**BELL GULLY**

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**Submission on the proposed changes to the Securities Regulations**

## 1. Introduction

1.1 This submission is prepared by Bell Gully in response to the discussion document titled 'Changes to the Securities Regulations' released by the Ministry of Economic Development in April 2009.

1.2 Bell Gully's corporate and commercial practice is consistently recognised as the market leader in New Zealand by credible legal and financial research houses. Our expertise covers a wide range of corporate and transactional work, including mergers and acquisitions, corporate restructurings, public offerings and corporate finance. We advise a number of New Zealand's leading listed companies on capital raising, other NZX matters and various other corporate transactions.

1.3 We have closely followed the work of the Capital Markets Development Taskforce (**CMDT**), NZX, the Securities Commission and the Ministry of Economic Development as they proposed measures that are designed to make it easier for businesses to raise capital. We have been actively involved by suggesting ideas and making submissions based on our experience.

1.4 The views expressed in these submissions are those of a number of members of our Corporate/Commercial Department with relevant experience. They do not necessarily represent the views of our clients.

## 2. General observations

2.1 Bell Gully supports the objectives that are stated to underpin the proposals contained in the discussion document of improving and modernising securities disclosure obligations, reducing compliance costs and providing greater flexibility with respect to the content requirements for securities offer documents.

2.2 From our perspective however, the changes suggested in the discussion document are satisfactory but only as a "stop-gap" measure pending a thorough review of the Securities Act disclosure regime which, we understand, is scheduled for later this year. Bell Gully strongly supports this comprehensive review of New Zealand's securities offer disclosure regime. We expect that such a review will consider a number of significant issues affecting securities offer disclosure in New Zealand, including:

(a) the need to move away from a prescriptive disclosure regime to that of an Australian-style full and fair disclosure regime; and

(b) the removal of duplicate disclosure by requiring both an investment statement and prospectus. We believe that the investment statement is something of a failed experiment in simplifying securities disclosure and its use should be discontinued.

2.3 We set out our specific comments on the discussion document below. We have adopted an "exceptions-based" approach. We have not addressed the questions where we agree with the proposed changes and have commented only where we consider it necessary.

## 3. Specific comments

***Use in prospectuses of financial statements prepared under the Financial Reporting Act***

3.1 We support the general proposal. However, we note that this assumes that the Securities Act will continue to impose a prescriptive disclosure regime, including the requirement that prospectuses contain certain financial information. This may not be the case if prospectus disclosure regime is to migrate ultimately to a "full and fair disclosure" model such as that used in Australia.

***Application of relevant financial reporting standards to summary financial statements***

3.2 Again, if summary financial information is going to remain a disclosure requirement in prospectuses, then we support a move to ensure greater consistency (and reduce compliance costs) by requiring compliance with applicable financial reporting standards.

***Prospective financial information in prospectuses***

3.3 We are not convinced that the prospectus disclosure regime should prescribe a requirement for prospective financial information (**PFI**) to be included in a prospectus. On balance, we believe that the Australian approach to this issue is more appropriate, by requiring information about the issuer's prospects but not mandating a requirement for prospective financial information. That Australian approach is illustrated by the policy statements published by the Australian Securities and Investments Commission (**ASIC**), referred to below. They state that, when considering the inclusion of PFI, an issuer must balance the value of the information against the likelihood that the information may be misleading. ASIC further cautions that if PFI is based on hypothetical assumptions (rather than reasonable grounds) it is likely to be misleading and provide little informational value to investors.

3.4 The view adopted in practice in Australia is that, if the issuer has a reasonable basis for providing such prospective information, then it should be provided but this question of whether that reasonable basis exists should be a matter for the directors of the issuer. The Australian experience also indicates that the length of the projected period should also be a matter for the issuer, and is heavily influenced by market practice. In more certain times, this was also the New Zealand experience. In many cases, prospective statements of cash flows were provided for periods longer than the ensuing 12 months currently required by the Regulations. This occurred for reasons that included alignment with accounting periods (for comparison purposes) and being seen to "meet the market" when compared with the information provided in conjunction with other recent offerings.

3.5 A requirement to include PFI (whether limited to cash flows or extended to full prospective financial information) currently puts New Zealand out of step with relevant overseas benchmarks. This desire not to add such 'country specific' factors is relevant, not only on a trans-Tasman basis but also when considering the needs and expectations of other offshore interested parties (including directors, promoters and sellers). Conformity becomes relevant for offerings with an international component, even if that component is only by means of the experience of the investment banking and other advisors involved with the offer. Our experience is that if those advisors cannot get comfort with the local regulatory requirements, they are unlikely to recommend the offer structure to their clients.

3.6 Again, using the concept of trans-Tasman harmonisation as our benchmark, we believe that any revamp of the prospectus disclosure regime is necessarily going to involve a much more proactive role for the relevant regulatory agency. This may mean that the Securities Commission has to adopt a similar approach to that adopted by ASIC and provide policy

guidance on a number of content issues, including that of inclusion of prospective financial information. This may mean adopting a stance (similar to that evidenced by the relevant ASIC policy statements) that on some occasions prospective financial information should not be included at all, particularly where the level of uncertainty about the economic climate and future prospects of the issuer may mean that the inclusion of such information is misleading. The latter point is particularly relevant; not only at times such as in the present financial climate, but also for many start-up businesses seeking to raise capital for what may be an unproven business model or concept.

3.7 Therefore, we submit that if a full set of prospective financial statements is to be included in a prospectus where an issuer is undertaking an initial offer of equity securities or an offer of participatory securities, the inclusion of PFI in the first instance should be optional rather than compulsory and, amongst other things, will depend on whether the directors of the issuer consider that there is a reasonable basis for making such a projection.

3.8 We agree that, more often than not, a full set of prospective financial statements is likely to provide more useful information than a prospective statement of cash flows. However, a compulsory requirement to provide full prospective financial statements places significant obligations on an issuer and its directors when undertaking an initial offer of equity securities or an offer of participatory securities. In the current financial climate, such a compulsory requirement to provide full prospective financial statements is likely to provide a disincentive to issuers considering making a public offer of securities. Such a prescription will also be a significant disincentive to start-up businesses seeking to raise capital and simply adds another reason for such businesses to seek capital by other means. The rather limited resources of friends and family and angel-type audiences for such capital raisings forces business developers to look offshore for expansion capital.

3.9 We understand that, where possible, there is an aim to standardise the disclosure requirements across various investment products and this is reflected in a number of the proposed technical changes included in the discussion document. The rationale behind this approach appears to be that if similar disclosure requirements are imposed on issuers of various financial products, the information provided will be “comparable” to prospective investors. While we understand that allowing issuers the option of including PFI (full or otherwise) may be viewed as detracting from this objective, we caution that in many instances fundamentally different financial products are being offered and a rigid standardised approach to disclosure on the grounds of comparability is less than optimal. Instead, we encourage a flexible approach whereby the issuer is given the option of including the information and is allowed the opportunity of assessing its materiality and balancing this against the risk that the information will be misleading.

3.10 Amending the Securities Regulations to allow issuers undertaking an initial offer of equity or participatory securities the option of including full prospective financial information would be a positive step towards aligning New Zealand’s PFI regime with that of Australia. If the requirement was optional, issuers would be required to consider whether the PFI meets the requisite threshold to be included in the prospectus. If the information is material it should be included in the prospectus and if the information is misleading, then the directors of the issuer will be personally liable.

3.11 In responding to the proposal, we have also been guided as to the application of FRS-42. As a result, we suggest that if PFI is to be mandated, a distinction should be made between new issuers and those existing issuers able to use a short-form prospectus (or perhaps just NZX listed issuers). If PFI is to be mandated, we are supportive of a policy that provides that, in the case of a new issuer, it should be “full form”. However, we do not believe that this necessary in the case of existing issuers. To illustrate our point, we note that currently listed issuers can put earnings guidance and other forward-looking statements in stock exchange releases ahead of a capital raising and then cannot repeat that information in the prospectus without a full set of prospective financial statements. As a result, we believe that the test that should apply to PFI should be the same as all information to be included in a prospectus. That is, if it is material, it

should go in the offer document (and if it is misleading, then the issuer and its directors should be exposed to liability).

***Disclosure of terms of participation deed***

We support the simplification objective that underpins the proposal. However, we believe that this proposed amendment ignores the impact of recent developments on the practices of trustees as a direct result of recent comments of the Securities Commission and (particularly) the Registrar of Companies about the conduct and competence of trustees. In short, without specific guidance as to what constitutes a fair summary of the principal terms of a deed of participation, the objectives of this proposal may be frustrated because trustees are likely to require a conservative approach to such disclosure requiring that all or almost all of the key terms of the deed of participation be reproduced in the prospectus.

***Inclusion in prospectuses of material comments on prospective financial information (specific CMDT recommendation)***

3.12 Bell Gully supports this proposed amendment and agrees that it should be extended to cover all PFI and not just PFI that takes the form of commentary or analysis of PFI in the prospectus. We do not see an issue with removing this prohibition, given that Regulation 9 requires that any information which is included in an advertisement must be consistent with the information contained in the registered prospectus.

***Rewrite and technical changes to modernise the regulations***

3.13 We agree that many of the regulations are outdated and need to be modernised or removed. The proposed technical changes largely achieve this.

3.14 We query whether the amendment to Regulation 21 amounts to a substantive change. We understand the proposed amendment is intended to allow investors to be able to compare the returns on various financial products. However we are concerned that the definition of “returns” is broader than “interest” and may include the capital growth of the investment. While it is possible to state a fixed amount of interest payable on the investment, obviously it would not be possible to provide a “rate of returns” if this were to include, for example, share price growth.

***Conditions on use of simplified disclosure prospectuses***

3.15 We support the option of a Simplified Disclosure Prospectus (**SDP**) for listed issuers who are subject to continuous disclosure obligations. For this reason, we share the concerns of a number of market participants that what was intended to be a rapid response (initially by the CMDT) to the current financial climate is still not close to implementation. As a result, we urge that the regulations needed to implement the SDP proposal be promulgated urgently. In doing so, we also register our agreement that the option to use an SDP should be extended to cover complex products.

3.16 In our view, the SDP represents a positive step towards aligning New Zealand’s disclosure regime with that of Australia. It will enable listed issuers to offer designated debt and equity securities of equal or higher rank than those securities already on issue without the need to duplicate information that is already publicly available through the NZX continuous disclosure regime. While the expected benefits should not be overstated given the need for a due diligence process of some form, in any event, the SDP will definitely streamline the capital raising process and reduce unnecessary compliance costs for listed issuers.

3.17 While we support the SDP, we understand the importance of ensuring detailed information is available to prospective investors, particularly in respect of complex financial products where detailed information relating to the operation of the security and the associated risks is particularly important. The SDP does not alter these requirements. Instead, it “simplifies” the offer document by removing duplicated information (mostly in the business description and

financial statements) which is already in the public domain. Consequently, we see no reason why the option to use an SDP should not be available to issuers considering offering complex financial products. In the current economic climate, we support any proposal which provides options to issuers seeking to raise capital in a more efficient manner.

3.18 To this end, we are concerned about a number of comments in the Select Committee report on the Securities Disclosure and Financial Advisors Amendment Bill. Specifically, the Select Committee made comments about the extent of the disclosure and the due diligence investigation to be undertaken by a listed issuer (which the Select Committee acknowledges is subject to continuous disclosure) for subsequent capital raisings. These comments tend to indicate that the Select Committee may not adequately grasp the nuances of the costs and risks associated with undertaking various forms of due diligence investigation. Quite simply, if the obligations on issuers and directors are not sensibly restricted to material information relating to the rights and liabilities of the securities being offered and that the continuous disclosure obligations have been met, then there is little to be gained by implementing the SDP proposal. We suggest caution when considering whether the content requirements for an SDP should cover extended concepts of materiality or that those content requirements include a loosely defined "catch-all" requiring disclosure of any other material matters.

## 4. Further information

4.1 Thank you for this opportunity to make this submission. If you require any further information in relation to this submission please contact any of the following members of our Corporate/Commercial Department with any such request:

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Yours faithfully
**Bell Gully**

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