

**Reprint  
as at 15 March 2021**



## **Financial Markets Conduct (Shares in Investment Companies) Designation Notice 2017**

(LI 2017/104)

Pursuant to section 562 of the Financial Markets Conduct Act 2013, the Financial Markets Authority, having complied with the requirements set out in section 563 of that Act, gives the following notice.

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### **Notice**

#### **1 Title**

This notice is the Financial Markets Conduct (Shares in Investment Companies) Designation Notice 2017.

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#### **Note**

Changes authorised by subpart 2 of Part 2 of the Legislation Act 2012 have been made in this official reprint.  
Note 4 at the end of this reprint provides a list of the amendments incorporated.

**This notice is administered by the Financial Markets Authority.**

## 2 Commencement

This notice comes into force on 19 May 2017.

## 3 Interpretation

(1) In this notice, unless the context otherwise requires,—

**Act** means the Financial Markets Conduct Act 2013

**asset manager** means, in relation to an investment company, a person who manages some or all of the investment property of the company

**ASX** means the securities exchange operated by ASX Limited under that name

**ASX shares** means shares to which either of the following applies:

- (a) the shares are quoted on the ASX; or
- (b) it is a term of an offer of the shares that the shares will be approved for trading on the ASX immediately after the shares are issued

**investment adviser** means, in relation to an investment company, a person who provides ongoing or regular financial advice to the company

**investment company** means a company—

- (a) whose principal business consists of investing in investment property; or
- (b) that holds itself out as being a company whose principal business consists of investing in investment property

**investment manager** means, in relation to an investment company, a person who manages the investment of some or all of the investment property of the company

**investment property** means 1 or more of the following:

- (a) a financial product;
- (b) a commodity;
- (c) foreign currency;
- (d) real property

**key service provider** means, in relation to an investment company, a person who acts as an asset manager, investment adviser, or investment manager in relation to the company

**NZX Main Board** means the financial product market operated by NZX Limited under that name

**NZX Main Board shares** means shares to which either of the following applies:

- (a) the shares are quoted on the NZX Main Board; or
- (b) it is a term of an offer of the shares that the shares will be approved for trading on the NZX Main Board immediately after the shares are issued

**Regulations** means the Financial Markets Conduct Regulations 2014

**voting rights concerning directors** means the rights of any holder of shares in a company to vote on a poll at a meeting of the company on any resolution to appoint or remove a director.

- (2) References in this notice to provisions of the Companies Act 1993 must be read, if the company is an overseas company, as references to the equivalent provisions under the legislation relating to companies of the jurisdiction in which the company is incorporated.
- (3) Any term or expression that is defined in the Act or the Regulations and used, but not defined, in this notice has the same meaning as in the Act or the Regulations.
- (4) An example used in this notice is only illustrative of the provisions to which it relates. It does not limit those provisions.
- (5) If an example and a provision to which it relates are inconsistent, the provision prevails.

Clause 3(1) **ASX**: inserted, on 9 June 2017, by clause 4 of the Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2017 (LI 2017/116).

Clause 3(1) **ASX shares**: inserted, on 9 June 2017, by clause 4 of the Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2017 (LI 2017/116).

Clause 3(1) **financial advice**: revoked, on 15 March 2021, by clause 4 of the Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2020 (LI 2020/334).

Clause 3(1) **NZX Main Board**: replaced, on 1 January 2019, by clause 4 of the Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice (No 2) 2018 (LI 2018/266).

#### **4 Designation of shares as managed investment products**

Shares to which this notice applies are declared to be managed investment products.

#### **5 Shares to which notice applies**

This notice applies to shares if—

- (a) the shares are issued after the commencement of this notice by an investment company; and
- (b) either or both of clauses 6 and 8 apply; and
- (c) the shares are not NZX Main Board shares or ASX shares; and
- (d) the shares are not redeemable shares (within the meaning of section 8(1)(b)(iii) of the Act).

Clause 5(c): amended, on 12 February 2018, by clause 4(1) of the Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2018 (LI 2018/6).

Clause 5(c): amended, on 9 June 2017, by clause 5 of the Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2017 (LI 2017/116).

Clause 5(d): inserted, on 12 February 2018, by clause 4(2) of the Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2018 (LI 2018/6).

## 6 Reduced powers of shareholders

- (1) This clause applies if the terms of any offer of shares or an investment company's constitution has the effect of 1 or more of the following:
- (a) the shares do not confer on the holder all of the rights set out in section 36(1)(a) of the Companies Act 1993;
  - (b) a director of the investment company can be appointed or removed other than by a resolution of shareholders;
  - (c) the voting rights concerning directors attached to the shares are disproportionate to the amount to be paid for the shares when calculated using the formula in clause 7.
- (2) The following are disregarded in applying subclause (1)(b):
- (a) a director appointment that can be made under section 153(1) or 154 of the Companies Act 1993; or
  - (b) a director appointment that can be made by the board of the investment company pursuant to a power in the constitution of the company to appoint 1 or more additional directors to the board to fill a vacancy, provided that the terms of the appointment or the investment company's constitution requires that the director must retire (but can be reappointed by shareholders) at the first annual meeting of shareholders after the appointment; or
  - (c) a director appointment that can be made by a director of the investment company pursuant to a power in the constitution of the company to appoint an alternate director.

Clause 6(2)(b): amended, on 12 February 2018, by clause 5(1) of the Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2018 (LI 2018/6).

Clause 6(2)(c): inserted, on 12 February 2018, by clause 5(2) of the Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2018 (LI 2018/6).

## 7 Calculation of disproportionate voting rights concerning directors

In clause 6(1)(c), the reference to the voting rights concerning directors attached to the shares being **disproportionate to the amount to be paid for the shares** means that the cost of the voting rights concerning directors attached to the shares being offered is materially higher than the average cost of all voting rights concerning directors on issue, calculated using the following formula:

$$a \div b > c \div d$$

where—

- a is offer price per share
- b is voting rights concerning directors per share offered
- c is the aggregate fair value of all shares carrying voting rights concerning directors in the investment company immediately following the issue of

the shares being offered, determined in accordance with generally accepted accounting practice

- d is a reasonable estimate of the total voting rights concerning directors attached to all shares on issue in the investment company immediately following the issue of the shares being offered.

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### Examples

#### *Example 1*

ABC Limited (an investment company) is seeking to raise \$25,000 by issuing 2,500 shares. The company offers Class B shares to investors for \$10 per share. Each Class B share confers 1/10 of a vote on a resolution of shareholders (including a resolution to appoint or remove a director).

Before the offer, ABC Limited has 750 Class A shares on issue, held by the founders of the company. Each Class A share confers 1 vote on a resolution of shareholders (including a resolution to appoint or remove a director).

The aggregate fair value of the shares carrying voting rights concerning directors in the company immediately following the issue of the shares being offered will be \$25,750.

The formula is—

$$10 \div 0.1 = 100$$
$$25,750 \div [(2,500 \times 0.1) + 750] = 25.75$$

One voting right will cost an investor \$100. So the cost of the voting rights concerning directors attached to the shares offered is materially higher than the average cost of all voting rights concerning directors on issue (\$25.75, being the average cost of a voting right).

#### *Example 2*

XYZ Limited (an investment company) is seeking to raise \$25,000 by issuing 25,000 shares. The company offers shares to investors for \$1 per share. Each share confers 1 vote on a resolution of shareholders (including a resolution to appoint or remove a director).

Before the offer, XYZ Limited has 750 shares on issue, held by the founders of the company. Each share confers 1 vote on a resolution of shareholders (including a resolution to appoint or remove a director).

The aggregate fair value of the shares carrying voting rights concerning directors in the company immediately following the issue of the shares being offered will be \$25,750.

The formula is—

$$1 \div 1 = 1$$
$$25,750 \div (25,000 + 750) = 1$$

One voting right about directors will cost an investor \$1. This is equal to the average cost of a voting right about directors. So the cost of the voting rights concerning directors attached to the shares offered is not materially higher than the average cost of all voting rights concerning directors on issue.

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## 8 Entrenched key service provider arrangements

- (1) This clause applies if an investment company (A) has entered into, or has agreed to enter into, a contract for services (a **services agreement**) with a key service provider (B) and either or both of the following apply:
  - (a) B owns or controls assets—
    - (i) that are material to the operation of A's principal business; and
    - (ii) the benefit of which A could not reasonably obtain for a materially similar cost from another person on arm's-length terms if the services agreement with B were terminated:
  - (b) the services agreement—
    - (i) is on more favourable terms to B than arm's-length terms; or
    - (ii) is, or will be, for a term longer than 3 years and cannot be terminated by A without cause under the terms of the services agreement; or
    - (iii) requires A, or an associated person of A, to pay a fee for termination by A of the services agreement that exceeds the specified amount.
- (2) In subclause (1), **arm's-length terms** means terms that, in light of the contract as a whole, would be reasonable in the circumstances for parties connected or related only by the transaction in question, each acting independently, and each acting in its own best interests.
- (3) In applying subclause (1)(a), B's control of assets may be disregarded if B has control only because of rights that B has under the services agreement with the investment company.
- (4) In subclause (1)(a)(i), assets are **material to the operation of A's principal business** if the removal of those assets would, or would be likely to, have a material adverse effect on A's financial position or performance, or on A's ability to perform the usual activities and services related to its principal business on a continuous and satisfactory basis.

## 9 Calculation of specified amount

- (1) For the purposes of clause 8(1)(b)(iii), **specified amount** means the lesser of—
  - (a) 30% of the value of the payment required to be made to the key service provider for the entire term of the agreement or 5 years, whichever is shorter; and
  - (b) 50% of the value of the payment required to be made to the key service provider for the remaining term of the agreement.

- (2) The payment in subclause (1) excludes any reimbursable costs and expenses.

**Example**

Investment company A has entered into an investment management agreement with investment manager B under which A will pay B a management fee of \$200,000 per year. The investment management agreement has a 6-year term.

Year of termination	30% of payment for shorter of entire term or 5 years	50% of payment for remaining term	Specified amount
0	\$300,000	\$600,000	\$300,000
End of Year 1	\$300,000	\$500,000	\$300,000
End of Year 2	\$300,000	\$400,000	\$300,000
End of Year 3	\$300,000	\$300,000	\$300,000
End of Year 4	\$300,000	\$200,000	\$200,000
End of Year 5	\$300,000	\$100,000	\$100,000
End of Year 6	\$300,000	\$0	\$0

- (3) If the fee for termination required to be provided to the key service provider for the purposes of clause 8(1)(b)(iii), or the payment required to be made to the key service provider for the purposes of subclause (1), is not a fixed amount in the services agreement, then a reasonable estimate of the amount of that fee or payment must be used.

**Example**

Investment company A has agreed to pay investment manager B an annual performance fee of 20% of net gains in the fair value of the equity of the company. To calculate the amount of the payment required to be made to B, A will need to make a reasonable estimate of the anticipated fair value of the equity of the company at the end of each financial year over the remaining term of the agreement.

**10 Designation of company as managed investment scheme**

Companies that issue shares to which this notice applies are declared to be managed investment schemes in relation to those shares.

**11 Designation of offers through licensed intermediaries**

An offer of shares to which this notice applies that would not otherwise require disclosure under Part 3 of the Act only because of the exclusion in clause 6 of Schedule 1 of the Act does require disclosure under Part 3.

Dated at Auckland this 12th day of May 2017.

Nick Kynoch,  
General Counsel.

## Statement of reasons

**Note: The following statement of reasons should be read in conjunction with the statement(s) of reasons appended to the:**

- **Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2020**
- **Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice (No 2) 2018**
- **Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2018**
- **Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2017**

This notice comes into force on 19 May 2017. The notice declares that certain shares in investment companies are managed investment products rather than equity securities for the purposes of the Financial Markets Conduct Act 2013 (the **Act**), and that the company that issues the shares is a managed investment scheme. The notice also declares that an offer of the shares that could otherwise be made as an unregulated offer in reliance on the exclusion in Schedule 1 of the Act for offers made through a licensed intermediary (eg, a licensed crowd funding service provider) is required to be made as a regulated offer.

The notice applies to shares in investment companies (excluding shares quoted on the NZX Main Board) that satisfy the criteria set out in the notice. The criteria relate to circumstances—

- where shareholders have reduced powers (eg, because the shares offered do not confer usual equity voting rights, or confer disproportionately restricted rights to vote on resolutions to appoint or remove directors, or where directors can be appointed or removed otherwise than by shareholder resolution); or
- where a key service provider to the company is entrenched to such a degree that the ability to terminate that service provider's arrangements would be frustrated.

The Financial Markets Authority (the **FMA**), having complied with the requirements set out in section 563 of the Act, considers that it is appropriate to grant the designations because—

- the designation of the shares as managed investment products, and the consequential designation of the company issuing those shares as a managed investment scheme, is desirable because the shares are in economic substance managed investment products. This being the case, the requirements of the managed investment scheme regime will better address the purposes of the Act than the requirements of the equity securities regime; namely, that the application of—
  - Part 4 managed investment scheme governance requirements will ensure that appropriate governance arrangements apply, and so provide for



more effective monitoring and reduce governance risks associated with shares to which the notice applies:

- Part 3 managed investment scheme disclosure requirements will better enable investors offered these shares to make an informed decision as to whether to invest. The ongoing disclosure requirements applying to managed investment schemes will better enable investors to monitor their investment:
- these designations will promote the development of fair and transparent financial markets by reducing the ability of issuers to avoid the managed investment scheme requirements in the Act by issuing shares that are in economic substance more akin to managed investment products than equity securities:
- a designation preventing shares, which would be designated under the class designation as managed investment products, from being offered through a crowd funding platform as an unregulated offer will prevent issuers from circumventing the effect of the class designation:
- the certainty provided by these class designations will better enable issuers to consider the potential impacts of these designations on their offer and themselves early in their offer design process and this promotes the informed participation of issuers in New Zealand's financial markets.

The FMA is therefore satisfied that making the declaration is necessary or desirable in order to promote 1 or more of the main or additional purposes of the Act, in particular,—

- to promote and facilitate the development of fair and transparent financial markets; and
- to provide for timely, accurate, and understandable information to be provided to persons to assist those persons to make decisions relating to financial products; and
- to ensure that appropriate governance arrangements apply to financial products that allow for effective monitoring and reduce governance risks.

**Note: The preceding statement of reasons should be read in conjunction with the statement(s) of reasons appended to the:**

- **Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2020**
- **Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice (No 2) 2018**
- **Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2018**
- **Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2017**

## Reprints notes

### 1 *General*

This is a reprint of the Financial Markets Conduct (Shares in Investment Companies) Designation Notice 2017 that incorporates all the amendments to that notice as at the date of the last amendment to it.

### 2 *Legal status*

Reprints are presumed to correctly state, as at the date of the reprint, the law enacted by the principal enactment and by any amendments to that enactment. Section 18 of the Legislation Act 2012 provides that this reprint, published in electronic form, has the status of an official version under section 17 of that Act. A printed version of the reprint produced directly from this official electronic version also has official status.

### 3 *Editorial and format changes*

Editorial and format changes to reprints are made using the powers under sections 24 to 26 of the Legislation Act 2012. See also <http://www.pco.parliament.govt.nz/editorial-conventions/>.

### 4 *Amendments incorporated in this reprint*

Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2020 (LI 2020/334)

Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice (No 2) 2018 (LI 2018/266)

Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2018 (LI 2018/6)

Financial Markets Conduct (Shares in Investment Companies) Designation Amendment Notice 2017 (LI 2017/116)