

Clear, Concise and Effective Disclosure?

Report on the implementation of the guidance by issuers in the first year
October 2013



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Introduction

In June 2012 FMA issued its *Guidance Note: Effective Disclosure* (**Guidance Note**).

The Guidance Note aimed to provide issuers of securities and their directors and advisers with an understanding of the approach we intended to take in reviewing prospectuses and investment statements (disclosure documents) for compliance with the law. It also provided our views on good practice for preparing those documents.

The Guidance Note was aimed initially at all new disclosure documents. We signalled that we would use it as part of our risk-based assessment of newly-issued disclosure documents from July 2012.

For continuous issuers, who had existing disclosure documents in the market, the Guidance Note was effective from 1 January 2013.

We had had intensive engagement with issuers and their advisers over the publication of the Guidance Note. We signalled that we would continue to engage on an on-going basis.

We are encouraged by the willing engagement of some issuers, particularly by issuers of continuous offers. However we feel there is still some way to go before the market achieves the objective of providing better quality information for retail investors. The disclosures we have seen so far are unlikely to meet the Financial Markets Conduct Act's (FMC Act) requirement for information in a product disclosure statement to be worded and presented in a clear, concise and effective manner.


We will therefore continue to work with issuers on their current documents to ensure a smooth transition to the new disclosures under the FMC Act. This report is one of the ways we can help to lift the standards of disclosure documents entering the market.

Since issuing the Guidance Note in June 2012, FMA has reviewed a large number of offer documents. FMA has engaged with issuers before registration on documents for novel products, strategic issues, complex or significant issues of securities.

Over the period since June 2012, we've seen a wide range of approaches and responses to our guidance.

These include:

- issuers who have adopted the new approach. These issuers have placed their customer at the forefront of their disclosure document writing and design process;

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- issuers who continue to view (or treat) disclosure documents as lawyer-led risk control mechanisms for the directors. Some of these issuers continue to produce long and/or dense documents such that investors may be put off reading them. Others may have taken some steps towards providing clear and effective disclosure, but the length of documents continues to deter investors from reading them; and
 - issuers who have made no attempt at all to follow our guidance.

In this report we outline our findings and observations to help issuers and their advisers understand our expectations of 'clear, concise and effective' disclosure. We seek disclosure that aids, rather than hinders, investor decision making.

Our findings and observations

Layout and presentation

We have seen some major progress in the presentation and layout of documents. Some issuers have made a real effort to reduce the amount of jargon. Some have included a 'key information' section. Some have presented the document/s in a way that aids access and navigation by retail investors.

We reiterate the need to keep sentences short and remove (or explain) legal terms and industry jargon.

Lengthy documents

A significant number of the major initial public offerings (IPOs) made in the review period failed to meet good practice standards. The documents were so long, and included so much information, that we doubt many retail investors would have read them. Those who did read them would have had difficulty understanding the material risks and benefits.

It has become the practice in the IPO sector to combine the investment statement and prospectus in one document. The result is a document that is large, complex and daunting for retail investors.

In our view, use of disclosure documents of this length is not good practice. It may even deter members of the public from investing in the offer. Under the FMC Act these documents will not meet the statutory test of clear, concise and effective.

We are told that issuers have been advised that a two-document approach carries 'legal risk' for the issuer and its directors. Our view is that separation of disclosure documents, as intended by the Securities Act, does not increase legal risk.

Diagrams and charts

In limited cases we have seen diagrams and charts used effectively to illustrate complex business and offer structures.

Branding

We have seen a mixed approach to the use of brand information and material. We recognise it is important for documents to be attractively presented. However brand information must not mask or detract from important information about the offer. It is not good practice to let branding dominate the document.



Risks

We still have not seen an example of a good description of risks that are specific to the offer. Risks are rarely ranked in order of significance to the business. The retail investor would not be able to readily understand and assess risk. We did see some attempts to explain risks in a clear and concise way. However, the risk disclosures we have seen are still too lengthy and too generic to hit the mark.

Inclusion of Material Information

We have seen one good example of balanced information about directors. In that case the directors had been involved in failed finance companies. One director was subject to legal proceedings at the time of the offer. These facts were made clear to investors alongside other relevant career and industry history.

Financial information

Details of financial performance and position is a key component of disclosure documents. We have seen one good example of clear and effective presentation of financial information. Analysis of pricing and profitability was well laid out using clear diagrams and explanations of concepts. It included cross references and disclaimers to further information to avoid the information being misleading. It provided useful explanations in line with FMA's non-GAAP financial information Guidance Note.

We recently worked with an issuer on a plain English introduction to their financial information. This provided a helpful basis for the investor to understand the concepts in the more detailed financial information that followed. We encourage issuers to continue to make improvements to achieve better disclosure of financial information.


The future of disclosure

The FMC Act comes into effect during 2014. There will be new disclosure requirements for offers of financial products. Investment statements and prospectuses will be replaced by a Product Disclosure Statement (PDS). The PDS will have to follow prescribed disclosure requirements. The intention is that investors will have clear, concise, and effective information to help them understand the benefits and the risks involved in the offer. The aim is for investors to make informed investment decisions.

The information will be divided into two parts, with a short one to two page key information summary at the front, and a more detailed second part. It will provide all of the information essential to an investor's decision about whether to invest. In the case of the PDS for less complex managed funds, such as KiwiSaver, the disclosure will be short and simple and highly standardised to make it easy to understand and compare different funds. All other material information not in the PDS will be available on a public website called the Register of Offers.

The Ministry of Business Innovation and Employment will issue the draft requirements of the PDS in late 2013. Market participants will be consulted on the draft requirements of the PDS before the FMC Act regulations come into effect.

Right now, you can build your capacity to comply with the new requirements when they come into effect by following the Guidance Note.



Often when FMA implements a new regime, we allow market participants a period of time to adapt to the new regime before we take stronger enforcement action. We have taken this approach with participants about our expectations for effective disclosure since July 2012.

The FMC Act will have a long transitional period and it will be December 2016 before all issuers are required to comply with the new requirements. During this transition we will continue to review disclosure documents against the Guidance Note. We encourage participants to work with us to help achieve 'clear, concise and effective' disclosure. In turn this will assist with transition to the new FMC Act requirements.

We will also publish more reports like these to help issuers produce clear, concise and effective information.