

# **Securities (Local Authority Exemption) Amendment Bill**

Government Bill

## **Explanatory note**

### **General policy statement**

This Bill amends the Securities Act 1978 to provide local authorities with an exemption from the full disclosure requirements of that Act when issuing debt securities to the public. This reduced disclosure requirement will exempt local authorities from the requirement to produce a prospectus signed by all councillors when issuing debt securities to the public. They will still be required to produce an investment statement with a certificate signed by 2 councillors.

A similar disclosure exemption for local authorities was repealed in 1996 (with effect from 1998), in order to make them subject to the same obligations as companies and other corporate entities. This approach did not take into account differences in the respective reporting regimes and legal frameworks, and resulted in discouraging local authorities from offering debt securities to the public.

The Bill aims to deal with 2 problems—

- (a) differences and duplication in the disclosure requirements under the Securities Act 1978 and the Local Government Act 2002; and
- (b) the inappropriateness of the corporate governance principle of collective responsibility when applied to local authorities.

The broad policy objective of the Securities Act 1978 is to promote investor confidence in the capital markets. The information disclosure regime in the Securities Act 1978 seeks to achieve that policy objective by ensuring that investors receive full, accurate, and timely disclosure from issuers of information material to their investment

decisions. This includes information covering the specific securities product being offered, the current position and future prospects of the provider, and relevant information relating to the industry involved.

Local authorities, through their statutory obligations under the Local Government Act 2002, effectively operate in a manner that achieves the policy objectives of the Securities Act 1978 as stated above. They are public bodies that cannot be wound up for default, and have a discretionary power to support their financial commitments through a “rates as security” provision.

Problem (a): Local authorities operate under significant disclosure requirements with regard to their finances, plans, and prospects. They are required to produce annual planning and reporting documents that include audited financial statements that comply with generally accepted accounting practice. This covers the primary information required in a prospectus for debt securities concerning the present financial position and performance of the issuer.

They are also required to produce an independently audited long-term council community plan that covers details of all services and capital works proposed, and associated funding arrangements. Included in this plan are 10-year prospective statements of financial performance, financial position, cash flows, and movements in equity. As a consequence, there is a substantial degree of duplication between the Local Government Act 2002 disclosure requirements and those in the Securities Act 1978 and associated regulations.

Duplication of disclosure results in additional compliance costs for little or no benefit, and has contributed to the withdrawal of local authorities as issuers from the debt securities market.

Problem (b): The signature and liability provisions in the Securities Act 1978 also present a problem for local authorities. The current requirement under the Securities Act 1978 that all elected members sign the prospectus in effect means that unanimous support for a project (and the issuing of debt to fund that project) is needed for a local authority to issue debt securities to the public.

While company directors tend to operate under the principle of collective responsibility, no such obligation exists within local government. One of the constitutional principles of local government is that elected members are not liable (at law) for decisions and actions they do not support. Hence, a single dissenting councillor

can prevent a debt security from being issued by refusing to sign the prospectus.

Under the proposed changes contained in the Bill, 2 councillors will still be required to sign-off on an investment statement relating to the offer of a debt security. Regulation 17 of the Securities Regulations 1983 requires all advertisements (including investment statements) to be signed by 2 councillors. This is sufficient assurance that the information disclosed is an adequate and accurate account of the specific issue on offer.

The combined effect of the 2 problems has led to local authorities effectively withdrawing from the public debt securities market. With the exception of Auckland City Council, all local authority borrowing (primarily used for infrastructure development) has since been obtained from financial institutions.

Infrastructure assets are long-term investments, and borrowing helps spread the cost over the life of the asset. Consequently, financial decisions by local authorities raise important issues of equity, including inter-generational equity and affordability. Local authority long-term plans show that local authorities are undertaking some \$30.8 billion in capital works—network or community infrastructure—in the 10 years to June 2016, and that due to potential “front-loading”, 50% of this amount could be required by 2009.

### **Clause by clause analysis**

*Clause 1* is the Title clause.

*Clause 2* states that this Bill comes into force on the day after the date on which it receives the Royal assent.

*Clause 3* provides that the Bill amends the Securities Act 1978.

*Clause 4* inserts a definition of local authority in section 2(1) of the Securities Act 1978. Local authority is defined in the Local Government Act 2002 to mean a regional council or territorial authority named in Schedule 2 of that Act. It does not include council-controlled organisations or council organisations.

*Clause 5* inserts a new exemption for local authorities issuing debt securities in section 5 of the Securities Act 1978. The effect of the exemption is to remove the requirement for local authorities to register a prospectus for the issue of debt securities.

Local authorities issuing debt securities will be borrowing under the Local Government Act 2002. Under their general powers, local authorities may charge a rate or rate revenue as security for the issue of debt securities, or allow market forces to determine the risk premium applicable to the particular offer. If a local authority charges a rate or rates revenue as security, and there is default resulting in a receiver being appointed, section 115 of that Act enables the receiver to assess and collect a rate to recover funds to meet the local authority's loan commitments.

## **Regulatory impact statement**

### **Executive summary**

The Review of Financial Products and Providers (**RFPP**) has identified some issues concerning the current disclosure regime of the Securities Act 1978 that with clarification could improve the consistency of application of the Act, and help to reduce compliance costs for issuers.

With regard to local authorities, currently the cost of preparing disclosure documents and having them audited can be prohibitive for those issuing other than large debt issues. Also, the signature and liability provisions of the Securities Act 1978, which require all elected members to sign a prospectus, have been identified as a problem.

Consideration of the level of disclosure that local authorities currently operate under covering their finances, plans, and prospects, has led to a proposal to provide an exemption for local authorities through an amendment to the Securities Act 1978. This will grant local authorities reduced disclosure requirements in line with similar existing exemptions for the Crown, the National Provident Fund Board, the Reserve Bank, and Housing New Zealand Corporation.

This paper recommends that the previous exemption for local authorities to have reduced disclosure requirements be reinstated. This would exempt local authorities from producing a prospectus, but they would be required to produce an investment statement with the requirement that a certificate, as set out in regulation 17 of the Securities Regulations 1983 for advertisements, be signed by two councillors covering the investment statement disclosure.

The local authorities would retain the discretionary power, as set out in section 12 of the Local Government Act 2002, to charge a rate or

rates revenue as security over an issue to the public. The main impact of this amendment will be to reduce compliance costs by easing the process for local authorities to offer securities to the public while expanding the investment options for retail investors.

### **Adequacy Statement**

The Ministry of Economic Development (MED) confirms that the Code of Good Regulatory Practice and the regulatory impact analysis (RIA) requirements, including the consultation RIA requirements, have been complied with. A regulatory impact statement (RIS) was prepared, and MED considers the RIS and the RIA analysis undertaken to be adequate. A draft RIS was circulated with the Cabinet paper for departmental consultation purposes.

### **Status quo and problem**

Currently local authorities operate under the same general powers to borrow as companies and other corporate entities and are therefore subject to the same restrictions under the Securities Act 1978. However, there are some significant differences in the reporting regimes and legal frameworks of local authorities and corporate entities.

Currently, the cost of preparing disclosure documents and having them audited can be prohibitive for entities issuing other than large debt issues. This potentially excludes smaller local authorities, some of whom are facing significant challenges with water and sewerage infrastructure development, from raising capital via debt issues to the public. (Local authority long-term plans show that local authorities are undertaking some \$30.8 billion in capital works—network or community infrastructure—in the 10 years to June 2016.)

The signature and liability provisions of the Securities Act 1978 also present a problem for local authorities. The current requirement under the Securities Act 1978 that all elected members sign a prospectus means, in effect, that unanimous support for a project, and the issuing of debt to fund that project, is needed in the local authority in order to issue debt securities to the public.

While company directors tend to operate under the principle of collective responsibility, no such obligation exists within local government. One of the constitutional principles of local government is that elected members are not liable (at law) for decisions and actions they did not support.

Subsequently, the net effect of the removal of the earlier exemption for local authorities from the Securities Act 1978 has been the withdrawal of local authorities from the public debt securities market. Since 1998, only one local authority—Auckland City Council—has issued debt securities to the public. With that exception, all local authority borrowing has since been sourced from financial institutions.

Local authorities operate under significant disclosure requirements with regard to their finances, plans, and prospects. They are required to produce annual planning and reporting documents that include audited financial statements that comply with generally accepted accounting practice and Financial Reporting Standard 42. Therefore they cover the primary information required in a prospectus for debt securities concerning the present financial position and performance of the issuer.

They are also required to produce an independently audited long-term council community plan that covers details of all services and capital works proposed, and associated funding arrangements. Included in this plan are 10-year prospective statements of financial performance, financial position, cash flows, and movements in equity. As a consequence there is a substantial degree of duplication between the Local Government Act 2002 disclosure requirements and those in the Securities Act 1978 and Securities Regulations 1983.

Finally, financial decisions by local authorities raise important issues of equity, including inter-generational equity and affordability. Section 101(3) of the Local Government Act 2002 places local authorities under a statutory obligation to consider this inter-generational equity principle (along with community well-being) when making funding decisions. Infrastructure assets, which are the primary recipient of local authorities funding, are long-term investments, and borrowing helps spread the cost over the life of the asset.

### **Objectives**

It is important to ensure that compliance costs are only imposed if they are outweighed by the benefits the disclosure regime provides to investors. The reporting regime currently required of local authorities provides significant disclosure, meaning that compliance with

the full disclosure regime of the Securities Act 1978 produces duplication of information and added costs.

The objectives behind the disclosure regime for securities offerings are to ensure that investors receive full, accurate, and timely disclosure from issuers of information material to their investment decisions. This allows investors to make an informed decision on the potential risks and returns of their investment choices and to take responsibility for their own investment decisions.

Concurrently, the regime seeks to provide issuers with cost-effective access to capital from the public, therefore the disclosure regime should not impose any unnecessary compliance costs and ensure that issuers can raise capital from either public or private sources.

The reinstatement of an exemption for local authorities would provide local authorities with a reduced disclosure regime due in part to the disclosure requirements they already meet under the Local Government Act 2002 (Part 6 and Schedule 10). This would help to reduce compliance costs and ease the process for local authorities to offer debt securities to the public while expanding and diversifying the investment options for retail investors.

### Alternative options

The options available are full compliance with the disclosure regime of the Securities Act 1978 or to grant an exemption. Given that the former has been identified as a problem, the following are sub-options available to progress an exemption:

- *apply to the Securities Commission for an exemption*: There may be significant impediments to the Commission being able to grant an administrative exemption given the current policy of the Securities Act 1978. This is therefore not considered a preferred or likely option;
- *proceed with the inclusion of an exemption in the RFPP legislation process*: Such an exemption is being considered for other groups of issuers that are currently required to disclose significant material information through other documents;
- for local authorities this would require the production of a transaction-specific document with a certificate of compliance signed off by the chief executive of the local authority.

This document would provide a reduced disclosure requirement that is consistent with the RFPP proposed single offer document regime:

- an option for local authorities to charge a rate or rates revenue as security under section 12 of the Local Government Act 2002 would be retained.

This option is dependent on the proposed new single offer document disclosure regime, which is due for Cabinet consideration later this year with a likely enactment date of 2010. This time frame does not suit the local authorities' need for significant capital expenditure due by 2009.

### **Preferred option**

*Propose urgent stand-alone local authority legislation to meet prospective funding demands sought by 2009:* This would mean creating a suitable legislative vehicle to facilitate the amendment and it would require alignment and consistency with the later RFPP proposals.

The proposed reduced disclosure requirement would exempt local authorities from the current regime, which requires the production of both an investment statement and a prospectus, including full sign-off by all councillors of the prospectus, for the offer of any debt securities to the public.

Instead, local authorities would be required to produce only an investment statement, which in the terms of the Securities Act 1978 is an advertisement, and therefore requires a certificate to be signed by two directors (councillors) under regulation 17 of the Securities Regulations 1983. There is also the option available to the local authority to charge a rate or rates revenue as security for any issue of debt securities to the public.

MED proposes this stand-alone option as the preferred option. It meets the aims of the Ministry's overall review of financial regulation by reducing compliance costs and the cost of raising capital while maintaining appropriate standards of disclosure. Also, due to the fact that it is a reinstatement of a previous exemption, it can be implemented simply and quickly.

MED proposes an announcement by the Prime Minister/Minister at the next Local Government Forum informing the authorities and the marketplace of the proposed amendment. This would help enable



the local authorities to structure their immediate debt with a view to the proposed changes.

### **Implementation and review**

Change is required to section 5(3)(b) of the Securities Act 1978 to restore the previous exemption for local authorities. It is proposed that this change will form the Securities (Local Authorities Exemption) Amendment Bill.

There is no current place on the legislation programme for this Bill, but, as it is a short Bill of low complexity that will significantly and quickly expand the avenues by which local authorities can raise capital, it is proposed that it proceed with some urgency. It will be able to come into force upon passage as there will be no transition issues.

### **Consultation**

This paper has been prepared in consultation with the Treasury, the Securities Commission, the Ministry of Justice, and the Department of Internal Affairs.

Officials' identification of this issue and the development of this proposal were also informed by expert advisory groups comprising people from key industry and professional groups through the Review of Financial Products and Providers, including Local Government New Zealand.

The Ministry of Economic Development released a discussion document in September 2006 on securities offerings as part of a wider series of discussion documents relating to this Review. The discussion document included a section considering possible exemptions for local authorities. It was widely publicised and was also made available on the Ministry website. Approximately 140 submissions were received, fifteen of which were directly relevant to the proposal in this paper.

Therefore, the proposal in this paper is presented on the basis of an inclusive consultation process. Two questions were asked: should local authorities have an exemption from (1) the disclosure regime, and (2) the requirement for all councillors to sign the offer document? Half of the submitters agreed that both exemptions be granted.

Two submitters disagreed with the first exemption for reduced disclosure, but approved of an alternative mechanism to meet the signatory requirements—the added complexities of implementing the latter without the disclosure exemption would unnecessarily exacerbate the offer process.

The arguments of those opposed to granting local authorities either exemption were—

- that all issuers should have the same disclosure obligations—not a strong or relevant argument given that other exemptions exist; and
  - that it would provide local authorities with an unfair market advantage—there is no evidence to support this argument and, from the above analysis of the reporting and legal differences between local authorities and companies, the opposite seems to be the case.
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# **Securities (Local Authority Exemption) Amendment Bill**

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### **The Parliament of New Zealand enacts as follows:**

#### **1 Title**

This Act is the Securities (Local Authority Exemption) Amendment Act **2007**.

#### **2 Commencement**

This Act comes into force on the day after the date on which it receives the Royal assent. 5

#### **3 Principal Act amended**

This Act amends the Securities Act 1978.

#### **4 Interpretation**

Section 2(1) is amended by inserting the following definition in its appropriate alphabetical order: 10

“**local authority** has the meaning set out in section 5(1) of the Local Government Act 2002”.

#### **5 Exemptions from this Act**

Section 5 is amended by inserting the following subsection after subsection (3): 15

“(3A) Nothing in sections 37, 37A(1)(c) and (d) and (1A), and 39 to 44 applies in respect of a debt security the issuer of which is a local authority.”

