

The Treasury

Reserve Bank Act Review Phase 2 Consultation 3 Submission Information Release

February 2021

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- [23] 9(2)(a) - to protect the privacy of natural persons, including deceased people
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Submission to Treasury

ON

Consultation Document 3: Safeguarding the future of our financial system: Further consultation on the prudential framework for deposit takers and depositor protection, Phase 2 of the Reserve Bank Review

'Chapter 3: The regulatory perimeter'

Introduction

1. This Submission is from Trustee Corporations Association of New Zealand Inc (**TCA** or, the **Association**) in response to the Treasury Consultation Paper: Safeguarding the future of our financial system: Further consultation on the prudential framework for deposit takers and depositor protection, Phase 2 of the Reserve Bank Review, March 2020 (**Consultation Paper**).
2. TCA supports the Treasury's initiative to undertake the Reserve Bank Act Review, and considers it is particularly important in light of the evolving nature of the financial markets and the Reserve Bank of New Zealand's (**RBNZ**) corresponding prudential role since the enactment of the Reserve Bank of New Zealand Act 1989 (**RBNZ Act**) nearly 30 years ago. TCA considers it is good practice to review all regulatory frameworks from time to time to ensure they remain fit for purpose.
3. TCA would be very happy to meet with Treasury to discuss any aspect of this submission. We can be contacted at:

Trustee Corporations Association of New Zealand Inc
Level 6
191 Queen Street
Auckland

PO Box 10 133
Wellington 6143

Attention: David Brown Douglas
Ph: [39]
Email: [35]

About TCA

4. TCA is a long-established association representing supervisors licensed under section 16(1) of the Financial Markets Supervisors Act 2011 (**Licensed Supervisors**). The Members of the TCA are: Public Trust, Trustees Executors Limited, The New Zealand Guardian Trust Company Limited, Covenant Trustee Services Limited, and Anchorage Trustee Services Limited (**TCA Members**).
5. TCA Members provide prudential supervision for a wide range of investment products and financial arrangements through various legal structures appropriate for the particular product offered. In certain instances, Managed Investment Schemes and Debt Issuers (including Non-bank Deposit Takers (**NBDTs**)) must appoint a Licensed Supervisor to meet regulatory requirements before an offer of a financial product can be made to the market.
6. TCA maintains relationships with government ministries, regulatory bodies and financial sector groups.
7. As at 30 June 2020, TCA Members supervised funds in excess of \$490 billion. All supervisors holding an FMA licence are TCA Members.

Defining the Regulatory Perimeter

8. TCA will fully support the Treasury and RBNZ to implement a single licensed deposit-taker framework that is efficient and best serves the interests of consumers. However, in our view, Licensed Supervisors are best placed to continue to supervise NBDTs even under the proposed approach to defining the regulatory perimeter set out in Chapter 3.1 of the Consultation Paper (**Proposed Regulatory Perimeter**).
9. As noted in previous submissions we believe that, given its primary function of formulating and implementing monetary policy in accordance with the promotion of a sound and efficient financial system, RBNZ is better suited to the role of a prudential regulator monitoring larger financial institutions as opposed to being a frontline regulator of smaller entities.
10. Licensed Supervisors have established themselves as the clear leader in frontline conduct regulation and given their specific capabilities and experience, are better suited to continue to operate as conduct regulators for NBDT finance companies that do not take insured deposits or offer transactional services but issue other types of debt securities to retail investors (**Finance Companies**). This submission is focused on the proposed regulation of such Finance Companies and the two options presented in Chapter 3.2 of the Consultation Paper.

Regulation of Finance Companies

11. TCA agrees that prudential regulation should be retained for Finance Companies and supports the introduction of a restricted licence category for Finance Companies as proposed under Option 1 in the Consultation Paper. We agree with the benefits specified in respect of Option 1 and make the following additional comments set out below.

Market benefits

12. TCA considers that a separate licensing regime will allow for proportionate compliance requirements that better reflect the smaller size of a number of NBDTs in operation and the size of the NBDT market as a whole in New Zealand.
13. As previously submitted on this point, the amount of NBDT assets, at \$2.66 billion, is very small compared to the \$584 billion of assets held by banks in New Zealand. TCA's view is that smaller NBDTs should be subject to proportionately fewer compliance requirements relative to larger financial institution, given the fact that the soundness of the financial system would not be fundamentally affected by their individual, or even their overall failure.
14. Further, if a "one size fits all" approach under Option 2 were adopted, compliance costs may be too high for smaller NBDTs causing the dominance of larger institutions, particularly banks. This would lead to reduced competition and further barriers to entry for new market participants. A separate licensing approach allows for the differential treatment of Finance Companies, as is appropriate given the small size and reduced resources available to many of these entities.
15. We also note that a number of NBDTs have exited the market in the last few years given the rigidity of some of the regulatory requirements that they have faced. While a number of these businesses have been able to continue to exist, primarily through wholesale funding, this has undoubtedly created a vast reduction for investment opportunities in the retail investor space. A single approach under Option 2 would certainly lead to the exit of a number of NBDTs or at least a shift by them to wholesale funding as the only way to remain viable.

Continued "hands on" supervision by Licensed Supervisors

16. An additional benefit of Option 1 is that it would result in the continued supervision of Finance Companies by Licensed Supervisors. As previously submitted, TCA considers that Licensed Supervisors are best placed to provide the level of frontline supervision required to provide investors with confidence that their investment is subject to effective supervision intended to protect their interests.
17. A clear and long-established role of providing "hands-on" supervision has allowed Licensed Supervisors to develop a very close understanding of how financial institutions operate and what processes, procedures and controls they have in place to comply with their duties and requirements.
18. The move towards a financial system that places a greater focus on the interests of consumers/investors has meant that a Licensed Supervisor's role is to act on behalf of investors. The Trust Deed model supports this, placing responsibility on the Licensed Supervisor to act in the best interest of investors and providing the Licensed Supervisor with powers to remedy breaches including promptly reporting the nature of the breach and other information to investors. In contrast, RBNZ is more focused on systemic risk.
19. Licensed Supervisors have reputational, legislative and strong fiduciary duties and incentives to act in investors' interests and to protect their interests. As a result, a move to an alternative model that changes or removes the role of Licensed Supervisors would be detrimental to the ability of finance companies to operate effectively and subsequently for investors' interests as a whole.
20. TCA's main concern with any alternative approach, particularly if supervision were to move to being a role of the RBNZ, is that RBNZ's focus may shift to larger entities which will ultimately have a detrimental impact on individual investors. Smaller NDBTs are likely to be not as well-resourced and less likely to have a team or even an individual dedicated to regulatory compliance on a day-to-day basis. This compels the need for "hands-on" supervision and guidance only able to be offered by Licensed Supervisors. We consider Licensed Supervisors are better placed to provide this intensive supervision, as opposed to RBNZ whose mandate is to maintain a 'sound and efficient financial system' and which is therefore better suited to supervision of larger, more systemic, entities.
21. Further, if Option 2 under the Consultation Paper were implemented and RBNZ adopted the role of frontline supervisor, there would likely be an increase in issuer levies for NDBTs, creating a further reason for them to exit the market. With Licensed Supervisors remaining under Option 1, competition between those Licensed Supervisors ensures that the fees for NDBTs remain low. If a number of NDBTs were to leave the market, this would also exacerbate the homogeneity of our financial system, reducing diversity, efficiency and competition in the New Zealand financial system.

Products and risks involved are different

22. Establishing a restricted licence category would provide for a seamless continuance of the disclosure and governance requirements under the Financial Markets Conduct Act 2013 (**FMC Act**) for existing Finance Companies, which we believe are needed for companies of this nature. The exclusions that are currently available to banks under the FMC Act regime are not appropriate for Finance Companies as the products offered are different in nature and there are different risks involved.
23. In addition, and as noted in the Consultation Paper, it would provide a simple way to determine whether the FMC Act requirements apply or not i.e. it would be clear that the FMC Act only applies to products issued by restricted licence holders but not other deposit takers (including credit unions etc. that provide services akin to a bank).

24. As noted in previous submissions, TCA considers it is beneficial to align with other regimes as appropriate.
25. TCA agrees with comments raised in the Consultation Paper that treating a Finance Company in the same way as a bank under Option 2 in the Consultation Paper would create a perception that the products available through a Finance Company were the same as those offered by a bank. Having in place differential treatment through a restricted licence regime will help prevent confusion amongst consumers and clarify that there are different risks involved.

Final observations/comments

26. TCA considers that the advent of an initial restricted licensing process for Finance Companies would helpfully provide RBNZ with the ability to review an existing Finance Company's capability or make a preliminary assessment of the capability for a new entrant Finance Company to comply with RBNZ's prudential requirements.
27. We believe this review/assessment process combined with the ability for Licensed Supervisors to maintain supervision of on-going compliance, would lead to a greater level of confidence of individual investors in Finance Companies and enable those companies to compete with larger financial institutions.
28. In summary, we consider Option 1 as the best approach to ensure the continued confidence in finance companies and that Licensed Supervisors are best placed to supervise NBDTs and continue to provide assurance to RBNZ that NBDTs are functioning well and within agreed limits in New Zealand. We believe this joint approach, where Licensed Supervisors are focused on individual entity risk and RBNZ is focused on systemic risk benefits both individual investors and the financial system as a whole.

Richard Spong
Chairman
Trustee Corporations Association of New Zealand Inc

1 October 2020