



COVERSHEET

Minister	Hon Andrew Bayly	Portfolio	Commerce and Consumer Affairs
Cabinet paper	Financial Markets Conduct Regulations Minor and Technical Changes (2018)	Date to be published	Originally published in 2018. Republished in 2024 after faulty link

List of documents that have been proactively released		
Date	Title	Author
May 2018	Financial Markets Conduct Regulations Minor and Technical Changes	Office of the Minister of Commerce and Consumer Affairs
2 May 2018	Financial Markets Conduct Regulations Minor and Technical Changes DEV-18-MIN-0061 Minute	Cabinet Office
21 February 2018	Regulatory Impact Summary: Application of Insider Trading Prohibition	MBIE

Information redacted

NO

Any information redacted in this document is redacted in accordance with MBIE's and MFAT's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

In Confidence

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Economic Development Committee

Financial Markets Conduct Regulations: Minor and technical changes

Proposal

- 1 This paper seeks policy approval for changes to the Financial Markets Conduct Regulations 2014 to address technical issues that have emerged since 2014. To give effect to the policy decisions sought, this paper also seeks approval for the submission of the Financial Markets Conduct Amendment Regulations 2018 to Executive Council.

Executive summary

- 2 The Financial Markets Conduct Act 2013 (FMC Act) significantly reformed financial markets laws with the aim of increasing investor confidence and improving access to capital for businesses to grow. The Financial Markets Conduct Regulations 2014 (FMC Regulations) provide the supporting detail behind the FMC Act.
- 3 The FMC regime came fully into force on 1 December 2016 and feedback from market participants has generally been positive.
- 4 However, as expected given the size of the regime, technical issues have emerged as participants began operating under the new regime. Some of those issues have been addressed in miscellaneous amendments to the FMC Regulations that were passed between 2015 and 2017. Amendments of a 'repair and maintenance' nature will be required on an ongoing basis to ensure that the policy objectives of the regime are met. This paper seeks approval for further minor changes.
- 5 The changes proposed are primarily aimed at providing clarity and avoiding unnecessary compliance costs, while maintaining investor confidence. The proposed changes include:
 - 5.1 requiring that financial service providers cannot continue to provide services to existing clients if the provider has made a material error in disclosure information and continuing services is not in the clients' best interests;
 - 5.2 clarifying that insider trading rules generally do not apply to the sale and purchase of financial products when they are first issued (as consistent with the long-standing position in New Zealand under the previous legislation); and
 - 5.3 providing that money-handling obligations in relation to derivatives do not apply to certain transactions entered into by sophisticated New Zealand wholesale investors.
- 6 Approval for regulations giving effect to the above changes is being sought at the same time as cabinet policy approval for the changes. This enables the change referred to in

paragraph 5.1 to come into force as soon as possible after related changes to the FMC Act have come into force on 30 March 2018.

Background

- 7 The FMC Act significantly reformed the laws governing how financial products are offered to investors and the responsibilities of those who deal in financial products. It seeks to increase investor confidence and improve access to capital for businesses to grow. The FMC Regulations provide the details needed to support the FMC Act. Feedback from market participants on the regime has generally been positive.
- 8 The FMC regime regulates a broad range of often complex financial products. As expected given the size and complexity of the regime, a number of technical issues have emerged and are continuing to emerge since participants began operating under the new requirements.
- 9 The Ministry of Business, Innovation and Employment (MBIE) has an ongoing work programme working closely with the Financial Markets Authority (FMA) to actively respond to issues identified by market participants, including through making ongoing improvements to the FMC Act and FMC Regulations.
- 10 Four sets of miscellaneous amendment regulations were passed between 2015 and 2017 to address such technical issues, focusing on those that had greater impact on providers' ability to transition smoothly into the FMC regime.
- 11 To ensure that the policy objectives of the regime are continuing to be met, improvements of this 'repair and maintenance' nature will be required on an ongoing basis to address issues that have not yet been worked through or identified.

Comment

- 12 This paper proposes changes to the FMC Regulations, primarily to provide clarity and avoid unnecessary compliance costs, while maintaining investor confidence.

Providing that services cannot continue where not in clients' best interests

- 13 The FMC Act currently provides that where a provider of crowdfunding, peer-to-peer lending or Discretionary Investment Management Services (DIMS) discovers they have made an error in disclosure information given to existing clients, they must suspend services to those clients until the error is corrected.
- 14 However, there are times when it may be desirable for the provider to continue services even though there has been misleading disclosure. For example, DIMS is a service where the client authorises the provider to decide what financial products to buy or sell on the client's behalf. Even if the provider has given misleading disclosure, it may be desirable in some cases for the provider to continue the service and sell some of the client's assets if the provider expects their value will likely reduce.
- 15 To recognise this, changes to the FMC Act were made in the Regulatory Systems (Commercial Matters) Amendment Act 2017 so that where there has been misleading disclosure, providers can continue services to existing clients except in any circumstances prescribed in regulations. The changes in that Amendment Act came into force on 30 March 2018.

- 16 Any regulations to prescribe circumstances where service cannot continue should also come into force as soon as possible. Otherwise providers have an unrestricted ability to continue services in the event of a disclosure error.
- 17 I propose that regulations prescribe that providers cannot continue services to existing clients where it is not in those clients' best interests. For example, it may not be in clients' best interests to continue the service if the provider fails to disclose a significant risk associated with investing through the service, and if continuing the service will expose investors to that undisclosed risk.
- 18 Some DIMS providers submitted that it may be unclear in practice whether ongoing service would be in "clients' best interests". Providers suggested that they should always continue services to give effect to the investment strategy agreed by the client.
- 19 However, the proposed regulations are consistent with DIMS providers' existing general obligation to act in clients' best interests. I consider it strikes an appropriate balance between promoting investor confidence and facilitating efficient financial markets by allowing services to continue in many instances even where there has been a disclosure error. If necessary, officials will discuss with the FMA about providing guidance to industry on the application of the test.

Clarifying that insider trading rules do not apply when products first issued

- 20 The insider trading provisions in the FMC Act provide that if a person has access to information ahead of the rest of the market, they must not undertake trades in financial product markets (e.g. NZX) using that information.
- 21 Since the FMC Act passed in 2013, there has been some uncertainty in the market as to whether the wording of the new provisions mean that the rules apply purely to the secondary market (i.e. where financial products listed on NZX are traded between investors), or whether they also apply to the primary market (where financial products *to be* listed on the NZX are first created and issued to an investor).
- 22 The intention of the FMC Act was to largely carry over the insider trading provisions from the previous Securities Markets Act 1988, which applied only to the secondary market.
- 23 Expanding the insider trading rules to the primary market may inhibit some common forms of capital-raising. For example, a business may negotiate to privately issue shares to a large wholesale investor. Material non-public information may be provided to the investor so that they can make an informed decision. Applying insider trading rules may inhibit the disclosure of information that is important for the operation of these forms of capital-raising.
- 24 Given uncertainty about the interpretation of the FMC Act, temporary holding measures including temporary exemption regulations have been in place effectively exempting the primary market from the insider trading provisions (preserving the then status quo) with some exceptions. Previous measures have been short-term solutions only and it is important to clarify this issue as soon as possible.
- 25 I now propose clarifying that the insider trading rules generally do not apply to the acquisition of newly-issued financial products in the primary market (i.e. generally reflecting the previous temporary regulations and the position prior to the FMC Act). The insider trading rules would still apply in respect of newly-issued derivatives and units in

listed unit trusts that are continuously offered, as the nature of those products is such that the distinction between a new issue and a secondary market trade generally does not apply.

- 26 The proposal avoids unnecessary compliance costs by allowing commonly accepted forms of capital-raising such as private placements to continue, while still giving potential investors access to the information needed to make investment decisions. Obligations under the Companies Act 1993 also mean that interests of the company and existing shareholders are still protected to ensure that, for example, directors cannot use inside information to issue shares to themselves or associates on favourable terms. Industry, NZX and the FMA all support this approach.

Other changes

- 27 The attached regulations also give effect to a decision by Cabinet in June 2016 to clarify the scope of the derivative money-handling obligations so that they do not apply more broadly than is necessary to protect derivatives investors [EGI-16-MIN-0134 refers].

- 28 I also propose some other very minor changes to the FMC Regulations:

28.1 removing a reference to bank “quarterly” disclosure statements as a consequential amendment following changes to banks’ disclosure requirements in Orders in Council made under the Reserve Bank of New Zealand Act 1989; and

28.2 addressing minor errors in relation to timeframes associated with the making available of company annual reports to shareholders.

Delegated authority for further issues

- 29 Industry are continuing to identify further issues as they begin operating under the FMC regime and a number of issues already identified have not yet been worked through. I expect that further amendments to the FMC Regulations may be required to address some such issues. To address any such issues in an expedient manner, I seek your agreement to delegate authority to me to make decisions until 1 December 2019 (the third anniversary of the FMC regime fully coming into force) on any minor policy issues relating to the FMC Regulations of the nature discussed in this paper, provided they are consistent with the purposes of the FMC Act.

Regulations to give effect to the proposals

- 30 To give effect to the above proposals and decisions as soon as possible, this paper also seeks approval for the submission of the Financial Markets Conduct Amendment Regulations 2018 to Executive Council.

- 31 It is important to approve the regulations at this point so that regulations prescribing circumstances for continuing services are made as soon as possible after related changes to the FMC Act have come into force on 30 March 2018, and so that clarity on the insider trading issue is provided as soon as possible.

Financial Implications

- 32 There are no financial implications from the creation of these regulations.

Timing and 28-day rule

- 33 The regulations will come into force on 7 June 2018, 28 days after their notification in the Gazette.

Compliance

- 34 The proposed regulations and amendment order comply with:
- a. the principles of the Treaty of Waitangi;
 - b. the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
 - c. the principles and guidelines set out in the Privacy Act 1993;
 - d. relevant international standards and obligations; and
 - e. *the LAC Guidelines on the Process and Content of Legislation* (2014 edition), which are maintained by the Legislation Design and Advisory Committee.
- 35 A number of statutory prerequisites apply to the development of these regulations and the amendment order. They require that the regulations be consistent with the purposes of the FMC Act; be developed in consultation with the FMA or upon the FMA's recommendation; and be no broader than is reasonably necessary.
- 36 The FMA has been consulted on all the regulations that I am proposing be made. I have taken into account the relevant considerations and consulted with others during the development of the regulations, as provided for and required by the FMC Act.

Regulations Review Committee

- 37 I do not consider there to be grounds for the Financial Markets Conduct Amendment Regulations 2018 to be drawn to the attention of the House.

Certification by Parliamentary Counsel Office

- 38 The amendment regulations and order have been certified by PCO as being in order for submission to Cabinet (subject to compliance with the consultation and other requirements referred to in recommendation 6).

Regulatory impact analysis

- 39 The Regulatory Impact Analysis Review Panel has reviewed the attached Regulatory Impact Summary (RIS) prepared by MBIE in relation to the insider trading proposal. They consider that the information and analysis summarised in the RIS meets the criteria necessary for Ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper.
- 40 The Regulatory Impact Analysis Team at the Treasury has advised that a Regulatory Impact Analysis is not required for the other proposals in this paper because of their minor or technical nature.

Publicity

- 41 MBIE will communicate these policy changes to representatives of affected stakeholders.

Consultation

- 42 The FMA, the Treasury, the Reserve Bank and the Department of the Prime Minister and Cabinet (Policy Advisory Group) have been consulted on this Cabinet paper.
- 43 Officials have consulted with the FMA and representatives of affected parties in relation to the content of the proposed regulations. Groups consulted include derivatives issuers, DIMS providers, law firms, NZX, and Shareholders Association.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

- 1 **note** that minor technical issues have emerged as expected since industry began operating under the Financial Markets Conduct Act 2013 (FMC Act) and the Financial Markets Conduct Regulations 2014 (FMC Regulations);
- 2 **agree** that where a provider of a Discretionary Investment Management Services, crowd-funding or peer-to-peer lending platform services makes an error in disclosure information given to existing clients, they cannot continue to provide services to those clients if it is not in those clients' best interests;
- 3 **agree** to clarify that the insider trading rules do not apply to the sale and purchase of financial products when they are first issued, except in relation to derivatives and newly issued units in listed unit trusts that are continuously offered;
- 4 **note** that in June 2016 Cabinet agreed to clarify the scope of the derivative money-handling obligations in the FMC Regulations so that they did not apply more broadly than necessary to protect derivatives investors [EGI-16-MIN-0134 refers];
- 5 **note** that the Financial Markets Conduct Amendment Regulations 2018 give effect to the decisions referred to in recommendations 2-4 above;
- 6 **note** that:
 - 6.1 sections 448 and 549 of the FMC Act requires the Minister of Commerce and Consumer Affairs to consult the Financial Markets Authority (FMA) before recommending regulations under the FMC Act;
 - 6.2 section 550 of the FMC Act (procedural requirements for regulations relating to exemptions) requires the Minister of Commerce and Consumer Affairs to have regard to the purposes of the FMC Act and be satisfied that the extent of an exemption is not broader than is reasonably necessary before recommending regulations;
- 7 **note** the advice of the Minister of Commerce and Consumer Affairs that the requirements in recommendation 6 above have been met;

- 8 **note** the Financial Markets Conduct Amendment Regulations 2018 will come into force on 7 June 2018;
- 9 **authorise** the submission of the Financial Markets Conduct Amendment Regulations 2018 to the Executive Council;
- 10 **authorise** the Minister of Commerce and Consumer Affairs to make decisions on any minor policy issues prior to 1 December 2019 relating to the FMC Regulations of the nature referred to in recommendations 2-4, consistent with the purposes of the FMC Act.

Authorised for lodgement

Hon Kris Faafoi

Minister of Commerce and Consumer Affairs