



Financial Advisers (Non-NZX Brokers—Client Money) Exemption Notice 2017

Pursuant to section 148 of the Financial Advisers Act 2008, the Financial Markets Authority, being satisfied of the matters set out in section 148(2) of that Act, gives the following notice.

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Notice

1 Title

This notice is the Financial Advisers (Non-NZX Brokers—Client Money) Exemption Notice 2017.

2 Commencement

This notice comes into force on the day after the date of its notification in the *Gazette*.

3 Revocation

This notice is revoked on the close of 30 November 2020.

4 Interpretation

- (1) In this notice, unless the context otherwise requires,—
Act means the Financial Advisers Act 2008

client money trust account means a trust account required by section 77P(1)(b) of the Act

financial product transaction means a transaction involving the acquisition or disposal, or the variation of the terms of an acquisition or disposal, of a financial product or other dealing in relation to a financial product

financial product transaction business means the business of facilitating or arranging the settlement of financial product transactions on behalf of, or for the benefit of, clients

firm money means money held by or for a non-NZX broker on his, her, or its own account

good broker practice means exercising the care, diligence, and skill that a reasonable broker would exercise in the conduct of a financial product transaction business in the same circumstances

non-NZX broker means a broker that is not an NZX broker

NZX broker means a broker that is a Market Participant Accepting Client Assets (or that has any equivalent replacement designation) within the meaning of the NZX Participant Rules

NZX Participant Rules means the NZX Participant Rules made by NZX Limited.

- (2) For the purposes of this notice, a practice or an action of a non-NZX broker that involves client money being held together with firm money is **reasonably necessary** if—
- (a) the non-NZX broker has taken reasonable steps to investigate alternatives that would overcome or reduce the extent to which client money is held together with firm money; and
 - (b) the non-NZX broker is satisfied on reasonable grounds either that, in the circumstances, there are no alternatives available or that any such alternatives—
 - (i) would pose an undue risk to the prudent and orderly conduct of his, her, or its financial product transaction business; or
 - (ii) are not able to be accessed or implemented without exposing the non-NZX broker or his, her, or its clients to an unreasonable level of cost or delay or risk; or
 - (iii) would be contrary to the best interests of his, her, or its clients in being able to undertake financial product transactions in a timely and prudent manner.
- (3) Any term or expression that is defined in the Act and used, but not defined, in this notice has the same meaning as in the Act.

5 Exemption from obligation to hold client money separately in order to reduce risk of client money shortfalls

- (1) Every non-NZX broker to which the exemption in this clause applies is exempt from section 77P(1A) of the Act to the extent that it is reasonably necessary for firm money to be held together with client money in a client money trust account in order to reduce the risk of a shortfall arising in the client money held for a client in that account.
- (2) The exemption in this clause applies to a non-NZX broker that has notified the FMA in writing that he, she, or it intends to rely on this notice.

6 Conditions of exemption in clause 5

The exemption in clause 5 is subject to the conditions that—

- (a) firm money must be held together with client money only to the extent that is reasonably necessary for the purposes of the non-NZX broker conducting his, her, or its financial product transaction business in a prudent and orderly fashion; and
- (b) the non-NZX broker must not place firm money into the client money trust account for any purpose other than facilitating or arranging the settlement of 1 or more financial product transactions for a client or reducing the risk of a shortfall arising in the client money held for a client in that account; and
- (c) the non-NZX broker must take reasonable steps to ensure that the amount of firm money in a client money trust account is no more than the amount that is reasonably necessary to facilitate or arrange the settlement of 1 or more financial product transactions for a client and to cover the risk of a shortfall arising in the client money held for his, her, or its clients at any time; and
- (d) the non-NZX broker must take all reasonable steps to ensure that client money remains separately identifiable from firm money; and
- (e) the non-NZX broker must document, implement, and monitor processes that are consistent with good broker practice and that are appropriate to manage the risks to clients associated with not separating firm money from client money, in reliance on the exemption in clause 5, in the context of the non-NZX broker's financial product transaction business.

7 Further conditions of exemption in clause 5

- (1) The exemption in clause 5 is subject to the further conditions that—
 - (a) the non-NZX broker must maintain at least 1 client money trust account at a bank in New Zealand in each currency in which it accepts money from or on behalf of clients; and
 - (b) the non-NZX broker must give each of his, her, or its clients the following information in writing before the broker holds any client money for

that client or, if a client is an existing client when this notice comes into force, as soon as is reasonably practicable after that date:

- (i) a statement that all client money received by the broker for or on account of the client will be held on trust for the client and deposited in a client money trust account; and
 - (ii) a summary of the terms of that trust; and
 - (iii) a statement to the effect that an amount of money held by or for the broker on his, her, or its own account may be deposited by the broker in the client money trust account to the extent that is reasonably necessary to reduce the risk of a shortfall arising in the client money held for a client in that account and otherwise on the terms and condition of this notice; and
 - (iv) a description of any risks to clients that the broker is aware of that exist or are likely to arise as a result of client money not being held separate from firm money in reliance on the exemption in clause 5; and
- (c) the non-NZX broker must, in relation to each client money trust account,—
- (i) have obtained from the bank holding that client money trust account a written acknowledgement of the trust status of that account; and
 - (ii) ensure that the words “client funds account”, “trust account”, “client funds a/c”, or “trust a/c” appear in the name of that client money trust account; and
 - (iii) if the name, account number, or status of that client money trust account changes, obtain from the bank holding that client money trust account a new written acknowledgement of the trust status of that account as soon as practicable after the date of the change; and
- (d) the non-NZX broker must, on each business day, take adequate steps to reconcile the records for each client money trust account with the records of the bank holding the client money trust account for the purpose of identifying whether there is any shortfall in the client money held for a client in the client money trust account or any risk that a shortfall may occur; and
- (e) if, on any business day, the non-NZX broker identifies that there is a shortfall or a risk that a shortfall may occur, the non-NZX broker must take reasonable steps to rectify the shortfall or prevent that shortfall occurring by paying into the account, before the end of that business day, by way of, or on account of, a buffer an amount of firm money that is not less than the amount of the shortfall or anticipated shortfall; and

- (f) the non-NZX broker must retain written records of the operation of each client money trust account that include the following information, and make those records available to the FMA as soon as practicable after the FMA makes any request:
 - (i) details of any shortfalls that occurred in the client money held for a client in the client money trust account; and
 - (ii) details of any risks that a shortfall might arise in the client money held for a client in the client money trust account identified by the non-NZX broker; and
 - (iii) details of any payments of firm money into a client money trust account by way of, or on account of, a buffer; and
 - (g) the non-NZX broker must obtain, within 4 months after each relevant date, a report from a qualified auditor regarding the non-NZX broker's compliance with the conditions in this notice during the relevant period and provide a copy of that report to the FMA within 20 working days after it has been obtained; and
 - (h) the non-NZX broker must ensure that the qualified auditor provides to the FMA any information that the FMA may request from the qualified auditor regarding the non-NZX broker's compliance with the conditions in this notice during the relevant period as soon as practicable after the FMA makes any request; and
 - (i) the non-NZX broker must provide the qualified auditor with all necessary access to its systems and records, and otherwise co-operate fully with the qualified auditor, to enable the qualified auditor—
 - (i) to assess ongoing compliance by the non-NZX broker with the conditions in this notice; and
 - (ii) to provide the reports and other information required by this notice; and
 - (j) the non-NZX broker must provide the FMA and the qualified auditor with a written consent authorising the qualified auditor to provide the FMA with the information required by this notice; and
 - (k) the report obtained from the qualified auditor under paragraph (g) in respect of the non-NZX broker's compliance with the conditions in this notice must be prepared in accordance with the applicable auditing and assurance standards issued by the External Reporting Board under section 12 of the Financial Reporting Act 2013 (for example, the Standard on Assurance Engagements 3100 Compliance Engagements (SAE 3100)).
- (2) In this clause, unless the context otherwise requires,—
bank in New Zealand has the same meaning as in section 5 of the Act

buffer means firm money belonging to the non-NZX broker that is deposited into a client money trust account and retained in that account for the purpose of reducing the risk of a shortfall arising in the client money held for a client in a client money trust account

business day means a day on which banks are open for trading in Auckland and Wellington

qualified auditor has the meaning given to it in section 461E of the Financial Markets Conduct Act 2013

relevant date, in relation to a non-NZX broker, means either of the following, provided that the first relevant date is before the first anniversary of the date on which the non-NZX broker notifies the FMA that it intends to rely on this notice:

- (a) the broker's balance date;
- (b) an alternative date in each calendar year determined by the non-NZX broker and notified to the FMA in writing to be its relevant date for the purposes of this notice (but that first relevant date need not be in a particular calendar year)

relevant period, in relation to a non-NZX broker, means a 12-month period ending on the relevant date of the broker, and if, as a result of the date on which it became a non-NZX broker or a change of the relevant date of the broker, the period ending on that date is longer or shorter than 12 months, that longer or shorter period is a relevant period.

Dated at Auckland this 25th day of July 2017.

Nick Kynoch,
General Counsel.

Statement of reasons

This notice, which comes into force on the day after its notification in the *Gazette* and is revoked on the close of 30 November 2020, exempts certain brokers, on conditions, from section 77P(1A) of the Financial Advisers Act 2008 (the **Act**). The exemption will apply to brokers who are not NZX Market Participants (**non-NZX brokers**).

Section 77P(1A) is the requirement inserted into the Act on 1 December 2014 that money and property held by a broker on his, her, or its own account must be held separately from client money and client property (the **segregation requirement**).

This notice grants an exemption to permit a buffer of money held by a broker on his, her, or its own account (**firm money**) to be kept in a non-NZX broker's client money trust account.

The exemption will permit the commingling of client money with firm money to the extent that is reasonably necessary to reduce the risk of a shortfall arising in the client money held for a client in a client money trust account.

A practice or an action will be regarded as reasonably necessary if the non-NZX broker—

- has taken reasonable steps to investigate alternatives that would overcome or reduce the extent to which client money is held together with firm money; and
- is satisfied on reasonable grounds either that, in the circumstances, there are no alternatives available or that any alternatives—
 - would pose an undue risk to the prudent and orderly conduct of his, her, or its business; or
 - are not able to be accessed or implemented without exposing the non-NZX broker or his, her, or its clients to an unreasonable level of cost or delay or risk; or
 - would be contrary to the best interests of his, her, or its clients in being able to undertake financial product transactions in a timely and prudent manner.

A similar exemption from the segregation requirement was granted in 2015 to brokers who are NZX Market Participants. The main differences between the 2 notices are as follows:

- the NZX broker exemption permits the operation of gateway accounts (which are accounts used specifically for transacting with particular settlement systems), whereas this non-NZX broker exemption does not;
- *clause 7* of this non-NZX broker exemption contains conditions additional to those contained in the NZX broker exemption.

The Financial Markets Authority (**FMA**), after satisfying itself as to the matters set out in section 148(2) of the Act, considers it appropriate to grant the exemption set out in the notice for the following reasons:

- shortfalls in a broker's client money trust account may occur for a variety of reasons, including timing issues (eg, for offshore trades), changes in foreign exchange rates, processing errors, tax or fee payment obligations, payments being dishonoured or reversed, failures by clients to lodge funds, and internal errors;
- these shortfalls, unless addressed, may result in insufficient funds being available to settle financial product transactions on behalf of clients or one client's funds being used to settle another client's transaction:

- historically, many brokers in New Zealand have mitigated the risks of shortfalls arising by maintaining a buffer of their own money in their client money trust account. This practice contravenes the segregation requirement under the Act:
- upgrading or changing existing systems and processes to mitigate the risks of a shortfall arising without use of a buffer is likely to result in significant compliance costs and business disruption for brokers and their client. These brokers will be best able to minimise and manage the impact of the costs and disruption if they have a transition period that allows them to spread costs over time and take advantage of any scheduled upgrades or reviews:
- conditions will limit the use of buffers to where they are reasonably necessary in order to facilitate the settlement of financial product transactions for a client or reduce the risk of a shortfall arising, and brokers will be required to take all reasonable steps to ensure that client money remains separately identifiable and that the amount of firm money held in a client money trust account is no more than is reasonably necessary to cover the risk of a shortfall arising:
- requirements in relation to the establishment and operation of the client money trust account and for a declaration of trust will ensure that a trust is established to protect client money held by the broker in the client money trust account. Additionally, conditions will also require brokers to keep records on compliance with the requirements under this notice and make them available on request, and independent verification regarding compliance will be provided through an assurance engagement obtained from a qualified auditor:
- in these circumstances, the FMA is satisfied that the costs of full and immediate compliance by brokers with the segregation requirement (if an exemption was not granted) would not be justified by the benefit of a significant reduction in risks for clients.

Issued under the authority of the Legislation Act 2012.

Date of notification in *Gazette*: 27 July 2017.

This notice is administered by the Financial Markets Authority.