9 March 2012

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

Contact:

Peter Neilson	Deborah Keating
Chief Executive	Executive Officer
peter@isi.org.nz	Deborah@isi.org.nz
04 831 0306	04 831 0308

Total pages: 20

FMA Consultation Paper - Guidance Note: Effective Disclosure

The Financial Services Council of NZ ("FSC") (previously the Investment Savings and Insurance Association of NZ Inc.) appreciates the opportunity to comment on the FMA's Guidance Note on Effective Disclosure.

FSC members (see list at end) are key providers of KiwiSaver schemes and other managed investment schemes and, as such, will be directly affected by the FMA's proposed guidance.

Introduction

FSC members are very supportive of the objective of improved disclosure for investors in retail managed investment schemes. The Investment Savings and Insurance Association contributed extensively towards that objective with submissions on the Review of Financial Products and Providers in 2006, through the development of the financial adviser legislation in 2008, the Review of Securities Law in 2010 and the drafting of the Financial Markets Conduct ("FMC") Bill, introduced to Parliament at the end of 2011 and currently before the Commerce Select Committee.

We understand that some issuers have asked for guidance from FMA on specific aspects relating to discontinuation of the pre-vetting process and we agree that provision by FMA of specific guidance in certain areas, such as 'other material matters', is a useful part of the FMA role.

We are concerned, however, that the proposed Guidance Note appears to go much further than that and risks creating another layer of compliance in reviewing existing disclosure documentation and supporting material at considerable cost for all issuers.

We note that an all-encompassing process to deal with the future product disclosure requirements for KiwiSaver and managed investment schemes is already underway through the FMC Bill and the regulations that are to flow from it. Members of the FSC are naturally reluctant to implement a new set of disclosure requirements at the present time when such a fundamental change to the disclosure landscape is so close.

In discussions with FMA officials we have been advised that the intention is not to increase the amount of disclosure that is currently required, but rather to ensure that all material information is provided and that it is presented in an easily understandable manner. FMA intends the Guidance Note to help issuers comply with current legal requirements and their review and on-going surveillance will be looking for genuine attempts to comply.

It would be helpful for the Guidance Note to focus on identifying the current legal requirements and providing guidance as to matters that should be considered to meet those legal requirements. The guidance should be phrased appropriately, for example 'issuers should consider matters such as…'.

It is unfortunate that the Guidance Note gives the impression that there is widespread non-compliance with the current requirements for documents to contain information that is prescribed or otherwise material, and for documents not to be false or misleading in a material particular, as we do not believe this to be the case. There is no doubt that we share FMA's overall objectives with regard to the standard of disclosure to retail investors in managed investment schemes. However, we do have some concerns with the content and direction of the Guidance Note, which we have endeavoured to incorporate into our responses to specific questions posed by the FMA.

.....

Guidance Note Para or table	Consultation Paper question	Submission	Recommendation	Statutory Refs
	1	**Implementation** One of our key concerns relates to the status of the proposed Guidance Note. On page 1 of Attachment 'A' it states that the Guidance Note will have no legal status other than as a description of the intended approach of the FMA in reviewing disclosure documents. This appears to be at odds with the wording of the Consultation Paper which refers in a number of places to 'compliance' with the Guidance Note. In particular, paragraphs 6-7 of the Consultation Paper give a strong impression of regulation. We consider this to be a fundamental problem with the Guidance Note as it gives an implied status of regulation that has no legal foundation. While we understand that the FMA did not intend to imply more than guidance, it is very likely that directors will be reluctant to sign off disclosure documents without strict compliance. This will inevitably incur major expenditure in reviewing and revising documents and obtaining legal and audit checks for all existing disclosure documents and related material before 31 December 2012. It will also increase the information included in the offer documents, which is contrary to FMA's intended outcome. Implementation of the Guidance Note would require new processes to be written within issuing companies, staff to be trained on the new processes, and documents to be	We recommend: • Exemption of prospectuses from the scope of the Guidance Note; or • Application only to new issues and exemption of continuous issue managed fund products; or • As a minimum, removing the requirement for the prospectus to include a plain English summary of the trust deed. We also recommend: ▪ the Guidance Note is rewritten so that specific parts target specific classes of security and refer back to applicable provisions of the regulations; ▪ The document is rewritten as guidance, removing the "required" "comply" language throughout; ▪ The deadlines are removed; and ▪ Additional consultation is undertaken.	

		reviewed, approved and re-issued. As well as direct costs, this would involve considerable expense in staff time, particularly in view of the requirement to include information from parts of the business (internally and externally) not currently involved in the preparation of disclosure documents and also copy writers /proof readers to ensure disclosure documents are rewritten in "plain English". The timeline proposed by the FMA is unnecessarily short in two respects. The chart at paragraph 5 sets 26 March as the date for publication of the final Guidance Note. Taking into account the deadline of 9 March for making a submission, that does not allow time for further discussion and consultation on issues that arise during the submission process. Secondly, the date set for 'compliance' with the Guidance Note is unrealistic, taking into account the time required for revision and approval of disclosure documents, whether or not any amendment is required. It is usual to allow 2-3 months for the renewal of disclosure documents to be approved and signed-off under current legislative requirements. A complete review and re-write of the disclosure documents is likely to take even longer. In addition, members issue a number of products and will therefore have to amend numerous offer documents within a very short timeframe. Quite apart from these concerns, we do not believe that the FMA has a legal basis for imposing specific dates for 'compliance'. Existing disclosure documents are issued on the basis that they comply with existing legal requirements and the existence of guidance should not		

		affect that status. As noted above, the Investment Savings and Insurance Association made extensive submissions over many years in order to assist improved regulation of managed investment schemes in New Zealand. The FSC is currently preparing a submission on the FMC Bill which is expected to substantially change the disclosure requirements for managed investments schemes, replacing the Investment Statement and Prospectus with a *"prescribed length"* Product Disclosure Statement. One of the key objectives of the new regime is to make disclosure information more accessible to retail investors and to facilitate comparison of different products. The effect of the Guidance Note is to circumvent the process that has been chosen by Parliament for implementation of the new regime. In view of the significant changes to industry regulation that will result from the new legislation, Government has allowed an extensive lead-in time to allow for consultation on the FMC Bill and on the regulations that will follow it. We support that process. If the Guidance Note is to apply to both prospectuses and investment statements it needs to be clearer how the guidance applies to each document. The Guidance Note should not apply to any other document. In particular, we have concerns relating to the intended application of Section C, the Key Information section. It is not clear how the FMA intends for this to apply and it seems to be in conflict with current legal requirements,		

		including the Securities Regulations. This would also have the potential to be repetitive and increase the length of offer documents, and would therefore not meet the FMA's objective for documents to be "concise". We believe that, if changes to the content and format of the offer documents are warranted, this should be undertaken by an amendment to the Regulations and not via a guidance note. In addition it is generally understood that prospectuses are not widely read documents. With the FMC Bill working through a process in which disclosure documents are suggested to be substantially changed (for this very reason), we consider these changes to the prospectus for managed investment schemes are unwarranted. Of particular concern to issuers would be the cost involved if a plain English summary of the trust deed was included.		
	2	**Clear, concise and effective** No. While we agree that producing clear, concise and effective disclosure documents is an appropriate objective, it is not the current legal test that documents are required to pass in New Zealand. Current legislation requires disclosure documents not to be 'false or misleading in a material particular'. Specifically, the Securities Regulations state that "An advertisement must not contain any information, sound, image, or other 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."	We recommend that "clear, concise and effective" should be stated clearly as guidance rather than a legal test.	

		A new legal test should not be introduced via a guidance note. Our preference would be to maintain the current focus of resources on ensuring the Investment Statement is as readable as possible.		
	3	Considering the expected disappearance of the prospectus after enactment of the FMC Bill, it would be a very costly exercise to “plain English” existing prospectuses. Even for those that require no, or only minimal, changes the process of review and approval involves considerable time and expense. We also believe that in any case "plain English" would be difficult to achieve and potentially misleading in light of the level of prescribed content in prospectuses. It is important to recognise that care needs to be taken when imposing a blanket requirement to use “plain English”. For example, the Guidance Note suggests that the word ‘likely’ is used instead of the words ‘not unlikely’. They mean quite different things. We reiterate our earlier point that ensuring all documents use "plain English" is not justified as it will be very costly and in some cases (e.g. a plain English summary of the trust deed) would be inappropriate.	We recommend that "plain language" and "plain English" are stated clearly as guidance rather than as a requirement.	
	4	It is not always preferable for prescribed information to be given prominence over other information that in fact may be more material to an investor's decision. The existing regime contains limited examples where information is required to be provided at a particular	Any amendment to the content or format of offer documents should be made in amendments to the Regulations. The requirement to include a key information section in prospectuses and investment statements	

		level of prominence. Also, we note our comments in response to question 1 in relation to current legal requirements. Given that the content of prospectuses and investment statements is largely prescribed by regulations (including the order of information) it is hard to give aspects in the Guidance Note priority over content required by law.	should be deleted.	
	5	No. We do not agree with the proposed guidance. Investment statements, in particular, need to be appealing for investors to read. Some investors are more visually-oriented and images could assist their engagement with disclosure documents. In addition, at present the FMA has required that brand information only be included where it will assist the investor's understanding. This is not the legal test and should be removed. Brand information, photographs, and all other content is acceptable provided that such content does not mislead, deceive et cetera in accordance with the current legal tests.	The Guidance Note should not set out requirements or tests for the inclusion or exclusion of information. The existing legal tests should prevail.	
	6	No. There is no current legal test of "effectiveness" in New Zealand and it should not be introduced through the Guidance Note. In addition, we are concerned that the guidance on effectiveness is very subjective and will potentially lead to different interpretations that will not facilitate comparison between products. See also the response to	There is no current legal test of "effectiveness" in New Zealand and it should not be introduced through the Guidance Note.	

		question 2.		
	7	No. There is no current legal test of "effectiveness" in New Zealand and it should not be introduced through the Guidance Note.	There is no current legal test of "effectiveness" in New Zealand and it should not be introduced through the Guidance Note.	
	8-10	As stated previously, the Guidance Note should not include a requirement to have a key information section in offer documents. If it is rephrased as guidance rather than a requirement, the Guidance Note needs to clarify which of the key information matters in Section C apply to both the investment statement and the prospectus. The information that is required to be included in offer documents is prescribed by law. Additional information should be included at the discretion of the issuer where it is material to the offer or where the offer document would be misleading without it. Furthermore, it is arguable whether the information identified by FMA is "key information" in respect of all offers of securities; some information will be more relevant to particular types of offers. It is therefore inappropriate to attempt to define "key information". Including a requirement to refer to information (e.g. related party transactions) in the investment statement even if there are none that are material (if that is what is intended) would work against a 'concise' document. In contrast to recent experience with certain issues of	Any amendment to the content or format of offer documents should be made in amendments to the Regulations. The requirement to include a key information section in prospectuses and investment statements should be deleted. We recommend that either the guidance relating to matters to be disclosed in the prospectus should be set out separately or prospectuses should be exempted from the coverage of the Guidance Note. Our preference would be for prospectuses for continuous issue products to be exempt from the coverage of the Guidance Note.	

		debt securities, we believe it needs to be recognised that related party transactions are not, and never have been, a feature of managed investment schemes. We are aware of only one example in recent times where a related transaction in regard to a KiwiSaver scheme was at issue; such a structure is not, however, representative of the way managed investment schemes are generally structured and operated in NZ. The business model may be key information for some classes of security but not for others. The factors set out in Table V relating to the business model do not work or are not relevant for managed investment schemes. As many competition law cases demonstrate, identifying competitors can be extremely difficult and require expert opinion and judgement (e.g. what is a market?). In addition, listing competitors could be misleading unless there is more guidance around this. For example, simply listing other companies that issue managed investment funds could be misleading without stating the reasons why they are a competitor and that will lead to very lengthy documentation. Consideration must also be given to the impact of a change in competitors, e.g. a major new entrant or the merger of lesser players to form a major competitor, and whether this would require disclosure documents to be updated.		
	11-13	No. We believe this is far too much information for managed investment schemes and would detract from	We recommend that no additional content should be required to be disclosed, except to the extent it should be disclosed to meet existing	

		information regarding the actual investment. This information should not be introduced through the Guidance Note. Furthermore, the Companies Act already governs disclosure of remuneration information and it is difficult to see why additional remuneration information should be prescribed in the Guidance Note when it does not need to be disclosed under the Securities Act and Regulations or the Companies Act. There may also be employment law/privacy issues with disclosing such personal information publicly in the absence of any statutory requirement to do so. Current regulations only require information to be stated about auditors and directors and not senior managers. Also, this information has potential to become out of date more regularly. Updates should not be required unless changes are material. This could lead to big compliance costs which in the end would be borne by investors.	legal tests and requirements.	
	14-16	No. Disclosure of risks should be consistent with current legal requirements. The Guidance Note should not encourage issuers not to disclose risks that may impact that issuer. This approach may be misleading and contrary to existing legal requirements. It is not clear whether section 39-42 is aimed at the issuer, the investment or both. In the context of	No additional content should be required, except to the extent it should be disclosed to meet current legal tests and requirements.	

		managed investment schemes the risks of an issuer may not be material to the investment. It is also unclear what is meant by a "risk model" in Table VII and whether this is useful information for an investor. It should not be the issuer's role to balance risks and benefits – that may be financial advice. We also do not believe issuers should explain steps taken to mitigate risk as that could be misleading.		
	17	No. We believe this information adds no value for investors in managed investment schemes. Disclosure of related party transactions should be consistent with existing legal requirements and we note our point above regarding the key information section. In addition, it requires information to be disclosed that may not be material to investors and does not take into account the corporate form or investment approach of particular types of entities.	No additional content should be required, except to the extent it should be disclosed to meet current legal tests and requirements.	
	18	No comment.		
	20	While a credit rating is a requirement for an NBDT, stating the issuer's credit rating (should they have one) for other classes of security may be irrelevant and could be misleading, especially in the case of managed investment schemes. It is also likely that the detailed information required would add significantly to the length of the offer documents.	We recommend that disclosure of such information should not be required unless it is considered material to a particular offer and therefore required to be disclosed to meet current legal tests.	
	21	Where used in the appropriate situations, for some	We recommend that no disclosure of such	

		classes of security, the credit rating may be material.	information should be required unless it is considered material to a particular offer.	
	22	We believe the content of the offer documents should be determined by issuers in accordance with the existing requirements.		
	23	We have no objection to the definition of financial information in the Table XVI, subject to existing legislative requirements	As a general recommendation, the tables set out throughout the Guidance Note should be edited to remove any reference to "requirements" and to indicate that they are indicative only. At present, they encourage the "tick the box" approach that FMA is trying to avoid. We recommend that the Guidance Note acknowledge that there is no legal requirement to include financial information in an investment statement.	
	24	No, subject to existing legislative requirements. We consider it is potentially confusing to require a reference to prospective financial information if it is not provided and not required to be provided. Indicative returns should not be required. Furthermore, this part of the Guidance Note refers to the "clear, concise and effective" test. We note our previous comments regarding this test. Providing indicative returns for future periods is not a feature of offers given the fact that there is no agreed methodology and anything presented would be totally reliant on subjective assumptions and would risk misleading. We are not aware of disclosures of this nature being required overseas.	The reference to the "clear, concise and effective" test should be removed.	

	25	Yes. However, our previous comments regarding the "clear, concise and effective" test also apply here.	The reference to the "clear, concise and effective" test should be removed.	
	26	We believe the content of the offer documents should be determined by issuers in accordance with the existing requirements. In particular, we do not believe it is appropriate to require issuers to comment on the performance of their competitors.		
	27	Yes		
	28	Yes. However, this part of the Guidance Note refers to the "clear, concise and effective" test. We note our previous comments regarding this test.	The reference to the "clear, concise and effective" test should be removed.	
	29	Yes, where appropriate for the security type and subject to existing legal requirements.		
	30	No. Guidance should be specific to the security type to avoid further complications and recognise that issuers currently prepare the prospectus in accordance with the relevant schedule of the existing Securities Regulations 2009. The Securities Regulations specifically state that an investment statement is not required to state that a matter is not applicable to the securities, (Reg 20).		
	31	No. We note our previous comments regarding the key information section.		
	32-33	No. We see no reason why KiwiSaver is treated separately to other managed investment schemes,	It is not clear why these sectors were selected.	

		especially considering the direction of the FMC Bill.		
	34	As above, we see no reason why KiwiSaver is segregated from other managed investment schemes in paragraphs 66 - 78. We agree that the suggestions are appropriate for all managed investment schemes (subject to existing legislative requirements). There is an added difficulty for KiwiSaver schemes to comply with the timing of 'compliance' with the Guidance Note arising from the varying dates for transition to the KiwiSaver Amendment Act 2011. That work has had more reasonable consultation timeframes and FMA will have the opportunity to issue binding guidance under the Securities Act on the framework and methodology that issuers are to use. Paragraph 68 needs further detail to clarify how prescriptive it is intended to be. For example, some funds would be considered to be "diversified" even if they only hold one class of asset – that is, they are diversified within that asset class. Similarly, it is possible to have a conservative fund with some investments that are high risk. Paragraphs 66 to 78 refer to disclosure of investment performance and costs. The requirements around presentation and calculation of returns are currently the subject of MED consultation on periodic reporting and the Guidance Note needs to be consistent with this work. In the second bullet point of Paragraph 77 '(intermediate		

		entities, whether related or unrelated)' should be defined.		
	35	No. It is sufficient that the matters to be disclosed by KiwiSaver issuers are determined by law and by the issuer's assessment of whether the information is otherwise material.		
	36-38	The requirements of Table XII should be subject to existing legal requirements and the following comments. It is not clear whether this applies if the debt security is held in a fund where capital and interest is guaranteed. It is also not clear whether the information in paragraphs 79-84 is to be considered solely for finance companies or for all debt securities. There needs to be clarity around whether this applies to debt securities where they are held in a fund in which part of the fund assets are lent, but other parts of the assets are invested. We would like "related party transactions" to be defined. Some of the information proposed is potentially commercially sensitive eg "valuations".		
	43	While we agree with the pursuit of clear, concise and effective disclosure, it is currently not a legal requirement. The FMC Bill (currently before the Select Committee) will substantially change the requirements for offer documents and we believe that issuers should not be amending offer documents in the manner		

		suggested by the Guidance Note at this stage.		
	44	We do not consider it appropriate for the FMA to pre-empt the development of the new legislative regime by imposing new requirements that are likely to make it more difficult for retail investors to compare disclosure documents for different products. That is the expected impact of leaving it up to issuers to decide what 'compliance' with the Guidance Note will look like in their documents. There appears to be a 'one size fits all' view of securities regulation in the drafting. In a number of instances it is not clear as to whether the Guidance Note applies to the prospectus, investment statement or both. For example, Key information (Page 13) – it is not clear whether it is to be in the prospectus, the investment statement or both. The Guidance Note lists items "we expect disclosure documents to identify and explain as a minimum" but then paragraph 32 implies the key information for investment statements is just what is outlined in Schedule 13.	We recommend the FMA: • Review the legal powers behind the Guidance Note, including the implications the document may have should legal proceedings be taken against an issuer. • Review the timing of the Guidance Note and the justification for delaying at least until enactment of the FMC Bill. • Provide greater clarity in the Guidance Note as to where it does and does not apply.	
	45	Yes. Although advertisements need to be consistent with offer documents, the nature of an advertisement varies significantly to offer documents.		
	46	We believe the current advertisement regime works well. Any guidance should be looked at in conjunction with existing legislative requirements and future legislative requirements (eg in parallel with the enactment of the FMC Bill, regulations for an NBDT, issuer status change		

		and licensing of the trustees in respect of KiwiSaver schemes.)		
	47	Not entirely. Given the Guidance Note is very unclear in parts as to how it applies to the prospectus and investment statement (and where the relevant information goes in each document), and given the fact it is trying to prescribe requirements (as opposed to providing guidance) it risks issuers putting in all of the 'required' information and creating confusion within the documents thereby creating investor-confusion.		
	48	No.		
	49	Our members have identified (as an estimate) increased compliance costs which will ultimately be passed on to the investors. Members currently follow a comprehensive due diligence process for a prospectus annual renewal which takes 2- 3 months to complete from initial review through to on-line registration with the Companies Office. This allows for the simultaneous updating and production of the investment statement (considered current good industry practice). One of our members has advised that, in order to comply with the Guidance Note, costs may treble across current product offerings as a result of input required from the following resources: • all key internal business stakeholders in Product, Investments, Finance, in-house Legal, in-house Tax, Marketing and Administration, Chief Financial Officer & Chief Executive Officer		

		• key external stakeholders such as Trustee/Statutory Supervisor, solicitors, auditors & taxation advisors • internal Due Diligence Committee • Board members • Plain-English copywriters.		
	50	None at all.		

List of FSC Members

FSC MEMBERS

AIA NZ
AMP Financial Services/ AXA New Zealand
ANZ Bank
Asteron Life Ltd
BNZ Investments and Insurance
CIGNA Life Insurance NZ Ltd
Fidelity Life Assurance Co Ltd
FNZ
Gen Re LifeHealth
Hannover Life Re of Australasia Ltd
Kiwibank Ltd
Mercer
Munich Reinsurance Co of Australasia Ltd
Pinnacle Life
Public Trust
RGA Reinsurance Co. of Australia Ltd
Sovereign Ltd
Swiss Re Life & Health Australia Ltd
TOWER New Zealand
Westpac Bank

Associate Members

Bell Gully
BNP Paribas
Bravura Solutions
Burrowes & Co
Chapman Tripp
Davies Financial & Actuarial Ltd
Deloitte
DLA Phillips Fox
Ernst & Young
InvestmentLink (New Zealand) Ltd
KPMG
Kensington Swan
Melville Jessup Weaver
Minter Ellison Rudd Watts
Morningstar Research Ltd
PricewaterhouseCoopers
Russell McVeagh
Simpson Grierson