



**Financial Markets Conduct Bill
NZX Submission
9 September 2011**

Clause	Clause heading	Submission
Part 1	Preliminary Provisions	
Clause 8	"debt security"	<p>The definition includes a redeemable share in an entity. This aspect of the definition focuses on one aspect of a security, which may not be determinative of the economic substance of the financial product. (Refer paragraph 10 - 12 of Part one of the MED commentary which states that the focus of the definition are on the economic substance of the financial product and not just its legal form.) A share that is redeemable does not necessarily have other characteristics of a debt security, such as a fixed return, or a right to repayment of a fixed amount. For example, ordinary shares may be issued under an employee share scheme that may be redeemable in the event that the relevant employee's employment terminates. NZX submits that to be classified as a debt security a redeemable share should also confer on the holder a preferential right on a liquidation of the issuer, carry a fixed rate of return and only limited voting rights.</p>
Clause 8	"derivative"	<p>NZX supports the definition as drafted, which expressly includes CFDs. NZX also supports the exclusion of contracts which do not permit cash set-off between the parties.</p> <p>NZX submits that paragraph (d) should be clarified. The reference to "tangible property" excludes New Zealand or foreign currency, which means that the definition of derivative would apply to any contract where one party has an obligation to pay money in any currency for the purchase of "tangible property" and any one or more of paragraphs (A) to (D) in paragraph (a)(ii) apply. Is the definition intended to apply to a situation where an investor in New Zealand instructs a broker to sell shares on the ASX and the broker converts the proceeds of sale into New Zealand dollars before paying the proceeds to the client? NZX submits that a financial product should not be categorized as a derivative solely because the investor may be exposed to a foreign currency risk. Or does the application of subclause (3) of clause 8 provide otherwise?</p>

		<p>NZX submits that it is unclear whether the definition covers a contract for the creation/issuance of a security (for example, in a rights issue or a bond offer) or a CFD or other risk product, where the obligations of the “investor” are determined with respect to the price/volume of physical product to be delivered under cooperative or other corporate supply arrangements. NZX submits that the definition of derivatives should cover these types of arrangements, which have the element of a derivative or risk product, and should not be covered by the exemption in paragraph (d) because they relate to the delivery of property.</p> <p>NZX submits that equity options and convertible securities issued by the issuer of the underlying should be treated as equity securities and/or debt securities and not as derivatives. This is so that the disclosure obligations are consistent with NZX’s practice concerning the quotation of securities on the NZSX, NZDX or NZAX and derivatives quoted on the derivatives market. Is this achieved by paragraph (d) of the definition?</p>
Clause 8	“derivatives issuer”	<p>This definition provides that a derivatives issuer is a person that is in the business of offering derivatives. NZX submits that this definition should be extended to cover persons that offer derivatives in the course of and for the purpose of their business, otherwise it may not cover persons whose principal business is another field, but which might have a significant operation issuing derivatives. For example, a gold miner that hedges its exposure to the gold price by offering gold derivatives to investors to match off their risk of for other purposes. The definition needs to expressly capture corporates who provide financial risk mitigation derivative products.</p>
Clause 8 and clause 6 and clause 294	<p>“derivative”</p> <p>“financial markets”</p> <p>When financial product market taken to be operated in New Zealand</p>	<p>Paragraph (d) of the definition of “derivative” includes options, swaps, CFDs etc. that are recurrently entered into in the <i>financial markets</i>. The definition of “financial markets” means the financial markets in New Zealand.</p> <p>Clause 294 provides assistance to determine when a “financial product market” is taken to be operated in New Zealand but this clause does not appear to apply in relation to the definition of “financial market”. Is it intended to apply here?</p> <p>NZX submits that by including the reference to “financial markets” in paragraph (d), the bill may not apply to derivative products available in overseas markets and that are offered to New Zealand investors. NZX submits that this exception would not be consistent with the purpose of the legislation.</p>
Clause 8	“managed investment product”	<p>The reference to “a right to participate in or receive a financial benefit” means that this definition is potentially wide. Under clause 9(1) “financial benefit” is defined to mean “capital, earnings, or other financial returns”. NZX submits that this definition should be clarified so that contracts for the sale of an</p>

		asset, or contracts for services, for example, are not covered.
Part 3 and Schedules 1 and 2	Disclosure of offers of financial products	
Clause 30	Treatment of offers of renewal and variations	This clause provides that an offer of a renewal or variation of the terms or conditions of a financial product is an offer of the financial product as renewed or varied. NZX assumes that this clause is consistent with clause 21 of Schedule 1 that provides that an offer of a renewal or variation does not require disclosure under Part 3. Should the words “as renewed or varied from time to time” be included in the clause? What requirements are there for disclosure in respect of renewals or variations?
Clause 32	PDS must be prepared and lodged	In the context of exchange traded derivatives (“ETDs”), does clause 32 mean that an NZX Derivatives Participant will be required to prepare and lodge a PDS for ETDs? The exclusion for derivatives in clause 17 of Schedule 1, would suggest that a PDS would be required in this situation. NZX submits that an intermediary who acquires an ETD for a client should not be required to prepare a PDS in relation to an ETD. The requirements in relation to disclosure and advice in relation to ETDs would be covered by the rules of the market on which the ETDs are traded, which means there is no need for a PDS. If there were it would make the cost of listing a product on exchange with all the risk mitigation, central clearing and other benefits prohibitively expensive. You would only see markets where investors (including retail) buy product of an issuer and also take counterparty and other risks that are not regulated. Conversely, counterparty risk on a regulated clearing house is regulated. To leave the requirement as proposed would create an arbitrage away from regulated exchange market derivatives. This is not sensible and is like the finance company arbitrage of 2000 – 2008, (i.e., unhealthy and potentially very damaging to investors and the wider economy).
Clause 36	PDS treated as having been given if application form that is used was included in, or accompanied by PDS	NZX suggests that the words “making the offer” should be inserted after the words “by or on behalf of the person” at the end of paragraph (i) of paragraph (b), to clarify which “person” is distributing the PDS.
Clause 39	Disclosure of material information and content of PDS and register entry	This section relates to a PDS prepared or required to be prepared by an issuer. Query how this applies where the offer is made by an “offeror” and not the “issuer”.

Clause 40	Meaning of material information in this Part	<p>MED has suggested two options for the definition of “material information”. Option A relates to information that a reasonable person would expect, if it were publicly disclosed, to have a material effect on the demand for the financial products on offer. Option B relates to information that would be likely to influence persons who commonly invest in financial products in deciding whether to acquire the financial products on offer.</p> <p>NZX supports Option B. NZX submits that information relevant to “demand” is not the same as information relevant to “price”. We do not agree that Option A is similar in concept to the continuous disclosure requirements. “Demand” for a financial product may be influenced by a number of matters that are not directly attributable to the product itself, for example, in relation to a debt security, the interest rate offered, compared to other rates on offer in the market may affect demand. There might be a big demand for a product for a number of reasons, but there may be other information that is highly important to an investor that might not affect demand.</p>
Clause 51	When supplementary document or replacement PDS may be lodged	<p>This clause sets out the circumstances when lodgment of a supplementary document or replacement PDS may be lodged. Query whether the circumstances are wide enough to ensure that an issuer is able to amend a PDS when required.</p>
Clause 60	Issue or transfer void if quotation condition not fulfilled	<p>This clause provides that if a PDS states or implies that financial products are to be quoted on a financial market, the allotment or issue will be void if application for admission to quotation is not made within 7 days after the date of the PDS, or the products are not admitted to quotation within 3 months after the date of the PDS.</p> <p>NZX queries whether this provision should contemplate that the financial product offered might not be allotted until after the 3 month period has ended. For example, an issuer whose ordinary shares are quoted might offer a security that is convertible into an ordinary share. If the security converts after the three month period, the shares issued on conversion will not be quoted within the three month period and clause 60 might apply to render their allotment void.</p>
Clause 63	Misleading or deceptive statements etc,	<p>The words “continue to” do not seem to be necessary.</p>
Clause 69	Prohibition of offers in course of unsolicited meetings or communication	<p>This section replaces the prohibition of offering securities “door to door”. NZX submits that this should be clarified. Does this prohibit an intermediary/offer or from sending a prospective investor advertising material and then following up with a meeting or a phone call? What is an “unsolicited meeting”?</p>

Clause 101	Duty of issuer to provide requested information and reports to supervisor	NZX submits that this clause should be clarified so that subclause (1) is clearly limited by subclause (2). (i.e., that a supervisor can only request information from an issuer that is relevant to the performance of the supervisor's functions.)
Clause 103	Power of supervisor to engage expert	NZX submits that the power of a supervisor to engage an expert should be limited to situations where it is relevant to the performance of the supervisor's functions.
Clause 117	Contents of governing document for registered scheme	Paragraph (d) requires the governing document for a registered scheme to provide for the methodology and other rules applying to asset valuations and pricing. NZX submits that the reference to "pricing" should relate to the pricing of interests in the scheme and the paragraph would be clearer if this was clarified.
Clause 125 and clause 126A	General duties applying in exercise of manager's functions Duties of directors and senior managers of manager	These clauses prohibit a manager of a registered scheme and its directors or senior managers from making use of information acquired through that role in order to gain an improper advantage, or cause detriment to the scheme's participants. NZX submits that this prohibition is vague and should be clarified. NZX also submits that the concept of "detriment" should be considered in the context of the particular fund and associated arrangements in relation to the fund. There may be things that the director or senior manager is legitimately required to do that may be "to the detriment of scheme participants".
Clause 138	Duty of supervisor to refuse to act on wrongful directions	This clause contemplates that all schemes will have a "statement of investment policy and objectives". This may be the case where the manager of the scheme has an investment discretion, but this will not always be the case. In the case of the Smartshares ETFs, the trust deed requires the manager to track a particular index, and there is no need for a separate statement of investment policy and objectives. NZX submits that that the clause should contemplate this difference in respect of passive funds. NZX also submits that paragraph (b) of subclause (1) should be clarified so that the question of whether or not an acquisition or disposition is "manifestly not in the best interests of the scheme participants" is determined in the context of the nature of the investment and the terms of the governing documents.
Clause 141	Manager and Associated Persons cannot vote if interested in resolution	This clause prohibits a manager and its associates from voting in respect of their interests in a registered scheme where the manager is interested in the resolution. NZSX Listing Rule 9.2 contains provisions that regulate Material Transactions between Listed Issuers and Related Parties, (as defined). Listing Rule 9.3 sets out the circumstances when a security holder is prohibited from voting on a particular matter. NZX has the power to waive the requirements of Rules 9.2

		<p>and 9.3, and believes that this flexibility is necessary to ensure that such transactions are not frustrated.</p> <p>The prohibition in clause 141 would apply to prevent a manager of a listed registered scheme and its associated persons from voting in circumstances where they would be permitted to vote under the NZSX Listing Rules, as the Listing Rules only impose such restrictions in the context of Material Transactions and NZX has the power to waive those restrictions.</p> <p>NZX submits that the Listing Rules should apply to quoted funds and not be limited by clause 141. NZX is not aware that there have been any issues with the operation of these Rules in relation to managed funds, and submits that it is not necessary for legislation to override the Listing Rules in this way.</p>
Clause 142 and clause 143	<p>Requirement for statement of investment policy and objectives</p> <p>Changes to statement of investment policy and objectives</p>	<p>These clauses require a manager of a registered scheme to have a statement of investment policy and objectives.</p> <p>NZX submits that these matters should be able to be contained in the governing documents for the registered scheme.</p> <p>NZX also submits that a statement of investment policy is not necessarily relevant to all registered schemes. For example, they are not necessary where the registered scheme can invest only in a very limited class of investment. See the submission above in relation to clause 138.</p> <p>NZX also suggests that the wording in paragraph (c) of subclause (1) should read “methodology for developing and amending the investment strategy, and for measuring performance against the investment strategy”. It is not correct to refer to the measurement of a strategy.</p>
Clause 145	Action that must be taken on limit breaks	<p>This clause requires a manager to report a “limit break” to the supervisor of a fund. Note that the Smartshares ETFs are required to track particular indices, and permit “tracking errors” i.e., they contemplate that sometimes it is practically difficult to replicate the index exactly. NZX submits that the clause should allow for a materiality threshold that would need to be reached before reporting is required. We note that there is a materiality threshold in clause 146, and suggest that these clauses should be consistent.</p>
Clauses 150, 151 and 152	Related Party Transactions	<p>See our submission in relation to clause 141 above.</p> <p>NZX submits that in relation to NZX listed funds, the provisions in the NZSX Listing Rules should apply, and that NZX should be able to waive those requirements where the policy of the Related Party provisions of the Listing Rules are not offended.</p>

Schedule 1 Part 1 clause 8	Share Purchase Plan	NZX notes that no disclosure exclusion has been included in Schedule 1 in respect of share purchase plans. NZX submits that consistent with the policy behind the Securities Act (NZX - Share and Unit Purchase Plan) Exemption Notice 2010, it may be appropriate for the Bill to include a disclosure exclusion in respect of share purchase plans, on the terms and conditions contained in the Exemption Notice, which would avoid the need to periodically renew the exemption notice which is currently due to expire in 2015.
Schedule 1 Part 1 clause 12	Small Offers	NZX submits that the “20 investor” limit may need to be clarified. How are offers made to more than one person jointly to be counted? NZX submits that paragraph (5) which defines “personal offer” is fairly vague, and could be difficult to apply in practice.
Part 4 and Schedule 3	Governance of financial products	
Clause 173	Duty of investment manager, administration manager, and custodian to report serious problems	This clause requires an investment manager, administration manager or a custodian of a registered scheme to report “serious breaches”, including a breach of a governing document that relates to the financial product. NZX submits that not all breaches of governing documents are “serious”, and suggests that the Ministry should consider whether only material breaches should be required to be reported. NZX also submits that there should be provision in the clause to ensure that the manager is informed of a material breach.
Clause 189	Issuers must keep registers of regulated products	NZX submits that where a register is kept by an external third party registry service provider, that the registry service provider, must, if requested by the issuer, use reasonable best endeavors to provide information about the issuer (for example annual reports) to the underlying beneficial holders of securities rather than solely to the legal holders who appear on the register. This is to ensure that the information about the investment is sent to the ultimate investor and any intermediary custodian or nominee does not unilaterally restrict the flow of information between an issuer and the ultimate investor. NZX also submits that this clause and the following clauses that relate to registers should not apply to derivatives. While NZX agrees that issuers of derivatives should be required to keep a records of derivatives, the requirements for registers which are a concept applied to securities is not appropriate for derivatives. A register makes sense in the securities context because it is necessary for an issuer to be able to determine who all the current holders are for the purposes of paying benefits, determining the right to vote, etc. However, the nature of a derivative, being a bi-lateral contract independent of other similar contracts, does not give rise to similar requirements. Furthermore, NZX notes that Participants in NZX’s Derivatives Market will be subject to requirements to keep records relating to their activities and submits

		that it is unnecessary to impose specific legislative requirement on persons subject to the Rules of a registered market that regulate those activities.
Clause 193(3)(b)	Public inspection of register	This clause should read “must be available for inspection in the manner specified in section 194 by <i>that person</i> ”.
Clause 196(2) and (3)	Restriction on use of information in registers	As drafted, the clause allows a person to use register details to contact persons named on the register where the issuer has approved the use of that information. How would this apply where a broker is the issuer of an exchange traded derivative? Would the broker be able to itself use or allow the derivatives register to be used by someone else to market debt / equity products? See also our submission in relation to clause 189 What is a “prescribed purpose” in clause 196(3)?
Clause 197 and 198	Issuer to send confirmation of financial products Requirement for confirmation document does not apply in certain circumstances	It is unclear whether the requirement to send confirmation is a requirement to send a “certificate” in respect of a security, or whether this is some other communication confirming the holding. NZX submits that every issuer should be required to confirm in writing the details of a financial product that is held by a person within a certain time after issue or transfer, but that the statutory requirements for a “certificate” can be done away with. If the “issuer” is a person who is acquiring an exchange traded derivative for another person, this requirement could be met by providing a contract note in accordance with the rules of the relevant exchange. There is no need for an additional requirement under legislation for exchange traded derivatives. If the requirement for a certificate is to be retained, then NZX submits that the clause should be clarified to make it clear that only the requirement for a “certificate” falls away if clause 198 applies (i.e., if the product is transferable by means of a system that does not require a certificate for the transfer of product). There should still be a requirement for the issuer to confirm allotment or transfer of the financial product, even if a “certificate” is not required for transfer. Note that NZCDC’s system for the transfer of legal title to securities does not require production of a certificate for transfer, however the NZSX Listing Rules still require an Issuer to send a statement to security holders of their holding.
Clause 211 Clause 212(2)	Meaning of Material Information Meaning of Generally	NZX submits that there should be no distinction in the test applying to material information between the cash equity and derivatives market, and that both definitions should refer to “price” not “value”. In NZX’s view, “price” has an element of objectivity that “value” does not. A financial product may be of a different value to different people. Even if the market for a product is illiquid, there will be some evidence of

	Available to the Market	“price”, so there is no need to use “value as a reference solely because there is not much liquidity in the product.
Clause 217	Situations giving rise to relevant interests	This clause provides that a person does not have a relevant interest in financial products in some situations, including where a person is authorised to undertake trading activities on a licensed market under paragraph (b). In the course of obtaining regulatory approvals before the introduction of the clearing house in 2010, NZX obtained exemptions from the corresponding provisions of the Securities Markets Act for Clearing Participants, and also for the companies in the New Zealand Clearing and Depository Corporation Limited Group. These are contained in the Securities Act (NZCDC Settlement System) Exemption Notice 2010. NZX submits that these exemptions should be contained in clause 217, because they are similar in principle to the exemption in paragraph (b), i.e., the exemption is provided because the relevant interest only arises because the person has a role in the operation of the market.
Clause 218	Prohibition of insider conduct	MED has asked for submitters’ views on whether the prohibition should be extended to other financial products. NZX agrees that the insider trading prohibition and the directors and officers disclosure regime should be extended to trading in non-quoted derivatives where the underlying is a quoted financial product of a listed issuer. In NZX’s view, the policy rationale for the insider trading prohibition is applicable here. NZX would also support the introduction of similar prohibitions and regulation in respect of trading in non-listed issuers’ financial products, as NZX believes that this is an area where retail investors face significant risk of loss when dealing with insiders of non-listed issuers.
Part 5	Dealing in financial products on markets	
Clause 290	What is financial product market	<p>The Bill considers a financial product market to include a “<i>facility by means of which offers to acquire or dispose of financial products are regularly made or accepted.</i>” NZX would expect that where a derivatives issuer offers multiple unlisted contracts for difference to retail investors, that issuer would be regulated as a financial product market as well as a derivatives issuer. NZX submits that the term “<i>facility</i>” should include where an issuer has a consistent practice of issuing multiple financial products to retail investors or other non-institutional purchasers.</p> <p>NZX also submits that the Ministry should consider how clause 290(3) might relate to clause 293. What other matters would the FMA take into account in determining whether the exemption in subclause (2) should be disappled, other than the number and value of transactions conducted on the facility?</p>

		NZX does not support the exemption suggested in the Exposure Draft from the licensing regime for wholesale investors who trade listed securities in dark pools. This has the potential to further erode the liquidity of New Zealand's capital markets and allow dark pool operators advantages (in that they would not be subject to compliance costs such as self reporting) that would not be available to other market operators.
Clause 298	When license may be issued for overseas regulated market	NZX submits that overseas regulated markets should only be licensed to operate an overseas market in New Zealand where the overseas regulator provides equivalent relief to New Zealand market operators. There are two options here. Either an overseas operator should not be permitted to offer a market into New Zealand unless a New Zealand market operator is permitted to operate in the overseas jurisdiction on the same terms on which the overseas operation is permitted to operate in New Zealand, or the Minister should be required to impose conditions in the license of an overseas market operator that reflect the operations/impact in New Zealand and that meet the regulatory standard in New Zealand that would be required of a New Zealand based operator. The Minister should not be permitted to issue a license merely because the applicant is regulated by an overseas regulator. This should be made a condition in clause 298. In addition NZX would support the ability for the FMA to provide "no action letters" to be expressly referenced in the legislation, rather than being understood to be within the powers of the FMA.
Clause 299	Conditions of license	This clause contains a reference to the clearing and settlement arrangements for licensed markets. NZX agrees it is appropriate for different markets to have different arrangements for clearing and settlement. However, NZX submits that there should be a level playing field in this area in respect of overseas-regulated markets in particular, and also in relation to clearing facilities that are operated in New Zealand. One of the matters that the Minister should be required to consider in relation to overseas-regulated markets is whether the operator of the clearing and settlement system to be used to clear and settle the market should be required to obtain designation under Part 5C of the Reserve Bank of New Zealand Act 1989 as a condition of a license granted under clause 298, i.e., whether the clearing and settlement system is also being offered into New Zealand. Furthermore, NZX submits that a regime for overseas regulated clearing and settlement systems should be included in the Reserve Bank Act similar to the regime for markets in this bill. This would ensure the coherence of the regime for regulation of market infrastructure.
Clause 300	Procedural requirements	NZX notes the requirement for the Minister to give an applicant for a market license no less than 10 working days written notice of conditions that are "materially more restrictive" than those requested in the application. NZX submits that this clause is problematic, because it is not clear how the requirement fits

		in with the general rules of administrative law that would be relevant to the exercise by the the Minister of the power to grant licenses. This clause should not limit any other general rules of administrative law, for example for the Minister to give notice of matters relevant to the license. An applicant for a license should expect to receive a draft of the license for comment, not just notice of the conditions that might be “materially more restrictive”. An applicant and the FMA may not share the same view as to whether a particular matter is “materially more restrictive”.
Clause 303	FMA must maintain list of licensed markets on its Internet site	NZX notes the requirement for the FMA to include in the list of licensed markets, the market rules for the financial product market. NZX would not agree to the FMA providing an electronic copy of NZX’s market rules for download through the FMA’s website, and submits that the list should only be required to contain reference to the rules. Alternatively, the requirement could be for the FMA to provide a link to the licensed operator’s website where a copy of the rules can be obtained.
Clause 306	Procedure for varying of conditions or suspension or cancellation of license	NZX notes the requirement for the Minister to give notice of a decision to vary, suspend or cancel a market license to “prescribed persons”. What persons are likely to be prescribed here?
Clause 312(4)	Approval process for proposed market rules and rule changes	NZX supports the inclusion in the Bill of the provision which allows an approval period to continue where an applicant amends the new rules or rule change in response to comments from the FMA. In addition NZX submits that immaterial or typographical amendments to a new rule set or rule change should not trigger the commencement of a new approval period.
Clause 319	Licensed market operator must give report on compliance with licensed market obligations to FMA	<p>The compliance report obligation in the Bill, applies only to licensed market operators. NZX notes that under clause 298, overseas regulated markets may be licensed to operate the same market in New Zealand. NZX understands that the consequence of this is that the overseas regulated market would be a licensed market operator and would therefore also be required to provide a compliance report in accordance with clause 319, NZX would support this approach.</p> <p>However, NZX is concerned to ensure that there is a level playing field for licensed market operators and submits that overseas operators who operate sizeable New Zealand markets (e.g. the ASX) should be subject to the same levels of oversight as a New Zealand based operator. NZX submits that the bill should contain a direction to the Financial Markets Authority that overall the level of oversight review should be similar for New Zealand market operators and foreign market operators who operate at similar scale in New Zealand.</p>
Subpart 10	Unsolicited Offers to	This subpart prohibits unsolicited offers. NZX submits that this subpart should not cover the usual

	purchase financial products off-market	activities of an NZX Participant who might contact an existing client to ascertain whether there is interest in acquiring or disposing of a security. A transaction such as this might lead to a market transaction, or might lead to the participant "crossing" the transaction in their own books, subpart 10 should not prohibit conduct that is currently usual market practice.
Part 6	Licensing and other regulation of market services	
Clause 370	When provider of market series must be licensed	Some participants in the derivatives industry do not issue derivatives, rather they provide advice, and may introduce their clients to others who are derivatives issuers. These activities must be separated from the obligations of an issuer, and regulated separately. What kind of circumstances will be prescribed for the purposes of the exception for participants in licensed markets in clause (2)?
Part 9 and schedule 4	Miscellaneous provisions	
Clause 581A	Transition Process for licensed markets	NZX awaits further detail on how the transitional process will operate.