BUDDLE FINDLAY

Legal update - Financial Markets Conduct Regulations - Licensing

23 October 2014

What's happening?

As mentioned in our previous updates the 'near-final' draft of the Financial Markets Conduct Regulations 2014 (Regulations) was released on 26 September 2014 to give market participants an opportunity to prepare for the full implementation of the Financial Markets Conduct Act 2013 (FMCA) on 1 December 2014. The Regulations will cover all aspects of the FMCA, and will replace the (more limited) Financial Markets Conduct (Phase 1) Regulations 2014.

This particular update is concerned with licensing obligations under the FMCA. Broadly speaking the general trend in our financial markets has been to move to a greater degree of licensing and supervision by the Financial Markets Authority (FMA) and other regulators, and the FMCA continues this trend.

Who will need to be licensed?

By way of background, once the FMCA is fully implemented there will be six categories of persons requiring licences as set out below, some new and some carried over from the existing regime.

Existing licensing: prescribed intermediary services - crowdfunding and peer-to-peer lending

From 1 April this year, crowdfunding and peer-to-peer lending both became "prescribed intermediary services" for the purposes of the FMCA, and market participants were eligible to apply for licences. Firms such as PledgeMe are now licensed to provide these services, enabling them to raise capital and facilitate lending without requiring securities law disclosure.

New licensing requirements

From 1 December 2014, the following persons will need to be licenced:

- Managers of registered schemes
- Independent trustees of registered schemes that are restricted schemes
- Derivative issuers
- Discretionary investment management services (DIMS) providers.

Fund managers

The FMCA has introduced a requirement for the managers of registered schemes - that is, managed investment schemes that are registered for the purpose of making regulated offers to retail investors - to hold a market services licence. As we have previously noted, this obligation only applies to issuers who choose to adjust to the new regime by offering their products under the FMCA, rather than the Securities Act 1978 (while issuers continue to offer their products under the Securities Act 1978, the FMCA does not apply). For this reason, issuers will have up to two years to obtain their licences from the FMA, depending on when they wish to begin offering under the new legislation.

Independent trustees

Independent trustees are a new category of licensed person under the FMCA. Under the FMCA KiwiSaver schemes and superannuation schemes will be rolled into the general category of managed investment schemes and, as noted above, will require a licensed manager (as well as a licensed supervisor). In many cases however, these existing schemes do not separate the management and supervisory functions, but instead the trustee performs both. Therefore the requirement to appoint a manager and supervisor will potentially be burdensome for some.

The creation of the independent trustee role gives these schemes the option to avoid these requirements, by registering as "restricted schemes" under the FMCA and having an independent trustee in place of a manager and supervisor. The independent trustee will be an individual who is licensed by, and accountable to, the FMA. As with licensed managers, there will be a transitional period of up to two years for existing schemes to adjust to the new requirements.

Derivatives issuers

As we have commented previously, the full implementation of the FMCA will also mean the repeal of the Securities Markets Act 1988 (SMA), which will only remain in force for transitional purposes. Under the FMCA the current SMA concepts of "futures contracts" and "futures dealers" will be replaced with "derivatives" and "derivatives issuers". A derivatives issuer, defined under the FMCA as a person who is in the business of entering into derivatives, will need to hold a licence from the FMA if making regulated offers (that is, offers to retail investors).

On this basis persons who deal in derivatives will need to consider whether they require a licence under the FMCA. There are two forms of assistance provided. The FMCA itself contains a transitional provision, whereby persons authorised or approved under the SMA as futures dealers have the benefit of a transitional licence for a period of up to two years if they require it. Also, the Regulations have provided a grace period by delaying the implementation of the disclosure regime for derivatives for six months (that is, until 1 June 2015) or up to 12 months for persons with transitional licences.

DIMS providers

Another major shift of the FMCA is to introduce the concept of a corporate licence to provide DIMS. At present under the Financial Advisers Act 2008 (FAA) these services are carried on by authorised financial advisers (AFAs), who are natural persons. By introducing a DIMS licence as a category of licence this enables body corporates to provide these services. At the same time, the FAA will be amended to reduce the scope of services open to AFAs, so that only personalised DIMS can be provided. Again, as with the other categories of market service licence designated under Part 6, the Regulations have provided a transitional regime to assist AFAs who currently provide DIMS in adjusting to the new procedures.

What's new with the Regulations?

The Regulations provide more detail on the licensing process and supplement the provisions that are set out in Part 6 of the FMCA. In addition to the Regulations, the FMA has also published guides to the licensing process which provide a summary of the different obligations.

Although the licensing criteria vary for each of the different classes of market service licence, there are certain common elements:

- **Criteria set out in the FMCA itself** - these include the most important requirements - fitness and propriety of the would-be licensee and its directors and senior managers and capability to effectively perform the relevant market service or services
- **Additional eligibility requirements and conditions specified in the Regulations** - these are detailed in regulations 186 to 188 and 191 to 198 – there is a common standard condition for all classes of licensees to report specific events to the FMA (such as changes in directors, or pending litigation) and a range of specific eligibility criteria and conditions for different classes of licensees, for example, that independent trustees must report serious problems with the managed investment schemes they oversee to the FMA
- **Standard terms and conditions imposed by the FMA** - the Regulations also give the FMA the power to impose standard terms and conditions for different classes of licensees within quite broad parameters, for example, the FMA has published its proposed standard terms and conditions for derivatives issuers.
- **Additional conditions that may be imposed on specific licensees** - the FMA may also use its power to set conditions to impose specific conditions on particular applicants - this might be used as a "training wheels" approach to licensing a new market participant or the FMA may impose additional conditions on a licensee as a supervisory matter to deal with issues affecting that particular licensee - for example, restricting the scope of activities the licensee may provide while problems are dealt with.

While the requirements set out in the FMCA have remained constant, the additional detail in the Regulations and the FMA's updates have helped flesh out the details of what is required for a market services licence.

What should market participants do next?

We recommend that market participants should:

- As a first step, assess whether they will need to obtain a licence under Part 6 of the FMCA
- If they consider that they will require a licence, consider when they would like to transition to the new regime

- Review the Regulations and the FMA's guides to the licensing process for a summary of the matters that applicants will need to demonstrate to the FMA to obtain their licence.

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