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**OFFICE OF THE MINISTER
OF COMMERCE**

The Chair

Cabinet Economic Growth and Infrastructure Committee

Regulatory Systems Bill - Commerce & Consumer Affairs issues

Proposal

- 1 This paper seeks approval for about 30 amendments to nine Commerce portfolio Acts and one Consumer Affairs portfolio Act to be included in the Regulatory Systems Bill.

Executive Summary

- 2 The Regulatory Systems Bill will be an omnibus bill to improve statutes that affect businesses and housing regulatory systems. Other Ministry of Business, Innovation and Employment ministers have submitted papers to this meeting seeking decisions for other matters to be included in the Bill. Although the changes to individual statutes do not warrant stand-alone bills, together the changes will make a significant difference.
- 3 From the Commerce and Consumer Affairs perspectives, I am seeking approval for changes to financial sector, corporate governance, insolvency, competition and consumer law statutes, along with the repeal of some redundant enactments. Those changes are aimed at enhancing the business environment, improving regulatory systems and removing redundant provisions. The three relatively significant proposals are discussed below.
- 4 First, I propose that provisions in insolvency legislation that allow financial transactions under a netting agreement between a company that is in liquidation or administration or a person in bankruptcy and another person to be set-off against each other also be available to trusts. These 'netting' provisions benefit both parties to the agreement because they reduce counterparty risks and the amount of capital that banks are required to hold under prudential supervision rules. However, it is uncertain whether these provisions apply to trusts. This means that the bank's capital adequacy ratio must cover the gross, not the net amount for trusts. This unnecessarily increases banks' costs, which are passed onto trust customers. The Companies Act and Insolvency Act should be amended to make it clear that the netting provisions apply to trusts.
- 5 Second, I propose amendments to the Insolvency Act that would provide the Official Assignee (OA) with the standing to apply to the court to challenge the validity of a trust. This change, which was recommended by the Law Commission, will increase creditors' protections from sham structures by allowing the OA to claw back payments and asset transfers to trusts prior to entry into bankruptcy. The change is needed to bring the law in future back to what it was prior to a widely criticised Court of Appeal decision made in 2007.
- 6 Third, I propose that the Takeovers Panel be given the power to adjudicate expense claims that result from an unsuccessful takeover attempt. At present, such disputes need to go to the High Court. This can be expensive and time consuming.

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Background

- 7 The purpose of the Regulatory Systems Bill is to bring together a collection of amendments that will improve several statutes. The amendments are relatively uncontroversial changes to deal with issues that inhibit the efficiency and effectiveness of regulatory systems. Dealing with these issues through the Regulatory Systems Bill will reduce the risks of systemic regulatory problems. Other benefits include reducing compliance for business, aligning the law across different classes of entity and streamlining regulatory systems.
- 8 The Commerce and Consumer Affairs Acts that will be affected by the proposals in this paper comprise:
 - a. *Corporate governance*: Companies Act, Friendly Societies and Credit Unions Act, and Takeovers Act
 - b. *Financial sector*: Building Societies Act, Financial Advisers Act, Financial Markets Authority Act, Financial Markets Conduct Act and New Zealand Superannuation and Retirement Income Act 2001
 - c. *Competition and consumer*: Commerce Act and Fair Trading Act
 - d. *Insolvency*: Companies Act and Insolvency Act.
- 9 The problems associated with these Acts do not warrant stand-alone Bills. This is evidenced by the fact that some of the amendments could have been made years ago had the opportunity arisen. The net benefits of the changes across all portfolios taken together are sufficient to justify having a bill.
- 10 My three main Commerce-related proposals are summarised below.

Netting rules under the Companies Act and Insolvency Act

- 11 When a company or other entity goes into liquidation or voluntary administration, the Companies Act provides that financial transactions between the insolvent entity and another party can be “set-off” if there is a formal netting agreement between them. There are similar provisions in relation to personal bankruptcy in the Insolvency Act. The effect is that amounts payable by or to each party are the net debit or credit respectively. That net balance becomes the amount that may be claimed or payable in the final tallying up of the assets of the insolvent entity. For example, if A owes B \$100 dollars and B owes A \$60 the gross amount is \$160 (being the sum of the two amounts) but the net amount is only \$40 (being the difference between the two amounts). A only has to pay B \$40 under a netting agreement and B pays nothing.
- 12 Netting agreements confer significant benefits for financial market participants because they reduce the amount of exposures between participants. This in turn reduces systemic risk because there is less likelihood that the failure of one participant will lead to the failure of another.
- 13 Banks are significant users of netting agreements. Those agreements reduce the amount of capital banks are required to hold by the Reserve Bank for prudential supervision purposes. There is sufficient certainty in the Companies Act and the Insolvency Act for a counterparty which is a company or an individual to obtain these benefits. However, it is not completely certain that the provisions apply where the arrangements is with a trust. This means that the bank must hold sufficient capital based on the gross, not the net amount where the counterparty is a trust. The additional capital charges are passed onto the trust when the risk is generally the same as for a company.

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- 14 I am proposing amendments that will mean that trusts will be able to obtain the benefits that companies and individuals can already obtain under the netting rules.

Sham structures under the Insolvency Act

- 15 Modern insolvency law is founded on the idea that it is better for society as a whole to write off the difference between what a debtor owes and what can reasonably be paid. This provides the debtor with the opportunity to make a fresh start. The bargain that the law strikes for providing the fresh start is that, with limited exceptions, the person's property becomes available to be realised and distributed to creditors.
- 16 The Acts governing insolvency include protections against debtors who dispose of property for inadequate or no consideration prior to bankruptcy. Asset transfers and payments made prior to the formal insolvency procedure can be 'clawed back' for transactions dating back five years in the case of gifts and two years where it is alleged that there was inadequate consideration.
- 17 The problem that needs to be corrected relates to personal bankruptcy under the Insolvency Act 1996. Prior to the Court of Appeal's decision in *Official Assignee v Wilson* in 2007, it was commonly understood that the Official Assignee (OA) was able to allege sham structures whether or not the bankrupt could have done so. However, the Court held that the OA could not challenge a trust structure if the bankrupt himself could not have challenged it. The Court stated that the bankrupt, having established the trust, could not in future claim that they never intended to establish it. Therefore, the OA could not challenge it either because he was standing in for the bankrupt.
- 18 This decision has been criticised by several commentators, the New Zealand Law Society and the Law Commission. They state that the position of the OA is not to be equated with the position of the bankrupt for all purposes. It ought to be open to the OA to claim that third parties hold property on trust for the bankrupt estate. Therefore, the OA should be permitted to apply to the court for relief in the interests of the person's creditors.
- 19 I agree. The *Wilson* decision has made it relatively easy for debtors to hide assets from their creditors. An individual can transfer assets to a trust structure under which the assets are supposedly being held in trust for the beneficiaries, when in reality they are being held for the benefit of the settlor. The settlor then enters bankruptcy, but under *Wilson*, the OA is unable to test whether the assets are in fact the bankrupt's property.
- 20 As recommended by the Law Commission in its 2013 report *Review of the Law of Trusts*, there is a need to legislate to allow the OA to apply to the court to challenge the validity of a trust regardless of whether the bankrupt could have done so before bankruptcy. This change will allow the OA to challenge trust structures that are allegedly being used to shield against the payment of debts. Without the change, creditors of bankrupts are potentially being deprived of substantial amounts of money.
- 21 The change will not have any impact on the vast majority of the hundreds of thousands of trusts in New Zealand [redacted] * [redacted] In addition, it will not affect corporate insolvencies under the Companies Act 1993 as the proposed change only relates to personal bankruptcies under the Insolvency Act 1996.

Disputes about expenses under the Takeovers Code

- 22 The Takeovers Act 1993 sets out the framework for takeovers regulation. The detailed requirements appear in the Takeovers Code which is enforced by the Takeovers Panel.

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The Code governs takeover transactions affecting companies listed on a registered exchange or with 50 or more shareholders and share parcels. The purpose of the Code is to protect the rights of shareholders of the target company.

- 23 Rule 49 of the Code enables target companies to recover from the offeror their properly-incurred takeover-related expenses as a debt due where the offer has failed. The purpose of this rule is to discourage vexatious or ill-conceived bids, particularly because of the disruptive effect that a hostile takeover offer can have on the target company.
- 24 The Panel previously thought that it had the power to adjudicate rule 49 disputes. However, in 2010 the High Court ruled that the Panel did not have the necessary jurisdiction. This means that any such disputes must be taken to the Court. This process can be expensive and time-consuming. Cases must be prioritised alongside other court business, and decided according to formal procedural requirements, which can affect timeliness. In the only rule 49 proceedings to date that got close to being heard by a court, an out-of-court settlement was reached five years after the takeover offer failed, just before the court hearing was due to take place.
- 25 I am proposing that the Takeovers Act be amended to grant jurisdiction to the Panel to consider Code company takeover expense disputes. The Panel is the expert quasi-judicial specialist body in this area. Panel members are experienced market participants who understand the procedural and commercial dynamics faced by Code companies. In addition, the Panel is accustomed to making timely and cost-effective decisions. Granting jurisdiction to the Panel will significantly speed up proceedings and reduce the cost of resolving expense-related disputes. It will be necessary to move rule 49 from the Code to the Takeovers Act to give effect to this change.
- 26 I am also recommending two other changes. First, decisions of the Panel should be appealable. This approach would be consistent with the Legislation Advisory Committee's Guidelines.
- 27 Second, I also recommend that the Takeovers Act should provide for the enforcement of the Panel's expenses decisions as judgments of either the District or High Court, depending on the amount of the expense award. This would help ensure compliance with Panel decisions.

Other proposed Commerce and Consumer Affairs amendments

- 28 I am also proposing 28 minor and technical amendments to ten statutes. Those changes and the reasons for proposing them are summarised in Annex 1.

Consultation

- 29 The Ministry of Justice, Inland Revenue, Reserve Bank, Retirement Commissioner and Treasury were consulted on this paper. The Department of the Prime Minister and Cabinet was informed.

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Financial Implications

30 There are no financial implications.

Human Rights

31 There are no adverse human rights implications. Item 26 in Annex 1 will improve privacy outcomes.

Legislative Implications

32 Under the 2014 Legislation Programme, the Regulatory Systems Bill has a category 5: to be referred to a select committee in 2014. The intention is that drafting instructions will be provided to Parliamentary Counsel Office by 30 June. The Bill would be ready for introduction after the General Election.

Regulatory Impact Analysis

33 The General Manager, Strategic Policy Branch and the Ministry of Business, Innovation and Employment Regulatory Impact Analysis Review Panel have reviewed the attached Regulatory Impact Statement (RIS) prepared by the Ministry of Business, Innovation and Employment. They consider that the information and analysis summarised in the RIS meets the criteria necessary for ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper.

Omitted

Recommendations

I recommend that the Committee:

Policy issues

- 1 **Note** that the Regulatory Systems Bill is an omnibus Bill that will improve several regulatory systems under legislation administered by the Ministry of Business, Innovation and Employment;
- 2 **Agree** that the following Commerce and Consumer Affairs portfolio changes be included in the Regulatory Systems Bill:
 - 2.1 Amend the Companies Act and Insolvency Act so that it is certain that trusts are able to obtain the benefits available to companies and individuals under the netting provisions in those Acts;
 - 2.2 Amend the Insolvency Act 2006 to provide that the Official Assignee with the power to apply to the court to challenge the validity of a trust regardless of whether the bankrupt could have done so prior to the bankruptcy;
 - 2.3 Transfer jurisdiction for resolving expense disputes relating to failed takeover offers made under the Takeovers Code from the courts to the Takeovers Panel;
 - 2.4 The minor and technical changes described in Annex 1 of this paper;

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- 3 **Note** that other Ministers have submitted proposals for other changes to be included in the Regulatory Systems Bill;

Legislative implications

- 4 **Note** that the Regulatory Systems Bill has a category 6 priority (to be referred to a select committee in 2014);
- 5 **Note** that the Regulatory Systems Bill is the responsibility of the Minister for Economic Development;
- 6 **Invite** the Minister for Economic Development to issue drafting instructions to Parliamentary Counsel Office in relation to the Commerce and Consumer Affairs portfolio changes to be included in the Regulatory Systems Bill;

Publicity

- 7 **Authorise** the Ministry of Business, Innovation and Employment to place this paper on its website;
- 8 **Note** that the Minister of Commerce will issue a media statement in relation to the credit union changes detailed in Table 8 of Annex 1; and

Omitted

Hon Craig Foss
Minister of Commerce

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Annex 1: Minor and technical changes

Table 1: Building Societies Act 1965

No. 1: Replace the requirement for two directors to sign the annual return with a requirement for it to be signed by a director, or by a solicitor or chartered accountant authorised for that purpose.
Reason: This approach, which is used in the Companies Act, better reflects commercial reality.
Benefits: Reduces compliance costs.
Costs: Nil.
No. 2: Remove requirement to include information about shares summaries, capital shareholders, share transfers and bonus ballots in the annual return.
Reason: There has been no value in disclosing this information since 1 December 2010, which is when the prudential supervision regime that applies to credit unions under the Reserve Bank of New Zealand Act 1989 came into force.
Benefits: Removes unnecessary compliance.
Costs: Nil.

Table 2: Commerce Act 1986

No. 3: Repeal a section that refers to the Evidence Amendment Act 1980.
Reason: The references are outdated and incorrect due to the Trans-Tasman Proceedings Act 2010.
Benefits: Improves legal clarity.
Costs: Nil.
No. 4: Replace an annual levy setting collection and wash-up cycle with a multi-year cycle.
Reason: Parliamentary Counsel Office has advised that this change is needed to be consistent with a recent Cabinet decision to move the Commerce Commission to a multi-year appropriation structure.
Benefits: Removes any risk of unlawful appropriations.
Costs: Nil.
No 5: State that lay members of the High Court are only required for cases that are appeals against Commerce Commission determinations.
Reason: This change will remove a contradiction between two sections about whether a lay member is necessary to constitute a sitting of the court in all or only some cases.
Benefits: Improves legal clarity.
Costs: Nil.

Table 3: Companies Act 1993

No. 6: Provide Registrar with the power to remove a company from the overseas company register if it has ceased to carry on business in New Zealand.
Reason: There is no need for the overseas company to appear on the register.
Benefits: Increases the integrity and accuracy of the register.
Costs: Minor administrative costs associated with the removal process.
No 7: The Act requires the Registrar to be notified of variations to compromises with creditors made under the Companies Act, but not variations of other compromises. Add a requirement to notify the Registrar of variations to other compromises.
Reason: Placing the variations on the register provides useful information to creditors about future payments to them.
Benefits: Increases transparency.
Costs: A small cost associated with filing the additional information.
No 8: As is already the case for a large company with one or more subsidiaries, remove requirement

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for a large company with no subsidiaries to prepare entity financial statements if it is a subsidiary of a body corporate registered in New Zealand that is required to prepare group financial statements.
Reason: The group's internal administrative and structural arrangements should not have any impact on the company's reporting obligations. Users most need the group financial statements because they report on the financial position, financial performance and cash flows in relation to all of the resources under the entity's control.
Benefits: Avoids the inconvenience of registering a subsidiary to be eligible for the exemption.
Costs: Nil.
No 9: Clarify netting provisions to address five process uncertainties and anomalies.
Reason: The netting provisions are not consistent across all situations where these agreements are used.
Benefits: Increases legal certainty.
Costs: Nil.
No 10: Remove the requirement for listed companies to notify shareholders of financial assistance given to shareholders to acquire shares.
Reason: Consistent with the continuous disclosure requirements in securities legislation, listed companies should notify the licensed market to which they belong, not shareholders.
Benefits: Reduced costs for listed companies.
Costs: Nil.
No 11: In relation to company liquidations, change the requirement for making the Order in Council that makes an index-linked change every three years to the maximum dollar employee priority payment from 3 to 4 months after the end of the adjustment period.
Reason: The 28 day rule is invariably waived because Statistics New Zealand does not publish the relevant index information until about half way through the 3 month period. It is impractical to complete the drafting of the order, obtain cabinet approval and provide time for the Governor-General to sign the order in the remaining 2 or 3 weeks before the start of the 28 days.
Benefits: Stakeholders receive adequate forewarning of the adjustments.
Costs: Nil.

Table 4: Fair Trading Act 1986

No. 12: Align definition of 'financial services' with definition in the Financial Markets Conduct Act.
Reason: Ensure consistency between regimes.
Benefits: Increases clarity about the split of regulatory responsibilities between the Commerce Commission and Financial Markets Authority (FMA).
Costs: Nil.

Table 5: Financial Advisers Act 2008

No. 13: Clarify that where a person (A) acts on behalf of the business of another person (B), that while B has the liability for A's obligations, A is still the person required to meet these obligations.
Reason: To protect B's interests.
Benefits: Creates certainty for A, B and third parties.
Costs: Nil.
No. 14: Narrow the definition of 'acting on behalf of the business of another person' so that it does not transfer liability to a person who is arranging a service on a client's behalf.
Reason: The law is confusing.
Benefits: Creates legal certainty for all parties.
Costs: Nil.
No 15: State that fines are recoverable as a debt to the High Court.

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Reason: Provides the FMA with an effective means to recover fines.
Benefits: Reduces the cost of collecting fines.
Costs: Nil.

Table 6: Financial Markets Authority Act 2011

No. 16: Add the Secret Commissions Act 1910 to the list of financial markets legislation in Part B of Schedule 1.
Reason: The Secret Commissions Act prohibits (i) gifts or other consideration as an inducement or reward for acting or not acting in relation to their principal's affairs or business, and (ii) showing favour or disfavour to any person in relation to their principal's affairs or business. This conduct is relevant in relation to financial markets participants and overlaps with other Acts enforced by the FMA.
Benefits: Facilitates FMA's investigation and prosecution of contraventions by financial markets participants while not affecting enforcement by other agencies.
Costs: Nil.

Table 7: Financial Markets Conduct Act 2013

No. 17: Make minor changes to approximately 10 sections to (i) shift some matters currently dealt with in the regulations into the Act or vice versa and (ii) clarify relationship between Act and regulations.
Reason: Removes minor inconsistencies between the primary and secondary legislation.
Benefits: Improves legal clarity by aligning requirements.
Costs: Nil.
No. 18: Make the licensing test for applicants and their related bodies fully consistent.
Reason: There is no reason to have different requirements.
Benefits: Removes a risk that the licensing test is too narrow for related bodies corporate.
Costs: Nil.
No. 19: For registered schemes, require financial statements to be filed within four months of the scheme's balance date, not within four months of the scheme manager's balance date.
Reason: This change is needed in relation to schemes that have a different balance date than that of the scheme manager.
Benefits: Removes legal uncertainty.
Costs: Nil.
No. 20: Empower the FMA to make exemptions from Part 8 of the Act.
Reason: Part 8 contains prohibitions on indemnity and insurance that may not be appropriate in all circumstances.
Benefits: Removes unnecessary compliance.
Costs: Nil.

Table 8: Friendly Societies and Credit Unions Act 1982

No. 21: (a) Provide for credit unions and associations of credit unions to incorporate. (b) Simplify the statutory objects of an association to cover generally the conduct of activities for the benefit of its members and as authorised by its rules. (c) Enable credit unions and associations of credit unions in the pursuance of their objects to have all the powers of a natural person. (d) Remove the "ultra vires rule" insofar as an ultra vires act would otherwise render the relevant transaction invalid or unenforceable, and instead include provisions relating to validity of acts similar to those in the Companies Act.
Reason: Credit unions and the New Zealand Association of Credit Unions are unincorporated associations of persons and need to have a trustee to hold property and conduct business. The current objects and powers of associations of credit unions, and the ultra vires rule also

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give rise to uncertainty and complexities in application. This causes inefficiencies and uncertainties as to the respective roles of the boards or committees of management and their trustees, and the powers of those bodies.
Benefits: Promotes innovation, efficiency and accountability and removes unnecessary operating and compliance costs.
Costs: Nil other than one off implementation costs.
No. 22: Vest the assets, liabilities, undertaking and business of existing credit unions and the NZACU in the new incorporated entities with a tax base roll over from the old entity to the new so that the transfer itself does not generate tax.
Reason: Needed to give full effect to item no. 19 relating to incorporation of credit unions and NZACU.
Benefits: Legal certainty with tax neutrality.
Costs: Nil, other than low one off implementation costs
No. 23: Permit credit unions to make loans to SMEs that are related to members of that credit union.
Reason: There is an unnecessary step under the current law. The loan is made to the member who on-lends it to the SME, with the credit union taking collateral security from the SME as well.
Benefits: Reduces transaction costs.
Costs: Nil.
No. 24: Reduce the minimum number of credit union members needed for an association of credit unions to be validly constituted from seven to two.
Reason: The need to gain economies of scale has seen the number of credit unions decline to 20. The number could fall further.
Benefits: Avoids risks of NZACU losing its legal status.
Costs: Nil.
No 25: Any other consequential amendments to the FSCU Act as determined by the Minister for Economic Development and Minister of Commerce as necessary or desirable to give full effect to the changes in nos. 21-24 above

Table 9: Insolvency Act 2006

No. 26: Official Assignee must send summary of assets and liabilities to creditors as soon as possible after an application for entry to no asset procedure is made. Delay the requirement until after the applicant is admitted.
Reason: Summaries can be unreliable because the OA often does not have complete creditor information when application for entry is made.
Benefits: Increases reliability of information. Also provides privacy benefits because about 25% of applications are declined.
Costs: Nil.
No. 27: Add a power for the OA to discharge the supervisor of a summary instalment order who has subsequently been convicted of a dishonesty offence.
Reason: It is inappropriate for dishonest persons to hold a fiduciary position.
Benefits: Reduces risks of misappropriation.
Costs: Administration costs associated with the discharge process.
No. 28: Add a provision that allows the OA to terminate a summary instalment order.
Reason: The OA currently uses a power to vary or discharge an order for discharges. That power was not designed for termination purposes.
Benefits: Removes any risk that terminations are unlawful.
Costs: Nil.
No. 29: The OA is required to publish in the <i>Gazette</i> and electronically a bankrupt's detailed final statement of receipts and payments. Replace that provision with a requirement to provide the

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statement to all creditors, and provide copies to third parties on request.
Reason: It is unusual for persons other than creditors to have a use for this information.
Benefits: Removes unnecessary publication costs.
Costs: Nil.
No. 30: Replace the requirement for the OA to apply to a court for release from all bankrupt estates with a provision that the OA may apply for release.
Reason: An application for release is an administrative matter which assists the OA in the conduct and completion of a bankrupt's affairs and releases the OA from the right and obligation to continue to administer the bankrupt's estate. However, the OA considers that the liability risk is almost always very close to nil and that requiring her to apply to the court every time is unnecessary. In addition, the change will not adversely affect the interests of bankrupts.
Benefits: Removes an unnecessary statutory obligation.
Costs: Nil.

Table 10: New Zealand Superannuation and Retirement Income Act 2001

No. 31: Add the following functions for the Retirement Commissioner:
- to promote public information and education about financial matters to assist individuals to make confident and informed financial decisions; and
- to advise on financial literacy issues, when requested to do so by the Minister.
Reason: Provides Commissioner with an explicit mandate to work in the financial literacy space.
Benefits: Ensures that the Act accurately reflects the work that the Commissioner already carries out.
Costs: Nil.

Table 11: Repeal redundant legislation

No. 32: Repeal redundant enactments that are administered by MBIE, including moving unspent provisions to other enactments and providing for savings where appropriate. Examples are the Year 2000 Information Disclosure Act 1999 and the Post Office Act Repeal Act 1987.
Reason: Removes legislation that has no substantive effect.
Benefits: Reduces total volume of legislation.
Costs: Nil.