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OFFICE OF THE MINISTER OF COMMERCE AND CONSUMER AFFAIRS

Chair

Cabinet Economic Growth and Infrastructure Committee

Modernising Companies' Annual Report Notice Requirements and Minor Changes to the Financial Markets Conduct Regulations

Proposal

- 1 This paper seeks policy approval for amendments to the Financial Markets Conduct Regulations 2014 (FMC Regulations) to enable certain companies to make their annual reports available to shareholders electronically, in order to implement changes made to the Companies Act 1993 in 2016. This paper also seeks approval for other minor changes to the FMC Regulations.

Executive Summary

- 2 Changes were made to the Companies Act 1993 in 2016 to provide "FMC reporting entities" with an alternative process for making their annual reports available to shareholders. FMC reporting entities include listed and other companies that offer financial products such as shares and bonds under the Financial Markets Conduct Act 2013 (FMC Act) regime, as well as banks, KiwiSaver managers, licensed insurers and other entities that obtain money from the public.
- 3 The changes were intended to reduce compliance costs particularly for listed companies. It allows for a more electronic process, instead of the current requirement to send to shareholders each year a copy of the annual report or a notice asking if they would like to receive an annual report.
- 4 Regulations need to be made under the FMC Act to specify the alternative process. I propose that regulations provide for companies to:
 - 4.1 make available their annual reports on their website; and
 - 4.2 ask shareholders at least once if and how they wish to receive the annual report.
- 5 I propose that the alternative process be mandatory for FMC reporting entities that issue equity securities (e.g. shares) regulated by the FMC Act regime. This captures listed companies which are likely to benefit most from the alternative process. Other FMC reporting entities can opt-in to the alternative process.
- 6 The proposed changes will reduce compliance costs while still maintaining shareholders' access to information. The changes are largely supported by the Listed Companies Association, Shareholders Association and NZX, amongst others.
- 7 This paper also seeks approval for other minor changes to the FMC Regulations to address technical issues that have emerged as participants begin operating under the new requirements of the FMC regime.

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Background

- 8 The Companies Act 1993 requires certain companies, including publicly listed companies, to:
- 8.1 prepare an annual report setting out prescribed financial and other information about the company; and
 - 8.2 send to each shareholder each year either a copy of the annual report or a notice asking the shareholder if they would like to receive a copy of the report (Section 209 Notice). The notice or annual report can be sent electronically, but only if the shareholder has opted-in in accordance with the relevant legal requirements.
- 9 Access to a company's annual report is important to enable shareholders to access information about their investment and to support their participation in the company, for example by holding directors to account at the Annual General Meeting.
- 10 However, the requirement to send a Section 209 Notice each year is imposing unnecessary costs in today's digital world.
- 11 For that reason, changes were made to the Companies Act 1993 to allow certain financial markets participants to make their annual reports available using an alternative process to be prescribed in regulations (instead of the Section 209 Notice process). This was seen as particularly beneficial for listed companies that have a large shareholder base. This paper seeks approval for the alternative process to be set out in FMC Regulations.
- 12 This paper also proposes some other minor technical changes to the FMC Regulations to address technical issues that have continued to emerge as participants begin operating under the new FMC regime, which recently came fully into force in December 2016.

Comment

Making annual reports available to shareholders electronically

- 13 The changes made to the Companies Act in 2016 allow "FMC reporting entities" to use an alternative process prescribed in regulations for making annual reports available to shareholders. FMC reporting entities include those entities that issue financial products such as shares and bonds under the FMC Act regime, banks, KiwiSaver scheme managers, licensed insurers and other entities that obtain money from the public.
- 14 Regulations are needed to prescribe the alternative process to be used and the FMC reporting entities that must follow that alternative process. Other FMC reporting entities can then opt-in to the alternative process.
- 15 I propose that the regulations provide for an alternative process as follows:
- 15.1 **Entities that must comply:** those FMC reporting entities that are issuers of regulated equity securities (e.g. ordinary shares) under the FMC Act¹ must comply with the alternative process. This captures listed companies which are

¹ Note that this will include those companies that first issued shares under the previous Securities Act 1978, but that are now subject to the FMC Act regime.

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likely to benefit most from the alternative process. All other FMC reporting entities can opt-in to complying with the alternative process instead of the Section 209 Notice process.

Under the alternative process:

- 15.2 **Requirement to publish on a website:** a company's annual report must be made publicly available on the website of the company or another website maintained by or on behalf of the company. The annual report must remain available on the website for a period of at least 5 years.
- 15.3 **Seeking shareholders' election:** the company must notify shareholders at least once to ask whether they wish to receive the annual report free of charge either in hard copy or electronically by email. The notice must include the address for the website where the annual report will be located. The notice:
- 15.3.1 can be electronic if the shareholder has previously elected to receive communications electronically;
 - 15.3.2 can be sent by a share registrar on behalf of the company, and can be combined with a notice relating to another company or another matter concerning the same company. E.g. a person who has shares in five listed companies may receive one notice asking them if and how they would like to receive annual reports for any or all of those companies.

Shareholders that do not respond will not receive a copy of the annual report, but will be able to access the report on the company's website.

- 15.4 **Timing of new alternative process:** My intention is that FMC reporting entities can choose to adopt the alternative process as soon as regulations are in force. For those companies that will be required to comply with the alternative process, I intend there to be a short lead-in period of a few months before the requirements become mandatory, to enable those companies to make the necessary systems changes. The exact timing will be assessed at the time when approval for the regulations is sought.
- 16 The above approach will provide cost savings particularly for listed companies. Computershare – providers of share registry services to more than half of the companies listed on NZX – has estimated that in excess of \$300,000 will be saved on printing, postage, and labour as a result of the proposal across the companies they represent.
- 17 The changes are also broadly supported by the Shareholders Association, although they did submit that companies should be required to send the notice a second time if there is no response (particularly where the notice relates to more than one company). This is to protect against the risk that the notice is overlooked or lost in the mail.
- 18 I have decided against requiring a second notice be sent. A nil response would most likely be due to a shareholder not wanting to receive a copy of the annual report. A shareholder will also be able to advise the company at any time how they wish to receive the annual report going forward.
- 19 To mitigate the risk of shareholders missing the relevant notice(s), I expect officials to work with the Shareholders Association and other organisations to encourage shareholders to actively select how they wish to receive the annual report.

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Annual reports for managed investment schemes

- 20 Annual reports for managed investment schemes (e.g. KiwiSaver) are currently made available to scheme members (e.g. those that contribute to a KiwiSaver scheme) using a process similar to the existing Section 209 Notice process for companies' annual reports.
- 21 I consider that there may be benefits in allowing managed investment schemes to follow a similar alternative process to those proposed in paragraph 15 above, but consider that further consultation on that issue is required. I seek Cabinet's agreement to delegate authority to me to make decisions on such an alternative process for managed investment schemes following further targeted consultation.

Other miscellaneous changes

- 22 I also propose some other minor technical changes to the FMC Regulations to address technical issues that have continued to emerge as participants begin operating under the new FMC regime. I propose the following minor changes to address some of those issues:
- 22.1 Defined benefit schemes are retirement schemes where a member receives payment based on a formula (e.g. length of employment) rather than based on their contributions to the scheme. Unlike other schemes, defined benefit schemes are already not required to provide quarterly "fund updates" because information about the performance of a fund is not as relevant to members. Consistent with that, a regulation change is required so that defined benefit schemes are also exempt from entering the same information on the FMC offers register.
- 22.2 Under the FMC regulations, different requirements apply to non-bank deposit takers (e.g. credit unions) depending on whether they have an "investment grade credit rating" – which is defined in the regulations with reference to each registered credit rating agency. As the rating agency Equifax Australasia Credit Ratings Pty Limited was registered after the FMC Regulations were first made, an amendment to the definition of investment grade credit rating is required to include this rating agency.
- 23 Further issues are being identified as industry begins operating under the FMC regime which came fully into force on 1 December 2016. I expect that further FMC Regulation changes may be required later this year to address issues that have not yet been identified or worked through. To address any such issues in an expedient manner, I seek your agreement to delegate authority to me to make decisions on any minor policy decisions during the first full year of the regime to 30 November 2017 provided they are consistent with the policy frameworks previously agreed by Cabinet in relation to the FMC Act and FMC Regulations.

Consultation

- 24 The FMA, the Treasury, the External Reporting Board and the Reserve Bank have been consulted on this Cabinet paper. The Department of the Prime Minister and Cabinet has been informed.
- 25 Officials have consulted with representatives of the Listed Companies Association, Shareholders Association, NZX, share registry service providers (Link Market Services and ComputerShare) and the law firm Chapman Tripp in relation to the annual report notice requirements. Those consulted broadly supported the proposals.

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- 26 Officials will continue to engage with stakeholders during the drafting process in order to refine the details of the regulations.

Financial Implications

- 27 There are no financial implications from the creation of these regulations.

Human Rights

- 28 There are no inconsistencies between the proposals in this paper and the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993. There are no gender or disability perspective implications from the proposals in this paper.

Legislative Implications

- 29 Regulations will be prepared in accordance with the Financial Markets Conduct Act 2013.

Regulatory Impact Analysis

- 30 The Regulatory Impact Analysis Team at the Treasury has advised that a Regulatory Impact Statement (RIS) is not required for the proposed changes because of their minor or technical nature.

Publicity

- 31 I intend to issue a press release announcing the annual report changes following Cabinet approval. This will better enable companies to prepare and take advantage of the lower cost alternative process at an earlier date.
- 32 I also intend that a copy of this paper will be published on the Ministry of Business, Innovation and Employment's website with any appropriate redactions.

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Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

Making annual reports available to shareholders electronically

- 1 **note** that changes to the Companies Act 1993 made in 2016 provide for FMC reporting entities to make their annual reports available to shareholders using an alternative process, and that regulations are needed to prescribe the details of the alternative process;
- 2 **agree** that FMC reporting entities that are issuers of regulated equity securities under the Financial Markets Conduct Act 2013 must comply with the alternative process, and that all other FMC reporting entities can opt-in to the alternative process;
- 3 **agree** that under the alternative process, a company's annual report must be made publicly available on the company's website or another website maintained by or on behalf of the company;
- 4 **agree** that the company must write to shareholders at least once to ask if and how they wish to receive annual reports;
- 5 **authorise** the Minister of Commerce and Consumer Affairs to make a decision following further consultation on whether annual reports for managed investment schemes should also be made available using a similar alternative process;

Other miscellaneous changes to Financial Markets Conduct Regulations

- 6 **agree** to remove the requirement for defined benefit schemes to enter fund information in the public offers register, to align with existing exemption for those schemes from providing fund updates;
- 7 **agree** to amend the definition of investment grade credit rating in the regulations to include a rating for the agency Equifax Australasia Credit Ratings Pty Limited;

Regulations

- 8 **invite** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to draft regulations to give effect to the decisions in this paper;
- 9 **authorise** the Minister of Commerce and Consumer Affairs to make further decisions, consistent with the policy frameworks agreed by Cabinet in relation to the Financial Markets Conduct Act and Regulations, in relation to any other minor or technical policy issues prior to 30 November 2017;
- 10 **agree** to publish this Cabinet paper on the Ministry of Business, Innovation and Employment's website with any appropriate redactions.

Authorised for lodgement
Hon Jacqui Dean
Minister of Commerce and Consumer Affairs