CHAPMAN TRIPP

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Dear Bryan

SUBMISSION ON FINANCIAL MARKETS CONDUCT BILL

1 We set out in the Schedule to this letter Chapman Tripp's submission on the exposure draft of the Financial Markets Conduct Bill.

2 Chapman Tripp is a leading New Zealand full service law firm which covers specialities including capital raisings, mergers and acquisitions, financial services, funds management, KiwiSaver, superannuation, insurance, banking and general corporate, commercial, property and tax advice. This submission has been prepared with the input of the following specialists:

Bradley Kidd
Emma Sutcliffe
Geof Shirtcliffe
Mike Woodbury
Roger Wallis
Ross Pennington
Tim Williams

3 In the limited time available we have sought to focus on what we consider to be the more significant items raised by the draft Bill. We anticipate that there will be additional drafting and consequential matters, which can be addressed at a later stage, possibly in the Select Committee.

4 We would be happy to meet with you and other Ministry of Economic Development officials in relation to the submission, if that would be helpful.

Yours faithfully

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SCHEDULE – DETAILED SUBMISSIONS

Clause number	Clause heading	Submission
Part 1	***Preliminary provisions***	
Clause 6	**Interpretation**	
	"advertisement"	This definition refers to any form of communication *"to the public"*. This reference should be removed, given this concept is not reflected elsewhere in the Bill.
	"give"	We submit that the definition of "give" (which is based on the current Securities Act definition of "receive") should be changed to take into account electronic modes of delivery which are now commonplace, including delivery of a PDF or hyperlink to a known email address.
	"governing document"	This definition should clarify that for any managed investment scheme constituted by a trust deed, *governing document* means that trust deed. Without this it is arguable that the definition in (b) (by referring to agreements that govern scheme activities) extends to other documents such as an administration or investment management agreement, which in turn would be governed – inappropriately – by for example the prescriptive content requirements in clause 117 and the amending restrictions in clause 121.
	"insolvent"	We submit that paragraph (b)(ii) should expressly not apply to a defined benefit superannuation scheme. It would effectively require such a scheme to maintain a structural surplus. Members of defined benefit schemes will be suitably protected under actuarial and annual reporting requirements as well as employers' contractual funding obligations.
Clause 9(2)(c)	**Definitions of managed investment scheme and financial benefit**	
	Insurance contracts	The exclusion from the definition of managed investment scheme of a "pure risk" contract of insurance in clause 9(2)(c) should be the same as that used in the Financial Advisers (Definitions, Voluntary Authorisation, Prescribed Entities, and Exemptions) Regulations 2011.
Clause 10	**Definitions of "issuer" and "issued"**	
10(1)(b)(i)	**"Issuer" – debt security**	Because "debt security" is defined to include redeemable shares, the definition should refer to "interest ***or other returns***".

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10.1(b)(iv)	**"Issuer" – derivative**	We believe that the concept of an "issuer" does not align with exchange-traded derivatives, because the issuer could, depending in the circumstances, be a range of persons (for example, the clearing house, the original holder and any transferees). We therefore submit that there should be an exclusion for exchange-traded derivatives from the requirements that attach to a product which is "issued" (for example, disclosure), on the basis that only the exchanges themselves should be regulated. This should also be sufficiently flexible to extend to exchange-traded derivatives, with a recognition regime for overseas exchanges. In addition, comparable exemptions should be implemented for OTC products that are required to be settled through central clearing counterparties (for example, OTCs undertaken through parties which are regulated by the rules of a particular exchange, the result of which is to require OTC trades to be settled through that exchange's CCP, even though the OTC is not an exchange traded derivative) In our view this is optimally achieved through regulations recognising specified exchanges, rather than on a case-by-case licensing basis.
10(2)(c)(i)	**"Issued" – KiwiSaver**	Clause 10(2)(c) provides that making a further contribution to a superannuation or KiwiSaver scheme does not constitute a fresh "issue" of a financial product. We support this recognition of existing practice for superannuation schemes. We submit that this concept should apply equally to other types of managed investment schemes, as it would provide certainty that an updated PDS does not need to be provided to for investors who make regular contributions to the scheme. If there are materially adverse circumstances affecting the scheme, or there is a materially (adverse) misleading statement in a PDS, under clause 63 the offer could not continue, and in those circumstances it would be reasonable to require an issuer to give a new PDS to the repeat investors before their next investment.
Clause 12	**Miscellaneous interpretation provisions**	
	12(2)(c)	The words "incorporated by reference or referred to in" in this clause (replicating section 55(b)(iii) of the Securities Act) have proven historically problematic, as they have been interpreted as meaning that, when a web reference is included in an offer document, all the material in that website is potentially covered

Clause number	Clause heading	Submission
		by the relevant regulations, prohibitions and liabilities and must be subject to due diligence accordingly. We submit that the provision should clarify that reference to a web address is not deemed to incorporate the contents of the entire website. More generally, treating any statement or information as included in a PDS, register entry or other document if it is "referred to" in it creates considerable risk (and hence additional transactions costs). In our view, it is not necessary. The (appropriate) purpose is to prevent disclosure obligations being "bypassed" by use of other documentation not subject to the bill's disclosure obligations. This is obviously a risk with material which accompanies or is incorporated by reference into a PDS, register entry or other document. But, in our submission, the risk is not nearly so acute merely as a result of it being "referred to". We submit, therefore, that the words ""or referred to in" be deleted from clause 12(2)(c) – or, if considered more appropriate, that they be qualified by the insertion, immediately after them, of words to the following effect: "(except if the PDS, register entry or other document contains a prominent statement to the effect that the material or information referred to has not been vetted by the issuer or offeror and is not subject to the requirements of this [bill]".

Clause number	Clause heading	Submission
Part 2	***Misleading or deceptive conduct or false or misleading representations***	
Clause 16	**Misleading or deceptive conduct generally**	
		This clause prohibits misleading or deceptive conduct in relation to the supply of a "financial service". This potentially overlaps with sections 34 and 77L of the Financial Advisers Act (*FAA*), which has a similar prohibition in relation to "financial adviser services" and "broking services" respectively. We submit that clause 16 should be amended to remove this overlap, so that conduct which is regulated by sections 34 and 77L of the FAA is not capable of being subject to a parallel action under clause 16.
Clauses 17 and 18	**Misleading conduct in relation to financial products/Misleading conduct in relation to financial services**	
		Both of these clauses contain references to "the public". Similar to our comment on the definition of "advertisement", these references should be deleted.

Clause number	Clause heading	Submission
Part 3	**Disclosure offers of financial products**	
Clauses 28-30	**Options and convertibles**	
		We agree that, with options and convertibles, the offer should be of both the option/convertible and the underlying (and that both should be subject to disclosure when the option / convertible is issued and not upon exercise or conversion). We also submit that there should be no disclosure on exercise or conversion beyond the relevant ongoing requirements of the general law (which will include publication of current financial statements and, if listed, various periodic and continuous disclosure requirements).
Clause 33	**Purpose of PDS**	
		Clause 33 provides that the PDS, like the existing regime for investment statements, is aimed at the "prudent but non-expert person". While as an underlying purpose this seems sensible, we draw your attention to our comments on clause 39, where we suggest a more targeted disclosure and liability regime for managed investment schemes.
Clauses 39	**Disclosure of material information**	
		We believe that a **targeted disclosure regime** is appropriate for managed investment schemes. Specifically, rather than requiring a PDS and the register entries to disclose all "material information", the level of disclosure required should be targeted to the scheme in question. This recognises that an investment in a scheme is fundamentally different from an investment in a company issuing debt or equity. Without a targeted approach, we believe there is a prospect that issuers may instead originate financial products under the less stringent Australian regime, and offer into New Zealand under the Trans Tasman Mutual Recognition regime (see further our recent publication which considers this item). Specifically: • The "material information" disclosure touchstone for schemes could adopt the Australian standard in section 1013E of the Corporations Act – being "information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail investor, whether to acquire

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		the product" – to the extent it is actually known by the manager (see section 1013C(2) of the Corporations Act). • There should be a liability regime under which the issuer is primarily liable for any breaches, with the directors only being liable if the issuer does not pay (this aligns with the Cabinet Paper earlier this year which signalled a focus on issuers having primary liability – see also our comments on clause 40 and 462 below). • Criminal liability on directors should only arise in egregious situations, where they have engaged in "knowing and reckless" behaviour. See also our comments on clause 39 above.
Clause 39(1)(b(iv)	**Disclosure of material information and content of PDS and register entry**	
		This clause should allow for lodgements later than the date of the PDS, as the Securities Act currently allows for now (it currently provides that the PDS must be dated the day it is lodged, which is not sufficiently flexible to allow for delays).
Clause 40	**Material information**	
		Two possible disclosure standards for disclosure of all "material information" have been proposed: • **Option A**: information that a reasonable person would expect, if it were publicly disclosed, to have a material effect on the demand for the financial product on offer, and • **Option B**: information that a reasonable person would expect would, or would be likely to, influence persons who commonly invest in financial products in deciding whether to acquire the products on offer. In either case, information would only be material if it relates to the financial products on offer, or the particular issuer or offeror, rather than financial products, issuers or offerors generally. In Australia, the disclosure standard for shares and debt securities is all information that investors and their professional advisers would reasonably require to make an informed assessment of the rights and liabilities attached to the securities, and the assets and liabilities, financial position and performance, profits and losses and prospects of the issuer. Issuers must disclose what they know, or ought to know having made reasonable enquiries, which gives rise to significant due diligence

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		processes, as issuers and advisers seek to minimise liability for defective disclosure. By contrast, for managed investment products and derivatives, the Australians have a 'directed disclosure' regime focused on information the issuer actually knows that might reasonably be expected to have a material influence on the decision of a reasonable retail investor to acquire the product. Disclosure content for simpler products is largely prescribed. In our view thought should be given to applying different "materiality" requirements to different types of product, as what is appropriate for genuine (equity) fundraising is not automatically appropriate for managed investment products and derivatives. As indicated in our comments on clauses 39 and 462, without the introduction of a targeted disclosure regime and appropriate amendment being made to the liability regime, there is a real risk that, at least for managed investment products and derivatives, the less onerous (but still appropriate) Australian liability regime and disclosure standards could encourage issuers to prepare disclosure documents under Australian law and offer into New Zealand under the mutual recognition of securities regime – which would undermine the draft Bill objective to develop New Zealand financial markets.
Clause 41	**Consent of person to whom statement is attributed**	
		The range of persons from whom consent will be required under this clause is too wide, and would conceivably require consents from agencies like the IRD and Morningstar, where their material is referenced in the PDS. Given the liability attaching to persons consenting under section 462(4)(b)(v), it is highly likely that an issuer will have difficulty in obtaining consents to statements. In our view, in light of the liability profile for persons consenting, a sensible limitation on this clause would be for consent to be required only from persons endorsing the product.
Clause 42	**PDS must be worded in a clear, concise and effective manner**	
		We submit that clause 42 should be deleted. Instead, the content of a PDS should be prescribed by regulation, so that value judgements associated with the requirement to be "clear, concise and effective" are eliminated.

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Clauses 45-46	**Notification of FMA; Waiting period**	
		In our view retention of the existing "waiting period" regime in the Securities Act is undesirable, for a number of reasons: • The relatively small scale of the New Zealand capital market means that timing of execution is critical. The uncertainty caused by the waiting period can potentially have a real impact on the success of a capital raising. • The consequences of requiring amendments after launch of an offer can be significant, given the additional printing, legal, audit and other costs that can arise. • For listed securities, offering documents and advertisements will be scrutinised by NZX. • During an offer period issuers must be alive to, and manage, material changes of circumstance in any event. While we accept that this is the Australian position, our understanding is that there have been issues with the regime in Australia. In addition, we would submit that the Australian market is substantially larger than ours, so the "execution risk" factors described above may not be as acute as they are in New Zealand. Moreover, we believe that the waiting period is inconsistent with the main purpose of the Bill "to promote the confident and informed participation of businesses, investors, and consumers in the financial markets". This purpose is best achieved by enabling issuers to have the FMA consider offering documents prior to launch.
Clause 55	**Consents needed for lodgement**	
		Consistent with our comments on clause 39 above, we submit that director consents should not be required to accompany a PDS for a managed investment scheme, when lodged.
Clause 56	**Issuer must keep a copy of consent**	
		We submit that a time period for the retention of consents be specified.
Clause 60	**Issue or transfer void if quotation condition not fulfilled**	
		We submit that the "void allotments" regime in this clause should be deleted. As has been the experience with the existing Securities Act, allotments which are void *ab initio* create

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		significant market uncertainty, particularly where the void securities have been dealt with subsequently (for example, transferred or redeemed). We also note that any misleading statements about quotation would be caught by the general obligation not to mislead.
Clause 63	**Misleading or deceptive statements etc**	
63(1)(a)		We submit that the requirement to cease to offer financial products under a regulated offer where there is a misleading statement in a PDS or register entry should only apply if that statement is misleading "in a material adverse particular". Items which may be misleading but are beneficial to investors should not prevent the issuer from continuing to offer the product. In those circumstances an issuer should be able to correct the statement when the PDS is next updated for other reasons.
Clause 65	**Expiry**	
65(3)		This clause appears to require the expiry date for a PDS to be the same day in each year. In our view, this is overly restrictive and should be deleted.
Clause 69	**Prohibition of offers in course of unsolicited meetings**	
		We submit that this clause is too restrictive. It could constrain legitimate conversations by providers with existing or new customers about financial products which may be appropriate for them. The Financial Advisers Act requirements provide adequate consumer protection for these types of conversations.
Subpart 3	**Advertising and publicity**	
71-74		We submit that clauses 71-74 should be removed. Our experience has been that the existing "pre-prospectus publicity regime", even when it was amended in 2004, is overly restrictive and creates market confusion. The general requirements for advertisements not to be misleading or deceptive provide adequate protection in respect of advertisements in the pre-offer period (and this would be consistent with the February Cabinet Paper).

Clause number	Clause heading	Submission
Schedule 1	**Disclosure offers of financial products (when disclosure is required)**	
General		On the whole, Schedule 1 is to be welcomed – particularly the introduction of the small offers exclusion and the move towards self-certification. It addresses a range of difficulties in the current exemptions regime, and introduces some helpful safe harbours. However, there are some points which we think are worthy of further attention.
Clause 4	**Offers to close business associates**	The "brightline" tests for "close business associate" in clause 4(2) are welcome. However, who fits within the catch-all clause 4(3) is not clear, as it is not clear what might constitute a "close" relationship. In our view, the significant criterion should not be how "close" the relationship is but whether or not it is a relationship which means the person is able to obtain the information specified in sub-clauses (a) and (b). In our view the word "close" should be omitted and replaced with "pre-existing". Employee share schemes are only exempted if the offers to employees represent 10% or less of the equity securities of the same class within a 12 month period. This replaces the current 12-month cap of 5% and total cap of 15% for unlisted securities, but is problematic where a separate class of securities has been established for employee remuneration.
Clause 8	**Offers under employee share purchase schemes**	The exclusion for employee share schemes is welcome, given the large number of companies which wish certain employees to be shareholders. However, the requirement that the shares be offered as part of remuneration, and separately from any other offer, is likely to prove problematic for many companies. It is not uncommon for companies who wish certain employees to be shareholders to see that not as part of remuneration but as something additional – for example, paving the way for potential succession planning, "signalling" to the relevant employees of the regard in which they are held over and above their remuneration (particularly where there are expectations about remuneration relativities which make differentiation in that manner difficult), or increasing the relevant employees' connection with the company by giving them some "skin in the game". Such offers will often be explicitly distinguished from remuneration. Moreover, they will not infrequently be offers at a fair value – i.e. requiring the employee who wishes to accept the offer to pay a price for the shares which reflects their current worth – so that the employee truly feels that s/he has "skin in the game" rather than seeing the equity as "icing on the cake" or providing little more than an option on the upside. It is difficult to meaningfully construe an

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<tr><td></td><td></td><td>offer to subscribe for shares at fair value (and to enter into a shareholders' agreement at the same time) as "remuneration" in any conventional sense – and trying to force the square peg of such an offer into the round hole of "remuneration" risks uncertainty, confusion and unnecessary risk of failing to meet the technical requirements of the exclusion.

At a more technical level, offers to employees are often made contemporaneously. The requirement for any offer to be "separate from any other offer" should be qualified to permit other employee offers and offers to employees who are close business associates. It would also be helpful to define "specified employee" to include labour-only contractors.

Finally, it is not uncommon for employee share offers to be extended not merely to employees but to their family trusts. These will, typically, be discretionary trusts for various beneficiaries (usually including the employee), none of whom has a vested interest. While the employee will typically be a trustee, there will usually be other trustees and they will be required to act unilaterally. It is difficult to say that a trust having these characteristics is "controlled" by the employee for the purposes of clause 9. Accordingly, if clause 9 is not itself amended to permit offers to trusts of which an excluded persons is a trustee and a beneficiary, a specific provision to this effect should be included in the employee share scheme exclusion (and in the exclusion for close business associates, in respect of such associates who are employees).

Accordingly, we submit that clause 8 of Schedule 1 be amended as follows:

• by the deletion from clause 8(1)(a) of the words "is made as part of the remuneration arrangements for the employee, and";
• by the addition at the end of clause 8(1)(a) of "(other than any other offer to a specified employee or an employee who is a close business associate of the issuer)";
• by deleting the existing clause 8(2)(a) and replacing it with the following: "means an employee of or labour-only contractor to the issuer of the equity securities or any of its subsidiaries (or the trustees of a trust of which any such employee or contractor is a [trustee and] beneficiary)".

We also submit that clause 4(1) of Schedule 1 be amended by the insertion, after "close business associate of the offeror", of the following "(or the trustees of a trust of which any such</td></tr>
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		associate is a [trustee and] beneficiary)".
Clause 9	**Offers to persons under control also do not need disclosure**	The express extension of exemptions to controlled entities is sensible and welcome. However, as indicated in respect of clause 8 (and clause 4), it does not include typical family trusts, which are very common in New Zealand. Typically the relevant individual will be a trustee and discretionary beneficiary, but will not "control" the trust. In our view, it would be appropriate to extend clause 9 to include trusts of which the relevant person (or an entity controlled by the relevant person) is a trustee and of which the relevant person is a beneficiary - at least in respect of the exemptions for close business associates, relatives, and employee share schemes. We also consider it would be appropriate to give consideration to extending clause 9 (as so amended) to include offers to persons who are in the investment business (clause 33), large persons (clause 35) and eligible investors (clause 37). (Note, in this context, that the reverse concept - attributing investments held by controlled persons to the controlling person - is already included in clause 34(2).) If considered necessary, some "anti avoidance" provisions could be included alongside that extension - for example, to exclude any controlled entities which are intended not to remain under such control and any trusts which are primarily intended to benefit persons who are not relatives of the relevant person.
Clause 10	**Offers of financial products under dividend reinvestment plan**	The exclusion for dividend reinvestment plans only applies where the products are held on terms that "entitle" the holder to subscribe for them by applying all or any part of a dividend. Many securities are not issued with such an inbuilt "entitlement" to subscribe. The intent of this restriction should be clarified - i.e. to make it clear that the entitlement arises not under the terms of the relevant product but by virtue of the holding of that product.
Clause 14	**Offers of controlling interest where there are 5 or fewer investors**	The requirement that persons be "in a position to obtain from the offeror" the information that will enable them to assess the merits of the offer and the adequacy of information provided could cut across arrangements that private parties would otherwise be happy to agree. For example, an acquirer may be happy to proceed on the basis of a limited due diligence (including an acknowledgment that some key information is not able to be provided because of third party confidentiality restrictions), on the basis that the price justifies the risk and/or that appropriate warranties (and, possibly, warranty insurance) will be provided. In such circumstances, it is not appropriate that the acquirer/s might nonetheless be entitled to a "second bit at the cherry" by claiming that the requirements of clause 14

Clause number	Clause heading	Submission
		were not satisfied. At a minimum, limitations on available information which are acknowledged and accepted should not prevent reliance on this exclusion – for example, by the inclusion in clause 14(c), after "the persons who acquire equity securities under the offer are", of "(except to the extent that they have agreed otherwise prior to agreeing to acquire the securities)".
Clause 18	**Offers of category 2 products by registered banks**	We strongly support the exclusion for category 2 products and debt securities issued by registered banks and their subsidiaries (clause 18 of Schedule 1), as this treatment appropriately recognises the prudential supervision other requirements to which registered banks are subject under the Reserve Bank of New Zealand Act 1989. We also submit that this exclusion should be extended to cover overseas banks which are subject to a comparable level of regulation in a foreign jurisdiction (which we would expect would include the US, Australia most Eurozone and jurisdictions, as well as some Asian jurisdictions.
Clause 35	**Meaning of large**	The definition of "large" is very large by New Zealand standards. The inclusion of this exemption presumably reflects an (appropriate) view that persons who are over a certain size should be considered "big enough and ugly enough to look after themselves". In our view, that threshold can credibly be said to be reached at levels well below those currently specified. Consideration should be given to lowering the test.
Clause 38 and 41	**Reliance on certificates**	The intention of providing greater certainty by inclusion of "brightline" certification tests is, as noted above, welcome. However, clauses 38 and 41 threaten to undermine the efficacy of these provisions by excluding reliance by a person who has "reasonable grounds to believe" that the certification is incorrect. The risk of hindsight reassessment of what might constitute "reasonable grounds" may well give rise to considerable reluctance to rely on such certificates at all. In our view, thought should be given to excluding only persons who have actual knowledge that a certificate is incorrect (and, perhaps, those who are "willfully blind" to a certificate's incorrectness).

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Part 4 and schedule 3	**Governance of financial products**	
Clause 111(1)(f)	**Initial and ongoing registration requirements for all managed investment schemes**	
		Clause 111(2) prescribes that none of paragraphs (a) to (e) of clause 111(1) apply to a restricted scheme, but does not exempt a restricted scheme from the external custody requirement in 111(1)(f). It follows that (unlike a retail scheme, where the supervisor can provide custodial services) every restricted scheme will require an external custodian appointed pursuant to clause 135. We do not consider this compulsory additional intermediation to be appropriate in cost benefit terms for a restricted scheme. If this submission is accepted then clause 135(2) will need consequential amending to delete the words in brackets. More generally, clauses 111(f) and 135 should not apply to any scheme if (or to the extent that) it simply invests in another registered scheme or schemes rather than directly in underlying assets.
Clauses 112 and 113	**Additional and ongoing registration requirements for KiwiSaver schemes and superannuation schemes**	
		Purpose constraints -112/113(1)(b) We submit that the word *"principal"* should be inserted before the word *"purpose"*. Section 116(1)(b) of the KiwiSaver Act 2006 and section 2A(1)(a)(i) of the Superannuation Schemes Act 1989 both use the expression *"principal purpose"* and removal of the word *"principal"* creates an inconsistency with (for example) the provisions in the KiwiSaver Scheme Rules allowing home purchase withdrawals (where there is absolutely no connection with retirement) and withdrawals for hardship and permanent emigration, and clause 113(1)(d) which expressly contemplates superannuation schemes allowing withdrawals other than for retirement purposes. Retaining *"principal"* strikes the right balance and removes any doubt about the permissibility of such features as: • the leaving service benefits and early partial withdrawal facilities provided by registered superannuation schemes; and • the provision of death and disability insurance. Superannuation schemes commonly provide for insured benefits payable on death or disability. **Superannuation schemes offering wholesale membership – 113(1)(b)**

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		For completeness, we consider the words *"or indirectly"* in clause 113(1)(b) a little too oblique to cover schemes which also allow admissions to membership, as wholesale (i.e. investment only) members, by the trustees of the superannuation schemes which have other superannuation and KiwiSaver schemes as their members. We note that *"or indirectly"* is also included in clause 112(1)(b) despite KiwiSaver schemes being unable to admit other schemes' trustees as members. We submit that clause 112(1)(b) should have added to it the words *"or to pay benefits to persons who are the trustees of a superannuation scheme or Kiwisaver scheme"*. A number of major retail superannuation schemes which are offered to natural persons also have wholesale membership provisions allowing other scheme's trustees to join as investment-only members, so this uncertainty must be addressed even if it is intended that purely wholelsale schemes will no longer be treated as superannuation schemes for legislative purposes. **New Zealand criteria (superannuation schemes) – 112/113(1)(c) and 112/113(2)** We understand the intention here is to require compliance with the New Zealand criteria solely when a person is admitted to membership. Almost all schemes (including KiwiSaver schemes) will have retained members who joined as NZ residents but are no longer living or normally living in New Zealand. It would be inappropriate (as well as unworkable in some cases, such as for pension-based schemes and others that allow deferral of benefit payments) to require members to cease their membership when ceasing to live in New Zealand. This policy intent would be clearer if at clauses 112(1)(c) and 113(1)(c), the word *"participation"* was replaced with *"new membership admissions"*. Clause 10 of the draft Bill preserves the *"member"* concept. More generally we submit that, for a superannuation scheme, restricting new member admissions to New Zealand citizens or permanent residents who are currently living, or normally living, in New Zealand will be inconsistent with the Prime Minister's financial hub objectives. It will also be overly restrictive in a range of circumstances such as where: • a person is employed in New Zealand on a temporary working visa (perhaps pursuant to a secondment or an intra-group transfer) and is offered membership of an employment-related superannuation scheme as a term of employment; or

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		• a New Zealander who lives overseas wishes to transfer superannuation savings home for when they return. We are aware of a number of cases where strict insistence on compliance with the New Zealand criteria for new member admissions would adversely affect existing employer-based or otherwise restricted-offer scheme sponsors' recruitment and retention initiatives or even charitable activities, despite there being no inconsistency with the wider policy intent (which we understand is to prohibit New Zealand-registered superannuation schemes being made available to overseas retail investors with no connection to New Zealand). At a minimum, there should accordingly be a provision for the FMA to exempt particular schemes on prescribed conditions.
Clause 117	**Contents of governing document for registered scheme**	
117(1)(f)		The reference to "fees" in this clause is too narrow and should be amended so that it is possible to specify a numerical range of (or cap on) fees, as well as allowing reimbursement of the relevant parties from the assets of the scheme.
117 generally		Section 117 should either: • exempt existing registered superannuation schemes (and, at a minimum, restricted KiwiSaver schemes) from having to demonstrate compliance with any provisions other than paragraphs (d) and (f) to (h), because by reason of the prescriptive requirements in section 7 of the Superannuation Schemes Act 1989 and section 119 of the KiwiSaver Act 2006 existing scheme deeds will otherwise already be adequately prescriptive; or • incorporate a facility for the FMA to exempt particular schemes (for example restricted schemes) from all or any of the relevant prescriptive requirements so as to avoid imposing an undue advisory and amendment cost impost on existing members.
Clause 121	**Changes to governing document**	
121(2)		Consistent with existing practice, we submit that it should be possible for amendments to be made to a governing document without investor consent if those amendments are required by law or other regulation (even if they have an adverse impact). In addition, the requirement in clause 121(2)(a)(i) for approval by *"scheme participants"* should not extend to amendments made to employer plans within multi-employer superannuation

Clause number	Clause heading	Submission
		schemes which will only affect persons employed by the relevant employer. If an amendment is being made to a particular participation agreement then only those members whose membership is governed by the relevant participation agreement should be required under 121(2)(a)(i) to approve that amendment by special resolution. Many technically "defined benefit" superannuation schemes (which we note are defined at clause 147(1) but not in clause 6) are now cash accumulation section-dominated, with relatively few members eligible for "defined benefits" in the true sense. For defined benefit schemes, clause 121(3)(b) (which we note has no materiality threshold) is also more restrictive than the existing section 9(a) of the Superannuation Schemes Act 1989 in that it would extend to future as well as past service-based benefits. If clause 121(3)(b) is to be retained then we submit that the words *"who would be adversely affected by the amendment or replacement"* should be replaced by a paraphrasal of section 9(a) of the Superannuation Schemes Act 1989 – the meaning of which is now well-understood - but with the addition of a materiality requirement for consistency with 121(2)(a)(ii). Importantly, if an amendment was considered to give rise to an immaterial adverse effect then it still could not proceed without FMA consent under clauses 121(1) and (2)(a)(ii), so members would be protected accordingly.
Clause 125	**General duties applying in exercise of Manager's functions**	
125(1)(c)(ii)		A manager has common law duties to act in the interest of investors generally (and this is reflected in clause 125(c)(i)). In our view, overlaying those common law duties with a further statutory requirement to treat investors "equitably" creates confusion, and should be removed.
125(1)(d)		A manager should be permitted to use information for other purposes (e.g. marketing other products) where the investor has consented to that use. This clause should be amended to allow that possibility
Clause 127	**Contracting out of management functions**	
		In our view, consistent with common practice, as long as any contracting out of manager functions is reasonable and has been appropriately monitored, the manager should not be liable for performance by the third party (instead, the scheme would have a contractual claim against the provider). This concept should be

Clause number	Clause heading	Submission
		reflected in the Bill, in place of clause 127(2)(b).
Clause 132	**Duty of manager to provide requested information to supervisor**	
132(3)(b)		The requirement for all reports requested by the supervisor to be signed by two directors (or one director, if there is only one) is administratively impractical, and should be deleted.
Clause 134	**Power of supervisor to engage expert**	
134(2)(b)		It is unreasonable to expect the manager to meet an expert's fees if the manager is not at fault, and this clause should be amended to reflect that. Experts should not be engaged lightly, and in our view an amendment to this effect strikes an appropriate balance between giving the supervisor freedom to engage an expert in appropriate circumstances and allowing the manager the freedom to operate without undue intrusion.
Clause 136	**Custodian holds scheme property on trust**	
136(2)		The requirement for a custodian to ensure that scheme property is "held separate" from other property of the custodian (including other registered schemes) should be amended to require separate record-keeping only.
Clause 138	**Duty of supervisor to refuse to act on wrongful directions**	
138(1)(b)		This clause significantly extends the existing provision under section 12(1)(c) of the Unit Trusts Act, which only requires the supervisor to refuse to act if the direction is "manifestly not in the best interests of unit holders". We believe only the section 12(1)(c) requirement should be carried over into the Bill. Any extension along the lines proposed would increase compliance costs (which would ultimately be borne by investors), as supervisors will need to build compliance systems to monitor whether a breach will occur, as well as create uncertainty for managers.
Clause 145	**Action that must be taken on limit breaks**	
		We submit that: • only *material* limit breaks need to be reported to the supervisor.

<table>
<tr><th>Clause number</th><th>Clause heading</th><th>Submission</th></tr>
<tr><td></td><td></td><td>• there should be an opportunity for limit breaks to be remedied within a reasonable period, and if they are remedied within that period there should be no reporting obligation .</td></tr>
<tr><td>Clause 152</td><td colspan="2">Certain related party benefits permitted without supervisor consent</td></tr>
<tr><td></td><td></td><td>We believe that the related party rules in this clause (and clauses 150-151) are sensible but too restrictive. They should be amended to allow the payment of fees and reimbursement of expenses to the manager and the supervisor.</td></tr>
<tr><td>Clause 153</td><td colspan="2">Additional restrictions on transactions of a restricted scheme</td></tr>
<tr><td></td><td></td><td>The restrictions in paragraph (a) will be unworkable for restricted schemes in circumstances where, for example:
• some or all scheme assets are managed on arms' length terms or better by a professional investment manager which happens to be an associated person of the trustee(s) or the sponsor; or
• scheme assets are invested wholly or partly in registered schemes which are managed by associated persons of the trustee or the sponsor (this pooling is a common method of ensuring simple and cost-effective investment arrangements and the underlying investments themselves are in third party securities).
Restricted schemes should be permitted to invoke clause 150 to 152-equivalent provisions to enable such arrangements to continue.
Clause 153(a) is also giving rise to significant concerns for a number of restricted schemes which have some of their assets allocated to employer-issued shares or employer-operated businesses. The 5% threshold (which should expressly be confined to circumstances other than those contemplated by clause 150 to 152-equivalent provisions – i.e. to true related party investments) will force the divestment of well-performing investments often entered into based on a deep understanding of the sponsor's business and a philosophy of encouraging employee proprietorship.
In order to remain reliably below the 5% threshold at all times, as restricted scheme would need to adhere to an even lower benchmark allocation to the relevant investment(s) so as to ensure that (for example) outperformance relative to other scheme investments did not trigger any consequent breach of that 5% limit (which would need to be complied with in market</td></tr>
</table>

Clause number	Clause heading	Submission
		value, not merely benchmark asset allocation, terms at all times). We submit that the draft Bill should do either or both of the following if there are to be differential constraints imposed on restricted schemes making related party investments: • prescribe a workably higher threshold, and optimally express it in benchmark (not actual) asset allocation terms; and/or • allow the grandfathering of existing restricted schemes' pre-existing related party investments (in structural and benchmark asset allocation terms) at least for a period, while prohibiting those arrangements from being altered in such a way as to increase existing related party investment exposures. It is relevant here that restricted schemes will: • require independent licensed co-trustees (or trustee directors) who are subject to the same standard of care as professional trustees; and • be required to interact more closely with the FMA than retail schemes in certain key respects. Restricted scheme trustees will also be required to maintain, register and adhere to SIPOs and will owe governance duties that require both strict adherence to members' best interests and (in practical terms) adequate ongoing investment diversification. We accept though that there is a clear policy objective of imposing some form of additional restriction on related party investments by restricted schemes. Particularly if clause 153 continues prescribing a 5% threshold (which will force complete divestment of a related party investment in some cases) then schemes should be given a reasonable period to effect a controlled sell-down of related party assets either entirely or, where practicable, to a level comfortably below the prescribed limit. For completeness, we can see no policy justification for clause 153(b) to prohibit financial assistance to scheme participants outright, and in this regard we endorse the comments in the Workplace Savings NZ submission which we have reviewed in draft.

Clause number	Clause heading	Submission
Clause 173	**Duty of investment manager etc to report serious problems**	
173(2)(a) & (d)		As with our earlier comment on clause 145, we submit that only *material* breaches (or potential breaches) should need to be reported under this clause.
Clause 189	**Issuers must keep registers of regulated products**	
		We submit that existing exemptions from the requirement to keep registers (e.g. registered banks under section 5(2C) of the Securities Act) or allow inspection (e.g. the Securities Act (Cash and Term Portfolio Investment Entities) Exemption Notice 2009, should be carried over into the new regime. In addition, the requirement in Clause 189 to keep a register does not align with how derivatives work in practice. We suggest that the register requirement only applies to securities, and for derivatives issuers there be a record keeping obligation, requiring records to be kept of all confirmations of derivatives.
Clause 197	**Issuer to send confirmations of financial products**	
		Clause 197 requires the issuer of a regulated product to send to the product holder a confirmation document, evidencing the nature, terms and conditions of the product and the name of the product holder, within 1 month of issue. We submit that: • Consistent with current legal requirements for managed funds (see the Securities Act (Unit Trust Certificates) Exemption Notice 2002), confirmations for managed fund holdings in managed investment schemes should only be required to be sent every six months. • For derivatives, there should be sufficiently flexibility to allow the confirmation of the derivative trade to be sent. • There should be no requirement for the confirmation to "properly evidence the *terms and conditions*" - as in the extreme this would require a copy of the relevant constitution or trust deed to accompany the confirmation. • Existing relief for continuously issued securities (see for example, the Securities Act (Cash and Term Portfolio Investment Entities) Exemption Notice 2009, and the Securities Act (Continuous Debt Issues) Exemption Notice 2002) should be carried over into the new regime.

Clause number	Clause heading	Submission
Part 5	**Dealing in financial products on markets**	
Clause 218	**Insider conduct prohibition**	
		In our view, the bill should not include a prohibition on insider trading in non-quoted financial products. Such prohibitions are primarily designed to protect market integrity – which does not apply to private transactions which are not conducted on a market and do not concern securities which are listed on a market. The existing non-listed security "insider trading" prohibitions only apply to directors (Companies Act 1993 section 149) and (in limited cases) to other offers to the public (Securities Act 1978 section 6A). An extension to all transactions in non-quoted products would constitute a material expansion of scope and accordingly a material increase in transaction costs and risks – none of which would be justified by the core concerns with which insider conduct prohibitions as they apply to listed securities are concerned.
Clause 289	**Licensed markets**	
		Subpart 7 of Part 5 of the Bill focuses on the licensing of financial products markets (including derivatives markets) operating in New Zealand. We are supportive of this concept and submit that, where financial products are traded on such markets, compliance with the rules of such market, together with any regulations applicable to acting as an intermediary, should largely comprise the extent of regulation in that context. In our view, there is a compelling case to recognise foreign markets which are subject to comparable levels of regulation as New Zealand. We submit that this could be reflected in regulations which specify certain foreign jurisdictions and markets which are deemed to be sufficiently regulated for these purposes, with the effect that they have the same treatment as our local markets under the Bill.
Clause 293	**Exemptions**	
		It is not uncommon for companies which (or the parent companies of which) have employee shareholdings to facilitate in some way the transfer of those shareholdings, whether by way of buyback or by way of transfer to other employees (whether or not existing shareholders). Not infrequently, such arrangements will include an annual valuation exercise (which enables a value for shares to be struck) and/or the matching of buyers and sellers (whether through a formal, documented process or a more informal "matchmaking" of those the company knows to be interested in buying and in selling). Many (or most) of such

Clause number	Clause heading	Submission
		arrangements will constitute a "financial product market" for the purposes of clause 290, meaning that the relevant company will therefore require a license and will have the obligations set out in clause 295. These requirements are likely to place a very significant dampener on the willingness of such companies to operate such arrangements (which, by their nature, are not "proper" markets in the core sense contemplated by section 295). This, in turn, may well adversely impact on the desirability of employee share schemes for both companies and their employees. The exemption in clause 293(a) may exclude a number of such arrangements. But there is clearly a risk that others are not excluded – particularly given the cap of only $2 million – or that they are forced to take "evasive action" by deliberately not facilitating some transactions in order to ensure they stay below the threshold. This is unnecessary. It would be more appropriate to introduce an additional exemption for persons who "operate" such "financial products markets" for a single issuer. While it may be appropriate to require licensing and observance of core market integrity obligations from a person who is in the business of facilitating trades in products issued by numerous people, there is little reason to apply the same requirement to the numerous single-issuer (and often informal) arrangements which merely provide some liquidity options for employee shareholders. Accordingly, we submit that clause 293 be amended by the inclusion of an additional sub-clause (b) (and the renumbering of the current (b) and (c) accordingly) as follows: "the only financial products in respect of which offers or invitations are made on the market are financial products issued by one issuer" (or, if a narrower exemption is required, "the only financial products in respect of which offers or invitations are made on the market are financial products issued by the market operator or a related company of the market operator").

Clause number	Clause heading	Submission
Part 6	**Licensing and other regulation of market services**	
Clause 381	**License may cover subsidiaries**	
		We support the possibility for a licence to cover subsidiaries. We would also strongly encourage the inclusion of express machinery requiring the FMA to facilitate "centralised compliance" for corporate groups holding multiple licences.
Clause 393	**Licensee must report material matters**	
393(2)(a)		A licensee should only be required to report *material* breaches of a market services licensee obligation.
Clause 395	**FMA's powers in case of breach of market services licensee obligation, material change etc.**	
395(3)		We submit that it should be possible for a licensee to remedy any breach, before the FMA can cancel the licence.
Clause 411	**Client agreement**	
Application of subpart		We submit that it is inappropriate for the client agreement requirements to apply to derivatives, given that global market practice for derivatives is that they are issued on standardised terms and conditions which the client is in no position to alter.
Clause 413	**Changes to client agreement**	
		We submit that the requirement for client agreement changes to be consented to by each retail investor will be impractical for a "mass-market" service provided to large numbers of clients. We believe that it should be possible to change client agreements unilaterally, if the change is not material (or is required to comply with legislation), or if notice has been given to the retail client.
Subpart 6	**Provision of discretionary investment management services (DIMS)**	
		While we generally support the approach to DIMS in the draft Bill, we believe the regime would benefit significantly from further industry consultation, particularly given the industry is still in a bedding down phase following implementation of the Financial Advisers Act (*FAA*).

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		In particular, we believe it would be useful for the industry to understand how the Bill will approach the interplay between the DIMS regime and the FAA. In that context, we believe it would be highly desirable to avoid any "overlapping regulation" which would result if a DIMS licensee (who has decided to be licensed for DIMS solely under the Bill) becomes subject to FAA requirements through conditions of the licence requiring compliance with both the Bill and the FAA.
Clause 421	**Action that must be taken on limit breaks**	
		Similar to previous comments, we submit that only *material* limit breaks need to be reported to the FMA.
Clause 423	**General prohibition on transactions giving related party benefits**	
		Similar to our comments on clause 152, we believe that the related party rules should be amended to allow the payment of fees or reimbursement of expenses to the DIMS licensee.
Clause 426	**Requirement for custodian**	
426(2)(b)		We submit that the requirement in clause 426(2)(b) that a custodian must not be the same person as, or associated with, a DIMS licensee (unless the licence permits otherwise) should be deleted. This clause appears to be predicated on an assumption that an independent custodian will always produce a better consumer protection outcome than an associated custodian. In our view this will not always be the case, and the proper emphasis should be on the governance, compliance and management surrounding the custodian arrangement, rather than on the ownership relationship.
426(3)		We do not support the suggestion that a DIMS licensee should be jointly and severally liable with the custodian for the holding of investor property. This concept does not recognise the fiduciary duties owed by a custodian to investors, which in our view (if properly structured) provide adequate consumer protection. It would also result in DIMS providers looking to manage their responsibility with "back to back" arrangements with custodians (which will either not be entertained by custodians, or if they are, at a cost which would ultimately be borne by the investor), as well as potentially resulting in increased insurance costs for

Clause number	Clause heading	Submission
		the DIMS licensee.

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<tr><th>Clause number</th><th>Clause heading</th><th>Submission</th></tr>
<tr><td>Part 7</td><td colspan="2">Enforcement and liability</td></tr>
<tr><td>Clause 462</td><td colspan="2">Compensatory orders</td></tr>
<tr><td></td><td></td><td>In our view the liability regime for defective disclosure imposes liability on too broad a range of market participants.

The February Cabinet Paper said:

There is strong anecdotal evidence that the preparation of disclosure documents is sometimes seen as an exercise in risk management and fear of liability, rather than a genuinely useful mechanism for conveying information....The risk of liability arguably encourages issuers to add in unnecessary matters, due to concern around potential liability for missing issues out.

The Cabinet Paper observed that under current law directors are liable for most breaches, but that under the new regime issuers will have primary liability for contraventions in relation to the issue of securities.

Unfortunately this has been lost sight of in the draft Bill: under section 462, liability for compensatory orders rests with the offeror (and issuer, if different), each director (at the relevant time), an underwriter named in the deficient PDS or the register entry, anyone named in the document who consented to the misleading statement or to other material on which the misleading statement was based, and every other person who "contravenes" the disclosure obligation (where "contravene" is very broadly defined, as in the Securities Markets Act 1988, to include (inter alia) any person who aids, abets, counsels, procures or is "in any way, directly or indirectly, knowingly concerned in, or a party to" the contravention).

Investment bankers, lawyers, accountants and other professional advisers will be potentially caught in this net. The consequence is very likely to be higher underwriting and other transaction costs than would otherwise be the case. In Australia a similar approach to share and debt security issuance has resulted in expensive disclosure document litigation against professional advisers - for example Ingot Capital Investments v Macquarie Equity Capital Markets, where the advisers proved the statements made were not misleading, but only after a 108 day trial. Significantly, in Australia liability for defective managed investment scheme and derivative product disclosure statements is focused is on the product issuer, and directors are liable only if</td></tr>
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Clause number	Clause heading	Submission
		the issuer does not pay. See, also, our related comments on clauses 39 and 40.