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### OFFICE OF THE MINISTER OF COMMERCE AND CONSUMER AFFAIRS

Chair  
Cabinet Economic Growth and Infrastructure Committee

## Amendments to the Financial Markets Conduct Regulations 2014

### Proposal

- 1 This paper seeks policy decisions for amendment regulations to provide minor changes and improvements to the Financial Markets Conduct Regulations 2014 (FMC Regulations) in respect of managed investment schemes, Crown and bank limited disclosure, and a number of other obligations.

### Executive Summary

- 2 The Financial Markets Conduct Act 2013 (FMC Act) significantly reformed securities laws with the aim of increasing investor confidence and improving access to capital for businesses to grow.
- 3 Implementing the FMC Act reforms is a key part of the Government's Business Growth Agenda.
- 4 The FMC Act came into force on 1 December 2014. There is a two-year transition period ending on 30 November 2016 before all industry participants are required to fully comply with the Financial Markets Conduct (FMC) regime. Providers of some types of products were required to transition earlier and are already operating under the new regime.
- 5 As expected given the size and complexity of the regime, technical issues have emerged as many participants prepare to fully transition into the FMC regime and others begin operating under the new requirements. Some issues were addressed in amendment regulations made in 2015 and in May 2016.
- 6 This paper seeks policy approval for further minor changes, primarily to tailor specific aspects of the regime to particular non-standard circumstances and to adjust certain details of the regime where technical issues have emerged in practice.
- 7 The proposed amendments aim to reduce compliance costs, while maintaining investor confidence and investor information. The changes are largely in response to issues raised by the industry or the regulator.
- 8 The proposed changes include:
  - 8.1 allowing superannuation schemes closed to new members to provide fund updates annually rather than quarterly;
  - 8.2 removing the requirement for superannuation master trust providers to upload employer-specific disclosure documents to the public offers register (but still requiring them to be provided to employee investors);

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- 8.3 allowing superannuation scheme providers to offer schemes that comply with rules set by the United Kingdom (UK) so that transfers from UK pension plans are able to be made without attracting an additional tax assessment;
- 8.4 clarifying the definition and criteria of “New Zealand fixed interest” for the purpose of managed fund disclosure so that it includes debt securities that are connected to New Zealand, for example, by being price sensitive to New Zealand market factors;
- 8.5 providing that the offeror of a Crown-issued financial product is responsible for providing disclosure, but that the Crown is responsible for ensuring the disclosure document is compliant with the FMC Act and Regulations;
- 8.6 allowing the trust deed of a credit union or building society to specify the quorum threshold and override a default 25 percent quorum threshold; and
- 8.7 a number of other more minor and technical changes.

### Background

- 9 The FMC Act significantly reformed the laws governing how financial products are offered and the responsibilities of those who deal in financial products. The FMC Act seeks to increase investor confidence and improve access to capital for businesses to grow.
- 10 Implementing the FMC Act reforms is a key part of the investment work stream of the Government’s Business Growth Agenda.
- 11 The FMC Act came into force on 1 December 2014. There is a two-year transition period ending on 30 November 2016 before all industry participants are required to fully comply with the FMC regime. Providers of some types of products were required to transition earlier and are already operating under the new regime.
- 12 As expected given the size of the reforms, a number of technical issues have emerged as many participants prepare to fully transition into the FMC regime and others begin operating under the new requirements. The Ministry of Business, Innovation and Employment is taking a ‘living system’ approach to the FMC regime. This involves an ongoing programme actively monitoring and engaging with stakeholders on the legislation, and responding to implementation issues.
- 13 Some issues were addressed in amendment regulations made in 2015 and in May 2016 [LEG-16-Min-0068 and LEG-15-Min-0054 refers].

### Comment

- 14 This paper proposes changes to the FMC Regulations, primarily to tailor specific aspects of the regime to particular non-standard circumstances and to adjust certain details of the regime where technical issues have emerged in practice. The changes are largely being made in response to issues raised by industry and/or the Financial Markets Authority (the FMA) and are aimed at reducing compliance costs for businesses, while maintaining investor confidence and investor information. The proposed changes are set out below.

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### Managed investment schemes

#### *Reducing disclosure obligations where there would be limited benefits for investors*

- 15 The FMC Regulations prescribe the manner and content of disclosure that must be provided in relation to managed investment schemes both at the point of sale and periodically on an ongoing basis.
- 16 I propose to amend two specific disclosure obligations in order to reduce compliance costs in particular non-standard situations. Specifically, I propose that:
- 16.1 superannuation or workplace savings schemes (or parts of such schemes) which are closed to new members at the time of their registration and which remain closed be required to provide fund updates annually rather than quarterly and be subject to the same register entry requirements as “restricted schemes”. This applies the same disclosure obligations to closed schemes regardless of whether they have chosen to register as restricted schemes or not; and
- 16.2 providers of superannuation master trust schemes should not be required to upload employer-specific Product Disclosure Statement (PDS) supplements to the public Disclose Register. The supplements are not useful to the wider public who cannot join the scheme and would potentially include confidential information. They must still be provided to employees who are eligible to join the scheme.

#### *Amending superannuation scheme rules to allow ROPS compliant schemes*

- 17 Superannuation schemes, which are open to new members, must comply with the rules set out in the FMC Regulations. These rules are intended to ensure that superannuation schemes are robust and are legitimate retirement savings schemes. The rules include, for example:
- 17.1 a lock-in of funds until the participant reaches the New Zealand superannuation qualification age, or 5 years earlier in cases of permanent retirement;
- 17.2 permitted withdrawal in cases of serious illness; and
- 17.3 permitted withdrawal in cases of significant financial hardship, up to the value permitted by the relevant governing document.
- 18 Some superannuation scheme providers would like to offer schemes that comply with Recognised Overseas Pension Scheme (ROPS) requirements set by the UK Government. These schemes are able to receive transfers from UK registered pension plans without attracting an additional tax assessment.
- 19 When the rules for superannuation schemes were included in the FMC Regulations, it was intended that they would allow schemes that comply with ROPS requirements to be established.
- 20 However, in April 2015, the UK Government made changes to the rules and introduced an age based rule. This rule precludes providers from releasing funds before the UK retirement age (55 years), except in cases of serious illness.

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- 21 A number of superannuation scheme providers, who would like to offer a ROPS compliant scheme, are concerned that this is not possible under the FMC Regulations, due to the rule permitting withdrawal in cases of significant financial hardship.
- 22 I therefore propose amending the FMC Regulations to ensure that the rules accommodate providers offering schemes that comply with the ROPS requirements.

### *Clarifying the “New Zealand fixed interest” category for managed fund disclosure*

- 23 Retail investors in managed investment schemes, such as KiwiSaver, receive quarterly fund updates about the performance of their fund, which includes information on the composition of the fund based on categories of assets (e.g. debt or equity). Some of these categories also include a geographical component (e.g. New Zealand fixed interest and international fixed interest).
- 24 There is some confusion in the industry about the scope of the definition of “New Zealand fixed interest”, particularly relating to whether certain types of fixed interest debt securities fit within this category. There is a risk that this will lead to different classifications by issuers, reducing useful comparison across funds.
- 25 Arguably, the definition does not include some debt securities that industry currently classifies as New Zealand fixed interest. Fund managers consider that “New Zealand fixed interest” includes debt products that are price sensitive to New Zealand market factors, such as New Zealand’s yield curve and credit spread.
- 26 I propose to amend the definition of “New Zealand fixed interest” to provide clarity to industry and ensure that it includes debt securities that are connected to New Zealand, for example, by being sensitive to New Zealand market factors. Officials will work with the FMA and industry on the details of the amendments, and criteria to determine a connection to New Zealand.

### **Limited disclosure regime**

#### *Clarifying obligations under the limited disclosure regime*

- 27 The FMC Act provides that certain offers of financial products are not subject to the general requirements (such as disclosure and governance) of the FMC regime. This includes certain bank debt products and Crown-issued financial products.
- 28 The FMC Regulations instead require a limited disclosure document when these products are provided to retail investors, and special rules apply where the issuer and the offeror to retail investors may be different entities. However, the regulations currently impose some responsibilities that do not sit with the appropriate entity, or are not required.
- 29 I therefore propose to amend the regulations:
- 29.1 to provide a mechanism whereby the offeror of Crown-issued financial products is responsible for providing disclosure (as it currently is), but that the Crown is responsible for ensuring the disclosure document is compliant with the FMC Act and Regulations. This is because the Crown is the most appropriate entity to produce a compliant limited disclosure document. It also aligns with the position

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for financial products which are regulated by the general FMC requirements when those products are sold by an intermediary;

29.2 to clarify that the obligations to check a bank's compliance with their disclosure obligations at point of sale, which apply to an "offeror" for bank debt products, is limited to intermediaries on-selling to retail investors. These obligations inadvertently apply to a retail investor when they on-sell to other retail investors, and should not apply because an intermediary will already have checked the bank's compliance with its disclosure obligations; and

29.3 *[withheld under section 9(2)(f)(iv) of the Official Information Act 1982]*

### Other obligations

#### *Allowing the trust deed for credit unions to set quorum requirements*

- 30 The FMC Regulations require the trust deed of credit unions to set quorum requirements for voting on special resolutions, which must be no less than 25 percent of members. If the quorum is not met, a second meeting can be organised for ten days after the first and the members that are present after 30 minutes are sufficient for the quorum.
- 31 The purpose of the quorum requirements is to ensure sufficient member representation in passing special resolutions that affect members' rights. Requiring a second meeting was thought to be the best way to maximise member participation where quorum was not achieved, even though a second meeting would cause compliance cost.
- 32 However, new information about voting structures and participation levels show that credit unions (which have one member and one vote) and building societies (which are not closely held and members are geographically spread) will rarely achieve the 25 percent threshold, and will mostly rely on the second chance provision. This results in a two-step meeting process that is significantly more onerous and costly than estimated when the regulations were developed.
- 33 I propose to amend and streamline the quorum regulations for credit unions and building societies, by allowing the trust deed to specify the quorum threshold and override the minimum 25 percent threshold. Streamlining the quorum requirements this way removes the need to rely on a second meeting, and reduces the cost for credit unions to make commercial decisions. I note that trust deeds will continue to require investors to be notified of, and to receive an outline of special resolution's substance, to alert members and encourage their participation.
- 34 The proposal allows credit unions and building societies to work with their supervisors to develop quorum thresholds, with consideration of the voting structures and participation levels that these entities experience, to ensure sufficient representation by members in passing matters that affect their rights. While this may mean it takes a lower number of members to achieve a quorum for some credit unions and building societies, this proposal would be an improvement from the status quo; if only one member turned up at the second meeting that would be deemed a quorum.

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- 35 When the Ministry of Business, Innovation and Employment carried out a targeted consultation on this issue, Co-op Money (a representative industry body) suggested providing additional flexibility by enabling the “rules” of credit unions and building societies to set the quorum requirement. However, the FMC framework emphasises strong governance processes, and I consider that the trust deed is the best place to set out the quorum requirements. Further, it gives supervisors a central role in developing the quorum requirements.

### *Other miscellaneous changes*

- 36 I also propose some other minor technical changes to the FMC Regulations:
- 36.1 Some entities are currently unable to issue a PDS immediately after their most recent accounting period before they have completed their audited financial statements for that period. I propose that in the four months before it is required to complete audited financial statements, an entity be allowed to issue a PDS using its most recently prepared financial statements and interim financial information instead (subject to testing the feasibility and detail of the proposed solution with the FMA and representatives of affected industry participants). This is consistent with the position under the previous Securities Act 1978 regime.
- 36.2 I propose that the financial information requirements in relation to businesses acquired by the issuer be clarified, particularly in relation to issuers that have acquired the assets of a business rather than shares (subject to testing the feasibility and detail of the proposed solution with the FMA and representatives of affected industry participants). The regulations should clarify that the periods covered in the acquired business’ financial information should broadly correspond with the periods covered in the issuer’s financial information.
- 36.3 *[withheld under section 9(2)(f)(iv) of the Official Information Act 1982 ]*
- 36.4 Derivative issuers must hold and safeguard investor money and assets, to reduce the exposure of clients to risks of loss if the issuer fails. The application of these custody arrangements may apply more broadly than necessary to protect derivative investors. I propose to clarify the territorial scope for these custody arrangements and the types of transactions that they should apply to.
- 36.5 Providers of Discretionary Investment Management Services (DIMS) are required to give an investment proposal to a potential investor. The practical consequence of the current requirement for providers to create an investment proposal, containing certain information at a “stated date”, is that they are either creating two investment proposals per year, or they have a period of time (for example, a month) where they do not have a valid investment proposal to provide to potential investors. I propose to amend the regulations to ensure that a DIMS provider is only required to create one investment proposal per year.

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- 36.6 I propose to amend the annual reporting requirements for DIMS providers, to require them to give an explanation of the nature of the assets that they include in the “other” category in the pie graph setting out the composition of financial products in the investor’s portfolio. Currently, when a DIMS provider invests in a “diversified fund”, for example, this is included in “other” with no further information.

### *Other matters*

- 37 Industry are continuing to identify further issues as they prepare to transition into the FMC regime before the 30 November 2016 deadline. Regulation changes may be required to address issues that have not yet been identified. To address any such issues in an expedient manner prior to the end of the transition period, I seek your agreement to delegate authority to me to make decisions on any minor policy issues that arise before 30 November 2016 provided they are consistent with the policy frameworks previously agreed by Cabinet in relation to the FMC Act and FMC Regulations.

### **Consultation**

- 38 The FMA, the Treasury, the Reserve Bank and Inland Revenue have been consulted on this Cabinet paper. The Department of the Prime Minister and Cabinet has been informed.
- 39 Officials have consulted with the FMA and representatives of affected parties in relation to the content of the proposed regulations. Groups consulted include fund managers, banks, credit unions, trustees, law firms, and/or their representatives. The changes are largely in response to issues raised by the industry or the regulator.
- 40 Officials will continue to engage with stakeholders during the drafting process in order to refine the details of the regulations.

### **Financial Implications**

- 41 There are no financial implications from the creation of these regulations.

### **Human Rights**

- 42 There are no inconsistencies between the proposals in this paper and the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993. There are no gender or disability perspective implications from the proposals in this paper.

### **Legislative Implications**

- 43 Regulations will be prepared in accordance with the Financial Markets Conduct Act 2013.

### **Regulatory Impact Analysis**

- 44 The Regulatory Impact Analysis Team at the Treasury has advised that a Regulatory Impact Statement (RIS) is not required for the proposed changes because of their minor or technical nature.

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### Publicity

- 45 The Ministry of Business, Innovation and Employment will communicate these policy changes to representatives of affected stakeholders.

### Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

- 1 **note** that implementing the Financial Markets Conduct Act reforms is a key part of the Government's Business Growth Agenda;
- 2 **note** that in June 2013 the Cabinet Business Committee and in July 2014 the Economic Growth and Infrastructure Committee agreed to the regulations needed to implement the Financial Markets Conduct Act 2013 (FMC Act) [CBC Min (13) 4/6, EGI Min (14) 16/9 refer];

### Managed investment schemes

- 3 **agree** that superannuation or workplace savings schemes (or parts of such schemes) which are closed to new members be required to provide fund updates annually rather than quarterly and be subject to the same register entry requirements as restricted schemes;
- 4 **agree** that employer-specific supplements to Product Disclosure Statements will not be required to be uploaded to the public offers register;
- 5 **agree** that superannuation scheme providers are able to offer schemes that comply with Recognised Overseas Pension Schemes rules that are set by the UK Government;
- 6 **agree** to clarify the definition and criteria of "New Zealand fixed interest" for the purpose of managed fund disclosure so that it includes debt securities that are connected to New Zealand, for example, by being price sensitive to New Zealand market factors;

### Limited disclosure requirements

- 7 **agree** to provide that the offeror of a Crown-issued financial product is responsible for providing disclosure, but that the Crown is responsible for ensuring the disclosure document is compliant with the FMC Act and Regulations;
- 8 **agree** to clarify that the offeror's obligations to check a bank's compliance with their disclosure obligations for bank debt products is limited to intermediaries on-selling to retail, and does not apply when a retail investor on-sells to other retail investors;
- 9 *[withheld under section 9(2)(f)(iv) of the Official Information Act 1982]*

### Other obligations

- 10 **agree** to allow the trust deed of a credit union or building society to specify the quorum threshold and override a default 25 percent threshold required by the regulations;



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- 11 **agree** to allow an entity to use its most recently prepared financial statements and interim financial information where it wishes to issue a Product Disclosure Statement in the period before it is required to complete audited financial statements for its most recent year (subject to testing the feasibility and detail of the proposed solution);
- 12 **agree** to clarify the financial information requirements for acquired businesses so that the periods covered in the acquired business' financial information should broadly correspond with the periods covered in the issuer's financial information (subject to testing the feasibility and detail of the proposed solution);
- 13 *[withheld under section 9(2)(f)(iv) of the Official Information Act 1982]*
- 14 **agree** to clarify the territorial scope for custody obligations for derivatives issuers so that they do not apply more broadly than necessary to protect derivatives investors;
- 15 **agree** to amend the investment proposal requirements for Discretionary Investment Management Services providers so that they are not required to create more than one investment proposal per year;
- 16 **agree** to require Discretionary Investment Management Services providers to explain in their disclosure document, the nature of the assets included in the "other" category of investments if they invest in diversified funds;

### Regulations

- 17 **invite** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to draft regulations to give effect to the decisions in this paper;
- 18 **authorise** the Minister of Commerce and Consumer Affairs to make further decisions, consistent with the policy frameworks agreed by Cabinet in relation to the Financial Markets Conduct Act and Regulations, in relation to any other minor or technical policy issues that arise prior to 30 November 2016.

Authorised for lodgement  
Hon Paul Goldsmith  
Minister of Commerce and Consumer Affairs