

Submission to Ministry of Economic Development

Financial Markets Conduct Bill Exposure Draft



6 September 2011

Clause Number	Clause heading	Submission
Part 1	Preliminary provisions	
6	Interpretation	<p>The definition of "advertisement" refers to communication made to "the public or a section of the public" (which is not defined in the FCMB). The definition should be amended so that it includes communication to any person, unless it relates to an offer that is excluded under Part I of Schedule 1.</p> <p>Guidance as to the valuation of contingent liabilities (such as that provided in section 4(4) of the Companies Act 1993) should be included in the definition of "insolvent".</p> <p>In relation to the definition of "redeemable share", clauses 6(3)(a) and (b) should be amended so that a share or product may be redeemable:</p> <ul style="list-style-type: none"> • in any of the circumstances set out in paragraph (a); and • for consideration determined under any of the methods set out in paragraph (b). <p>The definition of "special resolution" as it relates to "debt securities" requires clarification. Specifically, the meaning of value of debt securities is unclear and "value" is not defined. The reference should be to the "nominal amount" of the debt securities, which is consistent with the position under the Securities Regulations 2009 for calling meetings of debt security holders (clause 3(1) of Schedule 15).</p>
7	Meaning of financial product	<p>We agree that the position of derivatives under the Gambling Act 2003 ("Gambling Act") should be addressed in the FMCB. While section 40 of the SMA is helpful, it is somewhat narrow in scope. A broad Gambling Act confirmation should be included (Option A) as this will remove any uncertainty as to the application of the Gambling Act to derivatives.</p>
8(1)	Definitions relating to kinds of financial products	<p>As currently drafted, spot transactions may be caught by the proposed definition of "derivatives". This should be clarified by way of an express carve-out from the definition.</p> <p>The proposed scope of paragraph (d) of the definition of "derivative" should be amended to address the following points:</p> <ul style="list-style-type: none"> • The term "tangible property" is not defined in the FMCB, and the absence of a definition will lead to uncertainty as to what constitutes "tangible property". In addition, references to "tangible" property would likely exclude property such as emission units. The reference

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		<p>to "tangible" should be removed from this limb.</p> <ul style="list-style-type: none"> The restrictions as to set-off in paragraphs (d)(ii) and (iii) should be removed. OTC derivatives contracts that are physically settled commonly contain set-off provisions aimed at reducing transaction cost (eg International Swaps and Derivatives Association, Inc. ("ISDA") documentation relating to emissions forwards typically permit set-off of same-day settlement obligations). Derivative transactions having such set-off provisions should not be excluded from paragraph (d).
10(1)	Definitions of issued and issuer	<p>Clause 10(1)(b)(i) defines "issuer" in respect of a "debt security" as the person "liable to repay money or pay interest under the security (other than as guarantor)". We note that directors could be required to repay money received under clause 62(3). The definition should be amended so that it does not include any persons who may be contingently liable to pay any amount under debt securities, and not only guarantors.</p> <p>We support clarifying the definition of "issuer" in respect of a "derivative contract" where there is intermediation by reference to the parties to the legal relationship (ie option A), which aligns with clause 10(2)(b).</p>
10(2)		<p>The FMA should have the express power to extend the scope of clause 10(2)(c)(i) and (ii) to other managed investment schemes under which participants make ongoing investments.</p>
12(2)(c)	Miscellaneous interpretation provisions relating to statements and information	<p>Paragraph (2)(c) should be amended to clarify that, where a statement or other information is incorporated by reference or referred to in an offer document, only the statement or information that is expressly incorporated or referred are included. This is a particular concern when referring to websites. A particular page may be referred to. It should be clear that the balance of the information on the website is not then incorporated by reference.</p>
Part 2	Misleading or deceptive conduct or false or misleading representations	
17, 18 and 21	Misleading and deceptive conduct generally; misleading conduct in relation to financial products; limited application of Part in relation to newspapers,	<p>The term "public" is used in these sections. Guidance should be provided by the FMA as to the interpretation of the term. Relevant jurisprudence under the Fair Trading Act 1986 ("FTA") should be considered in order to ensure that the regulation of misleading and deceptive conduct is consistent across both Acts.</p>

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	magazines, broadcasting, etc	
17 and 18	Misleading conduct in relation to financial products/financial services	The word "any" should be inserted before "financial products" and "financial services" in clauses 17 and 18.
19	False or misleading representations	There is an overlap between the provisions of clause 19 and the duties of financial advisers not to engage in misleading and deceptive conduct under the Financial Advisers Act 2008 (" FAA "). The FMCB should clarify the relationship between the two Acts.
21	Limited application of Part in relation to newspapers, magazines, broadcasting, etc	The exemption provided by this clause should not extend to the issuer, or an agent, providing quotes to a newspaper. For investor protection, this provision should be narrowed so that it only relates to the protection of the media.
23	Territorial scope of Part	Part 2 should only be applicable if the offer or issue of financial products, or provision of a financial service, occurs in New Zealand. As currently drafted, it provides that Part 2 applies to "conduct outside of New Zealand... to the extent that that conduct relates to dealings in financial products... that occurs (in part or otherwise) within New Zealand." Given that "dealings in financial products" includes "anything that is preparatory to, or related to, any dealings in financial products", Part 2 could potentially apply to all offshore financing activities conducted by New Zealand-based entities.
Part 3 and schedules 1 and 2	Disclosure offers of financial products	
30(2); clause 24 of Schedule 1	Treatment of offer of renewals and variations; disclosure and other requirements.	Clause 30(3) and clause 21 of Schedule 1 should be amended to exclude any variation required by (or consequential upon) legislative changes from any disclosure requirements arising from clause 30(2) (and clause 24 of Schedule 1).
34, 35, 36 and 37	PDS must be given if offer requires disclosure; certain situations in which clause 34 does not need to be complied with; PDS treated as having been given if application form that is used was included in, or accompanied by, PDS; offence to knowingly or recklessly contravene clause 34	<p>Each of these clauses refers to a "person who makes the offer", which should be amended to refer to the "offeror" as defined in clause 6.</p> <p>These sections do not expressly cater for when the applicant (A) appoints an agent to attend to these matters. For example, if a person (A) will be out of NZ and grants a power of attorney to a person. It is necessary to assume that section 36 applies as the securities are issued to A in accordance with an application form, even though that form is signed by A's agent (with therefore no evidence that A ever received the PDS).</p>

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35	Certain situations in which clause 34 does not need to be complied with	<p>Clause 35(a) should be amended to clarify that it would also apply if the new PDS contains different information, provided that information is not materially adverse to an investor.</p> <p>A transitional provision should be included stipulating that a further PDS is not necessary when the investor has receipt of an investment statement or disclosure document that the issuer is required to give under the Securities Act 1978 ("SA") or the Securities Markets Act 1988 ("SMA") regimes.</p>
36	PDS treated as having been given if application form that is used was included in, or accompanied by, PDS	<p>Clause 36 should be available to issuers conducting an electronic offer. For example, an issuer should be treated as having complied with clause 34 if the issuer has reasonable grounds to believe that the person making an application had the opportunity to view or download an electronic version of the PDS (eg they first check the box that they have done so before they are able to access the application form).</p>
38, 62, 66, 70	Right to withdraw and have money returned; Choices open to offeror; How offeror must deal with applications on expiry; Financial products offered in course of unsolicited meeting or communications may be returned and refund obtained	<p>Clauses 38(3)(b), 62(3), 66(5) and 70(3) impose liability on directors for the return of funds (plus interest), even if the director knew nothing of the contravention. The lack of any knowledge element to the imposition of personal liability on directors in these provisions is inappropriate - it could discourage the involvement of directors of a high calibre and/or be detrimental to the development of New Zealand's capital markets.</p>
39	Disclosure of material information and content of PDS and register entry	<p>Clause 39(1) should be amended so that it creates an obligation on an issuer to disclose material information from when the PDS is submitted for lodgment.</p>
40	Meaning of material information in this Part	<p>The "Option B" proposal put forward by the MED is the most appropriate of the available options. However, Option B should have a higher materiality threshold, and should be amended to "significantly influence".</p>
41	Consent of person to whom statement attributed	<p>At present, this clause captures statements that are in the public domain (such as statements published by the Government). Requiring issuers to seek consent for those statements would unnecessarily increase issuers' compliance costs. Accordingly, there should be an exception from clause 41 for references to statements that are of public record, and which are properly attributed.</p>
42	PDS must be presented, in clear, concise and effective manner	<p>The phrase "effective manner" is ambiguous. There should be a clearer and more objective standard such as "reasonably clear and concise".</p>

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49	Waiting period does not usually apply to continuous issue PDSs	Clause 49 should be amended to clarify that the first PDS issued by continuous issuers under the FMCB is not subject to the waiting period.
55	Consents needed for lodgement.	<p>Clause 55(1) provides for the consent of every director before lodgment of a PDS, supplementary document or replacement PDS. This is potentially very onerous for issuers of multiple securities. For large issuers undertaking regular financing activities, we doubt this is realistic.</p> <p>If pursued the change could impact on innovation and growth in the financial products markets. It is important that the FMCB regime and in particular the requirements on directors in connection with the offer documents for financial products is consistent with other competing jurisdictions. For example, under section 1015B of the Corporations Act, directors' consent is required for a PDS for a managed investment product only if the product will be traded. The same regime should be adopted in the FMCB.</p> <p>Imposing liability on directors for disclosure documents is not appropriate. Directors should, however, ensure that there are reasonable due diligence and verification processes in place for each PDS. Individual scrutiny and consideration of each PDS by each director of an issuer adds little to that process which is of benefit to investors.</p>
62	Confirmation whether or not the applicant still wants to acquire	The practice adopted by a number of issuers in the past has been to ask the applicant to advise if they wish to withdraw and then to proceed if that request is not received. It should be made clear that silence is not deemed confirmation.
63	Misleading or deceptive statements, omissions, and new matters requiring disclosure	This clause (and others identified in this submission) should incorporate a materiality threshold so that a technical or otherwise immaterial breach will not give rise to a contravention.
64	Persons who must inform offeror about disclosure deficiencies	Clause 64(2)(d) refers to "underwriters". This term is also used elsewhere in the FMCB. As obligations and liabilities are placed on such persons, the term should be defined. Imposing liability on underwriters does not fit with their role in New Zealand financial markets and is likely to be detrimental to the development of such markets by increasing the costs of new issues and potentially decreasing the pool of underwriters prepared to take on the role.
65	Expiry	A fixed expiry date for a continuous issue PDS is unnecessary. Clause 63 provides sufficient protection for investors by requiring the document to be updated

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		when it becomes misleading.
69	Prohibition of offers in the course of unsolicited meetings or communications in certain circumstances	This clause goes further than is necessary to ensure an appropriate level of consumer protection. There are already restrictions in the FAA which should be sufficient to provide an appropriate level of consumer protection.
71	Advertising or publicity for regulated offers	<p>Clause 71(1)(b) should be removed. It is unclear why wording from the existing SA definition of "advertisement" is included in clause 71(1)(b) when the definition of advertisement in the new FMCB is limited to a promotion for the purposes of promoting the offer.</p> <p>Clause 72 would not be required as a consequence of the above.</p>
76	General exceptions	<p>The exception set out in clause 76(a) should apply whenever a listed issuer determines that it should make an announcement "to the market".</p> <p>An exception similar to that of section 734(7)(e) of the Corporations Act should be introduced into the FMCB. It allows reports published by independent parties that refer to a proposed offer of securities to be published prior to lodgment of a disclosure document, provided that the report is not for reward.</p>
83	Defective disclosure ongoing	<p>Please refer to the submissions on clause 63.</p> <p>In addition, if it is clear that information submitted to the register that subsequently became misleading has clearly been superseded then it should not be captured by this clause.</p>
Part 4	Governance of financial products	
94	Changes to the trust deed	<p>The clause should provide that, where a supervisor has taken appropriate advice, no liability should attach to the supervisor for certifying that an amendment to the trust deed will not have a material adverse effect on holders. Otherwise supervisors may be reluctant to give their certification, resulting in issuers being forced to seek special resolutions for all amendments to the trust deed.</p> <p>It should be made clear that the supervisor is only required to consider the effect of the amendments on all holders (and not individual holders) by adding the word "generally" after the words "holders of the debt securities" in clause 94(2)(a)(ii).</p> <p>Amendments that are required in order to comply with any applicable legislation should be carved-out by including a new subclause (iii) to clause 94(2)(a).</p> <p>Similar amendments should be made to clause 121</p>

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113	Additional initial and ongoing registration requirements for superannuation schemes	As currently drafted, New Zealand companies are prevented under clauses 113(1)(c) and (d) from offering superannuation schemes to employees that are overseas citizens working in New Zealand. This appears to be an oversight and will need to be addressed by amendments/exemptions.
114	Additional ongoing registration requirements for restricted scheme	<p>Clause 114(1)(d)(iii) should be amended to clarify that either a trustee of the scheme, or a director of the sole corporate trustee of the scheme, must be independent and licensed.</p> <p>The reference to "is not a promoter" in clause 114(2)(b) should be deleted.</p>
117	Contents of governing document for registered scheme	The ambit of clause 117(j) is uncertain. This provision could be replaced by providing that other matters required to be set out in the governing document will be prescribed by regulations.
118	Limits on permitted exemptions and indemnities	This clause should include administration managers as well as investment managers.
125	General duties applying in exercise of manager's functions	<p>We agree that managers should owe a duty of care to scheme participants, however this should be subject to compliance with the governing documents of the scheme and contain an acknowledgement that managers have a commercial relationship with investors.</p> <p>Clause 125(2) is unnecessary as the duties and liabilities of both the manager and the supervisor are clearly specified in the FMCB.</p> <p>The clause should not draw a distinction between the duties of a manager appointed pursuant to a trust deed, and the duties of a manager appointed pursuant to the terms of another form of governing document.</p>
126	Duty of manager and investment manager to comply with relevant professional standard of care	This clause should include administration managers as well as investment managers.
126A	Duties of directors and senior managers of manager	Clause 126A should expressly provide that it does not restrict the holding, or trading, by directors or senior managers of financial products which may also be held or traded by the registered scheme with the manager's consent and provided that it is not to the detriment of the scheme
136	Custodian holds scheme property on trust	The word "participants" should be deleted from the end of clause 136(1). The property will be held on behalf of the overall scheme, in accordance with the governing documents of the scheme, rather than for scheme

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		participants themselves. The distinction is important to allow the property to be dealt with in accordance with the scheme documentation.
144	Lodging of statement of investment policy and objectives and changes to statement	Each PDS should include a summary of the statement of investment policy and objectives, and of the ability for changes to be made to that statement. This will ensure that the statement is delivered to the investor in an accessible format. We suggest that clause 144 be deleted and that regulations will provide for the relevant information to be included in the PDS.
146	Action that must be taken on pricing errors and failure to comply with pricing methodologies	<p>The requirement to report "material" pricing errors or non-compliance is potentially onerous and complex with significant commercial and compliance impacts.</p> <p>What is "material" will vary significantly depending on the type of scheme.</p> <p>The provision contemplates that the FMA would create "frameworks or methodologies" that will determine whether a pricing error is "material". The FMCB should expressly set out some guidance and principles that informs the FMA when developing the relevant "frameworks or methodologies".</p>
172 - 183	Intervention in debt securities and registered schemes	Subpart 4 of part 4 is only meant to apply to regulated offers of debt securities (see clause 86(1)(b)). This reference to subpart 4 only applying to a "regulated offer of debt securities" is not replicated in subpart 4. Given clause 86(1)(b), this appears to be an oversight. The reference to regulated offers should be inserted into subpart 4 in order to avoid any uncertainty as to its application.
189	Issuers must keep registers of regulated products	<p>Clause 189 imposes an obligation on issuers of regulated products to maintain a register of regulated products and "all financial products that are of the same class as those regulated products of which it is the issuer". In order to provide certainty as to what constitutes a financial product of the same "class", the FMCB should include a definition of "class" for the purposes of this clause. "Class" could be defined as financial products of the same type which have identical rights, privileges, limitation and conditions.</p> <p>The obligation to maintain a register does not fit well with all types of financial product. In particular, the requirement to maintain a register does not make sense for derivatives where the derivatives issuer issues a derivative as principal (ie they are not acting on behalf of a third party). In such situations the requirement to have a register does not provide greater protection for the investor as they will already know the material terms of their contractual relationship with the issuer. In addition, unlike other forms of financial products (such as debt securities),</p>

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		investors of derivatives do not act as a class when taking action against the issuer. Therefore, the need for a centralized database of holders and related information seems unnecessary for derivatives. We note that this aspect is addressed by clause 193(2)(b).
197	Issuer to send confirmation of financial products	<p>In relation to managed investment schemes where investors continually make contributions at their discretion it is not appropriate that the issuer is required to provide a confirmation each time. The continuous reporting obligations to be applied to managed investment schemes will provide investors with appropriate updates.</p> <p>The documentation for OTC derivatives generally prohibits unilateral transfers by parties. That is, both parties are generally required to agree to any proposed transfer. Accordingly, the requirement to send confirmation documents on transfers of OTC derivatives does not appear to be necessary.</p>
Part 5	Dealing in financial products on markets	
217	Situations not giving rise to relevant interests	Clause 217(1) should expressly exclude an employee from having a relevant interest if the employee is acting in their employment capacity on behalf of the employer.
218	Prohibition on insider conduct	<p>At paragraphs 100 and 101 of the Request for Submissions paper, the MED has sought views from submitters on whether the current prohibition on insider trading in quoted financial products should be extended to trading in non-quoted financial products.</p> <p>The current prohibition on insider trading should not be extended to trading in non-quoted financial products. The prohibition on insider trading in quoted financial products aims to maintain public confidence and ensure 'outside' investors that there are appropriate incentives for persons who are not insiders to invest in public, regulated capital markets. This, in turn, promotes depth and liquidity in these markets. The regulation of insider conduct and the related disclosure requirements aim to protect retail investors from disadvantages associated with the information gap that exists in relation to insiders with superior access to information on a particular issuer.</p> <p>The same justifications do not apply in markets for non-quoted financial products. These markets are designed to accommodate wholesale trading between participants who have the expertise and ability to readily obtain information about financial products in which they choose to invest. Trading does not have the same level of intermediary involvement and is more likely to be direct and bilateral by nature. The costs</p>

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		<p>imposed by regulation are reduced and the risks of investing are increased to suit the nature and risk appetite of investors in these capital markets.</p> <p>Extending the prohibition on insider trading would be inappropriate for these markets and would be likely to increase the compliance costs associated with trading on unquoted markets.</p>
227	Exception in case of knowledge of person's own intentions or activities	As currently drafted, the exceptions in clause 227 would not appear to apply to a party that is aware of its own intention as well as the intention of a counterparty that intends to trade with it. This may arise in the context of cross transactions of financial products quoted on the NZX. The clause should be amended so that the exceptions cover situations where a person is also aware of the counterparty's intention.
235	Inside information obtained by independent research and analysis	<p>At paragraphs 100 and 101 of the Request for Submissions paper, the MED contemplates removing the defence for insider trading if information is obtained by independent research and analysis. The removal of this defence could result in information obtained by legitimate research and analysis (which has not been obtained from an issuer) being captured under the prohibition. This would be directly contrary to the original intention of the legislation and the market efficiency rationale which is the focus of our current insider trading regime. Capturing this type of information would, over time, be likely (we think) to suppress the availability and quality of research and analysis in our capital markets. This would restrict the flow of valuable market information and the attainment of efficient price discovery in our capital markets. We disagree with the comments at paragraph 107 of the Request for Submissions paper suggesting that this defence is inconsistent with the general insider trading regime. The research and analysis defence was carefully considered in the original Cabinet Paper released by the Minister of Commerce in 2003, as a pre-cursor to the 2006 amendments to the Securities Markets Act. These amendments signalled a policy shift away from a prohibition of insider trading based on fiduciary duty principles to a focus on market efficiency. The market efficiency concept considers market efficiency as a whole and the effect that perceived insider trading has on market participation by non-insiders. The source of the information should be relevant to the determination of whether the information was legitimately obtained. The prohibitions on trading should not extend to legitimate conduct by persons who are not connected to the issuer concerned.</p> <p>The effect of the changes introduced in 2006 was to create a broader net of conduct that is <i>prima facie</i></p>

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		<p>prohibited under the Act. It was recognised during the passage of the Securities Legislation Bill and in Parliamentary debates that a number of exceptions were needed to balance this effect so that appropriate market conduct was still allowed to occur. The Commerce Committee concluded in its report on the Securities Legislation Bill that research and analysis defence was necessary to address concerns that skilled investors should not be caught as insiders. We do not consider that the carve-out under section 212(1)(c) of the FMCB for deductions, conclusions or inferences drawn from information "generally available to the market", on its own, would provide appropriate protection for skilled investors or market analysts, in particular, because of its limited reach to information that falls within section 212(1)(a) and (b) of the definition of "generally available to the market".</p> <p>One of the criticisms of the Australian insider trading regime (upon which our regime was based) is that the use of information that has not been sourced directly or indirectly from the issuer and that has been gathered through research and analysis can be unlawful under the regime. We see no need to follow the approach taken in Australia in this regard.</p>
273 and 288	Offences relating to substantial holdings and interests registers	Section 35E(2) of the SMA provides for a reasonable excuse defence to a contravention of register obligations substantially similar to those set out in the FMCB. Assuming that there is no policy basis for the removal of the defence, it should be retained.
Part 6	Licensing and other regulation of market services	
392	Licensee must deliver regular reports to FMA	Careful consideration should be given with respect to the scope of the proposed reporting obligation for certain entities (such as registered banks and members of a QFE group) to ensure that the requirement is not inconsistent with other legislation (eg the Reserve Bank of New Zealand Act 1989 (" RBNZ Act ") and the FAA).
393	Licensee must report certain matters	The threshold in clause 393(b) should be clarified by referring to "material changes in circumstance which has, or is likely to have, a material adverse effect on the licensee's ability to comply with its market services licensee obligations".
395	FMA's powers in case of breach of market services licensee obligations, material change etc	The FMA's powers under clause 395(2) should be limited in circumstances where a breach has not occurred (but is only likely to occur). In those situations the FMA should only be entitled to require the licensee to submit an action plan under subclause (2)(b).

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401	Directions	See the submission in relation to clause 395, above.
408	Disclosure statement	Where the information required to be disclosed under the FMCB is identical to those required under other legislation, separate disclosure documents should not be required.
409	Misleading or deceptive statements or omissions	The FMCB should provide guidance on what "materially" means in the context of clause 409.
412	Requirement to have client agreement	Further consideration should be given to what will constitute a "client agreement". In certain circumstances, existing documentation used by market participants already set out the nature of the contractual relationship between the parties and each party's rights and obligations (such as the ISDA Master Agreement). Where such agreements exist additional documentation should not be required. In addition, the timing for entry into a client agreement should be clarified.
415	Meaning of provider of discretionary investment management services and related terms	We note that section 12 of the FAA does not include a definition of "investment mandate", nor does it appear to be included in the amendments to the FAA contained in the FMCB.
416	DIMS licensee's duties	The duty of the DIMS licensee should be to act in the best interests of the relevant class of investors, not individual investors. This could be clarified by including "class of" immediately prior to "investors" in clause 416(c)(i).
426 (and 11(1))	Requirements for custodian (and definition of "associated")	A modified definition of associated should apply for the purposes of clause 426 since it would be very likely that a custodian will be associated with a DIMS licensee set out in clause 11(1) - for example they will be accustomed to acting in accordance with the wishes of the DIMS licensee.
428 and 429	Regulations relating to derivatives issuers	Clause 428 contemplates that regulations made under clause 429 will apply to both regulated and unregulated offers and whether the derivatives issuer is licensed or not. This has the potential to impose "back door" requirements on derivatives issuers who are not required to be licensed under the Act. For example, clause 429(a) appears to leave the door open for future regulations which regulate the operation of a wholesale derivative issuer's business. Such regulations would cut across what would otherwise be a clear distinction between offers to wholesale investors and offers to retail investors. Regulations under clause 429 should not result in "back door" regulation of wholesale derivative issuers. In addition, where regulation are being considered for licensed derivatives issuers under clause 429(a),

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		consideration should be given to existing regulatory requirements imposed on certain categories of derivatives issuers (such as registered banks under the RBNZ Act). Finally, we submit that regulations under paragraphs (b) to (e) will not be appropriate for derivatives issuers contracting as principal where they receive money/property in respect of amounts payable under the contract, or where legal title to the collateral is transferred to the derivatives issuer under an ISDA English law Credit Support Annex.
Part 7	Enforcement and liability	
Part 7	Enforcement and liability - general	<p>We have the following concerns with the liability regime under the FMBC:</p> <ul style="list-style-type: none"> (a) the significant uplift in penalties that go from a current maximum of \$1,000,000 under the SA to a maximum of \$5,000,000 under the FMBC is not warranted or justified; (b) penalties for Part 2 contraventions are disproportionately high compared to other regulated industry sectors and businesses governed by the FTA regime; (c) the significant increase in the number of civil remedy and Tier 1 criminal provisions for technical, non-material breaches is unduly punitive; and (d) the imposition of strict liability and removal of knowledge and material prejudice requirements is not justified. <p>In our view:</p> <ul style="list-style-type: none"> (a) It is not appropriate to make directors personally liable unless they have direct knowledge or involvement in the contravention. (b) The lack of knowledge requirement in many of these provisions and the absence of a materiality threshold (such as that previously set in section 55C of the SA and section 42T(1)(c) of the SMA) mean that issuers are at risk of litigation for a technical, non-material breach of the civil remedy provisions and/or criminal liability for any of the Tier 1 infringement provisions. (c) Although the infringement notice regime is intended to be similar to an (expensive) "speeding ticket", the ramification for participants in international markets, may be significant. (d) Litigation or an infringement notice under clause 474 must be disclosed in due diligence

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		<p>for offshore capital fundraising programmes. This could put entities at risk of being unable to raise funds from offshore markets.</p> <p>In response to these issues, we submit that:</p> <ul style="list-style-type: none"> (a) penalties must be reduced to align with penalties that apply to other regulated industry sectors; (b) for similar reasons, strict liability should apply to only a very limited number of offences; (d) the civil remedy and tier 1 criminal liabilities provisions should be revised so that they apply either only when the contravention is material or when the relevant person knew of the contravention; and (e) at a minimum, the Court should have regard to the state of mind of the person(s) involved in the contravention when determining a penalty at the request of the FMA.
431	Meaning of "contravene"	The definition of "contravene" should be exhaustive. The broad extension of civil liability currently proposed is inappropriate and will be likely to negatively impact on the quality and availability of directors and advisors.
433	When FMA may make stop orders	Please see the submission on clause 64. A materiality threshold should apply limit the circumstances where the FMA may make stop orders.
436	FMA may make interim stop order pending exercise of powers	<p>As currently drafted the FMA's power to make interim stop orders is too broad and would have a chilling effect on new offers. We note that:</p> <ul style="list-style-type: none"> • Under the current regime, the power to make interim stop orders is exercised by the Court and there are a number of protections for the offeror. such as the right to be notified and to be heard before the orders are made. No equivalent rights exist under clause 436 until after the interim stop order has been made. Similar rights should be given to offerors under the FMCB by providing that for example, the FMA's power is only exercisable after the expiry of a notice period. • the length of the "interim" period that is contemplated - up to 30 working days is excessive and would likely prejudice any ability to revive an offer subject to an interim stop order. We submit that the length of the interim order should be limited to a shorter period, for example, 48 hours.
456	When court may make pecuniary penalty orders	The threshold that there be a contravention caused material prejudice before pecuniary orders are made in

Clause Number	Clause heading	Submission
		section 42T of the SMA should be retained.
462	Terms of compensatory orders	<p>As noted in the submission on clause 64 above, the imposition of liability on underwriters is inappropriate and contrary to the development of a robust capital market in New Zealand.</p> <p>We note that no mention to underwriter liability was made in any consultation documents or policy documents released by the Cabinet. The policy basis for this significant change is therefore unclear.</p> <p>In New Zealand, underwriters rely on offer documents in underwriting offers and, when required, subscribing for the financial products that they underwrote. This is in sharp contrast with other jurisdictions where the underwriter assumes responsibility for the offer documents, performing due diligence and ensuring that the offer is successful. Imposing "underwriter liability" and requiring the underwriter to take responsibility for the offer document is unnecessary and would be contrary to market practice in New Zealand.</p> <p>The practical outcome of imposing underwriter liability is that the cost of underwritten offers will rise - for example, the due diligence process and PDS preparation will become more expensive as more parties (and advisors) will be involved. Much of that increase in compliance cost would be unnecessary. In addition, it would likely reduce the availability of underwriting.</p>
463	Person treated as suffering loss or damage in case of defective disclosure	We consider that the clause, as currently drafted, is problematic for a number of reasons. Most importantly, it does not permit an issuer to rebut the presumption by arguing that an investor did not rely on the defective disclosure, or that the defective disclosure did not cause loss or damage. The investor should be required to prove some element of causation between the loss or damage suffered and the defect.
462, 465 and 466	Terms of compensatory orders; Due diligence defence; General defences	<p>See submissions on clause 55.</p> <p>Clauses 462, 465 and 466 should be aligned with the Corporations Act, which imposes personal liability on a director if it can be established that the director was involved in the preparation of the offer document, or caused or contributed to the offer document being defective.</p>
478	Offence of knowingly or recklessly contravening prohibition on further offers where defective disclosure in PDS or register entry	It is inappropriate to treat indirect accessory liability under clauses 431(e) and (f) for a contravention as a tier 4 criminal offence without the accessory having actual knowledge of the contravention.

Clause Number	Clause heading	Submission
Part 8	Regulations and exemptions	
508	Miscellaneous provisions relating to regulations	Clause 508 provides for a broad power for the Minister to make regulations in consultation with the FMA that relate to different matters being "prescribed, prohibited, restricted, specified or required by regulations in respect of different kinds or classes of financial products, services, persons or other circumstances". The FMCB in general leaves much of the substantive requirements to be determined by regulation. This creates a risk that stakeholders and market participants will not be given the adequate ability to consider, in advance, any proposals for promulgation of new requirements by regulation.
515	FMA may make interim reclassification orders pending exercise of powers	Rights to be put on notice and to be heard do not exist under clause 515 until after the interim reclassification order has been made. The length of the interim period (up to 15 working days or longer by notice) creates uncertainty for holders and issuers of the relevant product and will impose excessive commercial costs.
554	Principal Act Amended	<p>Extensive notes are included in subpart 5 of Part 9 of the FMCB in relation to licensing for providers of DIMS, explaining the proposed licensing regime and the intended overlap with the FMCB and the FAA. It is not clear why financial service licences should be split across these two Acts and why there isn't simply a requirement that a provider of a DIMS be licensed in accordance with the FAA (particularly as that Act is to be amended to reflect the substantive requirements of licensees under the Act). In addition, this seems to ignore that some DIMS licensees may have obligations under the FAA. A split of the type currently contemplated by the FMCB will encourage regulatory arbitrage, something that seems undesirable.</p> <p>We also query whether another form of license ought to be required for registered banks and deposit takers, which are already subject to substantial regulation.</p>
Part 9 and schedule 4	Miscellaneous provisions	
570	Amendments to Trustee Company Act 1967 and Public Trust Act 2001	Restricting the use of group investment funds and preventing the making of a regulated offer of a managed investment product in a group investment fund appears contrary to the underlying intention of the FMCB (as reflected in clause 108). If this is the policy decision, appropriate transitional provisions should be included, as otherwise the FMCB could impose considerable compliance costs on existing GIFs.

Clause Number	Clause heading	Submission
Schedule 1	Provisions relating to when disclosure is required and exclusions	
Clause 4 of Schedule 1	Offers to close business associates	Close business associates should include trustee and beneficiaries along the lines set out in clause 5(2)(c) of Schedule 1
Clause 7 of Schedule 1	Offers of financial products through DIMS licensee	<p>Issuers should be subject to the usual disclosure requirements when issuing to a DIMS licensee. The DIMS licensee should not be required to pass such disclosure on to investors, but should be required to maintain a record of such disclosure, and to make investors aware that such disclosure is available for review. Otherwise the exception would incentivise issuers to issue through a DIMS licensee so that they are not required to disclose in accordance with Part 3 of the FMCB.</p> <p>Clause 7 should also apply to advisers offering discretionary investment management services in accordance with the FAA.</p>
Clause 8 of Schedule 1	Offers under employee share purchase schemes	It should not be necessary for an offer to be separate from any other offer of equity securities by the issuer in order for this clause to apply. The conditions of the clause should be revised to make it clear that other contemporaneous capital raisings will not invalidate an issuer's reliance on this exemption.
Clause 28 of Schedule 1	Sale where financial products issued with view to original subscriber dealing with products	<p>Clause 28 should only operate where the purpose of the issue and then resale (rather than simply an issue) is to attempt to avoid the disclosure requirements of the FMCB. As it is currently drafted the provision is too ambiguous and too broad. Most securities are by design intended to facilitate liquidity and on-selling, which would provide grounds for concluding that the products were issued with the view for the original subscriber dealing with the product. In practice, this clause would require every issue of non-regulated products to include express selling restrictions.</p> <p>In addition, under clause 28, a shorter six month period would be appropriate. This is consistent with overseas practice, for example under rule 144 of the US Securities Act 1933.</p>
Clause 34 of Schedule 1	Investment activity criteria	Careful consideration should be given to the "investment activity criteria" in subclauses of clause 34 (b) and (e) of schedule 1 as it may in some circumstances capture unsophisticated investors. In some circumstances capture unsophisticated investors who would not qualify as "eligible" under either the FAA or fall within current exemptions under the SA. Consideration should be given to revising these provisions to ensure the FMCB provides adequate

Clause Number	Clause heading	Submission
		consumer protection.
Clause 37 of Schedule 1	Eligible investors	This clause requires an authorised financial adviser to sign a written confirmation of the certification relating to eligible investors. In contrast, section 5D of the FAA contemplates financial advisers, QFE or brokers signing the written confirmation of the certification. This appears to be an oversight and it is submitted that clause 37 should be consistent with section 5D of the FAA.