**OFFICE OF THE MINISTER
OF COMMERCE**

The Chair
**CABINET ECONOMIC GROWTH AND INFRASTRUCTURE COMMITTEE**

# SECURITIES LAW REFORM

## PROPOSAL

1 This paper seeks Cabinet approval to reforms of New Zealand securities law, including changes to:

- The definition of security and the exemptions from the securities law regime;
- Disclosure requirements for issuers;
- The governance of collective investment schemes; and
- A range of other matters, including the liability regime for breaches of securities law.

## EXECUTIVE SUMMARY

2 Securities law governs how financial products are created, promoted and sold, and the ongoing responsibilities of those who offer, deal and trade them. Securities law aims to facilitate the development of an efficient capital market by encouraging the development of confident and informed investors, and assisting businesses to access capital.

3 There has been a comprehensive work programme in the financial sector area in recent years which has included, amongst other things, the prudential regulation of non-bank deposit takers and insurance companies, and the licensing of key financial sector participants such as financial advisers, trustees and auditors. This paper complements the work in this area and is the result of a wide-ranging review of securities law that has focused on:

- The scope of securities law (i.e. which financial products, and offers of those financial products, should be regulated under securities law);
- What the disclosure obligations of issuers should be;
- How collective investment schemes should be regulated; and
- A range of other matters including the liability regime for breaches of securities law, public enforcement of directors' duties, and the appropriate regulatory framework for securities exchanges.

4 The paper proposes substantial changes to these aspects of securities law.

**Scope of securities law**

5 The paper proposes that the current definitions of different types of security be replaced by four classes of regulated financial product: equity, debt, collective investment schemes, and derivatives. These classes of regulated financial product would be defined to a greater extent upon the economic substance of the product than is currently the case. The paper also proposes providing for two categories of regulated financial service: non-pooled investment schemes, and specified intermediary services.

6 The paper also proposes that the current concept of the regime only regulating securities offered to the public be abolished. In its place, this paper proposes that all offers of regulated financial products be covered by the regime unless specifically exempted. It also proposes that the exemptions be clarified and two new exemptions added.

**Disclosure obligations of issuers**

7 The paper proposes that the current requirement for issuers to prepare a prospectus and investment statement be replaced by a requirement to prepare a single product disclosure statement (PDS) tailored to retail investors. The PDS would be divided into two parts, a short one to two page key information summary to facilitate comparisons between products, and a more detailed second part with all of the information that is essential to an investor's decision about whether to invest. PDSs would be tailored to fit specific financial products (for example, there may be different PDSs for different kinds of collective investment scheme). The content of PDSs would also be heavily prescribed, and the length of the PDS would be prescribed, where practical, given the nature of the financial product being issued.

8 Additional disclosures for secondary audiences (such as analysts and market commentators) would be provided on the new Register of Securities established by the Financial Markets (Regulators and KiwiSaver) Bill. In addition, the paper proposes some additional ongoing disclosure requirements for debt issuers, and where appropriate, collective investment schemes. It also proposes shifting to a principles-based approach to the regulation of advertisements.

**Collective investment schemes**

9 Many of the key issues identified with the current regulatory framework for collective investment schemes relate to the multiplicity of forms schemes can take and the resulting inconsistency of governance and legal obligations across those forms. The paper proposes creating a single collective investment scheme regime, in effect a statutory overlay, under which schemes would be free to adopt any legal form but would be required to comply with a common set of substantive requirements sufficient to ensure an adequate level of investor protection. It also proposes that the regime provide for a special company form of collective investment scheme in order to aid product innovation and facilitate greater share market participation.

10 The overlay would require all collective investment schemes to have an external supervisor. The external supervisor would also be primarily responsible for the custodianship of the assets of the scheme, and would be responsible for supervising the manager of the scheme (who would also be the issuer of interests in the scheme for the purposes of securities law).

11 Supervisors and fund managers would have a prescribed set of functions and duties that they must adhere to and cannot contract out of. The paper also proposes that fund managers be subject to a fit and proper person test, given the risk associated with fraudulent or dishonest behaviour by those in this role.

12 In recognition that there are legacy issues with some existing workplace superannuation savings schemes, the paper does not propose that they be covered by the new regime. However, the paper proposes that such schemes be required to appoint an independent trustee so as to better safeguard members' interests.

**Other matters**

13 The paper proposes a range of other changes to strengthen the securities law framework; the most important of these changes are the public enforcement of directors' duties and the liability regime for breaches of securities law. Specifically, the paper proposes that:

- The most egregious breaches of directors' duties be subject to criminal liability, and be publicly enforceable by the Financial Markets Authority and the Registrar of Companies;

- The liability framework for securities law be amended to focus on civil remedies and obtaining compensation for investors, with only the most egregious cases having criminal offences; and

- Officials do further work on the appropriate regulatory framework for the regulation of securities exchanges, and report back to Cabinet on this matter by 31 May 2011.

**Structure of securities legislation**

14 Finally, the paper proposes that the Securities Act 1978 and the Securities Markets Act 1988 be repealed and re-enacted into a single piece of legislation, which will incorporate the changes to securities law proposed in this paper.

15 It is proposed that those parts of the Securities Act 1978 and the Securities Markets Act 1988 that are not affected by the changes proposed in this paper be carried over into the new legislation (subject to minor or technical drafting changes).

## BACKGROUND

### The scope and objectives of securities law

16 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.

17 In particular, securities law regulates entities that:

- Seek funding through equity or debt instruments;
- Invest in financial assets on behalf of others; or
- Enter into derivative contracts for risk hedging or speculation.

18 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.

19 The principle objective of securities law is to facilitate capital market activity, in order to help businesses to grow and to provide individuals with opportunities to develop their personal wealth.

20 Investors need to be satisfied that they and their advisers have the information required to make confident and informed decisions and that obligations on issuers and others will be enforced. Issuers need investor participation in capital raisings to be successful, and regulation needs to achieve the desired objectives at minimum cost.

### Scope of the Securities Law Review

21 In recent years there has been a wide ranging programme of reform of financial sector legislation. This reform agenda has been progressed on a staged basis according to the priorities of the Government of the day, and has included:

- The new regulatory regime for financial service providers enacted in 2008 through the Financial Advisers Act and Financial Services Providers (Registration and Dispute Resolution) Act 2008;
- Prudential regulation of non-bank deposit takers enacted in 2008 through part 5D of the Reserve Bank of New Zealand Act 1989, and a licensing regime for deposit-takers being developed;
- Prudential regulation of the insurance sector enacted in 2010 under the Insurance (Prudential Supervision) Act 2010;

- A new licensing regime for securities trustees and statutory supervisors that will be established by the Securities Trustees and Statutory Supervisors Bill;

- The establishment of a new consolidated market conduct regulator for the financial sector, the Financial Markets Authority (FMA); and

- Measures to strengthen the governance of and disclosure by KiwiSaver schemes.

22 The Securities Law Review aims to address most of the remaining gaps in the financial sector reform agenda and focuses primarily on:

- The scope of the securities law regime (i.e. what financial instruments and offers of securities should be covered by the regime);

- The disclosure requirements of issuers;

- The regulation of collective investment schemes; and

- A range of other matters including the liability regime for breaches of securities law and the public enforcement of directors' duties.

**Context to the Securities Law Review**

23 New Zealand's securities law has been amended multiple times since the Securities Act 1978 was enacted. This review provides an opportunity to rewrite the legislation in an integrated and coherent manner. The review is timely as it allows us to take into account the work of the Capital Market Development Taskforce (the Taskforce), the global financial crisis and the failure of many finance companies in New Zealand.

*The Taskforce*

24 The recommendations of the Taskforce formed the basis of much of the discussion document I released in June 2010. Submissions on that document and detailed analysis by officials have led to some adjustments to the original Taskforce proposals, although the basic framework recommended by the Taskforce forms the backbone of the proposed review. In many cases the changes were necessary because the Taskforce's proposal were at an 'in principle' level and further analysis was required to develop concrete proposals. Appendix 4 contains an analysis of the Taskforce's proposals on securities law compared to the changes proposed in this paper.

25 In two key areas discussed in more detail below, the proposals go further than that suggested by the Taskforce. First, on balance, I am recommending a light fit-and-proper person licensing regime for fund managers. The Taskforce did not explicitly consider this issue and on balance the public submissions on this issue (including from industry members) were in favour of licensing.

26 Secondly, I am proposing that the FMA and Registrar of Companies have the ability to enforce egregious breaches of directors' duties in some key areas. There would be a high threshold to be met before action would be possible. The Taskforce did not recommend such a power. However, the Institute of Directors supported this power in its submission on the discussion document that I released in June 2010.

*Lessons from the financial crisis*

27 Many countries have reviewed their financial sector regulatory structures since the crisis and in most cases appear to be substantially increasing the regulatory burden. While much of the focus is on banks rather than securities markets, there has been a tightening of requirements on exchanges and moves to require more derivatives trading to occur on regulated exchanges. Regulators have sought to reduce the amount of activity that occurs outside of the regulatory umbrella. I propose to report back to Cabinet on the regulation of exchanges in April 2011.

28 In New Zealand most derivatives activity occurs between banks (which are well regulated by the Reserve Bank) and/or is on markets which are authorised and overseen by regulators. Accordingly, there is less need to make a change here.

*Comparison with other countries*

29 The changes proposed in this paper will ensure that New Zealand's regime for disclosure is at the fore-front of international developments. In other areas the regulatory burden will generally be lighter than in other countries, reflecting the smaller size of many of our firms and markets and our desire to be competitive relative to other regimes, including Australia. While generally appropriate for our domestic needs, the lighter regulatory regime does make it more difficult to achieve full mutual recognition for our regime by offshore authorities which are accustomed to a more intrusive regulatory environment.

*Regulatory philosophy underlying the Securities Law Review*

30 The current securities law regime is based upon mandatory disclosure and governance/supervisory requirements for issuers. An alternative approach would be merit-based regulation of financial products. This would involve the regulator performing its own assessment of the merits of particular products and banning those products that it considered were too risky or mispriced.

31 The analysis undertaken as part of the review has not suggested that a shift to a merit-based regulatory regime would be appropriate. Such a regime would run the risk of stifling innovation in the financial sector. It would also have the drawbacks of being difficult and expensive to administer and run the risk that the government could be seen as the guarantor of the quality of investments that are provided to the market.

32 As is discussed further below, most of the problems with the current regime have arisen through failures in the current requirements relating to disclosure, governance and supervision, rather than being inherent in a regime based upon these requirements. As a result, I do not propose a move to merits-based regulation.

*Legislative process*

33 I intend to release an exposure draft of the Bill prior to introduction in Parliament. Given the technical and complex nature of the work, officials will actively engage with stakeholders during the drafting process, which may result in some changes to the Bill. I propose that I be authorised to make changes consistent with the policy framework proposed in this paper.

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

## PROPOSED STRUCTURE OF NEW SECURITIES LEGISLATION

### Status quo and problem definition

35 As noted above, New Zealand securities law is primarily contained in the Securities Act 1978 and the Securities Markets Act 1988. These pieces of legislation have been amended on numerous occasions in the last 30 years. This has resulted in legislation that in certain respects lacks a coherent and rational structure, and can be difficult to navigate for all but the most experienced securities law practitioners.

36 For example, the overall objectives of securities legislation are not set out in either the Securities Act 1978 or the Securities Markets Act 1988. In addition, certain fundamental obligations under securities law (such as the prohibition on misleading or deceptive conduct when trading in securities) are not prominently set out in the legislation.

### Proposed structure of securities legislation

37 I propose that the Securities Act 1978 and the Securities Markets Act 1988 be repealed and re-enacted into a single piece of legislation that will incorporate the changes to securities law discussed in the remainder of this paper. Where I am not proposing any changes to parts of the Securities Act 1978 or the Securities Markets Act 1988, I propose that those parts be carried over into the new securities legislation (subject to minor or technical drafting changes). This structure was recommended by the Taskforce.

38 In addition, I propose that the purpose of the securities law be set out clearly in the legislation as being the facilitation of capital market activity, in order to help businesses to grow and to provide individuals with opportunities to develop their personal wealth.

39 I also propose that the new legislation provide that an obligation to not engage in misleading or deceptive conduct when dealing in securities (in both private and public markets) be the primary obligation of issuers and financial market participants under securities law. Other provisions relating to disclosure and governance will flow out of this primary obligation.

## GENERAL DEFINITION AND CATEGORISATION OF REGULATED FINANCIAL PRODUCTS AND SERVICES

### Status quo and problem definition

40 The current Securities Act 1978 defines security as "any interest or right to participate in any capital, assets, earnings, royalties or other property of any person". Securities under this definition may come within any one of six categories: equity, debt, units in unit trusts, interests in superannuation schemes, life insurance policies, and participatory securities.

41 The current definitions of the different types of security are largely based upon the legal form of the specific security being offered, and result in the following problems:

- The fact that the current definitions are largely based upon the legal form of the security means that some securities are not categorised correctly and can thereby avoid the appropriate legal requirements. For example, a company can choose to issue specially structured shares that have rights equivalent in economic substance to a debt security or interest in a managed fund, but which are treated as equity securities by the Securities Act 1978. This has the result that, amongst other things, the issuer can avoid the requirement to have a trustee;

- The category of participatory security is a catch-all for those securities that do not fall within any of the other definitions. However, if a security is classed as a participatory security it is subject to certain requirements that may not be appropriate in many cases, in particular, the requirement to appoint a statutory supervisor;

- The current definitions capture certain matters that should arguably not be covered within the regime. For example, certain types of clubs and charitable entities that offer philanthropic type investments;

- There is uncertainty around how certain types of derivative should be regulated; and

- The current regime effectively restricts the ability of market participants to carry out particular services or activities, such as peer-to-peer lending.

**Proposed definitions of regulated financial products and services**

42 To address the problems outlined above, I propose that securities law should cover the following four categories of regulated financial product:

- Equity securities;
- Debt securities;
- Collective investment schemes; and
- Derivatives.

43 Appendix 1 sets out the current working definitions of each of these financial products. The working definitions of these categories are more focused on the economic substance of the financial product being offered, and will be refined during the drafting of the legislation, in consultation with industry participants.

44 I also propose that the legislation provide for two categories of regulated financial service, specifically:

- Provision of non-pooled investment schemes (for example, where a person offers a service of investing funds on behalf of another person through a structure such as a wrap account); and
- Provision of specified intermediary services (for example, where a person operates a peer–to-peer lending service).

**Regulatory requirements arising out of the different classification of financial products**

45 I propose that issuers of any of the new categories of regulated financial products would be subject to the following requirements (unless covered by an exemption):

- Equity: A requirement to make disclosures to investors;
- Debt: A requirement to make disclosures to investors, and a requirement to have a trust deed and trustee;
- Collective investment schemes: A requirement to make disclosures to investors, and a requirement to have an external supervisor (who would also have responsibility for the custodianship of the assets of the scheme). They would also be subject to extensive additional requirements that are discussed in more detail below; and
- Derivatives: A requirement to make disclosures to investors, and a requirement to be licensed by the FMA where they are in the business of dealing in derivatives.

46 In addition, I propose that providers of regulated financial services be subject to the following requirements (unless covered by an exemption):

- Provision of non-pooled investment schemes: A requirement to make disclosures to investors (providers of non-pooled investment schemes will also be subject to other regulation under the Financial Advisers Act 2008 and Financial Service Providers (Registration and Dispute Resolution) Act 2008); and

- Provision of specified intermediary services: A requirement to be licensed by the FMA.

**Designation power**

47 While it should be clear in the vast majority of cases which category of regulated financial product or service applies, I consider that it is necessary for the regime to have the flexibility to deal with cases where the categorisation is not clear.

48 Accordingly, I propose that the FMA have a power to designate a financial product, arrangement or transaction to be in a particular category of financial product or service.

49 This could include designating a product that would otherwise fall outside the definitions of regulated financial products, clarifying that a product is in a particular category (if there is uncertainty), or shifting a product from one category to another (if, for example, the regulation of that category is better suited to the product).

50 The FMA would be able to make designations applying to either individuals or classes of individuals.

51 The requirements for the FMA to designate a product or service would be that:

- The FMA is satisfied that the product or service is in the nature of an investment or can be used to hedge financial risk;

- The FMA is satisfied that it is in the public interest to designate the product or service, having regard to its objective;

- The FMA has consulted with affected parties; and

- Within 30 days of designating the product or service, the FMA publishes a statement of its reasons.

52 Designations would not be retrospective, but would apply to all subsequent allotments of the product or offers of the service. For example, if a product that was originally treated as equity was designated by the FMA as being debt, then the requirement to have a trustee would only apply to future allotments of that product.

53 Where the FMA is considering designating a product or service, I propose that the FMA will be able to issue an interim stop order preventing further allotment of a product, or offer of the service, until a decision is made.

54 The requirements for the FMA to issue an interim stop order would be that the FMA is satisfied that it is in the public interest to issue an interim stop order. Upon issuing an interim stop order, the FMA would have up to 20 working days to make a decision before the order would automatically lapse.

55 In making a designation, the FMA would be able to customise the regulatory requirements attaching to that designation by exempting the issuer or service provider from particular requirements of securities legislation, or by imposing particular requirements of securities legislation on the issuer or service provider (that would not otherwise apply to the designated category). For example, the FMA could provide for tailored disclosure requirements, or require the product to have a licensed trustee.

## LICENSING OF SPECIFIC FINANCIAL MARKET PARTICIPANTS: DERIVATIVES DEALERS AND REGULATED INTERMEDIARIES

### Derivatives dealers

56 Both parties to a derivative contract are issuers. However, transactions will typically involve one party or intermediary who is in the business of dealing in derivatives.

57 I propose that persons who are in the business of dealing in derivatives be required to be licensed by the FMA (in most cases they are currently required to be authorised by the Securities Commission or an authorised futures exchange at present). I propose that these persons be able to be licensed for particular classes of derivatives, or derivatives generally, and subject to terms and conditions. Before granting a licence, I propose that the FMA must be satisfied that the following licence criteria will be met by the applicant:

- The applicant is a body corporate that is incorporated in New Zealand or an overseas company registered under the Companies Act 1993;
- Every director and senior manager of the applicant is of good character;
- The applicant is registered under the Financial Service Providers (Registration and Dispute Resolution) Act 2008;
- The applicant's directors and senior managers have the experience, skills, and qualifications needed to issue derivatives to members of the public;
- The applicant has the financial resources and systems to meet its obligations to those it issues derivatives to; and
- The applicant maintains adequate professional indemnity insurance for its business at all times.

58 As part of its obligations as a licensee, the licensee must observe good practice in dealing with client funds and property. This requirement will be aligned with those of brokers under the Financial Advisers Act 2008. Specifically, this will mean that:

- Funds received from clients must be paid into a separate client funds account;
- The applicant must account properly to individual clients for client money or property received;
- The applicant must not apply client funds or property in any way except in accordance with the written terms of the derivative contract with that client;
- The applicant must ensure that client fund account records are maintained that disclose clearly the position of the client money in the client fund account;
- The applicant must ensure that client property records are maintained that identify the client property, show the date when the client property was received, and if the client property has been disposed of, show where the client property was disposed of and to whom; and
- Records must be kept in a manner that enables those records to be conveniently and properly audited or inspected.

59 The licensee would also be required to immediately notify the FMA in writing of any material matter that may affect the company's ongoing compliance with the licence criteria or any breach of the terms and conditions of its licence. Additional licence terms and conditions could also be set in regulations or by the FMA, and the FMA would have the power to vary the terms of a licence.

60 A statutory exemption from the licence requirement would also be provided to dealers in foreign exchange.

**Regulated intermediaries**

61 Intermediaries in the investment context are individuals or organisations that operate as brokers between parties to securities transactions. Some intermediaries, such as futures dealers and venture capital scheme administrators, already operate under tailored regimes in the current securities law, and provide valuable services in the financial sector. These regimes allow brokers to take on some of the disclosure and governance requirements of the "issuer" of securities, as they are best placed to do so.

62 I propose that a licensing regime be created to generalise this concept to allow new intermediaries to be authorised by the FMA to provide certain types of services. A person licensed as a regulated intermediary would be able to take on responsibility for meeting certain regulatory requirements, such as disclosure, record keeping etc, on behalf of an issuer. This regime would be used where it is impractical for an issuer to meet the requirements of securities law and a supervised intermediary is better placed to do so.

63 The proposed licensing regime will include the following features:

- A regulated intermediary will need to be licensed by the FMA before operating;
- The intermediary will need to be a fit and proper person to be an intermediary;
- The FMA may impose specific conditions on the intermediary;
- The intermediary must inform the FMA of changes to material matters concerning their license;
- The FMA will be able to respond to new information concerning the intermediary in various ways, including by varying, placing restrictions, suspending and cancelling their license; and
- There will be a right of appeal to the High Court from an FMA decision in relation to the license.

64 Providers of peer-to-peer lending services would be the only class of regulated intermediaries initially defined under securities law. These services allow investors to lend money to individual borrowers, with the service acting as a 'matchmaker'. They have become popular overseas in recent years, but the current securities regime in New Zealand has made it impractical for them to operate in New Zealand.

## WHICH OFFERS OF FINANCIAL PRODUCTS SHOULD BE COVERED BY SECURITIES LAW?

### Status quo and problem definition

65 Securities law currently provides that offers of securities to the public are covered by the regime unless they are exempted. The Securities Act 1978 provides for several different kinds of exemptions (some of which only result in partial exemptions from the legislation). There are currently four broad categories of exemption:

- Offers that are not made to the public. These exemptions apply to, amongst others, relatives or close business associates of the issuer, habitual investors, and persons who have, or are each required to, pay a minimum subscription price of at least $500,000;
- Exempted offers: This exemption is provided in section 5 of the Securities Act 1978 for offers to wealthy investors (being persons with net assets over $2 million, or income greater than $200,000 per year) and persons certified on reasonable grounds by an independent financial service provider as sufficiently experienced that they can assess the offer without a prospectus and investment statement;

- Other statutory exemptions: These cover a diverse range of entities (such as the Reserve Bank and the National Provident Fund) and products that would otherwise come within the definition of security (such as interests in land); and

- Securities Commission exemptions: these include offers to certain types of investor (e.g. employee share schemes) and other case-by-case exemptions for classes of offer and individual issuers.

66 There are a variety of problems with the existing exemptions. Most importantly:

- An overarching issue with some of the exemptions is that – whether by design or because of the way they have been interpreted by the courts – their scope is unclear. Some issuers are advised against obtaining funding from investors who should be able to participate in private offerings, or are exposed to risks (of void offers and criminal charges) that they should not be exposed to. Unclear exemptions can also harm investors by preventing them from participating in private securities offers;

- Many of the exemptions are based on subjective characteristics rather than objective tests. This limits their use to only clear-cut situations; and

- There are sometimes disproportionate consequences for accidentally including members of the public in a private offer. While the boundaries of the private offer exemption are uncertain, the consequences of getting it wrong are severe. It takes only one member of the public to receive the offer for it to be considered a public offer and therefore outside the scope of the exemptions. If this occurs, or if for any other reason an offer is made in breach of the Act, the offeror and its officers may have committed a criminal offence, may be subject to management banning orders and may be liable for repayment of all the funds received (i.e. the offer is void).

**Proposed exemptions**

67 I propose that all offers of regulated financial products should be covered by the regime unless they are specifically covered by an exemption, which will help to address the potential lack of clarity in certain cases around the boundary between ‘public’ and ‘private’ offers. In light of this change, and the specific problems that arise with many of the current exemptions, I propose that exemptions to securities law be provided for the following classes of offer:

- Offers to sophisticated investors;

- Offers to persons with a close relationship to the issuer;

- Offers of equity as part of employee share schemes;

- Small offers of equity or debt securities; and

- A number of more narrow exemptions relating to specific entities or products.

68 Any offers made under these exemptions would be subject to liability for false and misleading statements. However, offers to sophisticated investors and persons with a close relationship to the issuer would be exempt from all other regulatory requirements.

69 Offers to employees and small offers would have minimal disclosure requirements, but would be exempt from other regulatory requirements.

*Sophisticated investors*

70 I propose that there be a principle-based definition of 'sophisticated investor' with bright-line safe harbours. The principle-based definition would be (subject to drafting): "A person who has previous experience in investing in securities that allows them to assess the merits of the investment, the value of the securities, the risks involved, their own information needs, and the adequacy of the information provided by the issuer of the security."

71 The bright-line safe harbours would cover:

- investment businesses;
- persons who meet certain quantitative investment activity criteria;
- large entities;
- certain government entities; and
- persons investing large amounts over $500,000.

72 Working definitions of the specific exemptions for these persons are included in Appendix 2. These definitions will be refined during the drafting of the legislation, in consultation with industry participants.

73 I note that in these working definitions there has been a tightening of the exemption in relation to wealthy investors. As mentioned above, there is currently a standalone exception for wealthy investors (persons with net assets over $2 million, or income greater than $200,000 per year). I propose that these wealthy persons must also have demonstrated investment activity or experience before being exempted under a bright-line safe harbour.

74 This would ensure that an investor is not considered 'sophisticated' and therefore automatically exempted just because they have recently come into a sizeable amount of money, for example by selling a farm or business. I consider this to be an important protection for some investors.

75 Investors who do not qualify under one of the bright-line safe harbours may still take advantage of the principle-based definition of 'sophisticated investor'. However, in order to ensure that the appropriate set of investors fall within the exemption, I propose that those seeking to take advantage of the principle-based definition be required to have their qualification approved by an Authorised Financial Adviser.

76 In the first instance, the issuer (which for these purposes would include providers of non-pooled investment schemes) would be responsible for ensuring that the investors meet any criteria and are sophisticated investors. The issuer could, however, request that an investor certify in writing that they meet any of the safe harbour requirements, or produce an approval from an Authorised Financial Adviser where the investor seeks to rely on the principle-based definition. The issuer would be entitled to rely on the investor's certification, unless the issuer knows that the statement is false. It would be an offence to encourage a person to self-certify knowing that the certification is false, and for an investor to self-certify knowing that the certification is false.

77 In assessing whether or not a person is sophisticated, calculations that involve a person's assets, revenues or investments would include relevant related entities (e.g. the same company group). If a person is sophisticated, other relevant related entities would also be exempt (e.g. companies controlled by that person).

*Persons with a close relationship to the issuer*

78 I propose that there be a number of specified exemptions for 'persons with a close relationship to the issuer', who, broadly speaking, are persons who, by virtue of their relationship with the issuer or a director of the issuer, have the knowledge or the means to obtain the knowledge of information that would normally be disclosed under the disclosure obligations in securities law. The specific exemptions for persons with a close relationship to the issuer would cover:

- Relatives; and
- Close business associates.

79 Working definitions for these safe harbours are included in Appendix 2. These definitions will be refined during the drafting of the legislation, in consultation with industry participants. If a person has a close relationship to the issuer, other relevant related entities would also be exempt (e.g. companies controlled by that person).

*Offers of equity as part of employee share schemes*

80 Employee share schemes are plans under which employees are given shares or options in the company. Employee share schemes are intended to link employee remuneration to the performance of the company, and therefore create incentives for employees to improve company performance. They are also used as a partial substitute for cash remuneration (especially in young, rapidly growing companies that are 'cash poor'), and to foster a sense of ownership among employees and participation in the company's management and direction. To create incentives to boost long-term company performance, shares are often intended or required to be held for long periods before they are traded, and options may have significant delays before they can be exercised.

81 I propose an exemption for employee share schemes based on Securities and Exchange Commission Rule 701 in the United States. Employee share schemes meeting certain criteria would be exempt from most disclosure and governance requirements. A short-form disclosure document would be required that would likely include:

- The full terms of the offer;
- A statement of the purpose of the scheme;
- A statement, prescribed in regulations, of the generic risks of such schemes; and
- A copy of the issuer's financial statements, audited (if available), and the issuer's annual report (if available).

82 The precise contents of this disclosure document would be specified in regulation.

83 The conditions for use of this exemption would be:

- It is for equity securities, equity warrants, or equity options in the issuer;
- It does not exceed 15% of the gross assets of the company; and
- The offer is made as part of remuneration arrangements and separate from any other financial product offering by the issuer.

*Small offers*

84 I also propose that a new exemption be provided for small offers. This exemption would increase the ability of small companies to raise capital, and results from a recommendation of the Taskforce. The exemption would be similar to one in place in Australia, which I understand has proved to be a useful tool.

85 I propose that the offer would need to meet the following criteria to be eligible for the exemption:

- The offer is for equity or debt securities in a person that is a non-property company;
- $2 million may be raised per 12 months;
- The company may have up to 20 investors per 12 months; and
- There is a cap of $100,000 per investor per 12 months, unless the investor is sophisticated.

86 For these kinds of offers a very basic disclosure document would be required that would state that:

- Because this is a small offer, it has an exemption from normal disclosure and (where relevant) trustee requirements; and
- The investor accepts full responsibility for making the investment decision and should seek independent financial advice if in doubt.

87 I also propose that there be certain marketing restrictions to reduce the risk that potential investors may be harmed by rogue traders.

*Other exemptions for specific entities or products*

88 In addition to the exemptions canvassed above, I recommend that a number of other more specific exemptions be provided for. The majority of these exemptions would either be carried over directly from the current Securities Act 1978 or slightly amended versions of exemptions that are currently provided for in that Act. The specific exemptions I am proposing are:

- Offers of previously allotted securities as provided for currently in the Securities Act 1978;
- The purchase of a unit title under the Unit Titles Act 2010 and associated interests in common property and a body corporate (on the basis that it is adequately regulated by the Unit Titles Act);
- The purchase of an interest in a registered retirement village (on the basis that it is adequately regulated by the Retirement Villages Act 2003);
- Debt securities issued by registered banks (including bank deposits and term deposits), callable building society shares; and bonus bonds (which are all currently exempt from securities law requirements);
- Securities issued by the Crown, National Provident Fund, Government Superannuation Fund, RBNZ, Housing New Zealand, Local Government and Registered Charities (although they may still be subject to lesser disclosure requirements in certain circumstances); and
- Equity securities or interests in a collective investment scheme allotted under a dividend reinvestment plan, subject to certain conditions (although this exemption will only apply to disclosure requirements).

## DISCLOSURE

### Point of sale disclosure - status quo and problem definition

89 The Securities Act 1978 provides for disclosure to potential investors in the form of a 'prospectus' and an 'investment statement'. In general, where an offer of securities is made to the public, a prospectus must be registered and be provided to potential subscribers on request, while an investment statement must be provided to the investor before subscribing for the security.

90 Prospectuses are intended to provide full details of the offer and the circumstances of the issuer. In general, prospectuses must not be false or misleading, including by failing to refer, or give proper emphasis, to known adverse circumstances.[1] Specific content required in prospectuses is prescribed in regulations. In most cases the regulations require that prospectuses disclose "all material matters in respect to the offer". In addition, the regulations specify particular detailed requirements depending on the type of offer and type of security.[2]

91 By contrast, an investment statement is intended to provide key information to assist a prudent but non-expert person to decide whether or not to subscribe for securities, and bring to their attention important information available in other documents. An investment statement must not be likely to deceive, mislead, or confuse with regard to any particular that is material to the offer of securities to which it relates and must be consistent with any registered prospectus referred to in it. The investment statement was originally introduced because it was felt that prospectuses did not fulfil all the needs of retail investors, and a separate, more accessible document was required.

92 There is currently only one set of requirements for investment statements for new offers of securities, regardless of the type of security.[3] The current investment statement uses a question and answer format, and must include details about the securities, the people involved, the monies payable, any charges, the returns, the risks, alterations, terminating or selling, contacts, complaint resolution, and where other information can be obtained.

93 I consider that there are a number of specific problems with the current regime. In particular:

- The focus of the current enforcement regime is slanted towards false or misleading statements in a prospectus. Given that the document provided to all investors is the investment statement, this should be the most important document and the document subject to most scrutiny;

[1] See sections 37A(1)(b), 42, 44 and 55.
[2] See, for example, Securities Regulations 2009, schedules 1 to 12.
[3] Securities Regulations 2009, schedule 13. A particular form of investment statement is required for moratorium proposals under the Securities (Moratorium) Regulations 2009.

- Investment statements have become increasingly lengthy which has undermined their initial rationale. Material is duplicated between the investment statement and prospectus, and there is limited use of cross references;

- Prospectuses appear to be excessively long. A random sample of 100 prospectuses from 2008 found they ranged from 16 to 354 pages in length, with a median of 63 pages. While there was some variation between prospectuses for different types of securities types, all were generally long; and

- Given the length and complexity of offer documents, retail investors cannot readily compare different investments in order to make an informed investment decision.

94 These problems are caused by three main issues: deficiencies in the current legal framework concerning the content required to be included in prospectuses and investment statements, concerns about the risk of liability, and issuers lacking incentives to provide adverse information to investors in a concise and clear manner.

*Deficiencies in the legal framework*

95 The prescribed matters that must be included in prospectuses have arguably not kept pace with market developments. Prospectuses duplicate information that might be more easily accessible through other means. These other means may include contacting issuers directly or accessing aggregated and comparative information from specialist service providers. In addition, the required contents of prospectuses are not well tailored to a clearly defined audience, whether that audience is retail investors, or other information users like market analysts.

96 The requirements for investment statements do not provide sufficient guidance to issuers about what matters should be included and are relevant to the various questions that must be answered in an investment statement. For example, when answering the question “What are my risks?” in the investment statement, it is unclear whether these risks should be generic or specific to the particular product, industry, or issuer. The content of investment statements also duplicates much of the content of prospectuses. There is no requirement to register investment statements, even though investors are much more likely to have seen the investment statement rather than the prospectus before buying securities.

*Concerns about the risk of liability*

97 There is strong anecdotal evidence that the preparation of disclosure documents is sometimes seen as an exercise in risk management and fear of liability, rather than a genuinely useful mechanism for conveying information (although some market participants appear to see the due diligence exercise involved in preparing such documents as a valuable discipline on would-be issuers). The risk of liability arguably encourages issuers to add in unnecessary matters, due to a concern around potential liability for missing issues out.

*Issuers' incentives to present information clearly*

98 With certain relatively minor exceptions, the law does not prescribe how material must be presented in prospectuses and investment statements. While many issuers do endeavour to present information as clearly as possible to investors, the lack of control over how information is presented means that key information can be difficult to find in a prospectus or investment statement. There is also a tendency for prospectuses and investment statements to contain large amounts of marketing material that can detract from investors' ability to easily identify key information about the investment.

**Product disclosure statement**

99 To address these problems with the existing regime, I propose that the current requirement to prepare a prospectus and investment statement be replaced by a requirement to prepare a single disclosure document, called a Product Disclosure Statement (PDS). The PDS would only contain information that is essential to an investor's decision, and would be specifically targeted at retail investors.

100 The PDS would be heavily prescribed for mainstream products in order to promote comparability. Separate requirements would be prescribed for different types of financial product and different types of offer. This would enable comparability between similar products and offers, while ensuring the most relevant information is provided to investors.

101 In designing the PDS the level of standardisation would vary from financial product to financial product. The content would be prescribed in regulations made under the new securities legislation, as it is under the 1978 Act. This follows the approach taken to development of product disclosure statements in Australia, which is progressively working through the products to produce tailored documents, starting with collective investment schemes. For managed fund products, the length of the documents could be prescribed.

102 I propose that the PDS have two parts. The first part of the PDS would be a key information summary (KIS). I consider that there is value in requiring a two page summary at the beginning of even very short PDSs, as this would make it easier for investors to compare offers side by side.

103 The PDS would be prescribed in regulations, with contents along the lines of the following:

- **Equities:** Details of the issuer including a brief description of its business, the type and class of security, the price, whether the securities will be listed, the issuer's dividend policy (including whether dividends can be reinvested), how investors can get their money out, and a summary of the purpose of the issue (e.g. retiring existing debt, new acquisitions etc.);

- **Debt**: Details of the issuer including a brief description of its business, the type and structure of the security, the credit rating (if any), the interest rate (or how it is calculated), the term of the investment, whether and how an investor can withdraw before maturity, and a summary of the purpose of the issue (e.g. retiring existing debt, funding lending activity, new acquisitions etc.);

- **Collective investment schemes:** Details of the people involved in the fund's management; the investment options (conservative, balance, aggressive rent etc), whether returns will be paid to investors, reinvested, or whether that will be optional, the asset classes invested in and the minimum contribution levels or rates, historical return information and how investors may withdraw heir money;[4] and

- **Derivatives:** The details of the counterparty to the derivative, the underlying commodity, index, asset or security, and how the derivative makes/loses value, potentially a statement that this is a complicated financial product that should not be entered into without financial advice, and how investors can get their money out.

104 The main body of the PDS would then contain more detailed information of the product, but as noted above this information would only be information that is considered crucial to an investor's decision. It could also incorporate information by reference, for example, to the Register of Securities or the issuer's website.

**Register of Securities**

105 The Financial Markets (Regulators and KiwiSaver) Bill establishes a new electronic register of securities offerings, which will help to facilitate comparability between documents.[5] I propose that more detailed information about the offer be placed on the Register of Securities. This information may include, for example, full financial statements. The purpose of this disclosure would be to provide additional information for retail investors who may want to know more, and to provide information that may be of use to key secondary audiences like analysts and financial advisers.

106 I propose that issuers continue to be required to disclose any other material matters relating to the offer, in addition to the prescribed disclosures that will be required, but that this disclosure be made on the Register rather than in the PDS (although the PDS may contain a summary of this information in order to avoid key material for retail investors being 'hidden' on the Register).

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[4] Offers of non-pooled investment scheme services would also be required to provide a PDS to investors, and the KIS would be likely to contain similar matters to the KIS for collective investment schemes.

[5] The Financial Markets (Regulators and KiwiSaver) Bill is currently before the Commerce Select Committee, which is due to report back to the House by 28 February 2011.

107 In order to keep printing and production compliance costs down, it is anticipated that matters that change relatively frequently and are not key for investors, like directors' addresses, would not be required to be kept up to date in the PDS, but they would be kept up to date on the Register. However, the PDS would state the date it is printed and where on the register to look for updates. Potential investors would be able to request a printed copy of material on the Registrar prior to subscription.

**Ongoing disclosure**

*Status quo and problem definition*

108 Much of the current disclosure requirements under the Securities Act 1978 relate to disclosure at the point of sale, rather than ongoing disclosure to a holder of securities. Effective ongoing disclosure is important for many types of financial products, both in order to inform investors of the status of their investment on an ongoing basis, and to help to ensure the accurate pricing of the investment where there is a secondary market for trading that investment.

109 Equity securities are already subject to annual reporting requirements and derivatives are generally short-term products. For this reason, I do not consider that there is a need for additional ongoing disclosure requirements for issuers of these securities. However, I consider that there should be additional ongoing disclosure requirements for debt and collective investment schemes.

110 In respect of unlisted debt securities, holders of debt securities are not necessarily informed about material changes in the issuers' circumstances that may impact on the likelihood of default by the issuer. This makes it difficult for investors to understand the value of their securities if they wish to sell them. It also means that investors are not necessarily fully informed if the risk of the security changes over time. While such material changes in circumstances will have been reported to the trustee if they have a bearing on the likelihood of default, I do not consider that this detracts from the value of such matters also being reported to investors.

111 I also consider that there are problems around the lack of ongoing or comparable disclosure by collective investment schemes and non-pooled investment vehicles. In particular, these entities do not always report to their members about basic matters such as fees, asset allocations, and returns. Even in those cases where such reporting takes place, different entities use different methods of calculating matters such as fees and returns. This makes it harder for investors to judge fund performance over time.

*Ongoing disclosure - Debt*

112 The key information for an investor in debt securities is information that indicates the likelihood of default by the issuer. The matters indicating the likelihood of default by the issuer will need to have been disclosed in the PDS and on the securities register. In addition, where there is any material change in these matters during the year, this should have been reported to the trustee.

113 However, to ensure that such information is accessible to investors and the public at large, I propose that debt issuers be required to update any material change to certain prescribed matters on the Register of Securities. These matters could include changes to credit ratings, changes to guarantors of the issuer, and significant changes to the terms of the trust deed. The full list of matters to be subject to event based disclosure will be set out in regulations.

*Ongoing disclosure - Collective investment schemes and non-pooled investment vehicles*

114 In April 2010 Cabinet agreed to the provision of regulations that would require periodic reporting by KiwiSaver schemes to their members. Work is currently underway on designing these regulations, which will require quarterly reporting of at least the following matters:

- All fees and charges (for example, in the form of a Total Expense Ratio);
- Asset holdings (including, for example, percentages of the different types of assets and disclosure of top ten portfolio holdings);
- Conflicts of interest (for example, investments in related parties); and
- Fund returns (ideally both gross and net of all fees and taxes).

115 I consider that quarterly reporting to investors in collective investment schemes and non-pooled investment vehicles is appropriate, and that the above matters provide a good starting point for the matters that should be disclosed on this basis. The detail of the required contents of the quarterly reports will be prescribed in regulations, and will be informed by the ongoing work on KiwiSaver disclosure requirements.

**Advertising**

116 Securities law currently provides for a range of highly prescriptive rules around the contents of advertisements (for example, a requirement that an advertisement must not state or imply that an investment is safe). Many of these requirements are unduly prescriptive and do not necessarily cover all of the most important matters that could be addressed in an advertisement.

117 Accordingly, I propose that these rules be replaced by a requirement that an advertisement must not contain any matter that is likely to deceive, mislead or confuse with regard to any particular in the advertisement that is material to the offer of financial products in the advertisement. I consider that this requirement will ensure that advertisements contain the key information that investors require to make sound judgements concerning the investment.

### Celebrity endorsements

118 Finance company collapses in recent years have highlighted the role of celebrity endorsements of financial products. In at least one case, a celebrity specifically endorsed the strength of a finance company, while in another instance the person may have been used because their primary employment created a sense of integrity.

119 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. I consider that this has the potential to undermine the disclosure regime, which is designed to ensure that investors have the best possible and most relevant information before them when they make important decisions that may involve their life savings.

120 For this reason, I have directed my officials to consider options for regulation in this area. These options will include the possibility of celebrities being liable to investors for untrue statements that they make when endorsing products in a similar way to 'experts' in the existing regime. I propose to report back to Cabinet by 31 May 2011 on this issue.

## COLLECTIVE INVESTMENT SCHEMES

### Status quo and problem definition

121 A collective investment scheme is a vehicle in which investors give money to someone else to invest, with the earning of a financial return being a significant objective, and investors do not maintain day-to-day control over the management of their money. This includes, but is not limited to, pooled vehicles often referred to as 'managed funds'.

122 Collective investment schemes are pitched largely at the retail-end of the investment product market. They provide individual investors with a means of accessing a diversified portfolio of investments suited to their investment risk profile. Some retail investors do not have the resources, knowledge or skills to undertake this role themselves, and cannot otherwise access investment products that are reserved for sophisticated investors and institutions or which require a large investment amount. Globally, collective investment schemes are the most common method of investing for retail investors.

123 Generally speaking, in a collective investment scheme the fund manager[6] manages and promotes the scheme. The various tasks associated with operating the scheme (e.g., making investment decisions, holding assets, scheme administration) may be either performed by the fund manager or contracted to others. Most regulatory regimes provide for an external supervisor who monitors the fund manager and associated persons, checks that the scheme is operated in accordance with contracts, trust deeds, constitutions etc, and acts in the interests of investors. Certain tasks (such as the holding of scheme assets) are often also separated from the fund manager.

124 In New Zealand collective investment schemes can employ a variety of legal forms including unit trusts, superannuation schemes, trusts and partnerships. Some forms are of general application and can be used by anyone for any class of investments (e.g., unit trusts and participatory securities). Others may only be offered by certain persons (for example, group investment funds offered by trustee companies), or may only be used for specific classes of investments. However, there are some impediments to the use of other legal forms, such as companies, as collective investment schemes.

125 There are a variety of problems with the current regulation of collective investment schemes. In particular:

- Inconsistent governance and obligations across legal forms: Collective investment schemes can adopt various legal forms leading to inconsistency in both the rights of investors and duties of fund managers. Despite all collective investment schemes undertaking the same purpose irrespective of the scheme's form, there is no minimum standard of protection for investors. Different forms have different oversight of and obligations for fund managers. This complexity can reduce effectiveness of monitoring, reduce competition and make it difficult for investors to understand and compare collective investment schemes and fund managers.

- Lack of fund manager accountability: For some forms of collective investment schemes, it is only the trustee or statutory supervisor who owes a direct duty of care to investors. The fund manager has a contractual relationship with the trustee only (and no direct duty to investors in the scheme). In unit trusts there are some specific duties owed by the fund manager to investors, but the duties remain unclear to industry participants and investors, are difficult and expensive for individuals to enforce, and have rarely been tested in law. The fund management agreement is a contract between the trustee or statutory supervisor and the manager and it is this that determines the obligations on the manager. Investors are not party to the agreement (or any delegation documentation, such as the investment management contract) and fund managers discharge their obligations to the scheme by carrying out their duties to the standards stipulated in the contract. Problems can arise due to the fact that the fund manager is also typically the fund's founder.

[6] In this paper, the fund manager is assumed to have an equivalent meaning to the "manager" as currently defined in the Unit Trusts Act 1960.

- Inadequate supervision of fund managers: Most collective investment schemes are required to have an external supervisor (for example, the trustee) that is responsible for monitoring the performance of the fund manager. Because the entity which selects, contracts with, and appoints a supervisor is usually the fund manager there is an inherent conflict of interest. However, not all collective investment schemes are required to have an independent supervisor nor do all types of securities technically require a supervisor (for example, contributory mortgages, proportionate ownership schemes and superannuation schemes). The power to remove the fund manager, when the fund manager's direction is manifestly not in the interests of investors, is not a consistent requirement across the various collective investment scheme structures.

- Problems with pricing and valuation: Fund managers or a related party often perform collective investment scheme administration, including calculation of unit prices and asset valuation. There are a number of issues regarding the treatment of pricing errors, including that: 1) there is no agreed industry wide policy as to how to deal with pricing errors; 2) there is no regulatory oversight as to how these errors are treated by the collective investment schemes or trustees and; 3) pricing error policies are not usually disclosed by collective investment schemes. Pricing errors can potentially have a significant impact on investor returns, especially those buying into, or cashing out of, the collective investment scheme.

- Problems with redemption/exiting rules: The liquidity policies of collective investment schemes do not always create fair situations for investors – particularly where the collective investment scheme is under performing. For example, where a collective investment scheme is having difficulty liquidating assets, it might allow investors to redeem their units on a first-come, first-served basis. This means that, until (or unless) the collective investment scheme is 'rebalanced' with more liquid assets, those remaining in the collective investment scheme are exposed to a higher level of risk, and those exiting the collective investment scheme benefit to the detriment of remaining investors.

- Impediments to the use of open ended investment companies: Internationally, the use of a company structure for collective investment schemes is commonplace, but there are impediments in New Zealand to the use of a company as a vehicle for a collective investment scheme. Amongst other things, these impediments include the prohibition on corporate directors, and the rules regarding the redemption of shares under the Companies Act 1993, which can make it difficult to manage the continuous issue and redemption or shares which is necessary for a managed fund.

**Proposed regulatory framework for collective investment schemes**

*Summary*

126 Many of the key issues identified with the current regulatory framework for collective investment schemes relate to the multiplicity of forms and the resulting inconsistency of governance and legal obligations across those forms. In order to address these issues a number of options are available. One is to prescribe a single legal form and set of substantive legal requirements which all collective investment schemes must adopt. The other is to create a single collective investment scheme regime, in effect a statutory overlay, under which schemes would be free to adopt any legal form but would be required to comply with a common set of substantive requirements.

127 I consider that the latter option will allow future product innovation while ensuring minimum and consistent standards of investor protection. The approach is one of substance over form whereby a scheme that is, for all intents and purposes, a collective investment scheme will be captured by the regime. This will reduce opportunities for regulatory arbitrage.

128 The single collective investment scheme regime would require all collective investment schemes to have a manager, who is responsible for the management of the scheme, and an external supervisor, who is licensed under the regime established by the Securities Trustees and Statutory Supervisors Bill and is responsible for the oversight of the manager and the custodianship of the assets of the scheme.

129 The regime would also address the following matters:

- The functions, duties and powers of the manager and supervisor of all collective investment schemes;
- The remedies for breaches of duties by fund managers;
- The duties of custodians, where the supervisor of the scheme chooses to contract out the custodial role to a third party;
- The removal of supervisors and fund managers;
- The valuation of scheme assets, and treatment of pricing errors and limit breaks by the scheme;
- Constitutional documents;
- The conduct of investor meetings;
- Whistle-blowing; and
- Related party transactions.

130 How these matters would be treated under the proposed collective investment scheme regime is discussed below. However, I anticipate largely maintaining the existing governance regime for some types of existing participatory securities, such as syndicates owning racehorses and forestry.

*Functions, duties and powers of the supervisor and manager of a collective investment scheme*

131 I propose that the supervisor and manager of collective investment schemes have the functions and duties set out in Appendix 3 of this paper, subject to drafting and further industry consultation.

132 In addition, I propose that supervisors also have the following powers:

a To require periodic reporting from the fund manager, in addition to the requirements to publish quarterly information as proposed above in the section on disclosure;

b To request information relating to the collective investment scheme, or to the business, property or the affairs of the fund manager and to inspect or review, or appoint a person to inspect or review, the fund manager's books and papers and all books and papers relating to the collective investment scheme;

c To summon a meeting of investors or require a fund manager to summon a meeting of investors. For example, the supervisor may wish to use this power to obtain directions from the investors, or for investors to vote on a resolution to remove the fund manager. This is consistent with current requirements under the Unit Trusts Act 1960;

d To attend and be heard at a meeting of investors of the collective investment scheme, and to nominate a person to chair a meeting of investors, where that meeting was requested by the supervisor or investors. This allows the supervisor to communicate with the investors of the collective investment scheme (for example, by keeping the investors informed about relevant matters) as well as provides the power necessary to ensure a meeting, which was not initiated by the fund manager and therefore may be contentious by nature, is run fairly;

e To apply to the court for a direction that the fund manager comply with its duties or with the terms of the constitutional document or of the offer or the funds management agreement, within a specified time frame. For example, a direction to act, a direction prohibiting the fund manager from acting, an order imposing terms or conditions on the fund manager or on the operation of the collective investment scheme, or an order that no more investors be accepted into the collective investment scheme;

f To take an action to the court on behalf of investors to seek a remedy (including compensation) for breach by the fund manager of any of its duties or the terms of the constitutional document or of the offer;

g To apply to the court for the types of orders currently available to trustees and statutory supervisors under section 49 of the Securities Act 1978. This includes court orders that the provisions of the constitutional document be amended; that restrictions be imposed on the fund manager; direct the fund manager or supervisor to convene a meeting of security holders; or give such other directions as the court considers necessary to protect the interests of security holders, other holders of securities of the issuer, any guarantor of the securities or the public[7];

h To apply to the High Court to assess damages against a delinquent director or other officer of the fund manager if, in the course of winding up the collective investment scheme, it appears that the fund manager has misapplied, retained or become liable for any money or property of the collective investment scheme, or committed any misfeasance or breach of trust in relation to the collective investment scheme. I propose to base this power on that contained in section 27 of the Unit Trusts Act 1960;

i To amend the constitutional document upon consultation with the fund manager, but without consultation with investors, in cases where the amendments are not prejudicial, administrative or are clearly in the interests of investors; and

j To amend the constitutional document upon consultation with both the fund manager and investors, in all cases other than those outlined above and subject to a vote of investors/ shareholders being not less than 75 percent of those who vote.

*Breach of fund managers' duties*

133 In order to ensure that fund managers are appropriately incentivised to fulfil their functions and duties, it is necessary that there be consequences for failure to do so. In the event the fund manager, or any delegate, breaches any of its duties owed to investors, or the terms of the constitutional document or the terms of the offer, the fund manager would be liable to investors. In addition, I propose that the following steps also be able to be taken in these circumstances:

a Investors be able to call a meeting of investors to consider what actions to take against the fund manager;

b Investors be able to remove the fund manager or give directions to the fund manager (for example, a direction that the collective investment scheme be wound up) if the investors obtain the appropriate threshold at a meeting of investors;

c Investors be able to direct the supervisor to take an action to Court to seek compensation for loss caused by a breach;

d The FMA be able to take an action to Court to seek a civil penalty against the fund manager or seek compensation from the fund manager on behalf of investors; and

[7] Section 49(3) Securities Act 1978.

e The fund manager be able to be liable for criminal penalties in situations where there is a high level of culpability.

*Functions and duties of custodians*

134 All collective investment schemes will be required to place the fund assets with an independent custodian. The external supervisor will be legally responsible for this role, but will be able to contract out the custodial function to a third party if they so choose. In New Zealand there is no specific regulation covering custodians or depositories although most other jurisdictions have a form of licensing or prudential supervision.

135 While I do not consider that the licensing of custodians is necessary, I consider it prudent to put in place some additional requirements, specifically:

- that any custodian undertaking services on behalf of a collective investment scheme in New Zealand be required to maintain a presence (e.g. an office or resident director or representative) in New Zealand; and

- That all records of asset ownership be maintained in New Zealand.

*Removal of the supervisor*

136 The Securities Trustees and Statutory Supervisors Bill currently before the House provides for a licensing regime which will give the FMA the power to remove the supervisor where there has been egregious misconduct. However, it does not provide a process for investors to remove the supervisor in situations where investors are simply unhappy with the supervisor's performance.

137 The supervisor is, in effect, the investors' agent and is there to oversee their interests. Therefore, the investors, if a sufficient number agree, should have the right to replace the supervisor. The threshold for removing a supervisor needs to be set at a level to preclude vexatious action by disgruntled investors. I consider that investors holding at least 75 percent of the value of interests in a scheme should be required to vote in favour of removing the supervisor for this to take place. The FMA would appoint an interim supervisor when the investors do not decide immediately on a replacement supervisor.

*Asset valuation*

138 It is important that returns and pricing of fund assets are calculated equitably and accurately for two key reasons. Firstly, investors need accurate information to gauge performance. Secondly, it is important to ensure accurate prices are applied at the point where investors are entering or exiting a collective investment scheme. The terms and conditions associated with the benefits or returns that a collective investment scheme investor obtains, the pricing of those benefits, and the way in which they can be realised can all influence the value of the investor's financial interest. It is important that they are clear and evident to the investor and that the investor has some protection against unnecessary changes to these provisions.

139 As a result, I propose that the FMA be required to prepare guidance on the appropriate process for the valuation of assets and how often those valuations need to occur. Collective investment schemes would be required to state that they have complied with these guidelines in their PDS and quarterly reporting, and if they have not, the reasons why not.

*Pricing errors and limit breaks*

140 Pricing errors are a risk to investors, especially when they are entering or exiting a collective investment scheme. As previously stated, accurate pricing of interests in the scheme is essential to enable investors to monitor its performance. At the moment there is no industry standard for addressing pricing errors. In addition, there is also no standard approach for whom to notify when such an error occurs. It is essentially up to each fund manager to decide how to address these problems.

141 Limit breaks, where a collective investment scheme breaches investment limits set in its constitutional document and its offer document, can affect the nature and the performance of a collective investment scheme. Again, there is no set approach for dealing with limit breaks.

142 144 I propose that managers should be required to report to the supervisor of the scheme when a pricing error or limit break occurs, and that the supervisor should be required to report the pricing error or limit break to the FMA where the error is 0.5 percent or more of the value of a unit or the value of the scheme.

143 In addition, I propose that there be a duty on the manager to take action to reimburse current or former investors who are affected, as well as the scheme itself, except if it appears to the supervisor that the breach is of minimal significance. Where a supervisor believes that reimbursement or payment is inappropriate and should not be paid then they should also be required to report this to the FMA.

*Constitutional documents*

144 The constitutional documents of a collective investment scheme comprise any document that establishes or provides for the operation of the legal form (e.g. trust deed, partnership agreement, company constitution) and any document that provides for the supervision of the scheme. It may be possible for there to be a single constitutional document for some forms, such as trusts. To ensure that constitutional documents are of the required standard, I propose that all constitutional documents be required to address the following matters:

- Investment policy and objectives: A clear statement about the core investment policies of the scheme, including:
  - The risk/return profile;
  - Major classes of assets that are prohibited or permitted;
  - Asset class preferences; and

  - Investment benchmarks and performance measurement indices if applicable.

- Authorised investments: What limits are in place on the nature or type of investments, or the limits on each type of asset, and what methodology is used for developing, amending and measuring the investment strategy;

- Entry and exit rules: What the entry and exit policies of the scheme are;

- Contribution levels and rates: What the process is for establishing and revising/changing contribution levels and rates;

- Returns and pricing: What the conditions are in relation to allocations, withdrawals, redemptions and distributions, and what the methodology is for valuing the assets of the scheme (if this varies from the guidelines prepared by the FMA);

- Fees: What fees could/might be charged and how fees can be changed; and

- Winding up: What circumstances trigger a wind-up and distribution of the assets of the fund.

145 In addition, I propose that material changes to constitutional documents require the consent of a majority of investors.

*Meetings*

146 The ability to call meetings is an important mechanism for investors of a collective investment scheme to exercise control over the fund manager and supervisor. It is also important to have some restrictions on the ability of investors to call meetings, as meetings are generally held at some cost to the scheme. However, it can be difficult for investors to effectively co-ordinate a large number of investors in order to call a meeting.

147 The Unit Trusts Act 1960 provides that a meeting of investors can be called by unit holders holding not less than 10 percent of the value of the unit trust. It also provides that a resolution to direct the trustee can be passed by unit holders with three-quarters of the value of interests in the unit trust, which are held by unit holders who are present (in person or by proxy) or making written votes, and who hold not less than one-quarter of the value of all the interests in the unit trust.

148 I propose that these thresholds for calling a meeting and passing a resolution directing the trustee also be applied to all other collective investment schemes.

*Electronic voting*

149 The nature of collective investment schemes means that it can often be difficult to hold meetings and get investors to vote on matters. Permitting electronic voting is likely to improve investor participation in decisions relating to the operation of the scheme. Amendments to the Companies Act 1993 that permit electronic voting are included in a Bill that is currently before the House. There will also be provisions around electronic authentication. This will align New Zealand law with widespread best practice in overseas jurisdictions.

150 I recommend that the rules for electronic voting relating to collective investment schemes should align, to the extent possible, with the new Companies Act provisions.

*Whistle-blowing provisions*

151 The Superannuation Schemes Act 1989 currently contains a whistle-blowing provision requiring any administration manager, investment manager, actuary or auditor of a scheme to disclose information to the regulator when they form the opinion there is a serious problem with the scheme. This Act also provides an associated protection against any liability for such disclosure when it was made in good faith.

152 I propose that this type of provision be applied across all collective investment schemes, as it will help to minimise the risk of unfair and fraudulent conduct.

*Related party transactions*

153 Currently, there are no general rules applying to all collective investment schemes around the quantity, or disclosure, of related party transactions. Related party transactions often take place in the normal course of business and, for the most part, are undertaken for legitimate purposes. However, there are instances where a high degree of related party lending has occurred, serving only the interests of the issuer and not the investors. This has led to poor investor outcomes.

154 The Deposit Takers (Credit Ratings, Capital Ratios, and Related Party Exposures) Regulations 2010 contain provisions on related party transactions that apply to non-bank deposit takers (NBDT). The regulations require that the limit on aggregate credit exposure of a NBDT, (or its borrowing group) to all related parties must be fixed by an agreement between the NBDT and the trustee and be specified in the trust deed, provided it does not exceed a maximum limit of 15 percent.

155 The definition of 'related party' in the regulations includes persons in which the deposit taker or a group member has a substantial interest, sister entities of the deposit taker or of a group member, persons with which the deposit taker or a group member (or a person with a substantial interest in the deposit taker or group member) have inter-locking boards, and directors and senior office holders and their relatives of the deposit taker or group member. It also includes subsidiaries of the deposit taker or of a group member, persons with a substantial interest in the deposit taker or group member, persons whom the deposit taker or group member has a substantial interest in, persons whom have a substantial interest in entities in which deposit taker or group member has substantial interest and sister entities.

156 The NZX Listing Rules also set out rules around when an ordinary resolution must be sought in order to proceed with a related party transaction. The threshold is transactions that have an aggregate net value in excess of 10 percent of the market capitalisation of the issuer.

157 In recent years, related party transactions have been a feature of finance company failures in New Zealand. I consider that there should be a consistent set of rules applied to all collective investment schemes so as to reduce the risks to investors associated with high levels of related party transactions. The NBDT rules will still apply to that subset of collective investment scheme, but I consider those rules set too high a burden to be applied generally across all collective investment schemes as related party transactions will, for the most part, be legitimate.

158 I consider that disclosure of all related party transactions should be required, and that there should also be requirements on fund managers to report to the external supervisor (and supervisors to report to the FMA) when related party transactions exceed a specified threshold. I propose that the threshold be set at 10 percent, in line with the NZX Listing Rules. This would enable supervisors and the FMA to be alerted to potentially inappropriate related party transactions which may lead the FMA to more closely monitor or investigate the issuer.

159 Given that most related party transactions are legitimate and it is an important feature of many business structures, I consider that placing restrictions on the amount of these types of transactions or requiring supervisor or investor approval would be over-burdensome.

**Provision for open-ended investment companies**

160 One area where New Zealand has lagged behind other jurisdictions is in the adoption of the open-ended company form for collective investment schemes. Open-ended investment companies (OEICs) pool money from many investors and invest the money in equities, bonds, money-market instruments, other securities, or even cash. Investors purchase shares in the company from the OEIC itself or through a broker, and cannot purchase the shares from other investors on a secondary market, although the shares can be quoted on an exchange.

161 OEIC shares are 'redeemable'. This means that when investors wish to sell their shares, they sell them back to the OEIC or to a broker. The price that investors pay for OEIC shares is the fund's net asset value (NAV) per share, plus any fees. The price that investors receive when they redeem their shares is the NAV per share, minus any fees. OEICs, as such, reflect the actual value of the underlying assets and so do not trade at a premium or discount. This aids transparency and competition. Investor protection for OEIC shareholders in the UK is delivered through the custody of the scheme's assets which must be held by a depositary (an independent authorised firm). In New Zealand this could be achieved through requiring all such companies to appoint a licensed supervisor.

162 Providing the option of a company form for collective investment schemes will aid product innovation and will facilitate greater share market participation by providing a vehicle that better enables retail investors to access the market in a diversified manner.

163 I propose that a special class of open-ended investment company be provided for under New Zealand law. This would be a form of company that would, amongst other things, allow for corporate directors and have specialised rules relating to the issue and redemption of shares to more efficiently allow for the entry and exit of investors. It would also be subject to the generic collective investment scheme regime outlined above. However, subject to the changes necessary for it to operate like open-ended investment companies overseas and comply with the collective investment scheme regime outlined in this paper, it would need to comply with the same basic rules as other New Zealand companies.

**Regulation of fund managers**

164 The fund manager plays a pivotal role in collective investment schemes. It is the fund manager who establishes the fund, solicits investor funds and to whom investors have delegated the investment-decision making function. These characteristics lead to information and power asymmetries between the investor and the fund manager that can leave investors vulnerable to self-interested behaviour.

165 Once current legislation is fully enacted, fund managers will become one of the few providers of financial services not required to be licensed, although they will be required to be registered under the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

166 The primary rationale for implementing a form of fund manager regulation is that it would provide a framework for the regulator to take an ex-ante approach to governance rather than being limited to enforcement only after wrongs have occurred. It would provide a means for the regulator to build constructive working relationships with the sector from the outset. Licensing regimes provide the regulator with the tools to work hand-in-hand with industry to build better capability and skills and develop robust processes.

167 Further, there are significant lapses of time in the current enforcement regime from when misconduct is discovered to the completion of the court process. During that time, a fund manager may still solicit funds from the public. A licensing regime would enable the regulator to take more immediate action through the suspension of a license, thus precluding such misconduct being perpetuated on further unsuspecting investors. Submitters considered that, for those schemes that are well-run and well-administered, compliance costs arising out of a licensing regime would be minimal.

168 Other features unique to the nature of collective investment schemes make it difficult to preclude opportunistic operators from entering the sector. Fund managers may lose much or all of investors' money but the fund manager itself (as a separate entity) is unlikely to be placed in receivership. As such, there is no identifiable mechanism available to the regulator to disqualify or ban a director or senior manager of a fund manager, unlike the case of directors of failed companies. In the current regulatory framework, it is difficult for the regulator to exercise oversight of this sector.

169 The main argument against fund manager regulation is that other regulation in train (Securities Trustees and Statutory Supervisors Bill, Financial Advisers Act 2008, and Financial Service Providers (Registration and Dispute Resolution) Act 2008) is sufficient. However, the Financial Advisers Act is designed to regulate the distribution of funds and the regime imposed by the Financial Service Providers Act is limited to a negative licensing process excluding those currently bankrupted, subject to a management banning order or convicted of criminal fraud within the last five years. There is no mechanism by which the regulator may give consideration to a fund manager's character or lack of experience.

170 There is also a concern that regulation of fund managers would give rise to moral hazard whereby investors would associate FMA regulation of fund managers as consistent with providing a form of guarantee. Any regulation would need to consider this issue carefully.

171 173 The decision on whether or not to regulate fund managers is not clear cut. On balance, I do not believe it is in the interests of our financial markets, and investors as a whole, to leave a sector of the market unregulated and to create an area for the less scrupulous to congregate. Therefore, I propose that an authorisation regime for fund managers be introduced whereby the FMA will require that all fund managers (comprising the directors, senior managers and controlling owners) be registered and to meet a 'fit and proper' test. This would require the key personnel controlling the fund manager to satisfy a 'good character' test.

172 The details of what the FMA would take into account in determining eligibility under the 'fit and proper' test will be set out in regulations. Features of this regime will include:

- A person must apply to the FMA for registration before acting as a retail fund manager;

- The authorised fund manager must inform the FMA of changes to material matters concerning their authorisation;

- The FMA will be able to respond to new information concerning the fund manager in various ways, including by varying, placing restrictions, suspending and cancelling their authorisation;

- There will be a right of appeal to the High Court from any FMA decision in relation to an authorisation; and

- Where a fund manager has no license, or that license has been revoked, the FMA will appoint a temporary fund manager and the fund's supervisor would seek to appoint a replacement fund manager with the consent of the fund's investors.

**Application of the statutory overlay for collective investment schemes to offers of insurance products with an investment component**

173 In accordance with the proposed definition for collective investment schemes, insurance contracts with an investment component would be caught by the proposed collective investment scheme regime. These are, on the whole, legacy products and industry have expressed concern that it is difficult to separate out the investment component of these products from the insurance component. Furthermore, the insurance/investment split is specific to the policy holder and not generic. Such insurance contracts will be regulated by the Reserve Bank under the Insurance (Prudential Supervision) Act 2010.

174 I propose that all such existing insurance contracts with an investment component be exempt from the proposed collective investment scheme regime, but that any future insurance contracts with an investment component be subject to the proposed collective investment scheme regulatory regime.

**Special regime for workplace savings schemes**

175 In the last decade, there has been a substantial decline in the number of customised workplace savings schemes, in particular defined benefits schemes. This has partly been driven by tax changes and the introduction of KiwiSaver, but also a general change in the nature of the employer-employee relationship as society has moved from a 'job-for-life' ethos to one where people have multiple careers over the course of their working lives.

176 Many employers who continue to offer a workplace superannuation scheme in addition to KiwiSaver use a master trust structure whereby they outsource the funds management and administration to a large corporate collective investment scheme provider. Master trusts are an off-the-shelf collective investment scheme product and I therefore propose that they be regulated in the same manner as all other collective investment schemes and that the fund manager will be deemed the issuer.

177 However, there still remain a number of company-specific schemes in which the employer is the trustee and the employee benefits offered are substantial. These schemes are considered 'not-for-profit' as they are designed to be run solely for the benefit of members. Oversight and governance is usually provided by employee representatives, employer representatives and sometimes an independent trustee such as the company's accountant or lawyer. There is no requirement for any trustee to have financial industry experience or skill.

178 My concern is that while the employer contribution may be substantial, it forms part of the employees' remuneration and should, therefore, be regarded as belonging to the employee. Furthermore, most employees are expected to co-contribute. As such, it should not necessarily be the employer's prerogative to decide how such schemes should be managed and what they should invest in.

179 The argument for better regulation of these schemes is that members will be relying on these schemes to deliver them benefits in retirement. While the trustees might have best intentions, they are not necessarily skilled in that capacity. A greater degree of investment management capability may well lead to better investment performance.

180 The argument against regulating these schemes is that the associated compliance costs would penalise scheme members and lead to scheme closure.

181 I propose all existing workplace schemes who meet the definition of 'not-for-profit' (being where all benefits accrue to the members and excluding those that are master trusts which are dealt with separately above) be 'grandfathered' but remain open to new members where those new members are employees and meet the criteria set out in regulations. Excluding new members would likely lead to the closure of the schemes all together as they require a certain level of membership to remain viable.

182 I also propose that such schemes be required to appoint an independent trustee as approved by the FMA and who can demonstrate a degree of investment management skill and experience. This has the effect of creating a tiered regime for trustees but is, I consider, the most expedient approach in order to ensure greater governance while mitigating compliance cost. I also propose that a requirement be enacted preventing investments of greater than five percent in any one asset or total investments of greater than five percent in any employer related parties. The FMA will continue to have a monitoring role through its absorption of the office of the Government Actuary.

183 Lastly, I propose that all future workplace schemes will come within the aegis of the proposed collective investment scheme regime and must meet the regulatory requirements.

## Regulation of exchange-traded funds

184 Exchange-traded funds (ETFs) are a relatively new product offering but are rapidly evolving.[8] ETFs are currently subject to continuous disclosure. This requirement is currently largely redundant due to the fact that ETFs tend to be index-tracking funds and are merely a conduit for grouping investments into transparent and liquid underlying assets which are subject to the same disclosure requirements as the fund itself. The ETF issuer cannot control the value of the underlying asset(s) and, therefore, the value of the ETF itself.

185 However, globally there has been a move to more complex and actively-managed ETFs. I propose that further work be conducted on the appropriate disclosure requirements for exchange traded funds, and that I report back to Cabinet on this issue by 31 May 2011.

### LIABILITY REGIME FOR SECURITIES LAW

## Status quo and problem definition

186 The liability regime is an integral part of the securities law framework. It sets out the circumstances where liability arises for contraventions of securities law, including when injured investors may seek compensation and when company directors and others may be criminally prosecuted for their conduct.

187 Several key principles underpin the liability regime. It should promote compliance with the securities law and deter conduct that undermines market integrity and confidence. It should also promote informed participation in the market by investors through the provision of adequate, swift and effective compensation for those suffering harm and the visible punishment of wrongdoers. At the same time, the regime should not be so strict as to deter innovation or conduct that is beneficial for society.

188 It is also important for confidence in the regime that its provisions are clear and accessible for those who are subject to or have an interest in it, including directors, issuers and investors. This means that to the extent possible, all of the relevant provisions should be contained in one regime.

189 The current regime is complex, with overlapping liability provisions found in a number of legal sources. The Securities Act 1978 contains a number of civil and criminal liability provisions in respect of the issue of securities, including misrepresentation in securities offer documents. The Securities Markets Act 1988 contains a liability regime that regulates conduct in secondary markets, including insider trading provisions. Supplementing these Acts are serious criminal offences in the Crimes Act 1961 (particularly in relation to fraudulent conduct), and other liability regimes in the Fair Trading Act 1986, Contractual Remedies Act 1979 and under the law of torts.

[8] An exchange-trade fund is an investment fund traded on a stock exchange that traditionally invests in a basket of securities that make up an index or a benchmark (such as the S&P 500 or ASX 200).

190 This regime lacks coherence and is difficult to understand for those who are subject to it or who wish to apply it. The overlap of criminal offences and civil pecuniary penalties in respect of the same conduct is of particular concern. For example, there are regulatory and serious criminal offences in respect of false statements in a prospectus. The same conduct is also subject to civil pecuniary penalties. It is not clear how these different forms of liability interact to promote the objectives of the liability regime.

**Proposed liability regime**

191 I propose that the liability regime be simplified in order for its different components to promote the principles set out above more effectively. I consider that adopting a comprehensive regime that contains an escalating hierarchy of liability is the best way to achieve this. To the extent possible, the new legislation will be a 'code', (i.e. a complete regime that sets out all instances when liability will occur).

192 Under this proposal, the regime would be designed so that only egregious violations of securities law would be the subject of serious criminal offences. An egregious violation would be one where the contravention was deliberate or reckless. I consider that criminal offences with the possibility of a substantial fine and considerable length of imprisonment are appropriate to deter and to sanction this level of conduct.

193 At the present time, such serious offences can be prosecuted under general criminal law provisions in the Crimes Act, including section 242, which in part relates to untrue statements in a prospectus. I propose that new securities-specific offences be created in the new legislation to provide for a more coherent enforcement regime for criminal breaches of securities law.

194 I propose that it will be necessary for the liability regime to include some minor regulatory offences to provide criminal sanctions for behaviour that contravenes the regime and is harmful, but is not sufficiently serious to warrant the imposition of the proposed significant criminal offences. These kind of offences exist in the current regime, and I understand that they have proved to be effective tools.

195 I propose that conduct that violates the securities regime but is not sufficiently serious to warrant the imposition of the criminal liability noted above should be dealt with through a civil pecuniary penalty regime. While there is no doubt that the prospect of a criminal conviction is a powerful deterrent, as noted above I consider that criminal offences are most appropriately reserved for serious misconduct. For lower-level contraventions, for example where there is a minor and careless, but not reckless or intentional, misstatement in a prospectus, I consider that a civil penalty regime is best placed to sanction this conduct. Civil pecuniary penalties, if set at a high enough level, will be adequate to provide deterrence in these situations and promote compliance with the regime. They would also strike an appropriate balance between deterring undesirable conduct and not deterring conduct that may be beneficial to the market but that the possibility of criminal liability may discourage.

196 I propose that the civil pecuniary penalty regime be based on the current regime contained the Securities Act 1978 and Securities Markets Act 1988. This would enable the regulator to seek a declaration that a civil liability event has occurred. There would be a presumption that conduct that contravenes certain provisions of the securities regime is considered to be a civil liability event. Certain defences may be available to rebut this presumption. The consequence of a civil liability event occurring is that the court or body hearing the dispute may then make an order of a pecuniary penalty against the person who is liable. It would also be able to impose a compensation order on that person to compensate affected investors for loss where appropriate.

197 In addition to the criminal and penalty regime, it is important to create a framework to enable investors to have adequate causes of action available to them to seek compensation for losses caused by contraventions of the securities regime. I propose that investors have the right to cancel their investment and seek a refund of their subscription where an offer is made without appropriate disclosure document or the disclosure document was misleading or deceptive in an material particular. This will replace the current confusing regime, which provides that certain allotments of securities are void, or voidable at the option of the subscriber.

198 It is currently very difficult for an investor to obtain compensation for a misstatement due to materiality, reliance and causation requirements, which may require each investor to prove that their reliance on particular misstatement caused the amount of loss they seek. I propose that this situation be rectified by a shift to a regime where all investors would have a right of compensation where a misstatement is material and would have affected a reasonable person.

199 It is important to set out who is liable for contraventions of the securities regime. At present, directors are liable for most breaches of securities law. I propose that under the new regime, issuers will have primary liability for contraventions in relation to the issue of securities. In addition, there will be instances where directors will also be primarily liable for these contraventions. For contraventions involving secondary market issues, such as insider trading, I propose that the person responsible for the conduct in question will be primarily liable for the contravention.

200 A further issue that I consider needs to be addressed in the liability regime is the overlap between the Fair Trading Act 1986 and securities law. This overlap is currently managed by section 5A of the Fair Trading Act, which provides that a person will not be liable under the Fair Trading Act for conduct regulated by securities law unless they would also be liable under securities law for that conduct. I consider that this provision is confusing and that the interface between the Fair Trading Act and securities law requires clarification.

201 I propose to report back to Cabinet by 31 May 2011 in further detail on the liability regime, including the new offences and penalties for contraventions of the securities law regime.

**Public enforcement of directors' duties**

202 The Companies Act 1993 imposes a range of duties on directors. The directors' duties are owed to the company and the company is responsible for enforcing the duties. The Companies Act also provides for shareholders to take derivative actions on behalf of the company. In practice, many directors' duties cases take place after a company has become insolvent. In those cases, enforcement action is generally taken by a receiver or liquidator. The Registrar may also apply to the Court for a management banning order in respect of directors who have acted in a reckless or incompetent manner in the performance of their duties as a director. Cabinet decided in July 2010 to allow the Registrar to ban directors on this basis.

203 There are disincentives for companies and shareholders to take private actions. The company must weigh up the expected compensation awarded if the case is successful against the cost of taking legal action. Individual shareholders are very unlikely to take a derivative action, given that any remedies awarded by the Court (e.g. compensation) will be awarded to the company. It is difficult to coordinate a group of shareholders to take legal action.

204 During consultation, submitters were asked to provide their views on whether public enforcement of directors' duties should be introduced and, if so, should criminal offence provisions be included. Many submitters expressed the concern that public enforcement would discourage individuals from becoming directors or taking reasonable business risks. The Institute of Directors supported the idea of public enforcement.

205 However, there is the potential for substantial harm to individual and public interests from directors breaching their duties, in particular where they are directors of companies that hold substantial assets in a fiduciary capacity for broad groups of outsiders, as in finance companies. Many investors lost much or all of their savings and endured a significant fall in their standard of living as a result of finance company failures.

206 Many submitters were in favour of criminalising intentional dishonest behaviour by directors. A criminal offence is appropriate where the conduct in question will cause substantial harm to individual or public interests. On the other hand, civil penalty provisions, with the lower standard of proof, i.e. cases being judged on the balance of probabilities, would result in too great a risk of people being deterred from taking on directorships. They would also put the regulator in the position of second-guessing the soundness of directors' business decisions.

207 The Companies Act 1993 already includes a number of criminal offences for specific fraudulent conduct such as making false statements relating to the company, falsifying records and taking property of the company for one's own benefit. In relation to financial markets, the Securities Act provides for offences by directors relating to the statements in prospectuses and in the allotment of securities.

208 In addition, Crimes Act 1961 offence provisions, such as those relating to theft in a special relationship, dishonestly using a document and promoters using a false statement can and are being used in relation to some forms of egregious conduct in financial markets.

209 There is, however, no offence provision in these or any other Acts to deal specifically with certain types of conduct by directors covered by directors' duties after the allotment of securities. A concern expressed following the finance company failures was the lack of appropriate powers for regulators to take action against directors of those companies for apparent reckless or dishonest conduct. In addition, there are not any offence provisions that would deal with the intentional breach of directors' duties, such as a situation where a director intentionally takes action which is to the detriment of the company or intentionally incurs obligations for a company in circumstances where the company will be unable to meet those obligations.

210 To provide a comprehensive range of offences to punish serious offending by directors, I propose that an offence be created for intentional contraventions of the following duties:

- To act in good faith and in what the director believes to be the best interests of the company;
- To avoid carrying on the business of the company in a manner likely to create a substantial risk of serious loss to the company's creditors; and
- To not incur an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

211 By criminalising only intentional egregious behaviour, I consider that there will be an appropriate balance between not deterring competent people from becoming directors, but providing a deterrent to dishonest conduct.

212 The types of conduct that would be caught by this offence would be difficult for a regulator to detect before the collapse of a company. Information from whistleblowers within the company can be vital for the exposure of this type of serious misconduct. Therefore, I propose to provide protection from court or disciplinary proceedings for people inside the company, such as employees, who voluntarily disclose a director's wrongdoing.

213 The Financial Markets (Regulators and KiwiSaver) Bill provides that the Financial Markets Authority may exercise another person's right of action against a financial market participant when this is in the public interest. This includes the power to bring civil proceedings on behalf of a company against its directors for a breach of directors duties.

214 The power to bring criminal proceedings for egregious breaches of directors' duties would be in addition to this power in the Financial Markets (Regulators and KiwiSaver) Bill.

## POTENTIAL ADDITIONAL FUNCTIONS AND POWERS OF THE FINANCIAL MARKETS AUTHORITY

### No action letters and rulings

215 It is inevitable that there will be uncertainty about what type of security certain products will be classified as. It will be open to issuers to engage with the FMA about their product and/or transaction and how they propose to treat it. I therefore expect that the FMA will issue no action letters, where appropriate, confirming that it will not take action if the transaction as described goes ahead.

216 Many submitters were favour of the FMA having the power to issue binding rulings as this would provide increased certainty around the interpretation of the law. While I acknowledge that in principle this approach appears to provide greater certainty, in practice the rulings would be subject to appeal. There are also issues regarding the scope of determinations depending on how they are interpreted. I therefore consider that the FMA should not be given the power to make binding rulings.

### Credit Contracts and Consumer Finance

217 The Credit Contracts and Consumer Finance Act (CCCFA) regulates, amongst other things, the provision of consumer credit. The Commerce Commission is currently responsible for the enforcement of obligations under the CCCFA. Consideration has been given to whether this function should be transferred to the FMA. Submitters' views were mixed on this issue, but generally thought that no change was necessary. At the present time, I do not see a compelling reason to shift this function from the Commerce Commission to the FMA.

### Financial literacy

218 The Financial Markets (Regulators and KiwiSaver) Bill currently provides that one of the FMA's functions is to promote the confident and informed participation of businesses, investors, and consumers in the financial markets, including (without limitation) by:

(i) collecting and disseminating information or research about any matter relating to those markets;

(ii) issuing warnings, reports, or guidelines, or making comments, about any matter relating to those markets or financial markets participants or other persons engaged in conduct that involves dealings in securities (including in relation to one or more particular persons);

(iii) providing information about its functions, powers, and duties under this Act and other enactments (including promoting awareness by investors that all investments involve risks and that it is not the role of the FMA to remove those risks); and

(iv) providing, or facilitating the provision of, education about any matter relating to those markets (for example, education about investing).

219 Given this function, I would expect that the FMA would take an active role in the promotion of financial literacy (while working in conjunction with other relevant agencies, such as the Retirement Commissioner. I do not consider that there is any current need to provide more direct legislative backing to the FMA carrying out a role in respect of financial literacy. As recommended by the Taskforce, I am working to improve the coordination of the Government's financial literacy efforts.

## Monitoring and evaluation

220 Currently, there is a significant lack of whole of sector data on the financial sector. For example, there is little information available on activity in private markets, and no way of telling how often, and in what circumstances, existing exemptions from securities law are used. This lack of data can be an impediment to effective policy making, although considerable amounts of data are gathered by particular agencies (for example, the Reserve Bank).

221 Whether more information on the operation of the sector should be collected by regulators and policy makers was consulted on as part of the Securities Law Review. Generally, submitters were concerned about the additional costs that could be imposed by the need to collate and provide this information to public agencies. For the moment, I do not propose that any additional information requirements be placed on financial sector participants in order to obtain better whole of sector data.

### REGISTERED AND UNREGISTERED EXCHANGES

222 Currently, an exchange must currently be registered if it calls itself a "stock exchange" or "securities exchange", or states or implies that it is regulated, or if the Minister declares that it must be registered. The provisions of the Securities Markets Act 1988 that apply to registered exchanges 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.

223 The Taskforce recommended that registered exchanges should be able to operate unregistered markets which would be exempt from the requirements of the Securities Markets Act. Such an approach would help to attract liquidity for small issuers and could be used as an initial step towards listing on a fully regulated exchange.

224 In addition, the Financial Markets (Regulators and KiwiSaver) Bill provides for a more clearly specified set of rules around the oversight of registered exchanges. Submissions on the Bill, which is currently before the Commerce Select Committee, have raised a number of concerns with the proposed rules in the Bill regarding the oversight of registered exchanges.

225 I consider that any regulatory framework for securities exchanges must:

- Ensure competitive neutrality between different exchange operators; and
- Allow for different tiers of requirements for different levels of securities markets.

226 I propose to report back to Cabinet by 31 May 2011 on the appropriate regulatory framework for the regulation of securities exchanges.

## OTHER MATTERS

### Public access to securities registers

227 Issuers are obligated to keep a register of securities and investors. Any holder of securities may access the registers without paying a fee and any other person can request a copy for a fee. Concerns have been raised about the ability of third parties to access registers for improper purposes, such as the solicitation of donations or making predatory offers to buy securities from investors.

228 Australia has introduced a proper purpose test whereby the issuer may refuse access to the register unless they are satisfied that the person is seeking access for a proper purpose. The legislation includes a non-exhaustive list of improper purposes. In a New Zealand context, I consider that this approach is too restrictive as it would potentially prevent access to registers for the purpose of making a legitimate offer to purchase securities from investors. I therefore do not recommend that we adopt an approach based on the current Australian rules.

229 I recommend that legislation provide a strict liability offence where a person uses information about a person obtained from a register to contact or send material to the person, for example advertising material, or where they disclose the information knowing it is likely to be used for that purpose. It would not be an offence if the use or disclosure of the information is relevant to the holding of interests or exercising rights or where it has been approved by the company.

230 In order to protect investors from predatory offers, I recommend that there be rules around how unsolicited offers can be made. These would include requiring the person making an offer to provide an offer document specifying, amongst other things, a fair estimate of the value of the securities that are the subject of the offer and an explanation of how the estimate was arrived at, and a cooling off period.

### The Hague Convention on indirectly held securities

231 The Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary ("the Convention") was developed because there was no common international legal approach to determine the applicable law in proprietary issues affecting securities holdings in securities accounts maintained by an intermediary.

232 The Convention states that the applicable law is that provided for in the contract between the account holder and the intermediary. The Convention provides fall-back rules in situation where there is no express agreement.

233 Many submitters indicated that they have had relatively few encounters with conflicts of laws, but considered that it would be beneficial to align New Zealand's law with the Convention. This would require a small amendment to the Personal Property Securities Act 1999.

234 Accordingly, I propose to align New Zealand's law with the Convention. This will provide parties with greater certainty and confidence which may result in increased capital inflows to New Zealand. It would also help to achieve harmonisation of the New Zealand and Australia personal property regimes under the Single Economic Market Outcomes frameworks.

**Management bans**

235 Management banning provisions are currently found in a range of company and securities law statutes. Automatic bans for five years apply for convictions for the following:

- An offence in connection with the promotion, formation or management of a company;
- An offence involving dishonesty;
- Making an untrue statement in a prospectus, or making an offer of securities in contravention of the Securities Act 1978;
- A dealing misconduct offence under the Securities Markets Act 1988; and
- An offence against the Takeovers Act 1993.

236 In addition, the Registrar of Companies has the power to prohibit a person from managing a company for up to five years where the Registrar is satisfied that the person was at least partly responsible for a company's financial difficulties. Such bans have been imposed on a number of directors of failed finance companies. I consider that the current maximum period is not sufficient to protect the public interest adequately. I therefore propose that the maximum period for regulator-imposed bans be increased to 10 years. As provided for in the Financial Markets (Regulators and Kiwisaver) Bill, the Registrar or the FMA will be empowered to impose a ban. Cabinet also decided in July 2010 that the Registrar will have jurisdiction to ban a director in certain circumstances where the director has breached their duties.

237 Currently, the Court has the power to impose bans for a broader range of conduct for a period of up to 10 years. An application to the court would likely be made for the most serious types of misconduct and can be made where a person has been banned in another jurisdiction (which could be for a period longer than 10 years). To provide adequate protection for the public from misconduct by directors, I propose that the High Court have the discretion to impose indefinite banning orders.

## Special partnerships

238 The Limited Partnerships Act 2008 establishes the legal form of limited partnership in New Zealand. A limited partnership is a form of partnership with two classes of partners. These are general partners who are jointly and severally liable for the debts of the partnership, and limited partners, whose liability is limited to the extent of their capital contribution to the partnership. The Limited Partnerships Act also superseded the special partnership provisions of the Partnerships Act 1908, and provided that no new special partnerships could be registered under those provisions (as special partnerships have a maximum seven year lifespan, this means that all special partnerships will have expired before 1 May 2015.

239 Special partnerships that want to transition to become a limited partnership would have to wind themselves up and register as a limited partnership. Transferring the rights and liabilities of the special partnership to a limited partnership in these circumstances is likely to involve some cost and uncertainty for special partnerships. As a result, I propose that a special partnership that registers as a limited partnership succeeds to the rights and liabilities of the special partnership.

### CONSULTATION

240 The Ministry of Economic Development (MED) released a discussion document on the policy proposals covered by the paper in June 2010. 98 submissions were received, which informed the proposals discussed in this paper. MED has also met with many submitters, informally consulted on some of the technical aspects of the proposals contained here and held several seminars with industry participants.

241 The Treasury, Reserve Bank, Ministry of Justice, Securities Commission, and Legislation Design Committee were consulted on the contents of this paper. The Department of Prime Minister and Cabinet has been informed.

242 Treasury is supportive of most of the changes proposed here. However, Treasury does not support the proposal to develop a licensing regime for fund managers at this time (recommendations 107-109). There are a range of other initiatives already in train or being proposed as part of the securities law review that seek to lift conduct in that area. These include:

- the establishment of the Financial Markets Authority and its increased focus on detecting and taking action against wrong-doing across the entire financial sector;
- reforms aimed at lifting the performance of trustees and financial advisers as agents of unsophisticated investors who a key target group for managed funds investment;
- registration requirements for all Financial Service Providers that will prevent people who have been convicted of financial crime (and some other crimes) from operating in the sector;

- measures aimed at clarifying the duties owed by fund managers to investors; and

- requirements for clearer and more periodic disclosure by KiwiSaver providers to better enable investors and commentators to monitor performance.

243 Given that none of these changes are fully in place yet, it is not clear that introducing licensing at this time would have sufficient benefits to outweigh its costs to the sector and the additional costs to the FMA in undertaking this additional function.

**FISCAL IMPLICATIONS**

244 There will be fiscal implications arising out of this certain proposals in this paper, such as the licensing of derivatives dealers, investment brokers, and fund managers. A detailed budget and request to establish any new appropriations that are required will be submitted to Cabinet separately by 31 May 2011.

**HUMAN RIGHTS**

245 The proposals in this paper may raise issues under the New Zealand Bill of Rights Act 1990. Officials from the Ministry of Economic Development and the Ministry of Justice will work together on these issues during the drafting of the Bill to ensure consistency with the Bill of Rights Act. A final view on the consistency of these proposals and the Bill of Rights Act will be possible once the legislation has been drafted.

**LEGISLATIVE IMPLICATIONS**

246 The proposals in this paper will require the repeal of the Securities Act 1978 and the Securities Markets Act 1988, and the enactment of a new Securities Act. They will also involve amendments to legislation resulting from the Securities Trustees and Statutory Supervisors Bill and the Financial Markets (Regulators and KiwiSaver) Bill.

247 The proposals in this paper may also require the repeal of the Unit Trusts Act 1960, and amendments to the Companies Act 1993, KiwiSaver Act 2006, Superannuation Schemes Act 1989, and other business related legislation.

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

**REGULATORY IMPACT ANALYSIS**

249 The Regulatory Impact Analysis requirements apply to the proposal in this paper and a Regulatory Impact Statement (RIS) has been prepared and is attached.

250 The Regulatory Impact Analysis Team has reviewed the RIS prepared by the Ministry of Economic Development and associated supporting material. The information and analysis summarised in the RIS with regard to the changes to the Securities Act and Securities Markets Act meet the quality assurance criteria.

251 I have considered the analysis and advice of my officials, as summarised in the attached RIS 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**

252 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 post a copy of this paper on its website.

**RECOMMENDATIONS**

253 It is recommended that the Committee:

1 **Note** that the Review of Securities Law follows on from other aspects of the government's financial sector reform programme, which has also included the prudential regulation of non-bank deposit takers and insurance companies, the forthcoming occupational regulation of financial advisers and trustees, and the decision to establish the Financial Markets Authority.

2 **Note** that the Review of Securities Law is focused on:

2.1 The scope of the securities law regime (i.e. which financial products, and what offers of those financial products, should be regulated);

2.2 Disclosure requirements for issuers;

2.3 The regulation of collective investment schemes; and

2.4 A range of other matters including the liability regime for breaches of securities law, the regulatory regime for securities exchanges, and public enforcement of directors' duties.

*Proposed structure and objectives of new securities legislation*

3 **Note** that the Securities Act 1978 and the Securities Markets Act 1988 have been amended on numerous occasions in the last 30 years, and in certain respects lack a coherent and rational structure.

4 **Agree** that the Securities Act 1978 and the Securities Markets Act 1988 be repealed and re-enacted in a single Act incorporating the changes proposed in the following recommendations.

5 **Agree** that where parts of the Securities Act 1978 and the Securities Markets Act 1988 are not affected by the following recommendations, those parts be carried over into the new securities legislation (subject to minor or technical drafting changes).

6 **Note** that the Financial Markets Authority is expected to have as one of its objectives facilitating fair, efficient and transparent financial markets.

7 **Agree** that the primary objective of the new securities legislation should be, subject to drafting, to facilitate capital market activity in order to help businesses to grow and to provide individuals with opportunities to develop their personal wealth.

8 **Agree** that a general prohibition on misleading and deceptive conduct should to apply to all dealings in securities, in both private and public markets, in addition to substantive requirements, such as the requirement for the issuer to make disclosure and comply with any governance requirements.

*Scope of securities law*

9 **Note** that the Securities Act 1978 currently defines "security" as any interest or right to participate in any capital, assets, earnings, royalties, or other property of any person.

10 **Note** that the Securities Act provides for six categories of security: equity securities, debt securities, units in a unit trust, interests in a superannuation scheme, life insurance policies, and participatory securities.

11 **Agree** that securities law should regulate four classes of financial product:

11.1 Equity;

11.2 Debt;

11.3 Collective investment schemes; and

11.4 Derivatives.

12 **Note** that working definitions of each of the four classes of regulated financial product are contained in Appendix 1, subject to drafting and further industry consultation.

13 **Agree** that securities law should regulate two classes of financial service:

13.1 Provision of non-pooled investment schemes; and

13.2 Provision of specified intermediary services.

14 **Note** that the only class of specified intermediary services currently proposed is the provision of peer-to-peer lending services.

*Designation powers over financial products*

15 **Note** that it is important for securities law to have the flexibility to accommodate financial products and services that do not clearly come within the definition of a particular regulated financial product or service.

16 **Agree** that the FMA have the power to designate a financial product and service that would otherwise fall outside the definitions of a regulated financial product or service, or to shift a financial product from one category of regulated financial product to another.

17 **Agree** that certain conditions must be met for the FMA to designate a product as coming within a particular class of regulated financial product or service, based on the following:

17.1 The FMA is satisfied that the product is in the nature of an investment or can be used to hedge financial risk;

17.2 The FMA is satisfied that it is in the public interest to designate the product;

17.3 The FMA has consulted with affected parties; and

17.4 the FMA publishes a statement of its reasons.

18 **Agree** that when considering whether to designate a financial product or service as coming within the scope of a particular class of regulated financial product or service, the FMA have the power to issue an interim stop order prohibiting allotment of the product or service.

19 **Agree** that when designating a financial product or service as coming within a particular class of regulated financial product or service, the FMA would be able to customise the regulatory requirements attaching to that designation.

*Licensing of specific financial market participants: derivatives dealers and regulated intermediaries*

20 **Note** that, in order to carry on business, dealers in derivatives are currently required to be authorised by the Securities Commission.

21 **Agree in principle** that derivatives dealers be required to be licensed by the Financial Markets Authority, in accordance with specified criteria and subject to any licence terms or conditions imposed by the FMA, and subject to Cabinet approving detailed costings for these functions that will be prepared by the Minister of Commerce by 30 April 2011.

22 **Agree in principle** that as part of its obligations as a licensed derivatives dealer, a licensee must observe licence conditions imposed by the FMA and specified conduct standards, and be required to notify the FMA of matters that may affect the dealers compliance with its obligations.

23 **Agree in principle** that a statutory exemption from the requirement for derivatives dealers to be licensed be provided to dealers in foreign exchange.

24 **Note** that at present, the requirements of securities law effectively prevent certain legitimate business activities, such as person-to-person lending services, from being carried out.

25 **Agree in principle** that a licensing regime be established for certain intermediaries in circumstances where it is impractical for an issuer to meet the requirements of securities law and a supervised intermediary is better placed to do so (subject to Cabinet approving detailed costings for these functions that will be prepared by the Minister of Commerce by 31 May 2011).

26 **Agree in principle** that the licensing regime will include the following features:

26.1 A regulated intermediary will need to be licensed by the FMA before operating;

26.2 The intermediary will need to be a fit and proper person to be an intermediary;

26.3 The FMA may impose specific conditions on the intermediary;

26.4 The intermediary must inform the FMA of changes to material matters concerning their license;

26.5 The FMA will be able to respond to new information concerning the intermediary in various ways, including by varying, placing restrictions, suspending and cancelling their license; and

26.6 There will be a right of appeal to the High Court from an FMA decision in relation to the license.

27 **Agree in principle** that providers of person-to-person lending services be the only intermediaries to be initially covered by the licensing regime for intermediaries referred to in recommendation 26.

*Exempt offers of regulated financial products*

28 **Note** that there are currently a range of exemptions from securities law for, amongst other things, offers to sophisticated investors and persons related to the issuer, and for offers of particular types of products.

29 **Note** that there are a number of problems with existing exemptions, such as difficulties in applying some exemptions due to their subjective nature, and potentially disproportionate consequences for accidentally including a member of the public within an offer.

30 **Agree** that all offers of regulated financial products are to be covered by securities law, unless they are specifically exempted.

31 **Agree** that there will be a principle-based definition of 'sophisticated investor'.

32 **Agree** that there will be specific exemptions for different kinds of sophisticated investor, specifically:

32.1 Investment businesses;

32.2 Persons who meet certain quantitative investment activity criteria;

32.3 Large entities;

32.4 Certain government entities; and

32.5 Persons making investments of over $500,000.

33 **Note** that working definitions of the principle-based and specific exemptions for sophisticated investors are included in appendix 2, subject to drafting and further industry consultation.

34 **Agree** that an issuer may request that an investor certify in writing that they come within one of the specific definitions for different kinds of sophisticated investor, and that the issuer is entitled to rely on the investor's statement, unless the issuer knows that the statement is false.

35 **Agree** that it will be an offence to encourage a person to self-certify themselves as coming within one of the specific exemptions for different kinds of sophisticated investor knowing that the certification is false.

36 **Agree** that it will be an offence for an investor to self-certify themselves as coming within one of the specific exemptions for different kinds of sophisticated investor knowing that the certification is false.

37 **Agree** that investors seeking to take advantage of the principle-based sophisticated investor exemption would be required to have their qualification under the exemption approved by an Authorised Financial Adviser.

38 **Agree** that if a person comes within one of the exemptions for different kinds of sophisticated investor, relevant entities related to that person will also be exempt (e.g. companies controlled by that person).

39 **Agree** that there will be specific exemptions for persons with a close relationship to the issuer, specifically:

39.1 Relatives; and

39.2 Close business associates.

40 **Note** that working definitions of the specific exemptions for persons with a close relationship to the issuer are included in appendix 2, subject to drafting and further industry consultation.

41 **Agree** that if a person comes within the definition of close business associate, relevant entities related to that person will also be exempt (e.g. companies controlled by that person).

42 **Agree** that an exemption be provided for employee share schemes, subject to certain conditions based on the following:

42.1 it is for equity securities, equity warrants, or equity options in the issuer;

42.2 it does not exceed certain 15 percent of the gross assets of the company; and

42.3 The offer is made as part of remuneration arrangements and separate from any other financial product offering by the issuer.

43 **Agree** that a short-form disclosure statement would be required for employee share schemes that come with the scope of the exemption referred to above.

44 **Agree** that an exemption be provided for small offers meeting the criteria based on the following criteria:

44.1 The offer is for equity or debt securities in a person that is a non-property company;

44.2 $2 million may be raised per 12 months;

44.3 The company may have up to 20 investors per 12 months; and

44.4 There is a cap of $100,000 per investor per 12 months, unless the investor is sophisticated.

45 **Agree** that a short warning statement be provided to investors for offers that come with the scope of the exemption referred to above, and that these offers be subject to marketing restrictions.

46 **Agree** that exemptions be provided for previously allotted securities as provided for currently in section 6 of the Securities Act 1978.

47 **Agree** that an exemption be provided for the purchase of a unit title under the Unit Titles Act 2010 and associated interests in common property and a body corporate.

48 **Agree** that an exemption continue to be provided for the purchase of an interest in a registered retirement village.

49 **Agree** that the following entities have exemptions from the governance requirements and some of the disclosure requirements:

49.1 The Crown;

49.2 National Provident Fund;

49.3 Government Superannuation Fund;

49.4 Reserve Bank of New Zealand;

49.5 Housing New Zealand;

49.6 Local Government; and

49.7 Registered Charities.

50 **Agree** that an exemption also be provided for the following products:

50.1 Debt securities offered by registered banks, including bank deposits and term deposits;

50.2 Callable building society shares; and

50.3 Bonus bonds.

51 **Agree** that equity securities or interests in a collective investment scheme allotted under a dividend reinvestment plan will be exempt from most disclosure requirements, subject to certain conditions.

*Point of sale disclosure*

52 **Note** that the Securities Act 1978 generally requires issuers of securities to the public to prepare a prospectus and investment statement.

53 **Note** that there are a number of problems with the current prospectus and investment statement requirements, including:

53.1 The focus of the current enforcement regime is slanted towards false or misleading statements in a prospectus, but the document provided to all investors is the investment statement;

53.2 The current split between the investment statement and prospectus regime is not well defined, material is duplicated between the documents, and there is limited use of cross referencing; and

53.3 Prospectuses and investment statements appear to be excessively long, which makes it less likely that retail investors will read them.

54 **Note** that, in most cases issuers are currently required by the regulations to include all material matters in the prospectus and specific information about matters such as risks and returns in the prospectus and in the investment statement.

55 **Agree** that the requirement to prepare a prospectus and investment statement be replaced by a requirement to prepare a product disclosure statement.

56 **Agree** that the product disclosure statement only contain information that is essential to an investor's decision, and be specifically targeted at retail investors.

57 **Agree** that the product disclosure statement will usually be divided into two parts:

57.1 A key information summary of around 1-2 pages that summarises the key features of the investment and risks associated with it; and

57.2 A more detailed description of information that is essential to an investor's decision.

58 **Agree** that the content of the product disclosure statement be tailored for different types of financial product (and where appropriate, financial service) and different types of offer.

59 **Agree** that where appropriate given the nature of the product and/or offer, the length of product disclosure statements be prescribed and may incorporate material by reference.

60 **Note** that the Financial Markets (Regulators and KiwiSaver) Bill establishes a new electronic register of securities offerings, which will help to facilitate comparability between documents and to make more detailed information available about offerings.

61 **Agree** that issuers of regulated financial products be required to disclose on the Register of Securities information prescribed in regulations and any additional information about the offer that is required to ensure that all material information has been disclosed (if required).

62 **Note** that the purpose of disclosure on the Register of Securities would be to provide additional information for retail investors who may want to know more, and to provide information that may be of use to key secondary audiences like analysts and financial advisers.

63 **Agree** that the content of product disclosure statements and the required disclosures on the Register of Securities be prescribed in regulations, which will be developed over the next 18 months.

*Ongoing disclosure*

64 **Note** that holders of debt securities are not necessarily informed about material changes in the issuers' circumstances that may impact on the likelihood of default by the issuer.

65 **Agree** that issuers of debt securities be required to update the Register of Securities any material change to certain prescribed matters that may impact on the likelihood of default by the issuer.

66 **Note** that in April 2010 Cabinet agreed that KiwiSaver schemes be required to report on a quarterly basis to investors on the following matters:

66.1 All fees and charges (for example, in the form of a Total Expense Ratio);

66.2 Asset holdings (including, for example, percentages of the different types of assets and disclosure of top ten portfolio holdings);

66.3 Conflicts of interest (for example, investments in related parties); and

66.4 Fund returns (ideally both gross and net of all fees and taxes).

67 **Agree** that collective investment schemes and non-pooled investment schemes be required to report on a quarterly basis to their members on the matters outlined in recommendation 66.

*Advertising*

68 **Note** that securities law currently provides for a range of prescriptive rules around the contents of advertisements (for example, a requirement that an advertisement must not state or imply that an investment is safe).

69 **Agree** that current rules around the regulation of advertising be replaced by a prohibition, based on the requirement that an advertisement must not contain any material that is likely to deceive, mislead or confuse with regard to any particular in the advertisement that is material to the offer made in the advertisement.

*Celebrity endorsements*

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

71 **Invite** the Minister of Commerce to report back to Cabinet by 31 May 2011 on the need for further regulation in this area.

*Collective investment schemes*

72 **Note** that collective investment schemes are vehicles in which investors give money to someone else to invest, with the earning of a financial return being a significant objective, and investors do not maintain day-to-day control over the management of their money.

73 **Note** that in New Zealand collective investment schemes can employ a variety of legal forms including unit trusts, superannuation schemes (including KiwiSaver), trusts and partnerships.

74 **Note** that there are a variety of problems with the current regulation of collective investment schemes including:

74.1 Inconsistent governance and obligations across legal forms;

74.2 Lack of fund manager accountability;

74.3 Inadequate supervision of fund managers;

74.4 Problems with pricing and valuation;

74.5 Problems with redemption/exiting rules; and

74.6 Impediments to the use of open ended investment companies.

75 **Agree** that a single set of governance and regulatory requirements be applied across all collective investment schemes irrespective of their legal form, apart from some existing participatory securities where the current regime will largely continue.

76 **Agree** that all collective investment schemes be required to have a manager who is:

76.1 responsible for the management of the schemes; and

76.2 the issuer of interest in the scheme for the purposes of securities law.

77 **Agree** that all collective investment schemes be required to have a supervisor who is:

77.1 licensed under the regime established by the Securities Trustees and Statutory Supervisors Bill;

77.2 responsible for supervising the manager of the scheme; and

77.3 responsible for custodianship of the scheme assets.

78 **Agree** that the supervisor of a collective investment scheme have functions, duties and powers based on the working drafts set out in Appendix 3, subject to drafting and further industry consultation.

79 **Agree** that the manager of a collective investment scheme have functions and duties based on the working drafts set out in Appendix 3, subject to drafting and further industry consultation.

80 **Agree** that a range of remedies be available if a manager of a collective investment scheme breaches their duties, including the following:

80.1 Investors will be able to call a meeting of investors to consider what actions to take against the fund manager;

80.2 Investors will be able to remove the fund manager or give directions to the fund manager (for example, a direction that the collective investment scheme be wound up) if the investors obtain the appropriate threshold at a meeting of investors;

80.3 Investors will be able to direct the supervisor to take an action to seek compensation for loss caused by a breach;

80.4 The FMA may take an action; and

80.5 The fund manager may be liable for criminal penalties in situations where there is a high level of culpability.

81 **Agree** that the supervisor of a collective investment scheme is legally responsible for the custodianship of the assets of the scheme, but may contract this role to a third party.

82 **Agree** that when carrying out its custodial role, the supervisor of the scheme and any third party the supervisor has contracted the custodial role to be required to:

82.1 maintain a presence in New Zealand; and

82.2 maintain all records of asset ownership in New Zealand.

83 **Agree** that investors in a collective investment scheme should have the power to remove the supervisor of the scheme where investors holding at least 75 percent of the value of interests in the scheme approve the removal, and that the FMA would appoint an interim supervisor if the investors do not decide immediately on a replacement supervisor.

84 **Note** that it is important in a collective investment scheme that the pricing of units are calculated equitably and accurately so that investors can accurately gauge scheme performance, and so that unit prices are accurately measured when investors enter or exit the fund.

85 **Agree** that the FMA be required to prepare guidance on the appropriate process for the valuation of collective investment scheme assets and how often those valuations need to occur.

86 **Agree** that collective investment schemes be required to state in their product disclosure statement and quarterly reporting that they have complied with guidance referred to in recommendation 85, or if they have not, the reasons why not.

87 **Agree** that managers of collective investment schemes be required to report to the supervisor of the scheme when a pricing error or limit break occurs.

88 **Agree** that where a pricing error or limit break exceeds 0.5 percent of the value of a unit or the value of the scheme, the supervisor must report this to the Financial Markets Authority.

89 **Agree** that in the event of a pricing error or limit break occurring, there be a duty on the manager to take action to reimburse current or former investors who are affected, and the scheme itself, except if it appears to the supervisor that the breach is of minimal significance.

90 **Agree** that where a supervisor believes that the manager should not be required to reimburse current or former members, they be required to report this to the Financial Markets Authority.

91 **Note** that there is currently a risk that the constitutional documents of some collective investment schemes may not address all essential matters relating to the management of the scheme that impact on investors.

92 **Agree** that the constitutional documents of all collective investment schemes be required to address all of the following matters:

92.1 *Investment policy and* objectives: A clear statement about the core investment policies of the scheme;

92.2 *Authorised investments*: What limits are in place on the nature or type of investments, or the limits on each type of asset, and what methodology is used for developing, amending and measuring the investment strategy;

92.3 *Entry and exit rules*: What the entry and exit policies of the scheme are;

92.4 *Contribution levels and rates*: What the process is for establishing and revising/changing contribution levels and rates;

92.5 *Returns and* pricing: What the conditions are in relation to allocations, withdrawals, redemptions and distributions, and what the methodology is for valuing the assets of the scheme (if this varies from the guidelines prepared by the FMA);

92.6 *Fees*: What fees could/might be charged and how fees can be changed; and

92.7 *Winding up*: What circumstances trigger a wind-up and distribution of the assets of the fund.

93 **Agree** that material changes to constitutional documents must be approved by a majority of investors.

94 **Note** that the ability to call meetings is an important mechanism for investors of a collective investment scheme to exercise control over the fund manager and supervisor.

95 **Agree** that investors in a collective investment scheme holding not less than 10 percent of the value of the scheme may summon a meeting of investors.

96 **Agree** that a resolution to direct the supervisor of a collective investment scheme can be passed by investors with three-quarters of the value of interests in the scheme, which are held by investors who are present (in person or by proxy) or making written votes, and who hold not less than one-quarter of the value of interests in the scheme.

97 **Agree** that members of collective investment schemes be able to use electronic voting, subject to the same rules as applying to companies that use electronic voting.

98 **Note** that whistle-blowing provisions help to minimise the risk of unfair and fraudulent conduct by the manager of a collective investment scheme.

99 **Agree** that any administration manager, investment manager, actuary or auditor of a scheme be required to disclose to the FMA where they form the opinion there is a serious problem with the scheme, and will be protected against any liability for such disclosure where it was made in good faith.

100 **Note** that related party transactions have been a feature of many finance company collapses in recent years.

101 **Agree** that the manager of a collective investment scheme be required to report all related party transactions to the supervisor of the scheme.

102 **Agree** that the supervisor of the scheme be required to report to the FMA if the manager of the scheme engages in one or more related party transactions within a certain period (anticipated to be six months) that individually or collectively are worth more than a certain limit (anticipated to be 10 percent) or more of the value of the scheme.

*Provision for open ended investment companies*

103 **Note** that the use of open ended investment companies as collective investment schemes is widespread in other jurisdictions.

104 **Note** that certain aspects of New Zealand company law (such as the prohibition on corporate directors and rules regarding the issue and redemption of shares) make it difficult to operate an open ended investment company in New Zealand.

105 **Agree** that a special class of open ended investment company be provided for under New Zealand law, which would be broadly based upon existing company law, but which would, amongst other things, allow the use of corporate directors and have tailored rules relating to the issue and redemption of shares.

106 **Agree** that open ended investment companies be subject to the same regime that is proposed in recommendations 72-102 for other collective investment schemes.

*Authorisation of fund managers*

107 **Agree in principle** that fund managers must be authorised by the FMA, subject to Cabinet approving detailed costings for these functions that will be prepared by the Minister of Commerce by 31 May 2011.

108 **Agree in principle** that the authorisation of fund managers will involve checking that the directors, senior managers, and controlling owners of the fund manager meet a "fit and proper" person test.

109 **Agree in principle** that other features of the authorisation regime will include:

109.1 A person must apply to the FMA for authorisation before acting as a fund manager;

109.2 The authorised fund manager must inform the FMA of changes to material matters concerning their authorisation;

109.3 The FMA will be able to respond to new information concerning the fund manager in various ways, including by varying, placing restrictions, suspending and cancelling their authorisation;

109.4 There will be a right of appeal to the High Court from any FMA decision in relation to an authorisation; and

109.5 Where a fund manager has no license, or that license has been revoked, the FMA will appoint a temporary fund manager and the fund's supervisor would seek to appoint a replacement fund manager with the consent of the fund's investors.

*Treatment of insurance products with an investment component*

110 **Agree** that all current insurance products with an investment component be exempted from having to comply with the proposed regime for the regulation of collective investment schemes set out in recommendations 72-102.

111 **Note** that all future insurance products with an investment component be required to comply with the proposed regime for the regulation of collective investment schemes referred to in recommendations 72-102.

*Treatment of workplace savings schemes*

112 **Note** that in the last decade, there has been a substantial decline in the number of customised workplace savings schemes, in particular defined benefits schemes.

113 **Note** that many employers who continue to offer a workplace superannuation scheme in addition to KiwiSaver use a master trust structure whereby they outsource the funds management and administration to a large corporate collective investment scheme provider.

114 **Agree** that master trusts be regulated in the same manner as all other collective investment schemes (i.e. that the fund manager will be deemed the issuer and the trustees will be responsible for custodianship of the assets of the scheme and the supervision of the fund manager).

115 **Note** that there remain a number of company-specific superannuation schemes whereby the employer is the trustee and the employee benefits offered are substantial, and number of other restricted entry superannuation schemes, where membership is restricted to a certain industry, profession or calling (restricted schemes).

116 **Agree** that all existing restricted schemes may retain their current structure of a trustee that is responsible for the custodianship and management of the assets of the scheme.

117 **Agree** that any future schemes be regulated in the same way as other collective investment schemes.

118 **Agree in principle** that all existing restricted schemes (except those that use a master trust structure) be required to appoint an independent trustee as approved by the FMA, subject to Cabinet approving detailed costings for these functions that will be prepared by the Minister of Commerce by 30 April 2011.

119 **Agree in principle** that when assessing an independent trustee for restricted schemes, the FMA must assess the trustee's investment management skill and experience.

120 **Agree** that existing restricted schemes be prohibited from entering into the following transactions:

120.1 Investments of greater than five percent in any one asset; or

120.2 Total investments of greater than five percent in any employer related parties.

*Exchange-traded funds*

121 **Note** that continuous disclosure may be an inappropriate requirement for exchange-traded funds due to the fact that they tend to be index-tracking funds and are merely a conduit for grouping investments into transparent and liquid underlying assets which are subject to the same disclosure requirements.

122 **Note** that globally there has been a move to more complex and actively-managed exchange-traded funds.

123 **Invite** the Minister of Commerce to report back to Cabinet by 31 May 2011 on the appropriate disclosure requirements for exchange traded funds.

*Liability regime for securities law*

124 **Note** that the securities law currently provides for a range of civil and criminal remedies in certain circumstances.

125 **Note** that in all other circumstances, the civil and criminal remedies relevant in a securities law context are found in other legislation, such as the Crimes Act 1961 and the Fair Trading Act 1986 or in the general law relating to trusts and contracts.

126 126 Agree that the objectives of the liability regime for securities law should be to:

126.1 Deter non-compliance and encourage voluntary compliance with the law;

126.2 Provide remedies for those harmed by undesirable conduct that occurs; and

126.3 Punish non-compliance.

127 **Agree** that the securities law liability regime be redrafted, as far as possible, as a code designed to achieve these objectives using a mix of criminal offences and civil remedies, including pecuniary penalties specific to securities law.

128 **Agree** that serious criminal offences should be limited to the most egregious breaches of securities law.

129 **Agree** that the liability regime will provide for regulatory offences for breaches of securities law that are harmful but not sufficiently serious to warrant the imposition of the criminal offences.

130 **Agree** that civil remedies (i.e. pecuniary penalties and compensation orders) should be available for contraventions of the securities law.

131 **Note** that securities law currently provides that certain allotments of securities are void, or voidable at the option of the subscriber.

132 **Agree** that the current provisions that provide for void and voidable allotments be replaced by provisions that allow for subscribers to cancel their allotment and obtain a refund from the issuer in certain circumstances.

133 **Note** that directors are currently liable for most breaches of securities law.

134 **Agree** that where appropriate, securities law contraventions should provide for liability on issuers as well as, or in place of, directors.

135 **Note** that the interface between the Fair Trading Act and securities law is confusing and requires clarification.

136 **Invite** the Minister of Commerce to report back to Cabinet by 31 May 2011 on the detailed design of the liability regime for securities law.

*Public enforcement of directors' duties*

137 **Note** that the Companies Act 1993 imposes a range of duties on directors that are owed to, and may be enforced by, the company.

138 **Note** that there are disincentives for companies and investors to take private actions to enforce directors' duties.

139 **Note** that an excessive liability risk has the potential to dissuade persons from acting as directors.

140 **Agree** that it be a criminal offence to recklessly or intentionally breach any of the following directors' duties under the Companies Act:

140.1 To act in good faith or in what the director believes to be the best interests of the company;

140.2 To avoid carrying on the business of the company in a manner likely to create a substantial risk of serious loss to the company's creditors; and

140.3 To not incur an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so.

*Additional functions and powers for the Financial Markets Authority*

141 **Agree** that the FMA will have the power to issue no action letters.

142 **Note** that the FMA will not have the power to make binding rulings.

143 **Note** that responsibility for the enforcement of the Credit Contracts and Consumer Finance Act will remain with the Commerce Commission.

144 **Note** that the FMA will have a role in the promotion of financial literacy.

145 **Note** that there is a lack of data on certain aspects of the financial sector but that, due to concerns about imposing additional compliance costs, there will be no additional information requirements placed on financial market participants in order to obtain better whole-of-sector data on the financial sector.

*Securities markets*

146 **Note** that the provisions of the Securities Markets Act that apply to registered exchanges and public issuers listed on it, including continuous disclosure, are costly and can preclude smaller businesses from accessing capital to develop and grow their business.

147 **Invite** the Minister of Commerce to report back to Cabinet by 31 May 2011 on the appropriate regulatory framework for the regulation of securities exchanges.

*Other matters*

148 **Note** that concerns have been raised about the ability of third parties to access registers for improper purposes, such as the solicitation of donations or making predatory offers to buy securities from investors.

149 **Agree** that it be a strict liability offence where a person uses information about a person obtained from a register to contact or send material to the person, for example advertising material, or where they disclose the information knowing it is likely to be used for that purpose, except where the use or disclosure is relevant to the holding of interests or exercising rights or where it has been approved by the issuer.

150 **Agree** that a person making an unsolicited offer to buy securities be required to provide prospective sellers with an offer document specifying, amongst other things, a fair estimate of the value of the securities that are the subject of the offer and an explanation of how the estimate was arrived at, and a cooling-off period.

151 **Agree** that New Zealand align its legislation with the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary.

152 **Agree** that the maximum period for a prohibition of a person from managing a company by a regulator be increased to ten years.

153 **Agree** that the High Court be empowered to impose orders for an indefinite period, banning people from being a director or taking part in the management of a company.

154 **Agree** that when a special partnership transitions into a limited partnership it automatically secedes to the rights and liabilities of the special partnership.

*Fiscal*

155 **Note** that the implementation of the following recommendations have not been costed:

155.1 Recommendations 21-22 (licensing of derivatives dealers);

155.2 Recommendations 25-27 (licensing of regulated intermediaries);

155.3 Recommendations 107-109 (licensing of fund managers); and

155.4 Recommendations 118-119 (authorisation of independent trustees for workplace saving schemes).

156 **Invite** the Minister of Commerce to report back to Cabinet by 31 May 2011 with full costings on the implementation of licensing or authorisation regimes for derivatives dealers, investment arrangers, independent trustees for workplace superannuation schemes, and fund managers.

157 **Note** that final decisions on whether or not to proceed with the proposals noted in recommendation 155 will be taken in light of full costings of these proposals.

*Legislation*

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

159 **Note** that an exposure draft of the Bill will be released for consultation, following which a revised Bill will be introduced to Parliament.

160 **Note** that officials will continue to engage with stakeholders during the drafting process, and that this may result in minor or technical changes to the Bill.

161 **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.

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

*Publicity*

163 **Note** that the Minister of Commerce will issue a press release on Cabinet's decisions on the matters covered by the above recommendations.

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

Hon Simon Power
**Minister of Commerce**

Date signed: _____

## APPENDIX 1: WORKING DEFINITIONS OF DIFFERENT CLASSES OF REGULATED FINANCIAL PRODUCT

### Definition of equity securities

"Equity" means an investment that is any interest in or right to a share in, or in the share capital of, the entity; and includes:

(a) company shares, except for those included in the debt definition;

(b) shares issued under the Co-operatives Companies Act 1996;

(c) Industrial and Provident Society shares; and

(d) Building Society shares except for those that are debt.

### Definition of debt securities

"Debt" means an investment that is any interest in or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing by, any person; and includes:

(a) A debenture, debenture stock, bond, note, certificate of deposit, and convertible note; and

(b) A preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount.

This will include arrangements that do not provide a profit for the investor, but require a repayment of financial assets (e.g. interest-free loans).

### Definition of a collective investment scheme

"Collective Investment Scheme" (CIS) is an investment with the following features:

(a) investors contribute assets as consideration to acquire rights to benefits produced by the scheme;

(b) the contributions are pooled, or used in a common purpose, to produce financial benefits for the investors in the scheme; and

(c) the investors do not have day-to-day control over the operation of the scheme.

A CIS is not debt and not equity unless it is an open-ended investment company.

**Definition of a derivative**

A derivative is an agreement that involves the following:

- An obligation to provide consideration at a future time.
- The amount of consideration or value of the agreement is derived from an underlying reference item (the “underlying”).
- The underlying includes items such as assets, currency rates, interest rates, indices, commodities, and climatic variables.
- A derivative will include agreements that are:
  - a contract for difference or a swap;
  - a futures agreement or forward;
  - a cap, collar, floor or spread; and
  - an option.
- Contracts for the future delivery of property that may only be settled by delivery of that property will not be derivatives.
- Contracts for the future provision of services will not be derivatives.
- The agreement is not debt, equity or CIS.

## APPENDIX 2 – PRINCIPLES AND WORKING DEFINITIONS FOR EXEMPTIONS FROM SECURITIES LAW

### Sophisticated investors

1 The proposed exemptions for offers to sophisticated investors will cover offers to:

- Investment businesses;
- Persons undertaking a certain degree of investment activity or with a certain degree of investment experience;
- Large entities;
- Certain government entities; and
- Persons making investments in excess of $500,000.

2 There will be a principles-based approach of "sophisticated investor" with bright-line safe harbours. The principle-based definition would be (subject to drafting): "A person who has previous experience in investing in securities that allows them to assess the merits of the investment, the value of the securities, the risks involved, their own information needs, and the adequacy of the information provided by the issuer of the security".

*Investment businesses*

3 Investment businesses will include any person whose principal business is one of the following:

- investing;
- keeping, investing, administering, or managing money, securities, or investment portfolios on behalf of other persons;[9]
- entering into derivative transactions, or trading in money market instruments, foreign exchange, interest rate and index instruments, transferable securities (including shares), and futures contracts;[10]
- a financial adviser service;
- acting as a deposit taker as defined in the Reserve Bank of New Zealand Act 1989;
- acting as an insurer; and
- a combination of the above.

4 Investment businesses will also include any person who is one of the following:

[9] Based on Section 5(d) of the Financial Service Providers (Registration and Dispute Resolution) Act 2008
[10] Based on section 5(k) of the Financial Service Providers (Registration and Dispute Resolution) Act 2008

- a bank registered under the Reserve Bank of New Zealand Act 1989;
- a registered exchange;
- a licensed derivatives market;
- a licensed derivatives issuer;
- a licensed collective investment scheme supervisor;
- a QFE or AFA licensed under the Financial Advisers Act 2008; and
- an insurer licensed under the Insurance (Prudential Supervision) Act 2010.

**Investment activity and experience**

5 Any person who meets two of the following criteria:

- Owns, or at some point over the past two years has owned, a portfolio of specified financial products of $1 million or more. Specified financial products include equity securities, debt securities, collective investment schemes and derivatives, but exclude common retail products (e.g. bank deposits, KiwiSaver schemes, and superannuation schemes) and shares in businesses that the person controls.
- Has carried out 10 or more transactions of specified financial products of over $20,000 in the last two years.
- Has carried out 5 or more transactions of specified financial products of over $100,000 in the last two years.
- The person (or a director, trustee or employee of the person who participates in the investment decision) works or has worked in an investment business (defined above) for at least one year in a role that requires knowledge of investment in specified financial products, at some point over the past 10 years.
- The person has for the past two years had income exceeding $200,000 per annum, or owns net assets exceeding $2 million.

**Large entities**

6 Entities which, over the last two accounting periods, have one of the following:

- Gross assets of $10,000,000; or
- Annual turnover of $20,000,000.

**Government**

7 Certain government entities, including:

- Local authorities;
- A Crown entity;
- A State enterprise;
- The Reserve Bank of New Zealand; and
- The National Provident Fund (and a company appointed under clause 3(1)(b) of Schedule 4 of the National Provident Fund Restructuring Act 1990).

**Investments exceeding $500,000**

8 A person who has invested an amount greater than $500,000 or an investment by a person who previously invested $500,000 in the same entity or assets.

**Persons with a close relationship to the issuer**

9 The proposed exemptions for offers to persons with a close relationship to the issuer will cover offers to:

- Relatives; and
- Close business associates.

**Relatives**

10 Relatives would include a person's spouse, and anyone "within the fourth degree of blood relationship" to the person or the person's spouse. In relation to any given person, this includes that person's spouse, and that person's:

- Children, grandchildren, great-grandchildren and great-great-grandchildren;
- Parents, grandparents, great-grandparents and great-great-grandparents;
- Siblings, nephews, nieces and grand-nephews and nieces;
- Aunts, uncles and great-aunts and uncles;
- First cousins; and
- All of the above of the spouse of the person.

**Close business associates**

11 Close business associates would include:

- A senior manager of the issuer;

- Investors with an equity stake above 10% in the issuer (i.e. major shareholders);
- Directors, senior management, and major shareholders of related companies;
- Persons who are partners to whom the Partnership Act 1908 applies; and
- Certain relatives of the above, being children, grandchildren, parents, grandparents, and siblings of the person or the person's spouse.

12 The definition of "senior manager" would be based on the Australian Corporations Act 2001, s9, "a person who (i) makes, or participates in making, decisions that affect the whole, or a substantial part of the business; or (ii) has the capacity to affect significantly the business's financial standing".

**APPENDIX 3: WORKING DRAFTS OF PROPOSED FUNCTIONS AND DUTIES AND POWERS OF SUPERVISORS AND MANAGERS OF COLLECTIVE INVESTMENT SCHEMES**

| | *Supervisor of collective investment scheme* | *Manager of collective investment scheme* |
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| *Functions* | ▪ To act in the best interests of investors, to act on their behalf, and to fulfil all of the other duties of a trustee of a unit trust;<br>▪ To negotiate the terms of the constitutional document and the offer of the securities with the fund manager (refer to the section on constitutional documents);<br>▪ To take responsibility for custody of scheme property; and<br>▪ To supervise the fund manager to ensure compliance with its obligations and seek appropriate remedies on behalf of investors for any breaches. | ▪ To offer and issue securities in the collective investment scheme (this is the same function as currently prescribed in section 3(2)(b) of the Unit Trusts Act);<br>▪ Responsibility for ensuring that investment occurs in accordance with the constitutional document, and monitoring any individual investment manager, whether internal or external. Although the fund manager will be able to contract out the investment management function, the fund manager will ultimately remain responsible for investment management;<br>▪ To maintain robust systems and controls and to appropriately manage risk;<br>▪ To report to the supervisor**,** and to investors of the collective investment scheme, and publish quarterly information; and<br>▪ To be responsible for all administration and management functions. |
| *Duties* | ▪ To act in the best interests of investors and not to act on the fund manager's direction if the direction is manifestly not in the interests of investors;<br>▪ Not to act on the fund manager’s direction if the direction is in breach of the constitutional document or investment policy of the collective | ▪ To act in the best interests of investors;<br>▪ To adhere to the terms of the constitutional document;<br>▪ To adhere to the obligations and duties of a fiduciary;<br>▪ To ensure that the collective investment scheme, including purchase/sale of investments and management |

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| | investment scheme;<br><br>▪ To monitor a fund manager's adherence to the terms and duties in the constitutional document and collective investment scheme's management agreement, the terms of the constitutional document and the terms of the offer. This includes ensuring that the collective investment scheme's assets are invested in accordance with the collective investment scheme's objective;<br><br>▪ To take any relevant enforcement action within its powers against the fund manager and to seek remedies on behalf of investors where a fund manager breaches any of its duties to investors;<br><br>▪ To comply with its reporting requirements to investors and the Authority, including regular reporting requirements and any other requirements such as advising investors regarding moratoria proposals;<br><br>▪ To comply with any reasonable requests for information about the collective investment scheme and/or the supervisor for the purposes of the proposed legislation from the Authority and to allow the Authority, or a person appointed by the Authority, to make inspections for the purposes of the proposed legislation;<br><br>▪ To respond to an attestation request by the Authority; | of assets, is carried on in a proper and efficient manner. This includes the duty to use its best endeavours and skill in carrying out its functions. Because investors do not have day-to-day control over the operation of the collective investment scheme or of the fund manager, it is important that fund managers observe a high standard when operating the collective investment scheme. Where a fund manager has delegated any of its duties, including investment, it will be responsible for the actions of its delegate;<br><br>▪ Where an investor has given reasonable notice requesting information relating to the affairs of the collective investment scheme, to provide such information. This duty allows investors to be provided with relevant information about the collective investment scheme and the fund manager, and enables investors to make informed decisions about the collective investment scheme (for example, to direct the fund manager to act) or for themselves individually (for example, to exit the collective investment scheme);<br><br>▪ To ensure reporting requirements specified in the legislation and the constitutional document are met (for example, keeping proper books of account and having them audited periodically);<br><br>▪ To register any documents required to be registered with the Authority (for example, issue documents and ongoing disclosure);<br><br>▪ To pay or pass to the supervisor any money and other collective investment scheme property received by the |

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| | ▪ To maintain appropriate custodial arrangements, whereby the assets are segregated and are held in the name of the supervisor or external custodian. It is proposed that the supervisor would retain liability for the performance of the duties and obligations relating to the custody of the collective investment scheme assets, even if an external custodian is appointed. Like the supervisor, any nominated custodian would have to be independent from the fund manager. This requirement for the supervisor to ensure sufficient custodial arrangements are made will help ensure consistency across different legal forms. This duty will also ensure that collective investment scheme property is ring-fenced and therefore adequately protected, reducing the risk of fraudulent conduct;<br><br>▪ To act on the directions of investors so far as the law and the constitutional document dictates;<br><br>▪ To convene and chair meetings of investors; and<br><br>▪ To explicitly disclose the duties that they owe to individual investors and any restrictions on these, and annually declare (e.g. in their statements to individual investors) that they have not breached their duties. | fund manager in respect of purchases of, or subscriptions for, interests in the securities within a prescribed period. This duty ensures the fund manager is accountable for any monies and other collective investment scheme property it receives from investors;<br><br>▪ To provide the supervisor with such information as it requests relating to the collective investment scheme, to the business or the affairs of the fund manager, or to breaches, and to allow the supervisor, or a person appointed by the supervisor, to inspect or review the fund manager's books and papers and all books and papers relating to the collective investment scheme. This power ensures the supervisor is kept informed about the activities of the fund manager and the collective investment scheme, and assists the supervisor in its monitoring and supervisory role;<br><br>▪ To summon a meeting of investors when so requested by the supervisor or the investors;<br><br>▪ To provide the Authority with such additional information as it requests relating to the collective investment scheme, to the business, property or the affairs of the fund manager, or to breaches where it has been unable to obtain the necessary information directly from the supervisor;<br><br>▪ To report to investors and to keep them informed about their investments. In order for investors and their agents to be able to monitor the management of their investments it is proposed that fund managers send a periodic statement to investors. This is described further |

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| | | the disclosure chapter; and<br><br>▪ To explicitly disclose the duties that they owe to individual investors and any restrictions on these, and annually declare (for example, in their statements to individual investors) that they have not breached their duties. |
| *Powers* | ▪ To require periodic reporting from the fund manager, in addition to the requirements to publish quarterly information as proposed above in the section on disclosure;<br><br>▪ To request information relating to the collective investment scheme, or to the business, property or the affairs of the fund manager and to inspect or review, or appoint a person to inspect or review, the fund manager's books and papers and all books and papers relating to the collective investment scheme.<br><br>▪ To summon a meeting of investors. For example, the supervisor may wish to use this power to obtain directions from the investors, or for investors to vote on a resolution to remove the fund manager;<br><br>▪ To require the fund manager to summon a meeting of investors. This is consistent with current requirements under the Unit Trusts Act. We do not consider the fund manager should be allowed to decline a supervisor's request to summon a meeting of investors because matters | |

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| | to be discussed at a meeting might concern, for example, breach by the fund manager and/or a resolution to remove the fund manager;<br><br>▪ To attend and be heard at a meeting of investors of the collective investment scheme. This is a fundamental right which allows the supervisor to communicate with the investors of the collective investment scheme – for example, by keeping the investors informed about relevant matters;<br><br>▪ To nominate a person to chair a meeting of investors, where that meeting was requested by the supervisor or investors. This power is necessary to ensure a meeting, which was not initiated by the fund manager and therefore may be contentious by nature, is run fairly;<br><br>▪ To apply to the court for a direction that the fund manager to comply with its duties or with the terms of the constitutional document or of the offer or the funds management agreement, within a specified time frame. For example, a direction to act, a direction prohibiting the fund manager from acting, an order imposing terms or conditions on the fund manager or on the operation of the collective investment scheme, or an order that no more investors be accepted into the collective investment scheme;<br><br>▪ To appoint a replacement fund manager with the consent of the fund's investors where a fund manager has no license, or that license has been | |

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| | revoked.<br><br>▪ To take an action to the court on behalf of investors to seek a remedy (including compensation) for breach by the fund manager of any of its duties or the terms of the constitutional document or of the offer;<br><br>▪ To apply to the court for the types of orders currently available to trustees and statutory supervisors under 49 of the Securities Act. This includes court orders that the provisions of the constitutional document be amended; that restrictions be imposed on the fund manager; direct the fund manager or supervisor to convene a meeting of security holders; or give such other directions as the court considers necessary to protect the interests of security holders, other holders of securities of the issuer, any guarantor of the securities or the public;<br><br>▪ To apply to the High Court to assess damages against a delinquent director or other officer of the fund manager if, in the course of winding up the collective investment scheme, it appears that the fund manager has misapplied or retained or become liable or accountable for any money or property of the collective investment scheme, or committed any misfeasance or breach of trust in relation to the collective investment scheme. It is proposed that this power will be similar to that contained in section 27 of the Unit Trusts Act.; | |

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| | ▪ To amend the constitutional document upon consultation with the fund manager, but without consultation of investors, in cases where the amendments are not prejudicial, administrative or are clearly in the interests of investors; and<br><br>▪ To amend the constitutional document upon consultation with both the fund manager and investors, in all cases other than those outlined above and subject to a vote of investors/ shareholders being not less than 75 percent. | |

## CAPITAL MARKET DEVELOPMENT TASKFORCE RECOMMENDATIONS RELATED TO THE SECURITIES LAW REVIEW

### Retail investors – promoting trust

*Aim: promote trust, safety and appropriate products for retail investors*

| Area | Recommendation | Action proposed in the Securities Law Review and other work |
|---|---|---|
| *Improve governance of managed funds* | 1. Fund managers and supervisors should explicitly disclose the duties that they owe to individual investors and any restrictions on these, and should annually declare (e.g. in their statements to individual investors) that they have not breached their duties. | It is proposed as part of the Securities Law Review that supervisors and fund managers will have a prescribed set of functions and duties that they must adhere to and can not contract out of. These functions and duties will be implied into constitutional documents. Fund managers will be required to report to their supervisor where they have breached a duty and supervisors will be required to report to the FMA under the Securities Trustees and Statutory Supervisors Bill on their compliance with the duties they owe. In addition, there will be various remedies available to investors. |
| | 2. Entry, exit and unit pricing rules that are fair to all investors severally should be established and disclosed to investors. | It is proposed as part of the Securities Law Review that the FMA will be required to prepare guidance on the appropriate process for the valuation of collective investment scheme assets and how often those valuations need to occur. Constitutional documents of collective investment schemes will be required to set out the fund's entry and exit rules as well as contribution rates and the processes for pricing and charging fees. |
| | 3. Improve and standardise periodic statements to managed fund investors so that asset holdings and performance are clear and comparable. | A discussion document, *Periodic Disclosure for KiwiSaver Schemes*, is currently being consulted on. It contains proposals for regulations to be made under the Financial Markets (Regulators and KiwiSaver) Bill that will prescribe quarterly reporting by retail KiwiSaver schemes on fees, returns and performance, portfolio holdings and conflicts of interest. It is intended that a similar approach will eventually be extended to apply to other collective investment schemes as part of the Securities Law Review. |
| *Disclosure – make it meaningful for investors* | 4. Replace the investment statement and prospectus with a new two-part disclosure document that aids understanding and comparability. The first part should be 1-2 pages long, and much more standardised than the investment statement in content and presentation. | It is proposed as part of the Securities Law Review that the Investment Statement and Prospectus be replaced with a Product Disclosure Statement that will only contain information essential to an investor's decision. The Product Disclosure Statement would normally be divided into two parts, with the first part being a 1-2 page key information summary and the second part containing more detailed information. Further information is proposed to be made available on the Register of Securities that will be established by the Financial Markets (Regulators and KiwiSaver) Bill. |

| Area | Recommendation | Action proposed in the Securities Law Review and other work |
|---|---|---|
| | 5. Include a warning label on disclosure documents where products are particularly risky or complex to encourage investors to exercise caution and seek independent advice. | The Financial Markets (Regulators and KiwiSaver) Bill gives the FMA the power to issue warnings and to require issuers to disclose warnings in a prominent place. |
| | 6. Create a centralised website for disclosure documents that allows for easy comparison between products. | The Financial Markets (Regulators and KiwiSaver) Bill provides for the establishment of a centralised securities register which issuers must ensure is up to date. The Register will allow for greater comparability. |

## Markets

### Public equity markets

*Aim: greater breadth (more representative of economy), increased liquidity and greater birth rate of new companies moving on to the market*

| Area | Recommendation | Action proposed in the Securities Law Review and other work |
|---|---|---|
| *Improve the "birth rate" on to public markets* | 7. Allow NZX (as a registered exchange) to own and operate unregistered and exempt exchanges – so that NZX capability and expertise is available to help develop the pipeline of companies coming through to fully public markets. | As part of the Securities Law Review it is proposed that the Minister of Commerce report back to Cabinet on this issue by 30 April 2011. |
| | 8. Create an environment in which unregistered and exempt exchanges can develop their own rules with a lower regulatory burden than on NZX (e.g. without continuous disclosure), so that companies can attract the capable directors and quality intermediary resources with the ability to help companies develop business plans and raise capital for growth. | As part of the Securities Law Review it is proposed that the Minister of Commerce report back to Cabinet on this issue by 30 April 2011. |

### Private markets

*Aim: Growing more companies and better linking to public markets*

| Area | Recommendation | Action proposed in the Securities Law Review and other work |
|---|---|---|

| Area | Recommendation | Action proposed in the Securities Law Review and other work |
|---|---|---|
| *Clarifying boundaries with public market* | 9. Review Securities Act and revise current Securities Act exemptions to provide a set of clearer, broader exemptions – registered investors; the existing exemption for "those who invest money as a principal business activity"; other professional investors with clear, quantified set of criteria; investors who have obtained a recommendation from a conflict-free authorised financial adviser; a more clearly defined exemption for relatives and close business associates; wealthy investors; and small offers. | As part of the Securities Law Review it is proposed to clarify exemptions using a combination of bright line and principles-based examples and definitions. It is proposed to add additional exemptions for "small offers" and employee share schemes.<br><br>Do not propose to create an exemption for investors who invest via an independent authorised financial adviser at this time given public submissions on this suggestion. |

**Derivatives markets**

*Aim: improve risk management in the New Zealand economy*

| Area | Recommendation | Action proposed as part of the Securities Law Review and other work |
|---|---|---|
| | 10. Improve regulatory clarity for derivatives products. | As part of the Securities Law Review, it is proposed to treat derivatives as one class of regulated financial product. This will have the effect of bringing derivatives into the same broad regulatory framework as other financial products like equity and debt securities. This will clarify when offers of derivatives are covered by securities law and the disclosure and supervisory arrangements that will apply when derivatives are offered and traded. |

**Regulatory agencies**

*Aim: Proactive enforcement of ethical behaviour to facilitate capital market activity*

| Area | Recommendation | Action proposed as part of the Securities Law Review and other work |
|---|---|---|
| *Clarify objectives of regulation* | 11. Set of objectives to focus on healthy vibrant capital markets, which includes protecting and enhancing our reputation for transparent and ethical behaviour. | As part of the Securities Law Review it is proposed to set out the purpose and objectives of securities law in the new legislation, focussing on facilitating capital market activity. |

| Area | Recommendation | Action proposed as part of the Securities Law Review and other work |
|---|---|---|
| *Design of regulators* | 12. We believe that any ongoing drive for greater international capital market integration needs to be measured against clear long-term benefits for New Zealand's capital market, such a better allocation of capital, improved risk management, and increased competition. | The proposals for the Securities Law Review have been developed with this issue in mind. |
| | 13. Review and clarify roles and scope of regulatory agencies to reduce duplication and conflicts of interest, build capability and scale around centres of excellence, and ensure that the focus of regulatory agencies is on facilitating capital market activity. This is likely to mean:<br>▪ Consideration of consolidating parts of the Companies Office, Securities Commission and NZX Disciplinary Tribunal into a new market conduct regulator.<br>▪ Some front-line market monitoring activity remains with NZX, with protocols around referrals to the regulator and ability of regulator to initiate investigations. | Under the Financial Markets (Regulators and KiwiSaver) Bill, the Financial Markets Authority will take over the existing functions of the Securities Commission, the Government Actuary, and certain regulatory functions of the Ministry of Economic Development and the NZX. |
| *Targeted enforcement* | 14. Greater emphasis on monitoring and enforcement capability and activity. | The Financial Markets (Regulators and KiwiSaver) Bill implies that the Financial Markets Authority will have a more active surveillance and enforcement role in relation to those markets, and will have additional functions and powers. |
| | 15. Give regulators the power to have an ongoing monitoring role of all public securities – whether listed or not – and to deem products to be securities where products appear to be securities. | As part of the Securities Law Review it is proposed that the Financial Markets Authority will have a power to designate a financial product, arrangement or transaction to be in a particular category of financial products. This could include designating a product that would otherwise fall outside the definitions of regulated financial products, clarifying that a product is in a particular category, or shifting a product from one category to another.<br>Increased reporting obligations are also proposed for debt and CIS securities to allow for increased monitoring by both investors and the regulator. |

| Area | Recommendation | Action proposed as part of the Securities Law Review and other work |
|---|---|---|
| | 16. Give the regulator the power to seek civil remedies on behalf of investors and to initiate and coordinate class actions. | As currently drafted, the Financial Markets (Regulators and KiwiSaver) Bill gives the FMA the power to exercise certain rights of action or to take over certain proceedings.<br>As part of the Securities Law Review it is proposed that the Minister of Commerce will report back to Cabinet by 30 April 2011 on the detailed liability regime for securities law. |

**Progress and Interim Report**

| Source | Recommendation | Action proposed as part of the Securities Law Review and other work |
|---|---|---|
| Progress report | 17. Amend requirements for Securities Commission exemptions to be gazetted to be consistent with Takeovers Panel. | Clause 120 of the Financial Markets (Regulators and KiwiSaver) Bill inserts a new section 70 into the Securities Act which amends the process for making exemptions. Individual exemptions will come into force at the time they are made rather than after gazetting, which is the process that applies to exemptions granted by the Takeovers Panel. However, class exemptions will not come into force until after gazetting, which is the current approach under securities law. |
| Progress report | 18. Allow issuers to file section 37A(1A) certificates to extend the life of a prospectus and advise investors of a material adverse change to the company's financial position. | As part of the Securities Law Review, it is proposed that under the new regime the Product Disclosure Statement (PDS) will not have a finite lifespan but issuers will be required to keep the information updated so that it is not incorrect or misleading. Financial statements and other information will be kept on the Register and therefore issuers will be able to update this information without issuing a new PDS. |
| Progress report | 19. Remove restrictions on pre-prospectus publicity. | As part of the Securities Law Review it is proposed to remove the current restrictions on pre-prospectus publicity. |
| Progress report | 20. Create a statutory exemption in the Securities Act for employee share schemes. | As part of the Securities Law Review it is proposed to provide an exemption for employee share schemes subject to certain conditions. |

| Source | Recommendation | Action proposed as part of the Securities Law Review and other work |
|---|---|---|
| Progress report | 21. Remove voiding of entire offers when they are taken up by a single member of the public. | As part of the Securities Law Review, it is proposed that the current provisions that provide for void and voidable allotments will be replaced by provisions that allow for subscribers to cancel the allotment and obtain a refund from the issuer in certain circumstances. This will mean that entire offers will not be void when taken up by a single member of the public. |
| Progress report | 22. Certification of a wealthy person should occur any time 12 months prior to subscription, rather than prior to the offer. | Under the Securities Law Review, it is proposed that there will be no "wealthy person" exemption under the new regime. However, there will instead be a series of exemptions for sophisticated investors. It is also intended to allow certification 12 months prior to subscription rather than the offer. |
| Progress report | 23. Allow $500,000 minimum subscription for non-public offers to be paid in instalments. | It is not proposed to allow this amount to be paid in instalments. |
| Progress report | 24. Remove vendor shareholder liability in IPO exits. | As part of the Securities Law Review, it is proposed that vendor shareholders should only remain liable where they are directors, or have acted as promoters for the IPO. |
| Progress report | 25. Clarify that a special partnership that re-registers as a limited partnership succeeds to the rights and liabilities of the special partnership. | It is proposed to make this change as part of the Securities Law Review. |
| Interim Report | 26. Consider adding a new "registered investors" exception to the non-public offers section of the Securities Act. | It is not proposed to add a new "registered investors" exemption to securities law as part of the Securities Law Review, as there is the potential for the misuse of such an exemption. However, it is proposed that investors will be able to certify themselves as coming within the scope of particular exemptions, and that the issuer will be able to rely on this certification in the absence of information suggesting that it may be incorrect. |
| Interim Report | 27. Consider adding as an additional exception to the Securities Act an equivalent of the Australian "20:12 rule". | As part of the Securities Law Review it is proposed to add a new "small offers" exemption similar to the Australian rule that will exempt equity and debt issuers who raise a maximum of $2m from 20 investors in a 12 month period, with a cap of $100,000 per investor. |
| Interim Report | 28. Amend Securities Act to define investments in limited partnerships under the Limited Partnerships Act 2008 as equity investments. | It is not proposed to make this change as part of the Securities Law Review, as investments in limited partnerships are effectively investments in collective investment schemes rather than equity securities. |

| Source | Recommendation | Action proposed as part of the Securities Law Review and other work |
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| Interim Report | 29. Include a new power for the Securities Commission to issue "no action" letters, which would prevent it from taking action in relation to a matter (particularly where the question of breach is arguable or on matters which are not material). | As part of the Securities Law Review it is proposed that the Financial Markets Authority have the power to issue no action letters. |
| Interim Report | 30. Retrospective exemption power for the Securities Commission. | As part of the Securities Law Review, it is not proposed that the Financial Markets Authority have the power to issue retrospective exemptions. |