

The Chair  
**CABINET ECONOMIC DEVELOPMENT COMMITTEE**

**REVIEWS OF FINANCIAL PRODUCTS AND PROVIDERS AND FINANCIAL  
INTERMEDIARIES - OVERVIEW PAPER**

**PROPOSAL**

- 1 This paper seeks the Committee's agreement to:
  - a A two step approach to introducing legislation to implement the findings of the reviews of Financial Products and Providers and Financial Intermediaries;
  - b The finalisation of funding implications prior to the introduction of legislation;
  - c Announcement of decisions; and
  - d Deferral to 30 November 2007 of a report back to Cabinet on how the trans-Tasman Council for Banking Supervision can be expanded to include coordination on prudential supervision.

**EXECUTIVE SUMMARY**

- 2 This is one of six papers that report on the outcomes of reviews of Financial Products and Providers and Financial Intermediaries.
- 3 It provides the Committee with an overview of the two reviews and seeks the Committee's agreement to:
  - a A two step approach to introducing legislation to implement the findings of the reviews of Financial Products and Providers and Financial Intermediaries:
    - i Beginning with legislation to implement decisions contained in the accompanying papers necessary to achieve compliance with international obligations and to better protect consumers through:
      - (a) Registration of all financial service providers;
      - (b) Improved supervision of corporate trustees;

- (c) Improved trustee-based prudential supervision of non-bank deposit takers overseen by a single prudential regulator, being the Reserve Bank of New Zealand;
      - (d) Regulation of Financial Advisers; and
      - (e) Provision for a comprehensive approach to consumer dispute resolution and redress.
    - ii Followed by legislation to implement a second tranche of decisions to be taken by November 2007 on those parts of the review necessary to:
      - (a) Improve supervision by corporate trustees of collective investment schemes and debt issuers;
      - (b) Simplify and improve security offerings disclosure;
      - (c) Modernise insurer prudential and market conduct regulation;
      - (d) Consolidate regulation of mutuals' governance; and
      - (e) Regulate platforms and portfolio management services.
  - b Consider the funding implications for the Ministry of Economic Development, the Securities Commissions and the Reserve Bank of New Zealand prior to the introduction of legislation;
  - c Announcement of decisions; and
  - d Deferral to 30 November 2007 of a report back to Cabinet on how the trans-Tasman Council for Banking Supervision can be expanded to include coordination on prudential supervision.
- 4 This paper should be read in conjunction with the following papers:
- a Registration of Financial Service Providers
  - b Trustee Supervisory Model
  - c Institutional Arrangements for Prudential Regulation
  - d Regulation of Non-Bank Deposit Takers
  - e Financial Advisers – A New regulatory Framework
  - f Consumer Dispute Resolution and Redress

## BACKGROUND

- 5 Non-bank financial products and providers include insurance, collective investment schemes, platforms and portfolio management services, non-bank deposit takers, securities offerings and issuers of equity and debt securities.
- 6 These products and providers are currently regulated by a myriad of laws that have been developed in different decades and centuries, with confusing and conflicting objectives. This has led to gaps in coverage, inconsistencies in the regulatory treatment of similar products and unnecessary compliance costs. There are concerns about the adequacy of consumer protection in some areas and the overall effectiveness of regulation in achieving its objectives. In some areas New Zealand does not comply with current international principles and obligations including some of the recommendations of the Financial Action Task Force's 40 Recommendations on Money Laundering and its 9 Special Recommendations on Terrorist Financing.
- 7 To improve regulation of non-bank financial institutions, financial products and financial intermediaries, two separate but related reviews were commenced in 2004 and 2005, being:
  - a Review of Financial Intermediaries; and
  - b Review of Financial Products and Providers.
- 8 Both reviews share the objectives of:
  - a A sound and efficient financial system;
  - b Investment which encourages growth and innovation;
  - c An environment which facilitates wealth accumulation; and
  - d Confidence in the sector which encourages participation by consumers and market participants.
- 9 Both reviews were informed by expert advisory groups and taskforces made up of people from key industry organisations, industry participants, professional organisations and government bodies. Their input contributed to officials' identification of issues and development of proposals for consultation. Officials' proposals for consultation were noted by Cabinet prior to consultation in 2006. Over the three month period allowed for consultation, around 140 written submissions were received on each review. The implications of these submissions for the original proposals have been considered by officials and are reflected in the proposals to the Committee.
- 10 Officials have also given further consideration to institutional arrangements for prudential regulation of non-bank deposit takers and insurers, and the process for drafting and introducing the necessary legislation to implement the findings arising out of the reviews of Financial Intermediaries and Financial Products and Providers.

## Previous Consideration

- 11 On 12 December 2005, Cabinet considered domestic institutional arrangements for financial sector regulation and regulation of financial intermediaries [Cab Min (05) 41/1 refers] and:
- a Directed the interdepartmental working group (Chair, Treasury) to report to EDC on detailed institutional arrangements for the prudential regulator by 30 November 2006 [CBC Min (05) 18/28]; and
  - b Agreed in principle to a co-regulatory model for financial intermediaries and directed officials to carry out further detailed design work [CBC Min(05) 18/31 refers].
- 12 On 23 August 2006, EDC considered proposals to release a series of discussion documents as part of the review of Financial Products and Providers and [EDC Min (06) 13/7 refers]:
- a Noted the intention of the Minister of Commerce to release the following discussion documents;
    - i Overview of the Review and Registration of Financial Institutions
    - ii Review of Securities Offerings
    - iii Supervision of Issuers
    - iv Collective Investment Schemes
    - v Non-Bank deposit Takers
    - vi Insurance
    - vii Mutuals' Governance
    - viii Consumer dispute resolution and redress
    - ix Platforms and Portfolio Management Services
  - b Invited the Minister of Commerce to submit a further paper to Cabinet by April 2007 seeking approval for policy decisions on the Review of Financial Products and Providers; and
  - c Agreed to defer the report to Cabinet on detailed institutional arrangements for the financial sector prudential regulator to April 2007.
- 13 On 2 April 2007, Cabinet agreed to defer the above report backs to 30 June 2007 [CAB Min (07) 11/4 and EDC Memo (07) 6/1 refer].

## Overview of Proposals

- 14 If agreed to, the proposals arising from the reviews of Financial Intermediaries and Financial Products and Providers will result in a comprehensive

modernisation of the regulatory frameworks that apply to all non-bank financial institutions, participants and products. The intent is to achieve a more effective and consistent regulatory environment that better achieves government policy objectives, while keeping any necessary compliance costs to a minimum and improving consumer confidence in the sector.

- 15 The proposals will also help ensure that New Zealand meets its international obligations, especially those arising from its membership of the Financial Action Task Force which sets global standards for combating money laundering and terrorist financing.
- 16 For some sectors (such as non-bank deposit takers and financial advisers) this will mean an overall increase in the level of government regulation.
- 17 The main proposals arising from the reviews, so far, are contained in the accompanying papers and relate to the need to:
  - i Register all financial service providers which provide financial services in or from New Zealand. This is necessary to provide an initial means of identifying and monitoring financial service providers and is a critical first step in the implementation of other review proposals. It is also necessary to achieve compliance with international obligations;
  - ii Strengthen the current model of trustee supervision that applies to debt issuers, non-bank deposit takers, and collective investments schemes, by licensing trustees and providing for their supervision by the Securities Commission. This is necessary to promote consistency, provide assurance that trustees are competent and to achieve compliance with international obligations;
  - iii Strengthen trustee-based prudential regulation of non-bank deposit takers by, among other matters, requiring them to meet minimum prudential, governance and fit and proper requirements administered by a single prudential regulator that would also regulate insurers;
  - iv Provide for more comprehensive regulatory oversight of financial intermediaries by a government regulator (in conjunction with industry professional bodies). This is necessary to improve consumer confidence in the sector and to achieve compliance with International Organisation of Securities Commissions' objectives and principles of securities regulation; and
  - v Provide for effective consumer dispute resolution and redress across all parts of the sector. This is necessary to improve consumer confidence in the sector.

- 18 A further paper recommends that the Committee confirm Cabinet's earlier in principle decision that the Reserve Bank of New Zealand be the single prudential regulator (for banks, non-bank deposit takers and insurers).
- 19 Further policy work is necessary before decisions can be taken on the following additional proposals arising from the Review of Financial Products and Providers to:
- i Enhance the trustee supervision model for collective investment schemes and debt issuers. The focus of this work is on improving the consistency of supervision by trustee's of collective investment schemes and debt issuers by setting in law minimum requirements for supervision and ensuring that trustee's have appropriate duties and powers to perform their roles;
  - ii Simplify and improve the relevancy of disclosure requirements for issuers of securities. The focus of this work is on clarifying the definition of public investors to which disclosure laws apply and simplifying the current two document disclosure regime to reduce compliance costs on issuers while ensuring that public investors are adequately informed in their investment decisions;
  - iii Modernise regulation of insurers in terms of both their prudential operation and their conduct. The focus of this work is on ensuring a consistent approach to the regulation of insurers through licensing and supervision by a single prudential regulator and improved market conduct and disclosure requirements;
  - iv Improve governance of entities utilising a mutual form. The focus of this work is on the development of base level corporate governance requirements for mutuals that would be set in a single statute; and
  - v Regulate platforms and portfolio management services. The focus of this work is on ensuring minimum protections for consumers of platform and portfolio management services that perform advisory and custodial roles.
- 20 Given the enhancements to KiwiSaver announced in Budget 2007, and Ministerial decisions to progress regulation of KiwiSaver compliant schemes separately, the proposed report back to Cabinet in November 2007 on collective investment schemes will include consideration of the implications for all superannuation schemes of the decision to progress regulation of KiwiSaver compliant schemes separately.

### **A Two Step Approach to Legislation and Decision Making**

- 21 When taken together the above proposals will require a large legislative and operational effort to implement.

- 22 *A Financial Products, Providers and Intermediaries Bill* is currently included in the 2007 Legislation programme in Category 4 (to proceed to select committee in 2007).
- 23 I am advised by officials that the policy and drafting work necessary to complete this Bill for introduction would take up two years to complete. This would mean that legislation which is urgently required to implement the necessary proposals to improve New Zealand's compliance with the Financial Action Task Force Recommendations and to improve consumer confidence in the sector would not be passed in 2008.
- 24 To ensure that legislation necessary to implement the most urgent proposals is progressed quickly I propose a two-step approach to the drafting and introduction of legislation, beginning with that legislation necessary to implement decisions on the proposals contained in the accompanying papers. These are the highest priority proposals and are necessary to achieve compliance with international obligations and to better protect consumers through:
- a Registration of all financial service providers;
  - b Improved supervision of corporate trustees;
  - c Improved prudential supervision of non-bank deposit takers;
  - d Regulation of Financial Advisers; and
  - e Providing for a comprehensive approach to consumer dispute resolution and redress.
- 25 Subject to the proposed report back to the Committee on the fiscal implications of these proposals (as discussed in paragraph 38), I intend seeking approval to introduce the following Bills, to be passed in 2008, to implement the above the provisions:
- a Financial Advisers Bill; and
  - b Financial Service Providers Registration and Dispute Resolution Bill.
- 26 The Minister of Finance will separately report on legislation necessary to implement proposed changes to the governance and accountability arrangements necessary to make the Reserve Bank the single prudential regulator. This is likely to require a further Bill, also to be passed in 2008.
- 27 A second tranche of legislation would be developed with a longer timetable to provide for the implementation of less urgent initiatives necessary to:
- a Improve supervision collective investment schemes and debt issuers by Corporate Trustees;
  - b Simplify and improve security offerings disclosure;

- c Modernise insurer prudential and market conduct regulation;
- d Consolidate regulation of mutuals' governance; and
- e Regulate platforms and portfolio management services.

28 I propose reporting back to Cabinet with proposals necessary for the drafting of this second tranche of legislation on each of the above by November 2007.

#### **IMPACT ON RELATED WORK**

- 29 The trans-Tasman Council on Banking Supervision was established by the Minister of Finance and the Australian Treasurer in 2005 as a forum to progress trans-Tasman issues in banking regulation, including supervisory cooperation, policy coordination, and joint crisis preparedness.
- 30 In December 2005, Cabinet agreed in principle, that the scope of the trans-Tasman Council for Banking Supervision be expanded to cover co-ordination on trans-Tasman issues in prudential supervision in the financial sector more broadly, subject to further work.
- 31 Cabinet directed the interdepartmental working group, chaired by Treasury, to report to back to Cabinet by 30 November 2006 on details of how the trans-Tasman Council for Banking Supervision could be expanded to include co-ordination on prudential supervision more generally, taking into account the directions of the Review of Financial Products and Providers and discussions with Australian officials [CBC Min (05) 18/29 refers].
- 32 Consideration of extending the role of the trans-Tasman Council for Banking Supervision is closely related with policy decisions being taken on the Review of Financial Products and Providers. Therefore on 3 May 2007, it was agreed to extend the report back date until 28 September 2007 [EDC Memo (07) 8/1 refers].
- 33 As this paper directs officials to report back to Cabinet by 30 November 2007 on the second stage of the Review of Financial Products and Providers, including the regulation of insurance, I propose that the report back date on expansion of the role of the trans-Tasman Council for Banking Supervision be extended correspondingly to 30 November 2007.

#### **CONSULTATION**

- 34 The proposals in this paper have been developed in consultation with the Treasury, the Ministry of Justice, the Securities Commission and the Reserve Bank of New Zealand. The following departments have also been consulted on the proposals made in this paper and their views incorporated: the Ministry of Consumer Affairs, the Inland Revenue Department, Department of Labour, Department of Internal Affairs, State Services Commission, Retirement Commission, Ministry of Social Development, Ministry of Foreign Affairs and Trade, Ministry for the Environment, Te Puni Kokiri, Customs Department, Department of Building and Housing and the Office of the Privacy

Commission. The Department of the Prime Minister and Cabinet has been informed of the proposals.

#### **FISCAL IMPLICATIONS**

35 Implementation of the proposals in the accompanying papers will have implications for the roles and functions of the Ministry of Economic Development, the Securities Commission and the Reserve Bank of New Zealand [...]:

a [...];

b [...];

c [...];

d [...]

e [...].

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36 [...].

37 I propose to report back to Cabinet, prior to the introduction of the first tranche of legislation, with detailed costings of these proposals by 30 November 2007, rather than as part of Budget 2008, and seek any increases in baseline funding for Vote:Commerce at that stage. I also propose that officials consider options for industry or other self funding in that report back.

38 The Minister of Finance will separately report on the funding implications of additional functions for the Reserve Bank associated with its prudential supervision of non-bank deposit takers as part of the proposed July 2007 report back on non-bank deposit takers.

#### **HUMAN RIGHTS**

39 Overall the proposals in this and the accompanying papers do not appear to be inconsistent with the New Zealand Bill of Rights Act 1990, or the Human Rights Act 1993. However, if any issues do arise, officials from the Ministry of Economic Development and Ministry of Justice will work together to ensure that the legislation is consistent with the Bill of Rights Act. A final view as to whether the proposals will be consistent with the Bill of Rights Act will be possible once the legislation has been drafted.

#### **PRIVACY IMPLICATIONS**

40 Officials from the Ministry of Economic Development have received an initial assessment of the privacy implications of the proposals and will work with the

Office of the Privacy Commissioner to ensure consistency of the legislation with the Privacy Act 1993 during the drafting process.

#### **LEGISLATIVE IMPLICATIONS**

- 41 A Financial Products, Providers and Intermediaries Bill is included in the 2007 Legislation programme in Category 4 (to proceed to select committee in 2007).

#### **REGULATORY IMPACT ANALYSIS**

- 42 Regulatory Impact Statements are attached to each of the accompanying papers.

#### **PUBLICITY**

- 43 There has been significant interest in the reviews of Financial Intermediaries and Financial Products and Providers, especially from market participants, some of whom have been involved as members of advisory groups and in making submissions to the reviews.
- 44 I propose announcing the decisions on this paper and each of the accompanying papers including the details of further work requested of officials and the specific policy decisions on 19 June 2007. This will provide feedback and some certainty to market participants, and allow a sufficient lead time for the sector to prepare for changes to regulatory frameworks,

## RECOMMENDATIONS

45 It is recommended that the Committee:

- 1 **Note** that a Financial Products, Providers and Intermediaries Bill is included in the 2007 Legislation programme in Category 4 (to proceed to select committee in 2007);
- 2 **Note** that a period of up to two years would be required to complete the policy and drafting work necessary to introduce this bill for all of the proposals arising from the reviews of Financial Intermediaries, Financial Products and Providers and Domestic Institutional Arrangements;
- 3 **Agree**, subject to the report back in recommendation 5 below on the detailed costings of the following proposals and the implications for Vote:Commerce, to a two-stage approach to legislation beginning with the introduction of legislation most urgently needed to implement decisions necessary to achieve compliance with international obligations and to better protect consumers through:
  - 3.1 Registration of all financial service providers;
  - 3.2 Improved supervision of corporate trustees;
  - 3.3 Improved prudential supervision of non-bank deposit takers, to be overseen by a single prudential regulator that would also be responsible for the prudential regulation of insurers;
  - 3.4 Regulation of financial intermediaries;
  - 3.5 Providing for a comprehensive approach to consumer dispute resolution and redress;
- 4 **Note** that policy recommendations necessary to draft legislation in respect of the proposals in 3.1, 3.2, 3.3, 3.4 and 3.5 are contained in the accompanying papers entitled:
  - 4.1 Registration of Financial Service Providers;
  - 4.2 Trustee Supervisory Model;
  - 4.3 Institutional Arrangements for Prudential Regulation;
  - 4.4 Regulation of Non-Bank Deposit Takers;
  - 4.5 Financial Advisers – A New regulatory Framework;
  - 4.6 Consumer Dispute Resolution and Redress;
- 5 **Direct** officials from the Ministry of Economic Development, in consultation with the Securities Commission and Treasury, to report back to Cabinet by 30 November 2007 on the detailed costings and funding

options for Vote:Commerce output expenses arising from the additional functions associated with the registration of all financial service providers; the regulation of financial advisers; the strengthened supervision of corporate trustees; and provision for industry provided dispute resolution schemes including options for industry or self funding;

- 6 **Note** that officials from the Reserve Bank in consultation with the Treasury will report separately to Cabinet in July 2007 on details related to the regulation of non-bank deposit takers, including funding requirements;
- 7 **Direct** officials from the Ministry of Economic Development (lead), the Treasury, the Reserve Bank of New Zealand and the Securities Commission to report back to EDC by 30 November 2007 with proposals to provide for:
  - 7.1 A single regulatory regime for collective investment schemes including the implications for all superannuation schemes of Ministerial decisions to separately progress regulation of KiwiSaver compliant schemes;
  - 7.2 Improved trustee supervision of debt issuers;
  - 7.3 An improved approach to disclosure for securities offerings;
  - 7.4 Necessary amendments to the law relating to insurer contracts and disclosure;
  - 7.5 A comprehensive and simplified approach to regulating Mutuals' governance;
  - 7.6 The regulation of platforms and portfolio management services that perform investment discretions on behalf of investors;
- 8 **Direct** officials from the Reserve Bank of New Zealand (lead), the Treasury, the Ministry of Economic Development and the Securities Commission to report back to Cabinet by 30 November 2007 with proposals to provide for a comprehensive prudential regulatory regime for insurers;
- 9 **Invite** the Minister of Commerce to announce the government's decisions on the reviews of Financial Intermediaries and Financial Products and Providers including details of:
  - 9.1 The two step approach to legislation;
  - 9.2 The specific policy decisions made on proposals in the accompanying papers;
  - 9.3 The further work directed of officials in Recommendations 7 & 8 above;
- 10 **Agree**, as part of the above announcement, to publicly release this paper and the related papers on:

- 10.1 Registration of Financial Service Providers;
  - 10.2 Trustee Supervisory Model;
  - 10.3 Institutional Arrangements for Prudential Regulation;
  - 10.4 Regulation of Non-Bank Deposit Takers;
  - 10.5 Financial Advisers – A New regulatory Framework;
  - 10.6 Consumer Dispute Resolution and Redress;
- 11 **Note** that in December 2005, Cabinet agreed in principle, that the scope of the trans-Tasman Council for Banking Supervision be expanded to cover co-ordination on trans-Tasman issues in prudential supervision in the financial sector more broadly, subject to further work; and directed the interdepartmental working group, chaired by Treasury, to report back to Cabinet by 30 November 2006 on details of how the trans-Tasman Council for Banking Supervision can be expanded to include co-ordination on prudential supervision more generally, taking into account the directions of the Review of Financial Products and Providers and discussions with Australian officials [CBC Min (05) 18/29 refers]; and
- 12 **Agree** to extend the report back to Cabinet on how trans-Tasman Council for Banking Supervision be expanded to include coordination on prudential supervision to 30 November 2007.

Hon Lianne Dalziel  
**Minister of Commerce**