FinancialServicesCouncil.
growing and protecting the wealth of New Zealanders

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Submission by: Financial Services Council (previously the Investment Savings and Insurance Association)

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Second Consultation - Guidance Note: Effective Disclosure

The Financial Services Council of NZ (FSC) (previously the Investment Savings and Insurance Association of NZ Inc. - ISI) appreciates the opportunity to comment on the FMA's Second Consultation on the Guidance Note on Effective Disclosure. The ISI made a submission on the first draft of the Guidance Note.

We very much appreciate that the FMA decided to have a second round of consultation. The industry is dedicated to producing high quality and practical disclosure documents while minimising compliance costs for issuers. This is best achieved when there is a frank and open relationship between the FMA and industry organisations. We agree that a 'clear, concise and effective ' standard will improve the quality of disclosure and help potential investors make better investment decisions.

A list of FSC members is included at the end of this submission.

Please contact us if you would like to discuss this submission in more detail.

Comments

1. The FSC appreciates that the FMA has responded to submissions by making a number of changes to the Guidance Note. Significant improvements could still be made to the Note's effectiveness if it was thoroughly edited for conciseness. A Guidance Note of 52 pages on top of required familiarity with base regulation simply adds to compliance costs for providers and their advisers. We would be concerned if this is to be the model for future guidance notes.

The Guidance Note's audience is issuers and advisers who have a good understanding of the basic legal requirements and these should not need to be reiterated. The Guidance Note is undesirably discursive. It is also imprecise for such an audience – e.g. paragraph 19 simply talks about the Act and Regulations when it is only talking about the Securities Act and Regulations (previous statutory references in this section include the FMA Act, the Securities Trustees and Statutory Supervisors Act and the Auditor Regulation Act). Some references to defined terms are italicised and others not (e.g. mortgage scheme and property scheme).

2. We are still concerned that the Guidance Note is extending the present explicit content requirements without full analysis of the practicalities and then leaving it to issuers to grapple with what is reasonable detail. Raising factors that *may* be relevant or material and requiring issuers to document reasons for not including them further increases compliance costs. An example is disclosure of direct and indirect costs in paragraphs 127 and 128. We question whether clause 7(2) of Schedule 13 to the Securities Regulations only relates to 'direct' costs where there are a number of tiers of investment management in a managed fund. Fees to a sub-manager certainly affect investor returns and are payable from the scheme's assets in their entirety. In our view, managed funds do their best to describe those fees while recognising that disclosure may be difficult to quantify and is complicated. The present regulations recognise these difficulties by only requiring a statement of the types of fees under clause 7(2). Actual fee disclosure requirements are presently being developed by MED for KiwiSaver schemes with the expectation that they would be applied more widely under the revised securities regulations presently being developed. Fee disclosure requirements should be considered more fully as part of that regulatory development process.

3. While the inclusion of a key information section sounds good in principle, it needs to be considered in the context of the prescriptive content requirements of investment statements and prospectuses. Which of the prescribed content is not key information? A key information section that omits prescribed information may be seen to be misleading and leads to issuer doubt about what information to include. It will also increase the length of disclosure documents and compromise standardisation of format and comparability.

4. Given the different purposes of investment statements and prospectuses, the Guidance Note still does not distinguish appropriately between them – e.g. see the answer to question 5 and the key information section treatment referred to in the answer to question 7.

5. The Guidance Note should not reiterate statutory requirements particularly the Securities Regulations. The Note should confine itself to information not specifically required, but that the FMA considers may be materially misleading if omitted, and comments on the FMA's approach to required content – e.g. paragraph 107.

6. The definition of mortgage scheme should follow the 'core business' approach of the definition of a property scheme – i.e. at least 50% of the scheme is invested in mortgages.

7. Paragraph 110 should refer to Table XVII not XVIII.

Feedback questions

Topic 1: Timeframe

Question 1: Does the proposed new timeframe present difficulties for issuers or investors that would make it unworkable?

Answer: No, the revised timeframe is reasonable.

Question 2: If so, please suggest changes to the timeframe. Please focus these changes on enabling us to deliver on our objectives for issuing the guidance note (see paragraphs 9-12 of the revised draft) in a timely way, without creating disproportionate expense.

Answer: n/a.

Topic 2: Status of guidance

Question 3: Is the status of the revised guidance, and how FMA will use the guidance in reviewing disclosure documents, clear?

Answer: The status of the Guidance Note could be clearer.

Question 4: If not, please refer us to specific respects where further clarity would assist.

Answer: The status of the Guidance Note is covered in the introductory comments section – a reasonably discursive section outlining the FMA's overall approach. As we noted in our submission on the first draft, the principal focus for issuers is to draft disclosure documents that meet the legal requirements. The Guidance Note is essentially an outline of factors the FMA will consider when assessing disclosure documents against legal requirements. It would lead to a more concise guidance note if the key points in the introductory comments on the status of the Guidance Note were combined with and added after the key legal requirements in section A.

Topic 3: Length of disclosure statements

Question 5: Are there any respects in which it is not clear that it is for the issuers to form a view as to materiality?

Answer: Again, this is a key point that is not clearly presented. It applies to both investment statements and prospectuses. However, in the Introductory Comments section it is covered under paragraph 28 in a section headed 'Prospectuses' and is not mentioned in the key points of the Introductory Comments of Section A. Paragraph 26 states 'we will consider whether the prospectus contains all material information'. It is only the last sentence two paragraphs later where it is stated 'It is for you to judge whether a factor is material in the context of your particular offer'. The message that primary responsibility for determining materiality is with issuers is still confused.

Paragraph 13 notes that the FMA's review of disclosure documents is selective. The Guidance Note would be much clearer if issuer responsibility for content and judgement on materiality was stated up front and the FMA's review and powers in respect of investment statements and prospectuses placed in this context. While issuer judgement on materiality is covered in the body of Guidance Note, the key points of Section D should also highlight issuers' primary role in forming that judgement and the FMA's review powers.

There is inconsistent reference to disclosure documents when outlining the responsibility to disclose all material information. The requirement to include all material information applies explicitly to prospectuses and implicitly to investment statements (sections 43F and G of the Securities Act). However, references to materiality sometimes refer to disclosure statements in general and other times to the prospectus (e.g. the 2nd and 3rd bullets in the Key points of section D).

Greater guidance should also be given where the Guidance Note suggests a factor may be material but is not a specific disclosure requirement for investment statements or prospectuses (e.g. qualifications and experience of senior management, auditors) and make it clear in which document the FMA considers it should be included. The content requirements for investment statements are quite prescriptive and include a reference to other information being available in the prospectus. There should also be guidance to the use of subsection 55(b) of the Securities Act - which allows inclusion in disclosure statements by reference – particularly in relation to investment statements.

The Securities Regulations requirements for prospectus contents have a section 'Other material matters'. The content requirements of other sections of the prospectus are prescriptive with the implication that the other material matters are included in the material matters section rather than a more relevant section. Splitting up related matters (e.g. qualifications and experience of senior management) will make a prospectus even more difficult to read. The Guidance Note should make it clear other material matters should be included in related, prescribed sections of the prospectus (and investment statements, if that is the intention).

Question 6: Are there any respects in which you consider the revised guidance continues to encourage inclusion of additional, and immaterial, information?

Answer: Yes -see below.

Question 7: If so, please identify specific paragraphs that have the above effects.

Answer: Paragraph 33 talks about making necessary or *desirable* amendments. Despite the present requirement that investment statements, in particular, contain key information and are succinct, the experience has been 'if in doubt, include it' leading to long and unwieldy investment statements. Use of 'desirable' reinforces this behaviour and, particularly considering the overhaul of disclosure requirements under the Financial Markets Conduct Bill, reference to 'desirable' amendments should be deleted.

The first Key point in Section C implies that a key information section is desirable. Given that the Securities Act requires investment statements to contain key information and the desirability of standardising investment statements to help investors compare potential investments, issuers should not be encouraged to add another key information section to investment statements. Any key information deficiencies in investment statements should be addressed in due course by the PDS requirements under the FMCA.

A statutory requirement should be viewed as a compliance issue and not something that needs to be disclosed. Compliance issues should form part of the FMA's review of disclosure documents only. Disclosing statutory requirements simply increases the length of the disclosure document compromising the requirement to be succinct. The Auditor Regulation Act requires auditors of

issuers to be licensed so the reader should be able to assume they are licensed. Only material restrictions or limitations on an audit firm's licence should need to be disclosed. (Given the critical role of auditors, it would be expected that an auditor would be either competent or not to conduct an audit, not that an auditor licence condition would materially affect a potential investment decision.) Regarding paragraph 76, we would expect auditor independence to be fundamental to the audit role. It is covered by NZICA's International Standard on Auditing (New Zealand) 200 and we would expect auditor independence to be covered by any grant of accreditation under the Auditor Regulation Act.

Similarly, where a trustee or statutory supervisor is required to be licensed it shouldn't be a disclosure requirement. When the Financial Markets Conduct Act is fully in force, the full licensing requirements for managers, statutory supervisors and independent trustees will be in place. If a trustee or statutory supervisor is not required to be licensed we should be able to assume that Parliament has decided that there is good reason for not requiring a licence (e.g. restricted schemes) and that disclosure is not material. In the transition period until the FMCA is effective and licensing requirements are not complete, licensing disclosure may raise unwarranted concerns and confuse potential investors. For example, a superannuation scheme trustee cannot be licensed as such under the STSS Act – to disclose any other licences held would simply be confusing.

Regarding the length of disclosure documents, the Guidance Note should also address the use of subsection 55(b) of the Securities Act that allows inclusion in disclosure statements by reference, particularly of information that may be complicated or subject to regular change –e.g. sub-managers and fees. References to issuer websites is an efficient way of disclosing relevant and changing information, particularly if the disclosure document is online, and is increasingly used in other jurisdictions.

Topic 4: 'Ownership' of the process

Question 8: Are there any remaining respects in which it is not clear how we will work with issuers to understand the rationale for their views, before deciding whether it will be appropriate to exercise statutory powers in particular cases?
If so, please identify specific paragraphs or sections in the guidance that are not clear.

Answer: See the answer to question 3. It is not clear that ownership of the development of disclosure documents is primarily with issuers and that the FMA will only exercise its powers under the Act if it finds a deficiency in disclosure documents after a discretionary review.

List of FSC Members

FSC Members
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