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Draft Financial Markets Conduct Amendment Regulations 2020

1. Thank you for providing us with extracts of the draft Financial Markets Conduct Amendment Regulations 2020 (**Draft Regulations**).
2. As you are aware, last year NZX Limited (**NZX**) provided a submission in response to the consultation paper titled "New Financial Advice Regime Exemptions" (**Consultation Paper**) published by the Financial Markets Authority (**FMA**). Our submission supported the continuance of the relief provided by the Financial Advisers (NZX Brokers – Client Money and Client Property) Exemption Notice 2015 (**NZX Broker Exemption**) and the Financial Advisers (Non-NZX Brokers – Client Money) Exemption Notice 2017 (**Non-NZX Broker Exemption**) (together, **Exemptions**).
3. NZX understands that the Government has determined to carry over the requirements of the Financial Advisers (Custodians of FMCA Financial Products) Regulations 2014 (**Custodial Regulations**) and the Exemptions in the Draft Regulations.

Comments on the Draft Regulations

Custodial obligations

4. Draft Regulation 229P excludes from the definition of relevant custodial service '*any service to the extent that client money or client property is held solely for completing a transaction, securing an obligation or both*'. We therefore understand that the reporting and custodial assurance obligations contained in Draft Regulations 229Q to 229W will not apply to NZX Participants, Clearing Participants or Depository Participants, in respect of client money or property held by them to effect trades on NZX's markets.
5. We note that section 77C of the Financial Advisers Act 2008 (**FAA**) expressly excludes both designated settlement system operators and licensed derivatives issuers from the definition of a 'broking service' (and therefore a custodial service). While the exclusion in Draft Regulation 229P presumably operates to similarly exclude designated settlement system operators and licensed derivatives issuers from Draft Regulations 229Q to 229W, we query whether this should be made more explicit. We note that the proposed new clause 21 to Schedule 5 of the Financial Markets Conduct Act 2013 (**FMCA**) (contained in Schedule 2 to the Financial Services Legislation Amendment Act 2019 (**FSLAA**)) contains these express exclusions for the purposes of defining 'regulated client money or property services'.
6. In the context of derivatives issuers we also note Draft Regulation 229W(3) disapplies Draft Regulations 229Q and 229V to relevant custodial services provided to a wholesale client by a derivatives issuer, in respect of derivatives investor money and derivatives

investor property. This suggests that derivatives issuers may be able to provide relevant custodial services within the definition contained in Draft Regulation 229P, and therefore fall within the custodial obligations set out in Draft Regulations 229Q to 229W. We suggest that this point is clarified.

Client money and client property provisions

7. Draft Regulation 229ZA reflects clause 5 of the NZX Broker Exemption, but includes a new provision that the relief from holding client money and client property separately is subject to the NZX provider having reasonable grounds to believe that it has adequate systems and procedures to comply with the duties set out in Schedule 21B to the FMCA as set out in Schedule 2 to the Draft Regulations. The duties in Schedule 21B include those that are currently contained as conditions in clause 6 of the NZX Broker Exemption.
8. We note that this approach to codifying duties, has been taken to enable minor breaches of the matters specified in clause 3 of Schedule 21B to not prevent an NZX provider's ability to rely on the relief from proposed section 431ZC(2) of the FMCA (as set out in the FSLAA). We expect that it will not be reasonable for an NZX provider to purport compliance with Draft Regulation 229ZA(2) in the situation where more significant, or systemic minor breaches of the duties contained in proposed Schedule 21B occur. We suggest that this should be addressed in guidance from the FMA. We also query whether any breach of a duty in proposed Schedule 21B could trigger a disciplinary consequence for an NZX provider under the FMCA?
9. We suggest that it would be helpful for the Draft Regulations to further clarify the definition of the term 'trust account' perhaps by reference to the matters set out in Draft Regulation 229ZC(2)(iv) and (v).
10. We note that the duties contained in clause 5 of proposed Schedule 21B apply certain duties on non-NZX providers that are equivalent to certain requirements contained in the NZX Participant Rules (for example: clause 5(1)(c) of proposed Schedule 21B). We note that equivalent duties have not been imposed on NZX providers (presumably on the basis that they are required to meet these obligations under section 18 of the NZX Participant Rules), and suggest that if this is the case it may be appropriate to include in clause 3 of Schedule 21B a duty that an NZX provider must comply with the client asset obligations of the NZX Participant Rules.

General

11. Thank you for the opportunity to provide this submission in respect of the Draft Regulations, we would be happy to discuss our comments with you.

Yours sincerely,



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