

Consultation paper: Charities raising funds through debt securities

The Financial Markets Conduct Act 2013 (FMC Act) requires organisations offering debt securities to disclose certain information and to have a licensed supervisor.

Currently, registered charities whose total planned or existing debt is \$15 million or less, are exempt from similar requirements under the Securities Act 1978, which lowers their compliance obligations.

This current charities exemption is due to expire on 30 November 2016. We are reviewing whether similar relief should be given under the FMC Act.

We propose that no exemption be granted to charities issuing debt securities, and to subject them to standard FMC Act requirements.

We would like your feedback on our proposal.

About this consultation:

This consultation is for:
charities, their advisors and the
public

It aims to:
seek feedback on whether charities issuing debt should be
exempted from FMC Act requirements

Next steps

The current Securities Act exemption expires on 30 November 2016. We plan to announce our decision in December 2015 to give affected charities time to transition into, and to comply with, any new obligations.

Submissions close on 5 November 2015. The form at the back provides more details.

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Document history

This version was issued in September 2015 and is based on legislation as at the date of issue.

FMA document reference code 2641023

Overview and summary of proposed approach

1. The Securities Act (Charity Debt Securities) Exemption Notice 2013 (Charity Debt Exemption Notice) expires on 30 November 2016. It exempts registered charities offering debt securities to the public from certain requirements under the Securities Act 1978.
2. Although the Securities Act has been repealed, transitional provisions in the FMC Act have the effect that the Charity Debt Notice continues to apply until its expiry.
3. The FMC Act now governs how financial products are offered, promoted and sold. It also governs ongoing responsibilities of those who offer, deal and trade in financial products. We propose not to recommend a similar exemption under the FMC Act. Our reason is we do not see a further exemption for standard debt offers as necessary or desirable to promote the purposes of the FMC Act. We think debt offers should be subject to FMC Act requirements irrespective of who is making the offer.
4. Interested parties may still wish to submit on whether any special features of particular fundraising arrangements by charities mean they should not be subject to standard regulation under the FMC Act bearing in mind the purposes of the FMC Act.
5. It is important to remember donations are not subject to FMC Act obligations. Also, charities issuing debt securities may come within some of the statutory exclusions from FMC Act obligations set out in Schedule 1 of the FMC Act. The schedule 1 exclusions most relevant to charities are the small offers, wholesale investors, and crowd-funding and peer-to-peer lending exclusions.
6. Before making a decision, we welcome submissions and input on the questions below.

Existing exemption

7. Under the [Charity Debt Exemption Notice 2013](#), charities issuing debt securities are exempt from certain securities law requirements.
8. This exemption expires on 30 November 2016. Without a further exemption or transitional relief, charities offering debt securities must comply with FMC Act requirements from 1 December 2016, unless they fall within the specific statutory exclusions in schedule 1 of the FMC Act.
9. The appendix has details about the Charity Debt Exemption Notice.

Debt issuer obligations under the FMC Act regime

10. Charities offering debt securities without an FMC Act exemption, or which do not come within any statutory exclusion, will from 1 December 2016 have to comply with disclosure and governance obligations of the FMC Act and may have higher standards of financial reporting.
11. Charities offering debt securities will be required to:
 - register a product disclosure statement (PDS) and enter other material information in the Disclose Register (an online register) (Part 3 of the FMC Act)
 - have a trust deed and a licensed supervisor to manage the deposits (part 4 of the FMC Act)
 - prepare and file financial statements that comply with the top tier of generally accepted accounting practice (for example, in accordance with public benefit entity standards for not-for-profit entities)
 - have their financial statements audited by a licensed auditor (part 7 of the FMC Act).
12. If charities do not wish to comply with these obligations, and if they do not fall within the schedule 1 exclusions discussed next, they will have to stop offering debt, and repay existing debt (unless the FMA grants an exemption). We discuss below a transitional proposal for charities ceasing to offer debt securities.
13. A donation of money, where the donor has no right to be repaid the money, is not a debt security. [FMC Act requirements do not apply to donations](#). This review has no impact on donations.

Schedule 1 exclusions

14. There are no exclusions in the FMC Act specifically for charities. However, some schedule 1 exclusions that provide relief from the standard disclosure, governance and financial reporting requirements may be relevant to some charities. These include the exclusions for:
 - small personal offers if the offeror has 20 or less investors and raises \$2 million or less in any 12-month period (small offers exclusion, schedule 1 clause 12 FMC Act)
 - offers to wholesale investors; there are different categories of wholesale investor (wholesale investor exclusion, schedule 1 clause 3 FMC Act)
 - offers of debt or equity securities through peer-to-peer lending or crowd-funding services (offers of financial products through licensed intermediaries exclusion, schedule 1 clause 6 FMC Act). The maximum that can be raised under this statutory exclusion is \$2 million in any 12-month period for existing and new offers (combined with any offers made under the small offers exclusion).

15. You can find more information on schedule 1 exclusions [here](#).

Proposed approach

16. The FMA may grant exemptions for up to five years when necessary, or desirable, to promote one or more of the purposes of the FMC Act. An exemption can be no broader than what is necessary to address the matters that gave rise to the exemption. While investors lending to a charity may wish to support the charitable cause, we can only grant an exemption if it promotes the purposes of the FMC Act, and we cannot take into account investors' motivations.
17. The main purposes of the FMC Act are to:
 - promote confident and informed participation of businesses, investors, and consumers in the financial markets, and
 - promote and facilitate the development of fair, efficient, and transparent financial markets.
18. The Act's additional purposes are to:
 - provide for timely, accurate and understandable information to help people make decisions about financial products and financial services
 - ensure financial products and certain financial services have proper governance structures that would allow for effective monitoring and governance risk control
 - avoid unnecessary compliance costs
 - promote innovation and flexibility in the financial markets.

Proposal: no exemption for charities

19. We think there are good reasons for charities offering debt to provide the same protections to investors as other debt issuers, particularly FMC Act disclosure and governance obligations, and to be subject to the same scrutiny.
20. FMC Act requirements ensure investors are well informed about debt offers and issuers' conduct meets a minimum standard. PDSs and the additional information available on the Disclose Register help investors make informed investment decisions. Governance obligations, among other things, require that a supervisor is appointed to act in the interest of the investors. The FMC Act imposes statutory duties of care on licensed supervisors, provides for accountability and builds investor confidence. Some of the disclosure information required by the FMC Act is not available from other sources. Further, the governance requirements are not required under other legislation. Debt issuers subject to the FMC Act have high standards of financial reporting and must have a licensed auditor.
21. Although an exemption could potentially be granted from financial reporting obligations in the FMC Act, charities have financial reporting obligations under charities law. Charities law requires registered charities to meet certain standards of financial reporting and to have financial statements audited or reviewed. Any FMC Act exemption would not therefore significantly reduce financial reporting obligations. For more information, see the Charities Services website [here](#).
22. It is not readily apparent how exempting charities issuing debt from disclosure and from having a licensed supervisor and financial reporting would promote the FMC Act purpose of fair, efficient and transparent financial markets. Our view is we should take a consistent approach to regulating the offer of similar types of financial products by different market participants. We also think investors lending to a charity should be entitled to the same protections as they would have with any other investment.

23. Charities have ways to raise funds without having to comply with FMC Act obligations. Some charities may be able to take advantage of the specific statutory exclusions in schedule 1 of the FMC Act set out above. In addition, donations are not subject to the FMC Act. If a person wishes to support a charity, and does not expect to receive interest or to have their capital returned to them, then they have the option of donating.
24. Charities seeking the benefit of an exemption would often be raising more than \$2 million in debt. This is because charities raising less than 2 million may be able to structure an offer within the \$2 million limit applying to the small offer and licensed intermediaries statutory exclusions. A debt issue of over \$2 million is a significant amount of debt and such offers should be subject to FMC Act requirements.
25. Other considerations are listed below.
 - The new FMC Act rules require a more investor-focused and concise approach to offer information. This may be easier for charities to comply with.
 - Giving an exemption would mean little oversight of the debt security fundraising activities of charities.
 - Higher-than-usual risks might exist because in an effort to keep costs low, charities might have fewer systems and processes in place than other types of organisations.
 - Some charities may offer rates and terms that are similar to those offered by retail banks. These types of opportunities are likely to be viewed as investments by the participants, rather than opportunities to support the charitable cause.
 - Even if a loan is interest-free, the investor's capital is still at risk, and so the protections of the FMC Act are appropriate.
26. Factoring all of the above, our view is that charities that are not able to take advantage of the statutory exclusions should be subject to the standard disclosure, governance and other requirements of the FMC Act. However, we will carefully consider all submissions before reaching a final decision.
27. One idea raised with us is to provide a limited exemption for charities. This involves debt issues that do not have an investment element to them, where people lending money to a charity are motivated by charitable purposes and will not receive any return on their loan, other than repayment of the original investment.
28. We think the same considerations already discussed apply to this arrangement. Even with limits on the amount a charity can raise, or each investor can place with the charity, such arrangements still place the lender's capital at risk, and FMC Act disclosure and governance requirements are appropriate.
29. However, we invite feedback on whether there are any particular charitable fundraising arrangements that you consider should not be subject to the standard regulation under the FMC Act, bearing in mind the purposes of the FMC Act.

Transition relief for existing debt securities

30. The current exemption is effective until 30 November 2016 (unless a charity opts into the FMC Act rules earlier). It may be appropriate to provide transitional relief if we do not grant a further exemption, or if we grant an exemption on more restricted terms.
31. Our view is, generally, new debt offers should be subject to the new FMC Act rules. Investors are likely to benefit from a higher level of reporting, and be assured that good governance is in place.
32. An exemption could however be given for existing debt issued under the Securities Act exemption. This is because those who have lent money knowing that the extra level of information and governance is not provided, may be prepared to continue lending on that basis.

33. However, for debt continuing for a longer term, we think investors are best protected if the FMC Act rules apply to it. Another possible approach to transitional relief is to offer relief for existing debt under the Securities Act exemption, but to subject new debt offers to FMC Act requirements. With this option, charities with different obligations for existing and new debt might have increased compliance costs.
34. Taking all these issues into account, we propose exempting existing debt from ongoing FMC Act requirements if the charity ceases to offer new debt. We also propose this transitional relief is subject to a condition that all existing debt is repaid within a reasonable time. We are proposing a period of five years, and would like submissions on whether five years is a reasonable time to repay all existing debt.

Time to comply if no further exemption is given

35. Charities that have been relying on the current exemption will need time to comply with the new requirements if we do not grant an exemption. We propose that charities intending to continue to offer new debt should not qualify for any transitional relief. This means they will need to comply for their new and existing debt offers.
36. We plan to announce a final decision by December 2015. The current exemption ceases to have effect on 30 November 2016, leaving one transition year to comply for debt offers that do not come within any exemption.

Questions for submitters

No exemption

1. Do you agree that generally charities issuing debt should be subject to the same FMC Act requirements as other persons and organisations offering debt? If you disagree, please state reasons for your view. Explain how any general exemption for charities would promote the purposes of the FMC Act, and justify the risks raised by relief from standard disclosure, supervision and financial reporting requirements.
2. Do you agree the schedule 1 exclusions are likely to cater to the majority of circumstances where charities might seek to raise money through debt securities issue? If not, which circumstances do you think would not be covered?

Grounds for any limited exemption

3. If you think exemptions should be granted, what FMC Act obligations do you think charities offering debt should be exempt from, and why? The new obligations would be:
 - disclosure: product disclosure statements and information provided for the register
 - governance: a trust deed and licensed supervisor
 - financial reporting and auditing: generally there are higher standards for entities offering debt.
4. What features and limits would be appropriate to ensure any exemption gives effect to the purposes of the FMC Act?

Transitional issues

5. What are the transitional issues if an exemption is not granted?
6. What is a reasonable period for repayment of debt if there is to be transitional relief? Is five years too long or too short a period?

Other issues

7. Do you have any other comments?

The next step

How do I make a submission?

Please use the form on the next page which details what you need to do. Forms must be submitted electronically in both PDF and MS word formats and emailed to consultation@fma.govt.nz. Please put 'Charities raising funds through debt securities: your organisation name' in the subject line.

Submissions close on Thursday 5 November 2015.

Where can I get more information?

You'll find more information on our website www.fma.govt.nz.

If you have questions about the consultation process, please get in touch on 0800 434 567.

Feedback: Charities raising funds through debt securities

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Feedback on Charities Raising Funds by Debt Securities: your organisation name' in the subject line. Thank you. **Submissions close on Thursday 5 November 2015.**

Date: _____ Number of pages: _____

Name of submitter: _____

Company or entity: _____

Organisation type: _____

Contact name (if different): _____

Contact email and Phone: _____

Paragraph or Question Number	Comment	Recommendation
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You don't need to quote from the consultation document if you use part & paragraph numbers.

You may attach extra pages - please label each page with your name & organisation.

Feedback summary – if you wish to highlight anything in particular

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.

Appendix

The Securities Act (Charity Debt Securities) Exemption Notice 2013

The current Charity Debt Exemption Notice was issued under the Securities Act 1978 (which is now repealed). The Notice exempts registered charities that offer debt securities from the following Securities Act requirements:

- to appoint a licenced trustee to supervise the debt securities and to have a trust deed that sets out the powers and duties of the trustee
- to disclose prescribed information about the debt securities in a registered prospectus, and to give each investor an investment statement before they subscribe
- for the directors to review and sign off every advertisement about the securities.

The charity must comply with these conditions to rely this exemption:

- The charity must give an 'information document' to prospective investors. The document must include:
 - a warning that the offer is not subject to securities law requirements for offer document and independent supervision
 - risks may not be as fully disclosed as they would be in a standard offer document
 - the FMA has not examined the offer
 - limited key information that is usually required in an investment statement such as descriptions of the risks and returns, the terms of the offer, and any other information material to the offer.
 - exemptions from the normal requirements have been granted on the basis that investors in charities are not necessarily seeking a commercial return but wish to support the organisation.
- The amount of debt securities already owing and the amount being offered by the charity must not total more than \$15 million.
- Charities must notify us of their intended reliance on the Charity Debt Exemption Notice and provide certain information annually to the FMA.

The \$15 million upper limit applies to religious charities from 1 April 2015.

At the time this exemption was granted we said a fresh review would take place for any further exemptions under the new FMC Act regime.

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