



Guidance Note

KiwiSaver Distribution and Disclosure

24 March 2010

1 Introduction

- 1.1 The Securities Commission is responsible for the enforcement of securities law.
- 1.2 All issuers of KiwiSaver schemes are required to comply with the securities law when offering membership in their schemes to the public.
- 1.3 The Commission acknowledges the importance of the KiwiSaver scheme in encouraging New Zealanders to make provision for their retirement. The Commission notes 1.3 million people and \$4.88 billion of their money are invested in KiwiSaver schemes. Accordingly it is important that investors can have confidence in the integrity of the processes by which they choose to join a KiwiSaver scheme and the accuracy of the materials they consider in reaching that decision.
- 1.4 The Securities Act provides a number of remedies to investors when securities are offered or allotted in contravention of the securities law. The primary remedy available is a right to obtain a full refund of money invested. However by the nature of the KiwiSaver regime this remedy is not fully available in relation to KiwiSaver contributions. While a member may require a KiwiSaver issuer that has allotted securities in contravention of the Securities Act to refund contributions, those contributions must be transferred to another KiwiSaver provider, and are not available to the investor until they are entitled to make a withdrawal under the KiwiSaver regime.
- 1.5 Accordingly, as a decision to join and contribute to KiwiSaver is irrevocable, the Commission believes that particular care needs to be taken by KiwiSaver issuers to ensure that the required disclosures and other promotional materials are accurate, clear, unambiguous and that the methods of distribution utilized are within the requirements of the law and are fair and transparent.
- 1.6 This technical guidance is directed to KiwiSaver issuers and managers. It sets out the Commission's expectations of them in the promotion and distribution of their schemes, and in particular:

- a. The conduct of persons distributing KiwiSaver products on behalf of KiwiSaver issuers;
 - b. The calculation and presentation of investment performance figures; and
 - c. The disclosure and application of investment mandates and investment practices.
- 1.7 The Commission is considering issuing further, less technical information directed to members of the public considering investing in a KiwiSaver scheme. This will address matters the Commission believes a person should make themselves aware of and address when considering joining a KiwiSaver scheme.
- 1.8 The Commission also notes that while this guidance note specifically addresses issues arising in relation to KiwiSaver schemes, the compliance matters raised are equally applicable to all managed fund issuers and promoters.

2 Distribution

- 2.1 The Commission has become aware of a number of circumstances where KiwiSaver membership has been solicited in an unusual or confusing manner. These have included door to door sales techniques, sales approaches from suppliers of other household services and inclusion of KiwiSaver membership within unrelated household arrangements. In some cases investors have been unaware that they were committing to KiwiSaver membership, with some believing they were purchasing household products. In other cases immediate inducements have been offered for long term membership.
- 2.2 Section 35 of the Securities Act prohibits the offering of securities on a door to door sales basis. The Commission also believes that other forms of high pressure or coercive or misleading selling are inappropriate for KiwiSaver schemes.
- 2.3 Where KiwiSaver issuers utilise direct distributors to distribute their products, the Commission will hold the issuer responsible for any false, misleading or confusing statements or conduct arising from those activities. The Commission would expect that before an application for membership of a scheme was accepted, the issuer would have taken reasonable steps to satisfy themselves that the applicants were aware of the nature and extent of the obligations they were incurring and had made the investment decision fairly freely and on a properly informed basis.
- 2.4 KiwiSaver issuers should also be aware of the requirements of the incoming Financial Advisers Act and its effect on the requirements for distribution of their products.
- 2.5 Finally the Commission notes that identical concerns are applicable to members who are being encouraged to rejoin a scheme from which they may have withdrawn. Where a KiwiSaver issuer or manager seeks to encourage a former member to rejoin a scheme (or “reinstate” scheme membership) the full disclosure and application process must be completed, on the same basis as if the member were a new member joining the scheme.

3 Disclosure of Investment Performance

- 3.1 Clause 4(7) of Schedule 3C of the Securities Regulations 1983¹ requires each KiwiSaver scheme to disclose in its registered prospectus the investment performance of the scheme (or each fund within the scheme) over the preceding five years, together with a statement of the basis of the calculation of that figure.
- 3.2 The Commission interprets this as a requirement to disclose the performance of the investments made by the fund in the ordinary course of its investment mandate. This is distinct from the overall financial performance of the fund or the fund's return to investors. The financial performance of a fund may be affected by a number of factors other than the level of investment returns. These include the level of fees charged to the fund, extraordinary non-investment income and usual fees and expenses rebated to the fund. Transactions with related parties on other than arms length terms, such as at below market prices and ex gratia payments can also materially influence a fund's financial performance. These factors must be excluded from the statement of investment performance and the existence of the transactions clearly disclosed. While the Commission does not currently have jurisdiction in relation to the management conduct of KiwiSaver issuers and managers, it regards transactions with related parties on other than arm's length terms as questionable behaviour. The Commission will consider making recommendations regarding further regulation in this area during any review of the law relating to KiwiSaver schemes or managed funds generally.
- 3.3 A common means of calculating "investment performance" is use of the change over a period in the unit price applicable to interests in unitised schemes. However where unit prices are calculated by reference to fund net asset values, extraordinary non-investment income and rebated management or administration fees can affect this calculation. Where this results in material variation from the underlying investment performance these factors must be excluded, and the nature and effect of the extraordinary items on fund performance or investor return disclosed. Furthermore, where unit price variations are used as an indicator of investment performance, the explanation of the method of calculation of the performance figures should include an explanation of the means of calculating those unit prices.
- 3.4 In addition, any non-investment income or returns should not be reported as, and should be clearly separated from, investment returns in the financial statements contained or referred to in a prospectus. Where investment returns are materially affected by related party or other extraordinary or non-recurring transactions, the Commission expects these transactions and their effect to be disclosed. This disclosure should be made both in the financial statements and wherever the figures contained in the financial statements are otherwise used.
- 3.5 Generally, where any information is rendered misleading by omission of material details, the law requires those additional details to be disclosed. This is equally applicable to statements of investment and fund performance. For example, this will occur where:

¹ See also Clause 4(7) of Schedule 6 of the Securities Regulations 2009.

- funds are promoted on the basis of short term returns that are inconsistent with the longer term returns for that fund; and
 - funds are promoted on the basis of returns available to a particular group or class of members that are not typical returns available to all members;
- 3.6 Regulation 9 of the Securities Regulations 1983² requires material used in advertising to be consistent with the disclosures contained in the prospectus. Accordingly issuers must take great care to ensure that basis of calculation and presentation of investment performance used in advertising is consistent with the investment performance disclosed in the prospectus.
- 3.7 Further, while issuers are free to use performance indicators other than investment performance (such as fund performance or a fund's return to investors) in advertising, if those performance indicators vary materially from the investment performance disclosed in the prospectus, the Commission expects that variation to be clearly disclosed and reference made to the investment performance information contained in the prospectus.
- 3.8 Where other performance indicators (such as fund performance or a fund's return to investors) are used, in addition to consistency with the regulatory compliance, those statements must also not be misleading or confusing in their own right. The Commission believes that the treatment of fees, extraordinary items and fee rebates also have the potential to produce misleading or confusing results in this area. The Commission will have regard to compliance with accepted industry standards³ when assessing the accuracy of these calculations.
- 3.9 Where comparisons between the investment or fund performance of various KiwiSaver schemes are made in advertisements, these comparisons must not be misleading. In particular, care must be taken to ensure the returns compared are calculated on an equivalent basis, are calculated for comparable periods and that the comparisons made are otherwise fair and reasonable. Comparisons of funds with materially different investment policies and practices may also be misleading. The source and method of calculation of comparisons should be disclosed.
- 3.10 Further, where the figures used to make those comparisons are calculated by the KiwiSaver issuer or manager rather than an independent body, this must be disclosed along with the method of calculation. The same considerations apply where figures produced by an independent body are recalculated, averaged or aggregated by the KiwiSaver issuer or manager.
- 3.11 The Commission notes that the law does not currently prescribe or favour any particular method of calculating investment performance. However, the Commission believes that consistency and comparability in this area is highly desirable. The Commission would encourage industry participants and their industry bodies to work together to develop a standard method for measurement of investment performance that is consistent with the requirements of the securities legislation. If such a consensus can

² See also regulation 24 of the Securities Regulations 2009.

³ For example the CFA Institute "Global Investment Performance Standards"

be achieved, the Commission will consider issuing further guidance as to the acceptability of such a methodology as sufficient compliance for its enforcement purposes. In the absence of a consensus the Commission may need to consider the need to recommend legislative intervention in this area.

4 Disclosure of Investment Mandates and Investment Practices

- 4.1 Clause 4(6) of Schedule 3C of the Securities Regulations 1983⁴ requires each KiwiSaver scheme to disclose the investment objectives and policy of the scheme (or each fund within the scheme) together with a statement of the means by which those objectives and policies may be changed.
- 4.2 Where scheme mandates or statements of investment policies and objectives are widely drawn so as to effectively allow unlimited investment discretion, the disclosures made should include the issuer's actual investment intentions during the currency of the prospectus. The Commission does not believe that the requirements of the regulations are met by statements of investment policies so broad and all encompassing as to give no meaningful indication of the actual investment activities that will be undertaken. The disclosures made should be sufficient to enable potential members to identify the nature of the fund concerned and the risks and likely returns of investment.
- 4.3 The names and descriptions attached to funds should also fairly reflect the true nature of the investment objectives and policies, and must not mislead as to the actual nature of the investment.
- 4.4 Again while issuers are free to make other statements as to investment methodologies and practices in their investment statements and other advertisements, regulation 9 of the Securities Regulations 1983⁵ requires these documents to be consistent with the disclosures made in the prospectus. While this does not necessarily require the disclosures to be made on identical terms, issuers should exercise extreme care when making more expansive statements, such as statements of current, intended or likely practice. Where the description of the nature or scope of that practice or intention varies materially from the disclosure made in the prospectus, the Commission expects that variation to be clearly disclosed and reference to be made to the information contained in the prospectus.
- 4.5 Statements of investment mandates and practices must in all cases be true and accurate. Where actual practice materially varies from the disclosed policies and objectives this will render the prospectus or advertising misleading. The Commission expects that where any such material variations arise they be disclosed by immediate amendment of the KiwiSaver scheme prospectus and withdrawal of misleading advertising. This can apply where a fund invests outside its stated policies and practices and where a fund limits its investment to a narrower selection of investments than disclosed in its stated policies and practices. In both cases this can be misleading as to the true nature of the investment offered.

5 Compliance Responsibility

⁴ See also Clause 4(6) of Schedule 6 of the Securities Regulations 2009

⁵ See also regulation 24 of the Securities Regulations 2009

- 5.1 The trustee of each scheme is the issuer of those securities, and thus the trustee (and its directors) bear primary responsibility for ensuring the accuracy and compliance of the scheme documentation. The Commission does not accept any lower standard of responsibility from professional trustees or Trustee Companies who may be acting for unrelated KiwiSaver fund managers.
- 5.2 Scheme promoters such as scheme managers and their directors will also bear responsibility, but not to the exclusion of the trustees' obligations.
- 5.3 While directors may engage or utilise company officers, staff and external advisors to prepare disclosure documents, they bear the ultimate responsibility for the documents they sign or approve, and must ensure that any reliance on third parties is reasonable and justifiable.

6 Guidance Only

- 6.1 This notice is intended for general guidance. The Commission cannot give rulings on the interpretation of the law or provide legal advice. This note signals the approach the Commission intends to take to the law, but does not bind the Commission to any particular interpretation or action. The Commission may publish further guidance notes over time, and the Commission is not bound by this or any other guidance note.

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