Productivity Commission Inquiry into Regulatory Institutions and Practices

Case Study: Regulation of the financial sector

February 2014

I Introduction

1. The Government has asked the Productivity Commission to review and make recommendations on how to improve the design and operation of regulatory regimes in New Zealand. As part of the Productivity Commission's review, the Terms of Reference for the review require the Commission to undertake a series of case studies aimed at comparing and contrasting institutional arrangements and regulatory practices across different regulatory regimes. These case studies are intended to provide insights into regulatory design and process to assist in the Commission's review.

2. The Commission has decided that one of these case studies should focus on the regulatory arrangements applicable to the financial sector.

3. This case study relates to the regulatory framework in the financial sector. It covers:

    - an overview of the financial sector and the regulatory arrangements applicable to it;
    - a brief summary of recent reforms to the financial sector regulatory framework and the main drivers of those reforms;
    - an overview of key features of the financial sector regulatory architecture, including the governance and transparency arrangements of the main regulators;
    - coordination arrangements between regulators; and
    - a summary of issues raised in discussions with stakeholders, as part of the preparation of this case study.

4. The case study concludes with some key findings.

5. Appendices attached to this paper provide further details on elements of the regulatory arrangements in the financial sector.

6. The case study was prepared having regard to information on financial sector regulation released by the regulators, applicable international standards and codes, and a range of other relevant information, including published Cabinet papers relating to financial sector reforms.

7. An important element in the case study was discussion with a range of stakeholders to seek their views on a number of key issues relating to financial sector regulation. The list of entities and persons interviewed is attached in Appendix 1.

8. The issues discussed with stakeholders included:

   - the regulatory architecture in the financial sector – including the allocation of responsibilities to particular regulatory agencies;
   - the cost-effectiveness of regulation in achieving statutory objectives;
   - compliance costs, efficiency costs and administrative costs of regulation;
   - the quality of the regulation-making process, including issues relating to consultation and the cost/benefit analysis of regulation;
   - coordination between regulators;
   - governance, transparency and accountability arrangements applicable to regulators, including regulator performance assessment; and
   - the avenues available to regulated entities to seek to have regulatory decisions reviewed by an independent party.

9. A summary of views provided by stakeholders is included in the case study. For confidentiality reasons, the views of individual entities or persons are not disclosed.

10. Consistent with the Terms of Reference for the Productivity Commission's review, the case study does not include an evaluation of, or recommendations in relation to, particular regulations or regulators. Nor does it assess the extent to which the New Zealand regulatory frameworks are in compliance with relevant international standards and codes. These considerations are out of scope for the Productivity Commission review and therefore this case study. Rather, the focus of this case study is on the broader regulatory architecture of the financial sector and the regulation-making process, and the possible scope for improvements to regulatory arrangements at a general level.

II Overview of the financial sector

Main functions of the financial sector

11. The financial sector is a critically important part of the New Zealand economy and society. It performs functions that are essential to a modern, efficient and sound economy, including:

   - the intermediation between those with funds to invest and those seeking access to funds;

- a repository for savings in a wide range of forms, including bank deposits, bonds, equities, managed funds and superannuation schemes;

- investment of wealth and the management of associated risks;

- facilitation of payments and settlement of transactions, both in domestic and foreign currency;

- provision of credit and liquidity;

- provision of products and services to assist in the management of financial and other risks; and

- the allocation of resources within the economy.

12. By their nature, these functions are critical to the economy. A sound, resilient and efficient financial sector is one of several prerequisites to sustainable and balanced economic growth, and to the economic and social welfare of society. In contrast, a financial sector that is unstable and/or inefficient is likely to weaken the economy, making it more vulnerable to economic and financial shocks, suppress the average trend rate of growth over the longer term, and potentially create or exacerbate economic and fiscal imbalances in the economy. As seen in the global financial crisis, and in many national or regional financial crises in earlier years, acute or protracted instability in the financial system can have severe, far-reaching and long-term economic and social costs.

13. It is for these reasons that regulation of the financial sector seeks to promote financial system stability, resilience to economic shocks, efficiency in the performance of financial system functions, integrity of markets, and a reasonable degree of protection of users of the financial system.

Main components of the financial sector

14. The financial sector is a complex structure comprising three main components:

- ***Financial institutions*** - entities, such as companies and other legal vehicles, which perform a range of financial functions, including banking, insurance, securities trading, wealth management and financial advisory services.

- ***Payment and settlement systems*** – systems that enable financial institutions and their customers to transfer value and settle financial obligations.

- ***Financial markets*** – institutional arrangements that enable financial instruments to be traded between buyers and sellers.

15. The table below provides an overview of these three main components of the financial sector and their respective functions.

Table summarising main components of the financial sector

Financial institutions	Functions
Financial intermediaries	
Registered banks - retail, wholesale and multi-purpose. These are licensed and supervised by the Reserve Bank of New Zealand (RBNZ). ***Non-bank deposit-takers (NBDTs)*** - retail-funded finance companies, building societies and credit unions. These are regulated by the RBNZ and supervised by trustee corporations which are in turn supervised by the Financial Markets Authority (FMA). ***Other providers of credit, and wholesale deposit-taking or bond issuance*** – eg non-retail-funded finance companies and investment companies. These are overseen by the FMA to the extent they are public issuers.	Functions include: • deposit-taking; • issuance of bonds and certificates of deposit; • intermediation of funds; • provision of credit and liquidity; • provision of payments services; • provision of financial risk management services, such as currency and interest rate hedges; and • wealth management.
Insurers/reinsurers	
General insurers. These are licensed and supervised by the RBNZ.	Functions include: • insurance for property risk; • income protection insurance; • reinsurance (in some cases); • business-related insurance; and • public liability insurance.
Life insurers. These are licensed and supervised by the RBNZ.	Functions include: • provision of life insurance; • investment products; and • some forms of superannuation.
Superannuation schemes	
These are overseen by the FMA.	Functions include: • provision of defined contribution schemes, including Kiwisaver schemes; and • provision of defined benefit superannuation schemes, generally being confined to employer-based schemes.
Providers of managed funds.	
These are overseen by the FMA if public issuers.	Functions include:

	• provision of wealth management and funds management services.
Other categories of financial service providers	
Securities and investment firms. These are overseen by the FMA.	Functions include: • the buying and selling of listed equity, debt and other securities; • the management of initial public offerings of equity and debt securities; and • the provision of financial advisory and wealth management services.
Financial advisers. These are licensed and overseen by the FMA.	Functions include: • the provision of advice on financial products and saving and investment options.
Trustee corporations. These are licensed and supervised by the FMA.	Functions include: • the provision of trustee services for various trust accounts; • the supervision of NBDTs; and • the performance of supervision functions via trust deed requirements for entities which offer debt securities, unit trusts, KiwiSaver default schemes or participatory securities to members of the public.
Payment and settlement systems	**Functions**
Exchange Settlement Account System (ESAS) – Operated by the RBNZ.	Real time gross settlement – for the settlement of large-value inter-bank transactions.
NZ Clear – Operated by the RBNZ.	Provides a range of services for member entities (mainly banks and large corporates), including: • delivery-versus-payment settled real time for a range of financial instruments (including certificates of deposit, bonds and equities); • transfers of financial instruments; • transfers of cash; • foreign exchange transaction confirmations; and • an electronic tender facility.
Paper Clearing System – overseen by Payments NZ Limited and subject to oversight by the RBNZ.	Provides a system for exchanging paper-based payments, such as cheques.

Bulk Electronic Clearing System – overseen by Payments NZ Limited and subject to oversight by the RBNZ.	Provides a system for exchanging large-volume low-value electronic payments, such as direct debits, direct credits and automatic payments.
High Value Clearing System – overseen by Payments NZ Limited and subject to oversight by the RBNZ.	Provides a system for exchanging high-value payments via real time settlement in ESAS.
Consumer Electronic Clearing System – overseen by Payments NZ Limited and subject to oversight by the RBNZ.	Provides a system for exchanging payments electronically, mainly of a retail nature – eg EFTPOS and Paymark.
Financial markets	**Functions**
Capital markets, including for: • equities; • bonds and other debt instruments; and • exchange-traded funds. Most exchange-traded financial instruments in New Zealand are listed and traded on the New Zealand stock exchange – NZX. Entities that issue equities, bonds and other financial instruments which are listed on the NZX are subject to the rules specified by the NZX. The FMA has supervisory responsibilities in relation to the NZX.	Provides markets for raising funds via equities, debt and hybrid financial instruments. Provides markets for buying, selling and pricing equity, debt and other financial instruments.
Money markets	Provides an infrastructure for short-term debt financing and investment – eg between banks and large corporates.
Derivatives markets, including: • interest rate and exchange rate swaps; and • interest rate and exchange rate options.	Provides the means by which some types of financial risks can be managed – eg interest rate and exchange rate risks.
Futures markets. These are subject to oversight by the FMA.	Provides standardised forward contracts for products traded at a future date – eg interest rate, exchange rate and commodity instruments.
Foreign exchange market	Provides a market for exchanging one currency for another at spot or forward prices.

16. Although New Zealand's financial system is small by world standards, it is nonetheless a substantial proportion of the New Zealand economy. As at 30 June 2013, for example, total financial system assets were stated by the RBNZ to be $514 billion (which excluded the assets of general insurance companies and some other categories of financial

institution). Of this total, $413 billion was held by registered banks, $14 billion by non-bank lending institutions and $87 billion by funds under management[1]. Total financial system assets represented over 240% of New Zealand's GDP. This places New Zealand broadly in the middle of the range of OECD countries in terms of the size of the financial system relative to the size of the economy. It reflects that New Zealand, while small, has a relatively advanced economic infrastructure in which most economic activity relies in one way or another on some aspect of the financial system, and where most economic transactions are conducted through banking and payment channels.

Legal framework of the financial sector

17. The financial sector, like many other parts of the economy, operates within a complex structure of statute law, case law, regulations, administrative rules set by regulators, bilateral contracts set by industry participants, and various forms of multilateral agreements between parties. These are briefly summarised below.

Statutes

18. Statutes enacted by the New Zealand Parliament provide the foundational legal framework within which the financial sector operates. They include statutes that provide the legal forms which entities may take in order to conduct business, the powers available to such legal entities to enter into contracts of various kinds and the rules governing their activities.

Statutes not unique to the financial sector

19. Most statutes are not unique to the financial sector, but nonetheless provide essential foundations for the operation of many financial institutions and the conduct of business in the financial sector. These include the *Commerce Act 1986*, *Companies Act 1993*, *Consumer Guarantees Act 1993*, *Contracts Enforcement Act 1956*, *Fair Trading Act 1986* and *Financial Reporting Act 1993*.

Statutes specifically applicable to the financial sector

20. A number of statutes are specifically applicable to the financial sector and prescribe, among other matters:

- the organisational form a financial institution may take and requirements in relation to that organisational form (eg as with credit unions and building societies);
- rules for the conduct of specific types of financial business;
- requirements for specified types of financial businesses to be registered or licensed;
- a legal framework for the monitoring and supervision of specified financial businesses, and for the specification of prudential or market conduct requirements applicable to such entities; and

[1] Source for financial system asset data is the RBNZ *Financial Stability Report* published in November 2013.

- a legal framework establishing regulators and providing them with the powers required to perform their assigned functions.

21. The main statutes relevant to the financial sector are listed in Appendix 2, together with a brief description of the purposes of each statute.

Regulations

22. Many statutes empower the making of regulations to set out more detailed requirements that are too technical in nature or too prone to the need for periodic change to be included in statute. A number of the statutes of particular relevance to the financial sector, including the *Insurance Prudential Supervision Act 2010*, the *Reserve Bank of New Zealand Act 1989*, and the *Securities Act 1978*, to name just a few, contain regulation-making powers that have been used to promulgate regulations which set out specific requirements for various categories of financial institution.

23. The regulations provide relatively detailed and technical rules applicable to many aspects of financial sector activity, including the nature of permissible activities which can be performed by financial institutions, the rules relating to how specific financial services may be provided, and the prudential and market conduct requirements to be complied with by financial institutions.

Case law

24. Case law provides a further aspect of the legal framework within which the financial sector operates. The courts play an important role in interpreting and making rulings on statute and regulation, as well as contractual and other arrangements. Case law influences what kinds of financial services may be provided, who may provide them, the means by which particular services or functions may be conducted, and the rights and obligations of the respective parties to particular types of services or functions.

Regulatory requirements made administratively by regulators

25. Financial sector regulators provide a further element of the legal framework within which the financial sector operates by prescribing requirements through their administrative powers. For example, one of the regulatory agencies – the Reserve Bank of New Zealand (RBNZ) – has wide-ranging powers under its empowering statutes (eg the *Reserve Bank of New Zealand Act 1989* and the *Insurance Prudential Supervision Act 2010*) to specify prudential requirements for the financial institutions it licenses and supervises, such as registered banks and insurers. The Financial Markets Authority (FMA) imposes a range of market conduct requirements through administrative powers on the entities over which it has regulatory responsibility, such as public issuers of securities, trustee corporations and auditors.

International standards and codes

26. Increasingly, financial sector regulation in New Zealand and in all OECD countries is being influenced by international standards and codes set by the international standard-setting bodies. There has been a proliferation of international standards in the last 10

years or so, and especially since the global financial crisis of 2007 to 2010. Although the standards are not legally binding on countries, there is considerable, and increasing, pressure for countries to comply with the standards. That said, there is some discretion as to the precise form by which the standards may be applied in each country, depending on the nature of its financial system, regulatory frameworks and policy objectives.

27. New Zealand, like all OECD countries, is periodically assessed for its compliance with international standards and codes. The last formal assessment was made by the International Monetary Fund (IMF) in 2003, when it conducted a Financial Sector Assessment Programme (FSAP) assessment of New Zealand.

28. The main standard-setting bodies relevant to the New Zealand financial sector are set out below. In most cases, the standard-setting bodies are affiliated to the Bank for International Settlements and are generally governed by the financial authorities of the jurisdictions which are members of the G20.

- The ***Financial Stability Board (FSB)***, which oversees global financial stability issues and sets the international standard for financial crisis resolution. It also provides guidance on various other financial sector regulatory issues, including risk management, risk culture and macro-prudential supervision issues.

- The ***Basel Committee on Banking Supervision (BCBS)***, which sets the international standards for banking regulation, such as the standards relating to banking supervision, capital adequacy and liquidity, and guidance on stress testing, macro-prudential supervision and bank governance issues.

- The ***International Association of Insurance Supervisors (IAIS)***, which sets the international standards for insurance regulation and supervision.

- The ***International Organisation of Securities Commissions (IOSCO)***, which sets the international standards for securities market regulation.

- The ***Financial Action Task Force (FATF)***, which sets anti-money laundering standards;

- The ***Committee on Payment and Settlement Systems (CPSS)***, which sets the international standards for payment and settlement systems.

29. As discussed in the next section of this paper, financial sector regulation in New Zealand has grown substantially in recent years and plays an increasingly important role in determining the parameters within which financial services and functions may be provided, the terms on which they are provided, who may provide them, and the requirements these providers must meet in order to be permitted to perform specified services or functions. Much of this growth in regulation has occurred in the context of the proliferation and increasing influence of international standards and codes.

Contractual arrangements and agreements

30. Contracts between financial institutions and their customers, and between financial institutions, also play a key role in the functioning of the financial sector. Most financial

services and functions are governed by contractual or industry agreements of one kind or another. In turn, these operate within the parameters set by relevant statutes, regulations, case law and regulator administrative requirements.

31. Most contractual agreements are generally of a bilateral nature – ie between two parties (eg a bank and its customer or an insurer and its customer). However, there are also many contractual arrangements which take the form of multilateral agreements between several parties, such as the contractual arrangements which underpin several parts of the payment system (eg as with the contractual arrangements between Payments NZ Limited, affiliated payment systems and participants).

III Overview of financial sector regulatory arrangements

32. This section of the paper provides a summary of the financial sector regulatory framework in New Zealand, including recent changes made to financial sector regulation.

Objectives of regulation

33. Regulation of the financial sector in New Zealand, like regulation of financial sectors in other OECD countries, takes a number of forms and seeks to meet a number of objectives. At a general level, regulation of the financial sector in New Zealand seeks to promote:

- a stable financial system that is resilient to economic and financial shocks;
- financial institutions which conduct their business prudently and, at least in the case of systemically important financial institutions, have a low probability of default;
- the resolution of financial institution distress in ways that minimise adverse impacts on the financial system and seek to protect key users of the financial system, such as depositors and policyholders, from loss (but not to necessarily insulate them from loss);
- an efficient financial system – ie a financial system which:
    - is contestable and competitive;
    - produces cost-effectively the financial services and products that financial system users want;
    - is dynamically efficient (flexible and adaptive to changing circumstances); and
    - facilitates an efficient allocation of resources, based on sound risk assessment and pricing;
- market integrity, including a financial system which is effective in detecting and preventing financial crime;
- a financial market which is accessible, transparent and fair for its users; and

- a reasonable level of protection for users of the financial system, especially depositors in banks, insurance policyholders and retail investors.

34. In addition to these objectives, financial sector regulation is also intended to *avoid* certain outcomes. In that regard, regulatory policy generally seeks to avoid or minimise:

    - moral hazard risks – ie the risk that regulation could induce financial institutions to take greater risks than they otherwise would as a result of a perceived or actual presumption that the government will come to their rescue if they get into difficulty;

    - fiscal risks, such as implicit or explicit guarantees from the taxpayer;

    - excessive compliance costs for regulated entities;

    - unintended and undesirable distortions to market activity;

    - unnecessarily high hurdles for entry into the financial system and impediments to competition;

    - a non-neutral regulatory treatment of financial institutions that provide the same or similar services;

    - dilution of market discipline on financial institutions; and

    - reduced incentives for, or unnecessary impediments to, financial innovation.

35. Striking the right balance in regulation to meet all of the desired objectives and avoid or minimise the economic and social costs of misguided regulation is a major challenge. As noted in this paper, many of the stakeholders interviewed in the course of preparing this case study are of the view that New Zealand has yet to get the balance right, and that further improvements in regulatory architecture and in the quality controls around regulation-making are required.

Types of regulation

36. Different types of regulation are designed to meet one or more of the above objectives. Generically, the main types of regulation are:

    - ***Financial service registration.*** This is a requirement that all providers of defined types of financial services and products must be registered by a regulatory authority. It seeks to ensure that all such financial service/product providers are identified and meet minimum integrity requirements (such as key personnel not having serious criminal records). The financial service registration function of the Ministry of Business, Innovation and Employment (MBIE) performs this function.

    - ***Prudential regulation and supervision.*** Some categories of financial institution are required to be licensed and prudentially regulated and supervised. These are

mainly those financial institutions whose business is systemically important and/or where they enter into financial contracts with their customers which involve repayment of fixed amounts (eg as with deposits and some kinds of insurance), such as banks and insurers. Prudential regulation and supervision is designed to promote the prudent management of financial institution risks in order to achieve a low probability of institutional default, minimise contagion risk, and enable the regulators to resolve distress in a manner that minimises damage to the financial system. It also seeks to protect depositors, policyholders and some other categories of creditors, but not to completely insulate them from risks. The RBNZ is the prudential regulator and supervisor.

- ***Market conduct regulation and supervision.*** This involves the licensing, regulation and supervision of financial service providers who provide services or products to the public. This form of regulation seeks to ensure that the entities in question meet minimum standards of market conduct to provide some degree of retail investor protection. Examples are the qualification requirements and market conduct rules applicable to financial advisers. The FMA is responsible for market conduct regulation and supervision.

- ***Disclosure regulation.*** Providers of financial products and services to the public are required to comply with financial and product disclosure rules. These seek to promote better-informed financial decision-making by investors, especially retail investors, and to promote market-based incentives for sound risk management by financial service providers. The FMA is the principal regulator of disclosure for public issuers. The RBNZ is the regulator of financial disclosure by banks.

- ***Regulation to detect and prevent financial crimes.*** This involves the regulation and supervision of many categories of financial institutions and other entities to ensure that they comply with market integrity requirements, particularly the requirements relating to anti-money laundering and combatting the financing of terrorism. In New Zealand, there are three regulators in this area: the Department of Internal Affairs (DIA), the FMA and the RBNZ, each with responsibility for their own regulated entities.

- ***Regulation of financial market and financial system integrity and stability.*** This involves the regulation and supervision of some categories of financial systems (eg payment and settlement systems) and markets (eg exchange-listed equity and bond markets) to ensure that they meet requirements relating to system and market stability, integrity and transparency. The FMA is responsible for the regulation of most financial markets, particularly the NZX, and some settlement systems, while the RBNZ is responsible for payment system oversight.

Main changes to financial sector regulation in recent years

37. The last decade has seen substantial changes to the regulatory framework governing the financial sector. In particular, there have been major changes to the regulatory arrangements since 2005, when the government of the day initiated a major review of financial products and providers. These reforms were undertaken in the context of earlier regulatory reforms to the financial sector, including the establishment of fomalised bank

registration and supervision in 1986 and the tightening of securities market requirements, including insider trading laws, in the late 1980s.

38. In summary, the main regulatory changes made in the last decade have included (in chronological order):

- the establishment in 2008 of a requirement for all financial service providers to be registered, administered by MBIE;
- a requirement, first introduced in 2008, for certain categories of financial service providers to be members of approved dispute resolution arrangements;
- the introduction in 2008 of licensing, regulation and supervision of financial advisers, with the FMA as the regulator responsible for this;
- the establishment in 2008 of strengthened prudential regulation of NBDTs and the enactment of legislation in 2013 for the soon-to-be-introduced licensing of NBDTs, under which the RBNZ has responsibility for licensing and regulating NBDTs and trustee corporations have supervisory responsibility for NBDTs;
- the introduction in 2009 of AML regulation and supervision requirements, with the DIA, FMA and RBNZ each acquiring responsibility for AML regulation and supervision in respect of the entities for which they have regulatory responsibility for other purposes;
- the establishment in 2010 of a formalised licensing, prudential regulation and supervision regime for insurers, with the RBNZ as the licensing and supervisory authority;
- the introduction in 2011 of licensing and oversight requirements for auditors, with the FMA being responsible for licensing and supervision;
- the establishment of the FMA in 2011 as the market conduct regulator and supervisor for New Zealand, replacing the former Securities Commission and Government Actuary, and a substantial widening of the regulatory and supervisory powers of the FMA relative to those that were available to the Securities Commission;
- the establishment in 2011 of a licensing and supervisory regime for trustee corporations overseen by the FMA;
- a strengthening in the period 2005 to 2013 of prudential regulation of banks by the RBNZ, including the introduction of modified Basel II and then Basel III requirements, strengthened local incorporation and outsourcing requirements, liquidity requirements and crisis resolution requirements;
- the introduction in 2013 of macro-prudential regulation by the RBNZ;

- proposals introduced in 2013 to tighten the regulatory requirements relating to the provision of credit by lenders, overseen by the Commerce Commission; and

- proposals released in 2013 to establish new statutory powers to facilitate the regulation and supervision of payment and settlement systems by the RBNZ and FMA.

39. These changes have been driven by a number of factors. Key drivers included the following:

- In the latter half of the 1980s and early 1990s, New Zealand underwent a period of significant deregulation. This was especially the case in the financial sector. Deregulation went further in New Zealand than in most OECD countries. In part, this was attributable to the need to unwind the intensive and excessive regulation of the financial sector that was put in place in the early 1980s, which had resulted in New Zealand having one of the most intensively (but unintelligently) regulated financial sectors in the OECD. In part, the deregulation of the mid to late 1980s also reflected a view that regulation was often not a cost-effective means of meeting desired objectives and outcomes, and had the potential to impose major compliance costs and efficiency distortions. A further element of deregulation occurred in the early 1990s with an unwinding of some of the bank prudential supervision framework that had been established in the late 1980s. This unwinding reflected a view by the RBNZ that banking system stability outcomes could be achieved more cost-effectively, and with lower moral hazard risks, by strengthening public disclosure and director requirements for banks, and by reducing the extent of prudential regulation and supervision.

  As a result, by the mid-1990s, the financial sector in New Zealand became one of the least regulated financial sectors in any OECD country. Some of the re-regulation in the last 5 to 10 years reflected a view that the deregulation process had gone too far and that, as a result, New Zealand was exposed to unacceptably high financial sector risks. This view was accompanied by increasing evidence from around the world that market-based incentives do not necessarily align with desired economic and financial outcomes. Indeed, as the global financial crisis demonstrated, market-based incentive structures and under-regulated markets and systems can lead to excessive risk-taking, inappropriate pricing of risk and ultimately financial instability.

- Another driver of the major regulatory reforms of recent years was a recognition of the inconsistency of regulatory arrangements across different parts of the financial sector, such that some financial products and services were regulated differently to similar products and services for no reason other than the ad hoc development of regulation over earlier years. There was a desire to promote a more consistent and competitively neutral regulatory framework across financial products and providers.

- The major failures of finance companies in the period 2007 to 2010 was a further catalyst for regulatory reform, including in respect of the regulation of NBDTs (including retail-funded finance companies), the regulation of trustee corporations (as the supervisors of NBDTs), the regulation of financial advisers and a

strengthening of disclosure requirements. It also served as a catalyst for greater efforts to enforce existing regulatory requirements, especially by the FMA, which pursued court actions over 2011 to 2013 against a number of finance company directors. The widespread collapse of finance companies and the large losses sustained by retail investors demonstrated the need for a strengthening of regulation in all these areas.

- Related to the above points, there was an increasing recognition that regulatory arrangements in the financial sector were poorly aligned to the desired outcomes of financial stability, efficiency, fairness and integrity. This was in part due to the deregulation of earlier years, in part due to the ad hoc and inconsistent nature of financial reforms over many years, and in part due to the often poorly specified outcomes and objectives of regulation.

- A further consideration leading to the major changes to regulation over the last five years or so was a recognition that New Zealand had fallen behind international standards and codes on financial sector regulation. Over the 2000s there was a significant increase in the scope and intensity of international standards governing financial sector regulation. In contrast, with only a few exceptions, New Zealand had either loosened financial sector regulation or taken little action to increase regulation over this period. By the mid to late 2000s, it was apparent that New Zealand regulation had fallen significantly behind international norms (both in terms of international standards and practice). This was the case in most areas of financial sector regulation, including the regulation and supervision of banks, insurers, NBDTs, market conduct regulation and the regulation of payment and settlement systems.

40. The regulatory reforms in the financial sector over recent years have largely addressed the above issues and are likely to strengthen New Zealand's financial sector in ways that better align with the desired outcomes referred to earlier. However, as discussed later in this paper, the reform process has given rise to many concerns by stakeholders that may warrant further attention from the government, particularly as regards the quality of regulatory policy-making, the cost/benefit analysis of policy proposals, the adequacy of consultation with stakeholders, and the governance, accountability and transparency of regulators.

Financial sector regulators

41. Under the new regulatory arrangements brought into effect in recent years, the two main regulators of the financial sector in New Zealand are the RBNZ and the FMA. These two regulators represent the so-called "twin peaks" model of financial sector regulation and follow in the example set by Australia (except there the prudential regulator has been separated from the central bank) and, more recently, the UK.

RBNZ

42. The RBNZ is responsible for the licensing, prudential regulation and supervision of banks and insurers, the regulation of NBDTs and the oversight of the payments system. It also has responsibility for Anti-Money Laundering (AML) supervision of these

entities. The RBNZ will soon have responsibility for licensing NBDTs to ensure that they meet "fit and proper" requirements and minimum prudential standards.

43. The main regulatory purpose of the RBNZ is to promote the maintenance of a sound and efficient financial system by promoting the prudent management of risks and sound capital arrangements for banks, insurers and NBDTs in order to seek to keep the probability of institutional failure relatively low (but not zero). It also seeks to manage any financial distress event in a manner that avoids significant damage to the financial system. Implicitly, but not explicitly, the RBNZ also has responsibility for providing a certain degree of protection to bank depositors and insurance policyholders, but not to completely insulate them from losses that could arise from the failure of a bank or insurer.

FMA

44. The FMA– established in 2011 (replacing the former Securities Commission) – is the market conduct regulator. It has responsibility for promoting and facilitating the development of fair, efficient, and transparent financial markets. It seeks to do this by regulating and overseeing financial and product disclosures of a wide range of financial institutions, overseeing the conduct of financial markets, and licensing and supervising various categories of financial market participants, including financial advisers, auditors and trustee corporations. The FMA also has responsibility for AML supervision of the entities it oversees for other purposes.

Other regulators

45. In addition to these two main regulators, there are several other regulators with specific responsibilities for aspects of financial sector regulation. Briefly, the main ones are:

- The ***Commerce Commission*** - which has responsibility to promote competition in New Zealand markets, to prohibit misleading and deceptive conduct by traders and to monitor and enforce regulatory requirements relating to the provision of credit.

- The ***Ministry of Business, Innovation and Employment (MBIE)*** – which operates the Financial Service Providers Register (FSPR) via the Companies Office. MBIE also has policy responsibility for overseeing many aspects of financial sector regulation (principally the areas not overseen by the RBNZ), as well as oversight of the FMA.

- The ***Department of Internal Affairs (DIA)*** – which conducts Anti-Money Laundering (AML) supervision in respect of the entities for which it has supervisory responsibility.

46. In addition, The Treasury, while not a regulator, has responsibilities for advising the government on financial sector policy issues, including on regulatory architecture, and for overseeing the overall regulatory framework.

47. Appendix 3 provides a summary of the main regulators and their key responsibilities.

Governance, allocation of powers, funding and accountability arrangements of the regulators

48. There is a large variety of governance, funding and accountability arrangements across the financial sector regulators. This partly reflects that each regulator was established at different times and in different contexts. It also reflects a tendency for regulatory functions to be grafted on to existing regulatory agencies without necessarily any change being made to the governance arrangements. This is the case with the RBNZ, for example, where its governance arrangements were established in 1989 and largely designed for its primary function of monetary policy. Little specific regard was given then to the governance issues applicable to its regulatory functions. Moreover, since 1989, its regulatory functions have been very substantially expanded, but no changes have been made to its governance arrangements.

49. The variety of governance, funding and accountability arrangements also reflects that some regulators are constituted as Independent Crown Entities (eg the FMA and the Commerce Commission), some as government departments (eg the DIA) and some as entities of a unique constitutional nature – as with the RBNZ.

Governance

50. As a result of these considerations, the main regulators of the financial sector have different governance arrangements:

- ***RBNZ.*** The regulatory powers of the RBNZ are vested in the Governor of the RBNZ – it is a single decision-maker model. There is a RBNZ board, but it is solely responsible for assessing the performance of the Governor and RBNZ and has specific responsibilities regarding the appointment of the Governor and Deputy Governor. The RBNZ board has no powers in relation to the RBNZ's regulatory functions. It can give advice to the Governor, but the advice is non-binding.

- ***FMA.*** In contrast, the FMA governance model comprises a relatively large board, all of whom are non-executive. The board is a decision-making body and exercises the powers of the FMA except to the extent that the board delegates specific powers to the CEO.

- ***Commerce Commission.*** The Commerce Commission has yet another governance model. It is governed by a relatively small board of between 4 and 6 executive commissioners. They have the authority to exercise the powers of the Commission.

51. There may be sound reasons for some differences in governance arrangements across the regulators, given the different scale and scope of their respective regulatory functions, and their other responsibilities (eg as with the RBNZ's monetary policy role). However, at least in some respects, the differences appear to be ad hoc and not necessarily well-anchored to sound regulatory governance principles. As noted by stakeholders and discussed later in this report, a principles-based review of governance arrangements of all financial sector regulators may be desirable, with a view to ensuring that there is consistency in the governance model except where divergence can be justified by regard to the particular characteristics of the respective regulators and their functions.

Allocation of powers

52. Equally, there are significant differences in the allocation of powers across the regulators. The main sources of regulatory powers are statute, regulations, decisions exercisable by the relevant minister and decisions exercisable by the regulatory body.

53. The FMA has powers to determine specific requirements for particular regulated entities, but the main requirements are set out in regulations made by Executive Council on the recommendation of the Minister of Commerce. The primary responsibility for advising on regulations rests with MBIE, as the policy agency, rather than the FMA. In contrast, in the case of the RBNZ, most of the regulatory requirements imposed on affected entities are exercisable by the RBNZ itself via conditions of registration. Relatively few requirements on regulated entities supervised by the RBNZ are specified in regulations made by Executive Council. Examples are disclosure requirements for banks and prudential requirements for NBDTs.

54. As noted by stakeholders, and discussed later in this paper, it would be desirable for a principles-based review of the allocation of regulatory powers, with a view to establishing a more consistent approach to the allocation of powers between regulations, ministers and regulators, and one that ensures appropriate accountability, transparency, and checks and balances.

Allocation of responsibility for promotion of legislation and regulations

55. There is also an inconsistency in the allocation of responsibility for the preparation of proposals and drafting instructions for legislation and regulation between regulators. In the case of most regulators, including the FMA and Commerce Commission, the responsibility for drafting proposals for legislation and regulations relating to their respective powers rests with a government department (MBIE in the case of these two regulators) – ie there is a separation of responsibility between the policy formulation and regulatory administration functions. In contrast, and uniquely, the RBNZ itself has responsibility for drafting proposals for legislation and regulations under its jurisdiction – ie there is no substantive separation of the policy formulation and regulatory administration functions in the case of the RBNZ.

56. This inconsistency was noted by some of the stakeholders interviewed. They took the view that there should be a clear separation between the agency responsible for promoting legislation and regulation, and the regulator, in order to promote greater quality control of the legislation-making process and reduce the risk of excessive concentration of power in the regulator.

Consultation requirements

57. There is also a significant variation in the obligations on regulators as to when and how they consult regulated entities, with no standardisation as to the process required for consultation, the minimum period for consultation, the nature of the obligations to have regard to the views of those consulted, or the nature of the obligations on regulators to respond (in summarised form) to the submissions they have received.

58. As noted later, a greater degree of consistency across regulators may be desirable.

Transparency and accountability of regulators

59. Similarly, there is a lack of consistency in the transparency and accountability arrangements of regulators. All financial sector regulators are required to issue an annual report of some form and to issue a statement of intent. However, the specific requirements in relation to the form and content of annual reports and statements of intent are not applied in a consistent manner between regulators.

60. As noted later in this report, the statutes governing regulators do not specify requirements for Key Performance Indicators (KPIs) – eg a requirement for the relevant minister to determine KPIs for the respective regulator (after consultation with that regulator).

61. Likewise, there are no requirements for performance assessment arrangements, whereby the regulators are subject to external performance reviews on a regular basis.

Funding of regulators

62. The funding arrangements also vary considerably between regulators. For example, the FMA is funded through a combination of levies on regulated entities and an annual appropriation from Parliament. The RBNZ is funded through income it derives from its functions as the central bank (ie issuing currency and managing foreign exchange reserves), subject to five yearly expenditure budgets set by the Minister of Finance. It does not charge fees to regulated entities (other than one-off fees for licensing).

63. Appendix 4 summarises the main governance, accountability and funding arrangements of the main regulators in New Zealand.

64. As noted later in this report, it may be desirable to review the governance, accountability and funding structures of the regulators to assess whether they meet international best practice, and to assess whether there may be benefit in introducing greater standardisation of arrangements between at least the main financial sector regulators.

Coordination between regulators

65. Given the complex range of regulatory requirements applicable to the financial sector, and the number of regulators involved, coordination between the regulators is essential. Effective coordination is essential in order to avoid unnecessary duplication of function, avoid unnecessary inconsistency in approach to related issues, and to synchronise consultation with stakeholders on cross-regulator issues where practicable. Coordination is also important in order to ensure an exchange of information between regulators to enhance their effectiveness and to lower administrative costs for regulators and compliance costs for regulated entities. Importantly, coordination is also essential in order to promote a holistic approach to financial sector regulation, such that the "big picture" issues are adequately taken into account in seeking to promote a sound, resilient, efficient and dynamic financial system.

66. Coordination is not only crucial between regulators in New Zealand. It is equally essential between New Zealand regulators and their foreign counterparts, especially those

in Australia, given the close interconnectedness between the Australian and New Zealand financial systems. In particular, this suggests the need for ongoing liaison, cooperation and coordination between:

- the RBNZ and the Australian Prudential Regulation Authority (APRA) and Reserve Bank of Australia (RBA);
- the FMA and MBIE, respectively, and the Australian Securities and Investment Commission (ASIC) and the Australian Commonwealth Treasury;
- the RBNZ, FMA and DIA, respectively, and AUSTRAC – the Australian AML regulator; and
- the Commerce Commission and MBIE (via the Ministry of Consumer Affairs), respectively, and the Australian Competition and Consumer Commission (ACCC) and the Australian Commonwealth Treasury

67. It is also essential that the New Zealand regulators remain well connected to, and in regular liaison with, the international standard-setting bodies, given that international standards are increasingly becoming a key driver of financial sector regulation in every country, including New Zealand.

68. Coordination between the regulators domestically occurs both bilaterally and multilaterally. In some cases, this is done with statutory backing – ie where a particular statute imposes an obligation on a regulator to coordinate and cooperate with another regulator (eg as where the RBNZ is required by the Reserve Bank of New Zealand Act 1989 to consult the FMA in connection with disclosure requirements for banks). However, in most cases, it is done voluntarily by the regulators as part of the conduct of their business. As noted later, some stakeholders assert that coordination between regulators tends to be mainly on an issue-by-issue basis, rather than on a more comprehensive and holistic basis.

69. Coordination and cooperation is facilitated in a number of ways. One of these is the use of bilateral MOUs, such as the MOU between the FMA and RBNZ. There are also MOUs between regulators and co-regulatory bodies, such as private sector entities which have oversight responsibility over financial market participants. Examples of these are the MOUs between the FMA and NZX, and the RBNZ and the Trustee Corporations Association.

70. A number of the regulators also have bilateral MOUs with their foreign counterparts, particularly in Australia. Examples are the MOU between the FMA and ASIC, and the MOU between the RBNZ and APRA.

71. Until fairly recently, multilateral coordination and cooperation between the regulators in New Zealand occurred relatively informally via an ad hoc committee of regulators which met from time to time. This was mainly a forum for information exchange than for more structured cooperation and coordination of regulatory activity.

72. More recently, a significant step forward occurred with the establishment of the Council of Financial Regulators (COFR). The COFR aims to contribute to the efficiency and

effectiveness of New Zealand's prudential and financial markets regulatory model and to promote the stability of the New Zealand financial system by providing a forum to review industry trends and issues. The COFR's main objectives are to:

- share information on the strategic priorities of member agencies;
- identify important issues and trends in the financial system that may impinge upon achievement of the agencies' regulatory objectives, and where appropriate agree processes to address those issues;
- ensure a coordinated response to issues that may require a cross-agency involvement and put in place appropriate mechanisms to achieve this; and
- ensure that appropriate co-ordination arrangements are in place for responding to events or developments.

73. The members of the COFR are the RBNZ, FMA, MBIE and The Treasury. The COFR generally meets on a quarterly basis and the chair rotates between the FMA and RBNZ.

74. The COFR does not include other financial sector regulators, such as the DIA and Commerce Commission, but there is scope for them to be invited to attend where appropriate.

75. The COFR does not meet with industry associations. There is currently no formalised means by which the regulators, Treasury, and the relevant financial sector industry associations meet to exchange information and views on financial sector issues.

76. In terms of international multilateral coordination and cooperation – especially with Australia – there is limited coordination at present. Most coordination and cooperation occurs bilaterally between the respective regulators. There is a Trans-Tasman Council on Banking Supervision (TTCBS) which meets around once a year. However, this only covers banking and some broader financial stability issues; it does not address the full range of coordination across all financial sector regulatory areas. Nor does it include all the relevant regulators. Its current membership is:

- New Zealand Treasury (co-chair)
- Australian Commonwealth Treasury (co-chair)
- APRA
- RBA
- RBNZ

77. ASIC informally participates in some TTCBS meetings.

78. As noted below, there is scope for enhancement to trans-Tasman cooperation and coordination arrangements.

IV Summary of views expressed in interviews with stakeholders

79. The preparation of this case study included interviews and discussions with a wide range of stakeholders. See Appendix 1 for a list of those interviewed. A number of issues were raised by stakeholders in these discussions. This section of the paper summarises the main points raised.

Overall regulatory architecture

80. The main points made by stakeholders in relation to the overall architecture of the regulatory framework for the financial sector included the following:

- ***Demarcation between FMA and RBNZ.*** The "twin peaks" model (ie the division of responsibility between the RBNZ and the FMA) was generally seen as a sensible regulatory framework for the financial sector. However, there was concern by some that the demarcation between the RBNZ and FMA is not sufficiently clear in some areas, such as AML regulation, aspects of trustee corporation supervision, aspects of NBDT regulation and disclosure requirements. Some interviewees expressed a desire to see greater clarity and transparency of the regulators' respective responsibilities and a clearer demarcation between them in areas where there are overlaps.

- ***AML regulation.*** Many of those interviewed expressed the view that it was not efficient to have three AML regulators – DIA, FMA and RBNZ. It was noted that this created inconsistency in approach between the regulators, lack of sufficient coordination and unnecessary compliance burdens for the many entities (eg banks) which are subject to AML regulation by all three regulators. Some of those consulted suggested that AML regulation should be consolidated into one regulator – either the FMA or RBNZ – as with Australia's AUSTRAC.

- ***Division of responsibility between FMA and MBIE.*** Concerns were also expressed at the splitting of regulatory functions between the FMA and MBIE, especially with regard to financial service registration functions. Views were expressed that it may make sense, and reduce administrative and compliance costs, if all financial registration functions were located in the FMA, much as occurs in Australia via ASIC.

- ***Disparate arrangements relating to regulator governance and accountability.*** Concerns were raised at the disparate arrangements between regulators with respect to governance and accountability arrangements. As noted earlier in this paper, there is a wide range of governance models across the regulators. Views were expressed by many of those interviewed that a more standardised model should be adopted, with a view to establishing a consistent set of minimum standards for governance and accountability arrangements. In particular, concerns were raised in respect of the following matters:

    - The single decision-maker model in the RBNZ was regarded by some as concentrating too much power in one person and creating a risk of poor quality decision making. Many favoured a model in which the governance of the RBNZ, and other regulators, is vested in a small (4 to 5) member full-time executive board, with a view to deriving the benefits of diversity of skill and experience and reduced risk of dominance by one person. It was noted by

some stakeholders that this governance structure is commonly applied in other countries, including in Australia in respect of APRA and ASIC.

- The large non-executive board arrangement for the FMA was also regarded as sub-optimal, with some asserting that it created conflicts of interest, made decision-making slower and less efficient than necessary, and diluted accountability for decision-making. Again, a small full-time executive board was generally favoured.

- Some expressed the view that governance and accountability could be enhanced through a small (4 to 5) member *non-executive* performance assessment board which would be responsible for overseeing the performance of the executive board (ie the decision-makers) in the regulator, and reporting their findings annually or six monthly to the relevant minister.

- ***Minimum requirements for governance.*** Some suggested that it would be desirable for the government to establish minimum requirements relating to governance arrangements which would apply to all regulators, even though the specific governance arrangements may vary across regulators. The minimum requirements could include:

  - The need to document the regulatory decisions made by a regulator's governing body and the reasons for decisions made, so that those responsible for overseeing the performance of the regulator could assess the basis on which decisions are made.

  - Where a regulator's governing body has more than one member, the views/votes of each member should be recorded in respect of all significant regulatory decisions and possibly publicly disclosed.

  - There should be a clear documentation of the means by which conflicts of interest within the regulator and its governing body are identified, avoided or managed.

- ***Allocation of powers between statute, regulation, ministers and regulators.*** Some of those interviewed suggested the need for a more consistent set of guidance from the government as to the allocation of powers between statute, regulation, ministerial determination and administrative rules set by the regulator. It was noted that there are significant inconsistencies across the regulators in this regard, with some (eg the FMA) having many regulatory requirements determined through regulations made by the Executive Council, while in some other cases (eg the RBNZ) regulatory requirements are often determined administratively by the regulator, without any approval by ministers or Cabinet.

  Some stakeholders suggested that it would be desirable for the government to establish a set of standardised criteria that would determine the allocation of powers between statute, regulation, ministers and regulators, with a standardised set of accountability arrangements for each category of power allocation.

- ***Conflicts of interest within regulators.*** A number of those interviewed noted that some regulators – with the RBNZ being mentioned more than others – have conflicts or potential conflicts of interest in their respective functions. In the case of the RBNZ, for example, potential conflicts can arise between the RBNZ's role as an owner/operator of some payment and settlement systems, on the one hand, and a regulator of payment systems on the other. It was also observed that potential conflicts or tensions can arise between monetary policy objectives, macro-prudential objectives and micro-prudential objectives. It was suggested that the government should review the relevant regulators, with a view to ensuring that potential or actual conflicts are either eliminated or managed in a manner that meets standards set by the government.

- ***Operational independence.*** It was noted that regulators need to have operational independence with respect to regulatory decisions in respect of individual regulated entities – eg in setting particular prudential requirements for specific regulated entities (such as the level of capital ratio), in monitoring and supervising regulated entities, and in taking enforcement actions. However, some noted that the notion of independence had been extended too broadly – eg to the determination of the regulatory requirements where these are determined by the regulator on its own, rather than by regulations made by the government.

  It was suggested that the government should determine the parameters of operational independence on a principles basis and apply this consistently across regulators. Some stakeholders suggested that independence should be confined solely to regulatory decisions relating to individual regulated entities and not to the determination of general regulatory requirements and policy. Many stakeholders indicated that it was not appropriate for any regulator to have responsibility for drafting proposed amendments to legislation or regulations which they administer, and noted that this was a generally recognised principle in other countries.

KPIs and performance assessment

81. Some observations were made in relation to the clarity and transparency of regulator objectives and performance assessment arrangements:

- ***Clarity and transparency of objectives.*** Some interviewees noted that there was a lack of clarity and transparency with respect to the objectives of regulators. Although the statutes establishing regulators and regulatory frameworks include objectives or purposes, these tend to be expressed in generalised and high-level terms. A number of stakeholders expressed a desire to see a clearer, more specific, comprehensive and visible statement of regulatory objectives for all regulators.

  There was also a desire for regulators to be required to disclose, in meaningful detail, how particular regulatory initiatives are designed to meet the specified objectives. Some stakeholders thought it desirable and appropriate for specific regulatory objectives to be set by the responsible minister, after consultation with the regulator and other stakeholders. One example mentioned was a form of "Regulatory Outcomes Statement", in which the relevant minister would specify

the outcomes expected of the regulator – albeit often in qualitative rather than quantitative terms.

- ***Key Performance Indicators for regulators.*** Many of the stakeholders interviewed expressed the view that the financial sector regulators do not have sufficiently transparent or well-developed Key Performance Indicators (KPIs), and that this reduced their accountability. A widely held view was that all regulators should be required to have KPIs, where the KPIs are set by the relevant minister (and not by the regulator), in consultation with the regulator and other stakeholders. It was generally considered that KPIs should be *outcomes* based rather than *output* based, with care being given to avoid perverse incentive effects. Some suggested there may be a need to distinguish between long-term KPIs, for which the regulator would be held accountable over the long-term, and shorter-term KPIs, for which the CEO or governing board should be held accountable over the term of their appointment.

  In the case of the RBNZ, some stakeholders noted that consideration should be given to amending the relevant legislation to require a Policy Targets Agreement (PTA) to be established and periodically reviewed between the Minister of Finance and the Governor of the RBNZ (or a new Executive Board of the RBNZ), in respect of macro-prudential and micro-prudential regulation respectively. They noted that this would be a parallel to the PTA requirement that has long applied in respect of monetary policy. Stakeholders who raised this issue noted that a PTA for regulatory matters would not include a quantitative target, but would, instead, be expressed in mainly qualitative terms.

- ***External performance assessment of regulators.*** It was generally believed that regulators are not subject to adequate external scrutiny for their performance. In this context, many expressed the view that annual reports and statements of intent, while necessary and useful, are not adequate for assessing regulator performance. Similarly, there were concerns expressed as regards the adequacy of scrutiny via ministers and Parliamentary select committees. A further concern was expressed that neither Treasury, nor the Office of the Auditor-General and Audit New Zealand (referred to in this paper loosely as the Audit Office), exercise sufficiently close scrutiny of regulators. There was a general consensus that external scrutiny needs to be considerably strengthened, including through regular external expert evaluation (eg where Treasury or the Audit Office would periodically engage appropriate experts, nationally or internationally, to review and report on the performance of the regulators).

Cooperation and coordination between regulators

82. Most of those interviewed expressed concern about the inadequacy of consultation between regulators and wanted to see a considerable strengthening to promote more effective cooperation and coordination, both within New Zealand and between New Zealand and Australia. Specific points are set out below.

- ***Bilateral cooperation and coordination between regulators domestically – more strategic focus needed.*** As noted earlier in this paper, regulators in the financial

sector typically have bilateral cooperation and coordination arrangements, usually formalised by way of an MOU. Many stakeholders observed that, from their perspective, the consultation and coordination between regulators (eg between the FMA and RBNZ, FMA and MBIE, and DIA, FMA and RBNZ) was mainly on an issue-by-issue basis, rather than on the overall strategic direction of regulation. They wanted to see more effective coordination between regulators on *strategic* regulatory direction in areas where regulatory responsibilities overlap or interrelate.

- ***Synchronisation of consultation.*** Stakeholders interviewed also asserted that there is inadequate coordination between regulators for the purpose of synchronising stakeholder consultations on related regulatory proposals (eg between FMA and MBIE), so that consultations on related issues are progressed in an integrated manner. It was noted that this would reduce compliance costs and enable stakeholders to make better-informed submissions on issues of a related nature.

- ***Staggering of consultations.*** Some stakeholders commented that there is inadequate coordination between regulators with a view to staggering consultations so as to avoid over-burdening stakeholders (and particularly regulated entities) with too many consultation papers at any one time. It was noted that there have been periods when regulators have released many consultation papers in concentrated periods with insufficient regard to the ability of stakeholders to give adequate consideration to the issues in question. There was an expressed desire for more effective coordination between regulators, with a view to reducing the "congestion" of consultation processes and to assist stakeholders to better respond to consultation papers.

- ***Multilateral domestic regulator coordination.*** Some stakeholders noted that there is insufficient coordination between regulators at a multilateral level. As a result, there is insufficient consideration given to the overall strategic direction of financial sector regulation and the net efficiency and compliance implications of regulation. It was asserted that there is also insufficient consideration given to the interconnections between regulatory initiatives and overall economic policy objectives – eg the inter-play between the regulation of the financial sector and resource allocation in the economy.

  It was noted by some stakeholders that the Council of Financial Regulators (COFR) provides a useful forum for such coordination. However, it was noted that the COFR does not comprise all financial sector regulators – eg the Commerce Commission and DIA are not members of the COFR. Moreover, there is little transparency as to what the COFR does and therefore how effective it is in coordinating regulation across the sector. Some stakeholders therefore suggested that more visibility as to the activities of the COFR would be desirable and that its membership should be expanded to include all relevant financial sector regulators.

  It was also noted that there could be merit in Treasury being the chair of the COFR, with a view to promoting a more effective engagement by Treasury in overseeing coordination among the regulators and a more strategic and holistic approach to financial sector regulation.

- ***Coordination with Australian regulators.*** A number of stakeholders noted the importance of the relationship between New Zealand and Australia in the financial sector, given the close inter-connectedness between the two countries' financial systems, financial markets and economies. Some stakeholders suggested that there is insufficient consultation and coordination between the New Zealand regulators (especially FMA, RBNZ and DIA) and their respective Australian counterparts (APRA, ASIC, AUSTRAC and RBA). It was noted that there were occasions when, for example, there have been uncoordinated information requests from RBNZ and APRA on closely related issues. In addition, it was asserted that there have been occasions when the regulatory policy direction pursued in New Zealand has had insufficient regard to the regulatory direction being pursued by Australia.

  It was recognised that there will be occasions when different policy stances are appropriate, but there was a general perception that the regulators do not adequately cooperate and coordinate, both bilaterally and multilaterally. In the latter regard, it was suggested, for example, that the New Zealand and Australian COFRs could usefully meet at least annually to facilitate more effective coordination between the two countries' financial sector regulators, with the Australian and New Zealand Treasury departments being closely involved in the process.

Consultation with stakeholders on regulatory proposals

83. A number of stakeholders expressed dissatisfaction with the quality and process of consultation by regulators on regulatory proposals. It was noted that there is a lack of consistent practice across regulators on consultation processes, including in respect of the stage at which consultation occurs in the policy formulation process, the minimum period allowed for consultations, responses to submissions made on regulatory proposals, the obligations to have regard to the views of those who make submissions, and the circumstances in which a second round of consultation would be appropriate. General concerns expressed related to:

    - consultation occurring relatively late in the policy formulation process, creating an impression that the regulators had already made up their mind on the regulatory proposal and that they were not genuinely interested in the views of stakeholders on alternative options;

    - insufficient time being allowed for consultations on proposals, thereby reducing the scope for meaningful input from stakeholders and reducing the quality of regulatory outcomes (with the RBNZ's consultations on Open Bank Resolution and macro-prudential proposals being cited as recent examples);

    - lack of peer review or other external scrutiny (eg by Treasury) of regulatory proposals before they are released, and therefore inadequate accountability of regulators for the quality of the regulatory policy proposals;

    - lack of adequate response to submissions and therefore reduced accountability of the regulator and compromised quality of policy-making; and

- regulators often not seeking a second round of consultation, even when the first round revealed major concerns by stakeholders.

84. Some stakeholders suggested that the government could usefully provide guidance or minimum requirements that would apply in a standardised way to all regulators, including in relation to:

- an obligation on regulators to consult stakeholders early in the policy formulation process, where practicable, with a view to more effectively harnessing stakeholder input into policy development;

- a requirement for external peer review (eg by Treasury or an appointed panel of experts) of major regulatory proposals at an early stage in the policy formulation process;

- a minimum period for consultation to allow for effective stakeholder input;

- a requirement on regulators to coordinate with other regulators, with a view to ensuring appropriate coordination of related proposals and to seek to avoid excessive concentration of consultations in any one period;

- a requirement for regulators to issue a response paper, setting out in reasonable detail the submissions made and the regulator's response to the submissions, with some external peer review involved in the process; and

- a requirement for a second round of consultation where practicable and where the regulator has made significant changes to the proposals following the first round of consultation.

85. As noted earlier in this paper, there was also concern at the lack of coordination between regulators in consulting stakeholders on related regulatory proposals. Examples were cited where different regulators have released regulatory proposals at different times on regulatory proposals of a closely related nature, where it would have been more efficient if the two proposals were subject to a simultaneous consultation process. It was also noted that a lack of consultation between regulators often results in too many proposals being released at the same time or in a concentrated period, making it difficult for stakeholders to adequately respond to the proposals. A coordinated approach that allows for a more reasonable pace and sequencing of reform, where practicable, would be desirable.

86. A number of stakeholders thought it would be desirable for there to be regular (eg six monthly or annual) consultation forums between all financial sector regulators and representatives of stakeholders to exchange views on regulatory matters. In particular, some stakeholders suggested that it would be helpful if the COFR (expanded to include all financial sector regulators) and industry associations could meet once or twice a year for this purpose. It was suggested that Treasury might appropriately be the coordinator and chair of such meetings.

Regulatory Impact Statements and cost/benefit analysis

87. Most of the stakeholders interviewed expressed concern at the quality of the cost/benefit analysis undertaken in the regulatory policy formulation process and the associated quality of Regulatory Impact Statements (RISs). General criticisms made included the following:

- The RIS is prepared relatively late in the policy formulation process, such that the regulator has already determined their preferred option. As a result, alternative options tend to receive relatively little substantive analysis and the quality of the cost/benefit assessment of regulatory options is compromised.

- The quality of analysis on benefits and costs of proposals, including the regulator's preferred option, tends to be relatively weak in many cases. Stakeholders expressed a desire to see more comprehensive analysis of costs and benefits, with evidence cited for argumentations made in RISs.

- A number of stakeholders were critical of the quality of external scrutiny of RISs, suggesting that there should be considerably greater peer review of draft RISs by appointed experts engaged by Treasury or some other party other than the regulator. Many felt that Treasury either needed to increase the resourcing of its RIS review process or that a new agency should be established dedicated to reviewing all RISs and overseeing the regulatory quality control process, similar to the arrangement that exists in Australia with the Office of Best Practice Regulation.

- Some stakeholders also argued that RISs should be subject to oversight by a minister with dedicated responsibility for regulatory quality control, rather than this being the sole responsibility of the minister sponsoring the regulatory proposal. They argued that this would enhance the quality of the RIS, the contestability of ideas in the regulation-making process at cabinet, and the accountability of the minister responsible for promoting the regulatory proposal.

88. Stakeholders suggested that the RIS process would benefit from fundamental review, with a view to addressing the above concerns.

Merits review

89. A common theme raised by many stakeholders is the inadequacy of the avenues for the review of decisions made by regulators. In respect of most regulation affecting the financial sector, judicial review is the only substantive avenue available to regulated entities to seek to have regulator decisions reviewed by an independent authority. Exceptions to this are in relation to some regulator decisions, such as licensing and fit and proper rulings by regulators, and determinations made by the Commerce Commission on competition issues, where there are often rights of appeal to the courts. In most other areas, however, the only legal mechanism available for formal challenge to a regulator decision (eg on prudential regulation, setting of capital requirements or decisions on market conduct) lies in judicial review.

90. Although judicial review is clearly an important legal avenue available to regulated entities, it is limited in its scope. In essence, it only facilitates court review of whether a

regulator acted within its permissible powers and followed reasonable process in the exercise of its powers. Judicial review does not enable the courts to review the economic substance of the decisions made by the regulator.

91. A number of stakeholders expressed a desire to see consideration given to other avenues for the legal review of regulator decisions, including prudential and market conduct decisions. They argued that this would strengthen the accountability of regulators for their decision-making and sharpen the incentives for better quality decision-making and regulatory outcomes.

92. An example of merits review is the Australian Administrative Appeals Tribunal (AAT). This is a quasi-judicial body that was established by the Australian Commonwealth Government in 1975. It has the power to review (upon request by an interested party) wide-ranging decisions made by any federal government agency, including financial sector regulators. The AAT can overturn decisions made by regulators. Its decisions are subject to appeal to the courts.

93. Stakeholders suggested that the government should give formal consideration to introducing a system similar to the Australian AAT arrangements, noting that this would not only strengthen the accountability of regulators and enhance the quality of decision-making, but would also complement the move towards closer integration of the Australian and New Zealand financial systems. Some stakeholders suggested alternative merits review arrangements, including an option under which regulated entities could seek mediation by an independent expert mutually agreed between the regulated entity and the regulator.

V Conclusions – Findings of this case study

94. Recent years have seen major changes to the financial sector regulatory arrangements in New Zealand. In most cases, it can be reasonably argued that the changes made were well overdue and will assist in better aligning New Zealand's regulatory framework to international standards and best practice. In time, it is also likely that most of the changes made to the regulatory arrangements could be expected to better achieve the desired financial sector outcomes than under the previous regulatory arrangements.

95. However, notwithstanding the improvements made to the financial sector regulatory arrangements, it can be persuasively argued that there are still significant shortcomings in the overall architecture of the regulatory arrangements and in the regulation-making process.

96. Some of these shortcomings are not unique to the financial sector. For example, the disparity and inconsistency across regulators in governance, accountability and transparency arrangements are by no means unique to the financial sector; they apply to regulators in other sectors of the economy. Similarly, the contention that there is inadequate KPI specification for regulators and that performance assessment of regulators is insufficiently comprehensive in the financial sector could also be made in relation to many other sectors of the economy. The same argument can be made for the alleged inadequacy of the RIS process; the concerns expressed on this are not unique to the financial sector.

97. However, in other areas there would appear to be some architectural features of the regulatory arrangements specific to the financial sector that warrant particular attention, such as the multiple AML regulator framework, the inadequacy of demarcation between some of the responsibilities of the FMA, MBIE and RBNZ, the lack of transparency of the COFR, and the potential conflicts of interest that exist within some regulators.

98. In the context of these observations, a number of findings can be concluded – some applicable to regulation generally and some that are specifically applicable to the financial sector. The key findings are summarised below.

Findings of a generic regulatory nature

99. Key findings include:

- ***Governance, accountability and transparency arrangements for regulators.*** There would be benefit in the government giving consideration to developing principles-based criteria for the governance, accountability and transparency arrangements applicable to regulators, drawing on best international practice and standards (including those of the OECD and IMF), with a view to establishing greater consistency in these arrangements across regulators. In particular, consideration needs to be given to the risks associated with regulator governance arrangements that involve either a single decision-maker or a large non-executive board. The former carries risks of excessive dominance by one person, while the latter risks cumbersome decision-making, diluted accountability and potential conflicts of interest. A small executive board is a governance option that might warrant consideration.

- ***Regulatory objectives and KPIs.*** The objectives of regulators would benefit from review, with a view to the government establishing outcomes-based objectives for regulators. Consideration could also be given to the specification of KPIs for regulators, mainly of an outcomes-based nature, where the KPIs are set by the responsible minister after consultation with the regulator and other stakeholders.

- ***Performance assessment of regulators.*** Consideration could be given to enhancing the performance assessment framework for regulators, whereby regulators are subject to more focused and comprehensive performance assessment, on a regular basis, including through the engagement of international experts.

- ***Consultation principles and standards.*** Consideration could be given to the development of minimum standards for consultation on regulatory proposals, including in respect of minimum periods for consultation, obligations to have regard to the views of stakeholders, transparency of the assessment of submissions and regulator responses, and greater involvement of external expert review of regulatory proposals. Greater consistency across regulators in terms of consultation processes would be desirable.

- ***Regulatory Impact Statements.*** There would be benefit in reviewing and strengthening the RIS process. In particular, it would be desirable to consider

requiring RISs to be developed at a relatively early stage in the process of regulation policy-making and for all RISs to be subject to more robust external scrutiny by a dedicated agency, appropriately resourced, than is currently the case. Greater use of independent expert peer review may also be beneficial. Consideration might also usefully be given to establishing a permanent ministerial position with specific responsibility for overseeing the quality of regulation-making, including representing the views of an independent RIS assessment agency at Cabinet.

- ***Merits review.*** Consideration could be given to the options for strengthening the ability of regulated entities to seek independent review of regulator decisions. One option that would warrant consideration is the establishment of a merits review framework similar to the one in Australia.

Findings specific to the financial sector

100. Key findings include:

- ***Stocktake of financial sector regulation.*** Once the current phase of regulatory changes have been completed, it may be desirable for the government to take stock of the regulatory framework for the financial sector. This would provide an opportunity to assess the adequacy and cost-effectiveness of the recent regulatory changes and to do so in a more holistic and comprehensive whole-of-sector way than has occurred to date. Any such review would benefit from input by international experts. The next FSAP assessment of New Zealand by the IMF might represent such an opportunity.

- ***Objectives of financial sector regulators.*** There would be benefit in greater specification of regulatory objectives of the financial sector regulators, preferably on an outcomes basis. This should be done on an holistic basis so that overall financial sector and economic objectives can be factored into each regulator's objectives. One option might be to establish a "Regulatory Outcomes Statement" set by the relevant minister for each regulator, which would be subject to regular review.

- ***KPI specification.*** In association with the preceding point, consideration could usefully be given to the development of outcomes-based KPIs for each regulator, where these are specified by the relevant minister after consultation with the regulator and stakeholders. Regulator performance could be assessed against KPIs, drawing on peer review by appropriately qualified experts.

- ***Demarcation between regulators.*** It would be desirable for greater clarity on the demarcation between the responsibilities of the financial sector regulators, with a view to avoiding unnecessary overlaps in responsibility. This is particularly pertinent as regards aspects of the regulatory responsibilities of the FMA and MBIE, the FMA and RBNZ, the Commerce Commission and the RBNZ (in respect of financial sector competitiveness issues), and the AML regulators.

- ***Governance of regulators.*** There is considerable disparity in the governance arrangements of financial sector regulators. Current governance arrangements may

well be sub-optimal, especially in the case of the FMA and RBNZ. A review of the governance frameworks would be desirable, with reference to best international practice and IMF principles on regulator governance. Consideration should be given to a principles-based approach to regulator governance arrangements.

- ***Regulator independence.*** Consideration should be given to the principles governing regulator independence, with a view to determining, on a consistent basis, the matters on which the regulators should have operational independence (and accountability) and the matters which should be subject to ministerial or cabinet determination.

- ***Conflicts of interest within regulators.*** There appears to be the potential for conflicts of interest within some regulators as regards the different functions they perform. The RBNZ is arguably an example of this. A review of this issue, with a view to introducing measures to eliminate or better manage conflicts would be desirable.

- ***Coordination between regulators.*** Consideration should be given to strengthening the coordination arrangements between financial sector regulators, both bilaterally and multilaterally. In particular, the objectives, membership and transparency arrangements of COFR should be reviewed by the government, with a view to establishing a whole-of-sector regulatory coordination framework. Greater transparency of COFR's activities and policy thinking would be desirable.

- ***Coordination with Australia.*** Closer coordination between regulators in New Zealand and Australia is desirable. In particular, regular coordination between the New Zealand and Australian COFRs should be established and overseen by the government, anchored to an agreed set of trans-Tasman financial sector policy objectives.

- ***Coordination with industry.*** Consideration should be given to establishing a regular (at least annual) consultation between an expanded COFR, industry representatives and other stakeholders to review and assess regulatory developments against desired outcomes. This could be overseen by Treasury.

Appendix 1

List of stakeholders consulted in the preparation of the case study

The following entities and persons were interviewed in the preparation of this case study. The views expressed in the case study are those of the Commission and do not purport to necessarily represent the views of those interviewed.

Financial institutions

ANZ Bank New Zealand Limited
Bank of New Zealand
Tower Limited
Westpac New Zealand Limited

Regulators and other government agencies

Commerce Commission
Financial Markets Authority
Ministry of Business, Innovation and Employment
Reserve Bank of New Zealand
The Treasury

Industry associations

Financial Services Council of New Zealand
Financial Services Federation Inc.
Insurance Council of New Zealand
New Zealand Bankers' Association
New Zealand Association of Credit Unions
Payments NZ Limited

Individuals

Rod Carr, Chairman of the Board of the RBNZ and former Deputy Governor and Acting Governor of the RBNZ
Simon Jensen, Buddle Findlay
Claire Matthews, Centre for Banking Studies, Massey University
David Tripe, Centre for Banking Studies, Massey University

Appendix 2

Main statutes relevant to financial sector regulation

This table identifies the main statutes relevant to financial sector regulation. The statutes are presented in chronological order.

Statute	Main purposes
Industrial and Provident Societies Act 1908	The Industrial and Provident Societies Act governs the establishment and operation of industrial and provident societies. The Act is overseen by both the FMA and the Registrar of Industrial and Provident Societies.
Unit Trusts Act 1960	The Unit Trusts Act requires each unit trust to have a trustee and a manager, and includes obligations and restrictions on trustees and managers. The FMA and the Registrar of Companies have a role in supervising unit trusts, including in relation to their managers and trustees.
Building Societies Act 1965	The Building Societies Act provides for the establishment and administration of building societies. The FMA and the Registrar of Building Societies each have supervisory and enforcement powers under the Act to ensure the effective management and operation of building societies.
Trustee Companies Act 1967	The Trustee Companies Act 1967 provides for the appointment of a trustee company to a range of offices and positions, and regulates the operation of trustee companies.
Securities Act 1978	The Securities Act regulates the public offer of securities in New Zealand. The Act sets out when and how an offer can be made to the public and specifies who is responsible for the offer. It also sets out the applicable penalties and liabilities when the Act or regulations are not complied with. The Act gives the FMA broad powers to review offer documents and to suspend or prohibit public offers where the FMA thinks this is in the public interest.
Friendly Societies and Credit Unions Act 1982	The Friendly Societies and Credit Unions Act governs the registration and operation of friendly societies and credit unions. It

	places certain restrictions on the structure and operations of friendly societies and credit unions.
Securities Markets Act 1988	The Securities Markets Act regulates trading in listed and unlisted securities. The FMA has supervisory and enforcement powers under the Act which allow it to monitor whether those involved with the trading of securities comply with the Act's various disclosure and conduct requirements, and to undertake investigations and enforcement action. The FMA also supervises registered securities exchanges and the market rules of those exchanges. It has the power to veto or request new market rules or give a registered exchange a binding enforcement order.
Superannuation Schemes Act 1989	The Superannuation Schemes Act provides the main legal framework and governance arrangements applicable to superannuation schemes. Under the Act, the FMA oversees the registration and administration of superannuation schemes. It also monitors managers and trustees of superannuation schemes and has powers to ensure they comply with their statutory obligations.
Reserve Bank of New Zealand Act 1989	This Act establishes the Reserve Bank of New Zealand (RBNZ) as New Zealand's central bank and sets out the functions, objectives and powers of the RBNZ. Part 5 of the Act gives the RBNZ the powers to register and supervise banks for the purposes of: • promoting the maintenance of a sound and efficient financial system; and • avoiding significant damage to the financial system that could result from the failure of a registered bank. The Act empowers the RBNZ to regulate NBDTs. Part 5C of the Act provides for the designation of settlement systems. Designation gives statutory backing for

	finality of settlement and netting through a designated settlement system. Part 5C also makes the FMA a joint regulator of designated settlement systems with the RBNZ.
Companies Act 1993	The Companies Act governs the incorporation, management and operation of companies in New Zealand. The Registrar of Companies oversees the administration of companies. The FMA also has an important investigative and enforcement role under the Act, and has the power (along with the Registrar of Companies) to place companies in liquidation and to ban certain people from being directors of, or managing, companies.
Financial Reporting Act 1993	The Financial Reporting Act sets out the financial reporting requirements for entities that have distributed securities to the public, and certain other companies - such as companies that exceed certain asset or turnover thresholds. For some entities, their financial statements must also be audited and publicly filed. The FMA can grant exemptions from specific reporting requirements of the Act to certain overseas companies (or types of companies) that have distributed securities to the public.
Corporations (Investigation and Management) Act 1991	The Corporations (Investigation and Management) Act allows the government, through the Registrar of Companies and the FMA, to intervene in cases of corporate distress or fraud, where conventional procedures for dealing with the affairs of the corporation are inadequate. Under the Act, the FMA (or the Registrar of Companies, with the consent of FMA) can take action in relation to 'at risk' corporations. The FMA can also recommend to the Minister of Commerce that a corporation be placed into statutory management.
Securities Transfer Act 1991	The Securities Transfer Act specifies an approved manner in which listed and unlisted securities may be transferred in New Zealand, including electronically.

Personal Property Securities Act 1999	The Personal Property Securities Act mainly relates to: • the enforceability of an interest in personal property created or provided for by a transaction that secures payment of money or performance of an obligation; • how to determine the priority between security interests in the same personal property; and • how to determine the priority between a security interest and another type of interest in the same personal property.
Credit Contracts and Consumer Finance Act 2003	The Credit Contracts and Consumer Finance Act prescribes the requirements relating to the provision of credit, including the information which consumers must be given, when it must be given and what form the information should take. The Act sets minimum standards for some contractual terms, such as the way in which interest is calculated and charged. There are also rules on credit fees and credit related insurance.
KiwiSaver Act 2006	Parts 4 and 5 of the KiwiSaver Act govern the establishment, registration and administration of KiwiSaver schemes, and set out the responsibilities of managers and trustees of those schemes. Part 4 sets out protective provisions and other details which are deemed to be included in KiwiSaver schemes' trust deeds and prescribes member reporting requirements. Schedule 1 sets out governance and withdrawal rules for KiwiSaver schemes, and Schedule 2 covers applications to register a scheme as a KiwiSaver scheme. Under the Act, the FMA oversees the registration and administration of KiwiSaver schemes, and is responsible for maintaining the KiwiSaver schemes register. It also monitors managers and trustees of KiwiSaver schemes, and has powers to ensure they comply with their statutory obligations.

Financial Advisers Act 2008	The Financial Advisers Act regulates the provision of financial adviser and broking services to clients in New Zealand. Under the Financial Advisers Act, any person who provides such services in the course of their business is required to: • take an appropriate degree of care; • refrain from certain conduct (such as conduct that is misleading or deceptive); • be registered on the Financial Service Providers Register; and • be a member of a dispute resolution scheme if the services are provided to retail clients.
Financial Service Providers (Registration and Dispute Resolution) Act 2008	The Financial Service Providers (Registration and Dispute Resolution) Act is a companion Act to the Financial Advisers Act. The Financial Service Providers (Registration and Dispute Resolution) Act requires anyone in the business of providing a financial service in New Zealand to be registered. If the person provides a financial service to retail clients, they must also be a member of a dispute resolution scheme.
Anti-Money Laundering and Countering Financing of Terrorism Act 2009	The Anti-Money Laundering and Countering Financing of Terrorism Act seeks to impose a risk-based approach to tracking possible money laundering and terrorism financing activity, and to bring New Zealand into line with internationally recognised standards for anti-money laundering legislation.
Insurance (Prudential Supervision) Act 2010	The Insurance (Prudential Supervision) Act is administered by the RBNZ for the purposes of: • promoting the maintenance of a sound and efficient insurance sector; and • promoting public confidence in the insurance sector. The Act applies to all insurers carrying on business in New Zealand and includes: • a licensing system for insurers;

	• imposition of prudential requirements on insurers; • supervision by the RBNZ of compliance with the prudential requirements; and • powers under the Act for the RBNZ in respect of insurers in financial distress or other difficulties.
Securities Trustees and Statutory Supervisors Act 2011	The Securities Trustees and Statutory Supervisors Act established a compulsory licensing regime for trustees of debt securities and unit trusts, and statutory supervisors of certain collective investment schemes and retirement villages. The FMA oversees the licensing regime, which came into force in October 2011, and has an ongoing supervisory and enforcement role in relation to the performance of licensed trustees and statutory supervisors.
Auditor Regulation Act 2011	The Auditor Regulation Act establishes a framework for the regulation of auditors of financial issuers. The Act came fully into force on 1 July 2012.
Financial Markets Authority Act 2011	The Financial Markets Authority Act established the FMA as an independent Crown entity, and sets out the FMA's main objective. This is to promote and facilitate the development of fair, efficient, and transparent financial markets. The Act sets out the functions and powers of the FMA.
Non-Bank Deposit-Takers Act 2013	The Non-bank Deposit Takers Act introduces a licensing regime for Non-bank Deposit Takers (NBDTs), which include finance companies, building societies, and credit unions. The Act also gives the RBNZ new powers to detect and intervene should an NBDT become distressed or fail. The Act substantially retains the existing prudential requirements covering credit ratings, governance, risk management, capital, related party exposures, and liquidity requirements. However, it introduces a licensing requirement for NBDTs which includes the requirement for

	an NBDT to have suitable directors and senior officers.
Reserve Bank of New Zealand (Covered Bonds) Amendment Act 2013	The Reserve Bank of New Zealand (Covered Bonds) Amendment Act provides greater certainty and transparency for covered bonds issued by banks. The Act provides for covered bond programmes to be registered and monitored by the RBNZ. It also provides legal certainty that if a bank fails, the covered bond holders will have access to the cover pool assets.

Appendix 3

Table summarising the main financial sector regulators and their functions

This table identifies the main regulators of the financial sector and their respective functions and statutory purposes.

Regulator and key functions	Objectives of function
Reserve Bank of New Zealand	
Licensing and prudential supervision of registered banks, and managing the distress or failure of a registered bank.	Promoting the maintenance of a sound and efficient financial system and avoiding significant damage resulting from the failure of a bank.
Licensing and supervision of insurers and managing the distress or failure of an insurer.	Promoting the maintenance of a sound and efficient insurance sector and promoting public confidence in the insurance sector.
Regulating NBDTs. The RBNZ will acquire new functions in 2014 to license NBDTs and to have powers to respond to NBDT distress or failure.	Promoting the maintenance of a sound and efficient financial system, and avoiding significant damage to the financial system that could result from the failure of an NBDT.
The designation of settlement systems.	The RBNZ oversees payment systems for the purpose of promoting the maintenance of a sound and efficient financial system.
The design and implementation of macro-prudential policy.	The RBNZ's stated objective of its macro-prudential policy is to increase the resilience of the domestic financial system and to counter instability in the domestic financial system arising from credit, asset price or liquidity shocks. The instruments of macro-prudential policy are designed to provide additional buffers to the financial system that vary with the macro-credit cycle. The Minister of Finance and Governor of the RBNZ have entered into a MOU to facilitate consultation on macro-prudential policy issues. However, decisions rest with the Governor of the RBNZ.
Provision of lender of last resort and liquidity support to the financial system	This function is anchored to the objective or promoting a sound and efficient financial system and avoiding or minimising significant damage resulting from the distress or failure of a bank, or from other shocks to the financial system.

Regulating and supervision banks, insurers, NBDTs for Anti-Money Laundering (AML) purposes.	To: • detect and deter money laundering and the financing of terrorism; • maintain and enhance New Zealand's international reputation by adopting, where appropriate in the New Zealand context, recommendations issued by the Financial Action Task Force; and • contribute to public confidence in the financial system.
Financial Markets Authority	
The FMA's general functions are to: • promote participation of businesses, investors, and consumers in the financial markets; • exercise the powers and duties the FMA has under various statutes; • enforce securities, financial reporting, and company law as they apply to financial services and securities markets; • monitor compliance with, investigate and enforce; financial markets legislation; • monitor, and inquire into or investigate matters, relating to financial markets, or the activities of financial market participants or any person involved with those markets; • review the law and practices relating to financial markets and financial markets participants; • co-operate with other law enforcement or regulatory agencies, including the RBNZ, Commerce Commission, Serious Fraud Office, Department of Internal Affairs and Police, as well as foreign regulators.	The overall objective is to promote and facilitate the development of fair, efficient, and transparent financial markets. The FMA aims to have the following impacts on financial markets: • financial markets participants have clear and well-understood responsibilities; • investors have access to the information they need to make informed decisions; • investors clearly understand and have confidence in the regulation of financial markets; • emerging risks to FMA's objective are identified, and appropriate responses are developed; • financial markets are efficient, resilient and internationally attractive; • the costs and benefits of the regulatory regime are proportionate.
The FMA licenses and supervises Authorised Financial Advisers (AFAs) and	See above purposes

Qualifying Financial Entities (QFEs). It monitors compliance with the Code of Professional Conduct and other obligations of AFAs and QFEs to ensure they exercise the standard of care, diligence and skill required.	
The FMA regulates securities exchanges (including overseeing the NZX), brokers, trustees and issuers.	See above purposes
The FMA licenses and supervises securities trustees and statutory supervisors.	See above purposes
The FMA oversees the registration and administration of KiwiSaver and Superannuation Schemes, and is responsible for maintaining the KiwiSaver schemes register. The FMA also monitors managers and trustees of KiwiSaver and superannuation schemes, and has powers to ensure they comply with their statutory obligations.	See above purposes
The FMA gathers market intelligence about local and global developments that may affect capital markets generally or particular investors.	See above purposes
The FMA runs a Financial Reporting Surveillance Programme that aims to educate and encourage issuers to improve the quality of their financial reporting.	The reviews aims to ensure that: • issuers' financial statements are clear and comprehensive; • investors can have confidence in the credibility of financial information provided by issuers; and • high-quality financial reporting contributes to the integrity of New Zealand's securities markets.
The FMA reviews issuers' financial statements against New Zealand Generally Accepted Accounting Practice (NZ GAAP).	The purpose of the reviews is to form a view on: • the level of issuer compliance with NZ GAAP; • whether any breach of NZ GAAP identified requires enforcement action; and • the overall quality of financial reporting practices by issuers.
The FMA may review a registered prospectus to determine whether it:	See above purposes

• complies with the Securities Act 1978 and the Securities Regulations; • contains any material incorrect descriptions or errors, or any material matter that is not clearly legible; or • is false or misleading, or omits any material particular.	
The FMA licenses and regulates auditors	To: • promote, in respect of issuer audits, quality, expertise, and integrity in the profession of auditors; and • promote the recognition of the professional status of New Zealand auditors in overseas jurisdictions.
The FMA conducts AML supervision in respect of the entities for which it has supervisory responsibility.	To: • detect and deter money laundering and the financing of terrorism; • maintain and enhance New Zealand's international reputation by adopting, where appropriate in the New Zealand context, recommendations issued by the Financial Action Task Force; and • contribute to public confidence in the financial system.
Commerce Commission	
The Commerce Commission's purpose is to achieve the best possible outcomes in competitive and regulated markets for the long-term benefit of New Zealanders.	To promote competition in New Zealand markets and to prohibit misleading and deceptive conduct by traders.
In the context of the financial sector, the main role of the Commerce Commission is to administer the Credit Contracts and Consumer Finance Act.	Main purposes are to: • protect the interests of consumers in connection with credit contracts, consumer leases, and buy-back transactions of land; • provide for the disclosure of adequate information to consumers under consumer credit contracts and consumer leases;

	• enable consumers to become informed of the terms of consumer credit contracts or consumer leases before they become irrevocably committed to them; • enable consumers to monitor the performance of consumer credit contracts or consumer leases; and • prevent oppressive lending.
Department of Internal Affairs (DIA)	
DIA conducts Anti-Money Laundering (AML) supervision in respect of the entities for which it has supervisory responsibility.	To: • detect and deter money laundering and the financing of terrorism; • maintain and enhance New Zealand's international reputation by adopting, where appropriate in the New Zealand context, recommendations issued by the Financial Action Task Force; and • contribute to public confidence in the financial system.
Ministry of Business, Innovation and Employment (MBIE)	
MBIE operates the Financial Service Providers Register (FSPR) via the Companies Office. Under the new regime, a wide range of financial service providers (FSPs) need to be registered to legally provide financial services. This provides a minimum process of "negative vetting" to ensure that all financial service providers are identified and, in order to be registered, must not have criminal records of a specified nature.	The Financial Service Providers Act requires anyone in the business of providing a financial service in New Zealand to be registered. If the person provides a financial service to retail clients, they must also be a member of a dispute resolution scheme.
MBIE, via the Companies Office, is the government agency responsible for administering the Personal Property Securities Register (PPSR). The PPSR is the register where details of security interests in personal property can be registered and searched.	

Appendix 4

Governance, accountability and funding arrangements of regulators

Regulator	Governance	Accountability	Funding
RBNZ	The RBNZ is established under the Reserve Bank of New Zealand Act 1989. The Governor is the CEO of the RBNZ and is the sole decision-maker for powers vested in the RBNZ. In many of its regulatory functions, the Governor has the power to determine prudential requirements through conditions of registration and prudential standards. However, in the case of some regulatory powers, such as the making of regulations relating to NBDTs or bank disclosure matters, regulations are made via Executive Council on the recommendation of the Minister of Finance on a recommendation from the RBNZ. Some crisis management powers are vested in the Minister of Finance (on the recommendation of	The RBNZ is required to report annually to Parliament pursuant to its Act. Under section 162A of the Reserve Bank of New Zealand Act 1989 (the Act), the RBNZ must provide to the Minister a *Statement of Intent* (SOI) for that financial year and at least the next two financial years. The RBNZ is subject to scrutiny through its Annual Report and Statement of Intent. It is also subject to scrutiny via Parliament's Finance and Expenditure Committee. Treasury provides oversight of the RBNZ's performance. The RBNZ is subject to audit by the Auditor General.	The RBNZ is funded via the income it earns from its activities (mainly associated with its currency issuance and reserves management functions), but where the RBNZ budget is set on a five yearly basis by the Minister of Finance. The RBNZ does not charge fees to regulated entities (other than fees for certain licensing processing).

	the RBNZ), such as appointing a statutory manager, or where the RBNZ must obtain the consent of the Minister to issue directions to a bank. The Governor is appointed by the Government (via the Minister of Finance) on the recommendation of the RBNZ Board. The RBNZ Board is a performance monitoring board; it has no authority to exercise the powers of the RBNZ, but can give (non-binding) advice to the Governor. Aside from its monitoring role, the Board has responsibility for appointing the Deputy Governor (on the recommendation of the Governor) and recommending to the Minister of Finance the appointment of the Governor. The Board is solely a non-executive board, aside from the Governor, who sits on (but does not chair) the Board.		
FMA	Established as an Independent Crown Entity under the	The FMA is covered by the requirements applicable to Independent Crown	The FMA is funded partly by annual appropriation and partly through fees

	Financial Markets Authority Act 2011. The FMA is governed by a non-executive board of up to 9 members and up to a further 5 associate members. The members are appointed by the Minister of Commerce. The Chair of the Board is appointed by the Minister of Commerce. The CEO is appointed by the Minister of Commerce The Board exercises the powers of the FMA but can delegate to the CEO.	Entities, including in respect of the obligation to report annually to Parliament and to issue three yearly Statements of Intent. The FMA is subject to scrutiny by Parliamentary select committee. MBIE has oversight of the FMA, as has Treasury. The FMA is subject to annual audit by the Auditor-General.	and levies imposed on regulated entities and set by regulation.
Commerce Commission	Established by the Commerce Act 1986 and is subject to the Crown Entities Act 2004. Governed by a commission of mainly full-time commissioners (between 4 and 6), appointed on the recommendation of the Minister of Commerce by the Governor-General. One is appointed as Chairperson and another as Deputy Chairperson.	The Commerce Commission is subject to the Crown Entities Act. It must issue an annual report to Parliament. It must issue a Statement of Intent. It is subject to oversight by, among other agencies, MBIE and Treasury. It is subject to scrutiny by Parliamentary select committee.	It is funded by annual appropriation and through levies set by regulation.

	Decisions are made by the Commission. Regulations are made by the normal regulation-making process.		