REGULATORY IMPACT STATEMENT

SECURITIES LAW REVIEW

AGENCY DISCLOSURE STATEMENT

This regulatory impact statement (RIS) has been prepared by the Ministry of Economic Development (MED).

It provides an analysis of options to improve securities law in New Zealand. The securities law review takes place following several rounds of consultation over a number of years on a very broad range of securities law issues. During that time, decisions have already been taken by Government on large parts of securities law. This includes the establishment of a new market conduct regulator, changes to the governance and reporting obligations of KiwiSaver schemes, prudential oversight of non-bank deposit takers and insurance companies, licensing of trustees and financial advisers, oversight of auditors, reform of securities regulations, reform of laws on insider trading and market manipulation, introduction of a simplified prospectus regime for listed issuers, and the introduction of a designation regime for clearing and settlement systems.

The scope of this review of securities law is therefore limited to remaining issues in New Zealand's securities regime and does not seek to reconsider decisions already taken, although where appropriate, it does discuss whether any alterations are needed to ensure consistency across the regime.

This RIS is further restricted to the most important policy decisions made in the accompanying Cabinet paper. Less important recommendations and detailed considerations have been omitted to keep the overall length and complexity of the RIS manageable.

The analysis is based largely on impacts identified in submissions received in response to the Discussion Document. These seldom included quantitative estimates of costs and benefits or the impact on specific transactions that submitters have been involved in. Data is not collected on regulatory costs, nor is data available on capital market activity outside of public offerings. The analysis notes the relevant recommendations made by the Capital Market Development Taskforce (CMDT) in its 2009 report.

Some of the policy options considered are likely to have consequences that the government has stated will require a particularly strong case before regulation is considered. For example, licensing regimes are likely to be costly to comply with and would create barriers to entry. Other options are intended to remove costs, such as an exemption from regulatory requirements for those making relatively small offers of securities. In most cases, the proposals aim to make the existing regime work more effectively and are likely to (after any transition costs) slightly reduce business compliance costs.

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STATUS QUO AND PROBLEM DEFINITION

Securities law governs how financial products are created, promoted and sold, and the ongoing responsibilities of those who offer, deal and trade them. In particular, securities law regulates entities that seek funding through equity or debt instruments, invest in financial assets on behalf of others, or enter into derivative contracts for risk hedging or speculation. It does this primarily by requiring the disclosure of certain information to investors, setting governance requirements on issuers of securities, and through the enforcement of breaches of securities law.

These 'levers' influence behaviour in securities markets. Disclosure provisions require certain information to be disclosed to investors in a manner that is clear and standardised, to allow comparison across products and informed decision making. Governance requirements set the requisite competencies, experience and ongoing duties that fund managers and those involved in the investment or protection of investors' money must meet. They may also require the implementation of supervisory bodies, with the aim of improving accountability and confidence in financial markets. Enforcement provisions set out the circumstances of liability for contraventions of securities law, including when injured investors may seek compensation. This ensures that appropriate incentives exist for market participants to comply with the law and deters conduct that undermines market integrity. Appropriately designed and implemented levers promote functioning and efficient financial markets by encouraging the development of confident and informed investors, and assisting businesses to access capital.

New Zealand's securities law is contained in a number of Acts. The core provisions are set out in the Securities Act 1978 (which deals with primary markets) and the Securities Markets Act 1988 (which deals with secondary markets). Managed funds are regulated (in sometimes inconsistent ways) in the Unit Trusts Act 1960, the Superannuation Schemes Act 1989 and the KiwiSaver Act 2006.

However, the current legislation is outdated and does not take account of changed business practices. Key issues with the current legislation are:

- The boundaries between those investors covered by the regime and those not tend to be principles-based and unclear. This imposes costs on issuers as legal advice is often required on the treatment of potential investors and this will often not be definitive. There are also concerns from some that the current exemptions are too narrow, i.e. some sophisticated investors are inadvertently captured by the regime, and it is too difficult for young firms to raise relatively small amounts of money.

- Mandated disclosures fail to adequately inform investors, as they tend to be poorly structured, too long, and unclear. The impact of this is that investors cannot make informed decisions or do not participate in the market at all.

- Inconsistencies and lack of clarity about how products are defined mean that similar products are regulated differently, with some regulation taking a form over function approach which can inhibit innovation. For example, some products are regulated as debt when in fact they are more akin to equity. Managed funds are regulated by the form of the vehicle rather than substance. The definitions around derivatives are outdated and unclear. This lack of clarity imposes costs on market participants and may inhibit the development of New Zealand's capital markets.

- Possible under-enforcement of some provisions of securities law, such as directors' duties. This may be because the right to enforce directors' duties lies with the company and it is very difficult for shareholders to take a derivative action. The Bill establishing the Financial Markets Authority (FMA) gives the FMA the ability to enforce directors' duties where it is in the public interest. The lack of enforcement may also be because the penalties attaching to breaches of directors' duties are such that they disincentivise shareholders from taking legal proceedings.

Lengthy disclosure documents do not provide well targeted information to investors. Uncertainty and lack of clarity in the current regime causes increased costs for issuers. Inconsistencies in the way products are regulated and inadequate governance requirements in some cases create a risk that issuers will not act in the best interests of investors and inhibit effective monitoring and enforcement. The regime needs to be designed in a way that provides sufficient protection for investors without stifling innovation.

OBJECTIVES

The objective is to facilitate capital market activity. For this to occur, both investors and issuers have to be willing to engage in the market. The following are intermediate objectives:

- Providing information well targeted to serve investors' decisions and their abilities to understand the information provided;
- Reducing costs to issuers by providing sufficient certainty around their obligations and removing unwarranted obligations;
- Ensuring that products have adequate governance arrangements to allow for effective monitoring and reduce governance risks;
- Effective enforcement of breaches of duties to provide incentives for issuers to play by the rules while giving investors a degree of assurance that they can rely on the rules being enforced (particularly where large numbers of retail investors are involved); and
- Ensuring that the regulations allow an appropriate level of innovation and flexibility in the market.

While some of these intermediate objectives might at times conflict, a balance needs to be struck as the market will not develop and be efficient and effective if it does not meet the needs of both investors and issuers.

REGULATORY IMPACT ANALYSIS

Specific regulatory requirements vs. merit regulation

Securities law covers a wide range of matters across a complex set of products. Currently, there are overarching requirements that prohibit any dealings in securities that are misleading or deceptive or likely to be so. These are analogous to provisions in the Fair Trading Act 1989 applying to all goods and services, and provide a backdrop to the more specific requirements.

In addition to these generic provisions, securities law imposes certain disclosure and governance obligations on those issuing or trading in securities and provides for enforcement of breaches of these obligations. So long as these obligations are met, there are no restrictions on the types of products that can be offered to the public or on the types of businesses that can raise funding. Regulators do not currently assess the pricing of an investment offered to the public, the likelihood that an investment will be successful or – except in specific prudential regulatory regimes – impose conditions that reduce the likelihood that a company offering securities to the public will fail.

An alternative approach would be for the regulator to perform its own assessment of the merits of investments on behalf of investors and to ban investments that it felt were too risky or mispriced.

"Merit-based" regulation could provide a greater level of investor protection. However it would be expensive to administer and would likely impede capital raising (especially by those offering high risk-high return investments) and innovation in financial services. It would also create an expectation that government would compensate investors who suffered losses, which would encourage risk-taking behaviour by issuers ("moral hazard").

For these reasons we do not propose to move to merit-based regulation.

The options and the interrelationship between them

Given that merit-based regulation is not proposed, the key issues in the securities law review can be analysed in a framework comprising the three levers discussed in the introductory section – disclosure (i.e. the information that has to be disclosed and to whom), governance (i.e. requirements around the governance of those issuing securities), and enforcement (the penalties for breaching the regime and the effectiveness of enforcement).

Although treated separately to make the analysis tractable, there are connections between these issues. For example, placing more restrictive requirements on the governance arrangements of particular securities issues might mean that less information needs to be provided to investors as they will be more able to rely on robust governance provisions. Similarly, an onerous enforcement and penalty regime may lead to excessive disclosure to cover legal obligations (inadvertently reducing the usefulness of that disclosure) and inhibit innovation.

Given these interactions, there are multiple possible combinations of disclosure, governance and enforcement. This Regulatory Impact Analysis starts from the status quo. Most of the changes discussed seek to improve the usefulness of disclosure for the target audience and provide for more consistent governance between like products (i.e. a focus of substance over form to reduce the risk of regulatory arbitrage). Substantive increases in required governance are only proposed where it seems likely that changes in disclosure would not be sufficient to meet the desired objectives (e.g. due to the level of financial literacy of the population). Decreases in governance are proposed where existing requirements appear to serve limited purpose or can be achieved other ways more effectively. Changes to enforcement provisions are proposed where it appears that the existing regime does not appear to provide a range of sanctions which are appropriate to the wrong-doing and able to be effectively used by the regulator.

Analysis of the options

Under each of the levers we have included a table outlining our assessment of how each of the options impacts on the objectives. Our assessments are largely qualitative and based on the information provided by submitters throughout the consultation process. The analysis is constrained in that very few submitters provided detailed information about quantifiable costs in relation to each of the issues.

We have described the impacts on the objectives as being either positive (benefit) or negative and the scale of the impact as small, moderate or high. We have also taken into account (where relevant) the number of market participants that would be impacted. The table below shows the approach we have taken.

	Impacts on a small number of market participants	**Impacts on a large number of market participants**
Small positive/negative effect on objectives	Small benefit/negative	Moderate benefit/negative
Medium positive/negative effect on objectives	Small benefit/negative	Moderate benefit/negative
Large positive/negative effect on objectives	Moderate benefit/negative	High benefit/negative

Lever: Disclosure

This lever requires those issuing securities to the public to disclose prescribed information, and defines who is included in the definition of the "public". The aim is to ensure that potential investors have sufficient information to make an informed choice where they are not likely to be able to require the issuer to provide them the information otherwise. Evidence from behavioural economics and surveys of financial literacy suggest that the general public have limited ability to understand financial information. There is also scope for issuers to disclose risks in a manner that understates their importance. Issuers want clarity around who is not a member of the public so that they know when statutory disclosure obligations are not required, and on the sorts of information provided and the way in which products will be regulated. Consistency helps investors understand that products which appear similar will be treated in similar ways.

Defining "the public"

There are currently broadly-worded exemptions from disclosure and governance requirements for those offering securities to sophisticated investors and those they have a close relationship to (e.g. relatives and business associates). The boundaries between these exemptions could be clarified to improve certainty. Broadening the scope of some of the exemptions or adding new exemptions may also enhance the ability of businesses to raise capital. The CMDT recommended that the current Securities Act exemptions be revised to provide a set of clearer, broader exemptions to the Act.

There are two options for clarifying the definition of the public. The first is to redefine the principles-based boundaries for who falls inside the definition. The second involves supplementing these exemptions with more "bright line" definitions of who is inside or outside the definition of the public. This would reduce costs to issuers from obtaining legal advice, and the added clarity may encourage issuers to raise funds in situations where legal risks preclude this at present. This option was strongly supported by submitters and it does not alter the broad substance of who is inside or outside the definition.

Based on the analysis in the table, we propose that a hybrid of the two options be adopted. This approach would result in definitions that are adequately certain but that also provide an appropriate degree of flexibility.

The options for broadening the exemptions to the regime include:

- allowing those advised by authorised financial advisers to be exempt;
- allowing those making small offers to be outside the public market;
- allowing employee share schemes to be exempt; and
- broadening the scope of those who can opt out of the regime by lowering the sophistication threshold.

Broadening the exemptions would widen the group that are not covered by disclosure obligations and some of the governance obligations in securities law. This would make it easier for issuers to find a pool of investors who can invest in issues without the requirement to prepare a prospectus or comply with some governance requirements (e.g. having a trustee for a debt issue). This would lower compliance costs for those issuers. On the other hand, it would increase the risk that some investors would opt out without fully understanding the consequences of their actions. There is also the risk that, over the longer term, investors would lose confidence in markets if there were ongoing examples of investors losing money to issuers via these exemptions.

Submitters did not provide quantitative information on the likely cost and benefit of any change here, making it difficult to assess the merits of any widening of the exemptions. Submitters had mixed views about the benefits of broadening the categories of people beyond the status quo. There was little support for allowing unsophisticated investors to opt out of the regime – even with a degree of protection, such as following independent financial or legal advice. However, most favoured adding two new categories – the small offer exemption and the employee share scheme.

Given this, we propose that in addition to the current exemptions to the definition of the public, that additional exemptions be created for “small offers” and employee share schemes. The small offer exemption would allow equity and debt issuers to raise $2 million in a 12 month period from 20 investors, with a cap of $100,000 per investor. Issuers of small offers would be required to disclose that an exemption from the normal product disclosure and trustee requirements applies and that in accepting the offer, the investor accepts full responsibility for the investment decision and should seek independent financial advice if in doubt. There would also be marketing restrictions to ensure vulnerable consumers are not inappropriately targeted.

These exemptions would improve access to capital for smaller issuers without significantly increasing the number of investors falling outside the regime. We also consider that the design of the exemption as outlined above will ensure that unsophisticated investors are adequately protected. We do not propose any further new exemptions as we consider that they would overly narrow the scope of the regulatory regime, which would risk some groups of investors falling within one of the exemptions unintentionally.

Defining products

There are currently various categories of security in the Securities Act – debt, equity, units in a unit trust, interests in a superannuation scheme, life insurance policies and a catch-all participatory security to cover all other securities that do not fall into one of the other categories. In addition, there is a definition of futures contract in the Securities Markets Act, which is not consistent with the definition of securities in the Securities Act. The current boundaries of some of these categories are unclear and they are based more on what the product is called rather than the underlying structure of the security. The lack of certainty with the definition of futures products arguably undermines market development in this area. The CMDT recommended clarifying this part of the law.

We propose to have four categories of regulated product:

- Equity securities. The most common form of equity is a share in a company;
- Debt securities. At a basic level, a debt security is a right to be paid money that has been lent to another person. Corporate bonds and debentures are common examples of debt;
- Collective investment schemes. These are investments where the key feature is the pooling of assets by investors. This category includes unit trusts; and
- Derivatives. The key feature of derivatives is that there is an obligation to provide consideration at a future time, and that amount of consideration is in turn based on a separate reference item. Examples of derivatives include. foreign exchange or commodity derivatives.

This is a complicated aspect of securities law that needs to be able to cater for the complexity of financial products in the markets. We propose improving certainty in this area by changing the definitions of the various categories of security and to base those definitions more on the underlying substance of the products, rather than their legal form. For example, companies that are acting as collective investment schemes will be regulated as such. This will mean products are regulated appropriately and consistently.

Submitters generally agreed with this proposal. However, some noted that there will always be products which can have the characteristics of more than one type of security. Given the potential complexity of products, it would either be necessary to constrain the types of products which can be offered to fit within the categories defined, or allow for a degree of flexibility. It is likely that there are good business reasons for some securities to differ from standard classifications. Rather than prevent these being offered, it is proposed that the regulator have the ability to designate the category (or categories) which apply to particular financial products, along with the relevant governance and disclosure obligations. The designation power will be initiated by the regulator, but it will be able to give clarity ex ante about how it intends to treat certain products through no action letters.

Disclosure requirements

Under the current two-document system issuers must generally produce an investment statement and a prospectus. Currently there are concerns that issuers provide such extensive information (in order to reduce their risk of liability for false or misleading statements, including by omission) that investors do not receive relevant information in an accessible form. Additionally, for some issuers, such as debt issuers, collective investment schemes and non-pooled investment schemes, there are no ongoing disclosure requirements. This means that investors receive limited or no information following the initial point-of-sale disclosure.

The four main options to improve this situation are to provide enhanced education and investment literacy resources to investors, require a single detailed document setting out all information required, to refine the current two-document system and to provide ongoing disclosure requirements in circumstances where these do not currently exist.

The CMDT recommended that the investment statement and prospectus be replaced with a new, two-part disclosure document that aids understanding and comparability. The first part should be one to two pages long, and much more standardised in content and presentation than the investment statement.

We consider that education is important as it raises literacy which results in investors making better informed decisions. The provision of educational information will be a function of the FMA. However, this only goes some way in solving the problem; the information provided to investors also needs to be targeted and appropriate. A single detailed document would reduce some costs for issuers, but would not necessarily lead to investors receiving more accessible and useful information.

We therefore favour moving to a shorter, more prescribed product disclosure statement (PDS) to replace the investment statement. A PDS would provide a more concise set of essential information that is specifically targeted at retail investors. Further, more detailed, information would be available on the securities register. Issuers would be required to provide a printed copy of this information on request.

The content of PDS would be heavily prescribed for mainstream products in order to promote comparability. Separate requirements would be prescribed for different types of financial product and different types of offer. This would enable comparability between similar products and offers, while ensuring the most relevant information is provided to investors.

In designing the PDS the level of standardisation would vary from financial product to financial product. The content would be prescribed in regulations made under the new securities legislation, as it is under the 1978 Act. This follows the approach taken to development of product disclosure statements in Australia, which is progressively working through the products to produce tailored documents, starting with collective investment schemes. For managed fund products, the length of the documents could be prescribed.

We estimate that the cost of the current regime ranges from $10,000 to $150,000 per initial public offering. We expect that as a result of the new regime there would be an initial cost associated with changes in processes and systems around disclosure. The ongoing costs are likely to be similar or possibly lower than the current costs, but we cannot estimate by how much, as the ongoing costs of the new regime will depend upon the details of the new regulations.

The risks associated with the proposed change are (i) that the prescribed information will not be the information investors require or (ii) that issuers continue to provide all potentially relevant information to investors, making it almost impossible for retail investors to discern the information they need to make an informed judgement. These risks could be mitigated through working with issuers and investors when designing the regulations that will set out the specific disclosures required by different issuers.

We also recommend developing ongoing disclosure requirements for debt issuers, collective investment schemes and non-pooled investment schemes to ensure investors are adequately informed of any material changes in the risk of the security over time. This disclosure is additional to the PDS noted above.

We consider that the recommended changes to the disclosure regime will result in more meaningful and useful disclosure to investors.

Lever: Disclosure

Options	Impact on objective: providing information well targeted to investor decisions	Impact on objective: Reducing costs to issuers	Impact on objective: Ensuring that products have adequate governance arrangements	Impact on objective: Effective enforcement of breaches of duties	Impact on objective: Ensuring appropriate flexibility and innovation in the market	Preferred option (Y / N)	Comments and risks
Defining the public							
Redefining principle-based boundaries for who is inside and outside the scope of securities law.	Small benefit	Small benefit	Small benefit	High benefit	Small benefit	Y	Principle-based boundaries on their own are unlikely to be clear enough for issuers to make private offers.
"Bright line" tests for who is inside and outside the scope of securities law.	Small benefit	Moderate benefit	Small benefit	Moderate benefit	Small negative	Y	Makes clear who is in and who is out of regime. On its own, it may be less flexible for some.
Exemption if invest via independent Authorised Financial Advisers	Moderate negative	Small benefit	Moderate negative	Small negative	Small benefit	N	Requires Financial Adviser regime to be robust and for advisors to be able to demand appropriate disclosure from issuers. May not be frequently used.
Exemption for "small offers"	Moderate negative	High benefit	Moderate negative	Small negative	Moderate benefit	Y	Effectively allows small groups of unsophisticated investors to invest in private offers. Reduces capital-raising costs for small businesses. Safeguards could include limits to investment. Reduces regulatory burden.
Exemption for employee share scheme	Small benefit	Moderate benefit	Small benefit	Small negative	Small benefit	Y	Allows issues to employees and provides flexibility in remuneration policies.
Ability to opt-out of the regime with a lower degree of sophistication	High negative	High benefit	Moderate negative	Moderate negative	Moderate benefit	N	Would broaden exemption regime. Risk is that if criteria markedly different from those for sophisticated investors (under the bright-line exemptions) then there is potential for some to opt-out but not be in a position to fully judge the risks of the investment.
Defining products							
Definitions consistent with the substance rather than form of the product	Moderate benefit	Small benefit	Moderate benefit	-	Moderate benefit	Y	Definitions proposed for debt, equity, collective investments, non-pooled investments and derivatives. Would require definition of collective investment schemes that take a company form.
Definitions consistent with the form rather than substance of the product	Small negative	Small negative	Moderate negative	-	Small negative	N	Results in some products not being captured by the regime when they should be and consequently those products lack adequate

							disclosure and/or governance arrangements.
Modify definition of futures contract to give greater clarity	Small benefit	Medium benefit	Moderate benefit	-	Small negative	Y	Makes clear who is in and who is out of regime. On its own, it may be less flexible for some.
Give regulator the power to deem products to be certain types of securities	Moderate benefit	Medium benefit	Moderate benefit	-	Small benefit	Y	May in some cases provide certainty for issuers. Ensures that products have appropriate governance arrangements. Will impose costs on the regulator.
Disclosure requirements							
Enhanced education to increase investment literacy levels of investment	No benefit	Moderate benefit	-	-	Small benefit	Y	
Single document that contains all disclosures	No benefit	Small benefit	-	-	Small negative	N	Full disclosure required, but can be done in a manner which makes it difficult for retail investors to understand risk fully.
Shorter, prescribed disclosure to replace investment statement, with additional detailed information on central website	Moderate benefit	Moderate benefit	-	-	Small benefit	Y	If can prescribe key information, then essential information will be available for investors and different issues will be more comparable. Risks are that the most important information may not be prescribed or that issuers will look to provide more information which hides risks and limits comparability.
Mandate ongoing disclosure requirements for debt issuers, collective investment schemes and non-pooled investment schemes.	Moderate benefit	Small negative	-	-	Small benefit	Y	Will ensure investors are kept well informed on an ongoing basis. Will impose some costs on issuers. There is likely to be an initial cost in setting up the systems and process and the ongoing costs are likely to be minimal.

The table above shows the marginal impact of each option on the objectives, compared to the status quo. The impact can be positive (benefit) or negative, and can be small, moderate, or high. Where the impact of the option is negative, the boxes are shaded.

Lever: Governance

In addition to disclosure, issuers of some types of financial products must meet certain standards of governance when offering securities to the public. For example, issuers of debt securities are currently required to be supervised by a trustee, and are bound to a trust deed that they negotiate with the trustee. Other types of collective investment schemes (KiwiSaver schemes, superannuation schemes, unit trusts, etc) must also often be externally supervised, and owe particular duties to investors. These are intended to ensure that issuers are accountable, investors' assets are protected from fraudulent practices and investors have mechanisms for monitoring issuers and participating in collective decision-making.

The CMDT recommended that the government improve and standardise principles-based duties owed to investors in managed funds by requiring both supervisors and fund managers to:

- have a direct legal relationship with individual investors, and a duty to act in their best interests (except where this would not maintain fairness between members);
- owe a fiduciary duty of care to investors;
- explicitly disclose these duties (and any restrictions on them) to individual investors; and
- annually declare (for example, in their statements to individual investors) that they have not breached their duties.

Accountability to investors

In a collective investment scheme, an agent essentially manages investors' money and investments on their behalf. Where the scope of the direct relationship with individual investors is unclear, the risk that issuers of these schemes will not act in the best interests of investors significantly increases. It is therefore important that appropriate mechanisms are in place to enable investors to hold issuers to account.

There are currently a range of duties imposed in common law and statute on fund managers and trustees. These are not always explicit and differ depending on the form of the investment vehicle. It is also largely left to the fund manager and its supervisor to determine the processes for pricing, pricing errors, limit breaks (when the fund manager breaches its investment mandate) and related party transactions. Related party transactions in particular have been a feature of many of the finance company failures. This results in regulatory uncertainty and creates scope for investor confusion and for issuers to act in a way that is not in the best interests of investors.

One option to clarify and strengthen the accountability of fund managers and trustees to investors is to prescribe a set of functions and duties in the new legislation. In order to ensure the processes used by fund managers and trustees are robust and consistent, broad rules and/or guidance could be developed to provide a framework for pricing, dealing with pricing errors, limit breaks and related party transactions. A further safeguard could be to require administrative functions to be carried out by an independent third party. Alternatively, both of these issues could be addressed by the development of non-binding industry codes of practice and/or guidelines.

Based on the analysis on the table, we recommend prescribing standard functions and duties for fund managers and trustees in the new legislation. This will alter the status quo by prescribing a standardised set of duties for all fund managers and trustees, regardless of the type of investment vehicle. This will involve consolidating the current duties set out in statute and common law and imposing a duty on fund managers to act in the best interests of investors. Submitters generally agreed that a mandated set of duties would be useful, however, some noted that in order to accommodate the various legal forms of collective investment schemes, the duties of fund managers and trustees will need to be sufficiently flexible or provide for exemptions in appropriate circumstances. We agree that if the duties are too rigid, this may inhibit innovation in the sector. Relatively high level duties will provide an appropriate degree of accountability to investors and are not likely to impose any significant cost as many of the duties are already in existence in various pieces of legislation. The new regime would outline available remedies where a breach of a duty takes place including, for example, the ability of investors to remove the fund manager or direct the trustee to take action to seek compensation.

We also recommend that broad rules and/or guidance be developed regarding the treatment of pricing, limit break and related party transaction issues. Again, this is not likely to impose any significant cost on collective investment schemes and provide safeguards to ensure that investors' money is adequately protected. To enhance transparency and accountability to investors, fund managers could also be required to set out the processes in the constitutional document and disclose where the process adopted by the scheme differs from any guidance. This would provide a degree of flexibility for issuers, while ensuring investors are well-informed of issuers' practices.

Ensuring the capability of fund managers

In addition to ensuring accountability, we consider that there should also be some measures put in place to ensure that fund managers of collective investment schemes are sufficiently capable to carry out the role. Currently fund managers and custodians must be registered under the Financial Service Providers (Registration and Dispute Resolution) Act 2008. Under this legislation certain persons are disqualified from registering, being those who are bankrupt, subject to director or management bans, those with recent criminal convictions for dishonesty, or those with convictions for money laundering or the financing of terrorism. There are however minimal other requirements for undertaking these roles.

Trustees provide a degree of oversight of fund managers, primarily around ensuring that the fund manager complies with the terms of its trust deed and offer of securities. This role is being strengthen by the Securities Trustees and Statutory Supervisors Bill (which will implement a licensing regime for trustees), however, the supervision provided by trustees only relates to fund managers' compliance with their obligations; it does not ensure that fund managers have the requisite skills and experience.

One option is to rely on the supervision of trustees and the duties of fund managers proposed to be set out in legislation (as discussed above). Another option is to rely on industry standards being developed and complied with. A further option could be to impose additional requirements on fund managers through a licensing regime. This could be a "light" licensing regime involving the FMA or trustee being satisfied that the licensee is of good character. Alternatively, a more comprehensive licensing regime could be adopted which would require assessment of competency, adequacy of systems and capital adequacy. The costs and benefits of each of these options are set out in the table.

Our preferred option is a light licensing regime whereby the FMA licenses those it considers have the necessary skills and experience to carry out the role. The majority of submitters supported licensing fund managers for this purpose. A licensing regime would also allow the regulator to form a constructive relationship with the fund manager from the outset and will enhance their ability to intervene quickly when investors' interests may be at risk rather than being limited to enforcement only after a manager's lack of capability has resulted in investor loss. The fund manager's ongoing compliance with its duties will continue to be monitored by the trustee. This is separate role and we do not consider that there will be any significant overlap between the role of trustees and the role of the regulator in this instance. There is a risk that licensing fund managers will create barriers to entry and could stifle innovation. There will also be costs associated with a licensing regime, but submitters indicated that for diligent fund managers the costs are likely to be minimal.

Another issue is the inadequacy of protections around how assets of a scheme are held and managed. Custodians, who are typically delegated this responsibility by trustees, are currently unregulated in New Zealand.

There are three options for enhancing the safeguards in this area. One option would be to rely on the creation of industry standards. A second option could be to license custodians, or an alternative, lower cost regime, would be to impose certain duties on those who perform the custodian role, for example, ensuring that they have a presence in New Zealand and keep their records in New Zealand.

Submitters were generally in favour of licensing custodians; however, we consider that imposing duties on custodians could achieve the same objectives at a lower cost. Trustees (who will be licensed under the regime being implemented through the Securities Trustees and Statutory Supervisors Bill) would retain responsibility for ensuring that custodians comply with their duties and any breach would be enforceable against the trustee. This duty is consistent with the other roles of a trustee.

Peer to peer lending and investment arrangers

Peer to peer lending describes a situation where borrowers with poor or no credit history form a relationship with a range of investors and in return investors, utilising the internet to interrogate and assess prospective borrowers, are able to determine their own appetite for risk and return. In this way entrepreneurial enterprises can source funding that may otherwise be unavailable. This type of activity is effectively prevented by the current requirements of the securities regime.

One way to bring these activities within the regime so that they can be established in New Zealand is to place the legislative requirements on a supervised (licensed) intermediary, such as an investment arranger, who are better placed to fulfil the requirements. Alternatively, the status quo could be retained which would mean peer to peer lending services would continue to be prevented from operating in New Zealand.

We propose that investment arrangers be licensed and exempted from the securities law requirements. We propose that Cabinet make a decision subject to it approving detailed information around the costs of such a regime by 30 April 2011.

Scope of collective investment scheme governance requirements

The number of workplace superannuation schemes has declined over the past decade due to changes in tax and the introduction of KiwiSaver. Not all of these schemes are currently regulated under securities law but all are subject to the provisions in the Superannuation Schemes Act and in some cases the Unit Trusts Act. Employees who are members of such schemes rely on the scheme to save for their retirement and therefore should be offered the same level of protection and assurance as members of other similar schemes such as collective investment schemes.

Many of the schemes that remain operate through a master trust. These are an off-the-shelf collective investment scheme product and therefore we proposed that they be regulated in the same manner as all other collective investment schemes. This will impose additional costs for scheme providers, however, these are likely to be minimal given that these schemes will generally already have an independent trustee.

There also remain a number of company-specific schemes whereby the employer is the trustee and number of other restricted entry superannuation schemes, where membership is restricted to a certain industry, profession or calling (restricted schemes). Long term performance of these schemes is often poor as employers do not always have the necessary skills, and the lack of oversight of these schemes has meant that there is scope for employers to put their own interests ahead of investors.

Imposing the full suite of collective investment scheme governance requirements on these schemes would impose significant costs and may result in some schemes to close. Employer superannuation schemes could be excluded from the securities law regime altogether or could be subject to a less burdensome regime. Alternatively employees who put money into employer superannuation schemes could be informed that the scheme does not fall within the ambit of the securities regime and provided an explanation of what this entails and any rights they have.

Based on the analysis in the table we recommend placing less burdensome requirements on company specific employer superannuation schemes and restricted superannuation schemes to ensure employees have an adequate level of protection. This would require the appointment of an independent trustee who is approved by the FMA and who can demonstrate a degree of investment management skill and experience. It is proposed that all company specific and restricted schemes be grandfathered and open to new members, while all new schemes will be brought within this new regime. This would eliminate the risk of closure of current schemes but in the long term is likely to lead to decreased number of these types of schemes. We consider that this is justified given the high level of trust that employees place in these schemes to safeguard their money for retirement.

Lever: Governance

Options	Impact on objective: Providing information well targeted to investor decisions	Impact on objective: Reducing costs to issuers	Impact on objective: Ensuring that products have adequate governance arrangements	Impact on objective: Effective enforcement of breaches of duties	Impact on objective: Ensuring appropriate flexibility and innovation in the market	Preferred option (Y / N)	Comments and risks
Strengthening accountability to investors by issuer							
Standard functions and duties for fund managers	-	Small negative	Moderate benefit	High benefit	Small negative	Y	Provide clarity across fund types and ensure that obligations are explicit and understood. Currently a lack of clarity about extent of fund managers' duties.
Mandating external administration	-	Small negative	Small benefit	-	Small negative	N	Would impose some costs, but ensure that pricing and other functions are independently verified and reduce the scope for problems to remain hidden. Would impose costs on fund managers. May not be necessary if there is adequate guidance around pricing processes.
Mandating processes for pricing, errors, limit breaks, related party transactions etc	-	Small negative	Moderate benefit	Moderate benefit	Small negative	Y	Would support consistent reporting of fees and ensure deviations from investment mandates are consistently dealt with.
Industry codes of practice or guidelines	-	Small benefit	Small benefit	Small negative	Small benefit	N	Reasonably cheap way of changing industry behaviour. Rules are not binding and enforcement mechanisms are weak.
Assurance around fund managers' capability							
Reliance on trustee supervision and duties	-	Small negative	Small benefit	Small benefit	Small benefit	N	Will provide some incentives for managers to act in the best interests of investors, However, does not prevent incompetent or inexperienced people taking up positions as fund managers.
Rely on industry standards to ensure fund managers and custodians act appropriately	-	Small benefit	Moderate negative	Small negative	Small benefit	N	Reasonably cheap way of changing industry behaviour. However, standards are not binding and enforcement mechanisms are weak.
"Light" licensing of fund managers based on 'good character' requirements	-	Small negative	Small benefit	Moderate benefit	Moderate negative	Y	Would enhance current registration regime. Would impose some costs but likely to be minimal.
Full licensing of fund managers including assessment of competency, systems, capital adequacy	-	Moderate negative	Moderate benefit	Moderate benefit	High negative	N	Unsophisticated investors are heavy users of these products and likely expect robust regulatory frameworks around them. Creates higher barriers to entry, and risks inhibiting competition and innovation in the fund

							management industry.
Licensing of custodians	-	Moderate negative	Moderate benefit	Moderate benefit	Small negative	N	Typically hold the actual funds or investments for the trustee and fund. Currently fully reliant on trustees to choose and monitor custodians. Enhance regulator's ability to monitor custodians
Mandated duties for custodians	-	Small negative	Small benefit	Moderate benefit	Small negative	Y	Trustees responsible. Likely to impose minimal costs. May be some costs involved for custodians located offshore. Ensures custodians act in investors' best interests.
Peer to peer lending and investment arrangers							
License investment arrangers and bring them within securities regime	-	Small benefit	Small benefit	Small benefit	Moderate to high benefit	Y	Will allow peer to peer lending services to operate in New Zealand. Will provide a means for small New Zealand businesses and start-ups to access capital for relatively low cost.
Scope of collective investment scheme governance requirements							
Include employer superannuation schemes operating through a master trust in CIS regime	-	Moderate negative	Moderate benefit	Small benefit	Small negative	Y	Will mean they are treated consistently with other CIS. Likely to impose limited costs on scheme providers although may result in smaller schemes being closed.
Exclude employer superannuation schemes operating through a master trust in CIS regime	-	Moderate benefit	Moderate negative	Small negative	No change	N	Would be treated inconsistently from other CIS. Lesser degree of protection for employees. Greater risk of poor performance and loss of employees' money.
Include company specific and restricted superannuation schemes within CIS regime	-	Moderate negative	Moderate benefit	Small benefit	Small negative	N	Would likely mean that smaller employer superannuation schemes would cease to operate as independent entities. Risks less here given schemes are generally not-for-profit and intended to benefit employees. However, employers and other trustees may have good intentions but lack necessary skills in investing their employees' money.
Grandfather provision with new company specific and restricted superannuation schemes subject to special regime for regime with less burdensome requirements	-	Small negative	Small benefit	Small benefit	Small benefit	Y	Few costs imposed on current not for profit employer superannuation schemes. Members of new schemes will have a greater level of protection than those in current schemes which may result in investors being treated differently. Greater risk of poor performance and loss of employees' money in current schemes.
Exclude company specific and restricted superannuation schemes from securities regulation	-	Moderate benefit	Moderate negative	Small negative	Small benefit	N	Lack of oversight may mean that long-term performance is poorer than otherwise and there is scope for abuse by employers (e.g. by investing employee savings in related-party securities). Greater risk of poor performance and loss of employees' money.

Provide members of company specific and restricted superannuation schemes with information about any rights and exclusion from regulatory regime	Small benefit	Small benefit	Moderate negative	Small negative	Small benefit	N	Not-for-profit employer superannuation schemes would be exempted from securities regime. Lack of oversight may mean that long-term performance is poorer than otherwise and there is scope for abuse by employers. Greater risk of poor performance and loss of employees' money.

The table above shows the marginal impact of each option on the objectives, compared to the status quo. The impact can be positive (benefit) or negative, and can be small, moderate, or high. Where the impact of the option is negative, the boxes are shaded.

Lever: Enforcement

The effectiveness of our securities laws depends not only on the regulatory requirements imposed on issuers and others involved in financial products, but also on how those requirements are enforced by the FMA. This includes the range of remedies available (e.g. civil or criminal liability, management bans, and infringement notices), the powers of the FMA (e.g. to issue no action letters, and exemptions), and the effectiveness of the judicial process. The CMDT recommended that emphasis be given to monitoring and enforcement capability and activity.

Offences and penalties

The offences and penalty levels in securities law have a significant impact on the incentives faced by issuers and directors. The current regime is complex and incoherent, with a number of overlapping provisions contained in numerous acts including the Securities Act 1978, the Securities Markets Act 1988, the Crimes Act 1961, the Fair Trading Act 1986 and the Contractual Remedies Act 1979, as well as common law remedies.

This regime lacks coherence and is difficult to understand for those who are subject to it or who wish to apply it. The overlap of criminal offences and civil pecuniary penalties is particularly confusing. For example, there are regulatory and serious criminal offences in respect of false statements in a prospectus. The same conduct is also subject to civil pecuniary penalties. Both the regulatory and serious criminal offences have the potential for significant terms of imprisonment, even though the required mens rea (intent) elements differ substantially. It is, therefore, unclear how these different forms of liability interact to promote the objectives of the liability regime. We consider that significant benefit could be gained from rationalising the liability regime.

Therefore, we are proposing to simplify the regime so that its different components more effectively promote compliance with the securities law and deter conduct that undermines market integrity and confidence. In order to achieve this, we must consider each of the available penalties and their appropriateness for the conduct. The possible options are:

- Serious criminal offences with the possibility of significant period of imprisonment;
- Regulatory offences with criminal penalties (primarily a fine); and
- Civil offences with pecuniary penalties.

We recommend that based on the analysis set out in the table, a combination of these penalties should be used for breaches of securities law. The penalties should be sufficient to deter breaches but also commensurate with the conduct. The regime will, therefore, be designed so that only egregious violations involving deliberate or reckless behaviour will be subject to serious criminal offences. We also propose that new securities-specific offences be created in the new legislation to provide for a simple enforcement regime for criminal breaches of securities law. These will effectively replace existing offences in other acts and reduce overlaps.

We are proposing that it will be necessary for the liability regime to include some minor regulatory offences to sanction behaviour that breaches the regime and is harmful, but is not sufficiently serious to warrant the imposition of serious criminal offences. We are also proposing that conduct that violates the regime but is not sufficiently serious to warrant the imposition of the criminal liability noted above should be dealt with primarily through a civil pecuniary penalty regime. Some of the current regulatory offences that involve less culpable behaviour could be replaced with civil pecuniary penalties to better align the offence and potential penalties with the conduct. The lower civil standard of proof will make it easier to enforce breaches but is likely to be adequate to deter breaches of obligations. It is also less likely to discourage people taking up directorships and other beneficial market activity.

As a related issue, it is currently very difficult for an investor to obtain compensation where an issuer has made a misleading or deceiving statement, as the investor must prove that their reliance on the statement caused loss. We propose giving investors a right of compensation where they can show that the misstatement is material and it would have affected a reasonable person. This involves a slight lowering of the standard of proof which will make it easier for investors to seek compensation, but which may result in more risk adverse behaviour by issuers. In particular, there is a risk that it may result in larger disclosure documents if issuers attempt to reduce their exposure to liability. We consider that this risk is relatively low and could be mitigated by the proposed disclosure regime.

We have consulted with the Ministry of Justice on this proposal. They have confirmed that they are comfortable with the suggested approach.

While the above principles will provide the conceptual foundation of the liability regime, the detail of the regime (such as specific offences) will be provided to Cabinet by the end of April 2011.

Accountability of directors

A particular area of concern has been the possible under-enforcement of directors' duties. Company directors owe a number of duties to the company and shareholders, such as a duty to act in good faith and in the best interests of the company. Directors' duties are currently enforceable by civil action taken against them by the company, by shareholders, or in some cases by shareholders on behalf of the company (this is known as a derivative action). It is difficult for shareholders to take action themselves despite the potential for substantial harm to individual and public interests from directors breaching their duties.

Under the Financial Markets (Regulators and KiwiSaver) Bill, the FMA will be able to take civil actions on behalf of shareholders or companies where it is in the public interest. This will go some way in improving enforcement in this area, however, enforcement could be further enhanced by attaching additional penalties for breaches of directors' duties. There are three options; the first would involve civil penalties that could be imposed at the same time as damages. Alternatively, new regulatory offences could be applied on a strict liability basis with fines. Another option is more serious criminal offence where breaches involve dishonesty, or are intentional or reckless.

Submitters had mixed views about further penalties for breaches of directors' duties. Offences for dishonest breaches of directors' duties received the most support. There are currently no offence provisions for intentional breaches of directors' duties, for instance where the director intentionally incurs obligations for a company knowing that the company would be unable to meet those obligations. The potential for significant harm to arise from these situations is substantial. Accordingly, we propose to impose criminal offences for the most egregious breaches where a director acts dishonestly or intentionally or recklessly causes harm. We consider that that this will have a beneficial deterrent effect on harmful behaviour. The effect on most directors should be relatively small, as the threshold is higher. As a result, it is not likely to cause risk adverse behaviour by directors but there is a higher burden of proof and it may overlap to some extent with existing fraud provisions in the Crimes Act.

Management bans

There are currently a range of management banning provisions in company and securities legislation where directors commit serious offences. The Registrar of Companies has the ability to impose a maximum banning period of five years, while the High Court can in certain circumstances impose a maximum ban of ten years. These periods are not adequate to properly protect the public interest as people are able to re-enter the market as directors once the relatively short banning period has ended.

There are three main options for improving this situation. The Companies Office could publish a list of directors who had been banned. Another option could be to expand the list of matters in section 151(2) of the Companies Act 1993 that result in a person being disqualified from being a director, to include the offences that currently result in banning orders. Alternatively, the current maximum banning periods could be extended.

We prefer the latter option. Providing a list of directors who have committed offences is not likely to be read by everyone and therefore may not provide adequate protection. Expanding the matters in section 151(2) of the Companies Act 1993 to include these offences is overly burdensome and may not be appropriate in all cases.

We propose that the new regime enable the Registrar of Companies and the FMA (which will have the power to impose bans in some instances pursuant to the Financial Markets (Regulators and KiwiSavers) Bill) to impose a maximum ban period of ten years. We also propose that the High Court have the discretion to impose an indefinite banning order. This will result in persons being banned from carrying on the role of director in appropriate circumstances where it is in the public interest, without placing overly burdensome restrictions on all directors.

Lever: Enforcement

Options	Ensuring the efficiency of enforcement	Reducing costs to issuers by providing sufficient certainty around their obligations and removing unwarranted obligations	Reducing the costs associated with enforcement	Effective enforcement of breaches of duties	Impact on objective: Ensuring appropriate flexibility and innovation in the market	Preferred option (Y / N)	Comments and risks
Effective penalties and remedies for breaches of securities law							
Criminal offences	-	-	-	Moderate benefit	Small negative	Y	Higher standard of proof. Less likely to cause risk adverse behaviour as only applies to most egregious behaviour. Incentive not to breach obligations intentionally or recklessly.
Regulatory offences	-	-	-	Moderate benefit	Small negative	Y	Strict liability so lower burden of proof. May result in risk adverse behaviour by issuers/directors. May in some cases result in penalties that are not commensurate with the offence.
Civil pecuniary penalties	-	-	-	Moderate benefit	Small negative	Y	Lower burden of proof than criminal offences. Provides a greater incentive for issuers not to breach duties than ordinary civil remedies. May not provide level of deterrence that criminal offence.
Create securities-specific offences to reduce overlaps with offences in other legislation	Moderate benefit	Small benefit	Small benefit	Small benefit	Small negative	Y	Will reduce overlaps in the liability regime. Increases certainty by including all offences applicable to securities law in one piece of legislation.
Compensation orders where investors suffer loss	-	-	-	Moderate benefit	Small negative	Y	Greater ability for investors to seek and receive compensation.
Effective accountability for directors							
Civil pecuniary penalties for breach of directors duties	-		-	Small benefit	Small negative	N	May dissuade some people from taking up directorships and cause directors to be more risk averse in making decisions. Lower burden of proof than regulatory offences below, but more costly to bring cases.
Regulatory offences for breach of directors duties	-	-	-	Moderate benefit	Small negative	N	May dissuade some people from taking up directorships and cause directors to be more risk averse in making decisions. Higher burden of proof than civil pecuniary offences, but cheaper to bring cases.
Criminal penalties for dishonesty offences	-	-	-	Small benefit	Small negative	Y	Effect on most directors should be relatively small, as directors can only be charged where it can be proven beyond reasonable

							doubt that a person was dishonest and intentionally or recklessly causing harm. Could result in some duplication of existing criminal offences in the Crimes Act.
Management bans							
Publish a list of directors who have been banned	Small benefit	Small benefit	Small negative	Small benefit	-	N	Relatively low cost. However, may not be read by all who may be potentially affected.
Include persons who have been subject to a banning order in the list of persons who are disqualified from being directors	Small benefit	Small benefit	Small negative	Small benefit	-	N	May be overly burdensome as will prevents directors who have been banned from ever being a director again.
Increase the maximum term of management bans	Small benefit	Small negative	Small benefit	Small benefit	-	Y	Will provide more adequate banning period to ensure consumers are appropriately protected. Not overly burdensome.

The table above shows the marginal impact of each option on the objectives, compared to the status quo. The impact can be positive (benefit) or negative, and can be small, moderate, or high. Where the impact of the option is negative, the boxes are shaded.

Consultation

The proposals in this RIS have been consulted on through a number of different processes over the past five years. The two most recent were:

- The Capital Market Development Taskforce (CMDT); and
- The Review of Securities Law Discussion Document.

The CMDT was established in July 2008 and was chaired by investment banker Rob Cameron of Cameron Partners. It had 14 other members from the private and public sectors. It conducted informal consultation with various industry participants and received submissions from stakeholders which informed its research and conclusions. The CMDT released its final report on 16 December 2009. The Taskforce made 60 recommendations for improving New Zealand's capital markets, and 20 of these relate to the securities law review. These recommendations included a number of the options considered in this RIS which have been noted in the analysis in the regulatory impact analysis section.

The Review of Securities Law Discussion Document was released by the Ministry on 21 June 2010 and submissions closed on 20 August 2010. 98 submissions were received. The views of these submitters are discussed in the regulatory impact analysis section above.

We note also that the Treasury has indicated that it does not support the proposal to license fund managers on the basis that it considers this to be unnecessary given the other reforms that are currently being implemented or are proposed as part of this review.

Conclusions and Recommendations

We recommend modifying the current regime to create a new regulatory regime that is more certain, provides robust regulatory requirements and incentives to act in the best interests of investors, and enhances enforcement.

Currently the boundaries between those who are covered by the regime and those who fall within the exemptions are unclear. We recommend clarifying these boundaries in order to increase certainty, reduce costs for issuers and ensure products have adequate regulatory requirements. We consider that wholesale broadening of the exemptions is not required, however, we recommend that two narrow exemptions be added for small offer and employee share schemes to improve access to capital. Clearly defining products in categories based more on their substance will result in products being subject to appropriate governance arrangements and regulatory requirements.

Disclosure documents under the current regime are long and do not provide well-targeted information to investors. We recommend improving the disclosure regime by requiring shorter, more prescribed product disclosure statements. This will provide more targeted information to investors so that they can make well-informed investment decisions.

Collective investment schemes are currently regulated according to the type of investment vehicle used which means that some investment vehicles are not appropriately regulated to provide adequate safe guards for investors. In some instances, the current governance requirements are inadequate. We recommend that the new regime provide more robust governance requirements for collective investment schemes by ensuring that fund managers have the appropriate skills and placing duties on fund managers, trustees and custodians to enhance accountability and provide incentives for them to act in the best interests of investors. This will also ensure that collective investment schemes have appropriate governance arrangements and enhance the regulator's monitoring and enforcement role.

The current liability regime is complex and overlapping and in some cases enforcement is not as effective as it could be. We recommend redesigning the liability regime to make it more coherent and align the penalties with conduct to ensure appropriate incentives are placed on issuers. Introducing a right of compensation for investors where an issuers' conduct is misleading or deceptive will enhance the ability of investors to enforce obligations owed by issuers. Similarly, we recommend introducing a criminal offence for egregious breaches of directors' duties to enhance enforcement without discouraging people from taking up directorships.

More generally, we consider that the costs imposed on issuers by the new regime are not likely to be significant, with most of the costs associated with the new disclosure regime and structural changes to collective investment schemes. We consider that these costs are warranted in producing integrity and restoring investor confidence in our capital markets. Submitters generally supported this view.

IMPLEMENTATION

[Withheld under sections 9(2)(f)(iv) and 9(2)(g)(i) of the Official Information Act 1982].

This legislation will repeal the Securities Act 1978 and the Securities Markets Act 1988 and re-enact them as a single redrafted Act containing the proposals discussed in this RIS. Those parts of the Securities Act 1978 and the Securities Markets Act 1988 which are unaffected by the proposals in this RIS would be carried over into the new consolidated legislation (subject to minor drafting changes). The proposed changes address aspects of the financial reform agenda that are not covered by other pieces of work currently in train. We expect that it will come into force 12 months after most of the other reforms are implemented.

[Withheld under sections 9(2)(f)(iv) and 9(2)(g)(i) of the Official Information Act 1982].

There is likely to be an industry working group established to help MED formulate regulations that will sit under the primary legislation over the next 18 months.

Transitional arrangements for the new legislation are likely to be along the lines of the following:

Offers of regulated financial products after the enactment of the legislation

The detailed content of prescribed disclosures under the new regime will be set out in regulations made under the new legislation. Subject to those regulations being enacted in time, six months after the enactment of the legislation all new offers of financial products will have to be made in accordance with the new definitions of financial products, the new exemptions, and the new disclosure requirements.

18 months after the enactment of the legislation collective investment schemes will have to comply with the new governance arrangements, and derivatives dealers will need to be licensed.

Offers of securities made before the enactment of the legislation

If securities offered before the legislation is enacted no longer come within the scope of the new regime, they will not be required to comply with any ongoing requirements under either the old or new regime once the new legislation is enacted.

If those securities are subject to any ongoing disclosure requirements under the new regime, issuers who issued regulated financial products before the commencement of the legislation will have to comply with the new ongoing disclosure requirements from 6 months after the enactment of the legislation

If those securities subject to any new governance or licensing requirements under the new regime, issuers who issued regulated financial products before the commencement of the legislation will have to comply with the new ongoing disclosure requirements from 18 months after the enactment of the legislation.

Role of the Financial Markets Authority

We anticipate that the FMA is likely to:

- Implement a detailed education campaign on the new requirements;
- Engage in discussions with industry participants on the application of the new categories of regulated financial products and the new exemptions;
- Provide detailed guidance to industry participants on the applicant of the new disclosure and governance requirements: and
- Provide guidance to potential applicants in respect of the licensing or authorisation regimes for derivatives dealers, fund managers, and investment brokers.

[Withheld under sections 9(2)(f)(iv) and 9(2)(g)(i) of the Official Information Act 1982].

As noted above, we anticipate that there will be an additional lead-in period of 6 to18 months after the commencement of the legislation before issuers will need to comply with the new disclosure requirements. We consider that this difference in timing is sufficient to mean that there will not be any significant risks associated with the FMA carrying out these functions.

MONITORING, EVALUATION AND REVIEW

MED will undertake a review of the effectiveness of the new legislation within five years of its enactment. MED will use information that will be gathered by the FMA as part of its market surveillance function, the information in the FMA's annual reports and the post-implementation review of the FMA to inform this review More specifically, the post-implementation review of the FMA will indicate how the FMA fits into the overall securities law system and any changes that will need to be made to improve the system as a whole and the FMA's place within it.

The FMA, which will be close to industry, and information gathered about the FMA, will be able to provide insights as to whether the exemptions have operated as intended. The FMA is also likely to be able to indicate to us whether it considers the boundaries between products are appropriate and whether there are any financial products that fall outside the regime but that should be included.

MED will gather appropriate information to ascertain whether the disclosure regime provides more targeted information for investors, allowing them to make better informed decisions. This may be through the FMA's assessment of the disclosure documents it reviews and the number of complaints it receives, surveys of investors, or information gathered by other organisations such as the Retirement Commission.

The effectiveness of the governance requirements will be able to be assessed through the reports provided by trustees to the FMA and through the FMA's direct monitoring of trustees and fund managers.

The effectiveness of the liability and enforcement regime will be largely informed by the FMA's annual reports which will provide both detailed and high level measures regarding enforcement and deterrence of breaches of securities law.