Is there any other information that is currently provided for in the prospectus that would be useful and important to include in the annual report to the regulator?

Ongoing Disclosure to the Investor

387. It is proposed that the following disclosure is required for investors:

a. No requirement for an annual report.

b. Requirement for an annual statement to be sent to members/investors.

c. Annual member statement to include additional information.

d. Financial statements on request (as above).

e. Advice of material changes (as above).

No Requirement for an Annual Report

388. There was debate in the CIS and Superannuation Advisory Groups on the merits and value of sending annual reports to investors and it was noted that there is not currently a requirement across the board for all CIS products to provide annual reports to investors.

389. The problems and issues with the annual reporting requirements are discussed above under section 4.4.6.2. However an alternative view is that annual reports are useful and important communication items for investors that keep them up to date and advise them of significant changes, and may trigger investors to reassess the appropriateness of their investment.

390. Comment has been made that the obligation should be on issuers to provide adequate information to investors to enable them to understand the value of, and any risks to, their investment. Investors do not know what information to ask for or what questions to ask of issuers and will not go to the effort of trying to find out, nor should they have to. The argument follows that there is, therefore, basic information that should be provided to investors.

391. It was suggested that as an alternative to issuing an annual report to investors, there should a requirement to produce an annual statement of an investor's investment supplemented with additional disclosure information.

Requirement to Send Annual Statement to Investors

392. The CIS Advisory Group considered that it is important that members/investors receive an annual statement, because it reminds investors that they have an investment and allows investors to monitor the management of their investments. It was noted that while there is no legal requirement at the moment across the board for all CIS products to produce annual statements for investors it is common market practice.

393. Currently superannuation schemes are required to provide an investor with an estimate of their benefits on request, and most schemes send an annual statement to investors as a matter of course. It is also noted that all master trust superannuation scheme providers and many administrators of stand-alone schemes now offer internet access to investors to view their account balances at any time.

394. In addition, a defined benefit scheme must provide a statement of assumptions used in calculating benefits (and, if different from other benefits calculated within the previous 12 months, a statement of the reasons why) on request.

395. It is, therefore, proposed that there be a requirement to produce and provide investors with annual statements of their investments in a product/scheme and benefits or withdrawal entitlements. This would include the following information (this is not an all-inclusive or exhaustive list and feedback is sought on this point):

Investor's opening and closing value of investment
Investor's contributions and any other third party (employer) contributions
All fees deducted
Investment earnings (net of tax)
Any withdrawals, benefits payments, redemptions
Value of the investment on withdrawal or redemption (e.g. for superannuation schemes this would include benefit on retirement, resignation, death etc)

Annual Member Statement to Include Additional Comforts and Information

396. The CIS Group considered that an annual statement to investors could provide key information to the investor, such as performance of the fund against the benchmark. This would enable investors to tell exactly how their funds have performed, and would give them grounds to make decisions as to whether to move their funds or not.

397. It was agreed by the Superannuation Advisory Group that there was some information currently provided in the annual report that is useful to investors and could still be reported on in the annual member statement. There was a difference of opinion within the Superannuation Advisory Group about what and how much information should be reported to members, and feedback is sought on this.

398. It is proposed that the annual statement to member investors should include advice of any material changes, for example, a change in the trustee, the issuer, or any of the managers of the investment, and trust deed changes or changes to the investment strategy. It was suggested by the Advisory Groups, however, that only changes that are material should be required to be advised to members/investors, but this point needs to be further debated and feedback is sought.

399. While at the moment there is a requirement for superannuation schemes to advise members of any trust deed amendments, it has been suggested that only trust deed amendments that are material to the investor's investment should be required to be advised to investors. This point also needs further discussion. The merits of when such changes should be advised – in the annual report or at the time of implementation – are discussed further under section 4.4.3 above.

400. The annual member statement should also include a comment that the full financial statements will be provided on request and are available on the issuer's website.

401. There should also be contact details for the investor to contact the trustee or issuer if the investor has any questions with regard to the investment and details of who to contact if the investor has a complaint.

402. The annual member statement should also advise the investor of what further information they can seek and how they can obtain it.

403. It is proposed that there be a requirement to issue annual statements to members within a specified time period and feedback is sought on what would be a reasonable timeframe.

404. The usefulness of abridged financial statements in annual reports to members was also debated. It was agreed within the Superannuation Advisory Group that there is no value in requiring providers to give investors even an abridged set of financials as investors are unlikely to read them. It was suggested by some that it is important that key data should be extracted from the product's financial statements and presented to members, such as:

The opening and closing total fund value of the scheme – to reassure members of the size and growth of the fund, or to highlight if there is any significant reduction in the overall size and value of the scheme and to ensure the issuer is accountable to investors to explain any significant changes (for example, if the funds halved in value due to a significant withdrawal of members or negative return).
The total contributions received for the year – to show extent of growth in new investors and investments.
The total benefits paid to all members over the year – to identify extent and number of withdrawals from the scheme.
The investment earnings of the scheme.

405. Further, it is suggested by some that perhaps it would be useful to the investor for issuers to be required to include a report (in effect an executive summary) in the annual member statement that provides information on any significant changes to the value of funds invested (e.g. by more than 20%), number of members, or performance.

406. It is noted, however, that for the above financial information to be included in the annual member statement, it would require the financial statements of the product to have been prepared. It was further suggested by the Superannuation Advisory Group that if the annual report requirement was to be removed, then the annual member statement should include some comfort statement from the trustee to replace the normal trustees' certifications and auditors' reports that have to date been provided to investors in the annual report. However, when discussed further with the CIS Advisory Group it was suggested that this is not practical and it raises timing issues that have been flagged as a concern in the past – that is, the preparation and audit of the financial statements can delay the issuing of investor statements.

407. While it is appreciated that investors should receive their annual statements as soon as possible after the end of the financial year, this needs to be balanced with ensuring that the information reported to investors is accurate (and has been accurately extracted from the financials) and the integrity of the information is not questioned. It should also be noted that investors can at any time request a statement of the value of their investments and internet access to investors' details is now more common than not. The timing of the issue of annual member statements needs to be discussed further, along with the requirements for financial information to be included. Feedback is sought on these issues.

408. The above information requirements were only briefly discussed with the CIS Advisory Group and further feedback is sought on the relevance and application of these requirements.

Questions for Submission

149. Should there be a requirement to provide investors with an annual report? If so, why? And what information should be included?

150. Should it be a legal requirement for issuers to provide investors with an annual member statement of the value of their investment in a product? If so, what information should be required to be contained in the statement?

151. What information that is currently required to be reported annually to investors is useful and should continue to be a requirement?

152. What information, if any, should be extracted from the financial statements and given to investors?

153. What enhancements should be made to the information currently provided in the member/investor annual statements and what additional information should be required to be included?

154. What level of comfort could be provided in the annual member statement to investors? For example, that the trustee and issuer have complied with all legal requirements in terms of their financial reporting and audit obligations?

155. Should the statement also include advice of any material changes that affect investors? If so, what are examples of material changes that should be advised to investors?

156. Should the statement also be required to include advice of any trust deed amendments or just material amendments?

157. In light of the absence of a requirement to register a prospectus, should the trustee or the issuer be required to produce a statement to confirm that the terms of the trust deed have been adhered to?

158. If there is a requirement to produce an annual report for investors, should it be allowed to be provided electronically (on request, or with the consent of the investor)?

159. Should there be a requirement to issue annual statements to members within a specified time period and, if so, what is a reasonable time period?

Application of Disclosure to Different Types of CIS

409. Consideration needs to be given as to how the above proposed regime might be applied consistently across all types of CIS and whether there should be any exceptions to the rules to accommodate specific products or whether there should be any additional requirements placed on specific products. Feedback is sought on any such specific issues and the implications for products.

Unit Trusts

410. No specific issues were raised in discussions with the CIS Advisory Group. However, it should be noted that there was no discussion with the CIS Advisory Group about the application of a requirement to produce an annual statistical data return to the regulator, so feedback is sought on this point.

Participatory Securities

411. Not all aspects of the reporting requirements may be appropriate or relevant for participatory securities. However, it should be noted that most participatory securities will become CIS, so consistency is important. Feedback is sought on this.

Question for Submission

160. Are there any specific issues for any particular type of CIS that need to be addressed differently or explicitly?

Master Trust Superannuation Structures

412. As noted above – the requirement on master trust scheme trustees to produce a report to all investors of the master trust means that the information reported is largely irrelevant to individual investors as it relates to the master trust as a whole, not to the underlying individual participating employer schemes. A proposed solution is that the investors' individual statements should include more relevant information that relates specifically to their membership in the participating scheme, as well as providing relevant and useful information on the wider master trust to put their investment in context.

413. The application of the above reporting structure and what additional information should be reported to investors of employer-sponsored superannuation schemes in master trusts needs to be discussed further and feedback is sought.

414. There is a question whether the annual reporting requirements outlined below should also apply to master trust superannuation schemes in respect of the underlying participating employer schemes.

Employer Stand-Alone Superannuation Schemes

<u>Annual Report to regulator</u>

415. It is proposed that, in light of the proposal to retain the current regulatory structure for employer-sponsored superannuation schemes (as explained in the *Collective Investment Schemes* discussion document), the current Superannuation Schemes Act requirement on the trustees to produce a detailed annual report to the regulator be retained.

416. It is suggested that the following information (based on the current requirements) should be covered in annual reports, as at the scheme's respective financial year end:

Numerical changes in membership of the scheme during the financial year
Statements/certificates by trustees: • that contributions required to be made in accordance with the trust deed have been made • that all benefits required to be paid in accordance with the trust deed have been paid • whether the market value of assets of the scheme exceed the total value of benefits payable on withdrawal of members • whether more than 10 percent of assets are invested in an employer associated with the scheme
A summary of any amendments to the trust deed since the last report
Names and changes of trustee (including directors of corporate trustee), administration manager, investment manager, insurer, actuary, auditor and solicitor
Name and address for correspondence
If benefits payable are based on the investment return of scheme assets, a statement of the crediting rate or rates applied during the year (it is noted that this should be amended to better reflect the intention of the requirement, which is to advise the total return for the complete 12-month period)

417. This annual report is in addition to the above requirement to furnish the regulator annually with a set of full audited financial statements.

418. This content of the annual report has not been discussed at length with the Superannuation Advisory Group, but the above does not include any additional information from the current requirements. Feedback is sought on this point.

419. Further, it is noted that there is a significant proportion of the above information that is statistical data and the value in the regulator receiving such statistical data at a common date is discussed further above. However, there is still a recognised need for issuers to continue to provide annual reports to the regulator - with exceptions to minimise, where possible, the duplication of any statistical information in the annual report.

420. It is recognised that there would be a few additional reporting requirements placed on employer-sponsored superannuation schemes to reflect the additional information disclosed in the offer document. One example is the dollar value of an employer's surplus in a scheme at each year end balance date and how any of the surplus has been utilised over the past year.

421. Feedback is also sought on what additional information should be reported to investors and what comfort statements could and should be included in the annual member statement – for example, should any of the above trustee certifications also be included in the member's statement?

Defined Benefit Superannuation Schemes

422. In line with the above comments relating to reporting requirements for employer-sponsored superannuation schemes, we are also proposing that the current disclosure requirements in the Superannuation Schemes Act, which apply specifically to defined benefit schemes, should, in general, continue to apply to all defined benefit schemes. These disclosure requirements are:

<u>For Investors</u>

423. A right for a member to receive on request a statement of the specific interest, mortality and other assumptions and bases of calculation applied in determining the value of the assets and liabilities of the scheme for the purposes of the actuarial examination required under the Superannuation Schemes Act.

424. Where a member is considering a proposed change to their benefits (e.g. an election to convert a benefit to a lump sum, an election to defer receipt of a benefit or an election to transfer the benefit), a right for a member to receive on request a statement of the specific interest, mortality and other assumptions and bases of calculation applied in determining the benefits under consideration and, where different assumptions and bases of calculation have been applied in the last 12 months to determine benefits similar to those under consideration, a statement of the reasons why the different assumptions and bases were applied.

425. Where a scheme is wound up, a member has the right to request a copy of the actuarial examination of the scheme, a statement of the specific interest, mortality and other assumptions and bases of calculation applied in determining the value of the assets and liabilities of the scheme for the actuarial examination and a statement of the specific interest, mortality and other assumptions and bases of calculation applied in determining the person's benefits.

426. Feedback is sought on what additional information, if any, should be reported to investors.

<u>To the Regulator</u>

427. That the trustees send a copy of the scheme's actuarial report (that examines the financial position of the scheme as at dates that are no more than three years apart) to the Government Actuary within 28 days after the date it is received by the trustees and no later than seven months after it was due.

428. That the trustees state in the annual report whether the market value of the assets at the close of the financial year equalled or exceeded the total value of benefits that would have been payable if all members had ceased to be members, and if provision had been made for the continued payment of all benefits being paid to members and other beneficiaries.

429. That the annual report includes a statement of whether contributions accord with the most recent actuarial report for the scheme; and a summary of the actuarial report if received since the last annual report.

430. It is proposed that, in addition to the above, defined benefit schemes should be required to disclose annually the wind-up position of the scheme – that is, what it means from the investor's perspective in terms of the actuarial value of members' benefits – on wind-up and on an ongoing basis.

431. It is recognised that the main risk to a member's benefit from a defined benefit scheme is the ongoing ability of the employer to fund benefits and meet any actuarial deficit. In light of this it is questioned whether there is a need for further disclosure relating to whether the employer has the capacity to discharge its obligations under the scheme to meet any actuarial deficit and to continue to fund members' benefits. However, it is appreciated that this might be very difficult to apply in practice and feedback is sought on this point. This issue is discussed further in the *Collective Investment Schemes* discussion document.

Questions for Submission

161. What additional information, if anything, would be important for investors in superannuation schemes to have access to?

162. Is the current information which is required to be produced useful for members of a superannuation scheme? Are any changes required? Does it provide sufficient information for members of employer schemes participating in master trusts, employer stand-alone schemes, and defined benefit schemes, or should additional/different information be required for these schemes?

163. If there is a requirement to produce an annual report, should investors in master trust participating schemes receive a tailored annual report that provides information specific to their investment?

164. Should the financial statements of employer stand-alone superannuation schemes be required to be publicly available on the Companies Office website?

165. How useful is the statistical information that is currently produced by the Government Actuary to the industry? Would additional or different data be more useful?

166. What information would the regulator need to be able to effectively monitor the trustee and the scheme more generally (for employer schemes)? Would this differ from the current requirements in the Superannuation Schemes Act?

167. Is all of the above information currently required for the regulator in respect of superannuation schemes necessary and relevant? What information, if any, could be extracted?

168. Should the annual reporting requirements (to the regulator) for employer-based stand-alone superannuation schemes also apply to master trust superannuation schemes in respect of the underlying participating employer schemes?

169. What additional information should be reported to members in defined benefit schemes and what "comfort statements" could and should be included in the annual member statement?

170. Should there be a requirement for disclosure of an employer's capacity to discharge its obligations under the scheme to meet any actuarial deficit and to continue to fund members' benefits? If so, how could such a requirement be applied in practice?

4.5 REGISTRATION OF DISCLOSURE DOCUMENTS

432. The feedback from advisory groups was that it would be helpful if disclosure information was only required to be filed with one office. For superannuation schemes, the requirement to file documents with both the Companies Office and the Government Actuary was considered excessive.

433. It is proposed that the following documents would be required to be registered with the Companies Office:

a. the trust deed, and any amendments;

b. the offer document and any amendments (see further specific comments for debt and equity and CIS and superannuation below);

c. the annual full audited financial statements; and

d. the statistical data return – see discussion under section 4.4.5 above.

434. The following explains any variations and additions to the above that specifically apply to debt and equity or CIS and superannuation.

4.5.1 Registration of Debt and Equity Documents

435. The offer document will be required to be updated and re-registered annually, alongside the requirement to register the annual audited financial statements.

4.5.2 Registration of CIS and Superannuation Documents

436. The offer document will only be required to be re-registered if/as/when anything material changes.

437. The annual report in respect of employer-sponsored superannuation schemes will be required to be registered.

438. Any participating employer deeds will be required to be registered.

4.5.3 Electronic Filing of Offer Documents

439. It is proposed that documents will be able to be filed electronically.

440. The registration process and requirements are discussed in further detail in Part B of the discussion document *Overview of the Review and Registration of Financial Institutions*.

Question for Submission

171. Should documents be able to be filed electronically?

4.6 ADVERTISING

Authorised Advertisements

441. Section 38 of the Securities Act defines "authorised advertisements" in relation to an offer of securities to the public. Any such advertisements must comply with the requirements of the Securities Act and Securities Regulations, which are that an advertisement must not contain any matter that is likely to deceive, mislead or confuse with regard to any particular that is material to the offer of securities contained or referred to in the advertisement;[54] and must be consistent with the registered prospectus referred to in the advertisement.[55] Regulations 11 to 23 of the Securities Regulations set out other matters that need to be complied with in an advertisement. The Securities Commission has the power to prohibit false or misleading advertisements.[56]

442. We seek feedback on whether there are any problems with the rules around advertising in the Securities Act and Securities Regulations and, if so, how these problems may be addressed. We have received some feedback that there is a problem with persons publishing ratings or rankings, of questionable merit, which have not been solicited by the issuer. We propose to address this problem by allowing only the issuer and promoter the ability to advertise.

Pre-Prospectus Advertising

443. Section 5(2CA) of the Securities Act provides an exemption from the requirements of Part 2 of the Securities Act (other than sections 38B and 58) and the Securities Regulations for pre-prospectus advertisements.

444. We have received feedback that the pre-prospectus advertising provision is not wide enough, in that it does not extend to offers which are not required to have an investment statement or prospectus, for example private offers. Section 5(2CA)(a) of the Securities Act requires that the advertisement state that the issuer is considering an offer of securities to the public, but that no money is currently being sought and no applications for securities will be accepted or money received unless the subscriber has received an investment statement.

[54] Regulation 8, Securities Regulations 1983.

[55] Regulation 9, Securities Regulations 1983.

[56] Section 38B, Securities Act 1978.

445. We seek feedback on whether the current pre-prospectus advertising provision is appropriate.

Questions for Submission

172. Are the current Securities Act and Securities Regulations requirements for advertisements appropriate?

173. If no, what issues need to be addressed and what improvements could be made?

174. Is there a problem with persons other than the issuer or promoter advertising an issuer's product? If yes, do you agree that this problem should be addressed by giving only the issuer and promoter the ability to advertise a product?

175. Are the current Securities Act requirements for pre-prospectus advertisements appropriate? For example, is the exemption for pre-prospectus advertisements wide enough?

176. If no, what issues need to be addressed and what improvements could be made?

APPENDIX ONE: CONSUMER RESEARCH

4.6.1.1 Financial Knowledge Survey

446. The Retirement Commission, in conjunction with ANZ and MED, has recently undertaken research into the financial knowledge of New Zealanders.[57] The *ANZ - Retirement Commission Financial Knowledge Survey* found that New Zealanders' knowledge levels are reasonable overall, but that there are gaps.

447. In relation to collective investment schemes and debt securities the survey found that:

a. 28% had invested or seriously considered investing in managed funds, contributory mortgage schemes, bonds, debentures or other debt securities;

b. 63% of the 28% had got advice;

c. people under 35 years of age were less likely to have got advice;

d. the predominant source of advice was a specialist investment advisor (56%);

e. 26% obtained advice from a relative or friend, 16% from an accountant, 14% from a share broker, 9% from a bank and 4% from a lawyer; and

f. 83% found the advice from a specialist investment advisor to be very useful or quite useful.

448. In relation to superannuation the survey found that:

a. 58% of those who have or had superannuation or insurance got advice in advance of signing the contract; and

b. the main sources of advice were the insurance company of agent or advisor (38%), an independent financial planner (36%) and a relative or friend (36%).

449. In relation to equities the survey found that:

a. 20% of respondents currently own shares;

b. 37% of the 30% who had bought or seriously considered buying shares through a public offering got advice before making their decision (which is substantially lower than for superannuation, life insurance, collective investment schemes and debt securities); and

c. the main sources of advice were relative or friend (36%), share broker (22%), specialist investment adviser (21%) accountant (21%) and lawyer (12%).

450. In relation to questions about obtaining written information about investments, the results showed that:

[57] A copy of the *ANZ - Retirement Commission Financial Knowledge Survey* can be found at www.retirement.org.nz.

d. 65% of investors or potential investors said they had obtained written information in advance. 64% believed they had obtained a prospectus, 56% a brochure and 46% an investment statement;

e. those who obtained an investment statement were asked how useful the 10 categories of information included in the investment statement were. All categories were regarded as very useful or quite useful by at least 87% of these respondents; and

f. the percentage rating a category of information "very useful" varied from 46% to 76%. The highest ratings were given to information about: "what the risks are" (76%), "what the returns are" (75%), "who to contact with enquiries" (74%) and "what the charges are" (76%).

4.6.1.2 CIS and Superannuation

Australian Research

451. According to a recent (March 2006) survey of superannuation funds in Australia conducted by online superannuation group Max Super – "*the main concern for consumers is a feeling that there is no reliable means to compare funds' performance, fees and investment options. This is compounded by the fact that key information needed to make decisions is often buried deep in websites or annual reports*." This is useful feedback that can easily be evidenced in the New Zealand market and is consumer feedback that should be heeded. Further it needs to be recognised that not everyone has access to the internet or email and therefore websites cannot be relied upon by issuers to meet the information needs of all investors.

Securities Commission and ISI 1999 Survey – Investors' Opinions of Managed Funds' Investment Statements

452. The 1999 survey conducted by the Securities Commission in consultation with the Investment Savings and Insurance Association – entitled: *Investors' Opinions of Managed Funds' Investment Statements*[58] is also useful in measuring consumer feedback on the effectiveness of the current disclosure regime. Appreciating that this survey was done in 1999 and things have in many respects moved on from this (in terms of industry refinements to the application of the rules to investment statements) there are still lessons to be learned from this feedback.

453. The findings included some initial observations on the structure of the investment statements surveyed and how the investors rated the understandability and usefulness of the investment statements. Some of the most pertinent feedback comments follow.

a. The length of the document could be reduced because of repetition.

b. The more concise aspect of the investment statement was supported over the detail included in the prospectus.

[58] A copy of the Securities Commission 1999 survey: *Investors' Opinions of Managed Funds Investment Statements* can be found on the Securities Commission website www.sec-com.govt.nz/publications

c. Charts were an understandable and useful means through which to provide information.

d. On occasion answers given to different questions seem to contradict each other.

e. There appeared to be a demand, in the case of combined offers of managed funds, that issuers answer the question – “How do I work out which product is right for me?”

f. While written comments suggested that some questions and their answers were of no interest, the percentage of respondents who read the answer to a particular question suggests that all of the current questions were considered to be of interest to investors.

g. The survey also concluded that the understandability of the answer acts as a constraint on the perceived usefulness of the answer. That is; an answer that cannot be readily understood is also less useful.

h. Investors most frequently queried the quality of the answers given to the questions: “What are the charges?” “What returns will I get?” “What are my risks?”

i. There was little guidance on which product to choose and how the investment should be used.

j. In terms of the additional information included in the investment statements there was some information that was repetitious and other information that could have been better placed in the prospectus.

k. Time spent reading the investment statements varied widely – with 16 percent of respondents indicating they spent two hours reading an investment statement, 32 percent sent an hour, 30 percent spent 30 minutes and 22 percent spent only 15 minutes.

APPENDIX TWO: SUMMARY OF QUESTIONS FOR SUBMISSION

Application of the Securities Act 1978

1. What protections, in addition to the prohibition on misleading or deceptive conduct in relation to any dealings in securities, should apply to private offers of securities?

2. Should the distinction between offers made under sections 3 and 5 of the Securities Act be retained?

3. Do you agree that the exemption for relatives and close business associates can be improved by focusing on the principle of the exemption, i.e., that by virtue of their relationship with the issuer, the investor has the knowledge of or access to the information that would normally be disclosed by the issuer under the Securities Act?

4. Should we list examples of the types of relationship that might satisfy this exemption? If yes, where should this list appear? In legislation or in guidance provided by the Securities Commission? What would it cover and why?

5. Do you agree to the use of a list of criteria to define a sophisticated investor? If no, why?

6. If yes, should a sophisticated investor be defined by reference to the following criteria:

    - transactions of a significant size on securities markets at a specified frequency over a specified period;
    - the size of the investor's securities portfolio;
    - works or has worked for at least one year in the financial sector in a professional position which requires knowledge of securities investment; and
    - experience in the industry to which a particular investment relates.

7. If you agree with the above criteria, how many of these criteria should an investor satisfy in order to be considered a sophisticated investor? Why?

8. Should sophisticated investors be able to self-certify as sophisticated investors, or should sophisticated investors be certified by a third party? Why?

9. How often should investors have to certify as sophisticated investors? For example, prior to each offer? Every six months? Every 12 months?

10. What evidence should the investor have to provide the Registrar of Companies to show that it meets the criteria for sophisticated investors?

11. Is an exemption for minimum subscription price needed if we have a sophisticated investor exemption?

12. If yes, what should the minimum subscription price be? And, how would this meet the objectives of the Securities Act?

13. Should the exemption for "any other person" be removed?

14. If no, which type of investor will it catch that will not already be covered under the proposed definitions for close associates; professional and sophisticated investors; and offers with a minimum subscription?

15. Should the exemption for wealthy investors be retained? If no, why? If yes, how does this meet the objectives of the Securities Act?

16. Do you agree that if there is a security that is offered in conjunction with an offer of land, which is not the interest in land itself, it should be excluded from this exemption and subject to Part II of the Securities Act?

17. Is there anything else that should be changed to clarify the scope of this exemption? Do the words in paragraph 5(1)(b)(i) add anything to the provision, or should the exemption simply apply to any estate or interest in land that does not form part of a contributory scheme?

18. Should we introduce a small offers exemption?

19. Are there any policy considerations that would justify such an exemption?

20. Although it is inconsistent with the policy of the Securities Act, is there sufficient harm in allowing a small offer exemption to justify not doing so?

21. Could sufficient protection be provided to investors by imposing restrictions on:

    - who the offer can be made to?
    - the advertising and promotion of the offer?

22. Should issuers of investment grade rated debt have reduced disclosure obligations, by virtue of having an investment grade rating? Why?

23. Should local authorities have an exemption from the disclosure regime in the Securities Act? Why?

24. If no, should local authorities have an exemption from the requirement for all councillors to sign the offer document, whilst retaining liability on all councillors for the content of the offer document? Why?

25. Should issuers who are subject to the continuous disclosure regime and who want to issue new securities of a class already listed, be able to use a transaction-specific offer document? If no, why?

26. Should issuers who are subject to the continuous disclosure regime and have either listed equity or listed debt securities, be able to use a transaction-specific offer document if it wants to issue new debt securities? If no, why?

27. Should the transaction-specific offer document contain the following:

    - any information material to the securities being offered that had not previously been disclosed, including as a result of any of the exceptions to the continuous disclosure regime; and

- reference to the information that has already been disclosed by the issuer under the continuous disclosure provisions since the latest registered statement of financial position, and where that information can be obtained;

- a statement by the directors of the issuer as to whether, after due enquiry by them in relation to the period since the date of the latest registered statement of financial position, there have, in their opinion, arisen any circumstances that materially adversely affect: the trading or profitability of the issuing/borrowing group; the value of its assets; or the ability of the issuing/borrowing group to pay its liabilities due within the next 12 months?

28. If no, what disclosures should the listed issuer make in the transaction-specific offer document?

29. For what time period should a listed issuer have been subject to the continuous disclosure regime before it can use the transaction-specific offer document?

30. Should the transaction-specific offer document be registered with the Registrar of Companies?

31. Should the listed issuer have to provide a copy of the registered transaction-specific offer document to any person who requests it?

32. Should the listed issuer be able to raise further capital with the transaction-specific offer document by making an offer announcement to the market and informing investors that the transaction-specific offer document is available on the NZX website and the issuer's website (if it has one)?

33. Should the Securities Commission have the power to deny a listed issuer access to the transaction-specific prospectus if it has breached any provisions of the Securities Act or the continuous disclosure regime?

34. Should the exemption for all contributory mortgages be removed?

35. Alternatively, should only the exemption for contributory mortgages used for development purposes be removed?

36. If the exemption for all contributory mortgages should be removed, should solicitors who offer contributory mortgages continue to have an exemption from the disclosure regime?

37. Should section 6(7) of the Securities Act extend to the content of the disclosure documents?

38. Is the current definition for equity appropriate? If no, how could it be improved?

39. Is the current definition for debt appropriate? If no, how could it be improved? Is there a need for a clearer generic definition, in addition to the indicative list of specific debt security instruments?

40. Where should the line fall between a security and a derivative? For example, should a derivative be defined as a financial product that provides either second level or synthetic

exposure to the property, rights, capital, or earnings underlying a security, or to any commodity?

41. Are there any problems with definition of “promoter”?

42. If yes, how might these problems be addressed?

43. Are promoters subject to the appropriate liabilities? If no, what liabilities should promoters be subject to?

44. Are there any problems with the current definitions of “issuer” in respect of each type of security?

45. If yes, how could these problems be addressed?

Disclosure – Offer document

46. Should the issuer be allowed to repeat information disclosed in Part A of the proposed offer document in Part B?

47. Should issuers be allowed to include additional voluntary information in Part B of the proposed offer document?

48. If yes, how should that voluntary information be incorporated? For example, should the voluntary information be included in the appropriate section of Part B or, at the end of the document? Should that voluntary information be highlighted as voluntary information or otherwise differentiated from the statutorily required information?

49. Should there be any restrictions on how the issuer may present the voluntary information? For example, should the issuer be restricted from giving the voluntary information greater prominence (e.g. printed in colour or larger font) than the statutorily required information?

50. What requirements, if any, should be placed on the content of the offer documents in terms of readability, conciseness and clear, plain language?

51. What are the benefits and risks of having generic educational information extracted from the offer documents? Would this aid or detract from investor understanding of the information in offer documents?

52. Should the generic educational material be included in the issuer’s offer documents? If so, in Part A or Part B or in a separate document (brochure/pamphlet) produced by the Government?

53. If generic educational information is retained in issuers’ offer documents should there be stipulated requirements around the wording and how this information is presented (for example, should it be highlighted and identified as not being product specific and being from an independent source)? If so, should the Government provide the required wording for all issuers to use?

54. Is there sufficient standard and common information about features and risks associated with various products to make this information useful?

55. Who should bear the costs of producing educational material?

56. Is it important that educational material is independently sourced?

57. Should the trust deed, financial statements and material contracts be required to be made available on the issuer's website? If not, why not?

58. What, if any, additional information should be required to be held on the issuer's website?

59. Is it sufficient that issuers make their financial statements (full/summary) available on their websites and the Companies Office website, and on request by investors? Or, should issuers be required to provide summary/full financial statements to all investors?

60. Is there any other information that is currently required to be in the offer documents, (for debt and equity or CIS and superannuation) that might be better suited to being provided on request?

61. Do you think relevant environmental information needs to be provided by issuers to provide appropriate disclosure of risk? If so, what type of information is important?

62. Do you think that current disclosure of material environmental information by issuers is adequate? If not, why not?

63. How, if at all, do you currently assess which environmental factors could affect financial returns on an investment?

64. What assistance, if any, do issuers require to ensure that disclosures of material environmental information are high quality, relevant and comparable?

65. Do you think the costs of environmental disclosure are significant, and if so, how significant would they be, and can they be justified?

66. Do you think that current disclosure of material environmental information by issuers is adequate to allow informed consumer choice? If not, why not?

67. To enable informed consumer choice, do you think issuers should disclose whether or not they take environmental factors into account? If so, what information would be important to provide when an issuer did take environmental factors into account?

68. How, if at all, do you currently assess which environmental information is of interest to investors?

69. What assistance, if any, do issuers require to ensure that disclosures of material environmental information are high quality, relevant and comparable?

Disclosure – offer document for debt and equity

70. Are these seven questions appropriate and sufficient to bring out the key features for equity and debt investors?

71. Should any questions be removed or added? If so, what?

72. Are the topics suggested under these questions appropriate and sufficient to bring out the key features for equity and debt investors?

73. Are these key features capable of being summarised meaningfully in less than five pages?

74. Do you agree with the approach of an overriding principle-based disclosure requirement supported by prescriptive disclosure requirements, which are tailored for different offers and issuers, for Part B of the offer document?

75. If no, do you support a principle-based disclosure requirement only?

76. Are the general headings listed in the First Schedule to the Securities Regulations sufficient and appropriate for equity securities?

77. If no, what headings would you remove or add?

78. Are the general headings listed in the Second Schedule to the Securities Regulations sufficient and appropriate for debt securities?

79. If no, what headings would you remove or add?

80. Do you agree that Part B of the offer document should contain a separate section on "Risks"?

81. Do you agree with the proposal to require issuers to split their disclosure on risks into three sections i.e. risks relating to: the security offered; the industry in which the issuer operates; and the issuer?

82. Do you agree that this proposal will make it easier for the investor to understand what risks apply to the offer of securities?

83. Should it be mandatory for first-time issuers of equity to produce prospective financial information?

84. If no, on what basis should issuers have to produce prospective financial information?

85. Should every issuer of equity securities be required to consider whether it should provide prospective financial information, based on whether such information is likely to be material to an investor's decision?

86. Should Part B of the offer document include a summary of the principal terms of the trust deed?

87. If yes, should the regulation prescribe what terms of the trust deed must be summarised?

Disclosure – Offer document for CIS and superannuation

88. Should all of the above information be included in Part A of the offer document? If not, what information should be excluded and why?

89. Should Part A of the offer document be able to stand alone as an offer document and therefore, be able to be relied upon by the investor without reference to Part B?

90. If Part A of the offer document is the only information that an investor reads before investing – does it tell the investor all the critical information that he or she needs to know? Is there any other information that should be included in Part A of the offer document that is useful or more relevant to investors?

91. What level of detail of the investment risk should be addressed in Part A of the offer document? For example, should the investment options and risk be to a level of detail that includes the asset class weightings? Or should that be addressed in Part B of the offer document?

92. Should Part A of the offer document be limited to a specified number of pages? For example, can the key features, benefits, risk and fees of various products be meaningfully and usefully summarised in fewer than five pages?

93. How should fees be disclosed in a standard format in Part A of the offer document? What is more appropriate for the investor – an MER, a worked dollar example, or both?

94. Should fees be required to be stated either net or gross for consistency and ease of comparison?

95. How could a generic worked example of fees be applied consistently and meaningfully across the various CIS products?

96. Can the Australian standard worked fee example be applied to products in New Zealand? If not, why not? If so, how could it be adapted to better suit New Zealand products?

97. Should past performance be included or excluded from Part A of the offer document? Why?

98. With the removal of the requirement to produce a prospectus is there any additional information from the current prospectus requirements that should be disclosed in Part A of the offer document?

99. Should Part A of the offer document be prescriptive rather than principle-based disclosure requirements?

100. Should the information that is generic to all CIS or particular CIS products (e.g. superannuation schemes) be extracted out of the offer document and be reproduced in a separate generic educational document?

101. What information should be required to be in Part B of the offer document and what information should be on request only?

102. With the removal of the prospectus is there any information that is currently contained in the prospectus that should be included in Part B of the offer document?

103. What level of detail of the investment risk should be addressed in Part B of the offer document? For example, should the investment options and risk be to a level of detail that includes the asset class weightings? Or is it sufficient to require that level of detail to be held on the issuer's website?

104. Should performance over various time periods be required to be provided or available? Is on the issuer's website sufficient, or should it be included in Part B of the offer document? Why? If included, should it be required to be disclosed or be disclosed on a voluntary basis? What prescription, if any, should there be around how performance figures are disclosed, and should they be presented in a consistent format? What qualifiers and disclaimers should be included?

105. Should there be a provision for "any other material matters" or information to be disclosed in Part B of the offer document?

106. How should fees be prescribed to be disclosed in order to ensure that the investor gets a complete picture of all fees and charges they could directly or indirectly incur?

107. Can the Australian standard fee template be applied to products in New Zealand?

108. Are there any specific issues that need to be addressed in relation to the proposed offer document disclosure for unit trusts?

109. Are there any specific issues that need to be addressed in relation to the proposed offer document disclosure for participatory securities?

110. How would the application of a standard format fee disclosure apply across all investment product types? What form of fee disclosure is most appropriate for and relevant to the investor?

111. What would Part A of the offer document disclosure requirements mean in relation to a master trust scheme? That is, where a product/scheme has a number of investment fund options on offer under the one product/scheme – should there be a Part A (of the offer document) for each underlying investment fund, or should all investment funds be included in the one product/scheme Part A of the offer document? What could be achieved within a short summary? What is considered to be the most useful disclosure for consumers and the easiest to understand?

112. Does the class exemption in clause 8(2) of the Securities Act (Multiple Participants Superannuation Schemes) Exemption Notice 1998, as renewed and amended in 2004, adequately address concerns about the confidentiality of employer participating agreements?

113. Should a Part A (of the offer document) be required for each employer participating scheme in a master trust – just as a supplement to the issuer-generic investment statement is required now? How would this be practically applied?

114. Is any of the required disclosure information not relevant for employer-sponsored stand-alone superannuation schemes?

115. Will some of the information proposed for the offer document be standard information about all superannuation schemes (and therefore better dealt with through the generic educational information produced by the regulator)? If so, which information?

116. Is it possible to achieve a useful summary of the key features and benefits of an employer-sponsored stand-alone scheme in fewer than five pages?

117. Are there any issues about superannuation schemes, as opposed to general CIS schemes, that would require longer disclosure?

118. Is there any particular additional information that should be required to be disclosed for employer-sponsored stand-alone schemes – would this differ for master trusts and stand-alone schemes?

119. What aspects of the suggested disclosure would be appropriate or inappropriate for defined benefit schemes? Is there any information that is useful for investors in other superannuation schemes that is not relevant for investors in defined benefit schemes?

120. What is the key information that needs to be disclosed for defined benefit schemes?

121. Is there any other information that would be useful for and important to investors in defined benefit schemes?

122. Should there be a requirement for issuers to summarise the trust deed? If so, what terms should be summarised? Alternatively, is it sufficient to rely on the offer document to, in effect, summarise the trust deed?

123. Are the issuer's material contracts considered to be commercially sensitive? If so, is it appropriate that they be required to be held with the Companies Office and publicly available on the Companies Office or issuer's websites? If not, why not? Or is it sufficient that there is only a requirement to summarise the contracts in the offer document?

124. Does the current provision to apply for an exemption from the Securities Commission work well in practice and adequately deal with the concerns over the commercial sensitivity of material contracts?

125. In light of the proposal to remove the requirement for an annual report, what additional information should be required to be usefully provided to prospective members before joining? Should this information be required to be disclosed or provided on request and on the issuer's website?

126. Is it reasonable to expect issuers to, on request by investors, provide a hard copy of any information that is held on their website (in particular to cater for those people who do not have internet access)?

Disclosure – Ongoing disclosure

127. Should the offer document for CIS have a prescribed and definitive life? For example, should it be updated annually? Or is it appropriate for the life of the offer document to be based on changes to material information? Is there a risk that the information becomes outdated? Should there be a prescribed timeframe for updating the offer document following any such material changes?

128. If the offer document for CIS does not have a definitive life, how would an investor know that the offer document given to them is the latest version? Should it be dated, and should the issuer be required to state when it will expire?

129. Would it be sufficient for the offer document for CIS to be signed off by the trustee and issuer annually as part of the requirements to report to the regulator – i.e., a confirmation statement provided to the regulator as part of the ongoing annual reporting requirements?

130. For CIS, should any material changes to either Part A or Part B require re-issue and re-registration of the offer document in its entirety, or can supplements adequately deal with any amendments?

131. Should there be a limited number of supplements that can be applied to any one offer document by an issuer – to avoid cluttering the offer document and making it unreadable and confusing for the investor?

132. Should only adverse material changes trigger the updating and re-issue of offer documents, or should any material change trigger a re-issue?

133. Should material changes be advised to investors at the time they are made? Or within a defined time period?

134. How should investors be advised of material changes?

135. Should all trust deed amendments be advised to investors? Or, should the issuer only be required to advise investors of material changes?

136. If the issuer should only be required to advise investors of material changes, what should be defined as "material"? Who should determine what is considered to be "material" – the trustee or the regulator?

137. What are the benefits of a continuous disclosure regime?

138. Are these benefits manifested for all issuers?

139. Which issuers should be required to comply with a continuous disclosure regime?

140. What are the costs of applying a continuous disclosure regime to these issuers?

141. How should these issuers make their continuous disclosures to the market?

142. What information would the regulator need to effectively monitor the issuer? And what should the regulator do with the information?

143. What information should be included in any statistical data return (at a common date) to the regulator? How should this differ from any information required to be reported to the regulator (at the issuer's year end)?

144. How useful would statistical information that is currently produced by superannuation schemes be to the industry if it was applied across all debt and equity and CIS? Would additional or different data be more useful?

145. How accessible is the above statistical data at dates other than the products'/issuers' respective year end?

146. Should issuers of all CIS products be required to produce an annual report to the regulator? If so, what information should be included in the issuer's annual report to the regulator?

147. Alternatively, should the requirement to produce an annual report to the regulator only apply to existing employer-sponsored stand-alone superannuation schemes, which are exempted from the proposed trustee supervisory model?

148. Is there any other information that is currently provided for in the prospectus that would be useful and important to include in the annual report to the regulator?

149. Should there be a requirement to provide investors with an annual report? If so, why? And what information should be included?

150. Should it be a legal requirement for issuers to provide investors with an annual member statement of the value of their investment in a product? If so, what information should be required to be contained in the statement?

151. What information that is currently required to be reported annually to investors is useful and should continue to be a requirement?

152. What information, if any, should be extracted from the financial statements and given to investors?

153. What enhancements should be made to the information currently provided in the member/investor annual statements and what additional information should be required to be included?

154. What level of comfort could be provided in the annual statement to investors? For example, that the trustee and issuer have complied with all legal requirements in terms of their financial reporting and audit obligations?

155. Should the statement also include advice of any material changes that affect investors? If so, what are examples of material changes that should be advised to investors?

156. Should the statement also be required to include advice of any trust deed amendments or just material amendments?

157. In light of the absence of a requirement to register a prospectus, should the trustees or the issuer be required to produce a statement to confirm that the terms of the trust deed have been adhered to?

158. If there is a requirement to produce an annual report for investors, should it be allowed to be provided electronically (on request, or with the consent of the investor)?

159. Should there be a requirement to issue annual statements to members within a specified time period and, if so, what is a reasonable time period?

160. Are there any specific issues for any particular type of CIS that need to be addressed differently or explicitly?

161. What additional information, if anything, would be important for investors in superannuation schemes to have access to?

162. Is the current information which is required to be produced useful for members of a superannuation scheme? Are any changes required? Does it provide sufficient information for members of employer schemes participating in master trusts, employer stand-alone schemes, and defined benefit schemes, or should additional/different information be required for these schemes?

163. If there is a requirement to produce an annual report, should investors in master trust participating schemes receive a tailored annual report that provides information specific to their investment?

164. Should the financial statements of employer stand-alone superannuation schemes be required to be publicly available on the Companies Office website?

165. How useful is the statistical information that is currently produced by the Government Actuary to the industry? Would additional or different data be more useful?

166. What information would the regulator need to be able to effectively monitor the trustee and the scheme more generally (for employer schemes)? Would this differ from the current requirements in the Superannuation Schemes Act?

167. Is all of the above information currently required for the regulator in respect of superannuation schemes necessary and relevant? What information, if any, could be extracted?

168. Should the annual reporting requirements (to the regulator) for employer-based stand-alone superannuation schemes also apply to master trust superannuation schemes in respect of the underlying participating employer schemes?

169. What additional information should be reported to members in defined benefit schemes and what "comfort statements" could and should be included in the annual member statement?

170. Should there be a requirement for disclosure of an employer's capacity to discharge its obligations under the scheme to meet any actuarial deficit and to continue to fund members' benefits? If so, how could such a requirement be applied in practice?

Disclosure – Registration of disclosure documents

171. Should documents be able to be filed electronically?

Disclosure - Advertising

172. Are the current Securities Act and Securities Regulations requirements for advertisements appropriate?

173. If no, what issues need to be addressed and what improvements could be made?

174. Is there a problem with persons other than the issuer or promoter advertising an issuer's product? If yes, do you agree that this problem should be addressed by giving only the issuer and promoter the ability to advertise a product?

175. Are the current Securities Act requirements for pre-prospectus advertisements appropriate? For example, is the exemption for pre-prospectus advertisements wide enough?

176. If no, what issues need to be addressed and what improvements could be made?