

Legal update - Financial Markets Conduct Regulations - Disclosure

15 October 2014

What's happening?

On 26 September 2014 an unofficial draft of the Financial Markets Conduct Regulations (Regulations) was released to give market participants time to prepare for phase 2 implementation of the Financial Markets Conduct Act 2013 (FMC Act) on 1 December 2014. The Regulations will cover all aspects of the FMC Act, and will replace the (more limited) Financial Markets Conduct (Phase 1) Regulations.

As we have discussed previously the new disclosure regime is scheduled to come into force on 1 December this year (for all classes of financial products other than derivatives), but the FMC Act provides for a transitional regime where issuers can continue to use "old" Securities Act documents or make an offer under the Securities Act regime after 1 December for a transitional period of up to 24 months. Accordingly market participants will have a transitional period when they can consider whether to use the new product disclosure statement and register entry regime or the old registered prospectus and investment statement regime. Schedule 1 of the Regulations includes relevant transitional provisions, but we note that these provisions are still being worked out and are subject to change.

In addition to this general transitional period, the Regulations delay the coming into force of the new regime for derivatives for a further six months (or a further 12 months for current futures dealers).

In a nutshell, what does the FMC Act say about disclosure?

Part 3 and Schedule 1 of the FMC Act set out when an offer of financial products to an investor will require disclosure and the form of that disclosure. Where disclosure is required the offer is "regulated". A regulated offer can only be made if a "product disclosure statement" (PDS) has been lodged with the Registrar of Financial Service Providers (Registrar), and all information for a "register entry" has been provided to the Registrar. The register entry will be publicly available on an electronic register of offers of financial products - officials have stated that the new register will be called "Disclose".

In addition to initial disclosure, the FMC Act requires that an issuer of a regulated product (which is a financial product that is offered under a regulated offer) provides information to the Registrar (and other prescribed persons) on an ongoing basis. This emphasis on updated disclosure, combined with a potentially "evergreen" PDS (that is, without a fixed expiry date as with prospectuses under the Securities Act), means that the obligations on issuers will change. Instead of the current cycle of preparing and registering a prospectus, and then replacing it once the set expiry date is reached, under the new FMC Act regime issuers will need to be mindful of their periodic reporting obligations, and will need to review their PDS from time to time to ensure that it remains accurate.

The content of the PDS and register entry information, as well as the detail of ongoing disclosure, is not set out in the FMC Act, as it is to be set out in regulations. This is one of the main reasons for market participants' eagerness around receiving the final regulations.

What do the regulations say about disclosure?

A lot. Therefore, in an attempt to make this update useful we simply highlight the main points below.

PDS

For an *issue* of financial products there are already exclusions from the Part 3 FMC Act disclosure requirements in Part 1 of Schedule 1 of the FMC Act and for a *sale* of financial products Part 3 FMC Act disclosure requirements do not apply except for situations set out in Part 2 of Schedule 1 of the FMC Act. The Regulations provide two more exceptions - a PDS is not required where an investor already holds the relevant financial products and the offeror has reasonable grounds to believe the investor

already has all required information, and if the financial products are NBDT debt securities (if Schedule 7 disclosure is provided).

Under section 50 of the FMC Act a PDS must be given to an investor before an application is accepted or financial products are issued or transferred, but the Regulations provide an exception to this where a category 2 financial product is being offered urgently, and in this case the PDS can be offered 10 working days after the issue/transfer takes place.

The Regulations set out specific detail around the content of a PDS including:

- Information that is required at the start of the PDS and stating that it must be on a separate cover page or right before the key information summary
- Length limits for both the key information summary and the PDS as a whole, varying between 12 and 60 pages or 6,000 and 30,000 words depending on the type of financial product for a PDS, and between 2 and 4 pages or 1,000 and 2,000 words depending on the type of financial product for a key information summary
- The rest of the content of a PDS in Part 1 of Schedules 2 to 7 of the Regulations (Schedule 2 for debt securities, except NBDTs, Schedule 3 for equity securities, Schedule 4 for a managed fund (essentially those managed investment schemes that are continuously offered and redeemed, or are highly liquid, together with KiwiSaver, superannuation, or workplace schemes), Schedule 5 for "other" managed investment schemes, Schedule 6 for derivatives and Schedule 7 for NBDTs). The content is essentially a key information summary made up of investment statement like questions followed by prospectus like terms including things such as key dates, offer terms, purpose of the offer, key features, risks of investing, fees involved, how to complain and where to find more information. While the disclosure is the similar, the terms do vary from schedule to schedule (and therefore for each type of financial product).

In addition, the Regulations:

- Contain a general requirement that a PDS be "easily readable"
- Clarify that blank pages will not be included in the length limits
- State that a PDS may relate to more than one class of financial products as long as they are of the same kind
- State what is required if something is incorporated by reference, when additional information may be included and where such information should be placed in the PDS
- State that an application form may be included in a PDS and it will not be included in a length limit.

Finally the Regulations do not require that a PDS be signed by all directors (the way a prospectus must currently be), but instead follows an approach more similar to the investment statement, with a "board's consent", which is signed by two directors of the issuer, being provided when the PDS is lodged with the Registrar.

Register entry

The Regulations set out the information that must be included in a register entry in Part 2 of Schedules 2 to 6 (separated out by type of financial product). The required information includes things such as the main terms of the offer, financial information where relevant, information about guarantees, credit rating, material contracts and issue expenses.

The Regulations make it clear that in addition to this information the register entry must also contain:

- All "material information" that is not in the PDS
- All information referred to in the PDS as being available in the register entry.

Ongoing disclosure

Ongoing disclosure for all issuers of financial products was introduced by the FMC Act. The Regulations set out details in relation to ongoing disclosure including:

- Specific changes that must be notified to the Registrar (which include a change to an address for communications, a change that makes information in the register entry incorrect or a change in circumstances that would have required different information to have been included had it arisen before the date of the PDS)
- Specific information that must be lodged with the Registrar to update the register entry separated out by type of financial product (contained in Part 3 of Schedules 2 to 6)
- What information an issuer must make available on request, as well as what events must be made publicly available
- For an evergreen PDS, a confirmation notice and a board's consent must be lodged with the Registrar in each year no later than a date of each anniversary of the date of the PDS and no later than 13 months after the previous confirmation notice was lodged

- The manager of a managed fund making a "fund update" publicly available for each fund within 20 working days after the last day of each quarter of the disclosure year (the specific details as to what should be included in a fund update is included in the regulations 57- 59)
- The manager of a registered scheme preparing an annual report within four months after the balance date of the scheme and sending a copy of that report within 28 days after the annual report is prepared (the specific detail of the annual report is set out in Part 5 of Schedule 4 for a managed fund and Part 4 of Schedule 5 for any other scheme)
- The issuer of a regulated product making "confirmation information" available to the product holder when the product is issued, transferred or held by a person (the detail of confirmation information and how it should be provided is set out in regulations 65 - 71).

What about the exclusions?

In some cases the FMC Act and Regulations impose partial disclosure for offers where the exclusions in Schedule 1 are relied on. These vary from case to case, but mostly require a set warning statement to be provided to investors, and either copies of relevant documents or details of where they can be accessed.

And (repeating) some good news about advertisements ...

As we have previously reported, a very helpful step is the end to the restrictive rules around advertisements that are currently set out in the Securities Regulations 2009, and in particular the requirement for a regulation 30 certificate for most advertisements. Instead, under the FMC Act regime advertisements for a regulated offer must simply contain one of two set statements, depending on whether a PDS has already been lodged for the regulated offer or is yet to come, and the general fair dealing provisions will apply rather than the current highly prescriptive rules.

What's next?

We recommend that clients should:

- Reach a view on whether their business will be making a regulated offer of financial products, and therefore need to provide disclosure to investors?
- Once you've mapped out how the disclosure aspects of the FMA regime will affect your business, plan the timetable for the transition process - while the transition provisions in the FMC Act give businesses up to two years to make the necessary changes, this time will pass quickly
- Keep an eye out for our updates on the governance, licencing and financial product markets aspects of the FMC Act regime.

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