

Our Ref:

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RECOMMENDATIONS FOR AMENDMENT OF PART III SECURITIES AMENDMENT ACT 1988

A DISCUSSION PAPER FOR PUBLIC CONSULTATION

1. BACKGROUND

- 1.1 Part III of the Securities Amendment Act 1988 regulates the activity of dealing in futures contracts in New Zealand.
- 1.2 The term "futures contract" is defined in section 37(1) of the Amendment Act and includes agreements to buy or sell a specified quantity of a particular commodity or financial instrument at a predetermined date in the future at a price agreed upon when the agreement is entered into. The definition also includes an option or right to assume rights and obligations under such an agreement and any agreement, option or right or class of agreements, options or rights declared by the Commission to be agreements, options or rights or a class of agreements, options or rights to which the requirements of the Act apply.
- 1.3 The term "dealing" in futures contracts is defined in section 37(5) of the Amendment Act to include acquiring or disposing of a futures contract on behalf of another person or advising or assisting a person in connection with the acquisition or disposal of a futures contract.
- 1.4 The purpose of Part III is to restrict futures dealing activity to persons who are subject to appropriate authorisation. Thus section 38(1) of the Amendment Act provides -

"No person may carry on the business of dealing in futures contracts unless -

 - (a) *That person is a member of an authorised futures exchange; or*
 - (b) *That person is authorised by the Commission by notice in the Gazette to carry on the business of dealing in futures contracts."*
- 1.5 An authorised futures exchange is a body corporate which has been declared by the Commission, pursuant to section 37(8) of the Act, to be such.
- 1.6 Dealing in futures contracts in contravention of the requirements of Part III is an offence.

- 1.7 The Commission proposes to recommend various amendments to Part III to enable its more effective operation. The purpose of this paper is to outline these proposed amendments and the reasons why they are sought and to invite comment from Members of the public.

2. PROPOSED AMENDMENT TO SECTION 38(1)

- 2.1 In administering Part III of the Amendment Act, the Commission has been constrained to interpret the word "member" in section 38(1)(a) to mean a shareholder of an authorised futures exchange. However, none of the dealers of the only presently authorised futures exchange, New Zealand Futures and Options Exchange Limited ("the Exchange"), are shareholders of the Exchange. More importantly, the Exchange is finding in this relatively complex age that it is not in a position to maintain a programme of regulation and supervision in respect of all futures contracts in which its members deal. It is no longer consistent with the policy of the Act for persons to be authorised as dealers, at least in respect of futures contracts generally, by virtue only of their membership of an authorised exchange. Thus, all persons who deal in futures contracts in New Zealand need to be authorised separately from their exchange to give reasonable effect to the policies of the present statute.
- 2.2 The Commission does not consider that it will be necessary to authorise individually all members of the Exchange where it is possible to limit the authorisation to the classes of contracts which members of the Exchange routinely deal in by virtue of their membership. The Commission considers that it would meet the policy requirements of the Act if dealers could be authorised as a class rather than by virtue of Exchange membership. The Commission would need to be empowered for this purpose.
- 2.3 The Commission therefore proposes to recommend that section 38(1) be amended to read:
- "No person shall carry on the business of dealing in futures contracts unless that person is authorised by the Commission, either individually or as a member of a class of persons, by notice in the Gazette to carry on the business of dealing in futures contracts."*
- 2.4 The Commission also proposes to recommend the introduction of a new section 38(1A) to read:
- "No person shall conduct a market or exchange in New Zealand for trading in futures contracts unless that person is an authorised exchange."*
- 2.4 The Commission is also considering the utility of a provision whereby no person would be permitted to act as a clearing house in respect of any market or exchange in New Zealand for trading in futures contracts, particularly where the clearing house is a guarantor of all market contracts, unless that person is authorised by the Commission to do so by Notice in the Gazette. The Commission would appreciate receiving comments concerning the utility of such a provision.

3. PROPOSED NEW SECTION 38A

3.1 Section 38(2) of the Amendment Act provides:

"For the purposes of paragraph (b) of subsection (1) of this section, any authorisation may be for-

(a) *Specified futures contracts:*

(b) *A specified class or specified classes of futures contracts:*

(c) *futures contracts generally:*

(d) *Futures contracts generally other than-*

(i) *Specified futures contracts:*

(ii) *A specified class or classes of futures contracts-*

and may be on such terms and conditions as the Commission thinks fit."

3.2 Section 38 does not expressly provide that the Commission shall have the power to vary or revoke any authorisation by the Commission pursuant to section 38(1)(b). No similar power of variation or revocation applies in respect of any declaration made under section 37. A power of variation or revocation is essential to the Commission's administration of Part III.

3.3 In this regard, the Commission notes that section 5(5) of the Securities Act 1978, which provides the Commission with the power to exempt any person from compliance with the requirements of Part II of the Securities Act, Part II of the Securities Amendment Act and any Regulations made under the Securities Act or Part II of the Amendment Act expressly provides that the Commission may vary or revoke any such exemption. Likewise, section 7A of the Securities Act provides that the Commission may vary or revoke the authorisation of a life insurance company pursuant to section 7A(2) of the Securities Act. Similarly, the Commission has power to revoke the approval of a trustee or a statutory supervisor under section 48 of the Securities Act 1978. It has been argued before the Commission, on the basis of the contextual analysis principles of statutory interpretation, that the absence of an express power of variation or revocation is an indication that Parliament did not intend the Commission to have such a power. The Commission has rejected this view. However it is undesirable that there should be any doubt on this matter.

3.4 The Commission therefore proposes to recommend that Part III be amended by inserting a new section 38A to read:

"[Amendment or Revocation of a Gazette Notice]. The Commission may at any time, by notice in the Gazette, amend or revoke any declaration or approval

given by it under section 37(5), 37(7), 37(8) or 38(1):

Provided that no such amendment or revocation shall affect any conduct, or any agreement, option or right or any authorisation made before the date of the amendment or revocation."

4. PROPOSED AMENDMENTS TO SECTION 37(1)

4.1 Section 37(1) provides definitions of terms used in Part III of the Amendment Act.

4.2 Section 37(1) contains the following definition:

"Authorised dealer in foreign exchange" has the same meaning as in section 2 of the Reserve Bank Act 1964".

4.3 The Reserve Bank Act 1964 has now been repealed by the Reserve Bank Act 1989.

4.4 The Commission therefore proposes to recommend that the definition of "authorised dealer in foreign exchange" in section 37(1) be deleted.

4.5 Section 37(1) also contains the following definition:

"Authorised Futures Contract" means a futures contract which is -

- (a) Made on, or effected through, an authorised futures exchange; or*
- (b) Made on or effected through, a futures exchange in a country other than New Zealand which is authorised by the laws of that country to operate as a futures exchange, by a person referred to in paragraph (a) or paragraph (b) of section 38(1) of this Act; or*
- (c) which is a futures contract of a class in which a person referred to in paragraph (b) of section 38(1) of this Act is authorised to deal."*

In view of the amendment to section 38(1) proposed by the Commission in 2.3 above, the Commission proposes to recommend that paragraph (b) be amended to read:

"(b) Made on, or effected through, a futures exchange in a country other than New Zealand which is authorised by the laws of that country to operate as a futures exchange, by a person referred to in section 38(1) of this Act; or..."

In view of the amendment to section 38(1) proposed by the Commission in 2.3 above, the Commission proposes to recommend that paragraph (c) be amended to read:

"(c) Which is a futures contract of a class in which a person referred to in section 38(1) of this Act is authorised to deal, in respect of that person:"

5. PROPOSED AMENDMENT TO SECTION 37(2)

5.1 Section 37(2) provides:

"For the purposes of this part of this Act, none of the following agreements or contracts is a futures contract:

- (a) *A currency swap agreement to which an authorised dealer in foreign exchange or a registered bank is a party:*
- (b) *An interest rate swap agreement to which an authorised dealer in foreign exchange or a registered bank is a party:*
- (c) *A forward exchange rate contract to which an authorised dealer in foreign exchange or a registered bank is a party:*
- (d) *A forward interest rate contract to which an authorised dealer in foreign exchange or a registered bank is a party."*

5.2 In view of the deletion of the definition of "authorised dealer in foreign exchange" proposed by the Commission in 4.4 above, the deletion of all references to an authorised dealer in foreign exchange in section 37(2) will also be necessary.

5.3 The Commission therefore proposes to recommend that the words "an authorised dealer in foreign exchange or" in each of clauses (a), (b), (c) and (d) of section 37(2) be deleted.

6. PROPOSED AMENDMENT TO SECTION 37(8)

6.1 Section 37(8) provides:

"The Commission may, by notice in the Gazette, declare a body corporate that conducts, or proposes to conduct, a market or exchange in New Zealand for trading in futures contracts to be an authorised futures exchange for the purposes of this part of the Act."

6.2 Section 37(8) does not state that a declaration made under that section may be upon such terms and conditions as the Commission thinks fit. The Commission has therefore had to obtain undertakings from the Exchange in lieu of imposing such terms and conditions. This has proved to be a cumbersome process. The Commission considers that it should be empowered under section 37(8) to declare a body corporate to be an authorised futures exchange upon such terms and conditions as the Commission sees fit.

6.3 The Commission therefore proposes to recommend that section 37(8) be amended to read as follows:

"The Commission may, upon such terms and conditions as the Commission thinks fit,

by Notice in the Gazette declare a body corporate that conducts, or proposes to conduct, a market or exchange in New Zealand for trading in futures contracts to be an authorised futures exchange for the purposes of this part of this Act."

7. SUBMISSIONS

Persons wishing to make submissions to the Commission on the proposed amendments should do so in writing by Friday 26 August 1994.

P.D McKenzie
Chairman