BUDDLE FINDLAY

Legal update - Financial Markets Conduct Act

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Implementation starting on 1 April 2014 - what's happening when?

As we have previously advised, the Financial Markets Conduct Act 2013 (FMCA) will come into force in a two stage process, on 1 April and 1 December this year. There is a large volume of material for market participants to digest:

- The FMCA itself (and the related Financial Markets (Repeals and Amendments) Act 2013 (FMRAA) which contains amendments to other legislation)
- The different regulations and commencement orders that are needed to bring the new legislation into force, most importantly the Financial Markets Conduct (Phase 1) Regulations 2014 (FMC Regulations)
- The Financial Market Authority's (FMA) expectations for new market applicants.

The purpose of this update is to briefly summarise where we are, what's still to come, and what the new regime means for different categories of market participants.

What's coming in April?

In broad terms the following key provisions are being brought into force from 1 April 2014:

- Selected exclusions from the disclosure requirements which the Government announced last year:
  - small offers (the $2 million / 20 investors / 12 month cap)
  - employee share purchase schemes
  - offers by listed issuers of quoted securities
  - dividend reinvestment plans
  - certain products offered by registered banks (currency forwards and category 2 products)
- The ability for crowd funding providers and peer to peer lending providers to apply for licences from the FMA, and a corresponding exclusion under the disclosure regime to enable investors to use their services
- The "fair dealing provisions" in Part 2 of the FMCA
- Amendments to the Financial Advisers Act 2008 (FA Act) relating to custody obligations
- The new financial reporting regime under the FMCA and Financial Reporting Act 2013, replacing the Financial Reporting Act 1993
- Some of the enforcement provisions in Part 8 of the FMCA, insofar as they relate to those parts of the new legislation being brought into force in April (so not, for example, the provisions for defective disclosure under Part 3).

What's still to come?

Those provisions of the FMCA (and amendments to, and repeals of, other legislation under the FMRAA) that will not come into force in April are scheduled to come into force in December this year. These will include the new disclosure regime for financial products, rules regarding dealing on markets, and the full suite of licensing obligations.

During the course of 2014 we can expect to see further development work to prepare for the new regime, including further regulations from the Ministry of Business, Innovation and Employment and licensing criteria and standard conditions from the FMA.

To the extent that licensing and disclosure requirements are finalised some time before the December implementation date, the FMA may be willing to engage with market participants by considering licence applications or other matters prior to the official 'start date'.

What does it all mean for market participants?

Businesses considering making a small offer:

- The small offers exclusion in the FMCA is one of the 'fast tracked' exclusions and will come into force from 1 April 2014
- As with the other fast tracked exclusions it is being treated as an exemption from the Securities Act 1978 (SA) pending full FMCA implementation in December, exempting issuers from the obligation to register a prospectus and prepare an investment statement
- The exclusion will enable companies to offer equity or debt securities without the usual disclosure requirements - up to $2 million in value of shares or debt securities, in a 12 month period, to no more than 20 investors
- The $2 million value is a 'global limit', and funds raised using a crowd funding provider will also count towards this total - so if an issuer has raised $800,000 using a crowd funding provider it will be limited to $1.2 million under the small offers exclusion
- The FMCA imposes restrictions on the use of the small offers exclusion, most importantly limiting advertising and the pool of persons to whom offers can be made - in short, the small offers exclusion is not intended to be made to the general public, and is more suited to angel investors or trade participants.

Companies seeking to use employee share purchase schemes to reward and incentivise staff:

- The new exclusion for employee share purchase schemes (ESPSs) will also be fast-tracked - companies will be able to offer shares to employees, directors, or contractors, either of the company itself or of a subsidiary entity
- Issuers will need to provide a brief disclosure document outlining the details of the ESPS, copies of financial statements in the annual report for the issuer (or information on how these can be obtained), and a prescribed warning statement.

Listed issuers seeking to raise additional capital:

- From 1 April 2014 listed issuers will be able to make rights issues and other similar offers of securities of a class that is already quoted, using a "term sheet" type document
- This exclusion is subject to the class of securities in question having been quoted for at least three months, and the issuer being up to date with its continuous disclosure and financial reporting obligations.

Issuers wanting to offer dividend reinvestment plans:

- Issuers will also be able to offer equity securities or managed investment products to existing holders through dividend reinvestment plans
- Issuers will need to provide potential subscribers with details of the dividend plan, financial statements and their most recent report, or information on how these can be obtained.

Registered banks:

- Parts of the provisions of the exclusion for registered banks will come into force from 1 April 2014, and the scope of the exclusion has been clarified with the FMC Regulations
- The general exclusion for offers of debt securities by registered banks will not come into force until 1 December 2014, however from April 2014 the following products will be exempted:
    - category 2 products issued by registered banks (including bank term and on-call deposits)
    - certain classes of category 2 products issued by a subsidiary of a registered bank (call fund, PIE term fund units, and certain bank notice products)
    - currency forwards with a settlement date of 12 months or less.

Prospective crowd funding and peer to peer lending providers:

- Crowd funding and peer to peer lending are the two new activities which interested persons will be able to apply for licences for from 1 April 2014

- At the same time as these activities are brought into the FMCA regime, and the FMA becomes able to issue licences, exclusions will come into force for financial products offered through crowd funding providers and peer to peer lenders
- The effect of these changes is to enable licensed crowd funders and peer to peer lenders to offer shares (in the case of crowd funders) or debt securities (in the case of peer to peer lenders) without the standard disclosure requirements - in effect the protection for investors comes from the licensing process and supervisory regime, rather than through the standard disclosure regime
- The FMC Regulations give a broad outline of the requirements for persons wishing to be crowd funders, with further detail to come from the FMA
- Once one or more crowd funders have been licenced by the FMA and commence operation, persons seeking to raise small amounts of capital will have the option to do so via a crowd funding platform. They will be subject to a $2 million cap aggregating funds raised through intermediaries and the small offer exclusion, as described above.

Financial advisers and brokers:

- The FA Act will be amended to tighten broking requirements with effect from 1 April 2014, with new regulations setting out further detail - the Financial Advisers (Custodians of FMC Financial Products) Regulations 2014
- One exception to the tightened broking conditions coming into effect is the prohibition on brokers placing their own funds in client money accounts - this requirement will not be phased in until December 2014
- From 1 December 2014, the full suite of changes to the FA Act (as set out in Part 2 of the FMRAA) will come into effect
- These further changes in December 2014 will be largely focused on overhauling the FA Act provisions relating to Discretionary Investment Management Services (DIMS) and amending definitions and other provisions to ensure general consistency with the FMCA.

Discretionary Investment Management Services providers:

- From 1 December 2014 it will be possible for interested persons to apply for a market services licence under the FMCA as a DIMS provider - the same date that the FA Act is amended to tighten the provision of DIMS under that regime
- The effect of the new FMCA provisions, together with the amendments to the FA Act, will be to draw a distinction between personalised DIMS and class DIMS, with a market services licence under the FMCA being necessary to offer class DIMS to retail clients
- The licensing requirements have partly started to come into force with the FMC Regulations, but we are awaiting further decisions from the FMA as to the shape of the supervisory regime.

Issuers of financial products:

- The main disclosure regime under the FMCA is expected to come into force on 1 December 2014, with the product disclosure statement and register requirements to be settled during the course of 2014
- The FMCA provides a transitional regime for issuers, during which issuers may choose to comply with the SA instead of the new regime, giving them time to roll over their offering documents
- The FMCA provides for a 24 month transitional period for continuous offerors and persons who currently do not require a prospectus under the SA, and 12 months for other issuers.

Trustees and statutory supervisors:

- Trustees and statutory supervisors will continue to have a role under the FMCA, and will be required under Part 4 to exercise governance over registered managed investment schemes and regulated offers of securities debt securities
- As noted above with issuers, there will be a transitional period where new offers may still be made under the SA regime, potentially until December 2016
- For past offers, there will be a requirement to move to the new governance requirements under the FMCA, with a two year roll over period - trustees and statutory supervisors will have to consider the timing of this transitional process with issuers.

Fund managers:

- As of December 2014 acting as a manager of a registered managed investment scheme will be a regulated activity requiring a market services licence from the FMA, with the licensing requirements due to be finalised during the course of 2014
- This will be a new regulated activity in the New Zealand context, with no current general requirement for fund managers to be

licenced at present

- This new obligation will be linked to the introduction of the new disclosure regime - issuers will only need to have a licensed fund manager in place when they wish to begin offering managed investment products under the new legislation, and will not need to do so while they continue to use the former SA regime under the transitional provisions.

Derivatives issuers:

- Derivatives issuers will need to be licenced from December 2014 onwards - as with the other regulated activities the full details of the licensing regime will be finalised during the course of 2014
- The FMCA provides a transitional regime at Schedule 4 which will give all persons currently authorised or approved under the Securities Markets Act 1988 as futures dealers a two year interim licence
- Consequently the main consideration during 2014 for market participants who are not authorised or approved under the current regime will be deciding whether they will need a derivatives licence.

Past issuers of debt securities, managed investment products, and participatory securities:

- As noted above these persons will need to review their trust deeds and other governing documents over the two year period from December 2014 and consider whether amendments are required
- There will be some situations where people who have been required to comply with the requirements of the SA for offers of participatory securities will not have a managed investment product on their hands (typically for products giving a property interest but with no actual investment component, such as marina berth licences) and hence will not be subject to the FMCA regime - the FMCA offers an option to remove statutory supervisors in these cases.

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