THE NEW ZEALAND
FINANCIAL MARKETS AUTHORITY

Submitted by
Philipp Maume
(Ph.D., Rechtsassessor)

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School of Law
Faculty of Business, Economics and Law
La Trobe University
Bundoora, Victoria 3086
Australia

August 2012
Thank you, Emma.

Thank you, Gordon.
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ABBREVIATIONS


AFA                            Authorised Financial Adviser

ASIC                           Australian Securities and Investment Commission

ASX                            Australian Securities Exchange

CEO                            Chief Executive Officer

CER                            Australia and New Zealand, Closer Economic Relations Agreement

Commerce Committee             Commerce Committee of the New Zealand House of Representatives


Council                        New Zealand Council of Financial Regulators

DIMS                           Discretionary Investment Management Services

FA Act                         Financial Advisers Act 2008 (NZ)

FATF                           Financial Action Taskforce

FMA                            New Zealand Financial Markets Authority

FMA Act                        Financial Markets Authority Act 2011 (NZ)

FMA Bill                       Financial Markets (Regulators and KiwiSaver) Bill 2010 (NZ)

FMC Bill                       Financial Markets Conduct Bill 2012 (NZ)

FSP Act                        Financial Service Providers (Registration and Dispute Resolution) Act 2008 (NZ)

FSA                            United Kingdom Financial Services Authority

FT Act                         Fair Trading Act 1986 (NZ)

GA                             Government Actuary

GDP                            Gross Domestic Product
<table>
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<tr>
<th>Acronym</th>
<th>Description</th>
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<tr>
<td>GFC</td>
<td>Global Financial Crisis 2008</td>
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<td>HoS</td>
<td>NZX Head of Market Supervision</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>IOSCO</td>
<td>International Organization of Securities Commissions</td>
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<tr>
<td>IOSCO Methodology</td>
<td>Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation</td>
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<td>IOSCO Principles</td>
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<td>MBS</td>
<td>Mortgage Based Securities</td>
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<td>MED</td>
<td>New Zealand Ministry of Economic Development</td>
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<tr>
<td>MOU</td>
<td>Memorandum of Understanding</td>
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<tr>
<td>NEU</td>
<td>New Zealand National Enforcement Unit</td>
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<td>NZMDT</td>
<td>New Zealand Markets Disciplinary Tribunal</td>
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<tr>
<td>NZSE</td>
<td>New Zealand Stock Exchange</td>
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<tr>
<td>NZX</td>
<td>New Zealand Exchange Ltd</td>
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<tr>
<td>OTC</td>
<td>Over-the-Counter Transactions</td>
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<tr>
<td>PDS</td>
<td>Product Disclosure Statement</td>
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<td>QFE</td>
<td>Qualifying Financial Entity</td>
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<td>RB Act</td>
<td>Reserve Bank of New Zealand Act 1989 (NZ)</td>
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<tr>
<td>SEC</td>
<td>United States Securities and Exchange Commission</td>
</tr>
<tr>
<td>SFO</td>
<td>New Zealand Serious Fraud Office</td>
</tr>
<tr>
<td>SFO Act</td>
<td>Serious Fraud Office Act 1990 (NZ)</td>
</tr>
<tr>
<td>SRO</td>
<td>Self-Regulating Organisation</td>
</tr>
<tr>
<td>Taskforce</td>
<td>Capital Markets Development Taskforce</td>
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<tr>
<td>TTOIG</td>
<td>Trans-Tasman Outcomes Implementation Group</td>
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SUMMARY

Since the end of 2008, the laws governing New Zealand’s capital markets have undergone major changes. A key step in the reform process was the disestablishment of New Zealand’s old securities markets conduct regulator – the Securities Commission – in May 2011. The Commission was replaced by the newly established Financial Markets Authority, a consolidated agency with a broader mandate and increased investigation and enforcement powers. The New Zealand Government has claimed that the creation of this ‘super-regulator’ is a significant step towards restoring confidence in the country’s financial markets, that had been shaken by the downfall of New Zealand’s finance companies in 2007 and the Global Financial Crisis from 2008.

This thesis provides an in-depth examination of the new Financial Markets Authority. Based upon the working postulate that strong, vibrant financial markets require a robust legal framework that includes enforcement by an effective enforcement agency, this thesis scrutinises the new regulatory framework introduced by the Financial Markets Authority Act 2011 (NZ) and collateral changes to a number of other statutes. The purpose of this thesis is to determine whether the recent reforms have created an agency able to effectively enforce the laws governing New Zealand’s capital and securities markets.

It is argued that the reforms have created a regulator whose functions and powers adhere to international standards as well as enforcement theory. The consolidation of regulators and the introduction of the financial markets law enable the Financial Markets Authority to regulate the financial markets in a comprehensive and coherent fashion. Overlaps with the functions of other agencies in New Zealand are remote and will hardly result in practical problems. The new enforcement regime enables the Financial Markets Authority to deal with breaches of the financial markets law quickly and to take a more proactive, responsive approach to regulation.
STATEMENT OF AUTHORSHIP

Parts of Chapters 3 and 4 of this thesis were published in short notes in law journals during the author’s SJD candidature. The publications are:


All these publications are duly referenced in the thesis. In all these publications the author collaborated with Gordon Walker, although no material provided by Gordon Walker was used in this thesis.

Except where reference is made in the text of the thesis, this thesis contains no material published elsewhere or extracted in whole or in part from a thesis submitted for the award of any other degree or diploma.

No other person’s work has been used without due acknowledgement in the main text of the thesis.

The thesis has not been submitted for the award of any degree of diploma in any other tertiary institution.

_________________     _______________________
(Date)       (Signature)
CHAPTER I: INTRODUCTION

This introductory chapter outlines the scope of this thesis. It provides a brief overview of the reforms of New Zealand’s securities laws and outlines the thesis question and the methodology that was used. Further, this chapter provides key definitions and the theoretical background for an analysis of the need for public enforcement in securities markets.

A Reform of New Zealand’s Financial Markets Laws

The reforms of the laws governing New Zealand’s securities markets can be separated into two groups, the continuous reforms that took place between 2000 and 2008, and the recent overhaul that commenced in 2008.

In 2000, the Labour Government announced the so-called ‘Four-Phase-Reform-Agenda’.

As at 2008, three of these four steps were completed. First, the Takeovers Code 2001 was introduced. The Code completed the Takeovers Act 1993 that finally came into force in 2001. In the second step, the powers of the New Zealand Securities Commission (the ‘Securities Commission’), the country’s main securities markets regulator, were extended in 2002. Further, a statutory continuous disclosure regime was introduced into the renamed Securities Markets Act 1988 (formerly the Securities Amendment Act 1988). The third step created a new regime prohibiting market abuse as well as a strengthened liability regime for insider trading. The fourth phase was intended to be a complete review of the Securities Act 1978 as part of the Review of Financial Products and Providers that was conducted in 2006. Despite the bulky discussion document issued by the Ministry of Economic


2 All references to statutes and other legislation are references to New Zealand statutes unless otherwise stated.
Development,\textsuperscript{3} no substantive changes to the Act were made. In the event, the reform process was overtaken by the domestic and global events that commenced in 2007. As a result the Four-Phase-Reform-Agenda remained uncompleted.

The latest reforms commenced in 2008. They brought the former reform agenda to an abrupt halt. The post 2008 reforms occurred in four interrelated areas. First, a regulation regime for financial intermediaries and financial institutions was introduced by the Financial Service Providers (Registration and Dispute Resolution) Act 2008 and the Financial Advisers Act 2008. Second, amendments to the Reserve Bank of New Zealand Amendment Act 2008 and the introduction of the Non-Bank Deposit Takers Act 2011 and the Insurance (Prudential Supervision) Act 2010 extended the Reserve Bank of New Zealand’s prudential supervision. Third, the Financial Markets Authority Act 2011 created a new market conduct regulator with extended powers to replace the Securities Commission. The fourth and latest step was the Financial Markets Conduct Bill 2011 that was introduced into Parliament in October 2011. As of August 2012 it has not been enacted. The envisaged statute purports to be coherent legislation covering all issues involving financial products. It will repeal five statutes, among them key legislation such as the Securities Act 1978 and the Securities Markets Act 1988, and no less than fourteen sets of delegated legislation. At the end of this process the law governing New Zealand’s capital markets will have fundamentally changed.

\textbf{B \quad Thesis Question}

The purpose of the recent reforms was to restore investor confidence in New Zealand’s capital markets.\textsuperscript{4} The Government had identified the lack of proper enforcement as one of the key flaws hampering the capital markets’ development. Hence, a key feature of the reforms was the creation of a new regulator, the Financial Markets Authority (the ‘FMA’),


in May 2011. The Government described the new agency as a ‘super-regulator’\(^5\) that consolidated the previously fragmented regulatory structure. The Government placed special emphasis on the new regulator’s ability to engage in proactive and publicly visible enforcement.\(^6\) Thus the FMA was vested with new and wider investigation and enforcement powers.

This thesis poses the following primary question: has the creation of the FMA resulted in an effective financial markets regulator with comprehensive powers? The secondary question is: if the answer to the primary question is negative, how should potential problems and shortcomings be addressed?

### C Significance of this Thesis

The literature on the new FMA is sparse. As far as scholarly literature is available, it focuses on single enforcement powers,\(^7\) does not take into account the changes envisaged by the Financial Markets Conduct Bill,\(^8\) or describes the recent developments in short notes.\(^9\) Currently no full analysis of the new regulatory structure exists.

This thesis makes a significant and original contribution to the existing knowledge on the rules governing New Zealand’s capital markets for two reasons. First, it provides the first in-depth analysis of the FMA’s role in the regulatory framework and its enforcement powers. Second, this study offers concrete proposals as to how potential shortcomings

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could be addressed either by further adjustments to the existing statutes or the FMA’s interpretation of its role in practice.

D Methodology

It can be argued that the Financial Markets Authority Act 2011 (the ‘FMA Act’) has only been effective since 1 May 2011 and hence any study on this topic is premature. However, this thesis focuses on an analysis of the regulatory structure that has been created. The upcoming further reforms, in particular the Financial Markets Conduct Act that will be enacted in the course of 2013, will not result in further institutional changes; no document issued by the Government indicates adjustments to the key ideas underlying the FMA. The pending reforms will be confined to the introduction of some additional powers and a new liability regime. These key concepts have undergone a long consultation process. There have been no indicators that the Commerce Committee of the House of Representatives is planning to make substantial changes to the structure of the FMA and to its enforcement role. Thus, it is unlikely there will be major changes in the parliamentary process. The functions and powers of the FMA are clear and can be subject to deep analysis.

In general, this work draws on specialist literature on the theory of securities regulation, including studies, scholarly articles, reports and statistics that are available in English. In respect of the reforms of New Zealand’s laws, it draws on primary sources, including legislation and case law. Particular emphasis is placed upon the Government documents that were issued during the intensive consultation processes.

There is no conclusive test to determine whether a regulator has comprehensive powers. However, a large body of literature suggests that it is crucial for effective enforcement to have regulators that have adequate powers, are well staffed and funded, and have operational and functional independence.¹⁰ The International Organisation of Securities

Commissions (the ‘IOSCO’) has developed a catalogue of principles for the structure of effective regulation that is very similar to the aspects identified in the aforementioned body of literature. These principles are flanked by a detailed methodology that enables an overall assessment of an enforcement system and, for example, has been used by the International Monetary Fund (the ‘IMF’)) to determine the effectiveness of several countries’ securities laws. In addition, the literature on strategic enforcement emphasises the need for a broad set of enforcement tools that should be available to the regulator, such as commencing civil litigation, issuing administrative penalties or warnings, or simply giving informal advice to market participants. There is hence a widely acknowledged catalogue of elements that are necessary or at least beneficial for effective public enforcement. This thesis uses these criteria to help answer the question as to whether the FMA is an effective regulator with comprehensive powers.


This thesis is divided into six chapters. The thesis begins with an introduction to the thesis question and the underlying key concepts. Chapter 2 describes the drivers that have led to reform of the laws governing New Zealand’s financial markets, such as the Global Financial Crisis (the ‘GFC’), the failure of New Zealand’s finance companies, the harmonisation of New Zealand’s and Australia’s business laws, the bad performance of New Zealand’s securities markets in general and the shortcomings of the laws governing these markets. Chapter 3 provides an overview of the reforms that have taken place between 2008 and August 2012. It discusses the reforms of the laws on financial intermediaries, the work of the Capital Markets Development Taskforce, the creation of the FMA, and the content of the Financial Markets Conduct Bill. Based upon these findings, Chapter 4 analyses the new regulatory structure, in particular the move towards a twin peaks system and the new financial markets law. Chapter 5 identifies potential gaps and overlaps of the regulators’ functions as a result of the reforms, for example, overlaps of the enforcement functions of the FMA and the Commerce Commission, the Serious Fraud Office and the Registrar of Companies. Chapter 6 addresses the FMA’s new enforcement powers in particular, the new liability regime, and the FMA’s options in respect of strategic law enforcement.

**F Definitions and Cornerstones of New Zealand’s Legal Framework**

1 **Financial Markets, Securities Markets and Capital Markets**

Despite trends towards global co-operation and harmonisation, securities regulation and related areas of law are still subject to domestic legislation. For this reason a consistent set of definitions does not exist at an international level. For example, *Black’s Law Dictionary* defines the terms ‘capital market’ and ‘financial market’ as ‘a securities market in which
stocks and bonds with long-term maturities are traded.¹⁵ On the contrary, the
Encyclopaedic Australian Legal Dictionary defines capital markets as ‘markets for both
long term and intermediate financial instruments, including both the stock and futures
markets, as well as markets for corporate and government bonds, and mortgages’.¹⁶
A financial market is defined as a ‘facility through which offers to acquire or dispose of
financial products are regularly made or accepted’,¹⁷ which is the exact definition given in
s 767A of the Corporations Act 2001 (Cth). New Zealand’s FMA Act, however,
subdivides financial markets into the market for financial services and the capital markets
(s 4), but without defining the latter.

These examples demonstrate that understandings of securities markets, financial markets
and capital markets are not consistent. This might be problematic for any in-depth analysis,
because commentators from different countries and with different backgrounds might have
different understanding of the relevant terms. A short overview of commonly used terms
and their meanings under New Zealand’s laws needs to be provided first. This brief
description is subsequently used for a short illustration of the structure of New Zealand’s
securities markets prior to the reforms that commenced in 2008.

2 Primary and Secondary Markets

The central legal term of the securities markets is ‘securities’. These instruments can
generally be described as ‘financial instruments issued by entities for the purpose of raising
finance through the markets.’¹⁸ The major categories include equities (shares), debt
(bonds), and derivatives.¹⁹ An essential feature is that securities are capable of being
traded.²⁰ Securities can be bought or sold in securities markets, which may or may not have
a physical location.²¹ Securities markets are a part of the financial markets. Financial
markets provide the activity for the borrowing and lending of funds and the transfer of

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¹⁶ LexisNexis, ‘Capital Markets’ in Encyclopaedic Australian Legal Dictionary (via LexisNexis Online, at 10
August 2012).
¹⁷ LexisNexis, ‘Financial Markets’ in Encyclopaedic Australian Legal Dictionary (via LexisNexis Online, at
10 August 2012).
¹⁸ Niamh Moloney, ‘Securities’ in Peter Cane and Joanne Conaghan (eds), The New Oxford Companion to
¹⁹ Ibid.
²¹ LexisNexis, ‘Securities Markets’ in Encyclopaedic Australian Legal Dictionary Online (via LexisNexis
Online, at 10 August 2012).
ownership of claims within the financial system of a country.\textsuperscript{22} Hence, the meaning of financial markets is wider than securities markets. They include, for example, non-transferable bank loans or other financial instruments to raise money.

The New Zealand definition of securities is provided by s 2D of the \textit{Securities Act 1978} (the ‘Securities Act’), which includes, inter alia, equity and debt securities, units in unit trusts, interests in superannuation schemes and life insurance policies. The policy basis of the statute is to delimit the information asymmetry between issuers and investors by information disclosure. The statute is complemented by the \textit{Securities Regulations 2009} (which replaced the \textit{Securities Regulations 1983}) that prescribe details for the respective disclosure document. A separate regime for derivatives does not exist. While the Securities Act sets out the framework for issuing securities to the public (primary market), the rules on securities trading (secondary market – for example, continuous disclosure obligations and prohibited behaviour like insider trading or market manipulation) are set out in the \textit{Securities Market Act 1988} (the ‘Securities Markets Act’). These laws governing the primary and secondary markets can be referred to as (substantive) securities laws.

3 \textbf{Securities Regulation}

The popular term ‘securities regulation’ is not legally defined and is therefore ambiguous. It can be used to describe the whole system of imposing rules on the securities markets, including their enforcement.\textsuperscript{23} The term ‘regulation’ may refer either to a piece of legislation that has been delegated to a Government body, pursuant to a parliamentary statute, or alternatively, to the work of a regulator that is in charge of market supervision and enforcement.\textsuperscript{24} Commentators use the terms ‘regulation’ and ‘supervision’ interchangeably. In this analysis the former, comprehensive understanding is applied – ‘regulation’ is the whole legal system that is imposed on the respective (securities or financial) markets. The Government agency in charge of supervision and enforcement is

\textsuperscript{22} Tunstall, above n 20.
\textsuperscript{24} See the definition of ‘Regulation’ in \textit{Encyclopaedic Australian Legal Dictionary Online} (via LexisNexis Online at 10 August 2012).
referred to as the regulator. ‘Securities law’ describes the substantive rules on securities offering and securities trading that fall under the regulator’s supervision.

Before the FMA was created, New Zealand’s main market conduct regulator was the New Zealand Securities Commission. The Registrar of Companies (the main regulator for companies) was in charge of the registration and examination of disclosure documents. Change-of-control transactions were supervised by the Takeovers Panel under the Takeovers Act 1993 and the Takeovers Code 2001. For listed companies, the New Zealand Exchange Ltd (the ‘NZX’) acted as the front-line regulator in respect of continuous disclosure under the NZX Listing Rules. Several other agencies were in charge of particular, limited aspects of regulation.

4 Financial Intermediaries

From an investor’s perspective, securities are financial products that are bought, held or sold for the purpose of generating returns. Investments in securities can be made directly in a securities market. In such case investor protection is provided by the securities laws governing the primary and the secondary market. However, in practice investments are often conducted with third party involvement. These third parties make independent investments on behalf of the investor but beyond the investor’s direct control, or provide advice to the investor who makes the investment directly. These third parties such as brokers, banks, advisers, collective investment schemes, fund managers or trustees have a direct or indirect influence on the respective investment. This could be problematic since it might result in a conflict of interest. For this reason, the regulation of this interface between investor and investment is a ‘key piece of the securities regulation jigsaw’. In this thesis, these third parties will be referred to as ‘financial intermediaries’. In New Zealand about 26 per cent of all financial assets are held by these intermediaries. Nevertheless, before 2008 New Zealand did not have a distinct regulatory regime for this type of financial business.


26 Victoria Stace, Securities Law in New Zealand (LexisNexis NZ, 2010) 499.

27 Gordon Walker and Alma Pekmezovic, Financial Adviser and Broker Regulation in New Zealand (CCH New Zealand, 2011) 27.
A closely related but nevertheless separate pillar in the regulatory system is prudential supervision which is the oversight of financial institutions and their affairs to ensure a sound, stable and efficient financial system.\(^{28}\) Its main aim is the reduction of the risk of financial failures on both a micro- and macroeconomic scale.\(^{29}\) Banks are the heart of the financial infrastructure and their key role as credit providers means that any disruption may spill over and damage the real economy. For this reason, banks and other deposit-takers such as insurance companies, building societies and credit unions are usually subject to a licensing regime and compliance standards. The international debate often refers to insurance supervision as a separate third pillar of the regulatory system.\(^{30}\) The reason for this is that the insolvency of a large insurer could also have a significant impact on the financial system and economy as a whole.\(^{31}\) Systematically these matters are dealt with by prudential regulation and not by a separate insurance supervision regime. For this reason, further analysis in this thesis will not treat insurance regulation as a distinct area of prudential supervision.

The close proximity of prudential and financial markets supervision is demonstrated by the fact that in some countries both supervision regimes are carried out by the financial markets conduct regulator (see, eg, the Financial Services Authority in the United Kingdom). In New Zealand, prudential supervision is conducted by the Reserve Bank of New Zealand (the ‘Reserve Bank’) under the Reserve Bank of New Zealand Act 1989. In 2008, the Act only covered registered banks and did not impose a supervision regime on non-bank deposit takers such as finance companies.

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\(^{28}\) See definition of ‘Prudential Supervision’ in Encyclopaedic Australian Legal Dictionary Online (at 28 January 2012).

\(^{29}\) Stace, above n 26, 562.


This thesis asks the question as to whether New Zealand has an effective financial markets regulator with comprehensive powers. The stipulation that this would be a desirable outcome draws on two interrelated key concepts. First, financial markets benefit from a robust legal framework that decreases information asymmetries and promotes market integrity (‘law matters’ thesis). Second, financial markets in particular require proper enforcement of the governing laws by public agencies. In combination, these concepts form the foundation for the reforms of New Zealand’s financial markets laws. Because of their importance they will be described in this introductory chapter in more detail.

Both concepts are related to the particular nature of securities. A security is an intangible good which means that it is a property right than can only be claimed or enforced by action and not by taking physical possession. An equity security (share) conveys rights under the company’s constitution and the relevant company law and can be traded like tangible property. Compared to tangible property, the value of an equity security is less influenced by objective criteria such as the material it is made of, and its manufacturer etc. Its value depends on what investors are willing to pay for it. As a result, the price of a security is volatile and depends on investors’ confidence in the markets in general and in the issuer in particular.

33 See Torkington v Magee [1902] LR 2 KB 427, 430.
Early works of law and finance followed the idea that securities markets should best be left unregulated (the so called ‘null-hypothesis’). This hypothesis is widely associated with the works of Stigler and Coase. The underlying idea is that issuers of securities have a genuine interest to disclose all relevant information to investors because they can demand a higher price for their shares. Issuers can rely on gatekeepers (auditors, underwriters) to certify the quality of their products. Securities exchanges can choose to impose additional legal obligations for listed entities, resulting in efficient self-regulation. Apart from that, the general law rules on contracts and torts provide sufficient protection. A genuine securities regulation regime either is not required (so it does not matter), or even has a harmful effect because it leads to higher compliance costs.

The opposing view argues that the general framework of contracts and torts is not sufficient for securities markets and thus a securities regulation regime is necessary (‘law matters’ thesis). It emphasises the correlation between investor protection and strong and efficient securities markets. ‘Efficiency’ in terms of the securities markets means that the prices reflect all the information available, resulting in ‘accuracy’ with respect to prices. The necessary investor protection can be promoted in various ways. A corporate law approach would be to improve corporate governance or the protection of minority shareholders. Under securities markets laws, on the other hand, investor protection is predominantly achieved by mandatory information disclosure and the promotion of market integrity. The conclusion is that law matters, because the law is beneficial for the growth of the securities markets. This theoretical argument for the ‘law matters’ thesis is backed by empirical research from law and finance literature, which suggests that investors provide less capital if their interests are not properly protected. The most influential works were published by La Porta, Lopez-de Silanes, Shleifer and Vishny between 1997 and 2006.

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38 Schaumann, above n 34, 2.
39 For an overview see Black, above n 10, 834-5.
40 For an overview see Utpal Bhattacharya and Hazem Daouk, ‘When No Law is Better than a Good Law’ (2009) 13 Review of Finance 577, 578; Black, above n 39, 834-8.
The structural problem of the securities markets is the information asymmetry between investors and issuers. Unless he or she is directly related to the issuer, an investor probably lacks knowledge about matters that could be important for the investment decision. This resembles the ‘lemons problem’ set out by George Akerlof in the early 1970s. Akerlof’s thesis was that information asymmetries that result in uncertainty about the quality of a product (for example, used cars) will lead to a decrease in the average used car price. Investors are not able to distinguish between good and bad quality cars (so called ‘lemons’) and will therefore only be willing to pay a lower average price. The result is that owners of good used cars will refrain from offering their cars in the ‘lemon markets’, resulting in a further decline of quality and prices. As Black has stated, the information asymmetries in securities markets make them a vivid example of a ‘lemons market’.

Regulation of offers of securities attempts to overcome information asymmetries by information disclosure. Theoretically, the informed investor should be able to weigh the potential risks and benefits of the investment and reach a conclusion what suits his or her needs best. Such rational and informed behaviour will result in the most efficient use of the investor’s resources, encouraging the flow of capital to firms with good prospects and resulting in allocation efficiency. The price of a share in the market will thereby reflect all available information (efficient markets hypothesis). However, this predominantly economic justification for mandatory information disclosure does not take into account that the underlying mechanism of information disclosure was a cornerstone of securities regulation long before the efficient market hypothesis became popular. Thus, the regulation of securities markets in order to protect investors is justified both from an economic and a legal perspective.

The second implication of the information asymmetry problem is the need for market integrity rules. Even if the initial information disclosure has been comprehensive, issuers, their affiliates and current shareholders still have a favoured position in respect of

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43 Black, above n 39, 786.
44 See John Coffee, Joel Seligman and Hillary Sale, Securities Regulation – Cases and Materials (Foundation Press, 10th ed, 2007) 5.
45 The further aspects of the efficient market hypothesis are hotly debated, see ibid 213-35.
information. They might make use of internal information to maximise their profits or manipulate the markets. Such conduct, or even rumours about such conduct, undermines investor confidence in the integrity of the financial markets and poses a threat to markets’ efficiency, in particular the cost of equity. Regulation should therefore detect, deter and penalise unfair trading practices such as insider trading to promote market efficiency and market fairness. Although some scholars argued since the late 1980s that insider trading should be permitted in order to make information available to the markets as soon as possible, most countries have introduced laws that ban insider trading. The IOSCO Principle No 36 views insider trading and market manipulation regimes as cornerstones of securities trading laws.

2 The Need for Public Enforcement

(a) Public and Private Enforcement

The second question is how the legal framework should be enforced. The literature on this topic is vast. As Polinsky and Shavell noted, between 1968 and 2000 more than two hundred articles have been written on the economics of enforcement in general. In short, any legal framework needs to be properly enforced. In fact, a good legal framework that is not properly enforced may even lead to a worse outcome than a bad framework, or no framework at all. The reason is that if a framework is not enforced, some market participants will obey the law, whereas others will not. Without enforcement, the violators’ behaviour gains them a competitive advantage over the others. This was aptly described by Bhattacharya and Daouk: If there are no gun laws, everyone has guns, and it is the Wild West … If there are gun laws that are not enforced, law abiders will not have guns. The outlaws will have more

51 Bhattacharya and Daouk, above n 48, 88-90.
53 Bhattacharya and Daouk, above n 40.
54 Ibid 579.
guns because they know that the law abiders do not have guns, and so the law abiders cannot protect themselves and are worse off than they were in a Wild West situation.

It is nowadays not seriously disputed that enforcement is key to promote investor confidence and hence it is key to securities markets law in general.\textsuperscript{55} However, the best approach to enforcement has been subject to intensive debate.

The first model is to rely on private enforcement, which means that market participants such as investors or issuers take action against other market participants that break the rules. This idea relies strongly on the idea of market integrity, the efficiency of the markets and self-regulation. The second option is to rely on public enforcement conducted by Government agencies. This approach relies on the premise that markets tend to fail and that it is in the public interest to promote compliance of financial markets participants in order to retain investor confidence. Both approaches are not mutually exclusive; they can be combined.\textsuperscript{56} The question is whether and to what extent there is a need for public enforcement in addition to private enforcement.

(b) Potential Disadvantages of Public Enforcement

Commentators have put forward a number of arguments against public enforcement.\textsuperscript{57} The first and most obvious disadvantage of a public enforcement regime is its cost. If a country funds a regulator that exercises unnecessary functions (in this case, enforcement), the expenditure of public money would be inefficient. If a private enforcement system results in a comparable level of investor protection, a public enforcement agency would not be necessary. The second major disadvantage is the quality of the regulator’s work. Regulatory staff is usually paid less than their colleagues employed by the regulated entities.\textsuperscript{58} This may result in lower qualifications, a lack of motivation or, even worse, a propensity for bribery. If regulatory functions such as enforcement are not exercised well, it might in the end lead to a result that is worse than a merely private enforcement regime. The third problem concerns the regulator’s independence. While private market participants’ behaviour usually follows clear financial interests, a regulator’s actions might

\textsuperscript{55} IOSCO, above n 12, 12.
\textsuperscript{56} Erik Bergloef and Stijn Claessens, ‘Enforcement and Good Corporate Governance in Developing Countries and Transition Economies’ 2006 (21) The World Bank Research Observer 123, 131.
\textsuperscript{58} Ibid.
be influenced or ‘captured’ by political motives that might prove detrimental to the needs of the markets. The fourth problem of public enforcement is that a regulator is not a part of the markets and thus not an insider. It therefore often lacks substantial information on both the general market and specific firm conditions.

But as sensible as these arguments may seem, they do not provide compelling reasons against robust public enforcement. In practice, lack of information can be countered by a proper market surveillance system and adequate investigation powers as described by IOSCO Principle No 10. It is in the discretion of the respective country to grant the regulator proper funding and independence. Thus, it is widely held among scholars and practitioners that adequate powers, funding and independence are crucial for an effective regulator. However, a lack of these elements might indicate an ineffective regulatory system, but they are no argument against public enforcement in general.

(c) Structural Problems of Private Enforcement

Public enforcement may come with a cost. However, full reliance on private enforcement exhibits a number of shortcomings that are of a structural nature and can hardly be countered in practice. This is a particular problem if the ownership of shares is dispersed and/or small investors are concerned.

The first problem is the detection of breaches. Victims of physical harm usually know who injured them. However, public enforcement can be necessary in areas in which the victim does not know that he or she was harmed or who caused the harm. This rationale applies to the securities market in particular as private investors are usually unable to detect market manipulation and insider trading. Even if a market shows signs of insider conduct, the investor will have problems identifying the specific wrongdoer. And even if the investor succeeded, he or she would face difficulties in proving the insider’s misconduct.

59 Ibid.
60 Ibid.
61 IOSCO, above n 11.
62 See, for example, Abrams and Taylor, above n 30; Black, above n 10. The IOSCO Principles No 2 and 3 (see above n 11) list functional independence and adequate resources as essentials for an effective regulator.
64 Polinsky and Shavell, above n 52.
The second problem is an investor’s lack of knowledge and resources. A private investor must be able to recognise forbidden behaviour in order to undertake private enforcement. The average investor cannot be expected to have profound knowledge of the financial markets law. Litigation related to breaches of financial markets laws will regularly require specialised, cost-intensive legal counsel. Investors also risk bearing costs if they do not prevail in court. They need to weigh these risks with the potential benefits of litigation. An investor will probably only take legal action if the potential amount of compensation is high enough to justify the risk of losing in court. Therefore the incentive to bring proceedings is low for small investors in particular.

The third problem is that private litigants act in their own interest and not in the public interest. Private litigants must be given clear incentives to take action. However, given the high risk of a lawsuit and the potentially meagre returns, many investors will not bother to file proceedings. A wrongdoer might try to make use of an investor’s predominantly financial concern and make the investor an offer in order to settle the matter. If the litigant accepts, the misconduct might remain a secret between wrongdoers and investors, potentially hidden from other investors. Other effects of settlements are that open questions about the law might not be clarified in court, and that the deterrence effect might be diluted.

The fourth problem is that private litigation often targets the wrong persons. Empirical research from the United States demonstrates that private litigation in general and securities class actions in particular usually target companies and not the individual wrongdoers. Settlements are conducted at the company’s costs, and personal liability of directors is rare. The result is that often money is simply transferred from one group of

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66 Jackson and Roe, above n 57, 209.
67 Bergloef and Claessens, above n 56, 128.
68 Jackson and Roe, above n 57, 209.
69 Polinsky and Shavell, above n 52, 65.
70 Jackson and Roe, above n 57, 209-10.
71 Polinsky and Shavell, above n 52., 65.
72 Coffee, above n 63, 305.
73 Ibid.
shareholders to another group of shareholders; such a mechanism hardly offers any deterrence and only benefits the lawyers who are involved.\(^75\)

The fifth problem is that private litigation is mostly repressive.\(^76\) Private investors do not perform market surveillance in order to prevent breaches of the law, and they do not administer the licensing of certain market participants. Their actions are limited to breaches of the law that have already occurred. Private investors may have the right to apply for an injunction. This, however, implies that they have learned about potential breaches of the law before they eventuated and is hence unlikely.\(^77\) As a side effect private enforcement exhibits particular weaknesses in identifying and preventing systemic risks.\(^78\)

These theoretical considerations in favour of public enforcement are convincing. Private enforcement may be effective if conducted by well-informed actors with well-aligned incentives.\(^79\) However, sole reliance or a strong emphasis on private enforcement leaves too many structural gaps.

\(d\) Empirical Evidence

Surprisingly, the empirical evidence on the issue is not clear at all. An influential paper published by La Porta, Lopez-de-Silanes and Shleifer (hereinafter ‘LLS’) in 2006 presented empirical evidence from various countries to demonstrate that, although the capital markets benefit from enforcement, the most effective way of promoting growth is to rely on information disclosure and private enforcement.\(^80\) Public enforcement played ‘a modest role at best in the development of stock markets.’\(^81\)

These findings were criticised by Coffee in 2007\(^82\) and by Jackson and Roe in 2009.\(^83\) They argued LLS had measured the effectiveness of public enforcement merely against the existence of public enforcement powers. The key issue is not whether the regulator has the formal power to sanction offenders, but whether it actually exercises the power.\(^84\) This is

\(^{76}\) Carvajal and Elliot, above n 23, 32.
\(^{77}\) Shavell, above n 65, 283-4.
\(^{78}\) Jackson and Roe, above n 57, 209.
\(^{79}\) Ibid 208.
\(^{80}\) La Porta, Lopez-di-Silanes and Shleifer, above n 35.
\(^{81}\) Ibid 20.
\(^{82}\) Coffee, above n 63, 242-253.
\(^{83}\) Jackson and Roe, above n 57.
\(^{84}\) Ibid 210; Coffee, above n 63, 244.
similar to the approach taken by Bhattacharya and Daouk in their analysis on the enforcement of insider trading in 2002.\textsuperscript{85} Jackson’s and Roe’s resource-based approach considered the actual level of public resources that a nation allocates to its financial regulators. They concluded that public enforcement is at least as important as private enforcement for the development of capital markets.\textsuperscript{86} It is fair to say that the question as to which is the most efficient enforcement system has not been fully answered yet.

However, this debate predates the GFC and thus does not take into account the failure of the whole financial market system. The GFC demonstrated a failure of market self-regulation as well as the weaknesses of public enforcement. The hard lesson was that markets fail, and that a failure of the financial markets has global economic impacts.\textsuperscript{87} The focus of the discussion about the role of the regulator has now shifted away from the most efficient approach to regulation towards a regulation that warrants systemic stability.\textsuperscript{88} As stated above, private law enforcement can hardly prevent systemic failures. From that point of view, it is understandable that the current debate places strong emphasis on powerful regulators.

Thus, although the empirical evidence is ambiguous, the theoretical advantages of a robust public enforcement regime are evident. This coincides with the recent debate after the GFC. In summary, this thesis will follow the postulate that strong public enforcement of securities laws is necessary and should be a major objective in the design of financial markets laws.

\textsuperscript{85} Bhattacharya and Daouk, above n 48.
\textsuperscript{86} Jackson and Roe, above n 57, 234-8.
\textsuperscript{87} For more details on the GFC, see below 21.
CHAPTER II: DRIVERS FOR THE REFORM OF NEW ZEALAND’S FINANCIAL MARKETS

A Introduction

Reform of company laws in general and securities laws in particular are usually driven by a crash or market failure.¹ New Zealand is no exception – the downfall of Securitibank in 1976 triggered the creation of the Securities Act, while the Securities Markets Act was the result of Black Monday, a world-wide stock market crash in 1987.² It appears obvious that the catalyst for the latest reforms was the GFC that started in 2007 in the United States. However, on closer examination additional reasons can be identified. First, New Zealand had suffered from a collapse of the finance industry even before the climax of the GFC. Second, the country’s capital markets were underdeveloped and in need of reform. Third, the old Four-Phase-Reform-Agenda had left several issues untouched, in particular the role of the regulator. Fourth, due to the ongoing globalisation of capital markets there was a constant process of further alignment of national legal frameworks, which also impacted on New Zealand. Fifth, Australia and New Zealand have been pursuing the idea of a single Trans-Tasman market, and this goal has heavily influenced developments in New Zealand’s capital markets laws in recent years.

Before analysing the latest reforms in detail, it is necessary to understand these underlying influences and policies. Hence this first chapter provides an overview of the events that took place between 2006 and 2008. It delineates the underlying main policies, thereby providing the framework for further analysis in the subsequent chapters.

B  The Global Financial Crisis

1  The Events 2007/2008

The impetus for the GFC came from the securities markets in the United States. Low interest rates had lead to a large housing bubble between 2001 and 2006. In the course of this boom the competition among money lenders and finance companies intensified and finally resulted in lowered signing standards and increasingly risky lending practices. In the end, a high percentage of the mortgages were classified as ‘subprime’, which refers to poor financial conditions and thus a high risk of default. These subprime mortgages were bundled with prime (normal) loans and traded in as mortgage based securities (hereinafter ‘MBS’). In 2006, interest rates started to rise again, resulting in higher monthly mortgage payments. Combined with an increasing level of unemployment, more and more people defaulted on their loans. At the same time, housing prices started to decline. The results were huge losses for the holders of MBS, resulting in increasing distrust among banks and finally leading to a massive credit crunch.

The impact of the subprime crisis on the financial system was devastating. The Dow Jones Industrial Average fell from over 14.000 in October 2007 to 6.700 in March 2009. U.S. and European banks lost approximately US$ 2.8 trillion between 2007 and 2009. The impact on the real economy is difficult to assess since the ramifications of the crisis are not confined to the capital markets, but spread to the job markets, dampened consumer demand and slowed down investment in research and development. Studies suggest that it has led to lower potential growth in the medium-term and large permanent output losses. The IMF found in 2009 that medium-term output losses following the banking crisis are close to 10 per cent over the following seven years. The European Commission was of the opinion that the GFC would result in a permanent output loss of 5 per cent in the Euro zone.

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3 The literature on the GFC is extremely voluminous. For the arguably most extensive overview, see United States Financial Crisis Inquiry Commission, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (January 2011) <www.gpo.gov>.
7 International Monetary Fund, Sustaining the Recovery (World Economic Outlook, October 2009), 1-3 <www.imf.org>.
addition, the bailouts conducted by Governments and the increased vigilance of credit rating agencies were catalysts for the ensuing debt crisis in the Euro zone.

The impact of the GFC on New Zealand (and Australia) is considered to be less serious. The investments made by New Zealand market participants in the subprime market were limited, although in some cases (such as the debt instruments issued by *Credit Sails Ltd*) local brokers invested in subprime securities. The decline in market value resulted in losses for many retail investors, including charitable, religious and other community groups.9 However, the big New Zealand banks (owned by Australian parents) had minimal exposure to the US subprime lending market and were thus hardly affected by the credit crunch in 2008. The banks capitalisation was not significantly affected; the global turmoil mainly led to higher efforts in raising capital and thereby to a decline of profits.10 Despite a sharp decrease of investment in the wake of the crisis, analysts estimated a potential growth of an average of 2.3 per cent of the gross domestic product (the ‘GDP’) between 2010 and 2015.11 However, as New Zealand has for a long time been a capital importing country (net capital inflow has averaged about 5 per cent of the GDP per year since the mid 1990s), the possible rise of capital cost and a disruption of capital influx were seen as potentially dangerous.12

2 Reasons

(a) Similarities to Former Crashes

In various ways the GFC had attributes similar to former stock market crashes. First of all, the crisis itself was triggered by market developments. A housing boom led to an asset price bubble which was flanked by a credit boom.13 The burst of such bubbles regularly leads to sharp declines of stock markets.14

9 Stace, above n 2, 35.
The second important aspect is the failing of the regulatory framework. In fact, opinions as to whether the crisis could have been avoided by better regulation diverge. For example, the final report prepared for the U.S. Government contains two different dissenting conclusions. Some commentators see the crisis as the latest result in a long line of human credulity; some primarily blame the regulatory system and the misbelief in the assumption that markets are sound and correct themselves; others see the GFC as a result of a combination of an institutional arrangement that favours banks and finance, and economic interests of Governments. The discussion seems to be influenced by ideologies and political standpoints.

However, there is a broad consensus that there have been flaws in the legal framework of the securities markets and that these contributed to the severity of the crisis. Several reports produced by Government bodies in the United States, the United Kingdom and by international organisations identified the following shortcomings:

- The non-bank finance industry made a significant contribution to the crisis. A particular problem was the role of the unregulated financial institutions (so-called ‘shadow banks’). These intermediaries do not put their customers’ money into their accounts but directly forward it to an investment. For this reason they did not fall under the banking regulation regime and were able to lend and borrow money...
with a much higher leverage than normal banks, making them more vulnerable to liquidity problems.\textsuperscript{24} This may be described as a failure of prudential supervision.

- Capital markets were facing a proliferation of financial products. Most of them can be classified as derivatives, which are contracts between parties requiring the occurrence of an event. In the financial context, derivatives are instruments whose value is measured by reference to an underlying contract or asset.\textsuperscript{25} These derivatives were often traded over-the-counter (‘OTC’) and not through standard agreements on an exchange.\textsuperscript{26} For this reason, they were not or only partially covered by market conduct regulation or stock exchanges listing rules.

- The ongoing securitisation of financial products led to a growing entanglement between financial services and securities markets. Hence, the growing number of mortgage defaults impacting on both securities markets and the finance sector. The combination of securitisation and OTC deals created a systemic risk for the whole financial system.\textsuperscript{27}

- Finally, the regulators were substantially understaffed and underfunded. An apt example is the U.S. Securities and Exchange Commission’s (the ‘SEC’) Division of Trading and Markets with seven staff members and no office heads.\textsuperscript{28} Commencing in March 2007, this division was charged with overseeing five otherwise unregulated broker-dealer firms that were the backbone of the shadow banking industry. No inspection of the subject firms was completed before the first breakdown in September 2008.\textsuperscript{29}

To sum up, regulation failed on various levels. The scope of banking regulation and the coverage of derivatives trading were too narrow. Underfunded, understaffed and disorganised regulators hampered efficient market supervision even in areas covered by securities and banking laws. This can be summarised as a de facto liberalisation of capital


\textsuperscript{26} Nan Seufert, ‘Time to Tame the “Wild Beast” in the Wild West? The Regulation of Disclosure of Equity Derivatives in New Zealand’ (2011) 29 Company and Securities Law Journal 5, 8; Lynch, above n 25, 1375.


\textsuperscript{28} United States Securities and Exchange Commission, SEC’s Oversight of Bear Stearns and Related Entities (2009), 49-50 <www.sec-oig.gov>.

markets laws. Although the securities and banking law was not de jure deregulated, the evolution and growth of markets resulted in an increasingly incomplete regulatory framework. From this point of view, the start of the GFC fits into the ‘usual’ scheme of stock market crashes.

(b) New Dimensions

On the other hand the GFC exhibited new dimensions. First, the growing number and complexity of financial products lead to an increased opaqueness. Risk assessments became more and more unclear, leading to insufficient monitoring by loan originators and an emphasis on boosting volumes to generate fees. Neither credit rating agencies nor banks assessed the risks that emanated from the toxic MBS properly and they underestimated the long-term risk. Others tried to get rid of toxic investments by selling them to inexperienced investors.

Second, the high level of leverage of unregulated financial institutions limited market participants’ abilities to absorb losses. Deposit-taking financial institutions generally tend to borrow on short maturities and lend on long maturities. If they face liquidity pressure and are not able to refund themselves with short term loans, they risk insolvency. The credit crunch hit non-regulated finance companies particularly hard. There were serious solvency concerns that spread through the whole industry. More extensive and robust prudential regulation with stricter capital requirements would have made the finance companies more stable and resistant against liquidity shortages.

Third, financial markets and finance institutions in different countries were increasingly interconnected. The credit crunch that started in the U.S. 2007 threatened European banks, such as the German IKB, the British Northern Rock or the French BNP Paribas. This identified weaknesses in the regulation of banks, both on a domestic and an international level. For this reason, the analysis of the GFC was not restricted to possible reforms of the regulatory system of each country. It became apparent that the reforms

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30 Reinhart and Rogoff, above 14, 342.
31 For an overview see Claessens et al, above n 13, 7-11.
32 Ibid 7.
33 Gucva, above n 5, 254-261.
35 Claessens et al, above n 13, 9-10.
36 Ibid 8-9.
needed to be coordinated on an international level. This new spin was described as the reform of the international financial architecture.\textsuperscript{37}

\section*{C Collapse of New Zealand's Finance Companies}

Before the GFC reached New Zealand, its domestic capital markets were facing problems. An inquiry conducted by the New Zealand House of Representatives in 2011 provides a good overview.\textsuperscript{38} New Zealand’s property sector had seen ten years of rapid growth. Development companies increasingly relied on finance companies for mezzanine funding to complement the mortgages granted by banks. Together with a high level of employment and favourable exchange rates, finance companies became a more and more attractive investment vehicle for private investors. The total assets of large finance companies (with deposits of more than NZ$ 100 million) rose from less than NZ$ 2 billion in 1998 to a peak of NZ$ 9 billion in 2007.\textsuperscript{39} Many of them had overstretched themselves, and a lowering influx of fresh capital put a growing number of companies under pressure. Commencing in May 2006, a total of 45 finance companies failed until 2010, putting at risk approximately NZ$ 6 billion of investor deposits. It is estimated that between 100,000\textsuperscript{40} and 200,000\textsuperscript{41} deposit holders were affected and the estimated losses exceeded NZ$ 3 billion. Given the small size of New Zealand’s population and capital market these numbers were devastating.

Although the events were not directly connected to the start of the GFC, the symptoms are similar. As in the U.S., the crash was ignited by the emergence and burst of a housing bubble. The finance companies’ policies of excessive lending lead to concentrations of risk, making the whole industry ill-equipped for a downturn of the property market. This


\textsuperscript{39} W R Wilson, L C Rose and J F Pinfold, ‘Examination of NZ Company Failures – the Role of Corporate Governance’ [2010] (2) \textit{Management Online Review} 1, 2.


\textsuperscript{41} House of Representatives, above n 38, 7.
even resulted in several cases of negligent or even criminal misconduct (deliberate misrepresentation and non-disclosure, fraud and Ponzi scheme scams).  

Regulation was neither able to prevent nor to stop the events. The first aspect is that the ambit of financial markets laws was too narrow; the New Zealand finance companies only partially fell within the regulators’ powers. The Securities Act only applied to offers to the public and therefore does not apply to OTC offers. The continuous disclosure regime that was set out in the NZX Listing Rules is limited to listed entities; and the Reserve Bank’s prudential regulation did not cover non-bank deposit takers. A separate licensing regime did not exist for non-bank financial companies, and therefore the regulators could not stop dubious players from entering the financial markets. The events also focused attention on the roles of trustees. Although playing an important role in the supervision of issuers, their accountability remained rather limited.

The second aspect is that the regulators failed to use their (limited) powers appropriately. In fact, the aforementioned inquiry report indicated there were cases in which it would have been possible to take action against finance companies. Some of the finance companies had a company structure and were thus subject to the Companies Act 1993; others issued shares to the public and therefore the Securities Act was applicable. There were also several cases of fraud. Hence the Registrar of Companies, the Securities Commission and the Serious Fraud Office had at least some powers to intervene but did not take action appropriately. The Securities Commission released several warnings on the risks of the problematic investments between 2004 and 2006. However, the regulator’s lack of intervention was nevertheless perceived in public as one of the main reasons for the crash.

At the end of 2010, more than 40 investigations have been conducted by the Securities Commission and several criminal charges were laid against directors of finance companies, mostly for breaches of the Securities Act. These investigations were conducted after the downfall of the finance companies. Therefore the directors’ conduct did not fall within

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42 Ibid 10-11.
43 Ibid 11-12.
44 Stace, above n 2, 5.
45 House of Representatives, above n 38, 11.
46 Prada and Walter, above n 25, Annex G.
regulatory gaps; the legal framework was there but it was not properly enforced. This demonstrates that the gaps in the legal framework were not the only reason for the ongoing misconduct – the regulators lacked market knowledge and investigation powers to identify the risks in time and lacked the capacity and powers to act appropriately after the risks became apparent. This is a failure of proactive regulation that is supposed to prevent mischief before it happens. An important lesson for New Zealand is that possible reforms must include reforms of the functions and powers of the regulators, in particular the proactive functions.

The chapter of the failed finance companies is not closed yet. So far the FMA has launched a mix of criminal and civil proceedings against the directors of 15 finance companies with 13 investigations continuing.\(^{49}\) Nine matters were referred to the National Enforcement Unit and the Serious Fraud Office.\(^{50}\) The Securities Commission’s and FMA’s investigations have lead to several convictions. In mid 2011 three directors of Nathans Finance were sentenced for breaching s 58 of the Securities Act,\(^{51}\) in early 2012 four directors of Lombard Finance & Investments\(^ {52}\) and three directors of Bridgcorp\(^ {53}\) were also sentenced. For 2011/2012 the Government allocated an additional funding of NZ$ 1 million to the FMA to continue litigation that is currently underway (in addition to the existing litigation funds).\(^ {54}\)


\(^{50}\) Ibid.


Another catalyst for law reform is New Zealand’s need for internationally well integrated markets. The country’s geographic location is considered the main restraint for economic growth, even shadowing the restraints caused by its lack of size and population.\textsuperscript{55} The ongoing integration can be separated into the Trans-Tasman co-operation with Australia and the globalization of financial markets.

1 \textit{Trans-Tasman Co-operation}

\textit{(a) The Closer Economic Relations and the Single Economic Market Program}

Australia and New Zealand have been in a process of aligning their economies for over thirty years now. The first step was the Australia and New Zealand Closer Economic Relations Trade Agreement (the ‘CER’), a regional free trade agreement that came into force on 1 January 1983. In 1988 a Memorandum of Understanding (hereinafter generally ‘MOU’) was entered into, obligating both countries to examine the scope for harmonisation of business laws and regulatory practice. Both parties agreed to keep each other informed of upcoming reforms of business laws.

The next major step was a new MOU in 2000, which was further revised in 2006 and 2010. Instead of harmonization it focused on co-operation to create a mutually beneficial commercial environment called the Single Economic Market. The shift results from the fact that full harmonisation works best when there is a full economic union.\textsuperscript{56} On the other hand, co-ordination of laws is viewed as ‘the default option where full economic union is neither present nor immediately feasible and, in practice, its operation seems bound to be fragmentary. Here, the best option is mutual recognition regimes’.\textsuperscript{57} As at 2000 a full economic union between Australia and New Zealand did not exist. As Goldwasser and Walker put it, there is therefore ‘considerable substance to the argument that the business law coordination project between Australia and New Zealand is less about co-ordination

\textsuperscript{57} Ibid.
per se than a conscious alignment of parts of New Zealand business law with those of Australia in order to facilitate a single market.\textsuperscript{58}

In 2009, the Trans-Tasman integration gained new momentum. On 20 June 2009 the Governments of both Australia and the New Zealand agreed to establish the Trans-Tasman Outcomes Implementation Group (the ‘TTOIG’).\textsuperscript{59} Its task was to pursue and to monitor progress of cross border initiatives agreed upon by the Governments. The focus was on delivering practical outcomes from the Single Economic Market. The TTOIG developed and is constantly updating the outcome proposals that include issues of Insolvency Law, Financial Reporting and Financial Services Policies, Corporations Law, Competition Policy, Intellectual Property Law and Consumer Law.\textsuperscript{60} The proposed timeline for the final implementation into national law varied (as at 2009) between two and five years.

The deepening Trans-Tasman co-operation might be described as the beginning of a loose confederation.\textsuperscript{61} The creation of a single market is arguably more important for New Zealand than for Australia. About 23 per cent of all exports from New Zealand go to, and 18 per cent of all imports to New Zealand come from Australia, making the country by far New Zealand’s most important trade partner. In contrast, New Zealand only ranks eighth among the Australian trade partners with a share of about 3 per cent.\textsuperscript{62} Australia’s economic importance for New Zealand’s economy is comparable to China’s importance for the Australian economy (25 per cent of exports, 19 per cent of imports).\textsuperscript{63} So obviously New Zealand is more likely to emphasize and place weight on the relationship between the two countries.\textsuperscript{64} This phenomenon is known from the international standardisation debate as the ‘race toward the hegemon’.\textsuperscript{65} Experience shows that the standard of the most


\textsuperscript{60} The original and updated versions of the outcome proposals are available under <www.treasury.gov.au/ttoig>.


\textsuperscript{63} Ibid.

\textsuperscript{64} Gordon Walker, ‘The CER Agreement and Trans-Tasman Business Law Coordination’ in Jianfu Chen and Gordon Walker (eds), Balancing Act – Law, Policy and Politics in Globalisation and Global Trade (Federation Press, 2004) 75, 82.

powerful player is often the one that dominates in a network. In international financial markets this is usually the United States or the European Union (with the United Kingdom in particular). Since the aforementioned ‘network’ is in this case the Trans-Tasman co-operation, the alignment of New Zealand’s business laws with Australia is logical.

(b) Effects on New Zealand’s Securities Regulation

(i) ‘Australianisation’

The idea of intensified co-operation heavily influenced the reforms of New Zealand’s securities laws from 2000-2008. The new insider trading and market manipulation regime set out in the Securities Markets Act was closely modelled to the Australian model. The new Takeovers Code 2001 was designed according to the Australian provisions. In both cases co-operation with Australia was not just the effect of the ongoing reform, but a major incentive to get the reforms underway. Commentators argue that this development was not in fact a convergence of two legal frameworks, but a deliberate one-way alignment of New Zealand’s securities laws to Australia (so called ‘Australianisation’). Thus, the ‘race to the hegemon’ occurred in New Zealand’s securities laws as well.

(ii) Mutual Recognition

The thrust towards mutual recognition is also demonstrated in securities regulation. In 2006 an agreement for the mutual recognition of securities offerings was entered into. After some necessary amendments to the Securities Act, the respective Securities (Mutual Recognition of Securities Offerings-Australia) Regulations 2008 were enacted in 2008. The Australian counterpart is set out in Part 8 of the Corporations Act 2001 (Cth) and the

Corporations Regulations 2001 (Cth). The new scheme allowed issuers to offer securities in both countries using the same offer documents. The ‘minimal additional obligations’ \(^{72}\) include a notification to the domestic regulator that a recognised offering is taking place and issuing of a warning statement stating that the offer procedures had not been subject to the domestic law. This wide recognition can be seen as the paradigm for closer Trans-Tasman relationships. \(^{73}\)

(iii) Persisting Differences

Despite the mutual recognition scheme, differences between the two national regimes persist. The provisions on initial offering disclosure are a good example: s 33 of the Securities Act prohibits offers to the public in the absence of the prescribed disclosure documents. Possible exemptions are set out in s 5 of the Act. In contrast, Australian law does not refer to the ‘offer to the public test’ and applies a much tighter ‘bright line test’. According to s 706 of the Corporations Act 2001 (Cth) any offer of securities for issue needs disclosure unless one of the exemptions in s 708 applies. The content of the disclosure documents also differs. Whereas the Securities Regulations 2009 require the satisfaction of certain conditions, s 710 of the Corporations Act 2001 (Cth) requires Australian prospectuses to include all information that investors or their advisers would reasonably need to make their investment decision. The necessary assessment of the company’s prospects includes a due diligence obligation. As Walker and Fox stated, it is ‘immediately apparent that the disclosure obligations imposed under Australian law are more onerous than the New Zealand equivalent’. \(^{74}\) The question is as to whether the upcoming reforms will lead to a further alignment between the disclosure regimes.

(iv) Roles of the Regulators

In 2005, the Australian Securities and Investment Commission (‘ASIC’) and the Securities Commission signed a memorandum of understanding on the exchange of information. \(^{75}\) Its purpose was to share intelligence on enforcement matters with a trans-Tasman element,


\(^{73}\) Davis, above n 61, 33-36.

\(^{74}\) Walker and Fox, above n 71, 265.

and to undertake joint enforcement initiatives. However, a joint regulator for both sides of the Tasman has never been seriously considered. In 1989, the Spencer Russell Report briefly discussed a possible merger between the stock markets of Australia and New Zealand’s and a joint regulator. The idea was dismissed as an inappropriate solution for the problems of New Zealand’s securities markets. The main concern was that a merger would be a severe disadvantage for New Zealand’s smaller listed companies.

Despite the ‘Australianisation’ of New Zealand’s securities laws the structure and functions of the two regulators were rather different. Australia followed the ‘twin peaks’ regime with a market conduct regulator and a prudential regulator. New Zealand on the other hand possessed a multitude of smaller agencies involved in market supervision and enforcement, each with different responsibilities. ASIC was in charge of both the prospectus registration process and the supervision of market conduct. In New Zealand, the registration of prospectuses and the enforcement of breaches were administered mainly by the Registrar of Companies, whereas the Securities Commission acted as the main conduct regulator. In contrast to Australia, New Zealand’s business laws have largely relied on private enforcement. Matters appropriate to listed public companies were largely to be dealt with in securities regulation and stock exchange listing rules, and the public enforcement regime has always been rather weak. Therefore the regulatory landscape and culture on each side of the Tasman are quite different. The question is whether further reforms will lead to a further alignment of supervision and enforcement structures.

(c) Conclusion

Because of Australia’s influence on New Zealand’s securities laws, all further reforms of New Zealand’s securities laws would need to take into account the Australian legal framework. Any change has the potential to be a step further towards a single economic market. On the other hand a reform that does not address the impact on Trans-Tasman businesses might hamper further economic integration. Market participants emphasize that

76 Ibid 3.
78 Ibid.
79 For more details see below 44.
alignment within the Trans-Tasman regulatory framework should be maintained (or created respectively) wherever possible.\textsuperscript{82} Hence the question is whether the mutual recognition regime from 2008 marked the last step of the alignment process.

2 Internationalisation of Financial Markets
(a) Globalisation

Since the late 1970s the financial markets have been undergoing severe changes. The main reason is globalisation on a political, economical and technological scale.\textsuperscript{83} The legal framework for financial services was deregulated in a large number of countries including New Zealand. One of the effects was the opening the financial markets to foreign participants. A growing number of countries had to finance their government debts, deepening the capital markets. The downfall of the Soviet Union and its satellite states in the early 1990s opened the whole of Eastern Europe to the international markets and capital flows. But perhaps the most significant catalyst was the fast progress of information technology and the internet.\textsuperscript{84} It has not only become possible and affordable for investors to gain the information they require to make their investment decisions. It has also become possible to invest in financial markets all around the world, and it has become easier for corporations to list on foreign exchanges. Together, these changes have produced an overwhelming trend towards international financial integration.\textsuperscript{85} Securities laws needed to respond to these developments.\textsuperscript{86}

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\textsuperscript{82} Prada and Walter, above n 25, 13.
\textsuperscript{85} The integration of the financial markets is of course only one element in the growing integration of economies, see World Bank, Globalization, Growth and Poverty: Building an Inclusive World Economy (Oxford University Press, 2001) 31-8.
Specific regulatory problems arising from international securities trading are mainly due to the different treatment of the same fact situation in different countries. Some securities laws result in additional compliance costs (for example, the need to publish additional prospectuses), which may hamper capital flows. On the other hand, a well designed set of rules may attract foreign capital, even if it significantly differs from other nations’ legal framework. This allows states to compete for foreign investment by framing their securities laws in a particular fashion that would be beneficial to investors. This approach was particularly popular in the 1990s when influential commentators argued that more regulation would impede the developments of capital markets.

New Zealand is a good example for competition presented by international capital flows. Although New Zealand has always been a capital importing country, the ‘national interest’ in capital importation as a main objective of securities regulation was not expressly stated prior to the Spencer Russell Reports in 1989. The reports highlighted the necessity for a regulatory structure which is ‘internationally compatible’ and has ‘comparable standards’. A couple of years later the Ministerial Working Group on Securities Law Reform came to a similar conclusion and stressed the benefits not only of internal integration, but also of international competition between financial market places. Its final report, the Roche Report, identified tight regulation as an obstacle for economic growth and endorsed light-handed regulation. The Working Group was of the opinion that the legal framework existed, but the rules were not properly enforced. However, both reports were shelved and nothing came from them. This was a good example of deregulation by inactivity that no further action was taken although both

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87 Kübler, above n 83, 112.
91 Ministerial Committee of Inquiry into the Sharemarket, above n 77, 5.
92 Ibid 27.
94 Ministerial Working Group on Securities Law Reform, above n 93.
reports stressed the need for better enforcement. Although attracting foreign capital was one of the main policy objectives of the Four-Phase-Reform-Agenda, a thorough reform of the regulatory landscape was widely seen as unnecessary.

(c) **Co-operation Model**

Other commentators argued that competition of securities laws would finally lead to a ‘race to the bottom’, where the national securities laws with the lowest compliance cost and the least regulatory restrains prevail. In the end, securities laws’ main objectives, the protection of investors and markets, would be at stake which could result in a negative outcome for all. This concern was later backed by substantive research data which demonstrated that tighter regulation can indeed have a positive influence on the growth of capital markets (‘law matters’ thesis).

Since the global implementation of uniform rules was (and is) highly unlikely, regulators and legislative bodies have focused on co-operation. The underlying concept is standard-setting. It constitutes a level below which a group of states agree that none will lower their regulatory standards in competition with each other. A major advocate for international standard-setting has been IOSCO. It was founded in 1983 and comprises national regulators and (as affiliated members) self-regulatory organisations. The IOSCO provides multinational dialogue and studies of matters of common concern to the members.

According to para 1.2 of the By-Laws, the IOSCO’s objective is to develop securities markets and to improve their efficiency, to co-ordinate the enforcement of securities regulation and to implement common standards. Due to the ongoing securitisation of financial products and the blurring boundaries between the different markets the IOSCO’s activities nowadays cover all kinds of financial markets laws.

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95 See Mortlock, above n 34, 33.
96 Ibid 22.
97 For a comprehensive overview and further reference, see Bollen, above n 66, 372-7.
99 Bollen, above n 66, 375.
100 For an overview over IOSCO’s history, structure and activities see, eg, Ian Tunstall, *International Securities Regulation* (Lawbook, 2005), 219-57.
101 Ibid 226.
The IOSCO’s role in fostering co-operation in the first fifteen years of its existence was described as ‘enigmatic at best’.\(^{102}\) This changed in 1998 when the standards for the regulation of financial markets, entitled *Objectives and Principles of Securities Regulation* (the ‘IOSCO Principles’),\(^{103}\) were published. These principles were revised in 2003 and are updated continuously. The latest version was published in June 2010.\(^{104}\) Although the IOSCO Principles have been subject to criticism,\(^{105}\) they nowadays represent international best practice for the design of national securities laws and their enforcement. The Principles follow three key objectives: to protect investors, to ensure that markets are fair, efficient and transparent, and to reduce systemic risk.\(^{106}\) Based upon these objectives there were 30 principles to be implemented in national securities laws. These principles focused on the ambit of financial markets laws and the role and powers of the regulator.

The IOSCO members have much to gain and little to lose from international co-operation on securities enforcement.\(^{107}\) In the early 2000s, New Zealand became an ‘enthusiastic supporter’ of international best practice models as set out in the IOSCO Principles.\(^{108}\) Given that New Zealand had mostly ignored developments in both its domestic and the international securities markets since the 1980s, this marks a clear turning point in the domestic development. Cabinet papers that were produced during the Four-Phase-Reform-Agenda regularly highlighted the necessity of following ‘international best practice’.\(^{109}\) This process was bolstered by the personal involvement of the long-time head of the Securities Commission, Jane Diplock, who was Chair of the IOSCO’s Executive Committee from 2005 until May 2011.\(^{110}\) In the last annual report filed by the Securities Commission in 2011, Diplock stated that the Securities Commission’s ‘IOSCO connection has also allowed this country to move from being an outlier of the international regulatory


\(^{105}\) The IOSCO was seen as reluctant to conduct serious revisions of the IOSCO Principles, see Jordan, above n 104.

\(^{106}\) IOSCO, above n 103, 3.

\(^{107}\) Bollen, above n 66, 382.

\(^{108}\) See Shelley Griffiths, above n 67, 989 with further reference.

\(^{109}\) See, eg, Minister of Commerce, above n 68, 2.

\(^{110}\) International Organization of Securities Commissions,’Maria Helena Santana of CVM Brazil to Chair IOSCO’s Executive Committee’ (Media Release 05/2011, 18 April 2011) <www.iosco.org>.
community to being a jurisdiction that has more influence than our small size and economy
would normally dictate.'

With the Four-Phase-Reform-Agenda incomplete, the question is whether New Zealand
finally has a legal framework that matches international best practice. Furthermore, any
further changes need to be considered in the light of the IOSCO Principles.

(d) New International Financial Architecture

The GFC has produced a new view on the integration of financial markets. The crisis
demonstrated that the interconnected financial markets were prone to contagion from each
other. Of course former, crashes of stock markets had also impacted on a global scale. For
example, Black Monday, a stock market crash that started on Monday 19 October 1987 in
New York, led to stock market losses of 22.6 per cent in the US, 41.8 per cent in Australia
and up to 60 per cent in New Zealand in one month. Despite the devastating
consequences for the stock markets, the crash spread to the real economy to a lesser extent.
The main difference in 2007 was that the different financial markets were highly
interconnected. The distinction between equity investments, other financial products and
(shadow) banking has blurred. Modern products may exhibit characteristics traditionally
associated with securities, banking and insurance combined in one product. Market
participants were active in all of these markets on a global scale, and thereby they were
often linked in reciprocal agreements.

Some of these market participants had reached a size and a level of interconnectedness
with other market participants that their collapse was likely to start a chain reaction all
around the globe (‘too systemic to fail’ rather than ‘too big to fail’). The fact that not
only banks, but securities firms and other non-bank financial institutions can be of

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112 See, eg, Peter Levy, ‘Internationalisation of Securities Markets: Jurisdictional and Enforcement Issues’
113 This has been pointed out since the 1990s, see for further reference Michael Taylor and Alex Fleming,
‘Integrated Financial Supervision – Lessons from the Northern European Experience’ (World Bank Policy
114 International Organisation of Securities Commissions, Methodology for Assessing Implementation of the
and Business of the Americas 279, 290-294.
systemic relevance is not new and had already been raised in the 1990s. However, the amount of money involved and the integration of markets have resulted in a growing number of systemic banks and non-bank financial institutions. Although a systemic market participant does not create the risk of a crash itself, it amplifies the impact on other institutions if such a market participant collapses.

Thus one of the goals of the reforms of the financial system which started after the GFC was to make the global financial system less prone to shockwaves that emanate from particular markets. Regulation and prudential supervision in particular, needed to be strengthened while less emphasis was put on the market and self discipline. Another goal was to ward off the trend towards protectionism that was sparked by the interventions of governments and central banks into markets and the currency system. Such interventions could also result in regulatory protectionism.

The structural problem of regulating interrelated international markets and systemic financial groups is that the powers of national regulators are generally limited to their domestic market. Imbalances of financial groups on a macroeconomic scale are therefore hard to detect and even harder to address. An obvious option is the establishment of an international hard law framework and an international regulator. However, this is not likely to happen; it is hard to imagine that countries such as, say, the United States or the United Kingdom would hand over the task of financial regulation from their national agencies to an international body. Besides, the different legal traditions and political objectives make an international super regulator an illusion. Hence, the main tools envisaged by scholars and practitioners for strengthening the international financial framework are improved co-operation between regulators (the exchange of information in particular), convergence of accounting standards and banking secrecy laws, and mutual recognition of regulatory frameworks. This process is far from being finished. Several international bodies such as the IOSCO, the International Accounting Standards Board, the

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118 See Fiennes and O’Connor-Close, above n 31, 10-12.
120 Jane Diplock, above n 72, 160.
123 For an overview see Diplock, above n 72, 156; Fiennes and O’Connor-Close, above n 31, 10-12.
Basel Committee on Banking Supervision and the International Association of Insurance Supervisors have commenced to work on new international standards. Other bodies such as the Financial Stability Board and the Financial Crisis Advisory Group were newly formed in 2008 and 2009 to coordinate the international reform efforts.

However, increased co-operation between regulators requires national regulators which work well. National regulators must have confidence in one another. A regulator that lacks powers and resources is not able to make a valuable contribution to world-wide systemic stability. It is likely to result in the opposite since an inefficient local regulator might be unable to detect risks in the supervised markets. This might lead to a false sense of safety because the potential risk would not come to the attention of the co-operation network. The overall result could be a misjudgement of the overall situation because weak points are not identified. This might to inactivity and an inappropriate allocation of resources. Therefore the first step towards a more stable financial architecture is, as Dani Rodrik put it, to ‘fortify the home front’.

The IOSCO Principles were extended to a total of 38 in 2010. The three major objectives are (1.) a more active role of the regulators in monitoring the perimeter of regulation and in identifying systemic risks, (2.) adequate auditing standards and (3.) improved oversight of rating agencies and other analytical service providers. This means a major extension of the international best practice and raises the question of whether New Zealand’s financial markets laws in general and the new regulator in particular meet the new international standards.

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125 IOSCO, above n 114, 10.
E  Quality of New Zealand’s Securities Laws

1  Scope and Quality of Securities Laws

(a) The ‘Wild West’

New Zealand’s securities regulation regime has been subject to criticism. Its history shows that a light-handed approach had been followed from the outset, avoiding a tighter regulatory framework while emphasizing the powers of the free market and the economic risks of administrative intervention. Before the stock market crash caused by Black Monday in 1987, New Zealand had gained a reputation as the ‘Wild West’ of share markets. Due to this ‘libertarian dogma and self-interest of some influential interest groups and key players’ New Zealand has constantly been slow in adopting new or additional regulation. A good example is the struggle for and against the implementation of takeovers regulation. Between 1980 and 1988, the Securities Commission had produced several proposals on takeovers regulation that were mostly ignored by the Government.

In 1993, the Takeovers Act 1993 was enacted in the wake of the creation of the new Companies Act 1993. However, the legislation remained incomplete and nothing more than a ‘sword of Damocles’ over market participants until the Takeovers Code 2001 finally came into force in 2001. It took more than twenty years to enact legislation that is considered a necessary piece of investor protection.

In 2003, the IMF conducted an assessment of New Zealand’s securities regulation against the IOSCO Principles. In all fairness it has to be noted that this assessment took place prior to the completion of the Government’s Four-Phase-Reform-Agenda. Arguably further reforms may have rectified some of the identified shortcomings. However, the survey

129 Farrar, above n 81, 392.
131 Bryan Gaynor, ‘Securities Regulation in New Zealand: Crisis and Reform’ in Gordon Walker and Brent Fisse (eds), Securities Regulation in Australia and New Zealand, (Oxford University Press, 1994), 10, 28.
133 Prada and Walter, above n 25, 20.
demonstrated how far away New Zealand’s securities regulation was from international best practice in 2003. The final report identified vast deficiencies in the regulation of collective investment schemes and financial intermediaries as well as substantial shortcomings in the enforcement, investigation and supervision powers of the Securities Commission. In total, only eight of the principles were considered to be fully implemented and seven to be broadly implemented. On the other hand eleven principles were assessed as only partially implemented and two as not implemented at all. The severity of this assessment is demonstrated when compared to Australia. In Australia, 21 principles were considered to be fully implemented and five as broadly implemented. Only two were criticised as partially implemented and one as not implemented.

(b) After the Four-Phase-Reform-Agenda: Persisting Criticism

The aforementioned Four-Phase-Reform Agenda mitigated some of the shortcomings of the legal framework. However, even after it was completed by three quarters in early 2008, New Zealand’s securities laws still exhibited weaknesses. This is especially true of the concept of the ‘offer to the public’ in s 3 of the Securities Act, which was seen as outdated and even called an ‘unmitigated disaster’. The term ‘security’ had always been widely interpreted, but the definition could be circumvented if carefully tailored offers. A recent example is the collapse of Blue Chip Ltd which caused NZ$ 84 million damages to investors. The New Zealand Court of Appeal held that the property investment that was offered did not fall within the meaning of ‘security’ as defined in the Securities Act. In cases like this the regulator lacked the power to declare the respective investment scheme a security in the terms of the Act. The result was that the statutory disclosure obligations did not apply and the regulators were not able to react.

Further, the scope of securities laws presented problems. A genuine derivatives regime did not exist. The disclosure provisions of the Securities Markets Act could be circumvented by OTC equity swap agreements. Under the Investment Advisers (Disclosure) Act 1996

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134 Ibid 38.
136 Walker and Fox, above n 71, 266.
137 See, eg, City Realities Ltd v Securities Commission [1982] 1 NZLR 74 (CA); Culverden Retirement Village Ltd v Registrar of Companies (1997) 8 NZCLC 261, 301 (PC).
138 Hickman & Ors v Turn and Wave Ltd [2011] NZCA 100.
139 See, generally, Seufert, above n 26.
financial advisers were only subject to a light-handed disclosure regime which was far from international best practice. Ironically further reforms were already underway when the crash of New Zealand’s finance companies started in 2006. After the aforementioned IMF survey had identified deficiencies in the regulation of financial intermediaries in New Zealand (a lack of entry requirements or a licensing regime in particular), the Government reacted and initiated a review of Financial Products and Providers in 2005. However, it was in 2008 when the first legislative changes came into force, and the new regime still did not cover collective investment schemes.

The quality of the disclosure documents was also in doubt. In 1996, a second, more concise investment statement was introduced. The result was that issuers had to provide for two disclosure documents (investment statement and prospectus). Public issuers had to comply with the continuous disclosure provision under Part 2 of the Securities Markets Act and under the NZX Listing Rules. Although the investment statement was perceived by many investors as helpful, the duplication of disclosure requirements was regarded as costly for issuers, unclear for investors and thus inefficient. In 2009, New Zealand ranked last in a survey on investors’ experiences in 16 developed Western and Asian countries especially with regard to complaints about the quality and transparency of prospectuses.

2 The Regulators

The Securities Commission as New Zealand’s main regulator was also subject to criticism. A survey that was commissioned by the Securities Commission in June 2009 and conducted by Michel Prada and Neil Walter (the ‘Prada/Walter Report’), provides a comprehensive overview.

140 Ibid 28-32.
145 Prada and Walter, above n 25.
First, the introduction of new financial products and continuing reforms led to a proliferation of regulatory bodies.\textsuperscript{146} This situation as of 2008 was as follows: although the Securities Commission was the main regulator, several other institutions were involved in securities regulation. The Registrar of Companies was responsible for the registration and review of prospectuses. The NZX was the front line regulator for listed companies. Although the Securities Commission’s annual supervision reports indicated that the Commission was rather content with the enforcement efforts of NZX, there was still criticism that NZX was a company acting as a regulator while at the same time it was listed on its own stock exchange.\textsuperscript{147} Further, the Commerce Commission and the Serious Fraud Office needed to enforce restrictions against particular misleading or fraudulent advertising. All kinds of takeovers were administered by the Takeovers Panel. The Government Actuary supervised superannuation and KiwiSaver schemes and was assisted by MED’s Insurance and Superannuation Unit, and the Reserve Bank acted as the banking regulator.

It is obvious that vital elements of securities regulation were not within the power of the main regulator, but with other administrative bodies. The former Chair of the Securities Commission, Jane Diplock, characterised the situation as a number of agencies ‘doing pieces of the same job’.\textsuperscript{148} The Prada/Walter Report identified a total of twelve agencies somehow involved in securities regulation.\textsuperscript{149} This number can be contrasted with the results of a report produced by the European Central Bank. In 2003, the 25 member states (and members-to-be) had an average of less than three financial supervision institutions.\textsuperscript{150} Comparisons like these are of course always difficult as it is unclear what can be identified as a financial supervision institution and what cannot. However, the numbers indicate that New Zealand’s regulatory structure, in particular given the small size of the country, was unnecessarily overstretched and fragmented. This regulatory structure was neither a sound use of resources nor did it facilitate well-concerted actions by regulators in cases of serious breaches of securities laws and market failure.

\textsuperscript{146} Ibid 11.
\textsuperscript{149} Prada and Walter, above n 25, 11.
\textsuperscript{150} European Central Bank, \textit{Developments in National Supervisory Structure} (June 2003) 4-5 <www.ecb.int>. 44
Second, despite the augmented powers of the Securities Commission it still lacked enforcement and investigation powers. Originally it had been installed as a mere law reform and monitoring body. Its role was more of an observer than of a protector of shareholders’ rights. Instead, New Zealand’s securities laws relied on private enforcement. This was described as ineffective and having ‘no legs’.

Although the Four-Phase-Reform-Agenda has extended the Securities Commission powers in recent years, all enforcement still had to go through the courts, the Securities Commission was unable to impose fines or penalties itself. In contrast, ASIC has the power to issue ‘infringement notices’ for breaches of disclosure provisions under Part 9.4AA of the Corporations Act 2001 (Cth). Further, the Securities Commission did not have the right to conduct inspections; it needed to rely on the Registrar of Companies under s 67A of the Securities Act.

There are several surveys that demonstrate the weaknesses of the enforcement regime. In the study conducted by La Porta, Lopez-de-Silanes and Shleifer in 2000, New Zealand provided a remarkably low level of public protection for investors, with particular low ratings for the Securities Commission’s ability to make rules or binding orders, and its weak supervisory functions. The final mark assigned to New Zealand was 0.33 out of 1 (at a mean of 0.62), putting it in line with countries like Zimbabwe (0.42), Sri Lanka (0.43), Nigeria (0.33) and notoriously light-regulated Ireland (0.37). In contrast, countries like Singapore (0.87), Australia (0.9), the United Kingdom (0.68) and the United States (0.9) received significantly higher marks. In the IMF’s Financial Markets Assessment Program the Securities Commission’s lack of investigation and enforcement powers was highlighted. The report conceded that the upcoming reforms of securities trading laws might rectify some of the shortcomings. However, the failure of the finance companies suggests otherwise.

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151 Gaynor, above n 131, 17.
153 Prada and Walter, above n 25, 40.
154 La Porta, Lopez-De-Silanes Shleifer, above n 98, 15.
155 International Monetary Fund, above n 132, 7-8.
156 Ibid 8. Griffiths also concluded that the most of the deficiencies were rectified in 2006, see Shelley Griffiths, ‘The Securities Commission’ in John Farrar et al (eds), Company and Securities Law in New Zealand (Thomson Brookers, 2008) 991, 997.
Third, the Securities Commission’s growing powers had not ended the discussions about its insufficient funding. The former Chairman Peter McKenzie conceded in the mid-1990s that the Securities Commission could do ‘much more were it provided with greater resources.’ The IMF stated that the Securities Commission would need additional funding if its powers were increased. The influential analysis by Jackson and Roe on the efficacy of public enforcement indicated an extremely low level of funding of New Zealand’s regulators in relation to the country’s GDP (37 at a median of 60).

These findings were confirmed by the Prada/Walter Report in 2009. The authors identified under-resourcing as the heart of many of the Securities Commission’s problems. New Zealand has been putting considerably less funding into market regulation than any other comparable country. The growing workload has led to a growth of demand in staffing. In 1993 the Securities Commission had 14 full-time employees, increasing to 22 in 2002, 30 in 2003, 40 in 2009 and 56 in 2010. Despite these growing numbers the Securities Commission had never been adequately funded for the services expected of it. The increasing workload since 2002 has only been partially funded, leading to shortages in staffing and infrastructure. The shortage of funding was seen as one of the reasons for the insufficient supervision of finance companies that contributed to their downfall.

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158 Peter McKenzie, ‘Reforming Securities Regulation in New Zealand’ in Gordon Walker and Brent Fisse (eds), Securities Regulation in Australia and New Zealand (1st ed, 1994), 35, 43.
159 International Monetary Fund, above n 132, 9-10.
161 Prada and Walter, above n 25, 29.
162 McKenzie, above n 158, 35, 43.
163 International Monetary Fund, above n 132, 9.
164 Securities Commission, above n 48, 25.
166 Ibid 5.
167 House of Representatives, above n 38, 11.
(d) Use of Powers

Fourth, the Securities Commission’s approach to regulation has been criticised. Despite the fact that the Securities Commission was regularly assessed as a body that was run efficiently, it interpreted its role rather conservatively. It often only acted following a complaint and showed reluctance to provide opinions and advice. The Securities Commission was not acting in a proactive, but a mainly reactive way. It was ‘perceived very much as an ambulance at the bottom of the cliff by many commentators, sharemarket participants and investors.’

It was urged to comment more bluntly about specific market trends and to play a more effective role by testing the legal boundaries of the relevant law in court. It can be assumed that this ‘conservative’ approach is closely linked to the lack of resources. It is likely that better funding would also put an end to the ‘conservative’ approach. Ironically the Securities Commission has recently shown more effort to take legal action against failed finance companies and their managers.

F Underperformance of New Zealand’s Capital Markets

New Zealand’s capital markets have been in constant decline since the 1990s. Stock market capitalisation in relation to the GDP dropped from 60 per cent in 1994 to 42 per cent in 2005. This development was not congruent with the worldwide trend of growing capital markets as the comparison with Australia demonstrates. In the same period, market capitalisation in Australia increased from 60 per cent in 1994 to 151 per cent in 2005. A

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168 See Prada and Walter, above n 25, 13.
169 Ministry of Economic Development, above n 157, 5; Prada and Walter, above n 25, 4-5; McKenzie points out that given its limited resources the Securities Commission conducted a surprisingly high number of investigations in the 1990s, see Peter McKenzie, above n 158, 43-4.
170 Prada and Walter, above n 25, 13.
171 New Zealand Shareholders Association, above n 147, 14.
172 New Zealand Shareholders Association, above n 147, 14.
173 Gaynor, above n 131, 18.
174 Prada and Walter, above n 25, 14-15.
175 See Securities Commission, above n 48, 5.
survey showed that the value of New Zealand’s domestic equity market was the smallest among countries of comparable size and economic structure.\textsuperscript{177}

The reasons for this underperformance appear to be various. Apart from obvious problems such as New Zealand’s distance to other markets, agriculture still plays a more important role in the economy than in comparable developed countries. New Zealand has seen a transition from an agricultural-based economy that heavily relied on its relations with Great Britain to a modern economy since the late 1970s.\textsuperscript{178} However, agriculture still provides for about two thirds of all exports\textsuperscript{179} and 11 per cent of the GDP.\textsuperscript{180} Many farmers are organised in cooperatives that are not publically listed and therefore do not contribute to the capital markets.\textsuperscript{181}

Besides, New Zealand’s economy is dominated by smaller firms that are usually not listed on the stock exchange.\textsuperscript{182} Among the few big firms a high percentage is owned by the state and not listed. These firms make up nearly 10 per cent of the GDP.\textsuperscript{183} In addition the number of foreign companies listed on NZX declined from 60 in 1999 to 26 in 2007.\textsuperscript{184}

Investors in New Zealand prefer investments in property over investments in capital markets, or they simply rely on bank deposits. A study conducted by the IMF in 2007 demonstrated that non-financial assets made up 76 per cent of total household assets in New Zealand.\textsuperscript{185} This percentage was significantly higher than in other developed countries. On the other hand the holding of both domestic and foreign equity only made up to 4 per cent.\textsuperscript{186} The main reason for this ‘home bias’ was that, as a result of rising property prices and generous tax deductibility, housing investors enjoyed returns that were superior to stock market returns.\textsuperscript{187}

\begin{thebibliography}{99}
\bibitem{177} Evans, above n 55, 4.
\bibitem{178} Between 1965 and 1989, the share of New Zealand’s exports going to Britain has fallen from 50 per cent to 7 per cent, see James Belich, \textit{Paradise Reforged} (University of Hawaii Press, 2001) 426.
\bibitem{181} Evans, above n 55, 7-9.
\bibitem{182} Ibid 14-17.
\bibitem{183} Capital Market Development Taskforce Secretariat, above n 180, 4-7.
\bibitem{184} Ibid 14.
\bibitem{186} Ibid 17.
\bibitem{187} Ibid 22-24.
\end{thebibliography}
The analysis has demonstrated that there were various drivers for the reforms of New Zealand’s capital markets. Two crises have aptly demonstrated the need to remedy shortcomings of the regulatory framework both on a domestic scale and on a global scale. But the reforms do not only need to address the identified weaknesses. They would have to deal with the unresolved problems of New Zealand’s flawed capital markets laws, namely an outdated disclosure framework for initial public offerings and a much too narrow scope of securities laws. However, particular attention needed to be given to the reform of the regulator itself. Both domestic and international developments show that New Zealand required a regulator with comprehensive functions and duties, proper enforcement powers and sufficient resources to use them. Future reforms also needed to be assessed as to whether they met the international best practice as set out by the IOSCO, and how they fit into the aim of a single Trans-Tasman economic market.
The second chapter provided an overview of the events that triggered the recent reform process, the international and regional trend towards co-operation in securities regulation, and the weaknesses of New Zealand’s capital markets and their legal framework. This third chapter focuses on the reforms that took place between 2008 and 2012. It begins with the work of the Capital Markets Development Taskforce and continues with a brief analysis of the new statutes.

A The Work of the Capital Markets Development Taskforce

1 The Taskforce – Members and Objectives

In July 2008, the Capital Market Development Taskforce (the ‘Taskforce’) was established by the Ministry of Economic Development (the ‘MED’). Its objective was not only a review of securities regulation but also all financial markets in New Zealand in order to improve the system as a whole. Thus, its brief included, inter alia, a focus on market infrastructure and design, rules for financial advisory services and tax matters. The 15 members of the Taskforce represented market participants, consulting firms, regulatory bodies and other government agencies. The Government described the Taskforce as ‘industry-led’. In fact, eleven members represented industry participants or consultants

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while only five members were from regulatory agencies (with one member representing both). In November 2008, the Taskforce published an interim report that concentrated on lowering barriers to capital-raising by the introduction of simplified disclosure documents. The purpose was to avoid the effects of the ‘credit crunch’ and to make raising equity capital easier. It resulted in minor changes to the Securities Markets Act and the introduction of the new Securities Regulations 2009 in late 2009.

The Taskforce released its final report called ‘Capital Markets Matter’ in December 2009. The comprehensive document contained a total of 60 recommendations. The Taskforce described capital markets as ‘engines of growth’ and scrutinised all possible levels to improve the markets’ performances. The guidelines for the reforms of securities regulation in particular were set out in Chapter 5, called ‘Rules and Regulation in New Zealand’s Capital Markets’. Other chapters addressed issues related to securities laws, such as funds managers’ duties or disclosure documents.

The Taskforce recommended two major steps in the reform of the securities markets: first, a review of securities laws, and second, an overhaul of the regulatory architecture. Other recommendations were direct implementations of these overarching principles or merely closed regulatory gaps (eg, regulation of wrap accounts), rectified legal uncertainty (eg, clarifications of exemptions for initial disclosure obligations) or were not directly related to securities regulation (eg, reforms of the tax regime). The two major recommendations are now considered in more detail.

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4 Cathy Quinn had a double function, working as a solicitor for one of New Zealand’s biggest law firms while also being a member of the Securities Commission.
6 Capital Markets Development Taskforce, above n 3.
7 Ibid 52.
8 Ibid 41-44.
9 Ibid 30.
The Taskforce recommended nothing less than a complete review of securities laws. Two central, interrelated policies were articulated. First, securities regulation needs to facilitate capital market activity for both issuers and investors. Second, further international integration of securities markets must be subject to clear net benefits for New Zealand.

(a) Return to ‘Real’ Investor Protection

The Taskforce recommended a complete review of securities law, focussing on ‘healthy, vibrant capital markets’. The final report states:

Securities legislation should have a clear and explicit objective. The Taskforce recommends that the overriding objective of securities legislation be to facilitate capital market activity – which means that it needs to work well for both issuers and investors.

This might seem a simple truism as healthy vibrant markets are the optimal basis for all capital raising and investment. The significance of the statement is demonstrated by the history of New Zealand’s securities laws and the Taskforce’s further observations. When introduced in 1978, the Securities Act was aimed at investor protection and reflected market failure theory and disclosure philosophy. Although investor protection always remained a main objective, it was later overshadowed by the national interest principle, the general deregulation movement and the application of public choice theory starting in the 1980s. The emphasis on private law enforcement (which could hardly be done by small investors) and the lack of a powerful market regulator led to a securities regulation regime that showed little emphasis on investor protection. The early 2000s four-step program took a step back and shifted the focus on investor protection again; for example, by implementing continuous disclosure obligations and providing more powers to the Securities Commission. The Taskforce followed this approach.

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10 Ibid 85.
11 Ibid 86.
12 Ibid 86.
13 Ibid 85.
15 See Andrew Simpson, ‘Public Choice Theory and Securities Regulation in New Zealand’ in Gordon Walker and Brent Fisse (eds), Securities Regulation in Australia and New Zealand (1st ed, 1994), 217.
16 See above 42-47.
Nevertheless, the Taskforce’s proposals also include a shift in policy. The Taskforce puts high emphasis on retail investors’ participation in public capital markets. This is remarkable as the interests of such persons have been neglected in the past. The Roche Report in 1991, for example, had expressly neglected the special needs of small investors. Their entrance to the capital markets was not seen as an objective for regulation; small and large investors should be treated likewise. The Taskforce’s acknowledges private investors’ preference for property investments and seeks to encourage them to participate in the capital markets. This coincides with the increased attention given to ‘customer’ protection in financial regulation in various jurisdictions. The Taskforce dedicates a whole chapter to the question of how legislation can achieve a higher level of information amongst retail investors. The first results of this new strategy appear in the recommendations given, all targeting badly informed retail investors:

- Reform of information disclosure: The existing disclosure documents should be replaced by a single two-part disclosure document, disclosure documents for particularly risky or complex investments should exhibit a warning label and a centralised information site for all disclosure documents should be established.

- Deepen (retail) investors’ knowledge: The quality of available investment literature should be improved and investing concepts added to school curriculums.

- Strengthen the regime for financial intermediaries: Disclosure obligations for fund managers and supervisors should be intensified and the use of the term ‘independent adviser’ restricted while imposing a fiduciary duty on those who use this title.

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21 Capital Markets Development Taskforce, above n 3, 30
22 Ibid 36.
23 Ibid 32-34.
24 Ibid 35.
(b) No Further Integration at All Costs

(i) Potential Dangers of Integration

As stated, New Zealand has open capital market settings and is especially well integrated with Australia and Southeast Asia, and to a lesser extent with other developed countries.25 A few months before *Capital Markets Matter* was released, the authors of the Prada/Walter Report had pointed out the general standpoint of practitioners on harmonisation with Australia in particular:

As a footnote, many people underlined the importance of staying aligned with Australia’s approach to market regulation when revising legislation and regulations. The trans-Tasman links between New Zealand’s banking systems and capital markets are significant. While it is necessary to develop approaches which are appropriate to New Zealand’s situation and needs, it is also important to maintain alignment … wherever possible.

In contrast, the Taskforce recommended that any further integration should be well thought through:

The rules and regulations developed in the United States, United Kingdom and, more recently, Australia set the overall tone for regulation in New Zealand. While many of the rules developed internationally may be appropriate for us, some will not be, and we will have to carefully consider the tradeoffs between developing something fit for purpose in New Zealand and adopting a regime that looks like those in other countries … We recommend that when pursuing international integration, the government should ensure that the net benefits are clear and the risk of unintended consequences minimal.26

In other words, the Government should keep an eye on international developments in securities regulation but restrain itself from adapting changes blindly. This represents a turning point in New Zealand’s securities regulation. For the first time, the risks of further integration were addressed. For years the influx of capital to New Zealand had been paramount. In the 1980s and 1990s, New Zealand had willingly embraced the international deregulation movement.27 Countries like Luxemburg had been seen as examples of small markets that became international financial hubs by lowering their regulatory barriers.28 In the 2000s, the approach changed. The Government sought to stimulate the influx of capital via a ‘race to the top’, becoming a strong supporter of the standards as set out by the IOSCO.29 However, in both periods the prevalent idea was congruent with international

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developments and New Zealand aimed for integration. The Taskforce’s recommendation is a clear counterpoint.

(ii) **Focus on Domestic Capital**

However, the Taskforce’s recommendation should not be mistaken for a call to protectionism. Its intention is rather to develop domestic capital as second cornerstone of the capital markets. This becomes clear when put in context with other considerations. The report’s introductory chapter states:

In addition, access to domestic capital is important. One of the lessons of the global financial crisis is that global markets can, and do, suffer unpredictable disruptions. Even in normal times, the evidence is that local markets matter for economic growth … While international capital markets can provide many of the services our economy requires, they will not provide them all … Taken together, these considerations argue for a focus on domestic capital market development as an integral part of our economic growth strategy.  

In Chapter 1 the Taskforce elaborates:

There is a widespread perception that most New Zealanders prefer to invest in property over capital markets. While there is a lack of comprehensive and up-to-date data on household wealth, it seems very likely that direct holdings of residential and commercial property for investment purposes exceed investments in public capital markets … These preferences are not surprising, given the poor behaviour and incompetence we have seen from some issuers and financial advisers, the limited options available to investors and the poor performance of some capital market products … It is critical for individuals’ wellbeing, and for the country as a whole, that our markets provide investors with better outcomes. We need to equip New Zealanders with the information and advice they need to make wise investment decisions, improve the quality of existing products and provide new opportunities to invest in high-quality products.

This reasoning complements the warning against further integration. The Taskforce suggested turning the focus towards local investors, and retail investors in particular. The recommendation had two aspects: first, broadening the scope of potential investors and second, (partly) immunizing New Zealand’s capital markets from global shockwaves. Thus, the new stance should not be understood as a new scepticism towards portfolio investment in New Zealand. The country’s national interest in capital influx surely persists. The focus on domestic investors should add a second, stabilising pillar to the country’s financial system.

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An ensuing question is how this approach fits into the processes of internationalisation in general and Trans-Tasman co-operation in particular. Remarkably, the international integration process championed by the IOSCO was not mentioned by the Taskforce at all. This absence in the final report is remarkable.

The role of the Trans-Tasman integration is perhaps even more interesting. In the chapters on financial intermediaries and market design Australia is mentioned a number times.31 The report refers to the Australian situation as an example of how the framework in New Zealand might be designed in the future. However, neither the 2006 MOU nor the Securities (Mutual Recognition of Securities Offerings-Australia) Regulations 2008 are mentioned. The Taskforce addresses the 2006 MOU indirectly only once, stating that as part of the single economic market, Australian investors, managed funds in particular, should be encouraged to invest in New Zealand.32 No further reference to the Trans-Tasman integration can be found. As stated,33 New Zealand’s securities regulation had been undergoing an ‘Australianisation’ for nearly a decade. It is possible that the Taskforce simply missed this aspect. This seems very odd. First, the Taskforce’s establishment (July 2008) coincided with the introduction of the mutual recognition regime (June 2008). The latter had been described by members of the Australian and the New Zealand Government as a ‘tremendous step forward’ and as a ‘key advance in the Single Economic Market agenda’.34 It is not likely that these events had escaped the attention of the Taskforce’s members. Second, the report’s chapter on tax reform emphasises the necessity of Trans-Tasman mutual recognition of imputation credits.35 Thus, the Taskforce must have had the Trans-Tasman co-operation in mind. Probably the omission of this key factor in New Zealand’s securities regulation was made intentionally. A plausible reason would be that the Taskforce saw the alignment with Australia’s securities laws, unless stated otherwise, as completed.

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31 Capital Markets Development Taskforce, above n 3, 32-33, 35, 45, 48, 59, 63.
32 Ibid 70-71.
33 See above 31.
The second major step in the reform of securities laws was the overhaul of the regulatory landscape. The Taskforce identified the shortcomings of enforcement practice and supervision as a major weakness of the current regime. The Taskforce committed itself to a strong model of market regulation. It stated:

We recommend greater emphasis on monitoring and enforcement capability and activity. In our view, rapid enforcement against market participants who breach ethical principles is critical to building confidence and participation in our capital markets...The roles of regulatory agencies, particularly concerning market conduct activities, should be comprehensively reviewed... New Zealand should move to a ‘twin-peaks’ model, with a market conduct regulator and a prudential regulator. In doing so, it will be important to ensure that the boundaries between the new market conduct regulator and the NZX and any separate Registrar of Companies’ functions are clearly delineated.36

This quotation envisages a strong market regulator with comprehensive powers and responsibilities. This is a major turning point in New Zealand’s securities regulation. Since the decline of the deregulation movement it has been widely held among commentators that supervisory capacity and the effectiveness of supervision should be the primary goal of any proposed regulatory reform.37 The importance of the regulators’ abilities and capacities are also reflected in IOSCO Principles Nos. 1-3 and 10-12. New Zealand’s securities laws had undergone large changes during the Four-Phase-Reform-Agenda, extending the Securities Commission’s enforcement powers, however, main issues such as underfunding and regulatory fragmentation had not seriously been tackled; a new regulatory structure had not been seen as necessary.38

In particular, the Taskforce suggested a consolidation of the Companies Office, the Securities Commission and the New Zealand Markets Disciplinary Tribunal into a market conduct regulator, with the Reserve Bank acting as prudential regulator (the so-called ‘twin peaks’ model).39 The new market conduct regulator would have the power to deem financial products to be securities where their substance resembles securities. The regulator’s activities would emphasize monitoring and it would play a more active role in the development of the securities regulation regime. Hence the new regulator should be

36 Ibid 85-86.
able issue a compendium of legal opinions (‘rule book’) and be given the authority to issue comfort and no action letters. The Taskforce suggested prioritising law enforcement, in particular visible enforcement to restore investor confidence. In the words of the Taskforce, ‘a gun-shy dog is useless for duck hunting’. The enforcement powers would include the right to seek civil remedies on behalf of investors and to initiate class actions.

B Legislative Responses to Reform New Zealand’s Capital Markets

1 Reform of Brokers and Financial Advisers Law

(a) Response to International Standard Setting

The report of the Taskforce did not only bring the Four-Phase-Reform-Agenda to a halt. The Taskforce’s work overlapped with the reform of the law on financial intermediaries. After the sobering assessment of New Zealand’s regulation of financial intermediaries by the IMF in 2003/2004, the Government established the ‘Taskforce on Financial Intermediaries’. Its final report ‘Confidence, Change and Opportunity’ was published in July 2005. It suggested stricter disclosure obligations, enhanced redress, sanctions and enforcement, and more transparent cost structures. The Government then started the ‘Review of Financial Products and Providers’ to develop an effective and consistent framework for the regulation of non-bank financial institutions. The aim was to create a registration and/or licensing regime. According to international best practice, only duly licensed or authorized persons should be permitted as market intermediaries. This concept stems from the IOSCO Principles that set out entry standards for financial intermediaries (see Principle No 29). Another factor was New Zealand’s membership of the Financial Action Task Force (the ‘FATF’), an inter-governmental body whose purpose

40 Ibid 85.
41 Ibid 88.
is the development and promotion of policies to combat money laundering and terrorist financing. The FATF has issued a total of 40 recommendations, with Principle No 23 stating that non-bank financial intermediaries should be licensed or registered and appropriately regulated.\textsuperscript{47}

After extensive industry consultations in 2006, two statutes were enacted in September 2008. Over the next two years these statutes were widely redesigned due to proposals made during the review conducted by the Capital Markets Development Taskforce. The final amendments passed Parliament in June 2010.

(b) Financial Service Providers (Registration and Dispute Resolution) Act 2008

The Financial Service Providers (Registration and Dispute Resolution) Act 2008 (the ‘FSP Act’) established a compulsory registration regime for financial service providers.\textsuperscript{48} Its purpose is to create a central register for offerors of financial services and thereby to prohibit ‘certain people’ from being involved in this industry: s 9(a)(b). The statute also mentions New Zealand’s obligation to comply with the FATF Recommendations: s 9 (c). The term ‘financial service provider’ is defined widely in s 5 and covers all kinds of financial advisers, brokers, banks, non-bank deposit takers, issuers of securities, trustees, insurers etc. Applicants for registration have to undergo a criminal conviction background check. According to s 14, those not eligible for registration are undischarged bankrupts, persons subject to a management banning order and persons who have been convicted of certain offences such as money laundering. The purpose of these limitations is obvious – notorious criminals and other wrongdoers should be barred from providing any financial services in New Zealand. Thus, the FSP Act establishes a minimum level of personal reliability in the industry. The second key aspect of the statute is mandatory membership of an approved dispute resolution scheme if the applicant is offering his service to retail investors: s 48.

The Registrar of Financial Service Providers is responsible for registration and enforcement under s 35. However, according to s 35(2) the person holding the office of the Registrar of Companies immediately before the commencement of the FSP Act is deemed

to have been appointed as the Registrar of Financial Service Providers. As a result, the Registrar of Companies is responsible for registration and enforcement under the FSP Act.

(c) Financial Advisers Act 2008

The Financial Advisers Act 2008 (the ‘FA Act’) provides for authorisation requirements for different kinds of financial advisers.\(^{49}\) Financial advisers are persons who provide financial adviser services: s 8 of the FA Act. According to s 9, a financial adviser service is performed if a person gives financial advice or provides a financial planning service or a discretionary investment management service. The statute distinguishes between Authorised Financial Advisers (‘AFA’) and registered advisers who do not require authorisation: s 16. Those eligible for authorisation are registered financial service providers with a good character who have the necessary skills: s 54. That means a potential authorised adviser might need to complete study courses before authorisation.\(^{50}\) Thus, the prerequisites to become an authorised adviser exceed the requirements of registration under the FSP Act.

A third type of adviser is the Qualifying Financial Entity Adviser who is employed with a Qualifying Financial Entity (‘QFE’): ss 16, 63. This basically catches all financial advisers who are employed in large finance companies. The regulatory approach is to achieve efficient regulation through a self-regulating QFE rather than by regulating its potentially numerous employees individually. QFEs have to be authorised: ss 64-67. They have an obligation to ensure that their employees and nominated representatives have the competence necessary to exercise reasonable care, diligence and skill in their financial advisory work.\(^{51}\) Brokers are also regulated under the FA Act. They are defined as intermediaries that receive, hold, pay or transfer client money or property as an intermediary: ss 77A-77B.

The FA Act introduces a tiered system of disclosure obligations for different kinds of advisers (ss 21-31) and brokers (ss 77E-77I) as well as conduct obligations such as duties


\(^{51}\) Walker, Pekmezovic and Fox, above n 49, 68.
of care, skill and diligence: ss 33, 77K. Before the creation of the FMA in May 2011, supervision and enforcement were conducted by the Commissioner for Financial Advisers, according to s 79 a member of the Securities Commission. The costs of the Securities Commission’s additional regulation activity were supposed to be covered by a levy to be paid by all financial advisers: s 153. However, due to the creation of the FMA the levy never came into force. The Commissioner appointed the Code Committee in September 2010 which drafted a Code of Conduct for financial advisers. After approval by the Minister of Commerce the Code came into force in December 2010.

It is interesting to have a closer look at the history of the amendments made to the FA Act in 2010. The original Financial Advisers Bill proposed a co-regulatory regime with the Securities Commission and industry bodies working together to create and monitor standards for financial advisers. The Securities Commission would have had general oversight while the industry bodies would act as front line regulators. The envisaged supervised self-regulation regime resembled the Securities Commission’s oversight over the NZX. It can be described as the light-handed approach to regulation that had been typical for New Zealand in the past. The impact of the Global Financial Crisis and the downfall of the financial companies triggered a much tighter authorisation regime in the FA Act and statutory conduct obligations.

(d) Trans-Tasman Integration

The law on financial intermediaries and on financial advisers in particular is a good example for the effects of the Trans-Tasman integration process. The Australian licensing regime for financial advisers was introduced in 2001 and came into force in 2002. It is set out in Ch 7 of the Corporations Act 2001 (Cth). The 2006 MOU addresses both countries’ laws on financial intermediaries in its work programme. In its final report the Taskforce on Financial Intermediaries paid much attention to the situation in Australia and took care to find a model closely aligned to the Australian Law. The following policy papers and the resulting Bill appear to have overlooked this alignment. As Walker and Pekmezovic

53 See Stace, above n 43, 509-10.
55 Walker and Pekmezovic, above n 44, 31.
state, it is a nice irony that the last minute changes made to the Financial Advisers Bill in 2010 moved the legislation much closer to the Australian regime again. The reasons can only be speculated upon, but it seems likely that the new agreement between Australia and New Zealand on the outcomes of the Single Economic Market have put the alignment of the two legal frameworks back on the map.

As soon as the FA Act and the FSP Act came into force on 1 July 2011, the newly established FMA issued the Financial Advisers (Australian Licensees) Exemption Notice 2011 which allows Australian licensees to offer financial adviser services in New Zealand by exempting them from key provisions of the FA Act. The exemption will remain in force until June 2013. Meanwhile long-term agreements for mutual recognition are being developed under the auspices of the TTOIG.

(e) Assessment

The new statutes have closed a gaping hole in New Zealand’s regulatory net. The registration regime of the FSP Act has the effect of an umbrella. The registration is a prerequisite for all further licenses required for offering specific financial services such as banking or giving financial advice. The level of protection provided by the registration regime might be rather low; its role is more of an identification system. However, it is an important first step towards a more proactive regulatory approach because, as Walker, Pekmezovic and Fox put it, ‘registration is the first step to compliance’. The more sophisticated authorisation regime for financial advisers adds a more substantive background check. This stricter approach is a renunciation of the light-handed self-regulatory regime favoured by New Zealand Governments for twenty years. The reforms of financial intermediaries’ laws are a harbinger of the coming overhaul of securities laws.

The duties of care, skill and diligence and the disclosure obligations resemble the regime for company directors under ss 137-140 of the Companies Act 1993. In combination, the FSP Act and the FA Act provide the opportunity for investors to sue financial advisers and brokers in cases of misconduct, while the regulators have the opportunity to revoke the

56 Ibid.
57 See above 29.
59 Walker, Pekmezovic and Fox, above n 48.
authorisation and eliminate the financial intermediary from the market. The ‘good character’ test provides the FMA with a flexible mechanism to refuse authorisation to dubious applicants rather than an inflexible test that merely relates to prior convictions. It did not take long before this mechanism was tested for the first time in court: A financial consultant applied to be licensed as an AFA. The FMA refused on the basis that the applicant had not disclosed that he had been convicted under the Building Act 2004 and therefore could not be seen as a person of good character. The District Court in Wellington confirmed the FMA’s decision.\footnote{Wood v Financial Markets Authority [2012] DCWN CIV-2011-085-954, 13 April 2012.} Harrop J took into account the purpose of the statute and confirmed that both the conviction itself and the failure to disclose it raised great concerns about the applicant’s character.\footnote{Ibid [69].} The decision indicates that the FMA will apply a strict understanding of the authorisation criteria.

However, the introduction of the two statutes cannot be described as a great leap forward. The new legislation merely lifted New Zealand’s regulation of financial intermediaries up to an internationally comparable level. The regulatory structure is a good example of the often criticised proliferation of regulatory bodies. Although financial service providers and financial advisers offer similar or even overlapping services, registration and enforcement were (prior to the creation of the FMA) administered by two different regulatory agencies (the Commissioner for Financial Advisers and the Registrar of Companies). Given that a financial adviser under the FA Act is concurrently a financial service provider under the FSP Act, this regulatory splitting seems odd. The Commissioner for Financial Advisers appeared to be a chimera. On the one hand, supervision and enforcement were not conducted by the Securities Commission, rather by the new Commissioner. On the other hand, the Commissioner was a member of the Securities Commission and thus integrated into the Securities Commission’s structure. This assignment of functions did not seem to follow a clear scheme.

Thus in summary, the reform of the law of financial service providers and financial advisers can be categorized as an intermediate step between the ‘old’ fragmented legal framework and the greater, more coherent reforms in 2011/2012.
(f) Further Reforms

In the wake of the downfall of the finance companies in 2006/2007, the New Zealand Government set in motion further reforms related to the capital markets. Since they are limited to particular issues they are only described briefly.

The ambit of prudential regulation was vastly extended. The *Reserve Bank of New Zealand Amendment Act 2008* extended the Reserve Bank’s prudential supervision to non-bank deposit takers while the *Non-Bank Deposit Takers Act 2011* introduced a respective licensing regime. A new, separate supervision regime for insurance companies was introduced by the *Insurance (Prudential Supervision) Act 2010*.

The *Securities Trustees and Statutory Supervisors Act 2011*, assented to in April 2011, established a licensing and enforcement regime for issuers of debt securities. The original Bill had been introduced into Parliament in December 2009 (at the same time as the Taskforce’s report was published) but was put on hold until the shape of the upcoming reforms became clearer. The Bill envisaged the Securities Commission as the authority in charge of the licensing regime. The Act shifted this duty to the FMA as the Securities Commission’s successor.\(^62\) The licensing regime will come into effect in October 2012.\(^63\)

However, even after all the aforementioned reforms New Zealand still lacked a distinct regime for collective investment schemes such as managed funds. If these schemes do not offer to the public, they only fall under entity-based regulation such as the *Companies Act 1993* or the *Unit Trusts Act 1960*. Such patchwork with widespread and overlapping responsibilities of distinct regulatory bodies had been criticised by the Taskforce.\(^64\)

\(^{62}\) For the structural regulatory changes made by the FMA Act, see below 67.
\(^{64}\) Capital Markets Development Taskforce, above n 3, 32-34, 42-45.
2 The Financial Markets Authority

(a) Introduction

The major overhaul of the legal framework commenced in early 2010. The Government reacted to one of the major recommendations of the Taskforce, the creation of a new market conduct regulator. After the Taskforce had released its report in December 2009, the MED quickly produced a Regulatory Impact Statement considering possible options, from intensified co-operation between existing regulators to a thorough consolidation, leading to the creation of a mega regulator. The ensuing Cabinet Paper issued by the Minister of Commerce favoured a wide, but not thorough consolidation and creation of a new agency. The proposal received Cabinet approval in April 2010. A second Cabinet Paper with additional policies was approved in September 2010. These legislative documents indicated the general thrust of the reforms. The overarching objective was to restore confidence in New Zealand’s financial markets. As the Minister of Commerce, Simon Power, put it in 2011, the Government wanted to restore ‘mum and dad investor confidence’. In particular, the documents identified the former lack of proactive enforcement as critical and expressed the Government’s explicit wish for the new regulator to act in a more proactive fashion.

On 28 April 2010, the Minister of Commerce announced the creation of a ‘super-regulator’ for the financial markets. On 14 September 2010, the respective Financial Markets (Regulators and KiwiSaver) Bill 2010 (211-1) was introduced into Parliament. The Bill was examined by the Commerce Committee which made some substantial amendments. The resultant Financial Markets Authority Act 2011 (the ‘FMA Act’) was passed by Parliament on 7 April 2011 and came into effect on 1 May 2011. The result was the

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69 Ministry of Economic Development, above n 66, 8-9; Minister of Commerce, above n 67, 1-5.
71 Ministry of Economic Development, above n 66, 9-10, 12.
72 Minister of Commerce, above n 67, 4.
74 Financial Markets (Regulators and KiwiSaver) Bill 2010 (211-2) as reported by the Commerce Committee.
creation of the FMA. The key concepts behind this new agency will now be considered in more detail.

(b) Structure

The FMA consolidated several previously independent regulators under one roof. It took over the Securities Commission’s function as the main market conduct regulator in New Zealand; Schedule 4 and s 84 of the FMA Act provide for the replacement of ‘Commission’ and ‘Securities Commission’ by ‘FMA’ in all relevant statutes on financial markets law. The Securities Commission staff members were transferred to the FMA. Thus, the new regulator is not an entirely new creation that started from scratch. It is rather a continuation of the Securities Commission that took over all its functions under several statutes.

In addition, other regulatory bodies were merged into the FMA. The Commissioner for Financial Advisers’ role was taken over: see Schedule 3 of the FMA Act. The Government Actuary (the ‘GA’) was disestablished and replaced by the FMA under s 85 and Schedule 4 of the FMA Act. In addition, the Insurance and Superannuation Unit of the MED was transferred to the FMA.

This sounds like a landslide of the regulatory landscape. However, a closer look shows that the overhaul was not as big as it appears. The Commissioner for Financial Advisers had already been a part of the Securities Commission under s 79 of the FA Act. The FMA’s structure is built on the Securities Commission’s staff members and organization. The only real consolidation was the disestablishment of the GA. The transfer of MED’s Insurance and Superannuation Unit is a necessary side action as the GA had been housed within the MED and drew on the Unit’s support. Hence, the new FMA appears more like a relabelled Securities Commission given additional responsibility for superannuation and KiwiSaver schemes. This is reflected by funding. The Securities Commission had total annual income of NZ$ 14.36 million in 2010, while the overall funding for all the regulators that were replaced by the FMA was about NZ$ 18 million. Hence around 80 per cent of the FMA’s structure is actually made up by the old Securities Commission, and 20 per cent by the GA and the MED. The new responsibilities under the FA Act, namely the authorisation of

financial advisers, would lead to a significant increase of the regulator’s workload. However, this would also have occurred in respect of the old Securities Commission. It therefore cannot be taken as an indicator for a severe restructuring of regulatory bodies.

The question is why this moderate increase in size has led to the disestablishment of the Securities Commission. The Regulatory Impact Statement produced by the Government to outline the shape of the reform had considered four models: 77

1. keeping the structure and intensify co-operation between regulators, or
2. merging functions into an existing body (i.e. the Securities Commission), or
3. creating a new, consolidated conduct regulator, or
4. creating a fully integrated regulator in charge of market conduct and prudential regulation.

In the following Cabinet Paper, the Minister of Commerce opted for the third model. 78 However, the Minister conceded that there is only little difference between the second and the third model. 79 Thus, it can be assumed that it would have been possible to retain the Securities Commission instead of creating a new agency (which induces transitional costs). Nehme suggests that the creation of a new single regulator aimed to ‘allow the regulator to adopt and develop a new culture focused on market supervision and enforcement’. 80 If we consider that the FMA is more of a re-labelled Securities Commission, it does not seem convincing that such a rebranding leads to a new culture. It is likely that improved supervision and enforcement powers in combination with a higher level of funding would be more efficient in creating the desired culture within the regulator.

The reason for the creation of the FMA appears to be psychological. The aforementioned Cabinet Paper states that the creation of a new agency ‘sends a clear signal to both market participants and the regulator that Government is looking for a different approach than currently taken by regulators. It also provides an opportunity to appoint a new Board.’ 81 This remark is not surprising since the Securities Commission was widely blamed for the downfall of the finance companies. 82

77 Ministry of Economic Development, above n 66, 18-22.
78 Office of the Minister of Commerce, see above 67, 6-8.
79 Ibid.
81 Office of the Minister of Commerce, see above 67, 8.
82 See above 26.
Investor behaviour and market confidence do not necessarily follow rational patterns. New Zealand’s capital markets were suffering from the combined impact of the GFC and the collapse of the finance industry. In such a critical situation it is understandable that a Government draws a clear line that from a rational point of view is not necessary. The comment on the establishment of a new Board fits into this scheme. In addition, it might suggest that the Government had lost confidence in the Securities Commission’s executive staff. This coincides with the fact that the new CEO, Sean Hughes, axed eight members of the leadership team that he had inherited from the Securities Commission. The reason was that, according to Hughes, ‘the roles of his leadership team would be vastly different’. At the same time, the new FMA Board comprises three former members of the Securities Commission. Hence it seems that the personal reshuffle was primarily aiming for new chief executives.

The first conclusion of this analysis is therefore that the purported overhaul of financial markets laws is not reflected by the FMA’s organisational structure. The new name and chief executive staff are supposed to demonstrate a clean cut between the old and the new regulator. However, the fact that the FMA is regularly referred to as the ‘single’ market conduct regulator suggests that future extensions of the regulatory net will be regulated under the auspices of the FMA and not in separate agencies. To that end, the creation of the FMA is not a regulatory landslide, but the beginning of a more coherent regulatory structure.

(c) Functions

Like the Securities Commission, the FMA is an independent Crown Entity under the Crown Entities Act 2004: s 7 of the FMA Act. However, although this status appears to be a continuation of the status quo, it results in a higher level of regulatory independence. As shown above, some branches of the MED were merged into the new FMA. Although the Securities Commission had been a fully independent body, the Government Actuary and the Insurance and Superannuation Unit were not formally independent, but part of the Government. The same applies to the Registrar of Companies. According to the IOSCO

Principle No 2, the ‘regulator should be operationally independent’. Without such independence market participants may doubt the regulator’s objectivity and fairness, with negative effects on the market’s integrity. In its assessment of New Zealand’s securities laws, the IMF identified the fact that the Minister of Commerce can influence some of the Registrar’s decisions as a weakness in the system. This flaw, however, was not considered serious because the Minister’s role was rather limited, and the Registrar was supposed to be independent in his decision making. The fact that the regulation of KiwiSaver schemes is now located within a fully independent regulator is nevertheless an improvement of the regulatory structure.

The FMA comprises between five and nine members and is able to act in divisions of three members: ss 10, 14. In addition, the Minister of Commerce is able to appoint up to five associate members for specified matters: s 12. This enables the FMA to deal with special requirements arising from its functions or to build up expertise in particular areas.

A major change is the change of the FMA’s top management. Unlike in the Securities Commission, the FMA’s Chair is non-executive. Instead, a new Chief Executive Officer is installed. This suggestion was raised in the Prada/Walter Report in 2009. The reason was that the old structure with an Executive Chair was designed for a small body with only 22 staff members. With staff numbers increasing, and together with the Chairs strong involvement in the IOSCO Board, market participants were afraid of a growing inability of the Securities Commission’s top management to make quick decisions if necessary. The FMA’s Board is chaired by Simon Allen, the former Chair of NZX Limited. Sean Hughes, a former executive of the Australian ASIC, was appointed as the FMA’s Chief Executive.

The FMA’s main objective ‘is to promote and facilitate the development of fair, efficient, and transparent financial markets’: s 8. This objective addresses the Taskforce’s

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85 IOSCO, above n 46.
86 IOSCO, above n 45, 26.
90 Ibid 25.
recommendation regarding the facilitation of capital markets activity as the overarching principle of securities regulation.\textsuperscript{93}

The FMA will monitor compliance and conduct investigations concerning all financial market legislation as set out in Schedule 1, Part 1: s 9. Its monitoring role will cover other statutes as far as they relate to financial markets. The FMA’s jurisdiction will extend to all ‘financial markets participants’. The original Bill had defined a financial market participant as a financial service provider in accordance with the definition of that term in the FSP Act. The House of Representatives Commerce Committee (the ‘Commerce Committee’) broadened the scope of the definition to any person who is or is required to be registered, licensed, appointed or authorised under any of the Acts set out in Schedule 1, Part 1. Hence, the term now covers all issuers in terms of s 2D of the Securities Act, s 2(1) of the Securities Markets Act and s 4 of the \textit{Financial Reporting Act 1993} as well as trustees, supervisors, managers, experts and qualified auditors within the meaning of s 2 of the Securities Act.

The FMA’s further functions resemble the Securities Commission’s functions, including the promotion of informed participation in the markets, which includes issuing reports, warnings and guidelines, and keeping the relevant law and practices under review. An active role in financial markets education as envisaged by the original Bill was discarded by the Committee in favour of a supplementary role to the work of the Retirement Commissioner as the principal educational body.\textsuperscript{94}

\textit{(d) New Powers}

Like the Securities Commission, the FMA will be able to, inter alia, request information (s 25), make confidentiality orders (s 42), accept enforceable undertakings (s 44) and cooperate with overseas regulators: ss 30-32. The regulator will also have new and more comprehensive powers. These are now discussed briefly.

\textsuperscript{93} Capital Markets Development Taskforce, above n 3, 85.
\textsuperscript{94} Commentary, Financial Markets (Regulators and KiwiSaver) Bill 2010 (211-2) as reported by the Commerce Committee 2.
(i) **Information Gathering**

The FMA itself may, or may authorise a specified person to, enter and search premises, subject to a search warrant: s 29. The Committee extended the new power to ‘vehicles’ and ‘other things’, meaning intangible things such as email addresses and internet data storage facilities. This provision was made because financial information is usually stored in computer files and aligns the FMA’s power to the changes envisaged by the Search and Surveillance Bill 2009.\(^95\) This new power is a great step forward because the FMA does not need to rely on the Registrar of Companies under Part 3 of the Securities Act anymore.

(ii) **Warnings**

One of the FMA’s functions will be to issue warnings on any matter relating to financial markets. This is not an overly new feature since the Securities Commission had a general, wide power to comment and conduct investigations as clarified in *City Realities Limited*.\(^96\) However, the power to issue warnings was extended and backed up with penalty provisions: The FMA is able to order issuers to place any such warning prominently on their websites and any offer document: s 49. Failure to comply with such an order is an offence punishable with a fine of up to NZ$ 300,000: s 51. The FMA has to give public notice about the reasons and the terms and conditions of the warning: s 50. The extended warning power is another step towards a more proactive approach to regulation. The warning power was used for the first time on 2 May 2011 – only one day after the creation of the FMA.\(^97\)

A similar new power was introduced into the Securities Markets Act. The Committee amended provisions to tackle unsolicited (‘low-ball’) offers that became an issue after the original Bill was introduced in September 2010.\(^98\) For this purpose, a new regulation-making power was introduced: ss 48DA-48DC of the Securities Markets Act. The new regulation may require offers to disclose the current market price or an estimate of the

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\(^95\) Ibid 3.

\(^96\) *City Realities Limited v The Securities Commission* [1982] 1 NZLR 74.


value of a security. The FMA will have the power to make ‘unsolicited offer orders’ according to s 42EA, eg by restraining persons from acquiring securities.

(iii) Power to Exercise an Investor’s Right of Action

Probably the most contentious new power relates to the enforcement of financial markets law: s 34 of the FMA Act. The FMA will have the discretionary right to commence or take over civil proceedings on behalf of investors against financial markets participants. It can only exercise this power in cases of public interest: s 34(5). Section 34(2b) explicitly addresses claims seeking damages or other relief for fraud, negligence, default and breaches of duty. Given that the FMA’s jurisdiction will cover directors and senior managers of financial markets participants, the right to commence civil proceedings on behalf of investors opens the door for public enforcement of directors’ and financial advisers’ duties in respect of the financial markets.

The urgency of the matter is demonstrated by the legislative process. Originally, the Government had not prioritised the introduction of the new power. The discussion document on the review of the securities laws issued in June 2010 addressed its introduction and requested feedback from market participants. However, after receiving submissions on the proposal, the Government decided not to wait and produced a separate Regulatory Impact Statement on the exercise of an investor’s right of action. The documents show that the FMA Establishment Board had suggested introducing the power as soon as possible. The Government decided that in order to restore confidence in the markets as soon as possible, the introduction should not be delayed until the review of securities laws was completed. Although it is not mentioned explicitly, this had a convenient side effect. The new power allows the FMA to bring civil proceedings against the directors of the failed finance companies. This is clarified by s 43 which states that the power can be exercised regardless of whether the relevant claim accrued before or after the commencement of s 34.

99 Commerce Committee, above n 74, 9.
100 For a more detailed discussion see below 187-195.
103 Ibid 1.
104 Office of the Minister of Commerce, above n 68, 3-5.
(iv) No Class Actions

The Taskforce had also recommended introducing a power to initiate class actions.\textsuperscript{105} The FMA Act contains no such power. However, if the FMA commences or takes over proceedings under s 34 of the FMA Act for one or more persons, the High Court may appoint the FMA to represent other persons having the same or a substantially similar interest (s 39). Although similar to a class action, this mechanism is not a joint action of investors, but the regulator acting on behalf of a group of investors. The Government wanted to postpone the introduction of a class action regime until the review of securities laws was completed,\textsuperscript{106} or as part of a separate general class action Bill.\textsuperscript{107} However, as at August 2012, neither of these has occurred.

(e) Funding the FMA

(i) Additional Funding

As a result of the extended function and duties of the FMA, an increase of the agency’s funding seems inevitable. Given that under-resourcing the regulator is and has always been one of the main problems of New Zealand’s securities regulation,\textsuperscript{108} the increase needs to be significant. As a comparison, the Securities Commission’s budget skyrocketed from NZ$ 8.9 million for 2009\textsuperscript{109} to NZ$ 14.36 million in 2010.\textsuperscript{110} The increased budget was the result of its additional responsibilities under the FA Act. Nevertheless, the Commission’s annual report revealed a net operating deficit of NZ$ 384,000 in 2011 after a deficit of NZ$ 320,000 in 2010\textsuperscript{111} and 280,000 in 2009.\textsuperscript{112}

It can be expected that the FMA will be assigned with additional duties as soon as the review and rewrite of securities laws have been completed. The House of Representatives’ report on the downfall of New Zealand’s finance companies states that a lot will be

\textsuperscript{105} Capital Markets Development Taskforce, above n 3, 88.
\textsuperscript{106} Ministry of Economic Development, above n 102.
\textsuperscript{107} Commentary, Financial Markets (Regulators and Kiwi Saver) Bill 2010 (211-2) as reported by the Commerce Committee 3.
\textsuperscript{108} See above 47.
\textsuperscript{110} Securities Commission, above n 75.
\textsuperscript{111} Ibid.
\textsuperscript{112} Securities Commission, above n 48, 34.
expected of the FMA, and that ‘continued commitment to its funding will be needed for the authority to realise its full promise’.  

The Chair of the FMA Establishment Board, Simon Botherway, was of the opinion that doubling the Securities Commission’s budget to about NZ$ 30 million would be appropriate to deal with the FMA’s new tasks properly. The Government seems to be committed to tackle the problem. In April 2011, it announced that the FMA’s budget for 2011/2012 will be NZ$ 24 million, growing to NZ$ 28 million to reflect transition costs, and hitting NZ$ 26 million in 2014/2015. In contrast, the Securities Commission’s budget for 2010 was about NZ$ 14.6 million, while the total budget of all regulators that were replaced by the FMA was about NZ$ 18 million. This increase of 44 per cent is of course significant. However, given the increasing workload and Mr. Botherway’s high expectations of the FMA and its funding, the increase appears relatively small.

(ii) Funding via FMA Levy

One of the most interesting new features of the FMA is the new levy on financial markets participants (s 68). The levy covers the additional costs of the FMA’s broadened jurisdiction, while the Crown funding remains at the same level as the amount allocated to the Securities Commission in 2011. This means that the Government is not willing to spend more money on the regulation of the financial markets than it did in past. The argument given by the Government is that anybody who benefits from the FMA’s work should make a financial contribution. Finding a right structure for the levy, and – in a second step – the right rates, is a delicate decision. If the rates are too high, or if a market participant is required to pay several levies, the regulated entity might see the whole

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114 Interest.co.nz, ‘Simon Botherways says new regulator needs twice Securities Commission’s budget to boost confidence’ (27 October 2010) <www.interest.co.nz>.
115 While the Securities Commission’s budget was set out for calendar years, the FMA’s budget will be set out in financial years. This results from the fact that the FMA was created in May 2011 and thus in the middle of the calendar year.
117 Securities Commission, above n 75.
119 Commentary, Financial Markets (Regulators and Kiwisaver) Bill 2010 (211-2) as reported by the Commerce Committee 6.
regulatory regime as burdensome and may start to resent the regulator.\textsuperscript{120} A particularly high levy might also discourage the participation in New Zealand’s financial markets.

The general idea of having market participants contributing to the regulator’s funding is not new. Scandinavian countries established the mechanism of co-funding the regulator via a levy when they established integrated regulators in the 1990s.\textsuperscript{121} The Financial Services Authority in the United Kingdom is completely funded by market participants, the funding being collected via fees and levies.\textsuperscript{122}

\textit{(iii) Consultation Process}

The FMA Act consolidated the imposition of levies by repealing s 153 of the FA Act and discarding a similar provision in the Securities Trustees and Statutory Supervisors Bill. The amount of the levy and the market participants subject to the levy is prescribed by regulation. In June 2011, the MED released a discussion document that set out a total of four different options for the funding of the FMA.\textsuperscript{123} These models differed in terms the amount of levies (separate levies for financial advisers and for entities regulated by the FMA in general, or a uniform levy) and as how the levy should be imposed (entity based, or according to the market participant’s involvement in the financial markets). The option favoured by the MED envisaged a levy of NZ$ 910,- payable by all financial service providers under the FSP Act and all issuers who are required to file financial statements under the Financial Reporting Act 1993.\textsuperscript{124}

The following consultation process is quite remarkable. Stakeholders filed 278 written submissions.\textsuperscript{125} No submission supported the MED’s preferred option. The submissions especially criticised that the levy would disadvantage smaller service providers and result

\textsuperscript{120} See Nehme, above n 80, 487 with further references.
\textsuperscript{122} United Kingdom, Financial Services Authority, Annual Report 2011/2012 (June 2012) 86 <www.fsa.gov.uk>.
\textsuperscript{124} Ibid 11.
\textsuperscript{125} New Zealand, Office of the Minister of Commerce, Fees and Levies for the Financial Markets Authority, the New Zealand Companies Office, and the External Reporting Board (Cabinet Paper, June 2012) 4 <www.med.govt.nz>.
in significant over- and double-charging. The MED discarded all four options, started a ‘targeted’ consultation on a revised levy proposal in November 2011 and released an exposure draft of the levy to a ‘small number of selected stakeholders’.  

(iv) Levy Structure

In June 2012, a final Cabinet Paper outlined the structure of the levy to the public. The levy would comprise 12 different classes that relate to the participation in a particular area in the financial markets, for example (1) registered financial service providers in general, (2) banks, (3) insurances, (4) licensed trustees and statutory supervisors, (5) issuers of specified managed funds, (6) FSPs offering broking services and authorised financial advisers, etc. Most of these different classes are subdivided into subclasses, according to the financial market participant’s size. Thus the amount of levies imposed on the participant depends on its size and its level of participation in the markets.

The respective Financial Markets Authority (Levies) Regulations 2012 came into force on 1 August 2012. The aim is to collect NZ$ 16.4 million per annum. The Government conceded that it lacked robust information about financial market participants. It was difficult to make precise estimates of the exact revenue that will be raised through the levy. The Government plans to review the levy in 2014.

(f) Changes of Securities Laws

(i) Changes to the Securities Act 1978

The Securities Amendment Act 2011 came into effect in stages beginning 1 May 2011. It will be in full force on 1 July 2013. Part 1 (‘Securities Commission’) and Part 3 (‘General Investigation and Enforcement Powers’) of the Securities Act have been replaced by Part 1 of the FMA Act (which establishes the FMA) and Part 3 of the FMA Act (‘General Information-Gathering and Enforcement Powers’). The role of the Registrar of Companies in registering prospectuses is redefined. While the Registrar is still in charge of the formal

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126 Ibid.
127 Ibid 5.
129 Ibid 1.
130 Ibid 6.
131 Ibid.
registration process, the FMA needs to consider whether prospectuses are misleading or false, and contain all required information: s 43F of the Securities Act. The Registrar has to notify the FMA of any registration or trust deed: s 43C. The FMA has five days (or longer when giving written notice) to assess the prospectus and, if required, issue a stop order. If the FMA is of the opinion that the prospectus does not comply with the Securities Act it may prohibit the allotment of securities and cancel the registration of prospectuses at any time. In addition, the FMA will be able at any time to prohibit the distribution of investment statements that are considered misleading, unclear or incoherent with any registered prospectus: s 43F. The additional duty of reviewing prospectuses further demonstrates the consolidation of powers with the FMA. However, it has to be noted that the Registrar is still in charge of registration and the review of prospectuses is now required to be undertaken of two regulatory bodies instead of one.

A new ‘register of securities offers’ will be established at the Registrar of Companies’ office: s 43N. The idea underlying this register as proposed by the Taskforce is that any interested person should be able to have access to information contained in prospectuses or other documents that might be relevant to investors: s 43O.132 The register will contain all relevant information including names of issuers and copies of all relevant documents.

(ii) Changes to the Securities Markets Act 1988

The Securities Markets Act has undergone wide changes as a result of the Commerce Committee’s review as reflected in the Securities Markets Amendment Act 2011. Some minor changes aim for harmonisation with overseas exchanges; others are of a more substantive nature. The approval of rules for registered exchanges will shift from the Minister to the FMA (ss 36FA-36L). The registered exchanges continue to enforce their own listing rules. The proposed creation of a statutory Ruling Panel to replace NZX New Zealand Markets Disciplinary Tribunal was discarded by the Committee as unnecessary ‘at this stage’ (a reference to the review of securities law).133 In turn, the new s 36Y of the Securities Markets Act aims to ensure that the exchange’s adjudicative body will be sufficiently independent. The original FMA Bill (211-1) had envisaged market integrity regulations for registered exchanges to have been made by Order in Council and enforced

132 Capital Markets Development Taskforce, above n 3, 30.
133 Commentary, Financial Markets (Regulators and KiwiSaver) Bill 2010 (211-2) as reported by the Commerce Committee 9.
by the FMA. These regulations would have overridden market rules in cases of inconsistency. However, this clause was deleted by the Commerce Committee.

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The Financial Markets Conduct Bill

As stated, the FMA Act fast-tracked the creation of a new regulator. The overhaul of securities laws was considered more complex and time consuming. The review started in June 2010 when the MED issued a discussion paper. In February and May 2011, two Cabinet Papers were released, setting out the main policies that took into account the submissions made during the consultation process. In August 2011, the MED released an exposure draft of the envisaged Bill (the ‘Exposure Draft Bill’) for consultation and requested submissions until 6 September. The final Financial Markets Conduct Bill 2011 (342-1) (the ‘FMC Bill’) was introduced into Parliament on 12 October 2011.

The goal of the FMC Bill is ambitious. It envisages a ‘one-stop-shop’ for all financial markets law, replacing the Securities Act, the Securities Markets Act, the Unit Trusts Act 1960, the Superannuation Schemes Act 1989 and the Securities Transfer Act 1991. In addition, a total of 14 regulations related to the aforementioned statutes would be revoked. The FMC Bill does not only rewrite the laws on financial products and services, it would also grant new powers to the FMA. In this way, the FMC Bill rounds off the FMA Act and the powers conveyed to the FMA.

The whole document contains a total of 619 pages, containing 713 clauses and four Schedules. It is a leviathan of a size that has never been seen in New Zealand’s business laws before. The Minister of Commerce called it a ‘once-in-a-lifetime re-write of securities laws’. Given that the legislation on financial advisers as well as the FMA Bill underwent

significant changes in the parliamentary process, it is a fair guess that the FMC Bill will suffer the same fate. For this reason it is unclear when the legislation will finally be passed. An optimistic estimate for the enactment would be early 2013.

(a) Structure

Part 1 of the FMC Bill provides for definitions and sets out the main objectives. Part 2 provides for prohibitions against misleading representations or conduct in connection with dealings in financial products. These provisions are based on equivalent provisions in the *Fair Trading Act 1986*. They would be predominantly enforced by the FMA and not by the Commerce Commission which enforces the fair trading laws.\(^\text{139}\) Here, we see a first result of the consolidation process. The creation of new regulation neither leads to the creation of a new regulatory body nor to a separate, existing regulator put in charge of supervision. Rather, the new law would be subject to the FMA’s authority as the main conduct regulator. Part 3 provides for the new system of public offerings and disclosure obligations. Part 4 houses various requirements for the governance of financial products and services. Parts of the Securities Markets Act are transferred into Part 5 of the FMC Bill which also contains a revised regime for securities exchanges. Part 6 provides for the licensing of certain market services, while Part 7 sets out the enforcement and liability regime. Part 8 sets out regulation making and exemption powers, while Part 9 houses repeal and transitional provisions.

(b) General Provisions

The main purposes are set out in cl 3. The envisaged Act would promote the confident and informed participation of businesses, investors, and consumers in the financial markets, and promote and facilitate the development of fair, efficient, and transparent financial markets. The definition is congruent to the FMA’s objectives as set out in ss 8-9 of the FMA Act and reiterates the overarching principles of financial markets law.

The central definition of the FMC Bill is the ‘financial product’ as set out in cl 7. Financial products include debt securities, equity securities, managed investment products and derivates. Further details are given in cl 8. This definition complements the ‘financial

\(^{139}\) Explanatory Note, Financial Markets Conduct Bill 2011 (342-1) 3-4.
markets participant’ and the ‘financial markets legislation’ (s 4 of the FMA Act) as key definitions of the financial markets law. It would replace the term ‘security’ that was vital to the old legislation.

According to the explanatory note of the FMC Bill, the categorization of financial products should focus on the economic substance of the respective investment, not just its legal form.\textsuperscript{140} Duties and obligations imposed on a particular financial markets participant would depend on the classification of the financial product. For this reason, the FMA will be given the power to designate products to be financial products of a certain class or move financial products from one category to another under cl 533 of the FMC Bill. This shows that the new financial markets laws would give a much more active role to the FMA than the old legislation.

\textbf{(c) Product Disclosure Statement and Disclosure Obligations}

The new disclosure regime exhibits some of the FMC Bill’s most significant innovations. The old system of ‘offers to the public’ would be discarded and replaced by a system that is closely modelled on Part 6D of the \textit{Corporations Act 2001} (Cth). According to cl 37 an offer of financial products for issue would require disclosure to an investor unless an exception applies. The FMA may declare an offer to require disclosure even if the offer falls under an exception: cl 533(1)(d). The additional rules for the sale of issues and the FMA’s power under cl 533 would, given that the FMA has the resources to assess offers if required, make it difficult to design investment offers that could not be caught by the disclosure regime.

The two-tiered information disclosure system would also be abolished. Instead, a sole Product Disclosure Statement (‘PDS’) would be required to be issued in respect of all regulated offers. This concept draws on the Taskforce’s final report. The Taskforce had envisaged a two-part disclosure document, the first part consisting of one or two standardized pages that make comparison between products easier and a second, more detailed part.\textsuperscript{141} According to cl 36, the purpose of a PDS is ‘to provide certain information that is likely to assist a prudent but non-expert person to decide whether or not to acquire

\textsuperscript{140} Ibid 48.
\textsuperscript{141} Capital Markets Development Taskforce, above n 3, 30-31.
the financial products.’ The shape and content of the PDS would be prescribed by regulations.

The new disclosure system is another step in the ongoing harmonization of Australia’s and New Zealand’s commercial laws. The FMC Bill imitates the Australian disclosure regime, discarding the old ‘offer to the public’ test and even using the name of the disclosure document for financial products under Part 7.9 of the Corporations Act 2001 (Cth), while cl 12 of Schedule 1 of the FMC Bill strongly resembles the definitions for small offers that are exempt from disclosure under s 708(1) of the Corporations Act 2001 (Cth). The difference is that the New Zealand version of the PDS would be the sole disclosure document for all kinds of securities whereas the Australian PDS only applies to financial products and expressly not to securities: s 1010A of the Corporations Act 2001 (Cth).

(d) New Licensing Regimes

Another recommendation of the Taskforce was the modernization and consolidation of the regime for managed investment schemes.\textsuperscript{142} Subpart 3 of Part 4 of the FMC Bill requires the registration of regulated offers made by managed investment schemes. Part 6 of the Bill provides for a licensing regime in respect of providers of particular market services. Licences would be necessary for managers of registered schemes, trustees of restricted schemes, providers of discretionary investment management services (‘DIMS’), and derivatives dealers: cl 387. The licence would be granted by the FMA to applicants who are ‘fit and proper’ to hold the licence and comply with all further requirements prescribed in regulations: cl 394. The envisaged licensing regime would apply to various financial markets participants who were previously unregulated. This would imply a larger workload for the FMA and necessitates a higher level of funding. The new licensing regime would continue the tougher approach taken by the FA Act and is a good example for the proactive approach of the new financial markets laws.

In its final report, the Taskforce had further recommended the development of ‘stepping stone’ exchanges for smaller companies.\textsuperscript{143} These exchanges would have a lighter regulatory burden than the NZX (for example without the requirement of continuous disclosure). Wholesale markets and financial product markets with fewer than 100

\textsuperscript{142} Ibid 32-33.
\textsuperscript{143} Ibid 17.
transactions a year or a total value of transactions below $NZ 2 million would be exempt: cl 310. In any case, licensed markets must to a reasonable extent provide for fair, orderly and transparent markets: cl 312. However, the Bill does not envisage the creation of an independent statutory body to deal with breaches of the listing rules. It carries forward the changes made to the FMA Bill in 2011,\footnote{See above 79.} obligating the financial product market to have an internal ‘sufficiently independent adjudicative body to adjudicate on contravention of market rules’: cl 312(b)(iv).

(e) Enforcement

The Bill provides for a new regime of enforcement and liability.\footnote{For a more detailed discussion of the new enforcement and liability regimes, see below 178-187.} Under the old regime the respective provisions were scattered over a number of statutes, resulting in an unclear legal framework. The Bill provides for a consolidation of the relevant provisions in Part 7. The civil remedy regime is largely based upon the Securities Markets Act. The main forum for enforcement is the High Court. It can make civil pecuniary orders, compensatory orders and declarations of contraventions: cl 466.

Perhaps the most remarkable new feature is the infringement notice under Subpart 5. For the first time, the New Zealand conduct regulator would be able to enforce the financial markets law on its own without participation of the Courts. The scope of infringement notices would be limited to insignificant breaches of the Bill, such as not supplying the Registrar with all required documents (cl 47) or offering financial products before the prescribed waiting period is over (cl 49). In addition, the infringement fee is limited to NZ$ 20,000 (or NZ$ 50,000 if dealt with in summary proceedings). However, the new regime would be a first step towards an independent regulator that is able to react to breaches of the financial markets law swiftly and independently.
(f) Summary

The FMC Bill is much too voluminous to be considered in detail here. However, the general approach to regulation appears obvious. First, the regulatory net is extended. New registration and licensing regimes would be introduced. Second, the FMA’s enforcement powers would be further extended. Third, the new areas of regulation would be supervised and enforced by the FMA. Thus, the FMC Bill carries forward the approach of a robust financial markets regime regulated by a single market conduct agency and completes the overhaul of financial markets law.

4 Analysis

At first glance, the New Zealand Government has closely followed the Taskforce’s recommendations. The FMA Act and the FMC Bill set in motion the two steps that the Taskforce considered necessary for the reform of New Zealand’s financial markets laws.

The creation of the FMA was intended to establish a consolidated regulator with comprehensive powers to deal with all matters arising in New Zealand’s financial markets effectively. Prima facie, the new FMA and the upcoming reform of substantive law are a great leap forward for New Zealand’s financial markets. The new statute and the upcoming FMC Bill seem to have addressed all three major shortcomings in the regulatory system – the fragmented regulatory structure, the lack of investigation and enforcement powers and inadequate funding. However, even vast improvements to a flawed system would not result in an effective system of financial markets supervision. In the result, the overarching question is: has the creation of the FMA established a regulatory agency that is able to supervise New Zealand’s financial markets effectively?

There are indicators that provide some doubts. The first major issue is the regulatory landscape and the underlying legal framework. Effectiveness is measured by whether a regulatory system achieves its objectives. Key to effective regulation is a comprehensive institutional framework with clear objectives that avoids regulatory gaps and overlaps and allows the consistent application of the substantive law. Although the FMA’s mandate is quite broad, several tasks in the regulation of New Zealand’s financial markets will still

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be assigned to other regulatory agencies such as the Registrar of Companies, the Takeovers Panel, the Reserve Bank, NZX, the Commerce Commission and the Serious Fraud Office. Thus, it is unclear if New Zealand now has a market conduct regulator with a clear and comprehensive mandate, and without unnecessary gaps and overlaps. These issues will be discussed in Chapter 4. As the creation of the FMA has not led to a full integration of regulators it is questionable whether there will be a clear demarcation between the regulators’ responsibilities and how potential conflicts could be resolved. This will be discussed in Chapter 5.

One of the lessons learned after the Global Financial Crisis and the downfall of the New Zealand finance companies is that the regulator must have comprehensive enforcement powers.\textsuperscript{148} The FMA has been provided with several new powers that the old Securities Commission did not possess. However, the new powers have either been cut back to a certain extent during the parliamentary process (for example, the power to exercise an investor’s right of action)\textsuperscript{149} or have been limited to minor breaches of law from the outset (for example, the power to issue infringement notices).\textsuperscript{150} Hence it is questionable if the scope of the FMA’s new powers would be wide enough, and how they could be used in practice. This will be discussed in Chapter 6.

\textsuperscript{148} See above 21-26.
\textsuperscript{149} See above 73.
\textsuperscript{150} See above 84.
CHAPTER IV: TWIN PEAKS AND THE FINANCIAL MARKETS LAW

Successful regulation and supervision of financial markets depend on a number of factors. All major prerequisites relate directly or indirectly to the regulator and include clear objectives, independence and accountability, adequate resources, effective enforcement powers, comprehensiveness of regulation and cost efficiency.\(^1\) The first key issue is the organisation of the regulators. In particular, how many agencies should be involved in supervision and enforcement, and what their responsibilities would be. The New Zealand Government’s announcement that the FMA would be a ‘super-regulator’\(^2\) suggests that the new regulator, unlike the Securities Commission, would not have to struggle with duplication and overlaps in the regulatory system.\(^3\) However, the question is whether and how far the FMA Act has remedied the problems that were identified by the Taskforce. Hence, this fourth chapter considers the new regulatory structure in detail.

\section*{A Regulatory Models}

Regulatory systems differ between states. Many states, particularly in Europe, have been reorganising their domestic regulators since the 1990s.\(^4\) For this reason, there has been a detailed discussion of different models, their advantages and disadvantages. In short, three different approaches can be identified.\(^5\) The first model separates competencies in separate regulators along the borderlines of the financial sectors. The second model is based on a

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complete consolidation of regulatory responsibilities across the financial sectors into a single agency. The third model envisages the consolidation of supervisory responsibilities by assigning two distinct agencies (‘twin peaks’); one aiming at safeguarding the soundness of financial institutions and the other focusing on the conduct of business tasks to protect investors. These three structures are discussed below.

1 Institutional Approach

(a) Theoretical Background

The first approach provides for regulation by institutions. The classification of the regulated entity is initially determined by its formal structure (for example, a registered company) or, alternatively, its main field of business (for example, a bank or a financial adviser). In most cases, the institutional model results from the introduction of new financial products and the ensuing enactment of new statutes to regulate the new products. Often the new statutes are regulated by new regulators. The resulting multitude of regulators was not planned from scratch. It is usually a process of market evolution and typical for the institutional approach.

The first problem of the institutional approach is a lack of efficiency. Running numerous regulators results in the costly duplication of organisational structures. More resources are consumed by administrative tasks and necessary co-ordination with other agencies. The result is a lower percentage of funding that can be spent on supervision and enforcement.

The second problem is consistency. Different regulators apply different rules to similar conduct, resulting in diverging conclusions and actions. Due to the integration of financial products and markets, participants are active in several segments, so that their

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8 Wymeersch, above n 5, 253.


10 Wymeersch, above n 5, 253.
supervision must be exercised by several regulators at the same time.\textsuperscript{11} On the other hand, it is possible that no action is taken against a particular behaviour of market participants because all regulators declare themselves not responsible. This problem could in theory be addressed by memoranda of understanding between the agencies. However, such improved co-operation requires resources and relies on the duplication of structures.

Despite the ongoing trend towards consolidation, several countries such as Argentina, Brazil, China, France, Russia, and, to a certain extent, the United States applied an institutional, non-integrated approach to regulation before the GFC hit the financial markets in 2008.\textsuperscript{12}

\textit{(b) New Zealand}

New Zealand with its numerous statutes and institutions involved in regulation had mainly pursued the institutional approach in the past. Several statutes related to the financial markets (including the \textit{Unit Trusts Act 1960}, the \textit{Companies Act 1993}, the \textit{KiwiSaver Act 2006}, the \textit{Superannuation Schemes Act 1989}, the FA Act and the FSP Act followed the institutional approach by referring to the entity’s nature and/or its main purpose. The role of the regulator was assigned to several authorities such as the Government Actuary, the Commissioner for Financial Advisers and the Registrar of Companies. The plurality of regulators led to the establishment of the Financial Regulator’s Coordination Group. The Group met on a quarterly basis to exchange information relevant for regulation, and to co-ordinate major policies.\textsuperscript{13} The co-operation was backed by several memoranda of understanding between the different agencies.\textsuperscript{14}

The New Zealand Government tried to achieve synergies in enforcement by creating specialised enforcement bodies to support the different regulators. An example is provided by the National Enforcement Unit (the ‘NEU’), a branch of the MED that acts on behalf of the Registrar of Companies and specialises in the investigation and enforcement of offences under several business law statutes. The Serious Fraud Office (the ‘SFO’) focuses

\begin{itemize}
  \item \textsuperscript{11} Ibid 265.
  \item \textsuperscript{12} For an overview see Cihak and Podpiera, above n 6, 137.
  \item \textsuperscript{13} See Geof Mortlock, ‘New Zealand’s Financial Sector Regulation’ (2003) \textit{66 Reserve Bank of New Zealand Bulletin} 5, 22.
  \item \textsuperscript{14} Ibid.
\end{itemize}
on serious or complex fraud and is therefore involved in the investigation and enforcement of fraud in the financial markets.

2 Functional Approach

(a) Theoretical Background

The functional approach structures supervision according to the objectives pursued by the different legal frameworks.\(^{15}\) This approach is sometimes referred to as ‘purposive’.\(^{16}\) In principle, there should be one agency for each objective pursued. Typical examples for the objectives pursued as reflected in the laws on securities and financial markets are investor protection (including retail investors and consumers), prevention of market failure, and ensuring that markets are fair and efficient.\(^{17}\) The number of identified areas of regulation can vary.\(^{18}\) These overarching objectives are reflected in law, such as a company’s behaviour against its customers, or an issuer’s behaviour against investors.\(^{19}\) In practice, the functional approach relates to a market participant’s activity in a particular situation, not to the type of entity or general type of business. Since in theory every objective pursued would require its own regulator, a strictly functional approach would not necessarily resolve the problem of a widespread, fragmented regulatory landscape.

The advantage of the functional approach is that it allows the application of the same set of rules for the same conduct.\(^{20}\) In theory, there will be one regulator standing up for the interest for which it has responsibility.\(^{21}\) The problem here is that it is difficult to distinguish or draw a clear line between the different objectives.\(^{22}\) It is, for example, hard to say which provision prevents market failure and which provision protects an investor. Overlaps are inevitable so that a straight objective-based approach will also lead to inconsistencies and duplications of structures.\(^{23}\) Furthermore, it is unclear which objective would be prioritised in cases of conflict. However, under a functional approach the risk of

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15 Wymeersch, above n 5, 266.
16 As opposed to ‘functional’: see Goodhart, above n 6, 8.
19 Llewellyn, above n 7, 14.
20 That is why the functional approach is sometimes referred to as ‘activity-based regulation’, see, eg, Llewellyn, above n 7, 19.
21 Wymeersch, above n 5, 266.
22 Ibid.
23 Goodhart, above n 6, 7.
regulatory gaps would be lower and could be reduced by proper communication between the agencies.

In practice, the functional approach goes hand in hand with a certain level of consolidation. Hence, function based structures are sometimes referred to as ‘partial integration’. The most stringent approach towards consolidation according to function is the so called ‘twin peaks’ model. It was first suggested by Andrew Hilton in 1994 and then named and elaborated by Michael Taylor. The aim is to consolidate regulators into two agencies, a market conduct regulator with the primary purpose of investor protection and a prudential regulator to safeguard systemic stability. The twin peaks model is followed by Australia, with ASIC acting as the market conduct regulator and the Australian Prudential Regulation Authority (‘APRA’) in charge of prudential supervision. As Goodhart states, the United States has developed a system that roughly approximates twin peaks, ‘with the Federal Reserve Bank coming close to a systemic stability (prudential) supervisor, and the SEC undertaking the conduct of business role’. However, it has to be noted that there are commentators who describe the regulatory structure in the United States as being not integrated.

(b) New Zealand

In New Zealand, the regulation of securities offerings and securities trading is not entity based, but activity based. The Securities Act applies to offerings to public offerings while the Securities Markets Act covers trading in securities. The nature of the issuer or trader does not matter. For both statutes, the Securities Commission acted as the regulator before it was replaced by the FMA. However, non-public offerings that do not fall within the ambit of Securities Act were only subject to entity based regulation with distinct regulators. For market trading in securities the situation is similar to the extent that the

24 Cihak and Podpiera, above n 6, 137.
28 Goodhart, above n 6, 8.
29 Cihak and Podpiera, above n 6, 137.
stringent NZX Listing Rules only apply to listed entities and do not catch unlisted issuers of debt securities. The regulation of takeovers under the Takeovers Act 1993 follows the activity-based approach because it applies to particular transactions that result in a change of control in the company. In this respect, supervision and enforcement is conducted by the Takeovers Panel and not by the Securities Commission/the FMA.

3 Integrated Approach

The integrated approach aims for a full consolidation of all financial and banking regulators. It is fuelled by the ongoing ‘de-segmentation’\(^{30}\) of markets and the blurring boundaries between financial products; on the one hand, between securities markets and financial services markets, and on the other hand, between banking and insurance products.\(^{31}\) The rationale is that a single regulator would be able to close all regulatory gaps and would be in a better position to deal with systemic risks because it regulates all aspects of the financial markets. The integrated approach takes the idea of consolidation to the extreme. Some of the arguments raised in favour of full integration also apply to the high level of consolidation envisaged by the twin peaks model. Other arguments are confined to the fully integrated model.

The first countries to move towards a single regulator model were Singapore in the 1980s\(^{32}\) and the Scandinavian countries in the early 1990s.\(^{33}\) Arguably, the most important creation of an integrated regulator took place in the United Kingdom, where the Securities and Investment Board was renamed the Financial Services Authority (‘FSA’) in 1997 and was given comprehensive powers under the Financial Services and Markets Act 2000 (UK).\(^{34}\) Several European countries such as Germany, Austria, Switzerland and Slovenia followed this example in the 2000s.\(^{35}\) Cihak and Podpiera counted a worldwide total of 32 fully integrated agencies at the end of 2007.\(^{36}\)

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30 Wymeersch, above n 5, 259.
31 Taylor, above n 26, 5-6.
32 Cihak and Podpiera, above n 6, 136.
35 See European Central Bank, above n 4, 3.
36 Cihak and Podpiera, above n 6, 136.
The Impact of the GFC

When the GFC hit the financial markets in 2008, the trend towards integrated financial supervision was still relatively new and most of the integrated agencies had just emerged. As a result, there was little empirical data that compared the efficacy of the twin peaks model against full integration. The most thorough analysis was conducted by Cihak and Podpiera and published in 2008. Their analysis of data from 84 countries suggested the application of the twin peaks model had no impact on the quality of supervision of securities and insurances, but resulted in a slightly higher quality of banking supervision.\(^{37}\)

However, the GFC did not prove either the idea of full integration or the twin peaks model as superior.\(^{38}\) Regulatory failure occurred in several areas of regulation, in particular in respect of securities and banking supervision.\(^{39}\) Due to the multitude of reasons for the crisis and their interdependency, it is difficult to assess how effective the competing regulatory structures were during the crisis. The two most important financial markets (the United States and the United Kingdom) were following different models and neither was able to prevent systemic instability in the banking system. Conversely, both Canada and Spain, with different supervisory approaches, were said to be less affected by the banking crisis.\(^{40}\)

The GFC triggered changes in the regulatory landscape of several countries. The United Kingdom abolished the idea of the integrated regulator in 2010, planning to disestablish the FSA and moving towards a twin peaks model. The stated reason was failure of banking supervision during the crisis,\(^{41}\) in particular failed co-operation between the FSA, the Bank of England and the Treasury in respect of the collapse of Northern Rock in 2008.\(^{42}\) In future, market conduct will in future be subject to the authority of the Financial Conduct Authority while prudential regulation will be carried out by the Prudential Regulation Authority, a subsidiary of the Bank of England. The respective Bills are currently in Parliament, and the changes are supposed to come in force in 2013. The fact that the

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\(^{37}\) Ibid 149.
\(^{39}\) See above 21-26.
United Kingdom finally abolished the idea of an integrated regulator of itself does not prove the superiority of the twin peaks model. However, it has to be noted that support for the case of full integration has lost the FSA and thus its most important advocate.

In the United States, further consolidation was set in motion after the Global Financial Crisis; for example by disestablishing the Office of Thrift Supervision in 2011 and establishing the Financial Services Oversight Council, which is supposed to monitor the stability of the financial system in the United States.\textsuperscript{43} In the European Union, a discussion about intensified co-operation and the creation of a European banking supervisor has commenced.\textsuperscript{44}

The international standard setting organisations refuse to give preference to either model. The IOSCO Principles (updated in the aftermath of the crisis) refer to the powers of the regulator, but not to the regulatory environment. The accompanying methodology document expressly states that the desirable attributes of regulation can be achieved either by one joint or separate regulators.\textsuperscript{45} Similarly, the Joint Forum on Bank Supervision does not give a recommendation as to which regulatory system is preferable. Although the Forum’s consultative document on the principles for the supervision of financial conglomerates stresses that the supervisor must have comprehensive power to oversee a whole financial groups, it highlights national discretion in terms of the regulatory structure.\textsuperscript{46} However, commentators do at least agree that the crisis has highlighted the necessity of a more effective institutional design of supervision.\textsuperscript{47} Thus, the importance of finding the most effective structure for securities and banking supervision persists.

\textsuperscript{43} Ibid 601.
\textsuperscript{44} Ibid 603.
\textsuperscript{46} The Joint Forum, Principles for the supervision of financial conglomerates – Consultative document (Basel Committee on Banking Supervision, December 2011) 7 <www.bis.org>.
International co-operation between national regulators does not have a significant impact on regulatory structure. As stated in Chapter 2, international co-operation necessitates an effective regulator to identify systemic risks and deal with transnational companies and transactions. A mostly or even fully integrated model might be beneficial for regulators or investors from overseas because they would have a one-stop-shop for all queries concerning financial markets. But this consideration appears rather theoretical and does not apply to New Zealand. Despite the known shortcomings of the regulatory landscape in New Zealand, the primary responsibilities for financial markets issues has always been clear: the Securities Commission (now the FMA) was the primary market conduct regulator while the Reserve Bank is in charge of prudential supervision.

Conclusion

An examination of the rationales for the different regulatory approaches shows some inconsistencies. Some of the arguments appear ambiguous and can be used to support different models (for example, avoiding the duplication of structures). As stated, however, several of the laws regarding the financial markets follow similar or even identical objectives. Hence, the idea of concentrating supervision and enforcement of related legal areas in one agency is obvious. Nonetheless, there does not seem to be a strong theoretical argument for full or partial integration. Among commentators it is widely held that there is no ‘best’ model, but only potential advantages and disadvantages in a particular jurisdiction. The Taskforce warned in its final report against importing ‘some notion of international best practice’. It thought that New Zealand should work out a sensible model for itself.

Hence, two questions need to be distinguished. First, what are the benefits of consolidation and to what extent do they apply? Second, should a separate prudential regulator be maintained or should all financial supervision be concentrated in one agency? Based upon

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48 See above 39.
51 Ibid.
these distinctions, an assessment of the situation in New Zealand can be made. However, special consideration will be given to the Taskforce’s analysis, the Regulatory Impact Statement prepared by the MED in 2010\textsuperscript{52} and the ensuing Cabinet Paper that set out the main policies.\textsuperscript{53}

B The Case for Consolidation

There is little doubt that the consolidation of small regulators is beneficial for the financial system as a whole. Criticism usually highlights possible excesses such as overregulation or oversized regulators, but it does not question the general benefits of consolidating regulators. The benefits and potential dangers of consolidation will now be considered. Next, the implications for New Zealand will be analysed.

1 Economies of Scale and Scope

(a) Advantages and Dangers

(i) Background

The first argument for regulatory consolidation is that it might lead to significant advantages in economies of scale and scope.\textsuperscript{54} A single, well-organised regulator could avoid costly duplication of infrastructure. Pooled resources like joint use of premises, human resources or a centralised IT department would be able to perform the same transactions for a larger amount of ‘customers’ at the same price and, vice versa, lower the price for a single transaction. Centralising resources would open the door to a more flexible allocation of resources. For example, if necessary, a larger regulator could quickly shift personnel or funds into an area where it is most needed – at the potential expense of other departments. In this way, complicated investigations could be conducted more easily without being restrained by annual funding.

\textsuperscript{52} Ministry of Economic Development, above n 38.
\textsuperscript{54} For the benefits of scale and scope see, eg, Briault, above n 9, 18;19; Cihak and Podpiera, above n 1, 9; Abrams and Taylor, above n 1, 6, 11; Davies, above n 49, 243-244; Llewellyn, above n 7, 22-23; Ferran, above n 34, 284.
On the other hand, the sheer size of the regulator might become problematic. First, there is no guarantee that a consolidated regulator really works more efficiently. Tension and miscommunication between different divisions under one roof are as possible as they are between different agencies. Second, a fully integrated agency might become unwieldy and difficult to run efficiently. The sheer size might reverse the advantages gained by economies of scale, leading to diseconomies of scale. The potential accumulation of powers has also been criticised because a massive, independent regulator might be difficult to control.

Arguments such as raised efficiency caused by economies of scale are difficult to measure. It is surely correct that a single agency under one roof is not necessarily more efficient than several specialised agencies. There is no evidence to suggest a clear relationship between size and efficiency. However, the basic assumption that avoiding the duplication of infrastructure would save costs is sound. Regulators also seem to consider the argument solid: Scandinavian regulators that have undergone consolidation were of the opinion that they have benefitted from the new structure. Also, the FSA reported substantial savings from the unification of support services: the budget of the consolidated agency when it began in 1999 was lower than the sum of its component parts in previous years, while delivering the same services.

In addition, studies showed that the removal of duplication and overlaps between the regulators result in lower ‘indirect’ compliance costs for the regulated firms. This reduction may even surpass the direct costs of funding the regulator itself. Lower compliance costs may lead to a higher level of acceptance of the regulator by regulated firms. This might be a valuable argument if the regulator’s funding relies on a market levy because in that case the market pays its regulator.

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55 Llewellyn, above n 7, 48-49; Ferran, above n 34, 284.
56 Cihak and Podpiera, above n 1, 11; Llewellyn, above n 7, 50.
57 Taylor, above n 26, 15.
58 Abrams and Taylor, above n 1, 13; Erik Bergloef and Stijn Claessens, ‘Enforcement and Good Corporate Governance in Developing Countries and Transition Economies’ 2006 (21) The World Bank Research Observer 123, 130; Ferran, above n 34, 279.
59 Davies, above n 49, 245.
60 Taylor and Fleming, above n 33, 18-9.
61 Briault, above n 9, 19.
62 Ibid 6 with further references.
(ii) Implications

The theoretical benefits of economies of scale and scope for New Zealand are obvious. It is not surprising that the Taskforce addressed reduction of duplications as a major driver for the consolidation of agencies in New Zealand.\(^63\) The MED also addressed the duplication issue:\(^64\) listed issuers potentially had to deal with the Registrar of Companies, the Securities Commission and the NZX in respect of their prospectuses. The Registrar had certain responsibilities concerning company directors’ compliance under the *Companies Act 1993*, while the Securities Commission was responsible for the potentially overlapping directors’ compliance with disclosure obligations.\(^65\) However, even though there was a strong functional fragmentation of regulators, the organisational aspect was somewhat consolidated: for example, the Registrar of Companies and the Government Actuary (along with several other agencies not related to the financial markets) were part of the Business Services Branch of the MED. The NEU and the Superannuation and Insurance Unit also operated as part of the MED. Thus, a number of regulatory functions had in fact been consolidated within the MED, while others (Securities Commission, NZX, SFO) remained independent. Hence, the organisational structure of regulators in New Zealand was already partly consolidated in the MED while the functional structure remained highly fragmented.

Given the relatively small size of New Zealand in general, and its financial markets in particular, the problem of potential diseconomies of scale is very unlikely to arise. After the transition process has finished, the new FMA will have an operating budget of about NZ$ 26 million per year,\(^66\) which is equivalent to approximately 120 full time employees.\(^67\) In comparison, ASIC had an expenditure budget of AU$ 386 million and 1932 full time staff members in 2010.\(^68\) Given these numbers, the theoretical concern that the new FMA might be oversized and unwieldy seems absurd. It is not surprising that this argument has not been addressed by the Taskforce or the MED at all.

However, it is unclear whether the new structure will really result in economies of scale. As shown in Chapter 3, the highly acclaimed consolidation was in fact a transfer of the

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\(^{63}\) Capital Markets Development Taskforce, above n 50, 87.

\(^{64}\) Ministry of Economic Development, above n 38, 10.

\(^{65}\) Ibid.

\(^{66}\) New Zealand Minister of Commerce, ‘Cabinet Approves Funding for FMA’ (Media Release, 20 April 2011) <www.beehive.govt.nz>.


Government Actuary and the Insurance and Superannuation Unit from the MED to the FMA. This was a transfer from one head organisation (MED) to another head organisation (FMA) without reducing the number of agencies involved. It can be assumed that the synergies in terms of infrastructure provided by the FMA are rather comparable to the synergies of having the respective functions under the roof of the MED. The real economies of scale will probably show after new tasks are assigned to the FMA by the FMC Bill and subsequent reforms of financial markets laws.

(b) The ‘Small Country Rationale’

(i) Background

The particular benefits of economies of scale for smaller countries are referred to as the ‘small country rationale’. Supervisors in small countries have stated that with a small financial sector, especially if it is dominated by foreign institutions, it would not be justified to set up three to four different regulators. A major issue for smaller countries is attracting well trained staff. Regulators need to compete with the private business world to attract highly qualified personnel. Smaller countries in particular face the problem that career prospects might make it more attractive to work for the regulated instead of the regulator. Suitable candidates can become such a valuable resource that it is essential to make them available for as many investigations as possible. Having one or two bigger regulators instead of multiple small agencies might offer potential employees additional job prospects and thereby make long term employment with the regulator more attractive. These arguments coincide with the empirical fact that smaller countries seem to favour a high level of integration over a medium level of integration.

69 Taylor and Fleming, above n 33, 18; Abrams and Taylor, above n 1, 13-14.
71 This problem does not only apply to regulators in small countries, but to all regulators, see, generally, Ferran, above n 34, 279.
72 Wymeersch, above n 5, 274; Llewellyn, above n 7, 28.
73 This had been a serious issue in reforms in the Scandinavian countries: see Taylor and Fleming, above n 33, 19.
(ii) **Implications**

The small country rationale applies to New Zealand in full. The country is small in size, but it nevertheless needs to provide for the full toolkit of financial markets regulation. Indeed, one of the main issues in New Zealand’s regulatory practice seems to be finding qualified staff members for the country’s regulators. The IMF stated in its financial sector assessment program that it was particularly difficult for the Securities Commission to recruit senior, qualified staff.\(^{75}\) NZX reported that it faced problems to replace senior staff in the Market Supervision branch.\(^{76}\) The Taskforce highlighted the need to recruit highly qualified employees for New Zealand’s financial markets in general\(^{77}\) and thereby acknowledged a general shortage of financial specialists who are willing to work for the regulator. The reform of the regulatory landscape should ‘build capability and scale around centres of excellence’\(^{78}\) in a single regulator. The MED agreed and criticised the lack of investigative expertise within the different regulators.\(^{79}\)

Only time will tell if New Zealand’s new regulatory structure will finally lead to an increase in professional expertise. The fact that the FMA will be – mainly due to new regulatory functions introduced by the FA Act and the FMC Bill – significantly bigger than the old Securities Commission at least suggests that the conditions for building up expertise have been improved. However, attractive remuneration, staff development and career opportunities will probably have a bigger impact on attracting and retaining highly qualified employees than the sheer size of the regulator.

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\(^{77}\) Capital Markets Development Taskforce, above n 50, 11.

\(^{78}\) Ibid 87.

\(^{79}\) Ministry of Economic Development, above n 38, 11.
2 Transitional Issues

(a) Speed of the Legislative Process

The process of consolidating regulators also raises issues. Abrams and Taylor refer to the problem as ‘Pandora’s Box’.\(^{80}\) As they point out, the creation of a new regulator is very often driven by political pressure. A Government may be tempted to rush the proposal through parliament quickly, before the balance of power changes. In such circumstances, there is a risk of flaws in the design of the regulator.\(^{81}\) This remark is sensible and may apply to the FMA Act. As stated earlier in this thesis, the creation of the FMA was fast-tracked by the New Zealand Government in order to restore confidence in the markets as soon as possible.\(^{82}\) A Cabinet Paper prepared in early 2010 highlights the danger of fast-tracking, in particular in respect of the review of Securities Law that was yet to come.\(^{83}\) It concluded that the need to re-establish confidence in the markets outweighed the risks associated with fast-tracking. The Treasury had even warned against fast-tracking.\(^{84}\) Nevertheless the plan to create a super-regulator was made public in April 2010, and the respective FMA Bill passed Parliament in April 2011. The whole legislative process took only a year. Given that the review of securities law had also commenced in June 2010, it can be assumed that all persons involved in the process had been working to establish the FMA as soon as possible. It is reasonable to propose that the FMA’s competences still need to be fine-tuned. This would also apply to the FMC Bill.

(b) Influence of Interest Groups

Another danger in the transitional process is that a consolidated agency generally requires new legislation or large amendments to existing statutes to give the new regulator its powers.\(^{85}\) In this process issues – for example, particular powers – which had previously been settled may be reopened, and new aspects such as an extension of the regulator’s powers may be opposed and in the end diminished. From a historical point of view, this risk is particularly high in New Zealand. As discussed in Chapter 2, the country followed

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\(^{80}\) Abrams and Taylor, above n 1, 16.
\(^{81}\) Ibid.
\(^{82}\) See above 67.
\(^{83}\) Office of the Minister of Commerce, above n 53, 3-5.
\(^{84}\) Ibid 33.
\(^{85}\) Abrams and Taylor, above n 1, 16.
the concept of light-touch regulation for decades.\textsuperscript{86} The business community opposed stronger regulation and public enforcement. For example, a former Chairman of the Securities Commission, Peter McKenzie, has observed in respect of the creation of the Commission that ‘both the government and the business community wished to establish a much less interventionist body than the SEC in the United States or the ASC in Australia.’\textsuperscript{87}

The legislative process that led to the enactment of the FMA Act indicates opposition among market participants. For example, the Government had addressed the potential power of the new regulator to exercise an investor’s right of action (now s 34 of the FMA Act) in the discussion paper on securities law reform.\textsuperscript{88} The ensuing Regulatory Impact Statement provides an overview of the submissions that were filed by market participants in respect of the proposed power.\textsuperscript{89} Out of twelve submissions, only three supported the idea while seven opposed it and three were neutral.\textsuperscript{90} The feedback on the closely related issue of public enforcement of directors’ duties was very similar (three submissions supporting, three submissions neutral and seven submissions opposing the proposal).\textsuperscript{91} These results suggest that many market participants are at least critical of the regulator’s increased powers. It furthermore suggests opposition to the new tighter regulation regime in general.

However, given the improvements made by the FMA Act and those envisaged by the FMC Bill, it cannot be expected that the influence of interest groups will lead to a weaker legal framework than the old legislation. They will tighten the regulation of financial markets in New Zealand. The decisive question will be whether the FMC Bill will survive the legislative process largely intact or if the proposed tight regime will be loosened, resulting in a regime that resembles the former, light-handed regulation.

\textsuperscript{86} See above 42.
\textsuperscript{90} Ibid 5.
\textsuperscript{91} Ibid.
(c) The Transition Process Itself

The third concern raised by Abrams and Taylor is the administration of the transition itself. Transitional issues can lead to short term weaknesses before the new regulator reaches its full strength. The creation of a new agency with a new internal structure and culture is regularly viewed by staff members with trepidation. Often employees take the opportunity to test the job market or retire. A good example is the Australian APRA. A report by the Royal Commission that examined the collapse of the HIH Insurance Group in 2001 conceded that the creation of APRA in 1998 led to negative short term effects in the quality of supervision. The main reason identified was the loss of key staff during the transitional process.

It could be particularly difficult to compensate for the loss of key staff especially in smaller countries. However, these concerns can be ruled out for the creation of the FMA. As discussed in the third chapter of this thesis, the reshaping of New Zealand’s regulatory architecture was not a merger of several well established agencies that resulted in a new agency starting from scratch, but an organisational continuation of the old Securities Commission under the name of the FMA with additional functions and some newly attached branches (for example, for the supervision of KiwiSaver schemes), and a new executive team. The process is not comparable to, say, the creation of the FSA in the United Kingdom which necessitated the consolidation of nine regulatory bodies.

Another concern raised by Abrams and Taylor is that managing the transitional phase itself would consume resources that are not available for supervision. In the case of the new FMA, the transition process comprised the transfer of a unit that had formerly been located in the MED, the establishment of a new office in Auckland, the replacement of outdated computer and telecommunications systems, and the recruitment of additional staff. Although this process surely involves planning, it is unlikely to result in serious

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92 Abrams and Taylor, above n 1, 16.
93 Ibid; Cihak and Podpiera, above n 1, 12.
95 See above 68.
96 See Briault, above n 9, 6.
97 Abrams and Taylor, above n 1, 16, Cihak and Podpiera, above n 1, 12.
99 Office of the Minister of Commerce, above n 67, 2.
transitional problems. Hence, it can be assumed that transitional problems in terms of establishing the FMA are rather remote and have not occurred as yet.

*(d) Broader Scope of Regulation*

Another related problem is that the consolidation of the underlying substantive law and the introduction of new statutes might result in additional tasks that outstretch the capacities of the fledging regulator. In the case of the FMA, this risk is mitigated by the fact that the agency is more of a continuation of the Securities Commission and can therefore rely on an existing internal structure.

However, the introduction of the new licensing regimes will probably put a lot of pressure on the regulator. When the FMA was established in May 2011, it was required to continue ongoing investigations and prosecutions concerning failed finance companies. There are strong indicators that the overlapping introduction of the licensing regime overstretched the resources of the FMA. When the FA Act was introduced in June 2010 it envisaged the new licensing regime for financial advisers to be in place on 1 July 2011. By the end of June 2011 there were rumours in the media that there was a backlog of approximately 200 to 300 unprocessed applications (out of approximately 1,700 in total).\(^{100}\) In October 2011, the FMA’s Chief Executive Sean Hughes admitted that the ‘FMA’s resources have been fully occupied in its first six months on the reviews into and investigations of legacy finance company collapses, as well as implementation of financial adviser reforms and building new organisational capability.’\(^{101}\)

It can be assumed that this exceptional workload also impacted on other areas of enforcement, for example, in regards of insider trading. In 2008, New Zealand introduced a rigid new regime modelled quite closely to the Australian law. Under this new system NZX had and still has the obligation to detect potential breaches of the insider trading provisions and, if the suspicion is substantiated, refers them to the Securities Commission (or after May 2011: to the FMA).\(^{102}\) Between 2009 and 2011, the Annual Reports and further media releases of the Securities Commission and the FMA do not show any prosecutions for insider trading conduct. It has to be noted that the Annual Reports of

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\(^{100}\) Catherine Harris, ‘Fears of Financial Adviser Shortage’ (30 June 2011) <www.stuff.co.nz>.


\(^{102}\) For a more detailed discussion of this regime see below 147-150.
NZX’ Markets Disciplinary Tribunal show several insider conduct alerts for this period, for example 11 alerts in 2010.\textsuperscript{103} It is unlikely that all these incidents proved to be false alarms and that insider trading in New Zealand simply vanished after the introduction of the new regime. It is more likely that the FMA was simply stripped of its resources and prioritised the prosecution in respect of the finance companies and the licensing of financial advisers. The combination of two extraordinary events may be too much for a newly created regulator, possibly leading to a neglect of other duties.

3  \textit{Consistency}

(a)  \textit{Consistent Application of the Law}

The second main argument for consolidation is the higher level of consistency and comprehensiveness of regulation. A single regulator would not be subject to different interpretations of statutes or diverging agency cultures. It would be easier for an integrated agency to act quickly because it does not have to coordinate with other bodies if several areas of regulation are concerned.\textsuperscript{104} Gaps between different regulatory jurisdictions could be closed\textsuperscript{105} and regulatory arbitrage could be avoided.\textsuperscript{106} Greater consistency would increase the regulator’s accountability for the outcome of its work – it would become less likely that agencies are caught in ‘turf wars’\textsuperscript{107} or ‘blame games’ in cases of regulatory failure.\textsuperscript{108} The regulator could ensure that similar financial products receive comparable regulatory treatment. This would level the playing field for all financial sector participants\textsuperscript{109} and prevent market intelligence from being confined to one agency.\textsuperscript{110}

\textsuperscript{104} Briault, above n 9, 18; Taylor and Fleming, above n 33, 17; Ferran, above n 34, 290-1.
\textsuperscript{105} Taylor and Fleming, above n 33, 13.
\textsuperscript{106} Ibid 19; Abrams and Taylor, above n 1, 12.
\textsuperscript{107} Abrams and Taylor, above n 1, 12-13.
\textsuperscript{108} Cihak and Podpiera, above n 1, 10.
\textsuperscript{109} Ibid 9.
\textsuperscript{110} Taylor and Fleming, above n 33, 2.
(b) Implications for New Zealand

The need for regulatory consistency is a striking argument. It is imperative that no market participant falls through the regulatory net, either because the substantive financial markets laws do not apply, or because the regulators are, or claim that they are not responsible. There is empirical evidence that demonstrates that more integration does lead to a higher consistency and quality of supervision.\(^\text{111}\) With an integrated approach it is much more likely that at least one regulator takes action – or takes the entire blame for not taking action. The downfall of New Zealand’s finance companies in 2006/2007 is an apt example: majority controlled, unlisted issuers of debt securities were neither subject to the Securities Commission’s and NZX’s market conduct supervision nor the Reserve Bank’s prudential supervision. After the crash, the Registrar of Companies complained that he lacked powers to act against failures of corporate governance and the role of auditors and trustees, while the Securities Commission complained a lack of powers to enforce market conduct rules appropriately.\(^\text{112}\) The MED stated that there is ‘strong anecdotal evidence that serious problems were known to exist … before the collapse took place’ and ‘no regulator took effective action before the collapses happened.’\(^\text{113}\)

The Taskforce also addressed the consistency issue. It stated that there ‘could be gains from greater consolidation of regulatory activities – to reduce both actual and perceived overlaps and fill any gaps.’\(^\text{114}\) The MED highlighted that the co-ordination of the regulators’ activities is time-consuming and confusing to the public.\(^\text{115}\) The unclear demarcation between responsibilities encourages regulatory agencies to ‘lead their role narrowly and treat matters that are not squarely within their remit as not their responsibility.’\(^\text{116}\) In summary, the obvious conclusion is that regulatory consistency would be a major benefit for New Zealand’s financial markets.

\(^{111}\) Cihak and Podpiera, above n 1, 26. Cihak and Podpiera, above n 6, 149.


\(^{113}\) Ministry of Economic Development, above n 38, 11.

\(^{114}\) Capital Markets Development Taskforce, above n 50, 87.

\(^{115}\) Ministry of Economic Development, above n 38, 10.

\(^{116}\) Ibid.
The New Financial Markets Law

The trend to merge supervisors often goes along with an extension of the regulatory ambit by adding new regulated entities or new objectives for which previously no distinct regime existed. For example, the creation of the FSA in the United Kingdom involved an overhaul of the whole legislative underpinning of financial regulation.

The situation in New Zealand is similar. Apart from the creation of the new regulator, the FMA Act houses a completely new field of law, the ‘financial markets law’. As stated, New Zealand’s law had been separated into several areas that were connected to the financial markets. The FMA Act put an end to this plurality by introducing the financial markets law. It rests upon four core definitions which appear in s 4 of the FMA Act. The first definition is ‘financial markets’, which means the financial markets in New Zealand and includes markets in New Zealand for the provision of financial services and the capital markets of New Zealand. The term ‘financial service’ is given the same meaning as in s 5 of the FSP Act. Insofar the new legislation follows a coherent approach. The definitions of ‘financial markets legislation’ and ‘financial markets participant’ will be discussed in more detail now.

Financial Markets Legislation

The meaning of the term ‘financial markets legislation’ is set out in Schedule 1 of the FMA Act. Schedule 1 is divided into two parts:


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117 Wyneersch, above n 5, 274.
118 See Davies, above n 49, 238.
The significance of the division between Part 1 and Part 2 of Schedule 1 of the FMA Act appears in s 9(1)(c), which sets out the FMA’s functions and powers:

(c) to monitor compliance with, investigate conduct that constitutes or may constitute a contravention of, and enforce –

(i) the Acts referred to in Part 1 of Schedule 1 (and the enactments made under those Acts); and

(ii) the Acts referred to in Part 2 of Schedule 1 (and the enactments made under those Acts) to the extent that those Acts or other enactments apply, or otherwise relate, to financial markets participants.

Thus, while the statutes listed in Part 1 fall under the FMA’s jurisdiction without restraint, the statutes listed in Part 2 are only covered to a certain extent. Hence, Part 1 sets out the core legislation for financial markets law while Part 2 delineates areas of law that constitute financial markets law in a broader sense (the ‘penumbra’ of financial markets law). In this way, there are direct and indirect targets of financial markets law, with the definition provided in Schedule 1 of the FMA Act as the overarching umbrella.

(ii) Financial Markets Participant

Previous legislation governing New Zealand’s capital markets laws has been incoherent and fragmented. For example, the Securities Act applies to offers of securities to the public. The Securities Markets Act deals with persons trading (or involved in trading) in securities and with issuers listed on the NZX. The Financial Reporting Act 1993 refers to listed and unlisted ‘issuers’ in s 4 of that Act. The FA Act applies to persons who offer financial adviser services. Finally, the FSP Act applies to people who offer any kind of financial service.

Definitional incoherence causes practical problems. As it turns out, majority-controlled unlisted issuers of debt securities have been the key corporate governance problem in New Zealand in the past decade. Evidence for this proposition is provided by finance company failures in New Zealand as described in Chapter 2 of this thesis. The inapplicability of the Listing Rules, combined with significant weaknesses in the Companies Act 1993 (eg, weak related party transaction rules) and the securities regulation

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120 Ibid 455 with further references.
121 See above 26.
regime (as far as unlisted issuers of debt securities were concerned), were among the reasons for the finance company failures of recent years.\textsuperscript{122}

The definition of ‘financial markets participant’ now provides the ‘personal’ scope of financial markets law. The FMA Act does not pursue definitional diversity. Instead, it addresses one person in s 4, the “financial markets participant”, meaning a person (inter alia) who is, or is required to be, registered, licensed, appointed, or authorised under, or for the purposes of, any of the Acts listed in Part 1 of Schedule 1 or any of the enactments made under those Acts. This definition includes all of the aforementioned persons. It covers related bodies and, very significantly, directors and senior managers. The comprehensive definition of ‘financial markets participant’ opens the door for the personal liability of directors and managers throughout all of the financial markets law. Equally significantly, it catches an issuer within the meaning of s 4 of the \textit{Financial Reporting Act 1993}.

\textit{(iii) Consistent Framework}

The first consequence of the new financial markets law is that the law governing New Zealand’s capital markets and financial services needs to be approached differently. As stated the legislative past was characterised by a proliferation of regulatory bodies as well as a multitude of statutes with differing scope and objectives. For example, the FA Act is a consumer protection statute.\textsuperscript{123} On the other hand, the Securities Act and the Securities Markets Act have – subject to the prevalent political climate – aimed for the influx of capital and/or investor protection.\textsuperscript{124} Investor protection is thereby not congruent with consumer protection since investments can be either made by retail or professional investors. This is a good example of the consistency problems that arise in respect of the functional approach to regulation.\textsuperscript{125} Deviating objectives influence the regulators’ work and may lead to an incoherent application of the relevant statutes. This is addressed in the IOSCO Principle No 1 which foresees that the responsibilities of the regulator should be clear and objectively stated.

\begin{itemize}
\item \textsuperscript{122} Maume and Walker, above n 119, 455.
\item \textsuperscript{125} See above 91.
\end{itemize}
The FMA Act now sets out uniform objectives for the FMA, i.e. ‘to promote and facilitate the development of fair, efficient, and transparent financial markets’ (s 9). Hence, the new law creates a sole conduct regulator in charge of financial markets law bound to one single objective in the application of all the statutes listed in Schedule 1. This objective should not be reduced to a mere guideline for the FMA. It sets the baseline for financial markets law in general.\(^\text{126}\)

In this way the reforms have created a consolidated regulator that is able to apply the law consistently – the consolidation of the substantive law enables the FMA to follow a consistent approach throughout all the markets of financial products and services. In addition, it extends the FMA’s new investigation and enforcement powers to all areas of financial markets law. This ‘umbrella’ approach vastly improves the possibility of enforcement of the separate statutes (see, for example, the civil litigation launched under s 34 of the FMA Act against finance company directors). Given that the consolidation of the regulatory agencies has not been as impressive as it had appeared at first glance, the consolidation of the substantive law is the more remarkable innovation resulting from the FMA Act.

(iv) **Limits**

However, the exact ambit of the FMA’s jurisdiction remains unclear. The referral in Schedule 1 of the FMA Act is extremely wide. For example, the *Companies Act 1993* is listed in Part 2 of Schedule 1. Thus the FMA is empowered to enforce the *Companies Act 1993* to the extent that the Act relates or applies to financial markets participants. According to s 4 of the FMA Act an issuer of securities under the Securities Act falls under the definition of ‘financial markets participant’. A company that, for example, issues shares to the public therefore is a ‘financial markets participant’ which falls under the jurisdiction of the FMA.

The problem is that s 9(1)(c)(ii) does not contain any further restraints to the definition of ‘financial markets participant’, and Part 2 of Schedule 1 only refers to the financial markets participant and not to the participant’s conduct. A literal approach to the referral in Part 2 of Schedule 1 could lead to the conclusion that every conduct of a company that has issued shares would fall under the FMA’s jurisdiction, even if the conduct is not related to

\(^{126}\) Maume and Walker, above n 119, 457.
the financial markets. For example, internal matters or mismanagement could be covered by the FMA’s jurisdiction.

However, according to s 5 of the Interpretation Act 1999 the meaning of an enactment needs to be ascertained from its text and in the light of its purpose. According to s 3 of the FMA Act, the statute’s main purposes are to establish the new FMA, to state the FMA’s objectives and functions, to provide for its investigation and enforcement powers, and to disestablish the Securities Commission and the Government Actuary. This catalogue does not give any insights about the extent of the FMA’s jurisdiction. However, as discussed in Chapter 3 and explicitly stated in the first sentence of the Explanatory Note to the FMA Bill, the FMA Act made ‘changes to the functions, duties, and powers of regulatory bodies in order to restore investor confidence in New Zealand’s financial markets’.127 Extending the FMA’s jurisdiction to the whole penumbra of financial markets law regardless of the nature of the conduct does not contribute to restoring confidence in the financial markets. It would be more convincing to limit the FMA’s powers to a financial market participant’s conduct that directly relates to the core of the financial markets law as set out in Part 1 of Schedule 2 of the FMA Act. That would mean that the FMA could enforce all breaches of, for example, the Companies Act 1993 if the respective provision that is breached by the conduct is related to the financial markets. For example, failure to notify the Registrar of Companies of a change of company directors (s 159 of the Companies Act 1993) is not directly related to conduct in the financial markets and would thus not be subject to the FMA’s jurisdiction. If, on the other hand, a listed company acquires its own shares and fails to send a notification containing the particulars to its shareholders within three months as prescribed by s 65(2A), a clear connection to the financial markets would exist. In such a situation the company would have offered and issued the shares to the public in the past, which resulted in the company becoming a financial markets participant. The FMA would be empowered to enforce the breach in such circumstances. If the FMA followed this approach, it would need to ascertain which conduct and which provisions of the Companies Act 1993 relate to financial markets conduct and which do not. This might be time consuming, but it could avoid unnecessary overlaps between the core of the financial markets law and its penumbra.

According to Llewellyn, the combined consolidation of regulators and substantive law is prone to lead to overregulation.\(^{128}\) This results in avoidable costs. A supervisory regime is not a result of market evolution; it is usually imposed externally by the Government. The result could be an over-supply as well as over-demand as market participants perceive the agency’s services as free. In the end, an over-reliance in the market regulator’s activity might ensue. This might result in particularly bad outcomes in cases of market failure because the market participants are less vigilant about misconduct. A market regulator with comprehensive objectives is more likely to extend its regulation in cases of doubt than several small regulators with clear objectives.\(^{129}\)

However, it is not apparent that the creation of the FMA and the coming FMC Bill will lead to the substantive law being over-regulated. As shown in Chapter 3, the new registration and licensing regimes for financial service providers, financial advisers, collective investment schemes, and derivatives dealers are extending the ambit of regulation significantly.\(^{130}\) However, the new framework is merely closing regulatory gaps that were criticised by the IMF and the FATF.\(^{131}\) Thus, New Zealand has reached a level of regulation that is internationally comparable, but does not suffer from over-regulation.

5 Remaining Overlaps

However, the question is whether New Zealand has sufficiently undergone regulatory consolidation as envisaged by the Taskforce. Unlike in Australia, the New Zealand market conduct regulator is not the same body as the corporate regulator. Similar to the United Kingdom, corporate regulation is carried out by the Registrar of Companies which also has some regulatory functions under the financial markets law. The FMA does not have comprehensive powers in other areas of regulation either. NZX remains the front line regulator for listed companies under the FMA’s oversight. The plan to establish a statutory Rulings Panel to replace the NZXDT was discarded by the Commerce Committee and does not appear in the final Financial Markets Conduct Bill. In addition, overlaps with the enforcement functions of the Serious Fraud Office, the National Enforcement Unit and the

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\(^{128}\) Llewellyn, above n 7, 22-23.

\(^{129}\) Abrams and Taylor, above n 1, 17.

\(^{130}\) See above 60-65, 83.

\(^{131}\) See above 59.
Commerce Commission seem possible. Takeovers are not part of the financial markets law and are therefore not subject to the FMA’s supervision at all.

6 Conclusion

The analysis comes to an unambiguous result – New Zealand’s regulatory landscape has undergone a process of consolidation that is supported by theoretical considerations. The new regime will probably result in advantages in terms of economies of scope and scale, and it will probably avoid regulatory gaps. Concerns about of overregulation, of an oversized regulator and of transitional issues hardly apply to New Zealand and should therefore not be serious issues in practice. The most significant innovation is the introduction of the financial markets law, providing a consistent legal framework for New Zealand’s financial markets.

The consolidation fits into the general trend towards consolidation that commenced in the 1990s in Europe. The fact that it took New Zealand until 2011 to abandon the old regulatory system and modernise the legal framework is yet another example of the slow adaptation of new developments in securities regulation caused by the country’s traditional libertarian dogma. However, the consolidation of the regulatory landscape was not as thorough as it could have been. The key question is which regulatory overlaps exist under the financial markets law. This is discussed in Chapter 5 of this thesis.
C  The Case for a Single Regulator

Apart from the benefits of consolidation and regulatory consistency, the second major question of regulatory theory is the role of the prudential regulator. Even full consolidation of all market conduct regulators would not necessarily result in a fully integrated regulator. As stated, a twin peaks model with a separate prudential regulator could be an alternative to full integration. This issue and its implications for New Zealand are now discussed.

1  Systemic Risks and Financial Conglomerates

The main argument for the full integration of all financial supervision is that a single regulator would be in a better position to deal with systemic risks. The emergence of new financial products has blurred the boundaries between financial markets participants and classical banks. Some financial companies are managing their customers’ assets in deposits, while banks (investment banks in particular) are participating in securities trading. They are subject to prudential regulation as well as market conduct regulation. A single agency would ‘mirror’ the nature of the participants and products in the financial market.

An investigation that is conducted by different regulators (for example, market conduct and prudential regulators) would need a high level of co-operation and an efficient flow of information between regulators. It has to be clear which agency is the lead regulator that puts together the pieces into a whole picture and makes the final decision. A single regulator would have a clearer view of the overall characteristics of financial conglomerates, allowing it to identify systemic risks and to deal with them more efficiently.

An integrated agency would in addition be the only contact point for large financial institutions, bolstering its standing when facing large, multinational financial conglomerates. Having one merely one regulator would have merits of simplicity. The licensing practice could be streamlined so that, for example, a bank that offers financial

132 See, eg, Briault, above n 9, 14.
133 Ferran, above n 34, 277.
134 Abrams and Taylor, above n 1, 11.
135 Wymeersch, above n 5, 269
136 Ferran, above n 34, 278.
services would only need to go through one licensing procedure (as a ‘one-stop-shop’). Such a ‘one-stop-shop’ approach might be beneficial for international coordination of regulators’ activities because foreign agencies would have a single contact point for transnational issues.

This argument is a more specific variation of the benefits of consistent regulation in general. It is fairly convincing. A single decision-making structure should be beneficial for the regulation of financial conglomerates because a single agency would theoretically resolve the problem of information flows between specialised regulators. Again, an efficient information system would not be guaranteed under the roof of one agency, but it could be achieved more easily. However, the argument is not fully persuasive for the distinction between full integration and twin peaks. The coordination of investigations and information flows would not be overly complicated between two agencies. Given that prudential regulation and market conduct regulation are rather distinct areas, it should be obvious which agency would act as the main regulator in an investigation.

2 One Size Does Not Fit All

Against the benefits of consolidation the argument has been made that ‘one size fits all’ may prove inadequate in practice. First, different agencies exercise different内部 cultures on how to deal with the regulated market participants. Abrams and Taylor, for example, described banking supervisors as being ‘more like doctors examining the health of the patient, while securities supervisors are more like policemen trying to catch the miscreant securities dealers’.

Second, unified regulation might lead to a ‘moral hazard’ problem. The public is likely to assume that all creditors of institutions supervised by the single regulator would receive equal protection. Thus, if banks and their customers are protected from losses in the event of a failure, while private customers of other financial institutions are not, the public may perceive this as an inappropriate preference of banks.

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137 Abrams and Taylor, above n 1, 10-12.
138 Ibid.
139 Ibid 18.
140 Ibid.
141 Taylor, above n 26, 3.
Third, full integration of regulatory functions in one agency might lead to an imbalance between market conduct rules and systemic stability. The question behind this is if or to what extent banks are special.¹⁴² In an integrated agency, the branch responsible for conduct regulation is usually larger, with much regulation and supervision involved. It is therefore in need of a lot of resources. Nevertheless, the prudential regulation branch, although being smaller, has a larger impact on incomes and national wealth in the long run.¹⁴³ It would be dangerous if prudential regulation would play the ‘second fiddle’¹⁴⁴ within an integrated agency. The different focus of the two purposes is so pronounced that it makes sense to keep them divided between separate bodies.¹⁴⁵

Two of these three arguments could be countered in practice. Different supervisory cultures could be maintained by a divisional separation under the roof of the integrated agency, and the moral hazard argument is clearly a question of a proper information policy. Even so, as Briault observes, the public’s understanding of the regulatory system is regrettably so low that moral hazard will probably not arise anyway.¹⁴⁶

However, the problem of the prudential regulator playing the second fiddle seems valid. If two supervisory models collide within one organisational structure, it is likely that one of them will prevail. A separation between prudential and conduct regulation in independent agencies could make sure that neither benefits at the expense of the other. This conclusion is now backed by the FSA itself. The *Turner Review*, commissioned by the FSA, stated that full integration ‘clearly creates the danger that there will be inadequate specialist focus on either, and in particular that a focus on conduct issues may crowd out prudential, particularly in good economic times when financial instability risks may appear less pressing.’¹⁴⁷ The report concluded that changes in the internal structure of the FSA might be necessary.¹⁴⁸ However, it deemed it necessary that the UK Government not only restructure the FSA, but disestablish it and create a new separate prudential regulator.¹⁴⁹ A joint paper issued by the Bank of England and the FSA in May 2011 outlined the approach...

¹⁴² Briault, above n 9, 30.
¹⁴³ Goodhart, above n 6, 9.
¹⁴⁴ Ibid.
¹⁴⁶ Briault, above n 9, 26.
¹⁴⁷ Financial Services Authority, above n 40, 92.
¹⁴⁸ Ibid.
¹⁴⁹ See above 93.
of the announced Prudential Regulation Authority to fulfil its statutory objectives. It concluded that the approach taken by the FSA lacked focus on prudential issues and that a single objective regulator for prudential regulation would be able to put a better focus on the stability of the system.

3 The Role of the Central Bank

It is widely held that the central bank needs to play a role in macro-prudential surveillance. However, the degree of its involvement in micro-prudential supervision is unclear. The creation of a fully integrated regulator would mean that banking supervision and monetary policy (conducted by the central bank) would need to be separated. This has been criticised since interest rates are heavily linked to the soundness of banks and the financial system as a whole. There are synergies between the information required for monetary policy and banking supervision. Thus the separation of these functions could create new diseconomies of scale by duplicating structures as well as a need for an efficient system of sharing information. However, as Cihak and Podpiera’s empirical analyses suggest, whether prudential supervision is located inside or outside the central bank has no significant impact on the quality of supervision. Thus the question of the central bank’s involvement in banking supervision should be answered in accordance with the respective country’s situation and specific needs.

4 Implications for New Zealand

(a) Insignificance of the Systemic Stability Argument

As stated, the GFC had not given any insights about which regulatory structure is superior. However, there is a wide consent among commentators and practitioners that the focus of prudential supervision needs to change. In the past, prudential supervision primarily took microeconomic aspects into consideration. Prudential regulators tried to warrant the stability of banks and other deposit takers by safeguarding single institutions. The GFC

151 Ibid 4.  
152 Cihak and Podpiera, above n 6, 138 with further references.  
153 Ibid.  
154 Abrams and Taylor, above n 1, 19.  
155 Cihak and Podpiera, above n 1, 26; Cihak and Podpiera, above n 6, 142.
demonstrated that this approach is insufficient. In the future, stronger emphasis on the macroeconomic aspects of the banking system would be required.\textsuperscript{156}

This development needs to be considered for New Zealand. We have to keep in mind the structure of the country’s banking system. All major banks are subsidiaries of Australian banks; the New Zealand and the Australian financial markets are highly integrated.\textsuperscript{157} According to Goodhart this structure implies a ‘somewhat more relaxed view of banking supervision’ for New Zealand.\textsuperscript{158} Hence New Zealand’s prudential regulation is not in the driver’s seat when dealing with the soundness of the banking system. Its capital markets are small even for a country of its size.\textsuperscript{159} Under these two premises it is unlikely that a domestic financial conglomerate would come into existence that would be so complex that it would necessitate a fully integrated regulator. If a financial institution posed a systemic risk it would be more likely that a foreign (in particular, Australian) regulator would play the main role. The hard truth is that the structure of New Zealand’s prudential regulation is insignificant for systemic stability of the banking system as a whole. The ensuing conclusion is that the arguments to warrant systemic stability are of lesser significance for New Zealand’s regulatory landscape. A small country with limited resources should not waste them in areas where their impact is insignificant.

This view leads to further insights about the focus of the domestic regulatory structure. New Zealand’s prudential regulation should focus on the stability of its domestic banks and finance companies on the microeconomic level. As far as the system as a whole is concerned, prudential regulation should be limited to giving assistance to the Australian prudential regulator. Such an approach would free resources for areas in which domestic regulation can make a difference, such as restoring and preserving investor confidence by market conduct regulation and safeguarding the soundness of the financial institutions.

\textsuperscript{156} See above 25, 39-42. \\
\textsuperscript{157} See above 22; Glenn Boyle, ‘Capital Market Integration: A Review of the Issues and an Assessment of New Zealand's Position’ (March 2009) 10-27. \\
\textsuperscript{158} Goodhart, above n 6, 11. \\
\textsuperscript{159} See above 48-50.
(b) **Efficient Allocation of Resources**

The monetary policy and the efficiency argument were particularly relevant for the Taskforce. In its report it stated:

> For example, the Reserve Bank of New Zealand argues that the recent crisis has illustrated that there can be gains from having the prudential supervisor also engaged in monetary policy formulation. Maintaining this synergy appears more important than separating out monetary policy and creating a single prudential and market conduct supervisor for the financial system.\(^{160}\)

The MED stated in its Regulatory Impact Statement that a fully integrated regulator could exhibit some advantages in terms of economies of scale.\(^{161}\) However, the MED did not express confidence that full integration would result in significant benefits, as the GFC suggested little difference in the performance of regulators in countries where the twin peaks or single regulator models had been adopted.\(^{162}\) It further highlighted that inconsistencies are unlikely to arise as it should not be difficult to distinguish between prudential and market conduct rules.\(^{163}\)

In the end, the financial markets reforms adopted the Taskforce’s suggestion. Prudential regulation remains with the Reserve Bank and will not be transferred to the FMA. This decision seems reasonable as monetary policy and prudential regulation promise more synergies than prudential and market conduct regulation. It coincides with the latest trends in regulation theory towards twin peaks regulation (i.e. the disestablishment of the FSA in the United Kingdom).

If we consider these arguments, the Government’s decision to keep banking regulation under the roof of the Reserve Bank is sensible. The small country rationale dictates that the number of regulators should be kept as low as possible, and it seems implausible that New Zealand would be able to attract enough specialised staff for a separate agency. The fact that no new agency has to be created eliminates the impact of negative transitional effects. By retaining monetary policy and prudential regulation in the Reserve Bank and market conduct regulation in the FMA, New Zealand achieves a higher level of integration than, for example, Australia. It is noteworthy that this understanding of the twin peaks model does not coincide with the Australian approach. The Taskforce envisaged a twin peaks model with the Reserve Bank in acting as the prudential regulator. In Australia, APRA is

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\(^{160}\) Capital Markets Development Taskforce, above n 50, 87.

\(^{161}\) Ministry of Economic Development, above n 38, 22.

\(^{162}\) See above 93-95.

\(^{163}\) Ministry of Economic Development, above n 38, 22.
responsible for banking regulation while monetary policy is still taken care of by the Reserve Bank of Australia. The New Zealand approach seems sensible, given the relative insignificance of its banking sector for international systemic stability.

**Summary**

New Zealand actioned the consolidation of its financial markets regulatory structure later than most other countries (in particular those in Europe). Given New Zealand’s specific situation, the decision to leave prudential supervision with the Reserve Bank is sensible. The perhaps most significant step forward is the introduction of the financial markets law as umbrella legislation for all financial markets conduct.

However, the reform of the regulatory landscape did not go as far as it might have gone. This leads to two questions: first, does the new demarcation between the FMA, the Reserve Bank, the Registrar of Companies, the Takeovers Panel, the Commerce Commission and the NZX make sense or is there room for improvement? Second, how could overlaps be tackled without creating new inconsistencies? This will be discussed in the following chapter.
CHAPTER V: THE FRINGES OF THE FMA’S JURISDICTION

A Introduction

As set out in Chapter 4, the introduction of the FMA Act in 2011 consolidated the regulatory architecture of the financial markets, creating a twin peaks model. However, there are still other agencies involved in the regulation of the financial markets and the allocation of enforcement functions in respect of the FMA and other regulators varies. Key characteristics of the present regulatory quilt are as follows:

- Overlapping scope of statutes and thus overlapping regulatory functions: investigation and prosecution of serious fraud (FMA and Serious Fraud Office), enforcement under the Companies Act 1993 (FMA and Registrar of Companies), and enforcement in relation to misleading and deceptive conduct (FMA and Commerce Commission).
- Regulators sharing functions, and acting jointly: oversight of designated settlement systems (FMA and Reserve Bank).
- Regulators sharing functions, but administering different aspects of regulation: registration and review of prospectuses (FMA and Registrar of Companies).
- One regulator with oversight of a self regulating organisation (FMA and registered exchanges)
- FMA not assigned as regulator (Takeovers Panel)

This chapter discusses the FMA’s relationship with other agencies involved in regulation of the financial markets. The main issue is whether the new framework avoids inconsistency and duplication of structures. Where supervision and enforcement are undertaken by a regulator other than the FMA, or shared with another regulator, cooperation between these bodies is critical and the ability to do so in a timely and effective manner should be particularly scrutinised.1

There are three possible approaches as to how potential overlaps could be addressed. The first and most obvious is statutory clarification. As the reform of New Zealand’s financial markets laws are not yet complete, further adjustments of the respective Acts are possible. Second, the agencies can try to resolve conflicts and overlaps by entering into a MOU. This approach would require voluntary co-operation between the regulators. It might prove difficult to resolve conflicts in practice because regulatory agencies do not tend to waive their powers readily. Third, the FMA might, in cases of overlap, limit its activities to avoid double investigation and enforcement.

B  The Serious Fraud Office

1  Overlaps

The first major overlap occurs between the FMA and the SFO. The SFO was created under the Serious Fraud Office Act 1990 (the ‘SFO Act’) in response to the stock market crash of 1987, its establishment reflecting the increased awareness for the dangers of ‘white collar’ crime in the 1980s. It was modelled closely on the SFO in the United Kingdom. In 2010, the NZ SFO had a budget of NZ$ 7.5 million and 35 full time staff members. The SFO is smaller than the new FMA with its budget of NZ$ 24 million in 2012. In 2012 and 2013, the SFO’s annual budget will be boosted temporarily to approximately NZ$ 10.4 million due to additional funding through the ‘Vote Serious Fraud’ program. The additional resources will be spent mostly on litigation against directors of failed finance companies.

The SFO’s purpose is to detect and investigate cases of serious or complex fraud as provided by s 4 of the SFO Act. The aim is to conduct prosecutions separate from, but in consultation with, other government agencies such as the police. The SFO Act does not

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5 See above 74.
6 New Zealand, Serious Fraud Office, Briefing to Incoming Minister (December 2011) 5 <www.sfo.govt.nz>.
7 Ibid.
define the term ‘fraud’, and the SFO interprets its role broadly. According to the ‘Briefing to the Incoming Minister’, a comprehensive of the SFO produced by the agency itself,

... Fraud essentially relates to any deceptive or dishonest activity which causes actual or potential financial loss to any person or entity. It includes theft, forgery, false statements in connection with the promotion of a company, false accounting and dishonestly using documents to obtain a financial gain.  

There is no statutory definition for ‘serious’ or ‘complex’ either. However, the SFO has developed indicative criteria such as (1) the involvement of multiple victims, (2) the sum of money lost exceeding NZ$ 2 million, or (3) a level of complexity beyond the resources of other law enforcement agencies. The SFO wants to ‘focus on cases that are small in number, but large in terms of the scale of the alleged fraud and/or impact they have on public confidence in the ... integrity of the business sector.’ The overlap with the responsibilities of the FMA is obvious. Fraudulent behaviour of financial markets participants (for example, directors of issuers) regularly involves several victims and the damage often exceeds NZ$ 2 million. In addition, the complexity of financial markets law and the fact that white-collar wrongdoers are in most cases vigorously defended, regularly lead to particularly complex cases.

The overlap only occurs in a confined area. The FMA’s enforcement mandate covers criminal prosecution, civil litigation and, under the FMC Bill, the envisaged infringement notices, to the extent that the conduct falls within the scope of the financial markets law. The SFO’s mandate covers breaches of financial markets law as well as non-financial markets law such as parts of the Crimes Act 1961, but is restricted to the prosecution of criminal offences. Thus, the overlap only exists for criminal offences in relation to the financial markets.

However, the overlap is not just a theoretical issue. Both civil and criminal enforcement matters need prior investigation, which may be conducted by both agencies. The SFO concedes in its Briefing for the Incoming Minister that the current system of overlapping

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8 Serious Fraud Office, above n 6, 18.
9 In former times the line had been drawn at NZ$ 500,000, see, eg, Shameen, above n 3, 196.
10 New Zealand, Serious Fraud Office Website, What is Serious Fraud? (13 April 2012) <www.sfo.govt.nz/what-is-serious-fraud>.
11 Ibid.
12 For example, the FMA started civil proceedings against directors of the Hanover Group where investments totalled NZ$ 25 million, see New Zealand Financial Markets Authority, ‘FMA files civil proceedings against directors and promoters of Hanover Group’ (Media Release, 2 April 2012) <www.fma.govt.nz>.
responsibilities is not necessarily the most cost-effective way to achieve the greatest
deterrence for financial crime. It refers to the investigations conducted in the aftermath of
the downfall of the finance companies. The involvement of the Securities Commission
(now the FMA), the SFO, the Commerce Commission and the MED created costly
duplication and potential for conflicting outcomes. As the SFO stated, it is ‘arguable
whether this has been the best use of limited law enforcement resources.’

The FMA’s approach towards co-ordinating prosecutions with the SFO seems
heterogeneous. In the Bridgecorp prosecution, the FMA laid charges on the directors that
led to convictions for, inter alia, breaches of the Securities Act and the Companies Act 1993 in April 2012. The court hearing on the SFO’s charges (which were not related to
financial markets law) will not commence before September 2012. In the prosecution of
directors of South Canterbury Finance, the FMA decided to support the SFO which had
filed a total of 21 charges against the directors. The Belgrave prosecution is a joint
prosecution conducted by the FMA and the SFO under the Securities Act, the Crimes Act 1961 and the Companies Act 1993.

2 No Structural Changes

The Government had been aware of the overlap, but did not pay too much attention to it. In
the Cabinet Paper that lay the foundations for the FMA, the Minister of Commerce
proposed not to shift functions from the SFO to the FMA. He stated that both agencies
should develop a ‘close working relationship.’ Further documents on the review of
securities laws do not discuss a shift of functions at all. Thus, the Government accepted

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14 New Zealand Serious Fraud Office, Briefing to Incoming Minister (December 2011) 23
<www.sfo.govt.nz>.
15 Ibid.
16 Ibid 24.
Zealand Financial Markets Authority, ‘FMA Welcomes Bridgecorp Verdicts’ (Media Release, 5 April 2012)
<www.fma.govt.nz>.
18 See New Zealand, Serious Fraud Office, ‘SFO Lays New Charges Against Bridgecorp’ (Media Release, 19
19 Financial Markets Authority, above n 17.
20 New Zealand Financial Markets Authority, ‘FMA Supports South Canterbury Finance Prosecution’ (Media
21 New Zealand Financial Markets Authority, ‘FMA Welcomes Belgrave Finance Guilty Plea (Media
22 New Zealand, Office of the Minister of Commerce, Creating a Financial Markets Authority and
potential overlaps and relied on the agencies to resolve the problem themselves. Neither agency was put in the driver’s seat for prosecutions in relation to financial market matters. It is interesting that the Government refused to make substantial changes to the SFO’s responsibilities for the second time since 2008. In 2007 the Labour Government introduced the SFO (Abolition and Transitional Provisions) Bill 2008 into Parliament. Its aim was to disestablish the SFO and transfer the authority for white collar fraud investigations to the police. The reason given by the Government was that the mainstream coalition of crime fighting agencies’ abilities to fight serious fraud would be enhanced by moving the SFO’s functions. The greater plan was to establish an Organised Crime Agency within the New Zealand Police and to meld the SFO into it. After some delays in the legislative process, the Bill was stopped by the newly elected Government in November 2008. The reason given was that it was the wrong time to remove the independent capability of the most engaged fraud investigation agency. The ‘wrong time’ refers to the downfall of the finance companies and the perceived failure of regulatory agencies.

The SFO had been subject to criticism in the past. The agency was confronted with allegations of misconduct, lack of staff competence and a focus towards promising cases (‘cherry-picking’). However, as Peursen and Balme show, the respective evidence given in the media was rather anecdotal than empirical. On the other hand, the SFO had a formidable success rate of 90 per cent in its prosecutions. Thus, it seems sensible that the new Government, facing a catastrophic loss of public confidence in the financial markets, relied on an apparently efficient prosecution body that did not have to undergo substantial restructuring and could deal with serious misconduct quickly. This interpretation is backed by the inquiry conducted by the House of Representatives. It stated in 2011 that the investigations conducted by the SFO took, and continue to take, precedence over the investigations of other regulators, which presumably includes the FMA. The report suggested to transfer parts of the SFO’s jurisdiction into the FMA as well. But as the Government has not reacted to this suggestion yet, and it has not restructured the SFO’s

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23 See in detail Van Peursem and Balme, above n 13, 305-306.
24 Ibid 313, with further references.
25 See New Zealand, Office of the Minister of Justice, Establishment of an Organised Crime Agency and Disestablishment of the Serious Fraud Office (Cabinet Paper, 2007).
26 Van Peursem and Balme, above n 13, 310.
28 Ibid 305.
29 New Zealand House of Representatives, Commerce Committee, Inquiry into Finance Company Failures (October 2011) 32.
30 Ibid.
role, it is unlikely that the overlap between the SFO and the FMA will be resolved on a statutory basis in the future.

3 Memorandum of Understanding

On 20 December 2011 the SFO and the FMA signed a Memorandum of Understanding (the ‘SFO MOU’). The document contains in cl 1.1 the agencies’ commitment to promote investor confidence, and to contribute to the efficiency of New Zealand’s financial markets. In order to pursue these objectives cl 1.4 provides for an extensive catalogue of mutual information sharing obligations. Representatives will meet every month to discuss the progress of their investigations (cl 4) and on a quarterly basis for more general strategic co-ordination: cl 3.2. This framework should enable an appropriate flow of information between the two agencies. The fact that both the FMA and the SFO are now located in Auckland (due to the recent opening of a second FMA office in Auckland) should also make a positive contribution.

However, the SFO MOU does not resolve the crucial issue of how conflicts could be resolved. Clause 2 delineates the parties’ primary responsibilities. The FMA is primarily responsible for prosecutions under financial markets legislation (which is set out in Schedule 1 of the FMA Act) while the SFO is in charge of prosecution for offences that constitute serious or complex fraud. If one party realises in the course of its activity that a matter also falls into the other party’s primary responsibility (‘Joint Interest Matter’: cl 5.1), the other party will be notified and provided with copies of all relevant documents. In such a case, the parties decide whether a joint investigation will be conducted. If they decide to conduct such an investigation, the CEO of the FMA and the Director of the SFO would set out a Joint Investigation Protocol: cl 5.2. Thus, neither agency is given precedence nor is there a mechanism for mandatory merger of investigations.

If, due to a joint or separate investigation, it has been determined that an offence has been committed, the representatives would meet and determine the most efficient and effective

33 The fact that the SFO in Auckland was physically separated from other Government agencies in Wellington was seen as a potential impediment for an efficient exchange of information: see van Peurse and Balme, above n 13, 313.
means of co-ordinating prosecutions (cl 5.5). The term ‘co-ordinating’ suggests that the idea underlying the SFO MOU is that each agency conducts its own prosecution unless the agencies decide otherwise. A sole responsibility of one agency to lay all charges to save resources is not provided. Only in certain cases (for example, double jeopardy) are the agencies required to determine which charges are laid by which party (cl 5.7b). If no agreement can be reached, the Solicitor General has to determine the matter (cl 5.7c). Thus a limited clearing mechanism exists for this specific situation, but not in general.

4 Options Available to FMA

Each agency would need to find a reasonable approach to determine when to pursue its own prosecutions. The first objective must be to avoid unnecessary duplication of investigation and prosecution. On the other hand, the SFO and the FMA must make sure that they do not undertake selective enforcement.34 This would be problematic on ethical grounds. Further, if the public is of the opinion that matters are not prosecuted, the main goal of restoring investor confidence would be jeopardised. A reasonable approach would be that the FMA tries to limit its own activities as soon as a Joint Interest Matter is identified. This results from the three following considerations.

(a) Ambit of Responsibilities

A comparison of the ambit of both agencies’ responsibilities suggests that the FMA should play the ‘second fiddle’ in Joint Interest Matters. The SFO is not a financial markets regulator, but rather a specialised crime fighting unit whose responsibilities might coincide with those of the FMA. Its mandate to prosecute criminal offences is very broad and covers all activities that can be subsumed under ‘fraud’; for example under the Crimes Act 1961, but also under financial markets law. The FMA has also been given a broad mandate, but it is confined to Schedule 1 of the FMA Act.35 That would mean that the FMA would not be able to prosecute Joint Interest Matters that exceed the ambit of the financial markets law comprehensively. On the contrary, the SFO would be able to prosecute non-financial

35 See above 107-110.
market law matters as well as matters within its ambit. A possible approach to avoid duplication would be to reduce the FMA’s action to a supporting role as soon as a Joint Interest Matter is identified. Only if the consequences of a breach of financial markets law are greater than other potential offences prosecuted by the SFO (for example, the expected sentence is much larger under financial markets law), should the FMA initiate own prosecution.

(b) Focus of Work

The second consideration is that the FMA should not put too much emphasis on prosecutions. As stated, the SFO is more of a specialised police agency while the FMA is a regulator with a number of functions and duties. This does not necessarily mean that the SFO is more competent in conducting prosecutions. However, due to more than two decades of experience, the SFO’s staff members are probably more specialised and more experienced in prosecution than the FMA’s staff. For example, the SFO claims to have the largest resources in forensic accounting in the public sector.\(^\text{36}\) Duplication in a country with limited resources (see the ‘Small Country Rationale’)\(^\text{37}\) would be inefficient.

If the SFO identifies a matter of serious fraud in the financial markets, it would be acting within its primary (or sole) responsibility. On the other hand, the FMA has a number of additional duties such as general market surveillance, the review of prospectuses and education in general. If the FMA decides to stand back and play only a supporting role in respect of the SFO’s prosecution, this would concern only one area of its responsibilities. However, if the SFO played a supporting role in respect of the FMA’s prosecution, this derogates from its primary responsibility, ie, its ‘home ground’. It would be arguably easier for the FMA to play the supporting role.

A leading role for the SFO in Joint Interest Matter prosecutions would not result in a lighter regulatory approach. It would highlight areas of supervision and enforcement that cannot be covered by the SFO, in particular in respect of proactive tasks such as the review of prospectuses or the authorisation of financial advisers. Instead of duplicating costly prosecutions, the FMA should put more emphasis on proactive activity and civil enforcement. For example, less reactive enforcement (for example, prosecutions) would be

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\(^{36}\) Serious Fraud Office, above n 14, 2, 16.

\(^{37}\) See above 99.
necessary if diligent reviews detected shortcomings of prospectuses at an early stage. The same applies to market surveillance that detects flawed business models or misleading offers. Such an emphasis on prevention would coincide with the general stance of financial markets law reform and would be an effective tool to restore confidence in the markets.

(c) Transitional Issues

A more practical consideration relates to the fact that the FMA is a new body with several new responsibilities. As stated in Chapter 4, the unanswered question of the FMA’s financial needs and its funding remain an element of uncertainty. The implementation of the authorisation regime for financial advisers has already strained the FMA’s resources, probably limiting its ability to prosecute for insider trading. The enactment of the new licensing regimes under the FMC Bill would provide for a further increased workload for the FMA.

The SFO, conversely, is an established agency that does not need to find its feet. For 2012 and 2013 it has been allocated an additional NZ$ 7.5 million per year for the finance companies prosecutions. A review of the SFO’s budget is expected for 2014. The review of the FMA Levy is scheduled for the same year. At that time, the FMA should be fully established and the extent of its new duties should be clear. Until then the FMA should try to focus on its other duties and refer Joint Interest Matters to the SFO whenever possible.

5 Conclusion

The agencies’ objectives and the focus of their work suggest that the FMA should limit its action to a supporting role in Joint Interest Matters as often as possible. The fact that the FMA may not have the ability to conduct efficient enforcement in the next two years due to transitional and funding issues highlights the fact that this should occur for the period between 2012 and 2014.

38 See above 104.
39 Serious Fraud Office, above n 14, 5.
40 See above 76.
C The Commerce Commission

1 Overlap under Current Legislation

The Fair Trading Act 1986 (the ‘FT Act’) sets out the basic rules for trading in goods and services. The key rule is that no person shall, in trade, engage in conduct that is misleading or deceptive or is likely to mislead or deceive: s 9 FT Act. Enforcement under the FT Act is conducted by the Commerce Commission, an independent crown entity under s 8A of the Commerce Act 1986.

There is a material overlap between the FT Act and the financial markets law because the inclusion of false, misleading or untrue statements in an offer document or advertisement can result in liability under the Securities Act, the Securities Markets Act and/or the FT Act. This overlap is currently addressed by s 5A of the FT Act, s 63A of the Securities Act and s 19 of the Securities Markets Act. According to s 5A(a) of the FT Act, ‘a court hearing a proceeding brought against a person under this Act must not find that person liable for conduct … that is regulated by the Securities Act 1978 if that person would not be liable for that conduct under that Act.’ Section 5A(b) of the FT Act provides a similar rule for conduct that is regulated by the Securities Markets Act.

2 Overlap under the FMC Bill

(a) The Government’s Approach

In the first Cabinet Paper on the review of securities laws the Government identified the link between securities law and fair trading law as ‘confusing’. The second Cabinet Paper set out three possible approaches to rectify the confusion. The first was a carve-out from the FT Act for matters relating to the financial markets. As a result, these matters would be regulated by the FMA under the prospective FMC Act exclusively. The Government dismissed this idea because of the risk of leaving regulatory gaps. The second approach, a duplication of rules in the financial markets law and the FT Act, was dismissed. Although

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43 Office of the Minister of Commerce, above n 41, 15-16
44 Ibid 15.
it would eliminate gaps, it could instead create overlaps, uncertainty about the relationship between ‘some provisions’ and uncertainty as to which regulator should take action. The third and favoured approach was to implement a ‘precedence’ of the financial markets law. Persons would not contravene ss 9-13 of the FT Act if they have contravened comparable provisions of the new legislation. The Government was of the opinion that this would encourage the FMA rather than the Commerce Commission to issue proceedings. According to this, cl 567 of the FMC Bill would repeal the old s 5A of the FT Act and replace it with a new rule stating that ‘conduct that contravenes Part 2 of the Financial Markets Conduct Act 2011 does not contravene any of sections 9 to 13.’

(b) Criticism

The Commerce Commission criticised cl 567 in the consultation process. The Commission argued that the proposed clause would not provide clarity as to how the overlapping legislation would interact. The wording of cl 567 suggested a carve-out rather than a precedence of the financial markets law. The result would be that the Commerce Commission would lose its jurisdiction over conduct in the financial markets, which might lead to regulatory gaps. A particular problem would arise in relation to credit contracts and in misrepresentations relating thereto, that could be classified as ‘financial service’ under the FMC Bill.

The MED noted the criticism and conceded that the issue required further consideration. This comment suggests that the delineation of the FMC Bill and the FT Act will undergo further changes in the near future, probably during the review conducted by the Commerce Committee. As a ‘partial fix’, cl 466 of the FMC Bill was amended in a way that the Commerce Commission would now be allowed to apply for pecuniary penalties for contraventions of Part 2 of the FMC Bill (i.e., misleading or deceptive conduct) for overlapping matters if the FMA consents.

45 Ibid.
46 Ibid 16.
47 Ibid.
49 Ibid 332.
50 Ibid 331.
51 Ibid.
(c) **Comment**

(i) **Similarities to the Relation between the FMA and the SFO**

The interaction of the FT Act and the FMC Bill is a good example of a regulatory overlap. It resembles the overlap between the responsibilities of the FMA and the SFO. The important difference is that the Commerce Commission only enforces a single statute whereas the SFO deals with different kinds of fraud and dishonest behaviour in several statutes. The more precisely defined role of the Commerce Commission makes a solution for overlapping responsibilities easier because basically there needs to be clarification only for the interaction of two statutes (or three statutes if the Securities Markets Act is included). The second difference is that the overlap of the available remedies is larger between fair trading and financial markets law – although misrepresentations under the FT Act are mostly criminal offences, the statute also provides for a limited range of civil remedies; for example, civil penalty orders and injunctions: ss 40A, 41. The third difference is that the Government seems to be willing to put the FMA in the driver’s seat while assigning a supplementary role to the Commerce Commission. Conversely, regarding the interaction between the SFO and the FMA, the Government has refused to provide precedence to either agency. This dissimilar treatment of a similar overlap is surprising.

(ii) **Interpretation of cl 567**

The proposed new s 5A of the FT Act would stipulate that conduct that ‘contravenes’ Part 2 of the proposed FMC Act does not ‘contravene’ ss 9-13 of the FT Act. The meaning of ‘contravene’ is ambiguous. As the Commerce Commission pointed out, it could be understood as a prohibition against double jeopardy, as a real carve-out that makes the FT Act generally inapplicable, or as a rule that gives precedence to the FMC Act if both statutes can be applied. Another submission by ANZ pointed out that cl 567 might be interpreted in a way that the exclusion of the Commerce Commission’s jurisdiction only applies if a contravention is established by the FMA. This would result in uncertainty and costly double investigations. The envisaged s 5A of the FT Act would contain two layers

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52 See above 124.
53 Ministry of Economic Development, above n 48, 331.
54 Ibid 330.
of ambiguity: first, what is the exact relationship between the two statutes, and second, who determines the contravention.

(iii) Options for Clearer Delineation

In respect of regulatory clarity, a carve-out would be the best solution. Given the aforementioned difficulties, the MED conceded after the consultation process, in contradiction to the Cabinet Paper, that a ‘full carve-out may be desirable’.\(^55\) Hence, the Commerce Commission suggested unambiguous wording: ‘Nothing in sections 9-13 of the FT Act shall apply to financial products and services as defined in the FMC Act.’\(^56\) The phrase ‘apply to financial products and services’ would draw a clear line between both statutes. It is preferable to the term ‘contravention’ because an assessment of whether a financial product or service applies should be easier than an assessment of whether there is a possible contravention of the Act(s). The ensuing question is which agency determines whether a financial product or service applies. This might become a problem if the FMA and the Commerce Commission disagreed about the nature of a product or service. Given that the Government wanted to give precedence to the financial markets law, it would be preferable to give the FMA the possibility to overrule the Commerce Commission’s decision if the FMA is of the opinion that a financial product or service is in question (and the Commerce Commission does not share that view).

The ensuing question is whether a carve-out would lead to gaps in the regulatory landscape. Clauses 16-19 of the FMC Bill are modelled closely on sections 9-13 of the FT Act. They have been slightly ‘customised’ for the financial markets context.\(^57\) For example, the phrase ‘in connection with the supply or possible supply of goods or services’ (s 13 of the FA Act) resembles the phrase ‘in connection with any dealing in financial products, the supply or possible supply of financial services’ in cl 19 of the FMC Bill. The substance of the provisions would remain untouched. Thus, no substantial gap would exist between the two statutes because the proposed FMC Act would apply to financial services or products, and the FT Act would apply to all other supplies of goods and services. The result, however, would be that the Commerce Commission would not have the opportunity to enforce misconduct in relation to consumer contracts that are classified as financial

\(^{55}\) Ibid 331.
\(^{56}\) Ibid.
\(^{57}\) Explanatory Note, Financial Markets Conduct Bill (342-1) 10.
products in terms of the FMC Act. An ancillary jurisdiction of the Commerce Commission for these cases as envisaged by cl 466 of the FMC Bill (ability to apply for remedies if the FMA consents) seems sensible.

(iv) Change of Enforcement Regime

The remaining problem is that the enforcement regimes of the FT Act and the FMC Bill are different. As stated, the FT Act primarily relies on criminal offences. The FMC Bill puts emphasis on civil penalties and reserves criminal offences for most ‘egregious’ breaches of financial markets laws. Apparently, misleading or deceptive conduct under Part 2 of the FMC Bill was not considered sufficiently egregious to make it a criminal offence. Although the FT Act provides criminal penalties for such conduct, the respective conduct would result in a civil penalty under the FMC Bill. For example, a misleading representation under s 13 of the FT Act is a criminal offence (s 40) while a misleading representation in connection with any dealing in a financial product (cl 19) would merely result in a civil penalty or other civil remedies: cl 467. This appears to be an inconsistency between the FMC Bill and the FT Act, or even a ‘softened’ enforcement regime. However, on closer examination, this concern does not seem justified. According to s 40(1) of the FT Act, a contravention of s 13 would result in a fine not exceeding NZ$ 200,000 for bodies corporate, and not exceeding NZ$ 60,000 in other cases. Under the proposed FMC Act, misleading conduct under Part 2 of the Act would be classified as serious misconduct that would result in a maximum penalty of NZ$ 1 million for individuals and NZ$ 5 million for bodies corporate: cl 473(1)(2). Since this is a civil penalty and not a criminal offence, the less stringent standard of proof for civil matters would apply. Moreover, the market participant who contravened the proposed FMC Act would also face other remedies such as compensation. Thus, the new enforcement regime would enable the FMA to enforce the law on misleading conduct easier and faster (because of the lower procedural requirements) and with higher penalties (because of the increased maximum).

58 Ibid 6.
59 For a more detailed discussion of the new liability regime, see below 179-183.
60 The standard in civil matter is met if the proposition is ‘more likely to be true than not’. In criminal matters, the standard is ‘beyond reasonable doubt’. For both definitions, see Miller v. Minister of Pensions [1947] 2 All ER 372.
3 Conclusion

The interaction of the FT Act and the FMC Bill will probably be subject to further considerations in the legislative process. A carve-out from the FT Act flanked by the limited possibility of enforcement by the Commerce Commission would be a straightforward solution. The civil penalty regime under the FMC Bill would probably result in more and quicker enforcement with high penalties.

D The Registrar of Companies

The most obvious regulatory overlap within the financial markets law exists between the FMA and the Registrar of Companies. The office of the Registrar was introduced by the Companies Act 1955, a nearly exact copy of the Companies Act 1948 (UK). The Registrar is now the principal regulator under the Companies Act 1993, while the overall responsibility lies with the MED. The Registrar heads the Companies Office. The current Registrar is Neville Harris, who was appointed in 1989. He is in charge of maintaining the public register of companies and has a number of statutory responsibilities in relation to supervision of corporate bodies. The overlaps between the Registrar and the FMA occur in two areas: first, registration of prospectuses, and second, enforcement under the Companies Act 1993 and the Securities Act.

1 Registration of Prospectuses

(a) Registrar’s Role under the Securities Act

Before the introduction of the FMA Act in 2011, the Registrar was in charge of the registration and review of prospectuses under ss 42-44 of the Securities Act. He could refuse registration if he was of the opinion that a prospectus contained false or misleading

62 Gordon Walker et al, Commercial Applications of Company Law in New Zealand (CCH New Zealand, 4th ed, 2012), 40
64 Ibid 40-41.
information: s 43(5). The Registrar was able to conduct investigations when issues of non-compliance arose while the Securities Commission was required to rely on the Registrar’s investigation powers if it conducted own investigations: s 67A. In its final report the Taskforce suggested that the new regulator take over ‘at least some’ of the Registrar’s functions.65

When the FMA was created, some amendments were made to the Securities Act, which included the registration process. The term ‘Registrar’ referred to the Registrar of Financial Service Providers: s 2 of the Securities Act. That does not result in a substantial difference because, as stated, the Registrar of Companies acts as the Registrar of Financial Service Providers: s 35 of the FSP Act.66 Thus, the Registrar of Companies is still in charge of the registration of prospectuses under s 42 of the Securities Act. As discussed in Chapter 3, however, the review of prospectuses was transferred from the Registrar to the FMA.67 In addition, the Registrar was to establish a register of securities. Thus, although some of the Registrar’s functions under the financial markets law were transferred to the FMA, the Registrar’s role was retained and even extended in other areas.

(b) Registrar as Keeper of Registers

On its face, the development described above does not correspond with the idea of a ‘one-stop-shop’ in financial markets law and suggests an inefficient duplication of structures. However, on closer examination such concerns do not seem to be justified.

The first reason is that the potential overlaps are minimal. The Registrar’s role under the Securities Act is limited to some aspects of the registration itself. He is allowed to refuse to register prospectuses that are not in writing, unsigned, or not clearly legible: s 42(2). Section 43A emphasises that it is not his function to consider if the prospectus contains false or misleading statements. The Registrar is not even allowed to refuse the registration if the documents are incomplete: ss 43A(a) and 39(1). All these functions are now exercised by the FMA. This separation of tasks is simple and clear and leaves no room for misunderstandings or gaps. It resembles the registration of financial service providers as

66 See above 60.
67 See above 78.
discussed in Chapter 3. While the registration of financial service providers primarily aims for identification, the more detailed application and assessment process for the authorisation of financial advisers is performed by the FMA. The pattern is clear: the Registrar’s role in general is to administer formal registration while the FMA monitors compliance with the substantive requirements of registration/authorisation.

The second reason is that there is no unnecessary duplication of structures. The office of the Registrar of Companies is an organisational unit of the Companies Office of the MED. The Companies Office maintains a number of other registers, inter alia, for overseas issuers (mainly from Australia), building societies, charitable trusts, co-operative organisations, auditors and unit trusts. Thus, the registration duties under the various statutes are vested in the Companies Office. This concentration builds up economies of scale, suggesting greater efficiency. Of course, the registration of prospectuses by the Registrar requires additional coordination between him and the FMA. According to s 43C(1), the Registrar must promptly notify the FMA of any registration or amendment to a registration for the purpose of a review by the FMA. If the FMA receives all necessary files electronically or has direct access to the register, there seems to be no reason why this process should be less efficient than a registration and review process conducted by a sole agency.

2 Enforcement

The delineation of enforcement duties between the two agencies appears less clear than the registration process. Two potential overlaps can be identified: enforcement under the Securities Act and enforcement under the Companies Act 1993, in particular the enforcement of directors’ duties.

(a) Enforcement under the Securities Act

Before the FMA Act came into force, the Registrar played an important role in the enforcement of the Securities Act. According to s 60A, the Registrar was entitled to apply for management banning orders. Although the Registrar’s functions did not include enforcement of the Act in general, he conducted enforcement if matters (in particular,  

68 See above 63.
69 For an overview see the Companies Office Website <www.companies.govt.nz>. 

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criminal offences) were referred to him by the Securities Commission.\textsuperscript{70} In this case, enforcement was conducted by the NEU, a subdivision of the Companies Office.\textsuperscript{71} These referrals made sense for a couple of reasons. First, the notoriously underfunded Securities Commission was able to outsource enforcement to a more specialised body, the NEU. Second, the arguably most important offence under the Securities Act concerned misstatements in prospectuses. This directly related to the review of prospectuses by the Registrar. From that point of view, it was sensible to let the body that makes the material assessment to also conduct enforcement.

The amendments made to the Securities Act in the wake of the creation of the FMA have not changed this part of the legal framework. However, the practical situation has significantly changed. First, the FMA will have greater resources than the old Securities Commission, and enforcement is supposed to be one of its priorities. Thus, it is less likely that referring matters to the NEU would be necessary on the basis of scant resources and know-how. Second, the FMA is now in charge of the review of prospectuses. It would seem odd to refer matters to the NEU if the FMA has already completed its assessment of the prospectus. These changes suggest that the FMA will refer to the NEU less than it did in the past. This corresponds with the Minister of Commerce’s view that the FMA is supposed to conduct its own enforcement activity.\textsuperscript{72}

\textit{(b) Enforcement under the Companies Act 1993}

The FMA’s jurisdiction covers the statutes listed in Part 2 of Schedule 1 of the FMA Act to the extent that they relate to financial markets participants. As stated in Chapter 4 of this thesis, the FMA should limit its enforcement to cases that directly relate to the financial markets.\textsuperscript{73} As stated in Chapter 3, the FMA has the power to enforce directors’ duties.\textsuperscript{74} In this respect no overlap between the FMA and the Registrar can be identified. The FMA’s power to commence (or take over) civil proceedings rests upon the recently introduced s 34 of the FMA Act. Neither the \textit{Companies Act 1993} nor any other statute contains a provision that gives the Registrar a comparable power. Hence, the Registrar is unable to

\textsuperscript{71} Ibid 7.
\textsuperscript{73} See above 110.
\textsuperscript{74} See above 73.
enforce directors’ duties.\textsuperscript{75} It might seem odd that the financial markets regulator has the power to enforce directors’ duties whereas the corporate regulator lacks such a power. However, it fits into New Zealand’s history of a weak corporate enforcement regime.\textsuperscript{76}

Further, the FMA received genuine statutory powers under the \textit{Companies Act 1993} that can be exercised without consent from the Registrar. If the company in question is a financial markets participant, the FMA may apply to court to appoint or remove an administrator (ss 239L, 239R), apply to court to disqualify directors (s 383) and prohibit persons from managing companies under certain circumstances: s 385. The Registrar can apply for the same orders, so there is a potential overlap. However, the exercise of these powers will usually be annexed to larger litigation or prosecutions for breaches of financial markets law (for example, the disqualification of a director who is responsible for the intentional issue of misleading prospectuses). In these cases it is clear that it is the agency that conducts an investigation and the enforcement that also applies for these additional court orders. In the result, the overlaps between the FMA and the Registrar in respect of their statutory enforcement powers under the \textit{Companies Act 1993} will be rare.

\section{Conclusion}

The responsibilities of the FMA and the Registrar are clearly delineated. The registration process for disclosure documents follows a clear and sensible allocation of tasks and is congruent with the approach taken under the FSP Act and the FA Act.

\textsuperscript{75} It has to be noted that the Companies and Limited Partnerships Amendment Bill 2011 (344-1) will introduce a new s 138A into the Companies Act, making knowing breaches of directors’ duties a criminal offence: see below 179.

1 Coordination of Financial Market Participants’ Supervision

As discussed in Chapter 4, New Zealand restructured its regulatory architecture according to the twin peaks model, with the FMA acting as market conduct regulator while the Reserve Bank remains the prudential regulator. The coordination of these two tasks should be rather unproblematic. First, the agencies’ approaches to supervision are different. The FMA as the market conduct regulator is more of a policeman that prevents and punishes misbehaviour in the market, while the Reserve Bank safeguards the financial health of market participants and the financial system as a whole. Thus the actions taken by the two agencies and the reasons to take action will be different in most cases; overlaps in terms of enforcement are unlikely.

Overlaps in respect of information gathering appear possible, though. The FMA monitors and collects information from financial markets participants. The Reserve Bank gathers information on prudentially regulated entities such as banks and non-bank deposit takers, and about the economy in general. Overlaps occur if a financial markets participant who is subject to prudential regulation is concerned, or in the unlikely situation where market conduct results in a systemic risk for New Zealand’s financial system. However, it is likely and probably inevitable that both agencies would monitor the same market participants from time to time.

The FMA and the Reserve Bank have already taken steps to promote the efficient flow of information. In September 2011, the Council of Financial Regulators (the ‘Council’) met for the first time. The FMA and the Reserve Bank are the only permanent members; the Treasury and the Ministry of Economic Development are only associate members. The Council is to meet on a quarterly basis and identify important issues and coordinate responses that require cross agency involvement. The Council’s predecessor, the Financial Regulators’ Coordination Group, had comprised eight full members. The fact that the amount of regular members has been reduced from eight to two does not only

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78 Ibid.
illustrate the FMA’s dominant role in the regulatory landscape, it should also make coordination much easier.

Further, the FMA and the Reserve Bank entered into a Memorandum of Understanding in September 2011. Its purpose is to avoid any costly separate collection of the same information, and to enable the efficient transfer of information already gathered by one agency. Joint actions should be taken wherever possible. Unlike the MOU between the FMA and the SFO, the MOU between the FMA and the Reserve Bank should be sufficient for the coordination of tasks. This is because there are only very minor overlaps of enforcement functions.

2 Settlement System Oversight

The second overlap between the two agencies’ functions is the joint oversight over designated settlement systems under Part 5C of the Reserve Bank of New Zealand Act 1989 (the ‘RB Act’). The statute is listed in Part 2 of Schedule 1 of the FMA Act and is therefore part of the financial markets law. The joint regulator model was introduced in 2009 with the Securities Commission and the Reserve Bank sharing some functions. It is based upon a recommendation of the Taskforce in its final report. The FMA took over the Securities Commission’s role in 2011.

Efficient payment and securities settlement systems are key components of the financial architecture. A settlement in terms of the RB Act means the making of a payment or the transfer of the title to, or an interest in, property, including securities: s 156M. Designated settlement systems receive legislative backing for the finality of the settlement, which means that a settlement that was made in accordance with the rules of a designated settlement system cannot be reversed or set aside: s 156R.

Operators of settlement systems can apply for designation under s 156Z. The joint regulators will consider a number of issues, inter alia the applicant’s capacities and capabilities, and its compliance with international standards. The designation itself is

81 Capital Markets Development Taskforce, above n 65, 78.
provided by Order in Council on the advice of the Minister of Justice and the Minister of Commerce in accordance with a joint recommendation of the two regulators: s 156. Variation and revocation of the designation follows the same process and criteria as the designation itself: s 156ZD. Although the joint regulators do not make the final decision in respect of designation, the practical oversight of designated settlement systems lies with them. The FMA and the Reserve Bank entered into a Memorandum of Understanding on designation and oversight in December 2011. The document provides detailed procedures for meetings and the flow of information between the regulators. However, the joint regulator model does not apply if a ‘pure payment system’ is concerned: s 156P. In this case, the Reserve Bank acts as the sole regulator. Thus the joint regulator model only applies to securities settlement systems.

Potential overlaps seem remote. The RB Act envisages the two regulators acting together. There can be no gap between two agencies, and there is no unnecessary duplication of structures. As at 2012, the only designated settlement system for securities is that operated by the New Zealand Clearing and Depository Corporation (NZCDC), a 100 per cent subsidiary of NZX. The other two designated settlement systems (ESAS and CLS) are pure payment systems and thus not subject to the FMA’s jurisdiction. Given the size of New Zealand’s financial markets it is unlikely that additional settlement systems will be necessary. Thus, the potential overlap between the functions of the Reserve Bank and the FMA is remote.

3 Conclusion

The separation of regulatory functions between the FMA and the Reserve Bank is clear and does not cause concern. The joint regulation of settlement systems requires co-ordination between the two agencies. Since this supervision relates to a single designated settlement system the additional work does not seem significant.

85 For more details see Reserve Bank of New Zealand Website, Designated Settlement Systems <http://www.rbnz.govt.nz/finstab/payment/4184013.html>.
F Oversight of Registered Exchanges

1 Self-Regulation Organisations and Securities Markets

(a) Advantages

Not all regulatory functions in relation to New Zealand’s financial markets are exercised by Government bodies. Registered exchanges are subject to a co-regulatory regime that relies on self-regulation of respective exchanges under the supervision of the FMA. In terms of regulatory theory, a registered exchange is a Self-Regulatory Organisation (‘SRO’). SROs are entities that exercise some degree of regulatory authority over an industry or profession. They are particularly popular in the financial markets.

Reliance on SROs comes with a number of potential advantages, most of which result from the fact that an SRO is part of the markets which it is supervising, and sometimes also operating. It should have market expertise, enabling it, at least in theory, to react to market developments quickly. For SROs operating securities markets this argument is particularly valid because the operator of the market should have unrivalled technical expertise. As a business entity, the SRO is able to pay wages that exceed wages usually paid by the Government, thereby creating an incentive to attract competent staff.

From the Government’s perspective reliance on self-regulation is attractive because the costs of supervision and enforcement can be passed on to the market participants as SROs are usually funded directly by the industries they regulate. It also allows the Government to distance itself from the markets, enabling it to avoid or shift the blame if something goes wrong. As it is in the SRO’s best interest to promote confidence in its own market and

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88 Gadinis and Jackson, above n 86, 1250.

89 Ibid 1251; John Coffee, Joel Seligman and Hillary Sale, Securities Regulation – Cases and Materials (Foundation Press, 10th ed, 2007) 673.

90 Austin, above n 86, 449.
establish a good brand name, it can be expected that the SRO would take any reasonable efforts to promote efficient and transparent markets.\textsuperscript{91}

\textit{(b) Risks}

A co-regulatory regime with an SRO as front line regulator carries risks. In general, SROs are often related to the deregulation movement because an SRO in charge of market supervision diminishes the functions of the regulator. The fact that SROs might act in market participants’ interests rather than in the public interest has been subject to criticism because of the potential conflict of interest.\textsuperscript{92} Seeking to increase the number of listed companies and thereby raising its revenue, the SRO might apply rules that promote management interests or apply a lax approach to enforcement.\textsuperscript{93} Even if the SRO takes its enforcement mandate seriously, it would still lack the investigation powers that a public regulator regularly possesses.\textsuperscript{94}

The advantage of the SRO being a market participant might be deceiving, because, as Austin points out, the superior market knowledge of a truly independent SRO would likely diminish over time, approximating the market knowledge of an outsider.\textsuperscript{95} Further, a referral system between the SRO and the regulator in relation to serious misconduct makes the regulator dependent on the SRO. Moreover, in a referral system the regulator is not fully accountable (as set out in IOSCO Principle No 2) because it is able to blame the SRO for insufficient supervision efforts.\textsuperscript{96}

\textit{(c) SROs in Practice}

In practice, co-regulatory models are characterised by SROs that are responsible for the primary regulation of the markets, with the regulator’s role limited to licensing markets, oversight of the SRO, enforcing serious matters referred to it by the SRO and regular

\begin{footnotes}
\item[92] DeMarzo, Fishman and Hagerty, above n 86, 688; Gardinis and Jackson, above n 86, 1249.
\item[93] Gardinis and Jackson, above n 86, 1253.
\item[94] Gardinis and Jackson, above n 86, 1255.
\item[95] Austin, above n 86, 449.
\end{footnotes}
reporting duties.\textsuperscript{97} These safeguards should, in theory, make sure that the SRO acts in the public interest rather than in its own interest.

Overall, the IOSCO acknowledges SROs as adequate to exercise regulatory oversight of market participants (see IOSCO Principle 9). Accordingly, many countries apply a co-regulatory system for their securities markets.\textsuperscript{98} The oversight of exchanges can be undertaken by one two or more agencies.\textsuperscript{99} In relation to the extent of their regulatory functions and the regulator’s oversight, SRO models can be classified as limited, strong, or independent.\textsuperscript{100} In a limited exchange SRO model, a public authority is the primary regulator which relies on the exchange to perform certain regulatory functions tied to the operation of the market (for example, market surveillance and listing).\textsuperscript{101} In a strong exchange SRO model, the exchange’s regulatory functions extend beyond their market operation, including the regulation of members’ business conduct.\textsuperscript{102} The independent model relies extensively on an independent SRO that is not a market operator to perform extensive regulatory functions. If, conversely, the regulator exercises all regulatory functions itself, an exchange cannot be described as an SRO (statutory model).

Australia has recently tightened the regulation of its exchanges. In terms of regulatory theory, Australia has moved from a strong exchange SRO model towards a limited exchange SRO model.\textsuperscript{103} This accords with the international trend as this model is becoming increasingly prevalent as Governments increase the power and resources of statutory regulators in response to the GFC.\textsuperscript{104} As at 1 August 2010, ASIC has taken over all regulatory functions from the Australian Securities Exchange (the ‘ASX’).\textsuperscript{105} Prior to that date, the ASX had set out and enforced its own market rules, referring serious matters to ASIC. The new regime allows ASIC to impose market integrity rules on the registered exchanges and enforce them under Part 7.2A of the \textit{Corporations Act 2001} (Cth).\textsuperscript{106}

\textsuperscript{97} Austin, above n 86, 449.
\textsuperscript{98} For the arguably most comprehensive overview of different models and their application in a number of countries see John Carson, ‘Self-Regulation in Securities Markets’ (Worldbank Research Working Paper No 5542, January 2011) <www.worldbank.org>.
\textsuperscript{99} Ibid 17.
\textsuperscript{100} Ibid 17.
\textsuperscript{101} Ibid.
\textsuperscript{102} Ibid.
\textsuperscript{103} Ibid.
\textsuperscript{104} Ibid 19.
\textsuperscript{105} Australian Department of the Treasury, ‘Minister Announces ASIC to Take Over Supervision of Australia’s Financial Markets from 1 August 2010 (Media Release No 86, 8 July 2010) <http://ministers.treasury.gov.au>.
\textsuperscript{106} For a more detailed discussion of the new regime see Austin, above n 86.
Further, ASIC will be supervising market events in real time. ASX, however, will continue to enforce breaches of its listing rules.\textsuperscript{107} The reason for these changes was not the GFC, but the Government’s plan to encourage larger competition between registered exchanges.\textsuperscript{108} It was seen as inappropriate for the ASX to maintain its regulatory role if competitors started trading in ASX-listed securities.\textsuperscript{109}

\textit{(d) Development in New Zealand until 2011}

Prior to 2002, the New Zealand Stock Exchange (the ‘NZSE’) was the country’s main exchange.\textsuperscript{110} It was a largely unregulated entity that relied on the obligations that were set out in the contracts between the NZSE and the entities that were listed on its market. As these obligations were merely contractual, the Securities Commission had no means of regulating the NZSE market. This system was similar to the independent member SRO model.\textsuperscript{111}

After a debate about a merger with the Australian Securities Exchange in the early 2000s,\textsuperscript{112} the \textit{New Zealand Stock Exchange Restructuring Act 2002} enabled the NZSE to transform into a limited company, and to rename it New Zealand Exchange Ltd (NZX).\textsuperscript{113} This new company operated three main markets: the NZX Stock Market as the equities market, the NZX Debt Market and the NZX Alternative Market which enables companies that are not suited for the NZX Stock Market (for example, because of their structure or size) to raise capital from the public. In 2003 new conduct rules, comprising new listing and participation rules, were introduced. Amendments to the Securities Markets Act backed the listing rules with statutory provisions. The Securities Commission now had the power to enforce compliance by a listed company where the NZX’s listing rules applied.\textsuperscript{114} The regulatory system resembled the strong exchange SRO model. In 2010, the \textit{Authorised Futures Exchange (NZX Limited) Notice 2010} authorized the NZX to operate an additional derivatives market, the NZX Derivatives.

\begin{footnotes}
\footnote{107}{Explanatory Memorandum, Corporations Amendment (Financial Market Supervision) Bill 2010 (Cth) 17.}
\footnote{108}{Austin, above n 86, 445.}
\footnote{109}{Ibid.}
\footnote{110}{For a history of the NZSE and the NZX see, eg, Victoria Stace, \textit{Securities Law in New Zealand} (LexisNexis NZ, 2010) 355-6.}
\footnote{111}{Querverweis.}
\footnote{113}{Ibid.}
\footnote{114}{Stace, above n 110, 357.}
\end{footnotes}
Under s 36ZL Securities Markets Act as amended by the Securities Markets Amendment Act 2006 (the ‘Pre-FMA Securities Markets Act’), the Securities Commission was entitled to refer certain matters to NZX. In February 2003, the Securities Commission and NZX signed a Memorandum of Understanding that governed the division of competences between the two bodies and recognized that NZX was the front-line regulator. The Securities Commission confined itself to supervision and review of securities markets and enforcement of certain breaches of securities law: cl 4.1 of the MOU. In 2004, NZX created a separate entity, the NZX Discipline, to adjudicate in respect of alleged breaches of the NZX Listing Rules and Participant Rules. This body was renamed New Zealand Market Disciplinary Tribunal (the ‘NZMDT’) in 2008.

The NZX has remained the only licensed market operator in New Zealand. Until July 2012, no MOU between the FMA and NZX has been signed, although the FMA recently stated its intention to do so.

2 Registration and Supervision of Exchanges in New Zealand Today

(a) The Regime under the Securities Markets Act

The introduction of the FMA was accompanied by changes to the registered exchange regime in Part 2B of the Securities Markets Act. No person may operate a securities exchange unless that person is a registered securities exchange or a subsidiary of a registered exchange (s 36B). The Minister of Commerce may exempt securities exchanges from any requirements of Part 2B (s 36E).

The key provision for the registration and approval procedure is s 36Y. The registered exchange must:

- to the extent that it is reasonably practicable, do all things necessary to ensure that each of its registered markets is a fair, orderly, and transparent market;
- have adequate arrangements for operating its registered markets,
- have sufficient resources to operate the registered markets properly.

116 Stace, above n 110, 370.
The application for market registration needs to be filed with the FMA and include a proposal for its applicable market rules: s 36F. The market rules must comprise listing rules that relate to the approval of issuers and their behaviour, and business rules that relate to the authorisation of people who trade in securities and their respective conduct: s 36I. The FMA must approve the application unless it is satisfied that the applicant does not comply with the key criteria that are set out in s 36Y.

If the registered exchange is approved, it is required to provide an annual report to the FMA and the Minister of Commerce, addressing the extent to which it has complied with its obligations: s 36YA. The FMA has the right to conduct a general obligations review at any time: s 36YC. If the FMA is of the opinion that the exchange has failed to meet its obligations under s 36Y, the FMA can require the exchange to submit an action plan to remedy the shortcoming: s 36YD. If the exchange refuses or does not comply with an action plan approved by the FMA, the Minister of Commerce may, on the recommendation of the FMA, provide a general obligation direction to the registered exchange: s 36YF. This mechanism enables FMA to force an exchange to make changes to the way the exchange operates and supervises the markets. Under the Pre-FMA Securities Markets Act, the Securities Commission lacked such a power and was only able to criticise flaws in NZX’ market supervision.118

(b) Amendments under the FMA Act

In comparison to the regime that had been in force prior to the introduction of the FMA, the new regime under the amended Securities Market Act provides a stronger role for the regulator. Under the old regime, it was the ‘chief executive’ which approved the application of an exchange to be registered under 36F of the Pre-FMA Securities Markets Act. Under s 2 of the Act, chief executive ‘means the chief executive of the department that, with the authority of the Prime Minister, is for the time being responsible for the administration of the Act’. Thus, the Minister of Commerce was responsible for the registration of exchanges.119 Under s 36F(2)(3) of the current Securities Markets Act, this function is now exercised by the FMA. The process for approval of market rules has undergone similar changes. Under the Pre-FMA Securities Act, the approval of new or

118 See, for example, the repeated criticism of the insufficient separation of market operation and market supervision, see below 151.
amended market rules was made by Order-in-Council upon recommendation by the Minister of Commerce: s 36O. Thus the approval of exchange rules lay in fact with the Minister of Commerce.\textsuperscript{120} The Minister merely had to ‘seek advice’ from the Securities Commission under ss 36N and 36O of the Pre-FMA Securities Markets Act. So the FMA Act shifted the power to approve registered exchanges and related internal rules from the Minister to the FMA, which is a significant improvement of the regulator’s powers and independence. However, the Minister alone has the power to grant exemptions from the registration and approval regime. It is unclear why this mechanism remained untouched during the legislative process because it is not coherent to assign the power to approve exchanges to one body, and the power to exempt exchanges to another. The respective legislative materials do not address the issue.

Another important change is the new approval procedure for amending the exchange’s market rules. Under the Pre-FMA Securities Markets Act, exchange rules automatically came into force unless they were disallowed by the Minister of Commerce. The Minister could disallow a rule if he or she was satisfied that the rule was not in the public interest, which was difficult to satisfy.\textsuperscript{121} The fact that the NZX Board of Directors was able to change the rules of the NZX markets without consultation with market participants,\textsuperscript{122} in combination with the listed companies’ obligation to amend their rules accordingly without delays (‘auto-pilot rule’), resulted in the NZX’s ability to change its market rules on a day to day basis.\textsuperscript{123} The need to get the FMA’s approval under s 36L of the current Securities Markets Act before the new rules come into force puts an end to this regulatory gap.

The original FMA Bill (211-1) had envisaged a further increase of the FMA’s involvement. The original FMA Bill had envisaged a new power to make market integrity rules similar to ASIC’s rule making power under Part 7.2A of the \textit{Corporations Act 2001} (Cth). The underlying purpose of such rules would have been to override conduct rules that posed a threat to market integrity in circumstances where the exchange would have been unable to remedy the problem. Such rules would have been introduced by regulation made

\textsuperscript{120} From the legislative materials it appears obvious that the decision itself was made by Minister and the approval by the Order-in-Council was a mere formality, see, eg, Office of the Minister of Commerce, \textit{Creating a Financial Markets Authority and Enhancing KiwiSaver Governance and Reporting} (Cabinet Paper, 2010) 14 <www.med.govt.nz>.

\textsuperscript{121} Ibid 16.

\textsuperscript{122} Changes of the market rules had to be provided to the Minister of Commerce under s 36J of the Pre-FMA Securities Markets Act, but remained in force unless the Minister disallowed the rule: s 36M.

by Order-in-Council upon recommendation by the Minister of Commerce (s 36Q) and enforced by the FMA (for example, under s 42 ZH of the Securities Act).\textsuperscript{124} The Commerce Committee, however, was of the opinion that the envisaged rules might increase uncertainty. It considered that ‘such reserve regulation-making powers are not urgent, and could be considered further in the review of securities laws.’\textsuperscript{125} However, the FMC Bill does not include any power for the FMA to impose market integrity rules on registered exchanges.

\textit{(c) Proposed Changes under the FMC Bill}

The proposed regime for registered exchanges is set out in Subparts 8 and 9 of Part 5 of the FMC Bill. The new law would comprise a combination of rules from the Securities Markets Act and Part 7.2 of the Australian \textit{Corporations Act 2001} (Cth). The main term is ‘financial product market’, which means facilities in which offers to acquire or dispose of financial products are regularly made or accepted (cl 307). This is a literal duplication of the definition of ‘financial market’ under s 767A of the \textit{Corporations Act 2001} (Cth).

The operation of a financial product market would be prohibited unless the person held a financial product market license or an exemption applied: cl 310. The general obligations for operators (cl 312), the application process (cl 313) and the conditions under which the license would be granted (cl 314) would be very similar to the system under the Securities Market Act. However, there would be one significant change – although the application would need to be filed with the FMA, the final decision on granting the license would be made by the Minister of Commerce: cl 314. The FMA would merely provide ‘advice’ to the Minister under cl 313(3). This is an exact copy of ss 795A and 795B of the \textit{Corporations Act 2001} (Cth) and would result in a step back from the regime that was introduced in May 2011, demoting the FMA to an advisory role. It is unclear if this proposed change is an intentional re-establishment of the procedure as set out in the Pre-FMA Securities Markets Act, or simply a result of copying and pasting the Australian framework uncritically. If the former, it would be inconsistent with the general approach towards a regulator with comprehensive powers. If the latter, it would disregard the fact that ASIC is in direct charge of market supervision and has the power to impose integrity

\textsuperscript{124} Exemplary Note, Financial Markets (Regulators and KiwiSaver) Bill 2010 (211-1) 6.
\textsuperscript{125} Commentary, Financial Markets (Regulators and KiwiSaver) Bill 2010 (211-2) 9.
rules on the market operator if necessary. In that respect, it would be of lesser significance to allocate the approval power to the Minister because ASIC possesses methods to achieve effective market supervision even if it were in disagreement with the Minister’s decision. Either way, allocating the approval power to the Minister of Commerce is inconsistent.

(d) Conclusion

In summary, the Government augmented and widened the regulator’s powers in respect of registered exchanges. However, it did not alter the general regulatory structure. Despite the international trend towards the limited exchange SRO model, New Zealand’s frontline regulation of listed entities will continue to apply the strong exchange SRO model. The positive aspect of this approach is that the FMA can rely on existing structures and try to improve them step by step.

3 Conflicts of Interest

(a) The NZX Conflict Management Policy

One of the structural problems of self-regulated exchanges is the conflict between the exchange’s role as the market operator and its role as the market supervisor. In the case of NZX, the potential conflict of interest is particularly delicate because the NZX, a for-profit company, is listed on its own market, the NZSX. The NZX faces a double conflict of interest, because it is the market operator and a market participant. It is not surprising that this combination has been subject to criticism. One example given is that prior to 2009, the NZX was unwilling to provide full market announcements in real time while it profited from selling that same real time information to subscribers, giving them a head start of 20 minutes and thus enabling a form of insider trading.126 Official reports were more reserved in their criticism. The Prada/Walter Report noted a number of market participants’ concerns about the NZX’s role, but admitted that no examples of regulatory failure had come to the authors’ attention.127 The legislative materials issued by the Government before the

126 New Zealand Shareholders Association, above n 147, 11.
creation of the FMA do not state that regulatory failure occurred in the past, but address the potential conflicts in much detail.\textsuperscript{128}

The NZX Board has attempted to address the issue by introducing a Conflict Management Policy in January 2008.\textsuperscript{129} This policy is still in force. The aim is to quarantine the core supervisory functions into a separate branch called Market Supervision, which is chaired by the Head of Supervision (the ‘HoS’).\textsuperscript{130} The NZX Board formally remains in charge of both commercial and regulatory sides of the NZX’s business, but delegates all regulatory functions jointly to the NZX CEO and the HoS and ‘provides a mechanism to ensure the independence of the Head of Supervision and that no undue commercial pressures are brought to bear on her or her team.’\textsuperscript{131} The NZX Board tries to achieve this objective by meeting with the HoS without the CEO present and providing support if necessary.\textsuperscript{132}

This form of separation of market operation and market supervision has been subject to criticism in the past. In its oversight review for 2008, the Securities Commission was concerned about the joint exercise of regulatory functions by the CEO and the HoS.\textsuperscript{133} It was of the opinion that the joint exercise did not comply with the prerequisite of regulation because it was not sufficiently independent from commercial influences as set out in the IOSCO Principles.\textsuperscript{134} It would have been possible to transfer the regulatory functions to the HoS alone, without the participation of the CEO. The Securities Commission suggested a formal separation of the functions of the HoS and the CEO.\textsuperscript{135} The NZX noted the criticism but insisted that all respective duties had been discharged appropriately, and therefore no further action was required.\textsuperscript{136} In the oversight review for 2009 and 2010, the Securities Commission reiterated its criticism.\textsuperscript{137} The NZX had acquired several businesses in 2009, and the Securities Commission was of the opinion that potential conflicts of interest would arise because the NZX and its subsidiaries were facing a growing number of competitors that were listed on the NZX markets.\textsuperscript{138} The FMA raised the same issues and made the

\begin{itemize}
  \item Ministry of Economic Development, above n 66, 12-13; Office of the Minister of Commerce, above n 67, 13-18.
  \item Ibid 5.
  \item Ibid.
  \item Financial Markets Authority, above n 117, 22.
  \item Ibid 15.
  \item Ibid 14.
  \item Ibid 8-9.
  \item Ibid 27-8.
\end{itemize}
same suggestions in its first review of the NZX’s obligations in 2012.\textsuperscript{139} It pointed out that the conflict is not restricted to the HoS him- or herself, but to a number of employees. For example, all of Market Supervision’s solicitors were involved in commercial legal work.\textsuperscript{140}

As at July 2012, the NZX has not expressed any intention to change its structure accordingly, but it has at least announced a review of its internal structure for the second half of 2012.\textsuperscript{141} It is unclear why the NZX insists on keeping its CEO involved in regulatory work. Neither the document that sets out the policy nor other statements explain why joint regulation is the preferred option. However, neither the Securities Commission nor the FMA have found evidence that conflicts of interest have adversely affected the exercise of regulatory functions. Nonetheless, as the NZX admits, the mere perception of a conflict can be as damaging as an actual conflict and needs to be dealt with accordingly.\textsuperscript{142}

\textit{(b) Options}

\textit{(i) Improvement of the Status Quo}

The first and most simple option would be a clear separation between the regulatory functions of the HoS and the management functions of the CEO. This would mean continuing but improving the status quo. The advantage of this approach would be that the change would not require restructuring the regulatory landscape, and it would not involve notable costs. The NZX would need to identify involvement of the HoS in market operations as well as other employees’ involvement in the regulatory functions. In a second step, all cross-involvements would need to be severed to make the HoS fully independent.

However, even a clear separation of functions within NZX would not dispel all concerns about conflicts of interest. The HoS and her staff would still be employees of NZX, which means that the work of the HoS could never be fully independent. Further, a mere internal separation of functions relies strongly on the person who acts as the HoS. An incident in 2011 demonstrates that the structure within the NZX is fragile and needs to be questioned. In 2011, the HoS went on parental leave. In her stead, the NZX Board appointed the Corporate Counsel to cover the position, performing both the Corporate Counsel and

\textsuperscript{139} Financial Markets Authority, above n 117, 22-3.
\textsuperscript{140} Ibid 25.
\textsuperscript{141} Ibid 23.
\textsuperscript{142} NZX, above n 129, 4.
acting HoS roles.\textsuperscript{143} The problem was that the Corporate Counsel was involved in his employer’s major business activity, which is running the NZX markets. Hence, the already fragile line between market operations and market supervision collapsed. As stated in Chapter 4, New Zealand has a limited number of financial markets experts.\textsuperscript{144} NZX noted that it had experienced some difficulties with filling the HoS role with external contractors in the past.\textsuperscript{145} Thus, it might have been difficult to find a suitable replacement for the HoS. However, the fact that the NZX was not able to find a suitable person among its own supervision staff suggests a lack of resources. Appointing an interim HoS who is clearly involved in the market operation business suggests carelessness or at least a lack of sensitivity to the issue.

A second argument against the status quo is that the NZX is currently the only market operator in New Zealand. As stated above, the main driver for the recent reform of exchange supervision in Australia was to facilitate competition between exchanges and to minimise market entry barriers.\textsuperscript{146} If, hypothetically, a second operator obtained a market, it would need to develop its own conflict management policy. For a new and arguably smaller market operator it would be probably even more difficult to draw a clear line between market operation and supervision. In summary, continuation of the status quo is undesirable.

(ii) Transfer of Supervision to the FMA

A second option would have the FMA take over all supervision functions from NZX. The result would be a change from the strong exchange SRO model towards the limited exchange SRO model. The exchange’s role would be limited to operating the market and monitoring compliance with its own rules. Such an approach would approximate the changes made in respect of ASIC and the ASX. The two benefits would be that any conflict of interest would be resolved, and that other operators of exchanges would find it easier to enter the market.

A change towards the limited exchange SRO model is, however, not a realistic model for New Zealand. First, a transfer of responsibilities would necessitate amendment of the

\textsuperscript{143} Financial Markets Authority, above n 117, 22.
\textsuperscript{144} See above 101.
\textsuperscript{145} Financial Markets Authority, above n 117, 23.
\textsuperscript{146} See above 146.
Securities Markets Act and the FMC Bill respectively. A full transfer of supervisory functions to the regulator has not been discussed during the reform process. It is unlikely that the Government has the political will for such a major change to the regime.

The second reason is that the FMA is not a market participant and thus lacks advantages in terms of market information that the NZX possesses. The FMA would need to make up for that by poaching staff members from regulated entities or the NZX itself, which would result in high costs. For ASIC with its operating budget of AUSD$ 386 million\(^{147}\) this might be feasible. For the FMA with its much smaller budget, this would be problematic.

The third and closely related reason is that constant market supervision would probably overpower the FMA’s resources. In 2011 and 2012, the NZX Market Supervision Unit comprised between 15.75 and 17.5 full-time employees.\(^{148}\) Given that the FMA had expressed concerns that these numbers were too low,\(^{149}\) the FMA would probably need to hire approximately 20 new staff members if it were to take over direct supervision of registered exchanges. This would necessitate a significant increase in funding and most likely a further adjustment of the FMA levy. Thus, although a transfer of market supervision to the FMA would be a good solution, the related financial problems that would make this an unrealistic option.

(iii) **Transfer of Supervision to a Subsidiary**

A third option would be to require the markets to form an independent SRO whose sole role would be the supervision of the securities markets. This could be a subsidiary of the market operator. In the United States, the New York Stock Exchange applies such a model, having delegated the supervisory functions to a non-for-profit subsidiary called NYSE Regulation.\(^{150}\) Similarly, the NASDAQ is supervised by NASD Regulation, a subsidiary of the National Association of Securities Dealers.\(^{151}\) In Australia, prior to the reforms in 2010, market supervision had been exercised by ASX Markets Supervision Pty Ltd, a subsidiary of the ASX.\(^{152}\) The advantage of such an approach is that it achieves a formal separation of

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\(^{148}\) Financial Markets Authority, above n 117, 25.

\(^{149}\) Ibid 25-6.

\(^{150}\) For more details see Coffee, Seligman and Sale, above n 44, 641-2.

\(^{151}\) Ibid.

\(^{152}\) Carson, above n 98, 29.
market operation and market supervision. It remains debatable, though, if the regulatory arm of for-profit market participants can be effectively insulated from its parents.\textsuperscript{153} However, the creation of a separate legal entity would draw a clearer line than the internal approach taken by NZX.

In the case of NZX, the application of the approach would require the creation of a new subsidiary and the transfer of the Market Supervision branch. NZX would need to introduce a policy that prevents employees of either body to be involved in the other body’s work. In particular, a clear distinction between the executive staff of the two entities would be necessary. NZX’ annual report under s 36YA of the Securities Markets Act (cl 336 of the FMC Bill) would need to cover the subsidiary’s budget and staff arrangements as well as the exercise of its supervisory function. If necessary, the FMA could require NZX to action the necessary changes under s 36YD of the Securities Markets Act: cl 339 of the FMC Bill. Thus the transfer to a subsidiary would not require any changes to existing statutes. In summary, the creation of a subsidiary seems a feasible way of separating NZX’ supervisory functions from its business activities.

\textit{(c) Enforcement}

\textit{(i) Market Supervision}

Another aspect of the conflicts of interest problem is enforcement. Under the Securities Markets Act, the registered exchange enforces its own listing rules. The detection of breaches is performed by NZX’s Market Supervision Unit. If Market Supervision (assisted by NZX Surveillance) detects a possible breach, it decides whether to refer the matter to the NZMDT. Market Supervision further notifies the FMA of all significant breaches of the listing rules, the FMA Act, the Securities Act, the Securities Markets Act and \textit{Takeovers Act 1993}: s 36ZD. The term ‘significant’ indicates that not all breaches need to be reported to the FMA; the registered exchange has to determine as to which breaches it considers 'significant'.

The Market Supervision Unit is pivotal for all aspects of enforcement. If its market surveillance system and investigations are inadequate, the FMA would be unable to take action in respect of breaches of financial markets law that occur in New Zealand’s biggest

\textsuperscript{153} Ibid 642.
market, leaving a large gap in the regulatory system. The FMA, however, seems to be quite satisfied with Market Supervision’s performance. Although the FMA’s oversight review indicates some concern about delays in the investigation of matters, the criteria and processes in respect of supposed breaches were generally approved. In total, the NZX notified the FMA of 38 alleged breaches of the listing rules, while an additional 17 matters were determined to be less significant.

(ii) New Zealand Market Disciplinary Tribunal

The NZMDT is an independent adjudicative body that is resourced by NZX. Its purpose is to adjudicate breaches of the NZX market rules. Under the NZ Market Disciplinary Tribunal Rules the NZMDT can impose penalties on listed entities and suspend them from trade. Decisions can be appealed in the Appeals Panel. As stated in Chapter 3, the Government had originally planned to convert NZMDT into a statutory panel. After the FMA Bill had been introduced into Parliament, the Commerce Committee discarded the idea and favoured a continuation of the NZMDT under the auspices of NZX.

The real issue is not whether the NZMDT is a statutory body or an independent part of NZX. The issue is whether the NZX refers a sufficient number of matters to the NZMDT. This is because the NZMDT can only act if a matter was referred to it by the NZX. In 2011, only four matters were referred. This represents a 50 per cent reduction in referrals against the previous low in 2010 (eight referrals). Given that NZX counted a total of 55 alleged breaches of its market rules and notified the FMA of 38 significant breaches, the number of referrals to the NZMDT is alarming low. It may be more important that the NZX refers significant breaches of its listing rules or of the relevant statutes to the FMA. However, the low number of referrals to the NZMDT suggests that the NZX is not sufficiently committed to enforcement of breaches of its rules.

155 Ibid 24-5.
156 Ibid 24.
158 Ibid [4.2].
159 Ibid [5.3].
160 See above 80.
161 Financial Markets Authority, above n 117, 60.
162 Ibid.
164 See also Financial Markets Authority, ibid 60.
4 Conclusion

The recent reform of the regulatory architecture resulted in some changes in the relation between the regulator and registered exchanges, increasing the FMA’s powers in several areas. However, despite the international trend towards stronger involvement of regulators in market supervision, New Zealand will retain its current system which envisages a strong role of the mainly self-regulated exchange. It would be sensible for the FMA to push for a transfer of market supervision to an independent subsidiary of NZX and make sure that this subsidiary is well-resourced, to help overcome or limit potential conflicts of interest.

G The Takeovers Panel

The Takeovers Act 1993 and the Takeovers Code 2001 are not mentioned in Schedule 1 of the FMA Act. They are not part of the financial markets law and are therefore not regulated by the FMA. Takeovers are still regulated by the Takeovers Panel. Thus, there is no potential overlap between the two agencies. However, persisting regulatory fragmentation and the unnecessary duplication of structures might be an issue.

1 The Relation between the Financial Markets and Takeovers Law

The idea of takeovers regulation is to protect minor shareholders in change-of-control situations.165 New Zealand follows the model of ‘enhanced participation’, which means that an offeror who wants to acquire more than 20 per cent of the shares of a listed company (or of an unlisted company with more than 50 shareholders and more than NZ$ 20 million of assets) must make an offer to all shareholders on the same terms.166 The precise nature of takeovers regulation is unclear. On the one hand, change-of-control situations and the protection of minority shareholders are typical aspects of corporate law. On the other hand, a takeover is a securities transaction to which the company is not

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166 Griffiths, above n 165, 1143-1147; Stace, above n 110, 377-8.
Thus takeovers regulation can be seen as closely related to financial markets law or even a part of it.

The critical interrelation between securities markets supervision and takeovers regulation is demonstrated by a number of studies from several countries that found takeover announcements are often preceded by abnormal trading activities immediately prior to the announcement. These coincidences suggest insider trading. From this point of view it could make sense to assign takeovers regulation to the financial markets regulator. For example, the International Monetary Fund’s assessment of New Zealand’s financial markets in 2004 reviewed the Securities Commission, the Registrar of Companies and the Takeovers Panel as the three securities regulators, which suggests that takeovers regulation is part of financial markets regulation.

2 New Zealand

Although there has been a reshuffle of New Zealand’s regulators, the Takeovers Panel has been retained as a separate body and takeovers regulation as a separate area of law. Both the Regulatory Impact Statement and the Cabinet Paper that prepared the creation of the FMA quickly dismissed the idea of transferring takeovers regulation to the FMA and did not provide further explanation. It seems odd, however, that statutes such as the Building Societies Act 1965 and the Industrial and Provident Societies Act 1908 fall under the financial markets legislation as set out in Sch 1 of the FMA Act, whereas the closely related takeovers regulation does not.

Under the new legislation, the Takeovers Panel and the FMA are supposed to assist each other and ‘may’ provide all available information to each other s 15A of the Takeovers Act 1993 and under s 30 of the FMA Act. Interestingly, NZX must notify the FMA and not the Takeovers Panel if it suspects a significant contravention of the Takeovers Act 1993:

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170 International Monetary Fund, above n 75, 7 <www.imf.org>.
171 Ministry of Economic Development, above n 52, 21.
172 Office of the Minister of Commerce, above n 53, 6, 41.
s 36ZD of the Securities Markets Act. As of July 2012, no MOU between the FMA and the Takeovers Panel bodies existed.

The main issue in respect of the Takeovers Panel is that its role does not fit into the general approach of the recent law reforms. Although it is an independent crown entity under s 5(2) of the *Takeovers Act 1993*, the Takeovers Panel sees itself as a ‘committee of the market’.\(^\text{173}\) It follows the idea of industry self-regulation. As stated in Chapter 2, this reluctant stance towards tighter regulation combined with reliance on the markets contributed to the poor performance of New Zealand’s capital markets in the past.\(^\text{174}\) The idea of market self-regulation does not coincide with the new, stricter approach that has been followed since the creation of the FMA. In contrast, the licensing and registration regime for financial intermediaries had been redesigned before it came into force, away from a light-handed supervision model towards a tighter regime enforced by the FMA.\(^\text{175}\) The Government, however, still does not seem to plan any substantial changes to the takeovers regime. In November 2011 the Companies and Partnerships Amendment Bill 2011 (344-1) was introduced into Parliament. It envisages new powers for the Registrar of Companies and further aligns the *Companies Act 1993* and the *Takeovers Act 1993* as suggested by the Taskforce,\(^\text{176}\) but does not refer to the financial markets law. The respective Cabinet Paper\(^\text{177}\) does not mention the relation between the FMA and the Takeovers Panel either. It can be concluded that the Government does not intend to make structural changes to the FMA’s role in takeover regulation.

In all fairness it has to be said that this co-operation model is not a serious flaw in the new regime. Other countries such as the United Kingdom and Australia also have separated market conduct and takeover regulation. Besides the boundary between financial markets law and takeovers law is clear. The takeover regime becomes relevant as soon as a shareholder wants to acquire more than 20 per cent of the shares the company. Such transactions are a special form of securities transaction that has additional implications. However, the separation between financial markets law and takeover law is another indicator that the consolidation of the regulators and the legal framework was less


\(^{174}\) See above 42, 46.

\(^{175}\) See above 61-63.

\(^{176}\) Capital Markets Development Taskforce, above n 65, 67.

thorough than it could have been. It might be worthwhile to create a system in which the Takeovers Panel retains its independence, but is subject to the FMA’s supervision. Such a model would resemble the FMA’s oversight role of registered exchanges and warrant a minimum level of influence on takeovers regulation to achieve a coherent legal framework.

H Conclusions

The overlap of the enforcement roles of the FMA and the Commerce Commission are limited to misleading or deceptive conduct in the financial markets. The Government is aware of the overlap and is attempting to address it in the coming reforms. The new civil liability regime will probably result in a higher level of enforcement activity.

The overlap between the enforcement functions of the FMA and the SFO is more difficult to handle. The Government is aware of the issue but prefers an amicable solution by means of a Memorandum of Understanding. The SFO MOU, however, does not effectively prevent double investigation and enforcement. The FMA should refer prosecutions to the SFO as often as possible and focus on proactive supervision and civil litigation.

The delineation between the roles of the FMA and the Registrar in respect of registration and enforcement of directors’ duties is quite clear. The involvement of the Registrar in the registration process is not an unnecessary duplication of structures, but a sensible bundling of all registers in one agency.

The overlaps between roles of the FMA and the Reserve Bank are minimal and have arguably been addressed properly in the respective MOU.

The current reform has increased the FMA’s powers in respect of registered exchanges. The fact that some new provisions are modelled on the Australian law, however, will lead to inconsistencies. The NZX’ approach to resolve potential conflicts of interest is unsatisfactory. A sensible approach to this issue would be the creation of a new, well-funded subsidiary.

The demarcation between the Takeovers Panel and the FMA is also clear. However, the fact that the market conduct regulator has no hand in the regulation of takeovers at all does not fit into the concept of a consolidated super-regulator.
The FMA Act was introduced and the FMA was created, inter alia, to strengthen the enforcement regime. This chapter considers the new regime. First, theoretical approaches to promote market participants’ compliance (i.e., supervision and enforcement) are discussed. Second, the ‘old’ enforcement regime with the Securities Commission as the main regulator is compared with the extended regime under the FMA Act and the FMC Bill. Third, the new powers will be considered in more detail.

**A  Enforcement Theory**

1  Enforcement and Supervision

(a)  Reactive Enforcement

As discussed in Chapter 1, this thesis rests upon the hypothesis that effective public enforcement is crucial for the financial markets. To determine what effective public enforcement is, we must determine what is meant by the term ‘enforcement’. *Black’s Law Dictionary* defines enforcement as the ‘act or process of compelling compliance with a law, mandate, command, decree, or agreement’. According to the *Australian Law Dictionary*, ‘enforcement is an authorised exercise of power against a person who has not voluntarily complied with an order within the time allowed by the authority making it.’ Thus, enforcement is a method to compel compliance with the law. Compliance is a more general term used to describe adherence to laws, regulations and rules. Law enforcement

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1 See above 10-18.
has a disciplinary function; it provides *ex post* sanctions for breaches of the law.\(^5\) Hence, enforcement is a reactive approach to address breaches of the law that occurred in the past. Typical enforcement tools available to regulators are criminal penalties, civil penalties and administrative penalties. The typical tool available to market participants is compensation.

**(b) Proactive Supervision**

A second method of encouraging compliance is supervision.\(^6\) Supervision is *ex ante* – its aim is to identify issues early in the regulatory process and prevent problems before they arise.\(^7\) Supervision can be described as a proactive approach. It is a crucial addition to enforcement activities because reactive enforcement can never fully restore both material and immaterial losses to investors or to the markets.\(^8\)

Supervision is governed by a tight legal framework, including barriers to entry for market participants (for example, licensing regimes), or by standardised scrutiny of particular products (for example, registration and review of prospectuses). On the other hand, compliance by supervision is also achieved by the regulator’s general conduct, for example market surveillance, public warnings and advice for market participants and investors. Generally, in comparison with enforcement actions, supervision is less confrontational because it involves interaction with the regulated instead of punishing them for wrongdoings.\(^9\) In contrast to enforcement, supervision via licensing or interaction with market participants can only be exercised by public authorities (or by SROs that act instead of public authorities), and not by private market participants.

\(^5\) Ibid 5. In the past some commentators described ‘compliance’ and ‘deterrence’ as competing models. These terms are confusing because the issue was whether compliance was best achieved by persuasion or by sanctions, and not a competition between compliance and deterrence. For references see Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press, 1992) 20.


\(^7\) Carvajal and Elliot, above n 4, 4.

\(^8\) Ibid.

\(^9\) Ibid 4.
The distinction between supervision and enforcement appears straightforward. However, it is difficult, if not impossible, to separate supervision and enforcement in practice.\(^\text{10}\)

The first reason is the strong interdependence between supervision and enforcement. In theory, a perfect supervision regime would detect and prevent a large number of potential breaches of the law and thereby render enforcement unnecessary. On the other hand, without enforcement, compliance would probably be less thorough because there would be no working deterrence mechanism, leaving supervision ‘unsupported’.\(^\text{11}\) As a result, a low level of enforcement activity does not necessarily indicate a lazy regulator. It is possible that the regulator puts strong emphasis on proactive measures, resulting in less of a need for reactive enforcement. Conversely, a high level of successful enforcement action does not necessarily indicate an effective or efficient approach taken by the regulator because this could reflect insufficient supervision. However, a good enforcement regime is able to compensate for flaws in the supervision regime, and vice versa. These considerations are reflected by the different approaches taken by regulators in practice. For example, the U.S. SEC heavily relies on reactive enforcement whilst the U.K. FSA places emphasis on advising and assisting market participants.\(^\text{12}\) Thus, in terms of regulation theory, the two regulators responsible for the largest financial markets in the world appear to be at opposite ends of the regulatory spectrum.\(^\text{13}\)

The second reason is that some tools available to the regulator are able to be used for both proactive supervision and reactive enforcement. For example, enforceable undertakings under s 46 of the FMA Act may be used in any matter in which the FMA exercises its functions. The acceptance of a written undertaking by the FMA would prevent any further or possible breaches of financial markets law.\(^\text{14}\) To that extent, enforceable undertakings are a proactive tool because they focus on the market participant’s behaviour in the future. On the other hand, they may be used to impose – with the market participant’s consent – sanctions on the market participant, which would focus on his behaviour in the past.

\(^{10}\) Ibid 30.

\(^{11}\) Ibid 5.


Similarly, an investigation conducted by the FMA might result in information being obtained that would be necessary for later enforcement actions, or that could prevent possible breaches of the law. Thus, the regulator’s tools do not necessarily fit into only one of the two categories; often a tool has both proactive and reactive elements.

The conclusion is that an assessment of the effectiveness of an enforcement regime must take into account both proactive and reactive mechanisms. This is acknowledged by the IOSCO methodology which states that both preventative and corrective measures are fundamental for the enforcement of securities laws.\textsuperscript{15} The interrelations and overlaps between supervision and enforcement are relevant for this thesis. As stated in Chapter 3, the New Zealand Government wanted to strengthen the enforcement system to restore investor confidence in the financial markets.\textsuperscript{16} The Government highlighted the necessity to deal with breaches of the financial markets laws quickly, and the need for a more proactive approach to regulation to be taken by the regulator.\textsuperscript{17} Thus, it would be imprecise to say that the FMA’s enforcement powers were extended by the recent reform. It would be more appropriate to say that the FMA has been and will be provided additional proactive and reactive powers to foster compliance with the financial markets rules. However, commentators and the New Zealand Government use the term ‘enforcement’ in a broad way, including both preventative and reactive regulatory tools.\textsuperscript{18} Thus, this thesis will use the term ‘enforcement’ in the same way.

2 \hspace{1em} \textit{Comprehensive Enforcement Powers}

\hspace{1em} (a) \hspace{1em} \textit{IOSCO Methodology}

An ensuing question is what powers regulators must have in order to conduct effective enforcement. IOSCO Principle No. 10 states that ‘the regulator should have comprehensive enforcement powers’. The IOSCO Methodology, however, provides only limited insight. The key questions set out in the IOSCO Methodology require the regulator to have the power to initiate criminal and civil proceedings and to impose administrative sanctions.\textsuperscript{19} The regulator must have the investigation powers necessary to obtain all relevant

\begin{footnotesize}
\begin{enumerate}
\item See above 67.
\item Ibid.
\item Ibid.
\item See, for example, the discussion about the ‘enforcement pyramid’ that includes preventative and reactive tools, see below 169-171.
\item IOSCO, above n 15, 64.
\end{enumerate}
\end{footnotesize}
information required to impose sanctions upon the wrongdoer.\textsuperscript{20} Where an authority other than the regulator takes enforcement action, the regulator must be able to share its information with that authority.\textsuperscript{21} Finally, private persons must be able to seek their own remedies for misconduct relating to the securities laws.\textsuperscript{22}

These assessment criteria remain rather vague; the IOSCO Methodology does not delineate different enforcement methods in more detail. The reason is that the IOSCO Principles remain unspecific as they describe international best practice for laws from different legal systems, in particular civil and common law jurisdictions.\textsuperscript{23} Instead, the assessment of the effectiveness of an enforcement regime should ask whether the system as such enables the regulator detection, investigation and prosecution of violations of securities laws.\textsuperscript{24}

\textit{(b) Enforcement Pyramids}

A second way to determine the comprehensiveness of an enforcement regime is the use of the enforcement pyramid. This is closely related to the concept of ‘responsive regulation’ which has its roots in game theory.\textsuperscript{25} The concept assumes that regulators will never have the resources to prevent or remedy all breaches of the law. Thus, the regulator’s actions should be responsive to the regulated’s behaviour, and the regulator should try to motivate the regulated to comply with the law on his or her own.

In 1984, Scholz argued that the optimal enforcement strategy would be ‘tit-for-tat’.\textsuperscript{26} That is, the regulator should hold back punishment as long as the wrongdoer co-operates and should only exercise punishment if strictly necessary. In 1992, Ayres and Braithwaite suggested several enforcement strategies, including self-regulation, enforced self-regulation, and command regulation with discretionary or non-discretionary punishment.\textsuperscript{27} They pointed out that business conduct can have several motivations, such as financial return, reputation, social responsibility, other individual (sometimes irrational)

\begin{thebibliography}{9}
\bibitem{20} Ibid 65.
\bibitem{21} Ibid 66.
\bibitem{22} Ibid.
\bibitem{23} Ibid 58
\bibitem{24} Ibid 66.
\bibitem{25} Game theory is a theory of decision making, see, generally, Martin Osborne, \textit{An Introduction to Game Theory} (Oxford University Press, 2004).
\bibitem{27} Ian Ayres and John Braithwaite, \textit{Responsive Regulation: Transcending the Deregulation Debate} (Oxford University Press, 1992).
\end{thebibliography}
motivations, and a combination thereof. Thus, it is difficult to develop fixed strategies for how regulators should deal with market participants. The regulator needs to be able to deal with each situation in an appropriate fashion. It should have an escalating set of enforcement tools that enables it to react to the wrongdoer’s behaviour flexibly. If the severity of a regulatory sanction is put on the x-axis of a diagram, and the frequency of the use of the sanction on the y-axis, the diagram would show a pyramidal structure. The exact form of the pyramid may vary from jurisdiction to jurisdiction. The enforcement pyramid suggested by Ayres and Braithwaite appears below.

**Figure 6.1: Ayres and Braithwaite Enforcement Pyramid**

![Enforcement Pyramid Diagram](image)


In 1993, Fisse and Braithwaite applied these general ideas to the liability of corporations. They observed that the more sanctions available to the regulator, the more effective the regulatory outcome. Their conclusion was that if there are several possible sanctions for

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29 Ibid 36-8.
31 Ibid 91-2.
one breach, then it is more likely that at least one of the sanctions would address the misconduct efficiently. The different sanctions available to the regulator should have different levels of escalation, beginning with the regulator trying to persuade the corporation and climaxing in capital punishment, such as ‘incapacitation’ (deregistration or license revocation) of the corporation. In theory, the regulator would not use the harsher sanctions as frequently as the lighter enforcement tools; the regulator would only move to the next level of escalation if compliance could not be achieved with less incisive methods. The availability of several sanctions addressing one act of misconduct enables a regulator to enforce breaches of the law in the most effective and efficient way. According to Fisse and Braithwaite, an enforcement pyramid under Corporations Law could look as follows:

**Figure 6.2: Fisse and Braithwaite Enforcement Pyramid**

![Enforcement Pyramid Diagram]

Source: Brent Fisse and John Braithwaite, *Corporations, Crime and Accountability* (Cambridge University Press, 1993) 142

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32 Ibid.
In 1998, Dellit and Fisse relied on these pyramids and applied the concept to the regulation of securities markets in Australia. The result is an enforcement pyramid in which corporate liability has been replaced by regulatory tools that were available under Australian securities laws in 1998.

Figure 6.3: Dellit and Fisse Enforcement Pyramid

Source: Chris Dellit and Brent Fisse, ‘Civil and Criminal Liability under Australian Securities Regulation: Possibility of Strategic Enforcement’ in: Gordon Walker and Brent Fisse (eds), Securities Regulation in Australia and New Zealand (LBC Information Services, 2nd ed, 1998) 570.

There is no conclusive test to determine whether New Zealand’s new enforcement regime is fully comprehensive and effective. Although the idea of responsive regulation primarily relates to the way regulators use their powers, and not to the powers that they have at their

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33 Chris Dellit and Brent Fisse, ‘Civil and Criminal Liability under Australian Securities Regulation: Possibility of Strategic Enforcement’ in: Gordon Walker and Brent Fisse (eds), Securities Regulation in Australia and New Zealand (LBC Information Services, 2nd ed, 1998) 570.
disposal, it provides an important insight for the assessment of the effectiveness of the enforcement regime. If regulators pursue responsive regulation and strategic enforcement, they must have a wide range of enforcement tools available. The enforcement pyramids, in particular the pyramid for Australian securities regulation introduced by Dellit and Fisse, provide suggestions as to which tools might be necessary. Further, the regulator must be able to use these different tools flexibly. If the scope of application of some regulatory tools is unnecessarily narrow, the regulator’s ability to apply a responsive approach would be limited.

B Enforcement Regime Prior to 2011

Although New Zealand’s old enforcement regime (i.e., before the reforms of 2008-2012) had been criticised as ineffective,\(^\text{34}\) it has to be noted that the Securities Commission had several powers at its disposal. These powers were granted under the Securities Act and the Securities Markets Act. They are now discussed so they can be compared to the FMA’s enforcement powers.

1 Persuasion and Warnings

The lowest tier in every enforcement pyramid is persuasion.\(^\text{35}\) A regulator that applies a persuasive approach tries to achieve compliance by communicating with market participants. The regulator can offer assistance or guidance, either by way of direct communication with market participants, or by providing information to the general public. The Securities Commission’s power to interact with market participants was confirmed in the landmark decision of *City Realities Ltd.*\(^\text{36}\) The High Court held that the Securities Commission’s function to keep practices relating to securities under review (s 10 of the

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\(^{34}\) See above 42-48.

\(^{35}\) Ayres and Braithwaite, above n 27, 22-3.

\(^{36}\) *City Realities Limited v The Securities Commission* [1982] 1 NZLR 74.
Securities Act) included observing what the existing practices were which necessitated enquiries into matters and interaction with market participants.\(^{37}\)

Warning the market participant that his or her behaviour results or might result in a breach of the law and therefore trigger the regulator’s intervention is not an intervention into the market participant’s rights, but merely constitutes interaction by the regulator informing the participant of possible future intervention. This has to be distinguished from warning the public in order to prevent further harm; for example, a warning issued by the regulator that a purported investment opportunity is misleading or fraudulent. The Securities Commission’s powers included providing such warnings to potential shareholders.\(^{38}\)

2 Negotiations and Settlement

The second tier of the enforcement pyramid is the regulator’s power to negotiate with the market participant about his behaviour in the future.\(^{39}\) On the second tier, the regulator can act without applying for court orders. Perhaps the most important regulatory tool is the enforceable undertaking. An enforceable undertaking is a promise enforceable in court: s 69K of the Securities Act.\(^{40}\) The alleged offender will promise the regulator to do or not to do certain actions.\(^{41}\) Accordingly, the result achieved in the enforceable undertaking will reflect the compromise made by the involved parties.\(^{42}\)

Enforceable undertakings are flexible tools; if the regulated refuses to enter into the agreement, the regulator can decide whether to take administrative, civil or criminal action.\(^{43}\) Apart from this flexibility, enforceable undertakings avoid the cost and delays of court proceedings.\(^{44}\) The Securities Commission’s power to accept written undertakings was introduced into the Securities Act in 2002.\(^{45}\) More than ninety per cent of the

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38 Weiss, ibid, citing City Realities Limited v The Securities Commission [1982] 1 NZLR 74.
39 Dellit and Fisse, above n 33, 583-5.
41 Ibid.
enforceable undertakings accepted by the Securities Commission related to breaches of fundraising provisions in the Securities Act.\footnote{Ibid 291.}

The Securities Commission could also suspend or prohibit faulty prospectuses, investment statements or advertisements: ss 38B, 44. Under the Securities Markets Act, the Securities Commission’s powers to prevent market misconduct were extended in February 2008. It could make prohibition and corrective orders in cases of market manipulation (s 42) or disclosure orders if continuous disclosure obligations were had been contravened: s 42B. Investment advisers and brokers could be temporarily banned from market activities if they breached their obligations: s 42D.

3 Civil Remedies

On the third tier of escalation, the regulator must be able to enforce compliance with the market rules if all negotiations with the market participant fail. The regulator’s powers in this respect consist of only civil remedies.\footnote{Dellit and Fisse, above n 33, 585-6.} The difference with the second tier is that the regulator cannot impose the remedy himself, but needs to rely on the courts.

Under New Zealand’s old enforcement regime, the Securities Commission could apply for compensation to be paid to third parties in cases of misstatements in disclosure documents under s 55G of the Securities Act.\footnote{For more details on the civil liability regime under the Securities Act see Victoria Stace, Securities Law in New Zealand (LexisNexis NZ, 2010) 158-167; Shelley Griffiths, ‘The Primary Market’ in John Farrar (ed), Company and Securities Law in New Zealand (Thomson Brookers, 2008) 999, 1053-5.} The Securities Commission could also apply for management bans (s 60A) or for an order to freeze assets or other orders to protect aggrieved persons: s 60H. Under the Securities Markets Act, the Securities Commission could apply for injunctive relief (s 42K), compensation for aggrieved parties for breaches of any civil remedy provision under the Act (s 42ZA), and various other remedy orders that were necessary to prevent or remedy breaches of the Act: s 42ZE.\footnote{For more details on the civil liability regime under the Securities Markets Act see Shelley Griffiths, ‘The Secondary Market’ in John Farrar (ed), Company and Securities Law in New Zealand (Thomson Brookers, 2008) 1061, 1129-1132.}
Civil Penalties

The fourth step of regulatory escalation is the imposition of civil penalties on wrongdoers.\textsuperscript{50} Enforcement via civil proceedings is traditionally exercised by private persons for their own benefit.\textsuperscript{51} Its primary aim is compensation and not punishment.\textsuperscript{52} However, business laws in Australia and New Zealand provide civil penalty provisions that punish breaches of statutory provisions.\textsuperscript{53} Thus, although civil in nature, these remedies exhibit elements similar to criminal offences; for example, their purpose is to deter market participants from breaking the law in the future.\textsuperscript{54} Civil penalties can be described as ‘hybrids’ of classical criminal and civil law enforcement.\textsuperscript{55}

Civil sanctions are applied particularly in white-collar and drug matters because of the high punitive power they can represent.\textsuperscript{56} As their application is not restrained by criminal procedure, imposing them can be cheaper, quicker and more efficient than imposing criminal sanctions.\textsuperscript{57} Civil penalties are usually imposed by the courts on application by the national regulator and not by private market participants; see, for example s 1317J of the Corporations Act 2001 (Cth) and s 42T of the Securities Markets Act.

New Zealand’s securities laws do not refer to civil penalties, but to pecuniary penalties. The meaning, however, is the same. The situation concerning pecuniary penalties in New Zealand’s securities laws prior to the FMC Bill was as follows: under s 55F of the Securities Act the Securities Commission could apply to court to impose pecuniary penalties up to NZ$ 500,000 if statements in disclosure documents were untrue or if a regulation made under the Act was breached. Under s 42T of the Securities Markets Act, the Securities Commission could apply for civil penalties for breaches of any civil remedy provision. The civil remedy provisions included insider trading, market manipulation, general dealing misconduct, substantial security holder disclosure, and investment and brokers disclosure: s 42S. Section 42W limited the maximum penalty to NZ$ 1 million.

\textsuperscript{50} Dellit and Fisse, above n 33, 586-8.
\textsuperscript{51} Robert Austin and Ian Ramsay, Ford’s Principles of Corporations Law (LexisNexis Butterworths, 14th ed, 2010) [3.390].
\textsuperscript{53} Austin and Ramsay, above n 51.
\textsuperscript{55} Mann, above n 52, 1799.
\textsuperscript{56} Ibid 1798.
\textsuperscript{57} Ibid.
Criminal Penalties

An even stronger form of punishment is the imposition of criminal liability. Criminal liability has several purposes, such as the education of criminals and society in general, or the rehabilitation of wrongdoers.\(^{58}\) The most important purpose is to punish breaches of laws and regulations and bring offenders to justice, thereby serving repressive purposes. Second, imposing these punishments deters future wrongdoing and serves preventative, forward looking purposes.\(^{59}\)

Prior to the reforms of 2008-2012, New Zealand’s securities laws contained several offences for breaches of the law. Under the Securities Act, it was an offence punishable by imprisonment of up to five years or with a fine not exceeding NZ$ 300,000 to include misstatements in advertisements or prospectuses: s 58 of the Securities Act.\(^{60}\) In addition, persons involved in issuing securities based upon faulty disclosure documents could be convicted with a fine not exceeding NZ$ 300,000: s 59. Other offences related to obstructions of the Securities Commission’s powers (s 59A) and breaches of orders made by the Securities Commission or the Court; for example, ss 38B, 60C and 60K.

The number of criminal liability provisions in the Securities Markets Act was vastly increased in 2008.\(^{61}\) Insider trading (s 8F), false or misleading statements (s 11A) and false appearance of trading (s 11D) became criminal offences punishable by imprisonment of up to 5 years imprisonment and/or a fine of up to NZ$ 1 million. Other offences related to the failure to disclose relevant interests in a transaction (s 19ZD), to disclose substantial holdings (for example, ss 35BA, 35D and 35H), registered exchanges’ numerous obligations in relation to the regulator (for example, ss 36G, 36P, 36Q and 36 Z, 36ZX), or to investment advisers and brokers’ disclosure obligations; for example, ss 41P, 41Q and 41R. Similar to the Securities Act, the Securities Markets Act contained several offences for non-compliance with orders made by the Securities Commission or by the Court; for example, ss 42J, 43M, 43 H, 43T. Thus, New Zealand’s securities laws contained a large number of criminal offences before the reform of 2008-2012.


\(^{60}\) For more details on the criminal liability regime under the Securities Act see Stace, above n 48, 167-171; Griffiths, above n 48, 1055-6.

\(^{61}\) For an overview of criminal liability under the Securities Markets Act see Griffiths, above n 49, 1127-9.
6  *Incapacitation*

The highest level of punishment in the enforcement pyramid is incapacitation.\(^{62}\) For a corporation this could mean de-registration and the end of the corporation’s existence. Because of its severity and finality, corporate incapacitation is reserved for persisting and continuing grave contraventions of the law.\(^{63}\) In the context of financial markets, incapacitation is usually understood in relation to market licenses.\(^{64}\) If participation in a financial market requires a license, its revocation would remove the former licensee from the market. Prior to the reform of 2008-2012, New Zealand’s old financial markets regime did not contain any license requirements and had been criticised by the IMF in 2004.\(^{65}\) The Securities Commission neither had the power to keep potential wrongdoers out of the market nor to remove them from the market. Only the NZX and the NZMDT were able to ban market participants, which was by suspending trading in a particular security if a breach of a listing rule occurred.\(^{66}\)

7  *Summary*

This overview shows that the Securities Commission had a wide range of enforcement tools at its disposal. However, two structural shortcomings can be identified. First, the Securities Commission lacked power to remove participants from the markets, and it had to rely on the courts for enforcement. Second, the enforcement tools focused on reactive measures, such as civil litigation or criminal prosecutions.

\(^{62}\) Fisse and Braithwaite, above n 31, 143.

\(^{63}\) Dellit and Fisse, above n 33, 591.

\(^{64}\) Dellit and Fisse, above n 33, 590-2.


\(^{66}\) See above 158.
C The New Enforcement Regime

The FMA Act and the FMC Bill contain some significant changes to the enforcement regime. When the Government announced the creation of the FMA, it highlighted its wish for a regulator that placed emphasis on enforcement, and took a more proactive approach to regulation.67 The FMA Act introduced the FMA’s power to exercise an investor’s right of action: s 34.68 The FMC Bill would set out a new liability regime including civil and criminal liability, such as the FMA’s power to address minor breaches of the law by imposing a fine (infringement notices). The FMC Bill would also introduce licensing regimes and thereby the power to remove offenders from the financial markets (incapacitation), and provide the FMA with the power to issue ‘no action letters’ and extended powers to accept enforceable undertakings. These powers are now considered in more detail.

1 The Proposed Criminal Liability Regime

(a) Offences

The FMC Bill contains a number of criminal offences. The Government’s approach is to reserve criminal liability for behaviour that is particularly reckless and egregious.69 For contraventions that are harmful but not sufficiently serious, the Government prefers a civil penalty regime.70 The focus on civil penalties may suggest a lighter liability regime because it lacks the possibility of imprisonment. However, a focus on civil penalties does not necessarily result in a weaker liability regime because the generous assignment of civil penalties to minor contraventions might also build up a high level of deterrence.71

The Government had originally planned to introduce a tiered system of criminal offences with six steps based upon the severity of the contravention, starting on tier one with fines of a maximum of NZ$ 20,000, tiers two and three containing civil penalties and civil remedies, and tier four to tier six containing offences punishable by imprisonment of up to

67 See above 66.
68 See above 73.
70 Ibid.
71 See above 175.
10 years and/or a NZ$ 1million fine for individuals and NZ$ 5million for bodies corporate.\textsuperscript{72} The Consultation Draft Bill reduced the number of tiers to four.\textsuperscript{73} This structure was seen as confusing by market participants; in particular, the unclear distinction between tier one infringement offences and tier two civil remedies.\textsuperscript{74} In the FMC Bill, the structure was further reduced to two tiers. A minor contravention of the FMC Bill would typically result in a civil remedy and/or an infringement offence.\textsuperscript{75} For serious contraventions, the contravention would be a criminal offence if it was committed knowingly or recklessly.\textsuperscript{76} The offences under the FMC Bill would still follow a similar pattern because the maximum time of imprisonment and the maximum fine can be categorised into four tiers:

\textit{Table 6.1: Offences under the FMC Bill}

<table>
<thead>
<tr>
<th>Clause</th>
<th>Title</th>
<th>(Individuals) Imprisonment</th>
<th>Fine (NZ$)</th>
<th>(Others) Fine (NZ$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>190</td>
<td>FMA’s directions to supervisor (or issuer)</td>
<td>-</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>370</td>
<td>Offence for failing to comply with direction</td>
<td>-</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>419</td>
<td>Consequences of failure to comply with directions</td>
<td>-</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>461</td>
<td>Consequences of failing to comply with FMA’s orders</td>
<td>-</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>70</td>
<td>Offering financial products in entity that does not exist</td>
<td>3 years</td>
<td>200,000</td>
<td>600,000</td>
</tr>
<tr>
<td>198</td>
<td>Offence of false or misleading statements</td>
<td>-</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>35</td>
<td>PDS must be prepared and lodged</td>
<td>-</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>40</td>
<td>Offence to knowingly or recklessly contravene section 37</td>
<td>-</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>238</td>
<td>Criminal liability for insider conduct</td>
<td>-</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>259</td>
<td>Criminal liability for false or misleading statement or information</td>
<td>-</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>264</td>
<td>Criminal liability for false or misleading appearance of trading</td>
<td>-</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>489</td>
<td>Offence of knowingly or recklessly contravening other provisions relating to defective disclosure</td>
<td>-</td>
<td>300,000</td>
<td>300,000</td>
</tr>
<tr>
<td>488</td>
<td>Offence of knowingly or recklessly contravening prohibitions on offers where defected disclosure in PDS or register entry</td>
<td>10 years</td>
<td>1,000,000</td>
<td>5,000,000</td>
</tr>
</tbody>
</table>

Another new feature in the liability regime is criminal liability of company directors for knowingly breaching their duties under the *Companies Act 1993*. The Draft Consultation Bill had contained this in a new s 138A, but the FMC Bill does not include this clause. The provision would be implemented by the Companies and Limited Partnerships Amendment Bill 2011 (344-1) instead. That Bill can be considered as part of the new liability regime because its aim is to ‘increase confidence in the financial markets’. Given that the offence would be located in the *Companies Act 1993*, the NEU would act as the primary regulator. However, if the directors are financial market participants, the FMA will also be empowered to prosecute the matter.

(b) Infringement Offences

A major change to the enforcement of criminal offences would be the introduction of infringement offences under Subpart 5 of Part 7 of the FMC Bill. Infringement offences would be ‘relatively less serious contraventions of the Bill.’ Clause 6 lists a total of 31 infringement offences. Most of them relate to formal requirements such as keeping accounting records in English (cl 216), and keeping them available for inspection (cl 218) and obligations to provide information to the FMA or investors; for example, failure to submit all prescribed documents when a PDS is lodged (cl 47), failure to lodge changes of trust deeds (cl 96) and failure to lodge changes of supervisors in a registered scheme (cl 178). Thus, generally, infringement offences seem to concern ‘bright line’ rules, where breaches would be easier to identify and to prove.

If a person breached an infringement offence provision, the FMA would have two options under cl 490: first, to commence summary proceedings under the *Summary Proceedings Act 1957*. In this case, the offender would be liable on conviction to a fine not exceeding NZ$ 50,000. Second, to issue an infringement notice under cl 491. The infringement fee for each infringement offence is to be prescribed by regulation, but may not exceed NZ$
20,00: cl 522(1)(f). The discussion document on the reform of securities laws indicates that the Government has fees of about NZ$ 2,000 in mind.\textsuperscript{83}

Thus, the FMC Bill would introduce two types of offences: ‘normal’ criminal offences that would require prosecution and ‘minor’ offences that could be dealt with either in summary proceedings or by issuing an infringement notice. It is noteworthy that the FMC Bill contains a total of 31 infringement offences, but only 13 ‘normal’ offences. Thus, there is a clear emphasis on infringement offences in the FMC Bill. However, this would not result in a softened liability regime. The main reason for the relatively high number of infringement notices is that the FMC Bill would punish minor breaches of the law that previously did not result in punishment; for example, the failure to notify the Registrar of Companies of changes to disclosure documents: cl 80 of the FMC Bill and s 43 of the Securities Act.

2 \textit{The Proposed Civil Remedy Regime}

\textit{(a) Civil Remedies}

The proposed civil liability regime is set out in Subpart 3 of Part 7 of the FMC Bill. It is based on ss 42R-42ZJ of the Securities Markets Act. The subpart has undergone the transition from the Consultation Draft Bill to the final Bill without major amendments; the only substantial changes were made in respect of pecuniary penalties. The Commerce Commission would have a limited power to apply for pecuniary penalties for breaches of Part 2 of the FMC Bill (cl 472),\textsuperscript{84} and the possibility of pecuniary penalties imposed on directors for breaches of disclosure provisions has been clarified: cl 472.

As in the Securities Markets Act, the liability regime in the FMC Bill revolves around ‘civil remedies’ (cl 466) and the underlying civil remedy provisions: cl 467. Civil remedy provisions are provisions about misleading or deceptive conduct, offer provisions, governance provisions, market provisions, unsolicited offer provisions, licence provisions and failure to comply with orders made by the FMA. The Government tried to introduce,
to the extent possible, a ‘code’ which means a complete regime that sets out all instances when liability will occur.\(^85\)

If a civil remedy provision is breached, the FMA or any other person could apply for a declaration of contravention (cl 468), compensatory orders (cl 477) or other orders: cl 481. The fact that investors would able to apply for all remedies except pecuniary penalties would be a significant extension of investor’s rights in respect of securities offerings because under s 55C of the Securities Act only the FMA has the right to file an application for a declaration of contravention. As Xiao states, it is likely that the proposed changes would result in an increase in civil actions brought by investors.\(^86\)

Courts would be able to impose several civil remedy orders for the same conduct: cl 483. However, only one pecuniary penalty order could be made for the same conduct: cl 484. For all civil remedies the rules of civil procedure would apply, including the civil standard of proof: cl 487. Defendants could raise the due diligence defence – that the contravention was beyond their control and they took reasonable precautions: cl 486.

(b) Pecuniary Penalties

Pecuniary penalty orders would only be able to be made on application of the FMA or on application of the Commerce Commission if the conduct contravenes Part 2 of the FMC Bill: cl 471. Because of the Government’s decision to focus on civil penalties to create additional deterrence, the number of pecuniary penalty provisions was greatly increased. This was heavily criticised in the consultation process by markets participants.\(^87\)

The FMC Bill would introduce two classes of penalty orders to determine the maximum penalties to be imposed. For minor breaches the maximum penalty for contraventions by an individual would be NZ$ 200,000 and NZ$ 600,000 in any other case: cl 473(3). This equates to the maximum fines imposed for a number of criminal offences under the FMC Bill.\(^88\) For breaches of provisions listed under cl 473(2) such as, inter alia, all provision on misleading and deceptive conduct or offer provisions, the maximum penalty would be NZ$ 200,000 and NZ$ 600,000 in any other case.

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\(^{85}\) Office of the Minister of Commerce, above n 69, 41.


\(^{88}\) See above 179.
1 million if the wrongdoer is an individual, and NZ$ 5 million in any other case. This would be a significant increase because the corresponding s 42W of the Securities Markets Act generally stipulates a maximum of NZ$ 1 million. The new limit would even equate the maximum fine for the reckless contravention of offer provisions when the disclosure in a PDS is defective (cl 488), which is the offence with the highest possible punishment (10 years and NZ$ 1 million for individuals or NZ$ 5 million in other cases). Thus, the maximum civil penalty would be higher than most fines for criminal offences. The combination of higher fines and the fact that they would not be – due to the civil standard of proof (cl 487) – as difficult to achieve in court would probably result in a tightened regulatory regime.

3 Infringement Notices

(a) Theoretical Background

The new infringement notice system would be a conceptual novelty in New Zealand’s financial markets law. For the first time, a regulator in the financial markets would be able to punish contraventions of the law directly without applying for court orders. This mechanism is called an administrative penalty. The advantages of administrative penalties are that the issuing body is usually highly specialised and can address misconduct faster than it would be possible in a court of law. Infringement notices are a less strict form of administrative penalty. Infringement notices impose lower fines than administrative penalties, and are usually imposed without hearing the alleged offender, although there is usually a mechanism to review the notice and initiate a court review.

Some common law countries, such as Australia, are reluctant to provide their regulators wide powers to issue administrative penalties. Instead, emphasis is placed on civil

90 Although some commentators argue that infringement notices and administrative penalties are different forms of monetary penalties, see Nehme, above n 81, 24-5.
91 Ibid.
penalties that are imposed by courts upon application of the regulator. The main problem is that in the case of administrative penalties non-judicial bodies impose sanctions and not the courts. This raises the question of the independence and transparency of a decision that is made by the same body that conducted the investigation into the matter.93 Another underlying question is the separation of powers between courts and administration.94 The issue is controversial, as demonstrated by the debate on the infringement notice regime under the Corporations Act 2001 (Cth). In 2004, a new Part 9.4AA was introduced, giving ASIC the power to issue infringement notices for breaches of continuous disclosure obligations. Although administrative sanctions are common in other areas of Australian law, for example under the Taxation Administration Act 1953 (Cth),95 and although the new regime only applied to continuous disclosure obligations and only contained limited penalties, it was heavily criticised by several commentators as unnecessary, inefficient and unconstitutional.96

(b) The New Regime

The Securities Commission was never been able to impose administrative penalties or infringement notices. In 2002, a discussion paper issued by the MED requested submissions as to whether there was a need for administrative monetary penalties.97 After very negative feedback from market participants with only one supporting submission from the Securities Commission, the Government dismissed the idea.98 The lack of an administrative penalty regime was later criticised in the Prada/Walter report.99 The second Cabinet Paper on securities law reform in May 2011 described the concept of infringement notices for minor circumventions of the law.100 The purpose was to ‘speed up the process

93 Australian Law Reform Commission, above n 89, 688.
96 See above n 92.
of enforcing breaches’. The infringement notice should be a ‘speeding ticket’ that could be issued straight away.

However, the concept of infringement notices is not new. In total, 22 of New Zealand’s statutes contain infringement notice regimes; for example, the *Fisheries Act 1996*, the *Gambling Act 2003*, the *Building Act 2004*, the *Sales of Liquor Act 1989*, and the *Land Transport Act 1998*. As in the FMC Bill, all these statutes provide for infringement notices as an alternative to summary proceedings; see, for example, s 138 of the *Land Transport Act 1998*. Thus, the Government did not need to develop a new concept, but was able to rely on mechanisms that exist under other statutes. The infringement notice regime under the FMC Bill was not modelled on the Australian infringement notice regime under the *Corporations Act 2001* (Cth).

The proposed infringement notice regime would be confined to minor contraventions of the FMC Act. Infringement notices would have lower maximum penalties than pecuniary penalties. However, the limitation of infringement fees under the FMC Bill of NZ$ 20,000 would not be unusual. The limitations of infringement fees under other statutes lie between NZ$ 500 (for minor breaches of the *Sales of Liquor Act 1989*) and NZ$ 50,000 (for breaches of the *Gambling Act 2003* by gambling license holders). By comparison, the Australian infringement notices under the *Corporations Act 2001* (Cth) are limited to AUS$ 100,000, 66,000 and 33,000, depending on the market capitalisation of the fined entity: s 1317DAE(2).

(c) Relevance for the FMA

Although infringement notices under the FMC Bill impose relatively lower penalties than pecuniary penalties, the new regime is an extension of the agency’s options. In terms of the enforcement pyramid, infringement notices would be a tier two response because the FMA would be able to exercise the power without reliance on the courts. Accordingly, launching summary proceedings under cl 490(1)(a) would be a tier three response because the courts would be involved.

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101 Ibid 14.
102 Ministry of Economic Development, above n 73, 6.
103 For an overview see Nehme, above n 90, 26-7.
If a market participant committed an infringement offence, the FMA would have three options: (1) to issue summary proceedings, (2) to issue an infringement notice or (3) to do nothing. The FMA could make its decision taking into account the market participant’s will to co-operate and his or her past behaviour. This would open the door for a ‘tit-for-tat’ responsive approach. In particular, the FMA could take into account the market participant’s willingness to enter into an enforceable undertaking.

However, three factors in the proposed regime would limit its use for the FMA in practice. First, as stated, the Government envisaged infringement fees of NZ$ 2,000. Any deterrence resulting from such a low amount would probably be insignificant. Hopefully, the resulting regulation would prescribe infringement fees that are closer to the maximum of NZ$ 20,000. Second, unlike enforceable undertakings, the infringement notice regime would only apply to the proposed FMC Act and not to other financial markets legislation (for example, the FA Act). In order to achieve regulatory consistency, it would be sensible to introduce infringement fees to other statutes that fall within the FMA’s jurisdiction. Third, unlike in Australia, infringement notices are no alternative to civil penalties. Under the Corporations Act 2001 (Cth), ASIC can decide whether to enforce continuous disclosure obligations by issuing an infringement notice, or by issuing civil proceedings.104 Under the FMC Bill, infringement notices could only be issued for contraventions of infringement offences and civil penalties could apply to any breach of civil remedy provisions.105

(d) ‘Real’ Administrative Penalties?

The question is whether the introduction of a stricter administrative penalty regime would be sensible. The MED had considered this option because of low deterrence resulting from infringement notices.106 However, the subsequent Government documents on securities law reform do not address the issue.

Formally, the introduction of a ‘real’ administrative penalty regime would not face problems. Unlike Australia, New Zealand does not have a codified constitution that limits the Parliament’s power to delegate the power to impose sanctions to administrative bodies.

105 See below 184.
106 Ministry of Economic Development, above n 83, 193.
An administrative penalty regime already exists under the *Fisheries Act 1996*, which contains both infringement notices (see above) and administrative penalties. Sections 88 and 113Z empower the Ministry of Fishery to impose an administrative penalty for offences that contain a maximum fine of NZ$ 250,000. The administrative penalty is limited to one third of the maximum monetary penalty if the person were convicted in court: ss 88(7) and 113ZD(1).

Administrative penalties would close the gap between infringement notices on the one hand, and fines and civil penalties imposed by courts on the other hand. Circumventions of financial markets law that are of a more serious nature than infringement offences, but not as severe to justify a civil penalty, could be dealt with more quickly. This would be particularly useful if the circumvention is clear and could be easily proved. In such a situation court proceedings would be an avoidable delay. This would resemble the ‘infringement notice’ regime under the *Corporations Act 2001* (Cth), which is in fact a full administrative penalty regime.

As stated, the FMC Bill contains criminal offences with a maximum penalty of NZ$ 200,000 and NZ$ 300,000.\(^{107}\) The lower tier of civil penalties is limited to NZ$ 200,000 for individuals and NZ$ 600,000 for bodies corporate.\(^{108}\) These amounts roughly resemble the regime under the *Fisheries Act 1996*, which enables the Ministry of Fishery to issue administrative penalties for contraventions of provisions that have a maximum penalty of NZ$ 250,000. It would be possible to provide the FMA with the power to deal with such breaches in a comparable fashion, which would mean that an administrative penalty not exceeding one third of the maximum penalty under the FMC Bill could be imposed. For example, for the breach of a civil remedy provision that would result in a maximum pecuniary penalty of NZ$ 200,000 for individuals, the FMA could impose a maximum administrative penalty of NZ$ 66,666.

(e) **Summary**

The new infringement notice regime would extend the FMA’s powers to deal with breaches of the law more quickly and efficiently than it would be possible in civil proceedings. However, the limitation of infringement offences (which do not apply to civil

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\(^{107}\) See above 177.

\(^{108}\) See above 185.
remedy provisions) and the low fines would significantly limit the regime’s use for a responsive regulatory approach. The introduction of a real administrative penalty regime as provided in the *Fisheries Act 1996* would close the gap between insignificant infringement fees and the severe civil penalty regime.

4 **Negotiation and Settlement**

The FMC Bill would extend the FMA’s power to interact with market participants in order to promote compliance. Clause 597 would add a new s 9(1)(a)(v) to the FMA Act, giving the FMA the power of ‘stating whether or not, or in what circumstances, the FMA intends to take or not take action over a particular state of affairs or particular conduct …’. This would allow the FMA to issue ‘no action letters’¹⁰⁹ which had been suggested by the Taskforce in its final report.¹¹⁰ Such a statement could provide security to market participants that are not sure if their conduct breaches the law (for example, if the wording of a provision is unclear) and is another element of a proactive approach taken by the regulator. Clause 599 would insert a new 46(1A) to clarify that an undertaking may be given in connection with a under s 9(1)(a)(v) of the FMA Act.

The FMA’s power to accept enforceable undertakings would be further amended by cl 600 of the FMC Bill. The Government wants to extend enforceable undertakings into a ‘formal mechanism to enter into a settlement with a market participant.’¹¹¹ The FMA would be empowered to accept ‘an undertaking to pay compensation to any person or otherwise to take action to avoid, remedy, or mitigate any actual or likely adverse effects arising from a contravention … of any provision of the financial markets legislation’ and to accept ‘an undertaking to pay to the FMA an amount in lieu of a pecuniary penalty’: s 46A of the FMA Act. The Government is of the opinion that these extensions of the undertaking regime, in combination with the increased focus on infringement notices and civil penalties, would assist in achieving faster resolution of legal proceedings.¹¹² In its enforcement policy (which does not include amendments proposed by the FMC Bill), the FMA encourages markets participants who are interested in a settlement to contact the regulator as soon as possible with a settlement proposal that is ‘developed, include[s] draft

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¹⁰⁹ Explanatory Note, Financial Markets Conduct Bill (342-1) 52.
¹¹⁰ See above 59.
¹¹¹ Office of the Minister of Commerce, above n 178, 14.
¹¹² Ibid.
admissions, a detailed and realistic remediation proposal, and reparation where possible.\textsuperscript{113}

The extended enforceable undertaking regime would be a large step forward towards regulatory flexibility. If it is obvious that a market participant has breached the financial markets laws, or if the market participant admits the breach, the FMA could save time and costs and enter into a settlement with the wrongdoer. For example, the FMA could offer a settlement that contains lower amounts payable than the FMA expects to be achievable in court. The result would be a compromise between the regulator and the regulated. If the regulated does not agree, the FMA would still have the option to issue court proceedings.

5 \textit{Power to Exercise an Investor’s Right of Action}

\textit{(a) Scope of Application}

Section 34 of the FMA Act empowers the FMA to commence or take over civil proceedings against financial markets participants as a result of an inquiry or investigation conducted by the FMA.\textsuperscript{114} The enforcement pyramids described above do not contain such a power. However, the investor’s right of action fits into the third tier because the investor’s action would result in civil remedies.\textsuperscript{115} The fact that the regulator and not the investor exercises the investor’s right the right does not change the nature of the proceeding or its aim.

The new power is similar to some of the FMA’s existing powers under financial markets legislation. Section 55G of the Securities Act enables the FMA to apply to court to order a liable person to pay compensation to an investor who subscribed for securities on the faith of an advertisement or registered prospectus that included an untrue statement. A similar power is set out in s 42ZA of the Securities Markets Act for breaches of market conduct rules. The effect of all three provisions is similar because in all cases an application made by the regulator may result in a court order to pay compensation as a result of a breach of financial markets law.

\textsuperscript{113} New Zealand Financial Markets Authority Website, \textit{FMA Enforcement Policy} <www.fma.govt.nz/laws-we-enforce/enforcement/fma-enforcement-policy>,


\textsuperscript{115} See above 174.
The new provision’s primary objective is to promote the public interest rather than to obtain redress for investors, although redress (for example, compensation) would often follow if the FMA’s action were successful.116 The power covers all matters under financial markets legislation except criminal matters: s 34(2)(a). It includes proceedings seeking damages or other relief for fraud, negligence, default or breach of duty, committed in relation to the aforementioned inquiry or investigation: s 34(2)(b). The wording of s 34(2)(b) is very similar to the wording of s 50(a) of the *Australian Securities and Investment Commission Act 2001* (Cth) (‘ASIC Act’). It does not refer to financial markets legislation. Hence, a literal interpretation of s 34(2)(b) would suggest that the FMA could exercise the investor’s right of action even if the misconduct did not fall under the financial markets legislation.

However, this understanding would be probably too wide. There is no need to extend the FMA’s power beyond the penumbra of the financial markets law because it would not assist in achieving the FMA’s main objective – to promote and facilitate fair, efficient and transparent financial markets: s 8. It is more likely that the Government wanted to clarify in s 34(2)(b) that, for example, corporate matters such as breaches of directors’ duties are covered.117 The imprecise wording of the provision is probably the result of the apparent resemblance to s 50(a) of the ASIC Act. The Australian law does not contain a list of financial markets legislation, as set out in Schedule 1 of the FMA Act, and the New Zealand Government probably forgot to add a limitation to financial markets legislation when drafting the FMA Bill.

However, it is not likely that the broad scope of s 34(2)(b) would become an issue in practice. The subsection refers to acts ‘committed in connection with a matter to which the inquiry or investigation referred to in subsection (1) related.’ It can be assumed that an investigation conducted by the FMA would relate to conduct in the financial markets. The investigation would therefore most likely relate to financial markets legislation as set out in Schedule 1 of the FMA Act.

117 See Xiao, above n 86, 28.
(b) Public Interest

The FMA can only exercise the investor’s right of action if it is in the public interest: s 34(3). According to s 34(5), in determining whether to exercise the power, FMA must have regard to its main objectives as set out in s 8 of the FMA Act, the general business significance of the matter and the expected effect of the proceedings on financial markets participants. Further, the FMA must decide whether using the power would be an efficient use of its resources and to determine the likelihood of the investor commencing or diligently continuing the proceedings. The wording of the latter in s 34(5) suggests that the FMA may let the investor commence proceedings and the FMA may decide whether to take over the proceedings at a later date, depending on the diligence of the litigant in the proceedings. The FMA is not limited to these elements; it may take into consideration any other matters that it considers relevant: s 34(5)(f). The section does not set out a preference for any of the considerations. In exercising its power, the FMA may (not ‘must’) take into consideration the interests of the person whose right is to be exercised, and the interests of its potential shareholders, members, security holders and creditors: 34(3). In summary, ss 34(5) and s 34(3) provide the FMA with a wide discretion as to whether and how it exercises the power.\(^\text{118}\)

The FMA has concretised the envisaged use of s 34 in its enforcement policy, which states that the power under s 34 will likely be used in ‘a case that involves risk of serious harm to the market, significant risk of loss, … a large number of investors, high product risk, … particular investor vulnerability, or a case involving predatory, prevalent or increasing patterns of misconduct’.\(^\text{119}\)

(c) FMA’s Application for Leave

If the investor has not commenced proceedings, the FMA could exercise its power under s 34 without the leave of the High Court: s 35(1). The investor whose rights are concerned has to be notified, giving the investor a 30 day period to commence proceedings or to


object to the FMA commencing proceedings. If the investor has already commenced proceedings, or objected to the FMA commencing proceedings, the FMA needs to apply for leave of the High Court under s 36(1). According to s 36(2), the High Court must grant leave if it is in the public interest for the FMA to exercise the power under s 34 and the FMA, rather than the investor, to control the conduct of the proceedings. Section 36(4) stipulates that the High Court must take into account whether the investor intends to commence or diligently continue the proceedings, the interest of persons referred to in s 34(3) (see above), and any other matters it considers relevant. Until August 2012, the FMA has not made use of its power under s 34 yet, so there is no guidance as to how the High Court would exactly interpret the public interest test under s 36(2). The wording of s 36(2) suggests that the High Court would apply criteria similar to those set out in s 34(5).

However, the High Court cannot grant leave if the investor is an individual: s 36(3). This means that the FMA cannot exercise its power under s 34 if an individual investor objects.\footnote{Ibid 498.} The question is what the reason for this restraint is. When the FMA Bill was introduced into Parliament, the proposed s 36 did not distinguish between individuals and other investors – if an investor objected, the High Court was able to grant leave. The House of Representative’s Commerce Committee inserted cl 36(2A), which has become s 36(3), so that individuals would be free to ‘opt out and take their own action if they chose.’\footnote{Commentary, Financial Markets (Regulators and KiwiSaver) Bill (211-2) as reported by the Commerce Committee 4.} The Commerce Committee explains the necessity of the amendment as follows:\footnote{Ibid.}

\begin{quote}
We note that the power is similar to that available to the market conduct regulator in Australia, the Australian Securities and Investment Commission. The changes we propose would further align the two regimes … We recommend amendments to strengthen the rights of individuals.
\end{quote}

Hence, the Committee provided two reasons for the adjustment: first, aligning the provision to Australian Law, and second, strengthening an individual’s rights.

\begin{quote}
\footnotetext{120} Ibid 498.
\footnotetext{121} Commentary, Financial Markets (Regulators and KiwiSaver) Bill (211-2) as reported by the Commerce Committee 4.
\footnotetext{122} Ibid.
\end{quote}
(i) Alignment to Australian Law

The argument for further alignment to Australian law is not convincing. The new restriction indeed resembles s 50 of the ASIC Act, but ASIC has, in fact, much wider powers. Formally, ASIC requires the investor’s written consent to commence proceedings, which might indicate that the FMA’s powers are wider. However, the Australian regulator is able to intervene in any proceeding related to unconscionable conduct and consumer protection in relation to financial services with the leave of the court under s 12GO of the ASIC Act. There is no restriction on the Court’s discretion to grant leave although an individual objected. ASIC may even intervene without leave under s 1330 of the Corporations Act 2001 (Cth) in any matter relating to that Act, which would include corporate fundraising under Pt 6D. Hence, while ASIC is able to override (directly or with the court’s leave) objections of individuals and corporations, the FMA is not able to obtain leave if an individual objects. Therefore the result of the Committee’s amendments is not a further alignment to Australian law, but rather a misalignment that curtails the FMA’s powers in comparison to ASIC’s powers in respect of individual investors.

(ii) Protection of an Individual’s Rights

The second argument provided by the Commerce Committee is the need to strengthen the individual’s rights. Nehme states that the new regime ‘balances concern of public interest with concerns about usurping the interests of private parties and their rights to represent themselves’. The amendment by the Commerce Committee enables an individual to ward off any attempts of the FMA to take over or commence proceedings against the individual’s will. This is an improvement of the individual’s rights. However, the important question is why such an improvement is necessary. The Commerce Committee’s statement does not provide an explanation. One possible answer can be found in the Regulatory Impact Statement that had been produced by the MED before the FMA Bill

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124 For a discussion of ASIC’s intervention powers see Bird, above n 118.
125 Xiao, above n 86, 28.
126 Nehme, above n 118, 498.
was introduced into Parliament. The MED’s consultation with industry participants resulted in a rather critical feedback. The document addresses concerns that the FMA’s power to take over actions might ‘block private settlement and enforcement.’ The MED nevertheless recommended the introduction of the new power because the requirement of the court granting leave sufficiently protected the investor.

The argument to strengthen the rights of individuals is not convincing for several reasons. First, the new power can hardly be described as a limitation of an individual’s rights. An enforcement regime needs to find a balance between private and public enforcement. The IOSCO Methodology, for example, states that the regulator’s enforcement powers ‘should not compromise private rights. Private persons should be able to seek their own remedies.’ At first glance, the FMA’s power to exercise an investor’s right of action might seem like a restraint of private rights of action. However, it has to be noted that use of the power does not make the FMA a party to the proceedings. The FMA rather begins and carries out the proceedings in the name of the investor, which is consistent with ASIC’s role under s 50 of the ASIC Act. The investor does not lose any rights, the investor is simply not able to conduct the proceedings himself. This might even be beneficial, because if the proceedings are carried out by a specialised regulator such as ASIC (or the FMA), the investor would ‘reap the advantages from the representation of a single, specialised body, with economies of scale and experience in securities fraud.’

Second, the FMA’s use of the power in s 34 is subject to court control. If the investor objects, the High Court would apply a public interest test (s 36(2)) and would expressly have to take the investor’s interests into consideration: s 36(4)(b). If the FMA has exercised its power, the proceedings cannot be settled, compromised or discontinued without the leave of the High Court. This mechanism makes sure that the FMA does not try to discontinue proceedings that develop in an unexpected fashion way. It can be assumed that this level of court control should be sufficient to safeguard the investor’s interests.

129 Ibid.
130 IOSCO, above n 15, 66.
131 Nehme, above n 118, 497.
132 See Austin, above n 118.
Third, there is no obvious reason why an individual’s right to enforce his or her rights is any different from a non-individual’s right to do so. An individual’s right to take action against a financial markets participant will regularly concern compensation. It is not evident why an individual’s interest in taking action is any different than the interest of a body corporate and its shareholders. If the restraint were intended to protect private settlement and enforcement, it should cover both individuals and bodies corporate in the same way.

Fourth, the restraint collides with the overriding principle of s 34. As stated above, the FMA s shall use the power under s 34 to promote public confidence rather than seeking redress for investors.  

This understanding resembles ASIC’s statement that its priority lies with future compliance and not with recovery of investor’s money.  

As Xiao states, the FMA would probably be able to exercise the power under s 34 in the mere hope of deterring other financial markets participants’ from future misconduct.  

So, the public interest is given precedence over the investor’s personal interest.

Fifth, through the lens of enforcement theory, s 36 (3) would limit the FMA’s range of options when interacting with a market participant. Representatives of ASIC have stated in the past that the fact that written consent of the investor is required for ASIC to issue or take over proceedings can be a ‘headache and sometimes means proceedings are impracticable.’  

The effect on the FMA would probably be stronger because the FMA, unlike ASIC, is not able to override an individual’s objection. The most likely result is that the new power would rarely be used.

This would not be a major issue for misconduct under the FMC Bill because the FMA would still be able to apply to court for pecuniary penalties and compensation orders. This would not generally be possible for misconduct under other statutes. For example, a financial adviser would be liable for compensation if the adviser breached his or her duties of care, skill and diligence under s 33 of the FA Act. However, breaches of these duties do not give rise to a pecuniary penalty. If the adviser entered into settlement with an investor, and the investor objected to the FMA’s exercise of its power under s 34 of the FMA Act,

134 See above 170.  
136 Xiao, above n 86, 28.  
137 Cooper, above n 133.  
138 Taylor, above n 114, 76.
the FMA would have no power to issue proceedings against the adviser (as long as the adviser still meets the authorisation requirements prescribed in the FA Act). This is a gap in the enforcement regime.

(iii) Conclusion

In summary, the arguments provided in respect of the amendments to the FMA Bill are unconvincing. The new s 36(3) does not align New Zealand’s laws with the Australian regime, contradicts the purpose of the new regime and fails to give conclusive reasons for the distinction between individuals and bodies corporate. The amendment sent the wrong signal. Hopefully, this inconsistency will be rectified in further reviews of securities laws.

(d) Relationship to Compensation Orders

As stated, the FMA has the power to apply to court to order a liable person to pay compensation to an investor for breaches of the Securities Act (s 55G) and the Securities Markets Act (s 42ZA). Clause 477 of the FMC Bill is an exact copy of s 42 of the Securities Markets Act, so the regime under the FMC Act would also provide the FMA with the power to issue proceedings for compensation orders. The question is how cl 477 relates to s 34 of the FMA Act.

The first difference between cl 477 and s 34 is that the former does not require the satisfaction of a public interest test.\(^{139}\) However, in the past the Securities Commission only applied for compensation orders under the Securities Act and the Securities Markets Act if such an order was in the public interest.\(^{140}\) It took into account, for example, the likelihood of success, the potential benefit for the aggrieved investor and whether the regulatory outcome could be achieved by other means.\(^{141}\) As cl 477 is a copy of s 42ZA of the Securities Markets Act, it seems likely that the FMA will apply a similar test for cl 477\(^ {142}\) because its enforcement policy states that the FMA will generally not take action ‘where enforcement is not in the public interest.’\(^ {143}\) If that is the case, both applications

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139 See also Xiao, above n 86, 28.
141 Ibid.
142 Nehme, above n 118, 496.
143 Financial Markets Authority, above n 119.
under s 34 and cl 477 would be subject to a public interest test. To that extent there would be no difference in practice.

A second difference is the scope of the two powers. Clause 477 would apply to all breaches of civil remedy provisions under the proposed FMC Act. Section 34 applies to all statutes that are listed in Schedule 1 of the FMA Act, including all of the financial markets legislation and thus the upcoming FMC Act.\(^\text{144}\) The power to apply for compensation orders under cl 477 would be narrower because its application would be limited to one statute.

The third difference is that the power in cl 477 may still be used if an individual objects, and the FMA generally would not need the court’s leave to issue proceedings. Apparently the Government did not see the need to implement a mechanism to protect the individual’s interests as in s 34. This is sensible because under the civil remedy regime in the FMC Bill the FMA would make an application for compensation orders and it would become a party to the proceedings. It would not be necessary for the investor (the ‘aggrieved person’) to be a party to the proceedings: cl 477(2). There would be no need for further protection of the investor because the investor would not be stripped of his or her right to conduct the proceedings. However, it is unclear why the investors (individuals in particular) need to be protected under s 34 of the FMA Act, but not under the proposed FMC Act, if court proceedings initiated by the FMA in both cases aim for compensation of the investor. If the misconduct is covered by the proposed FMC Act, the FMA would apply under cl 477 and not under s 34 of the FMA Act, circumventing objections by investors. This is not coherent.

The most likely result will be that the FMA will hardly make use of s 34 of the FMA Act if an individual is concerned and misconduct relates to the FMC Act. Until August 2012, the FMA has commenced civil proceedings against the directors of six finance companies.\(^\text{145}\) All proceedings have been issued under ss 55C and 55G of the Securities Act.\(^\text{146}\) The FMA’s CEO, Sean Hughes, stated in December 2011 that the FMA was ‘examining avenues under section 34 to seek compensation from other parties on behalf of aggrieved

\(^{144}\) Clause 603 of the FMC Bill will amend Schedule 1 of the FMA Act, adding the FMA Act and the FMC Act to Part 1 of Schedule 1.


\(^{146}\) Ibid.
The FMA has not made use of s 34 of the FMA Act yet. This suggests that the FMA favours to apply for compensation orders under the Securities Act if possible. However, other statutes such as the Companies Act 1993 or the FA Act do not contain a comparable power to apply for compensation orders. Under these statutes s 34 would remain relevant because it would be the only way for the FMA to obtain compensation orders for aggrieved persons.

(e) Conclusion

The new power under s 34 of the FMA Act is a further avenue for the FMA to enforce misconduct. The restrictions in the legislative process may cause problems in the exercise of the new power if the investor is an individual. The reasons provided by the Commerce Committee are not convincing. However, cl 477 of the FMC Bill provides the FMA with a less complicated alternative to effect compensation to be paid to investors if the matter relates to misconduct under the FMC Bill.

6 Incapacitation

New Zealand’s old enforcement regime did not include registration and authorisation regimes. Thus, the Securities Commission did not have the power to ensure quality standards for financial intermediaries or to remove wrongdoers from the markets. However, the reform of financial adviser law in 2010 and the FMC Bill provide for several new licensing regimes that are now discussed.

(a) Authorisation of Financial Advisers

As discussed in Chapter 3, the introduction of the FA Act in 2010 established the first licensing regime for market intermediaries. Rather than to the term ‘licence’, the FA Act refers to an ‘authorisation’ for financial advisers. A licence is the ‘formal authority to do something that would otherwise be unlawful’. Broadly speaking, under s 18 of the FA

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148 See above 188.
149 See above 61-65.
Act, a person must not provide a financial adviser service unless the person is permitted to provide that service, which requires authorisation as a financial adviser or a QFE. So, despite the use of the term ‘authorisation’, the FA Act provides a licensing regime.

Those eligible for authorisation are persons who (1) are registered under the FSP Act, (2) are of good character, (3) meet the level of competency, knowledge, and skills specified in the code for an authorised financial adviser and (4) have not been convicted of a crime that would reflect adversely on the person’s fitness to act as an authorised adviser: s 54 of the FA Act. The FMA is empowered to cancel the licence if, for example, the adviser has breached the FA Act or no longer meets the requirements for authorisation: s 59.

(b) Market Operator Licences

The FMC Bill proposes a new licensing regime for operators of financial markets such as NZX. As discussed in Chapter 5, the new regime would resemble the regime for registered exchanges that was introduced into the Securities Markets Act in 2011. The importance of the proposed regime for the enforcement pyramid can be neglected because the removal of NZX market operator would mean that New Zealand would not have any licensed operator of financial product markets.

(c) Market Service Licences

(i) Licensing Process

Part 6 of the FMC Bill would introduce a new licensing regime for providers of market services. Such market service licenses would be required for managers of managed investment schemes (which would also require a licensed supervisor: cl 112), independent trustees of restricted schemes (which are schemes that are registered as KiwiSaver schemes: cl 6), providers of discretionary investment management services under s 12 of the FA Act, and issuers of derivatives: cl 387.

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151 See above 150.
152 Although providers of discretionary investment management services would not require licensing under the proposed FMC Act if the service is offered by an authorised financial adviser under the FA Act: see cl 387(3). This interaction between the statutes demonstrates that the authorisation regime under the FA Act is essentially a licensing regime.
Before the licence would be granted, market services would need to be registered under the FSP Act first. According to cl 394, the FMA must grant a market service licence if it satisfied (1) that the applicant is a fit and proper person, (2) that he is capable of effectively performing the service, (3) that there is no reason to believe that the applicant will not comply with the licence obligations, and (4) that the applicant and the applicant’s directors and senior managers satisfy all further requirements prescribed by regulation.

If the FMA refused the application, the applicant would be able to appeal the decision in the High Court under cl 507 of the FMC Bill. If the licensee circumvented his licence obligations, a material change of circumstances occurred in relation to the licensee, or if the licensee provided the FMA false or misleading information in his or her application to obtain or change a market licence: cl 412(1), the FMA would have the power to censure the licensee, require the licensee to submit an action plan or give a direction (cl 412(2)). If, as a result of such conduct, the licensee no longer meets the licensing requirement, the FMA would be able to cancel the market licence: cl 412(3). This decision could also be appealed in the High Court under cl 507.

Licensees would be subject to a number of license obligations, for example the obligation to file regular reports to the FMA (cl 409) and to file an action plan to remedy contraventions if required by the FMA: cl 412(2)). Breaches of obligations would result in pecuniary penalties which would be – similar to breaches of civil remedy provisions\(^\text{153}\) – divided into minor penalties not exceeding NZ$ 200,000 for individuals and NZ$ 600,000 in other cases (cl 446(3)) and larger penalties of up to NZ$ 1million for individuals and NZ$ 5million in other cases: cl 446(2).

\(\text{(ii) Comparison to Authorisation under the FA Act}\)

The proposed licensing regimes resemble the authorisation process under the FA Act.\(^\text{154}\) Under both statutes, the applicant must register under s 13 of the FSP Act, mainly for the purpose of identification. Next, the FMA performs a more substantial check by assessing the applicant’s qualifications and character. Some of the key criteria, however, seem to differ under the FA Act and the FMC Bill. For example, under the FA Act an authorised financial adviser must, inter alia, meet the level of competency set out in the code for

\(^{153}\) See above 182.
\(^{154}\) See above 61.
authorised financial advisers (s 54(a)(iii) of the FA Act). Under the FMC Bill, none of the proposed regimes would require satisfaction of such a test. To that extent, the licensing regime under the FMC Bill would be lighter.

The FMC Bill and the FA Act also apply different character tests. According to cl 394(a) the applicant would need to be ‘fit and proper’. The details of what the FMA would take into account in determining eligibility under the ‘fit and proper’ test would be set out in regulations. The FA Act requires in s 54(a)(ii) an applicant with a ‘good character’, which suggests a different yardstick. However, the Government indicates that key personnel of managed funds under the FMC Bill would need to satisfy a ‘good character’ test. This statement indicates that the ‘good character’ test would be a part of the ‘fit and proper’ test. It is likely that the FMA would apply similar criteria in determining a good character under the FA Act and under the FMC Bill. This indicates that the FMA, in determining whether to grant market service licences, would take into account the applicant’s past behaviour, in particular any convictions as held by the District Court Wellington in Wood v Financial Markets Authority in respect of s 54 of the FA Act. So although market service licenses would not be subject to the competency criterion, the FMA could apply the same strict rules for the good character test as under the FA Act.

Another potential difference is the validity of the FMA’s decision if it is appealed. Under s 140 of the FA Act, the FMA’s decision to grant or cancel a financial adviser’s authorisation remains in force unless the District Court decides otherwise. The FMC Bill does not contain such a clause. The reason for the discrepancy and the potential implications are unclear. The legislative materials that were issued before the introduction of the FA Act do not state whether s 140 of the FA Act merely clarifies the normal course where there is an appeal of the FMA’s decision. This might be an important issue in practice. If the cancellation of the license would be suspended as soon as the licensee appeals the decision, a potential wrongdoer would remain in the market. It is likely that, if this were the case, most decisions would be appealed. The result would be that upon appeal, the FMA’s power to cancel the license would be suspended until the High Court decides the appeal. This would contradict the general approach taken under Part 6 of the

156 Office of the Minister of Commerce, above n 69, 37.
157 Ibid.
158 See above 63.
FMC Bill, with the FMA making decisions and the High Court providing court control. The result would also be an inconsistency between the FA Act and the proposed FMC Act because under the FA Act the FMA’s decision would remain in force, whereas it would be suspended under the FMC Act. In order to achieve regulatory consistency, which is a major aim of the reform of New Zealand’s financial markets, appeals against the FMA’s decision to grant or cancel a licence should not result in the suspension of the decision.

(d) Implications

The proposed licensing regime for market services would cover various types of market intermediaries. It would complement the authorisation regime for financial advisers under the FA Act. The result would be a licensing regime that would be administered by the FMA and housed in two different statutes. This licensing regime would be placed on the highest tier of the enforcement pyramid because it would enable the FMA to remove the licensee (or authorised financial advisers) from the market. It is important that the decision about the removal of a market intermediary would be made by the FMA and not by the High Court (as compared to, for example, civil remedies). This would be a significant increase of the FMA’s powers. It is surprising that the Government is reluctant to grant the FMA the power to impose ‘real’ administrative penalties, and has curtailed the FMA’s power to commence or take over proceedings under s 34 of the FMA Act, but is apparently willing to grant the FMA the significant power to remove intermediaries from the market.

The efficacy of the new licensing regime will depend on the tests that the FMA will apply as prescribed by regulation. The Government indicated that the licensing requirements will not be too strenuous or cost intensive and, generally, will not require a test of competency and skill, as is required under the FA Act. Second, and perhaps even more important, the FMA will need the resources to administer the licensing regimes properly. It is unclear how many market participants would be subject to the licence regime. However, it can be assumed that the number would be substantial, which would result in a further increase of the FMA’s workload. The introduction of the authorisation regime for financial advisers in 2010/2011 strained the FMA’s resources and possibly limited its ability to

160 See above 105-111.
162 See above n 155.
enforce insider trading laws.\textsuperscript{163} It has to be hoped that the introduction of the licensing regimes under the proposed FMC Act do not result in similar problems. As discussed in Chapter 3, the new FMA Levy will be review in 2014.\textsuperscript{164} It can be expected that the costs of the new licensing regime will be taken into account in the review process.

7 Conclusion

The reform of New Zealand financial markets have made and will make significant changes to the enforcement of financial markets laws. The emphasis on pecuniary penalties will probably result in a tighter enforcement regime. The extended enforceable undertaking regime provides the FMA with additional options for negotiations and settlement. The infringement notice regime provides the FMA an additional option to deal with minor breaches of the law quickly. However, an extended administrative penalty regime as an alternative to pecuniary penalty orders would be preferable. The power to commence or take over an investor’s right of action enables the FMA to enforce directors’ and financial advisers’ duties. Under the proposed FMC Act the power would probably be less significant because an application for compensation orders under cl 477 would not be restrained by the investor’s right to object. The perhaps most important new feature will be the licensing regime for market intermediaries under the FMC Act. However, the efficacy of this regime will depend on the ensuing regulation and the FMA’s ability to administer the regime effectively.

\textsuperscript{163} See above 104.
\textsuperscript{164} See above 77.
The new enforcement pyramid for New Zealand’s financial markets would look as follows:

**Figure 6.4: New Zealand’s New Enforcement Pyramid**

In summary, the new enforcement regime contains some significant improvements. Despite some flaws and smaller inconsistencies it seems comprehensive has probably filled most of the gaps in the FMA’s enforcement toolbox, enabling it to focus on fast enforcement of the financial markets law and a more proactive approach to regulation.
CHAPTER VII: KEY FINDINGS AND CONCLUSION

The analysis has demonstrated that there were various drivers for the reform of New Zealand’s financial markets. Investor confidence in New Zealand was shaken by the Global Financial Crisis and the downfall of domestic finance companies. The law governing New Zealand’s financial markets was outdated and its scope too narrow. A serious shortcoming was a regulator that lacked funding and enforcement powers and had to share regulatory functions with other agencies, leading to inconsistencies and gaps in the framework.

The Capital Markets Development Taskforce reviewed New Zealand’s capital markets and made several suggestions to improve the system as a whole. In particular, it recommended a comprehensive review of securities laws and a reform of the regulatory architecture, with a consolidated regulator that would place emphasis on enforcement. The Government closely followed the Taskforce’s recommendations. The first main step was the creation of the Financial Markets Authority. The Government stressed that the main objective was to restore confidence in the markets. Thus, special emphasis should be placed on the FMA’s ability to act in a more proactive fashion and deal with breaches quickly. The Government also acknowledged the need for improved resources and tried to resolve the issue by augmenting the FMA’s budget and introducing a market levy. The second step of the reform will be the introduction of the Financial Markets Conduct Act, which will assign further functions and responsibilities to the FMA.

The reform of the regulatory architecture is congruent with theoretical considerations of commentators and practical experiences of regulators. Although the level of consolidation was smaller than it appeared at first glance, some important functions, such as the review of disclosure documents, have been transferred to the FMA. The new licensing and authorisation regimes under the Financial Advisers Act 2008 and the proposed Financial Markets Conduct Act will also be administered by the FMA. Most importantly, the creation of the ‘financial markets law’ set out in Schedule 1 of the Financial Markets Authority Act 2011 enables the FMA to apply consistent regulatory objectives to all laws.
governing New Zealand’s financial markets. The Government’s decision to retain prudential regulation by the Reserve Bank of New Zealand is, given the small significance of New Zealand’s banks and financial institutions to the stability of the financial system, sensible.

However, the reform of the regulatory landscape did not go as far as it might have gone and its results in regulatory overlaps between the functions of the FMA and other agencies. Most of these overlaps will probably be unproblematic in practice. The division of functions between the FMA as the main financial markets regulator and the Registrar of Companies as the keeper of registers is sensible. The relationship between the FMA and the Commerce Commission will need some streamlining. Comments given by the Ministry of Economic Development point towards a carve-out of matters relating to financial products from the _Fair Trading Act 1986_, and a precedence of the FMA in enforcement. This would be a convincing solution. The overlaps between roles of the FMA and the Reserve Bank in relation to financial markets participants are minimal and have arguably been addressed properly in the respective Memorandum of Understanding. The Government decided not to draw a clear line between the functions of the FMA and the Serious Fraud Office. However, the FMA can address potential overlaps by focussing on civil litigation and proactive measures, transferring criminal matters to the Serious Fraud Office whenever possible. Although the reform has increased the FMA’s powers in respect of registered exchanges, the new regime is not fully convincing due to inconsistencies. The NZX’s approach to resolve potential conflicts of interest is still unsatisfactory. A sensible solution would be the creation of a new, well-funded subsidiary.

The reform of New Zealand’s financial markets has made and will make significant changes to the enforcement of financial markets laws. Generally, the new enforcement regime mirrors the Government’s statement that it wants the FMA to focus on quick enforcement and a proactive approach to regulation. The emphasis on pecuniary penalties will probably result in a tighter enforcement regime. The extended enforceable undertaking regime provides the FMA with additional options for negotiations and settlement. The infringement notice regime provides the FMA with an additional option to deal with minor breaches of the law quickly. However, an extended administrative penalty regime would be desirable. The power to commence or take over an investor’s right of action enables the FMA to enforce directors’ and financial advisers’ duties, but is inapplicable if an individual investor objects. The perhaps most important new feature will be the licensing
regime for market intermediaries under the FMC Act. Although there is still room for improvement, these changes result in an enforcement regime that is internationally comparable. It follows the idea of pyramidal enforcement and enables the FMA to conduct responsive regulation.

The primary question of this thesis was: has the creation of the FMA resulted in an effective financial markets regulator with comprehensive powers? The answer is yes. Although some deficiencies have been identified in this thesis, they are of minor importance and will probably not affect the system as a whole.
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