Consultation paper

18 January 2021

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

Consultation: Review of the Wholesale Investor Exclusion $750,000 Minimum Investment Exemption

About this consultation paper

We are seeking feedback on the Financial Markets Conduct (Wholesale Investor Exclusion - $750,000 Minimum Investment) Exemption Notice 2017, which will expire on 4 February 2022.

We require feedback to inform our review of this class notice. We invite your comments on the questions posed in this paper. Please use the feedback form provided.

If you have questions, please email questions@fma.govt.nz or call us on 0800 434 566 (or +64 3 962 2698 if calling from outside New Zealand).

Submissions close at 5pm on Friday 26 February 2021.

This consultation is for all interested people including wholesale investors, banks, brokers, issuers and legal advisers.

It seeks feedback to inform our review of the Financial Markets Conduct (Wholesale Investor Exclusion - $750,000 Minimum Investment) Exemption Notice 2017

Document history

This version was issued in January 2021 and is based on legislation and regulations as at the date of issue.

Review timing and process

We plan to complete our review of the Financial Markets Conduct (Wholesale Investor Exclusion - $750,000 Minimum Investment) Exemption Notice 2017 (‘wholesale investor notice’) before it expires on 4 February 2022. If the outcome of the review supports the granting of the notice without substantive amendment for a further period, this will allow market participants to seamlessly continue to rely on the notice.

If the FMA decides that the exemptions in the wholesale investor notice are no longer warranted, or that substantive amendments are required, we will give you notice of this and, if needed, provide a transitional period to give you an opportunity to make any necessary changes to your business systems and processes.

Our process and timeline will vary depending on the significance of issues under consideration. The indicative timetable is noted below.

Date	Action
18 January 2021	Consultation paper published
26 February 2021	Feedback due to FMA
March – May 2021	Analysis of submissions, further development of policy proposals with additional targeted or public consultation if required
June 2021	Policy decision announced
Prior to 4 February 2022	If relevant, , granting of exemptions, drafting of notice and publication of notice to give effect to policy decision in advance of the expiry date. Possible additional targeted consultation on drafting, transitional arrangements etc.

FMA’s exemption powers

The FMA’s main objective is to promote and facilitate the development of fair, efficient and transparent financial markets. We have powers to exempt persons or transactions from compliance with requirements in the Financial Markets Conduct Act 2013 (FMC Act) and the Financial Markets Conduct Regulations 2014 (Regulations). These powers enable us to remove rigidities in the law to take into account circumstances that are unique to a particular class of market participant. In some circumstances we can tailor requirements for businesses to ensure they are reasonable and cost-effective, while still ensuring investors are appropriately protected.

Any exemption we grant must not be broader than necessary to address the matters that gave rise to it. We must also be satisfied that the exemption is necessary or desirable to promote one or more of the following purposes of the FMC Act:

- confident and informed participation in financial markets
- development of fair, efficient and transparent financial markets
- to provide for timely, accurate and understandable information to assist investment decisions
- to ensure appropriate governance arrangements apply to financial products and services, and allow for effective monitoring and reduce governance risks
- to avoid unnecessary compliance costs
- to promote innovation and flexibility in the financial markets.

About the wholesale investor notice

The $750,000 wholesale investor exclusion

Schedule 1 of the FMC Act provides statutory exclusions from the standard requirements of the regulated offers regime. This includes exclusions for offers of financial products to defined categories of wholesale investors. One category of wholesale investor the exclusion applies to is where the minimum investment is at least $750k. This is a bright-line test set on the basis that for this size of investment, the investor should have sufficient money at stake and sufficient bargaining power to negotiate with the issuer and exercise due diligence.

The key benefit for the market of the $750k investment exclusion is its speed and efficiency – the offeror can set the parameters of an offer at above $750k, ensuring all investors who acquire the financial products will, by definition, fall within the wholesale investor category.

To rely on this exclusion, a prescribed warning must be included on the front of all key offer documents and an investor acknowledgement must be obtained. The warning statement is detailed in the Regulations and explains that the usual rules do not apply to the offer and therefore the investor may not receive a complete and balanced set of information. The Regulations also detail the prescribed form for the investor acknowledgement.

The purpose of the investor warning and acknowledgement is to ensure investors know they are being treated as wholesale investors and that this means they will not receive the normal disclosures they would receive for a retail offer. A warning and acknowledgement is particularly important for this wholesale investor category because relatively inexperienced investors could potentially invest a large sum without understanding the consequences.

Rationale for relief

In early 2016, market participants raised concerns that the warning and investor acknowledgement were not practical in some circumstances and would significantly weaken the benefits and usability of the $750k investment exclusion.

The main concern raised by market participants was that offers by overseas issuers, particularly offers of ‘Kauri bonds’ (a New Zealand dollar-denominated security, registered in New Zealand and issued by a foreign issuer), were less likely to be extended to New Zealand’s debt capital market than under the Securities Act regime (that had a $500k minimum investment threshold to be categorised as a wholesale offer, with no other requirements for reliance). Market participants told us that overseas issuers need objective certainty to extend wholesale debt offers to New Zealand and seek to use standard offer documents across multiple jurisdictions. The requirement for the warning for New Zealand investors would not meet that criterion. It was also submitted that only institutional investors participate in the Kauri bond market.

Market participants also raised concerns that the usual warning and investor acknowledgement requirements had a disproportionate effect on offers of other unsubordinated debt securities in comparison to offers of other financial products. Wholesale markets for unsubordinated debt securities are highly fluid, market conditions may change rapidly, and offers must be quickly concluded while market conditions are favourable. The time and monitoring processes required with the usual warning and investor acknowledgement requirements would limit the ability of the market to operate efficiently. They said this was particularly the case for sales in the secondary market.

Relief granted in 2016

The Financial Markets Conduct (Wholesale Investor Exclusion - $750,000 Minimum Investment) Exemption Notice 2016 ("2016 notice") was put in place to address the concerns raised by market participants[1]. This notice has the effect of:

- exempting offerors of Kauri bonds from both warning and investor acknowledgement requirements (without conditions)
- exempting offerors of other unsubordinated debt securities from the investor acknowledgement requirement provided they include a warning statement only in the principal terms sheet (which must be given to the investor).

A distinction is drawn between the exemptions for Kauri bond offers and the exemptions for offers of other unsubordinated debt securities.

For Kauri bonds, no warning or acknowledgement is required. The FMA was satisfied that a complete exemption from the warning and acknowledgement requirements was justified due to the importance of the Kauri bond market to New Zealand's debt capital markets – the Kauri bond market is larger than the rest of New Zealand's debt capital markets combined and our review indicated that the investor pool is completely institutional. In the absence of such relief it was feared that the investor warning and acknowledgement requirements would have a cooling effect on investment opportunities for New Zealand businesses and on New Zealand's financial markets.

For other unsubordinated debt securities a warning is still required. The FMA considered that the interests of investors could be appropriately addressed, and unnecessary compliance costs avoided, by a single prominent warning in the principal terms sheet and no investor acknowledgement.

Review of the 2016 notice

During consultation on the 2016 notice, investor advocates expressed concern that offers of Kauri bonds might be made to investors who would otherwise be retail investors if they were not investing at least $750k, and that dispensing with the warning and acknowledgement requirements might result in non-habitual investors being unaware that they are participating in a wholesale offer.

To address these concerns, the exemptions in the wholesale investor notice were granted for one year to allow the FMA to monitor the use of the exemptions and carry out a general review of how the exemptions were working, including considering whether there was any inappropriate use.

The 2016 notice was reviewed by the FMA in late 2016 before its expiry in February 2017. In relation to Kauri bonds, the review found that the market was only just starting to rely on the wholesale investor notice, with no complaints or evidence that Kauri bond offers made in reliance on the wholesale notice were being targeted at, or taken up by, non-

[1] See the Regulatory Impact Statement for analysis of policy options considered.

habitual investors who would be retail investors if they were not investing at least $750.000. In relation to unsubordinated debt securities, the review found that offerors had not yet started to use the wholesale investor notice, likely because the review was only a few months after the wholesale investor notice came into force and offerors had not had time to operationalise use of the exemption.

The review recommended that, in the absence of evidence of inappropriate use of the exemptions, and in light of the market feedback that the exemptions were useful to facilitate wholesale offers, the exemptions should be available for a further five years with a review after two years. The wholesale investor notice was put in place and is this consultation is to inform our two year review.

The current review

This review of the wholesale investor notice provides us with the opportunity to work with stakeholders, including wholesale investors, banks, brokers, issuers and legal advisers. We require information about how the exemptions in the wholesale investor notice are being used, in order to be satisfied that they remain relevant and appropriate, and that retail investors are not being negatively affected by the lack of warning and acknowledgement requirements.

Feedback requested

Before we can grant the exemptions in the wholesale investor notice for a further period, we need to be satisfied that there is a need for the exemptions, that granting the exemption would promote one or more purposes of the FMC Act and that it is not broader than is reasonably necessary to address the regulatory issue. We rely on information from you to determine this. If we do not receive sufficient evidence and data that supports the continued need for the exemptions, the exemptions cannot be granted for an additional period. We need detailed information that provides evidence about the extent of reliance, the impact of the exemptions (and what the impact of not having the exemptions would be), and compliance costs. We are particularly keen to receive feedback on the questions below and we encourage all interested people to provide submissions and information to assist with our review.

Reliance

Q1. To what extent do you, your clients or your members rely on the wholesale investor notice exemption in relation to Kauri bonds? Please give details of:

a. the approximate value of Kauri bonds offered in reliance on the wholesale investor notice
b. the types of investors accepting offers of Kauri bonds made in reliance on the wholesale investor notice, including whether any are individuals or family trusts, and if so how many.

Q2. To what extent do you, your clients or your members rely on the wholesale investor notice exemption in relation to unsubordinated debt securities (or to what extent are you or they likely to rely on it in the future)? Please give details of the approximate value of unsubordinated debt securities offered in reliance on the wholesale investor notice and what proportion of the total unsubordinated debt securities market this is.

Regulatory burden

Q3. Has the wholesale investor notice removed unnecessary compliance costs? If yes, please provide actual or estimated dollar amounts.

Q4. Do you consider that the conditions under the wholesale investor notice impose unnecessary compliance costs? If so, please explain what those compliance costs are and why they are unnecessary.

Q5. If the wholesale investor notice is discontinued, please tell us about any impact this would be likely to have on offers of Kauri bonds and other unsubordinated debt securities.

Support for renewal

Q6. Do you support the granting of the exemptions in the wholesale investor notice for a further 5 years? What are the reasons for your view?

Q7. Do you think that standard warning and investor acknowledgement requirements should apply for investors in Kauri bonds and other unsubordinated debt securities who come within the $750,000 minimum investment wholesale investor category? Please tell us the reasons for your view.

Amendments needed

Q8. Do you think any amendments are needed to the wholesale investor notice if it is renewed? Please specify the amendments you propose, why you think they are necessary and how they promote or facilitate the purposes of the FMC Act.

Q9. Do you have any other comments in relation to the wholesale investor notice?

Feedback form: Review of Wholesale Investor Exclusion $750,000 Minimum Investment Exemption			
Please submit this feedback form electronically in both PDF and MS Word formats via email to consultation@fma.govt.nz with 'Feedback: Review of wholesale investor exclusion $750,000 minimum investment exemption' in the subject line. Thank you. Submissions close at 5pm on Friday 26 February 2021.			
Date: Number of pages: Name of submitter: Company or entity: Organisation type: Contact name (if different): Contact email and phone:			
Question number	**Name of notice**	**Comment**	**Recommendation**
You don't need to quote from the consultation document if you use question or page numbers. *You may insert additional lines or pages - please label each additional page with your name & organisation.*			
Feedback summary – *if you wish to highlight anything in particular.*			
Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act. The information we gather from this consultation will be utilised primarily for the purpose of considering whether the exemption noted should be grated for a further period and it may be used for other regulatory purposes as noted in the Transparency Statement on our website www.fma.govt.nz. Personal information gathered in this consultation will be handled in accordance with our Privacy Statement on our website ww.fma.govt.nz.			
Thank you for your feedback – we appreciate your time and input.			