

**INVESTMENT SAVINGS & INSURANCE ASSOCIATION OF NZ
INC**

Submission

to

**Ministry of Economic
Development**

on the

**Financial Markets Conduct Bill
Consultation Draft**

6 September 2011



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Investment Savings and Insurance Association of NZ Inc.

1.0 Introduction

- 1.1 The Investment Savings and Insurance Association ("ISI") is the industry association for the companies that issue and manage life insurance, superannuation and managed funds in New Zealand. ISI members are responsible for approximately \$67 billion funds under management. ISI members are also the leading providers of KiwiSaver funds and include the default providers.

A list of members is attached.

- 1.2 We welcome the opportunity to comment on the consultation draft of the Financial Markets Conduct Bill ("the draft Bill") following our comments last year on the Review of Securities Law discussion document. We have set out general comments below, followed by comments on specific points in the draft Bill, set out in the standard template. Not all sections of the draft Bill have been covered. We understand that a number of our members will be making their own detailed submissions on the draft Bill, including on clauses commented on in this submission.
- 1.3 We have noted that the purpose of the consultation is to obtain input on the technical detail of the draft Bill. As much of that technical advice will be provided by lawyers specialising in securities law our comments are relatively brief and are not intended as an exhaustive coverage of potential problems. We have focussed on concerns identified in our submission on the Securities Law Review consultation document and certain of the issues raised by MED for specific consultation.

2.0 General Comments

- 2.1 ISI supports the general policy direction of the draft Bill and commends the Minister and MED officials for the consultation process that has been followed in the development of the draft Bill.
- 2.2 We note that much of the detail of the new regime will be set out in regulations that have yet to be drafted and the content of these regulations will have a major impact on the workability of the legislation. We have found the 4 week period for comment on this draft Bill very demanding and we strongly recommend that consultation on the content of the regulations starts as early as possible in order to allow sufficient time for detailed input.
- We also strongly recommend that, following consultation on the prescribed matters, regulations are issued in a timely manner allowing providers sufficient time for implementation.
- 2.3 ISI supports the rewriting of the securities legislation to create a coherent regulatory regime, replacing the sometimes confusing provisions of the Securities Act, Securities Markets Act, Unit Trusts Act, Superannuation Schemes Act, Securities Transfer Act and parts of the KiwiSaver Act.

- 2.4 ISI supports the main purposes of:
- Promoting the confident and informed participation of businesses, investors and consumers in the financial markets; and
 - Promoting and facilitating the development of fair, efficient and transparent financial markets.
- 2.5 We look forward to the opportunity for further consultation on this important legislation.

Clause Number	Clause heading	Submission
Part 1	Preliminary provisions	
Clause 9(1)	Definition of managed investment schemes	<p>We support the definition of managed investment schemes used in the draft. Although the definition does not explicitly recognise the ‘pooled’ nature of an investment in such a scheme (as we recommended in our submission on the Securities Law Review discussion document), it achieves the same effect by excluding schemes in which investors gain separate beneficial interests in identifiable financial products.</p> <p>For the definition of managed investment scheme it would be useful to define ‘scheme’, for instance by using the definition from the Financial Advisers (Definitions, Voluntary Authorisation, Prescribed Entities, and Exemptions) Regulations 2011. In those regulations scheme means any agreement, arrangement, or understanding (whether express or implied), whether or not legally enforceable, and irrespective of substance or form.</p>
Clause 9(2)	Application of the managed investment schemes concept to property schemes	<p>We support the approach taken in the draft Bill which will exempt schemes where a participant’s interest is in separately identifiable or traceable property and the participant’s returns are not dependent on the contributions of other participants in the scheme.</p> <p>We recommend that an exclusion for insurance contracts should also be added to clause 8 (exclusions from the definition of “financial products”) to ensure there is no uncertainty as to whether insurance contracts might be considered debt securities.</p>
Clause 10	Definition of issued and issuer	<p>We note that under Clause 10 (2) (c) “a further contribution to a superannuation scheme, a KiwiSaver scheme, or other prescribed scheme of which A is already a member” will not be taken to be the issue of a financial product. We consider that this provision should be clarified to apply broadly to managed investment schemes to which regular contributions can be made.</p>
Part 2	Misleading or deceptive conduct or false or misleading representations	
Clause 19	False or misleading representations	<p>We note that there is some overlap between the provisions of clause 19 and the duties of financial advisers under the FAA. For clarity and consistency we recommend that the draft Bill specifically refer to the FAA, particularly if DIMS providers can be regulated under both the draft Bill and the FAA.</p>

Part 3 and schedules 1 and 2	Disclosure offers of financial products	
Clause 33	Purpose of the Product Disclosure Statement ("PDS")	We are comfortable with the purpose test set out in the draft Bill.
Clause 35(a)	Certain situations in which a PDS need not be given	We consider that it would also be reasonable that a new PDS need not be given, despite all of the information that it would be required to contain not being in the PDS already received by the investor, provided that the different information is not materially adverse to the investor.
Clause 39	Content and presentation of PDS	We believe that material information should be prescribed as being in either the PDS or the register to avoid a perceived unfair advantage amongst industry players.
Clause 40	Meaning of material information	<p>We endorse the efforts to remove the uncertainty around the definition of 'material' as that uncertainty has contributed to the length of disclosure documents and the cost of compliance for issuers.</p> <p>We understand that the content of the PDS will be prescribed by regulation and that other information considered material will be contained in the register entry (and referenced in the PDS). We believe that the definition of 'material' needs to take into account the different audiences for the information. While the PDS will be targeted towards the decision-making of the prudent but non-expert person envisaged by Clause 33, the more detailed and technical information that will be disclosed on the register is likely to be accessed more frequently by analysts and advisers than by the average investor.</p> <p>Accordingly, specifically in regards to managed investment schemes, we consider that the definition in Option B is more likely to result in the disclosure of information that is relevant to those people likely to be searching the register, without adding other information that could potentially have an effect on the decision of the prudent but non-expert investor. We recommend, however, that it should refer to information that would "significantly influence" persons. This option should ameliorate the current situation where the risk aversion of directors can result in the inclusion of additional disclosure information.</p> <p>It is recommended that thought also be given to applying different "materiality" requirements dependent on the type and complexity of the product.</p>
Clause 49	Waiting period does not usually apply to continuous issue PDSs	A transitional provision is required in respect of clause 49 where, as a result of the definition of a "continuous issue PDS", the first PDS issued by all managed investment schemes will be subject to a waiting period, even where it relates to

		schemes currently issued under an investment statement and prospectus.
Clause 55	Consents needed for lodgement	<p>We understand that several other submissions have been made recommending removal of the clause 55 requirement for director consent to be given to the issue of a PDS and we endorse that recommendation.</p> <p>While the draft Bill refers (under clause 55) to section 720 of the Australian Corporations Act 2001 the requirements of clause 55 are not consistent with the Australian regime. We believe that the Australian Act does not require director consent (or attach director liability unless they are directly involved in the PDS preparation) for a PDS produced for a managed investment scheme (unless it is exchange tradable) or a derivative.</p> <p>The requirement for director consent and the potential liabilities attributable to directors in respect of a PDS are not appropriate for an issuer with a number of continuously issuing products. The verification of a PDS should be a responsibility of the manager whereas the focus of directors should be on strategy and governance and on ensuring the right processes are in place to produce a compliant PDS.</p>
Clause 63	Misleading or deceptive statements, omissions etc	We recommend that clause 63 (1) (a), (b) and (c) should be amended to refer respectively to a material statement, a material omission and a material circumstance.
Part 4 and schedule 3	Governance of financial products	
Clause 109	Need to register managed investment scheme for regulated offer of managed investment product	We consider that the legislation should require those registered managed investment schemes ("MIS") that make regulated offers to file audited financial statements under the Financial Reporting Act.
Clause 111	Initial and ongoing registration requirements	While we support the general requirement in clause 111 for registered schemes to have scheme property held by an external custodian we question the need for this in respect of restricted schemes. There is a risk of incurring substantial extra cost for no benefit to scheme members
Clause 113	Additional initial and ongoing registration requirements	<p>Clause 113 (2) (b) limits membership of superannuation schemes to NZ residents. The reason for this limitation is unclear and, unless it can be justified, we recommend that it should be removed.</p> <p>We also endorse the submissions made by Workplace Savings NZ in respect of clauses 111-113.</p>
Clause 117	Contents of governing document for registered scheme	We have previously recommended that the requirement for fees and charges to be included in constitutional documents should be accompanied by information regarding the basis on which the level may be changed. As a minimum we

		<p>recommend that provision for this information should be included in clause 117. Sub clause (1) (f) should make it clear that the information to be disclosed does not include the amount of any fee payable under any contract to a service provider.</p> <p>While we have confined our submission on clause 117 to the above point, we note that a number of members will be making their own detailed submissions on a range of additional concerns with regards to clause 117.</p>
<p>Clause 121</p>	<p>Changes to governing document</p>	<p>Clause 121 will mean changes to a trust deed for MIS, including unit trusts, will only be able to be made by special resolution of scheme participants or if the supervisor or the FMA is satisfied the amendment does not have a material adverse effect on scheme participants.</p> <p>This makes sense for superannuation schemes where contributions are locked in. However, in an MIS where investors can transfer or withdraw on a daily basis (or weekly/monthly etc), it seems reasonable to allow the manager more flexibility to make changes to their product.</p> <p>For most existing unit trusts a deed amendment could be made as long as the change was "not materially prejudicial to the interests of unit holders generally" (or similar). This appears to be a lower threshold for changes than "material adverse affect". Further, in many modern unit trust deeds there will be an ability to amend any term of the deed, even if it may have a prejudicial affect, provided reasonable notice (which depends on whether unit holders can withdraw daily/weekly/monthly etc) is given to unit holders and they have the opportunity to withdraw without penalty (for example waiver of any exit fees etc).</p> <p>In our view this is important to allow products to remain flexible as structures and investment possibilities change. Provided scheme participants are provided notice, and the opportunity to withdraw without penalty, we cannot see why the governing documents should not be able to be amended in this way.</p> <p>We also recommend that clause 121 should include an over-riding provision for amendments to be made where necessary to comply with requirements of any applicable legislation.</p>
<p>Clause 125 & 126A</p>	<p>General duties applying in exercise of manager's functions</p>	<p>We note that Clause 125 (1)(c)(i) specifically requires a manager to act in the best interests of the scheme participants. While we agree that managers should owe a duty of care to scheme participants, we reiterate the recommendation in our previous submission that this should be subject to compliance with the governing documents of the scheme and acknowledgement that managers have a commercial relationship with investors.</p>

		We believe that clause 125 (2) is unnecessary given that the duties and liabilities of both the manager and the supervisor are clearly specified in the draft Bill.
Clause 132	Duty of manager to provide requested information and reports to supervisor	<p>We have some concerns about the practicalities of this clause and recommend that the requirement for reports to be signed by 2 directors should be revised.</p> <p>The Companies Act 1993 permits delegation of duties and responsibilities by the board of directors of an issuer to management. There does not seem to be any particular reason why such delegation should not be permitted for reports and information to be provided to the supervisor.</p>
Clause 144	Lodging of a SIPO	We recommended in our submission on the Securities Law Review that there should be some flexibility around the statement of investment policy and objectives (“SIPO”) as new types of investment can emerge over time. We recommend that the SIPO should not be required to be lodged with the Registrar. It should instead be provided to and monitored by the supervisor with reporting on changes or exceptions as part of the proposed regular reporting regime for scheme managers.
Part 5	Dealing in financial products on markets	
		No comments on Part 5.
Part 6	Licensing and other regulation of market services	
Clause 369	Overview	<p>We acknowledge that our submission on this point in response to the Securities Law review was not accepted and the policy decision has been made to require the licensing of market service providers.</p> <p>The MED commentary to the draft Bill notes that regulations will reflect the Cabinet decision that licensing of fund managers will be limited. It also notes the intention to include in the Bill a streamlined process for licensing of bodies that have already undergone the QFE approval process and welcomes input on how this might be achieved.</p> <p>The 4 week deadline does not allow sufficient time for detailed input on this point but we would be happy to provide further comment after consultation with members.</p>
Clause 382	FMA must maintain list of licensees on internet site	We note that there seems to be duplication of information and some potential for confusion between the list of licensees under clause 382 and the existing Financial Service Providers Register.
Subpart 6	Provision of discretionary investment management	We recommend that the inclusion of subpart 6 should be reviewed and whether DIMS should be regulated under the

	services	<p>draft Bill or the FAA, or both, should be reconsidered. One view is that, as DIMS are recognised as a service rather than a product, they do not sit comfortably within a section that covers the providers of products. The proposed treatment set out in the note to submitters under subpart 5 of Part 9 could potentially create confusion in distinguishing between DIMS provided under the FAA and the draft Bill.</p> <p>The proposal would redefine DIMS as either personalised or class DIMS and would require class DIMS with Category 1 products included in the mandate to be provided under a DIMS licence under the new regime.</p> <p>Under the proposal the only DIMS that would be able to be provided under the FAA would be:</p> <ul style="list-style-type: none"> • Personalised DIMS (which take account of the financial situation or goals of a named investor); • Class DIMS covering Category 2 products; • DIMS for wholesale clients <p>Providers of personalised DIMS under the FAA would, however, also be required to comply with additional disclosure obligations similar to those under the draft Bill.</p> <p>The proposal would also extend the FAA obligations on DIMS providers to treat advice on whether to enter or leave DIMS in the same way as advice on acquiring or disposing of a financial product.</p> <p>Taking into account the significance of these changes, and noting that there is a divergence of views on the appropriate treatment, we recommend further detailed consultation takes place with the Industry on the best regime for managing DIMS - whether that is via the FAA, the draft Bill or both - before any policy decisions are made.</p>
Part 7	Enforcement and liability	
		<p>While we have not had sufficient time to fully consider the implications of Part 7 of the Draft Bill, we note that it significantly increases penalties and introduces strict liability offences in a wide range of circumstances.</p> <p>We understand that a number of members have concerns with the ambit of Part 7 and will be making their own detailed submissions in respect of those concerns.</p>
Part 8	Regulations and exemptions	
Subpart 1	Regulations	<p>As noted earlier, a substantial amount of the detailed provisions of the legislation will be set out in regulations. For example, subpart 4 of Part 3 requires disclosure of prescribed information to prescribed persons at prescribed times. Comment on these requirements will not be possible until details are provided in the regulations.</p>

		Similarly, until the detail of the requirements is known, we cannot comment on the clause 392 requirement for licensees to provide reports to the FMA at prescribed times, or on the occurrence of prescribed events, and in the prescribed manner.
Clause 514	Transitional matters	<p>In our previous submission we supported the FMA having a designation power but recommended that it should be used only where there is evidence that it is necessary for investor protection and that it should not be retrospective.</p> <p>Given the potential impact of a designation change on the issuer, there needs to be provision for review or appeal of an FMA decision.</p> <p>We note that application of clause 514 to a MIS could result in some scheme participants being treated differently from others, depending on when they joined the scheme, and we recommend that this should be reconsidered.</p>
Subpart 10	Transitional provisions	<p>As the Bill is currently drafted it appears that an MIS (other than KiwiSaver and superannuation schemes) would be required to provide a PDS to all investors on enactment of the draft Bill, even though those investors will have already received an investment statement when they originally joined the scheme. We have recommended that clause 10 (2) (c) should be extended to include other MIS. If that recommendation is not accepted a transitional provision should be included to remove the need for a PDS to be sent to existing scheme members.</p> <p>The transitional provisions in this subpart do not fully address the issues that will be faced by providers of MIS. We suggest that a period of at least 2 years is likely to be necessary to transition from the current investment statement/prospectus regime to a PDS/register regime.</p>
Part 9 and schedule 4	Miscellaneous provisions	
Clause 585	Registration process for existing schemes	<p>Clause 585 notes that there will be a re-registration process for existing schemes. We understand that there are a number of potential issues for existing schemes that need to be taken into account in the transition, including:</p> <ul style="list-style-type: none"> • Ensuring the transition does not incur tax liabilities • Providing a facility to make changes to existing governing documents to comply with the registration requirements of the new regime • Ensuring that issuers are not required to make full disclosure to existing scheme participants (particularly in closed schemes) as a result of the transition.

List of ISI Members

ISI MEMBERS

AIA NZ
AMP Financial Services/ AXA New Zealand
Asteron Life Ltd
BNZ Investments and Insurance
CIGNA Life Insurance NZ Ltd
Dorchester Life
Fidelity Life Assurance Co Ltd
FNZ
Gen Re LifeHealth
Hannover Life Re of Australasia Ltd
Kiwibank Ltd
Mercer
Munich Reinsurance Co of Australasia Ltd
OnePath New Zealand Ltd
Pinnacle Life
Public Trust
RGA Reinsurance Co. of Australia Ltd
Sovereign Ltd
Swiss Re Life & Health Australia Ltd
TOWER New Zealand
Westpac/ BT Funds Management Ltd

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