A Guide to the Financial Markets Conduct Act 2013 Reforms

November 2013

FINANCIAL MARKETS AUTHORITY

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Introduction

This Guide explains the purposes of the Financial Markets Conduct (FMC) Act 2013 and how it fits in with other financial markets reforms. There is also a big picture view of the main reforms included in the FMC Act.

This Guide is not intended to provide a complete summary or to be a substitute for a detailed review of the FMC Act. Material in this Guide builds on the Ministry of Economic Development's (now Ministry of Business, Innovation and Employment (MBIE)), *Initial Briefing to Commerce Select Committee on the Financial Markets Conduct Bill* on 1 May 2012.

Purposes of the Financial Markets Conduct Act

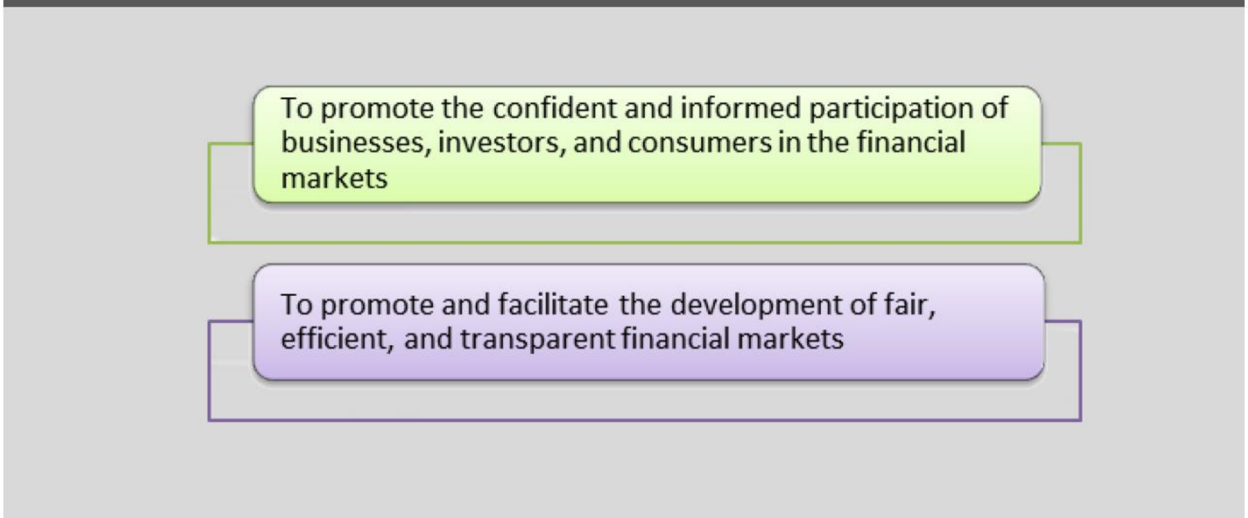
The FMC Act seeks to facilitate financial market activity…

The FMC Act governs how financial products are created, promoted and sold, and the ongoing responsibilities of those who offer, deal and trade them. It also regulates the provision of some financial services.

The principal objective behind the FMC Act is to facilitate capital market activity, in order to help businesses to grow and to provide individuals with opportunities to develop their personal wealth.

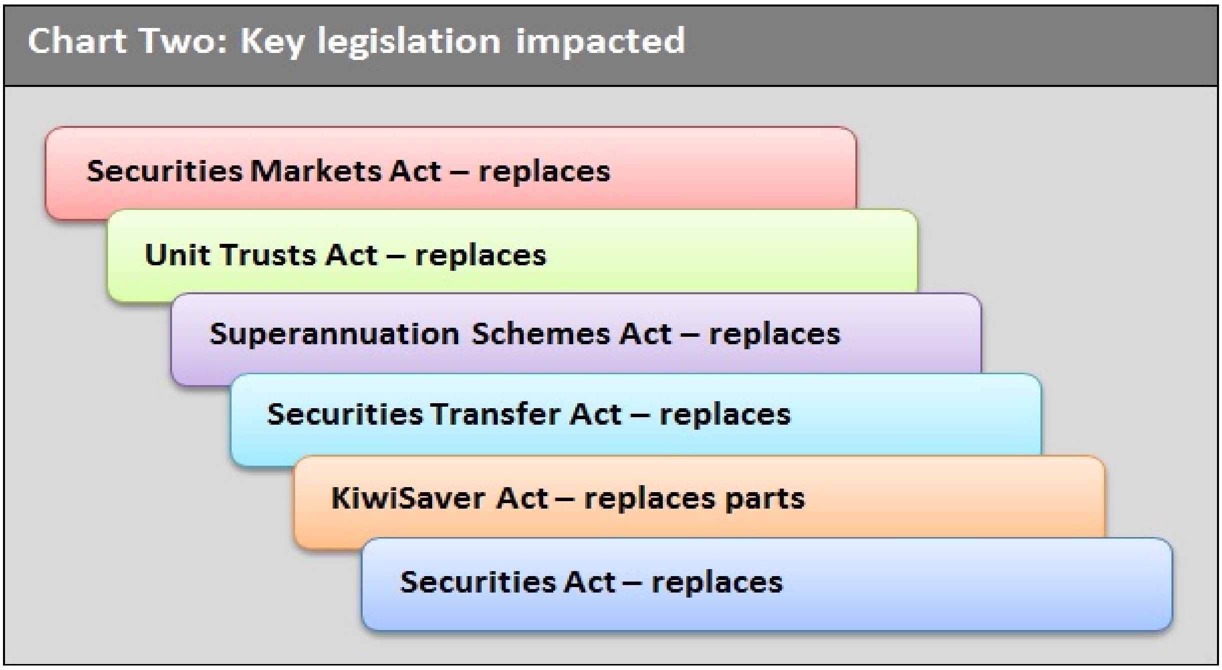
For this objective to be achieved, investors need to be satisfied that they and their advisers have the information required to make confident and informed decisions, that there will be appropriate governance arrangements in place and that obligations on issuers and others will be enforced. Issuers need investor participation in capital raisings to be successful, and regulation needs to achieve the desired objectives at minimum cost.

Chart One: Main purposes of the Financial Markets Conduct Act



New Zealand's current financial markets conduct law is primarily contained in the Securities Act 1978, supplemented by the Securities Markets Act 1988, the Securities Transfer Act 1991, the Superannuation Schemes Act 1989, the Unit Trusts Act 1960 and parts of the KiwiSaver Act 2006.

The FMC Act will replace that legislation. It will also amend other financial markets legislation including the Financial Advisers Act 2008, Financial Service Providers (Registration and Dispute Resolution) Act 2008, the Securities Trustees and Statutory Supervisors Act 2011 and the Financial Markets Authority Act 2011.



… and largely completes a wider set of financial market reforms

The FMC Act is part of a broader set of reforms that stem from the Review of Financial Products and Providers begun in 2005 (see Table One on page 7), but also responds to the recent global financial crisis, New Zealand finance company failures and the recommendations of the Capital Market Development Taskforce.

These changes address specific failings in the existing regime. The FMC Act is forward-looking and provides an integrated and enduring framework for the regulation of New Zealand's financial markets.

The framework for financial reporting for financial market participants is also under review. Substantive reporting requirements for issuers and other financial market participants will be included in Part 7 of the FMC Act under amendments made by the Financial Reporting Bill.

Table One: The reform of financial markets has been progressed on a staged basis:

a) A new regulatory regime for financial service providers was enacted in 2008 through the Financial Advisers Act and Financial Services Providers (Registration and Dispute Resolution) Act 2008.

b) Prudential regulation of non-bank deposit takers (NBDTs) was enacted in 2008 through Part 5D of the Reserve Bank of New Zealand Act 1989. The Non-Bank Deposit Takers Bill, which is before Parliament, will replicate (and repeal) Part 5D and also provide for a licensing regime for NBDTs.

c) The Securities (Disclosure) Amendment Act 2009 responded to the international financial crisis by removing unnecessary impediments to capital raising, while ensuring the timely disclosure of relevant information to prospective investors.

d) Prudential regulation of the insurance sector was enacted in 2010 under the Insurance (Prudential Supervision) Act 2010 with a licensing requirement in place in 2012.

e) A licensing regime for securities trustees and statutory supervisors was enacted in the Securities Trustees and Statutory Supervisors Act 2011 (which will be renamed the Financial Markets Supervisors Act).

f) FMA was established by the Financial Markets Authority Act 2011 to act as the consolidated market conduct regulator for the financial sector.

g) Measures to strengthen the governance of KiwiSaver schemes and their disclosure schemes were enacted in 2011.

Part 1: Preliminary Provisions

The main and additional purposes are in Sections 3 and 4…

The main purposes of the FMC Act (see Chart One on page 5) are set out in Section 3. These are based on the main objective of FMA (to promote and facilitate the development of fair, efficient, and transparent financial markets) and the key FMA function of promoting the confident and informed participation of businesses, investors, and consumers in the financial markets

Section 4 contains additional purposes relating to the provision of information to investors, appropriate governance arrangements, effective monitoring, avoidance of unnecessary compliance costs and the promotion of innovation and flexibility in financial markets.

These purposes will affect how the FMC Act is interpreted. In addition, particular provisions link back to them, so that the purposes become a check and balance in respect of powers. For example, when FMA is considering ‘calling-in’ a product by designation or granting an exemption, it must be satisfied that the exercise of the power is necessary or desirable in order to promote the purposes.

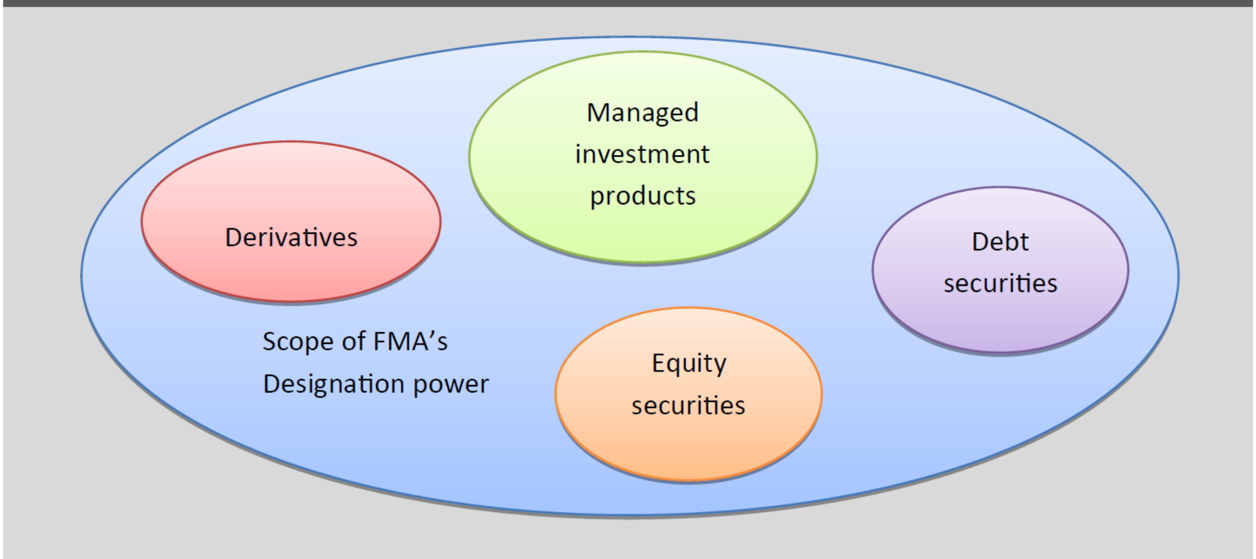
… and the four types of financial products are defined in Sections 6 to 10

The definitions of the financial products that are covered by the FMC Act are a central feature. A criticism of the definitions in the current Securities Act has been that they are largely based on the legal form of the security, rather than on their economic substance. This can mean that some securities are not categorised correctly and that their issuer can avoid the legal requirements that would be appropriate for them.

The FMC Act remedies this by defining products according to their underlying economic substance, while providing a degree of certainty around the treatment of common products. It defines four types of financial product: debt, equity, managed investment products, and derivatives.

Where the definitions do not result in appropriate outcomes, FMA has the power to designate products into the appropriate category. Products within a broad definition of 'security' that would not otherwise be a financial product will be able to be designated by FMA to be a financial product of a particular type. This ensures that the regime is flexible enough to deal with novel product types in the market and to prevent avoidance such as Blue Chip-type schemes.

Chart Three: Categories of financial products



Part 2: Fair Dealing

The FMC Act will be a one-stop shop for financial markets conduct…

The Act sets out core standards of behaviour that those operating in the financial markets will have to comply with. It provides for fair dealing in relation to financial products and financial services by prohibiting misleading or deceptive conduct, false, misleading, or unsubstantiated representations. It also prohibits offers of financial products in the course of unsolicited meetings.

The fair dealing provisions are based on equivalent provisions in the Fair Trading Act 1986 but with some customisation for the financial markets context. Although the Fair Trading Act will still apply to conduct relating to financial markets, the clear intention is that FMA will regulate such conduct.

The Commerce Commission will need FMA's consent to commence proceedings in respect of conduct in relation to a financial service or product. Such consent can also be granted on a class basis in respect of identified classes of conduct arising in relation to financial products and services. FMA's jurisdiction can also be amended by regulations.

FMA and the Commerce Commission will enter into a Memorandum of Understanding that describes the process for obtaining class consents and will work together to regulate fair dealing across all financial products and services. Proceedings in relation to unsubstantiated representations relating to financial products or financial services and offers in the course of unsolicited meetings can only be brought by FMA.

Part 2 applies to conduct in both the retail and wholesale financial markets. It sets out the main standards for advertising of financial products, but there are specific rules in Part 3 for advertising and promotion of regulated offers (see Part 3, subpart 3).

Part 3: Disclosure of Offers of Financial Products

Part 3 contains the core disclosure requirements…

Part 3 deals with the disclosure requirements for offers of financial products. The main purpose of regulating disclosure is to balance information asymmetries, as the issuer has more information than the investor about who is offering the product, the product itself, and the terms and conditions on which it is sold. This information asymmetry disadvantages the investor, resulting in an inefficient market.

… and replaces prospectuses and investment statements…

The Securities Act 1978 provides for disclosure to potential investors in the form of a 'prospectus' and an 'investment statement'. In general, where an offer of securities is made to the public, a prospectus must be registered and be provided to potential subscribers on request, while an investment statement must be provided to the investor before subscribing for the security. Prospectuses are intended to provide full details of the offer and the circumstances of the issuer. By contrast, an investment statement is intended to provide key information to assist a prudent but non-expert person to decide whether or not to subscribe for securities, and bring to their attention information available in other documents.

… with product disclosure statements tailored to retail investors…

The FMC Act will replace the current requirement for issuers to prepare a prospectus and investment statement with a requirement to prepare a single product disclosure statement (PDS) tailored to retail investors.

The PDS will be aimed at prudent, non-expert investors and be required to be worded in a clear, concise, and effective manner. The PDS will be required to be lodged on the register of offers of financial products. In addition to the PDS, issuers will be required to disclose other material information and documents on the register, where it will be available for interested investors and analysts. This register will be designed to aid comparability of offers by investors and also to allow for cost-effective updating of information by issuers. By allowing the PDS to be supplemented by the information disclosed on the register, the PDS can be a more-focused document.

Much of the detail concerning the content and presentation of PDSs and the register will be set out in the regulations. The PDS will be tailored to fit specific financial products. The content of the PDS will be heavily prescribed, and the length of the PDS will be prescribed where practical, given the nature of the financial product being issued.

It is likely that the PDS will be divided into two parts: a short one-to-two-page key information summary at the front, and a more-detailed second part with all of the information that is essential to an investor's decision about whether to invest.

On-going disclosure requirements are proposed for most financial products. It is likely that equity and debt products and more complex managed investment schemes will be required to make event-based disclosure. Managed funds are likely to have periodic disclosure obligations similar to current requirements for KiwiSaver funds.

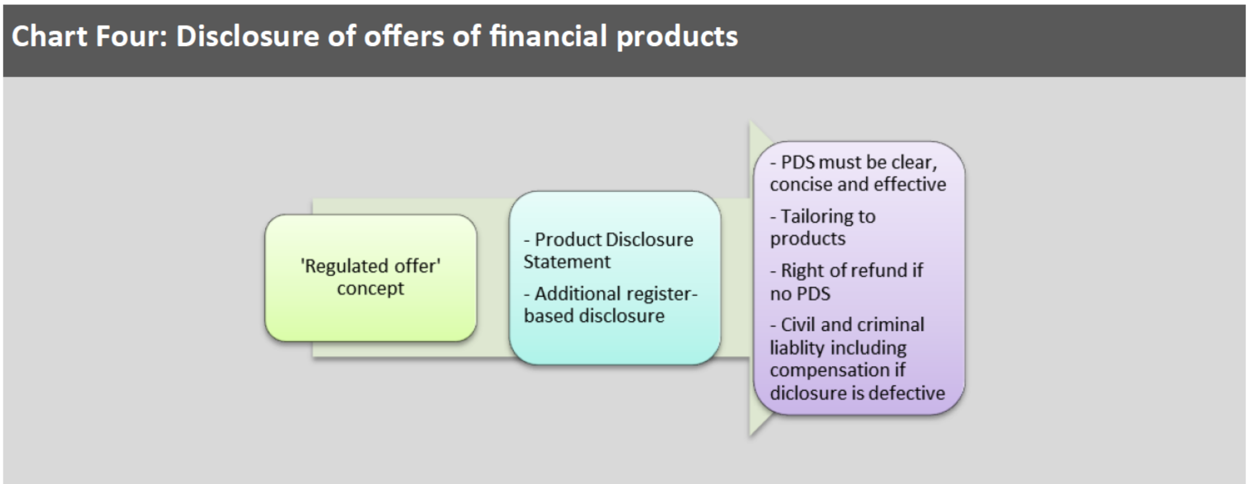
The current offer disclosure regime does not work well. The Capital Market Development Taskforce criticised disclosure as not being sufficiently standardised, concise, simple or understandable. Currently, both prospectuses and investment statements are long and difficult to understand without some expertise. One reason for these deficiencies is that issuers are faced with trying to produce readable disclosure documents while also having to cover all material matters relating to the offer. This is a challenging task.

The FMC Act defines a regulated offer…

Currently, failure to provide an investor with the required disclosure documents can result in the entire offer being void if even *one* investor who accepted the offer turns out to have been a member of the public or not exempt. This rule and the lack of certainty over the meaning of member of the public and scope of the exemptions has been a major source of problems with the current regime.

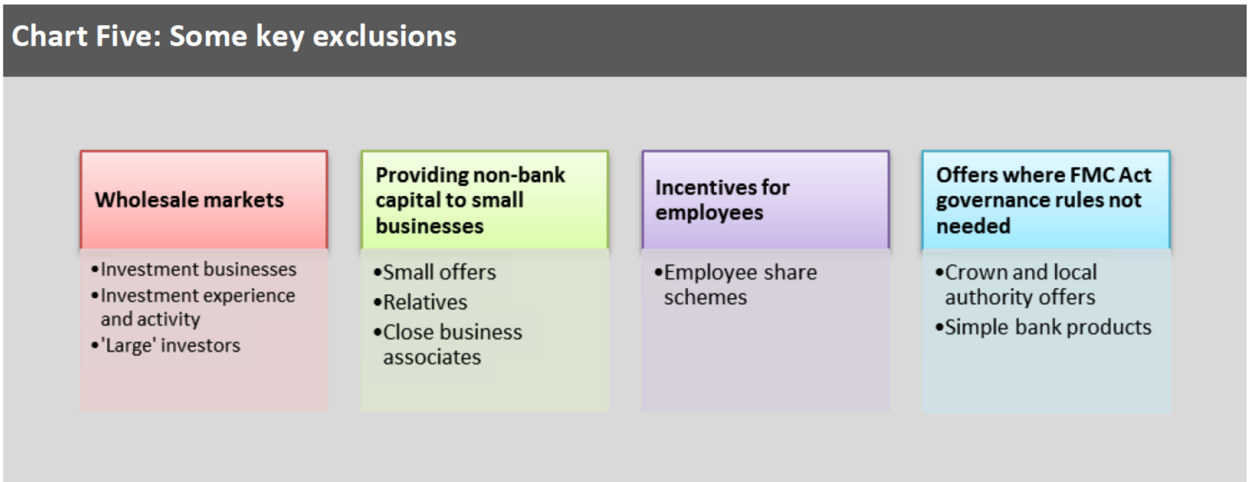
The FMC Act dispenses with the concept of 'offers to the public'. Instead, an offer of financial products requires disclosure to an investor unless an exclusion applies. If disclosure is required to one or more of the investors not covered by an exclusion, the offer is a 'regulated offer'.

Disclosure need only be made to those investors not covered by the exclusion but all the investors under the regulated offer benefit from the other protections under the regime. If disclosure should have been made to an investor, that investor is entitled to a refund of their subscription and compensation, but the offer to others will not be affected further. This is intended to help reduce the pressure on the boundary between regulated and other offers.



… using 'bright-line' exclusions set out in Schedule 1…

Disclosure is not required to investors who are considered to be capable of accessing the information they need (for example, due to their size and experience or their relationship with the issuer) and also for small offers of debt and equity (for example, through angel networks) or under employee share purchase schemes. Exclusions also apply where FMC Act governance requirements are unnecessary for specific offerors such as the Crown. These exclusions are set out in Schedule 1.



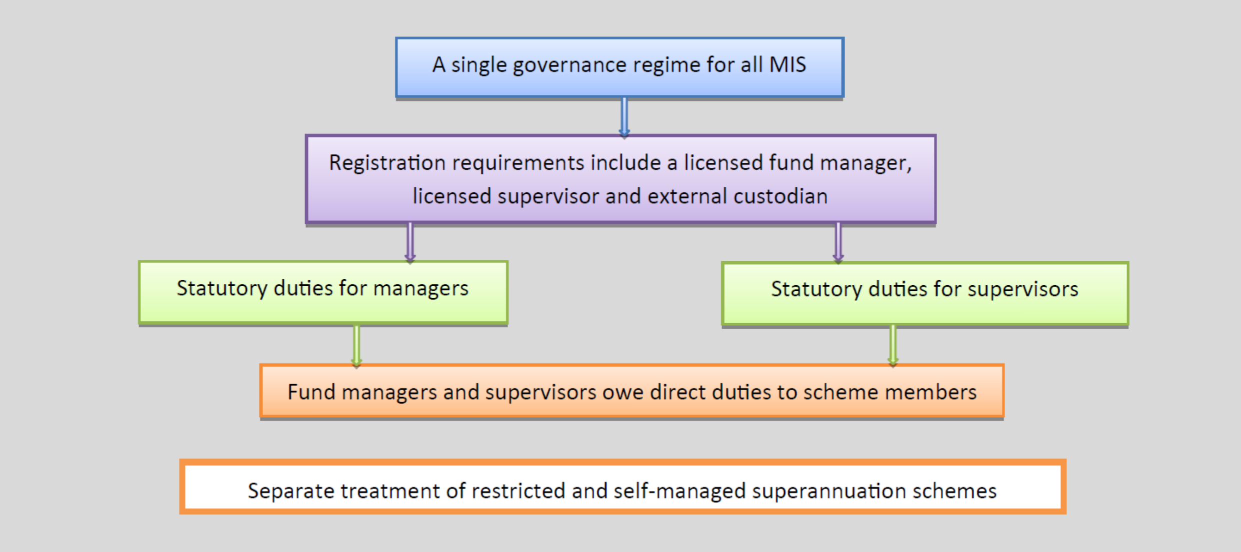
A key change from existing legislation is that there are more 'bright-line' and 'safe harbours' for exclusions. Investors may be able to self-certify that they are a 'wholesale investor' subject to strict rules. In addition, investors who consider that they have the knowledge and experience to assess offers will be able to certify this and have a professional adviser confirm the certification. Issuers will generally be able to rely on these certifications unless they know that they are incorrect.

… by licensing managers and supervisors and imposing direct duties to investors…

Most registered schemes will have to have a licensed manager and an independent licensed supervisor. Scheme property will be held by the independent supervisor or another independent custodian.

The FMC Act establishes statutory duties for both managers and supervisors. The duties include a duty to act honestly and with reasonable diligence, to act in the best interests of investors and to comply with a professional standard of care. There are limits on the rights of trustees and managers to protect themselves from liability. The duties and other obligations in Part 4 are legally enforceable by FMA and by individual investors, and can lead to significant pecuniary penalties and compensation.

Chart Six: Regulation of Managed Investment Schemes (MIS)



Part 3 provides for meetings of scheme participants, and limits the right of managers to vote their own interests at such meetings, for the purpose of discouraging managers from holding 'blocking stakes'. It regulates related-party transactions in relation to managed investment schemes, generally requiring these to be in the best interests of investors, made on arm's-length terms or in certain regulated products. It also requires schemes to have a statement of investment policy and objectives and imposes reporting requirements on managers and supervisors.

… while recognising that different types of schemes require some different rules…

The FMC Act sets out additional requirements for specific types of managed investment schemes, including KiwiSaver and superannuation schemes. KiwiSaver scheme requirements largely carry over existing requirements. Superannuation schemes will be required to be for the sole purpose of retirement.

Regulations will set out registration requirements for superannuation schemes with clear rules that 'lock-in' members savings until retirement and permit the trust deed to allow withdrawals on other limited grounds that ensure the schemes are consistent with the 'sole purpose of retirement' test. At present some superannuation schemes essentially operate on an unlocked basis.

The UK government has recently tightened the Qualifying Recognised Overseas Pension Scheme (QROPS) rules in response to perceived misuse of the regime, and the changes in the FMC Act are intended to ensure New Zealand schemes are able to make appropriate use of the QROPS regime through a new subtype of 'locked-in' superannuation scheme.

Some existing schemes will not need to split management and supervision and will instead be able to register as a 'restricted scheme'. Restricted schemes, which will mainly consist of employer, industry and closed schemes, will instead have a licensed independent trustee. Restricted schemes will be managed by the trustees who will owe the same duties as managers and will be governed in much the same manner as other schemes, but with greater FMA oversight.

Restricted schemes will also have a five percent limit on related-party transactions, except for investments in registered schemes or some bank products. If an employer fails and an employee loses their job, this should mean there is a reduced likelihood of the employee also losing a significant portion of the value of their superannuation scheme.

… by providing for FMA and the Courts to step in when issues arise…

Part 4 sets out a regime for dealing with issues that can arise, such as the replacement of supervisors or managers. It also sets out duties of auditors, actuaries, investment managers, administration managers and custodians to report breaches by issuers and duties of supervisors to report. It provides for FMA directions to supervisors and for applications to the High Court to remedy problems or to wind-up schemes.

… and requiring issuers to keep registers and have these reviewed or audited...

Part 4 also contains the rules for the keeping of registers by issuers of all types of financial products. Issuers must have the registers reviewed or audited by a qualified auditor.

Table Two: The main exclusions in the Act are for:	
• Offers to wholesale investors – this includes investment businesses, persons that meet certain investment activity criteria, large investors (in terms of net assets and turnover), government agencies, persons that have invested or will invest at least $750,000 • Offers to close business associates of the offeror – this includes directors and senior managers of the offeror or a related body corporate • Offers to relatives of the offeror or of a director of the offeror • Offers under employee share purchase schemes or dividend reinvestment plans	• Small offers – this new exclusion, based on Australian law, excludes offers of equity or debt securities limited to 20 investors and $2 million being raised in any 12-month period, subject to strict limits on how the offers may be made • Offers of financial products that are of the same class as quoted are financial products • Offers through certain people such as licensed intermediaries and discretionary investment management services (DIMS) licensees or by the Crown and registered banks in respect of simple banking products.

… while ensuring that offers made under the exclusions are appropriately regulated…

Even if an offer is made under exclusion in Schedule 1, Part 2 of the FMC Act will still apply to the conduct in respect of the offer. In addition, it is proposed that regulations will impose short-form disclosure, warning statements or other requirements for offers made in reliance on exclusions in Schedule 1.

… and prescribes the procedure for making regulated offers

Before making a regulated offer, a PDS must be lodged with the Registrar and a register entry completed. The FMC Act continues the current consideration period process, which provides an initial (five-to-ten-working-day) opportunity for FMA to consider a PDS register entry and governing documents before any financial products can be issued.

If an offer to a particular investor requires disclosure, then the PDS must be given to that investor prior to an application being made to acquire the products. There are exceptions to this rule to enable issuers to rely on application forms that are distributed with the PDS (provided an applicant confirms in the form that they received the PDS) or where disclosure was made to the investor in respect of an earlier offer. Knowing or reckless failure to comply with these requirements can lead to significant periods of imprisonment. Civil liability with pecuniary penalties also apply on a strict liability basis, subject to defences. Issuers are able to lodge supplementary or replacement PDSs and amend register entries to, for example, correct misleading or deceptive statements.

Part 4: Governance of Financial Products

Part 4 reforms the law relating to governance…

Part 4 of the Act makes wide-ranging changes to the governance rules that apply to financial products. The current governance requirements are scattered amongst a number of statutes and rely heavily on contract and trust law, which has led to under-enforcement. It applies to financial products offered under a regulated offer and to managed investment products in a registered scheme.

… by imposing legal requirements in respect of debt securities…

Part 4 requires trust deeds for regulated offers of debt securities to comply with specific requirements, imposes legal duties on supervisors to supervise the issuer and to act in the best interests of investors, limits the ability for supervisors to protect themselves from liability, imposes reporting requirements on issuers, and provides for meetings of investors. The provisions in respect of debt securities essentially consolidate and clarify the existing law.

… and by establishing a common set of requirements for managed investment schemes

Part 4 establishes a register of managed investment schemes, which will include all managed funds (e.g. unit trusts), property schemes, superannuation schemes and KiwiSaver schemes under which a regulated offer has been made and any scheme that chooses to register. It sets out a common set of governance requirements for registered schemes, irrespective of their legal form (which could be trusts, partnerships or contractual arrangements).

Part 5: Dealing in Financial Products on Markets

Insider trading, market manipulation and continuous disclosure rules continue…

Part 5 regulates financial product markets and activity on those markets. Many of the provisions in Part 5 are carried over from the existing laws.

The Securities Markets Act 1988 framework for regulating insider trading, market manipulation, continuous disclosure, substantial security holder disclosure and directors' and officers' disclosure has undergone substantial revision over the past decade.

As a result, these provisions are largely replicated in the FMC Act, apart from changes to fix anomalies or gaps in the current regime. This includes incorporating exemptions from regulations and FMA exemption notices into primary legislation, where desirable.

Part 5 also carries over existing provisions relating to unsolicited offers and (with some modernisation) the Securities Transfer Act 1991.

… financial product markets will now need to be licensed…

The FMC Act requires those operating financial product markets to become licensed. There will be exemptions for markets that do not meet certain size thresholds and additional exemptions in regulations. Licensed markets must have their rules approved by FMA.

Overall, the new regime imposes a higher level of oversight of existing registered or authorised markets and imposes licensing on currently unregulated markets.

Chart Seven: Exchanges

… and 'stepping stone' markets are provided for

The FMC Act contains a change in the regulation of financial product markets recommended by the Capital Market Development Taskforce. The current regime for securities and derivatives exchanges is effectively either all or nothing – exchanges are either fully regulated and comply with the regulatory regime (e.g. NZX), or are outside of the regime.

While the existing requirements for financial product markets will be continued for large markets under the Act, provisions have been made for 'stepping stone markets' under which disclosure requirements and conduct rules can be adapted to the particular market, issuers, and investors involved. The ability to tailor these requirements may be beneficial also for markets on which only certain types of products are traded, such as exchange traded funds.

Part 6: Licensing and Other Regulation of Market Services

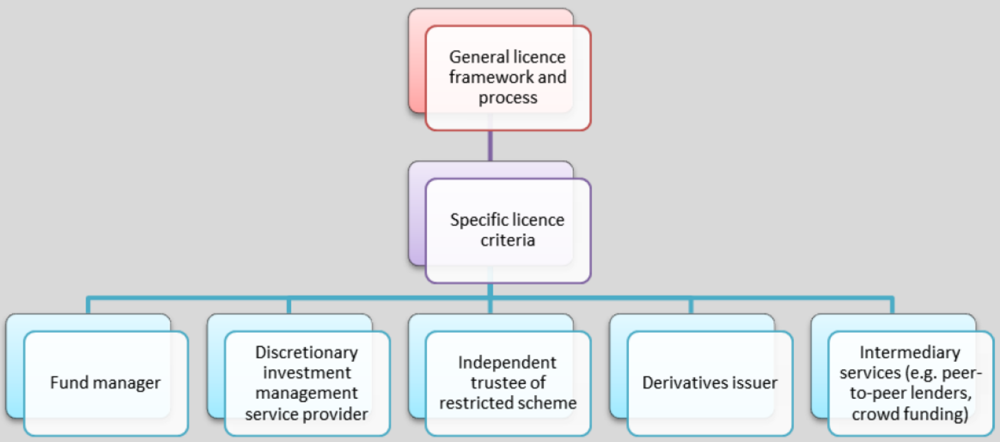
Table Three: Part 6 of the Act requires that providers of the following market services must be licensed	
• Managers of a registered scheme • Independent trustees of a restricted scheme	• Providers of a discretionary investment management service (DIMS) • Derivatives issuers in respect of a regulated offer of derivatives

Some financial market participants will be licensed under Part 6…

Part 6 also allow for prescribed intermediary service providers to be licensed. This licensing regime is intended to facilitate suitably regulated 'peer-to-peer lending' and 'crowd-funding' services to operate in New Zealand.

The FMC Act stops short of requiring licensing for custodians in respect of MIS and DIMS. However the FMC Act will impose legal duties on custodians and make the supervisor or DIMS provider jointly liable for a custodian's failings.

Chart Eight: Regulation of market services



Part 6 provides for the issue of licences, their conditions and their duration and for their monitoring and enforcement. Introducing this licensing regime brings New Zealand regulation in line with the way that most other jurisdictions treat these participants. Detailed licensing criteria will be set out in regulations.

… some of these will be licensed or authorised under other legislation…

Part 6 sits alongside the licensing regime for supervisors in the Securities Trustees and Statutory Supervisors Act, the Qualifying Financial Entity (QFE) and Authorised Financial Adviser (AFA) regimes in the Financial Advisers Act, the Reserve Bank's registration and licensing regimes for banks and insurers, and the soon-to-be-introduced licensing regime for non-bank deposit takers. The licensing process will take into account whether a market services applicant (or one or more of their directors or senior managers) holds such a license or is an AFA or a member of a QFE group.

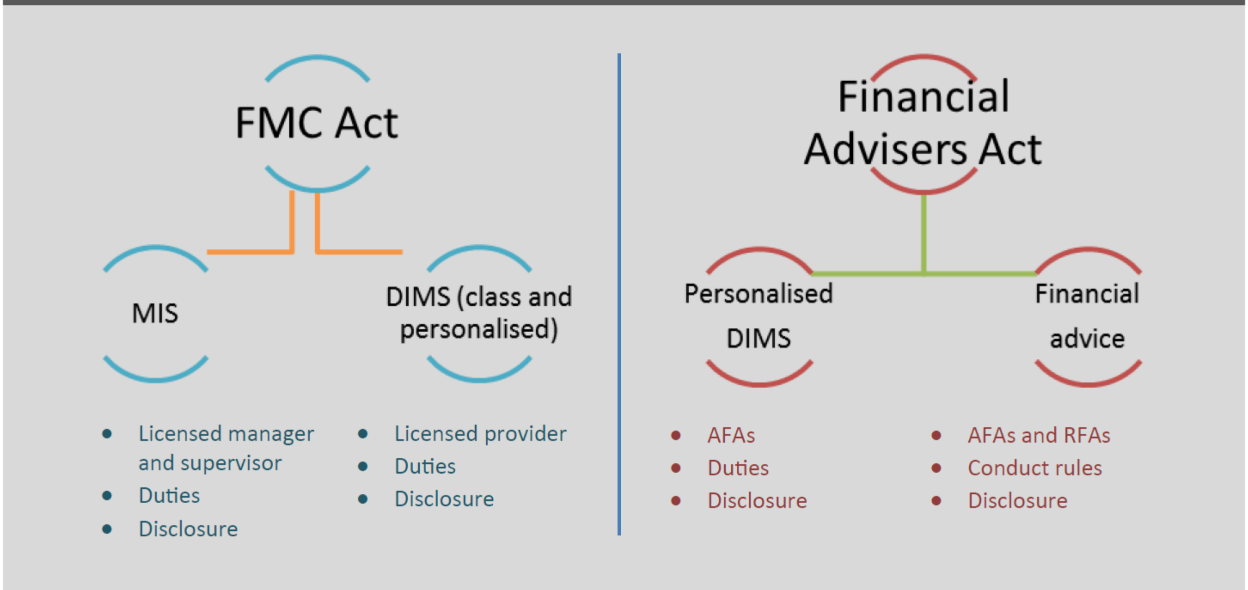
… and DIMS will be regulated under this Part and the Financial Advisers Act

The FMC Act sets out detailed rules that regulate the provision of DIMS. This service is the business of managing a person's investments under an investment authority and ranges from a personalised service provided as part of financial advice to a wholly class service where investors sign up to a model portfolio of investments through a 'wrap platform'.

A DIMS differs from a MIS in legal form, as each investor individually holds the underlying financial products, rather than an interest in a scheme that invests in those products. However, at least in the case of a model portfolio, the economic outcome is the same. The providers of these services are, in effect, performing an identical role to that of fund managers, and the FMC Act treats them largely in the same way. This includes imposing legal duties on the licensed DIMS provider and requiring the use of an independent custodian (unless the licence provides otherwise).

Advice about investing through DIMS will be regulated under the Financial Advisers Act in the same way as advice about investing in a managed investment scheme. However, licensed DIMS providers will be able to provide some incidental advice to clients in the ordinary course of providing DIMS.

Chart Nine: Regulation of Discretionary Investment Management Services (DIMS)



Provision of DIMS will also be regulated under the Financial Advisers Act. The Financial Advisers Act currently regulates DIMS because clients often give their financial adviser some discretion over their investments as part of the personalised service the adviser provides to them. The FMC Act takes the approach that a truly personalised DIMS service should continue to be able to be provided under the Financial Advisers Act, but that the duties of the advisers when providing those services need to align with the FMC Act. The Financial Markets (Repeals and Amendments) Act (which was split off from the FMC Act) will amend the Financial Advisers Act to provide for this alignment.

Part 7: Financial Reporting

FMC reporting entities must keep and audit accounting records

The Financial Reporting Bill will move substantive reporting requirements for issuers and other financial markets participants to a new Part 7 of the FMC Act and make a number of consequential changes.

The financial reporting obligations moving to Part 7 of the FMC Act are broadly similar to those in the Financial Reporting Act 1993 (see Table Five).

Table Four: The new Part 7 will:

- Apply to 'FMC reporting entities' including issuers, managers of registered schemes, licence holders under Part 6 (except independent trustees of restricted schemes), licensed market operators (other than overseas operators), licensed supervisors, listed issuers, registered banks, and licensed insurers
- Include building societies and credit unions as FMC reporting entities
- Require FMC reporting entities to keep proper accounting records, to prepare financial statements or group financial statements, to have these financial statements audited and to lodge these financial statements with the Registrar of Financial Service Providers.

Table Five: Key changes include:

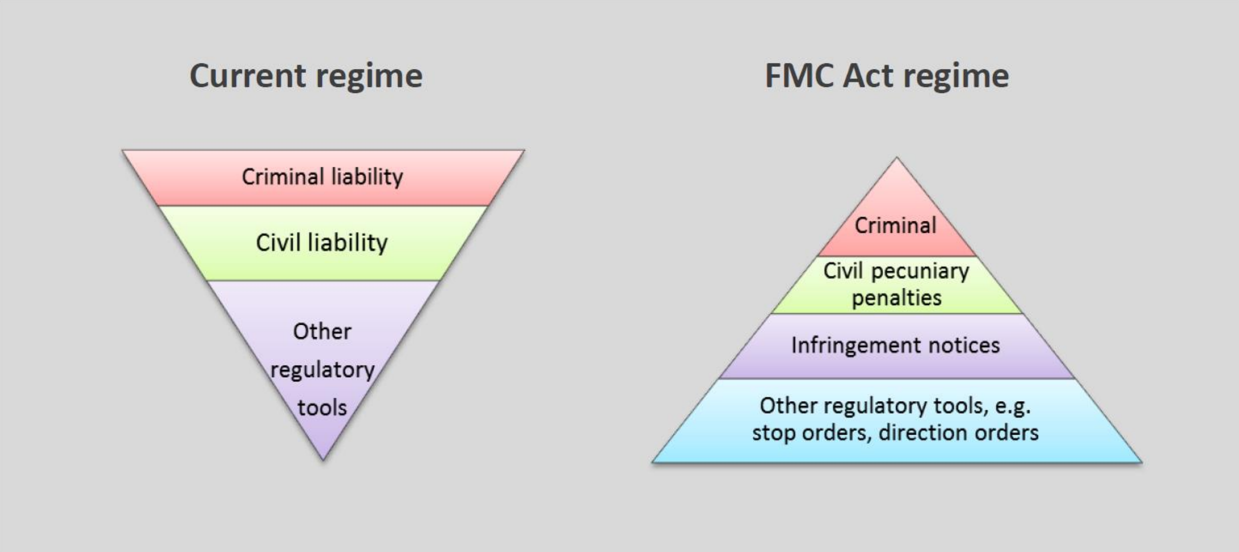
- A change in enforcement and liability regime away from a strict liability regime
- FMA can impose stop orders, direction orders and infringement notices in respect of contraventions of new requirements
- FMA can grant exemptions from provisions of the new requirements
- FMA will be able to designate entities as not having or having 'higher public accountability' and in doing so vary the content of their financial reporting
- FMC Reporting Entities with subsidiaries will only need to prepare group financial statements, with the External Reporting Board determining what, if any, parent entity information should be disclosed in the notes to the financial statements
- Financial statements will need to be registered within four months, shorter than the current six months.

Part 8: Enforcement, Liability and Appeals

New regime provides for escalating levels of liability…

The liability regime is a fundamental part of the FMC Act. It sets out the circumstances where liability arises for contravention of securities law, including when investors may seek compensation and when company directors and others may be criminally prosecuted for their conduct.

Chart Ten: Liability regime



The current liability regime is complex, with overlapping liability provisions arising from trust, common and statute law. The FMC Act simplifies the regime considerably by adopting a system of escalating levels of liability to ensure that the enforcement response is proportionate to the contravention.

… and FMA's regulatory 'toolbox' will be expanded…

FMA will have the power to make stop orders to prohibit further action in respect of offers of financial products with disclosure that is likely to deceive, mislead or confuse, and other contraventions of the Act.

Also, FMA may make direction orders in some circumstances to direct a person to comply with the law. The FMC Act also introduces an infringement notice regime, which will provide an effective remedy for minor compliance-type contraventions.

… the scope of criminal liability for disclosure contraventions is reduced but with higher penalties...

The FMC Act places an increased emphasis on civil liability for contraventions of the regime. Serious criminal offences that include the possibility of imprisonment are reserved for the most serious violations of the law, such as where the conduct in question involved knowledge or recklessness.

Offerors of products will be criminally liable under the FMC Act for knowingly or recklessly making an offer where there is defective disclosure. Directors will also be criminally liable if the offer document was issued with their authority, permission or consent and they know or are reckless about whether there is a defect.

Offerors of products will be criminally liable under the FMC Act for knowingly or recklessly making an offer where there is defective disclosure.

Directors will also be criminally liable if the offer document was issued with their authority, permission or consent and they know or are reckless about whether there is a defect.

This contrasts with the Securities Act which criminalises material misstatements in offer documents, regardless of whether there is a deliberate intention to deceive, and makes directors and promoters liable for a term of imprisonment of up to five years unless they can establish that they had reasonable grounds to believe and did believe, that the statement was true.

Although the FMC Act reduces the scope of criminal exposure by requiring the Crown to establish 'a guilty mind' maximum penalties are higher with up to 10 years in prison or a $1-million fine for an individual (or $5-million for a company).

… and a wider range of conduct that may result in civil penalties

The FMC Act significantly broadens civil liability for issuers, directors and other people who contravene or are involved in contraventions of the FMC Act. Because the regime is more prescriptive and contains more statutory rules, a wider range of conduct can result in civil penalties than under the current laws.

Civil liability orders are available for contravention or involvement in a contravention of civil liability provisions under the FMC Act.

Table Six: Civil liability orders that can be made are:
• A declaration of contravention • A pecuniary penalty order (up to a maximum amount of the consideration for the transaction, three times the amount of the gain made or the loss avoided, or $1-million in the case of a contravention by any individual or $5-million in any other case) • A compensatory order.

The FMC Act has a presumption, that when financial products decline in value as a result of a material defect in disclosure (such as a materially misleading statement), the investor has suffered a loss unless the decline in value is proved to have had another cause. However, the level of compensation will be for the Court to decide.

As noted above, persons who are 'involved' in a contravention will also face civil liability. Generally a person will only be found to be 'involved' in a contravention where only he or she was an intentional participant in the primary contravention and had knowledge of all the essential facts. However, directors of an issuer will be automatically treated as having contravened a core offer disclosure obligation where it is established that there has been a contravention by the issuer (subject to any exclusions prescribed by regulations).

The civil liability provisions are strict liability: a person who contravenes a civil liability provision is liable unless they make out a defence. There are defences; some apply to disclosure contraventions and others more generally for other contraventions (see Table Seven for examples).

Table Seven: Issuers (and their directors) will have a defence in relation to false or misleading statements in the PDS or on the register if they prove:
• They reasonably relied on information from another person (other than a director, employee or agent) • They made all enquiries that were reasonable in the circumstances and believed on reasonable grounds that the disclosure was not defective • They took all reasonable and proper steps to ensure the company complied with the FMC Act.

Part 9: Regulations, Transitional Provisions and Miscellaneous Provision

The FMC Act necessarily leaves the detail to regulations…

Part 9 provides for regulations to be made for the purposes of the FMC Act, including the form and content of the PDS, terms implied into the governing documents for debt securities and managed investment schemes, and the criteria and licence conditions under Part 6.

… and gives FMA the power to exempt, call-in and move products between classes

FMA's existing exemption power is carried over into the FMC Act and applies to all the substantive provisions of the Act. The exemption power will be used to deal with particular issues as they arise and for unusual circumstances.

Under the Securities Act, a 'security' that does not fall in one of other defined types is a 'participatory security'. This 'catch-all' category of security caught some arrangements that should not be regulated by securities law at all (such as marina berth licences after the development stage).

Currently people inadvertently caught must either rely on FMA exemptions or comply with the Securities Act. An additional problem that arises under the Securities Act is that some products are classified as a particular type of security when in substance they more closely resemble another type of security. Currently these product providers must also rely on FMA exemptions. Still other products are intentionally structured to fall outside particular rules in the existing regime in order to avoid the Act altogether, or to avoid governance requirements.

The FMC Act contains a new designation power to ensure that the new regime is flexible enough to deal with complex financial instruments and to ensure that the purposes of the Act are not frustrated.

The designation power enables FMA to call-in securities into one of the four classes of regulated products and to shift products between classes. FMA can also limit the scope of an exclusion in schedule 1, so as to bring the product within the regulated offer regime. The existence of this power has enabled the definitions in Part 1 to be more tightly defined and has allowed the regime to omit a 'catch-all' class of security.

… and there is a transition period of up to two years to comply with the new law

Under the FMC Act, issuers will be able to choose to register prospectuses for new offers under the current law during the first year after commencement (or two years for continuous issuers), but all offers and existing products must transition to the new regime within two years of commencement. However, once a scheme registers under the FMC Act, all offers and allotments under the current law must cease.

In the case of products that have been issued in the past that will be regulated under the new regime, the issuer has up to two years to move to the new regime, which will require most debt issuers and managed investment schemes to change their governing documents, and all managed investment schemes to register on the new managed investment scheme register.

The FMC Act includes provisions to facilitate changes to existing governing documents in order to comply with the new regime. It is intended that changes to schemes to comply with the new regime will not give rise to tax liability.

Existing registered exchanges and authorised futures exchanges will be treated as holding a financial product market licence in respect of each of their current markets, and a process is set out to enable currently unlicensed markets to seek a licence under the transitional provisions.

In respect of licensed services, it is intended that the requirement to be licensed will only apply once existing providers have had the opportunity to obtain a licence.

Financial Markets (Repeals and Amendments) Act

Repeals and amendments have been split into a separate Act…

Table Eight: The Financial Markets Conduct Bill was divided into two Acts just prior to being passed:	
• The FMC Act with all the substantive forward-looking law	• The Financial Markets (Repeals and Amendments) Act with all the repeals and amendments to other Acts.

… a number of Acts are repealed and more are amended

Five Acts will be repealed and a number of related regulations and notices amended. The most significant amendments are to the Fair Trading Act, Financial Advisers Act, Financial Markets Authority Act, KiwiSaver Act and Securities Trustees and Statutory Supervisors Act.

The Schedule to the Financial Markets (Repeals and Amendments) Act contains minor consequential amendments to Acts and regulations, mainly to update references to the Securities Act or other Acts to the new law in the FMC Act.

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