CHAPMAN TRIPP

SUBMISSION ON FINANCIAL SERVICE PROVIDERS (REGISTRATION) REFORM OPTIONS

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1 The Ministry of Business, Innovation and Employment (MBIE) has sought feedback on proposals to reform the Financial Service Providers registration requirements contained in the *Financial Service Providers (Registration and Dispute Resolution) Act 2008* (*FSPA*).

2 Please contact any of us to clarify any aspect of this submission. We plan to respond separately on the Ministry's proposals concerning the *Financial Advisers Act 2008.*

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We address the Ministry's questions in the order asked in the Options Paper.

Chapter 6 – Misuse of the Financial Service Providers Register

36) Do you agree with our assessment of the pros and cons of the options to overcome misuse of the FSPR?

Option 1

We question the practicality of requiring offshore-controlled entities to provide proof that they are licensed and/or supervised in their home jurisdiction and in any jurisdiction in which they are proposing to provide services.

We say this because:

- other jurisdictions may not license and/or supervise the provision of those financial services (either because they do not regulate that particular service or do not regulate the provision of services from offshore); and

- the proposal requires MBIE or another entity to make a qualitative assessment as to whether the offshore licence constitutes a genuine licence or a mere registration (in much same way as the FSPR).

We also query whether this option would in fact address the problem because:

- regulation in an offshore jurisdiction does not, of itself, signify that the entity is not registering on the Register with a view to taking advantage of New Zealand's reputation as a well-regulated jurisdiction; and

- conversely, the fact that an entity is not regulated in an offshore jurisdiction does not mean that it is registering in New Zealand to take advantage of New Zealand's reputation as a well-regulated jurisdiction.

However, we see value in statutory reform requiring offshore providers that are licensed to provide evidence of that and to confirm a clear legal basis that they can satisfy the Register's enquiries. In essence, requiring entities to prove that they are qualified to register on the FSP register before enabling them to register is both desirable and appropriate.

Option 2

While we support FMA having the power to direct the Registrar not to register, or to deregister, a financial service provider, we do not support the strengthening of FMA's powers in a way which diverges from the fundamental question of whether an entity is entitled to be registered.

As currently drafted, the FSP Act requires registration by financial service providers who are ordinarily resident in New Zealand, or have a place of business in New Zealand, regardless of where the financial service is provided, and imposes substantial fines for failure to do so.

Importantly:

- the purpose statements set out in sections 15A and 18A of the FSP Act for the exercise of FMA's powers to object to a registration or direct the deregistration of an entity;
- whether an entity provides a substantive amount of services from a place of business in New Zealand; or
- whether an entity is a 'repeat offender' that has previously been de-registered

do not go to the baseline obligation of a financial service provider to be registered in the first instance - as that is governed by section 8A.

This mismatch has unfortunate consequences where entities are incentivised by other New Zealand regimes (discussed below) to take a conservative approach to registration and register defensively.

While we are generally supportive of the requirement for overseas companies to disclose the status of their registration, we question whether FMA will have the resources to proactively enforce this requirement in all cases, given the amount of work and enquiry that may be required.

However, although this will have value where FMA receives a complaint about an offshore FSP which provides grounds to deregister, it does not address the base problem - as by the time a complaint has been made to FMA the reputability of New Zealand may already have been brought into question.

Option 3

While we would support the inclusion of a bright line test as to when the FSP Act applies, this test would need to be carefully drafted to provide certainty as to when an entity was required to be registered.

This test could usefully, in part, be aligned with the definition of "[carrying] on insurance business in New Zealand" in section 8(1) of the Insurance (Prudential Supervision) Act 2010 such that the FSP Act applies to a person who:

(a) is —

(i) a body corporate or an association of persons incorporated or formed in New Zealand; or

(ii) an overseas company that is required to be registered or deemed to be registered under the Companies Act 1993; or

(iii) an association of persons formed outside New Zealand that is carrying on business in New Zealand within the meaning of section 332 of the Companies Act 1993 (applied with all necessary modifications as if the

references in that section to an overseas company were references to an association of persons); or

(iv) ordinarily resident in New Zealand; and

(b) carrying on the business of supplying a financial service, (in part or otherwise) from within New Zealand regardless of where the financial service is received.

The advantage of this test is that it requires a degree of business enterprise to be undertaken in New Zealand, such that a FSP cannot simply have a place of business here with little else (we elaborate on this below). This territorial scope also aligns with (for example) the territorial scope in section 33(1) of the Financial Markets Conduct Act 2013 (*FMC Act*), which (amongst other things) applies to conduct by any person registered in New Zealand.

We consider that the shift in focus from where a service is "received" to where it is provided will ensure that entities must have a genuine connection to New Zealand before they are able to sustain a registration.

In addition, the replacement of the requirement that entities have "a place of business in New Zealand" with a requirement that they supply a financial service, (in part or otherwise) from within New Zealand, removes the incentive to set up dummy structures in New Zealand as it would be strongly indicative that an entity which has registered on the FSPR would or could also have obligations under the:

- Companies Act 1993;
- Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (*AML/CFT Act*); and
- Income Tax Act 2007.

Aligning the territorial scope of the AML/CFT Act with the FSP Act would also have the benefit of making the FSPR a more useful tool for meeting New Zealand's FATF obligation to create a register of entities regulated for AML purposes.

At present the mismatch between the scope of the AML/CFT Act and the registration requirements of the FSP Act undermines the usefulness of the FSPR for this purpose.

Option 4

We would support a new requirement that company formation agents operating in New Zealand be required to register on the FSPR, which would then be consistent with regulation of such persons under the AML/CFT Act.

Options 5 and 6

We do not support the restriction of public access to the FSPR either in whole or in part. The initial purpose of this register was to provide a register of entities captured by the AML/CFT Act.

In addition, the regulatory treatment of many commercial transactions depends on the characterisation of the parties involved (for example whether a party is an investment business for the purpose of clause 37 of Schedule 1 of the FMC Act and therefore is a wholesale investor for the purposes of that Act). The public nature of the FSPR is a key ingredient in enabling parties to easily undertake these checks.

37) What option or combination of options do you prefer and why? What are the costs and benefits?

We support a combination of options 1, 2, 3 and 4, with the most effective change brought about by option 3.

We consider that a shift in focus from where a service is "received" to a jurisdictional test requiring the carrying on of business from within New Zealand will ensure that entities must have a genuine connection to New Zealand before they are able to sustain a registration. This will also mean that entities which register on the FSPR will be holding themselves out to regulators as being subject to broader regulation in New Zealand and will likely discourage overseas entities from using the FSPR purely as a registration of convenience.

This new definition is also narrower in scope than that currently in the FSP Act so should not inadvertently bring entities within the purview of the FSP Act who are not already captured while enhancing MBIE's ability to monitor which entities are permitted to register.

38) What are the potential risks and unintended consequences of the options above? How could these be mitigated?

While we generally support the goal of preventing the misuse of the FSP Register by offshore entities, any change to the ability of entities to register on the FSPR must bear in mind the fact that registration on the FSPR has a number of consequences under other regimes.

Most notably, section 99B of the Credit Contracts and Consumer Finance Act 2003 (*CCCFA*) in essence bars a lender which is required to be registered on the FSPR and has failed to do so from enforcing the interest provisions of a loan which is:

- governed by the law of New Zealand; or
- would be governed by the law of New Zealand but for a choice of law provision in the contract, guarantee, lease, or transaction.

Section 99B of the CCCFA was enacted to give more teeth to the existing provisions that require persons who are in the business of providing a "financial service" (within the meaning of the FSP Act) to register under the FSP Act. In particular, section 99B was intended to target unscrupulous consumer lenders whose failure to register might further disadvantage consumers due to lack of recourse to a dispute resolution scheme.

While the CCCFA is primarily concerned with consumer lending transactions, the relevant terms are defined to have broad application, for example:

- section 6 of the CCCFA provides that **credit** is provided under a contract if a right is granted by a person to another person to incur a debt and defer its payment;
- section 4 of the CCCFA provides that **creditor** means a person who provides, or may provide, credit under a credit contract; and, if the rights of that person are transferred, includes the person for the time being entitled to those rights; and
- section 7 CCCFA provides that **credit contract** means a contract under which credit is or may be provided.

The breadth of these definitions means that many different types of loans made in or into New Zealand are potentially caught by the CCCFA.

The lack of certainty around the current territorial scope of the FSP Act, and the potential consequences of getting it wrong, mean that lenders are incentivised to take a conservative view and register on the FSPR for the avoidance of doubt. This is despite the fact that doing so potentially gives a false or misleading appearance with respect to the extent to which those lenders:

- provide, or will provide, financial services in New Zealand;
- provide, or will provide, financial services from a place of business in New Zealand; or
- are, or will be, regulated by New Zealand law in relation to a financial service,

and therefore may be deregistered on the direction of FMA.

A clear territorial boundary to the FSPR would remove this uncertainty.

39) Would limiting public access to parts of the FSPR help reduce misuse?

Limiting public access to the register could reduce the attractiveness of the FSPR as a registration of convenience as it would limit the ability of investors to independently confirm the "regulated" status of an entity.

However, closure could allow overseas entities to fraudulently claim that they are registered in New Zealand without third parties having the ability to independently verify that status.

We consider the issues of misuse of, and investor confusion about, registration could be practically reduced if register search results allowed for more detailed publication of the information maintained by registered providers.

Under section 15 of the FSPA, and regulation 4 and Schedule 1 of the Financial Service Providers (Registration) Regulations 2011 (*FSP Regs)*, a range of information must be provided and maintained.

However, under section 27 of the FSPA, and regulations 5 and Schedule 2 of the FSP Regs, only a limited part of this information may be shown in search results.

We suggest additions to the information in Schedule 2 of the Regulations, shown in highlighting below:

1 Any trading names used by the registered financial service provider.

2 If the registered financial service provider is an individual or a corporation sole,—

(a) any former names of the registered financial service provider:

(b) any aliases used by the registered financial service provider.

3 If the registered financial service provider is a body corporate that is not incorporated in New Zealand, the country or jurisdiction in which the registered financial service provider is incorporated and any unique identifier given to the provider on incorporation (such as its company registration number).

3A If the registered financial service provider is a body corporate or an unincorporated body:

(a) in relation to each director, senior manager, and controlling owner of the provider who is an individual, the director's, senior manager's, or controlling owner's full legal name and country of residence

(b) in relation to each director and controlling owner of the provider that is a body corporate,—

i. the director's or controlling owner's full legal name:

ii. if the director or controlling owner is not incorporated in New Zealand, the country or jurisdiction in which the director or controlling owner is incorporated:

iii. any unique identifier given to the director or controlling owner on incorporation (such as its company registration number).

4 If the registered financial service provider is a licensed provider,—

(a) the date on which the licence expires (if supplied by the licensing authority):

(b) whether or not the licence is suspended:

(c) whether or not any conditions are imposed on the licence:

(d) details of the conditions (if any) that are imposed on the licence (if requested by the licensing authority).

5 The unique identifier issued to the registered financial service provider by the Registrar.

Other Matters of concern

Issuers and offerors

We have a concern that each of sections 5(1) paragraph (i)(i) and (ia) of the FSPA unnecessarily brings into the scope of the FSPA entities that merely issue or offer financial products on an on-going basis.

For example, listed issuers or co-operatives that regularly issue securities (say, under a dividend reinvestment plan, or employee share scheme, or with transacting shareholders) could be said to be in the "business" of issuing financial products, particularly since the definition of **business** "*includes any profession, trade, or undertaking, whether or not carried on with the intention of making a pecuniary profit*".

Issuers of financial products that need a licence to operate are already captured by section 5(1)(B),(c),(id), and (id), so for those issuers sections 5(1) paragraph (i)(i) and (ia) are redundant.

Definition of "officer"

We also have a concern that a technical change to the definition of "officer" recommended by the Select Committee in the Health and Safety at Work Act 2015 could undermine the meaning of "**senior manager**" in the FSPA, and the FMC Act.

The Health and Safety at Work Act 2015 definition of paragraph (b) of "officer" is deliberately in near identical terms to the definition of "senior manager" in both the FSPA and the FMCA. However, the Select Committee also recommended adding a paragraph (d). We are concerned that if the same paragraph (d) change is not also made to the FSPA and FMCA, a court might discern some difference was intended.

Accordingly, we suggest the definition of "senior manager" is amended in the FSPA, and the FMCA, as follows:

> **senior manager**, in relation to a person (**A**), means a person who is not a director but occupies a position that allows that person to exercise significant influence over the management or administration of A (for example, a chief executive or a chief financial officer) and to avoid doubt, does not include a person who merely advises or makes recommendations to such a person.

Alignment of FSP categories with AML/CFT Act

As currently drafted, there is a degree of misalignment between the categories of FSP in section 5 of the FSP Act, and the categories of "financial institution" in the AML/CFT Act.

We query whether this difference is appropriate, given one of the aims of the FSP Act was to achieve registration of FSPs, so that entities subject to anti-money laundering obligations could be easily identified from the FSPR, consistent with Financial Action Task Force on Money Laundering (*FATF*) expectations.

Instead, the differences between the two sets of definitions have, in our experience, created some uncertainty and frustration in the market. Entities have to turn their minds to two different tests when logically there should be only one – with a number of "false positives" (e.g. entities may be caught by the wider definitions in the AML/CFT Act but are not required to register on the FSPR).

We favour targeted amendments to the definition of "financial institution" in the AML/CFT Act, to align those categories with the FSP Act categories (which in our perception are now reasonably well understood by the market).

Alignment of FSPR categories with FSP Act

From the outset, the FSPR registration categories (i.e. the actual categories in which a FSP may register on the FSPR website) have not aligned with the categories of "financial service" in section 5 of the FSP Act.

While market participants have dealt with this pragmatically, by registering in the most appropriate categories despite the misalignment, the consequences under the FSP Act of getting it wrong are significant.

We would support a change to the FSPR registration categories to align them with the categories in section 5 of the FSP Act. Of course, this would not preclude the FSPR from gathering information about any "sub-categories" into which an FSP falls if that information is helpful.

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