

Consultation Paper: Exemptions for small offers of co-operative shares

About this consultation paper

The Financial Markets Authority (FMA) is considering possible class exemptions to address issues faced by co-operative companies and industrial and provident societies (IPS) in complying with the Financial Markets Conduct Act 2013 (FMC Act) when making offers of co-operative shares where the shares provide the shareholder with transacting or other membership benefits and the amount of capital invested is small.

We want your comments on the exemption proposals discussed in this paper.

Submissions close on 6 May 2016. The form at the back provides more details.

How do I make a submission?

Please use the form provided at the end of this document – it has details of what you need to do. Forms must be submitted electronically in both PDF and Word formats, and emailed to consultation@fma.govt.nz – please put ‘Exemption for small offers of co-operative shares: [your organisation’s name]’ in the subject line.

Submissions close on 6 May 2016.

Next steps

After considering submissions, we will finalise our policy proposals and aim to have any exemptions in force by mid-2016.

Questions

If you have questions about the consultation process, please contact Kate Strevens, senior policy adviser, on 09 300 0480 or at exemptions@fma.govt.nz. Please title your email ‘Consultation Paper: Exemption for small offers of co-operative shares: [your organisation’s name]’.



Consultation paper

7 April 2016



About this consultation paper:

This consultation is for:
co-operative companies, industrial and
provident societies, and their
respective industry bodies, investors
and advisers.

It aims to:
seek views on our proposals for exemptive relief
under the FMC Act for certain offers of co-
operative shares.

Document history

This version was issued in April 2016 and is based on legislation and regulations as at the date of issue.

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Executive summary

1. Co-operative companies and IPS will need to comply with the requirements in the FMC Act by 30 November 2016 (or any earlier chosen FMC Act effective date) when they offer financial products.
2. A number of questions have been raised regarding whether the FMC Act's requirements are appropriate for some offers of equity securities and debt securities by co-operative companies and IPS, and whether class exemptions from these requirements might be necessary or desirable.
3. In most cases, we consider that co-operative companies and IPS making offers of equity securities or debt securities will be able to comply with the FMC Act requirements. In some limited cases, however, we consider class exemption support may be appropriate. This paper explains our class exemption proposals and invites submissions.
4. We are considering class exemptions from the disclosure requirements in part 3 and the financial reporting and audit requirements in part 7 of the FMC Act for offers of co-operative shares where:
 - the shares being offered provide the shareholder with transacting or other membership benefits
 - the amount that can be invested by the shareholders for those co-operative shares is small, or the value of those shares is small relative to the benefits received in relation to those shares.



Background

5. Co-operative companies and IPS have traditionally been accorded different legal status and treatment from ordinary companies under securities law. This is due in part to the different nature of, and context in which, co-operative company shares and IPS shares are used.
6. We are proposing relief for co-operative companies and IPS from the obligations of the FMC Act for certain types of equity securities offers made by them.

Co-operative companies

7. A co-operative company allows its owners to carry on business on a mutual basis. A co-operative company is incorporated under the Companies Act 1993, and registered under the Co-operative Companies Act 1996.
8. Transacting shareholders must hold at least 60% of the voting rights in a co-operative company. A dairy farmer supplying milk to a co-operative dairy company is a transacting shareholder, as is a plumber buying equipment from a plumbing supply co-operative company.

Industrial and provident societies

9. IPS must be registered under the Industrial and Provident Societies Act 1908. They must be incorporated and registered as a co-operative society or conduct business for charitable purposes. Like co-operative companies, IPSs are structured to group shareholders with similar interests under a single organisation.

Existing relief under the Securities Act 1978 (Securities Act)

10. At present, co-operative companies and IPS offerors benefit from class exemption relief (under the Securities Act) from certain disclosure requirements and, in the case of debt securities, relief from the requirements to have a trust deed and a supervisor¹. These Securities Act Class Exemptions enable co-operative companies and IPS to use a tailored prospectus regime (in their case, a short form evergreen prospectus) and the usual form investment statement.
11. The policy reasons supporting class exemption relief (and the related conditions) are long standing and include the following:
 - the nature of the relationship between co-operative companies and IPS and their respective shareholders is different to ordinary companies. Co-operative companies and IPS are owned or substantially owned by their members who use that organisation's services. Their main business is providing services to those members. This means that member shareholders of co-operatives and IPS generally have significant knowledge about the business of the co-operative companies or IPS. Securities law policy requires that investors receive material information in a timely manner. Having reduced tailored disclosure documents enables co-operative companies and IPS to provide information to investors that is appropriate to the nature of their business in a cost-effective way while still maintaining securities law investor protections

¹ The Securities Act (Co-operative Companies) Exemption Notice 2011 and the Securities Act (Industrial and Provident Societies) Exemption Notice 2011 (Securities Act Class Exemptions).



- when members purchase shares for the purpose of transacting, or receiving other membership benefits, they are not investing to make a capital gain. Additionally, the shares are often issued (and redeemed) at nominal value, which precludes the possibility of a capital gain.

Financial Markets Conduct Act 2013 (FMC Act)

12. The Securities Act Class Exemptions will expire at the end of the FMC Act transitional period. Post FMC Act transition, co-operative companies and IPS making offers of equity securities or debt securities need to comply with the fair dealing requirements in part 2; the disclosure requirements in part 3; the financial reporting and audit requirements in part 7; and (for issuers of debt securities) the governance requirements in part 4 that require them to have a trust deed and a supervisor. IPS shares that were participatory securities under the Securities Act will become equity securities under the FMC Act.

Schedule 1 exclusions

13. The FMC Act regime has introduced new opportunities for small-to-medium businesses seeking growth capital to raise funds without complying with the standard offers regime. Schedule 1 offers relief from many of the requirements, including instances where an offer is made to 20 investors or less, provided that not more than \$2m is raised in any 12-month period (small offers exclusion), and where an offer is made to a close business associate of the offeror (close associates exclusion).

FMC reporting relief

14. Additionally, where an issuer of equity securities has fewer than 50 shareholders, the financial reporting and audit requirements in part 7 of the FMC Act will not apply to that issuer. Instead, the financial reporting and audit requirements in the Companies Act 1993 will apply.

Tailored disclosure for co-operative shares

15. Under the Financial Markets Conduct Act Regulations 2014 (FMC Regulations), co-operative companies and IPS have been given a lighter disclosure compliance path for offers of 'co-operative shares'. The FMC Regulations define 'co-operative shares' as:

'Nominal value shares in a co-operative company that are offered only to persons who are, or immediately after the issue or sale will be, transacting shareholders of the co-operative company; or shares in an industrial and provident society.'

16. The tailored disclosure requirements in the FMC Regulations for offers of co-operative shares carry forward the policy supporting relief under the Securities Class Exemptions into the FMC Regulations.

17. These tailored disclosure requirements do not apply to debt securities and, at this stage, we do not believe it is necessary to provide co-operative companies or IPS with class exemptive relief from the requirements of the FMC Act when they offer debt securities.

18. The FMC Regulations enable issuers of co-operative shares to:

- provide risk and return information that is better tailored to co-operative companies and IPS but more limited than that provided by ordinary companies



- benefit from a partial carve-out from the disclosure of financial information requirements under the FMC Act; these issuers have the option to add additional co-operative-specific material, such as disclosure on rebates or returns
- add to the prescribed statements to refer to matters such as the redemption of member shares.

19. Below is a table summarising key existing relief available to offerors of co-operative shares under the FMC Act (not including possible relief under the close associates exclusion).

<i>No. of shareholders</i>	<i>0-20 (under \$2m per 12-months)</i>	<i>20-49</i>	<i>50 shareholders or greater</i>
<i>Disclosure requirements (part 3)</i>	No obligations (restrictions on advertising and a warning required)	Tailored disclosure obligations for offers of co-operative shares	Tailored disclosure obligations for offers of co-operative shares
<i>Financial reporting and audit requirements (part 7)</i>	No obligations (Companies Act 2013 applies)	No obligations (Companies Act 2013 applies)	Part 7 obligations apply
<i>Governance requirements (part 4)</i>	No obligations for equity securities	No obligations for equity securities	No obligations for equity securities

20. In our view, relief for offers of co-operative shares under the FMC Act already addresses the policy reasons that supported the Securities Act Class Exemptions. Only exceptional circumstances, which go beyond these policy reasons, would make further relief for offers of co-operative shares necessary or desirable.

21. This paper considers whether there might be exceptional circumstances that would support a decision to grant class exemptive relief for offers of co-operative shares.

The FMA’s exemption powers

22. We may grant exemptions for up to five years when necessary or desirable, to promote one or more of the purposes of the FMC Act. An exemption can be no broader than what is necessary to address the matters that gave rise to the exemption.

23. The main purposes of the FMC Act are to:

- promote confident and informed participation of businesses, investors, and consumers in the financial markets
- promote and facilitate the development of fair, efficient, and transparent financial markets.

24. The FMC Act’s additional purposes are to:

- provide for timely, accurate and understandable information to help people make decisions about financial products and financial services
- ensure appropriate governance structures apply to financial products and certain financial services that allow for effective monitoring and reduce governance risks



- avoid unnecessary compliance costs
- promote innovation and flexibility in the financial markets.

Consultation

25. On 13 March 2015, we sought feedback on offers made by co-operative companies and IPS in our consultation paper [Financial Market Conduct Act exemptions](#) where we noted:

‘FMC Act provisions will be appropriate in most cases. However there may be some exceptional instances where further relief is appropriate. An example may be where the level of financial investment is nominal, and the key reason for the investment is the opportunity to supply goods or services, rather than an investment opportunity.’

26. Two submissions were in favour of class exemptive relief. One submitter was in favour of extending class relief to organisations that act like co-operatives companies. We are not considering extending relief to that class of recipients at this stage.

27. The other submitter, Co-operative Business New Zealand (CBNZ), provided us with specific proposals regarding class exemptive relief.

28. CBNZ proposed (subject to certain exemption conditions) that co-operatives companies and IPS are given:

- an exemption for offers of co-operative shares where capital raising is limited to \$2m in any 12-month period. There would be no cap on the number of persons who can invest per annum (CBNZ proposal 1)
- an exemption for offers of equity securities and debt securities where the value of the securities issued is small relative to the value of the investment the shareholder has made in his or her own business (CBNZ proposal 2).

29. CBNZ submitted that this relief is necessary or desirable because:

- their proposed exemptions would give effect to one of the additional purposes of the FMC Act, which is to avoid unnecessary compliance costs
- the small offers exclusion has identified an acceptable level of risk for shareholders as being \$2m in any 12-month period. If the investor cap is removed, the number of investors may be increased. This will have a positive effect by reducing the size of their investment and reducing their level of risk
- the application of the close associates exclusion (while being wider than previous relief under s4(3) of the Securities Act) is not sufficiently certain to enable all co-operatives and IPS to be able to broadly rely on it when making offers of shares or debt securities.

30. In response to CBNZ proposal 1:

- We believe that both the \$2m in any 12-month period limit and the 20-investor cap are critical to the design of the small offers exclusion. We agree with CBNZ that, by dividing the \$2m in any 12-month period, by a number of shareholders that is greater than 20, the size of a member’s investment is potentially reduced as is the level of investment risk. However, this would be also true in the case of ordinary companies that are subject to a 20 investor cap under the small offers exclusion. Therefore, we do not agree with CBNZ that the small offers exclusion has identified an acceptable level of risk for shareholders (\$2m in any 12-month period) that can be separated from the investor cap rule.



- The small offers exclusion limits were put in place at a level that balances market risk and level of engagement. They will not necessarily meet the needs of all businesses seeking to rely on them. While a case could be argued that an increased number of investors does not prevent those investors having a close relationship with the issuer (as is presupposed with the small offers exclusion), the limits have been set in the interests of having parameters that are certain. Therefore, there is a clear legislative direction that the statutory exclusions should only apply when the bright-line tests are met. We believe that it would be inappropriate to move these by way of a class exemption.
 - We would like the shares offered to be tightly linked with the membership benefits provided by the offeror. CBNZ proposal 1 might enable an issuer to raise capital from transacting shareholders for an amount up to \$2m in any 12-month period without those shareholders receiving any additional membership benefits.
31. In response to CBNZ proposal 2, we agree that further exemptive relief should be considered where the value of the shares is relatively small. However, we see two practical difficulties in using the value of the shareholders' business as a reference:
- business valuations are subjective and can vary over short periods of time, particularly when it comes to commodities producers
 - some transacting shareholders might have a range of products, but only transact a small segment of products with the issuer.
32. Therefore, we believe that the better approach is to focus on the value of the shares relative to the notional membership benefits a shareholder will receive from those shares.
33. We acknowledge that the application of s4(3) of the FMC Act is not sufficiently certain as to enable all co-operatives and IPS to broadly rely on it when making offers of equity securities and debt securities. However, we don't view this as being a strong argument to support class exemption relief under the FMC Act. Whether s4(3) applies will depend on the facts of each case. We understand that the information disclosed by co-operative companies and IPS to their members varies across organisations. Offerors should individually assess whether they can use the close associates exclusion by looking at their own circumstances at the time they intend to make the offer.



Our proposal

Scope of exemption

34. We are considering an FMC Act class exemption that will provide a lighter compliance path for offerors of co-operative shares where a shareholder is only required to pay the offeror a small amount in order to transact or enjoy membership benefits.
35. This exemption will allow co-operative companies and IPS to make these small offers without having to prepare part 3 disclosure documents or comply with the part 7 financial reporting and audit requirements under the FMC Act.
36. More specifically, we propose providing exemptive relief for offers of co-operative shares where:
 - there is tight linkage between the shares issued, and the shareholder's transacting or member relationship with the offeror
 - the total amount a shareholder is required to pay for the shares to transact, or enjoy membership benefits, with the offeror is small.

Tight linkage between shares offered and member benefits

37. We propose the exemption be available on the condition that the co-operative shares are being offered to enable shareholders to transact, or enjoy membership benefits, with the offeror. This means that the exemption will not be available to a shareholder (who is already a transacting shareholder or member) where the shares' main purpose is not to enable the shareholder to transact or enjoy membership benefits.

Small investment test

38. We understand that persons pay for co-operative shares in order to transact, or enjoy membership benefits, with a co-operative or IPS in two ways:
 - a subscription(s) for a fixed number of shares (situation 1)
 - a subscription(s) for shares, where the required number of shares subscribed for is determined based on the volume of business the person transacts with the issuer, or the value of other membership benefits gained (situation 2).
39. We are proposing that, as a second condition of the exemption, the offer of co-operatives shares must be small. At this stage, we are proposing that small means meeting one of the following criteria:
 - shares which are required to be subscribed for in order for the member to transact, or enjoying membership benefits, with the offeror are limited to a maximum total capital investment per shareholder of \$1000 (this might apply in both situations 1 and 2) or
 - where the above does not apply, the value paid per co-operative share under the offer is less than 5% of the benefits received by a shareholder for each co-operative share held. This would apply in situation 2 only.
40. We are seeking a test for what is small that:



- is sufficiently flexible to cater for instances where even though a sizable capital investment will be made by a shareholder in the offeror, the amount invested is small relative to the volume of business transacted or membership benefits received
- will operate effectively for co-operatives and IPS that have a diverse range of purposes and structures
- will be reasonably easy to calculate to enable offerors to determine whether their offer will fall within the proposed class exemption.



Questions

- Q1. Do you agree with our proposal to grant class exemptive relief for co-operatives and IPS that offer co-operative shares? If you do not, please provide details for the reason.
- Q2. Do you agree that the policy reasons supporting the Securities Act Class Exemptions for offers of equity securities by co-operative companies and IPS have been largely addressed by existing relief provided under the FMC Act and FMC Regulations? If not, please provide the reasons.
- Q3. Do you believe that offers of debt securities by co-operatives and IPS should be given exemptive relief from the disclosure requirements in part 3, and the governance requirements in part 4 of the FMC Act. Please explain why or why not?
- Q4. Do you agree that the proposed class exemption must be conditional upon there being a tight linkage between the shares offered and the membership benefits obtained in connection with those shares? If you do not, please explain why. Will this condition be difficult to satisfy in the case of IPS that are charitable institutions, if so, why?
- Q5. Do you agree with our proposed test for what is 'small'? If you do not, please explain why and provide an alternative.
- Q6. Are there other criteria that might be relevant when determining whether an issue of co-operative shares is small? Please provide details.
- Q7. Are you aware of any particular co-operative, or IPS, that is likely to rely on the proposed exemption?
- Q8. Are you aware of any particular co-operative, or IPS, that is unlikely to be able to rely on the proposed exemption and which you believe will incur unnecessary compliance costs? Please estimate the amount of compliance costs and explain in detail why those costs would be unnecessary.
- Q9. What benefits and cost savings are there for a co-operative or IPS as a result of the proposed exemption from having to comply with the FMC Act (making allowance for the existing relief that is already available in respect of offers of co-operative shares).
- Q10. What risks are there in a co-operative or IPS being exempted from the disclosure requirements in part 3, and the financial reporting and audit requirements in part 4, when they offer co-operative shares. Please explain the nature and significance of the risks, including any impacts on the transparency of offer and financial information for those issuers.
- Q11. Do you agree this proposed exemption is both necessary and desirable? Please explain your reasons. If there is a particular aspect of the proposal you do not consider necessary or desirable, please identify that, and explain your reasons.
- Q12. Are you aware of any organisations that act like co-operatives but are not registered as co-operatives. Please provide details.
- Q13. Do you have any other comments on our proposals?

Feedback form: Exemption for small offers of co-operative shares

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with ' Exemption for small offers of co-operative shares: [your organisation's name]' in the subject line. Thank you.

Submissions close on 6 May 2016.

Date: _____ Number of pages: _____

Name of submitter: _____

Company or entity: _____

Organisation type: _____

Contact name (if different): _____

Contact email and phone: _____

Question or paragraph number	Response
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You don't need to quote from the consultation document if you note the paragraph or question number.

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.

Thank you for your feedback – we appreciate your time and input.