New Zealand Shareholders Association Inc.

NZSA

Many Investors, One Voice

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

Relationship of Submitter

The New Zealand Shareholders Association is the only independent national group that represents the interests of retail investors in the equity markets.

One of our major concerns is the need to engender confidence in the regulation and operation of the New Zealand capital markets. We therefore, take a close interest in the "public good" aspect of legislative changes or proposed exemptions from existing regulation as part of our core function.

This submission is written to present the perspective of the prudent, but non expert retail investor. This group relies on the integrity of laws and regulations being maintained so as to provide appropriate protections and disclosures.

We note also that with the rise in real estate sales prices, many individual investors have substantial sums to invest. It is presumptive to assume that they will not be attracted to or not offered a range of "wholesale" investments from time to time. Therefore any exemptions must necessarily be made with this in mind, as it cannot be assumed that only institutions or companies engaged in the financial markets will be affected.

Our comments are as follows.

The parameters under which an exemption can be granted are limited in legislation. In our view, the FMA is constrained from granting an exemption in this case as the proposal fails to meet those requirements.

Paragraph 22. We note the four key Purposes of the FMC Act, a document that was arrived at after lengthy and exhaustive consultation. In our view, the proposal to exempt certain issuers or clearing arrangements from the $750,000 investment exclusion requirements goes against three of the four purposes of the Act. There may be an argument relating to "avoiding unnecessary compliance costs", but it fails dismally on the other three. We note that these "compliance costs" are not quantified in any way in the discussion document. In our opinion, the effect may well be overstated. We think granting an exemption that cuts across three purposes of the Act undermines the integrity of that document and potentially opens the floodgates to a slew of other claims for exemptions, largely for administrative convenience rather than genuine purpose.

Paragraph 21. We fail to see how granting such an exemption can satisfy the FMA "that it is necessary or desirable for the purposes of the FMC Act". We note particularly the use of the plural term "purposes" which was the wording approved by Parliament. We also believe the relief being sought is broad and fails to meet the "extent of the exemption" requirements. Taken with the previous (Paragraph 22) situation, we consider the request for an exemption fails to meet several key thresholds.

Should you not be convinced by this "basic principle " argument, we comment specifically as follows:

Paragraph 4. No examples of costs are provided in the document. This makes it impossible to quantify benefits versus risks and is hearsay at best. The argument that investors do not read the warnings is irrelevant. Drivers do not always heed speed signs, but that does not mean we should remove them from the side of the road. We submit that a prudent investor should at least have the opportunity to know when an investment is exempt from important provisions of the FMC Act

Paragraphs 7 -12. We accept the comments about speed of making these issues and the difficulty with standardised international documentation. We are not convinced that some additional requirements around identifying wholesale investors would be a serious problem. Issuers will always be attracted to where money is available, and in the context of the likely amounts involved, a small cost impost for administration is not material. We note the comments about certification in other markets (Paragraph 12) and wonder why New Zealand should water down its investor protections to less than that required elsewhere.

Paragraph 14-20. We think the ability to self certify is an existing and effective way to mitigate any administrative of compliance cost issues. It was incorporated into the FMC Act for this very purpose and should not be easily discarded . The NZ based dealer/arranger makes the use of this device even simpler. All that is needed is to sight the document. Frequent investors in Kauri bonds can easily draw up a self certification document, which as FMA observes can remain in force for two years and are not issuer specific. Occasional investors (including individuals) would have to provide a certificate, but at least would be required to pause and consider whether the lack of protections increases the risk profile for themselves. This can only be a good thing.

FIRST QUESTION SET

1. We believe the compliance burden must be viewed in term of the cost/benefit in relation to the purposes of the Act. Therefore as outlined above, we do not believe that there is a real risk to future offerings of Kauri Bonds nor on balance that an exemption is warranted.
2. The other options available cover most situations in a timely and cost effective manner in our view.
3. The dealer/arranger has a "connection" to the issuer and is paid by them. Therefore we believe they are an "agent" of the issuer and have an obligation to see that New Zealand law is complied with.
4. Yes (obviously!!)
5. Exempting one product or group of products is the thin end of the wedge. Providing proper protection and disclosure was a key driver of the overhaul of commercial law. We believe the law

as it currently is should stand to maintain integrity and confidence in the operation of the NZ capital markets.

6. We cannot comment on the reluctance issue. However we note and support the FMA view on the use of safe-harbour certificates.

7. We agree with the FMA interpretation. Our interpretation of clause 45(1) indicates there is a need for "actual knowledge" and there is no obligation to query or check certificates in the absence of such knowledge. Therefore it follows that this is a virtually costless process.

8. We would expect comprehensive new customer information to be a standard requirement and it should or easily could incorporate wholesale/retail status questions. The current requirements for retail customers are very stringent anyway, and a couple more details are immaterial. Any requirements apply equally within each category of investor, so there is no competitive advantage to be gained and any additional costs will be passed through in fess. so again, there is no particular problem as it should all be user pays. This really is simply a cost of accessing this type of offer.

9. We believe that establishing the category they fit into is a basic requirement to develop there business strategy and be aware of accessible options.

Paragraphs 21 -22 See earlier comments under the heading "Parameters under which an exemption can be granted are limited in legislation ...."

Paragraph 23. We agree that this might be appropriate, but there is evidence presented that both individuals directly and potentially via nominee can access Kauri Bonds. Therefore this test is not met.

Paragraph 24. How hard is it for an electronic system to ask "Do you have wholesale status? Please supply a safe harbour certificate as proof."? We might accept limited exemptions for a specific electronic system, but only if limited to institutions. Nominee use would defeat this and would have to be banned. We doubt that would be well received. (Also see our answer to question 12 below)

Paragraph 26. It is not clear to us what the situation would be if a secondary sale of part of an exempt wholesale issue was to occur. Is a wholesale issue still a wholesale issue even if it is broken down into amounts below the threshold, and in that case, what disclosures are needed? This need considerable clarification .

Paragraphs 27-31. From the information provided, we think an exemption based on NZClear settlement will not be a viable solution. Our reasons are that use is not limited to institutions, nominees can mask the status of underlying investors and the system is under review and may not continue. In any event, such a process would risk focussing on process rather than the nature of the transactions being processed. In our view that would be unwise.

Paragraphs 32 -33. The issues raised underscore our key practical concern for newly wealthy but inexperienced retail investors. Essentially we would say, if investors don't know the risks of a particular investment, this needs to be drawn to their attention. Providing an exemption to the $750,000 threshold opens the real possibility that this may not occur.

SECOND QUESTION SET

10. Already addressed above. NZClear is not restricted to institutions. Nominees are a particular concern for us.
11. No . Refer to question 19.
12. The proposal potentially creates a monopoly situation in that institutions will take the easy path. We think all issuers should have a level playing field and the risk/reward aspect of their offering will then be the determining factor. This is the most efficient market mechanism.
13. We have no knowledge of the available platforms. However, exempting one platform or one category of issuer will inevitably lead to a flood of similar requests. This will potentially undermine the whole purpose of the protections in the FMC Act.
14.Unable to comment.
15. We don't know, but would expect issuers of derivative products would be watching this exemption request with considerable interest. Refer to question 13 above.
16. We are very reluctant to see any exemptions granted, particularly in the absence of any hard evidence to support the compliance cost contention. We should never lose sight of the purposes of the legislation .

Summary

- We think this proposed exemption is actually a solution looking for a problem.
- It is not in the interests of the broader market and re-introduces risks to wealthier retail investors that we fought hard to have removed in the first place.
- There are effective and inexpensive ways in which the issuer can establish that investors fit the wholesale category and these were carefully considered and widely canvassed prior to recent legislation.
- Administrative convenience is never a reason to remove principle based protections for investors.

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