

# SECURITIES COMMISSION NEW ZEALAND

## SIGNIFICANT CHANGES IN SECURITY LAW

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Securities market participants face major changes next year when a new law and regulations come into force.

The changes arise from the Securities Legislation Bill passed by Parliament in October 2006. The Bill amended various Acts including the Securities Act and the Securities Markets Act Regulations will be passed to bring these changes into effect. A handbook to help people understand the changes is being prepared by the Securities Commission. It will be published when details of the regulations are known and will be available free of charge.

### INSIDER TRADING LAWS

The new regime focuses on the threat that insider trading poses to the integrity and confidence of the market, rather than on the duty owed by officers or agents of a company to that company. Liability for insider trading is not limited to those who are connected or related to the issuer. A person becomes an insider by possessing inside information, rather than by being connected to the company to which the inside information relates.

An *information insider* is someone who has *material information* about a public issuer that is not generally available to the market, where the person knows or should know that the information is material and is not generally available.

*Material information* is information that would be expected to materially affect the issuer's share price if it were generally known.

Information insiders must not trade in securities, disclose the information to others to trade on, or advise or encourage anyone else to trade or hold securities.

Anyone who breaches the new insider trading law will be liable for substantial civil penalties. The maximum penalty in any case will be the greater of:

- the consideration paid for the shares;
- three times any profit made or loss avoided; or
- \$1 million.

Knowingly breaching this law will be a criminal offence. Anyone convicted could face up to five years imprisonment or a fine of up to \$300,000 for an individual and \$1 million for a body corporate.

There will be a number of exceptions and defences to liability, designed to encourage legitimate trading activity. These include:

- independent research or analysis;
- where both parties to a transaction have equal information;

- trading in accordance with a fixed trading plan;
- where trading or disclosure is required by law;
- underwriting agreements;
- knowledge of a person's own intentions or activities;
- agents and advisers acting on instructions;
- certain takeover-related activity; and
- trading where information is protected by Chinese Walls.

### NEW MARKET MANIPULATION AND GENERAL DEALING MISCONDUCT LAWS

Market manipulation involves behaviour or practices that are likely to give a false or misleading impression about the supply, demand, price or value of securities traded on a registered exchange. It includes practices known as ramping share prices, marking the close, pumping and dumping, wash trades and capping and pegging.

The new market manipulation law specifically prohibits:

- making false or misleading statements or spreading information which is likely to induce a person to trade or which might affect the price of the securities; and
- creating a false or misleading appearance of securities trading.

Any trade that does not result in a change of beneficial ownership will be presumed to give a misleading appearance of trading activity unless it can be shown that the transaction took place for a legitimate reason. This also applies where a person places matching buy and sell orders for a security.

Penalties for breaching the market manipulation laws will be similar to those for insider trading and include criminal offence provisions.

There is also a broad-ranging prohibition against any conduct related to any dealings in securities that is likely to mislead or deceive. This is similar to the prohibition in the Fair Trading Act 1986 for misleading or deceptive conduct. Anyone who engages in misleading or deceptive conduct can be subject to prohibition or corrective orders made by the Securities Commission and can be liable to pay compensation to anyone who suffers loss as a result of the conduct.

### SUBSTANTIAL SECURITY HOLDER DISCLOSURE

The aim of substantial security holder disclosure is to promote an informed market and to deter insider conduct, market manipulation and secret dealing in potential takeover bids by ensuring that all market participants have information about trading by persons who control

or influence significant voting rights in a public issuer.

The basic features of this law remain the same. Disclosure must be made when a person becomes a substantial security holder (at the 5 per cent threshold), whenever a holding changes by 1 per cent and when a person ceases to be a substantial security holder.

However, there have been some important changes. These include:

- a person becomes a substantial security holder by having a relevant interest in 5 per cent of the listed securities in any class (rather than 5 per cent of the total number of voting securities of an issuer); and
- disclosure applies to listed voting securities only, not to unlisted securities; but
- the Securities Commission can require any person to disclose the nature and extent of any relevant interests in securities of a public issuer, including in unlisted and non-voting securities.

Failure to comply with substantial security holder obligations will be a criminal offence, subject to a fine of up to \$30,000. Civil penalties of up to \$1 million can be imposed by the Court, which can also make a range of orders relating to any holding of securities, including orders to forfeit or dispose of securities.

### NEW INVESTMENT ADVISER AND BROKER DISCLOSURE REGIME

Investment advisers and investment brokers have additional disclosure obligations. Full disclosure must be made up-front by investment advisers before investment advice is given to members of the public and by investment brokers before receiving investment money or investment property from members of the public.

The disclosure is mandatory. It must be made in a disclosure statement and provided without the client having to ask for it.

The new rules will require more extensive information about fees, commissions and other remuneration. This will extend to any benefits to be received by the adviser, whether from the client or another source and will include "soft" commissions and indirect benefits relevant to the advice being given to the client.

Investment advisers' disclosure must include:

- their experience and qualifications;
- criminal convictions;
- the nature and level of fees charged;
- other interests and relationships; and
- types of securities the adviser advises on.

Investment brokers' disclosure must include:

- criminal convictions; and
- procedures for dealing with investment money and investment property.

Disclosure statements and advertising must not be deceptive, misleading or confusing and must be kept up-to-date.

Advisers and brokers must not recommend illegal offers of securities or receive investment money in respect of illegal offers of securities. A breach of this requirement is a criminal offence if the adviser or broker knew or ought to have known that the offer was illegal.

The Commission will have the power to enforce these and make prohibitive orders, corrective orders, disclosure orders and temporary banning orders.

Failure to comply with the disclosure obligations is an

offence with fines of up to \$300,000. Civil penalties of up to \$1 million can be imposed by the Court.

### ENFORCEMENT POWERS OF THE SECURITIES COMMISSION

The new securities markets law includes extensive public enforcement provisions. The Commission will be able to apply to the Court for various orders and also has increased administrative powers to intervene to protect investors.

The Commission can:

- seek pecuniary penalty orders for serious breaches of the law;
- seek civil remedies and penalties under the Securities Act where offer documents are likely to mislead investors, or for a breach of the disclosure provisions relating to contributory mortgages;
- seek compensation orders for loss suffered by investors;
- seek management banning orders against a person if they:
  - have been convicted for an offence under the Securities Act 1978; or
  - have had a pecuniary penalty order made against them; or
  - as a director have persistently contravened the securities laws, the Companies Act 1993, the Takeovers Act 1993 or the takeovers code;
- seek orders to preserve assets pending an investigation or prosecution; and
- make prohibition orders, corrective orders, and disclosure orders in relation to the market manipulation, general misleading conduct, and disclosure laws, and disclosure and temporary banning orders in respect of investment adviser and broker disclosure laws.



### REGULATIONS

The Ministry of Economic Development has recently published a discussion document seeking comment on regulations to be made under the new law. The regulations could affect the detail of the new requirements, especially the disclosure required by investment advisers and the timing for giving some information to clients. They may also contain some further exemptions from parts of the law. The exact shape of the new rules will not be certain until the regulations are settled.

While the timing for the introduction of the new law is not known at this stage, we expect the regulations to be made by the end of the year and the new rules to come into force in the first half of 2007. ▀

### CONTACT DETAILS

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