

**FINANCIAL MARKETS CONDUCT BILL**  
**SUBMISSION ON EXPOSURE DRAFT**  
**First NZ Capital Securities Limited**

Clause Number	Clause heading	Submission
Part 1	Preliminary provisions	
Clause 8	Definitions relating to kinds of financial products	<p>1. “derivative” – as currently drafted, spot transactions could be read as included within the definition of derivative. It is our understanding that it is not the intent of the MED to include spot transactions within the definition of “derivatives”.</p> <p>We welcome this view and suggest drafting clarifying this intent be added along the lines of:</p> <p>“; and</p> <p>(e) does not include an agreement entered into in the financial markets and commonly referred to in those markets, as a spot deal or transaction, or an agreement under which all consideration is to be provided by the parties no later than the number of days, prescribed by regulation for this purpose, after the day on which the transaction is entered into; and <b>[Note: Timing should be at least 3 business days, to accommodate standard timing for trades.]</b></p> <p>(f) does not include an agreement that all parties agree is not a derivative for the purposes of this Act” <b>[Include equivalent exception for other product categories.]</b></p> <p>2. In our view, currency forward transactions are sufficiently well-understood and vanilla that there is no need for them to be regulated as derivatives. We therefore suggest an additional exclusion from the definition of derivatives for “<i>transactions under which the parties agree to exchange one or more payments in one currency for one or more payments in another currency on one or more specified future dates</i>”.</p>
Clause 10	Definition of issued and issuer	<p><u>Derivative issuer – OTC:</u></p> <p>As drafted, the FMCB proposes where a firm enters into an OTC derivative contract/agreement with its client, that the firm is a derivative issuer.</p> <p>OTC products are typically bespoke in nature due to a high degree of tailoring to individual client requirements in terms of quantity, price, duration etc and thus are illiquid. As the derivative contract normally involves mutual obligations to be performed, a credit assessment is made of the client and credit support may be obtained. Accordingly clients are typically either high wealth / sophisticated / wholesale / business, commercial and not the wider public. Access and distribution of the product is therefore not widespread (as it is for exchange traded or IPO products).</p> <p>As part of the client assessment and documentation, NZX accredited firms are required under the NZX Rules to, inter alia, know their client including identifying their risk profile and disclosing risks of various products. There are also additional obligations, including conduct obligations, under the Financial</p>

Clause Number	Clause heading	Submission
		<p>Advisers Act.</p> <p>Accordingly we submit that clients are protected in respect of OTC derivative products by the NZX Rules and the Financial Advisers Act. It is therefore not required, nor appropriate, for additional regulation in respect of OTC derivative products to be imposed by the new legislation. As an alternative, NZX accredited firms should be exempt from the derivative issuer regime (including in respect of disclosure and licensing).</p> <p><u>For a derivative – intermediation vs principal:</u></p> <p>OTC derivative – intermediation would imply an agency relationship – this would be specific in the documentation with the 2 parties being made known to each other. This is not common, but the scenario is catered for in the market documents (ie ISDA). The FMCB should contemplate intermediation in OTC derivatives, and we propose that in this scenario the intermediary would not be treated as the issuer of the derivative.</p> <p>Exchange Traded derivative – these products are brought to market and are listed by the “originator” (the person who designed and has supported the derivative with the underlying asset, and thereby is responsible for delivery of the underlying). These products could be dealt by the intermediary between the market and clients in either an agency or principal relationship. Where the intermediary acts as agent, the originator should be the designated issuer of the derivative. Where the intermediary acts as principal, its role can be characterised as that of a broker, facilitating a sale and purchase of the underlying derivative between the originator/seller and the client. So again, the originator should be the designated issuer of the derivative. The intermediary is just the liquidity provider in the derivative product market and under this scenario the intermediary (acting as agent or principal), should not be treated as the issuer of the derivative.</p> <p>The proposal that the party responsible for collecting margin being the issuer does not reflect market practice, as a number of firms are providing collateral/margin management services as agents on behalf of issuers/intermediaries. These parties should not be treated as issuers if they are not responsible for the delivery of the underlying asset under a derivative.</p> <p>Given the above, an issuer of a derivative should be redefined for each OTC and Exchange Traded derivative as follows:</p> <p>OTC – “the person who enters into the transaction with the investor that constitutes a derivative, and does not include any person who enters into the transaction as agent for another person or persons.”</p> <p>Exchange Traded – “the person responsible for the delivery of the underlying asset to the investor under the derivative, or if the contract cannot be delivered against, the person from time to time that has or will have legal obligations to the investor on</p>

## First NZ Capital Securities Limited

Clause Number	Clause heading	Submission
		under the derivative.”
[insert rows]		
<b>Part 2</b>	<b>Misleading or deceptive conduct or false or misleading representations</b>	
[insert rows]		
<b>Part 3 and schedules 1 and 2</b>	<b>Disclosure offers of financial products</b>	
[insert rows]		
<b>Part 4 and schedule 3</b>	<b>Governance of financial products</b>	
Clause 189	Issuers must keep registers of regulated products	<p>This clause requires issuers to keep a register of regulated products and all financial products “of the same class”.</p> <p>1. It is not practical to keep a register of derivatives, as they are often entered into on a bilateral basis. The obligations in relation to maintaining a register should not apply to in respect of derivatives.</p> <p>2. It is not clear what is meant by “of the same class”. This is particularly problematic if derivatives are not excluded from the register obligations.</p>
<b>Part 5</b>	<b>Dealing in financial products on markets</b>	
Clause 218	Prohibition of insider conduct	<p>The MED is seeking views, inter alia, on whether there should be prohibition on insider trading in non-quoted financial products.</p> <p>We do not think this appropriate. The existing “insider trading” provisions for non-listed companies apply only to directors (Companies Act 1993 s.149) and (in limited cases) to other offers to the public (Securities Act 1978 s.6A). Extending the insider trading prohibitions to all dealings in non-quoted products would be a very significant intrusion into private affairs and is not justified by the core concerns which (now) underly insider trading prohibitions – i.e. preservation of market integrity. Rather, it is submitted that private treaty dealings which do not take place on a licensed financial product market (and do not concern products which are otherwise listed) should not be subject to those provisions.</p> <p>We note that the concept of prohibiting insider conduct in non-quoted financial products is not adopted in the UK legislation.</p>
Clause 291	Need for financial product license	<p>First NZ Capital is a privately owned firm – its shareholders comprise certain past and present directors and employees (including, in some cases, labour-only contractors) and/or their family trusts. First NZ Capital facilitates the purchase and sale of these shares amongst its existing shareholders by</p>
Clause 293	Exemptions	

## First NZ Capital Securities Limited

Clause Number	Clause heading	Submission
		<p>organising an auction process up to 4 times a year. Such processes are low key and relatively “informal”, in as much as they do not take place on anything resembling a product market. It would be a very significant matter for First NZ Capital to have to be registered and comply with clause 295 in order to continue to facilitate some liquidity amongst its shareholders.</p> <p>We assume that clause 293(a) is intended to exclude such “private” arrangements. However, the limits (100 transactions and \$2 million per year) are very low and could well be exceeded (particularly if an auction process is facilitated four times in a year). Moreover, we do not consider it appropriate or necessary that private arrangements which a company may organise to facilitate some liquidity amongst its shareholders should require licensing and entail obligations such as those under clause 295. While such matters may be appropriate for persons in the business of facilitating markets for several third parties, they are not appropriate for such single issuer arrangements.</p> <p>In our view, clause 293 should be amended to include an additional exemption for any such financial product market which extends only to securities of one issuer.</p> <p>This is not to say that a single issuer market could not opt in to the licensing regime if it chooses to – for example, to lend “credibility” and/or as part of a transition to becoming a multi-issuer market. However, this should not be required.</p>
<b>Part 6</b>	<b>Licensing and other regulation of market services</b>	
Clause 381	Licence may cover subsidiaries	First NZ Capital supports the proposition that a licence can be granted on the basis that it covers subsidiaries.
Clause 422	Definition of related party benefits	<p>Clause 422 (Related party transactions) defines a related party transaction. Clause 423 prohibits such transactions and Clause 424 has certain carve-outs.</p> <p>First NZ Capital submits that the carve-outs should be expanded to cover the following types of transactions:</p> <ul style="list-style-type: none"> <li>• fees collected out of investor property and received by an NZX Market Participant Firm – reflecting usual broker practice.</li> <li>• fees paid to associated custodians (see below our submission that DIMS custodians should not be required to be independent of the DIMS provider).</li> </ul> <p>Without these refinements significant amendments would need to be made to existing broker arrangements. These changes are in our view unnecessary, as it is widely accepted that the most efficient way to deal with broker / custodian fees is to deduct them from the client’s cash management account or other property held for the client. They also fail to recognise the existing regulatory controls to which NZX Market Participants are subject under the NZX Participant Rules (see further our comments on clause 426 below)</p>

Clause Number	Clause heading	Submission
Clause 426	Requirement for Custodian	<p>First NZ Capital submits that:</p> <ul style="list-style-type: none"> <li>• there should be no requirement for the custodian for a discretionary investment management service (DIMS) to be someone other than the DIMS licensee or a person associated with the DIMS licensee. For NZX Market Participants this requirement would be inconsistent with both the NZX Participant Rules and commonly accepted good broking practice.</li> <li>• a DIMS licensee and a custodian should not have joint and several liability for the holding of investment property.</li> </ul> <p>In addition, there is a terminology inconsistency between clause 426(1) and 426 (2)(b) on the one hand (which refer to “investor property”), and clause 426(2) on the other (which uses “scheme property”).</p> <p><b><i>Independent custodian not required</i></b></p> <p>NZX Market Participant entities that provide class DIMS to retail clients will be required to be licensed under the Bill</p> <p>The requirement under clause 426(2)(b) that a custodian of investor property is not the DIMS licensee, or associated with the DIMS licensee, fails to recognise that for NZX Market Participants there is already sufficient regulation covering the holding of client assets.</p> <p>Typically client assets managed under a discretionary mandate are administered in custody by a nominee company in the same group as the NZX regulated entity. NZX Participant Rule 18.15.1 (b) requires that a separate Nominee Company (as defined in the Rules) be established for the purposes of providing Custody Accounts. NZX Market Participant client agreements contain relevant clauses setting out the basis upon which the custody service is provided, both reflecting NZX rules and commercial norms for such service. Further, investor property will include cash, and again, the Participant Rules specify how that must be handled and accounted for.</p> <p>Clause 426 (2) proposes that the custodian used to hold and safeguard investor property must not be the same person as, or be associated with, the DIMS licensee (unless the license permits otherwise).</p> <p>The proposed use of an independent custodian provides no greater asset protection safeguard to the investor than a properly administered nominee company as custodian. The fact that the custodian may be associated with the DIMS licensee should therefore have no bearing. The holding and administration of investor property (cash and securities) is in a fiduciary capacity. In the context of NZX Participant Rules, the main purpose of the Rules is to ensure that through the Client Funds obligations and Nominee Company, the holder accounts for, and safeguards, investor property (client assets) at all times. The Rules dictate a high standard of custodianship and associated record keeping, including reporting to the clients in respect of their property in custody. The financial records in respect of client funds and Nominee Company and the internal controls / safeguards in place are independently audited.</p> <p>We therefore submit that there should be no requirement for the custodian for a discretionary investment management service (DIMS) to be someone other than the DIMS licensee or a person associated with the DIMS licensee. As an alternative,</p>

Clause Number	Clause heading	Submission
		<p>at the least there should be a carve-out for DIMS licensees who are also NZX Participants that administer client property in the form of client funds under the NZX Participant Rules and/or have associated companies that are bare nominees used to safeguard and administer investor property in accordance with the Rules.</p> <p>For identical reasons, a similar restriction should not be carried over to any amendments to the Financial Advisers Act 2008 (FAA). The following points are also relevant in this context:</p> <ul style="list-style-type: none"> <li>• In practice, no NZX adviser as an AFA will have anything to do with the administration and safekeeping of investor property in a Nominee Company. There is legal and functional separation of the custody and manager already</li> <li>• Inefficiency would be created by the proposal in that Participant firms and their employees as AFAs are free to provide advisory services and to continue hold client assets for non-discretionary clients with no requirement for an independent custodian. It would result in significant administrative inefficiencies if discretionary mandate assets were required to be held by an independent custodian while other (non-discretionary) assets were not.</li> </ul> <p>If the proposal stands unchanged, it will create serious challenges having to rewrite client agreements and restructure client asset administration (including use of sub-custodians) across broking firms.</p> <p>The transition costs will be significant, and will deliver a market windfall to the relatively small number of independent custodians in the New Zealand market. It could also have an impact on competition and consumer choice in the field.</p> <p><b><i>Joint and several liability inappropriate</i></b></p> <p>Further, Clause 426 (3) states that the DIMS licensee is jointly and severally liable with any custodian for the holding of investor property in accordance with this subpart.</p> <p>While the clause does not specify to whom joint and several liability is owed, we assume it is to the client.</p> <p>In any event, we do not believe that joint in several liability is appropriate, for the following reasons:</p> <ul style="list-style-type: none"> <li>• It does not recognise that custodians hold assets on trust for clients, and effectively have fiduciary obligations to those clients in any event – adding an extra layer of liability to that primary fiduciary relationship is unnecessary (particularly for firms regulated by the NZX Participant Rules).</li> <li>• In addition, if liability extends to any failure on the part of not just the custodian but any sub-custodian, there will be far reaching implications in terms of custody agreements and, the norms about liability in terms of appointment of sub-custodians.</li> <li>• It would result in increased costs for investors as a result of various factors (included increased insurance premiums for DIMS licensees and potentially increased charges from custodians where a DIMS licensee seeks “back to back” arrangements with the custodian to</li> </ul>

## First NZ Capital Securities Limited

Clause Number	Clause heading	Submission
		manage their own risk).
Part 7	Enforcement and liability	
Clause 462	Terms of compensatory orders	<p>Liability for defective disclosure extends under the Bill far more widely than is appropriate, including to underwriters (cl.462(4)(b)(iv)) and (in potentially many cases) to brokers, investment bankers and other advisers (via the definition of “contravene” in cl. 431 – particularly sub-clauses (c) and (e) of that definition). We had understood and expected that the liability regime would reflect the Cabinet Paper earlier this year which signalled a focus on issuers having primary liability. The inclusion of the “contravene” concept from the current Securities Markets Act 1988 and the express extension of liability for compensatory orders to underwriters is in our view inappropriate and very unhelpful for the New Zealand capital markets.</p> <p>In our view, this will at a minimum increase transactions costs as investment bankers and professional advisers become even more concerned about liability risks and insist on even more extensive due diligence processes. We think it also likely that it will mean some offers which would otherwise come to market do not do so, for want of an underwriter at an acceptable price (or even, potentially, for want of an investment banker). The New Zealand broker community is aware of the litigation that has ensued in Australia involving professional advisers and will be very concerned to avoid such a fate.</p> <p>Liability for knowing participation in a deliberate breach of disclosure requirements would be understandable. But the current bill goes too far.</p>
Part 8	Regulations and exemptions	
[insert rows]		
Part 9 and schedule 4	Miscellaneous provisions	
[insert rows]		