NEW ZEALAND
LAW SOCIETY
NZLS EST 1869

Law Society Building, 26 Waring Taylor Street, Wellington,
DX SP20202, Wellington or PO Box 5041, Lambton Quay,
Wellington 6145, New Zealand

TEL +64 4 472 7837 • FAX +64 4 473 7909
E inquiries@lawsociety.org.nz
www.lawsociety.org.nz • my.lawsociety.org.nz

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Financial Markets Authority
PO Box 1179
Wellington 6140

By email: consultation@fma.govt.nz

Dear Sir

Financial Markets Conduct Act class exemption development

The New Zealand Law Society (Law Society) welcomes the opportunity to comment on the Consultation Paper dated 13 March 2015.

The Law Society appreciates the extension of time afforded by the Financial Markets Authority to make this submission. However, the Law Society is concerned at the relative short time period allowed for consultation on these matters.

The numbering below reflects the numbering in the Consultation Paper.

A. Recognition of new offers and financial reporting under foreign regimes

A1. **Do you think the scope of the NZ connection the issuer has should influence the extent of relief provided? Should greater relief be provided (allowing greater reliance on the foreign regime), where the connection to NZ investors is more limited, or ancillary, to the offer in the foreign jurisdiction?**

The Law Society is largely comfortable with the existing regime for providing relief where there is an existing New Zealand connection with the issuer (e.g. rights issues to existing investors, including those in New Zealand). By contrast, it considers that proposals for greater relief / greater reliance on foreign offer documents where the connection to New Zealand investors is more limited should be approached with caution. While the argument in favour of trans-Tasman mutual recognition is compelling, it is not clear that there is a compelling argument in the case of other jurisdictions, even if there are growing capital flows between the home jurisdiction and New Zealand.

A2: **What criteria do you think should be considered in granting any relief from the NZ regime for offer and management of financial products? Further, in light of question A1, how (if at all) do you think this should differ in light of the connection of the issuer with NZ?**

The Law Society is comfortable with the existing criteria that focus on issuers listed on the principal exchanges of well-regulated jurisdictions.

A3: **What is the extent of relief you think should be granted? Should a PDS be required? Should a register entry be required?**

There is no pressing case for departing from the existing regime for extension to the general public including requiring a PDS (and as a result a register entry).

A4: **What conditions do you consider would provide important information or protections? Any warnings or information? An agent for service in NZ?**

As above, the Law Society is comfortable with the existing regime which requires both health warnings and the appointment of an agent for service in New Zealand.

A5: **Are there any circumstances you envisage would additionally require, and warrant, relief from NZ licensing requirements? Please explain.**

The Law Society is not aware of circumstances that would warrant class relief from the licensing regime. Market participants will be in a better position to comment on this question.

A6: **What criteria do you think should be considered in granting any relief from the NZ regime for financial statement preparation, audit and lodgement by issuers of financial products? Further, in light of question A1, how (if at all) do you think this should differ in light of the connection of the issuer with NZ? Please explain.**

The Law Society is comfortable with a proposal that continues to focus on complementary relief, such as that provided by the Financial Reporting Act (Overseas Companies) Exemption Notice 2013.

A7: **In the past, the FMA has individually assessed the offer and financial reporting regime of each foreign jurisdiction. We also considered the extent of regulatory body co-operation available (in light of whether the relevant foreign regulators are signatories to memorandum of understanding for information sharing and co-operation). Rather than recognising a limited list of identified jurisdictions, are there general requirements that market participants could assess their own proposed offer against? Would this provide sufficient certainty to those relying on the exemption? Would it provide sufficient protection to NZ investors?**

In the absence of some form of stock take of a number of foreign jurisdictions, the existing policy of having a limited number of specified jurisdictions (and memorandum of understanding on information sharing and co-operation) will continue to be appropriate.

B. Broader recognition of overseas audit regimes

B1: **Do you have any comment on the appropriate scope of relief?**

The New Zealand audit profession will be in a better position to comment on this question.

C. Charities raising funds by debt securities

C1: **Given the risks raised by relief from standard disclosure and supervision requirements what grounds, if any, provide justification for relief from the standard requirements for charities raising money by the issue of debt securities beyond the relief available in Schedule 1?**

The Law Society recognises the significant work undertaken by the charitable sector.

Some members of the legal profession favour a move towards harmonisation of entities conducting similar activities, which would inevitably mean phasing out class relief for those charities that are unable to make use of the Schedule 1 exemptions. The need for this type of vehicle is however being overtaken by other (probably more efficient) conduits.

Other members of the legal profession consider that there should continue to be a charity debt securities exemption to recognise the special status of charities and the fact that the investments they offer will often form part of, or be an obvious adjunct to, their charitable activities.

D. Venture capital schemes

D1: **Is there any appropriate basis to recognise an avenue for fundraising through a designated scheme administrator outside of the statutorily recognised crowd funding exclusion?**

There should be a move towards harmonisation of entities undertaking similar activities. New developments, such as those to recognise the development of crowd-funding, may however overtake the use of (or need for) the current exemption.

D2: **If so, is there continuing market demand?**

The Law Society notes the FMA's views that market demand for the current exemption appears to be declining.

E. Communal facilities offered with real property

E1: In what circumstances (if any) does the holding of communal interests in a subdivision raise financial markets-related risks?

This is an issue with significant uncertain boundaries. In this document 'community associations' is used to refer to both incorporated societies and companies.

Community associations are often set up for one or two key reasons:

1. to own common facilities; or
2. to enforce covenants or by laws relating to a development.

These reasons need to be kept in mind when considering an exemption.

The uncertainty in this area means lawyers acting for developers have faced difficult questions about whether the following are 'securities':

1. A right of way owned by multiple parties;
2. A recreation area; or
3. Shared infrastructure.

When these issues have been raised by individual lawyers with the FMA in the past, the FMA's general view has been that a right of way is probably treated as ancillary to a sale and purchase transaction, and so is not a security. However, shared recreation facilities or infrastructure may well be, whether owned as tenants in common, or by an incorporated society or company. This uncertainty can give rise to unnecessary compliance costs which fall on developers and ultimately on property owners.

The Law Society understands that some of the large-scale developments planned in the Auckland region involve a range of community assets that go beyond basic infrastructure. One example is shopping hubs that may be leased out. Other innovative ideas may be seen in developments with a social housing component or those in special housing zones.

E2: If the FMA decides to use its legislative tools to provide relief from financial markets regulation for communal interests in a subdivision, how can we differentiate and define the circumstances of entities (including companies and incorporated societies) that do not raise financial markets-related risks?

The focus should be on the role the vehicle performs, rather than its legal form. If common facilities are not covered by the Financial Markets Conduct Act, then how they are legally owned should be largely irrelevant. The vehicle may be something other than a company. Law reform in respect of incorporated societies may make them more popular vehicles and an LLP should not necessarily be ruled out as a vehicle, despite being more cumbersome to form and administer in many cases.

Regulation should be less prescriptive than the current exemption although the intention of the exemption should be clear.

However, some element of an "ancillary" test would be useful. For example:

If an agreement for sale and purchase of land requires the acquisition of a share in assets, or a share in a company, or membership of a society
- AND the society or company has a primary purpose of owning assets in the development for communal use (but could have an ancillary purpose of enforcing covenants or bylaws within the association);
- AND cannot carry on any other business;
- AND membership/shares are only available to those within the development

then it is suggested that no financial market related risk is raised.

It is unlikely that such a test would capture 'Blue Chip' type transactions as seen in *Hickman and Ors v Turner and Waverley Limited (formerly Turn and Wave Limited) and Ors* [2012] NZSC 72. .

E3: The exemption notices providing Securities Act relief, in relation to entities used for owning and managing communal property, require compliance with a number of conditions. To what extent do those conditions provide protections to property owners from financial markets-related risks? What are the compliance costs and impediments imposed by the conditions?

The Law Society considers that there are serious problems with the current exemption notice, because it is overly prescriptive. This can lead to technical non-compliance where compliance and fix-up costs can be prohibitive, particularly in small scale developments. These complexities can be used as a lever by those disappointed with their purchase.

Non-compliance issues can include the timing of transfer of assets and whether assets are leased or licensed. These could be better dealt with as matters of contract law (for example, by the law relating to misrepresentation). If required, infrastructure requirements could be covered by local government under the consenting process. Matters of title such as encumbrances and land covenants are dealt with under the general law, and shared facilities should be too. It should not matter for the purposes of any exemption whether land is leased or licensed; this is again a matter of contract law.

Compliance costs may be significant. A client will often not identify that there is a securities law issue. The lawyer must identify the issue for the client, and (often) recommend a formal opinion be done before the matter proceeds. A specific exemption has been considered necessary in many cases, which entails further costs. Securities compliance costs might be anywhere from $5,000 - $50,000, depending on the project. These costs could be minimised or avoided by clarity in the law.

The conditions in clause 6 of the current exemption notice are overly-prescriptive, and give rise to adverse incentives. The Law Society is aware of situations where purchasers have sought to exit contracts because of market changes or misrepresentation issues, but have relied on technical aspects of exemption non-compliance as these are easier to demonstrate. This increases the risk and complexity of developments involving communal facilities, which in turn restricts useful and efficient land use and tenure.

Any replacement exemption needs to be simple and clear, with most issues left to the general law.

F. Vehicles for managing costs

F1: In what circumstances does the holding of interests in these entities raise financial markets-related risks?

The Law Society considers it appropriate that a distinction continue to be made between vehicles that are simply used to provide a means of managing costs and those which are intended to create an investment-type return.

As well as the types of entities that are the focus of section E above, such schemes are common in the rural economy, where for example a company provides a low-cost and readily understood governance structure for routine communal assets such as many small rural water schemes. Holding interests in these entities raises few financial markets-related risks and some relief continues to be appropriate.

F2: If the FMA decides to use its legislative tools to provide relief from financial markets regulation of these interests, how can we differentiate and define the circumstances of entities (including companies and incorporated societies) that do not raise financial markets-related risks? Additionally please outline circumstances (commercial or otherwise) you are aware of where entities are established, not for investment purposes but, as a means to manage costs or coordinate the activities of members? What are the common characteristics of these arrangements?

Any such relief should be agnostic as to the legal structure of the vehicle. Currently incorporated societies appear to be less popular because the legislation governing them is out of date and they are therefore often not a suitable structure for even the most routine of developments, such as to address the knock-on impacts of aggregation of farms and the consequent impact on the communal assets being used by those farms. Continuing to use water as an example, such a low-cost management regime can be contrasted with the emergence of a number of capital-intensive water storage and irrigation projects which will need to offer some sort of investment-type return in order to generate the necessary capital to proceed.

Another example is the emergence of companies, including charitable companies, which are used as vehicles to manage infrastructure and costs (as a shared services vehicle) in a range of scenarios in, for example, the education and sports sectors. It makes sense for these entities to be able to develop in order to (for example) manage the back-office for a group of not-for-profit entities or provide common facilities including sporting facilities without raising financial markets issues or risks.

F3: To what extent do the circumstances, or entities used, reflect, or differ from, entities established for owning and managing interests in communally-owned real property in a subdivision?

It is not clear that there are significant points of difference with the circumstances, or entities used for owning and managing interests in communally-owned real property in a subdivision. In the handful of examples the Law Society is aware of, the points of difference are small and largely matters of context.

G. Racing livestock ownership syndicates

G1: Although racing syndicates may be a kind of investment, are they a financial markets matter?

As above, the Law Society endorses harmonisation and remains to be convinced that there is a point of distinction for racing syndicates that justifies ongoing class relief. However, many would be able to rely on the exclusions in Schedule 1, including that for small schemes.

H. Pre-payment facilities

H1: Do you have any preliminary comment on the extent to which, if at all, pre-payment facilities should be regulated by financial markets law?

The Law Society considers class relief of pre-payment facilities is appropriate where facilities are developed to simplify common and widespread transactions, for example in relation to carparking and commuter travel.

H2: Do some prepayment facilities have features that look more like financial markets products? If so, what are those features? If the FMA decides to use its legislative tools to provide relief from financial markets regulation for pre-payment facilities, how can we differentiate and define the circumstances of facilities that do not raise financial markets-related risks?

The Law Society is not in a position to comment on the relevant points of demarcation between a more routine pre-payment facility and those which look more like financial markets products, which will have a bearing on class relief. Market participants, particularly those in the banking sector, will be in a better position to comment on this question.

H3: To what extent is there an expectation or understanding by users of these services that financial markets law requirements, which usually apply to investments in financial products, would apply?

Anecdotally, the Law Society understands that users of these services would be surprised that financial markets laws apply, in the same manner as to more run-of- the-mill financial products. If this is the case, regulation may add a layer of costs with little or no discernible benefit to the end consumer.

I. Co-operatives

I1: In light of the existing tailoring for co-operative company shares in the equity Product Disclosure Statement, what (if any) additional relief do you think should be provided from the standard regulated share offer requirements for shares issued in a co-operative company where those shares are purchased for nominal value?

The Law Society is not aware of pressing calls from the co-operative sector for additional class relief from the disclosure regime.

I2: Are there any other circumstances where you consider relief should be provided? What relief do you propose, and on what basis?

In light of our comments in section F, there may be a trend for some of the (company) vehicles that are used to manage costs to become co-ops. Any such development should not be hampered by financial markets regulation where there is no investment type return. For example, costs savings in a shared services vehicle could be streamed by volume of activity.

J. Employee share purchase schemes

J1: Do you have any comments on our view that the Schedule 1 exclusion applies to offers made to eligible persons under the scheme, even if the shares are then issued to a person who is not an eligible person ie, a trust, closely held company, relative? Do you see any risks or difficulties with this interpretation?

There are benefits in the Schedule 1 exclusion applying to offers made to eligible persons under the scheme, even if the shares are then issued to a person who is not an eligible person (e.g. a relative, family trust etc.).

However, a similar argument can be raised in the case of other Schedule 1 exclusions affecting persons in a special relationship with the issuer.

J2: Do you see any substantive difficulty with the 10 per cent calculation? If so please explain.

As a result of the view that underpins J1 – there is a practical difficultly with applying the 10 per cent calculation.

J3: Are savings scheme securities still offered in conjunction with employee share purchase schemes? If so, is exemption support needed to allow these to be offered by overseas banks under employee schemes?

The Law Society understands that savings scheme securities continue to be offered because of regulatory advantages in some overseas jurisdictions. Market participants will be in a better position to comment on the numbers and the reasons for the apparent shift in the market appetite for such plans.

J4: Are there any other issues in relation to the application of the Schedule 1 exclusion or the associated warning and other disclosure requirements in the FMC Regulations that may require exemption support?

The Law Society is not aware of further issues in relation to the application of the Schedule 1 exclusion that point to the need for wider exemption support but market participants may have other views.

J5: Is there sufficient clarity around the treatment of phantom shares?

The Law Society notes the FMA's view about the treatment of 'phantom' share schemes but suggests that treating the benefit provided to a participant in such a scheme as a derivative is controversial.

The Law Society has reviewed the list of matters in Appendix 1 for "legislative instrument tool support" and looks forward to updates on the FMA's targeted consultation proposals currently under development. At this stage, it does not wish to be included in that targeted consultation process.

This letter has been prepared by the Property Law Section of the New Zealand Law Society. Any enquiries should be sent to Property Law Section Manager, Jennifer Chowaniec on jennifer.chowaniec@lawsociety.org.nz or 03 357 5307.

Yours faithfully

Chris Moore
President