



**BELL GULLY**

# Financial Services Quarterly

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WINTER 2009

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**BELL GULLY**

## financial services quarterly

**Welcome to the Winter 2009 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:

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- **Corporate governance in the credit crisis**
- **Non-bank deposit takers risk management guidelines released**

### **Need more information?**

For more information on any of the cases, articles and features in *Financial Services Quarterly*, please email [rachel.gowing@bellgully.com](mailto:rachel.gowing@bellgully.com) or call on 64 9 916 8825.

*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

### **Decision upheld in consumer credit test case appeal**

The High Court has confirmed the ability of lenders to set prepayment fees based on their business model and lending practices, rather than the "safe harbour" formula advocated by the Commerce Commission.

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## Legislation/In Parliament

### **Significant changes to the Australian Double Tax Agreement**

On 27 June, the New Zealand and Australian governments signed a revised Double Tax Agreement that, once in force, will replace the existing New Zealand-Australian Double Tax Agreement entered into in 1995.

### **Financial services law reform - how will this affect your business?**

A raft of legislation was passed by the New Zealand Parliament late last year that will substantially reshape the regulatory landscape for financial services providers.

### **Government deposit guarantee scheme to be extended**

The government guarantee on lending deposits is to be extended.

### **Securities and Financial Advisers Amendment Bills**

The Securities (Disclosure) Amendment Bill, which amends the Securities Act 1978, has been passed, as has the Financial Advisers Amendment Bill, which makes some minor changes to the Financial Advisers Act 2008.

### **Proposed changes to the Insolvency Act 2006**

The Commerce Committee has recommended that the Insolvency Amendment Bill 2009 be passed, with a few minor amendments.

### **Anti-Money Laundering and Countering Financing of Terrorism Bill**

A guide to the Anti-Money Laundering and Countering Financing of Terrorism Bill.

### **Government moves on finance company moratoria**

The Government hopes to have regulations simplifying and clarifying disclosure obligations for finance company moratoria introduced by the end of the year.

## In the journals

### **Corporate governance in the credit crisis**

Some suggestions for in-house counsel tasked with developing best practice in corporate governance.

### **Releases of guarantees and security**

This article provides a good summary of considerations around releasing guarantees and security and what to consider when varying underlying contracts.

## Recent Developments

### **Non-bank deposit takers risk management guidelines released**

The Reserve Bank has released its risk management programme guidelines for non-bank deposit takers.

### **Proposals for regulating financial advisers**

The Securities Commission has released a paper outlining proposals for the regulation of financial advisers, to take effect late next year.

### **International financial crisis group makes recommendations**

The Financial Crisis Advisory Group has published its recommendations relating to financial reporting and standards setting.

### **Capital Market Development Taskforce identifies big issues ahead**

The Capital Market Development Taskforce has released a progress report identifying issues facing New Zealand's capital markets.

### **Inquiry into finance company failures**

The Commerce Commission has set up terms of reference for its enquiry into finance company failures.

### **Financial reporting surveillance programme – Cycle 9**

The Securities Commission continues to find inadequacies in matters previously referred to issuers.

### **Companies Office blog**

The Companies Office has launched a blog site.

## In the courts

### Decision upheld in consumer credit test case appeal

*The High Court has confirmed the ability of lenders to set prepayment fees based on their business model and lending practices, rather than the "safe harbour" formula advocated by the Commerce Commission.*

The High Court<sup>1</sup> has upheld a decision of the District Court in which it dismissed charges against a creditor under the Credit Contracts and Consumer Finance Act 2003 (**CCCFA**). Visit [www.bellgully.com/resources/resource.01777.asp](http://www.bellgully.com/resources/resource.01777.asp) to view our earlier commentary on the District Court's decision.

#### *The District Court case*

The Commission had alleged that the prepayment fees charged by the creditor were unreasonable under the CCCFA because the formula it used did not involve a reasonable estimate of the creditor's loss on prepayment. Drawing on the "safe harbour" formula provided for in the CCCFA, the Commission alleged that the creditor's alternative formula did not relate to the time taken to re-lend funds, had no regard to changes in interest rates, and did not take into account mitigation of loss by re-lending. However, the court found that the safe harbour formula did not reflect the creditor's loss, was not suited to the creditor's business structure, and that the creditor's formula was reasonable.

#### *The High Court appeal*

The Commission appealed to the High Court. The focus of the appeal was whether the creditor was required to calculate its loss on the assumption that it would immediately re-lend the prepaid funds, despite the fact that it had excess funds available, and prepayment did not affect its ability to issue new loans.

The Commission contended that the reasonableness of any alternative formula used to calculate a prepayment fee must be considered against the principles inherent in the safe harbour formula. This would require allowances for changes in prevailing interest rates, mitigation of loss through re-lending, the reduction of the outstanding balance due over time, and the time value of money. In the Commission's view, although the CCCFA allows creditors to use their own formula, it was wrong for this creditor to depart from the safe harbour formula for reasons linked to its business structure, rather than reasons to do with the characteristics of loans themselves.

In the High Court, Justice Asher held that a prepayment fee calculation is not unreasonable if it involves an objective estimate, at the time of entering into the contract, of compensation to the creditor. It was further held that it is reasonable for a creditor to take into account the fact that a new loan will not replace the old one, and that profit on the loan is lost through prepayment.

The judge held that the CCCFA explicitly provides two alternatives - the safe harbour formula, or an appropriate alternative formula - and that the reasonableness of an alternative formula does not depend on its similarity to the safe harbour formula. "It makes no logical sense for the legislature to have provided for alternative formulae if they were to be driven by the terms of the safe harbour formula, and that the only benchmark is reasonableness".

Finally, the judge refused to accept the Commission's contention that it is inappropriate to consider the creditor's business structure in setting prepayment fees, saying that an assessment of reasonableness requires consideration of the loss of the actual creditor, and more than "a barren focus on a contractual term against a market backdrop".

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<sup>1</sup> in *Commerce Commission v Avanti Finance* HC Auckland CRI-2008-404-000210, 28 April 2009

The High Court's decision affirms the District Court's decision in this important test case, and gives lenders welcome guidance on the factors they need to take into account in setting prepayment fees.

## Defrauding creditors by transferring assets to trusts

*The Supreme Court has provided further guidance on when it will rule that the transfer of assets to a trust constitutes intent to defraud creditors.*

In this case<sup>1</sup>, the Supreme Court considered a transfer of property by a debtor to his family trust, which was said to have been made with intent to defraud creditors. The court found that the transfer of property was void.

A creditor loaned a substantial sum to provide capital for an individual's business. Without telling the creditor, the debtor transferred his house, which was his only substantial asset, to a family trust. When he subsequently defaulted on the loan, the creditor obtained judgment against him and brought a claim under section 60 of the Property Law Act 1952 (**PLA 1952**) to set aside the transfer of the property as having been made with an intent to defraud.

It was suggested during the hearing that a transfer of property for no monetary consideration gave rise to a presumption of an intention to defraud. The majority of the court found it unnecessary to decide whether this was correct. Instead, they held that the question of intent remains one of fact, but accepted that an inference of fraudulent intent may be drawn from the facts.

Counsel for the creditor argued that the debtor's financial circumstances were precarious, and the creditor's position was inevitably prejudiced by the transfer of the debtor's only substantial asset. In those circumstances an intention to defraud was established.

The court agreed that the circumstances showed an intention by the debtor to defraud his creditors.

In our view, this conclusion has lowered the bar for conduct sufficient to trigger section 60 of the PLA 1952. The debtor knew that one of the effects of the trust arrangement was to protect assets, but there was nothing untoward in the terms of the trust deed. The house had been transferred at value (by virtue of a deed of acknowledgment of debt), and the gifting programme was standard. To find the debtor intended to defraud the creditor ultimately required the court to infer a level of calculation and sophistication on the part of the debtor that may not have existed.

### *The effect of the decision*

Since implementation of the Property Law Act 2007 (the **PLA 2007**) on 1 January 2008, it is no longer necessary to prove that the debtor disposed of the relevant property with intent to defraud creditors. A transaction may be set aside if the relevant property was disposed of:

- as a gift; or
- without receiving reasonably equivalent value in exchange.

However, this case is still relevant because section 346 of the PLA 2007 provides that a disposition of property may be void if it is made with intent to defraud creditors. Also, transfers of property to trusts prior to 1 January 2008 are still governed by section 60 of the PLA 1952 and the decision in this case.

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<sup>1</sup> *Regal Castings v Lightbody* [2008] NZSC 87; [2009] 2 NZLR 433

## Solicitor not liable for creditor's loss

*A solicitor who failed to register a mortgage promptly was not liable for the creditor's loss, because the borrower was an impostor.*

This case<sup>1</sup>, heard in New Zealand's Supreme Court, was an appeal by the creditor from the Court of Appeal's ruling that the creditor could not claim loss by reason of a solicitor's undertaking to promptly register a mortgage.

The solicitor acted for both the creditor and the borrower in preparing the documentation for the mortgage. As it turned out, the borrower was an impostor, and was not the registered proprietor of the property the subject of the mortgage. The solicitor's certificate sent to the creditor contained the relevant undertaking to promptly lodge and submit the documents for registration.

The creditor had advanced a large sum to the impostor, which was secured by an all-obligations mortgage that was also executed by the impostor. The solicitor failed to register the mortgage promptly and, by the time it was lodged for registration, the fraud had been discovered. In the meantime, a caveat had been registered, which precluded registration of the mortgage.

The creditor argued that, if the mortgage had been registered before discovery of the fraud, the creditor would have had indefeasible title as mortgagee.

The creditor contended:

- that the void forged mortgage would have been treated as valid under the indefeasibility provisions of the Land Transfer Act 1952 (**LTA**) if it had been registered without fraud on its part before it became aware of the deception; and
- that the solicitor's failure to register the mortgage before discovery of the forgery deprived it of statutory validation.

As a result, the creditor claimed it had suffered loss of moneys advanced and the interest the loan continued to bear under the terms of the loan agreement, because it was unable to exercise power of sale of the property.

The Court of Appeal determined that the terms of the creditor's advance were recorded in a loan agreement, which was also a forgery and therefore a nullity, and not in the mortgage. Accordingly, even if the mortgage had been registered, no moneys were thereby secured and therefore the creditor could not claim loss by reason of the solicitor's failure to register the mortgage promptly.

The Supreme Court upheld the Court of Appeal's decision, agreeing that an indefeasible registered mortgage secured nothing if the debt in respect of which it charged the land was an obligation derived from a forged loan agreement. Therefore, the creditor had not shown it suffered loss through failure by the solicitor to register the mortgage.

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<sup>1</sup> *Westpac New Zealand Limited v Clark* [2009] NZSC 73

## Test case on voidable transactions

*The process for setting aside a preferential transaction was changed in 2008. A recent High Court decision is the first using the new process.*

### *The process*

A transaction that was entered into when a company was insolvent, and which had the effect of preferring one creditor over other creditors, may be set aside by a liquidator.

The process is commenced by the liquidator:

- filing a notice under s294(2) of the Companies Act in court; and
- serving a copy of this on the creditor.

Previously, a creditor who received a notice was required to file an application with the court in order for the transaction not to be set aside. Failure to file a court application resulted in the transaction automatically being set aside. Now, the creditor need only send the liquidator a written notice of objection within 20 working days of being served with the notice to avoid the transaction being automatically set aside. If the creditor takes this step, it is the liquidator who must file an application with the court in order to set a transaction aside.

To combat the prospect that a creditor without genuine grounds for objection would simply send a pro-forma notice of objection to the liquidator, creditors are required to set out full particulars of their reasons for objecting, identifying documents that evidence or substantiate these reasons. This requirement is also designed to ensure that:

- the information imbalance between a liquidator, who often has limited records, and the creditor, is addressed; and
- liquidators are fully informed as to both the substance and detail of a creditor's objection before determining whether or not to pursue a challenge.

### *The first case*

To some extent, the decision of the High Court in this case<sup>1</sup> undermines the rationale around the requirement to provide full particulars of the reasons for objection, because it shows that a creditor will not be prevented from relying on an argument that it has not set out in its notice of objection.

In the case, the creditor opposed the liquidator's notice on the basis that the company was solvent at the time of the transactions, and that the payment did not confer a preference on the creditor. At the hearing, however, the creditor pursued neither of these grounds and instead argued that the payments were made in the company's ordinary course of business.

Despite this, the judge held that the interests of justice required that the creditor should be permitted to advance the new argument. The judge conceded that, in certain cases, a liquidator would be prejudiced by a late argument to such an extent that the creditor should not be permitted to advance a new argument at all. However, in the present case, he considered that the creditor had filed a very detailed notice of opposition that set out its intention to raise the new argument and, accordingly, there had been sufficient compliance with section 292(4) to justify leave being granted to advance the argument.

### *The decision's merits*

While one of the policies behind section 294 – ensuring that liquidators are able to make informed decisions about whether to commence proceedings – is eroded by allowing creditors to raise arguments that should have been identified when the notice objection was served on the liquidator, in our view the decision is a fair one.

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<sup>1</sup> *Blanchett v Roofing Specialists Ltd* HC Hamilton, CIV-2007-419-00691, 5 May 2009

The significance of a notice to set aside a transaction is not always fully appreciated by creditors. It will often be the case that creditors do not seek legal advice until proceedings are issued. At this point, the creditor's legal advisers may well identify legitimate reasons why a transaction should not be set aside that the creditor did not raise itself. Except in cases where a creditor raises new arguments at a stage so late in the proceedings that the liquidator has no opportunity to respond to them, the creditor should be allowed to raise additional grounds not specified in the notice of objection. However, in such situations, it is appropriate that the liquidator be compensated in terms of costs, if he or she would not otherwise have issued proceedings had the argument been raised in the notice of objection.

## Guarantee or indemnity?

*This case provides a good summary of the distinction between a guarantee and an indemnity.*

The appellant in this case<sup>1</sup> entered into an agreement (the **Agreement**) with the first defendant, which operated a roll-on roll-off ferry service. The Agreement made provision for priority use of berths by the first defendant, for turnaround times, and for the construction of certain facilities. There was provision for index-linked charges and for an annual minimum throughput obligation, which required the first defendant to compensate the appellant in the event of a shortfall.

At the same time, the appellant entered into a written agreement (the **Letter Agreement**) with the second defendant, which was a company in the same group as the first defendant. The purpose of the Letter Agreement was to secure the position of the appellant, by way of recourse against the second defendant.

Under the terms of the Letter Agreement, the second defendant assumed "full responsibility for ensuring (and shall so ensure) that, for seven years from the date of this letter, [the first defendant] (i) has and will at all times have sufficient funds and other resources to fulfil and meet all duties, commitments and liabilities entered into and/or incurred by reason of the Agreement as and when they fall due, and (ii) promptly fulfils and meets all such duties commitments and liabilities."

Following certain disputes that had arisen between them, the appellant and the first defendant entered into a "time to pay" agreement. The first defendant subsequently ceased trading and was later put into liquidation.

The appellant sought to recover sums due from the first defendant under the Agreement and from the second defendant under the Letter Agreement.

In the lower court, judgment was given in favour of the appellant against the first defendant, but the claim against the second defendant was dismissed on the ground that the Letter Agreement constituted a guarantee that had been discharged by the "time to pay" agreement entered into between the appellant and the first defendant.

The appellant appealed, arguing that:

- the words "at all times" used in the Letter Agreement pointed to a primary liability on the part of the second defendant under an indemnity, and not a secondary liability under a guarantee; and
- in the alternative, the Letter Agreement was a legally binding letter of comfort.

The Court of Appeal considered whether the Letter Agreement was a guarantee or an indemnity, and made the following observations:

- Whether a document is a guarantee or an indemnity, or whether it imposes a secondary or a primary liability, will always depend on the true construction of the actual words in which the promise is expressed.
- It was not possible to reach the conclusion that the words "at all times", as used in the Letter Agreement, pointed to a primary liability on the part of the second defendant.
- Of much greater significance was the way in which limb (i) of the Letter Agreement defined the obligation of the second defendant by reference to the first defendant meeting all *its* duties, commitments and liabilities entered into and/or incurred by reason of the Agreement as and when they fall due.
- It was a "see to it" obligation: the second defendant would see to it that the first defendant performed its obligations under the Agreement. If the first defendant could not meet its liabilities to the appellant "as and when they fall due" (the primary liability), then the secondary liability of the second defendant would accrue by way of guarantee.

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<sup>1</sup> *Associated British Ports v Ferryways NV* [2009] EWCA Civ 189

- The court acknowledged that this would have been sufficient to protect the appellant but for the “time to pay” agreement, and would still have protected the appellant if the Letter Agreement had contained the common provision found in guarantees whereby a subsequent variation or “time to pay” agreement between the debtor and creditor expressed not to discharge the surety.

The Court of Appeal went on to consider whether the Letter Agreement was a guarantee or a letter of comfort, and noted that if the Letter Agreement was a legally binding letter of comfort, then, as with an indemnity, any liability would not be discharged by the “time to pay” agreement, due to a legally binding letter of comfort being a primary liability.

The court held, for the same reasons set out above, that the Letter Agreement did not constitute a legally binding letter of comfort because it did not give rise to a primary liability.

An **indemnity** is a primary obligation: “The Debtor or I will pay you.”

A **guarantee** is secondary obligation: “If the Debtor does not pay you, I will pay you.”

Under the common law, because the liability is secondary, a guarantee can be discharged by:

- a bilateral variation of the contract between the creditor and the debtor; and/or
- the giving of time by the creditor to a debtor under a contract.

An indemnity is not discharged by the above because the liability of the surety is a primary liability.

*Whether a document is a guarantee or an indemnity, or whether it imposes a secondary or a primary liability, will always depend on the true construction of the actual words in which the promise is expressed.*

## Is a term sheet a contract?

*This case<sup>1</sup> considered whether a term sheet constituted a contract.*

The claimants were a hedge fund and an investment manager. The defendants were the CEO and deputy CEO of a French company. The claimants contended that, by a funding agreement made in July 2007, the hedge fund agreed to provide an advance of \$30M to the defendants to assist them to complete funding of a private placement of securities of the French company. The investment manager was to be paid a fee for arranging the funding.

The claimants contended that the terms of the funding agreement were set out in a term sheet that was signed by the claimants and the defendants.

The scheme involved the funding provided by the hedge fund to be used to finance the purchase of warrants in the French company. The warrants were then to be transferred to an SPV to be established by the defendants, and were to stand as security for repayment of the advance. The defendants agreed, among other things, that:

- they would place other securities in the SPV by way of further collateral for the advance; and
- the hedge fund would be repaid the amount of the advance within one year from the funding date.

The advance was made and the private placement was successful. However, the defendants never established a SPV, and the hedge fund was never repaid. The hedge fund instead received the warrants, which had reduced in value.

The claimants alleged that the defendants were in breach of the funding agreement and claimed money due under it and damages.

The defendants denied that they had concluded any effective and enforceable contractual agreement with the claimants and, in particular, that there was no intention to create legal relations.

The defendants argued that they had merely signed a non-contractual commitment to continue negotiations and that they had expected after the term sheet was signed that there would be further discussions and lawyers would be instructed to draw up a legally binding contract.

The judge noted that, in deciding whether parties had entered into a contract, the courts normally applied an objective test: "how would a reasonable man versed in business have understood the exchanges between the parties?".

The court noted the following:

- The parties recognised that their agreement would later be incorporated into a formal document, and they expected that the terms of their commitment should be defined in more detail. This was not inconsistent with the parties having evinced an intention to be legally bound.
- There is no general rule that term sheets are, or are not, of contractual effect, and their status could be determined only by the nature of the particular document and the facts of the particular case.
- The judge held that the wording and presentation of the term sheet were such to evince an intention on the part of the parties signing it to enter into a contractual commitment.
- The judge noted that each page of the term sheet carried a footer that "the terms included are intended to create a binding obligation on the part of the Borrowers, the management and their affiliates". The judge stated that the argument that the parties evinced an intention to be bound did not depend on the footers. He held that it was demonstrated by the words under which the parties signed: "Please sign to acknowledge agreement and acceptance of the terms of the transaction".

The court concluded that, on an objective assessment, the parties to the term sheet evinced an intention to be bound contractually by its terms.

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<sup>1</sup> *Maple Leaf Macro Volatility Master Fund v Rouvroy* [2009] EWHC 257 (Comm)

Note that there is no general rule that term sheets are, or are not, effective as legally binding contracts. In the absence of specific wording to the contrary, their status may be determined only by the nature of the particular document and the facts of the particular case.

## **Lender not liable for borrower's business failure**

*When a lender sought summary judgment pursuant to a personal guarantee, the guarantor counter-claimed against the lender for breach of "fiduciary duties" owed to him.*

In this case<sup>1</sup>, the guarantor alleged that the lender breached its fiduciary duty to him in four ways:

- under the Fair Trading Act;
- by breach of trust and fiduciary duty;
- through knowing assistance; and
- by deceit.

Awarding summary judgment to the creditor, the court held that, when making an advance to a borrower to purchase a business, a creditor could not reasonably be expected to provide an assessment or warranty regarding the performance of that business in the future.

The guarantor's counterclaim was struck out.

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<sup>1</sup> *ANZ National Bank Limited v Pillay* HC-Auckland CIV 2009-404-001220

## Legislation/In Parliament

# Significant changes to the Australian Double Tax Agreement

On 27 June, the New Zealand and Australian governments signed a revised Double Tax Agreement (the **2009 DTA**) that, once in force, will replace the existing New Zealand-Australian Double Tax Agreement entered into in 1995 (the **1995 DTA**).

**The 2009 DTA is materially different to the 1995 DTA and incorporates changes to almost every article.**

This article addresses some of the more significant changes.

### Reduced withholding rates

#### DIVIDENDS

The 2009 DTA retains the existing 15% withholding rate for dividends as a default position, but introduces a new 5% rate and a complete exemption from withholding.

#### *5% withholding rate*

The new 5% rate applies where a dividend is derived by a company that holds 10% or more of the voting power of the dividend-paying company.

#### *Exemption from withholding*

An exemption from withholding applies to dividends derived by companies that hold 80% or more of the voting power of the dividend-paying company in the 12 months ending on the date the dividend is declared provided that one of the following tests is also satisfied:

- the recipient company is listed on the ASX or NZX (or another exchange approved by the IRD and ATO) or the recipient company's ultimate parent is listed on such an exchange (referred to as the "listing test"); or
- the recipient company's ultimate parent is resident outside Australia or New Zealand and would have been exempt from withholding tax on the dividend if the ultimate parent held the shares in the dividend-paying company directly (referred to as the "foreign residence test"). Currently, it appears that, for a dividend paid by a New Zealand company, these criteria could only be satisfied if the ultimate parent was a US resident that could have benefited from a 0% rate of withholding under the revised New Zealand / United States treaty.

If the recipient company satisfies the 80% ownership test, but not one of the "listing" or "foreign residence" tests, the company may nevertheless benefit from the exemption if the revenue authority in the dividend-paying company's country of residence determines that a new "anti treaty shopping" rule does not apply. Broadly, in the case of a dividend paid by a New Zealand company to an Australian parent, the IRD will need to form a view that the main purpose of the Australian company's shareholding (or any transaction involving those shares) is not to obtain the benefit of the exemption.

As yet, the IRD has not published any guidelines on how this determination procedure will operate in practice. Our expectation is that many entities will need to apply for determinations given the large number of unlisted Australian companies that operate through New Zealand subsidiaries.

It is noteworthy that the 80% ownership test (a prerequisite to the application of the exemption) cannot be satisfied unless the dividend-paying company has been in existence for 12 or more months. The 12 month period is not reduced for new entities that pay a dividend within 12 months of incorporation.

## INTEREST

The 2009 DTA retains the 10% withholding rate in respect of interest, but introduces a new exemption from withholding for financial institutions where interest is paid on a loan:

- to an unrelated borrower; and
- that does not form part of a "back-to-back" loan arrangement (no guidance is given to date as to what type of arrangements will constitute a back-to-back loan).

Restrictions on the application of the exemption mean that, for New Zealand sourced interest, the new exemption from withholding will only apply if Approved Issuer Levy is paid (where that regime is available) in respect of the interest. However, it is unlikely that these restrictions will operate in respect of interest paid to an Australian entity with a branch in New Zealand (because the Approved Issuer Levy regime would not be available in these circumstances).

## ROYALTIES

The 2009 DTA reduces the maximum withholding rate on royalties from 10% to 5%. The definition of "royalty" has also been limited to exclude payments for the use of, or the right to use, industrial, commercial or scientific equipment.

## CHANGES TO THE "PERMANENT ESTABLISHMENT" DEFINITION

The 2009 DTA introduces significant changes to the definition of "permanent establishment" (the profits of which are not exempt under the business profits article in the DTA). Some key changes are summarised below:

- A deemed permanent establishment will now arise where services are performed by an enterprise through an individual or individuals in the other country for more than 183 days in any 12 month period and (i) more than 50% of the enterprise's income in the period is from services performed in New Zealand or (ii) the services are performed in relation to the same project or connected projects.
- The definition of "substantial equipment" now only deems a permanent establishment to arise where a person "operates" substantial equipment in the other country for more than 183 days in any 12 month period. The previous wording was wide and, arguably, applied to deem a lessor under a cross-border dry lease of substantial equipment to have a permanent establishment in the country in which the equipment was used. The introduction of a 183 day test is also a positive development in that it ensures that a permanent establishment will not arise in the case of a fleeting operation of substantial equipment in the other country (e.g. simply sailing a barge through New Zealand waters).
- A wider dependent agent deemed permanent establishment test now applies where an entity has a dependent agent that has, and habitually exercises, authority to "substantially negotiate" or conclude contracts on behalf of an enterprise. Previous wording had referred only to authority to "conclude" contracts. This change may have significant consequences for sales representative operations that involve the negotiation of contracts in New Zealand on behalf of Australian principals. In the past, negotiated agreements may have been forwarded to the Australian principal for "approval" to avoid the Australian principal having a permanent establishment in New Zealand under the dependent agent test.

### **New "time bar" for attribution of profits to a permanent establishment**

The business profits article in the 2009 DTA now includes a seven year "time bar" that prevents the IRD and the ATO from making any adjustment to an attribution of profits to a permanent establishment. The seven year period runs from the date the taxpayer files its return in respect of the permanent establishment. The time bar does not apply in the case of fraud, gross negligence or wilful default, or where an audit has commenced within that seven year period.

This change means little for Australian residents that operate through New Zealand permanent establishments on the basis that those taxpayers already benefit from New Zealand's four year statutory time bar. However, the change is significant for New Zealand residents that operate through Australian permanent establishments because, at present, the Australian domestic law time bar does not apply to the allocation of profits to a permanent establishment.

## **Other important changes**

The 2009 DTA also includes a raft of other important changes, including:

- A new tax exemption for seconded employees who are seconded for 90 days or less in any 12 month period.
- A new article provides that income derived by a person through a fiscally transparent entity will be treated as derived by the person under the 2009 DTA if the entity is treated as fiscally transparent in either New Zealand or Australia.
- A new article will exempt pension payments derived from the other country that would have been exempt from tax had the person remained a resident of that other country. In addition, lump sum payments made to a person under a retirement scheme in the other country will now only be taxable in that other country (and not the country of residence of the person).
- Specific dual residence tie-breaker rules for dual listed company arrangements deem a dual listed company to be resident in the country of its incorporation, provided that the company's primary listing is also in that country.
- A new rule will claw back relief under the 2009 DTA for Australian residents that move to New Zealand and benefit from the "transitional residents" regime. There is no "mirror" rule for New Zealand emigrants to Australia.

## **Staggered application dates**

The changes to the withholding rates for dividends, interest and royalties will apply on the first day of the second month after both the New Zealand and Australian governments have given legal effect to the 2009 DTA. All other changes will apply on the 1 April following the date on which legal effect is given to the DTA. Early indications suggest that the ratification process may be completed by November this year.

## **Financial services law reform - how will this affect your business?**

*A raft of legislation was passed by the New Zealand Parliament late last year that will substantially reshape the regulatory landscape for financial services providers.*

For many financial service providers, who currently face little or no regulation of their New Zealand activities, this legislation will require significant extra attention to compliance. However, even those financial service providers who are currently highly-regulated in New Zealand (such as registered banks), will be affected by this legislation.

Most of the legislation is not yet in force, but will come into effect over the course of 2010. However, given the lead-in work required to address some of the new compliance obligations, it is important to consider the impact of this legislation now.

Bell Gully's Banking and Finance Team has prepared a guide to assist with navigating the legislation and determining the extent to which it may apply to various businesses.

[Financial Service Providers Law – Guide: http://www.bellgully.com/resources/resource.02356.asp](http://www.bellgully.com/resources/resource.02356.asp)

## Government deposit guarantee scheme to be extended

*The Government guarantee on lending deposits is to be extended.*

Finance Minister Bill English has stated that the Government will extend the Retail Deposit Guarantee Scheme and change some of its terms and conditions.

The current scheme ends on 12 October 2010, and the new scheme will start on 13 October 2010 and end on 31 December 2011.

"The Retail Deposit Guarantee Scheme was introduced as a direct response to international financial market turbulence. Immediate concerns about the stability of the financial system are now abating," Mr English says.

"The planned extension will help maintain confidence in New Zealand's financial institutions while achieving an orderly exit from the scheme."

Depositors and institutions have more than one year's advance notice before the scheme changes. They then have a further 14 months under the extended scheme.

The changes that will take effect after 12 October 2010 are:

- Fees paid by participating institutions will be changed to reflect their risk profile. The fees are set by the Minister of Finance, and are intended to approximately match longer term normal market pricing. Thresholds in the current scheme will be discontinued and the fees will apply to all funds in the new scheme.
- Eligible bank deposits will be covered up to a maximum of \$500,000 per depositor per institution and eligible non-bank deposits to a maximum of \$250,000 per depositor per institution. The maximum in the current scheme is \$1 million per depositor per institution.
- Deposit-taking institutions with a credit rating of BB or higher can apply to participate in the extended scheme. Institutions with a lower credit rating, or no rating, will no longer be eligible.
- Collective Investment Schemes won't be eligible for the new scheme.

All depositors currently benefiting from a Crown guarantee will have their deposits covered until 12 October 2010. Whether or not they are covered after that will depend on whether their institution voluntarily joins the new scheme.

A list of institutions covered by the scheme beyond 12 October 2010 will be available on the Treasury website once applications have been processed.

The level of fees, which will vary by credit rating and type or organisation, is set out in the table below.

Credit rating	Finance Companies (bpts)	Banks, Credit Unions, Building Societies, PSIS (bpts)
AAA +/-	15	15
AA+	15	15
AA	15	15
AA-	20	15

A+	25	20
A	30	20
A-	40	20
BBB +	60	25
BBB	80	30
BBB-	100	40
BB+	120	50
BB	150	60

## Securities and Financial Advisers Amendment Bills

*The Securities (Disclosure) Amendment Bill, which amends the Securities Act 1978, has been passed, as has the Financial Advisers Amendment Bill, which makes some minor changes to the Financial Advisers Act 2008.*

### *Securities Regulations 2009*

The Securities Regulations 2009, which will replace the Securities Regulations 1983, implement a range of recommendations made by the Capital Market Development Taskforce.

Commerce Minister Simon Power said that the regulations provided for the details of the new simplified disclosure prospectus for listed issuers that were established by the recently enacted Securities (Disclosure) Amendment Act 2009, and include a range of other amendments that will benefit issuers and investors.

"These new regulations should make a real difference for companies seeking to raise capital," Mr Power said. "In particular, the simplified disclosure prospectus will provide a significant reduction in compliance costs for listed issuers by removing the requirement to disclose information that is already available to the market."

The simplified disclosure prospectus provides for:

- listed issuers who are already subject to continuous disclosure requirements being required to produce only one disclosure document for a securities offering, instead of a full prospectus and an investment statement;
- a simplified disclosure prospectus for offers of securities of the same class as listed securities (which will rely more strongly on continuous disclosure);
- a simplified disclosure prospectus for offers of securities that rank equally or in priority to listed securities (which will rely on continuous disclosure to a slightly lesser extent); and
- listed unit trusts to use the simplified disclosure prospectus for offers of additional listed securities, and to offer higher ranking debt securities.

In addition to giving effect to the new simplified disclosure prospectus, the regulations also contain changes that are intended to reduce compliance costs and improve disclosure for issuers and investors.

The new regulations will come into force on October 1. However, issuers will be able to elect to offer under the existing regulations until June next year.

It is also expected that the regulations will help to reduce costs and time for businesses raising capital in this financially challenging environment, and is expected to help, in particular, small and medium size businesses that traditionally seek capital by "shoulder tapping" known investors.

### *Financial Advisers Amendment Bill*

Mr Power describes this Bill as "making some relatively minor changes to the Financial Advisers Act to ensure that the regime works as effectively as possible".

## Proposed changes to the Insolvency Act 2006

*On 28 May, the Commerce Committee recommended that the Insolvency Amendment Bill 2009 (the **Bill**) be passed, with a few minor amendments. If enacted, the bill will amend the Insolvency Act 2006 (the **2006 Act**) for the first time since it came into force on 3 December 2007.*

The principal changes proposed by the Bill concern:

- the cancellation of insolvent gifts by the Official Assignee;
- the status of fraudulent debts on discharge from the No Asset Procedure (the **NAP**); and
- the retention of information on the public register.

### CANCELLATION OF INSOLVENT GIFTS

The bill makes a number of changes to the insolvent gift provisions in the 2006 Act, largely returning to the position under the Insolvency Act 1967 (the **1967 Act**).

#### *Gifts within two years of adjudication*

Under the 1967 Act, the Official Assignee could cancel a gift made by the bankrupt within two years prior to adjudication, without needing to prove that the bankrupt was insolvent at the time of the gift.

The 2006 Act changed this by allowing the Official Assignee to cancel a gift only if the bankrupt was unable to pay his or her debts immediately after the gift was made. The 2006 Act creates a presumption that the bankrupt was unable to pay his or her debts during the two years prior to adjudication. However, if the recipient of the gift is able to rebut this presumption, the Official Assignee cannot cancel the gift.

Under the Bill, the position will revert to that under the 1967 Act, by allowing the Official Assignee to cancel any gift made by the bankrupt within two years prior to adjudication, irrespective of whether the bankrupt was insolvent at the time of the gift.

#### *Gifts within two to five years of adjudication*

Under the Bill, the position relating to gifts made within two to five years of adjudication also moves back to the 1967 Act.

Currently, the burden of proof lies with the Official Assignee to establish that the bankrupt was insolvent. The Bill shifts the burden of proof back to the recipient of the gift, so that the recipient will need to prove the bankrupt satisfied the solvency test to avoid the Official Assignee cancelling the debt.

In addition, the Bill makes a change to the time at which the bankrupt must be proven to have satisfied the solvency test. Under the current law, the test will be satisfied only if the bankrupt was able to pay his or her debts *immediately* after the gift was made. The Bill changes this, so that the bankrupt will satisfy the solvency test if, *at any time* after the gift but before adjudication, the bankrupt was able to pay his or her debts. This is also a return to the pre-2006 Act position.

#### *Solvency test for insolvent gifts and transactions at undervalue*

The Bill also modifies the solvency test for insolvent gifts so that it takes into account all debts owed by the bankrupt, not just those that were due. Contingent liabilities will consequently need to be taken into account in applying the test.

The same change applies where the Official Assignee seeks to make a recovery in respect of a transaction at undervalue. For all other irregular transactions (insolvent transactions and insolvent charges), the test takes into account only due debts.

#### *Commencement of changes*

The changes to the insolvent gifts rules will not be retrospective. They will apply only where adjudication has occurred after the amendments have come into force. If adjudication has occurred prior to this, the current provisions in the 2006 Act will continue to apply.

#### STATUS OF FRAUDULENT DEBTS ON DISCHARGE FROM NAP

Currently, when a debtor is discharged from the NAP, all of his or her debts that were unenforceable on entry into the scheme are cancelled. The Bill amends this blanket cancellation to exclude two types of fraudulent debt:

- any debt or liability incurred by fraud or fraudulent breach of trust to which the debtor was a party; and
- any debt or liability for which the debtor has obtained forbearance through fraud to which the debtor was a party.

While these types of debt will be unenforceable during the debtor's participation in the NAP, they will become enforceable again once the debtor is discharged. This change brings the position of fraudulent debts under the NAP into line with the position of such debts in bankruptcy.

This change will have retroactive effect: this part of the Bill is deemed to have come into force on 10 March 2009. Therefore, all fraudulent debts cancelled on discharge from 10 March 2009 will be revived when the Bill receives the Royal Assent.

#### **Retention of information on the public register**

The public register contains information on people who are, or have been, bankrupt or who are in the NAP. Information must currently be removed four years after discharge for bankrupts, and on discharge for those admitted to the NAP.

The Bill will change this, so that information on persons admitted to the NAP will be retained for four years after discharge, and information on bankrupts will be kept permanently, if they have multiple insolvency events. A person is defined as having multiple insolvency events if they have been bankrupted more than once, or have been bankrupted once and also discharged from the NAP.

While these changes will not be retroactive for persons admitted to the NAP, they will be for those who have multiple insolvency events. The Bill introduced into Parliament made it clear that this included bankruptcies under the Insolvency Act 1967 and the Bankruptcy Act 1908. The Commerce Committee recommended that this be changed so that it doesn't include bankruptcies under the 1908 Act, as records prior to the 1967 Act can be unreliable.

# **Anti-Money Laundering and Countering Financing of Terrorism Bill**

*A guide to the Anti-Money Laundering and Countering Financing of Terrorism Bill.*

A draft law aimed at eradicating money laundering and terrorist financing is now before Parliament.

The Anti-Money Laundering and Countering Financing of Terrorism Bill was introduced into Parliament in June, after an extended period of consultation.

This new legislation upgrades the Financial Transactions Reporting Act 1996 and will have significant implications for many businesses in New Zealand.

Bell Gully has prepared this [practical guide](http://www.bellgully.com/resources/resource.02369.asp) ([www.bellgully.com/resources/resource.02369.asp](http://www.bellgully.com/resources/resource.02369.asp)) to assist you to understand the Bill and to help with compliance planning.

Submissions on the Bill closed with the Foreign Affairs, Defence and Trade Select Committee on 6 August. The legislation is expected to be passed into law in the third quarter of this year. There will then be a two year transitional period before the new regime comes into effect.

[Click here for further details of the Bill's progression](http://www.parliament.nz/en-NZ/PB/Legislation/Bills/d/f/9/00DBHOH_BILL9270_1-Anti-Money-Laundering-and-Countering-Financing.htm) ([www.parliament.nz/en-NZ/PB/Legislation/Bills/d/f/9/00DBHOH\\_BILL9270\\_1-Anti-Money-Laundering-and-Countering-Financing.htm](http://www.parliament.nz/en-NZ/PB/Legislation/Bills/d/f/9/00DBHOH_BILL9270_1-Anti-Money-Laundering-and-Countering-Financing.htm))

## **Government moves on finance company moratoria**

*The Government hopes to have regulations simplifying and clarifying disclosure obligations for finance company moratoria introduced by the end of the year.*

Moratoria proposals are an alternative to receivership, for debt-issuing companies that are unable to pay their investors. They may involve capital restructuring or repayment plans. At present, 12 finance companies are in moratoria, with approximately \$2 billion involved.

Commerce Minister Simon Power has advised that Cabinet has agreed to the development of regulations that "will ensure key information is available to investors who are being asked to make significant decisions about their investments based on onerous and highly complex disclosure documents".

Concerned that disclosure currently provided by finance companies does not provide investors with the appropriate information to make sound decisions, Mr Power says that "the regulations will require debt issuers to provide clear and concise investment statements about moratoria proposals, along with independent expert advice, the views of the trustees, and the considerations of the company directors".

## In the journals

### Corporate governance in the credit crisis

**Sophie Gladwell and Dilmun Leach, NZ Lawyer Magazine, July 2009**

*Some suggestions for in-house counsel tasked with developing best practice in corporate governance.*

It has been eight years since Enron placed corporate governance under the spotlight for companies, investors and governments worldwide and the global financial crisis has renewed that focus.

While there have been many lessons learned and changes made since the 2001 scandal, deficiencies in corporate governance practices remain and have been highlighted by many corporate failings.

It is not surprising that corporate governance and its role in controlling and monitoring the business of companies is being scrutinised again as regulators, shareholders and others seek answers to questions such as how could it all have gone so wrong? And, more importantly, what lessons need to be learnt to avoid future crises?

The Organisation for Economic Co-operation and Development (OECD) has said that the "most obvious lesson is that corporate governance matters"<sup>1</sup>. Indeed, various reports into the crisis have revealed significant failures in four key areas: pay and bonuses, risk management, board performance and the involvement of shareholders.

In-house counsel can expect renewed focus on governance from their boards and others and may want to consider responding proactively to latest developments. This article provides background to the issues and some suggestions for developing best practice.

#### **Pay and bonuses**

In several jurisdictions worldwide, the business, public and regulatory worlds' attention has been focussed on executive remuneration practices, which are widely thought to have encouraged excessive risk taking.

The OECD notes that "there are big problems with the 'pay for performance' system"<sup>2</sup> which has caused a great deal of public anger in Europe, the US, Australia and elsewhere. However, according to the OECD, "pay for performance does work, but needs to be better managed and more transparent". Problems can arise, for instance, where remuneration decisions are not carried out at arm's length and it can be hard to establish the link between performance and remuneration.

Despite the OECD's view that the current system can work, reform in this area is becoming widespread. For example, in February new guidelines were introduced in the US to restrict executive pay for companies receiving government financial assistance. Reform proposals are also under consideration in Australia, aimed at curbing what the Government terms "excessive golden handshakes" paid to departing company executives. Similar concerns and developments are evident in Europe and Asia.

#### **Risk management**

The global financial crisis has revealed widespread and massive failures in risk management practices. Many economists, organisations and governments have suggested a link between poor risk management and corporate failings. One interesting example was recently given by the UK's Chancellor of the Exchequer, Alistair Darling:

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<sup>1</sup>*Corporate Governance and the financial crisis: questions and answers.* OECD, Mats Isaksson, Head of Corporate Affairs, 17 June 2009.

<sup>2</sup>*Corporate Governance and the financial crisis: questions and answers.* OECD, Mats Isaksson, Head of Corporate Affairs, 17 June 2009.

Last summer, just as the crisis began to bite, a senior banker told me that 'from now on we will only lend when we understand the risks involved'. I did wonder what they had been doing up until then. Months later we were the majority shareholder of that bank.<sup>1</sup>

The OECD has also recognised a connection between poor risk management and the crisis, in a report<sup>2</sup> published in February, concluding that the crisis can "to an important extent be attributed to failures and weaknesses in corporate governance arrangements which did not serve their purpose to safeguard against excessive risk taking in a number of financial service companies".

#### *Information and understanding the importance of risk issues*

The OECD report primarily examines the banking sector and significant events involving banks such as UBS, Société Générale and Bear Stearns, and suggests that in some circumstances information about risk was used inadequately. For example, less effective boards were unaware of strategic decisions being made by management and had not implemented an effective mechanism to enable boards to oversee the banks' risk appetite. Certain boards also had limited technical understanding of products, such as mortgage-backed securities, and a lack of control over balance sheet growth and liquidity needs.

The lack of active risk committees was also cited with Lehman Brothers' risk committee noted as meeting only twice and Bear Stearns' committee being formed just before it collapsed.

The inferior prestige and status afforded to risk management staff was highlighted by the OECD. For example, Société Générale informed its shareholders of an "imbalance...between the front office, focused on expanding its activities, and the control functions which were unable to develop the critical scrutiny necessary for their role".

#### *Best practice*

The OECD acknowledged that although rating agencies, disclosure and accounting standards played a role in causing the credit crisis, the best boards used their own powers to overcome weaknesses and associated risks in these areas. Effective boards implemented systems which led to the efficient sharing of information and open dialogue across management and the board.

Mats Isaksson, the OECD's Head of Corporate Affairs, has made recommendations to ensure that risk management systems are "continuously adjusted to corporate strategy and risk appetite"<sup>3</sup>. Specifically, boards need to be more exposed to risk issues and have all the necessary information to make informed decisions. This could be achieved by appointing a "special risk officer" to report directly to the board rather than via the CEO.

## **Board performance**

The UK Treasury published a report in May stating that "banks have failed because those leading and managing them failed"<sup>4</sup>. It quotes PIRC, a leading UK corporate governance consultancy, which accuses boards of being primarily responsible for the failure of banks because they "approved the business strategies and products that have caused such damage".

The UK Treasury highlighted a failure of non-executives to effectively oversee and act as a check on executive directors, and suggested that some boards "operate as members of a 'cosy club'". The UK Treasury suggested areas for reform, including:

- limiting the number of non-executive directorships that an individual can hold;
- requiring non-executives to have a relevant professional qualification to sit on the board;

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<sup>1</sup>Speech by the Chancellor of the Exchequer, the Rt Hon Alistair Darling MP, at Mansion House, London, 17 June 2009 <http://www.publications.parliament.uk/pa/cm/cmtreasy.htm>

<sup>2</sup>*The Corporate Governance Lessons from the Financial Crisis*. OECD, February 2009.

<sup>3</sup>*Corporate Governance and the financial crisis: questions and answers*. OECD, Mats Isaksson, Head of Corporate Affairs, 17 June 2009.

<sup>4</sup>*Banking Crisis: reforming corporate governance and pay in the City*. UK Treasury, 12 May 2009. The report examined and made recommendations for change in areas such as corporate governance, remuneration and the roles of credit agencies, auditors, the media and accounting standards. <http://www.publications.parliament.uk/pa/cm/cmtreasy.htm>

- broadening the talent pool from which the banks can draw upon in appointing non-executives; and
- examining ways to strengthen the relationship between institutional shareholders and non-executives.

#### *Poor board performance and the failure of New Zealand finance companies*

In New Zealand, the most glaring example of corporate governance failings has been among finance companies. A report from the Registrar of Companies to the Ministry of Economic Development<sup>1</sup> highlights board composition and the competence of directors as key factors contributing to the collapse of 29 finance companies in New Zealand in the last two years.

The report says that the boards of these finance companies tended to lack the breadth of experience and skills required to oversee the scale, complexity and characteristics of financing operations. The Registrar notes that several of the companies were led by a dominant chief executive and there was a pattern of several directors being previously involved in finance industry failures.

The Registrar criticised the behaviour of the boards of these companies, stating that “too often directors were not adequately informed, misled or failed to take sufficient interest in ... the company”.

### **Shareholder passivity**

Institutional shareholders have also been accused of failing in their task of scrutinising and monitoring the decisions of boards.

Ongoing developments in this area are likely, and, with the significant market falls we have seen during this crisis, institutional investors such as Legal & General Investment Management (LGIM) and others are realising that “all shareholders need to themselves take the issue of corporate governance seriously”<sup>2</sup> and develop an active ownership approach. LGIM has suggested measures such as setting up an investment forum, where shareholders can come together, voice their opinions and unite in lobbying companies on contentious issues.

The UK Treasury has also called on the Walker Review<sup>3</sup> on corporate governance in the banking sector to address the issue of shareholder engagement by recommending proposals to aid shareholder activism<sup>4</sup>.

While institutional shareholders, the UK Treasury and others have suggested that reform may be needed in this area, PIRC appears to consider that the problem may not be the corporate governance framework or mechanism itself, “but the failure of some shareholders to use the rights they have effectively”<sup>5</sup>.

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<sup>1</sup> 2007/08 Financial Review of the Ministry of Economic Development, Report to the Commerce Committee, 19 March 2009.

<sup>2</sup> *Fundamentals: The shareholders have spoken*, LGIM, 17 June 2009 (LGIM is the largest investor in the UK stock market, holding about 4.5% of shares listed on the London Stock Exchange).

<http://www.legalandgeneralmediacentre.com/Content/Detail.asp?ReleaseID=563&NewsAreaID=2>

<sup>3</sup> The Walker Review’s preliminary conclusions are due in autumn and its final recommendations by the end of 2009.

<sup>4</sup> *Banking Crisis: reforming corporate governance and pay in the City*. UK Treasury, 12 May 2009.

<sup>5</sup> <http://www.pirc.co.uk/news/story336.html>

## Issues for New Zealand companies and in-house counsel

Where do New Zealand regulators and the Government stand on the issue of reform versus better use of the current corporate governance framework? While it is difficult to say what reforms, if any, are likely to be proposed in the future, Jane Diplock, Chair of the Securities Commission, gave an interesting and perhaps telling speech in Hong Kong in May. She concluded by quoting Hector Sants, Chief Executive of the UK Financial Services Authority<sup>1</sup>:

The structure of governance in financial companies does not need radical overhaul. The attitudes and competence of the individuals who conduct that governance does. In particular we need to create governance arrangements that foster challenge without creating conflict. The effectiveness of governance is the key issue and addressing this challenge is the responsibility of all of us, not just regulators and boards.

The Securities Commission is reviewing the corporate governance disclosure practices of selected listed issuers as part of its ongoing financial reporting surveillance programme, with Jane Diplock noting that there is a need for "greater assurance that issuers have robust corporate governance arrangements in place".

Now is an opportune time for New Zealand companies to assess the effectiveness of their own corporate governance practices. In-house counsel may be able to play a key role in assessing compliance and highlighting areas for improvement, for example by prompting discussion on areas such as corporate governance and good housekeeping generally.

The starting point for any in-house corporate governance review should be based on New Zealand's own best practice guidelines, as envisioned by company law, the NZX's Corporate Governance Best Practice Code and the Securities Commission's set of nine principles entitled *Corporate Governance in New Zealand – Principles and Guidelines*. Together these provide a comprehensive framework for companies to develop sound corporate governance practices.

New Zealand companies and in-house counsel should also keep in mind corporate governance issues being highlighted in other jurisdictions. Here are some key corporate governance practices in-house counsel may wish to promote:

- Boards should check to ensure they have access to all relevant information. This includes ensuring that there are appropriate systems of control in place in particular for risk management, financial and operational control and compliance with the law. A "stock take" on such matters may be timely.
- Companies should consider re-emphasising the roles of the CEO and the board in the risk management process so that they can properly oversee, monitor and have a forward looking perspective of risk issues. In addition, if they have not already done so, boards should consider having separate risk and audit committees.
- Boards should ensure that when an independent director is selected, the focus is not only on independence and objectivity but also on capabilities. This may include acquiring appropriate skills upon appointment and ensuring they keep up-to-date with relevant laws, regulations and changing risks through in-house and external training. In-house counsel may wish to review current appointment policies and guidelines and also whether ongoing information and education processes could be improved.
- Participation of non-executive directors should be encouraged. For example, if directors have not had sufficient experience of the specific market in which the company operates, they should be given market-specific training. In-house counsel may wish to review the relevant induction programmes.

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<sup>1</sup> <http://www.sec-com.govt.nz/speeches/2009/260509.shtml>

- Companies should consider ways to encourage shareholder participation, perhaps through encouraging communication and fostering a mutual understanding between shareholders and non-executive directors. It may be timely to review policy and practice in these areas.

Although New Zealand's corporate governance framework may not be subjected to radical reform, the importance of good governance has clearly been recognised by the Securities Commission and others. It is in the best interests of all companies and organisations to assess, continually monitor and enhance corporate governance practices to improve performance, foster better relationships with shareholders and others and help avoid some of the failings that have contributed to the global financial crisis.

## **Releases of guarantees and security**

**Hazel Miller, Butterworths Journal of International Banking and Finance Law, May 2009, Vol 24, No 5**

*This article provides a good summary of considerations around releasing guarantees and security and what to consider when varying underlying contracts.*

The key messages to take from the article are:

- Releases of guarantees and security should be expressly documented in a deed of release.
- Where an underlying contract is varied, written consent of the guarantor should be obtained to avoid any unintended discharge of the guarantee.
- Where a secured contract is varied to any significant degree, written confirmation of security should be obtained.

## Recent developments

### Non-bank deposit takers risk management guidelines released

*The Reserve Bank has released its risk management programme guidelines for non-bank deposit takers.*

#### *Background*

The Reserve Bank of New Zealand Act 1989 (the **Act**) was amended in 2008 to establish a new framework for the regulation of non-bank deposit takers (**NBDTs**) by the Reserve Bank. A new Part 5D has been inserted into the Act, which requires NBDTs to comply with various prudential regulatory standards. Prior to the change, these entities were not subject to prudential supervision by a government regulator.

Under the Act, a NBDT includes someone who:

- “offers debt securities to the public of New Zealand” and
- “carries on the business of borrowing and lending money, or providing financial services, or both.”

Briefly, under the new regime, NBDTs are required to:

- have at least two independent directors;
- obtain a credit rating from an approved agency;
- observe new limitations on exposures to related parties;
- have a minimum capital ratio requirement of eight per cent; and
- observe new risk management requirements (not yet in force).

#### *Updates*

The Reserve Bank has updated its policy position in relation to:

- corporate issuers;
- funding conduits;
- payment facility providers; and
- entities exempted under the Securities Act 1978.

The Reserve Bank has also been working on two class exemptions:

- An exemption from the credit rating requirement if total liabilities are less than \$20 million. The exemption, made under Part 5D of the Act, is available to NBDTs whose consolidated liabilities are less than \$20 million (measured as an average over a 12 month period). There are certain conditions outlined in the exemption that must be complied with if NBDTs want to take advantage of it. To view a copy of the exemption notice, go to [www.rbnz.govt.nz/news/2009/3712168.html](http://www.rbnz.govt.nz/news/2009/3712168.html)
- An exemption from the requirement that the risk management programme must be signed off by a trustee if the NBDT has no trust deed. This will enable risk management programmes to be signed off by an alternative governing body. The Deposit Takers (Non-trustee Entities Risk Management) Exemption Notice 2009 comes into force on 1 September.

### *Risk Management Programme Guidelines*

The Reserve Bank has issued a discussion document relating to the risk management programmes required by section 157M of the Act.

The proposed risk management requirements are expected to come into force at the beginning of September 2009. At that time:

- every NBDT must have a risk management programme, and take all practicable steps to comply with its risk management programme; and
- each NBDT's trustee must be satisfied that the risk management programme meets the requirements of the Act.

The risk management programme must:

- be in writing;
- set out procedures that a NBDT will use for the effective identification and management of credit, liquidity, market and operational risks;
- set out auditable documentation and record keeping requirements; and
- describe the steps that the NBDT will take to ensure that the programme remains current, including procedures relating to identification of deficiencies and review of effectiveness.

The Reserve Bank has noted that the breadth and scope of a NBDT's processes and internal controls set out in its risk management programme will depend on the nature and size of the NBDT's business.

The risk management programmes should:

- cover the four types of risk:
  - credit risk (concentration risk, business cycle risk, country risk);
  - liquidity risk;
  - market risk (interest rate risk, foreign currency risk, equity risk); and
  - operational risk;
- quantify exposure to risk (and where not quantifiable, use qualitative measures); and
- include contingency plans for stress events.

The risk management guidelines provide no details as to the penalties that will be imposed for failure to comply with section 157M. However, under the existing sections, failure to comply with the NBDT regime may attract a fine of up to \$2 million for a body corporate, or a fine of \$200,000 and up to a year imprisonment for directors.

Visit [www.rbnz.govt.nz](http://www.rbnz.govt.nz) for responses to questions raised in submissions on the draft guidelines.

To read the risk management programme guidelines, go to [www.rbnz.govt.nz/finstab/nbdtr/regulation/3697899.pdf](http://www.rbnz.govt.nz/finstab/nbdtr/regulation/3697899.pdf)

## Proposals for regulating financial advisers

*The Securities Commission has released a paper outlining proposals for the regulation of financial advisers, to take effect late next year.*

The Staff Paper on Regulating and Supervising Financial Advisers, released in June, considers the practical implementation of the Financial Advisers Act 2008.

The paper covers the systems, procedures and capacity businesses will need to have in place to fulfil their obligations under the law, and divides financial advisers into the following three categories:

- advisers registered but not authorised;
- advisers registered and authorised; and
- entities/organisations that provide financial advice – qualifying financial entities (**QFEs**).

Legal obligations differ from one category to another.

Director of Supervision, Angus Dale-Jones, says: "These proposals are relevant to thousands of people working in the financial sector, affecting all businesses that give recommendations, opinions or advice about investments, insurance or credit products. The key objective is to promote high standards of professionalism and integrity for all financial advisers."

For a copy of the paper, go to [www.seccom.govt.nz](http://www.seccom.govt.nz)

## **International financial crisis group makes recommendations**

*The Financial Crisis Advisory Group (FCAG) has published its recommendations relating to financial reporting and standards setting.*

The FCAG was set up in December 2008 by the International Accounting Standards Board and the United States Financial Accounting Standards Board to advise the boards about standards setting implications of the global financial crisis, and potential changes to the global regulatory environment. New Zealand Securities Commission chair Jane Diplock is a member.

Ms Diplock says that *"the report highlights the importance to financial stability of high quality accounting standards, faithfully applied with rigorous independent audit. This is critical to restoring market confidence and ensuring economic growth"*.

The report sets out the following four principles in standard setting:

- effective financial reporting;
- limitations of financial reporting;
- convergence of accounting standards; and
- standards-setter independence and accountability,

and emphasises the need for a uniform set of internationally recognised accounting standards.

The group will meet in December to review progress made on its recommendations.

## **Capital Market Development Taskforce identifies big issues ahead**

*The Capital Market Development Taskforce has released a progress report identifying issues facing New Zealand's capital markets.*

In its interim report, made in November 2008, the taskforce made a number of recommendations to Government aimed at reducing costs while increasing the speed of accessing capital for New Zealand firms. Most of the proposals have now been implemented.

The July 2009 progress report outlines the framework the taskforce adopted to analyse the capital markets, the intended shape of its final report, and its views of the major issues facing New Zealand's capital markets.

Rob Cameron, the Taskforce chair, says that our poor performing capital markets are caused by a number of factors, including:

- low levels of investment in capital markets products;
- a large number of co-operative, government-owned, and foreign-owned companies that choose not to participate in New Zealand's capital markets; and
- market practices and financial adviser markets undermining investor returns.

The Taskforce is on track to provide its final report by the end of this year. To view the July progress report, go to [http://www.med.govt.nz/templates/MultipageDocumentTOC\\_\\_\\_\\_41676.aspx](http://www.med.govt.nz/templates/MultipageDocumentTOC____41676.aspx)

## **Inquiry into finance company failures**

*The Commerce Commission has set up terms of reference for its enquiry into finance company failures.*

Over the past three years, around 30 finance companies have gone into receivership or liquidation, entered into moratoria, or frozen repayments to investors. The Commerce Commission has agreed to conduct an enquiry into these failures.

Hon Lianne Dalziel says, "the committee ... wishes to focus on issues that do not appear to have been identified within current work programmes, and on particular issues which may benefit from the scrutiny a select committee can bring to bear".

The four broad areas identified are aimed at ensuring:

- investors are well-informed about investment proposals;
- investors understand the implications of a moratorium proposal before voting;
- advance actions can be taken to reduce the chances of failure; and
- adequate measures for redress exist when failures occur.

Based on these areas, the committee has set the following terms of reference for the enquiry:

- To examine the quality of information provided to investors when considering an investment decision and investors' ability to understand financial matters.
- To examine the quality of advice provided to investors in moratorium situations, including independent analysis of moratorium versus receivership and the independence of the management of the moratorium.
- To examine ways of minimising the chances of situations arising where the risk of failure is not adequately reflected in the risks identified to investors or the returns investors expect to receive for that level of risk.
- To examine the measures in place that provide redress to investors where failure occurs and wrongdoing is established, particularly whether these measures act as a significant disincentive for wrongdoing to occur.

The committee has made a call for written submissions on the terms of reference, with a closing date of 15 October 2009.

## Financial reporting surveillance programme – Cycle 9

*The Securities Commission continues to find inadequacies in matters previously referred to issuers.*

In Cycle 9, the Commission reviewed financial statements of 24 issuers with balance dates between March and December 2008, and found that issuers need to pay particular attention to the following when preparing their financial statements:

- impairment of assets and the associated disclosures;
- disclosure of significant assumptions relating to valuation of investment properties;
- disclosures relating to financial instruments; and
- disclosure of significant judgments, key assumptions and major sources of estimation uncertainty.

In addition, the following matters were identified as requiring attention:

- changes in, or review of, funding arrangements;
- the impact on classification of debt and the going concern assumption; and
- related party information, particularly key management personnel compensation (including directors).

## **Companies Office blog**

*The Companies Office has launched a blog site.*

The blog is seen by the Companies Office as a more contemporary way to engage with its clients and another tool to communicate with its client base, sitting alongside the Companies Office website, Contact Centre, the *Business Update* newsletter, *Facebook* and its *Twitter* presence.

Go to <http://blog.companies.govt.nz> to view the blog.

## Bell Gully news

### [Sir Peter Blake leadership legacy recognises inspiring Bell Gully partner](#)

Bell Gully partner Rachel Paris has been named as the youngest recipient in this year's prestigious Sir Peter Blake Leadership Awards.

### [Clear signals for future capital markets change – and more quick fixes now](#)

The taskforce charged with boosting New Zealand's capital markets and making it easier for business to raise capital has released further quick fixes and views on issues for long-term change.

### [New tax and litigation lawyers for Bell Gully](#)

Bell Gully has made four new appointments to its legal team in Auckland, including two new senior associates.

## Useful Web links

### *New Zealand Government*

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

### *New Zealand financial agencies and organisations*

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

### *New Zealand commercial sites*

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

### *Australian Government sites*

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

### *Australian commercial sites*

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

### *International sites*

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