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Financial Markets Conduct Bill

With a focus on the Exclusions

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April 2012

Overview of FMC Bill

Replaces financial market conduct regulation in number of statutes including Securities Act, Securities Markets Act, Unit Trusts Act

Financial Products Covered

- Consolidates categories of securities into debt, equity, managed investment products and derivatives
- Treatment based on underlying substance, removes cross-over risk
- Only products which are "investment products" or products to manage financial risk will be caught by the regulatory net

Misleading and Deceptive Conduct

- Incorporates general prohibitions from Fair Trading Act on misleading and deceptive conduct / representations

Overview of FMC Bill

Disclosure and Exclusions

- Approach to disclosure
 - a product disclosure statement (**PDS**) containing only information considered crucial to the investment decision; and
 - a public register containing all the other required information about the offer that does not fit in the PDS
- Substantially reworks the existing disclosure exclusions

Overview of FMC Bill

Governance

- The Bill rationalises the governance requirements for unit trusts, superannuation schemes, Kiwisaver schemes and life insurance policies into a single category known as **managed investment schemes** and applies a “one size fits all” regime
- *Key points – debt securities*
 - Trust deeds to comply with certain content requirements
 - Supervisor has prescribed functions (eg supervise issuer’s performance)
 - Supervisor subject to fiduciary style duties / std of care
 - Issuer has reporting duties to supervisor – including contraventions and financial problems
 - Related party transactions generally prohibited

Overview of FMC Bill

- *Key points – managed investment products*
 - Schemes must be registered and meet specific registration requirements regarding governance, supervisor etc
 - Governing documents to comply with certain content requirements
 - Role of manager and supervisor set out, including duties to scheme participants of a fiduciary nature
 - Related party transactions generally prohibited

Overview of FMC Bill

- Limited changes to insider trading, market manipulation, substantial security holders regimes, and directors and [senior manager] disclosure
- Deals with licensing and regulation of markets and providers of market services (eg registration of managers and trustees)

Overview of FMC Bill

- Enforcement and Liability
 - Introduces concept of infringement notices for minor breaches
 - Gives FMA right to issue stop orders and direction orders to prevent non-compliance
 - Increased emphasis on civil liability incl. FMA right to seek pecuniary penalties
 - Declaration of contravention – presumption misstatement caused decline in value – no need to prove reliance. Removes a substantial barrier to claims
 - Pecuniary penalty order – shift from cap of \$500k to greater of consideration / three times loss or gain / \$1million
 - Compensation orders
 - Other civil rights eg cancellation of agreements etc

Overview of FMC Bill

- Criminal regime largely restricted to egregious offences involving knowledge or recklessness (move away from strict liability)
- Maximum penalty increased from \$500k and three years jail to \$1million and 10 years
- Banning orders included

The Exclusions Regime

- Overview
 - Current regime
 - NZVCA submissions
 - Proposed exclusions

Current Regime

- Overarching requirement that an offer of securities must be ‘to the public’ before it will fall within the regulatory net
- Current exclusions include:
 - habitual investors
 - close business associates or relatives
 - offers over \$500,000
 - eligible investor category (ie. ‘wealthy’ or ‘experienced’)
 - those selected ‘other than members of the public’
 - various specific exemption notices (such as for employee share schemes)

Current regime – some problems

- Lack of definition:
 - offer to the public
 - habitual investor
 - close business associates
 - persons selected otherwise than members of the public
- Certification regime for experienced investors provided no safe harbour – if the certification was not based on reasonable grounds, it was not effective

NZVCA Engagement

- Extensive engagement by NZVCA with CMDTF and MED
 - Focus on:
 - identifying ways to facilitate efficient and cost effective capital raising
 - facilitation of employee incentivisation
 - ease of access to capital for the private capital markets
- and therefore:
- clarification of existing exemptions including bright line tests
 - self-certification
 - a small-scale offer exemption (like the Australia 20/12 rule)
 - changes to the regime to ensure that entire offers were not voidable on account of an ineligible investor being allotted with securities

Draft Bill: Outline of Changes

- Exclusions apply for:
 - investors considered capable of accessing the information they need (for example, due to their size and experience or their relationship with the issuer)
 - small offers of debt and equity (for example, through angel networks)
 - employee share purchase schemes

MED: Outline of Changes

- Overview of key changes
 - More bright line tests
 - Self certification with safe harbours
 - Small offers exemption
 - Clarity around offers to controlled entities (eg use of personal trusts and companies to hold investments)
 - Provision for prescribed disclosure for certain types of excluded offers
 - Offer not void where incorrect application of exclusions to single investor –refund and compensation available to affected investor only

New Regime

Wholesale investors exclusion:

- **Investment businesses:**
 - The principal business is investment or providing certain classes of investment advice / banks / insurers etc
- **Defined investment activity criteria:** An investor must meet at least two of the five criteria:
 - portfolio of at least \$1 million
 - undertaking at least five transactions over \$100,000 over the last two years or 10 of over \$20,000;
 - Net assets of \$2m or \$200,000 income
 - Previous employment with investment business
- **Large businesses:** Businesses with assets exceeding \$10 million or turnover exceeding \$20 million

Self certification safe harbour provided.

New Regime

- **Large subscriptions:** The previous carve out for investors subscribing for financial products worth more than \$500,000 has been extended to encompass amounts previously subscribed for from the same issuer for the same class of investment products
- **Eligible investors (experienced):**
 - self certification of financial literacy (ie. acknowledge that they understand the merits and risks of the transaction, their information needs and adequacy of information provided by the issuer)
 - grounds identified
 - financial advisor, chartered accountant or solicitor confirms investor has been sufficiently advised of the certification and has no reason to believe certification incorrect
 - Safe harbour provided to issuer so long as no reasons to believe experience or certification incorrect

New Regime

- **Close Business Associates:** The associates exclusion now contains both a general test and specific bright line tests:
 - **General test:** A person with a close business relationship with the issuer, allowing that person to assess the merits and adequacy of information received
 - **Bright line tests:** Close business associates include:
 - directors and senior managers of the issuer
 - those holding over 5% of an issuer's voting products
 - relatives (including wider family)

New Regime

- **Small Offers:** A 20/12 exclusion has been introduced which enables:
 - an offer of securities
 - to no more than 20 investors
 - in any 12 month period
 - subject to a cap of \$2 million
- Must be a “specified offer”: Made to persons:
 - with whom offeror has personal contact or professional or other connection; or
 - who have made statements of actions indicating they may be interested in offers of that kind – eg Angels; or
 - with income of more than \$200,000 pa

New Regime

- **Controlling Interest:**
 - acquisitions of more than 50% of an entity's voting products where there are less than five investors, subject to those people being in a position to obtain the information necessary to assess the merits of the offer and adequacy of information provided
- **Employee Share Schemes:**
 - offer made as part of remuneration arrangement
 - capital raising not primary purpose
 - scheme does not exceed 10% of the voting rights in the shares of the employer
- **No consideration:** exclusion created for offers of financial products for no consideration