**OFFICE OF THE MINISTER
OF COMMERCE**

The Chair
CABINET BUSINESS COMMITTEE

SECURITIES LAW REVIEW: ADDITIONAL POLICY DECISIONS AND COSTINGS

PROPOSAL

1 This paper seeks additional Cabinet decisions on matters arising out of the Securities Law Review. In particular, the appropriate regulatory regime for securities exchanges, the liability regime for breaches of securities law, and the costing of various licensing regimes previously agreed in principle by Cabinet.

EXECUTIVE SUMMARY

2 In March 2011 Cabinet agreed to comprehensive changes to New Zealand's securities law. These included:

- Changes to the scope of securities law (i.e. the definition of security and the exemptions from the regime);
- Changes to the disclosure regime for issuers of securities;
- Changes to the regulation of managed investment schemes; and
- Changes to a range of other matters, including the liability regime for securities law.

3 It was also agreed that the Minister of Commerce would report back to Cabinet on a small number of outstanding issues. This paper contains these report backs.

4 The current regime for securities and derivatives exchanges is effectively either all or nothing – exchanges are either fully regulated and comply with a robust regulatory regime (e.g. NZX), or are outside of the regime. The proposed regime will see all markets licensed (unless explicitly exempted) and then subject to requirements that are proportionate to the scale and risks posed by those markets and their participants. This was a recommendation of the Capital Market Development Taskforce and is intended to assist in the development of more lightly regulated markets that small, growth companies can use as stepping stones to larger, more heavily regulated markets.

5 Cabinet agreed in March 2011 to a new liability framework for securities law based upon pecuniary penalties and compensation orders for the all but reckless or intentional breaches, which would result in serious criminal penalties. The paper proposes several tiers of potential remedies for breaches within this broad framework ranging from fines of up to $50,000 to terms of imprisonment of up to 10 years depending upon the seriousness of the breach. In addition, the paper proposes that for the most minor breaches (i.e. those resulting in a fine of up to $50,000), the Financial Markets Authority (FMA) have the power to impose infringement notices of up to $20,000.

6 In addition to these matters, the paper:

- proposes to clarify the boundary between securities law and the Fair Trading Act 1986;
- concludes that the disclosure requirements of exchange traded funds can be adequately addressed through the new exchange regime outlined above;
- proposes that no additional action be taken to regulate celebrity endorsements of financial products on the basis that the proposed liability regime for securities law adequately addresses this issue; and
- seeks agreement to several licensing and authorisation regimes for specific financial sector participants that were agreed to in principle by Cabinet in March 2011.

7 Finally, the paper proposes that some services currently regulated in the Financial Advisers Act be shifted to the new securities legislation where appropriate to ensure that similar services are regulated in a similar manner.

8 A Bill is currently being drafted to give effect to the decisions that Cabinet made in March on the reform of securities law. Subject to Cabinet's agreement, the proposals in this paper will also be included in this Bill.

BACKGROUND

9 Securities law governs how financial products are created, promoted and sold (especially to the public), and the ongoing responsibilities of those who offer, deal, and trade them.

10 New Zealand's securities law is mostly contained in the Securities Act 1978 (which regulates primary markets where new securities are issued to investors) and Securities Markets Act 1988 (which regulates secondary markets where existing securities are traded and also derivatives). However, a number of other pieces of legislation contain aspects of securities law, including the Companies Act 1993, the KiwiSaver Act 2006, and the Reserve Bank of New Zealand Act 1989.

11 In March 2011 Cabinet agreed to fundamental reforms of securities law in New Zealand (CBC Min (11) 4/3, CAB Min (11) 10/1 refer). These reforms included major changes to the scope of securities law (i.e. the definition of securities and exemptions from securities law), the disclosure regime for issuers of securities, and the regulation of managed investment schemes.

12 It was also agreed that I would report back to Cabinet by 31 May 2011 on a number of outstanding issues, namely:

- the appropriate regulatory framework for securities exchanges;
- the appropriate liability regime for securities law;
- the boundary between securities law and the Fair Trading Act;
- the appropriate disclosure requirements for exchange traded funds;
- the appropriateness of regulating celebrity endorsements; and
- costings for various licensing regimes previously agreed in principle by Cabinet.

13 This paper seeks Cabinet agreement to proposed approaches to these issues.

COMMENT

Regulatory regime for securities exchanges

Background

14 The Securities Markets Act (SMA) currently regulates exchange operators (“registered exchanges”) which use the words “stock exchange” or “securities exchange” in their business name, or imply that a market they operate is regulated. Such operators are required to apply for registration of the markets they operate and become “registered exchanges”. The Minister of Commerce is also able to exercise a "call-in" power to require registration if an operator not being registered is likely to be detrimental to the integrity and effectiveness of securities markets in New Zealand, or the confidence of investors in securities markets in New Zealand.

15 An operator becomes a registered exchange by applying to the FMA for registration of one or more securities markets and submitting the rules of each market it operates for approval. If the rules are approved, registration follows automatically. NZX is currently the only registered exchange and operates several registered markets.

16 The provisions of the SMA that apply to registered markets and the companies listed on them include a requirement for a set of approved rules; a prohibition on insider trading and market manipulation; and requirements for directors, company officers and substantial securities holders to disclose their holdings and trades. Securities markets must also have continuous disclosure rules, which require the companies listed on them to inform the market of all matters that are material to the price of their securities.

17 Once registered, operators are subject to regular oversight reviews by the FMA. The FMA assesses how well the operator is meeting its obligations, such as running fair, orderly and transparent markets and enforcing its rules.

18 The SMA also regulates derivatives markets, which can be registered in two different ways. A derivatives market can be registered as an “authorised futures exchange”; NZX and ASX both operate markets registered through this process. Since 2009 an additional option has been created for existing registered exchanges to also operate “registered futures markets”. This registration process is the same as that for securities, but only applies to registered exchanges with existing registered markets in securities.

19 Unregistered market operators such as Unlisted (operated by Efficient Market Services Limited) and ShareMart (operated by Computershare Investor Services Limited) also provide a platform for issuers to have their shares traded, including by members of the public. However, their markets, issuers and participants are not subject to the SMA provisions (such as the prohibition on insider trading and disclosure requirements) that apply to registered markets.

Problems with the current regime

20 Unregistered exchanges have benefits for the companies listed on them and for their shareholders, but allowing them to operate without scrutiny also creates risk to the reputation of New Zealand's financial markets and people's confidence in them.

21 The Minister of Commerce can require an operator to register. However, there is a high threshold before this power can be used and the criteria for its exercise are unclear. It would be difficult to use this power pre-emptively.

22 Should trading on an unregistered market cause harm to investors (e.g. through undisclosed insider trading or deliberate market manipulation), it may be some time before the harmful activities occurring on it were discovered by regulators – and the damage may already have occurred. Unregulated markets have been vehicles for widespread fraud in other countries, such as the United States.

23 The current regulatory system also discourages the development of "stepping stone" markets. These are markets that are not completely unregulated, but which do not impose the same high level of regulation as the main board of NZX. The provisions of the SMA that currently apply to the main board of NZX and its participants, including continuous disclosure, are costly and therefore often preclude smaller businesses from accessing capital to develop and grow their business. Some markets aim to facilitate share trading among insiders in private and closely held companies. If the standard insider trading prohibition were applied to those markets, it would be difficult or impossible for insiders to make use of them.

24 Even on fully regulated markets, some products face unnecessary compliance costs because there is insufficient flexibility in the current regime. For example, passive index funds which derive their value from other assets in which the market is already well informed, must still comply with continuous disclosure rules. Another example is NZX's derivatives market, which required complex exemptions from the insider trading regime for it to facilitate risk hedging by commodity producers.

25 While the Minister of Commerce can give partial exemptions from the SMA, exemptions are often complex, inflexible and burdensome to apply for. Stakeholders have indicated that the exemption regime does not provide the degree of certainty required to undertake costly market development. The new securities bill could better accommodate alternative rules, including forms of disclosure and insider trading regimes.

26 A further issue is that there is misalignment between the registration procedure for securities exchanges and the oversight regime. This arises because an exchange must be registered automatically if the rules of its proposed market are in order. There is no testing of the character of the individuals managing the exchange (i.e. "fit and proper" standards) or the capability of the exchange to operate its market and meet its obligations. Without such testing, an exchange could be registered but then fail its first oversight review, or fail to operate its markets properly with consequent adverse effects for market participants and investors.

27 Some derivatives markets must meet criteria before being registered, but the legislation does not specify what matters have to be considered in making the registration decision, nor does it specify ongoing obligations. This has resulted in inconsistencies in the stringency of terms and conditions across derivatives markets over time.

Objectives of the proposed regime

28 I consider that any regulatory framework for securities and derivatives markets must:

- provide a clear and coherent set of entry criteria and ongoing obligations for operating a market;
- provide competitive neutrality between different market operators and their participants;
- allow for different tiers of regulatory requirements for different levels of markets; and
- ensure retail investors are provided with a clear understanding of the risks of participating in less regulated markets.

29 New Zealand securities markets held up well during the financial crisis. Firms were more able to continue to raise capital and there have been few issues of regulatory concern. The intention is therefore to modernise and streamline the legislation regulating markets, and not to impose substantial new burdens on market operators and participants.

30 I consider that we need to shift from “all or nothing” regulation – in which exchanges are either fully regulated and comply with a robust regulatory regime (e.g. NZX), or are effectively outside of the regime – to a more comprehensive and flexible regime. Regulation should be proportional to the nature, size, and risks of the market. Market operators should be able to innovate to create less regulated markets for smaller, growing companies, or for facilitating share trading among insiders in private and closely held companies.

31 Similar markets and their issuers and participants should be subject to similar regulatory obligations. Where overseas-based exchanges operate in New Zealand, the oversight applied to their New Zealand operations by the FMA and their home regulator (taken as a whole) should be equivalent to the oversight they would receive if they were based in New Zealand.

Proposed approach

32 I propose a single system of licensing operators of financial markets (both securities and derivatives markets). All operators of financial markets which are accessible by retail investors and fall above certain size or volume thresholds, or satisfy other criteria, will require a licence, unless they receive an exemption. This will require the formulation of appropriate definitions and criteria in legislation that capture significant securities and derivatives markets, but exclude those which simply facilitate private share transactions on an ad hoc basis. A working definition of "financial market" and potential thresholds are provided in appendix 1, and will be refined based on feedback from stakeholders. The definition is substance based, rather than relying on the name a business uses, as is the case with the current regime.

33 Operators would be licensed in respect of particular financial markets. Each operator could have a number of financial markets, with different rules applying to each. The FMA would conduct oversight over the activities of the operator in respect of markets rather than the operator as a whole (which may have unrelated business activities).

34 Similar to the status quo, there will be a procedure for overseas-based exchanges to be licensed in New Zealand as a separate category. This can occur where they are subject to equivalent regulatory oversight in their home country. It would entitle them to reduced oversight by the FMA. For example, their rules would not have to be approved by the FMA and the FMA may choose to conduct less frequent or comprehensive oversight reviews, but the FMA would make transparent the regulatory and oversight arrangements in place for those markets.

35 I propose that the new securities legislation explicitly provide for exchanges to adopt alternative rules where appropriate, including for ongoing disclosure and insider trading. There would be minimum standards covering matters such as misleading and deceptive conduct, market manipulation and potentially market abuse.

36 Legislation could allow for some markets to have rules for periodic disclosure, such as half-yearly reports of material changes, or event-based disclosure, such as reporting significant specified events as they occur (e.g. a major change to the operations of the business, or a credit rating downgrade). These forms of ongoing disclosure are less onerous than continuous disclosure and might be suitable for smaller businesses.

37 Some markets should be able to adopt alternatives to the current prohibition on insider trading. One of these alternatives could be a "notice and pause" insider trading regime. The notice and pause regime would require insiders to announce their intention to trade, and investors would be able to opt out of trades with insiders or withdraw their orders. There would be civil liability for failing to disclose, and either the FMA or investors would be able to seek compensation. In addition, the FMA could apply for a civil pecuniary penalty. Such a regime would help to ensure that investors knew when they were trading with insiders and decide whether or not to trade. Other alternatives include restricting trading by insiders to specific periods of time (e.g. following disclosure of information).

Resolving transitional issues and reducing uncertainty for existing market operators

38 Operators of existing registered markets have been subject to several years of Securities Commission oversight, which has become increasingly rigorous and formal over time. There would be few benefits from requiring them to incur the costs and risks of reapplying for a licence.

39 Operators of existing unregistered markets may be concerned that they or their market participants will be subject to new and disproportionate regulatory obligations that will effectively prevent them from operating. So far no registered market has been granted exemptions under the SMA, and the FMA is a new and independent regulator that has not had time to develop an approach to low-regulation financial markets.

40 These changes should not significantly increase the regulatory burden on operators that wish to continue to operate as at present.

41 I propose that the new securities legislation give initial licences and exemptions to the operators of existing registered and unregistered markets. Finalising these before the new securities law comes into force will reduce the uncertainty that regulatory changes might otherwise pose for current operators.

42 Where initial licences are granted, these will be subject to terms and conditions that will state which aspects of the regulatory regime apply to each of the operator's markets. The conditions will also include matters such as the way that the exchange represents its markets to investors and other aspects of its regulatory relationship with the FMA (for example, when and how frequently it must report to the FMA). My officials will work with the FMA and existing operators to develop these initial licences.

43 Where an existing market falls within the definition of "financial market" and meets the threshold for licensing but is of a scale or nature that makes regulation unjustified, it could be initially exempted from all regulatory obligations subject to terms and conditions. These terms and conditions will be developed for each market. These might include requirements that the operator cannot hold the market out as regulated, and which also require the operator to provide clear information about its regulatory status on its website, in any advertising, and before each trade takes place. The exemptions could then be revoked if the operator chooses to become licensed in respect of the market in future, or no longer meets the terms and conditions of the exemption. Officials will work with existing operators to develop these initial exemptions.

44 The proposed regime will not fully accommodate securities markets in which the market operator does not have a contractual relationship with the issuers of securities on that market. So-called "alternative trading systems" (such as Chi-X) compete with traditional securities markets in many countries by providing low-cost trading in the securities that are listed on those other markets. This may not be possible in New Zealand because each operator is responsible for regulating the issuers and brokers in their markets, and can be expected to restrict trades from occurring on alternative trading systems. Individual market operators have limited ability to supervise trading on alternative trading systems. Supporting the development of alternative trading systems would likely require some of market operators' regulatory functions to be transferred to the FMA, as has happened in other countries such as Australia and the United Kingdom.

45 Other countries have generally made regulatory changes once there has been a credible plan by an alternative trading system to enter their market. In part this is to ensure that the regulatory regime can be tailored to the type of entrant. At this stage I am not aware of potential entrants targeting the New Zealand market and do not propose changes to transfer market operators' regulatory functions to the FMA.

Disclosure requirements for exchange traded funds

Background

46 Exchange traded funds (ETFs) are a vehicle for retail investors to gain exposure to a basket of securities that replicate the weightings and component securities of broad-based indexes such as the S&P 500 or the NZX 50. Stock selection is made by way of a formula and exposure is achieved without the retail investor having to buy a share of each security directly. In New Zealand, the predominant domestic issuer of such funds is the NZX via its 'Smartshares' offerings.

47 Over time ETFs have evolved in complexity. The current range of ETFs on offer in New Zealand and Australia are, in the main, conventional funds that hold physical assets that broadly match the index or sector they track. This is in comparison to synthetic ETFs that replicate the performance of the underlying asset being targeted by entering into a swap transaction with a counterparty who agrees to pay the fund the return generated by the assets tracked by the fund. This adds counterparty risk for the investor.

48 To date, regulation in Australia has reflected the conventional nature of ETFs in their domestic market. The Australian Stock Exchange (ASX), in consultation with the Australian Securities and Investments Commission (ASIC), has developed a tailored framework for the trading and settlement of these particular types of products, known as the AQUA Rules.

49 The key feature of products listed under these rules is that they must derive their value from other shares, indices, currencies or commodities or other assets in which the market is already well informed. Most other jurisdictions regulate ETFs and structured products by way of exemptions to the primary legislation and through the registered exchanges listing rules. Last year ASX conducted a review of the market for ETF listings for ASIC and both parties were broadly comfortable with how the market is regulated.

Proposed approach

50 ETFs provide retail investors with a cost-efficient vehicle for gaining exposure to a broad and diverse range of securities. They can also provide a means for improving liquidity on markets.

51 At present, Smartshares funds disclose daily the fund's net asset value and transaction volume. The funds also report any dividends and distributions when applicable. As a rule the funds do not provide information specific to the underlying fund assets as this information will have already been disclosed to the market by the issuer of the underlying asset.

52 The strict application of continuous disclosure requirements to listed managed funds and exchange traded funds appears superfluous, in particular where the underlying asset invested in is subject to a robust and transparent pricing mechanism. Such an approach is the one taken by Australia whereby managed funds (including ETFs) are exempt from the continuous disclosure requirements but must still provide the ASX with information that may lead to the establishment of a false market in its products or would materially affect the price of its products.

53 I consider a similar approach could be achieved in New Zealand through the above proposal for a more flexible regime for financial markets, which would allow a market tailored for ETFs to be developed.

Liability regime for securities law

Background

54 There are a number of problems with the current liability regime for breaches of securities law. Most importantly, the regime lacks coherence and is difficult to understand for those who are subject to it or who wish to seek remedies. The overlap between criminal offences and civil pecuniary penalties in some circumstances is also a key issue that requires clarification.

55 Cabinet agreed in March 2011 to reform the liability regime for securities law. Amongst other things, Cabinet agreed that the primary objectives of securities law should be to:

- deter non-compliance and encourage voluntary compliance with the law;
- provide remedies for those harmed by undesirable conduct that occurs; and
- punish non-compliance.

56 At the same time, Cabinet agreed that the regime should be based on an escalating hierarchy of liability, with egregious violations of securities law subject to serious criminal offences and other violations primarily dealt with through a civil pecuniary penalty and compensation regime. I noted in

the Cabinet paper in February that I would report back in further detail on the design of the liability regime.

Proposed penalty tiers

57 I propose that there be six broad tiers of liability that breaches of securities law may be subject to depending on the significance of the breach. Specifically, I propose that these tiers be set as follows:

- Tier 1: Infringement notice of up to $20,000, infringement offence of up to $50,000;
- Tier 2: Civil penalty of up to $200,000 for individuals or $600,000 for corporates, plus compensation orders;
- Tier 3: Civil penalty of up to $1,000,000 for individuals or $5,000,000 for corporates (or the greater the amount of the consideration or 3 times the gain made or loss avoided for certain conduct on securities markets), plus compensation orders;
- Tier 4: Imprisonment for a term of up to 3 years and/or a fine of up to $200,000 for individuals or $600,000 for corporates;
- Tier 5: Imprisonment for a term of up to 5 years and/or a fine of up to $1,000,000 for individuals or $5,000,000 for corporates; and
- Tier 6: Imprisonment for a term of up to 10 years and/or a fine of up to $1,000,000 for individuals or $5,000,000 for corporates.

58 Appendix 2 provides examples of some of the specific types of breaches that I propose come within each liability tier. The full list of breaches that will come within each tier will be determined during drafting. In identifying which breaches should come within each tier, consideration will be given to matters including:

- whether the breach should be subject to strict liability (i.e. whether it is relatively minor and the plaintiff is best placed to prove their lack of culpability);
- the seriousness of the breach compared to other breaches and when considered against the objectives of securities law as a whole; and
- the appropriateness of criminalising certain types of conduct.

59 The final categorisation of penalties will also be tested by being included in an exposure draft of the Bill to be released later in the year.

60 Tier 1 liability consists of strict liability offences and are intended to deal with breaches of a more minor nature and where it is unambiguous that a requirement has not been met. I expect that tier 1 breaches will primarily only be breaches that can be committed by corporates. Tier 1 liability also includes infringement notices which the FMA could impose without the need to go to court. We anticipate that these infringement notices will fit into the generic process for other infringement notices under the Summary Proceedings Act 1957. As with other infringement notice regimes, this would include the defendant having the right to appeal the notice to court. I consider that the use of infringement notices will lead to more effective enforcement than present of these relatively minor contraventions. This should lead to improved deterrence with regard to these matters. The most serious offending against infringement offences may be proceeded against summarily in court, with a maximum penalty of $50,000. No conviction may be entered however.

61 I note that at present the regulator rarely takes proceedings just to enforce offences carrying $5,000 or $10,000 fines because the cost associated with taking proceedings does not often justify the imposition of such a small penalty. In addition, low fine levels have a relatively minor deterrent effect in a financial markets context and can become effectively just a cost of doing business. I consider that in these circumstances an infringement notice regime will make it more economic to enforce lower level breaches, and that a higher infringement fee of $20,000 is necessary in order to ensure that there is an adequate level of deterrence for these breaches.

62 Tier 2-3 liability consists of civil penalties and compensation orders (i.e. court orders requiring the offending party to pay compensation to a person who suffered loss as a result of the breach). Tier 2-3 liability is designed to deal with negligent breaches of more serious securities law obligations. In taking proceedings for a civil penalty and/or compensation order there would be no need to prove a mental element to the breach (e.g. that the breach resulted from an action entered into recklessly or intentionally). In addition, as these would be civil proceedings, they would be subject to a lower standard of proof. (i.e. the balance of probabilities rather than beyond reasonable doubt). However, the court would be required to consider the circumstances of the breach when determining the size of any civil penalty or order to pay compensation. In addition, I anticipate that an increased use of civil penalties will result in more cases being settled before going to trial, which will result in cost savings for the justice sector.

63 Tier 4-6 liability is for intentional or reckless breaches of more serious securities law obligations, and can result in criminal convictions and terms of imprisonment for offending parties. It should be noted that criminal liability for knowing or reckless misstatements is currently provided for by section 242 of the Crimes Act. I propose that a comparable offence be provided for in the new securities legislation. This is consistent with the approach of making the new liability regime a code as far as possible (i.e. a comprehensive collection of all relevant offences and penalties).

64 In summary, the new liability regime is unlikely to add significantly to the level of penalties applying to breaches of securities law overall, although the level of penalty applying to some breaches will increase (so for example, certain offences currently resulting in a maximum three year term of imprisonment or a fine, may now carry a higher level of fine). There will also be a slightly broader range of matters that will be subject to criminal offences carrying terms of imprisonment. However, this is balanced against the fact that a higher mens rea element will be required before a person can be convicted of these offences. The key features of the regime which are new are:

- an increased focus on civil remedies and infringement notices to speed up the process of enforcing breaches; and
- a major broadening of the court's power to order compensation be paid to investors.

65 The FMA currently has a power to seek enforceable undertakings by market participants (i.e. seek an enforceable commitment from a market participant to carry out certain action). I propose that this power be extended so that an enforceable undertaking could be used as a formal mechanism to enter into a settlement with a market participant. As with the increased focus on infringement notices and civil penalties, this will assist in achieving faster resolution of legal proceedings.

The boundary between securities law and the Fair Trading Act

Background

66 The Fair Trading Act (FTA) sets out the basic rules applying to all trading in goods and services. The basic rule under the FTA is that no person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive. The FTA also contains a range of other rules, including a prohibition on the making of false or misleading representations in connection with the supply or possible supply of goods or services or with the promotion by any means of the supply of goods or services.

67 In a financial sector context, the rules in the FTA substantially overlap with specific rules applying under securities law. For example, in certain circumstances the inclusion of a false, misleading or untrue statement in a prospectus, investment statement or advertisement could result in liability under the Securities Act 1978 or the FTA. This kind of overlapping jurisdiction creates a number of problems. In particular:

- it raises uncertainty about whether the FMA or the Commerce Commission should be taking proceedings, as the FMA is responsible for the enforcement of securities law and the Commerce Commission is normally responsible for enforcing the FTA;
- it creates uncertainty for market participants about how the requirements of securities law and the FTA interrelate; and
- it requires stakeholders to consider their compliance with two separate pieces of legislation in respect of the same conduct.

68 To address this issue, section 5A of the FTA currently provides that the court must not find a person liable under the FTA for conduct that is regulated by the Securities Act 1978 or the Securities Markets Act 1988 unless the person would also be liable under those Acts. There is also a parallel provision in the Securities Markets Act 1988.

Proposed approach

69 There are three broad options for setting the interface between securities law and the FTA.

70 The first option is to provide for a general carve out from the FTA for matters that are regulated under securities law. While providing clarity, this option runs the risk of leaving gaps in the regulatory framework under securities law that are currently filled by the FTA. Avoiding gaps would likely require duplicating most of the key provisions of the FTA in securities law.

71 The second option is to leave both securities law and the FTA applying to certain kinds of conduct. While avoiding the risks of gaps in the regulatory framework, this would leave uncertainty around which regulator was responsible for taking action in respect of conduct regulated under both securities law and the FTA. It would also leave the relationship between certain provisions in securities law and the FTA unclear.

72 The third option is to provide for an amended version of the status quo. This would provide that a person does not contravene the following provisions of the FTA if they have contravened the comparable provisions of the new securities legislation:

- The general dealing misconduct provision (section 9 of the FTA); and
- The prohibition on false or misleading representations (section 13 of the FTA).

73 This approach has a number of advantages. First, it encourages the FMA rather than the Commerce Commission to take proceedings, by giving securities law precedence where there is a direct overlap with the FTA. Second, it provides assurance to stakeholders that in areas of overlap, securities law takes precedence. Third, it avoids the need for a carve-out from the FTA as a law of general application. Fourth, it avoids the current uncertainty under section 5A of the FTA about what conduct is regulated under the Securities Act and the Securities Markets Act. I propose that this option be adopted.

Celebrity endorsements

Background

74 Finance company collapses in recent years have highlighted the role of celebrity endorsements of financial products. Advertisements of this nature can have a strong influence on the decision making process of investors when they are assessing investment options. This is particularly the case when a celebrity makes a statement endorsing the safety of a product. In March Cabinet agreed that I would report back on options for regulation in this area.

Proposed approach

75 Under the new securities regime, issuers and their directors will be primarily liable for breaches of disclosure obligations. However, other persons will be liable for misleading and deceptive statements where they consent to being identified in a product disclosure statement or advertisement as having made the statement.

76 In these circumstances, a person will be liable for a pecuniary penalty of up to $1,000,000 for individuals or $5,000,000 for corporates, plus compensation orders.

77 Accordingly, celebrities who make false or misleading statements on behalf of providers of regulated financial products or services under the new securities legislation will be subject to significant liability for doing so. They will not, however, be prohibited from endorsing a financial product or face any liability if a financial product they endorse fails and they have not made a false or misleading statement about that product.

78 I have considered whether more specific provisions should be made for celebrities endorsing financial products or services.

79 Given the magnitude of the potential liability that a celebrity would be exposing themselves to under the general provisions outlined above, I do not consider that there is any need for a more specific set of rules governing the liability of persons who endorse financial products or services. I also consider that it would be difficult to define what constitutes a “celebrity” for the purposes of a specific set of rules governing celebrity endorsements. Accordingly, I propose that no further action be taken in respect of celebrity endorsements at this time.

Costings for various licensing regimes previously agreed in principle by Cabinet

80 Cabinet agreed in principle (subject to costings) to licensing regimes for fund managers, intermediaries (initially peer-to-peer lenders), derivatives dealers and trustees of workplace savings schemes (CBC Min (11) 4/3, CAB Min (11) 10/1 refer)).

81 All of the licensing regimes will involve fees, set by regulation (following consultation with stakeholders). The fees will not change the FMA’s baseline appropriation (as agreed by Cabinet, (CBC Min (11) 4/3, CAB Min (11) 10/1 refer). The FMA will absorb the cost of implementing the regime within its baseline and the fees charged will therefore offset the levy that it is proposed to charge financial market participants.

82 None of the regimes proposed will involve the competency testing provided for financial advisers. Fund managers and trustees will be assessed on a fit-and-proper person test for key individuals based on character and experience. In addition, derivatives dealers and peer-to-peer lenders will have a limited assessment of systems and processes in place in their organisations.

Fund managers

83 The licensing regime proposed for fund managers is a fit-and-proper person regime which looks at the character and experience of senior staff. It is expected that this regime will involve a similar test to that applied by the Reserve Bank for directors of banks. The cost will be $7750 per fund manager, based upon the assumption of having to assess five senior staff per fund manager at a cost of $1,550 per person. It is intended that licences will be valid for five years. If 70 funds were licensed (with an average of 5 senior staff), the total cost would be $542,500 per five years, or $108,500 per year.

84 Cabinet has also agreed to a consistent set of governance obligations for fund managers. While these may impose some operational costs on fund managers, I would expect these costs to be limited for those fund managers currently following best practice.

Peer-to-peer lenders

85 Peer-to-peer lenders are effectively precluded from operating in New Zealand given the regulatory regime. Licensing is intended to introduce a regulatory regime for peer-to-peer lenders proportionate to the risks that they pose. The licensing criteria will look at the character and background of the key individuals involved, and also a limited assessment of organisational processes. It is estimated that licences will cost $10,000 per organisation per five years, and that two peer-to-peer lenders will enter the market initially. The estimated total cost per annum is therefore $4,000.

Derivatives dealers

86 The FMA currently licenses futures and options dealers – these will be known as derivatives dealers in the new regime. The March Cabinet paper set out criteria for licensing derivatives dealers, which include both individual and system assessments. It is estimated that the licences will cost $10,000. Assuming around 50 derivatives dealers in the market, the cost will be $500,000 spread over 5 years or $100,000 per year.

Trustees of workplace superannuation schemes

87 Cabinet agreed in principle to a requirement that workplace superannuation schemes (which do not have external supervisors) should be required to have at least one trustee licensed by the FMA who can demonstrate a degree of skill and experience. It is estimated that this will cost $1,550 per workplace scheme – or less if some of those licensed as trustees are a trustee for more than one scheme. The regime will apply to those schemes still accepting new members (approximately 100). The total maximum cost would therefore be $155,000 per five year period or $31,000 per annum.

88 These costs may initially not be evenly spread across the five year period if all licensing requirements come in over one year. However, over time as new individuals or organisations are licensed, the costs will fall more evenly across time.

Interface with the Financial Advisers Act 2008

89 The Financial Advisers Act 2008 regulates various kinds of portfolio management and broking services. At least some of these services are more related to matters that will be regulated under securities law than the Financial Advisers Act. For example, some discretionary portfolio management services provided through wrap platforms closely mimic collective investment schemes and are provided by the same entities, the main difference being that one is a service and one is a product. As part of the review of securities law it makes sense to ensure that like services are regulated in a like manner. This will involve looking at whether the regulation of these portfolio management and broking services should be shifted from the Financial Advisers Act to the new securities legislation and whether the regulation should be adjusted to ensure consistency in the regulation of similar services.

90 My officials will carry out further work and stakeholder consultation on this issue, but I propose that where the portfolio management or broking services that are regulated under the Financial Advisers Act are sufficiently analogous to services that will be regulated under the new securities legislation, then the regulation of those services be shifted from the Financial Advisers Act to the new securities legislation and adjusted where necessary to ensure consistency in the regulation of similar services. This is expected to mean that providers of these services will be licensed (if not already) to be a fund manager.

CONSULTATION

91 The Treasury, Ministry of Justice, FMA, and the Ministry of Consumer Affairs were consulted on the proposals in this paper. No significant concerns were raised, except by the FMA in respect of insider trading.

92 [withheld under sections 9(2)(f)(iv) and 9(2)(g)(i) of the Official Information Act 1982].

93 Targeted consultation on the proposals relating to registered exchanges was undertaken with NZX, Unlisted, Computershare and the New Zealand Shareholders Association. These stakeholders were comfortable with the broad direction recommended in this paper. Targeted consultation on the proposed liability regime for securities law was undertaken with the Crown Law Office, the Legislation Design Committee, and the Serious Fraud Office. Targeted consultation on the proposals regarding disclosure requirements for exchange traded funds was carried out with NZX.

FISCAL IMPLICATIONS

94 In March 2011 Cabinet agreed in principle to the introduction of licensing regimes for four types of financial market participant. Specifically, these are derivatives dealers, regulated intermediaries, fund managers and trustees of workplace savings schemes. These licensing regimes are to be administered by the FMA.

95 The cost of licensing will be covered by the existing appropriations that have been agreed for the FMA. The fees charged by the FMA for licences will therefore offset the general levy to be charged on financial market participants.

HUMAN RIGHTS

96 The proposals in this Cabinet paper appear to be consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. A final view as to whether the proposals will be consistent with the Bill of Rights Act will be possible once the legislation has been drafted.

LEGISLATIVE IMPLICATIONS

97 In March 2011 Cabinet agreed to wide ranging reforms to securities law that will require the enactment of new Act and the repeal or amendment of legislation including the Securities Act 1978, the Securities Markets Act 1988, the KiwiSaver Act 2006, and the Unit Trusts Act 1960 (CBC Min (11) 4/3, CAB Min (11) 10/1 refer).

98 [withheld under sections 9(2)(f)(iv) and 9(2)(g)(i) of the Official Information Act 1982].

REGULATORY IMPACT ANALYSIS

99 The Regulatory Impact Analysis requirements apply to the proposals in this paper relating to the regulation of securities exchanges and the proposed liability regime for securities law. The other proposals in the paper either do not have regulatory implications or are technical revisions to existing law. A Regulatory Impact Statement (RIS) has been prepared for the proposals relating to securities exchanges and the liability regime and is attached to this Cabinet paper.

100 The Deputy Secretary, Organisational Development and Support Branch, Ministry of Economic Development and the Regulatory Impact Analysis Review Panel have reviewed the RIS prepared by the Ministry of Economic Development and associated supporting material, and considers 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.

101 I have considered the analysis and advice of my officials, as summarised in the attached Regulatory Impact Statement and I am satisfied that, aside from the risks, uncertainties and caveats already noted in this Cabinet paper, the regulatory proposals recommended in this paper:

- Are required in the public interest;
- Will deliver the highest net benefits of the practical options available; and
- Are consistent with our commitments in the Government Statement on Regulation.

Publicity

102 Subject to Cabinet's agreement to the proposals in this paper, I intend to issue a press release announcing Cabinet's decision on these matters. The Ministry of Economic Development will also publish a copy of this paper on its website.

Recommendations

103 It is recommended that the Committee:

1 **Note** that Cabinet agreed in March 2011 to wide ranging reforms of securities law including changes to the scope of securities law, the disclosure requirements of issuers of securities, and the regulation of collective investment schemes (CBC Min (11) 4/3, CAB Min (11) 10/1 refer).

2 **Note** that in March 2001 Cabinet agreed that the Minister of Commerce would report back to Cabinet by 31 May 2011 on the following matters (CBC Min (11) 4/3, CAB Min (11) 10/1 refer):

2.1 The appropriate regulatory framework for securities exchanges;

2.2 The appropriate liability regime for securities law;

2.3 The boundary between securities law and the Fair Trading Act;

2.4 The appropriate disclosure requirements for exchange traded funds;

2.5 The appropriateness of regulating celebrity endorsements; and

2.6 Costings for various licensing regimes agreed in principle by Cabinet in March 2011.

Regulatory regime for securities exchanges

3 **Note** that the Securities Markets Act currently regulates securities markets.

4 **Note** that while some improvements to the regulation of markets were made in the Securities Markets Amendment Act 2011, the overall regime is not coherent and further streamlining is desirable.

5 **Agree** that the current separate systems of regulating securities and derivatives markets be replaced by a single system of licencing the operators of financial markets (securities and derivatives markets) in respect of those markets.

6 **Note** that a working definition of "financial market" and potential thresholds for when a market is required to be licensed or exempted are contained in Appendix 1, subject to drafting and further industry consultation.

7 **Agree** that all operators of financial markets meeting specified thresholds will be required to be licensed, unless they are exempted by regulations or the Financial Markets Authority.

8 **Agree** that operators of financial markets authorised in jurisdictions with equivalent regulatory oversight to New Zealand be able to be licensed to operate in New Zealand with reduced oversight by the Financial Markets Authority, where appropriate.

9 **Note** that registered markets are currently required to have continuous disclosure rules and insider trading on regulated markets is prohibited.

10 **Note** that other forms of rules, including for disclosure and insider trading, may be more suited to low-regulation exchanges.

11 **Agree** that the current legislative backing given to continuous disclosure rules in the Securities Markets Act be extended to backing for other disclosure rules, which would be agreed between operators of licensed financial markets and the FMA or set out in regulations.

12 **Agree** to continue the current ability to allow financial markets to be exempt from regulatory requirements where that is appropriate for the market under consideration.

13 **Agree** that alternatives to the current prohibition on insider trading be permitted for some licensed financial markets, such as an exemption or defense where a person has disclosed prior to trading that they have inside information and intend to trade ("notice and pause").

14 **Agree** that alternatives to other requirements on securities markets or their participants be permitted in regulations or by the FMA where appropriate for the market under consideration.

15 **Note** that introducing a new system of exchange regulation creates uncertainty and risk for existing registered and unregistered exchanges.

16 **Agree** to grant initial licences and exemptions to existing registered and unregistered exchanges.

17 **Agree** that the Minister of Commerce may determine the details of the initial registrations and exemptions referred to in recommendation 16, in consultation with existing exchanges and the Financial Markets Authority.

Liability regime for securities law

18 **Note** that Cabinet has previously agreed that the liability regime for securities law will be based upon pecuniary penalties and compensation orders except for the most serious breaches which will result in criminal offences carrying terms of imprisonment (CBC Min (11) 4/3, CAB Min (11) 10/1 refer).

19 **Agree** that, subject to drafting, there be six broad tiers of penalties under securities law as outlined in appendix 2.

20 **Agree** that the FMA will have the power to issue an infringement notice for offences in the first tier of penalties.

21 **Note** that there may be a small number of offences that will need to be provided for that do not come within the six tiers of liability outlined in appendix 2.

Boundary between securities law and the Fair Trading Act 1986

22 **Note** that certain breaches of securities law may also constitute breaches of the Fair Trading Act 1986.

23 **Note** that there are a number of problems with inter-relationship between securities law and the Fair Trading Act 1986.

24 **Note** that under the new securities legislation there will be general prohibition on misleading and deceptive conduct in dealing in regulated financial products and services that overlaps with the general prohibition on misleading and deceptive conduct which is provided for in the Fait Trading Act 1986.

25 **Note** that under the new securities legislation there will be a prohibition on the making of false or misleading representations in respect of regulated financial products and services that mirrors the prohibition on making false or misleading representations in the Fair Trading Act 1986.

26 **Agree** that a person does not contravene the following provisions of the FTA if they have contravened the comparable provisions of the new securities legislation:

26.1 The general dealing misconduct provision (section 9 of the FTA); and

26.2 The prohibition on false or misleading statements (section 13 of the FTA).

Celebrity endorsements

27 **Note** that celebrity endorsements in advertisements have been a feature of some financial products, including those offered by failed finance companies.

28 **Note** that under the new securities legislation a person will be liable for misleading and deceptive statements where they have consented to be identified in a product disclosure statement or advertisement as having made the statement.

29 **Agree** that given the potential liability of celebrities who make misleading or deceptive statements to investors, no further action is necessary to regulate celebrity endorsements at this time.

Costings for various licensing regimes previously agreed in principle by Cabinet

30 **Note** that in March 2011 Cabinet agreed in principle to licensing or authorisation regimes for the following (CBC Min (11) 4/3, CAB Min (11) 10/1 refer)):

30.1 Derivatives dealers;

30.2 Regulated intermediaries;

30.3 Fund managers; and

30.4 Trustees of workplace savings schemes.

31 **Note** that the total annual costs for industry as a whole of the licensing regimes in recommendation 30 above are:

31.1 Fund managers: $108,500;

31.2 Regulated intermediaries (peer-to-peer lending): $4,000;

31.3 Derivatives dealers: $100,000; and

31.4 Independent trustees of workplace savings schemes: $31,000.

32 **Agree** to provide for the licensing of derivatives dealers, peer-to-peer lenders, fund managers and independent trustees of workplace savings schemes.

Interface with the Financial Advisers Act 2008

33 **Note** that certain portfolio management and broking services currently regulated in the Financial Advisers Act may fit more appropriately in the new securities legislation.

34 **Agree** that where appropriate, the regulation of these services referred to in recommendation 33 be shifted into the new securities legislation and adjusted to ensure consistency in the regulation of similar services.

Drafting and publicity

35 **Invite** the Minister of Commerce to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above recommendations.

36 **Authorise** the Minister of Commerce to make changes, consistent with the policy framework in this paper, on any issues that arise during the drafting process.

37 **Note** that the Minister of Commerce will issue a media statement on Cabinet's decisions on the matters covered by the above recommendations.

38 **Agree** that the Ministry of Economic Development publish a copy of this paper on its website.

Hon Simon Power
Minister of Commerce

Date signed: ______________________

APPENDIX 1 – WORKING DEFINITION OF FINANCIAL MARKET

Based on the definition in the Australian Corporations Act 2001, a "financial market" would be a facility through which:

- offers to acquire or dispose of financial products are regularly made or accepted; or
- offers or invitations are regularly made to acquire or dispose of financial products that are intended to result or may reasonably be expected to result, directly or indirectly, in:
  - the making of offer to acquire or dispose of financial products; or
  - the acceptance of such offers.

A financial market within this definition would be required to be licensed or exempted if:

- It is accessible or used by retail investors (based on a similar retail/non-retail split as in other parts of the new securities bill); and
- One of the following applies:
  - The annual volume of transactions on the market exceeds 100 transactions and $2 million;
  - The market is operated by a person who operates another regulated market; or
  - The operator holds the market, or itself, out to be regulated.

APPENDIX 2 – PROPOSED LIABILITY TIERS UNDER THE NEW SECURITIES LEGISLATION

Liability tier	Penalty	Examples of breaches that may be covered by each tier
Tier 1	Infringement notice of up to $20,000, infringement offence of up to $50,000	Failure to keep a register of security holders Failure to comply with directors and officers disclosure obligations
Tier 2	Civil penalty of up to $200,000 for individuals or $600,000 for corporates. Compensation orders	Failing to comply with an order made by the Financial Markets Authority Breach of fund manager duties
Tier 3	Civil penalty of up to $1,000,000 for individuals or $5,000,000 for corporates (or the greater the amount of the consideration or 3 times the gain made or loss avoided for certain conduct on securities markets), plus compensation orders	Breach of insider trading obligations Breach of market manipulation obligations
Tier 4	Imprisonment for a term of up to 3 years and/or a fine of up to $200,000 for individuals or $600,000 for corporates	Product disclosure statement or advertisement is misleading or deceptive Operating a securities market without being licensed
Tier 5	Imprisonment for a term of up to 5 years and/or a fine of up to $1,000,000 for individuals or $5,000,000 for corporates	Contravening a management banning order Contravention of ongoing disclosure requirements for debt and managed investment schemes Offering a regulated financial product without a product disclosure statement
Tier 6	Imprisonment for a term of up to 10 years and/or a fine of up to $1,000,000 for individuals or $5,000,000 for corporates	Knowing or reckless inclusion of a false statement in a product disclosure statement with intent to induce a person to subscribe to a security or deceive/cause loss or advance property

Regulatory Impact Statement

SECURITIES LAW REVIEW: ADDITIONAL POLICY DECISIONS AND COSTINGS

AGENCY DISCLOSURE STATEMENT

This regulatory impact statement (RIS) has been prepared by the Ministry of Economic Development.

This RIS relates to February 2011 RIS and Cabinet paper that proposed a comprehensive reform of New Zealand's securities law.

This RIS addresses three issues:

- Regulation of securities and derivatives exchanges
- Penalties for breaches of securities legislation, and
- Costings for a number of proposed licensing regimes.

These are the key areas where further decisions are needed to complete the design of the overall securities regime.

A full status quo, problem definition, objectives and set of options are provided for the regulation of securities and derivatives exchanges. However, the liability regime was largely agreed by Cabinet in February and the options considered are therefore confined to further design of the penalties. Similarly various licensing agreements were agreed in principle in February, subject to providing costings.

As with the previous RIS, this RIS is based largely on impacts identified in submissions received in response to the securities law review discussion document (released June 2010), and information received from subsequent targeted consultation with stakeholders. Submissions seldom included quantitative estimates of costs and benefits, and data are not collected on regulatory costs. The proposals in respect of exchanges largely implement recommendations made by the Capital Market Development Taskforce in its 2009 report.

Some of the policy options are considered to have consequences that the Government has stated will require a particularly strong case before regulation is considered. In particular some of the options considered in relation to the regulation of securities and derivatives exchanges would require a wider range of exchange operators to seek authorisation or exemption. This would impose additional costs on those businesses and affect market competition. Important objectives of the options considered are (a) encouraging the development of markets with compliance costs for operators, issuers and participants proportionate to the firms involved and the size of the market, and (b) providing a greater degree of competitive neutrality between different market operators operating equivalent markets.

Bryan Chapple, Manager, Investment Law, Ministry of Economic Development

INTRODUCTION

This RIS relates to February 2011 RIS and Cabinet paper that proposed a comprehensive reform of New Zealand's securities law.

This RIS addresses three issues:

- Regulation of securities and derivatives exchanges
- Penalties for breaches of securities legislation, and
- Costings for a number of proposed licensing regimes.

These are the key areas where further decisions are needed to complete the design of the overall securities regime.

Part 1: Regulation of securities and derivatives exchanges

STATUS QUO AND PROBLEM DEFINITION

The Securities Markets Act (SMA) currently regulates "registered exchanges" (operators) who operate "registered markets" in securities. An operator becomes a registered exchange by applying to the FMA for registration and submitting the rules of its markets for approval. Once the market rules are approved, registration follows automatically. NZX is currently the only registered exchange, and operates several registered markets.

Under the SMA registered markets must have FMA approval of their rules and rule changes. The issuers listed on them are subject to continuous disclosure rules, which require them to inform the market of all matters that are material to the price of their securities. Insider trading and market manipulation are prohibited, and directors, company officers and substantial securities holders must disclose their holdings and trades.

Once registered, operators are subject to regular (at least annual) oversight reviews by the FMA. The FMA assesses how well the operator is meeting its obligations, such as running fair, orderly and transparent markets and enforcing its rules.
The SMA also regulates derivatives markets. There are two different legislative ways that a derivatives market can be registered. NZX and ASX both operate "authorised futures exchanges". Since 2009 an additional option has been created for those operating registered exchanges to also operate "registered futures markets". This registration process is the same as that for securities, but can only apply to those with existing registered markets in securities.

Unregistered market operators such as Unlisted (operated by Efficient Market Services Limited) and ShareMart (operated by Computershare Investor Services Limited) also allow issuers to list their shares and allow participation by members of the public. However, their markets, issuers and participants are not subject to the SMA provisions that apply to registered markets. There are still some restrictions on these markets and their issuers under other pieces of legislation and the common law. For example, the Fair Trading Act covers misleading and deceptive conduct and there are some more limited insider trading provisions in the Companies Act and Securities Act.

Market operators are generally not required to register, but an unregistered operator cannot call itself a “stock exchange” or “securities exchange”, or imply that it is regulated. The Minister of Commerce is also able to require an operator and its markets to be registered if not being registered is likely to be detrimental to the integrity and effectiveness of securities markets in New Zealand, or the confidence of investors in securities markets in New Zealand.

Most of the problems with the status quo that we identify below arise from the context in which the SMA and its amendments were developed. The registration procedure for securities exchanges was intended to allow the demutualisation of NZX in 2002 and many of the provisions of the SMA were designed with the regulation of NZX’s main market and its participants in mind. This means that the SMA does not provide a regulatory framework to suit the full range of desirable securities and derivatives markets, or potential new entrants.

The registration process does not align well with the formal oversight role of the FMA and the new obligations of registered exchanges under the amended SMA. An operator must be registered automatically if the rules of its proposed markets are approved. There is no testing of the character of the individuals managing the exchange (i.e. "fit and proper" standards) or the capability of the exchange to operate its market and meet its obligations. Without such testing, an exchange could be registered but then fail its first oversight review, or fail to operate its markets properly with consequent adverse effects for market participants and investors.

Derivatives markets have an up-front registration test (under the “authorised futures exchange” procedure), but the legislation does not specify what matters have to be considered in making the registration decision, nor does it specify the operator’s ongoing obligations. Stakeholders have reported dissatisfaction with the registration terms and conditions and supervision applied to derivatives exchanges over time.

The threshold for when a market operator and its markets are required to be registered is unclear and ineffective, and creates risks to the integrity and confidence in New Zealand’s financial markets. It is not clear that the public has particular expectations of a business calling itself a “securities exchange” or “stock exchange” that do not apply to businesses using other terms such as “securities market”, “stock market”, “share market” “share trading facility”, or “securities trading facility”.

Should trading on an unregistered market cause harm to investors (e.g. through undisclosed insider trading or deliberate market manipulation), it may be some time before the harmful activities occurring on it were discovered by regulators – and the damage may have already been incurred. Unregulated markets have been vehicles for widespread fraud in other countries, such as the United States.

The Minister of Commerce can require a market operator to register. However, there is a high threshold before this power can be used and the criteria for its exercise are unclear. It would be difficult to use this power pre-emptively.

The current regulatory system also discourages the development of "stepping stone" markets. These are markets that are not completely unregulated, but which also do not impose the same high level of regulation as the main board of NZX. The provisions of the SMA that currently apply to the main board of NZX and public issuers listed on it, including continuous disclosure, are costly and therefore often preclude smaller businesses from accessing capital to develop and grow their business. Some markets aim to facilitate share trading among insiders in private and closely held companies. If the standard insider trading prohibition were applied to those markets it would be difficult or impossible for insiders to make use of them. Regulatory inflexibility is likely to have contributed to the lack of development of these markets.

The Capital Market Development Taskforce recommended a more flexible regulatory system that would allow the development of markets that had less stringent disclosure and governance requirements. While there is now greater ability for the Minister of Commerce to give partial exemptions from the SMA, stakeholders have indicated that an exemption regime does not provide the regulatory certainty required to undertake the development of new markets. Legislation could better accommodate alternative rules, including for disclosure and insider trading.

OBJECTIVES

As with the overall reform of securities law, the objective is to facilitate capital market activity to encourage capital raising by businesses and better investment opportunities for investors. For this to occur, regulation needs to allow the development of markets that both investors and issuers are willing to engage in. The following are intermediate objectives:

- Improve the coherency and clarity of the regulatory regime;
- Provide competitive neutrality between different market operators operating equivalent markets;
- Support the development of "stepping stone" markets with compliance costs for operators, issuers and participants proportionate to the characteristics of the firms involved and the size of the market; and
- Transparent market rules and effective enforcement, that help investors to understand the risks of investing in less regulated markets, and give them a degree of assurance that they can rely on rules being enforced.

REGULATORY IMPACT ANALYSIS

Three sets of options are considered to address these problems:

- Changes to the process for registering securities and derivatives markets, for example by requiring an up-front assessment of an operator's ability to meet its regulatory obligations before registering it;
- Changes to the criteria for when a market has to be registered and the substantive regulatory obligations applying to registered markets and their operators; and
- If the preferred options for the above are implemented, transitional provisions for existing registered and unregistered markets.

The most important trade-off arises in relation to the criteria for when a market has to be registered and the substantive regulatory obligations applying to registered markets and their operators. Allowing markets to operate with fewer regulatory requirements than on NZX's main board has benefits for the market operators and the issuers listed on them, with the greatest potential gains accruing to small and growing businesses seeking equity capital. However, these markets do pose risks to investor confidence in New Zealand's financial markets and of investor confusion and harm.

Therefore we recommend a regulatory regime that balances these objectives by registering all financial markets (apart from those explicitly exempted) and allowing some registered markets to operate with less onerous rules that are agreed with the FMA or set out in regulations.

The following sections set out the options and their costs, benefits and risks in more detail. A summary table is provided on page 8.

Changes to the process for registering securities and derivatives markets

As noted in the status quo section, securities markets have their rules approved and are then automatically registered. Derivatives markets may go through the same process as securities markets (but only if the operator has an existing registered securities market) or registered separately as an "authorised futures exchange". The registration process for "authorised futures exchange" includes up-front testing by the FMA, and the FMA can also require the market operator to comply with conditions.

We have considered two options, both of which we recommend, for changing these mechanisms.

The first option is to adopt a single system of registering the operators of financial markets (both securities and derivatives markets). Under this option, an operator would be registered to operate particular securities or derivatives markets, which would be specified in its registration. The separate systems for registering derivatives markets would be removed. This option would simplify the regime and improve clarity.

A further option is to require an up-front assessment of an operator's ability to meet its regulatory obligations before registering it, and to allow terms and conditions to be imposed or registration to be removed. There would be an application procedure, including submitting market rules for approval. The registration obligations would be similar to the current ongoing obligations of market operators. Conditions on the registration could be imposed, for example specifying the kinds of financial products that may be traded on the market.

The second option would further improve the coherency of the regime by resolving the misalignment (discussed in "status quo and problem definition") between the registration procedure and the oversight role of the FMA. The ability to set and varying terms and conditions of registration and the ability to remove registration power may impose additional costs on securities market operators in the form of further regulatory requirements and restrictions on their activities. It may also have additional, minor benefits for investors compared to the status quo, for example conditions could be used to apply additional disclosure requirements on some registered markets. However, the FMA and the Minister of Commerce currently have extensive powers that could – in the worst case – impose significant costs on a registered operator, disrupt its operations and make it unviable. The addition of registration terms and conditions may therefore provide an alternative supervisory tool that is more efficient in some circumstances.

The securities law review discussion document asked submitters about whether any changes should be made to the process for registering exchanges. Submitters did not comment on this specific matter. Subsequent feedback from market operators and brokers indicated they were comfortable with the second option, on the basis that it was logical to require operators to pass an up-front test before being authorised rather than subjecting them to the review after being authorised.

Changes to the criteria for when a market has to be registered and the substantive regulatory obligations applying to registered markets and their operators

Regardless of which registration process is adopted, two separate questions arise: Which markets must be registered? And what substantive regulatory obligations will apply to registered markets?

Although these are two distinct issues, the costs and benefits of adopting a particular threshold for registration are highly dependent on the substantive regulatory obligations that will apply to registered markets. To avoid a complex matrix of costs and benefits, the following four representative options have been selected, ordered from the most flexible and liberal to the most restrictive:

- Option 1: Make securities and derivatives market regulation opt-in, with customised regimes for issuer disclosure, issuer governance, participant disclosure, market manipulation and insider trading;
- Option 2: Make minor changes to the requirements to become registered and allow low regulation markets to adopt customised rules;
- Option 3: Require all markets to be registered or exempted, and allow low regulation markets to adopt customised rules (the preferred option); and
- Option 4: Require all markets to adopt continuous disclosure and a prohibition on insider trading.

Option 1 is to make registration "opt-in", with the legislation also allowing the creation of customised rules for each registered market.

No operator would be compelled to seek registration, but some would likely choose to do so in order to obtain stronger legal backing for their rules (e.g. civil and criminal penalties for rule breaches) and credible enforcement mechanisms (e.g. the FMA enforcing some rules). This is the way that designated settlement systems are regulated by Part 5C of the Reserve Bank of New Zealand Act 1989. It is also effectively the way that Reserve Bank Act regulates banks, since an organisation must only register as a bank if it uses "bank" (or its derivatives) in its name or title. (Although prudential regulation has recently been extended to non-bank deposit-takers such as finance companies.)

Legislation would provide for markets to adopt their own rules covering matters such as for issuer disclosure, issuer governance, participant disclosure, market manipulation and insider trading. These would be backed by regulations recommended by the Minister after consultation with the FMA. The regulations would define the role of the FMA in enforcement, and breach by an issuer, broker or investor could attract civil or criminal liability within some constraints (e.g. on the size of fines or pecuniary penalties).

Option 2 would maintain the status quo in respect of who is required to become registered, with modifications to improve clarity. Unregistered markets would not generally be required to become registered, but they could not be misrepresented as regulated, and the Minister of Commerce would have a reserve power to compel them to become registered under some circumstances. The criteria for use of this reserve power would be redrafted to be clearer than under the current SMA. For example, it might include specific reference to incidence of actual harm to retail investors from the operation of the market, its size and significance to New Zealand's financial markets, and whether it fails to present its regulatory status clearly to investors.

Legislation would provide for the standard continuous disclosure and insider trading regimes, as at present. However, markets could adopt alternative rules for ongoing disclosure, insider trading and other matters, in a similar manner to Option 1.

Option 3 (the preferred option) would be to require all markets within some broad definition of “financial market” to be registered – with the possibility for exemptions. This will require a definition of “financial market” in legislation that includes significant securities and derivatives markets, but excludes those who simply facilitate private share transactions on an ad hoc basis.

Legislation would provide for the standard continuous disclosure and insider trading regimes with the ability to introduce alternative rules for disclosure, insider trading and other matters, via regulation or through agreement with the FMA.

Exemptions from registration would be permitted where FMA oversight would be excessively onerous, and the risks to investor confidence posed by the markets are low. These exemptions would be subject to conditions that would help to ensure that the market continued to be operated in a low-risk manner, for example limits on the way that the market is represented to investors.

Option 4 would, like Option 3, require all markets within some broad definition of “financial market” to be registered or exempted. However, all registered markets would be required to adopt the current, standard continuous disclosure and insider trading regimes.

All these options would improve the clarity and coherency of the regulatory regime and competitive neutrality to greater or lesser extent, as well as competitive neutrality.

The first three options would each provide a more flexible system of regulation than under the status quo. For example, tailored disclosure and insider trading rules could be developed for stepping stone exchanges. However, with more flexibility comes the risk of investor confusion. Investors would be faced with multiple tiers of markets and each would provide different rule sets and levels of protection. In some cases these could be operated by the same company. These risks could be mitigated if registration conditions placed restrictions on the branding and promotion of low regulation and alternative markets, so that they were clearly distinguished from fully regulated markets. Many other countries have secondary exchanges that are operated by the same businesses as primary exchanges. For example, the London Stock Exchange operates the Alternative Investment Market, and NADSAQ OMX operates a secondary market called OMX First North. Within these secondary markets there are sometimes “premium” markets which impose more onerous regulation on issuers than the secondary markets but less regulation than on the primary exchange. An example of this latter type of market is NASDAQ OMX’s First North Premier.

There are other important trade-offs. The more flexible options would be more likely to encourage the entry of new operators and financial markets, and a greater diversity of financial markets. They would therefore tend to promote the establishment of stepping stone markets than the more restrictive options. However, they also come with greater risks that markets in New Zealand are established without transparent market rules and effective enforcement, and greater risks of investor harm.

Transitional provisions for existing registered and unregistered market

Introducing a new system of exchange regulation creates costs, uncertainty and risk for the operators of existing registered and unregistered markets. Registered markets and authorised futures exchanges would potentially be required to re-apply for registration. Operators of existing unregistered markets may be concerned that they or their market participants will subject to new and disproportionate regulatory obligations that will prevent them from operating. So far no registered market has been granted exemptions under the SMA, and the FMA is a new and independent regulator that has not had time to develop an approach to low-regulation financial markets.

One option to address this issue is for the new securities bill to give initial registration and exemptions to the operators of existing registered and unregistered markets. Finalising these before the new securities law comes into force would reduce the uncertainty – and hence risks – that regulatory changes might otherwise pose for current operators.

However, it would result in a less coherent regulatory system, since existing markets would not have gone through the same process as new markets. Additionally if criteria are applied differently before legislation is enacted compared to afterwards, existing operators may have competitive advantages over new entrants or visa versa.

Summary of options, costs, benefits and risks

The following table outlines our assessment of how each of the options impacts on the objectives. Our assessments are largely qualitative, based on the information provided by submitters throughout the consultation process and our own research. The analysis is constrained in that very few submitters provided detailed information about quantifiable costs in relation to each of the issues.

We have described the impacts on the objectives as being either positive (benefit) or negative and the scale of the impact as small, moderate or high.

Option	Impact on objective: Improve the coherency and clarity of the regulatory regime	Impact on objective: Provide competitive neutrality between different market operators	Impact on objective: Support the development of "stepping stone" markets	Impact on objective: Trans-parent market rules and effective enforce-ment	Preferred option Y/N	Comments and risks
Registration mechanism						
Adopt a single registration system for both securities and derivatives markets, and remove the separate category of "authorised futures exchanges.	Small benefit	-	-	Small benefit	Y	Would simplify the regime and improve consistency
Require operators to pass registration criteria before becoming registered, and allow the FMA to impose terms and conditions on registration.	High benefit	-	Small negative	Small benefit	Y	Would improve the clarity and consistency of the regime, but other impacts would be minor, as registered exchanges are already subject to ongoing oversight by the FMA.
Changes to the criteria for when a market has to be registered and changes to the substantive regulatory obligations applying to registered markets and their operators						
Option 1: Make securities and derivatives market regulation opt-in and allow low regulation markets to adopt customised rules for continuous disclosure, insider trading, etc	Moderate benefit	High benefit	High benefit	High negative	N	Would free exchanges to develop their own rules and enforcement mechanisms, but also comes with risks that rogue market operators and traders harm investor confidence.
Option 2: Make minor changes to clarify the requirements to become registered and allow low regulation markets to adopt customised rules.	Small benefit	-	High benefit	Moderate negative	N	This would be a clearer and more flexible version of the status quo. However, registration would still be opt-in to some extent.
Option 3: Require all markets to be registered or exempted, and allow low regulation markets to adopt customised rules.	Moderate benefit	Moderate benefit	Moderate benefit	Small negative	Y	Requiring registration creates a barrier to entry at the lower end, but this is a lower risk option as all exchanges must be registered or explicitly exempted.
Option 4: Require all markets to adopt continuous disclosure and a prohibition on insider trading.	High benefit	High benefit	High negative	Moderate benefit	N	This option would probably close down the current unregistered exchanges and would prevent the development of "stepping stone" exchanges.
If the preferred options are accepted, transitional provisions for existing exchanges						
Introduce initial registrations and exemptions for existing registered and unregistered markets.	Small negative	Small negative	Moderate benefit	-	Y	Would reduce the risks that regulatory changes might otherwise pose for current operators. However, it would result in a less coherent regulatory system, and there are risks that existing operators have competitive advantages over new entrants or visa versa.

CONSULTATION

Many of the current ideas and policies on the regulation of exchanges have developed from the work and recommendations of the Capital Market Development Taskforce. The Taskforce saw an important challenge for New Zealand as attracting more risk capital and capability to help businesses, particularly small and medium enterprises, to grow. It envisaged unregistered or partly exempt markets operating with rules that sat between current unregistered exchanges like Unlisted and fully regulated markets like NZX's main board. These listing venues would keep compliance costs for listed issusers relatively low, while providing investors with greater rights and assurances than on existing unregistered exchanges or private share transfers. They would help to attract capital and capability to growing companies and prepare them for a listing on a fully regulated market.

The Taskforce's December 2009 report recommended that unregistered exchanges be allowed to remain unregistered, and there should be more willingness to allow "exempt" exchanges that are registered but exempt from some of the requirements of the SMA. The Taskforce noted that it needed to be clear to investors what laws and rules the issuers on these exchanges were subject to. The Taskforce also recommended that unregistered and exempt exchanges be allowed to develop their own listing rules and that registered exchanges be allowed to own and operate unregistered and exempt markets.

Following the Taskforce report, the Review of Securities Law discussion paper of June 2010 sought views from submitters about whether any changes were required to the provisions of the SMA that govern the registration and regulation of exchanges. This was followed by targeted consultation with operators of registered and unregistered exchanges (NZX, Unlisted and Computershare), brokers, and the New Zealand Shareholders Association.

The discussion document asked whether the current mechanisms for registering, requiring the registration of, and exempting securities markets were working, and how they could be improved. Six submissions (Unlisted, VINZ, Securities Industry Association, Grant Thornton, Blue Sky Meats, and Armillary Private Capital) appeared to support unregistered exchanges being allowed to remain unregistered. Three submissions (BNZ, the New Zealand Shareholders Association and NZX) appeared to favour all exchanges being registered. NZX's submission commented that "NZX considers that more work needs to be done to ensure that there is proper regulation of entities that are offering into New Zealand, and are, in substance, and regardless of the precise form of the operation, operating a securities' market."

Unlisted has subsequently indicated that operating as a registered exchange would be feasible if the process for obtaining registration is low cost, regulation applying to Unlisted and its issuers is sufficiently flexible (particularly in regard to disclosure and insider trading), and the FMA could not easily impose a higher regulatory burden subsequent to registration. Unlisted is of the view that the FMA is likely to be risk averse, with incentives that bias it towards imposing higher levels of regulation on registered exchanges than is desirable for market development.

The discussion document also asked about the pros and cons of allowing partial and full exemptions for registered exchanges (apart from the main board of the NZX) from the SMA.

Four submissions (Unlisted, William Foster, VINZ and Armillary Private Capital) argued that allowing NZX to operate an unregistered exchange would confuse investors. Two of these submitters (William Foster and Armillary Private Capital) also stated that it would allow anti-competitive cross-subsidisation.

Four submitters (Simpson Grierson, Grant Thornton, ISI and AMP) considered that all issusers listed on markets operated by registered exchanges should be subject to continuous disclosure.

Five submitters (Blue Kiwi Group, Bell Gully, NZX, INFINZ, Fonterra and the New Zealand Shareholders Association) supported partial exemptions for registered exchanges in appropriate circumstances. Submitters commented that:

- It would create a level of liquidity to small issuers which could be used as a first step to national markets;
- Some market depth could be gained by creating different tiers of markets; and
- There should be clear disclosure of the difference between registered exchanges that operate on the basis of partial exemptions and other registered exchanges.

The New Zealand Shareholders Association submission supported the possibility of second-tier exchanges, but considered that exemptions should not be given lightly (especially from continuous disclosure and insider trading requirements) and others should be able to make submissions on applications. They suggested that issuers above a certain size be required to list on a fully regulated market.

Part 2: Liability

STATUS QUO AND PROBLEM DEFINITION

The February Cabinet paper and regulatory impact statement set out and analysed issues with the current liability regime for contravening securities law. In summary, the present liability regime lacks coherence and contains confusing overlaps between different instances of liability. It is unclear how the different instances of liability interact to promote the objectives of the regime.

The February Regulatory Impact Statement noted that the effectiveness of securities law depends not only on the regulatory requirements imposed on issuers and others involved in financial products, but also on how those requirements are enforced by the FMA. In this context, the range of remedies available is a crucial part of the regime.

Cabinet agreed to simplify and rationalise this regime to meet the objectives of deterring non-compliance and encouraging voluntary compliance with securities law, providing remedies for those harmed by undesirable conduct, and punishing contraventions of the law. In order to achieve this, Cabinet agreed to a framework that would contain a combination of minor regulatory offences, pecuniary penalties, and serious criminal offences. Cabinet directed the Minister of Commerce to report back on the detail of this regime by the end of May 2011.

OBJECTIVES

The key objective of the liability regime is to encourage compliance with the law, as noted above. It is also important that the remedies or punishments in liability regime be proportionate to the wrongdoing in question, and that the costs of enforcement be kept low where possible.

REGULATORY IMPACT ANALYSIS

Penalty categorisation

We have assessed all current instances of liability in the Securities Act and Securities Markets Act, and where they will be retained, have categorised them into three main categories of liability event. We have also placed proposed offences within these categories. This will result in improved coherence of offence levels for different types of liability events, ensuring that the consequences of offending are proportionate to the seriousness of the contravention.

The three main categories of liability event: regulatory offences, civil pecuniary penalties, and serious criminal offences. We describe these categories in the table below.

Proposed category	Type of contravention	Comment
Regulatory offence	Contraventions with basic 'compliance' obligations that would not have serious consequences, e.g. failure by an issuer to maintain a register of securities.	Strict liability offences. Would be used for behaviour that results in simple clear-cut contraventions of the law. The FMA would have the ability to issue an infringement notice in respect of these offences. Penalty level would be a minor fine.
Pecuniary penalty	Civil liability for more serious contraventions, e.g. insider trading.	Civil liability for behaviour that is not sufficiently egregious to warrant the use of serious criminal offences. This category will be important for deterrence and will also provide a mechanism for harmed investors to seek compensation. Penalty will be a considerable fine.
Serious criminal offence	Egregious contraventions of securities law, e.g. knowing or reckless misstatements in a product disclosure statement.	Criminal responsibility for egregious contraventions of securities law. The behaviour must be reckless or intentional. Conviction will result in the potential for a significant term of imprisonment, creating a strong deterrent effect and effective punishment.

Infringement notices

We are proposing that the FMA will have the power to issue infringement notices in respect of the first category of offences. This would mean that the FMA would be able to issue a notice in respect of the contravention instead of the status quo of having to pursue the matter in a criminal court proceeding. The person receiving the notice would have the right to challenge the notice in court. We summarise the differences between the status quo and the proposed regime in the table below.

	Incentive to comply with law	Cost of enforcement	Proportionality to seriousness of contravention	Comments
Status quo: criminal enforcement through court proceedings	Low	High	Low	Unlikely to be enforced due to relatively high costs of court proceedings in relation to seriousness of contravention. Criminal conviction can be disproportionate to seriousness of contravention. Enforcement places burden on court system. Overall low deterrence value.
Proposal: Infringement notices	Medium	Low	High	Simple and cost-effective enforcement mechanism. Reduces costs for justice system. A fine that is proportionate to the seriousness of the contravention can be issued. FMA may still bring criminal proceedings for serious contraventions.

CONSULTATION

The proposals in respect of the liability regime were consulted on through the Review of Securities Law Discussion Document released in June 2010. The views of submitters were taken into account in the creation of the liability framework that Cabinet approved in the February Cabinet paper and in the design of the details described in this document. We have also consulted the Crown Law Office, Ministry of Justice, Treasury and Financial Markets Authority in relation to policy proposals concerning liability issues.

Part 3: Costings of licensing regimes

Cabinet has agreed in principle to the following licensing regimes, subject to costings:

- Derivatives dealers;
- Regulated intermediaries;
- Fund managers; and
- Trustees of workplace savings schemes.

All of the licensing regimes will involve fees, set by regulation (following consultation with stakeholders). The fees will not change the FMA's baseline appropriation (as agreed by Cabinet, CBC Min (11) 4/3, CAB Min (11) 10/1 refer). The FMA will absorb the cost of implementing the regime within its baseline and the fees charged will therefore offset the levy that it is proposed to charge financial market participants.

Fund managers

The licensing regime proposed for fund managers is a fit-and-proper person regime which looks at the character and experience of senior staff. It is expected that this regime will involve a similar test to that applied by the Reserve Bank for directors of banks.

Peer-to-peer lenders

Peer-to-peer lenders are effectively precluded from operating in New Zealand given the regulatory regime. Licensing is intended to introduce a regulatory regime proportionate to the risks that they pose. The licensing criteria will look at the character and background of the key individuals involved, and also a limited assessment of organisational processes.

Derivatives dealers

The FMA currently licenses futures and options dealers – these will be known as derivatives dealers in the new regime. The licensing criteria will look at the character and background of the key individuals involved, and also a limited assessment of organisational processes.

Trustees of workplace superannuation schemes

Cabinet agreed in principle to a requirement that workplace superannuation schemes (which do not have external supervisors) should be required to have at least one trustee licensed by the FMA who can demonstrate a degree of skill and experience.

The estimated costs of each licensing regime are:

	Average cost per organisation	Total annual cost for licensing the industry
Fund managers	$7,750 per organisation per five years	$108,500
Regulated intermediaries	$10,000 per organisation per five years	$4,000
Derivatives dealers	$10,000 per organisation per 5 years	$100,000
Trustees of workplace savings schemes	$1,550 per workplace scheme per five years	$31,000

These costings have been developed in consultation with the Financial Markets Authority. They are based upon estimates of how long it will take to assess applicants for the various kinds of licence and estimated hourly charging rates which include staff time and overheads. The costings take account of Treasury *Guidelines for Setting Charges in the Public Sector*.

Conclusions and Recommendations

On the basis of our assessment of the overall benefits, costs, and risks of each option for the regulation of securities and derivatives exchanges, we recommend:

- There should be a single system of licensing the operators of financial markets (both securities and derivatives markets) by the FMA;
- All markets should be licensed or exempted, with low regulation markets allowed to adopt alternative rules, including alternative disclosure and insider trading regimes. Exemptions should be granted where FMA oversight would be excessively onerous, and the risks to investor confidence are low. These exemptions should be subject to appropriate conditions to ensure that the exempt market continues to be operated in a low-risk manner; and
- The new securities bill should provide initial licenses and exemptions for existing registered and unregistered markets.

We recommend the above categorisation of penalties, and the use of infringement notices for regulatory offences. This will implement Cabinet's previous decisions in regard to the liability regime, and will result in improved and cost-effective enforcement of lower-level contraventions.

We recommend implementing the licensing regimes that were previously agreed in principle.

Implementation

The implementation process is the same as for the previous set of Cabinet decisions. In summary, new securities legislation implementing the policy proposals discussed in this RIS is likely to be introduced into Parliament towards the end of 2011. This legislation will repeal the Securities Act 1978 and Securities Markets Act 1988 and re-enact them as a single Act containing the proposals discussed in this RIS and in the previous Cabinet paper and RIS. This legislation is likely to be enacted in 2012.

18 months after enactment operators of financial markets will need to be licensed or exempted and will need to comply with the new oversight arrangements.

Monitoring, Evaluation and Review

Monitoring, evaluation and review will be conducted in accordance with the plan in the previous RIS. MED will undertake a review of the effectiveness of the new legislation within five years of its enactment. MED will use information that will be gathered by the FMA as part of its market surveillance function, the information in the FMA's annual reports and the post-implementation review of the FMA to inform this review.

The effectiveness of the exchanges regime will be assessed against the objectives outlined earlier in the RIS (e.g. improving the coherency and clarity of the regime, providing competitive neutrality between exchange operators, and ensuring transparent market rules and effective enforcement). The assessment will be informed by the FMA's annual oversight reports on registered exchanges, and by observing the extent to which "stepping stone" exchanges are able to operate and develop within the regime. To the extent that information is available, particular attention will be paid to the amount of capital raised by firms listed on stepping stone exchanges and any issues that arise for investors (including confusion).

The effectiveness of the liability and enforcement regime will be largely informed by the FMA's annual reports which will provide both detailed and high level measures regarding enforcement and deterrence of breaches of securities law.