NEW ZEALAND
BANKERS ASSOCIATION

Submission

to the

Financial Markets Authority

on the

Investor acknowledgement and warning for the $750,000 minimum investment wholesale investor exclusion

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Submission by the New Zealand Bankers' Association to the Financial Markets Authority on the Investor acknowledgement and warning for the $750,000 minimum investment wholesale investor exclusion

About NZBA

1. 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 strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following fifteen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - Bank of Tokyo-Mitsubishi, UFJ
   - Citibank, N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - 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.

Background

3. NZBA is grateful for the opportunity to submit on the Investor acknowledgement and warning for the $750,000 minimum investment wholesale investor exclusion consultation paper (Consultation Paper) in relation to the statutory exclusions from the standard requirements of the regulated offers regime under the Financial Markets Conduct Act 2013 (the Act).

4. The process around the development of the Act has been a good example of policy development that has actively involved the industry. NZBA commends the ongoing commitment to meaningful consultation and engagement and appreciates the invitation to participate in this targeted consultation.

5. The following submission makes some brief comments on the Consultation Paper.

6. If you would like to discuss any aspect of the submission further, please contact:

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Background

NZBA and its member banks have submitted on the $750,000 minimum investment wholesale investor exclusion throughout the development of the Act and the Financial Markets Conduct Regulations 2014 (the Regulations). We have also independently raised the issue for discussion with MBIE in August 2014, and a number of our members were party to the submission to MBIE dated 5 August 2014.

NZBA has remained across the discussions early this year led by Russell McVeagh and continues to support the positions advanced in those discussions.

NZBA strongly agrees with our member banks that the warning and investor acknowledgement is hugely impractical in many instances, and will have a substantial negative impact on New Zealand's debt capital markets. Further, we do not believe that the case has been made highlighting the harm that the investor acknowledgement seeks to address.

General

The regulatory impact statement that first discussed the $750,000 wholesale investor exclusion considered that the impact of the proposed changes would be both minimal and beneficial. NZBA considers that the change in threshold from $500,000 to $750,000 is workable, but strongly submits that the impact of the new requirements of an investor warning and acknowledgement are neither minimal nor obviously beneficial. These new requirements are problematic to the extent that this exclusion will not be used in the debt market. The lack of a workable brightline test will have a significant limiting effect on the wholesale funding market, and goes well beyond the "minimal" negative impact contemplated by the regulatory impact statement.

NZBA notes that the closest comparable jurisdiction, Australia, maintains a brightline $500,000 wholesale investor exclusion.

Other wholesale investor exemption categories also carry a significant compliance burden with them and are not suited to offers made in the wholesale or domestic debt securities markets. For example, many issuers are unlikely to be comfortable relying on safe harbour certificates for a number of reasons, including:

a. the number of certificates required, and the complexities of obtaining, managing and rolling over the safe harbour certificates is significantly more onerous on issuers than

being able to rely on a brightline test like the previous Securities Act $500,000 wholesale investor exclusion; and

b. issues may also arise in relation to the limitations on an organisation's ability to rely on safe harbour certificates due to the knowledge imputation attributed under section 535 of the Act. In practice, there is a risk for large organisations such as banks that knowledge in one part of the business could be imputed in a manner that removes the organisation's ability to have the protection of a safe harbour certificate.

Further information is provided below in more detail in our answers to the questions in the Consultation Paper.

Responses to Questions

Question 1: Do you consider the compliance burden of the investor warning and acknowledgement requirements is unreasonably high in some circumstances and will deter issuers from offering wholesale debt securities in NZ? If so, please explain the basis for this, and the particular circumstances where this will be the case. In respect of particular compliance costs, please estimate the quantum and provide a breakdown of the costs.

We strongly submit that the compliance burden of the investor warning and acknowledgement requirements is unreasonably high and will act as a deterrent for issuers wanting to offer wholesale debt securities in New Zealand. They will also be an impediment to secondary trading in such debt securities. The basis of this view is as follows:

a. Questionable Benefit

NZBA submits that the purpose of the exclusion is achieved without the warning and acknowledgement elements of the exclusion. NZBA understands the purpose of this exclusion is to inform investors, particularly relatively inexperienced investors, that they are being treated as wholesale investors, and inform them what this means.

Despite over a decade of experience with the existing minimum subscription exclusion (at its lower level of $500,000), NZBA is not aware of any issue in the market where issuers have deliberately used the existing $500,000 exclusion to target "mum and dad" investors to avoid the need to prepare disclosure documents under the Securities Act 1978. We consider such abuse unlikely in practice because investment schemes of any substantial size targeting unsophisticated investors would not be attractive to that investor base with such a high minimum investment, and more narrowly targeted schemes would likely either rely on other 'individual selection' exclusions, or none at all.

To the extent "mum and dad" investors are considering such an investment (which we do not believe is common), they would generally be in a strong position to make their own investment decisions and, therefore, do not need the same degree of protection as the general public. This is the policy underlying the Securities Act $500,000 exclusion.

If there were concerns with the existing $500,000 exclusion, NZBA submits that those have already been addressed by Parliament with the increase in the minimum amount from

$500,000 to $750,000. We submit the increased threshold is sufficient that any reasonable "mum and dad" investor would be sufficiently put on notice the offer was to 'wholesale' investors and strongly incentivised to take appropriate professional advice, and that the proposed warning and acknowledgement requirements would add little or no additional benefit in that regard.

In short, we consider that the purpose of the exclusion is achieved without the warning and acknowledgment elements of the exclusion.

b. *Nature of Market*

Issuers prefer an objective brightline exclusion when undertaking institutional capital markets offers. Issuers that commonly access the wholesale debt capital markets are overseas development banks and semi-governmental issuers who offer their global note programmes in New Zealand, and domestic banks, local government agencies and corporate issuers. The debt securities are normally highly rated and are typically (although not always as this is not mandatory) cleared through NZClear and distributed through reputable dealing houses.

New Zealand wholesale debt markets are an important part of the local capital markets infrastructure, but face strong competition with offshore NZD funding markets (such as the Euromarkets).

c. *Impact on Market*

NZBA submits that imposing investor warning and acknowledgment requirements on offers made in reliance on the $750,000 exclusion will have a substantial negative impact on New Zealand's debt capital markets, because it will:

i. make New Zealand a less attractive jurisdiction for issuers offering "wholesale" debt securities;
ii. result in issuers and holders having to undertake additional due diligence/verification on investors, which increases the administrative burden and cost of issuing in New Zealand;
iii. create impediments to secondary trading of wholesale debt securities; and
iv. make New Zealand out of step with Australia, detracting from both harmonisation and competitiveness.

d. *Warning and Acknowledgement*

NZBA submits that the warning and acknowledgement requirements are significantly more onerous than the equivalent disclosure made to retail investors by way of the product disclosure statement and the logic in these should align.

For retail investors, this material is disclosed once, with no requirement to repeat any of the warnings contained in the PDS in any other documentation, or to provide a copy of the PDS in relation to future deals in the same product. This is based on the premise that the prudent but non-expert investor will, having received this information once, be able to decide whether or not to invest. If a warning is indeed considered necessary, despite our comments in paragraph (a) above, this logic should be extended to it, which should be made to the investor once.

NZBA submits that the acceptance of the offer of securities should be a satisfactory acknowledgement of that warning in the same way that a retail investor is deemed to have acknowledged the risks identified in a PDS. If, as we suggest below, the warning is provided to the relevant investor in a prominent manner that clearly links it to the offer in question, this logic removes the acknowledgement element of the exclusion, as disclosure of the risks (in this case the effect of minimum subscription) has been made, and has formed a part of the investor's decision to subscribe.

Question 2: What difficulties do you foresee in operating under the other categories of wholesale investor instead of the $750,000 investment exclusion? To the extent any concern is that the alternative means of operation raise significant compliance costs, please estimate the quantum and provide a breakdown of the costs.

There are a large number of exemptions available under the Act and a considerable compliance burden is involved in complying with many of them. The management of these exemptions would require banks to design and install either a complex system to manage compliance with safe harbour certificates, or use manual checking, both of which are costly and time consuming. This is why banks have previously relied on a bright line test.

Further, we understand that while the current $500,000 bright line exclusion is widely used and will be until 31 May, our members are not using or planning to use the $750,000 exclusion as currently drafted because it will be too difficult and cumbersome to apply. It will therefore be a redundant option, especially at the bigger end of the market, because it would be too complicated and costly.

In particular, we note:

1. Issuers issue bonds quickly when market conditions are favourable. Having a clear brightline test regarding who offers can be made to assists in being able to access the market quickly, efficiently and in a cost efficient manner. It gives issuers certainty.
2. Requiring issuers to operate under the other categories of wholesale investor instead of the $750,000 exclusion (including obtaining safe harbour certificates) will significantly slow down the issue process, increase costs and increase the regulatory risk for issuers and investors. This will make accessing NZ capital markets less attractive in contrast to other jurisdictions.
3. We do not believe that wholesale issuers and dealers would rely on the safe harbour certificates without some form of due diligence given that clause 45 of Schedule 1 provides that an offeror cannot rely on the certificate if they know it is not in fact correct. In this regard, we note that section 535 attributes companies with the knowledge of its employees. This reinforces the view that issuers are unlikely to rely on the safe harbour certificates without due diligence. Due diligence is particularly difficult for offshore issuers who do not have a presence in NZ or familiarity with the NZ legal requirements. This may make NZ less attractive to offshore issuers in contrast to other jurisdictions.
4. It is possible that new certificates would be sought for each issue on a standalone basis. This again increases compliance costs and slows down the speed at which issuers can come to the market.

5. Obtaining safe harbour certificates would be difficult where a large wholesale issue is undertaken, as this would increase the number of certificates required and require compliance programmes to be put in place to monitor the receipt and acceptance of such certificates. In addition, given institutional securities trading is now almost entirely paperless, such a requirement could not practically be met without constructing specific systems to deal with it.
6. Requiring safe harbour certificates will impose due diligence requirements on investors given that it is an offence to give a safe harbour certificate that is false or misleading (clause 46).
7. If an investor is willing to give the certificate this would likely take time to provide which again slows down the speed at which these offers are currently undertaken. Furthermore, if certificates are given by some investors and not others then this does not assist issuers or investors when issuing and selling the bonds.
8. Requiring issuers to operate under the other categories of wholesale investor instead of the $750,000 is also problematic for secondary trading because initial subscribers and other holders of debt securities who wish to transfer their securities within 12 months of the initial issue would have to conduct due diligence prior to transfer. This may reduce liquidity in the secondary market and reduce the pool of investors willing to subscribe for initial wholesale issues of debt securities.

We have summarised some issues with the other categories of wholesale investors below:

Category	Reference	Problem
'Investment business' or 'government agency' exclusion	(clauses 3(2)(a), (d), 37 and 40, Schedule 1)	Due diligence required every time (in case the issuer loses or changes status) - the issuer will need to source evidence (eg by checking the Financial Service Providers Register) that the investor is that type of business or agency or adopt other processes to address the risk of status changes.
'investment activity' exclusion	(clauses 3(2)(b) and 38, Schedule 1)	Too complex to administer at all due to the considerations that would need to be made and the evidence required to satisfy the test is met. Additionally, this status is likely to change/fluctuate over time and for financial institutions that hold information about customers' position will make this challenging to rely on. In addition, it is unlikely that non-bank issuers will use this exclusion due to the risk that they might become a non-bank deposit taker.
'large' exclusion	(clauses 3(2)(c) and 39 of Schedule 1)	Requires the issuer to obtain evidence as to the financial elements of the test. It is unclear what kind of financial information can be relied on with certainty to satisfy this test and raises issues around the imputation of "knowledge" if the information used by the issuer to test the status changes.
'eligible investor' exclusion	(clauses 3(3) and 41	Problematic due to the third party confirmation requirement (in particular, this exclusion is time

	of Schedule 1)	consuming to apply) and the due diligence required to achieve this.

Question 3: What responsibilities does the NZ-based 'dealer' or 'arranger' carry out when facilitating a Kauri bond offer?

A dealer's principal role in any issue of debt securities is to distribute the securities. Under the Securities Act regime, dealers for wholesale issues commonly relied on the $500,000 minimum subscription exclusion to distribute debt securities. Absent a brightline test, from 1 June 2015, dealers will need to conduct due diligence on potential investors before they distribute any offer material (for example, term sheets) to potential investors. This will significantly slow down the offer and distribution process and provide issuers with less certainty of execution of their offer.

Requiring dealers to undertake the front-end due diligence of potential investors simply shifts the costs and burden from the issuer but does not address the consequences of requiring the due diligence in the first place.

Question 4: Are the dealers or arrangers in a good position to efficiently confirm an investor's wholesale status for the overseas issuer?

Banks acting as dealers are in a position to confirm an investor's wholesale status, but this would be a large and costly process to develop. Further, it is unclear whether an overseas issuer would be prepared to rely on due diligence conducted by an arranger. NZBA notes that the primary role of dealers is relationship manager and their core responsibility is to bring together the issuer and investor parties. They are not compliance specialists. Non-banks acting as dealer or arranger are unlikely have systems and processes in place to manage the requirements of this role, and would likely be reluctant to take on these responsibilities.

Question 5: We understand the most significant concerns relate to the wholesale debt security market, particularly the Kauri bond market. Do you think there are issues for other markets, where the compliance burden of the investor warning and acknowledgement requirements (or the alternate use of other wholesale investor categories) would be unusually high, which should also be considered? If so, please explain.

NZBA submits that the Consultation Paper has overlooked the domestic market. There are issues for the domestic market in any fund raising. The ability to use the $750,000 wholesale investor exclusion is an issue for the domestic market. In our view, the exclusion should be available regardless of the nature of the transaction being issued. As noted above, the effect of the exclusion in its current form is to render it unworkable and therefore completely redundant.

Question 6: For offers of debt securities other than Kauri bonds issues, what are the reasons for a reluctance to use safe harbour certificates to address any uncertainties or risks? (We consider that safe harbour certificates are particularly useful for the categories of wholesale investor that are less straightforward to apply to investors (for example, the 'large' category) given the certificates do not need to be provided on a deal-by-deal basis).

See our comments under question 2 above.

Question 7: Do you agree with our interpretation that clause 45(1) of Schedule 1 does not require an offeror to check publicly available information when they receive a safe harbour certificate from an investor? If not, please explain.

No. Please see comments under Question 2.

Question 8: What procedures are undertaken when a financial institution takes on new customers and is this information monitored and updated periodically? To what extent do these processes address matters related to an investor's wholesale/retail status? To the extent that these matters may not be specifically encompassed, do you think they could be incorporated efficiently? If not, please explain the quantum of costs and any issues for incorporating these checks into your 'Know Your Customer' procedures.

Members will address this question directly in their own submissions. Members have different processes to speak to different requirements, and many have multiple processes in place.

Question 9: Do you agree with the view that NZ businesses taking part in the financial markets as investors will find it useful to identify which category of wholesale investor they are in and, if necessary, be in a position to readily provide safe harbour certificates to address uncertainties? If not, please explain.

No. Institutional investors who participate in wholesale debt offers are unlikely to be interested in their particular status. These investors are already familiar with being considered wholesale on the basis of an investment in a security of a minimum denomination. The exchange of warnings and acknowledgments is simply an unnecessary compliance exercise for these investors. For other investors, it may be confusing, as they may be assessed as different statuses by different issuers and different statuses under different legislation.

Questions 10 - 16: Do you think a proposal for relief based on debt security transactions settled through NZClear addresses the concerns about the practical use of the investor warning and acknowledgement?

NZBA does not support designing an exemption by naming certain settlement systems.

Other Options

As noted in paragraph (d) of our answer to question one, we consider that an appropriate compromise might be to require a warning be provided to the investor that the $750,000 exclusion is being relied upon, without also requiring an acknowledgement from the investor.

This warning could be made prominently in any communication directly to the investor that clearly links it to the offer in question. We note that requiring the warning to be in the offer documents themselves would create significant difficulties and could create confusion for investors to whom the $750,000 exclusion will not apply.

We would be pleased to provide further information as to how this warning might fit in to the offer documents and would welcome the opportunity to discuss how this might operate.

As noted above, this applies the same logic as disclosure through a PDS to retail investors and addresses the perceived need to further draw investors' attention to the use of this exclusion, without being unduly burdensome.