

# Financial Services Quarterly

SPRING 2005

Bell Gully





**Welcome to the Spring 2005 issue of *Financial Services Quarterly*, a review of current legal issues in the financial sector.**

Each quarter, we summarise recent issues and preview upcoming developments under these headings:

In the courts  
In the journals  
Legislation/In Parliament  
Recent developments  
Bell Gully news  
Useful Web links

**In this issue...**

- New Zealand Bloodstock loses PPSA appeal
- Commerce Commission announces investigations into CCCFA breaches
- Second mortgagee loses out to GST paid by first mortgagee on sale
- Basel II
- Understanding bank risk in New Zealand
- Revised draft outsourcing policy for registered banks
- Progress on non-bank finance sector review

** Need more information?**

For more information on any of the cases, articles and features in *Financial Services Quarterly*, please email [katie.johnson@bellgully.com](mailto:katie.johnson@bellgully.com) or call on 64 9 916 8393.

*Disclaimer: this publication is necessarily brief and general in nature. You should seek professional advice before taking any action in relation to the matters dealt with in this publication*

## In the courts

### **New Zealand Bloodstock loses PPSA appeal**

The majority of the Court of Appeal has dismissed a high-profile appeal by New Zealand Bloodstock. In the High Court, New Zealand Bloodstock as lessor of a thoroughbred stallion lost priority in the stallion to the holder of a debenture over the lessee's assets. New Zealand Bloodstock had failed to register its "deemed" security interest under the Personal Property Securities Act 1999 (PPSA).

### **Bank "*unimpeachable*" in freezing customer's account without giving reasons**

In the UK, a court has agreed with a bank that believed it would be committing a criminal offence by unfreezing a customer's account or explaining to the customer why the account had been frozen.

### **More on undue influence**

The High Court has found that undue influence was exerted over the vendor of properties even though she received independent advice about the transaction.

### **Creditors defeated by matrimonial property agreement**

The majority of the Court of Appeal has found that a married couple successfully quarantined certain assets from the husband's business creditors through a matrimonial property agreement.

### **Rectification of clause in standard form mortgage**

In this case, the High Court allowed rectification in respect of a clause included in a standard form mortgage where the mortgagee had notice of the intended position.

### **Agreement to mortgage generally requires effective request for mortgage before caveat can be registered**

This case discusses a number of points of interest in construction/conveyancing situations relating to the existence of caveatable interests and the requirements for protecting them.

### **Intentions to novate and assign found to be mutually exclusive**

A UK decision that upheld the entitlement of a purchaser of debt to enforce rights under the facility agreement as transferee also noted that the purchaser's alternative claim as assignee would have failed.

### **Second mortgagee loses out to GST paid by first mortgagee on sale**

An appeal by a second mortgagee, which argued a right to claim in the distribution of the mortgagor's assets ahead of payment of the GST on the sale of the assets by the first mortgagee, has been dismissed.

## In the journals

### **Oi, that's my horse**

In this article, it is suggested that "*the booming economy has been masking serious flaws of the Personal Property Securities Act 1999 which will become only too apparent if the economy slows and receiverships increase*".

### **Basel II**

The author discusses the driving forces behind the new Basel Accord, its inherent risks and benefits, and sets out the view that even smaller economies (such as New Zealand) need to take note of the underlying developments.

### **Understanding bank risk in New Zealand**

In this article, the consequences of a bank failure in New Zealand, the issue of depositor protection, and the key findings of a risk awareness survey are discussed.

### **Australasia tackles banking integration**

This article looks at the challenges to the increased harmonisation of banking regulation across Australia and New Zealand, such as the new policies of the Reserve Bank of New Zealand on local incorporation requirements and outsourcing restrictions.

### **Can mutual set-off arrangements be set aside in liquidation despite mandatory statutory provisions?**

Two articles point to statements made recently by the Court of Appeal that appear to run contrary to well-established insolvency law principles.

### **Subordinate security potentially ineffective following sale by receiver**

Two articles examine the High Court's recent decision that, where a receiver sells personal property of a borrower, the sale automatically releases any security interest in those assets held by subordinate security holders.

### **Unconscionable demands under letters of credit, performance bonds and bank guarantees**

This article discusses exceptions to the autonomy principle under which payment instruments operate independently of any dispute relating to the underlying contract. In particular, the authors consider the development in Australia of an exception based on unconscionable conduct under the Trade Practices Act 1974 (Cth).

## Legislation/In Parliament

### **Progress on non-bank finance sector review**

The Government will soon develop options for reform as part of a wide-ranging review of how non-bank financial products and providers are regulated.

### **New insolvency legislation imminent**

New laws, expected to be passed soon, may necessitate changes to creditors' documentation and default-related processes (particularly those applying to companies).

### **Changes ahead for brokers and other financial intermediaries**

The Task Force on the Regulation of Financial Intermediaries has delivered its final report to the Government with recommendations for reform.

### **Australia/New Zealand business law co-ordination review announced**

The Memorandum of Understanding between the Australian and New Zealand governments on business law co-ordination has reached its five-year review point.

### **Anti-money laundering and anti-terrorist financing regulation to be increased**

In August, the Minister of Justice reiterated the need for New Zealand to tighten its safeguards against money laundering and terrorist financing.

### **Balancing consumer protection and regulatory costs**

The Ministry of Consumer Affairs has started a review of the pros and cons of "*industry-led regulation*".

## Recent developments

### **Revised draft outsourcing policy for registered banks**

The Reserve Bank has published a near-final draft policy on the requirements that will apply to large New Zealand registered banks entering into arrangements to outsource any business or function of the bank to a third party.

### **Commerce Commission announces investigations into CCCFA breaches**

The Commerce Commission announced in October that it has visited 50 credit providers in Auckland, Wellington and Christchurch to check on compliance with the Credit Contracts and Consumer Finance Act 2003, and it currently has 13 investigations underway into alleged breaches.

### **Securities Commission to increase co-operation with ASIC**

The New Zealand Securities Commission and the Australian Securities and Investment Commission met in August for the purpose of promoting greater regulatory co-operation between the two countries.

### **Best practice guidelines for reporting suspicious financial transactions**

The New Zealand Police Financial Intelligence Unit has released these guidelines to assist New Zealand financial institutions in complying with the requirements of the Financial Transactions Reporting Act 1996.

### **Securities Commission report on investor disclosure**

The Securities Commission has published a report on Cycle 1 of its broad financial reporting surveillance programme, which is reviewing the standard of financial reporting by New Zealand public securities issuers.

### **Practice note on prospective financial information in offer documents**

The Securities Commission has amended its practice note on prospective financial information, which assists issuers preparing offer documents during the transition to New Zealand Equivalents to the International Financial Reporting Standards (**NZ IFRS**).

## Bell Gully news

### **Tax advice: keeping it confidential**

Recent changes to the tax legislation extend the circumstances where you can refuse to disclose tax advice. We look at the changes.

### **Bell Gully advises on major gaming sector initiative**

Bell Gully has advised the Department of Internal Affairs on an initiative to bring greater accountability in community fundraising through the gaming sector.

The Department has signed a contract with gambling technology company Intralot New Zealand Limited for the provision and operation of an electronic monitoring system (EMS) for all gaming machines in New Zealand pubs and clubs. Bell Gully advised on the NZ\$35 million contract, which involves the design, build, testing, operation and management of a system to enable daily electronic monitoring of all non-casino gaming machines located in about 1,800 venues across the country.

### **Outsourcing: exit strategies as relationship building**

New Zealand companies are part of the global growth in the outsourcing of IT functions – a move some predict will be the rule rather than the exception by 2010. In this article we examine some of the key issues to consider in an outsourcing agreement when it comes to the potential need to sever the relationship - and the positives of dealing with these upfront.

### **Landmark agreement in Treaty settlement process**

The signing of an agreement in principle to settle a large number of Te Arawa's Treaty of Waitangi historical claims is a milestone in New Zealand's Treaty settlement history. The agreement in principle is not only significant in its own right, but also in the broader Treaty settlement framework, according to Bell Gully senior associate Damian Stone, who provided legal advice to the Te Arawa negotiation team. "The agreement between the Crown and groups within Te Arawa, a confederation of major North Island tribes, seeks to settle the largest number of claims in one deal and also within the shortest timeframe to date. This signals what can be achieved within a relatively short timeframe even in the most complex of situations," he says.

### **New Zealand law firm leader participates in China legal first**

Bell Gully Chief Executive Stephen Macliver is playing a key role in shaping a significant milestone for China's legal profession. He is part of the inaugural visit by the leadership of the International Bar Association (IBA) to China and will lead the first law firm management conference conducted by the IBA in China in November.

Stephen is the worldwide Chairman of the Law Firm Management Committee of the IBA, the global voice of the legal profession. At the beginning of November IBA leaders made an inaugural visit to China to sign a Memorandum of Understanding with the All China Lawyers Association (ACLA), to forge stronger links and relations between the two organisations and its members.

**For further details and more news visit: [www.bellgully.com](http://www.bellgully.com)**

## In the courts

### New Zealand Bloodstock loses PPSA appeal

*The majority of the Court of Appeal has dismissed a high-profile appeal by New Zealand Bloodstock. In the High Court, New Zealand Bloodstock as lessor of a thoroughbred stallion lost priority in the stallion to the holder of a debenture over the lessee's assets. New Zealand Bloodstock had failed to register its "deemed" security interest under the Personal Property Securities Act 1999 (PPSA).*

#### Facts

New Zealand Bloodstock leased a stallion named Generous to Glenmorgan Farm for an initial period of three years, on terms specifying that title at all times remained with New Zealand Bloodstock.

A couple of years earlier, Glenmorgan Farm had granted a debenture over *"all its present and future assets"* to a creditor, S.H. Lock (NZ) Limited. Both arrangements were entered into before the PPSA came into force on 1 May 2002. However, only the debenture was subsequently registered in accordance with the new legislation.

Glenmorgan Farm defaulted on its lease payments and New Zealand Bloodstock terminated the lease and re-took possession of Generous. Glenmorgan Farm also defaulted on its arrangements with S.H. Lock, which consequently appointed receivers in respect of the assets of Glenmorgan Farm and claimed entitlement to possession of Generous.

#### High Court decision

In the High Court<sup>1</sup>, Justice Allan held that S.H. Lock was indeed entitled to possession of Generous. Under the PPSA, a lease for a term of more than one year is deemed to be a security interest. Therefore, New Zealand Bloodstock should have registered its security interest during the transitional period in order to protect its rights.

New Zealand Bloodstock appealed on the basis that Glenmorgan Farm's security arrangements with its creditors should not be able to deprive it of its title to the stallion.

#### Court of Appeal decision

The majority of the Court of Appeal<sup>2</sup> agreed with Justice Allan and found that the debenture took priority over New Zealand Bloodstock's title to and possession of Generous.

The PPSA effectively subordinated New Zealand Bloodstock's title to the operation of the legislation. In other words, the relevant provisions of the PPSA were found to be a deliberate legislative exception to the principle that no-one can give a better title than he or she possesses.

The Court began by outlining the scheme of the legislation: *"the key features of our PPSA...are the adoption of a unitary concept of security (under which the legal forms by which security is obtained become largely irrelevant) and establishment of priority rules which depend primarily on time of registration save for the super priority accorded to registered purchase money security interests (i.e. in favour of unpaid vendors) over prior general securities."* It was noted that the PPSA provides for the creation of security interests, as well as for their enforceability, priority rules and a system of registration.

The majority then described the steps taken in its determination in favour of S.H. Lock as follows:

1. New Zealand Bloodstock's lease was a security interest for the purposes of the PPSA and *"that being the case, instead of enjoying its previously inviolable title to the stallion, New Zealand Bloodstock's interest...was liable to be overridden by a competing security interest"*;

---

<sup>1</sup> *Waller and Agnew and Another v New Zealand Bloodstock Limited and Another* (CIV-2004-404-004093, High Court Auckland, 2 December 2004)

<sup>2</sup> *New Zealand Bloodstock Limited and Another v Waller and Agnew and Another* (CA269/04, 21 September 2005)

## In the courts

2. under the PPSA, Glenmorgan Farm obtained rights in Generous;
3. the debenture was, as a matter of construction, effective to cover Glenmorgan Farm's rights in Generous;
4. S.H. Lock's security interest "attached" to those rights for the purposes of the PPSA – in this respect, the PPSA requires that value is given by the secured party, that the debtor has rights in the collateral, and that the security agreement is enforceable against third parties;
5. S.H. Lock's security interest was also "perfected" under the PPSA by the registration of a financing statement; and
6. New Zealand Bloodstock had not perfected its security interest and consequently S.H. Lock's interest took priority.

However, Justice William Young (dissenting) found that, because the debenture was entered into prior to the PPSA coming into force, it did not give S.H. Lock security over Generous. Under the pre-PPSA regime, Glenmorgan Farm would have had no proprietary rights in the stallion by virtue of the lease from New Zealand Bloodstock and, in Justice William Young's view, nothing in the PPSA created a new security interest for S.H. Lock in Generous when the PPSA came into force.

For that reason, the minority judgment concluded that S.H. Lock's security was in Glenmorgan Farm's contractual rights only, and so ownership of Generous at all times remained with New Zealand Bloodstock.

Nonetheless, the dissenting judge noted that *"New Zealand Bloodstock could have registered its security interest in Generous during the transitional period provided for by the PPSA and preserved its priority. In light of its failure to do so, New Zealand Bloodstock will have only itself to blame if it loses this case."*

Justice Baragwanath, delivering the majority judgment, pointed out that *"the major lessons of the case are two-fold: the statutory altering of the proprietary rights of a lessor; and the crucial importance of registration. These are policy choices which have been made and significantly alter what would otherwise have been the position."*

Commentators expect the decision to be appealed to the Supreme Court. We will update FSQ subscribers if an appeal is lodged.

## In the courts

### Bank "*unimpeachable*" in freezing customer's account without giving reasons

*In the UK, a court has agreed with a bank that believed it would be committing a criminal offence by unfreezing a customer's account or explaining to the customer why the account had been frozen.*

NatWest froze the account of Squirrell Limited (a mobile phone retailing company) without telling it why it had done so.

Squirrell applied to the Court for an order unfreezing the account and, in response, NatWest explained that it believed that it would be committing a criminal offence under the Proceeds of Crime Act 2002 (the **POCA**) in doing so<sup>1</sup>.

Section 328(1) of the POCA provides that "*a person commits an offence if he enters into or becomes concerned in an arrangement which he knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person.*"

Squirrell's account had grown substantially over a relatively short time and NatWest had informed Customs and Excise of this fact. Customs and Excise was consequently investigating Squirrell for possible tax offences.

However, section 338 of the POCA also sets out "anti-tip off" provisions, which NatWest believed prevented it from explaining its actions to Squirrell.

Justice Laddie expressed sympathy with Squirrell's position, noting that "*it, like me, has been shown no evidence raising even a prima facie case that it or any of its associates has done anything wrong*", and that the possible economic damage to Squirrell was severe.

Despite this, section 328(1) of the POCA was found to bite as soon as a person has any relevant suspicion (which falls short of prima facie evidence).

The purpose of the section in this context was to put NatWest "*under pressure to provide information to the relevant authorities to enable the latter to obtain information about possible criminal activity and to increase their prospects of being able to freeze the proceeds of crime.*" NatWest therefore did exactly as required of it by reporting its suspicions to Customs and Excise.

Under section 335 of the POCA, NatWest could then not move funds for seven working days and, because a notice of refusal to any transaction was sent by Customs and Excise within that time, a further 31 calendar days. Under the "anti-tip off" provisions, it also could not inform Squirrell as to the reasons for its actions.

NatWest's approach was therefore found to be "*unimpeachable*".

The provisions of the POCA go further than current New Zealand legislation affecting banks' obligations to report suspicions as to criminal activity. New Zealand legislation, for instance, does not contain an equivalent to the POCA's "anti-tip off" provisions.

Nonetheless, New Zealand banks may commit a criminal offence by dealing with property knowing or believing it to be, or being reckless as to the possibility of it being, the proceeds of a serious crime (section 243 of the Crimes Act 1961). New Zealand banks also have reporting obligations in respect of suspicious transactions under the Financial Transactions Reporting Act 1996.

---

<sup>1</sup> *Squirrell Limited v National Westminster Bank plc (Customs and Excise Intervening)* [2005] EWHC 664 (Ch)

For these reasons, and the likely tightening up of anti-money laundering laws in the future, New Zealand banks may look to follow NatWest's cautious approach of "exception reporting" to appropriate law enforcement agencies.

However, unless or until New Zealand law introduces prescriptive requirements for this procedure along the lines of the POCA, New Zealand banks may also need to give some thought to duties of confidentiality towards their customers as well as the hardship to customers that may result from the freezing of accounts.

## In the courts

### More on undue influence

*The High Court has found that undue influence was exerted over the vendor of properties even though she received independent advice about the transaction.*

The issue of undue influence in New Zealand has recently been undergoing developments. In particular, a recent Court of Appeal case explored the obligations for banks and other lenders to ensure the absence of undue influence in non-commercial situations, including the need to confirm directly with a guarantor that he or she understands the implications of the transaction. This case, although not concerning a lending transaction, shows that even an understanding of the implications of a transaction may not avoid undue influence.

Mrs Ganderton and Mr Behre, aged 88 and 74 respectively at the time of this court hearing, had become good friends after meeting in the late 1990s.

Mrs Ganderton sold two properties to Mr Behre, with both sale and purchase agreements involving substantial gifting and either all or a large part of the balance of the purchase price being satisfied by a credit for property services provided by Mr Behre.

They later fell out (Mr Behre believed this was because of Mrs Ganderton's jealousy of his relationship with another woman) and among other things Mrs Ganderton then claimed that the sales of the two properties had been made while she was subject to undue influence exercised by Mr Behre.

Mr Behre's defence relied on the fact that Mrs Ganderton had received independent advice on both sales.

In the High Court<sup>1</sup>, it was found that undue influence had been exerted in the circumstances. The undue influence was found to be of the type that arises from *"a relationship between two persons where one has acquired over another a measure of influence, or ascendancy, of which the ascendant person then takes unfair advantage"*.

Such influence may not involve any specific overt acts of persuasion: *"The relationship between two individuals may be such that, without more, one of them is disposed to agree a course of action proposed by the other. Typically this occurs when one person places trust in another to look after his affairs and interests and the latter betrays this trust by preferring his own interests. He abuses the influence he has acquired."*

In particular, relying on the authority of the English case of *Etridge*<sup>2</sup>, Justice Venning found that a person may understand fully the implications of a proposed transaction but may still be acting under the undue influence of another person, and proof of outside advice does not of itself necessarily show that there was no undue influence in completing the transaction.

---

<sup>1</sup> *Ganderton v Behre* (CIV-2004-463-000614, High Court Rotorua, 23 September 2005)

<sup>2</sup> *Royal Bank of Scotland plc v Etridge (No.2)* [2002] 2 AC 773

## In the courts

### Creditors defeated by matrimonial property agreement

*The majority of the Court of Appeal has found that a married couple successfully quarantined certain assets from the husband's business creditors through a matrimonial property agreement.*

The dissenting view may, perhaps, have been avoided if Justice Venning's decision in respect of section 47(1) had been challenged. Nonetheless, this case is a reminder to creditors of the importance of making full enquiries about, and imposing effective restrictions on, the existence of agreements as to the ownership of relevant assets by a debtor.

#### Facts

The Johnsons (who at all times lived together and remained married) entered into a matrimonial property agreement in 1993.

Under the agreement, the ownership of the couple's property was divided in such a way that Mr Johnson principally retained only company shares while Mrs Johnson held most of the couple's "hard assets", including the real property.

On the basis that Mr Johnson's shares were worthless or almost worthless, the imbalance in the property division was later calculated to be approximately \$550,000 in favour of Mrs Johnson.

The creditors in question were franchisees of Mr Johnson's business at the time that the Johnsons entered into the matrimonial property agreement. Some years later (in 2000), those franchisees successfully claimed against Mr Johnson in deceit, and Mr Johnson was subsequently made bankrupt.

#### High Court decision

Following Mr Johnson's bankruptcy, the High Court was required to decide whether the matrimonial property agreement was void for defeating his creditors<sup>1</sup>.

Justice Venning found that it was not "*an agreement...intended to defeat creditors*" for the purposes of section 47(1) of the Property (Relationships) Act 1976, which would have rendered it void against those creditors and the Official Assignee.

However, while Justice Venning did not believe that Mr Johnson's dominant *intention* was to defeat his creditors, section 47(2) of the Property (Relationships) Act 1976 specifies that any agreement having the effect of defeating creditors is also void "*against such creditors and the Official Assignee during the period of 2 years after it is made, but only to the extent that it has that effect*".

Justice Venning found that the limitation in section 47(2) meant that relief was not available to the Official Assignee because he had not been appointed within two years of the Johnsons' entry into the matrimonial property agreement. Nonetheless, relief was granted to the franchisees.

In Justice Venning's words, the reason for this was that "*the effect of section 47(2) is not to fix the time period within which the creditors or the Official Assignee must take proceedings but rather it defines the parties who may challenge the agreement. They are the Official Assignee and creditors, but both must qualify within two years of the agreement. In the case of the Official Assignee, he must have been appointed within that time. In the case of creditors, they must satisfy the Court that they were creditors of one of the spouses...during the two years immediately following the agreement.*" Mr Johnson's franchisees were, for the purposes of the Property (Relationships) Act 1976, his creditors at the time when the matrimonial property agreement was entered into.

#### Court of Appeal decision

---

<sup>1</sup> Felton & Others v Johnson (CP 419-SD97, High Court Auckland, 8 October 2003); Felton & Others v Johnson (CIV-1997-404-000182, CP 419-SD97, High Court Auckland, 12 February 2004)

In the Court of Appeal last month<sup>1</sup>, it was observed unanimously that Justice Venning's view of Mr Johnson's intention in entering into the matrimonial property agreement was "*perhaps fortunate*", given that Mr Johnson was separately found liable to his franchisees under the tort of deceit. However, no challenge was made by either the Official Assignee or the franchisees to the decision in respect of section 47(1).

On the section 47(2) point, the majority of the Court of Appeal found in favour of the Johnsons, on the basis that the ordinary meaning of the words in that section is that the two-year period is a limitation period.

Although the franchisees were creditors at the time of the agreement, no legal challenge to the agreement was made during the subsequent two-year period and indeed there was no obvious adverse effect to the franchisees resulting from the agreement during that time.

It was noted that it was important for parties to a matrimonial property agreement (and third parties dealing with them) to know that, after a reasonable period, the agreement will be safe from challenge unless it was one intended to defeat creditors – this is particularly so where the parties have separated (although that was not the case with Mr and Mrs Johnson). The consistency of the majority's approach with the general insolvency regime set out in the Insolvency Act 1967 was also discussed.

However, Justice William Young (dissenting) set out what he described as a "*strong view about the merits of the case*", finding that Mr Johnson defrauded the franchisees and conferred a windfall benefit on Mrs Johnson with the practical effect of defeating his creditors, whom (under the majority view) lost their rights to challenge the matrimonial property agreement before they even became aware of it. Justice William Young therefore recorded his agreement with Justice Venning's approach to section 47(2), in order to discourage people from "*playing the system*" and concealing transactions from creditors until it is too late to challenge them.

---

2 Johnson v Felton & Others (CA40/04, 12 September 2005)

## In the courts

### Rectification of clause in standard form mortgage

*In this case, the High Court allowed rectification in respect of a clause included in a standard form mortgage where the mortgagee had notice of the intended position.*

#### Facts

The plaintiff company held leasehold titles for certain office premises in central Wellington. Tenants took sub-leases from the plaintiff company and also held parcels of shares in the company proportionate to the floor space that they occupied in the premises.

Landcorp, the owner of the land on which the premises were built, subsequently sold its title to the land to the plaintiff company, and took a mortgage as security for the purchase price.

The defendant company later acquired Landcorp's rights following due diligence of Landcorp's files. The defendant company promptly sought early repayment of the loan on the basis that the mortgage (in the standard ADLS form) contained a clause entitling the mortgagee to call up all moneys owing to it in the event of a material change in the control of the mortgagor company.

The plaintiff company claimed that the standard clause was included by mistake, and Landcorp agreed that its inclusion had not been intended. Evidence was given that, at the time of the sale and mortgage, the plaintiff company and Landcorp had specifically agreed in the context of the loan agreement that a transfer of shares in the plaintiff company would not affect the loan. However, their minds had not been turned to the relevant clauses of the standard form mortgage.

The plaintiff company sought rectification of the terms of the mortgage.

#### High Court decision

In the High Court<sup>1</sup>, Justice Gendall explained that rectification is an equitable remedy available to change the wording of documents so as to coincide with what was agreed between the parties. However, he also noted that there is a long-recognised principle that a claim to rectification *"is not binding on a bona fide purchaser without notice (actual or constructive)"*.

Therefore, if the defendant company had acquired Landcorp's rights in good faith without notice of the true intended position, the plaintiff company's claim to rectification would fail.

In this case, however, Justice Gendall was satisfied that the defendant company (through its directors, agents, solicitors and shareholders) had actual or constructive knowledge of the mistake in the mortgage and so the plaintiff company succeeded in its claim.

---

<sup>1</sup> Fifty-Seven Willis Street Limited v Mortgage Holdings Limited (CIV-2004-485-116, High Court Wellington, 22 July 2005)

## In the courts

# Agreement to mortgage generally requires effective request for mortgage before caveat can be registered

*This case discusses a number of points of interest in construction/conveyancing situations relating to the existence of caveatable interests and the requirements for protecting them.*

From a creditor's perspective, it is important to ensure that due process is followed to protect any caveatable interest in property with certainty. The High Court in this case found that the creditor could not establish an equitable mortgage to support his claim to a caveatable interest by relying solely on the debtor's agreement to grant a mortgage if requested to do so. He also needed to have made the request for a mortgage. The creditor may have been lucky that, in the circumstances, the High Court also found that the agreement granted the creditor a separate caveatable interest despite the absence of an equitable mortgage, since it was noted that *"the matter is not free from doubt"*.

### Facts

The Kilmartins sold their house in the Auckland suburb of Glen Eden to Mr Monk, following which the balance of the sale price to be paid by Mr Monk was specified in a deed of acknowledgement of debt.

Under that deed, Mr Kilmartin was entitled to register and maintain a caveat over the property and to require Mr Monk to give a second mortgage over the property as security for any amounts owing to Mr Kilmartin.

On 9 September 2004, Mr Kilmartin signed a caveat over the property, which was registered on 13 September 2004. On the same day as the registration of the caveat, Mr Kilmartin's solicitor wrote to Mr Monk stating that Mr Monk had failed to repay the debt and requesting the second mortgage.

Mr Monk did not give the mortgage and disputed that there was any amount outstanding. Mr Kilmartin's affidavit before the High Court suggested that Mr Monk was wanting to conceal the existence of the debt from his wife.

Mr Monk subsequently attempted to sell the property and sought the withdrawal of the caveat in order to do so. He argued that Mr Kilmartin had no caveatable interest at the time when the caveat was lodged, on the basis that the agreement to execute a mortgage on request was not a sufficient interest alone.

According to that argument, Mr Kilmartin had no caveatable interest until the notice requesting the second mortgage was given (four days after the date on which the caveat was signed).

### High Court decision

The High Court<sup>1</sup> found that:

1. A caveat may be signed in anticipation of a caveatable interest coming into existence, but the caveatable interest must exist at the time of the caveat's registration.
2. An agreement by which a debtor merely agrees to grant a mortgage if requested to do so will not by itself create an equitable mortgage (a caveatable interest). An effective request for the mortgage must also be made by the creditor to the debtor. On the facts, Mr Kilmartin's caveat was registered before Mr Monk received the request, and therefore the equitable mortgage could not be relied on to support the caveat.
3. However, clause 3 of the deed of acknowledgement of debt said that *"the lender shall be entitled to register and maintain a caveat against 64 Routley Drive, Glen Eden (CT 80B/435) to secure his interest under this agreement until the debt is repaid"*. That clause was separate from Mr Monk's agreement to grant a mortgage on request. On the whole, in this case, clause 3 of itself implied that Mr Monk intended to confer a caveatable interest on Mr Kilmartin, meaning that it could be

---

<sup>1</sup> Kilmartin v Monk (CIV-2005-404-001517, High Court Auckland, 21 April 2005)

argued that Mr Kilmartin did have a sufficient interest in the property at the time the caveat was registered.

4. At any rate, a caveatable interest did come into existence as a result of the notice from Mr Kilmartin's solicitor requesting the second mortgage, and the Court could have (and would have) given Mr Kilmartin leave to lodge a second caveat based on that interest.

## In the courts

### Intentions to novate and assign found to be mutually exclusive

*A UK decision that upheld the entitlement of a purchaser of debt to enforce rights under the facility agreement as transferee also noted that the purchaser's alternative claim as assignee would have failed.*

#### Facts

Essar Steel, the borrower under a US\$40 million facility agreement with a syndicate of nine banks, found itself unable to repay its borrowings at the end of the initial two-year term. However, it successfully negotiated for the repayments to be made in instalments over the following five years.

Argo was an investment company incorporated in the Cayman Islands, which subsequently purchased some of the Essar Steel debt on the secondary debt market at a considerable discount.

Argo sued Essar Steel under the facility agreement for failing to make its repayments. Argo claimed that it was entitled to take enforcement action under the facility agreement as transferee. Alternatively, it claimed to be entitled to do so as assignee.

The facility agreement was expressed to be binding on all transferees and assignees of the parties, but distinguished between the right of a syndicate bank to:

1. assign its rights and benefits; and
2. transfer its rights, benefits and obligations to another bank or other financial institution (for which a specific transfer process was set out in a separate clause).

#### Commercial Court decision

The Court<sup>1</sup> found that the distinction in the facility agreement between the rights to assign and transfer indicated that the right to transfer in accordance with the specific process set out in the separate clause was a right to novate the facility agreement.

Novation of a loan involves the release by the borrower of the rights and obligations of the old lender and the creation by the borrower of new rights and obligations for the transferee. By way of contrast, assignment involves only the transfer of the assignor's rights (but not its obligations) to the assignee and there is no requirement for consent by the borrower.

Having found that Argo met the requirement of being a "*bank or other financial institution*" to which a syndicate bank could effect a transfer in accordance with the terms of the facility agreement, the Court concluded that the transfers to Argo were valid and effective.

The Court also held that, because there was a clear intention on the part of the banks and Argo that the facility agreement would be novated, it was unnecessary to decide Argo's alternative assignment claim. However, it said that the legal arrangements involved in a novation and an assignment were so different that an intention to undertake a novation was incompatible with a simultaneous intention to make an assignment of rights, and so Argo would have failed on that alternative claim.

---

<sup>1</sup> Argo Fund Limited v Essar Steel Limited [2005] EWHC 600 (Comm)

## In the courts

### Second mortgagee loses out to GST paid by first mortgagee on sale

*An appeal by a second mortgagee, which argued a right to claim in the distribution of the mortgagor's assets ahead of payment of the GST on the sale of the assets by the first mortgagee, has been dismissed.*

This New Zealand appeal<sup>1</sup> was heard by the Privy Council, which was required to consider, firstly, whether a mortgagee who exercises a power to sell property is liable for the GST payable on the sale and, secondly, whether it is entitled, as against subsequent security holders, to reimburse itself out of the proceeds of sale.

The facts of the case were that the first mortgagee sold the relevant property and paid GST on the sale to the IRD. It then reimbursed itself out of the proceeds of the sale and discharged its own debt, but the balance was insufficient also to discharge the second mortgagee's debt. The mortgagor was insolvent. The second mortgagee claimed a prior ranking to the IRD, and argued that it should have been paid ahead of the GST payment.

Their Lordships found that section 17 of the Goods and Services Tax Act 1985 clearly requires a mortgagee exercising a power of sale to pay the GST on any sale, and therefore effectively creates a debt between the mortgagee and the IRD. However, section 17 does not require the mortgagee to pay the GST out of the proceeds of sale or out of any particular fund, and the IRD has a claim only against the mortgagee and not by way of priority in the distribution of the mortgagor's assets.

The first mortgagee's claim to reimbursement was then found to be a valid claim to an "*expense occasioned by the sale*" for the purposes of section 104 of the Land Transfer Act 1952 (which regulates the application of the proceeds of a mortgagee sale).

The order of priorities set out in section 104 is:

- (a) ... the expenses occasioned by the sale;*
- (b) ... the money then due or owing to the mortgagee;*
- (c) ... subsequent registered mortgages or encumbrances (if any) in the order of their priority."*

The second mortgagee therefore left the Privy Council empty-handed.

---

<sup>1</sup> Edgewater Motel Limited and Others v Commissioner of Inland Revenue (PC 44-2003, 26 July 2004)

## In the journals

### Oi, that's my horse

Nick Bryant, *The National Business Review*, 5 August 2005

*In this article, it is suggested that "the booming economy has been masking serious flaws of the Personal Property Securities Act 1999 which will become only too apparent if the economy slows and receiverships increase".*

The claim of "serious flaws" in the scheme of the PPSA may be overstating the situation, but this article does highlight two important practical issues for creditors in protecting their security interests:

- Unsophisticated or occasional creditors may be unaware of the registration requirements of the PPSA, particularly in the case of "deemed" security interests such as leases for a term of more than one year.
- Although registering a financing statement is itself inexpensive, creditors may nonetheless find that the cumulative administrative costs of registration exceed the risks of losing out to a prior registered security holder. This is particularly the case where the nature of the creditor's business involves entering into numerous contracts of relatively low value and/or with a relatively low rate of default, e.g. contracts for supply including retention of title provisions. The non-registration approach does, however, require careful consideration by the creditor as to its tolerance for risk.

The article describes as "*canaries in the mine*" recent cases where lessors' interests were thwarted by the claims of registered security holders over the assets of lessees that had been placed in receivership.

In particular, the article mentions the *New Zealand Bloodstock* case<sup>1</sup> in which the receivers of a stud farm (who were appointed by the holder of a registered security interest over the farm's assets) were found to be entitled to enforce the security interest in respect of a stallion leased to the stud farm by a bloodstock auctioneering business.

The bloodstock auctioneering business had retaken possession of the stallion after the stud farm had defaulted on its lease payments, and sought to resist the receivers' claims to priority.

Mr Bryant notes that many entities are not aware of the workings of the new regime following the coming into force of the Personal Property Securities Act 1999 (the **PPSA**) in 2002.

For instance, under the PPSA, a leasing arrangement for more than one year (such as the one in question in the *New Zealand Bloodstock* case) must be registered in order for the lessor to ensure that it has priority over the leased assets.

He also reports that some companies are deliberately choosing not to incur the compliance costs associated with registering security interests under the PPSA and are instead shouldering the risks of default by their debtors.

The article states that the rule of thumb is not to register if the default risk is less than 60%, although this in turn raises complications for accountants and auditors.

---

<sup>1</sup> Waller and Agnew and Another v New Zealand Bloodstock Limited and Another (CIV-2004-404-004093, High Court Auckland, 2 December 2004); New Zealand Bloodstock Limited and Another v Waller and Agnew and Another (CA269/04, 21 September 2005)

## In the journals

### Basel II

Kevin Davis, *Journal of Banking + Financial Services*, June/July 2005

*The author discusses the driving forces behind the new Basel Accord, its inherent risks and benefits, and sets out the view that even smaller economies (such as New Zealand) need to take note of the underlying developments.*

#### Key messages

This article explains that Basel II was driven by the considerable growth in the activities of large international banks in highly developed financial markets, and advances in risk management practices.

It is one method for national regulators to ensure that such practices are improved, although the author expresses the view that *“for many economies, Basel II may, at this stage, involve too large a step to be taken in the near future”*. However, the broad objectives of Basel II may be able to be achieved in other ways.

According to the article, the pace of developments behind Basel II, including new financial instruments and advances in technology, is a critical consideration for bankers. In particular, banks that are able to adopt the most modern risk-identification techniques will be at the forefront of efficient pricing and product development (leaving behind their competitors).

However, the expense of the most sophisticated risk management systems will be prohibitive for smaller players. Unfortunately, this also means that the incentive of lower capital charges available to banks that are able to achieve the status of an internal ratings based (IRB) bank<sup>1</sup> under Basel II will not be feasible for many smaller banks or for banks in smaller economies.

#### Inherent risks

Mr Davis contends that the principal risks of Basel II are:

1. its effect on the relative competitive position of banks (for instance, the lower capital charges available to IRB banks may be significant, and IRB-based pricing may allow IRB banks to operate more effectively in certain markets than banks using the standardised model);
2. an increase in compliance costs (especially in order to achieve IRB status);
3. the potential that, if its standardised risk weighting schedules for different types of customers are not correct, the availability and cost of funds for those customers are distorted; and
4. possible *“pro-cyclical macroeconomic effects”*, e.g. the situation where banks' customer ratings decline in a recession and capital charges are therefore increased with the result that banks cut back on new lending, which in turn aggravates the economic downturn.

He also notes that the particular attention paid by Basel II to securitisation risks will be of interest to APEC countries.

However, the article goes on to say that these risks do not mean that Basel II should not be welcomed in the Australia-Pacific area, just that *“there is much to be done in assessing how the new Basel Accord needs to be implemented in the region to achieve the benefits of a more risk-sensitive capital-based supervisory process”*. In particular, attention should be paid to:

1. developing risk management skills and capacity within the banking sector (potentially involving challenging cultural changes);

---

<sup>1</sup> Under Basel II, IRB banks are able to determine customer ratings internally, as opposed to non-IRB banks that use standardised customer risk weighting schedules.

2. Pillar Two of Basel II, which emphasises an effective supervisory process (e.g. the ability to require banks to hold capital buffers above minimum requirements, the ability to intervene early, the ability to assess bank management capacity and governance requirements) – this article points to the various different approaches currently adopted by countries in the APEC region; and
3. Pillar Three of Basel II (market discipline), including information disclosure and other checks and balances designed to protect stakeholder interests – Mr Davis believes that there is significant scope for institutional changes to be made to increase the ability of “at risk” stakeholders to monitor and influence bank behaviour.

The article’s conclusion is that, while work continues to implement Basel II, it is important to remember that the ultimate objective is a safer and more efficient financial system, rather than simply the adoption of a new model for banking supervision.

## In the journals

### Understanding bank risk in New Zealand

Warwick Hale and David Tripe, *Journal of Banking + Financial Services*, June/July 2005

*In this article, the consequences of a bank failure in New Zealand, the issue of depositor protection, and the key findings of a risk awareness survey are discussed.*

The potential disruption to the banking system from the failure of a bank includes the inability for individual and business customers to make and receive payments (and the knock-on economic effects of this, such as the refusal of supply), the loss of depositors' funds, the costs to customers of re-establishing facilities with other providers, and the failure of other banks from the breakdown of inter-bank arrangements (which could result in a general economic liquidity crisis).

#### **Depositor protection**

This article explains that such potential consequences are used to justify regulatory intervention in the banking sector. For instance, some jurisdictions offer a system of deposit insurance in the case of bank failure (up to a limited amount), which is intended to promote financial stability by warding off a "run" on a bank in the event of a rumoured or impending failure.

#### **No formal deposit insurance system in New Zealand**

The authors describe the reasons for the absence of such a system in New Zealand as being the substantial cost involved and the risk that the promise of reimbursement discourages management from good risk management and also discourages depositors from monitoring and influencing the bank's position.

In place of this, banks in New Zealand are required to make public disclosures about their financial positions, with the objective that the responsibility is with each bank's customers to assess the risk of failure. This assumes, however, that depositors are aware that their funds are potentially at risk.

#### **Risk awareness research**

The article describes some "exploratory research" undertaken in Palmerston North in 2003 by way of a door-to-door survey in which questions were asked about people's understanding of these issues. The authors point out that the results are potentially subject to bias.

The strongest views expressed through the survey's key findings were:

1. money was safe, very safe or extremely safe in a bank (99% of respondents);
2. it was important, very important or extremely important to be told about the safety of bank deposits (93%);
3. the Government was either not very clear or extremely unclear in relaying to the public how safe people's bank deposits were (81%);
4. people did not know if the Government insured bank deposits (70%);
5. people did not know if the Government guaranteed bank deposits (59%);
6. people thought that their bank guaranteed that bank deposits were safe (55%); and
7. people did not know if the Reserve Bank had a function to protect depositors in the case of a bank failure (50%).

As the authors point out, the important lesson from this research was the number of "don't know" responses. The absence of an understanding by ordinary bank customers of the risks of their bank deposits may be an argument in favour of deposit insurance.

The article also suggests that further research may suggest a need for a public education campaign about these risks in the absence of a deposit insurance scheme.

## In the journals

### Australasia tackles banking integration

Ross Pennington and Sarah Raudkivi, *International Financial Law Review*, July 2005

*This article looks at the challenges to the increased harmonisation of banking regulation across Australia and New Zealand, such as the new policies of the Reserve Bank of New Zealand on local incorporation requirements and outsourcing restrictions.*

#### Features of the Australasian banking market

The authors describe the dominance of Australian-owned banks within the New Zealand market, in contrast to the greater percentage of home country ownership for registered banks in Australia (although it is still the case that the minority of registered banks in Australia are Australian-owned).

In terms of regulation, the Reserve Bank operates mainly as a “host regulator”, meaning that each New Zealand registered bank’s “home regulator” is responsible for supervising the parent bank and the global banking group while the Reserve Bank supervises the bank’s operations in New Zealand.

In practice, the Reserve Bank’s key relationship in this respect is with the Australian Prudential Regulatory Authority (**APRA**). The Reserve Bank’s approach has generally been one of light-handed regulation, with a focus on public disclosure. Meanwhile, according to this article, APRA has been seen to have a more hands-on approach to prudential supervision, with greater regulatory intervention for registered banks.

#### Comparison of the Australasian regulatory models

The authors outline certain complementary aspects of the regulatory arrangements between the two countries, noting that the “home-host” relationship between Australia and New Zealand is generally seen as an efficient one.

Certain other similarities are also described, such as the adoption by both countries of the basic Basel Accord norms for determining capital adequacy, and the similar entry and registration requirements for registered banks in both countries.

#### Differing objectives

The authors go on to describe some of the main differences in the regulatory models, noting that the major obstacles to substantial regulatory harmonisation may be the differences in depositor protection provisions (there being a depositor priority scheme in Australia, but not in New Zealand, in the event of the insolvency of a relevant financial institution) and the question of whether prudential supervision should be carried out by a single trans-Tasman regulator (the preferred Australian approach being that APRA becomes the sole supervisor, although this is not popular with the New Zealand authorities).

#### Managing an Australasian financial crisis – the stand-alone policy

This article also outlines the Reserve Bank’s introduction of policies designed to manage the risk to the New Zealand financial system generally of New Zealand registered banks outsourcing core functions to their foreign-owned parents (or otherwise diluting their ability to ensure the continuity of critical functions in the event of a crisis).

The two new policies are:

1. a local incorporation requirement (to increase legal certainty regarding the relevant procedures that apply in the event of financial distress); and
2. restrictions on the outsourcing of core functions<sup>1</sup>.

The authors point out that there is a question about the assimilation of these policies within the wider trans-Tasman harmonisation process.

### Steps towards harmonisation

The final section of this article describes the progress that has already been made towards increased co-ordination of Australian and New Zealand regulation, including:

1. meetings between senior officials of both governments;
2. a joint working group report on the two integration options of (a) APRA as sole trans-Tasman supervisor and (b) enhanced "home-host" co-ordination and co-operation between the regulators;
3. the establishment of a joint committee on the implementation of the new Basel II capital adequacy framework;
4. the establishment of the Trans-Tasman Council on Banking Supervision (to promote harmonisation);
5. the revision of the Reserve Bank/APRA Memorandum of Understanding on information sharing and bank visits; and
6. the institution of a joint working plan on crisis management and policy co-ordination.

The authors conclude by noting that official statements from both the Reserve Bank and the New Zealand Government have continued to emphasise the importance of trans-Tasman harmonisation.

However, inconsistencies with Australia's preferred approach to the co-ordination of prudential supervision and the implementation of Basel II (including the management of crisis management risks) will present some challenges.

<sup>1</sup> This article was published prior to the Reserve Bank's release of its [near-final draft outsourcing policy for registered banks](#)

## In the journals

### Can mutual set-off arrangements be set aside in liquidation despite mandatory statutory provisions?

**"Disturbing statements emerge from recent insolvency case in New Zealand", David Craig (partner, Bell Gully), Journal of Banking and Finance Law and Practice, December 2005**

**"Editorial: Liquidation and Set-Off", Andrew Beck, Company and Securities Law Bulletin, August 2005**

*Two articles point to statements made recently by the Court of Appeal that appear to run contrary to well-established insolvency law principles.*

A Court of Appeal decision in June determined that a set-off arrangement entered into by Newman Carrying Limited (by way of a mutual set-off agreement with Trans Otway Limited) shortly before Newman Carrying's liquidation was a "*payment of money*" that could be set aside by the liquidators as a transaction having preferential effect under section 292 of the Companies Act 1993 (the **Act**).

In the first article mentioned above, Mr Craig argues that financiers and swap counterparties should be worried by statements made in that case<sup>1</sup>.

In particular, having decided that set-off is a "*payment of money*" for the purposes of the Act, the Court of Appeal went on to hold that the transaction enabled Trans Otway to receive more than it would otherwise have received in the liquidation.

This meant that the "payment" of Newman Carrying's debt, which had been effected by way of set-off by Trans Otway against an equivalent amount owed by it to Newman Carrying, could be clawed back by the liquidators from Trans Otway.

However, Mr Craig points out that section 310 of the Act provides for the *mandatory* set-off of mutual claims owing between the insolvent company and another person as at the commencement of the liquidation.

Therefore, how could Trans Otway be better off as a result of its contractual right of set-off (as determined by the Court of Appeal) when the mandatory statutory right of set-off in section 310 would have produced exactly the same result?

Additionally, as discussed in this article, it seems that the mutual set-off agreement would have been a "*bilateral netting agreement*" for the purposes of sections 310A-O of the Act. As such, only the "*netted balance*" (in this case, zero) should have been payable to Newman Carrying by Trans Otway (and able to be clawed back by the liquidators).

The author points out that the liquidators may have been able to challenge the underlying transaction (i.e. the provision of freight services for which Newman Carrying owed Trans Otway money) under section 292. However, in this case, only the payment that was made in respect of that transaction was impugned, although it does not appear that Trans Otway raised this as an argument before the Court of Appeal.

The author concludes that this decision, while unfortunate, should not be interpreted as establishing that contractual rights of set-off are unenforceable in the liquidation of a New Zealand company.

The Supreme Court has granted leave to hear an appeal from the Court of Appeal's decision. However, the issues on appeal are narrow and are unlikely to touch on the matters outlined in this article.

Mr Beck's editorial in the second article noted above also observes that the line of reasoning adopted by the Court of Appeal in finding that Trans Otway received more through the set-off arrangement than it

---

1 Trans Otway Limited v Shepard and Dunphy (CA98/04, 13 June 2005)

would have received in liquidation is *“difficult to accept”* and calls for further judicial guidance to clarify the relationship between set-off rights and the liquidator’s power to avoid transactions.

## In the journals

### Subordinate security potentially ineffective following sale by receiver

**"High Court decision casts doubt on effectiveness of second-ranking securities", David Craig (partner, Bell Gully) and Jonathan Norman (solicitor, Bell Gully), Butterworths Journal of International Banking and Financial Law, September 2005**

**"When subordinate security is no security at all" Michael Arthur, Michael Harper and James McMillan, Company and Securities Law Bulletin, August 2005**

*Two articles examine the High Court's recent decision that, where a receiver sells personal property of a borrower, the sale automatically releases any security interest in those assets held by subordinate security holders.*

In the last edition of FSQ, we discussed the *Building Depot* case<sup>1</sup> and noted that the decision is an unfortunate result of an oversight in the drafting of the Receiverships Act 1993 and that legislation is in the pipeline to rectify the result.

Section 30A of the Receiverships Act 1993 currently states that *"if property has been disposed of by a receiver, all security interests in the property and its proceeds that are subordinate to the security interest of the person in whose interests the receiver was appointed are extinguished on the disposition of the property"*<sup>2</sup>. This allows a purchaser of the property to take it free from any competing security interests.

However, there is no statutory provision relating to receiverships that allows any surplus from the sale of personal property to be distributed to subordinate security holders. This is inconsistent with, in particular, the scheme of the Personal Property Securities Act 1999 for non-receivership sales, which allows subordinate security holders to rank ahead of unsecured creditors in the distribution of any surplus.

The authors of the first article (*"High Court decision casts doubt on effectiveness of second-ranking securities"*) discuss the fact that the High Court rejected submissions that Parliament had not intended subordinate security holders to rank alongside unsecured creditors, notwithstanding that the proposed amendment to the Receiverships Act 1993 had already been introduced into the legislative process.

The article also comments that, until that proposed amendment is enacted, one potential consequence of the *Building Depot* decision is that subordinate secured creditors may seek to buy out first-ranking secured creditors before a receiver is appointed.

The second article, *"When subordinate security is no security at all"*, agrees that subordinate security holders may wish to consider stepping into the shoes of the senior security holder before receivership in order to avoid the *Building Depot* effect. It is also suggested that other possible outcomes from the case are:

1. a first ranking security holder may be in breach of a priority agreement if a subordinate security interest is extinguished following a sale by a receiver – priority agreements often require the senior creditor to direct its receiver to distribute any surplus to subordinate security holders, but the Receiverships Act 1993 would currently require a receiver to make the distribution to the unsecured creditors instead;
2. instead of buying out the senior debt, subordinate security holders may also wish to consider, for instance, negotiating with the other creditors for personal property assets to be sold by the lowest

---

<sup>1</sup> Re The Building Depot Limited (in receivership and liquidation); Pardington and Another v Fletcher Distribution Limited and Others (CIV-2005-404-1347, High Court Auckland, 19 and 31 May 2005)

<sup>2</sup> As we mentioned in our last edition, it is important to note that this applies only to personal property security, and not to registered mortgages over land

ranking secured party (in order to preserve all of the security interests), or for the prior ranking secured parties to enforce only against specified property; and

3. receivers will need to be aware of the possibility of disputes over priority agreements.

## In the journals

### Unconscionable demands under letters of credit, performance bonds and bank guarantees

Matthew Bisley and James Mok, *Journal of Banking and Finance Law and Practice*, September 2005

*This article discusses exceptions to the autonomy principle under which payment instruments operate independently of any dispute relating to the underlying contract. In particular, the authors consider the development in Australia of an exception based on unconscionable conduct under the Trade Practices Act 1974 (Cth).*

The article concludes that the development of this new exception to the autonomy principle should not be a cause for concern about the reliability or usefulness of payment instruments, because it is still clear that the courts will preserve that principle unless there are special circumstances, and because the development of this area of law in other jurisdictions has not undermined the commercial value of such instruments. It is to be noted, however, that other commentary on these Australian developments has expressed a greater level of concern about the erosion of the autonomy principle.

By way of background, the article explains that the autonomy principle has previously been subject only to limited exceptions, which are mainly where a demand under the payment instrument involves fraud or forgery. However, two Australian cases have determined that unconscionable conduct under the Trade Practices Act 1974 (Cth) (the **TPA**) is another exception to the autonomy principle.

The authors state that these decisions have given rise to concerns that payment instruments will consequently become less reliable in terms of certainty of payment for the beneficiaries of the instruments – an issue that goes to the core of the purpose of payment instruments generally.

#### Commercial arrangements under payment instruments

The article outlines various international judicial statements that have emphasised the importance of payment instruments for efficient trade financing, and which account for the necessity of the autonomy principle to ensure that the issuer is liable under the instrument separately and independently from the underlying transaction.

In other words, the beneficiary under a payment instrument can claim the payment even if there is a dispute as to the underlying contract. Consequently, it is the payee, rather than the payer, that is able to retain the payment amount until any such dispute is resolved. The risk of the insolvency of the payee in the meantime is seen as a commercial risk assumed by the payer.

#### Primary cases involving payment instruments and unconscionable conduct under the TPA

Prior to the Australian cases relating to the TPA exception, the courts in Australia had made exceptions to the autonomy principle only where the demand for payment involved fraud or forgery or where stipulated conditions for payment had not been met.

However, the authors describe the *Olex Focas* case<sup>1</sup>, in which the Court issued an injunction to prevent the beneficiary of bank guarantees from demanding payment under them.

The Court, while not finding fraud, held that the beneficiary was acting unconscionably in contravention of section 51AA of the TPA. Section 51AA states that “*a corporation must not, in trade or commerce, engage in conduct that is unconscionable within the meaning of the unwritten law, from time to time of the States and Territories*”.

---

1 *Olex Focas v Sklodaexport* (1996) FLR 331; [1998] 3 VR 380

The beneficiary had threatened to demand the full amount of the guarantees although the guarantees had been made for the purpose of repaying certain advances, which had largely already been repaid.

The second case discussed is *Boral Formwork*<sup>1</sup>, in which relief was given under section 51AC of the TPA. In that case, a purchaser of scaffolding equipment sought an injunction to prevent the administrative receivers of the supplier claiming under letters of credit in respect of the purchase price without making allowance for rectification expenses that had been incurred by the purchaser when the equipment received had not complied with the agreement.

Section 51AC prohibits conduct which is, in all the circumstances, unconscionable in relation to the supply or acquisition (or possible supply or acquisition) of goods or services. It applies to transactions below AU\$3 million where the person alleging the unconscionable conduct is not a listed company.

### **Application of the TPA to payment instruments**

The authors consider an ongoing debate in Australia about the scope of the relevant provisions of the TPA. Notwithstanding the difficulties raised by that debate, the article goes on to analyse the line of case law in more detail to identify some guidance as to how the courts might apply those unconscionable conduct provisions to payment instruments.

In particular, the authors conclude that:

1. a beneficiary's conduct may be unconscionable if it claims payment to more than its entitlement under the underlying contract (although a claim to an amount that may be owed in the future would not be unconscionable);
2. there is no unconscionability in demanding payment of an amount that is genuinely disputed (even if the dispute has not been settled because of a delay caused by the beneficiary);
3. it is also not unconscionable to claim payment in order to apply pressure to resolve a dispute relating to the underlying contract;
4. there is no unconscionability if the beneficiary does not notify the issuer before making the claim for payment (unless it is required to do so under the contractual arrangements);
5. a bank will not be required to make any enquiries about allegations of unconscionable conduct, but may refuse to pay where there is clear evidence of unconscionability;
6. the unconscionability exception may apply where the fraud exception could also be relevant but where there is insufficient evidence to establish fraud, and so there may be more cases based on unconscionable conduct in the future;
7. the introduction of the unconscionable conduct exception to the autonomy principle avoided an alternative approach of the courts extending the existing fraud exception to the slightly uncertain concept of equitable fraud (which does not require intention or recklessness in relation to the deceit); and
8. the Australian position following *Olex Focas* and *Boral Formwork* is not altogether different to the position in England and the United States.

---

1 *Boral Formwork and Scaffolding v Action Makers* [2003] NSWSC 713

## Legislation/In Parliament

### Progress on non-bank finance sector review

*The Government will soon develop options for reform as part of a wide-ranging review of how non-bank financial products and providers are regulated.*

A review of the current regulatory arrangements for the non-bank financial sector has been completed, and has concluded that, although they are not fundamentally flawed, some changes are necessary.

#### Scope and purpose

Our last edition of *FSQ* covered the Government's announcement of a review of non-bank financial products and providers, including superannuation, insurance, managed fund products, and securities offerings, and the regulation of non-bank providers generally.

The Ministry of Economic Development (the **MED**) has explained that the aim of the review is to promote confidence and participation in financial markets by investors and institutions. Essentially, a stock-take of current regulation and an evaluation of the need for improvements is in progress. Treasury will also be considering whether any changes are needed to the administration of such regulation, including potential changes to the framework of domestic regulatory bodies.

#### Relationship with other reviews

The review will be informed by a number of separate reviews already planned or being carried out, as well as looking to identify other areas for appraisal. In particular, it is expected that the MED will take note of the recent report of the Task Force on the Regulation of Financial Intermediaries, and will work alongside moves towards greater trans-Tasman harmonisation (such as the proposed mutual recognition of securities offerings).

#### Direction of reforms

The MED has now completed a preliminary review of the current regulatory arrangements for the non-bank financial sector. From that review, early indications are that the following reforms will be considered by the Government:

- 1. Non-bank deposit-taking institutions**  
Additional supervision or licensing of non-bank deposit-taking institutions (**NBDTIs**), being financial institutions that take deposits from, or issue deposit-like debt securities to, the public, or which provide some form of transaction-making capacity to the public. A distinction is drawn, however, between NBDTIs and financial institutions issuing debt securities to the public that do not fall into the "deposit-taking" category.
- 2. Insurance providers**  
Additional supervision or licensing of insurance providers (potentially by a Government regulator where long-term or complex products are involved).
- 3. Trustee corporations and statutory supervisors**  
Greater oversight of trustee corporations and statutory supervisors in the performance of their functions, minimum requirements for people who wish to undertake the role currently performed by trustee corporations, a more standardised approach to trust deeds and trustee practices, and greater transparency and accountability for trustees and statutory supervisors.
- 4. Registration and entry requirements**  
A more comprehensive registration framework for, and increased monitoring of, financial providers (including financial institutions and intermediaries) and the imposition of further "fit and proper" requirements on financial providers.
- 5. Securities offerings and collective investment schemes**  
Re-consideration of the scope of the legislation and changes to the current disclosure requirements, possibly including re-visiting the effectiveness of the two-document disclosure system, considering whether the disclosure requirements for securities should be prescriptive or principle-based, and/or

introducing new provisions in relation to credit ratings, continuous disclosure and other investor-education requirements.

**MED target dates**

By end of 2005	▪ Develop draft options for reform in conjunction with advisory groups
Jan to June 2006	▪ Release discussion paper on options for reform
	▪ Consult publicly with industry sector for feedback
By late 2006	▪ Develop policy proposals in conjunction with advisory groups
2008	▪ Legislation to be passed

## Legislation/In Parliament

### **New insolvency legislation imminent**

*New laws may necessitate changes to creditors' documentation and default-related processes (particularly those applying to companies).*

The Government began work on a major review of New Zealand's insolvency laws in 1999. The review has now reached its final stages.

The key changes to be introduced by the law reform are expected to be:

1. the introduction of a business rehabilitation regime based on the Australian voluntary administration provisions (imposing a brief moratorium on creditors' claims while an administrator assesses the company's future);
2. amendments to the voidable transaction provisions (the new legal test for setting aside transactions will be modelled on Australian law);
3. providing a mechanism to enable streamlined procedures to be implemented for dealing with cross-border insolvencies; and
4. implementation of a quicker alternative to the current bankruptcy procedure for insolvent "consumer debtors" with no realisable assets; and
5. provisions to address the "phoenix company" problem by introducing further criminal penalties and restrictions on the re-use of insolvent company names by directors.

For more information, [http://www.bellgully.com/resources/resource\\_00031.asp](http://www.bellgully.com/resources/resource_00031.asp)

## Legislation/In Parliament

### Changes ahead for brokers and other financial intermediaries

*The Task Force on the Regulation of Financial Intermediaries has delivered its final report to the Government with recommendations for reform.*

It is likely that, at the least, new industry-specific legislation affecting financial institutions that use sales advisers or other intermediaries will be introduced in New Zealand.

The exact nature of the changes should be clearer by mid-2006, and financial institutions will then need to assess their business practices against the new requirements.

In the interim, the Government is inviting views on the Task Force's report and the design work that remains to be done to implement the recommendations.

#### Scope and purpose

Following a consultation period, the Task Force has delivered a final report to the Ministry of Economic Development (the **MED**), which included reform recommendations.

#### Areas of recommended reform

The Task Force recommended reform in three key areas:

1. **Enhanced standards**

The Task Force identified an issue with a lack of mandatory minimum industry-wide standards, meaning that there is scope to improve the overall quality of financial advice and information for consumers, and facilitate more effective management of conflicts. In its final report, the Task Force recommended clear and consistent general legal obligations and standards for intermediaries, and consistent application of baseline obligations for intermediaries performing similar functions.

2. **Enhanced redress, enforcement and sanctions**

The Task Force also recommended effective dispute resolution and disciplinary processes under a statutory regime, including penalties for non-compliance by intermediaries and effective remedies for consumers. This is considered to be crucial for consumer confidence.

3. **Enhanced disclosure and financial literacy**

The third recommendation was for improved disclosure obligations applying to a broader range of financial intermediaries, plus initiatives for enhancing consumer financial literacy. The aim of the reform is to enable consumers to make better decisions about an intermediary or financial product and to make comparisons. The Task Force also believed that it would encourage greater competition.

#### Mechanisms to implement reforms

Intermediaries are separated into three categories:

1. **Personal financial advisers**

These are individuals or businesses that provide broad financial planning advice or advice on financial products, and implicitly or explicitly advise the consumer on suitability or appropriateness for the consumer's personal circumstances.

Under the Task Force's recommendations, personal financial advisers are required to:

- be members of an approved professional body (with professional body rules), which bodies need to be approved by the Government and are subject to monitoring by an industry regulator;
- be on the register of personal financial advisers;
- comply with statutory standards, including standards similar to the current standards set out in the Fair Trading Act 1986 and other requirements such as agreeing with the clients the basis of

- remuneration and ensuring that clients' interests are given priority over any other incentives; and
- be subject to enhanced disclosure obligations.

**2. Product marketers**

Product marketers are individuals or businesses that promote financial products and provide more than factual information (for example, marketing aspects of the product) but do not advise on the suitability or appropriateness of the product for the consumer's personal circumstances.

The Task Force has recommended that they be required to:

- comply with certain statutory standards similar to the current standards set out in the Fair Trading Act 1986; and
- be subject to enhanced disclosure requirements including issuing a "health warning" to consumers as to the limits of the role that they undertake in comparison to personal financial advisers.

**3. "Information only" and "execution only" intermediaries**

"Information only" intermediaries are individuals or businesses who undertake a factual information function. "Execution only" intermediaries are firms or businesses who execute client instructions, where that execution function is linked to a personal financial adviser or product marketer role.

These intermediaries are recommended to be subject to requirements to:

- comply with certain statutory standards similar to the current standards set out in the Fair Trading Act 1986; and
- be subject to enhanced disclosure obligations, including disclosure of fees and charges, and any variable components of remuneration.

Although only personal financial advisers are required to be members of a Government-approved professional body under the Task Force's recommendations, all three types of intermediaries are subject to the jurisdiction of:

1. a single disputes resolution body; and
2. an industry-specific disciplinary body.

**MED next steps**

By end of 2005	▪ Some policy options ready
By mid 2006	▪ Detailed work on regulatory framework completed, to be followed by normal legislative process

The MED has announced that any changes will be developed concurrently with the work programme for the Government's general review of the non-bank finance sector. Legislation relating to that broader review is expected to be passed in 2008.

## Legislation/In Parliament

### Australia/New Zealand business law co-ordination review announced

*The Memorandum of Understanding between the Australian and New Zealand governments on business law co-ordination has reached its five-year review point.*

The Memorandum of Understanding signed in 2000 (the **MoU**) aimed to find ways to reduce transaction and compliance costs and to increase competition. These specific areas were identified by both governments in the MoU as possible candidates for further co-ordination:

1. providing for the cross-recognition of companies;
2. seeking to achieve greater compatibility in our disclosure regimes in relation to financial products;
3. managing cross-border insolvency;
4. providing a regulatory framework for recognising in each jurisdiction a stock market operating in compliance with comparable rules of the other jurisdiction;
5. exploring the potential for more closely co-ordinating the granting and recognition of registered intellectual property rights;
6. facilitating information sharing and, where appropriate, jointly participating in policy, compliance and education programs on consumer issues relating to business law, including consumer protection in electronic commerce;
7. seeking to achieve greater consistency in legislation affecting electronic transactions; and
8. exploring the potential for greater consistency in the trans-Tasman application and enforcement of competition law.

As pointed out by the Ministry of Economic Development (the **MED**), there have been a number of examples of increased alignment between Australian and New Zealand business laws over the intervening five-year period, such as changes to New Zealand's takeovers and insider trading laws, the adoption of International Financial Reporting Standards and the proposal for the establishment of a mutual recognition regime for offers of securities.

In July, the Minister of Commerce announced that the MoU would receive its five-year review, as agreed when it was signed in 2000. In accordance with terms of reference agreed by both governments, the MED and the Australian Treasury have been looking at:

1. whether the framework set up by the MoU needs to be modified;
2. what amendments need to be made to the MoU to reflect the changes to the commercial environment over the past five years; and
3. how the MoU can be amended to enhance future business law co-ordination.

Public submissions on the effectiveness of the MoU have also been sought by the MED. A report on the review is expected shortly.

For more information, see [www.med.govt.nz](http://www.med.govt.nz).

## Legislation/In Parliament

### Anti-money laundering and anti-terrorist financing regulation to be increased

*In August, the Minister of Justice reiterated the need for New Zealand to tighten its safeguards against money laundering and terrorist financing.*

New Zealand financial institutions should note that changes are likely to be required to:

- customer identification standards;
- record-keeping requirements;
- suspicious transaction reporting;
- ongoing monitoring of accounts and transactions; and
- company policies and compliance/training programmes.

A requirement is also expected to be introduced for directors, senior managers and significant shareholders of financial institutions to meet a “fit and proper persons” test.

The Minister of Justice announced in February that re-regulation would be likely in this area.

His latest announcement follows the publication of a report by the Financial Action Task Force (**FATF**), an international inter-governmental body, on New Zealand’s observance with FATF’s recommendations to counter money laundering and terrorist financing. The report essentially gave New Zealand a “could do better” grade.

In summary, FATF’s main conclusions, and the responses announced by the Government, are:

1. Since its last evaluation in 1998, New Zealand has made few changes to its anti-money laundering regime, but has introduced measures to combat terrorist financing (the Terrorism Suppression Act 2002).
2. The criminal justice legislative measures for combating money laundering and terrorist financing are generally sound. Some minor legislative changes, combined with additional resources and organisational changes, could further enhance the system. The Government has mentioned an amendment to the Financial Transactions Reporting Act 1996 to require financial institutions to obtain, verify and retain information about the originators of wire transfers (in line with FATF’s recommendations).
3. The requirements for record keeping and reporting of suspicious transactions are sound, but customer due diligence measures need to be amended to introduce requirements for properly identifying third parties for whom a customer is acting, and to remove a number of other limitations or exemptions. The Government has proposed an enforceable code of practice.
4. Guidelines for reporting entities need to be updated.
5. Appropriate mandatory requirements need to be introduced concerning financial institutions and their internal controls to prevent their control or acquisition by criminals. The Government has proposed a “fit and proper persons” requirement for directors, senior managers and significant shareholders of all financial institutions, in line with the banking sector. A registration regime for persons providing money transfer or currency exchange services has also been put forward.
6. Most importantly, an effective system needs to be introduced to supervise and/or monitor the compliance by relevant financial and other institutions.

The Government’s media statement regarding the increased regulation noted that the move had been welcomed by the United States Embassy. The Minister of Justice also acknowledged that the changes will result in unwelcome increased administrative costs for the financial sector.

The Government has circulated a discussion document for the purposes of consulting with the finance sector about the proposed changes.

For more information, see [www.justice.govt.nz](http://www.justice.govt.nz).

## Legislation/In Parliament

### Balancing consumer protection and regulatory costs

*The Ministry of Consumer Affairs has started a review of the pros and cons of "industry-led regulation".*

Industry-led regulation, such as voluntary codes of conduct and consumer dispute resolution processes, has been identified by the Ministry of Consumer Affairs as potentially a key strategy in consumer policy.

This review is therefore required to consider whether industry-led schemes are effective in promoting an environment in which consumers transact with confidence, and to clarify the circumstances in which such schemes work best.

A discussion paper released by the Ministry of Consumer Affairs identified the main questions to be addressed as:

1. how do industry-led schemes in New Zealand and overseas fit within the overall regulatory environment?
2. how effective are industry-led schemes in creating an environment in which consumers transact with confidence?
3. are there gaps in the coverage of schemes?
4. to what extent should the Government be involved in self-regulation?

The paper also outlined the background context to the review and set out a draft framework for evaluating industry-led regulation (to be used in developing best practice principles for effective schemes).

A subsequent paper is expected to examine the appropriate role for the Government in industry-led regulation. It will consider various models adopted overseas, and whether one of these models, or a hybrid, is appropriate for New Zealand.

For more information, see [www.consumeraffairs.govt.nz](http://www.consumeraffairs.govt.nz).

## Recent developments

### Revised draft outsourcing policy for registered banks

*The Reserve Bank has published a near-final draft policy on the requirements that will apply to large New Zealand registered banks entering into arrangements to outsource any business or function of the bank to a third party.*

This policy has been proposed by the Reserve Bank following discomfort about the dilution of control over core functionality within the New Zealand banking system (particularly because of the dominance of foreign-owned banks) and the possible economic consequences of that dilution in the event of stress or failure of a bank in New Zealand.

There has, however, been resistance to the proposed requirements on the basis of the increased compliance costs involved and the inefficiencies for foreign-owned banks involved in meeting jurisdiction-specific requirements for their New Zealand operations.

In releasing this near-final draft policy, the Reserve Bank has been at pains to point out that it has endeavoured to strike a balance between these concerns.

The revisions to the draft policy follow feedback on an earlier consultation paper issued in November 2004. The Reserve Bank is seeking to finalise the policy in late 2005.

The main thrusts of the draft policy are as follows:

1. **Large banks**

It applies to registered banks whose New Zealand liabilities, net of amounts due to related parties, exceed \$10 billion (*"large banks"*).

2. **Control over core functions in event of stress or failure**

The revised draft policy does not completely ban the outsourcing of core services. However, it states that large banks will normally be subject to a condition of registration requiring them to have the *"legal and practical ability to control and execute"* outsourced functions in the event of stress or the failure of the bank or a relevant service provider.

That control must achieve the following outcomes:

- the bank's clearing and settlement obligations can be met on the due day;
- the bank's financial risk positions can be identified on each day;
- the bank's financial risk positions can be monitored and managed on the day following a failure and on subsequent days; and
- the bank's existing customers can access payments facilities on the day following a failure and on subsequent days.

The *"legal ability to control and execute"* means the ability to invoke legal rights necessary to ensure the continuity of the relevant functions. According to the Reserve Bank, this would be assisted by, for instance, contractual terms being clear and complete, New Zealand being the governing law and jurisdiction of any contract, and service providers being regulated by the Reserve Bank rather than any overseas regulator.

The *"practical ability to control and execute"* means the ability to secure continuity within the required timeframes (bearing in mind that the enforcement of legal rights may involve a delay).

This relates to the availability and knowledge of personnel, and physical control over the relevant systems and data.

The Reserve Bank wants to mitigate the risks associated with the performance of functions outside New Zealand and the practice of service providers mingling the performance of functions for a New Zealand registered bank with the performance of functions for other entities.

3. **Board and executive accountability**

Large banks will also generally be subject to a further condition of registration requiring that:

- the management of the bank by its CEO (or equivalent) is carried out solely under the direction and supervision of the board;
- the CEO's employment contract is with the bank, and its terms are determined by the board; and

- all staff of the bank have their remuneration determined by (or under delegated authority from) the board or the CEO and are accountable (directly or indirectly) to the CEO.

The press release issued by the Reserve Bank in relation to the revised draft policy states that it incorporates the following changes from the November 2004 paper:

1. a greater emphasis on the primary responsibility of bank directors to manage outsourcing risk as a normal business risk;
2. a narrower focus on ensuring that large banks can continue to provide the core functions of liquidity, payments and transactions services, with less emphasis on other functions;
3. more clarity on the outcomes required by the policy; and
4. greater flexibility in the methods banks can use to meet those outcomes.

The Reserve Bank has also emphasised that the draft policy has been designed with a view to balancing the pros and cons of outsourcing within the banking system – essentially cost versus stability.

It is acknowledged, for instance, that outsourcing allows banks to lower their everyday operating costs, which makes for a more efficient financial system generally. However, any failure (even a short-lived one) by a large bank to provide core services such as liquidity, payments and transaction functions could have a serious effect on the New Zealand economy.

Indications of possible acceptable approaches to achieving the required outcomes where a core function is outsourced to a third party include:

1. alternative channels for the delivery of the function in the event of failure (e.g. "step-in" rights for the bank, backups or workarounds);
2. business continuity planning and regular testing;
3. explicit exclusion of statutory management of the bank from the definition of default events under contracts for core services; and/or
4. requirements that the service be provided from New Zealand or from a location close to New Zealand.

However, the acceptability of any such approach would depend on factors such as the materiality of the function in question and the impact of any failure on customers.

The Reserve Bank will be working with each bank to implement the draft policy taking into account its individual circumstances and investment cycles.

For more information, see [www.rbnz.govt.nz](http://www.rbnz.govt.nz).

## Recent developments

### Commerce Commission announces investigations into CCCFA breaches

*The Commerce Commission announced in October that it has visited 50 credit providers in Auckland, Wellington and Christchurch to check on compliance with the Credit Contracts and Consumer Finance Act 2003, and it currently has 13 investigations underway into alleged breaches.*

The Commerce Commission's clear message to the credit industry is that the time is now approaching when credit providers can expect enforcement action to be taken for breaches of the new legislation. The Commission has provided considerable information about the CCCFA to the industry and, since April, has been monitoring and investigating compliance. The Commission has particularly emphasised certain "strategic enforcement areas" on which it will be focusing its activities.

#### Monitoring and enforcement

The Commission described the results of its visits as a "mixed report card for the credit industry".

It has specifically stated that it will take enforcement action against breaches of the Credit Contracts and Consumer Finance Act 2003 (the **CCCFA**), and has reminded credit providers that this could result in criminal conviction with fines of up to \$30,000 or the payment of damages of up to \$3,000 per borrower.

However, the Commerce Commission has also said that it will continue to work with the industry to address issues that have come up. For instance, it intends to publish a guide to section 45 of the CCCFA (relating to third-party charges passed on to borrowers).

#### Warnings

The results of the Commission's compliance monitoring to date are:

1. a warning has been issued to an Auckland business that had not made any changes to its forms or procedures since the introduction of the CCCFA;
2. an investigation into an Auckland company involved in running buy-back schemes has been completed, with a warning issued to the company about several potential breaches of the CCCFA;
3. the Commission has issued two warnings to businesses for breaching the disclosure provisions of the CCCFA;
4. a warning has also been issued to a creditor for a matter relating to a fee charged on early prepayment of a consumer credit contract; and
5. 13 investigations into alleged breaches of the CCCFA are still open.

#### **"Strategic enforcement areas"**

The Commerce Commission has advised that the areas on which it intends to focus its monitoring and enforcement activities are:

1. the initial disclosure of the information required by Schedule 1 of the CCCFA in relation to consumer credit contracts;
2. breaches of disclosure standards (i.e. the CCCFA's specifications as to how disclosure must be made, including the requirement that all disclosures must be clear and concise);
3. unreasonable requirements to obtain credit-related insurance; and
4. unreasonable fees, including the calculation of fees representing a reasonable estimate of a creditor's loss on full prepayment of a consumer credit contract.

For more information, see [www.comcom.govt.nz](http://www.comcom.govt.nz).

## Recent developments

### **Securities Commission to increase co-operation with ASIC**

*The New Zealand Securities Commission and the Australian Securities and Investment Commission met in August for the purpose of promoting greater regulatory co-operation between the two countries.*

At the meeting in Sydney, an updated memorandum of understanding was signed in order to reflect recent changes to the regulatory functions of both agencies and to allow for co-operation and the smooth exchange of information (especially on enforcement matters).

The agencies also discussed the key regulatory developments and risks (including cross-border fraud) in their jurisdictions. Significantly, the progress that had been made towards the mutual recognition of cross-border offerings of securities was also on the agenda.

Jane Diplock, chair of the Securities Commission, said of the formal meetings with ASIC: *"We regard them as part of our work towards a single economic market that will benefit business and investors on both sides of the Tasman."*

For more information, see [www.sec-com.govt.nz](http://www.sec-com.govt.nz).

## Recent developments

### **Best practice guidelines for reporting suspicious financial transactions**

*The New Zealand Police Financial Intelligence Unit has released these guidelines to assist New Zealand financial institutions in complying with the requirements of the Financial Transactions Reporting Act 1996.*

The guidelines outline the laws in New Zealand relating to money laundering and the obligations of financial institutions to, for instance, verify customers' identity and report suspicious transactions.

They have been updated to include general information relating to money laundering (such as locations of specific concern to the police) and information relating to terrorist financing risks.

The guidelines will be updated again once the proposed legislation relating to New Zealand's compliance with international anti-money laundering and anti-terrorist financing standards has been finalised.

For more information, see [www.police.govt.nz](http://www.police.govt.nz).

## Recent developments

### Securities Commission report on investor disclosure

*The Securities Commission has published a report on Cycle 1 of its broad financial reporting surveillance programme, which is reviewing the standard of financial reporting by New Zealand public securities issuers.*

One of the functions of the Securities Commission is “to keep under review practices relating to securities, and to comment thereon to any appropriate body”. The Commission has therefore been undertaking a general review of financial reporting standards.

Cycle 1 of this surveillance programme involved a review of the financial reports of 40 public issuers in order to ascertain the level of compliance with the Financial Reporting Standards and New Zealand Generally Accepted Accounting Practice (**NZ GAAP**), and to assess the overall quality of the reporting.

The Securities Commission’s report on Cycle 1 has now been provided to the market to give specific guidance on the Commission’s expectations for disclosure. Although the report concludes that only two of issuers had serious problems with their reports, 16 other issuers had some shortcomings in their reports that needed to be addressed.

The report observes that the nature of many of the matters raised with issuers suggests that issuers should consider:

1. whether they have been sufficiently transparent in their disclosures;
2. whether they could pay greater attention to detail in complying with some of the ancillary financial reporting disclosures (e.g. disclosures in respect of financial instruments and related party disclosures); and
3. whether they could better manage some of the year-end processes for finalising the annual report (noting that the annual report, comprising the financial report and other statutory disclosures, should be reviewed before being dated and signed by the directors, and auditor sign-off should follow signing of the financial report).

In particular, it was noted that some disclosures simply raised further questions, which could have been avoided by more clarity and openness.

The report also identifies some inconsistencies discovered by the Cycle 1 review in substantial security holder disclosures and some potential gaps or delays in continuous disclosure notices. These issues were referred to the NZX.

Further surveillance is expected before the end of the year, and enforcement action could follow if breaches of disclosure requirements are revealed. Later review cycles will, in particular, look at adjustments made by issuers as they move towards the New Zealand Equivalents to International Financial Reporting Standards.

For more information, see [www.sec-com.govt.nz](http://www.sec-com.govt.nz).

## Recent developments

### Practice note on prospective financial information in offer documents

*The Securities Commission has amended its practice note on prospective financial information, which assists issuers preparing offer documents during the transition to New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS).*

The main principles of the practice note (which continue unchanged) are that:

1. prospective financial information for any future accounting period should be prepared on the basis of the accounting policies that the issuer expects to apply in that accounting period; and
2. New Zealand Generally Accepted Accounting Practice (**NZ GAAP**) information should be reconciled to NZ IFRS where a prospectus, which is registered before the issuer adopts NZ IFRS, contains NZ GAAP prospective or historical financial information for the transition period as well as prospective financial information prepared under NZ IFRS.

However, the amended practice note is intended to clarify that:

1. the NZ IFRS standards applying in respect of a prospective financial period are those that the issuer expects to apply for that period; and
2. the Commission does not expect issuers to reconcile prospective financial information between NZ GAAP and NZ IFRS unless the prospectus contains prospective financial information for an accounting period after the issuer's expected adoption date for NZ IFRS.

For more information, see [www.sec-com.govt.nz](http://www.sec-com.govt.nz)

## Useful Web links

### *New Zealand government*

- [Inland Revenue Department \[www.ird.govt.nz\]](http://www.ird.govt.nz)
- [Ministry of Economic Development \[www.med.govt.nz\]](http://www.med.govt.nz)
- [Ministry of Foreign Affairs and Trade \[www.mfat.govt.nz\]](http://www.mfat.govt.nz)
- [New Zealand Government \[www.govt.nz\]](http://www.govt.nz)
- [NZ Government E-Commerce Information \[www.ecommerce.govt.nz\]](http://www.ecommerce.govt.nz)
- [NZ Treasury \[www.treasury.govt.nz\]](http://www.treasury.govt.nz)
- [Office of the Clerk of the House of Representatives \[www.clerk.parliament.govt.nz\]](http://www.clerk.parliament.govt.nz)
- [Parliamentary Counsel Office \[www.pco.parliament.govt.nz\]](http://www.pco.parliament.govt.nz)

### *New Zealand financial agencies and organisations*

- [The Companies Office \[www.companies.govt.nz\]](http://www.companies.govt.nz)
- [Export Credit Office \[www.treasury.govt.nz/exportcreditoffice\]](http://www.treasury.govt.nz/exportcreditoffice)
- [NZ Law Commission \[www.lawcom.govt.nz\]](http://www.lawcom.govt.nz)
- [Office of the Banking Ombudsman \[www.bankombudsman.org.nz\]](http://www.bankombudsman.org.nz)
- [Office of Insurance and Savings Ombudsman \[www.iombudsman.org.nz\]](http://www.iombudsman.org.nz)
- [Office of the Privacy Commissioner \[www.privacy.org.nz\]](http://www.privacy.org.nz)
- [Personal Property Securities Register \[www.ppsr.govt.nz\]](http://www.ppsr.govt.nz)
- [Reserve Bank of New Zealand \[www.rbnz.govt.nz\]](http://www.rbnz.govt.nz)
- [Securities Commission \[www.sec-com.govt.nz\]](http://www.sec-com.govt.nz)
- [Takeovers Panel \[www.takeovers.govt.nz\]](http://www.takeovers.govt.nz)

### *New Zealand commercial sites*

- [CLANZ \[www.clanz.org\]](http://www.clanz.org)
- [Institute of Chartered Accountants \[www.icanz.co.nz\]](http://www.icanz.co.nz)
- [NZ Bankers' Association \[www.nzba.org.nz\]](http://www.nzba.org.nz)
- [NZ Business Roundtable \[www.nzbr.org.nz\]](http://www.nzbr.org.nz)
- [NZ Institute of Economic Research \[www.nzier.org.nz\]](http://www.nzier.org.nz)
- [NZ Exchange \[www.nzx.com\]](http://www.nzx.com)

### *Australian government sites*

- [Banking Ombudsman \[www.abio.org.au\]](http://www.abio.org.au)
- [National Office for the Information Economy \[www.ogo.gov.au\]](http://www.ogo.gov.au)

### *Australian commercial sites*

- [Australian Financial Markets Association \[www.afma.com.au\]](http://www.afma.com.au)
- [Australian Securities and Investment Commission \[www.asic.gov.au\]](http://www.asic.gov.au)
- [Australian Stock Exchange \[www.asx.com.au\]](http://www.asx.com.au)

### *International sites*

- [Bank for International Settlements \[www.bis.org\]](http://www.bis.org)
- [Global Banking Law Database \[www.gbld.org\]](http://www.gbld.org)
- [International Monetary Fund \[www.imf.org\]](http://www.imf.org)
- [International Swaps and Derivatives Association \[www.isda.org\]](http://www.isda.org)
- [NASDAQ \[www.nasdaq.com\]](http://www.nasdaq.com)
- [New York Stock Exchange \[www.nyse.com\]](http://www.nyse.com)
- [United States Securities and Exchange Commission \[www.sec.gov\]](http://www.sec.gov)
- [World Bank \[www.worldbank.org\]](http://www.worldbank.org)