16 June 2017

NZSUPERFUND
Te Kaitiaki Tahua Penihana Kaumātua o Aotearoa

Financial Markets Authority
PO Box 1179
WELLINGTON 6140

FEEDBACK: SUBSTANTIAL PRODUCT HOLDER DISCLOSURES

Thank you for the opportunity to provide feedback on the proposed guidance on substantial product holder ("**SPH**") disclosure obligations.

The Guardians of New Zealand Superannuation ("**Guardians**"), the Crown entity that manages the New Zealand Superannuation Fund ("**Fund**"), supports the FMA's efforts to ensure that SPH filings are consistent and that they promote a fair, efficient and transparent market. To that end, we have suggested several amendments to the proposed guidance.

Our completed feedback form is **attached** to this letter. In what follows, we also provide additional feedback on the specific issue of disclosure by individuals who manage funds in fund management firms, which we consider has significant implications for the market as regards the overall clarity of disclosures and compliance costs.

While we have (as requested) limited our feedback to the specific case of fund managers, we note that the scope of the guidance is actually much wider. The same logic applies to any entity where an individual or employee has authority to vote / sell a security held by the entity[1].

Disclosure by individuals

Relevant context
By way of background to our feedback, we set out a high level summary of relevant aspects of the Guardians' operations as they relate to listed New Zealand financial products:

- The Guardians has an in-house active equities team that manages a portfolio of listed New Zealand financial products and a Portfolio Completion team which includes authorised dealers that execute trades and manage the passive New Zealand equities in house mandate;
- All staff members are subject to restrictions under our securities trading procedure, including a requirement to obtain consent to trade restricted financial products (see Guardians' policy for the full definition, but this includes most listed securities in New Zealand or overseas). Members of the active equities team and the authorised dealers do not trade listed New Zealand equities on personal account;
- The Guardians has appointed two external New Zealand active equities managers, Devon Funds Management and Mint Asset Management, which also manage listed equities on behalf of the Fund. These managers trade autonomously within the parameters of their mandate, but Guardians retains voting power and reserves an overriding right to require shares to be sold (should it ever need to do so);
- The Fund's global index passive ownership via external managers, State Street, Northern Trust and BlackRock will at times include NZ equities;
- Voting of the shares is undertaken by the Guardians' Responsible Investments team. The team may consult with the external manager or New Zealand active equities team (as relevant). Given this is a firm decision, depending on the issue, the Chief

[1] This could include, for example, any company where the CEO or other staff member has delegated authority to vote / divest a SPH held by that company or Crown officials who can vote / divest a SPH interest held in a listed entity.

Investment Officer, Investment Committee or others may be involved in the decision making. The Guardians currently instruct global managers to vote according to their own policies, but Guardians retains the right to instruct such managers how to vote;

- The Guardians has Direct Investment teams which generally focus on the private markets, but can also take more opportunistic (generally larger) positions in particular listed companies. For example, the New Zealand Direct Investment portfolio includes 19.9% of Metlifecare;
- The Fund can have interests in listed financial products in a particular issuer through any combination of these channels (e.g. active equities, one or more external manager, passive exposure and/or as a direct investment);
- The Guardians has various layers of delegated authorities and processes for acquiring / disposing and voting of listed equities, which depend on the size of the position / transaction, how it is held and nature of the issue;
- Some transactions may involve a recommendation from the Guardians' investment committee (a management committee), although the investment committee itself does not have final authority on the matter;
- The Guardians makes SPH filings where its aggregate position is 5% or greater. These disclosures do not name specific individuals (in keeping with prevailing market practice), but do indicate which shares are held internally versus through a manager;
- The Guardians' external managers complete their own SPH filings as relevant.

Interpretation of section 235

The draft guidance:

- notes that there are several possible interpretations of section 235 of the Financial Markets Conduct Act 2013 ("**Act**"); and
- suggests that the most natural interpretation of the section is that an employee who manages a fund will generally need to make SPH disclosure in respect of financial products held by the fund on the basis that such employee "has the power to exercise, or control the exercise of" voting rights attached to, or "the power to acquire or dispose of, or to control the acquisition or disposal of", those financial products for the purposes of section 235.

However, for reasons set out below, we believe that there is a more natural interpretation of the section which is better supported by the purposes of the Act, the broader legislative framework and other relevant legal principles, and is supported by market practice. We have set out that interpretation below, but in short it is that ***disclosure under section 235 is only required by the firm and not specific individuals / employees acting on its behalf.***

Purposes of the Act

We agree with the draft guidance that the relevant purposes of the Act are to:

- promote and facilitate the development of fair efficient and transparent financial markets (section 3(b));
- avoid unnecessary compliance costs (section 4(c));
- promote fair, orderly and transparent financial product markets (section 229(1)(a)); and
- promote an informed market, and to deter insider conduct, market manipulation, and secret dealings in relation to potential takeover bids, by ensuring that participant in financial markets have access to information concerning the identity and trading activities of persons who are, or may at any time, be entitled to control or influence the exercise of significant voting rights in a listed issuer (section 273(1)).

In our view, these purposes do not support disclosure by individuals in the manner contemplated by the draft guidance. This is because:

- The guidance effectively requires disclosure of a firm's internal governance arrangements. As an institutional investor, we have no real interest in this information

being included in formal SPH disclosures. We need disclosure of the scope and nature of the firm's interest (i.e. as per prevailing market practice) – not the inner workings of how the firm exercises its voting rights and / or makes buy / sell decisions:
  - » Disclosure by firms (and not individuals) is the long-established and accepted market practice, and there has been no obvious need for disclosure by individuals;
  - » Disclosure by firms is also the prevailing market practice in Australia (based on a similar legislative framework).
- The proposed approach would result in repetitive, trivial disclosures. For large institutional investors (such as the Guardians), there could be a considerable number of filings depending on how the guidance is interpreted:
  - » There is a wide net of people who may need to disclose in respect of a SPH holding. In Guardians' case this could include staff at external managers as well as Guardians' own staff;
  - » Disclosure obligations will differ depending on the value of each position and how it is held. This is because different delegations will apply based on value and ownership chain of each position. For example, the relevant individuals could be quite different where the Fund holds a 5% position via the Guardians' active equities team, via one or more managers or both;[2]
  - » Note also that under normal delegation frameworks a power (e.g. to vote) will be delegated from the board, to the CEO and down via other reporting levels to the relevant person / people who typically exercises the power in their role. However, each person who delegates an authority still retains that authority themselves. So multiple people would hold any particular authority, even though they do not routinely exercise that power;
  - » Delegated authorities are frequently sub-delegated on a temporary basis to a person acting in a role during travel or other absences. This would trigger SPH notices at the start and end of the acting appointment;
  - » Role changes are not infrequent and may result in changes to delegated authority necessitating further SPH disclosure;
  - » It will not always be possible to combine different SPH disclosures given the nature of relevant interests may be different (e.g. one relevant interest may be for a power to vote; another may relate to buy/sell powers).
- The considerable volume of these disclosures would obscure other more significant information that is released to the market and detract from overall market transparency.
- The disclosures will be relatively complex to monitor, and result in increased compliance costs. Given the additional disclosure would, in our view, not be relevant information, this additional compliance cost is unnecessary. Note also that as the proposed SPH applies to each affected individual (rather than the firm) and those individuals may need / decide to take independent advice of their employing firm, which will be an additional cost.

We note that the same issues around disclosure by individuals have been considered previously in the context of amendments to the Securities Markets Act 1988 ("**SMA**") made in 2006, and that the relevant records indicate a clear policy intent that disclosure should be made by the firm, not specific individuals who act on its behalf.

- As you are aware, the Act carries forward from the SMA a specific exclusion for directors, such that directors are not required to disclose the relevant interests held by the body corporate of which they are a director. This exception confirmed standard practice before 2006, which was for the company (but not directors) to disclose.
- A paper by the then Minister of Commerce from when the director exception was included in the SMA states that the exception for directors was introduced "so as to

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[2] We have not included different worked examples in this feedback. However, we would be happy to provide practical examples to show the potential number and complexity of different disclosures that could be triggered if that would help the FMA develop its analysis.

remove any doubt that only a company must disclose substantial security holdings, and not its individual directors" and that individual disclosure by directors "does not appear to reflect the intention of the legislature" and would lead to "repetitive disclosures with no benefit to the market".

- The exception only applies to directors because they have a statutory power to manage the company (section 128 of the Companies Act 1993), which employees do not. The Minister of Commerce notes that directors had a concern that "as directors, they have the joint ability to exercise control over the company's assets, including its securities" and could therefore be required to disclose on a literal reading of the tests.
- Unlike directors, employees do not have an independent power to vote or buy / sell financial products. The power belongs to the firm and the employees are simply the instrument through which the firm exercises that power - the firm is free to vary or revoke the power at any time. Under principles of agency law the acts of employees acting within their authority are generally attributed to the employer rather than being regarded as independent acts.

Situation where a fund manager has a personal holding

We agree with the FMA that the most contentious situation is where an individual has power / control over the firm's position in an issuer and also a personal holding in the same listed issuer. The guidance notes that in this situation a conflict of interest can occur in this scenario which could influence decision-making.

This particular situation should not arise for the Guardians, because relevant staff members who undertake active equities trading do not trade listed New Zealand equities. However, we still consider that the proposed guidance is not necessary to address the issue:

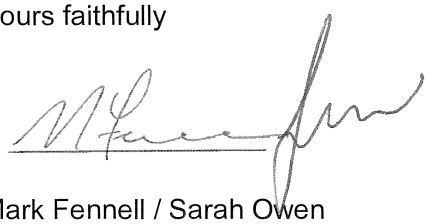
1. As a starting point, firms should have robust conflicts of interest policies that avoid / address any actual or perceived conflict of interest in this situation.
2. The existing SPH disclosure rules already cover this situation. For instance:
   - » if an individual holds a personal 5% position, he/she will need to disclose;
   - » the Act already sets out clear tests as to when an individual has the requisite level of control or influence over a firm, such that financial products held by the firm will be aggregated with the individual's personal holding (e.g. under section 237 of the Act, because the individual holds 20% of voting products in the firm or the firm's directors are accustomed to acting on the individual's directions);
   - » the proposed interpretation of section 235 of the Act would cut across these specific tests.

Suggested interpretation

Given the above, our suggested interpretation is that the "person" referred to in section 235(1) is the firm itself – not the individual staff members who simply process that power on behalf of the firm. We consider that this is better supported by the purposes of the Act and also results in better disclosure outcomes and appropriate compliance requirements/costs.

We would be happy to meet to provide technical information around any market or trading practices as may be relevant to help develop this guidance.

Yours faithfully



Mark Fennell / Sarah Owen
GM Portfolio Completion / General Counsel & GM Corporate Strategy

Feedback: Proposed guidance on substantial product holder disclosures

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with '**Feedback: Substantial product holder disclosures**' and your entity name in the subject line. Thank you. **Submissions close on Friday, 16 June 2017.**

Date: 16 June 2017
Number of pages: 7 (including cover letter)
Name of submitter: Mark Fennell / Sarah Owen
Company or entity: Guardians of New Zealand Superannuation
Organisation type: Institutional investor
Contact name (if different): As above
Contact email and Phone: Mark Fennell (phone: +649 308 2012; email: MFennell@nzsuperfund.co.nz) / Sarah Owen (phone: +649 308 2020; email: SOwen@nzsuperfund.co.nz)

Paragraph or Question Number:	Comment	Recommendation
You don't need to quote from the consultation document if you use question numbers. You may attach extra pages – please label each page with your name and organisation. You don't need to give an answer to every question if you don't want to.		
Q1: Do you think any content in our draft guidance is unclear or requires further clarification? Do you think we should include any further guidance relating to substantial product holders' disclosure obligations, which is not currently included?	See covering letter. The commentary around timeliness should be clarified as it relates to routine market trading by funds with multiple trading accounts. The guidance currently suggests that all filings should be complete within one business day of becoming aware of the events that triggered a disclosure. Guardians files immediately for significant off-market trades (e.g. block-trades) on T (i.e. trade date). However, for routine market trading, Guardians files on a T +2 basis against traded positions, as reported by our Custodian (Northern Trust). This is because trading in any particular financial product can occur through a variety of channels (e.g. Guardians' internal active	We suggest including a short sentence that for funds, filing of routine trading should occur upon reconciliation of positions, and reconciliations should occur at regular intervals to ensure filing is at least T+2. We note that this is consistent with the general timeframes for filing substantial holding notices in Australia, and that the FMA included a comment noting that fund managers needed to file after reconciling multiple trades as part of its 2014 review of substantial shareholder notice filings.

	equities team and external active managers). These trades need to be submitted to the Custodian (generally occurring on T or T+1), before booking and auditing occurs, and reported to ourselves, when we can confirm whether there has been a disclosable event. It is not practicable (and would be error prone) to file on any earlier timeframe, as Guardians' does not have verified information on its positions.	
Q2: Do you agree that the interpretation of the law set out in the final section of the guidance titled *Disclosures by individuals who manage funds* (the "interpretation") is the most natural interpretation of the law? If not, what is the most natural interpretation?	No, we do not believe this is the most natural interpretation. See explanation in covering letter.	
Q3: Do you think the effect of the Interpretation is useful to help prevent the 'mischief' outlined on page 5 above, and to help promote fair, efficient and transparent markets?	No, and it would be likely to have the opposite effect. The proposed Interpretation would stretch the SPH regime to address something which it was never designed to cover with and which isn't supported by the purposes of the Act. The Interpretation would significantly reduce the overall quality of disclosures and result in unnecessary compliance costs. See further explanation in covering letter.	
Q4: If you don't think the guidance is helpful to promote fair, efficient and transparent markets, please describe what disclosure rules you think should apply to individuals who manage funds? In particular: a. Should individual fund managers be required to disclose a personal holding in a listed issuer if their personal holding plus the holding of the fund they manage exceeds 5%? Why? b. Should fund management firms be required to disclose the names of the individuals that control their investments in listed issuers (when the fund's investment exceeds 5%) even if the individual(s) do not have their own personal holdings in those listed issuers? Why?	No. See covering letter for explanation.	

Q5: If you are a technical expert and think that different disclosure rules should apply, we would like your feedback on how best such different rules could be put in place, given the scope of the existing legislation and our regulatory powers.	Not applicable. However, we would be happy to provide technical information around any market or trading practices as may be relevant to help develop this guidance.	
Feedback summary – *if you wish to highlight anything in particular*		
Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.		
Thank you for your feedback – we appreciate your time and input.		