



6 September 2011

Investment Law Team  
Competition, Trade and Investment Branch  
Ministry of Economic Development  
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Dear Sir/Madam

### **Financial Markets Conduct Bill Exposure Draft**

The Australian Financial Markets Association (AFMA) welcomes the opportunity to comment on the exposure draft of the Financial Markets Conduct Bill (the draft Bill). AFMA represents over 130 members, including all of the main Australian and international banks operating in Australia, leading securities companies and brokers, State Government treasury corporations, fund managers and traders in specialised markets (see annex for a list of AFMA members). Many of AFMA's members also operate in the New Zealand financial markets, and many are currently Authorised Dealers under the Securities Markets Act. Accordingly, many of AFMA's members take an active interest in the reform of securities law in New Zealand.

The draft Bill is a welcome piece of reform that provides a more coherent structure for the regulation of financial markets and will provide financial market participants with greater certainty. We support the objectives of the reform, including that of promoting confident and informed participation of businesses, investors and consumers in financial markets. From a trans-Tasman perspective, the closer alignment of the Australian and New Zealand regulatory regimes, as reflected in the draft Bill, should facilitate greater ease for financial market participants in conducting business in both jurisdictions.

The attached submission raises some issues around the application of the draft Bill to derivatives, as well as the definition of wholesale investors. Please contact me at [dhang@afma.com.au](mailto:dhang@afma.com.au) or (612) 9776 7994 for further clarification or elaboration as required.

Yours sincerely

**Denise Hang**  
Associate Director, Policy

**FINANCIAL MARKETS CONDUCT BILL**  
**SUBMISSION ON EXPOSURE DRAFT**  
**Australian Financial Markets Association (DRAFT)**

Clause Number	Clause heading	Submission
<b>Part 1</b>	<b>Preliminary provisions</b>	
Clause 8	Definitions relating to kinds of financial products	<p><b>Debt Security</b></p> <p>The definition of 'debt security' is expressly stated to exclude a derivative of the kind referred to in paragraph (b) of the definition of derivative. Paragraph (b) of that definition includes at subparagraph (ii) an option but is stated to exclude an option to acquire a debt security. As such, options over debt securities appear to be excluded from the definition of both debt security and derivative. Is it intended that options over debt securities are not financial products?</p> <p><b>Equity Security</b></p> <p>A similar issue arises in relation to the definition of equity security. An equity security is defined as a share in a company, a share in an industrial and provident society and a share in a building society. The definition of 'derivative' expressly excludes in paragraph (b) an option over an equity security with the result that it appears an option over an equity security is not a financial product.</p>
Clause 10	Definitions of issued and issuer	<p><b>MED Commentary (paragraphs 68 – 73)</b></p> <p>The Ministry of Economic Development "Request for submissions and commentary" (Commentary) accompanying the draft Bill contains discussion at paragraphs 68 to 71 on the definition of 'issue' and 'issuer' in relation to derivatives, in particular, exchange traded derivatives involving intermediation. The Commentary discusses the legal relationship between three parties, the client (C), the client's own broker (A) who intermediates the trade and another broker (B) who faces either the exchange or the clearing house. The Commentary sets out the Ministry's understanding of the relationship as being a derivative contract between C and A and a back-to-back derivative contract between A and B.</p> <p>We question whether this is the correct analysis in relation to all exchange traded derivatives. At least in Australia in relation to the futures market, and we understand in the United States as well, it is more usual to view the relationship between a client (C) and its broker (A) as one of principal and agent. In the usual course, C instructs A to place an order, for example, a futures contract, on a particular exchange. If A is a participant on that exchange, A will place the order as agent for C. The majority, if not all, futures exchanges expressly provide that a participant who places an order on the exchange acts in a principal capacity when doing so but that does not disguise the fact that broker A is acting as agent for its client C. If A is not a participant on the exchange, A will engage a further agent, B, to place the order. Again, B will only deal on a principal basis with the exchange, but this again does not disguise the fact that B is acting as agent for A which, in turn, is acting as agent for C.</p> <p>By way of example, the ASX 24 rules require certain minimum terms to be inserted in all client agreements, an example of one being:</p>

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		<p>An appointment by the Client of the Managing Director of ASX Clear (Futures) as the Client's attorney to do all things necessary to transfer any Open Position <u>held by the Clearing Participant on the Client's behalf</u> to another Clearing Participant where the Clearing Participant status of the Clearing Participant has been suspended or terminated. (Rule 4.14(j)(vi)) (<i>emphasis added</i>)</p> <p>It is quite clear from this minimum term requirement that ASX 24 Clear views the relationship as one of principal and agent by virtue of its reference to the Clearing Participant holding open positions "on the Client's behalf".</p> <p>Another example is the International Uniform Brokerage Execution Services ("Give-Up") Agreement, an industry standard agreement used widely in the futures market. Clause 2 of that agreement refers to the customer authorising the executing broker to execute orders for customers, while clause 3 of the agreement expressly provides authorisation to each other party to use the services of one or more other persons in connection with their obligations under the agreement. Again it is clear from this agreement that the relationship between the customer and broker is one of principal and agent.</p> <p>We understand that it is usual in the United Kingdom to view the relationship between client and broker as a series of back-to-back relationships, however, this is not the only and possibly not the standard way of viewing the relationship in relation to on exchange derivatives.</p> <p>Our concern is that the legal relationship expressed in the Commentary may result in unintended consequences for various provisions in the Bill. It is clear that the Bill wishes to capture the situation where a broker deals in futures contracts for its clients and we would recommend that the various provisions relating to derivatives and the issuing of derivatives are drafted widely enough to capture the principal/agency relationship that arises in many instances, including Australia.</p> <p><b>Definition of "issued" for a derivative</b></p> <p>There is an issue with the definition of 'issued' as it relates to a derivative arising from the discussion above concerning back-to-back versus agency relationships. While paragraph (a) would capture an agency relationship in relation to a derivative – a derivative would be 'otherwise made available' to a person where a broker acts in an agency capacity in relation to an exchange traded futures contract – subsection (2)(b) may undo this by providing that despite subsection (1)(a), a derivative is issued to a person when the person enters into the legal relationship that constitutes the derivative. While subsection (2)(b) would apply to an over-the-counter derivative, it would appear to carve out exchange derivatives where the broker acts as agent for the client in acquiring or disposing of the contract. In the case of exchange traded derivatives, (2)(b) implies that the derivative is not issued until the contract between the broker and exchange is made.</p> <p>In our view, the definition of 'issued' as provided for in subsection (1)(a) is sufficient to capture exchange traded and</p>

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		OTC derivatives.
<b>Part 3 and schedules 1 and 2</b>	<b>Disclosure offers of financial products</b>	
Clause 67	Money for financial products must be held in trust	A question arises here as to whether this clause captures all instances where monies are held on behalf of a client. For example, this clause would not appear to cover any profits received by an exchange participant on behalf of a client following the disposal of a financial product on exchange. In such circumstances, the profits would be paid to the exchange participant but it would not appear that section 67 would require that money to be held in trust by the exchange participant prior to forwarding it to the client. This could put the client at risk if the exchange participant were to go into insolvency before repatriating the monies to the client
Schedule 1, Clause 3	Offer to wholesale investor	<p>Clause 3(3)(b) sets out the minimum value test for financial products, referring to the 'minimum amount payable' of \$500,000 by a person on acceptance of an offer of financial products. It is not clear how this will apply to a derivative – as an example, the Australian Corporations Act refers, in the case of a derivative, to a face value or notional amount of \$500,000. To make this test meaningful in the context of derivatives, the same approach should be adopted.</p> <p>There needs to be a test that can be used for small subsidiaries of large or listed overseas multinationals. For example, a small subsidiary that does not invest regularly but deposits money or takes out loans and hedges may not be able to meet the investment activity criteria. In Australia, the 'related body of wholesale client test' under regulation 7.6.02AD provides that, "If the financial product or service is or would be provided to, or acquired by, a body corporate as a wholesale client ("body corporate A"), related bodies corporate of body corporate A are taken to be wholesale clients in respect of the product or service."</p> <p>It may also be necessary to include a provision to take into account a client who is not a New Zealand person. For example, the Australian Corporations Act includes a provision for a foreign entity that, if established or incorporated in Australia, would be covered by one of the paragraphs relating to the professional investor test (see definition of professional investor in section 9(i)).</p>
Schedule 1, Clause 17	Offers of derivatives where derivatives issuer not involved	It is not clear what is meant by 'an offer of a derivative for sale'.
Schedule 1, Clause 34	Investment activity criteria	<p>Clause 34 specifies that two or more of the paragraphs set out under subclause (1) need to be met for the investment activity criteria to apply. It is our view that meeting one of the paragraphs should be sufficient for the purpose of the investment activity criteria. In our experience, subclause (1)(d) would most commonly be used by investors wishing to avail of the wholesale investor exclusions.</p> <p>In relation to Clause 34, it would be helpful to receive clarity that the criteria is applicable to a 'company' or 'entity' as well as</p>

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		<p>individual investors.</p> <p>Paragraph (b) refers to the price of each transaction being at least \$20,000. As with the \$500,000 test in clause 3(3)(b), there needs to be a mechanism to value a derivative, for example, face value or notional amount.</p> <p>Paragraph (c) also refers to the price of specified financial products being at least \$100,000 – this also needs to take into account a mechanism to value a derivative.</p> <p>Paragraph (d) sets minimum asset and turnover threshold in defining wholesale investors at \$2 million and \$200,000 respectively. These thresholds are inconsistent with the asset and turnover thresholds provided for in the Financial Advisers Act 2008 (FAA), which are both set at \$1 million (section 5C(1)(d)). Given that there would not appear to be any real reason why the standards would need to be different between the two types of financial services able to be offered under the FAA and the Bill, it would be easier to administer if the two tests were to be aligned.</p>
Schedule 1, Clause 37	Eligible investors	Subclauses (2) and (3) specifies the matters that a person must certify in relation to availing of the eligible investor provisions. The matters that must be certified are very subjective and open to challenge. In contrast, section 5D(1)(a)(i) of the Financial Advisers Act 2008 provides that eligible investors only need to certify that they have sufficient knowledge, skills or experience to be considered wholesale.
<b>Part 4 and schedule 3</b>	<b>Governance of financial products</b>	
Clause 197	Issuer to send confirmation of financial products	It is not clear how this clause and clause 198 would apply to derivatives, both over-the-counter and on exchange. In relation to a derivative, the derivative will not be 'sent' to a client and no notion of transfer is applicable to a derivative. There is no definition of 'confirmation document' and it is not clear whether this is intended to be a confirmation of the trade having occurred or a form of certificate of title.
Clause 201	Place where accounting records to be kept	This section needs to take into account the situation of an issuer that is not a New Zealand resident or does not have a place of business in New Zealand. It is not clear to whom or how such documents would be sent to or kept in New Zealand in such circumstances. As an alternative, the requirement could be that for foreign issuers the account records be made available to the FMA upon notice from the FMA.
<b>Part 6</b>	<b>Licensing and other regulation of market services</b>	
Clause 370	When provider of market services must be licensed	Part 6 sets out the provisions relating to the licensing of providers of market services. Providers that are required to be licensed will also be required to be registered under the Financial Service Providers (Registration and Dispute Resolution) Act 2008. These two processes should be streamlined for administrative ease.

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Clause 414	Application of subpart	Subclause 414(b) states that the provisions relating to discretionary investment management services (DIMS) applies to a person who acts as a custodian of investor property on behalf of retail investors under a DIMS provided by a licensee. It is unclear whether this applies to the person who is offering the DIMS and who outsources custody to a third-party custodian or to the custodian itself. Custodians will hold property on behalf of their fund manager clients, and such arrangement will not impact the assets being held. In our view, custodians should not be included within these provisions.
<b>Part 9 and schedule 4</b>	<b>Miscellaneous provisions</b>	
Clause 582	Authorised dealers treated as holding market services licence	Clause 582 sets out the transition of Authorised Dealers under section 38 of the Securities Markets Act to the new licensing regime. We support the proposed transitional arrangements.

## ANNEX – AFMA Members

Acciona Energy Oceania Pty Ltd  
AGL Energy Limited  
Alinta Energy  
AMP Capital Investors Limited  
AMP Services Limited  
ANZ Banking Group Limited  
Arab Bank Australia  
Arcadia Energy Trading  
Arrow Energy Trading Pty Ltd  
Aurora Energy Pty Ltd  
Ausgrid  
Australian Office of Financial Management  
AWB Services Limited  
AxiCorp Financial Services Pty Ltd  
Bank of America Merrill Lynch Australia  
Bank of China  
Bank of Cyprus Australia Ltd  
Bank of Queensland  
Bank of Tokyo-Mitsubishi UFJ Ltd  
Barclays Bank PLC  
Bendigo and Adelaide Bank Limited  
BGC Partners (Australia) Pty Ltd  
BNP Paribas  
BP Energy Asia Ltd  
Brisbane City Council  
Citi  
CLSA Australia Pty Ltd  
CMC Markets Asia Pacific  
Colonial First State Global Asset Management  
Commonwealth Bank of Australia  
Coventry Capital Limited  
Credit Agricole CIB Australia Limited  
Credit Suisse Management (Australia) Pty Ltd  
CS Energy Limited  
Cuscal Limited  
Custom House Currency Exchange (Australia) Pty Ltd  
Delta Electricity  
Deutsche Bank AG Australia  
Energy Developments Limited  
Eraring Energy  
Ergon Energy  
ERM Power Pty Ltd  
Essential Energy  
Evans and Partners Pty Ltd  
FIIG Securities Limited  
Financial and Energy Exchange Ltd  
First Commercial Bank Limited  
First Prudential Markets Pty Ltd  
GETCO Australia Pty Ltd  
Global Futures & Forex Ltd  
Goldman Sachs & Partners Australia Pty Ltd  
Greater Building Society Limited  
HSBC Bank Australia Limited  
Hydro Tasmania  
ICAP Australia Pty Ltd  
IG Markets Limited  
IMC Pacific Pty Ltd  
Infratil Energy Australia Pty Ltd  
ING Bank (Australia) Limited  
InterGen (Australia) Pty Ltd  
International Power (Australia) Pty Ltd  
Investec Bank (Australia) Limited  
JPMorgan Chase Bank, N.A.  
Kuwait Finance House (Australia) Pty Ltd  
Laminar Group Pty Ltd  
Lloyds TSB Bank plc, Australia Branch  
London Capital Group Pty Limited  
Loy Yang Marketing Management Company Pty Ltd  
Macquarie Generation  
Macquarie Group Limited  
MF Global Australia Limited  
Mizuho Corporate Bank Ltd Sydney  
MoneyGram  
Morgan Stanley Australia Limited  
National Australia Bank Limited  
Newcastle Permanent Building Society  
Newedge Australia Pty Ltd  
Nomura Australia Limited  
Northern Territory Treasury Corporation  
NSW Treasury Corporation  
OCBC Bank  
Optiver Australia Pty Ltd

Origin Energy  
Ozforex Pty Ltd  
QIC  
Queensland Treasury Corporation  
Rabobank  
Reserve Bank of Australia  
RMB Australia Limited  
Royal Bank of Canada  
Snowy Hydro Limited  
Societe Generale  
South Australian Government Financing Authority  
Standard Chartered Bank  
Stanwell Corporation Limited  
State Electricity Commission of Victoria trading as Vicpower Trading  
State Street Bank and Trust Company  
StoneBridge Group Limited  
Sumitomo Mitsui Banking Corporation, Sydney Branch  
Suncorp Metway Ltd  
Synergy  
Tasmanian Public Finance Corporation  
Territory Insurance Office  
TFS Australia Pty Ltd  
The Royal Bank of Scotland plc  
The Toronto-Dominion Bank  
Travelex Limited  
Treasury Corporation of Victoria  
TRUenergy Pty Ltd  
Tullett Prebon (Australia) Pty Limited  
Tyndall Investment Management Ltd  
UBS AG, Australia Branch  
United Overseas Bank Limited  
Verve Energy  
Western Australian Treasury Corporation  
WestLB Sydney Branch  
Westpac Banking Corporation  
Yieldbroker Pty Limited