

Legal update - Financial Markets Conduct Regulations - Financial product markets

13 November 2014

What's happening?

The final version of the Financial Markets Conduct Regulations 2014 (Regulations) were made by Order-in-Council on 3 November 2014 and notified in the Gazette on 4 November 2014, and can be accessed [online](#).

This particular update is concerned with financial product markets. At present the Securities Markets Act 1988 (SM Act) governs market misconduct and disclosure requirements, and the registration of securities exchanges and markets. The SM Act will be repealed on 1 December 2014. Part 5 of the Financial Markets Conduct Act 2013 (FMC Act) will replace the relevant provisions of the SM Act. For the sake of completeness we note that Part 5 of the FMC Act also provides for the transfer of transferable products (replacing the Securities Transfer Act 1991) and the regulation of unsolicited offers for off-market purchases of financial products, but this update will not focus on those provisions.

The Regulations are drafted to match the FMC Act, so Part 5 of the Regulations contains those regulations that provide more detail underlying Part 5 of the FMC Act.

How do the FMC Act and Regulations impact on secondary market disclosure requirements?

The SM Act sets out a range of disclosure obligations for listed entities ("public issuers") and associated persons:

- An obligation for public issuers to notify information in accordance with continuous disclosure requirements
- An obligation for holders of substantial interests in public issuers to declare their interests and any changes in those interests
- A similar obligation for directors and officers of public issuers to declare their interests in the public issuer and any changes in those interests.

These provisions are all substantively carried over into Part 5 of the FMC Act, at subparts 4, 5, and 6 respectively. The principal changes are to the nomenclature used - a "substantial security holder" under the SM Act becomes a "substantial product holder" under the FMC Act, for example. Similarly "public issuers" under the SM Act become "listed issuers" under the FMC Act. One substantive area of change is that the FMC Act provides that holdings of derivatives with a quoted underlying (for example, an option giving the ability to acquire a quoted share in a listed issuer) may be counted for the purpose of the FMC Act's disclosure requirements.

Generally speaking, however, as the SM Act provisions were themselves recently reviewed and amended in some cases (for example, by the Securities Markets Amendments Act 2011), these secondary market provisions have not been subject to the same degree of 'overhaul' as the disclosure and licensing regimes.

The Regulations support and give additional detail underlying these provisions. They mostly carry over the existing regulations that underpin the SM Act - the Securities Markets (Substantial Security Holders) Regulations 2007 and the Securities Markets (Disclosure of Relevant Interests by Directors and Officers) Regulations 2003.

How do the FMC Act and Regulations impact on market misconduct provisions?

In a similar manner to the secondary market disclosure provisions the market misconduct provisions, dealing with insider trading and market manipulation, are carried over from the SM Act to Part 5 of the FMC Act (in subparts 2 and 3 respectively). As with the disclosure related provisions for listed entities these are substantively untouched, with most of the changes reflecting the changes in nomenclature.

The Regulations provide detailed supporting provisions with regard to market manipulation, which carry over the provisions of the Securities Markets (Market Manipulation) Regulations 2007 in providing a safe harbour for certain

market stabilisation activities provided that they are carried out in the prescribed manner.

How do the FMC Act and Regulations impact on the licensing of financial product markets?

By contrast to the minimal changes to the disclosure and market misconduct provisions that are carried over from the SM Act to Part 5 of the FMC Act, the FMC Act does make more substantive changes to the provisions concerning market operators. While these do not affect listed issuers directly they are relevant in terms of the options that will be available for issuers seeking greater liquidity and the corresponding obligations.

In brief, under the current SM Act regime NZX is our sole registered exchange. The SM Act gives a ministerial power to "call-in" a market operator and require them to become registered, but this power has never been exercised (it was contemplated in 2004 / 2005 in respect of the Unlisted market, but not ultimately used). The effect of this is to provide a clear divide between listing and quotation on NZX, with the associated requirements under the SM Act as noted above, and using a facility such as Unlisted or ShareMart to provide an alternative trading mechanism for shareholders without the majority of the SM Act requirements.

The FMC Act alters this balance. Essentially it introduces the concept of a financial product market, broadly defined as a facility enabling the trading of financial products (with limited exemptions such as an issuer facilitating the trading of its own products), and requires persons providing such a market to obtain a financial product markets licence from the FMA. Also, the FMC Act provides for the ability for licensed market operators to establish new markets with exemptions from general requirements such as continuous disclosure.

This has been exercised in two ways. The power to modify the general Part 5 requirements has been exercised with the Financial Markets Conduct (NZX-NXT Market) Regulations 2014, which facilitate the establishment of the new NXT market with modified disclosure obligations.

The general requirement for market providers to be licensed is still 'in play'. The relevant commencement order, the Financial Markets Legislation (Phase 2) Commencement Order 2014, has delayed the coming into force of this general obligation, and we understand that both Unlisted and ShareMart are considering their options with officials - restructuring their operations to avoid coming within the licensing obligation under FMC Act, or seeking a form of "light-touch" market registration.

Depending on the outcome of this process, therefore, issuers considering their options to raise capital and increase liquidity of their shares will have an increased range of options.

What's next?

We recommend that market participants should:

- Review the new provisions in the FMC Act and Regulations against their counterparts under the current regime, to help adjust to the changes in nomenclature
 - Keep an eye out for developments with the various forms of "light-touch" markets.
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Auckland

**PwC Tower
188 Quay Street
Auckland 1010**

**PO Box 1433
Auckland 1140
New Zealand**

**P: +64 9 358 2555
F: +64 9 358 2055**

Wellington

**Aon Centre
1 Willis Street
Wellington 6011**

**PO Box 2694
Wellington 6140
New Zealand**

**P: +64 4 499 4242
F: +64 4 499 4141**

Christchurch

**83 Victoria Street
Christchurch 8013**

**PO Box 322
Christchurch 8140
New Zealand**

**P: +64 3 379 1747
F: +64 3 379 5659**