

## **The ASFONZ submission on the Review of Securities Offerings Discussion Document**

ASFONZ believes that this is a key area for the review and one where significant improvements to the current regime can be made. The level of understanding of financial products by investors generally is not high and this must be recognised when designing offer documents.

The current system, involving Investment Statements, has not been as successful in informing investors as would have been hoped. This is not because Investment Statements do not give investors the information that they need – with need as determined by officials. It is largely because the investing public is unwilling and/or unable to read and understand these documents.

We strongly support any moves to raise the general level of knowledge and understanding and are encouraged by recent moves in this area. In particular, we recognise the work of the Retirement Commission. However, it is likely to be some years before the results of any education campaigns start to be seen.

In the meantime we believe that it is preferable to ensure that investors are encouraged to focus on the vital elements of any investment that they may be considering. This may mean that some of the information that may be considered to be important in an 'ideal' world is not given the prominence that it has in the past.

We make this point at the beginning of this submission as we are concerned that, overall, the proposals for a new two part disclosure regime may end up looking too much like the current regime to make any real difference. If investors will not read current investment statements why would be think that they will read even Part A as proposed, let alone Part B?

ASFONZ, through its members, is well placed to assist in the development and 'market testing' of disclosure material, most particularly in the employer superannuation scheme arena. We would be pleased to be a continuing part of the consultation process. It is likely that there will be some useful opportunities for research in this area once KiwiSaver schemes start to be promoted.

Having said that, our comments on the Discussion Document questions follow:

- 1-2 No comment
- 3 We agree that the exclusion for relatives and close business associates can be improved by focusing on the principle of the exclusion, so that the exclusion applies where the relationship between the investor and the issuer is such that the investor has the knowledge or the means to obtain the knowledge of information that would normally be disclosed under the Securities Act.

In the context of employer-facilitated superannuation and KiwiSaver schemes, this would help clarify the circumstances in which offerings that are limited to senior managers or executives of the sponsoring employer may be able to be made other than on the basis that they constitute offers of securities to the public. This would facilitate greater innovation and targeting of savings initiatives, and assist employers to maintain confidentiality in respect of senior executive remuneration packages.

In most situations, we anticipate that the exclusion, if couched on a principles basis, will not be available as senior management personnel will not have sufficient access rights to information concerning the relevant scheme. This is appropriate where the relationship is such that such access rights do exist, it is also possible that the balance of convenience will result in trustees treating a targeted senior management offer as if full Securities Act compliance were required. However, we do not believe there is any public benefit in requiring such compliance to occur, and a clear public negative and savings disincentive if scheme trustees are forced to incur the attendant costs unnecessarily.

- 4 We believe that including a limited range of examples of relationships that might or will satisfy a principle-based close business associates test in the Securities Act itself would be helpful, as would retaining or expanding the range of examples of relationships that would not satisfy such a test. An example of the former is directors of the issuer company, and of the latter is the current confirmation that an employment relationship alone is insufficient to place an investor outside the public test. We believe it is desirable to provide greater certainty for issuers by locking in examples and fundamental principals in the legislation itself.

5-40 No comment

- 41-42 A number of employer-facilitated superannuation schemes involve one or more directors of an employer also being a director of a corporate trustee issuer, or an individual trustee. Paragraph (c) of the definition of promoter is open to interpretation as to whether or not such a person is a promoter and appears in conflict with paragraph (b).

There is no apparent benefit in treating a director of an issuer as a promoter, or in treating an issuer as a promoter. Such persons are already liable for misdemeanours to the same or greater extent as a promoter is liable under sections 56 and 59 of the Securities Act.

We believe the inconsistency in the current definition of promoter should be addressed by you expressly stating that neither issuer nor directors of an issuer are regarded as a promoter for the purposes of the Securities Act. This could be achieved by adding the words “,other than the issuer of the securities and its directors and officers” at the end of paragraph (a), paragraph (c) would then be left to address the position of a person acting solely in their professional capacity but classified so as to expressly state that this exclusion applies “unless that person is also a director or officer of a body corporate that is a promoter.” We also believe further clarity could be achieved by expanding the paragraph (c) exclusion for professional advisers to those who are merely involved in marketing or distributing the securities, without being involved in formulating a plan or programme pursuant to which the securities are offered.

We agree that the problem identified in paragraph 159 has arisen on a number of occasions. It would be helpful to be able to exclude such entities in appropriate circumstances, where there is an NZ resident entity that can assume that role.

- 43 We believe promoters are subject to the appropriate liabilities under the law as it presently stands, both under the Securities Act and other relevant legislation and common law.

44 & 45 No comment. We do not believe that there are any problems as far as superannuation schemes are concerned.

46 Proposed offer document

We are very supportive of proposed moves to

- reduce the complexity of the offer documents
- recognise the importance of reducing compliance costs
- target the offer documents more specifically to the type of product
- remove the need for a separate registered prospectus for superannuation and KiwiSaver schemes

We believe that retaining a prescriptive base for the documents is appropriate for the various reasons set out in the discussion document. However, this together with the succinct nature proposed for Part A of the offer document will of necessity lead to repetition in Part B. For all practical purposes Part A will be in the nature of an executive summary with the detail provided in Part B for those members who require (or are interested in) further explanation.

For those members who read Part B, the need to refer back to Part A for part of the explanation could be confusing and frustrating. This comment extends to cross-referencing within Part B. While there will certainly be points where it is appropriate and desirable excessive cross-referencing reduces readability. As a consequence, we believe the issuer should be allowed to repeat in Part B information disclosed in Part A.

47 The inclusion of voluntary information in the offer document to a certain extent depends on the relevance of the prescribed information in Part B. If the headings are properly targeted to the product and allow for a full explanation then the need for additional voluntary information may be quite limited. However, as there will invariably be an element of imposing the “one size fits all” through having a prescriptive approach, there will need to be some flexibility in the content. Excluding voluntary information might well prove to be misleading by precluding full explanation, and is likely to result in differences of views (and as a consequence, greater costs in obtaining compliance sign offs) as to what must and what cannot be included.

48 Where the voluntary information in an offer document is to provide fuller explanation of aspects of the scheme, it should not be differentiated from required information. To maintain readability it should be incorporated into the main body of Part B and not distinguished from that information.

Where the voluntary information is supplemental (for example, past performance or asset class weightings might be considered supplemental) these could more usefully be included as appendices. The appendices could then be updated as required (and registered as supplemental) without having to alter the main body of the offer document.

It is, however, difficult to see how the creation of a two part document will decrease the size of the offer document. Certainly schemes which are still required to register a prospectus will benefit; but for those schemes which are currently exempt from preparation of a prospectus, it seems that potentially their new offer document will be longer than their current investment statement.

- 49 We believe that restricting presentation styles in offer documents is unrealistic and will result in disputes and greater costs in signing off compliance. We also strongly support innovation in communication, as evidenced by the annual ASFONZ Communication Awards and disagree with prescribing restrictions that may stifle innovation, in the absence of a clear need.

We do, however, support a principle based restriction being imposed to the effect that information that is not strictly required in order to comply with the prescribed requirements of Part B must not be presented in such a fashion as to diminish the importance of the prescribed content. We believe such a restriction is sufficient without unduly limiting communication innovation – anything more restrictive heightens the risk that Part B will be presented alongside more visually appealing material and reduce the likelihood it will be read.

- 50 Concepts of readability and clear, plain language are very subjective and present opportunities for extensive debate over compliance if presented. The mechanics of many securities offered are inherently complex. In some instance, it is not possible to describe a scheme's features accurately in brief, simple terms. We believe that a principle-based standard of readability should be imposed, so that offer documents must be comprehensible by an unsophisticated non-expert investor, yet still contain sufficient details to satisfy a prudent non-expert investor.

#### 51-55 Educational Material

If educational material is not available in conjunction with the offer document then the member will be required to make additional effort to obtain that information. This heightens the risk of a member making a choice without understanding the full implications of that choice. Potential members will have varying levels of understanding of investment products, investment terms, risks and benefits. The inclusion of generic information within the offer document will enable members to readily access any additional information or explanations they might need. Issuers may also wish to include tailored educational material of greater relevance to the particular securities being offered, and this should be encouraged. Investors can ignore the educational material if they are comfortable with their level of understanding.

Educational information should be able to be included in the body of the offer documents or as an appendix. Providing it as a separate document would add to the proliferation of documents. The material is far more likely to be read in the context of relevant aspects of the offer document, than as a stand alone educational tool.

Generic educational material should not be required to be provided in a standard format. There should, however, be one document prepared by an independent body such as the Retirement Commission or MED and clearly identified as such. Part B could include a requirement to advise investors where to go to obtain such generic educational material.

As this is generic information and presumably forms part of the government campaign to raise financial literacy, the initial cost of development should be government's. If the material is provided in electronic form it could be readily incorporated into offer documents at little additional cost to the issuer. To the extent that an issuer incorporates generic educational material from an official recognised source, they should be relieved from any obligation to verify the accuracy of that material. Any

such material produced independently by the issuer should remain subject to the usual fair trading requirements.

57-60 On Request Material

On reflection, we do not believe that there should be a requirement for on request material to be on the issuer's website. Although websites and internet access are becoming increasingly common, they are a long way from having universal usage. In particular some employer superannuation schemes will not have websites and a significant number of members will not have ready access to the internet.

Where there is a website, the issuer is likely to use this facility for providing information voluntarily. It is not appropriate for them to be required to do so.

Most scheme members have little or no interest in the full financial statements of the scheme, and do not find them particularly understandable. The choice by most issuers to prepare and publish additional summary financial statements, and the fact that very few (if any) requests for copies of the full financial statements are received by trustees, are testament to this. Having the financial statements available on request would be sufficient as long as all members are advised that they are available.

61-69 Disclosure of Environmental Information

Disclosures of environmental information should be by way of additional voluntary information where they are relevant. For most employer superannuation schemes the investing is not performed directly by the issuer. Where a fund manager's mandate (or master trust product) requires environmental factors to be taken into account this should be described under a heading covering investment risk or investment choices. Further reference to environmental information should not be prescribed, and in many instances its lack of relevance in the employer superannuation context may make the inclusion of such information misleading.

70-87 No comment

88-110 Subject to the reservations expressed at the beginning of this submission, we are generally comfortable with the nature of the disclosure in part A. We note however that:

- Part A is covering most of the key questions asked in the current investment statement format. If the information is to fit in five pages then the explanations provided in key areas such as "What are the Benefits?" and "What returns will I get?" are likely to be over simplified. For this reason it will probably not be practical for Part A to stand alone, and not appropriate for it to be limited to 5 pages. Many schemes will require more pages than this to adequately describe relevant features even in minimalist terms, simply due to the complexity of the offering, in particular the benefit structure and the presence of investment choice.
- It is difficult to separate "benefits" from "returns" in the context of superannuation schemes as they tend to be expressed in current investment statements. The more normal interpretation of "returns" by members is "investment performance". They tend not to consider the frequency of contributions, employer contributions etc as part of their "return".

- In order to reduce compliance costs, it is important that the offer document does not need frequent updating e.g. for performance figures. The offer document should reflect the provisions of the trust deed and only require updating when the trust deed is amended or when some other material change is made to the scheme.
- Detailed discussion of risk is unlikely to fit comfortably in the proposed Part A, particularly where a product offers multiple investment choices.
- The issue with fee disclosure is not so much how they are disclosed, although we agree that anecdotal information suggests that members do not understand percentages nearly so well as dollar amounts, but to ensure that they are fully inclusive and that “apples are being compared with apples”. By extension it is important that the fees are prescribed to be either gross or net. With the advent of flow through of tax next year, gross fees are likely to be more relevant as the after tax amount will vary between members.
- We share the concerns already expressed relating to the use of MERs, even if there were to be a standard basis for calculation in use (we understand that the ISI standard is commonly only partially used). An MER is necessarily an historic figure, based on the last completed year’s accounts for the reporting entity as a whole. Therefore it reflects past expenses and not the future. It fails to take into account variations in fees that may apply to individuals or particular groups. It is difficult to see how it would take account of variable commissions that an adviser may charge.
- Although we favour the prescriptive approach, specifying a number of pages will probably not be helpful, as noted above. Some schemes will be more complex than others and require greater levels of explanation. An attempt to limit the number of pages may only result in the use of small font sizes, or other techniques to capture all the required detail in a confined space.

Given that Part A of the proposed offer document is intended to pose most of the questions in the current Investment Statement, Part B of the offer document is necessarily going to be repetitive unless there is provision to only address those questions/headings which require further explanation.

As commented with respect to Part A, the content of Part B of the offer document should also exclude information that requires regular updating. This would include items such as past performance and asset class weightings. As asset class weightings can vary frequently, but are commonly restricted by allowable ranges, the allowable range should be sufficient where this is applicable.

While disclosure of these items is desirable and should be subject to the same level of review as the body of the document, if they are in the form of appendices or in a supplementary form, they could more readily be kept up to date through the use of supplements without exposing issuers to the undesirable cost of continuously reprinting content that doesn’t change. It might be of value to allow for ‘registration’ of template supplements so that registration of an actual supplement is not required if only figures are changing.

It is likely that the description of benefits for superannuation schemes will need to be considerably more detailed than for other CIS. Generally in a CIS an investor will accumulate funds and at some point will have the right to withdraw those funds. In employer based superannuation schemes benefits are likely to vary depending on whether they crystallise due to retirement, redundancy, death, resignation etc.

## Master Trusts and Employer Stand-alone Superannuation Schemes

- 111 The discussion document notes that a master trust often offers multiple investment choices and it may be difficult to summarise these in Part A of the offer document. We submit that this problem will also be faced by a number of stand-alone schemes. The trend for these schemes is also towards offering multiple choices. It should be possible to provide a short description of each choice in Part A with the fuller description in Part B.

We believe that the confusion inherent in providing for a multiplicity of Part A documents for a scheme is highly undesirable, and inappropriate in the context of most employer-facilitated schemes. Different investment choices available to scheme members are best categorised as merely a feature of a particular scheme offering, and not a basis for structural segregation of disclosure documentation.

- 112 We are generally satisfied with the extent to which clause 8(2) of the Multiple Participants Exemption Notice addresses concerns over confidentiality, and submit that a similar balance between full disclosure and confidentiality of commercially sensitive information should be struck in any new regime. It would be desirable to include the provisions of this Exemption Notice into the revised legislation.
- 113 To the extent to which an employer participating scheme in a master trust constitutes a separate security offering, we support the ability to have a separate Part A for each such scheme. However, we do not believe this should be a prescribed requirement as some master trust offerings may be able to produce a generic Part A that adequately covers the prescribed information in a single document, with no real benefit achieved by requiring a multiplicity of Part A documents specific to each participant.

Care needs to be exercised when considering disclosure requirements that terms and conditions of employment are not confused with provisions of the investment. An example of this might be salary sacrifice arrangements, mentioned in paragraph 312. d. We suggest that salary sacrifice is not something that is 'allowed' by the scheme, but a salary sacrifice arrangement may need to be recognised (e.g. in vesting scales).

- 114-118 We submit that allowing for flexibility in how disclosure documents are compiled, subject to addressing the prescribed areas of important information, is essential. The variety of employer-facilitated scheme offerings is such that over-prescribing and restricting the content is likely to reduce the overall quality and relevance of offer documentation produced.

In particular, for many employer-facilitated schemes, it will not be possible to adequately cover off the prescribed Part A content in 5 or less pages. Dictating page numbers is contrary to the objective of providing meaningful disclosure, and is likely to create confusion due to the extent of cross-referencing required to adequately cover key features of complex offerings.

A point of difference we would see between the specific disclosures suggested for master trusts and stand-alone schemes is that a stand-alone scheme would have no need to explain why they had chosen a particular issuer. Other than that, we see no reason to presume any differences to the issues mentioned in paragraph 312.

119-121 Defined Benefit scheme structures and benefit features are varied.

Attempting to over-prescribe content for the offer documents for these vehicles is likely to be an exercise in frustration, as there is unlikely to be an effective “one size fits all” solution. We favour a principle-based approach, with issuers having the flexibility to tailor their documentation to appropriately address the generic requirements.

An example of this might be the question of risks. The risks for a member of a defined benefit scheme are different from those of most other CISs, and from those faced by the sponsoring employer.

122 Summary of Trust Deed

If the offer document does not provide an adequate summary of the key provisions of the trust deed under its various headings then the document will be deficient in its design. A further summary would be unnecessary duplication. We do not see any benefit in providing such a summary over and above the extent to which the trust deed must necessarily be summarised to adequately disclose features of the scheme.

123 Material Contracts

Material contracts with respect to a superannuation scheme are likely to cover contracts with service providers e.g. fund managers, administration managers, insurers. It is important for members to be able to find out who these people are but the level of interest in or relevance of actual contract terms is hard to see. The important factors about the contracts such as benefits provided, fees and charges and risks will be set out under the appropriate headings in the offer document. We do not believe there is any tangible disclosure benefit for members in requiring full contracts to be disclosed, and preference should be given to the desirability of maintaining confidentiality of commercially sensitive contractual arrangements.

The difficulties concerning ‘materiality’ have been referred to in the Discussion Documents and during Advisory Group meetings. We believe that one factor may have been overlooked and that is that materiality will differ between audiences. We understand and accept that from a product perspective, an agreement with an outside administration manager may well be a material contract. However, we do not understand or accept that this necessarily makes the terms of the agreement material to an investor. We support the view that this a contract in the ordinary course of business for the issuer and that it should not be necessary to include such agreements as ‘material contracts’ for most offerings.

124 The cost and inconvenience of applying to the Securities Commission for an exemption to prevent disclosure of material contracts is an unfortunate issue confronting many issuers, for little perceived benefit. Whilst the ability to seek an exemption is desirable as a general concept, the more appropriate response is to remove the requirement for disclosing material contracts at all. To the extent that their content is relevant for disclosure purposes, that content will need to be covered in Part A or Part B in any case.

125 Annual Report

Information normally found in a superannuation scheme annual report such as: the size of the fund, the number of members and the other information that it is suggested would be useful additions to the members annual statement, would also be useful to a prospective member in forming an opinion about the scheme.

126 No, but note that we have reservations about the compulsion to have a web-site.

127-136 Ongoing Disclosure

Material Changes

We concur that there does need to be a requirement for advising members of changes that are genuinely “material”. In our view, this could usefully be defined as:

“Any change that is reasonably likely to influence a person’s decision to:

- invest; or
- continue to contribute to an existing investment; or
- where a scheme provides an option to withdraw (or transfer), realise the investment; or
- where a scheme provides an ability for an investor to alter their investment, make an alteration to the person’s existing investment.”

Perhaps it would be helpful to develop some guidelines as to what the Securities Commission would and would not consider material to a reasonable person?

It is important that any definition of material change and the obligation upon issuers to advise members of such changes take into account the fact that for many employer-facilitated schemes, a current member will not have the ability to withdraw in response to a material change, as their savings are locked in. In addition, it is quite possible that some trust deed amendments – such as those of minor administrative or technical nature – will not be material to any reasonable investor decision. It should be made clear that such changes will not constitute a “material change”, notwithstanding the fact that such an amendment will still need to be registered with the relevant regulator. Some judgement should be permitted to the issuer as to the detail of explanation required about the change depending on its relative importance.

Advice of material changes would normally occur as part of good communication with scheme members, but this cannot be universally relied upon. A requirement to immediately notify of material changes and alter offer documents accordingly, coupled with an obligation to advise of all changes other than material changes with the next annual statement, would be appropriate.

Registered supplements to the offer document should be limited to information which changes regularly and is not integral to the wording of the offer document or does not conflict with content of the offer document – for example performance information or a directory. If a trust deed amendment or other change made an offer document misleading, or rendered the explanations inadequate, the offer document should be reissued. Otherwise, the possibility of a non-expert investor being confused by needing to rationalise the impact of a supplement that conflicts with the main body of the offer document is too great.

There are a couple of current issues that could usefully be clarified in revised legislation:

- A new Investment Statement (or Part A document) is issued and there has been a material change to the previous version, and in circumstances where regular contributions are being made under a continuous offering. Is it sufficient to notify investors, in writing, of the change that has occurred or is it necessary to send them the revised document before allocating further securities?
- An amendment is made to the participation agreement of a participant in a master trust. Currently this will mean that copies of the amending documentation must be filed with the regulator (Government Actuary), as well as with the Registrar of Companies, despite the fact that there is no requirement to file the original participation agreement with the GA, only the Registrar. Hopefully this apparent anomaly can be removed.

### Lifetime

We support the concept of offer documents having an indefinite life (subject to the requirements with respect to material changes) with an annual sign off to ensure they are being reviewed for currency by the issuer. This is consistent with minimising the cost of compliance wherever possible.

We believe that offer documents should be dated and that applications for securities, which are usually included in current Investment Statements, should bear the date of the offer document to which it relates. If there is a subsequent query, this enables the enquirer to establish whether the offer document used was the up to date version at the time that application was made.

137-141 No comment

142-145 Annual Statistical Data Return

The current level of data supplied to the Government Actuary in respect of registered superannuation schemes appears adequate and appropriate. We do not support any proposal to extend data gathering powers, given the additional cost and compliance burden this may place on issuers, in the absence of a clearly defined investor benefit from the gathering of such data.

We also doubt that all of the information is so readily available at any given date, as suggested in paragraph 369, particularly for stand alone superannuation schemes. We believe that a requirement to produce information at a common date might involve considerable expense and cannot see much added value.

146-170 Annual reporting

We firstly note a possible misunderstanding of current reporting requirements for superannuation schemes under paragraph 415. The current annual report is produced for the investors, not the Regulator. A copy is filed with the Regulator.

The concept of an annual statement supplemented by some additional disclosure information is appealing. There is little doubt that a member's primary interest lies in their account balance and the investment earnings added to or deducted from their account (net of all taxes and charges). Whether the annual reports currently produced provide relevant or useful information is largely dependent on the quality of the individual report and how regular the communication with members is. Some of the information currently required in the annual reports is not generally used by members. For example, financial statements even in summary form and accompanying audit reports are not widely read.

Members should certainly be provided with an annual statement. The content set out in paragraph 395 of the discussion document would generally be suitable. We note, however, that it will frequently not be possible to disclose all fees deducted as earnings from investments in pooled products are often reported net of fees.

Information that is of interest to members and might be provided with an annual statement could include: fund size, fund membership, investment performance, changes in trustees and changes in service providers. Information or comfort statements that cannot be provided until after the completion of audited financial statements should not be included. We re-iterate our earlier statements that universal access to information via websites should not be relied upon. The importance to members of receiving their annual advices promptly should not be discounted and there should be no unnecessary delays in so doing. Increasing the complexity of the information to be provided is likely to increase the risk of delay, and quite possibly confuse investors with excessive information of marginal relevance to their investment decision. As noted previously, in the context of locked in employer-facilitated schemes, investors are unable to react to adverse financial performance details, and should not be burdened with excessive information. The knowledge that the scheme is subject to regulation and that the regulator will require such statements should be sufficient.

A similar level of disclosure should apply to investors through master trust arrangements as to stand alone schemes. We see no rationale for treating these investors differently.

171 Yes but filing of hard copy should also be permitted.

172 – 176 We believe that the current requirements for advertisements are appropriate.