



## Managed Funds Committee

Max Batchelor, Chairman  
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Ms Ruth Smith  
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email: [rsmith@treasury.gov.au](mailto:rsmith@treasury.gov.au) 28 May 2004

Dear Ms Smith

## Trans-Tasman Mutual Recognition of Offers of Securities and Managed Investment Scheme Interests

**Discussion Paper issued May 2004. Submissions due 16 July 2004**

The Managed Funds Committee of the Australian Shareholders' Association has reviewed the Discussion Paper published by Treasury in May 2004 (the Paper) and prepared the attached submission.

While the stated aims of the "Mutual Recognition" concept appear laudable ("*confer benefits upon businesses and individuals by reducing barriers to cross-border activity*", p.1, the Paper), we are uncertain whether proposals such as this can achieve the aims, since it does not seem to propose any genuine reduction in the differences between the two regimes. The proposals do not deliver "*a single substantive regulatory framework*" (p.1, the Paper) but seem to add to the number of regulatory regimes facing both investors and business. Although it is likely that the proposals would achieve some reduction in costs for those who are offering securities and managed funds investments to the Australian and New Zealand public, benefits to issuers seem less than the (certain) increases in costs for the regulators and the investing public.

The attached submission outlines our concerns in greater detail.

We believe it would be more cost effective in the long run to attempt to reduce the underlying differences between the two regimes, and we would support such proposals. Resolving genuine differences may actually be delayed by the creation of such schemes as proposed in the Paper (Trans-Tasman Mutual Recognition Arrangements – TTMRAs). They are expensive to set up, costly to run (and dismantle) and divert resources from addressing the real differences. TTMRAs can obviously be set up in much less time that it would take to reach agreement on how to implement genuine convergence but, in setting up various TTMRAs, no progress is actually made towards the real goal.

Yours sincerely,

Max Batchelor  
Chairman, MFC

# Trans-Tasman Mutual Recognition of Offers of Securities and Managed Investment Scheme Interests

## ***Discussion Paper issued May 2004. Submissions due 16 July 2004***

The Managed Funds Committee (MFC) of the Australian Shareholders' Association has reviewed the proposals in the above discussion paper for a Trans-Tasman Mutual Recognition Arrangement (TTMRA) and makes the following comments. Answers to the questions specified by Treasury (and listed on p. 19 of the Paper) are given the Appendix to this submission.

The main objections to the proposals in the Paper are summarised below, followed by explanations in greater detail of the views of the MFC,

1. The proposed regime does not provide what it claims  
On page 1 of the Paper, the stated aim is "a single substantive regulatory framework". In fact, the proposals seem to add to the number of regulatory regimes facing both investors and business.
2. The proposed regime does not appear to provide much improvement over current arrangements for any stakeholders.  
Although it is likely the proposals will achieve some reduction in costs for those who are offering securities and managed funds investments to the Australian and New Zealand public, any benefits for issuers seem more than outweighed by the increases in costs for the regulators and the investing public. Consideration of the 'alternative models' in Section 4.2 fails to include, as an option, the continuation of current practice.
3. The proposals focus on initial prospectus, and not on-going reporting & trading requirements.  
There does not seem to be any recognition that the on-going requirements for (external) reporting to shareholders and fund holders will remain different, because of differences between the corporate legislation and the accounting standards.
4. The proposals do not include any specific reduction in actual differences between Australia and NZ.  
We are concerned that Mutual Recognition proposals such as this will actually delay progress on converging the two regulatory regimes applicable to securities and managed funds.

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These concerns are explained in greater detail as follows.

### **1. Proposed regime does not provide what it claims**

The stated aim for TTMRA is "a single substantive regulatory framework" (p.1, the Paper) but these proposals seem to add, doubling the number of regulatory regimes facing both investors and business. The outcome appears to be four regimes.

1. Issued Home: Aus
2. Issued Home: NZ
3. Issued Home: Aus and Host: NZ
4. Issued Home: NZ and Host: Aus

Both investors and regulators in each Host jurisdiction will need to be aware of the requirements of

- the (other) Home jurisdiction;
- their own Host requirements; and
- how their Hosting requirements differ from their own Home requirements (for Home-only offers) – and the Hosting requirements in the other jurisdiction.

This seems to place, initially, a fairly heavy burden on the legislative branch of each regulator to get effective regulations drafted in comprehensible English, that are ‘the same’ but interact with the differing substantive legislation. For example, in Section 5.2 (p. 12, the Paper), there is a distinct lack of clarity as to which jurisdiction regulator is required to enforce each (separate) part of the requirements, the “new” hosting rules, or the enforcement by a host regulator when the Home rules have been breached.

The enforcement branch of the regulator and the users (investors) in each country need then to understand the new requirements, preferably before the new scheme becomes operative. If the new requirements are not quickly and fully assimilated, the likely outcomes include:

- less effective enforcement by regulators on Hosted securities (compared to enforcement for their own Home-only securities);
- less genuine scrutiny by investors (who may not discover breaches of Home rules); and
- lower risks of legal action against issuers on Hosted securities.

Even if there is swift and effective assimilation of the new requirements, the costs of this learning curve are borne mainly by the regulators and issuers. Issuers will also need to understand the new requirements but, in general, they will benefit from the reduction in the preparation costs for initial offer and the reduced potential for subsequent litigation. The costs to an investor in a Host jurisdiction of taking action (even if they find out there is cause for action) are likely to be much higher than taking action against a Home-only offer. The majority of investors will have invested a relatively small amount and, to each investor, the costs are likely to exceed the entire value of their investment. On the other hand, each issuer is likely to be dealing in larger amounts and the cost of defending against any legal action will be relatively small compared to what they have at stake. The fundholders are likely to be dispersed and unorganised, and effective action is unlikely, even though the *total* detriment to them may be great. I do not believe it is true to say that the TTMRA would “*expose the offeror to civil action, criminal sanctions and other enforcement action in the home jurisdiction in the same manner as if the breach had occurred in the home jurisdiction.*” (p.12, the Paper).

In describing the details of the proposed model, it is stated (Section 5.1, end of second paragraph) that it will apply to offerors incorporated in the Home jurisdiction, having an established place of business in the Home jurisdiction or “registered in the Home jurisdiction as an overseas company”. We recommend that the last-named category not be included, since it introduces the possibility that a third legal jurisdiction might become involved in any litigation and undermines what is meant by observing the rules and regulation of the Home jurisdiction.

## **2. Proposed regime = little improvement over current arrangements**

It is assumed that the proposals will achieve some reduction in costs for those who are offering securities and managed funds investments to the Australian and New Zealand public, but the magnitude is uncertain.

It is not clear how much the current regime of exemption and exception costs an issuer seeking to offer in the other jurisdiction, (compared to costs in Home-only offers). The details of the proposed "model" do not appear to offer much in the way of cost reduction for issuers, since there seems to be substantial similarity between the old and new processing requirements.

Consideration of the 'alternative models' in Section 4.2 of the Paper did not include, as an option, the continuation of current practice. The two 'models' offered as 'alternatives' to the proposed are not explored in detail and are described in terms that support their rejection.

It is difficult to assess the relative merits when the most obvious other model that should have been considered is the current practice. The benefits claimed for the new model are those that would exist IF there were no current system of exemption and exception. Such comparison flatters the proposals.

### **3. Proposals focus on initial prospectus, not on-going reporting & trading**

There does not seem to be any recognition that the on-going requirements for (external) reporting to shareholders and fund holders will remain different, because of differences between the corporate legislation and the accounting standards.

There is no mention of the differences between trading and securities regulation, or in the role of financial advisers in making offers. Given that Australia has recently introduced much more complex rules governing financial services advisers, it is uncertain whether an Australian investor in a NZ offering will have the same protection as given when investing in an Aus-offering.

The proposals refer to securities and managed investment schemes, but it seems that the primary focus is on managed investment schemes and not on the issue of shares in listed companies. Australians can already buy shares in NZ companies listed on the ASX or those listed on the New Zealand Stock Exchange (and vice versa for NZ residents). This situation appears unchanged by the proposals and, indeed, not in need of fixing.

The on-going obligations on companies to report to their shareholders under the *Corporations Act 2001* (Part 2M.3) differ in many respects from the reporting regime in NZ. The proposals do not specify whether these requirements are to be affected by the TTMRA or are to remain the same. Despite the fact that both NZ and Australia are issuing new Accounting Standards adopting the International Financial Reporting Standards (IFRSs), the new regimes take effect at different times; from 1 January 2005 in Australia, but not until 2007 in NZ. Both countries have added to and subtracted from the IFRSs (for example, in the Investment Property Standard equivalent to IAS 40, NZ has removed the option to use cost or fair value for measurement (permitting only fair value). Thus, there will not be complete concordance on an on-going basis.

Further, registered managed investment schemes (MIS) in Australia are covered by the financial reporting requirements in Part 2M.3 of the *Corporations Act 2001*, and the directors & officers of the Responsible Entity are taken as the directors and officers of the MIS. Those MIS that are disclosing entities are subject to the disclosure requirements of the new Accounting Standard, AASB 1046, *Director and Executive disclosures by Disclosing Entities*. There is no NZ equivalent to this Standard and therefore it appears there will remain substantial differences between two reporting regimes for the foreseeable future.

It is uncertain whether the recent changes to require disclosure of fees by MIS have any parallel in NZ. Having achieved some improvement in this respect of Home offers, it seems unfortunate that the same disclosures will not be required in NZ offers hosted by Australia.

#### **4 Proposals do not include specific reduction in actual differences between A & NZ**

As noted in Point 1 above, the proposed model requires substantial legal modification and new requirements to be enacted in Australia and NZ. These are described in Section 5.3 of the Paper and they constitute what appears to be a complex 'add-on' to the present laws. However, the changes appear to affect only requirements relevant to Hosted offers and do not seem to require any harmonization (or reduction in real differences) between the requirements in each jurisdiction for Home offers.

Thus the proposals seem quite costly to implement and will make the law in each country more complex and more different from the other jurisdiction [in the manner in which it accommodates the Hosting requirements]. As noted earlier, this TTMRA appears expensive to set up, costly to run (and dismantle) and effectively diverting resources from addressing the real differences. TTMRA's can obviously be set up in much less time that it would take to reach agreement on how to implement genuine convergence but, in setting up various TTMRA's, no progress is actually made towards the real goal.

Progress toward genuine harmonisation would be likely to take much longer, and it may be difficult to sustain the political imperative over this much longer period. Some may see this as having the potential for the project to be cut off before completion and therefore wasting the money spent to cessation date (because full harmonisation did not result). However, this model was not set up & discussed as a genuine contender with the other 3 models. Even if the present proposals are implemented and the legislation is duly amended, it is still a waste of money. If judged against a criterion of how much integration has been achieved, the proposals will fail, since the underlying requirements for Home offers will not have changed.

## APPENDIX

### **Questions specified by Treasury, listed on p. 19 of the Paper:**

- 1 *What costs do the current requirements for trans-Tasman offers of securities impose on Australian and New Zealand issuers?*

The Paper outlines the current regime but does not give an indication of the number of issuers that are involved in (or use) the current exemption regime. The MFC is not in a position to quantify the costs to issuers. It would have been useful if respondents had also been asked to estimate costs under the proposed model. (see last paragraph in point 2 of submission)

It is suggested that it would have been useful to request respondents to estimate the costs to users (investors) as well as issuers.

- 2 *Should Australia and New Zealand put in place a mutual recognition regime for offers of securities and interests in managed investment schemes broadly along the lines described in this paper?*

No.

- 3 *Are there any features of the proposal set out in this paper which you see as particularly important in order to ensure that the regime achieves the objectives of facilitating investment between the two countries, enhancing competition in capital markets, reducing compliance costs for business, and increasing choice for investors?*

As explained in the body of the submission, we do not see any one of the proposals as being critically necessary to generating the desired benefits, primarily because we do not believe that the system can possibly achieve the desired outcome. In this question, it is noted that the benefit to investors is nominated as "increasing choice". By itself, increasing choice may or may not be a good thing. It is more likely that investors will incur higher costs.

- 4 *Are there any features of the proposal that you see as inappropriate or undesirable, and that you consider should be changed? How should they be changed?*

There are many features that give rise to concern and other features that we do not yet know about. One detail that we would recommend changing is permitting entities that are not even incorporated or constituted in a Home jurisdiction to make offers in the other (Host) jurisdiction. We do not support their inclusion.

- 5 *Are the proposed exemptions from the standard domestic requirements of each country's fund-raising laws for offers made under the mutual recognition regime, as set out in Appendix 2, appropriate? Should additional requirements be excluded? Should any of these requirements continue to apply to offers under the mutual recognition regime?*

See main body of submission.

- 6 *Is it appropriate to provide for special arrangements for enforcement of civil and/or criminal penalties for breach of the host jurisdiction's ongoing requirements, along the lines described in section 5.5 of this paper?*

Making 'special arrangements' appears contrary to the aim of "a single regulatory regime".

- 7 *Are there any other aspects of this proposal on which you wish to comment?*

See main body of submission.