**OFFICE OF THE MINISTER
OF COMMERCE**

The Chair
Cabinet Business Committee

Financial Markets Conduct Regulations Paper 1: Overview

Proposal

1 This is the first of four papers in which I am seeking policy decisions for the regulations that must be made under the Financial Markets Conduct Bill. This paper provides an overview of the regulations.

Executive Summary

2 Passing and implementing the Financial Markets Conduct Bill (FMC Bill) is one of the main initiatives in the Capital Markets workstream of the Business Growth Agenda.

3 The FMC Bill is a significant regulatory reform that will provide a step-change for New Zealand's capital markets. It is the final stage in a package of reforms of this sector begun in 2008. It has been informed by the lessons of the global financial crisis, the collapse of finance companies, and the recommendations of the industry-led Capital Markets Development Taskforce.

4 Overall, the FMC Bill represents a significant freeing up of capital-raising and has strong support from business, the finance industry and investor groups. It also seeks to ensure that financial markets regulation is clear, effective and reliable to achieve the purposes of the FMC Bill. New Zealand's current financial markets conduct law is spread over six Acts. The FMC Bill replaces this legislation with one new, shorter Act and brings New Zealand up to the standards of global best practice for financial markets regulation.

5 Regulation needs to work for all participants in financial markets, including issuers and investors. Investors need accessible information to make informed decisions. They need to be satisfied that investments will be well-governed and obligations enforced, enabling them to focus on investment risks and returns. Regulation should also assist businesses to bring good investment opportunities to market.

6 This series of Cabinet papers proposes regulations necessary to implement this new regulatory regime. The proposals in these papers have been the subject of public consultation via a discussion document. Following policy decisions and drafting, I propose to release an exposure draft of the regulations to consult further and refine the regulations.

Context to the Financial Markets Conduct Bill

7 Passing and implementing the FMC Bill is one of the main initiatives in the Capital Markets workstream of the Business Growth Agenda.

8 This significant regulatory reform will provide a step-change in New Zealand's capital markets. It has been informed by the lessons of the global financial crisis, the collapse of finance companies, and the recommendations of the industry-led Capital Markets Development Taskforce.

9 The FMC Bill completes the comprehensive programme of reforms in the New Zealand financial sector that Government has been progressing since 2008. These reforms have included the introduction of the financial advisers regime, the licensing of trustees and statutory supervisors, and the establishment of the Financial Markets Authority.

10 The FMC Bill's main purposes are to promote the confident and informed participation by businesses, investors and consumers in New Zealand's financial markets, and to promote and facilitate the development of fair, efficient, and transparent markets. While the Securities Act 1978 has been interpreted as being primarily about investor protection, investor protection is a means to achieving confident and informed participation in markets under the FMC Bill, not an end in itself.

11 The FMC Bill seeks to achieve, and explicitly balance, these main purposes by:

- Setting out standards of conduct expected of financial markets participants, based on the requirements in the Fair Trading Act
- Removing unnecessary compliance burdens on capital-raising, for example, through new exceptions for small offers
- Promoting innovation and new sources of capital, for example, by providing for lower-cost public listed markets and crowd-funding platforms
- Decriminalising conduct except where there is knowledge or recklessness, and instead providing for pecuniary penalties and a range of protective tools such as stop orders, enforceable undertakings and management bans
- Ensuring that activities within the regulatory net are properly regulated, for example through improving disclosure, licensing fund managers, and improving governance of managed funds offered to retail investors.

12 Overall, the FMC Bill represents a significant freeing up of capital-raising and has strong support from business, the finance industry and investor groups. It also seeks to ensure that regulation is effective, clear, and reliable where it is imposed.

13 Cabinet approved the policies reflected in the FMC Bill in February 2011 [CBC Min (11) 4/3] and May 2011 [CBC Min (11) 6/9]. Cabinet approved the FMC Bill for introduction in October 2011 [LEG Min (11) 22/4], and approved a supplementary order paper for the FMC Bill in April 2013 [EGI Min (13) 7/8]. Cabinet approved the release of a discussion document on the regulations relevant to these papers in December 2012 [EGI Min (12) 28/11].

14 The FMC Bill is expected to be enacted shortly and begin to come into force in the first half of 2014. The key current milestones are:

June 2013:	policy decisions on bulk of regulations from Cabinet
October 2013:	exposure draft of regulations released
March 2014:	regulations made
April 2014:	FMC Act begins to come into force.

15 This timeframe is ambitious. I consider that it is important to remain flexible and realistic with respect to the timing of the implementation of the regime. As this is a major reform, there is a considerable amount of implementation work that must be undertaken by government, market participants and FMA. While industry supports the reforms in the FMC Bill, it is important that the regime is implemented smoothly. FMA and MBIE will work closely with the industry to ensure that this occurs.

16 A crucial aspect of this implementation is the development of the online registers that must be made under the FMC Bill. A key intention of the Bill is to move to an online environment for business and investor interactions with government and for providing investor access to important information about financial products. The registers are a central plank of this ambition. They will contain information about offers of financial products and managed investment schemes that can be easily accessed and compared online by the public.

The required regulations

17 The Ministry of Business, Innovation and Employment released a discussion document on the proposals for the regulations in December 2012. It received 64 submissions from a range of stakeholders, including banks, brokers, law firms and the New Zealand Shareholders Association. The content of those submissions has been carefully considered and informs the proposals in these Cabinet papers.

18 Through this series of Cabinet papers, I am seeking policy decisions on the substantial body of regulations to fully implement the FMC Bill. Regulation needs to work for all participants in the financial markets, including issuers and investors. Investors must have confidence in the integrity of financial markets. This includes receiving accessible information to make informed decisions, and being satisfied that investments will be well-governed and obligations enforced. Regulation should also assist businesses in bringing good investment opportunities to market. The regulations proposed in these papers will support these purposes.

19 In addition, the FMC Bill carries over some existing law, particularly around financial markets. This law has undergone substantial revision over the past decade. As a result, these provisions are largely replicated in the FMC Bill, but with some changes to fix identified anomalies or gaps in the current regime.

20 There are a number of related existing regulations that also continue to be relevant under the FMC Bill framework (for example, the information that substantial shareholders in listed companies must disclose to the market and forms for transferring securities). I propose that these regulations be carried over with appropriate changes to ensure that they work effectively in the new regime and to update and improve them.

21 The most significant matters in this series of papers concern the following issues.

Disclosure (Paper 2)

22 The FMC Bill will be a success if investors are in a position to make confident judgements about the potential risks and returns from their investment decisions, informed by high-quality disclosure (information given to investors) and, where they want it, quality advice. The reforms improve disclosure through the use of single-product disclosure statements that tell investors the key information they need to know, backed by a public register that contains richer detail and facilitates comparison between products.

23 The risk of liability for false or misleading disclosure can lead to a tendency by issuers to make sure everything is disclosed. While this ensures that issuers give a complete picture of the risks and potential rewards of an investment, too much disclosure can obscure the important information. Evidence shows that the investing public has limited ability to digest complex financial information. This balance is the key trade-off reflected in the proposals sought in Paper 2.

24 These proposals focus on mandating short comparable information, particularly where there is significant retail investment (KiwiSaver schemes and other managed funds), with other information placed on the online register.

25 In addition, Paper 2 proposes a new obligation to provide limited ongoing disclosure for equity and debt products when key events occur. Although this will impose a cost on some issuers, this obligation is critical for updating investors on key changes to the risk or nature of their investment.

Governance (Paper 3)

26 Improved information is not sufficient. The FMC Bill also seeks to implement consistent and reliable governance rules that will be enforced by a proactive regulator. For example, managers of all retail managed investment schemes will both owe duties directly to investors to act in their best interests and be supervised by a licensed supervisor who is responsible for the custody of the assets of the scheme.

27 All investment carries risk, and part of taking risks is that sometimes investments fail. But retail investors should be able to expect that the people in charge of their investments are required to comply with a basic set of governance obligations, and that these obligations will be promptly and effectively enforced. Investors need to be able to make investment choices according to performance and risk differences of schemes. Basic standards of governance should not be a variable they have to consider.

28 The proposals in Paper 3 set out a baseline set of governance standards. They do not gold-plate. Critically, they rely on licensed supervisors to negotiate matters with issuers within the framework of their general statutory duties. In so doing, the proposals minimise the risk of compliance costs and poorly directed regulation. The proposals also seek to adjust the standard governance requirements where lower risk allows it.

Licensing (Paper 4)

29 The FMC Bill requires licensing of key financial markets participants, most notably fund managers. Licensing brings New Zealand into line with internationally expected norms of financial markets regulation.

30 Licensing does, however, bring risks of higher barriers to entry and of insulating incumbents from competition. Because of these risks, licensing under the FMC Bill is expected to be relatively light. But this needs to be balanced by the natural expectation that a licensed financial markets participant has passed at least basic checks and has at least a base level of competency.

31 This balance is a key trade-off. The licensing regime in the FMC Bill, as reflected in Paper 4, seeks to ensure that the unscrupulous and incompetent are excluded from the industry, rather than ensuring that every participant has a gold-plated compliance regime or that no one fails.

32 The proposals in Paper 4 leave discretion to FMA in certain areas, enabling FMA to take a risk-based approach. To balance this, the FMC Bill directs FMA to use its licensing discretions to further the purposes of the Bill (including the purpose of minimising compliance costs and promoting innovation and flexibility in financial markets) and not to unnecessarily restrict licensing.

Consultation

33 The proposals in these papers were developed in close consultation with the Financial Markets Authority. The Treasury, the Reserve Bank, the Ministry of Justice, and Inland Revenue were also consulted on these papers and are comfortable with their contents. The Department of Prime Minister and Cabinet has been informed.

34 The proposals in this series of papers have been subject to public consultation, both during the development of the FMC Bill and via a public discussion document on the regulations.

Financial Implications

35 This series of papers has no financial implications.

Human Rights

36 There are no human rights implications from this series of papers.

Legislative Implications

37 The proposals in this series of papers will require the making of regulations under the Financial Markets Conduct Bill once it is passed.

Regulatory Impact Analysis

38 The Regulatory Impact Analysis requirements apply to the proposals in this series of papers. A Regulatory Impact Statement for all of the papers has been prepared and is attached.

Quality of the Impact Analysis

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

Publicity

40 The Ministry of Business, Innovation and Employment will post a copy of this paper on its website.

Recommendations

It is recommended that the Committee:

1 **Note** that implementing the FMC Bill is a key action on the Business Growth Agenda that will provide an enduring financial market conduct regulatory regime that will help deepen New Zealand's capital markets and promote confident and informed participation by businesses and investors in financial markets

2 **Note** that Cabinet approved the policies reflected in the FMC Bill in February 2011 [CBC Min (11) 4/3] and May 2011 [CBC Min (11) 6/9]

3 **Note** that Cabinet approved the FMC Bill for introduction in October 2011 [LEG Min (11) 22/4], and also approved a supplementary order paper for the Bill that contained additional policy in April 2013 [EGI Min (13) 7/8]

4 **Note** that a substantial body of regulations need to be made under the FMC Bill to successfully implement it

5 **Note** that the proposals outlined in this series of Cabinet papers have been consulted on via a discussion document approved by Cabinet [EGI Min (12) 28/11] and released in December 2012

6 **Agree** that relevant existing regulations be carried over with appropriate modifications to ensure that they work effectively in the new regime and to update and improve them

Regulations

7 **Invite** the Minister of Commerce to issue drafting instructions to the Parliamentary Counsel Office to give effect to these recommendations and those in the accompanying series of papers

8 **Authorise** the Minister of Commerce to approve the release of an exposure draft of the regulations for consultation

9 **Authorise** the Minister of Commerce to make decisions on detail and to make changes, consistent with the policy framework in this series of papers, on any issues that arise during the drafting process

Publicity

10 **Note** that the Ministry of Business, Innovation and Employment will post a copy of these papers on its website.

Hon Craig Foss
Minister of Commerce

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