

Our Ref: 260-2

1 November 1996

INVESTMENT PRODUCT AND ADVISER DISCLOSURE - PROPOSALS FOR AMENDMENTS TO THE SECURITIES REGULATIONS

1. *Introduction*

- 1.1 The legislative package giving effect to the recommendations of the Working Group on Improved Investment Product and Investment Advisor Disclosure ("the Working Group") was enacted on 2 September 1996. The new law¹ is expressed to come into force on 1 October 1997 or such earlier date as may be appointed by the Governor General by Order in Council. In order to give effect to the new regime, the Securities Regulations 1983 ("the Regulations") will have to be substantially expanded and amended prior to the new legislation coming into force.
- 1.2 This letter and enclosures restate (and, to a limited extent, fine-tune) the Working Group's proposals for amendment of the Regulations and seeks final comments on those proposals. Comments should be in writing and received at the offices of the Commission no later than 6 December 1996.

2. *Overview of New Regime*

- 2.1 The new legislation will result in the most fundamental changes to the law relating to the offering of securities in New Zealand since the introduction of the Securities Act 1978 and the Securities Regulations 1983. Briefly, and in general terms, under the new regime:

¹ The legislation making up the new law comprises the Securities Amendment Act 1996, the Investment Advisers (Disclosure) Act 1996, the Financial Reporting Amendment (No.2) Act 1996, the Superannuation Schemes Amendment Act 1996 and the Unit Trusts Amendment Act 1996.

- ▶ the offering of interests in unit trusts, life insurance policies and superannuation schemes (with the exception of small employer superannuation schemes²) will be brought under the Securities Act and a prospectus will be required in each case;
- ▶ if financial statements have been registered under the Financial Reporting Act, then the relevant prospectus will not need to contain those statements (although in the case of prospectuses for equity, debt and participatory securities, those financial statements will have to include, or be accompanied by, the same financial information as would otherwise have been required in relation to the issuing group by the relevant schedules to the Regulations);
- ▶ it will be possible to extend the life of a prospectus (beyond the present 9 months) up to 18 months after the balance date of the most recent financial statements contained in, or referred to, in the prospectus provided that the directors register a certificate (in the case of equity debt and participatory securities with interim financial statements attached) certifying that, after due inquiry, the prospectus does not contain a false or misleading statement and the financial position of the issuer has not materially and adversely changed;
- ▶ all issuers will be required to issue an investment statement ("IS"). The purpose of the IS will be to provide key information to the prudent but non-expert investor. The intention is to enable such an investor to make meaningful comparisons between different types of investment products;
- ▶ The IS will replace the prospectus as the primary disclosure document - the relevant IS will have to be given to the investor before subscription (although application forms will no longer be required). By comparison, the prospectus (although remaining an offer document on the basis of which investors may subscribe) will be required to be provided to investors only on request;
- ▶ the IS will not be registered with the Registrar of Companies. However, an IS will be an "advertisement" for the purposes of the Securities Act;
- ▶ investment advisers will be subject to a two-tier disclosure requirement:
 - they will be required to make initial disclosure of their procedures for handling client money and property (where client money/property does not pass directly to the issuer/counterparty) as well as any convictions for dishonesty, any prohibition from taking part in the management of any business, or any bankruptcy, during the preceding five years;

² Essentially, employer-funded schemes which are in force when the legislation comes into effect and which, at the relevant time:

- had total assets of less than \$5 million at the end of the most recent financial year; and
- to which not more than 25 new members were admitted in that year.

- they will also be required to disclose details of their qualifications, remuneration and experience on request.

3 *Amendments to the Regulations - Consultation*

- 3.1 In general terms, section 70 of the Act provides that the Governor General may, in accordance with a recommendation of the Securities Commission, make regulations by Order in Council.
- 3.2 Section 70(3)(a) of the Act requires the Commission, before recommending any Regulations (or amendment to the Regulations), to do everything reasonably possible on its part to advise all persons and organisations, who in its opinion will be affected by any such amendment, of the proposed terms thereof and to give such persons and organisations a reasonable opportunity to make submissions thereon to the Commission.
- 3.3 However, in the present case, the Working Group has, following extensive consultation, already formulated and published formal proposals for the amendments necessary to give effect to the new regime. In recognition of this, section 38 of the Securities Amendment Act 1996 qualifies the requirements of section 70(3)(a) in the present case by providing that “[a]ny action taken by ... the Working Group ... in consulting ... on proposed amendments to the Securities Regulations 1983 shall be deemed to have been taken by the Commission under, and for the purposes of, section 70(3)(a)...”. The Commission must now complete that consultative process before making a recommendation to Government.
- 3.4 **Annexure I** to this letter contains a copy of the proposed amendments which were formulated by the Working Group and set out in the Working Group’s final report of 21 December 1995 (“the Working Group Draft”). However the draft amendments set out in Annexure I differ from the Working Group Draft in the following respects:
- Annexure I corrects a number of minor drafting and typographical errors in the Working Group Draft;
 - Annexure I incorporates a proposed transitional provision, as well as proposals for additional provisions (relating to call building society shares and prescribed interest rates, respectively) which were rendered necessary as a result of changes to the legislation in the course of its passage through the House;
 - Annexure I updates the accounting terminology in the Working Group Draft to conform with GAAP (i.e. “generally accepted accounting practice” as defined in the Financial Reporting Act 1993);
 - we have received various suggestions from a number of organisations for changes, primarily of a minor or technical nature, to the Working Group Draft and some of these are also included in Annexure I.

All of these proposed changes are clearly identified in the draft set out as Annexure I - underlining denotes the proposed addition of new words to the Working Group Draft and overstriking denotes the proposed deletion of words from the Working Group Draft.

- 3.5 The more significant of the proposed changes referred to in paragraph 3.4 are (in addition to being marked up in Annexure I) also listed in **Annexure II** together with brief background details in each case. It should be noted that Annexure II also concludes with details of two further suggestions for amendment which we have received (see points 15 and 16 in the list at Annexure II) neither of which have been incorporated in the marked up copy of the Working Group Draft (ie Annexure I).

4 *Amendments to Existing Regulations and to the First, Second and Third Schedules to those Regulations*

- 4.1 In light of the proposed updating of the accounting terminology in the Working Group Draft (see paragraph 3.4(c) above), we have found it necessary to propose certain changes to the present Regulations and Schedules in order to ensure conformity. A Schedule of our proposals in this regard is attached as **Annexure III**.
- 4.2 Once again, the proposed amendments are principally of a minor or technical nature. Where we consider that they raise issues of policy they are clearly identified as such in Annexure III.
- 4.3 One further point in this regard. The Working Group indicated in its final report that a review of other aspects of the existing Regulations should be undertaken. It should be noted that such matters are not within the scope of the present exercise. We propose, however, to deal with them in the context of a separate review and consultation exercise at a later date.

5 *Exemptions*

- 5.1 As a result of the substantial changes to the Act and the Regulations, many of the existing exemptions will no longer be necessary. Moreover, of those exemptions that do remain necessary, many will have to be largely re-written in order to take account of the numerous changes to the substance, and the numbering, of the Act and the Regulations. As a consequence, we think it may be desirable to revoke all existing exemption notices and issue new notices as and where appropriate. Such a course of action would also offer an opportunity to:

- ▶ review the policy underlying each exemption in light of the new legislation;
- ▶ standardise the terminology used in exemption notices and, in particular, the financial reporting terminology;
- ▶ standardise, and in many cases simplify, the drafting style of the exemption notices;

- ▶ facilitate the development of recommendations for the forthcoming review of the Regulations (see paragraph 4.3 above) by identifying matters which might more usefully be accommodated in the law itself, rather than in an exemption.

However, it will not be possible to make any definitive decisions in this regard until the text of the amendments to the Regulations is settled. In the interim, we are enclosing, as **Annexure IV**, a list of all exemption notices issued by the Commission. In due course, all persons who are presently relying on an exemption will need to consider their position, and in particular, consider:

- (a) whether any such exemption is likely to remain necessary under the new regime; and, if so
- (b) the nature of any exemptions they are likely to require.

In addition, there are a certain limited number of exemptions on which the Commission has been proactive in the past and on which we think it should continue to maintain an active policy and we shall be reviewing these ourselves. For the moment we identify, in particular, those exemptions which apply to overseas issuers.

6 *Timetable*

- 6.1 In addition to the transitional provisions in the new Act and the proposed Regulations, we think it is desirable to allow a reasonable period of, say, three months between the date on which the new Regulations are made (by Order in Council) and the date on which they come into force. On this basis, we estimate that a commencement date for the new regime of 1 October 1997 would require that the Order in Council making the new Regulations be made not later than 1 July 1997. On the advice of officials, we estimate that this would, in turn, require:

- (a) the Commission's formal recommendation (pursuant to section 70 of the Act) to be received by the Minister not later than the end of March 1997; and
- (b) the Commission to give formal notification in the Gazette of its proposed recommendations (pursuant to section 70(3)(b) of the Act) not later than the beginning of March 1997.

We do not think it practical to work for a commencement date of the new laws which is any earlier than 1 October 1997 (even though Section 1 of the Securities Amendment Act 1996 allows for this possibility).

7 *Conclusion*

- 7.1 Submissions are now invited in relation to:

- (a) the Working Group Draft (see Annexure I);

Note that, in view of the substantial consultation already undertaken by the Working Group, we do not expect there to be any need for a fundamental re-think of the general policy underlying the Working Group Draft.

- (b) the suggested amendments to the Working Group Draft as identified (by underlining and overstriking) in Annexure I;

Note that the more significant changes to the Working Group Draft are also identified separately in Annexure II;

- (c) the proposed amendments to the accounting terminology in the existing Regulations (see Annexure III).

Submissions should be addressed to:

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and should be received at the offices of the Commission no later than 6 December 1996.

Yours sincerely,



E.H. Abernethy
Chairman