



**SUBMISSION**

to

**The Reserve Bank of New Zealand**

and

**The Ministry of Economic Development**

on

**PRUDENTIAL DISCLOSURE REQUIREMENTS for  
NON-BANK DEPOSIT TAKERS**

**Discussion Document**

**April 2011**

## Introduction

1. This Submission is from Trustee Corporations Association of New Zealand Inc (“TCA”) in response to the Discussion Document dated April 2011. We are available to meet with the Reserve Bank of New Zealand (“the Bank”) and the Ministry of Economic Development (“MED”) to discuss our Submission. We can be contacted at:

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2. TCA is a long established association to which all Trustee Corporations belong. The members of the TCA are Public Trust and each of the Trustee Corporations authorised under the Trustee Companies Act 1967 to act as Corporate Trustee for financial products – being Trustees Executors Limited, The New Zealand Guardian Trust Company Limited, New Zealand Permanent Trustees Limited (wholly owned by Public Trust) and Perpetual Trust Limited. Covenant Trustee Company Limited, although not authorised under the Trustee Companies Act 1967, is an associate member of TCA.
3. TCA maintains relationships with government ministries, regulatory bodies and financial sector groups. TCA sets minimum standards as practice guidelines for the performance of Corporate Trustees – standards for integrity, competence, financial capacity, internal controls, powers and duties, standards for conflict of interest management and for reports from scheme operators.
4. Trustee Corporations are most often associated with drawing up wills and trusts, putting in place enduring powers of attorney and handling estates, a service known as Personal Trusts. TCA contends that its members are uniquely qualified to fill this important role which requires independence, experience, professionalism and above all a focus on investor and beneficiary protection.
5. TCA members also provide prudential supervision of a wide range of investment products and financial arrangements in a number of ways and at various levels. In certain instances, fund managers must appoint a Corporate Trustee to meet regulatory requirements before they can offer a financial product to the market.
6. As at 30 June 2010, total Personal Trusts (excluding agencies and administrations) under supervision exceeded 26,000 with a value in excess of \$6.3b. Corporate Trust funds under supervision exceeded \$159b.
7. TCA appreciates this opportunity to comment on the Discussion Document.

## TCA's General Comments

8. TCA has a number of general comments that it wishes to make before responding to the specific questions in the Discussion Document.
9. In principle, TCA fully supports the principles of investors in Non-Bank Deposit Takers (**NBDTs**) having access in a timely manner to all material information relevant to their decision to invest. However, TCA has a number of concerns about the specific proposals in the Discussion Document.
10. TCA wonders whether the proposals appropriately recognise and seek to harmonise with the comprehensive review of securities law that is currently being conducted. It is expected that New Zealand will have new securities law in place sometime in 2013 and that draft legislation will be introduced before the end of this year. Prudential disclosure about NBDTs will form part of the reforms contained in that comprehensive review. The Discussion Document's proposals are therefore an interim measure that will, after the drafting and promulgation of required regulations, endure for a limited period of say 18 months (or, in terms of the Discussion Document's proposals, only three or four of the six month disclosure periods). This will put NBDT industry participants in the position of having to expend resources to not only understand and prepare for the changes to be introduced by the securities law review but to also understand and put processes in place to come to compliance with the interim measures proposed by the Discussion Document. This has the potential to significantly increase the complexity of the regulatory environment.
11. On this point, TCA notes that the prudential disclosure model proposed in the Discussion Document is inconsistent with the Product Disclosure Statement regime proposed by the securities law review. The securities law review regime proposes that information that needs to be updated continuously (eg, financial and prudential information) would be disclosed and updated separately to the principal offering document. If, following consultation with industry, it is deemed necessary to implement interim prudential disclosures for the limited period before finalisation of the securities law review, TCA would consider that a model along the lines of that contemplated by the securities law review would be more appropriate. This would avoid what TCA understands will be the significant compliance cost involved in updating disclosure documentation on a regular basis and would ease the transition (and therefore the marginal compliance cost) into the regime proposed by the securities law review.
12. TCA therefore favours a model whereby prudential information is hosted online, either on the website of each NBDT or the website of the Reserve Bank. Prudential disclosures could then be updated more frequently and at lower cost than forcing them into the current disclosure documents. The Prospectus and Investment Statement would refer to the location of this website so that investors were aware of it. TCA notes that a central repository of disclosure information, hosted by the regulator (in this case the Reserve Bank) is consistent with both the current and proposed models for the registration of disclosure documents for securities offerings. For some time, the Companies Office has hosted Prospectuses and Financial Statements for issuers on its website and the level of information available through this mechanism will be expanded once the provisions relating to the new online Register of Securities Offerings are brought into force. TCA also perceives efficiencies in the website being hosted by the Reserve Bank (as opposed to NBDTs) as only one disclosure platform would need to be developed. There would also be the advantage that the Reserve Bank would be a 'one-stop-shop' for prudential disclosure thereby enhancing consistency in the presentation of information and ease of comparability between NBDTs.
13. TCA has reservations about the proposed active continuous disclosure of 'unexpected' changes to prudential information. The bulk of NBDT investments are fixed term. The secondary market for NBDT investments is limited and, where it does exist, illiquid. This

means that, even when NBDT investors understand the significance of the updated prudential information being presented, there is limited scope for NBDT investors to impose 'market discipline' in response to those updates because, in most cases, they simply do not have the option to exit their investment. At the same time, active continuous disclosure raises a raft of potential problems for NBDTs. TCA understands that the costs of implementing systems and processes to ensure that investors are sent updated prudential information would be material. There are questions about potential liability where updated prudential information is not received. There is uncertainty about what changes to the prudential position of the NBDT would trigger the active continuous disclosure obligation. TCA would therefore suggest a reassessment of whether the potential costs and difficulties of active continuous disclosure are realistically justified by the benefits for NBDT investors. If it is decided that active continuous updates of prudential information are required by NBDTs, TCA suggests an alternative method of implementation. As suggested above, prudential information should be hosted online, either on each NBDT's website or centrally on the website of the Reserve Bank. Investors could sign up for email updates from this website, with those emails being sent out each time that the prudential information was updated.

14. One area where TCA considers that additional disclosures would be necessary is in respect of other financial covenants which are contained in NBDT Trust Deeds. TCA suggests that these financial covenants should be described and compliance with those financial covenants disclosed, including details of the "waterfall of payments" in the event of default.
15. In principle, TCA supports external review of prudential disclosures. However, TCA has some doubts about the value that external review may have in practice, in light of current experience with evolving audit standards. There is also the additional cost involved in external review to consider. Given these potential practical issues, and recognising the discipline that would already be imposed on prudential disclosures by the existing liability regime for directors and officers under the Securities Act, thought needs to be given as to the best method of implementing external review, if it is deemed necessary. One suggestion that TCA has in this regard is for the Reserve Bank to liaise with the New Zealand Institute of Chartered Accountants to agree standard terms of engagement for the proposed assurance engagement.

## **TCA's Responses to Specific Questions**

Q1: Do you agree with this problem definition?

*Absence of good quality prudential disclosures*

16. As noted above, TCA supports improved prudential disclosures about NBDTs to investors.

*Disclosed information is not subject to external review*

17. TCA broadly supports external review of prudential disclosures. However, TCA has reservations about the value that such external review might have in practice, given the current experience with evolving audit standards and auditor reporting. In light of that current experience and recognising that the existing liability regime for directors and officers would already impose discipline on the accuracy of prudential disclosures, TCA suggests that thought should be given to the best method of implementing external review, should it be considered necessary. TCA's suggestion in this regard is that the Reserve Bank should agree standard terms of engagement for the external review with the New Zealand Institute of Chartered Accountants.

*Out-of-date prudential information could remain valid in the Prospectus*

18. This would only be a problem if the proposal to include prudential information in the Prospectus was implemented. As noted above, TCA considers that the most appropriate place for prudential disclosures is on each NBDT's website or a central website possibly hosted by the Reserve Bank. These prudential disclosures could then be made at greater frequency and lower cost. The Prospectus and Investment Statement would refer to the location of the website so that investors were aware of it. Investors could sign up for email updates that would be sent out whenever the prudential information changed. This proposal would avoid costly redrafting and amendments to Prospectuses and ensure that current prudential information was immediately available to the market. TCA notes that central hosting of disclosure information is not a new model. The Companies Office has been making prospectuses and financial statements of NBDTs available through its website for some time and this will be expanded when the amendments to the Securities Act relating to the new Register of Securities Offers are brought into force.

*Investors unaware of changes in an NBDT's disclosures*

19. As noted above, TCA does not consider this to be a significant issue. Most NBDT investments are fixed term. Where a secondary market exists for NBDT investments, it is illiquid. There is therefore limited opportunity for NBDT investors to impose 'market discipline' on NBDTs because, in most cases, they simply do not have the option to exit the investment. In any event, TCA's proposal of an NBDT or centralised website disclosure would make it easy for investors who were interested to receive updated prudential disclosures as changes occur.

**Q2 Do you agree with the capital disclosure requirements that are proposed for the prospectus?**

20. As noted above, TCA has reservations about prudential disclosure in the Prospectus. TCA favours an NBDT website or centralised website disclosure with the Prospectus referring to that disclosure.

**Q3 Do you agree with the disclosure requirements for related party exposures that are proposed for the prospectus?**

21. As noted above, TCA has reservations about prudential disclosure in the Prospectus. TCA favours an NBDT website or centralised website disclosure with the Prospectus referring to that disclosure.
22. As for the proposed related party exposure disclosure itself, TCA agrees with that disclosure but suggests that there should be disclosure of not only the maximum level of related party exposure imposed by the Regulations but also the maximum level imposed by the Trust Deed.

**Q4 Do you agree with the liquidity disclosure requirements proposed for the prospectus?**

23. As noted above, TCA has reservations about prudential disclosure in the Prospectus. TCA favours an NBDT website or centralised website disclosure with the Prospectus referring to that disclosure.
24. As for the proposed liquidity disclosure itself, TCA notes that unlike capital adequacy and related party exposure, the quantitative liquidity requirements are not tightly prescribed by regulations. Rather, the content of those requirements is negotiated between the NBDT and the Trustee, with regard being had to the Reserve Bank guidelines. This means that the actual quantitative liquidity requirements will vary as between NBDTs to a greater extent than the capital adequacy or related party exposure limits. This will impact on comparability. TCA therefore wonders whether the liquidity disclosure requirement might be better left as a simple yes/no answer to the question of compliance. Maybe a "raw"

measure could be put into the prudential disclosure form for general comparability with a proviso that the Trustee may prescribe another ratio.

**Q5 Do you agree with the credit rating disclosure requirements proposed for the prospectus?**

25. As noted above, TCA has reservations about prudential disclosure in the Prospectus. TCA favours an NBDT website or centralised website disclosure with the Prospectus referring to that disclosure. From time to time it may be necessary to update the Prospectus to give effect to a material change but of course only if the issuer is continuing to accept deposits.
26. As for the proposed credit rating disclosure itself, TCA broadly agrees with the proposed approach. However, TCA suggests that the degree (ie, +/-) of a credit rating should also be disclosed where this applies. TCA also considers that the credit rating disclosure should simply be that and not also strive to perform an educative function. As such, TCA would suggest that the Diagram 'illustration of an issuer's credit rating strength' should not be included as part of the disclosure.
27. As a general point, TCA notes that the credit rating requirement is in respect of the NBDT rather than in respect of the product being offered. This raises the question of issue verses issuer rating leading to the possibility for investors to be misled into thinking that the credit rating refers to the investment rather than the NBDT. This is an additional reason for disclosure on the NBDT's website or a centralised website, as such disclosure would clearly be in respect of the NBDT rather than the investment being offered under the Prospectus.

**Q6 Do you agree with the risk management programme disclosure requirements proposed for the prospectus?**

28. As noted above, TCA has reservations about prudential disclosure in the Prospectus. TCA favours an NBDT website or centralised website disclosure with the Prospectus referring to that disclosure.
29. As for the proposed risk management programme disclosure itself, TCA agrees with the proposed approach.

**Q7 Do you agree with the governance disclosure requirements proposed for the prospectus?**

30. As noted above, TCA has reservations about prudential disclosure in the Prospectus. TCA favours NBDT website or centralised website disclosure with the Prospectus referring to that disclosure.
31. As for the proposed governance disclosure itself, TCA agrees with the proposed approach.

**Q8 Do you agree with the disclosure requirements proposed for when an NBDT is exempted from a prudential requirement?**

32. Yes.

**Q9 Do you agree with the prudential disclosure requirements proposed for the investment statement?**

33. As noted above, TCA has reservations about prudential disclosure in offering documentation. TCA favours NBDT website or centralised website disclosure. TCA would therefore suggest that the Investment Statement refers to that website disclosure rather than making any prudential disclosures itself.
34. If it is decided that offering documentation will include prudential disclosure, TCA would agree with the proposed disclosure requirements for Investment Statement.

Q10 Do you agree with the prudential disclosure requirements proposed for the investment statement for credit rating disclosure as well as other prudential requirements, when an NBDT is exempted from a prudential requirement?

35. Same answer as for the previous question.

Q11 Do you agree with the prudential disclosure requirements proposed for advertisements?

36. Yes.

Q12 Do you agree that including standardised prudential disclosures as proposed will result in material benefits?

37. In principle, TCA supports increased prudential disclosure about NBDTs to investors and agrees that standardised prudential disclosures would result in benefits to investors.

Q13 Do you agree that the main incremental costs of this proposal relate to preparing and printing the four additional pages?

38. This is primarily a question for NBDTs rather than Trustees. However, TCA understands that there would be significant additional cost in the form of senior management time, additional independent director costs, additional legal review and sign-off and other advice.

Q13 How much do you expect the incremental per page cost of this proposal to amount to? Please provide a breakdown in terms of the additional hours (if this is relevant to measuring the costs) that will be involved in preparing this information, and the printing costs. How does this relate to the size of your prospectus?

39. This is primarily a question for NBDTs rather than Trustees.

Q14 How many copies of prospectuses would you print on average? How would you estimate this number?

40. This is primarily a question for NBDTs rather than Trustees.

Q15 Do you agree that option (e) is the best option?

41. TCA's proposal is that the Prospectus and Investment Statement do not contain any prudential disclosures themselves but would refer to online disclosure at the NBDT's website or a centralised website hosted possibly by the Reserve Bank. Option (b) is the closest to TCA's proposal, but it should be noted that unlike option (b), TCA favours the Prospectus and Investment Statement referring to a website where *all* prudential disclosures are made.

Q16 Do you agree that NBDTs should disclose whether the prudential disclosures have been based on audited or unaudited financial statements?

42. Yes.

Q17 Do you agree that other financial disclosures in the prospectus should also be updated at this frequency?

43. As noted above, TCA proposes that prudential disclosures should be made online rather than in the Prospectus or Investment Statement, partly to avoid the cost of updating that

documentation. Therefore, TCA does not agree that financial disclosures in the Prospectus should also be updated at the time that prudential disclosures are updated.

44. If it is decided that prudential disclosures are to be made in the disclosure documentation, TCA considers that it would be sensible for the other financial disclosures in the Prospectus to be made at this frequency.

Q18 Do you agree that there will be a material benefit from this proposal?

45. In principle, TCA supports improved prudential disclosures about NBDTs to investors. However, as noted above, TCA considers that there is a more effective and efficient method of making these disclosures available to investors: having the prudential disclosures on the NBDT's website or a centralised website hosted by the Reserve Bank.

Q19 Do you agree with our assessment of likely costs?

46. As noted above, this is primarily a question for NBDTs rather than Trustees. However, TCA understands that there would be significant additional cost in the form of senior management time, additional independent director costs, additional legal review and sign-off and other advice.

Q20 How frequently do you reissue your prospectus on average?

47. This is primarily a question for NBDTs rather than Trustees. However, TCA understands that normally, an NBDT would only issue a Prospectus once in the period and then extend the Prospectus with an extension certificate attaching interim financial statements. A prospectus would therefore last 12 to 15 months.

Q21 If you reissued your prospectus based on annual financial statements (i.e. every 12-15 months), what would you expect the incremental cost of the interim prudential update to be? Please provide a breakdown of the cost in terms of additional hours of work that will be necessary and printing costs, as well as any other details you think are relevant.

48. This is primarily a question for NBDTs rather than Trustees.

Q22 Do you agree with the structure of the assurance engagements being proposed – i.e a reasonable assurance engagement for annual prudential disclosures, and a limited assurance engagement for interim disclosures

49. In principle, TCA agrees with the structure of the assurance engagements being proposed. However, this is subject to our comments about the value of external review in practice, the discipline that would be imposed on prudential disclosure under the existing Securities Act liability regime for directors and officers, and an appropriate assessment of potential benefits against the potential costs.

Q23 Do you agree that there are material benefits from this proposal?

50. As noted above, in principle, TCA supports external review of prudential disclosures. However, TCA has some doubts about the value that external review may have in practice, in light of current experience with evolving audit standards. There is also the additional cost involved in external review to consider. Given these potential practical issues, and recognising the discipline that would already be imposed on prudential disclosures by the existing liability regime for directors and officers under the Securities Act, thought needs to be given as to the best method of implementing external review. One suggestion that TCA has in this regard is for the Reserve Bank to liaise with the New Zealand Institute of Chartered Accountants to agree standard terms of engagement for the proposed assurance engagement.

Q24 How much would you expect a full review of prudential disclosures to add to the cost of auditing annual financial statements expressed as a percentage of your asset base?

51. This is primarily a question for NBDTs rather than Trustees.

Q25 How much would you expect a limited review of prudential disclosures to add to the cost of auditing interim financial statements expressed as a percentage of your asset base?

52. This is primarily a question for NBDTs rather than Trustees.

Q26 Do you agree with the proposal that an NBDT should be required to actively notify existing investors of unexpected changes to prudential disclosures in its prospectus?

53. As noted above, TCA has reservations about the proposed active continuous disclosure of 'unexpected' changes to the prudential information to investors. The vast majority of NBDT investments are fixed term. The secondary market for NBDT investments is extremely limited and, where it does exist, illiquid. This means that, even when NBDT investors understand the significance of the updated prudential information being presented to them, there is limited scope for NBDT investors to impose 'market discipline' in response to those updates because they simply do not have the option of exiting their investment.

54. At the same time, active continuous disclosure raises a raft of potential problems for NBDTs. TCA understands that the costs of implementing systems and processes to ensure that investors are sent updated prudential information would be significant. There are questions about potential liability where updated prudential information is not received. There is uncertainty about what changes to the prudential position of the NBDT would trigger the active continuous disclosure obligation. TCA would therefore suggest a reassessment of whether the potential costs and difficulties of active continuous disclosure are realistically justified by the benefits for NBDT investors.

55. If it is decided that active continuous updates of prudential information are required for NBDTs, TCA suggests an alternative method of implementation. Prudential information should be hosted online, either on each NBDT's website or centrally on the website suggested for the Reserve Bank. Investors could sign up for email updates from this website, with those emails being sent out each time that the prudential information was updated. The Prospectus would refer to the location of this website so that investors were aware of it. TCA notes that a central repository of disclosure information, hosted by the regulator (in this case the Reserve Bank) is consistent with both the current and proposed models for the registration of disclosure documents for securities offerings. For some time, the Companies Office has made Prospectuses and Financial Statements available for public inspection on its website and the level of information available through this mechanism will be expanded once the provisions relating to the new online Register of Securities Offerings are brought into force.

56. The question of when updated prudential disclosures need to be made also needs to be clarified. In TCA's view, the current false and misleading test in the Securities Act is appropriate.

Q27 Do you agree that an NBDT should be able to choose how they notify existing investors of unexpected changes to disclosure documents?

57. As above.

Q28 Is it practical for an NBDT to email notification of changes to existing investors

58. This is primarily a question for the NBDT or the Reserve Bank (depending on who is hosting the website with prudential disclosures) rather than Trustees. TCA would not have

thought there was any practical impediment to emailing investors that had signed up for email updates from a prudential disclosure website.

59. TCA perceives that there would be efficiency and consistency if the Reserve Bank were the hosting entity as only one disclosure platform and email update system would need to be developed. There would also be the benefit that investors would have a 'one-stop-shop' for seeking and comparing prudential information online. This would aid in consistency and comparability as between prudential disclosures in respect of different NBDTs.

Q29 Do you agree that there is a material benefit from this proposal?

60. See answer to question 26, above.

Q30 What method would you choose to notify investors?

61. This is primarily a question for the NBDT or the Reserve Bank (depending on who is hosting the website with prudential disclosures) rather than Trustees.

Q31 How many times on average would you expect your prudential information to change unexpectedly outside of the six-monthly updates?

62. This is primarily a question for NBDTs rather than Trustees.

Q32 What would you expect the incremental cost of this option to be? Please provide details and breakdowns.

63. This is primarily a question for NBDTs rather than Trustees.

Q33 Do you agree that certain Appendix E requirements should be included in the prospectus and updated, six-monthly?

64. TCA agrees that certain Appendix E requirements should be disclosed along with other prudential information. As noted above, TCA does not agree that this disclosure should be made in the Prospectus. TCA's proposal is that this information should be disclosed along with the other prudential information on the NBDT's website or a central website as suggested to be hosted by the Reserve Bank. This information could be produced quarterly.

Q34 Do you agree that impaired and past due assets and a reconciliation of credit impairment allowances should be disclosed?

65. TCA agrees that impaired and past due assets should be disclosed. TCA considers that a reconciliation of credit impairment allowances may be going into too much detail particularly when this information will be available in the six monthly NBDT financial statements.

Q35 Is the proposed disclosure appropriate?

66. Yes.

Q36 Do you agree that large credit exposures should be disclosed?

67. Yes.

Q37 Is the proposed disclosure appropriate?

68. Yes.

Q38 Do you agree that credit concentration should be disclosed?

69. Yes

Q39 Is the proposed disclosure appropriate?

70. Yes

Q40 Are there any other ways that an NBDT could be required to disclose credit concentration that are favoured (for example by prescribing the use of ANSIC codes to classify the purpose of the loan)? What would be the incremental costs of a different way from what is currently required?

71. TCA has no comment to add.

Q41 Do you agree that capitalised interest should be disclosed in the prospectus and updated six-monthly?

72. TCA agrees that loans with capitalised interest should be disclosed.

73. TCA proposes that this information be disclosed, along with the other prudential information on the NBDT's website or a central website hosted by the Reserve Bank. TCA does not agree that these prudential disclosures should be made in the Prospectus.

Q42 Do you agree that the capitalised interest disclosure is appropriate?

74. Yes.

Q43 What do you expect the incremental cost of this proposal to be?

75. This is primarily a question for the NBDT or the Reserve Bank (depending on who is hosting the website with prudential disclosures) rather than Trustees.

Q44 Do you have any other comments or suggestions in relation to this discussion document

76. As a general comment the inclusion of time series information would give investors and other interested parties the opportunity to monitor trends.

77. TCA would appreciate continuing to be involved in the consultation process.

**Trustee Corporations Association of New Zealand Inc**  
**19 May 2011**