CHAPMAN TRIPP

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Dear Bryan

SUPPLEMENTARY SUBMISSION ON FINANCIAL MARKETS CONDUCT BILL

1 I have set out in the Schedule to this letter additional points to supplement Chapman Tripp's submission on the exposure draft of the Financial Markets Conduct Bill dated 6 September 2011.

2 I have covered a number of matters we discussed at our meeting on 23 August 2011, although some of the points reflect my further consideration.

3 As I am overseas for the next few weeks, I will have limited opportunity to discuss these points, but I may be able to clarify any comments by e-mail.

Yours sincerely

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SCHEDULE: SUPPLEMENTARY SUBMISSIONS

Clause Number	Clause heading	Submission
Clause 1	Title	The title does not currently reflect the central focus on financial products, as well as financial markets, and would be more accurately expanded to the "**Financial *Products and* Markets Act**".
Clause 2	Commencement	Subparts 2,3,4, and 5 of Part 8 should also commence from the Royal Assent date so FMA can commence work making exemptions, designating securities as financial products (or re-designating them), and making frameworks, before other Parts commence.
Part 1	***Preliminary provisions***	
New clause 5A	Extraterritoriality	The Act could usefully have a clause in the overview signposting where the Act has exterritorial effect provisions. For example: **5A Territorial effect** Generally this Act applies to conduct in New Zealand. However (a) *see* section 23 which extends Part 2 (general prohibition on misleading conduct) to conduct outside New Zealand by a person resident, incorporated or carrying on business in New Zealand (b) *see* section 31 which extends Part 3 (product disclosure) regardless where issues or transfers occur or where the issuer or offeror is resident, incorporated, or carries on business. etc.
Clause 6	**acquire**	For symmetry with **dispose of** the definition should include "taking a transfer of"
Clause 6	**agreement**	This extension beyond the usual meaning (i.e. a contract) should be deleted and replaced with additional words in the relatively few contexts where an extended meaning is appropriate (e.g. section 214(2) defining **relevant interest**). By contrast, in the section 6 definition of **governing document** the usual meaning is more appropriate; in section 230(c) (insider trading exception for pre-bid agreements) an enforceable contractual agreement should be required before the exception applies. If the rationale for the extended meaning was to broaden arrangements captured as derivatives, then section 8 could contain an extended meaning for that section only. Alternatively the word arrangement, rather than agreement, could be used in the derivatives definition as is the approach in s 761D Corporations Act 2001.
Clause 6	**company**	The definition would be better spelt out in full, rather than cross-referenced to the Companies Act 1993. In addition, overseas limited partnerships (as defined in the Limited Partnerships Act 2008) should be excluded from those bodies corporate incorporated outside New Zealand to be treated as companies, as they would be better treated as managed investment schemes for consistency with the application of the Act to New Zealand limited partnerships.

Clause Number	Clause heading	Submission
Clause 6	**continuous issue PDS**	The words "for subscription" are surplus and should be omitted, including because they do not easily fit derivatives. This definition would become unnecessary if our submission to abandon the "waiting period" regime is accepted.
Clause 6	**employee share purchase scheme**	Change "any of its subsidiaries" to "any related body corporate" [i.e. as defined in s 11(2)], to also covers situations where the parent entity, or a sister entity, of the issuer employees the relevant individual.
Clause 6	**governing document**	Paragraph (a) should be expanded to include "or (in the case of redeemable shares) the constitution or terms of issue governing the terms of such shares."
Clause 6	**security**	Additional sub-paragraphs (iii) and (iv) should be included to track the essential elements of the debt security definition, and to include renewals and variations (see also definition of **security** in s 2 Securities Markets Act 1988) to enhance the broad definition that sets parameters for when FMA can designate: (iii) a right to be repaid money or paid interest on money that is, or is to be, deposited with, lent to, or otherwise owing by any person (iv) any renewal or variation of the terms or conditions of any existing security; but Note, unlike section 8, sub-paragraph (iii) should adopt the broader definition of money to include money's worth, so the FMA could designate broader arrangements as debt securities in appropriate circumstances.
Clause 6	**subscribe**	This definition should be deleted, as the word **acquire** should be used in its place in the Act (except where the words are redundant – see comment on **continuous issue PDS** above.
Clause 8	**debt security**	Paragraph (b)(iii) should omit a redeemable share which is redeemable *only* at the option of the issuer, since such shares are more appropriately treated as equity securities (the word only is important as some preference shares may be redeemed in a range of ways).
Clause 8	**derivative**	Clause 8 does not include an equivalent exception to section 761D(1)(b) of the Corporations Act 2001, read together with Regulation 7.1.04(1) Corporations Act 2001, the effect of which is to exclude spot transactions (including FX transactions) with a settlement date a short time after the transaction date. It may be preferable to directly exclude such transactions e.g. by inserting an additional subparagraph (c)(ia): (ia) a contract to exchange one currency (whether in New Zealand dollars or not) for another currency that is to be settled immediately or within two days of the contract.

Clause Number	Clause heading	Submission
Clause 10	**issued**	Clause 10(1)(b)(ii) delete the words "building society, or other entity" and replace with "or building society", as the definition of equity security is limited to the three corporate forms identified (with an extended definition of company). Note, if (alternatively) the definition of "equity security" were to be expanded to other entities then it would treat an incorporated limited partnership as equity rather than a managed investment scheme, given the priorities in clause 7.
Part 3 and schedules 1 and 2	**Disclosure offers of financial products**	
General comment	Initial product disclosure	Generally, the provisions on initial product disclosure are overly prescriptive and several aspects copied from the Australian prescription would be better deleted and left to regulations if truly warranted. In several cases the general prohibition on misleading conduct will apply in any event. e.g. Provisions on issuers that do not exist, quotation statements, expiry date, and pre-offer publicity. It is interesting to contrast the numerous sections on initial product disclosure with the four clauses on on-going disclosure, which in the new framework requiring greater on-going disclosure may be just as important as the initial point of sale disclosure, particularly for managed funds and derivatives but also some debt securities.
General comment	Terminology	Varying expressions are used throughout Part 3 where "an offeror" could be used more simply (particularly since the definition of offeror covers both secondary sellers to which Part 2 of Schedule 1 applies, as well as an issuer). For example "A person who makes an offer…" (clauses 34, 35, 36, 37) should be "an offeror…" "If a person makes an offer…" (clause 48) should be "If an offeror…" "A person must not …" (clauses 68, 69, 71) should be "An offeror must not …" "A person does not" (clause 79) should be "An offeror does not"
Clauses 28-29	Treatment of options/convertibles	As noted in our 6 September submission, option c described at paragraph 76 of the discussion paper is the most appropriate – this would seem to require amendment to clause 28(1)(a) to provide in similar terms to clause 29. However it should not be necessary to maintain an evergreen PDS; instead regulations could be prescribed under subpart 4 requiring the most recent financial statements to have been made available (e.g. via an Internet website and on the register) prior to the exercise date/any conversion decision.
Clause 32	PDS must be prepared and lodged	The words "distribute an application form" should be expanded to "accept applications, distribute an application form, or issue securities", since in some offers applications may be accepted in a broader range of ways - e.g. through a website, intermediary, or by grant (of an option). This works correctly in clause 34.

<table>
<tr><th>Clause Number</th><th>Clause heading</th><th>Submission</th></tr>
<tr><td>Clause 33</td><td>Purpose of PDS and register entry</td><td>It would be preferable to use the defined term “retail investor” rather than the expression “prudent but non-expert person” given the disclosure regime takes a different approach from the failed investment statement/prospectus split, and there is no value using a different expression than that used elsewhere in the Bill.

It would be useful to add a subsection (2) and to amend the heading of clause 33 (by adding “and register entry”) to cross-reference the purpose of the register entry:

(2) see clause 2 of Schedule 2 for the purpose of a register entry</td></tr>
<tr><td>Clauses 39 and 40</td><td>Content of PDS and register entry</td><td>For the reasons discussed at our meeting on 23 August, set out in our submission dated 6 September, and our Brief Counsel Crime and punishment in the draft Financial Markets Conduct Bill, clauses 39 and 40 should provide more flexibility on the information required to be contained in the PDS for different products types.

There does not need to be a general material information disclosure standard prescribed in the Act at all.

If such a general disclosure standard is useful for equity or debt it could be addressed in relevant regulations. For derivatives and managed investment products a more directed disclosure regime is more appropriate in any event to more closely align with the Australian approach; otherwise issuers may prefer to lodge in Australia and offer into New Zealand under mutual recognition.

Also, given the PDS needs to be lodged with the Registrar (presumably for inclusion as one of the register entries – perhaps the Act could state that), clause 39(1)(a) is redundant.

Accordingly, the following changes should be made:
• delete clause 39(1(a)
• delete clause 39(2)
• delete clause 40.

For the regulations (rather than as clause 40), a preferred test would be one that more closely aligns with s 1013E of the Corporations Act 2011 – i.e. information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail investor, whether to acquire the product” – to the extent it is actually known by the issuer (see section 1013C(2) of the Corporations Act), and modified for the circumstances (see section 1013F(2) of the Corporations Act 2011). However paragraph (b) of the test currently set out in clause 40 is also a useful addition.

There is no reason why such a test modelled on the Australian funds/derivatives one could not also apply to New Zealand equity and debt issuance – there is no need to also refer to the investors professional advisers and limiting information to that actually known would reduce unnecessary due diligence required by the section 710 Corporations Act 2001 test.

A reworking of the test in regulations along the lines outlined could help achieve the main purpose of the Bill to develop New Zealand capital markets rather than risk capital flight to Australia through comparably unfavourable treatment of derivatives and managed</td></tr>
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Clause Number	Clause heading	Submission
		investment products.
Clause 41	Consents	As noted in our 6 September 2011 submission, clause 41 should be limited to consents of persons endorsing the offer, particular securities or issuer. Although the test has been copied from the Australian Corporations Act 2001, it does not currently reflect various class order exemptions to try to make the Australian requirement workable, particularly for credit ratings.
Clauses 45-46	Waiting period	In addition to our main submission discussion, deletion of the waiting period would reduce underwriting cost and facilitate listed issuers raising funds from a broader range of persons (as it would be more practicable to prepare a 'simplified disclosure prospectus' type PDS promptly following a wholesale offer placement), both of which would help achieve the purpose of developing New Zealand's capital markets.
Clause 55	Lodgement of consents	Paragraph (a) should be deleted and the clause limited to third party consents required by regulations (e.g. auditors, those endorsing the offer).
Clause 60	Quotation statements	This clause should be deleted and replaced with a simple requirement that any references to a licensed securities market or quotation of the financial product should be approved by the market licensee (i.e. as per regulation 39 of the Securities Regulations 2009). In any event, the consequence of non-compliance should not be to render the offer void.
Clause 64	Notification of disclosure deficiencies	Subsection (1) should refer to the issuer, not the offeror, since the issuer needs to prepare the PDS and maintain the register. Subsection (2) should be limited to the offeror (if different from the issuer), directors and those that have provided consents, for consistency with the February Cabinet paper decision that liability should fall primarily on the issuer and for the reasons explained in relation to clause 462 in our 6 September submission.
Clauses 65-66	Expiry date	This clause should be deleted, as the matter can be dealt with in regulations. A number of New Zealand offerors maintain 'evergreen' offer documents – e.g. co-operatives, employee share schemes, and there is no reason why the Act needs to curb the flexibility to do so.
Clauses 71-74	Pre-offer publicity	In addition to the general comments in our 6 September submission, clause 32 and Part 2 already provide sufficient restrictions on persons making misleading statements before preparation of a PDS. Clause 32 (in the expanded form suggested above) means offerors could not arrange for persons to pre-commit to accept the offer.
Clause 75	Post offer publicity	This section needs additional flexibility to cater for audio-visual advertisements (the current regime has required exemptions to be made that should be incorporated into the primary legislation).
Schedule 1, clause 8	Employee share schemes	The exemption should extend to a broader range of 'eligible persons' in the Securities Act (Employee Share Purchase Schemes—Listed Companies) Exemption Notice 2011 – i.e. persons providing personal services as contractors (not just employees), companies controlled by the employee, or family trusts for the benefit of the employee.

Clause Number	Clause heading	Submission
Schedule 1, clauses 29-31	Sales	As a general comment, the existing s 6(3) Securities Act 1978 provision is limited to equity securities (and s 6(3A) to sales by associates of the supervisor of a managed fund), and the Corporations Act 2001 provisions from which clauses 30 and 31 have been derived are limited to sales of equity and debt securities. The provisions do not have obvious application to managed investment products or derivatives but would be better directly excluded from such products – clause 28 is an adequate anti-avoidance provision.
Schedule 1, clause 29	Issuer involvement in sales, and exception for sales under pre-emptive rights	Clause 29 could be deleted given inclusion of the Corporations Act 'sale by controller' provisions. Alternatively Clause 29(2) should be amended to add the words "or governing documents of the issuer, or a pre-emptive rights agreement between product holders" after "constitution of the issuer" given the sale provisions extend beyond equity securities (e.g. governing documents for convertible notes may also contain pre-emptive right agreements) and that pre-emptive rights are often contain in shareholders' agreements (or limited partnership agreements) between holders instead of, or as well as, the issuer's constitution.
Part 5	**Dealing in financial products on markets**	
Clauses 211, 212	Material information	The words "or value" should **not** be included in the listed issuer information test. Given the New Zealand derivatives insider trading regime is (appropriately) limited to exchange traded derivatives, clause 211(2) should be amended to "price of quoted derivatives" rather than "value" and in clause 211(2) the words "or (in the case of derivatives) the value" should be deleted. The Securities Markets Act provisions were enacted prior to NZX establishing its derivatives market, so our recollection (as one of the experts consulted at the time) is that the same focus was not applied to removing the 'value' test for futures contracts when the 2006 securities trading law reforms were being finalised.
Clause 217	Situations not giving rise to relevant interests	Clause 217(d) should be amended to delete "members" and substitute "products holders". Clause 217(g) should be amended to substitute "product holder" for "member" and to add "or an agreement between product holders" after constitution to also cover shareholders' agreements where all holders have the same pre-emptive rights.
Clause 218	Insider trading	We are strongly of the view that the insider trading regime should not be extended to non-quoted securities, or OTC derivatives merely because the underlying is quoted – we think the Ministry made the correct policy choice in the 2006 reforms.
Clause 220	Tipping to hold	In addition to not carrying forward section 8D(b) of the Securities Markets Act 1988, the words "or hold" should be deleted from clauses 220(1)(b) and 220(2)(b) – the recipient of disclosed information will be restricted from tipping to hold by clause 221 but the discloser should not also be liable.
Clause 225	PDS preparation	This exception is appropriate, particularly given inclusion of the 'sale by controller' provisions in Schedule 1.

Clause Number	Clause heading	Submission
Clause 231	Takeovers exception	The words "a confidentiality agreement" should be replaced by "confidentiality requirements" in clause 231(2)(a) – it should not be necessary for advisers etc. to sign confidentiality agreements if already covered by duties of confidentiality to their clients – i.e. the fact of confidentiality rather than the form of it is what should be important under the section.
Clause 235	Research defence	Given the very narrow ambit of the exception, and that such information will probably already fall within clause 212(b) or (c), the defence is not needed except perhaps as a safe harbour for analysts where there may be some doubt about the ambit of s 212 (see the *R* v *Firns* litigation).
Clause 240	Information based manipulation	Clause 240(c) should be omitted given the preferred focus on quoted price of derivatives.
Clauses 253 and 254	Failure to comply with substantial product holder regime	Although more serious infringements are adequately sanctioned through the civil penalty provision, consider adding a tier-1 infringement for more practicable enforcement of less material infringements, such as late filings by fund managers – see section 35BA of the Securities Markets Act 1988 which is included as well as the civil remedies.
New clause 265A	Exception for overseas listed issuers	The exception contained in clause 16 of the Securities Markets (Substantial Security Holders) Regulations 2007 should be included in the primary legislation (although the word "incorporated" should be substituted for "registered" as strictly primarily overseas listed issuers should be registered as overseas companies under the Companies Act 1993 as they will maintain a branch share register in New Zealand). A mechanism would be needed to add to the excluded jurisdictions as required (in practice Australia and the UK are the most prevalent ones).
Clause 270	Register of substantial product holders	Clause 270(3) should be deleted – the other register provisions are not as prescriptive as to require an alphabetical order and chronological index.
Clause 274	Publication of substantial product holders	Clause 274 should not require a s 209 Companies Act 1993 notice to also refer to the substantial product holders – inclusion in the annual report provided to those that request one should be sufficient – the information is not material as it has already been disclosed to the licensed market and will often be rendered out of date by further notices after the record date (query deleting the section in entirety).
Clause 278	Director and senior manager disclosure	We support the narrowed application of the director and senior manager disclosure regime, through the focus on senior managers rather than 'officers' and to quoted financial products for which they may be information insiders. The regime should be further narrowed by removing the requirement to disclose in respect of quoted financial products of related bodies corporate – this unnecessarily requires directors or senior managers of special purpose debt issuers to make disclosures in respect of listed shares of the parent in circumstances where the managers are not otherwise directors, nor qualify as senior managers, of the listed parent. The Australian regime does not extend to related bodies corporate and in our view the extension generates compliance costs and does not serve the purposes of clause 277.

Clause Number	Clause heading	Submission

283A	Additional exemptions	We agree it would be worthwhile to incorporate additional exemptions for off-exchange transactions of the kinds reflected in Regulations 18 and 20 of the Securities Markets (Disclosure of Relevant Interests by Directors and Officers) Regulations 2003 and clauses 13 and 14 of the Securities Markets Act (Disclosure of Relevant Interests by Directors and Officers) Exemption Notice 2004. However we suggest:
		• that the conditions of exemption be simplified by simply extending the timeframe for compliance to 30 days after completion of the relevant transaction, rather than once each month
		• extending the exemptions to other common off-market transactions that have broad application, specifically:
		  • issues of quoted financial products pursuant to an amalgamation under Part 13 Companies Act 1993,
		issues, or cancellations, of quoted financial products under scheme of arrangement under Part 15 of the Companies Act 1993
		  • issues pursuant to a rights issue, or entitlement issue, of share or unit purchase plan.

Part 7	**Enforcement and liability**	
Clause 432	Directors treated as contravening	It is not clear this clause is needed, given the wide definition of "contravene". If the clause is retained, clause 432(a) should require the director's actual approval and knowledge of the relevant act or omission – the current language could cover decisions made by company officers under general delegation (an authority, permission) without the director being actively involved in the contravention.
Clause 462	Scope of liability for compensation	As outlined in our 6 September submissions, the scope of liability is inconsistent with the February Cabinet decision to make the issuer primarily liable for product disclosure contraventions, will undermine the purpose of developing New Zealand's capital markets, including through increased compliance cost, underwriting costs, insurance premia, and unnecessary conservatism on the part of issuer officers and professional advisers. The inclusion of underwriters does not reflect New Zealand market practice of those entities actually involved in issuance, and will increase underwriting cost or reduce availability of underwriting. A preferred approach would be: • delete clause 462(b)(i)-(iv) and substitute "the offeror(s)" • delete clause 462(c)(i)-(ii) and substitute "the issuer" • delete clause 462(d)(i)-(ii) and substitute "the licensee" • delete clause 462(e)(i)-(ii) and substitute "the person who provides the disclosure document" • include a provision equivalent to s 1016F(2) Corporations Act 2001, to deal with "shell company" risk • if considered necessary for deterrence, retain the civil pecuniary penalty to those that "contravene" clause 63, 83 or clause 25 of Schedule 1 • delete clause 462(5).

Clause Number	Clause heading	Submission
465	Due diligence	Clause 465 should be retained, although offerors should not need to have as much recourse to it if the suggested changes to clause 462 are made. It will still have its place, particularly for offerors less closely involved in preparation of the PDS.
478	Criminal offence for reckless contravention of point of sale disclosure	Given the extended definition of "contravene", for consistency with the February Cabinet decision to limit criminal liability to directors, "A person" should read "A director" and "the person" should read "the director". Alternatively, this section could have the extended meaning of "director" as clause 480(5).
479	Criminal offence for reckless contravention of on-going	As with clause 478, "A person" should read "A director" and "the person" should read "the director"
489	Auditor indemnities	The policy rationale for carrying forward the prohibition on issuers indemnifying auditors is not obvious. In practice, issuers sometimes seek to disclose historical audited financial statements for periods when the entity was not an issuer and the auditor was not paid a fee commensurate for the additional risk taken on for a public issue.
Part 8	**Regulations and exemptions**	
527	Offence for breach of mutual recognition regime	Section 527(c) should be deleted, given the Act will not carry forward the "promoter" concept.
Part 9 and schedule 4	**Miscellaneous provisions**	
Subparts 2 to 10	Amendments, consequential amendments and transitional provisions	As discussed, we suggest enactment of the amendments to other Acts and Regulations, and the transitional provisions, be shifted into a distinct Part that will become a separate Act - given the 'one-off' nature of the provisions, or limited duration of them , will avoid 'cluttering' the statue of on-going application. In our view this worked well for the Company Law Reform (Transitional Provisions) Act 1994.
Clause 553	Amendment to section 5A Fair Trading Act 1986	Section 5A should also exclude conduct that contravenes Part 3 of the Act (dealing with product disclosure), Part 5 of the Act (dealing with misleading conduct in relation to the secondary market), and sections 34 and 77L of the Financial Advisers Act 2008 (dealing with misleading conduct by financial advisers)
Clause 555	Interpretation	The definition of "promoter" should be deleted and section 18(1)(a)(ii) amended by deleting the reference to "a promoter" and substituting "a related body corporate of the QFE", given the Act will not carry forward the "promoter concept" and the suggested change will pick-up product issuers within the same corporate group as a QFE. Delete reference to "or promoter" in sections 137D(b) and 137N(b).
Clauses 572, 574, 575 and 576	Transitional period for product disclosure	A 12 month transitional period (for issuers to elect to continue to comply with the 1978 Act) would be more suitable given the extent of change (generally a 6 month transition has applied to regulation changes although the transition on commencement of the Securities Regulations 2009 was also longer).

Clause Number	Clause heading	Submission
Schedule 4, Part 1	Financial Reporting Act – section 6(f)	Section 6(f) and(g) should be substituted with sections that reads: (f) a company within the meaning of section 2(1) of the Companies Act 1993 that does not have more than 25 shareholders *or more than 25 share parcels* and that would, but for this section, be an issuer by reason only of the allotment of equity securities. (g) an issuer (within the meaning of the [Financial Products and Markets Conduct Act 2011] that has less than 25 financial product holders with an address on the register in New Zealand. The reference to share parcels is consistent with the proposed amendments to the meaning of **code company** by the Regulatory Reform Bill (to clarify that joint holdings get counted as one holding). The proposed paragraph(g) will mean that overseas issuers with relatively few product holders with a registered address in New Zealand will not need to comply with the Financial Reporting Act.
Schedule 4, Part 1	Financial Service Providers (Registration and Dispute Resolution) Act 2008) – sections 5(i), (ia) 48(3)	Section 5(i) should be deleted (and section 5(ia) renumbered 5(i). It should not be necessary for offerors to register under the FSPA – the issuer will need to be under the text of proposed section 5(ia) in any event (which is appropriate) – an offeror may simply be such as a 'one-off' Sale transaction under Part 2 of Schedule 1. The amendment to section 48(3) should read: "(3) However this obligation does not apply to a financial service provider in relation to providing a financial service referred to in **section 5(i)** merely because it provides only that service." This change would mean that special purpose issuers (common for debt) would not need to join a dispute resolution scheme (it may not have any business otherwise than raising money as a conduit issuer and advancing the proceeds to other members of the group). Also, it is odd to describe issuing securities as a "business".