



To
Ministry of Economic Development

For
Investment Law Team

From
Capricorn Society Limited

By
Email: investment@med.govt.nz

Date
Monday, 5 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**"). As an Australian cooperative company offering services to New Zealand members, Capricorn Society Limited ("**Capricorn**") has a keen interest in the Bill.

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

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Capricorn Society Limited
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Email: bradley.gannon@capricorn.coop

1.3 Alternatively, we would be happy for you to contact our New Zealand counsel:

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

2. Capricorn

2.1 Capricorn was originally established as a co-operative in 1975 in Perth, Western Australia to assist automotive repair and service businesses. Capricorn has since grown to offer a diversified range of products and services to its members, including travel, finance and mutual risk (an insurance alternative). We have over 14,000

members in Australia, New Zealand and the Republic of South Africa (with approximately 2,700 members in New Zealand).

- 2.2 Capricorn, like other cooperatives, issues member shares to its members. In Capricorn's case, its members are automotive businesses such as mechanics, auto electricians and spray painters. Members are required to hold a minimum of 200 (and a maximum of 200,000) in order to transact with Capricorn. Each New Zealand member share has a NZD\$1.00 value. Only members can hold shares in Capricorn.
- 2.3 The main benefit of holding shares in Capricorn is that members can purchase goods and services relating to the automotive trade from preferred suppliers of Capricorn on accounts provided by Capricorn. Capricorn collates all purchasers by members from preferred suppliers and issues each member with a monthly statement. Members have the convenience of a single trade credit account covering all Capricorn preferred suppliers (and on terms more advantageous than they may obtain from suppliers directly). Likewise, preferred suppliers have the convenience of a single account with Capricorn covering all its members so do not have to manage individual accounts and, importantly, Capricorn pays the supplier direct regardless of whether or not the member has paid (i.e. Capricorn covers the credit risk).
- 2.4 Capricorn may issue both dividends and rebates to members. Any dividend or rebate is determined by Capricorn's board having regard to its financial performance in the subject and previous years, retained profits and available cash as permitted by law. The main difference between dividends and rebates is that dividends are allocated among members in proportion to shares held, while rebates are allocated in proportion to purchases made via each member's Capricorn account in the relevant assessment period.
- 2.5 Further information about Capricorn is available at www.capricorn.coop.

3. Submissions

3.1 We have reviewed the Bill, and wish to comment on the following matters:

- (a) unsolicited offers of financial products ("anti-hawking");
- (b) the trans-Tasman mutual recognition regime;
- (c) certain financial product definitions;
- (d) cure periods; and
- (e) advertising.

3.2 We express no opinion as to the remainder of the Bill.

4. Anti-hawking

4.1 Clauses 69 to 70 of the Bill prohibit "unsolicited" offers of financial products. Clause 69 is in almost identical terms to section 736 of the Corporations Act 2001 (Cth), the "anti-hawking" provision. All offers of financial products made in the course of an

unsolicited meeting, telephone call or electronic communication are prohibited. Breach of this section is an infringement offence, and the recipient of the financial products may set aside the transaction.

- 4.2 Capricorn **opposes** clause 69 and introducing the Australian anti-hawking provision in New Zealand. In our view, this provision would cause significant difficulties in the New Zealand business environment.
- 4.3 We recommend that, consistent with Consumer Law Reform Bill prohibitions on "uninvited direct sales" that the anti-hawking provisions should not apply to dealings with businesses and should be limited to dealings with consumers.
- 4.4 Capricorn has first-hand experience with the equivalent provision in Australia. While we are able to manage the effects of the anti-hawking regime, it does create significant business impediments and additional compliance costs with no corresponding benefit.
- 4.5 As discussed above, the main driver for holding Capricorn shares is the ability to access Capricorn services, not "investing" in Capricorn for financial returns. Shares are used as a mechanism to facilitate membership and, in accordance with our co-operative principles, ensure profits are distributed back to members. Capricorn's business is therefore as a supplier of goods and services to businesses, not a provider of investment financial products. In New Zealand, the business supplies market is dominated by sales representatives – almost without exception, sales reps will visit customer businesses to promote their particular products and services. This includes Capricorn; our sales reps visit New Zealand automotive businesses to promote the services Capricorn is able to offer.
- 4.6 The effect of the anti-hawking provision would be to prohibit Capricorn sales reps to offer, or even discuss, Capricorn membership (which involves a financial product) with prospective new members; if the sales rep has approached the prospective member (as is invariably the case), this would amount to an unsolicited offer of financial products. To manage this in Australia, Capricorn has had to establish a category of non-shareholding members called "authorised purchasers". All would-be members must remain "authorised purchasers" for approximately six months before they are offered shares to avoid any suggestion of hawking at the time they joined. From Capricorn's perspective this effectively doubles the administrative burden of managing the membership basis (as we have to manage two classes of members) and it also denies the "authorised purchasers" the full benefit of membership.
- 4.7 In our view, this would unfairly prejudice Capricorn's commercial position due to its cooperative status, particularly compared to non-cooperatives. A non-cooperative competitor would be free to approach automotive businesses to the competitor's goods and services, as any such discussion would not involve an offer of financial products. However Capricorn would be prohibited from doing the same due to the anti-hawking provision.
- 4.8 Section 35 of the Securities Act currently prohibits door-to-door sales of securities. However, very importantly, this prohibition is limited to residential houses; it does not

prohibit offers of securities at business premises. Capricorn membership is offered exclusively to automotive businesses; we do not offer membership to non-businesses. Capricorn is not aware that any problems have been identified in the marketing of securities to businesses in the way Capricorn and other cooperatives do so. There is therefore no need for statutory intervention. We acknowledge that the current prohibition should be updated to include telemarketing push sales (or "boiler room scams"), however we **strongly submit** that the status quo should be maintained and that supplier businesses should be able to market financial products directly to customer businesses via sales reps.

4.9 In this regard, we note that the current Consumer Law Reform Bill also includes prohibitions on "uninvited direct sales" (clause 18 of the Consumer Law Reform Bill, new sections 36K-36R of the Fair Trading Act 1986). However, the definition of "consumer" in the Consumer Law Reform Bill is limited to a person who:

- (a) *acquires from a supplier goods or services of a kind ordinarily acquired for personal, domestic, or household use or consumption; and*
- (b) *does not acquire the goods or services, or hold himself or herself out as acquiring the goods or services, for the purpose of—*
 - (i) *resupplying them in trade; or*
 - (ii) *consuming them in the course of a process of production or manufacture; or*
 - (iii) *in the case of goods, repairing or treating, in trade, other goods or fixtures on land*

4.10 That is, the uninvited direct sales prohibition does **not** apply to supplier businesses marketing their products and services to customer businesses via sales reps. This approach may form a useful basis for considering amendments to clause 69 of the Bill.

4.11 Capricorn is also a member of the New Zealand Cooperatives Association. We have discussed this matter with the Association and other New Zealand cooperatives and understand that most (if not all) cooperatives also have sales reps. The prohibition on direct marketing of financial products would therefore appear to affect many cooperatives businesses in New Zealand.

5. Trans-Tasman mutual recognition

5.1 Clauses 524 to 543 of the Bill set out a framework for the mutual recognition of securities offers. These provisions appear to largely accord with the equivalent provisions in Part 5 of the Securities Act 1978 and the Mutual Recognition of Securities Offerings agreement between the governments of Australia in New Zealand.

5.2 We support any moves to simplify trans-Tasman businesses and therefore support these proposals. However, we suggest that you consider some additional matters.

5.3 Capricorn does not rely on the mutual recognition regime at present. This is because it would (and would continue to do so under the Bill) extend the Australian anti-hawking provisions to Capricorn's activities in New Zealand. This would be a significant impediment to Capricorn's New Zealand business. Capricorn therefore uses the Securities Act (Australian Issuers) Exemption Notice 2002 (the "**Australian Exemption Notice**") to offer its member shares in New Zealand, rather than the mutual recognition regime. Our view is that the additional compliance costs associated with the Australian Exemption Notice (particularly preparing a New Zealand investment statement) are significantly **less** than the costs of complying with the Australian anti-hawking provision. If our preceding submission concerning the anti-hawking provision is accepted, then it would be unjust if Capricorn were still forced to abide by the Australian anti-hawking provision by virtue of the mutual recognition regime.

5.4 We therefore strongly submit that you preserve the status quo, and maintain an alternative to the mutual recognition regime along the lines of the Australian Exemption Notice. This may take the form of an exemption from the disclosure requirements, rather than mutual recognition regime's approach of an exemption from all the requirements of Part 3 and 4 of the Bill. For example, it may be that an Australian issuer could use their current Australian offer documents instead of a New Zealand PDS and/or register entry, but would otherwise be subject to the Bill. As is the case currently, we suggest that the disclosure-only exemption would be in addition to the full mutual recognition regime, and the choice of regime would be left to the issuer concerned. This would enable Australian issuers to utilise the provisions of the Bill that better cater to the New Zealand business environment, particularly a better focussed anti-hawking regime.

6. Mutual recognition of financial services licences

6.1 We suggest that you consider extending the mutual recognition regime to apply to market services licensing under Part 6 of the Bill and other related legislation such as the Financial Advisers Act 2008. We consider that a holder of an equivalent overseas licence should be able to have that licence recognised in New Zealand without being subject to the full requirements of the licensing regime. This would accord with the intent of the Mutual Recognition of Securities Offerings agreement (albeit that the agreement applies to financial products rather than financial services), the Trans-Tasman Mutual Recognition Act 1997, and the Single Economic Market initiatives. Clause 298 of the Bill already proposes a streamlined process for overseas exchanges and markets to obtain a financial products market licence under the Bill.

6.2 We note for the sake of completeness that that Capricorn is not currently required to hold an AFS licence but an associated company through which mutual risk products are provided is licensed.

7. Financial product definitions

- 7.1 Clause 8 of the Bill sets out the various definitions of financial products. We welcome the clarification that cooperative member shares of companies registered under the Cooperative Companies Act 1996 are not debt securities.
- 7.2 As an Australian company, however Capricorn is not entitled to register under the Cooperatives Companies Act 1996. Capricorn's member shares are not redeemable (although Capricorn does enter into share buy back arrangements with members at its discretion) and will therefore be equity securities.
- 7.3 New Zealand cooperatives enjoy the benefit of tailored disclosure requirements under the Securities Act (Cooperative Companies) Exemption Notice 2011 and the Securities Act (Industrial and Provident Societies) Exemption Notice 2011. The Bill's explanatory note (and previous Ministry papers on this issue) appears to anticipate that different disclosure requirements will be prescribed for different types of financial products. We assume that this will be the case for cooperatives to maintain the current tailored disclosure requirements. We suggest that overseas cooperatives (including corporatised trading co-operatives) such as Capricorn should be able to be included in the definition of "cooperative" for the purposes of disclosure requirements under the Bill.
- 7.4 This would be an appropriate option, especially given the issues we have identified with the mutual recognition regime as it applies to Capricorn.

8. Cure periods

- 8.1 Clauses 61 and 62 appear to largely adopt the "cure period" regime for defective disclosure documents. We have experience of this regime in Australia and strongly support the adoption of an equivalent regime in New Zealand. In our view, the cure period regime strikes an appropriate balance between the interests of investors and issuers, and is a significant advance on the current New Zealand void/voidable regime.

9. Advertising

- 9.1 Clauses 71 to 79 appear to largely adopt the advertising regime currently contained in section 734 of the Corporations Act 2001 (Cth). We have experience of this regime in Australia and strongly support the adoption of an equivalent regime in New Zealand. In our view, it will assist with the advertising operations of trans-Tasman business such as Capricorn.

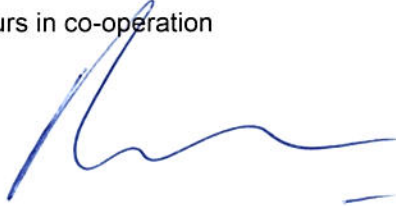
10. Concluding remarks

- 10.1 In summary, Capricorn's submissions on the Bill are 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 as per the current Australian Exemption Notice;
- (c) the trans-Tasman mutual recognition regime should be extended to trans-Tasman financial services licensing, as well as offers of financial products;
- (d) the financial products definitions should clarify that Australian (and potentially other overseas) cooperative member shares are able to be treated as cooperative securities;
- (e) the cure period and advertising regime proposed are supported and should be adopted in New Zealand.

10.2 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 in co-operation



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Capricorn Society Limited