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SECURITIES LAW DISCUSSION PAPER

Introduction

The New Zealand Law Society (Society), assisted by its Commercial & Business Law Committee, welcomes the opportunity to comment on proposals to substantially revise New Zealand's securities laws, outlined in *The Review of Securities Law, Discussion Paper, June 2010* (discussion paper).

Chapter 1 - Defining regulated financial products

Section 3 – Problems with the current regime

The Society supports the proposals to confine the securities disclosure regime to offers of securities that are financial products (aimed at generating an investment / financial return or hedging a financial risk).

The difficulties caused by the uncertain boundaries of the definition of "security", coupled with the difficulties associated with the distinction between public offers and private contracts and the severe consequences of making a public offer without satisfying the disclosure requirements, will stifle activity and impose significant compliance costs.

The suggested concentration on the "economic substance" of the relevant transaction to provide the basis for the key definitions on which any replacement disclosure regime must be founded is in the interests of certainty. Workable safe harbours and / or scope for obtaining rulings (possibly binding) will also be necessary to make the new regime workable for market participants and their advisers.

Section 4 - Proposals for reform

4.1 Specific categories of regulated financial products

Equity securities
A new definition that provides better alignment with financial accounting treatment should result in a clearer treatment of hybrid offerings. Further thought may also need to be given to some of the instruments used by co-operatives – which continue to be an important element of the economy, including in particular the rural economy.

Debt securities
Better alignment with accounting standards should resolve some existing difficulties – especially in the areas of hybrid offerings.

Collective investment schemes
Refer to our comments in respect of chapter 4, below.

Derivatives
It is desirable for the definition of derivatives to remove some of the existing questions about the definition of a futures contract. The benefits of carving out derivatives with a 100% initial margin payment are undermined by the scope for regulatory arbitrage.

In addition, there is a need to resolve existing questions about the application of section 3(2)(a)(iia) of the Securities Act to certain derivatives contracts where the amounts being hedged exceed $500,000.[1]

4.2 Call in powers
The ability for the Financial Markets Authority (FMA) to "call in" financial products will ensure flexibility, as well as addressing the concerns that some market participants will engineer financial products to either avoid regulation or have them categorised as one form of security rather than another. The discretion afforded to the FMA will preserve flexibility without materially compromising certainty if the "call in" power is exercised transparently, with the opportunity for market participants to make submissions and be provided with the reasons for decisions. Preferably, the FMA would also publish guidance about when and how the call in power will be exercised.

Rulings and guidance notes are further ways certainty can be increased in this context.

Designations should be able to be made subject to terms and conditions and be used in conjunction with the FMA's powers to make exemptions. This will give flexibility as new products develop, which is an inevitable feature of healthy capital markets activity.

4.3 No financial return / hedging element
There needs to be greater certainty about the boundaries of the relevant definitions, so that the shift from regulation according to legal form to one based on economic substance is consistently applied. Consequently, a number of existing arrangements that are caught by the definition of "participatory security" such as the use of some common facilities in lifestyle subdivisions, marinas and stadium seating packages may be excluded from the disclosure obligations. The proposal in paragraph 73 regarding the "no [financial] return" statement would be particularly useful in this regard.

4.5.1 Exemptions
Of the existing exemptions contained in section 5, the balance continues to be relevant (other than those for land and chattels and that for professional practices – for the reasons given in the discussion paper). It is unclear whether the exemption for certain employee share schemes continues to be relevant. It would be preferable for all such schemes to be treated on a uniform basis (even if section YA1 schemes are increasingly rare).

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[1] See *Braemar Lodge 2004 Ltd (in rec) v Prudence Kaye Owers & others* [2010] CA 50/210 16 July 2010 and the discussion about paragraph 4.10 below.

It makes sense for the balance of the exemptions in section 5 to 5C to be moved to regulation so that all the exemptions can be obtained from one source rather than a multiplicity of sources, as is presently the case. One criticism of the present patchwork of exemptions is that it makes the legislative framework inaccessible to all but those who practice full time in the area. This increases the cost of access to good quality legal advice.

4.5.2 Existing class exemptions

For the reasons noted above (i.e. one source of exemptions), it is desirable that class exemptions are either incorporated into changes to the primary legislation or moved to regulation to ensure that there is one source of exemptions. This makes the law more accessible because those general exemptions are proximate to the core rules, rather than being found elsewhere in standalone exemptions. It is also preferable to incorporate the exemptions for convertible securities and dividend reinvestment plans into the new legislation whereas specific (product) exemptions should continue to be dealt with by means of regulation.

4.5.3 Previously allotted securities / vendor shareholders

The difficulty of interpreting section 6 gives rise to confusion in the market place and unnecessary compliance costs. More guidance by the regulator as to the intended application of section 6 is desirable in the interests of clarity and lower compliance costs.

An example of difficulties experienced in practice are the problems associated with "knowing assistance" provided by a board through a pre-emptive rights sale process where shares are offered for sale to existing shareholders as a consequence of a shareholder seeking to exit their investment. The risk that the Securities Act disclosure regime might unexpectedly apply to such a transaction is of concern to issuers, directors and shareholders alike.

The discussion paper does not discuss one of the primary difficulties associated with the application of section 6; namely whose view (about resale) is relevant. There is no guidance or existing case law. Current market practice is that the view must be shared. This is particularly relevant in the case of an underwritten offer (and in this regard it is noted that section 6(7) refers to both the issuer and the allottee – so arguably the underwriter's view is relevant).

If the test is objective (i.e. are there reasonable grounds that one of the views for issuing the shares was for on-sale), any background material such as warranty provisions may not be of assistance as a defence. There is also a general principle of interpretation that anti-avoidance provisions are not to be interpreted leniently.

Underwriters are typically not long-term holders of securities. For this reason, there is a market concern that the issuer may risk being deemed to have a view (in respect of resale) if they are put on notice of the underwriter's intention to resell (or possibly even because they are aware that is the general market behaviour of underwriters).

This problem has been addressed in Australia with a specific exemption – see section 708A(12) of the Corporations Act.

It would be preferable if vendor shareholders, such as private equity funds, were not discouraged from undertaking a sale by means of an IPO. For that reason, it makes sense to exempt such vendor shareholders, where the original allotter issues a disclosure document and the vendor is not a director. As is discussed below in relation to chapter 3, section 6, there may not be a future for the curious anomaly created by the definition of a "promoter".

Material issue relevant to the legal profession
A significant issue for the legal profession arises in part 4.5.1 of chapter 1, at paragraph 82. This paragraph contemplates the removal of the exemption for professional practices currently provided for at section 5 of the Securities Act. The discussion paper suggests that the current exemption does not achieve its aim. It is accepted that the current exemption inadequately caters for professional service firms. But that is not a reason to remove it, rather the exemption should be amended to make it clear that an exemption applies in the case of Securities Act Schedule 2 professional service firms. The reason given is that conditions for a security (as defined) to exist will include 1) earning a return or hedging risk as a significant feature, and 2) investors must not have day-to-day control over the practice. Because these general requirements are proposed to be introduced, it is considered unnecessary to have a specific exemption for professional service firms. Equity partners in a law firm (and other professions) will make an investment in the partnership / company in a variety of circumstances. Features of being an equity partner in a large law firm would include a return and, ordinarily, not being involved in the day to day control over the practice – the very features which are proposed to constitute the investment as a security. In these circumstances, it is imperative that an exemption for investments in law firms is carried forward to the new Act.

Investment in professional services firms is not the kind of investment that the securities law regime should be concerned with. Such people investing are not members of "the public" but are principals of the firm in which they work and recognised as such through being offered partial ownership of the business. There appears to be no policy dispute about this issue but the discussion paper assumes that the exemption is maintained as a result of other, more general provisions. For the reasons given, the Society considers that an exemption similar to what is presently in section 5 of the Securities Act is imperative, to remove any doubt that a professional taking an ownership stake in the business he or she is a principal of is excluded from the securities law regime.

4.6 Investment brokers
Harmonisation of the requirements applying to different types of brokers is desirable in the interests of efficiency and clarity.

It would be preferable for the existing exemptions for contributory mortgage products to be phased out in favour of greater enhanced opportunities for comparison and a level playing field. As the reasons for the existence of this type of product are historical and have become less relevant, it is likely that they are a much less significant part of the marketplace.

4.7 Islamic finance
The only examples of Islamic finance instruments of which we are aware have come from offshore, in conjunction with private equity funding vehicles. As a result, it is not clear that there is currently sufficient demand for specific treatment. This may be a matter that the FMA addresses in future when there is evidence of demand.

Chapter 2 – Offers to exempt investors

Section 3 – Problems with the current regime

The problems identified with the existing framework for exemptions (carve-outs or safe harbours) from the Securities Act disclosure regime are well known. In addition, the existing scheme of safe harbours is confusing (because of the mix of full and partial exceptions, the fact that some carve-outs are subject to conditions and that the exceptions are found in different

places). They are also out of date and out of step with important developments in Australia in the last decade.

These difficulties create costs and risks that penalise both businesses seeking to raise capital and potential investors.

The proposals of the Capital Market Development (CMD) Taskforce recognise the realities of capital raising by small to medium enterprises (SMEs) in the New Zealand economy: the need to raise modest amounts of capital from small groups of people. This reflects factors such as the low levels of personal wealth (a reflection of New Zealand's poor savings record – which means that there are few high net worth individuals capable of bankrolling start-ups) and the restrictions on other forms of funding. The latter point is particularly relevant in the current financial climate as a result of credit rationing by banks. For this reason, the proposed safe harbour for "small" investments – using a '20 by 12' formula borrowed from Australia (offers to obtain up to $2 million from not more than 20 investors in any 12 month period) – is sensible.

The use of a 'bright line' test to identify when an investor qualifies under an exemption is desirable, to avoid subjectivity as far as possible (which appears to accompany reliance on the existing carve-outs).

Finally under the heading of problems, we agree with the statement that the rationale for the distinctions between the two groups of safe harbours for offers under section 3(2)(a) to persons who are deemed not to be members of the public and those under section 5 for certain subsets of the public (wealthy and experienced) are unclear. However, the consequences of relying on one set of carve-outs rather than the other produces different outcomes, and there are even process questions about (i) the ability of an issuer to rely on legal advice as to the whether an offeree falls within one of the safe harbours[2] and (ii) the consequences of relying on third party certification under sections 5(2CD) or 5(2CE) if the basis on which the certificate was given subsequently proves to be unfounded.

Section 4 - Proposals for reform

We agree with the proposal in paragraph 21 that responsibility for assessment of investor status as exempt should sit with the issuer. However, it is not clear whether consideration has been given to whether this is a subjective or objective test. A subjective test (i.e. whether the issuer's conclusion is a reasonable one) may be more workable.

4.6 Financial Reporting Act obligations

We agree with the proposals to retain exposure to civil liability for offers to exempt classes of investors – for false and misleading statements. We support the carve-out from criminal liability for offers made to "sophisticated" investors on the basis that they are better able to look after themselves, by both conducting their own due diligence and pursuing remedies.

A requirement that issuers of exempt offers register under the Financial Service Providers (Registration and Dispute Resolution) Act 2008, rather than creating two subsets of exempt offer (those under the existing section 3(2)(a) and those to wealthy / experienced investors), would achieve uniform take-up of dispute resolution procedures.

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[2] See *Ministry of Economic Development v Stakeholder Finance Ltd, Agnes Water Acquisitions Ltd and Robert Daniel McEwan (9 December 2008. Auckland DC CRI 2007-004-28150; CRI 2007-004-28160; CRI 2007-004-28102.).*

Registration on the Register of Securities would aid comparison as well as provide a means of monitoring market developments.

4.7 Exemption for investment businesses
The proposed clarification of the "habitual investor" definition by identifying the principal business more prescriptively is desirable.

A minimum size threshold may impose unnecessary entry costs on innovative start-ups in the funds management industry.

4.8 Exemption for sophisticated investors
Quantitative criteria to determine whether a person is a sophisticated investor are preferable in the interests of certainty, with further criteria to capture people who are in the investment industry (as opposed to those who simply have some business experience, which is too wide). Also, as noted in the discussion paper, there should be scope to qualify by having undertaken either (i) a number of regular investments, or (ii) a handful of high value investments.

4.10 Exemption for large investments of $500,000 or more
In its present form the exemption for follow-up investments in section 3(2)(a)(iib) is unhelpful because of the requirement for the investment to have been made in a single transaction and for the follow-up to be made within a short period of the initial investment. If an investor is able to make a high value investment over time (rather than necessarily in a single subscription), they should be capable of looking after their own interests.

The definition of "allotment" means that there is now considerable doubt that section 3(2)(a)(iia) can be relied on for some hedging products used by large businesses – with the result that there may be a sound argument for extending this exemption to apply to those who are required to commit at least $500,000 prior to allotment (rather than pay).

4.11 Exemptions for relatives, friends and close business associates
It would be desirable for the definition of "relatives" to include family trusts (compare section 5(2CDA)).

The result sought by the last subcategory of "close business associate" may be better achieved by retention of the "experienced" limb of the "eligible persons" carve-out.

Limited Partnerships should also be considered for inclusion in the list of people who are friends and close business associates (paragraph 58).

4.14 Concessions for small offers
The difficulties faced by start-ups in raising initial funding in this country and the absence of available pools of private savings for such investment in all but a very thin slice of the community are such that restrictions on general advertising of small offers may be problematic. A size restriction on individual investments under the 20 x 12 cap would not be desirable for the same reason.

4.17 Designation of investors
There are mixed views about the need for a designation power as such. However, as with the proposal for a call in power, such a mechanism could inject certainty into the application of some categories of the legislative framework. This is a key point for businesses looking to raise funds in a compliant manner without incurring the additional costs that are associated with uncertainty.

4.18 Void allotments
A balance between the subscriber's interests and those of the company and its investors needs to be achieved. The potential for offers to be avoided has significant consequences for the company and other investors who have invested subsequently on the basis of the company having a certain capital structure. In circumstances of strict liability, there is some sense in aligning the period during which the offer is voidable with the limitation period in the Fair Trading Act: 3 years.

Chapter 3 – Disclosure

Section 1 – Introduction

1.2 The purpose of disclosure
As a result of the size and features of the New Zealand market, a significant proportion of the retail investing public do not seek professional advice and, instead, rely on their own analysis. As a result, disclosure obligations should enable retail investors to make meaningful comparisons themselves or with a minimum of professional advice.

Section 2 – Point of sale disclosure – status quo and problem definition

2.2 Problem definition
Any new disclosure regime needs to recognise the differing needs of a professional / sophisticated audience and those of the retail investor. At present, the typical prospectus arguably does not meet the requirements of the professional reader while the investment statement does not address those of its (retail) target audience.

By continuing to use a prescriptive (checklist) disclosure model, there should be scope for some management of the costs of compliance. However, it may be impossible to legislate against the risk of issuers seeking to over-disclose information because of concerns about the risk of liability. At the same time, there needs to be a real emphasis on making disclosure materials readable and understandable and a sound basis for valid comparisons.

Opaque disclosures of non-specific risks do not benefit either the investor or the credibility of the discloser. But it is a brave issuer that does not include them given the standard market position of doing so. There may also need to be greater guidance as to what amounts to acceptable levels of clarity. This seems to be one of the drivers for reforms in the area of financial reporting standards and the challenge for regulators is to seek to achieve the same goals in the non-financial disclosures.

The current benefits of the prescriptive approach to securities disclosure are that it (arguably) requires disclosure against a finite set of criteria. A cost of any disclosure regime, and the attendant liabilities for the issuer and its directors, is the level of due diligence and verification required to ensure that the disclosure document meets the prescribed requirements.

A further cost arises because compliance with the Securities Act disclosure regime is portrayed in some circles as being highly specialised. There are also market perceptions that regulatory agencies share that view. While compliance requires appropriate advice, there are concerns that an understanding of the legislative regime should be more widely accessible in order to achieve greater levels of understanding and therefore compliance.

Section 3 – Point of sale disclosure – proposals

3.2 Framework for point of sale disclosure
We support the recommendation of the CMD Taskforce to move to a one-document disclosure model.

The disclosure requirements should focus primarily on the needs of the retail audience. The requirements of a professional audience can be met in other ways. This includes having other material "sit behind" the disclosure document or be incorporated by reference into it.

Any material made available by alternative means so that it sits behind the disclosure document or is incorporated by reference into it should also be lodged on the Register of Securities. The most logical example is registered financial statements, which do not need to be duplicated in a disclosure document given the ubiquity of access via the internet.

In passing, we also note that further thought will need to be given to the manner in which such filings are lodged and accessed. For example, currently some Companies Office filings of certain collective investment schemes are organised according to manager name (e.g. GIFs) and others by scheme name (e.g. unit trusts). Similarly, the requirements of scheme vs. manager filing of financial statements are not well understood because of the complexity in the underlying legislation.

3.3.1 Product disclosure statement
It is not clear that there is a need for both a key information statement and a restriction on length. A length restriction and a requirement that any other information that is referenced (or incorporated by reference) be made available by means of a website rather than in the document itself is preferable. That additional information should also be included in the Register of Securities. If the aim is simplicity and the ability to compare offerings, some restriction on the information able to be registered will be necessary.

3.3.2 Register of Securities
There is a good case for requiring that any information subsequently made available by an issuer, such as a response to its periodic (or even continuous) disclosure obligations should also be lodged on the register of securities.

3.4.1. Key information summary
In relation to the proposed options for risk disclosure, it is submitted that:

- **equity securities**: the preferred option (self-assessment of risks) is appropriate as the costs associated with third party assessment are likely to be out of proportion to the likely benefit to the reader;
- **debt securities:** again, the preferred option (risk ratings – with self-assessment for unrated debt securities) is appropriate although recent trends amongst ratings agency will need to be monitored;
- **collective investment schemes:** the preferred option (self-assessment) is appropriate and in keeping with the approach taken in respect of the (much larger) managed funds industry in Australia; and
- **derivatives:** the preferred option (self-assessment) is also appropriate – although see the comments in relation to paragraph 3.4.4 below about sophistication warnings.

However we note with option A, if a fuller set of risk disclosures (i.e. "further risks") are allowed in the body of the PDS, then there will need to be some constraints or the current market norms of opaque, almost boilerplate-type disclosure, will simply continue.

3.4.3 Use of educational material in PDSs

A disclosure document is not the right forum for educational matters. At most the document might direct the reader to where more information may be obtained.

3.4.4 Sophistication warnings

As a practical matter, an issuer would be ill advised to offer complex products to a retail audience without a sophistication warning. However, there is support for the proposal for a (risk) labelling scheme administered by the FMA, as long as there are adequate safeguards to ensure that this does not result in either (a) over-prescription by the regulator, or (b) an abdication of responsibility by issuers on the basis that the FMA will pick up the need for such disclosures.

3.4.5 Simplified disclosure prospectuses

The simplified disclosure prospectus (SDP) regime should be given more time to prove its worth. The drivers for introducing the SDP were valid and the introduction of the opportunity for listed issuers to use an SDP has proven worthwhile in a handful of offers that have utilised that opportunity to date. It is also noted that there are concerns that the initial crop of SDPs has followed the pattern of over-disclosing non-specific risks and adding too much opaque data in a manner that might be seen to be risk-averse to the issuer but is not likely to be overly instructive for investors.

Section 4 – Ongoing disclosure

4.2 Status quo and problem definition

As the market for unlisted securities is generally highly illiquid, imposing a form of continuous disclosure would impose a compliance cost on the issuer, with only questionable benefits for investors.

There may also be a need for a requirement to update for changes to the partners in a limited partnership, depending how they are characterised.

4.3 Proposals for reform

Debt

Recent market experience would indicate a need for debt issuers to update holders with developments that may have a bearing on the likelihood of the issuer continuing to be able to meet commitments. Whilst there needs to be a centralised repository for all such relevant information (in the form of the Register of Securities), it should also be considered whether such a development imposes a further duty on the issuer to update all security holders (perhaps directly).

Collective investment schemes

Similarly, the holders of interests in collective investment schemes should also receive updates of material developments affecting their investment.

Section 5 – Principles-based disclosure

5.5 International: principles- vs rules-based disclosure

For a document intended for a retail audience, the retention of an “all (material) matters” disclosure longstop is preferable. Without that disclosure, retail investors may simply miss material disclosures that are made elsewhere (such as by means of the Register of Securities) and not at least signalled in the disclosure document itself. However, some care needs to be taken to ensure that such a requirement and ability to lodge material on the Register of

Securities does not result in over-disclosure and the consequent reduction in clarity of understanding.

5.6 Proposals for reform

There is no need for initial or even periodic certification – other than in circumstances where there is a material development that warrants an amendment to a disclosure document. In that case, there is a need for some form of sign-off that the document (as amended) meets the requirements of the legislation. A legislative requirement for periodic review is helpful, albeit without certification criteria.

Section 6 – Promoters, experts, and celebrity endorsements

6.1 Promoters

There seems to be widespread confusion about the role of a promoter and the liabilities imposed on promoters. As a result, if the legislation is to continue to recognise the role of a "promoter" and impose disclosure obligations (and corresponding liabilities on promoters), a clearer statutory prescription that better matchesthe liabilities to the role undertaken by such a party is desirable. For example:

- matching the role of the promoter of a IPO by secondary sale – such as the exit by a private equity fund – with the role undertaken by that party in the IPO; and
- dealing with the issue of entities that lend their brand to certain securities offerings (i.e., the white label example).

6.2 Experts

The definition of experts and the boundaries that apply to the use of expert opinion are difficult to apply. As a result, even if the expert-specific requirements were to be removed and the law applying to misleading and deceptive conduct applied, misstatement by an expert may need to be either a subset of that existing standard or be the subject of more detailed regulatory guidance.

6.3 Celebrity endorsement

There does not appear to be a pressing need for the regulation of celebrity endorsements. Instead, market conditions and recent developments should have greatly reduced the incidence of such advertising.

Section 7 – Advertising

7.1 Pre-prospectus publicity

A checklist approach is preferable (i.e. a list of matters that may be included – but are not compulsory). Additional flexibility around securities advertising may be necessary if offer documents are more constrained. It may be preferable to achieve this by regulation to achieve greater flexibility. Banning powers should not be the sole means of policing.

7.2 Advertisements generally

7.2.2 General redrafting

The second of the over-arching principles noted in paragraph 223 should specifically require that advertising should not be inconsistent with material deposited on the Register of Securities.

There is also a need for clarity and relevance in this area of regulation. At present the treatment of investment statements as advertisements (needing to be certified) is unnecessary. Certification generally also appears unnecessary where the issuer and its directors are liable for the failure of advertisements to meet the prescribed standards.

7.2.3 Definition of advertisement
There are practical difficulties associated with the current definition of “advertisement”. For this reason, there should be a distinction between all forms of communication and narrower forms of specific "advertisements". There is a need to make the demarcation between "public" and "private" communications clearer, both in terms of the audience and content (so that the treatment of many forms of routine customer communications including, for example, a newsletter to existing investors is clearer).

Having made that distinction, there may not be:

- an adequate case made for different compliance obligations (or liabilities) – having published an advertisement is it likely that the issuer may have an onus of proof reversed (perhaps having to respond to a complaint by proving it was not misleading?); and

- a need for an investor to have to prove that other forms of communication were (i) made; and (ii) misleading?

Chapter 4 – Collective Investment Schemes

Section 2 – Status quo and problem definition

2.3 Problems with the current regime
A number of market conditions in New Zealand (including small size, lack of investor education and absence of sufficient analyst coverage) may mean that the market is not sufficiently well-informed or sophisticated to make meaningful comparisons without the involvement of a regulatory model that imposes uniform minimum standards across all types of offering – particularly in those areas where the differences between offerings represent material differences in the risk to the investor.

There are a number of examples of problems associated with different types of collective investment schemes that tend to support the issues highlighted in the discussion paper. Each of the types of collective investment scheme seems to have shortcomings. The most common criticism of those other than corporate vehicles (which have an independently minded governance structure) is that the incentives for different activities often mean that there is a mismatch of incentives for the manager when compared with the investor. These mismatches have been highlighted as a result of the current financial climate, which has provided ammunition for those who argue that the management of some schemes have pursued activities that stood to benefit the manager but exposed the investors to a great degree of risk. It may not be possible to legislate against the risk of such outcomes; there should be better disclosure and greater opportunities for investors to address these problems and thereby re-balance risk / reward equations. Indeed, some recent high-profile examples involving unit trusts and a property investment vehicle would indicate that there is greater willingness for investors to seek to address these problems when they become apparent.

Generally, amongst the range of possible alternative structures, unit trusts seem to be better understood, more common and have more benchmarks, particularly against overseas models. That is not to say that the present legislative framework regulating unit trusts is not in need of

refinement. Indeed, the prevalence of unit trusts when compared to other formats may mean that it is market forces rather than a superior legislative framework that is providing better protections for investors and (arguably) better alignments of interest between the manager and investors.

Section 4 – Proposals for reform

4.2 Registration
The use of common yardsticks should ensure that the costs of applying regulatory criteria are as low as possible. Much of the cost is already inherent in the existing structure in the sense that it is typically the trustee who is conducting health checks on constitutional documents and passing the costs of the health check on to the manager (which, in turn, passes them on to investors).

4.4 Licensing of fund managers
The benefits of licensing fund managers are unlikely to outweigh the costs of imposing these requirements on what is still a relatively small and developing industry. Such a licensing regime may simply cause distortions by driving investment into other areas where such costs are not imposed. For example, it may reduce the number of managed funds and cause entities that might otherwise promote new managed funds to look at other investment vehicles – such as return to the listed investment companies that were a feature of the 1980s.

An alternative approach may be to seek to achieve uniform disclosure against a common set of criteria to ensure that investors are adequately informed about the differences between different funds managers and collective investment schemes.

Rather than extended licensing requirements and fit and proper persons hurdles, a more scale-appropriate alternative may be to require better disclosure of items relating to management of the scheme against a uniform set of measurement criteria. This may include details of the management team as an alternative to regulatory supervision of the attributes of management.

It follows from the above comments that issues of costs and scale are likely to require a number of the issues that are addressed as a licensing requirement in Australia, to become a matter for the trustee or other statutory supervisor. In this regard, the FMA may be able to work with industry bodies to develop a set of industry criteria which could also be used as a basis of disclosure – on an "if not, why not" basis.

<u>Chapter 5 – Other matters</u>

Section 3 – Securities markets

3.2 Access to securities registers
The concern about access to securities registers for improper purposes is not so much in respect of 'predatory' offers for securities as cases where registers have been accessed for purposes other than those for which they were established. The risk associated with 'predatory' offers is likely to be addressed by normal market responses. By contrast, information privacy principles are unlikely to provide a complete answer to use of registers for a variety of other purposes, ranging from soliciting money for worthy causes to the now defunct finance company that, we understand, used this method to develop a marketing database.

The legislative proposals in Australia in this area are worthy of consideration, although it will be necessary to await the final outcome of the Australian Securities and Investments Commission (ASIC) review.

Section 4 – Financial Markets Authority

4.1 Guidance and certainty

Binding rulings
The idea that the FMA, as primary regulator, should have the power to make binding rulings has some immediate appeal in terms of the ability to provide greater certainty. However, in addition to the concerns expressed in the discussion paper about the exercise of such a (quasi-judicial) function, the practical experiences of dealing with IRD rulings indicate that the need for speed and certainty when faced with the demands of the very fluid environment in which capital markets transactions often take place, lead to the conclusion that something short of a binding rulings facility may provide a better alternative.

For example, greater use of guidance notes and interpretations such as those published by ASIC or the Takeovers Panel, and the ability of the FMA to issue 'no action' letters, may provide greater comfort in a wider variety of circumstances than might be achievable with a rulings mechanism.

Providing for the Rulings Panel to deal with NZX rules, to make rulings on cases stated might also be useful – perhaps in cases where an industry-wide approach is required. An example might be the subject matter of the Securities Commission's recent guidance note on the application of the Securities Markets Act to certain commodities futures contacts.

Retrospective exemptions
There have been instances when it would have been useful to be able to seek a retrospective tidy-up of small (administrative) matters. On balance, however, it is preferable for a Court to determine whether an otherwise invalid allotment should be validated – rather than arguing that securities issues should also be capable of being subject to the same powers that are granted to the Takeovers Panel.

No action letters
The FMA should have the power to issue 'no action' letters and this power should be specified in legislation (including the effect of such a letter). In this regard, we note the view expressed in the discussion paper that the Securities Act currently enables the Commission to issue such letters.

Again, in the interests of efficiency and certainty, it is suggested that such a power should be specifically added to the armoury of the FMA.

Gazetting of exemption notices
Individual (product) exemptions should be capable of coming into effect as soon as the FMA has made a determination. The current process with the delays associated with the review by Parliamentary Counsel and Gazettal itself, is often a source of frustration.

It would be desirable to achieve the same speed and efficiency with which ASIC provides declarations and other forms of relief for specific issues or issuers.

4.2 Authority's power to bring proceedings

Validity of settlements – Member's Bill
Where a breach has been claimed and an issuer makes a commercial decision to offer a settlement, it should be able to do so on a basis that is full and final. Without the necessary certainty that such an offer (if accepted) brings closure it is likely that settlements will be discouraged, with resulting cost to all parties and the system.

Section 5 – Director duties, management bans and bankruptcy

5.2 Management bans
There are concerns that the application of management bans is not taking some 'commercial hazards' out of circulation for sufficiently long periods. There should be scope for imposing more lengthy bans for extreme behaviour. As a result, the following would be desirable:

- scope for seeking a longer ban (on top of a base-level 5-year disqualification) by enabling the FMA to apply to the Court to extend such a ban; and

- scope for longer bans for some types of disqualifying behaviours.

5.3 Culpable bankrupts
For the same reason, there should be powers (for the Official Assignee) to seek to extend the term of bankruptcy of culpable bankrupts, and the onus of proof for demonstrating that a person who has been bankrupted on multiple occasions should be discharged should rest with the bankrupt.

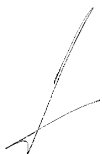
Section 6 – Enforcement

6.1 Infringement notices / administrative penalties
Infringement fines are of limited use in the context of (typically) high-value capital markets activities. In short, the administrative burden of imposing such 'speeding tickets' is likely to be out of all proportion to the benefits to be gained in terms of precedent value or behaviour modification.

An administrative penalty regime is likely to make more progress in achieving the desired outcomes. However, it is more important to provide the FMA with appropriate powers to pursue enforcement through the courts.

This submission was drafted with the assistance of the Society's Commercial and Business Law Committee. For further information about the submission, please contact the Committee's secretary, Vicky Stanbridge (NZLS Legal Affairs Department, ph (04) 463 2912 or vicky.stanbridge@lawsociety.org.nz).

Yours sincerely



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