

Financial Services Quarterly

SUMMER 2015



BELL GULLY

Welcome to the Summer 2015 issue of *Financial Services Quarterly*, a review of current legal issues in the financial sector.

Each quarter, we summarise recent issues and preview upcoming developments in these areas:

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Need more information?

For more information on any of the cases, articles and features in *Financial Services Quarterly*, please email rachel.gowing@bellgully.com or call on 64 9 916 8825.

Disclaimer: this publication is necessarily brief and general in nature. You should seek professional advice before taking any action in relation to the matters dealt with in this publication.

IN THE COURTS

Payments by a developer's financier to a construction company can be clawed back

A recent High Court judgment is set to have a significant impact on the way construction businesses are paid.

UK Supreme Court reconsiders rule against contractual penalty clauses

The United Kingdom Supreme Court has reconsidered the test for whether a liquidated damages clause is an unenforceable penalty.

Excessive penalty for non-payment not enforceable

The High Court has found that a late payment fee was unenforceable because it significantly exceeded the likely loss.

FMA held to be in breach of its natural justice obligations

The High Court has overturned the Financial Markets Authority's attempt to deregister a Financial Service Provider.

LEGISLATION/IN PARLIAMENT

Amendments to the FMC Regulations released

Supplementary regulations to the Financial Markets Conduct Regulations 2014 have been released to address disclosure and implementation issues.

New custody regulations released

New regulations have been published that clarify the application of the Financial Advisers Act 2008 to custodial service providers.

Government suggests options to improve financial advice laws

Commerce and Consumer Affairs Minister Paul Goldsmith has released a paper setting out options for improving financial advice legislation.

AFAs supplying personalised DIMS are put on same footing as DIMS licensees

The Financial Markets Conduct (Offers of Financial Products Through Authorised Financial Advisers Supplying Personalised DIMS) Exemption Notice 2015 came into force on 6 November.

Partial relief from client money and client property rules for NZX Brokers

The Financial Advisers (NZX Brokers – Client Money and Client Property) Exemption Notice 2015 came into force on 1 December 2015.

New rules on use of retention funds may miss the mark

New legislation has been passed that will place fresh obligations on developers and contractors over their use of retention amounts held under construction contracts.

Commerce Act up for review

The Ministry of Business, Innovation and Employment has released an issues paper “Targeted Review of the Commerce Act 1986”, seeking feedback on potential competition law reform.

First year of FMCA transitional period completed

The Financial Markets Conduct Act 2013 reached a significant milestone on 1 December 2015, but there is much work left to be done.

Changes to organised crime and anti-corruption legislation passed

The Organised Crime and Anti-corruption Legislation Bill has been passed in the form of separate amendments to 15 statutes.

Key contract and commercial law statutes to be updated

The Parliamentary Counsel Office and the Ministry of Business, Innovation and Employment have released an exposure draft of the Contract and Commercial Law Bill for public consultation prior to its proposed introduction to Parliament next year.

Exposure draft of new Incorporated Societies Act released for consultation

The Minister of Commerce and Consumer Affairs has released for consultation an exposure draft of the proposed Incorporated Societies Bill, which will repeal and replace the Incorporated Societies Act 1908.

RECENT DEVELOPMENTS

Trans-Pacific Partnership Agreement text released

The text of the Trans-Pacific Partnership Agreement has been released.

Companies Registrar interprets “lives in New Zealand” for resident director requirement

Under changes brought in by the Companies Amendment Act 2014, all New Zealand companies are required to have at least one director who either lives in New Zealand, or lives in Australia and is a director of a company incorporated in Australia.

Changes to the Banking Supervision Handbook

The Reserve Bank of New Zealand has updated a number of documents contained in the Banking Supervision Handbook.

OIO makes changes to “sensitive land” application process requirements

The Overseas Investment Office has released new and updated materials to help streamline the consent process for applications involving sensitive land, particularly where the “benefit to New Zealand” criteria for consent are relevant.

Latest from the Financial Markets Authority

- First annual report under the new regulatory regime published.
- Consultation on draft guidance on fund fees and returns for managed funds.
- Enforcement and investigations report published for the year ending 30 June 2015.
- Information sheet on custodian’s obligations.

IN THE COURTS

Payments by a developer's financier to a construction company can be clawed back

A recent High Court judgment¹ is set to have a significant impact on the way construction businesses are paid.

Commonly, a three way agreement is entered into between the financier, the developer, and the construction company, which provides for the financier to pay the construction company directly. This recent judgment demonstrates that payments to the construction company made under such a direct agreement can still be subject to attack by the developer's liquidator as a voidable transaction under section 292 of the Companies Act 1993.

For Bell Gully's commentary on this judgment, read our earlier client update [here](#).

¹ *Sanson v Ebert Construction Limited* [2015] NZHC 2402.

UK Supreme Court reconsiders rule against contractual penalty clauses

The United Kingdom Supreme Court has reconsidered the test for whether a liquidated damages clause is an unenforceable penalty.

In the recent case² the Supreme Court applied a new broader test whether a clause imposes a fee or obligation that is a genuine pre-estimate of possible loss to the innocent party on breach (a permissible liquidated damages clause) or is “extravagant” or “unconscionable” in relation to that possible loss (a penalty), asking whether the liquidated damages clause protects the legitimate interests of the innocent party. If so, it is not a penalty (unless it is out of proportion to that interest). This contrasts with the traditional test, which is to examine whether a clause imposes a fee or obligation that is a genuine pre-estimate of possible loss to the innocent party on breach (a permissible liquidated damages clause) or is “extravagant” or “unconscionable” in relation to that possible loss (a penalty).

The Supreme Court also expressly rejected the recent approach taken to these clauses by the High Court of Australia. As a result, New Zealand courts will eventually be faced with a decision on whether to follow UK or Australian law, the key difference being:

- under the English approach, a court may consider a broad range of matters in relation to the clause, and it is expected that a greater range of clauses are likely to be found to be genuine liquidated damages clauses as opposed to penalties, and
- under the Australian approach, the courts will apply a more restrictive and formulaic test, focusing on whether the liquidated damages sum is extravagant in comparison with the maximum conceivable loss. Under the Australian approach, there may be a higher likelihood that a liquidated damages clause with a deterrent purpose would be held to be an unenforceable penalty.

For Bell Gully’s commentary on this decision, read our article [Liquidated damages clauses: UK Supreme Court changes the law](#).

² *Makdessi v Cavendish Square Holdings BV* [2015] WLR(D) 439, [2015] UKSC 67.

Excessive penalty for non-payment not enforceable

The High Court has found that a late payment fee was unenforceable because it significantly exceeded the likely loss.

The case³ concerned a short term loan that attracted an AU\$500,000 per week late payment fee, which accumulated to a claim of AU\$30 million. The borrower sought a declaration that the late payment fee was unenforceable.

Two legal issues were identified:

- whether the penalty doctrine was engaged, and
- if it was engaged, whether the late payment fee was properly characterised as penal, or as a genuine pre-estimate of loss.

The court determined that the late payment fee was imposed as a penalty, and its predominant function was deterrence. As such, the first limb of the test was easily satisfied.

The court then considered whether the fee was enforceable, and found that it so significantly exceeded the likely loss that it qualified as extravagant and was therefore unenforceable. However, the court noted that this ruling was regrettable, given that the borrower was a sophisticated party who knew what it was signing up for.

The court recognised that there is legitimate scope for an argument that a lender's interest in the due performance of a repayment obligation is sufficient to avoid characterisation of a fee as extravagant. However, in this case, there was such a disproportion between the contracted rate of recovery and what the judge regarded as recoverable damages at common law that there was no "commercial justification" for the discrepancy.

³ *Torchlight Fund No.1 LP (In Receivership) v Johnstone* [2015] NZHC 2559.

FMA held to be in breach of its natural justice obligations

The High Court has overturned the Financial Markets Authority's (FMA) attempt to deregister a Financial Service Provider (FSP).

The judgment⁴ provides guidance on due processes that ought to be followed when the FMA exercises its statutory powers.

The judgment was a setback for the FMA, with the High Court overturning its attempt to exercise its new power to deregister a FSP.

The Court did so on the grounds that the FMA breached the FSP's right to natural justice. The case is the first time a Court has considered the new deregistration power, and the Court took the opportunity to clarify the grounds for deregistration and the process the FMA ought to follow.

Click [here](#) for more information.

⁴ *Vivier and Company v Financial Markets Authority* [2015] NZHC 2337.

LEGISLATION/IN PARLIAMENT

Amendments to the FMC Regulations released

*Supplementary regulations to the Financial Markets Conduct Regulations 2014 (**FMC Regulations**) have been released to address disclosure and implementation issues.*

The Financial Markets Conduct Amendment Regulations 2015 (the **2015 regulations**) largely address previously identified disclosure issues relating to non-standard offers, and some subsequent implementation issues. They also make a number of minor improvements to ensure the FMC Regulations apply appropriately.

Click [here](#) to read an overview of the key amendments.

A copy of the 2015 regulations is available [here](#).

New custody regulations released

New regulations have been published that clarify the application of the Financial Advisers Act 2008 (FAA) to custodial service providers.

The Financial Advisers (Custodians of FMCA Financial Products) Amendment Regulations 2015 (the **2015 custody regulations**) were promulgated in November, and are scheduled to commence on 17 December 2015. These regulations clarify the scope of the regulatory regime applicable to custodial service providers by confirming that:

- the definition of “FMCA custodial service” does not capture the mere holding of client money or client property for settlement purposes, and
- the obligation to comply with sections 77P to 77T of the FAA does not apply where the subscriber of the FMCA custodial service is an entity that is controlled by a person that is a “wholesale investor” (within the meaning of clauses 3(2)(a), (c) or (d) of Schedule 1 of the FMCA).

A copy of the 2015 custody regulations is available [here](#).

Government suggests options to improve financial advice laws

As part of the Government's broader review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008, Commerce and Consumer Affairs Minister Paul Goldsmith has released a paper setting out options for improving financial advice legislation.

The Government "aims to increase consumer confidence in financial advisers and the advice they give, so that people can make informed decisions about their money", according to Mr Goldsmith.

The feedback was that:

- the current regime is overly complex and reduces access to financial advice,
- current rules around the disclosure of commissions and potential conflicts of interest are inconsistent, and
- people don't always know whether they are getting genuine advice, or whether they are being sold a product, such as insurance or investments, and,
- the options paper canvasses different approaches to achieve greater consistency across the board. The options paper also seeks feedback on proposals designed to discourage misuse of the FSP register.

Submissions on Parts 1 and 2 of the options paper (which contain the proposals for improving the regulation of financial advice) are due on 26 February 2016. Submissions on the remainder of the issues raised in the paper are due on 29 January 2016.

Click [here](#) for more information, and to read the options paper.

First year of FMCA transitional period completed

The Financial Markets Conduct Act 2013 (FMCA) reached a significant milestone on 1 December 2015, but there is much work left to be done.

The first of December 2015 marked the halfway point of the two-year FMCA transitional period. As of that date:

- only continuous issuers and those issuers that have the benefit of an exemption under the Securities Act 1978 or granted by the Financial Markets Authority (**FMA**) may continue to offer securities under a Securities Act 1978 prospectus or investment statement;
- all derivatives issuers must use an FMCA compliant Product Disclosure Statement for regulated offers of derivatives;
- all derivatives issuers are required to comply with the derivatives investor money and investor property provisions of the regulations promulgated under the FMCA;
- all providers of discretionary investment management services must be licensed; and
- the licensed market operator provisions of the FMCA came into full force and effect.

Looking ahead, the priority for the FMA for the first half of 2016 will be processing outstanding market services licence applications. It is strongly recommended that affected businesses target a Q2 2016 submission date for these applications to allow enough time for these to be processed in advance of the 1 December 2016 deadline.

Click [here](#) for more information.

AFAs supplying personalised DIMS are put on same footing as DIMS licensees

The Financial Markets Conduct (Offers of Financial Products Through Authorised Financial Advisers Supplying Personalised DIMS) Exemption Notice 2015 came into force on 6 November 2015.

The effect of the exemption is to allow offerors to offer financial products through an authorised financial adviser (**AFA**) providing a personalised discretionary investment management service (**DIMS**) under the Financial Advisers Act 2008, without having regard to whether that AFA's client is a "wholesale investor" or a "retail investor" requiring full disclosure under Part 3 of the Financial Markets Conduct Act 2013 (**FMCA**). This is subject to a condition that it is the AFA who decides whether to acquire the financial products, and not the investor.

This puts AFAs in the same position as DIMS licensees who benefit from the disclosure exemption under clause 7 of Schedule 1 of the FMCA for offers made through DIMS licensees.

The time period for this exemption is limited to two years, during which time the Financial Advisers Act will be reviewed, and a decision made on whether the notice should be extended.

Partial relief from client money and client property rules for NZX Brokers

The Financial Advisers (NZX Brokers – Client Money and Client Property) Exemption Notice 2015 came into force on 1 December 2015.

This notice exempts brokers that are NZX market participants (NZX Brokers) from the requirement to segregate client money and client property from house assets, where the co-mingling of such property is reasonably necessary to:

- facilitate or arrange the settlement of financial product transactions in a prudent and orderly fashion; or
- reduce the risk of a shortfall arising in a client money trust account.

An NZX Broker can demonstrate that such an arrangement is “reasonably necessary” by:

- investigating alternatives to the proposed arrangement; and
- satisfying itself on reasonable grounds that any available alternatives would pose an undue risk to the prudent and orderly conduct of its business, or would not be able to be accessed or implemented in a timely and cost effective manner, or would otherwise be contrary to the best of interests of the NZX Broker or its clients.

This Exemption Notice can be accessed [here](#).

New rules on use of retention funds may miss the mark

New legislation has been passed that will place fresh obligations on developers and contractors over their use of retention amounts held under construction contracts.

An initial review of the changes suggests the amendments may introduce red tape without providing substantially greater protection for subcontractors in the event of a developer or contractor becoming insolvent.

The amendments may even expose directors, officers, subsidiary companies and possibly other third parties (such as banks) to new claims as recipients of retention amounts.

Click [here](#) for more information.

Commerce Act up for review

The Ministry of Business, Innovation and Employment (MBIE) has released an issues paper “Targeted Review of the Commerce Act 1986”, seeking feedback by 9 February 2016 on potential competition law reform.

Specifically, MBIE is seeking feedback on:

- the misuse of market power provisions (section 36 of the Commerce Act),
- alternative enforcement mechanisms, including the cease and desist regime, and
- the possible introduction of a new “market studies” function.

Click [here](#) for more information.

Changes to organised crime and anti-corruption legislation passed

The Organised Crime and Anti-corruption Legislation Bill has been passed in the form of separate amendments to 15 statutes.

The amendments are aimed at strengthening existing laws to combat organised crime and corruption, and improving New Zealand's ability to collaborate with international counterparts.

Click [here](#) to read a summary of the changes.

For Bell Gully commentary on the legislative amendments, read our earlier client update [Spotlight on organised crime and corruption: new law changes](#).

Key contract and commercial law statutes to be updated

The Parliamentary Counsel Office (PCO) and the Ministry of Business, Innovation and Employment (MBIE) have released an exposure draft of the Contract and Commercial Law Bill for public consultation prior to its proposed introduction to Parliament next year.

This is the first of the Bills to be introduced under the revision powers enacted in the Legislation Act 2012, which allow the Government to revise statutes to make them more accessible and easier to understand.

The statutes included in the Contract and Commercial Law Bill are the:

- Carriage of Goods Act 1979,
- Contracts (Privity) Act 1982,
- Contractual Mistakes Act 1977,
- Contractual Remedies Act 1979,
- Electronic Transactions Act 2002,
- Frustrated Contracts Act 1944,
- Illegal Contracts Act 1970,
- Mercantile Law Act 1908,
- Minors' Contracts Act 1969,
- Sale of Goods Act 1908, and
- Sale of Goods (United Nations Convention) Act 1994.

The PCO and MBIE are interested in obtaining feedback on the specific drafting changes made, and on whether the proposed Bill contains any inadvertent changes to the law.

Click [here](#) for more information.

Exposure draft of new Incorporated Societies Act released for consultation

The Minister of Commerce and Consumer Affairs has released for consultation an exposure draft of the proposed Incorporated Societies Bill, which will repeal and replace the Incorporated Societies Act 1908.

Click [here](#) to read an overview of the key changes.

RECENT DEVELOPMENTS

Trans-Pacific Partnership Agreement text released

The text of the Trans-Pacific Partnership Agreement (TPPA) has been released.

A copy of the TPPA is available [here](#).

The TPPA is expected to come into force within two years, once countries have completed their domestic legislative procedures.

In New Zealand, the text of the agreement, together with a National Interest Analysis, will be presented to Parliament for examination by the Foreign Affairs, Defence and Trade Select Committee. After that, the legislative changes required in order to implement the TPPA will go through normal Parliamentary procedures, including select committee scrutiny.

The TPPA cannot be modified unilaterally by New Zealand, but there is some flexibility in the way various measures can be implemented through domestic legislation and regulation.

The Government has summarised key outcomes of the TPPA for New Zealand in [TPP in Brief](#). It has also provided New Zealand-specific fact sheets, which set out information on the content of the TPPA. These are available [here](#).

For previous Bell Gully commentary on the TPPA, click [here](#) and [here](#).

Companies Registrar interprets “lives in New Zealand” for resident director requirement

Under changes brought in by the Companies Amendment Act 2014, all New Zealand companies are required to have at least one director who either lives in New Zealand, or lives in Australia and is a director of a company incorporated in Australia.

This requirement came into effect for newly incorporated companies from 1 May 2015, and for companies incorporated prior to that date from 28 October 2015.

The Companies Act 1993 does not define what is meant by the term “lives in New Zealand”, but recently the Companies Registrar has indicated that this will be interpreted on the basis that a director lives in New Zealand if he or she is “*personally present in New Zealand for more than 183 days in total in a 12-month period*”.

Click [here](#) for more information.

Changes to the Banking Supervision Handbook

The Reserve Bank of New Zealand has updated a number of documents contained in the Banking Supervision Handbook.

The updated documents are:

- Capital Adequacy Framework (standardised approach),
- Capital Adequacy Framework (internal models based approach),
- Framework for Restrictions on High-LVR Residential Mortgage Lending,
- Application requirements for capital recognition or repayment and notification requirements in respect of capital, and
- Connected Exposures Policy.

Click [here](#) for more information.

OIO makes changes to “sensitive land” application process requirements

The Overseas Investment Office (OIO) has released new and updated materials to help streamline the consent process for applications involving sensitive land, particularly where the “benefit to New Zealand” criteria for consent are relevant.

The key change is the requirement for a vendor to complete a new “Vendor Information Form”, which must be provided at the same time as an application for consent. This is to help the OIO understand the land or assets being acquired, and what would most likely happen without the proposed investment.

The OIO has also released an updated version of its Required Information Checklist for applicants.

A copy of the Vendor Information Form and updated checklist are available [here](#).

LATEST FROM THE FINANCIAL MARKETS AUTHORITY

First annual report under the new regulatory regime published

The FMA has published its first report under the fully implemented Financial Markets Conduct Act, highlighting activity for the 12 months to 30 June 2015.

The FMA's chief executive Rob Everett said "While the new regime is still in its infancy, we are pleased with the progress in establishing the framework for delivering a modern and flexible approach to regulating financial services".

Click [here](#) for more information, and to read the report.

Consultation on draft guidance on fund fees and returns for managed funds

The Financial Markets Authority (FMA) has released a guide aimed at fund managers preparing their first product disclosure statements and fund updates, as they make their transition to the Financial Markets Conduct Act regime.

This appears to be in response to the FMA's recent review of funds offer documents and disclosure statements under the Securities Act regime, in which the FMA saw some inconsistencies in how performance-based fees were disclosed, and how managers were calculating 0% prescribed investor rate (PIR) returns and fund charges.

The guide highlights the FMA's thoughts on the:

- calculation of returns applying a 0% PIR,
- classifying underlying fund charges, and
- calculation and disclosure of performance-based fees in managed funds.

Click [here](#) to read the guide.

Enforcement and investigations report published for the year ending 30 June 2015

This report shows the FMA's enforcement and investigations activities closely reflect its focus on the seven strategic priorities that it identified in its [Strategic Risk Outlook](#), released last year.

The key issues arising in most of the cases this year related to concerns with governance, culture and conflicted conduct. The report also signals the FMA's intention to rely on a wider range of regulatory tools, including enforceable undertakings, to achieve compliance.

Click [here](#) for more information, and to read the report.

Information sheet on custodian's obligations

The FMA has released a new information sheet outlining the obligations of custodians under the Financial Advisers (Custodians of FMCA Financial Products) Regulations 2014.

The information sheet explains the difference between a broker and a custodian, custodians for wholesale and managed investment scheme clients, and custodians' statutory obligations. It also lists examples of different custodial arrangements.

Click [here](#) to read the information sheet.

BELL GULLY NEWS

For further details and more news visit the [publications section](#) of our website

[RMA reform continues](#)

[Government likely to scrap "one-for-two" ETS surrender obligation](#)

[Amendments to the FMC Regulations released](#)

[Commerce Act up for review](#)

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[Tips for employers as the "silly season" approaches](#)

[Liquidated damages clauses: UK Supreme Court changes the law](#)

[Spotlight on organised crime and corruption: new law changes](#)

[New rules on use of retention funds may miss the mark](#)

[Australian Court determines project manager is not an "officer"](#)

[The Trans-Pacific Partnership agreement and the impact on the Overseas Investment Office](#)

[High Court finds that direct payment by financier to construction company can be clawed back by liquidator](#)

[Clarity on base erosion and profit shifting recommendations – but what next?](#)

[TPP finalised – key points you should note](#)

[FMA held to be in breach of its natural justice obligations](#)

[Corporate Reporter Issue No 37](#)

[NZ chapter of the Class Actions Global Guide authored by Bell Gully](#)

[Ministers block Lochinver Station purchase – what it means for overseas investors](#)

[Interlocutory Injunctions](#)

USEFUL WEB LINKS

New Zealand Government

- [Consumer Affairs](#)
- [Inland Revenue Department](#)
- [Ministry of Business, Innovation & Employment](#)
- [Ministry of Foreign Affairs and Trade](#)
- [New Zealand Government](#)
- [NZ Treasury](#)
- [Office of the Clerk of the House of Representatives \[New Zealand Parliament\]](#)
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New Zealand financial agencies and organisations

- [Commerce Commission](#)
- [The Companies Office](#)
- [Export Credit Office](#)
- [NZ Law Commission](#)
- [Office of the Banking Ombudsman – password required](#)
- [Insurance and Savings Ombudsman](#)
- [Privacy Commissioner](#)
- [Personal Property Securities Register](#)
- [Reserve Bank of New Zealand](#)
- [Takeovers Panel](#)
- [Financial Markets Authority](#)

New Zealand commercial sites

- [ILANZ](#)
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- [Chartered Accountants Australia and New Zealand](#)
- [NZ Bankers' Association](#)
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- [The New Zealand Initiative](#)

Australian Government sites

- [Banking Ombudsman](#)

Australian commercial sites

- [Australian Financial Markets Association](#)
- [Australian Securities and Investment Commission](#)
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International sites

- [Bank for International Settlements](#)
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AUCKLAND VERO CENTRE, 48 SHORTLAND STREET
PO BOX 4199, AUCKLAND 1140, NEW ZEALAND, DX CP20509
TEL 64 9 916 8800 FAX 64 9 916 8801

WELLINGTON 171 FEATHERSTON STREET
PO BOX 1291, WELLINGTON 6140, NEW ZEALAND, DX SX11164
TEL 64 4 915 6800 FAX 64 4 915 6810

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