**OFFICE OF THE MINISTER
OF COMMERCE**

The Chair
Cabinet Business Committee

Financial Markets Conduct Regulations Paper 4 – Licensing regimes

Proposal

1 This paper seeks policy decisions for regulations that must be made under the Financial Markets Conduct Bill. This is the fourth in a series of four papers on these regulations, and seeks decisions relating to the licensing of certain financial services.

Executive Summary

2 The Financial Markets Conduct Bill (FMC Bill) overhauls the regulation of financial products and certain financial services.

3 The FMC Bill includes a licensing regime for a number of financial services: fund managers, discretionary investment management services (DIMS), independent trustees of restricted schemes, derivatives issuers and licensed intermediaries (such as person-to-person lending services and crowd-funding platforms).

4 The licensing regime has been designed to be risk-based, flexible and relatively 'light' by international standards.

5 While the Bill provides the core eligibility criteria for obtaining licences and ongoing obligations of licensees, further detail has been left to regulations.

6 For licensees generally, it is proposed that regulations impose additional requirements around the holding of professional indemnity insurance, standard reporting to the Financial Markets Authority (FMA), contracting out of basic duties of care and a 'fit and proper' test for key personnel in related companies who provide the licensed service.

7 There are also proposals for specific categories of licensees:

- For DIMS, regulations are proposed to cover how DIMS licensees can give incidental advice and termination of DIMS client agreements
- For independent trustees of restricted schemes (such as workplace savings schemes) regulations would impose a whistleblowing obligation
- For derivatives issuers, regulations will cover minimum levels of capital or liquid assets, requirements around handling of client assets and ongoing client reporting.

8 Regulations are also required to enable prospective operators of person-to-person lending services and crowd-funding services to obtain licences and access exemptions in the FMC Bill for capital raising through these mechanisms.

9 Person-to-person lending services will need adequate systems for establishing the identity and creditworthiness of borrowers, and arrangements for the orderly administration of customers' contracts in the event that they cease to operate the service.

10 Equity-based crowd-funding services will also be permitted as a separate category of ‘prescribed intermediary’. As this is a new mechanism for capital raising and the market is evolving quickly, a relatively flexible concept of ‘crowd-funding platform’ will be introduced, with FMA having discretion about conditions of licence under this category.

Background

11 The Financial Markets Conduct Bill (FMC Bill) overhauls the regulation of financial products and certain financial services. The accompanying paper *Financial Markets Conduct Regulations Paper 1: Overview* describes the overall project. Before the FMC Bill is brought into force, a wide range of regulations are required to cover matters that were considered too detailed for inclusion in primarily legislation, or where change might be required as market practices evolve. This paper deals with the regulations relating to the licensing of certain financial services.

The FMC Bill’s licensing provisions

12 Part 6 of the FMC Bill requires that the following services be licensed by the Financial Markets Authority (FMA):

- Managers of registered managed investment schemes
- Independent trustees of restricted schemes
- Providers of discretionary investment management services (DIMS)
- Derivatives issuers who make regulated offers of derivatives.

13 In addition, Part 6 provides a voluntary licensing regime for prescribed intermediaries, including person-to-person lending services and crowd-funding platforms. When issuers of financial products make offers through licensed intermediaries, they are exempt from the usual disclosure and governance requirements in the FMC Bill.

14 The services listed above are not currently licensed, with the following exceptions:

- The majority of derivatives issuers are currently licensed by FMA as “authorised futures dealers” or “approved” to deal in futures contracts by an authorised futures exchange under the Securities Markets Act.
- While providers of DIMS are not themselves licensed, many are required by the Financial Advisers Act 2008 to employ authorised financial advisers to perform these services.

15 The FMC Bill’s licensing regime has two main parts – eligibility criteria and licensing conditions.

16 Eligibility criteria are the minimum standards that service providers must meet before they can be granted a licence. The main eligibility criteria in the FMC Bill for all licensees are:

- The applicant’s directors, senior managers and proposed directors and senior managers are fit and proper persons to hold their respective positions
- The applicant is capable of effectively performing that service (having regard to the proposed conditions of licence)
- There is no reason to believe that the applicant will not comply with the market services licensee obligations.

17 Conditions are the ongoing obligations that licensees must abide by. The FMC Bill provides that FMA can impose conditions that limit the services that are covered by the licence, and also conditions that relate to the eligibility criteria (for example, conditions to ensure the eligibility criteria remain satisfied).

Regulations required to implement the licensing regime

18 The FMC Bill provides for additional eligibility criteria and conditions to be introduced through regulations, where these are warranted. Where regulations specify additional conditions for a licence, they can either be standard conditions that apply to all licences, or regulations can specify the kinds of conditions that FMA can impose on a case-by-case basis.

19 Many of the proposals in this paper cover detailed conduct requirements that were envisaged in the original policy and were intended to be dealt with in regulations. These include various reporting requirements, insurance requirements and (for some derivatives issuers) capital adequacy and liquidity requirements.

20 In addition, certain functions of the FMC Bill, such as providing for licensed intermediaries (e.g. person-to-person lending providers and crowd-funding platforms) require regulations to operate. Regulations specify the types of intermediaries that can be licensed, and the eligibility criteria and conditions that they will be required to meet.

Approach of the licensing regime

21 The licensing regime has been designed to be risk-based, flexible and relatively 'light' by international standards. While it is appropriate that the financial services referred to in paragraph 12 be required to meet certain minimum standards, the regime must avoid creating undue barriers to entry and inhibiting competition.

22 For many proposed eligibility criteria and conditions, a key trade-off is to what extent the requirements are expressly prescribed in the regulations or left to FMA. Setting requirements out in regulations improves transparency and limits the potential for regulator overreach. However, it also limits flexibility and the ability for requirements to be risk-based.

23 The proposals in this paper contain a mix of prescribed requirements and FMA discretion.

24 When FMA exercises its licensing powers, the FMC Bill requires that it be guided by a number of principles:

- The exercise of its powers must be necessary or desirable in order to promote the purposes of the Bill. The main purposes are to promote the confident and informed participation of businesses, investors, and consumers in the financial markets, and promote and facilitate the development of fair, efficient, and transparent financial markets. Additional purposes include avoiding unnecessary compliance costs and promoting innovation and flexibility in the financial markets.
- It must not unnecessarily restrict the licensing of persons.

Regulations relating to all licences under the FMC Bill

25 For licensees generally, regulations are proposed in a number of different areas:

- Requirements for licensees to hold insurance
- Standard reporting by licensees to FMA
- Preventing licensees from contracting out of certain duties
- Fit and proper person requirements for authorised bodies of licensees.

Insurance requirements

26 It is common for financial services licensing regimes to require that licensees have adequate professional indemnity insurance or other insurance that covers costs and claims that could arise from civil proceedings. This is generally intended to address situations where licensees fail to meet their duties to investors, but lack sufficient financial resources to satisfy claims. This may result in insolvency, lack of compensation for breach of duties, and losses to investors and other creditors. Insurance may also provide a useful signal to regulators and other market participants about the ability of the licensee to comply with its legal obligations.

27 It is important that insurance requirements be tailored to the nature and scale of applicant's operations and risk exposures. To provide flexibility, I propose that the holding of adequate insurance be specified as a type of condition that FMA may impose on licences.

28 Before it could impose any condition around insurance, FMA must be satisfied that it is necessary or desirable having regard to the purposes of the Bill. These purposes include minimising unnecessary compliance costs.

Standard reporting by licensees to FMA

29 FMA has general powers to require licensees to report to it on matters that are relevant to meeting eligibility criteria for the holding of a licence. This would be likely to include reporting of significant events that impact on the licensee's business and authorised related bodies. The FMC Bill also provides a number of reporting obligations for managers and supervisors of managed investment schemes.

30 To assist consistency and transparency of the licensing regime, I propose that licensees report particular matters to FMA as a standard condition of holding any market services licence. These are, subject to drafting:

- The insolvency of the business or the insolvency or bankruptcy of any of its directors or senior managers
- Where a receiver, provisional liquidator, liquidator or a similar officer is appointed, or any resolution is passed or order made for the liquidation or dissolution of the business
- If the business, or any of its directors or senior managers, is charged with or convicted of any crime involving dishonesty (as defined in section 2(1) of the Crimes Act 1961), an offence under any Act referred to in Schedule 1 of the Financial Markets Authority Act 2011, and any overseas equivalent to these, or any offence carrying a maximum term of imprisonment of two or more years
- Any civil litigation or regulatory action pending or taken against the business, or any of its directors or senior managers whether in New Zealand or elsewhere, or any disciplinary action pending or taken, where this is relevant to the performance of its functions under the licence
- If any director or senior manager leaves the business or if any new director or member of senior management is appointed to the business
- Resignation and appointment of auditors
- Major transactions (as defined in the Companies Act[1]), or any change in control, legal structure or name.

Implied terms in client agreements to prevent contracting out of basic duties of care and liability for outsourced functions

31 Clause 133 of the FMC Bill provides that for managed investment schemes, if a manager contracts functions out to other parties, the manager must monitor the performance of those functions and the manager remains liable for their performance. Similarly the FMC Bill provides that fund managers and DIMS licensees have a duty to exercise a prudent level of care, diligence and skill. There is no equivalent provision in primary legislation for other licensees.

32 While these duties may apply in any case if the contract between licensees and clients were silent on them, licensees have the ability to contract out of them.

33 I propose that the following be implied into client agreements for other retail services, to prevent contracting out:

- A duty to exercise a prudent level of care, diligence and skill
- A term to the effect that if the licensee contracts another person to perform functions under the service, the licensee must ensure that the functions are performed with a prudent level of care, and the licensee is liable for negligence by the contractor.

[1] "Major transactions" are transactions to acquire or dispose of assets or liabilities that make up more than half of the company's total assets. An equivalent concept will be needed for licensees with other legal forms.

34 This helps to achieve the FMC Bill's objective to ensure that appropriate governance arrangements apply to financial products and financial services that allow for effective monitoring and reduce governance risks. Licensees could still contract out in respect of wholesale services.

Requiring key personnel in authorised bodies of licensees to be fit and proper persons to hold their respective positions

35 The FMC Bill requires that all of the directors and senior managers of the main licensee be 'fit and proper' persons to hold their respective positions. Cabinet has also agreed that for fund managers, controlling owners be subject to this test [CBC Min (11) 4/3 refers].

36 Clause 398 of the FMC Bill permits FMA to authorise related bodies corporate of the licensee to provide market services covered by the licence.

37 I propose that the fit and proper test for controlling owners be extended to other licensees.

38 I also propose that the fit and proper test also include key personnel of any related body that is proposed to be authorised to perform the service. Concerns about controlling owners and authorised related bodies' personnel (e.g. criminal convictions for dishonesty) are likely to be at least as relevant to licensing decisions as concerns about the directors and senior managers of the licensee. It is also possible that, without this test, a person could seek to avoid failing a good character test by appointing others to be directors of the licensee, or by operating an authorised body with a related company as the primary licensee.

FMA to consult with Reserve Bank when licensing banks, non-bank deposit takers and licensed insurers

39 Clause 395(1)(c) of the FMC Bill requires FMA to consult with prescribed persons before it makes a licensing decision. Similarly, clause 396 requires FMA to give written notice of its decision to grant a licence to prescribed persons.

40 I propose that FMA be required to consult with and notify the Reserve Bank when licensing banks, non-bank deposit takers and licensed insurers. This will help to ensure that FMA takes into account the views of the Reserve Bank in respect of its experience with the applicant. It ties in with its obligation in clause 395(1)(b) that FMA must have regard to existing licences held by the applicant, such as a bank registration. Together, these provisions will help to reduce duplication of assessments between regulators.

Regulations relating to independent trustees of restricted schemes

41 The FMC Bill provides reduced regulatory requirements for many industry and employer-sponsored managed investment schemes. These are called 'restricted schemes' in the Bill. Restricted schemes are not required to have a licensed fund manager and a separate licensed supervisor. Instead, one of their trustees must be an independent trustee licensed by FMA. The purpose of the independent trustee is to bring a level of professionalism to the board. Independent trustees also have some individual duties, such as certifying that a related party transaction should be permitted (clause 159).

Whistleblowing obligation

42 The trustees of restricted schemes have a collective duty to report serious problems in the scheme, such as contravention of the FMC Bill, to FMA. Generally trustees must act unanimously, unless the trust deed provides otherwise. However, individual trustees may not have a strong understanding of their obligations, and there are also disincentives towards making such reports, such as trustees becoming liable. This creates a risk that disagreements among the trustees mean that problems are not reported to FMA and dealt with in a timely manner.

43 Independent trustees have a role in providing a degree of professional oversight over these schemes.

44 I propose that licensed independent trustees have a whistleblowing obligation. They would be required to report to FMA where they have reasonable grounds to believe that there is a serious problem in the scheme – for example, trustees are likely to breach their obligations in a material respect or if the scheme is likely to become insolvent. This would be similar to the obligations placed on auditors, investment managers, administration managers, custodians and actuaries by clause 183 of the FMC Bill.

45 To protect the disclosure by the independent trustee, it would also be an implied term of the scheme's governing document that:

- The independent trustee's appointment may not be terminated by reason of the disclosure
- No person who is subject to the trust deed can take or assist the taking of a civil or disciplinary proceeding against the independent trustee by reason of the disclosure.

Regulations relating to DIMS

46 DIMS manage a person's investments under an investment authority. They range from a personalised service provided as part of financial advice to a wholly class service where investors sign up to a model portfolio of investments.

47 A DIMS differs from a managed investment scheme in legal form, as each investor individually holds the underlying financial products, rather than an interest in a scheme that invests in those products. However, at least in the case of a model portfolio, the economic outcome is the same. The providers of these services are performing a similar role to fund managers, and the FMC Bill imposes similar legal duties on the licensed DIMS providers, such as a duty to act in the best interests of investors. DIMS are required to have an independent custodian to hold investor assets, unless FMA licence conditions permit otherwise.

48 For DIMS, additional regulations are proposed to cover:

- Conditions on how DIMS licensees can give incidental advice
- Terminating DIMS client agreements.

49 Cabinet paper 2 on disclosure also discusses the content of service disclosure statements for DIMS.

Conditions on how DIMS licensees can give incidental advice

50 Clause 390A of the FMC Bill defines a DIMS to include providing "financial advice in the ordinary course of, and incidentally to, providing a discretionary investment management service […] for example, as to the appropriate scope of an investment mandate."

51 The Financial Advisers Act will cover advice to retail clients about whether a DIMS is appropriate and the investment options available under the DIMS. Once the client has joined the DIMS, however, the Financial Advisers Act will not apply to advice on matters incidental to the operation of the DIMS. This could include some amendments to investment options (e.g. because a product is removed from the platform), or changes to how returns are reinvested.

52 This raises the issue of what requirements should apply to persons giving incidental advice. The same regulatory problems may arise in respect of financial advice given in the course of DIMS as those that arise elsewhere, such as conflicts of interest, insufficient adviser skills and knowledge, and lack of due care. Some of these issues are dealt with through the FMC Bill's duties on DIMS licensees that apply to the DIMS, such as acting honestly in providing the service and a duty to comply with a professional standard of care.

53 I propose that incidental advice be an area that FMA can impose licence conditions.

DIMS client agreements

54 DIMS providers will be required to enter into written client agreements with investors. Regulations can prescribe the content of these agreements. While it would not be useful to prescribe content that will inevitably be included in any case, there may be items that are sometimes omitted from client agreements (especially where a DIMS provider is not well run) but which should be explicitly dealt with.

55 I propose that DIMS client agreements must provide adequately for:

- How custody over assets will be provided
- How rights relating to investor's assets will be exercised.

56 A particular issue for DIMS is how the client agreement may be terminated, and what then happens to the investor's assets.

57 Because the client owns the assets held by the DIMS they are, in the absence of any contractual restrictions, free to withdraw the DIMS providers' authority and take control of the assets. However, contracts with DIMS providers may restrict investors from doing so. In addition, there are likely to be circumstances when it is undesirable for investors to take control of assets – for example, when the assets are wholesale investments for which small holdings are not generally permitted, and which retail investors have difficulty exercising rights or making decisions.

58 Some DIMS client agreements allow the investor to terminate the agreement by giving written notice to the provider. Upon termination, assets are transferred to the investor or, if transfer is not possible, they are held on bare trust and potentially sold or redeemed (if reasonable under the circumstances) before being transferred.

59 It is important that there are appropriate mechanisms for clients to terminate contracts and take control over their assets. This is one of the features of DIMS that distinguishes it from managed funds, where investors have only an interest in returns from a pool of assets, not the assets themselves. This leads to a more relaxed regulatory environment for DIMS, such as not being required to have a supervisor.

60 I propose that investors have a right to terminate DIMS client agreements without penalty, and take control of assets within a reasonable period to allow for transfer or liquidation of their portfolio. The client agreement and DIMS licensee will need to deal appropriately with any wholesale assets held for the client. This would likely be implemented through a requirement that client agreements provide for these matters.

DIMS record keeping

61 As with other licensees, adequate record keeping is important for ongoing monitoring and enforcement of DIMS licensees' compliance with obligations, as well as for resolving any disputes that might arise between a licensee and investors.

62 All submitters agreed with a proposal in the regulations discussion paper that records be kept for a minimum of seven years that include:

- Records of all acquisitions and disposals of financial products relating to the service
- All documents required to be produced by the licensee under the FMC Bill and regulations.

63 I propose that this be a standard condition of licence for DIMS.

Exempt services

64 Regulations may exempt from the licensing requirement for DIMS. The Financial Advisers Act currently sets out a number of exemptions. Most of these exemptions are focussed on the giving of financial advice and included to allow persons or professions to continue to act in the ordinary course of their business without needing to comply with the Financial Advisers Act.

65 There are some exemptions that need to be applied to DIMS under the FMC Bill. These include exemptions for non-profit organisations that provide low-level management of clients' funds in basic deposit products on a cost-recovery basis, statutory activities of Crown organisations (other than Public Trust), and traditional trustee company activities that involve discretionary investment management services.

Wholesale DIMS

66 Licensed DIMS providers can offer both retail services and wholesale services. Wholesale services are those offered only to wholesale investors (i.e. those classified as sophisticated) and these services are not subject to many of the obligations that apply to retail services. These include duties to act in the best interests of investors using the service, a professional standard of care and restrictions on related party transactions.

67 An area of potential ambiguity and risk for investors is around whether they are part of the retail service offered by the DIMS, and receive the associated regulatory protections, or are being treated as part of the wholesale service and expected to negotiate these matters themselves.

68 I propose that a standard condition of holding a DIMS licence be an obligation to inform investors under a wholesale service that they are being treated as wholesale.

Regulations relating to derivatives issuers

69 Derivatives issuers are the only category of licensees with a roughly equivalent existing licensing regime – the majority are currently 'authorised futures dealers' under the Securities Markets Act. The Securities Markets Act gives FMA a broad terms and conditions power, which they use to impose conditions on authorisations.

Capital adequacy and liquidity requirements

70 Financial requirements, such as maintaining adequate capital and liquid assets, are a feature of the authorisation notices of many futures dealers who offer services to retail clients. FMA currently determines financial requirements of authorised futures dealers on a case-by-case basis and commonly imposes conditions that they maintain minimum levels of capital or liquid assets.

71 Some of the objectives of capital adequacy and liquidity requirements are to:

- Ensure that licenses are not granted in cases where applicants do not have sufficient resources to operate their proposed business
- A financial buffer that decreases the risk of a disorderly or non-compliant wind-up if the business fails
- Require sufficient equity to ensure that shareholders have incentives to avoid failure
- Reduce, to a limited extent, counterparty risks to investors due to business failure – allowing investors to focus more on the risks of the derivative contract itself.

72 I propose that FMA continue their current treatment of derivatives issuers in this respect. This would be achieved by specifying capital adequacy and liquidity as a type of condition that FMA can impose on licences for derivatives issuers. These requirements will not apply to licensed derivatives issuers who are already subject to prudential regulation by the Reserve Bank, such as registered banks.

Handling of client funds by derivatives issuers

73 Derivatives issuers often hold significant amounts of money on behalf of clients, in the form of margins, other deposits and trading profits. In the absence of adequate custody arrangements for this money, clients are exposed to risk of loss if the issuer fails.

74 There are existing regulations around how derivatives issuers hold and safeguard investor assets – the Futures Industry (Client Funds) Regulations 1990. These regulations will be repealed by the FMC Bill and will need to be replaced.

75 I propose that the basic approach of these regulations be continued. The existing regulations require that client money be held in segregated client funds accounts. These accounts pool client money, keeping it separate from the issuer's own funds. The use of client money is restricted.

76 The existing regulations were designed with exchange-traded derivatives contracts in mind. Particular issues arise in respect of retail over-the-counter contracts (i.e. not exchange-traded), which have developed significantly over the past 20 years and were not envisaged by the current regulations.

77 For exchange-traded derivatives, margins received from customers are on-paid to the exchange's clearing participants and clearing houses, which are regulated by the exchange.

78 Over-the-counter contracts, however, solely involve the derivatives issuer and the customer. The derivatives issuer has a choice about whether and how to hedge its exposure to the derivatives contract with the customer. The current regulations are unclear about how it can use client money in these hedging activities.

79 I propose that derivatives issuers have obligations to provide adequate protection to client money when hedging. This might include, for example, only placing client money with creditworthy and properly regulated counterparties, or with counterparties who agree to abide by the same treatment of client money as the derivatives issuer itself.

Ongoing client reporting by derivatives issuers

80 Some derivatives issuers enter into contracts with investors on a one-off basis, with each party having settlement obligations at a defined future date. In this case, it is not clear that there would be benefit in derivatives issuers providing ongoing reporting to investors in respect of their relationship.

81 Other derivatives issuers offer ongoing services to investors, in which:

- Investors often hold a number of derivative positions with the issuer at any one time
- The contracts do not expire, but must be closed out
- The issuer continually holds investor funds – these may be partly allocated to margins, while the rest is available for investors to withdraw.

82 For some of these services, some ongoing client reporting obligations are warranted. I propose that each investor be able to request the following information, either in hard copy or through an electronic facility:

- A record of their transactions
- Information about their derivative positions (e.g. a list of open positions and their current value)
- The cash held in their account and allocated to margins (if applicable).

83 If an electronic facility was not available to the investor on a substantially continuous basis, the investor would be provided with periodic reports containing the above information (either delivered in hard copy or through electronic means).

84 This would likely be implemented through standard license conditions in regulations.

Record keeping by derivatives issuers

85 Maintaining accurate records of dealings with clients are important for the day-to-day operations of a well-run derivatives business. Record keeping failures are often an aspect of firm failures and client losses. In addition, record keeping is important for both the firm and external parties (including FMA) to be able to effectively investigate any compliance or client relations issues that arise.

86 Currently, the authorisation notices of futures dealers commonly require them to keep records of dealings in derivatives contracts with clients, and of client money or property received, held or otherwise dealt with in connection with dealings in derivative contracts.

87 I propose to include record keeping requirements as a standard licence condition, along the lines of existing requirements in authorisation notices. These would be kept for a minimum of seven years.

Client suitability requirements

88 Product appropriateness requirements place obligations on issuers to ensure that products they offer are suitable for investors, even where they are not giving personal advice. These requirements are a feature of a number of overseas regulatory regimes for more complex products such as derivatives, including in the EU, Hong Kong and Singapore.

89 The rationale for these requirements is that for more complex products, disclosure alone may not result in informed decisions. Product providers are therefore given some degree of responsibility for ensuring that investors know the risks of what they are acquiring, or have received advice.

90 Submissions indicate that many derivatives issuers consider the appropriateness of products for customers at present. FMA does not currently impose appropriateness requirements, although it could under the existing law.

91 I propose that FMA continue to have discretion over product appropriateness requirements. This would be achieved by specifying these as a type of condition that FMA can impose on licences for derivatives issuers. This gives FMA the flexibility to respond to activities that are of particular concern, without imposing across-the-board requirements.

Leverage limits

92 Leverage limits apply to derivatives contracts that involve a small up-front margin payment being used to support a much larger exposure to an underlying asset or variable. For example, a contract for difference might give an investor exposure to the gains and losses from $100,000 worth of shares, with a $5,000 margin paid up-front (i.e. a 5% margin). This feature of contracts is referred to as leverage, and has similarities with the leverage that investors obtain by borrowing money to invest in other assets with a small initial deposit.

93 In a number of countries, including the US, Singapore, Hong Kong and Japan, there are quantitative limits on the amount of leverage that investors can be exposed to.

94 As with product appropriateness requirements, FMA does not currently impose leverage limits, although it could under the existing law.

95 I propose that FMA continue to have discretion over leverage limits. As with product appropriateness requirements, this would be achieved by specifying these as a type of condition that FMA can impose on licences for derivatives issuers. This gives FMA the flexibility to respond to activities that were of particular concern, without imposing across-the-board requirements.

Regulations relating to person-to-person lending services

96 Part 6 of the FMC Bill specifies that a person may hold a market services licence to act as a provider of prescribed intermediary services. Offers of financial products made through a licensed intermediary are exempt from the main disclosure and governance requirements in the FMC Bill.[2] The types of intermediary services for which a licence can be obtained, and the regulation of those services, has been left to regulations made under the Bill.

97 Cabinet has agreed that person-to-person lending services will be one of the intermediary services for which a licence may be issued [CBC Min (11) 4/3 refers]. Person-to-person lending services facilitate loans by matching potential borrowers to one or more lenders, usually through an internet-based platform. There are a number of major overseas person-to-person lending services, such as Prosper, Lending Club and Zopa. However, services of this kind have not been able to operate in New Zealand as they are not provided for in the current Securities Act.

[2] Clause 6 of Schedule 1

98 The principle behind permitting person-to-person lending services is that the service can provide oversight over borrowers that substitutes for the usual direct regulation of borrowers under the FMC Bill. It has been envisaged that person-to-person lending services would be responsible for matters such as:

- Establishing the identity and creditworthiness of borrowers
- Ensuring that investors receive adequate information upon which to base their decisions
- Managing ongoing payments between lenders and borrowers, with responsibility for pursuing borrowers in the event of default.

99 Regulations are needed to provide for the eligibility criteria and conditions of licence to give assurance that licensed providers can fulfil this role.

Services must be open and neutral platforms

100 It is a key principle of the regime that the platforms being operated are ‘open platforms’ that act as neutral brokers between issuers and investors. It is particularly important to the integrity of the regime that it not be abused by persons who seek licenses primarily to promote related party businesses or investment schemes without the normal disclosure and governance requirements of the FMC Bill. Furthermore, the rules and procedures that the service operates under must be clear and consistently adhered to.

101 I propose that these principles be reflected in the eligibility criteria for obtaining a person-to-person lending licence – and also a crowd-funding platform licence (discussed below).

102 This would include the following eligibility criteria, subject to drafting:

- The applicant’s service is generally open to issuers meeting pre-defined criteria, and the applicant will act as a fair and neutral broker between issuers and investors that use the service.
- The applicant's systems for the following are fair, orderly and transparent:
  - Eligibility criteria and processes for issuers to access the service
  - Eligibility criteria and processes for investors to access the service
  - Matching of issuers and investors by the service
  - Any processes for the assessment and evaluation of issuers and the communication of that information to investors
  - Investment of funds by investors, and (if applicable) payments from issuers to investors
  - If applicable, ongoing monitoring of issuers by the service.
- The applicant has adequate systems for managing conflicts between the interests of it and its associates, and its role as a fair and neutral broker between issuers and investors.

103 Acting as a ‘neutral broker’ means that services should not generally recommend particular borrowers as good investments. However, it is important not to prevent providers from communicating information about borrowers (including, for example, assessments of creditworthiness) or advertising of the service.

104 These principles are equally applicable to the crowd-funding platforms discussed below, and I propose that they apply there also.

Systems for establishing the identity and creditworthiness of borrowers

105 The making of any loan requires the lender (or an intermediary) to be confident of the identity of the borrower – without which it is impossible to enforce payment. It is also necessary to have information about the creditworthiness of the borrower to decide whether to bear the risk of default, and whether the interest rate adequately compensates for it.

106 When a person-to-person lending service matches lenders and borrowers who are strangers to each other, part of the service is generally verifying the identity and creditworthiness of borrowers. If lenders are either not provided with sufficient private information about borrowers (noting that borrowers do not have the statutory obligations of disclosure normally imposed by securities law) or are not competent in assessing their creditworthiness, they are likely to become reliant on the provider performing this service. In some services borrowers are anonymous, so this reliance is complete.

107 I propose that, as an eligibility criterion for obtaining a licence, providers must have adequate mechanisms for establishing the identity and creditworthiness of borrowers and communicating information about creditworthiness to investors. This would be assessed by FMA when a licence is granted. All submitters agreed with this approach.

Disclosure of information about the service

108 For investors to make informed decisions about participation in a person-to-person lending service, they will need access to information about how the service operates, their rights, and the risks involved. The FMC Bill provides for a "service disclosure statement" that must be given to customers before providing the service. Regulations can specify the content of this.

109 However, where person-to-person lending services are internet-based, information is more likely to be accessed if it is placed on relevant places on the service's website, rather than in a single document that is presented to investors as part of a sign-up process.

110 I propose that a service disclosure statement be provided, but that this be permitted to incorporate information from the website by reference. This would provide information such as:

- How the borrowing and lending processes work
- How creditworthiness of borrowers is assessed
- How their funds are handled by the service provider
- How loan contracts are concluded
- How loans are serviced
- Processes for the recovery of missed payments
- The fees and charges that apply
- How borrowers and lenders can make complaints
- Key personnel.

111 Note that some of this information is also proposed to be in the client agreement.

Client agreement

112 While FMA can enforce legislation and licensing conditions in respect of person-to-person lending services, there is also an important role for private enforcement by investors themselves. To facilitate this, there should be a clear written agreement between the service provider and investors that sets out how the provider will operate.

113 I propose that person-to-person lending services be required to enter into a written client agreement with investors. This must deal adequately with the following matters:

- How the borrowing and lending processes operate
- How investor money is handled by the service provider
- How loan contracts are concluded
- How loans are serviced
- Processes for the recovery of missed payments
- The fees and charges that apply.

Administration of customers' contracts in the event that they cease to operate the service

114 The closure of a person-to-person lending service, if not well managed, has the potential to harm existing lenders and, to a lesser extent, borrowers. The service provider may have been responsible for collecting payments of interest and principal from the borrower and transferring these to the lender. The service provider may be the only person with the borrower's contact details, and will hold records of the credit contract, what the borrower owes and the amount paid to date. The service provider is also likely to be in possession of a significant amount of lender and borrower money (which should be held in a trust account, in accordance with the Financial Advisers Act).

115 To address this risk, I propose that one of the eligibility criteria for person-to-person lending services be that they have adequate arrangements to ensure the orderly administration of its customers' contracts in the event that they cease to operate the service. Submitters have identified a number of ways that this requirement could be met in practice.

Caps on amount that can be lent and borrowed

116 The prescribed intermediaries regime is intended to provide for relatively small-scale fund raising, where the costs of compliance under the normal product disclosure statement (PDS) regime would be likely to far outweigh the benefits of the money raised. For this reason, fund raising through a licensed intermediary would generally be subject to a size cap.

117 Many person-to-person lending services are provided primarily, or exclusively, to facilitate the making of small, personal loans. If this is the focus of the exemption for licensed person-to-person lending services, there may be a case for a relatively small cap on the size of loans – for example, $50,000 or less over a 12 month period. Major overseas services along these lines have caps of US$35,000 (Prosper and Lending Club) and £15,000 (Zopa UK).

118 However, person-to-person lending services are a potential funding source for larger loans to small businesses. This would imply a borrowing cap more along the lines of the "small offers" exemption in the FMC Bill – up to $2 million in a 12 month period (the small offers exemption has a limit of 20 investors). Borrowers may choose to borrow from both a person-to-person lending service and separately through a small offer.

119 I propose that the maximum amount that can be raised in 12 months from both prescribed intermediaries and the small offers regime be limited to $2 million in total. This would be an obligation on the issuer, rather than on the person-to-person lending service, and it would not include money raised from wholesale investors. Most services are expected to impose smaller caps.

120 Another question is whether there should be cap on the amount that retail investors can lend, either per borrower or through each service overall.

121 I do not propose to prescribe a cap at this stage. There is no per-investor amount cap on use of the small offer exemption, for which significantly less disclosure is proposed. The requirement that person-to-person lending services have adequate systems for assessing borrower creditworthiness means that investors should be in a position to make an informed decision. However, use of this exemption, along with the small offers exemption, will need to be carefully monitored.

Regulations to permit equity-based crowd-funding services

122 Another type of prescribed intermediary that has been proposed is a crowd-funding platform. Crowd-funding refers to the process of pooling a large number of small contributions to fund a business or project. Many services that identify themselves as facilitating ‘crowd-funding’, both overseas and in New Zealand, currently provide for in-kind benefits and rewards to be received by those who contribute to projects. For example, a musician might use a crowd-funding platform to fund the recording of an album, and promise those who contribute a signed copy of the completed album or a voucher to attend a live performance. Because there are no financial returns to investors, this activity is not regulated by existing securities law or the FMC Bill.

123 A more recent development has been platforms for equity-based crowd-funding. Investors receive company shares or some other source of financial returns that depend on the success of the business. The United States has recently introduced a crowd-funding exemption from its Securities Act, as part of the Jumpstart Our Business Startups Act (“JOBS Act”). This exemption would allow capital raising through registered internet ‘funding portals’ or through registered broker-dealers. The exemption is subject to a number of conditions relating to, for example, limits on the maximum amount an issuer can raise, and the amount that each investor can contribute.

124 Enabling crowd-funding was highlighted in the Government’s Business Growth Agenda as an initiative to support early-stage and growth companies to access the risk-capital they need to grow.

125 I propose to specify ‘crowd-funding platform’ as a second category of prescribed intermediary services under the FMC Bill. This will enable providers of crowd-funding platforms to obtain a licence, and offers made through the provider will then be able to make use of the FMC Bill’s exemption from registering a PDS. Permitting crowd-funding platforms will open up significant new opportunities for small businesses to raise growth capital.

126 A number of the considerations applying to the regulation of person-to-person lending also apply to crowd-funding. However, as equity-based crowd-funding platforms are a new mechanism for firms to raise capital (even compared to person-to-person lending), it is difficult to anticipate what forms of crowd-funding will prove most beneficial and what regulatory problems they will pose. This makes it hard to design an effective regulatory environment in advance. A relatively flexible approach is desirable, subject to careful supervision by FMA.

Investor information

127 Any exclusion for crowd-funding must be consistent with the purposes of the FMC Bill. While the prescribed intermediary exclusion removes the regulatory obligations associated with traditional offers of securities, it is important that it promotes the confident and informed participation of businesses, investors, and consumers in the financial markets.

128 While issuers using crowd-funding platforms will not need to prepare a PDS, it is important that there are mechanisms for investors to make informed decisions. There may be a number of ways to achieve this, including:

- Issuer-prepared information
- Investors and issuers participating in open question and answer forums
- Visibility as to the funding currently pledged against the issuer's fund raising goals
- Due diligence and assessment by the crowd-funding platform.

129 I propose that as an eligibility criterion to obtain a licence, crowd-funding platforms will need to have their disclosure mechanisms approved by FMA. FMA would grant approval if it is satisfied that the disclosure mechanisms meet a principles-based standard specified in regulations. The standard (an eligibility criterion in the regulations) would be along the lines of "the crowd-funding platform provides facilities for investors to receive information sufficient to make an informed decision about whether or not to invest in issuers on the platform".

130 This provides flexibility for platforms to develop an appropriate mix of mechanisms for information provision. Disclosure will be expected to be proportionate to the amount of money being raised by issuers, and will form part of the platform's conditions of licence.

131 Crowd-funding platforms will also be required to:

- Have appropriate systems to conduct basic background checks to exclude offers by issuers where there is evidence that directors, senior managers or controlling owners are not of good character and reputation (this would be an eligibility criterion to obtain a licence)
- Disclose information about how the service works, including checks and assessments made of issuers, how any investor funds are handled by the service provider, the fees and charges that apply and how investors and issuers can make complaints (this would be through a service disclosure statement, as proposed for person-to-person lending services)

132 I also propose that as a standard condition of licence, investors affirm that they understand the risks involved, such as risk of entire loss of investments, and that they consider whether they could bear such a loss.

Client agreement

133 As with person-to-person lending services, there should be a clear written agreement between crowd-funding platforms and investors that sets out the rights and obligations of the parties.

134 I propose that crowd-funding platforms be required to enter into a written client agreement with investors. This would need to deal adequately with the following matters:

- How the platform's investment processes operate
- How investor money is handled by the platform (if applicable)
- Any ongoing monitoring of issuers that the platform proposes to perform
- The fees and charges that apply.

Investment caps

135 Above I propose an overall cap on the amount that can be raised through prescribed intermediaries and the small offers exemption of $2 million over 12 months. This would be an obligation on the issuer, rather than on the crowd-funding platform, and it would not include money raised from wholesale investors.

136 As with person-to-person lending, the issue arises as to whether a cap should be placed on the amount that retail investors can invest through a crowd-funding platform. If so:

- Should it apply to the total amount each investor can invest through the crowd-funding platform (a 'per-investor cap'), or the amount he or she can invest in a single issuer (a 'per-issuer cap')?
- Should the cap be a fixed amount, or should it vary according to investor income or wealth?

137 The US crowd-funding exemption has a per-investor cap that varies according the income or net worth of the investor. Investors can invest the following each 12 months:

- For investors with an annual income and net worth less than $100,000, the greater of $2,000 or 5 per cent of the annual income or net worth
- For investors with an annual income or net worth of more than $100,000, 10 per cent of investor annual income or net worth, up to a maximum of $100,000.

138 Compared to person-to-person lending, there may be a stronger rationale for a cap on crowd-funding investments, as the total amounts raised are likely to be higher, and the information that investors receive could be more variable. There may be greater uncertainty about what, if any, returns will be received from any given investment and the time horizons for receiving returns are also likely to be longer. Caps, especially per-investor caps, would reduce the risk that large scale investor losses damage the credibility of equity-based crowd-funding and the regulatory regime as a whole.

139 However, as noted above, there is no cap on the amount each investor can invest under the small offer exemption, for which minimal disclosure is proposed. A cap would create incentives for issuers to make separate offers to investors in reliance on the 'small offer' exemption rather than the prescribed intermediaries exemption.

140 Caps could be per-investor or per-issuer. A low per-investor cap would relegate crowd-funding to a marginal aspect of many investors' portfolios. A per-investor cap might also be difficult to enforce – investors may attempt to circumvent such requirements by creating multiple user accounts, or using multiple crowd-funding services or investing off-platform in the businesses that are listed.

141 A per-issuer cap would encourage diversification and limit losses from particular issuers, but would do less to limit investor losses in the event that there were systemic problems with listings on a particular crowd-funding platform.

142 The level of a cap is also difficult to set. A fixed cap is likely to suffer from being highly restrictive for relatively wealthy investors for whom the cap is small, whilst failing to offer meaningful protection to less wealthy investors for whom the cap may appear quite large. A cap that varies according to income or net worth would add more complexity to the regime and may be even more difficult to enforce without imposing significant costs and inconvenience on investors and providers.

143 My preferred approach is not to impose a cap at this stage, but this should be subject to further consultation in the exposure draft of the FMC Regulations. A final decision will be made when the regulations are finalised. The exposure draft would include four options, subject to drafting:

- No caps
- A fixed per-issuer cap of $15,000
- A fixed per-investor cap of $50,000 each 12 months
- A per-investor cap that varies with income and net worth, along the lines of the US regime.

Civil liability for breaches of standard licence conditions

144 Where licensees breach standard licence conditions imposed by regulations, regulations can provide for the breach to result in civil liability, including civil pecuniary penalties. If regulations do not provide for this, the breach will have licensing consequences only – for example, FMA can request that the licensee submit an action plan to resolve the breach, or issue directions.

145 It is appropriate that where licensees have clear obligations to do, or not do, particular things, there be potential civil liability for breaches. This ensures that there are incentives for compliance.

146 On this basis, I propose that breaches of the following licensing conditions be subject to civil liability:

- The obligation on licensed DIMS providers to notify investors using a wholesale service if they are being treated as wholesale
- The independent trustees whistleblowing obligation
- The seven-year record-keeping obligation on licensed DIMS providers
- The ongoing reporting obligations of licensed derivatives issuers
- The prohibition on recommending investments in particular issuers by person-to-person lending services and crowd-funding platforms
- The obligations on crowd-funding platforms to have potential investors affirm that they understand the risks of making investments through the platform.

Regulations dealing with changes of supervisors

147 Supervisors of financial products are licensed under the Securities Trustees and Statutory Supervisors Act 2011 (to be renamed the Financial Markets Supervisors Act). Supervisors of debt products are also trustees. Parliament recently enacted the Trustee (Public Trust) Amendment Act 2013 to clarify the basis for appointing Public Trust as the “trustee of last resort” in place of licensed trustees supervising financial products. The Amendment Act requires a resigning trustee to have met Public Trust’s fees and expenses if the trust itself cannot cover those fees and expenses.

148 The Amendment Act was an interim solution to apply only until the FMC Bill comes into force. Cabinet has noted that the Minister of Justice would seek my agreement to amend the FMC Bill in a further supplementary order paper [APH Min (13) 9/2 refers]. The FMC Bill will replace the interim solution with an ability for FMA to:

- Appoint a replacement supervisor from among all available licensed supervisors and
- Require an indemnity from the resigning supervisor as a precondition of the appointment.

149 FMA may have difficulty in getting licensed supervisors to take these appointments, even with an indemnity from the resigning supervisor. There is a partial alternative if a licensed supervisor refuses to accept the appointment. It allows FMA to appoint another person (such as an accounting firm) to act as the supervisor, which can be used if no licensed supervisor agrees to act.

150 However, by choosing to be licensed, supervisors should have a responsibility to share the ‘trustee of last resort’ role. This duty is analogous to the lawyer’s ‘cab rank rule’, which provides that a lawyer must not, without good cause, refuse to accept instructions from any client or prospective client for services within the reserved areas of work that are within the lawyer’s fields of practice. The further supplementary order paper will enable standard licence conditions to be set by regulations for supervisors, consistent with other licensed financial market participants. I propose that a duty analogous to the lawyer’s ‘cab rank rule’ be imposed by these licence conditions.

151 There are also other risks with supervisors being changed. Supervisors are the first custodians of property for managed investment schemes. Property and other rights and obligations need to be shifted to the replacement supervisor. Implied terms are proposed in paper 3 to ensure this appointment is effective to transfer the rights and obligations of the replacement supervisor. But in practice the retiring supervisor will need in practice to take various steps – for example sign across access to bank accounts. I propose that the retiring supervisor have a duty to give the replacement supervisor all reasonable assistance to facilitate the change.

152 These proposals were not discussed in the discussion paper on the proposed regulations and have arisen subsequently. Therefore, I consider they should be subject to further consultation before they are finalised. I propose that Cabinet agree these in principle, subject to further consultation.

Consultation

153 FMA, Treasury, Reserve Bank, Ministry of Justice, and the Inland Revenue Department were consulted on this paper. The Department of Prime Minister and Cabinet has been informed.

154 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

155 This paper has no financial implications.

Human Rights

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

Legislative Implications

157 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

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

Quality of the Impact Analysis

159 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

160 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 the Financial Markets Conduct Bill (FMC Bill) provides for the licensing of fund managers, derivatives issuers, providers of discretionary investment management services, independent trustees of restricted schemes and providers of prescribed intermediary services

2 **Note** that the FMC Bill requires that licensees satisfy FMA of these criteria:

2.1 The applicant's directors, senior managers and proposed directors and senior managers are fit and proper persons to hold their respective positions

2.2 The applicant is capable of effectively performing that service (having regard to the proposed conditions of licence)

2.3 There is no reason to believe that the applicant will not comply with the market services licensee obligations

3 **Note** that the FMC Bill provides for the regulations to specify additional licence criteria and licence conditions, and for FMA to impose conditions relating to any eligibility criteria and types of conditions specified in the regulations

4 **Agree** that licensees may be required by FMA to hold professional indemnity insurance or other insurance that covers costs and claims that could arise from civil proceedings

5 **Agree** that licensees be required to report events to FMA that could affect their ability to continue to meet eligibility criteria, such as insolvency, changes to directors and senior managers, and significant litigation

6 **Note** that Cabinet has agreed that as part of the FMC Bill's licensing regime, controlling owners of fund managers will be required to meet a 'fit and proper person' test [CBC Min (11) 4/3 refers]

7 **Agree** that controlling owners of all licensees be required to meet a 'fit and proper person' test

8 **Agree** that, where a licensee proposes that a related body be authorised to perform a licensed market service, key personnel in the related body be required to meet a 'fit and proper person' test

9 **Agree** that licensees be restricted from contracting out of basic duties of care and liability for outsourced functions

10 **Agree** that FMA be required to consult with and notify the Reserve Bank when licensing banks, non-bank deposit takers and licensed insurers

Regulations relating to independent trustees of restricted schemes

11 **Agree** that independent trustees of restricted schemes have a whistleblowing obligation, with protections from termination of appointment or proceedings arising from disclosures under the whistleblowing obligation

Regulations relating to discretionary investment management services (DIMS)

12 **Agree** that FMA may impose conditions on how licensed DIMS providers can give incidental advice

13 **Agree** that DIMS client agreements must provide adequately for:

13.1 How custody over assets will be provided

13.2 How rights relating to investor's assets will be exercised

13.3 Clients to terminate DIMS client agreements and take control of their assets within a reasonable time, with appropriate treatment of wholesale assets

14 **Agree** that where a licensed DIMS provider uses an associated body corporate as a custodian, FMA may set conditions to ensure that client assets are adequately safeguarded

15 **Agree** that licensed DIMS providers must retain for 7 years records of transactions and documents required to be produced under the FMC Bill and regulations

16 **Agree** that licensed DIMS providers must notify investors using a wholesale service if they are being treated as wholesale

17 **Agree** that regulations carry over current exemptions under the Financial Advisers Act 2008 that are relevant to DIMS with any modifications needed to apply them appropriately under the FMC Bill

Regulations relating to derivatives issuers

18 **Agree** that licensed derivatives issuers be required to maintain minimum levels of capital or liquid assets, where FMA determines this is appropriate, unless the licensee is already covered by adequate prudential regulation

19 **Agree** that the approach of the Futures Industry (Client Funds) Regulations 1990 to client assets be continued for derivatives issuers, with adjustments to ensure it works for over-the-counter derivatives and that issuers take adequate steps to ensure that client assets used for hedging are protected from insolvency

20 **Agree** that licensed derivatives issuers have ongoing obligations to report to clients on client accounts and transactions

21 **Agree** that licensed derivatives issuers must retain for 7 years records of dealings in derivative contracts with clients, and of client money or property received, held or otherwise dealt with in connection with dealings in derivative contracts

22 **Agree** that FMA may impose client suitability requirements and leverage limits in respect of licensed derivatives issuers

Regulations relating to person-to-person lending and crowd-funding

23 **Note** that Cabinet has agreed that person-to-person lending services be a permitted type of prescribed intermediary service [CBC Min (11) 4/3]

24 **Agree** that crowd-funding platforms be a second category of prescribed intermediaries

25 **Agree** that person-to-person lending services and crowd-funding platforms be required to be open platforms that act as neutral brokers between issuers and investors

26 **Agree** that key processes for person-to-person lending services and crowd-funding platforms be required to be fair, orderly and transparent, including:

26.1 Processes for issuers and investors to access the service

26.2 Matching of issuers and investors by the service

26.3 Where applicable, handling of investment funds and payments to investors

27 **Agree** that person-to-person lending services and crowd-funding platforms be required to provide investors with a service disclosure statement which must include, or incorporate by reference, information about the service, including:

27.1 How the service operates

27.2 Checks and assessments made of issuers

27.3 How any investor funds are handled by the service provider

27.4 The fees and charges that apply

27.5 How investors can make complaints

28 **Agree** that person-to-person lending services be required to enter into written client agreements with investors, that must deal adequately with:

28.1 How the borrowing and lending processes operate

28.2 How investor money is handled by the service provider

28.3 How loan contracts are concluded

28.4 How loans are serviced

28.5 Processes for the recovery of missed payments

28.6 The fees and charges that apply

29 **Agree** that issuers may only raise a total of $2 million in reliance on the exemptions for prescribed intermediaries and small offers each 12 month period

30 **Agree** that person-to-person lending services be required to have adequate systems for establishing the identity and creditworthiness of borrowers, and for communicating information about creditworthiness to investors

31 **Agree** that person-to-person lending services be required to have adequate arrangements for the orderly administration of customers' contracts in the event that they cease to operate the service

32 **Agree** that crowd-funding platforms be required to have a disclosure regime sufficient for investors to make an informed decision about whether or not to invest in issuers on the platform, to be assessed by FMA

33 **Agree** that crowd-funding platforms be required to enter into written client agreements with investors, that must deal adequately with:

33.1 How the platform's investment processes operate

33.2 How investor money is handled by the platform

33.3 Any ongoing monitoring of issuers that the platform proposes to perform

33.4 The fees and charges that apply

34 **Agree** that crowd-funding platforms be required to conduct checks to exclude offers by issuers where there is evidence that directors, senior managers or controlling owners are not of good character and reputation

35 **Agree** that crowd-funding platforms must require potential investors to affirm that they understand the risks of making investments through the platform

36 **Agree** that the exposure draft of the regulations include a number of options for caps on retail investment in licensed crowd-funding platforms

37 **Agree** that breaches of the following licensing conditions be subject to civil liability:

37.1 The obligation on licensed DIMS providers to notify investors using a wholesale service if they are being treated as wholesale

37.2 The independent trustee whistleblowing obligation

37.3 The record-keeping obligation on licensed DIMS providers

37.4 The ongoing client reporting obligations of licensed derivatives issuers

37.5 The prohibition on recommendations by person-to-person lending services and crowd-funding, in respect of issuers listed on their platforms

37.6 The obligations on crowd-funding platforms to have potential investors affirm that they understand the risks of making investments through the platform

38 **Agree in principle**, subject to further consultation and assessment of costs and benefits, to use licence conditions to impose duties on supervisors to:

38.1 Accept an appointment by FMA, analogous to the lawyer's cab rank rule

38.2 Give replacement supervisors all reasonable assistance to facilitate a change of supervisors.

Hon Craig Foss
Minister of Commerce

_____ /_____ /_____