



New Super Regulator with Super Powers?

Will the recent establishment of a new financial markets regulator win back the confidence of investors, whether small or large, given the harsh lessons handed out particularly to ordinary investors in recent years?

The Crown's new super-regulator – the Financial Markets Authority – recently opened its doors for the first time to little public fanfare.

The new independent entity is an amalgamation of the functions previously held by the Securities Commission and the Government Actuary (now both disestablished) and also incorporates some of the regulatory functions from the Ministry of Economic Development.

Given the recent instability of the financial markets its publicly stated primary goal of 'restoring investor confidence' will be welcome news to all including ordinary investors, albeit that patience might be required before the FMA fully takes flight.

RESTORING CONFIDENCE

Whatever its stated aims might be (and whatever it then goes on to achieve) what we do know is that it is an integrated service. While the entity has some additional new powers, the legislation for which it will be responsible is and has been largely in place for some time. As Commerce Minister Simon Power recently commented, certain problems fell through the cracks. As some high profile investments crashed the various regulators needed to first work out whose responsibility it was to oversee these investments. It is expected that lines of responsibility will now be clearly set and a far more decisive, swift and co-ordinated approach taken.

As often happens between government agencies relevant information does not always get passed on to those who might have some use for it. Again, having a single entity with broad scope over the country's financial markets would in theory address such issues.

It has also been reported that increased funding will go into the body, with funding of \$24 million for the 2011/12 year, up from an \$18 million budget for previous financial market regulators. It is understood that this funding will increase to \$28 million in the 2012/13 year, but then fall back to \$26 million for 2014/15 and beyond.

SUPER POWERS

In terms of its new powers we know that there is likely to be greater emphasis on investigation and enforcement. Its new powers, functions and duties include:

1. The power to exercise an investor's right to take civil action against a financial market participant when it's considered to be in the public interest to do so. Individuals can opt out of proceedings if they choose.

This will be of interest to the numerous investors left financially stranded by failed investments albeit it may be some time before we know what type of actions/claims the FMA will consider worth pursuing in the public interest.

2. The ability to prevent products from being structured to avoid being supervised by the FMA.
3. Enhanced warning powers to deal with low-ball unsolicited offers. Anyone with a history of making unsolicited offers will be made to display a prominent warning to that effect when they send documents to investors. The FMA can also require unsolicited offers to include minimum-offer periods, and disclosure of market price and other relevant information.

This power arises out of concerns of some unsolicited offers for shares in several New Zealand corporates, some of those offers being significantly below the share price on the sharemarket at the time but not clearly explained as such.

4. A new oversight regime for registered exchanges, including the ability to undertake real-time surveillance of market activity.

The message that has been sent out by the regulator at this early stage is that emphasis will be on "early detection and strong enforcement". As part of its first three year focus it will seek to:

1. Place a strong emphasis on surveillance, investigation and enforcement actions so as to have the greatest deterrent effect. Establish self-reporting and remediation policies.
2. Develop an intelligence gathering and analysis hub to disseminate information throughout the organisation.
3. Develop a robust case selection policy, which includes taking cases that test the boundaries of the law and develop new case law.
4. Develop and implement a referral management system including whistle blowers.

If only to underline its eagerness to flex its regulatory muscle it has already been before the courts in recent weeks on a number of claims successfully enforcing its new powers.

MUM AND DAD INVESTORS

The FMA has recently indicated that investors should also be careful of being classified as wholesale investors and losing retail 'mum and dad' investor rights and protections. Increased protections are being phased in (by 1 July 2011) for retail investors. These include advisers being subject to

professional conduct standards and disclosure requirements, and investors having the ability to complain to an independent dispute resolution scheme.

Advisers servicing only wholesale clients do not have to offer the same protections.

Relevant legislation defines wholesale investors to include local authorities and Crown entities, those who regularly invest money as part of their business as well as 'eligible investors' who certify themselves as knowledgeable.

Also, entities with net assets over a million dollars are also caught. This could include a farmer who has just sold the farm, or a retiring small business owner who places money in a trust or partnership entity. In other words the type of person who may not have the type of detailed financial knowledge you might expect a typical 'wholesale' client to have.

Investors who have been classified as wholesale clients have the ability to 'opt out' and be treated as a retail client if they choose.

ACCOUNTABILITY

The FMA will likely take the lead of other single entity financial regulators from around the world, including the UK's Financial Services Authority (albeit there has been recent talk of separating out its various responsibilities between separate agencies), which has been existence for over a decade. The UK regulator similarly has placed enforcement at the top of its stated agenda since the global recession.

While all of this might not be much comfort to those ordinary investors burnt by past investments there is an expectation now that a system, or body, is in place to both recognise and act on issues quickly. A new authority in this sense is however unlikely to be provide a complete remedy.

Ultimately, what will give investors confidence in the system is accountability. If the regulator is as serious as it claims, more company directors will need to be brought to account for the promises they have made and failed to keep.

Anyone with a further interest in the regulator should have a look at their website at <http://www.fma.govt.nz>. Amongst other things you will find a helpful section listing potential financial scam artists, and alerts and warnings relating to offers made by certain named individuals and companies.



Written by
Troy Wano
Solicitor

DDI: (06) 768-3710
Email: Troy.Wano@gqlaw.co.nz