



CAPRICORN

To
Ministry of Economic Development

For
Investment Law Team

From
Capricorn Mutual Management Pty
Limited

By
Email: investment@med.govt.nz

Date
6 September 2011

Dear Sir/Madam,

Financial Markets Conduct Bill

1. Introduction

1.1 Thank you for the opportunity to submit on the Ministry of Economic Development's ("**the Ministry**") Financial Markets Conduct Bill (the "**Bill**"). This submission reflects the views of Capricorn Mutual Management Pty Ltd ("**CMM**") in its capacity as the provider of management services to Capricorn Mutual Limited ("**Capricorn Mutual**"), a discretionary mutual operated for the benefit of its members.

1.2 We would be happy to discuss any matters of our submission. Our contact is:

(a) Tremayne West
General Manager – Protection
Capricorn Mutual Management P/L
Telephone: +61 8 9211 4322
Email: Tremayne.west@capricornmutual.com

1.3 Alternatively, you may wish to contact our New Zealand counsel:

Alastair Hercus
Partner
Buddle Findlay
Telephone: 04 498 7318
Email: alastair.hercus@buddlefindlay.com

1.4 We confirm that we have no objection to the Ministry publishing this submission on the Ministry's website.

2. Capricorn Mutual Limited

- 2.1 Capricorn Mutual is a member owned, member driven, not-for-profit organisation specifically formed to address the business and personal risk protection needs of its members by providing an insurance alternative. Capricorn Society Limited ("**Capricorn Society**") was instrumental in the formation of Capricorn Mutual; membership of Capricorn Mutual is only available to members of Capricorn Society, and Capricorn Mutual and Capricorn Society Limited share largely common boards of directors. CMM is a wholly owned subsidiary of Capricorn Society and provides management and administrative services to Capricorn Mutual. However the three companies are separate legal companies.
- 2.2 A mutual is an association of people with common risks or goals who pool financial resources to meet common financial obligations. The pooled resources of a mutual are used to meet the agreed financial risk obligations of each member of the mutual. In Capricorn Mutual's case, member contributions are pooled and available to meet agreed business and personal risks (e.g. fires, theft and public liability). A mutual is owned by its members. Each member has one vote regardless of the financial commitment made to the mutual. Capricorn Mutual is established as a company limited by guarantee under the Corporations Act 2001 (Cth).
- 2.3 Capricorn Mutual is a discretionary mutual. A discretionary mutual is a mutual where a member's entitlements are at the discretion of a person or people appointed by the members. This is the key distinguishing feature between a discretionary mutual protection and insurance contracts. The Board of Directors of Capricorn Mutual has been appointed for this purpose. The Board is drawn mainly from the membership of Capricorn Society so the Board has an understanding of the needs of the members and the business and personal risks that they face.
- 2.4 Capricorn Mutual has the discretion to decide whom to admit to membership and the discretion to decide whether or not to accept a member's application for protection. Only Capricorn Society members are entitled to apply for membership of Capricorn Mutual. Members make contributions to Capricorn Mutual which are then pooled and are available to be paid out, at the discretion of Capricorn Mutual, to cover certain agreed business and personal risks. Members of Capricorn Mutual have the right to have a claim for protection considered by the Board and the Board has the discretion to grant a member's claim for protection. As it is not for profit, there is no pressure to retain member contributions, at least in part, to provide any shareholders a return. As a prudent provider of risk protection Capricorn Mutual may look to "reinsure" major risks with third parties.
- 2.5 Only members of Capricorn Mutual are entitled to make a claim on Capricorn Mutual. This means that its members are not subsidising the cost of claims made by people outside the automotive industry.
- 2.6 Each claim is considered on its merits and circumstances. The Board has absolute discretion to refuse a claim. The discretion also allows the Board to exercise its

power so that in unexpected or special or unusual circumstances it may pay claims, which would ordinarily be excluded.

Capricorn Mutual holds an Australian Financial Services ("AFS") licence that covers its activities and is subject to an external dispute resolution process.

3. Submissions

3.1 We understand that Capricorn Society will be making separate submissions on the Bill to the Ministry. We have had the opportunity to review Capricorn Society's submissions in draft. For the reasons set out in Capricorn Society's submission, we consider that:

- (a) the anti-hawking regime should not apply to financial products offered to business customers;
- (b) the trans-Tasman mutual recognition regime should be supplemented by a more limited disclosure-only exemption for Australian issuers;
- (c) the trans-Tasman mutual recognition regime should be extended to trans-Tasman financial services licensing, as well as offers of financial products; and
- (d) the cure period and advertising regime as proposed should be adopted in New Zealand.

3.2 In addition, we wish to comment specifically on certain financial product definitions.

4. Mutual membership

4.1 Clause 8 of the Bill sets out the various definitions of financial products. In our view, the Bill does not adequately cater for membership of mutuals. Companies limited by guarantee do not have "shares", and therefore do not fit within the definition of equity security. We understand that New Zealand abolished companies limited by guarantee in the 1993 company law reforms. However, such vehicles are still common overseas, and the Bill's definition of "company" expressly includes overseas companies. This covers Capricorn Mutual. However, as Capricorn Mutual does not have "shares" it is not covered by the definition of equity security.

4.2 The member shares issued by other mutual entities such as industrial and provident societies and building societies are expressly included in the definition of "equity security"; we submit that the definition of equity security should expressly include membership of companies limited by guarantee.

4.3 We do note that the treatment of membership of mutuals is an issue under the current Securities Act 1978, as well as under the Bill.

5. Mutual risk management products

5.1 In addition to the general issues described above concerning mutual financial products generally, we are also unsure how Capricorn Mutual's risk management products would be treated under the Bill. In Australia fall within the scope of licensing

by the Australian Securities and Investments Commission ("**ASIC**"). ASIC considers mutual risk management products to be a facility for managing risk, and therefore within the scope of the Corporations Act (for more information see the ASIC Information Release available at <https://westpoint.asic.gov.au/asic/asic.nsf/byheadline/IR+03-17+ASIC's+interim+approach+for+regulation+of+mutual+risk+products?openDocument>).

- 5.2 It is not clear to us however that the Bill as currently drafted would produce a similar result. In particular, clause 9 of the Bill refers to "financial benefits", being "capital, earnings or other financial returns". On a plain reading of these words, this would exclude products designed to manage risk. It seems therefore that mutual risk management products would be outside the scope of the Bill altogether. We are not sure that this is the policy intent of the Bill, however.
- 5.3 In our view, the Bill should clarify the status of mutual risk management products one way or the other. Given the treatment of such products in Australia if a consistent approach was adopted in New Zealand and mutual risk management products were to be included as financial products for the purposes of the Bill Capricorn Mutual would seek to passport its Australian documentation into New Zealand. This largely reflects our current (voluntary) practice under the Securities Act.
- 5.4 We would be happy to discuss with you the appropriate substantive regulation of mutual risk management products. This would be applicable to New Zealand issuers of mutual risk management products.
- 5.5 Again, we note that the treatment of mutual risk management products is not clear under the current Securities Act.

6. Overlap with insurance legislation

- 6.1 Discretionary mutual risk management products may be interpreted by some as analogous to insurance. Such products are not subject to insurance regulation in Australia. We understand that the Finance and Expenditure Select Committee considering the Insurance (Prudential Supervision) Act 2010 expressly considered, but ultimately rejected, including discretionary mutual risk management products within the scope of New Zealand's insurance regulation (see pages 2 to 4 of the Select Committee report). As a result, such products are not subject to insurance regulation in New Zealand either.

7. Concluding remarks

- 7.1 In summary, CMM's submissions on the Bill are that:
- (a) the status of mutual membership, including membership of companies limited by guarantee, should be clarified;
 - (b) the status of mutual risk management financial products should be clarified;

- (c) the anti-hawking regime should not apply to financial products offered to business customers;
- (d) the trans-Tasman mutual recognition regime should be supplemented by a more limited disclosure-only exemption for Australian issuers;
- (e) the trans-Tasman mutual recognition regime should be extended to trans-Tasman financial services licensing, as well as offers of financial products; and
- (f) the cure period regime should be adopted in New Zealand.

7.2 Thank you again for the opportunity to review the Bill at the exposure draft stage. We trust this submission has been helpful for the Ministry in finalising the Bill. Please do not hesitate to contact us if you would like to discuss any aspect of this submission.

Yours sincerely

A handwritten signature in blue ink, consisting of several loops and a long tail, positioned below the text 'Yours sincerely'.

Tremayne West
General Manger - Protection
Capricorn Mutual Management P/L
(Manager of Capricorn Mutual Limited)