NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Commerce Committee

on the

Financial Markets Conduct Bill

10 May 2012

NEW ZEALAND BANKERS ASSOCIATION
Level 14, Kordia House, 109-125 Willis Street, PO Box 3043, Wellington 6140, New Zealand
TELEPHONE +64 4 802 3358 FACSIMILE +64 4 473 1698 EMAIL nzba@nzba.org.nz WEB www.nzba.org.nz

Submission by the New Zealand Bankers' Association to the Commerce Committee on the Financial Markets Conduct Bill

About the New Zealand Bankers' Association

1. The New Zealand Bankers' Association (NZBA) works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes which contribute to a safe and successful banking system that benefits New Zealanders and the New Zealand economy.

2. The following thirteen registered banks in New Zealand are members of NZBA:
   - ANZ National Bank Limited
   - ASB Bank Limited
   - Bank of New Zealand
   - Bank of Tokyo-Mitsubishi, UFJ
   - Citibank, N.A.
   - The Co-Operative Bank
   - The Hongkong and Shanghai Banking Corporation Limited
   - JPMorgan Chase Bank, N.A.
   - Kiwibank Limited
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited.

Introduction

3. NZBA supports the Financial Markets Conduct Bill (the Bill), which represents a significant modernisation of New Zealand's financial markets regulation, and appreciates this opportunity to provide input into its design.

4. NZBA would welcome the opportunity to make an oral submission to the Commerce Committee (the Committee).

5. NZBA makes submissions relating to the following areas, being of particular interest to member banks:
   a. The wholesale thresholds;
   b. The derivatives regime;
   c. The liability regime;
   d. The use of the terms 'send' and 'give';
   e. Streamlining the licensing provisions;
   f. Transitional arrangements; and
   g. Key managed investment scheme (MIS) provisions.

6. A range of technical amendments will improve the Bill and enable it to operate as efficiently as possible. Some member banks have made their own submissions, covering many of these technical issues. NZBA has chosen to focus its submission on a smaller number of policy issues that are of greatest significance to member banks as a whole.

7. If the Committee has any questions about this submission, or would like to discuss any issues in further detail, please contact me.

Karen Scott-Howman
Regulatory Director

Telephone: +64 4 802 3351 / +64 21 703 030
Email: karen.scott-howman@nzba.org.nz

Submission

Wholesale investors

The 'large' person threshold

8. **NZBA submits** that the thresholds in the 'large' person tests in clause 37 of Schedule 1 should, for entities but not individuals, be aligned more closely with the thresholds in the Financial Advisers Act 2008 (FAA).
9. In the context of businesses in New Zealand, the current test in clause 37 of Schedule 1 is too high and will apply to very few entities. This will result in unnecessary compliance costs for issuers and inconvenience for client businesses that do not require the protections of the Bill.
10. NZBA notes that under the Australian Corporations Act 2001 the threshold (for entities) is $2.5 million of net assets or $250,000 in annual income[1] and that the New Zealand economy is considerably smaller than Australia's.
11. This issue was carefully considered during the design of the FAA, which contains a similar test. This test was initially drafted much higher and was later reduced in order to better fit the New Zealand market place. NZBA asks the Committee to consider lowering the thresholds currently in the Bill.

The 'large offers' threshold: application to derivatives

12. **NZBA submits** that clause 3(3)(b) of Schedule 1 should be amended to refer to the notional amount of the derivative. This is the approach taken in Regulation 7.1.22 of the Australian Corporations Regulations 2001.
13. Clause 3(3)(b) of Schedule 1 of the Bill provides a useful arm to the wholesale client regime through an exclusion from disclosure requirements for large transactions. The current draft treats a transaction as wholesale if "...the minimum amount payable by [the subscriber] on acceptance of the offer is at least $500,000...".
14. However, this concept does not apply to derivatives in the same way as it does for conventional securities. Many derivatives contracts involve no consideration paid up front. Others would require a very large notional amount to meet the current $500,000 consideration threshold. Therefore, this clause should refer instead to the 'notional amount' of the derivative.
15. Similar amendments to cater for derivatives are also needed in other places where minimum transaction sizes are used, particularly clause 36 of Schedule 1.

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[1] See Section 761G(7)(c) of the Act and Regulation 7.1.28 of the corresponding Regulations.

The derivatives regime

16. **NZBA submits** that the Bill needs to be amended to accommodate derivatives more effectively. In particular, amendments are needed to:
    a. Fix definitions that do not apply well to derivatives;
    b. Target regulation to the appropriate parties;
    c. Clarify that derivatives disclosure is of a general nature and is not specific to individual contracts;
    d. Clarify that register entries for derivatives need not include individual contracts' terms; and
    e. Clarify that derivatives disclosure will not be subject to the five day waiting period.
17. **NZBA also suggests** that the Committee consider the relevant provisions of the Australian Corporations Act 2001 and the regime under the Securities Act (Registered Banks Futures Contracts) Exemption Notice 2007 as potential avenues for addressing the issues raised above.

General comments

18. The scope of the Bill is largely determined by reference to 'financial products', being equity, debt, MIS products and derivatives. As such, the Bill attempts to treat all four types of products as having broadly the same characteristics, with, for example, an issuer, an investor, a product with set features available for subscription by a range of investors, and so on. This regime is based on the current legislative framework that has existed for some time in the context of traditional securities. However, it does not apply well to derivatives.

Definitions

19. The Bill uses numerous terms and definitions drawn from existing securities legislation that are difficult to apply to derivatives. In particular, the definitions of 'derivatives issuer', 'offer', 'continuous issue PDS' and 'product holder' create significant difficulties.
20. Furthermore, the derivatives market is highly international, with trades routinely taking place between financial institutions around the world. As a consequence, it is important that the definitions used in New Zealand align with those used internationally for interpretational consistency.
21. Several member banks have made detailed submissions to assist in ensuring that the technical definitions in the Bill work appropriately. The International Swaps and Derivatives Association also made an informative submission to officials on the Exposure Draft of the Bill.

Target of regulation

22. **NZBA submits** that the derivatives framework needs to be amended to focus regulation on entities whose business consists of routinely making derivatives contracts available to enable other businesses to hedge their risk.
23. In the context of over-the-counter derivatives, there are two types of participant:
    a. Persons wanting to hedge their risk by entering into derivatives contracts; and
    b. Entities whose business consists of routinely making derivatives contracts available to enable other businesses to hedge their risk (termed here 'derivatives providers').

24. The appropriate target of regulation in the Bill is the 'derivatives provider', being analogous to the issuer of securities. Licensing and disclosure obligations are appropriate for derivatives providers but not for persons who merely enter into derivatives contracts to hedge their risk. Where a derivatives contract does not include a derivatives provider, being instead a mutual hedging arrangement between two businesses, regulation should not apply (aside from Part 2 of the Bill).
25. This appears to be the intended policy under the Bill. However, a degree of circularity in the definitions and the reliance on exemptions from requirements (instead of positively defining derivatives providers) makes it uncertain whether the Bill will function as intended.
26. NZBA would be happy to work with the Committee and officials to develop appropriate amendments.

Nature of derivatives disclosure

27. **NZBA recommends** that the Bill be amended so that it is clear that the product disclosure statement (PDS) and corresponding register entry will be of a general nature, covering the classes of derivatives that the derivatives provider/derivatives issuer makes available, rather than being specific to each contract and its own unique terms.
28. Under the Bill as currently drafted it is uncertain how disclosure would be made in the context of derivatives contracts. If derivatives disclosure is understood to function in the same way as an offer of conventional securities, this would suggest that nearly every over-the-counter derivatives contract would be a unique offer. This would occur because every derivatives contract has individual terms negotiated between the relevant counter parties. Technically, the derivatives issuer would need a distinct PDS and individual register entry for every derivatives contract, as the Bill does not contemplate different offers sharing a PDS or register entry.[2] This would clearly create a significant compliance cost without any benefit to investors, and is probably not the intended outcome.

Content of register entries for derivatives – 'material information'

29. **NZBA submits** that, like PDS disclosure, disclosure on the register should be in respect of the class of derivatives only.
30. Even if the PDS regime is amended to clarify that a PDS and corresponding register entry will apply to a broad class of derivatives, rather than to each individual contract, the 'all material information' requirement in clause 42(1)(b)(ii) could be interpreted as requiring disclosure of the details of each contract in that class. This is impractical, would probably confuse prospective clients and would involve the disclosure of commercially sensitive information.

[2] For example, clause 35(1)(a) requires that the issuer prepare "a product disclosure statement (PDS) for the offer" (emphasis added). Similarly, the definition of "register entry" reads "in relation to a regulated offer, means the entry for the offer in the register of offers of financial products" (emphasis added).

Disclosure waiting period

31. **NZBA submits** that derivatives disclosure should not be subject to the five day waiting period.
32. Derivatives contracts are entered into continuously by derivatives issuers and the terms are often negotiated on the spot with clients. As such, it is not practicable for the five day waiting period to apply to derivatives disclosure. However, it is unclear whether the exemption from the five day waiting period in clause 53 would apply to derivatives.
33. The Bill should be amended to clarify that the five day waiting period does not apply to derivatives. This could be done by amending clause 53, although another approach might be preferable once wider changes to the derivatives regime have been made.

Liability regime

Overarching framework and criminal liability for directors

34. NZBA approves of the changes to the liability framework for offers of securities under the Bill.
35. There has been some criticism of this model since the introduction of the Bill. However, although NZBA has reservations about some details of the regime, the general approach is appropriate and can achieve the objectives of promoting compliance, punishing wrongdoers and providing avenues by which investors can receive compensation, without incentivising unduly risk averse behaviour or deterring positive innovation.
36. NZBA notes that the introduction of a *mens rea* component for criminal offences by directors is in line with the general approach to criminal law in New Zealand. The requirement that a person have a certain state of mind in order to commit a criminal offence is status quo in other laws and NZBA supports aligning securities law with this model.
37. Furthermore, one effect of the use of strict liability criminal offences under the Securities Act 1978 has been a high level of risk-aversion on the part of diligent and compliant directors. In some instances this has led to higher costs and to disclosure statements being longer than they need to be, possibly discouraging investors from utilising them.
38. A liability framework that combines criminal sanctions for the worst conduct with a civil penalty regime provides directors and issuers with appropriate incentives to comply and enables investors to seek redress when necessary.

Penalties

39. **NZBA submits** that the penalties under the Bill should be aligned with penalties for comparable offences under other legislation.
40. Under the Bill as currently drafted, numerous offences have penalties that are significantly higher than those under comparable offences in other legislation. In particular:
    a. A breach of an obligation under Part 2 of the Bill can lead to a pecuniary penalty of up to $1 million for an individual and $5 million for a body corporate, which is significantly higher than the penalties under the Fair Trading Act 1986 for comparable obligations.
    b. The penalties under clause 446 are significantly higher than the comparable penalties under the FAA. This is especially relevant for providers of 'discretionary investment management services' (DIMS) and for 'qualifying financial entities' (QFEs), as DIMS can be regulated under both the FAA and the Bill, and QFEs will nearly always be product issuers under the Bill. See for example the maximum penalties imposed on bodies corporate relating to:
        i. Failure to deliver regular reports to the Financial Markets Authority (FMA) results in a penalty of $25,000 per QFE partner entity under the FAA, as opposed to $600,000 under the Bill; and
        ii. Failure to comply with an FMA direction results in a penalty of $25,000 under the FAA, as opposed to $600,000 under the Bill.
    c. Under section 55F of the Securities Act 1978, the maximum pecuniary penalty that can apply to an individual is $500,000, whereas the maximum under the Bill is $1 million.
41. As noted above, NZBA is in favour of the broad liability framework, noting in particular that it could have the benefit of reducing incentives to engage in unduly risk-averse behaviour. However, the size of the civil penalties currently in the Bill risks undermining this objective.
42. A primary example is in the context of disclosure documents and directors' civil liability. Although the Bill includes due diligence defences for directors, if penalties are overly high it is likely that directors will attempt to protect themselves by 'dumping' large amounts of information onto the register. This will undermine the usefulness of the register to investors, who might have to navigate through large numbers of documents or descriptions to find useful information.
43. There is no clear rationale for the significant increases to these penalties under the Bill. NZBA notes that an increase in penalties could be warranted for some criminal offences, where a *mens rea* component has been added. However, in the case of civil remedies this is not a factor and the Bill's penalties should be more closely aligned with comparable civil offences in other legislation.

Directors' reliance on experts and employees

44. **NZBA submits** that the Bill should be amended to make clear that directors can place reasonable reliance on employees and product experts when preparing disclosure documents.
45. The role of directors is governance. In the context of disclosure document compliance this involves ensuring that appropriate systems are in place and suitable people are appointed to key roles in the first instance, rather than necessarily getting personally involved in all details. This is particularly true in the case of disclosure documents for derivatives and MIS products, which are often complex and are offered in a range of different classes by issuers.

46. As such, directors should be able to place reasonable reliance on employees and product experts. Primary liability for breaches should lie with the issuer in the first instance, with directors subject to civil liability where they have failed in their governance responsibilities and not put in place appropriate procedures to ensure compliance.
47. However, recent court decisions relating to existing strict liability criminal offences suggest that these obligations cannot be delegated to specialists or employees.
48. The ability of directors to rely on appropriate employees and other experts should be made clear in the Bill. This could involve:
    a. Amendments to clause 447; and/or
    b. Amendments to the due diligence defences, for example by adding a provision similar to section 138 in the Companies Act 1993.
49. NZBA's member banks have made their own submissions on this issue and suggest several technical approaches to addressing it.

Infringement offence regime

50. **NZBA submits** that the Bill should be amended to include more process provisions around the issuance of infringement notices. Specifically, the Bill should be amended to:
    a. Require the FMA to consider giving a warning instead of issuing an infringement notice; and
    b. Give recipients of infringement notices a right to respond in respect of an infringement notice.
51. The Bill currently contains 31 'infringement offences' which enable cost effective enforcement where breaches are relatively minor.
52. Despite being targeted at deterring relatively minor offences, the infringement notice regime could indirectly have significant consequences for issuers. An infringement notice could invoke an unduly strong negative perception among investors, who might not necessarily understand that the relevant breach by the issuer could have been minor, technical and of no detriment to investors. This could impact on the issuer's ability to raise funds, both internationally and domestically.
53. It is therefore likely that infringement notices will have a greater impact on issuers than has perhaps been anticipated so far. This being the case, the Bill should include greater process provisions around the infringement notice regime.
54. NZBA understands that the FMA is likely to issue warnings to market participants in the case of minor, technical and unintentional breaches. This should be formalised in the Bill, for example by expressly giving to the FMA the power to issue warnings in lieu of issuing an infringement notice and requiring the FMA to first consider this option where the breach has been minor or technical. This will allow issuers to address the infringement through remedial action or engagement with the regulator.
55. Similarly, the Bill should be amended to give market participants the right to respond to the FMA in respect of an infringement notice. At present, the only recourse available is the Courts, which will be costly and potentially less economic in the short term than simply paying the infringement notice.

Use and definition of ‘give’

56. **NZBA submits** that ‘give’ should be used instead of ‘send’ throughout the Bill.
57. **NZBA also submits** that the definition of ‘give’ should be amended to:
    a. Clarify that it includes electronic delivery; and
    b. Future-proof the provision by allowing regulations to prescribe other means of delivery.
58. At present, the Bill uses both the term ‘send’ and the term ‘give’. As the former is not defined and the latter is, ‘send’ should be replaced by ‘give’ everywhere it appears in order to ensure clarity and consistency.
59. In order to ensure that the new financial products regulatory framework is modernised, it is important that the Bill make clear that technology can be used to meet ‘giving’ obligations. Amendments should be made to clarify that documents can be ‘given’ electronically by sending an appropriate hyperlink or attachment to a known email address. Clause 422(3) provides useful language that could be used to achieve this.
60. NZBA notes that similar changes to the Companies Act 1993 are currently being made under clause 47 of the Regulatory Reform Bill.

Streamlining the licensing regime

61. **NZBA submits** that clause 395(1)(b) should be amended to remove duplication between different licences and licensing regimes.
62. The Bill will create a number of new licences for market participants. Of particular relevance to NZBA’s member banks are the licences for:
    a. Derivatives issuers;
    b. DIMS providers; and
    c. Managers of registered schemes.
63. These will join a range of other licences and registrations already held by member banks and members of their banking groups, such as those for:
    a. QFEs;
    b. Registered banks; and
    c. Registered financial service providers.[3]
64. The number of different licences is likely to lead to duplication, inefficiencies and unnecessary cost for market participants.
65. Ideally these licences would be amalgamated into a single ‘institution’ licence with various authorisations for different services, similar to the Australian financial services licence regime. Changes to the authorisations (due to changes in corporate structure, for example) would be notified to the regulator on an ongoing basis.
66. If this is not attainable, the Bill should streamline the process for acquiring multiple licences as much as possible.
67. Clauses 319 and 395(1)(b) contain streamlining provisions already. Clause 319 is a useful and appropriate provision that recognises group structures. However, the requirement in clause 395(1)(b) that the FMA “have regard to whether the applicant is a QFE or a member of a QFE group or is a registered bank” should be strengthened.
68. The Bill should be amended so that applicants for a licence will not need to provide information demonstrating compliance with certain criteria when this information has

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[3] Under the FAA, Reserve Bank of New Zealand Act 1989 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008, respectively.

already been provided to satisfy application criteria for a licence the applicant already holds under the Bill or under another piece of legislation. The FMA should be required to take any prescribed requirement as met when the applicant already holds a market services licence, or is a QFE, registered bank or registered financial service provider if the prerequisite for the new licence is comparable, or inferior to, a prerequisite for the licence already held.

69. For example, if the prescribed prerequisites for derivatives issuers include capital adequacy rules, registered banks should not be required to demonstrate that they meet these, as registered bank status (granted by the Reserve Bank) should provide adequate assurance. Similarly, if the application for a DIMS provider licence requires that the applicant demonstrate that it has a risk management framework, this should not need to be submitted if it has already been supplied as part of QFE licensing.

70. Possible drafting under clause 395 could be:

> (1) The FMA must, before making a decision under **section 394**, —
>
> > (a) have regard to the prescribed matters; and
> >
> > (b) have regard to whether the applicant is a QFE or a member of a QFE group or is a registered bank;
> >
> > (c) consult with all prescribed persons or classes of prescribed persons (if any).
>
> (2A) Unless the FMA reasonably believes to the contrary, where the applicant is licensed, registered or authorised as a QFE, registered bank or in another manner as prescribed in regulations, take any matter referred to in section 394 or 395(1)(a) as proven if that matter is the same as, or of inferior standard to, a prerequisite for the existing licence, registration or authorisation;

Transitional arrangements

Uncertainty and flexibility

71. **NZBA submits** that the Bill should be amended so that the lengths of the two transition periods are set by regulations, rather than being set at 12 and 24 months in the primary legislation.

72. In the Bill as introduced, the transition will occur in two stages lasting 12 months and 24 months from the date of the relevant Order in Council (with a latest possible start date of 1 April 2015).

73. The transition from the current regime to the new one will be complex and industry is likely to require substantial time to implement the new regime, as it will require the redrafting of a large number of disclosure and governance documents, as well as new contracts and licence applications.

74. Furthermore, during the implementation transition period significant additional work load will be created for issuers, with large internal compliance projects and additional demand for external resources. The entire financial sector will be rewriting documents and undertaking wider compliance work at the same time. Therefore, it is likely that a lengthy period will be required for market participants to fully prepare to comply with the new regime, once all the details are finalised.

75. Although the transition will be a lengthy process, at this stage it is difficult to know exactly how long it needs to be, as most of the detail of the new regime has been left to regulations.

76. Compounding this issue is the risk that the design of the substantive regulations will be drawn out, as this task is likely to be difficult and complex, and because there will be a great many regulations to draft. If there is a fixed implementation timeframe, any delays at the regulation design stage will affect the applicable market participants'

implementation transition. In a worst case scenario, if the implementation transition ends too soon, firms could be forced to cease trading for a time or to suspend certain products.

77. It is therefore important that the length of the transition period be as flexible as possible. Orders in Council are the most flexible tool available to initiate sections of the Bill.

78. As such, the Bill should be amended so that the lengths of the two transition periods are set by regulations, rather than being set at 12 and 24 months in the primary legislation. This will allow for consultation on the appropriate length of the implementation transition following the promulgation of the regulations laying out the details of the regime.

79. This approach will provide maximum flexibility and will future-proof the Bill, ensuring that a transition period can be put in place that is appropriate to the details of the substantive regulations.

80. If this submission is not accepted, NZBA recommends that, at a minimum, the regulations containing the compliance details of the regime, along with any conditions set by the FMA, should be promulgated:
    a. Well ahead of 1 April 2015; and
    b. Well ahead of the Order in Council commencing the transition.

81. In particular, the following regulations will need to be prioritised to ensure that industry is able to properly assess their obligations as quickly as possible, following appropriate consultation:
    a. Disclosure requirements;
    b. Licensing requirements; and
    c. MIS registration and governing documents requirements.

82. This will enable industry to consider their new obligations as a whole and provide input on the length of time required to adapt their systems. Further Orders in Council initiating the 12/24 month transition can then be promulgated at an appropriate time, in light of industry feedback.

Transitional arrangements for products without a prospectus

83. **NZBA submits** that the transitional provisions should be amended to allow financial products issued without a prospectus to benefit from the full transition.

84. Some products (notably futures contracts) that will require a PDS under the Bill do not currently require a prospectus. These products are instead offered under an alternative product disclosure document provided for under an exemption notice.

85. The transitional provisions in the Bill currently allow such products to be offered under their existing regime until the '12 month date' (clause 672).

86. However, if a prospectus is registered before the 12 month date, products can be offered and allotted under it for up to 12 more months under clauses 674 and 677.

87. The process of preparing a PDS and register entry, and complying with any relevant new governance requirements is comparable for products that currently require a prospectus and those that do not. NZBA is not aware of any policy rationale for why these products should be treated differently.

88. Therefore, clause 677 should be amended to ensure that products issued without a prospectus benefit from the full transition.[4]

[4] Noting NZBA's submission above that the full transition timeframe should be set by regulations

Managed investment schemes

89. The Bill requires retail schemes to adopt a common legal model, with a manager as issuer and an independent supervisor.
90. Amendments to the MIS regime will be needed to address several outstanding issues. These issues are:
    a. Scheme participants have undue power to remove a scheme manager;
    b. Legacy schemes are subject to unnecessary obligations; and
    c. Liability when fund managers contract out certain management functions.

Scheme participants removing a scheme manager

91. **NZBA submits** that the Bill should be amended so that:
    a. Scheme participants are only able to remove their scheme manager when the manager has committed a material, unremedied breach of its obligations; and
    b. Fund managers have a right to be heard at any meeting of scheme members at which a vote to remove the manager is held.
92. Under clause 169 of the Bill, scheme participants can require a change of scheme manager by way of a special resolution.[5] However, in the case of schemes under which participants are entitled to redeem or transfer their investment without penalty, for example by redeeming their units in a unit trust, this power should be limited.
93. The intention behind this provision is to provide an additional option for investors in the event that a manager fails to comply with its duties under the Bill or under the terms of the scheme's governing documents. In this situation, this investor power is entirely appropriate.
94. However, at present the Bill gives scheme participants a blanket power that could be used in any circumstances, such as where a new fund manager approaches investors offering to provide management services at a lower cost.
95. At face value this might appear to be a desirable enhancement to market disciplines. However, managed investment schemes are frequently seeded by the fund manager, involving significant costs for development, maintenance and promotion. This investment is recouped over the long term through fees charged to the fund. A fund manager that wishes to move in and replace the original manager will not have any such costs to recoup and will therefore be able to undercut the manager that invested in the development of the fund initially. This uncertainty will create a disincentive against setting up new funds, decreasing the choice available in the market.
96. Where a fund allows members to redeem or transfer their investment without penalty, investors will be able to move freely to more affordable funds. Managers hoping to acquire new investors will first need to invest in developing their funds, removing the perverse incentive to avoid costs by taking existing funds over.
97. Therefore, the Bill should be amended to allow participants in a scheme that permits the redemption or transfer of investments without penalty to remove the manager only when the manager has committed a material, unremedied breach of its obligations.
98. Furthermore, the Bill should provide that the manager must have an opportunity to be heard at any such meeting.

[5] A special resolution "means a resolution approved by product holders holding no less than 75% of the value of the managed investment products held by those persons who are entitled to vote on a special resolution and voting"

99. This will protect managers from the risk of ill-informed, capricious or otherwise unwarranted actions by scheme participants, while still enabling an effective response if the manager has acted improperly.[6]

Legacy schemes

100. **NZBA submits** that 'legacy schemes' (restricted schemes that are closed to new members) should be grandfathered into the new regime and should not be subject to the obligations to have:
    a. At least one licensed independent trustee or, if the trustee is a corporation, a director of the trustee that is licensed and independent (clause 117);
    b. An external custodian that meets independence requirements (clause 143); and
    c. A statement of investment policy and objectives (clause 150).
101. The Bill as introduced contains a number of provisions that provide limited compliance relief for restricted schemes. This relief is appropriate for many such schemes but additional grandfathering should be provided for legacy schemes, being restricted schemes that are closed to new members. In the case of legacy schemes, the trustee, custodian and statement of investment policy and objectives obligations will impose a significant new compliance burden without benefit to investors.
102. Given the significant amendments to trust deeds and other changes that would be required for legacy schemes to comply with these new obligations, it has not yet been possible to calculate the likely compliance costs. However, it is clear that they will be significant. The costs of complying with these new rules will be passed on to scheme members.
103. Furthermore, NZBA is not aware of any particular problem in this area that needs to be addressed.

Liability and contracting out of management functions

104. **NZBA submits** that clause 133(2)(b) be amended so that fund managers are not liable for the conduct of third parties performing management functions, where the fund manager has complied with its obligations under clause 133(2)(a).
105. Clause 133(2)(b) of the Bill provides that a fund manager remains liable for the performance of any functions contracted out to a third party. This is despite the requirements in clause 133(2)(a) to take all reasonable steps to ensure that the contracted party carries out its functions properly and monitors its performance.
106. Where a fund manager has fulfilled its duties under clause 133(2)(a), it should be considered to have discharged its obligations. Rather than imposing liability on the fund manager for breaches by the contracted party, the scheme would be able to take action under contract.

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[6] This provision in the Bill can be compared with a similar provision in the Unit Trusts Act 1960 (UTS). The controls proposed in this submission do not exist under the UTA, which does not constrain the circumstances in which a vote can be held to remove a manager. However, the nature of the necessary vote is different. In addition to the requirement to have 75% of votes cast be in favour of removing the manager, section 18(2) of the UTA requires that those voting in favour "*...hold not less than one-quarter of the value of all the interests in the unit trust held by unit holders...*". Therefore, the comparable provision in the UTA contains a significant additional constraint in addition to those currently drafted in the Bill.