

Background

Non-bank financial products and providers include insurance, superannuation, collective investment schemes, platforms and portfolio management services, non-bank deposit takers, securities offerings and issuers of equity and debt securities. These products and providers are currently regulated by a myriad of laws, which has led to gaps in coverage, inconsistencies in the regulatory treatment of similar products and unnecessary compliance costs.

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: Review of Financial Intermediaries and Review of Financial Products and Providers (RFPP). Both reviews shared the objectives of: a sound and efficient financial system; investment which encourages growth and innovation; an environment which facilitates wealth accumulation; and confidence in the sector.

The Review of Financial Intermediaries involved the establishment of a Financial Intermediaries Taskforce, which designed a co-regulatory model involving Approved Professional Bodies as the frontline regulators and the Securities Commission as the overarching regulator.

The Review of Financial Products and Providers saw nine discussion documents issued in 2006: Overview of the Review and Registration of Financial Institutions; Review of Securities Offerings; Supervision of Issuers; Collective Investment Schemes; Non-Bank deposit takers; Insurance; Mutuals' Governance; Consumer Dispute Resolution and Redress; Platforms and Portfolio Management Services.

Overview of decisions

Changes arising from the reviews will mean 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 while keeping any necessary compliance costs to a minimum and improving consumer confidence in the sector. The changes will also ensure that New Zealand meets its international obligations, especially those arising from the Financial Advisory Task Force (FATF) to mitigate money laundering and the financing of terrorism.

Cabinet has agreed to a two phased approach to introducing legislation to implement the findings of the reviews of Financial Products and Providers, and Financial Intermediaries.

The Phase 1 decisions are to:

- **register all non-bank financial institutions.** This is necessary to provide an initial means of identifying and monitoring financial institutions and is a critical first step in the implementation of other review proposals. It is also necessary to achieve compliance with international obligations;

- **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 achieve compliance with international obligations;
- **strengthen the prudential regulation of non-bank deposit takers** by providing for corporate trustees to work to minimum prudential standards that would be developed and monitored by a single prudential regulator that would also regulate insurers;

Cabinet's earlier in principle decision that the Reserve Bank of New Zealand be the prudential supervisor has been confirmed;

- **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 [IOSCO](#) (International Organisation of Securities Commissions Organisations) Objectives and Principles of Securities Regulation;
- **provide for effective consumer dispute resolution and redress** across all parts of the sector. This is necessary to improve consumer confidence in the sector.

Further policy work (Phase 2) will be reported back by 30 November 2007 to finalise additional proposals from the Review of Financial Products and Providers to:

- **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;
- **simplify 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 so as to reduce compliance costs on issuers while ensuring that public investors are adequately informed in their investment decisions;
- **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 requirements;
- **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;
- **regulate platforms and portfolio management services.** The focus of this work will be on ensuring minimum protections for consumers of platform and portfolio management services that perform advisory and custodial roles.

Where can I find more information?

You can read more about the Review of Financial Products and Providers on the [MED](#) website at:

http://www.med.govt.nz/templates/ContentTopicSummary_479.aspx

If you cannot find an answer to your question there, contact: FPPreview@med.govt.nz

FINANCIAL ADVISERS – A NEW REGULATORY FRAMEWORK

Background:

New Zealand requires competent and reliable financial advisers to play a key role in addressing information asymmetry in the financial sector. The current voluntary or sector specific industry self-regulation of advisers is failing to ensure that advisers are accountable to the public; members of the public are able to make informed decisions about their advisers; and that advisers have the necessary experience and expertise. New Zealand has also been assessed as only partly implementing international regulatory standards for the monitoring of financial advisers, and there is insufficient information, monitoring and compliance to provide a basis for trans-Tasman mutual recognition of advisers.

The objectives of the new regulatory framework (which were generally endorsed by submissions) are:

- **Disclosure:** ensuring adequate disclosure of advisers' conflicts of interests, fees and competency so that members of the public can make informed decisions about whether to use an adviser and whether to take their advice;
- **Competence:** members of the public having advisers available that have the experience, expertise and integrity to effectively match a members of the public with products that best meet their needs and risk profile;
- **Accountability:** advisers being held accountable for any advice given and that there are incentives for advisers to manage appropriately conflicts of interest;

Similar to all financial sector work, the aim of the regulation is the promotion of a sound and efficient financial sector in which the public have confidence in the professionalism and integrity of advisers; regulation that is well targeted and does not impose unnecessary costs; and encouraging innovative and competitive markets.

This paper establishes a regulatory framework for those who provide financial advice (including mortgage brokers, insurance brokers, investment advisers and financial planners). The purpose of the framework is to set clear standards of practice and competency to benefit these advisers and members of the public; to allow New Zealand to better meet international regulatory standards; and to provide a firm basis for trans-Tasman mutual recognition of financial advisers.

The regulatory framework will replace the voluntary self-regulation and existing sector specific legislation to ensure consistency across the financial advice giving sector. Responsibility will be placed, under a co-regulatory model on Approved Professional Bodies and the Securities Commission to regulate those who provide financial advice. The Minister of Commerce will approve the approved professional bodies, which will in turn approve membership by Financial Advisers. All Financial Advisers will be required to belong to a minimum of one Approved Professional Body

The framework will primarily apply to individual advisers. However, financial advice giving businesses will have the choice to join approved professional bodies as

corporate members, and take over responsibility for their individual employees attaining the approved professional body standards.

Financial advice will include opinion/ recommendation/ guidance on the buying/ selling/ holding of financial products or investment and savings decisions given to a member of the public in the course of the adviser's business.

Who is a "Financial Adviser"?

A "Financial Adviser" is an entity or person who gives advice on financial products and/or investment and savings decisions to a member of the public. The new regulatory regime will primarily apply to individual advisers. However, businesses which employ financial advisers (e.g. banks, insurance companies, financial planning firms, etc) will have the choice to join [APBs](#) as corporate members. There will be no name protection for the term "financial adviser". The definition of Financial Advisers includes those people who call themselves mortgage brokers, insurance brokers, investment advisers, financial planners, including those who give pro bono advice, and real estate agents who provide opinions, recommendations and guidance on investment property (not primary places of residence).

What is "Financial Advice"?

"Financial Advice" includes opinions, recommendations, and guidance on the buying, selling and holding of financial products or investment and savings decisions, given to a member of the public, in the course of the adviser's business. This definition covers:

- some investment seminars
- certain radio broadcasts paid for by Financial Advisers (which have been advertised as providing advice)
- any material published by a Financial Adviser
- advice designed to sell third party financial products without regard to personal circumstances

It does **NOT** cover:

- social conversations
- acts of collecting information from members of the public (e.g. to complete an insurance policy) and placing promotional statements on display
- transmission of factual information given by an issuer or a product provider, or guidance about the procedure for buying/selling/holding financial products
- teachers talking about savings in classes
- news articles or commentary by journalists
- comments by government departments, regulators, or Ministers
- independent media commentary on bank products
- advice published at www.sorted.org on retirement savings and choices

What is a “Financial Product”?

There is a broad definition of “Financial Products” covering all categories of financial product, including debt/equity, credit and risk products, investment (real) property and other tangible products where there is an investment and savings element.

Why are Financial Intermediaries now referred to as “Financial Advisers”?

The term “intermediary” has been dropped in favour of the term “adviser” as this more accurately reflects the focus of regime, the function of an adviser and is a term more commonly understood and recognised.

Will all real estate agents be classified as Financial Advisers?

Only real estate agents giving opinions, recommendations and guidance on investment property (not primary places of residence) will be considered as Financial Advisers.

Will lawyers giving financial advice be classified as Financial Advisers?

Officials are currently examining the extent to which lawyers should be exempt from the regime with the desire to avoid dual regulation, and if additional regulation for lawyers and/or accountants is necessary. Ministry of Economic Development and Ministry of Justice officials will consult with the NZ Law Society on this.

What is the Register of Financial Service Providers?

The publicly searchable register is the database of Financial Advisers that will be drawn from information provided by Approved Professional Bodies. It will enable the public to verify the professional status of a Financial Adviser. This information will be available through the Companies Office as a searchable “notice board” of Financial Advisers.

Who are “members of the public”?

The regulatory regime applies only when advice is given to a “member of the public”. This is an accepted term, eg as defined in New Zealand’s securities legislation, which includes natural persons as well as small businesses. This will meet submitters’ concerns that financial decisions about asset protection and insurance are just as important for small businesses as for natural persons. For consistency, the same exemptions as in the Securities Act 1978 will be adopted here.

What does “Co-Regulatory Model” mean?

Co-regulation provides a means for government and industry to work together to achieve the objectives of competence, disclosure and accountability in a way that best meets the needs of financial advisers and consumers. Under the co-regulatory model, the Securities Commission will oversee the market as a whole, with the

Approved Professional Bodies (APBs) functioning as front-line regulators of financial advisers.

What is an Approved Professional Body (APB)?

An APB is an industry-based self-regulatory organisation/entity approved by the Minister of Commerce. All Financial Advisers will be required to be a member of at least one APB. An APB will:

- maintain a register of its members
- pass this information to the publicly searchable register of Financial Service Providers
- set entry level standards
- set ongoing standards
- monitor members (on a risk based approach sufficient to enforce compliance)
- carry out discipline for breaches of APB rules (with sufficient powers to investigate possible breaches)
- participate in a dispute resolution process
- report to the Securities Commission on its own corporate governance as well as Financial Advisers' behaviour

What is the Securities Commission's role in relation to the Co-Regulatory Model?

The Securities Commission will

- make recommendations to the Minister of Commerce on Approved Professional Body (APB) applications;
- retain the authority to inquire into matters affecting members of the public and/or the market (which includes enforcing the statutory conduct and disclosure requirements through civil and criminal penalties).
- evaluate the performance of APBs.
- have the necessary powers to obtain information from an APB
- take over the responsibility for an inquiry from an APB where the Securities Commission is satisfied that the powers of an APB are inadequate for inquiring into or addressing particular misconduct or where a conflict of interest necessitates it
- direct the APB to adhere to its rules
- ensure the overall health of the sector

What is "corporate membership" of an Approved Professional Body?

Businesses which employ financial advisers (e.g. banks, insurance companies, financial planning firms, etc) will have the choice to join an APB as a "corporate member". In order to obtain corporate membership, a business must satisfy the APB that it has the necessary processes to ensure the competency and integrity of its employees. While individual businesses are not precluded from becoming an APB, this is unlikely to happen in practice, because of the potential conflict that would arise

between the businesses obligations as an [APB](#) and as an employer. Instead, corporate membership allows businesses to retain responsibility for competency setting and monitoring, provided that, at a minimum, they meet the [APB](#)'s standards.

Can I be a Financial Adviser if I don't belong to an [APB](#)?

No. The minimum requirements for individual Financial Advisers stipulate membership of at least one [APB](#). Businesses have the option of corporate membership of [APBs](#).

What happens if a Financial Adviser is expelled from an [APB](#)?

There will be a requirement for information sharing between [APBs](#) and the Securities Commission. Depending on the nature and seriousness of the conduct that led to the expulsion, the Financial Adviser could be de-registered, or may be permitted to join a different [APB](#).

What are the statutory conduct obligations and statutory disclosure obligations for Financial Advisers?

Financial Advisers are required to comply with the following statutory conduct obligations:

- belong to at least one [APB](#)
- provide all required information to the [APB](#)
- act in accordance with the proposed legislation
- exercise reasonable care, diligence, skill
- act with integrity
-

Financial Advisers are required to disclose to their customers, in writing, prior to advice being given:

- details of [APB](#) membership
- qualifications and experience
- access to dispute resolution
- past criminal convictions
- relevant remuneration / relationship
- the type of advice given

These disclosure obligations are consistent with those of the Securities Markets Act. In addition to the minimum requirements of the statutory conduct and disclosure obligations, [APBs](#) will make rules for their members covering these, and other, matters.

What happens if a Financial Adviser breaches the statutory obligations?

[APBs](#) will be empowered, and have an obligation, to investigate possible breaches of [APB](#) rules and carry out discipline. The Securities Commission will take over the responsibility for an inquiry from an [APB](#) where the Securities Commission believes

that the powers of an APB are inadequate for inquiring into or addressing particular misconduct or where a conflict of interest necessitates it.

The Securities Commission will be given power under the regulatory framework to enforce the penalties and enforcement mechanisms for breach of Financial Adviser statutory obligations, rather than approved professional bodies taking on responsibility for prosecution.

Both criminal and civil penalties would apply for breaches of the statutory duties. The Securities Commission is already empowered to apply to the Court for criminal penalties for investment advisers, one of the subsets of Financial Advisers (refer Securities Markets Act).

What competencies are required of Financial Advisers?

These will be determined by each APB. It is up to each APB to determine what qualifications/ certification they will require of their members. This could include, for example, independent third party qualifications, APB in-house training or recognition of prior work experience.

Can an individual Financial Adviser join more than one APB?

Yes, you can join more than one APB. The minimum requirements for individual Financial Advisers stipulate membership of at least one APB.

Are the disclosure obligations of individual Financial Advisers different from those of employees of a business with APB corporate membership?

Corporate members of APBs will be responsible for disclosure about the business, rather than about the individual employee, in the case of some employees, to avoid call centre employees and bank tellers having to provide full disclosure in writing prior to giving advice. This is on the basis that the cost to organisations of providing this information would not be sufficient to justify the benefit to the consumer of knowing (for example) the exact qualifications of every bank teller. Instead, it is proposed that corporate members would take on responsibility for disclosing competency levels and remuneration levels where these are set by the entity or for groups such as tellers or call centre staff.

Can a business have more than one APB corporate membership?

Yes. As for individual financial advisers, a business may become a corporate member of more than one APB.

What happens if there is no APB for me to join? Will there be a default APB?

No. In the event that there is no APB for a particular sector of the market, officials will work with industry to extend the existing capabilities of existing bodies, or to promote the establishment of an appropriate body in the transition period of this regulatory framework.

The transition period allowed for the regulatory framework should guard against concerns that there will not be a suitable body to which an adviser can belong.

What are the minimum requirements to become an APB?

An APB must be approved by the Minister of Commerce, who will be advised by the Securities Commission. The Securities Commission bases its recommendation of approval on whether or not the APB rules and processes would allow the APB to meet the International Organisation of Securities Commissions (IOSCO) criteria. These minimum standards for APBs are adapted from those set by IOSCO for “self regulatory organisations” and will help set limits on any behaviour which is uncompetitive or not in the best interests of the regulatory framework. APBs will be required to:

- have the capacity to carry out the purposes of governing laws, regulations and APB rules
- enforce compliance by its members and associated persons with those laws, regulations, and rules
- treat all members of the APB and applicants for membership in a fair and consistent manner (including accepting corporate memberships)
- develop rules that are designed to set standards of behaviour for its members and to promote public protection
- submit its rules for review and approval to the Minister of Commerce, and ensure that its rules are consistent with any public policy directives made by the Securities Commission
- co-operate with the Securities Commission and other APBs to investigate and enforce applicable laws and regulations
- enforce its own rules and impose appropriate sanctions for non-compliance
- assure a fair representation of members in selection of its directors/administration of its affairs
- avoid rules that may create uncompetitive situations and
- avoid using the oversight role to allow any market participant unfairly to gain advantage in the market.

What is the approval process to become an APB?

- A potential APB will prepare its rules, governance structure and processes in consultation with the Securities Commission
- The potential APB submits its rules to the Minister of Commerce

- The Minister refers the rules to the Securities Commission for a recommendation within a set time
- The Securities Commission bases its recommendation on whether or not the APB rules and processes would allow the potential APB to meet the IOSCO criteria
- The Minister will then, within a reasonable time period, consider whether or not to approve the application to be an APB, taking into account the IOSCO criteria, the Securities Commission's recommendation, and public interest concerns
- The Minister then advises the potential APB whether or not they will be registered as an APB
- If the application is unsuccessful, the applicant can choose to start the application process again through consultation with the Securities Commission on the content of the rules

Are there any special requirements for Financial Advisers handling client monies?

Only those Financial Advisers who handle client money will be subject to additional conduct and disclosure obligations. Under these additional obligations it is proposed that the Securities Commission have the responsibility for monitoring advisers against these additional conduct requirements.

Will Australia recognise Financial Advisers who comply with this Act?

The basic principle guiding harmonisation in this area is that regulated entities operating in both countries will only need to fulfil a particular requirement once. This will facilitate the ability of Financial Advisers to operate in both countries, setting the regulatory basis for mutual recognition of Financial Advisers.

The Securities Commission will not be replicating the Australian Securities and Investments Commission (ASIC) role; it will instead focus on the health of the overall industry (and oversee APBs), while APBs will be responsible for the day-to-day monitoring of advisers. New Zealand and Australian officials are continuing to liaise to resolve any issues that may arise in the implementation of the regime.

When will the new Financial Advisers regulatory regime be in place?

- Legislation is expected to be passed in 2008
- APBs are expected to be in place by 2010
- The full regime is expected to be in force by 2012

What other legislation will be affected by the new Financial Advisers regulatory regime?

Financial advisers will continue to be subject to the general consumer protection requirements of the Fair Trading Act 1986 and Consumer Guarantees Act. These obligations will be supplemented with specific conduct and disclosure obligations under the proposed new legislation. This is consistent with the approach taken under other securities legislation, which complements the general coverage of consumer protection legislation.

Existing requirements on some financial advisers under the Investment Advisers (Disclosure) Act 1996 and Securities Markets Act 1988 will be replaced by the new Financial Advisers legislation, although note that the final form of the proposed legislation has not yet been settled.

The new legislation will not result in duplication with the Credit Contracts and Consumer Finance Act 2003 (CCCFA) in relation to disclosure for credit products, as the CCCFA expressly exempts contracts with an investment element, whereas the Financial Advisers' framework focuses only on investment and savings decisions.

What happens when a Financial Adviser breaches their statutory obligations?

APBs will be empowered, and have an obligation, to investigate possible breaches of APB rules and carry out discipline. The Securities Commission will take over the responsibility for an inquiry from an APB where the Securities Commission believes that the powers of an APB are inadequate for inquiring into or addressing particular misconduct or where a conflict of interest necessitates it.

The Securities Commission will be given power under the regulatory framework to enforce the penalties and enforcement mechanisms for breach of Financial Adviser statutory obligations, rather than approved professional bodies taking on responsibility for prosecution.

Both criminal and civil penalties would apply for breaches of the statutory duties. The Securities Commission is already empowered to apply to the Court for criminal penalties for investment advisers, one of the subsets of Financial Advisers (refer Securities Markets Act).

REGISTRATION OF FINANCIAL SERVICE PROVIDERS

Background: Currently, there is no way of identifying or monitoring providers of financial services. Data identifying all providers of financial services is important to regulators for the purpose of identifying risks in the sector, as well as those who are not complying with statutory requirements. Data is also necessary so that market participants (i.e. business analysts, financial advisers and consumers) can access information on a financial services provider. There is currently no assurance to consumers and investors that financial service providers have not been convicted of financial crimes or other misconduct or that they are fit to run financial institutions.

Submissions on the Ministry's discussion document generally supported the proposal for a registration system. Submitters also indicated the need to clearly delineate the functions and powers of the regulators and ensure that it is clear to financial services providers which regulator they need to deal with in a given situation.

The registration system for financial service providers will:

- identify financial service providers;
- allow more effective monitoring and evaluation;
- provide easy access to information about financial service providers;
- give some assurance about the integrity of people running financial service providers
- assist in meeting New Zealand's anti-money laundering obligations under the Financial Action Task Force (FATF) Recommendations.
- ensure that the directors and senior management of entities providing financial services have no record of criminal activities or having been bankrupt, or having been the subject of a director/management ban under companies or securities legislation.

Financial service providers providing defined financial services will be required to be registered in order to carry on business in New Zealand. The Registrar of Companies will have responsibility for establishing and maintaining the register. The Registrar will undertake enforcement functions in relation to breaches of the registration requirements, and will have the power to share information with the Securities Commission, the Reserve Bank, and other agencies that carry out anti-money laundering supervisory and enforcement functions, such as the Financial Intelligence Unit of the Police.

Who will be required to register as financial service providers?

Entities that will be required to register as financial service providers include: banks; friendly societies; credit unions; building societies; finance companies; issuers of equity and debt securities; issuers of collective investment schemes; trustees supervising these issuers; insurers; platform and portfolio service providers and custodians; investment brokers; dealers in securities and futures contracts; lending businesses; financial leasing businesses; money or value transfer services (e.g. money remittance); money and currency changers.

The definition is based on the Financial Action Task Force ([FATF](#)) definition of a financial institution.

Why are banks included, given this is for non-bank financial service providers?

The [FATF](#) definition covers a broader range of entities than those within the scope of the [RFPP](#). While banks will be included in the same registration system as other financial service providers, this will not alter the Reserve Bank's supervision functions in relation to banks under the Reserve Bank of New Zealand Act 1989.

Who will not be required to register as financial service providers?

Those defined by [FATF](#) as 'designated non-financial businesses and professions'; examples of which are accountants and lawyers. The Ministry of Justice's review of NZ's compliance with [FATF](#) recommendations will deal with any issues relating to those businesses and professions.

Why register Financial Service Providers?

The overarching objective is to promote confidence in the financial sector. The purposes of the proposed register are: to identify financial service providers and ensure that the controlling shareholders, directors and senior managers are subject to criminal checks, to enable members of the public to access information on the products and services provided by the entity, and to provide information about which consumer dispute resolution scheme the entity belongs to; and to assist the registrar and other regulators to enforce legislation regulating the financial sector.

The proposed registration system will also contribute to compliance with [FATF](#) recommendation 23 which requires New Zealand to have a comprehensive supervisory framework for "financial institutions".

The proposed registration system will also help regulatory authorities to assess what regulatory requirements are applicable to an entity (for example, prudential or market conduct regulatory requirements and anti-money laundering and countering the financing of terrorism ([AML/CFT](#)) monitoring requirements) because it will contain information on the types of financial services the entity provides. This means that it will be easier for the regulators to monitor and enforce the law.

Why not use the existing registration requirements?

(e.g. the Building Societies Act 1965, the Friendly Societies and Credit Unions Act 1982, and the prospectus registration requirement under the Securities Act 1978.)

These registration systems have been put in place for a range of purposes and do not provide complete coverage of financial service providers and the services they provide. As the information available on the registers does not identify the nature of

the financial services an entity provides, it is difficult to build up a complete picture of a provider's details and activities.

The current regulatory framework does not provide assurance to consumers and investors that financial service providers have not been convicted of financial crimes or other misconduct. This increases the risk of unfair, fraudulent or negligent misconduct in relation to financial service providers.

New Zealand is currently not compliant with Recommendation 23 of the Financial Action Task Force's 40 Recommendations on Money Laundering which provides for the implementation of measures to prevent criminals from controlling or managing financial institutions and to subject directors and senior managers of some financial institutions to fit and proper evaluations.

What information sharing arrangements are there to avoid duplicating Financial Service Providers registration requirements?

The regulatory agencies involved in the financial sector do have related roles. It is therefore proposed that the Registrar have the power to share information, for the purpose of assisting in the exercise of financial sector regulatory functions, with the Securities Commission, the Reserve Bank, and other agencies that carry out anti-money laundering supervisory and enforcement functions, such as the Financial Intelligence Unit (FIU) of the Police. The regulatory agencies will have a duty to cooperate with each other in performing these functions. The specific agencies involved will be determined by the outcome of the Ministry of Justice FATF Compliance Review. The Registrar will also have the ability to use information communicated to it by the other agencies in the performance of its functions and duties.

Who will be the Registrar of Financial Service Providers and what will be the Registrar's responsibilities?

The Registrar of Financial Service Providers (the Registrar) will be the person holding office as the Registrar of Companies. The Registrar will be responsible for establishing and maintaining a register of financial service providers. As part of the registration procedure, the Registrar will carry out checks of applicants. The Registrar will check that the controlling shareholders, directors and senior management of entities applying for registration meet negative assurance criteria.

The Registrar of Financial Service Providers will also be responsible for removing entities from the register where he or she receives notification from an entity or from the relevant regulator or a consumer dispute resolution scheme that the entity no longer meets the registration requirements.

What information is required for Registration of Financial Service Providers?

Registration will require the following information

- name of entity;
- name of dispute resolution scheme to which the entity belongs (this is a requirement of registration and is part of the changes to consumer dispute resolution and redress
- list of categories of financial services provided (as prescribed in regulations).
- details of controlling shareholders, directors, and senior management for negative assurance checks

Registered financial service providers will be obliged to notify the Registrar within a specified period of changes in the information they have provided.

The Registrar will be required to notify the financial service provider where a director or senior manager does not meet the negative assurance criteria. The entity will then be required to advise the Registrar within a time period prescribed in the Act of the action that has been taken to ensure that it meets the registration criteria. If the Registrar receives no notification within the required time period the entity will be removed from the register.

What are the negative assurance criteria for Registration of Financial Service Providers?

The negative assurance criteria require that no controlling shareholder, director or senior manager of a financial service provider:

- is an undischarged bankrupt;
- is a person who is prohibited from being a director or promoter of or concerned in the management of a company under the Companies Act, Securities Act, Securities Markets Act or the Takeovers Act;
- has been convicted of a crime involving dishonesty or fraud within the preceding five years, or has been convicted of a crime involving money laundering or financing of terrorism; and
- is or has been subject to a confiscation or forfeiture order under the Proceeds of Crime Act 1991 or, in the event that it is enacted, such an order under the Criminal Proceeds (Recovery) Bill, which is before the Justice & Electoral Select Committee.

What are the positive assurance (“fit and proper”) criteria for Registration of Financial Service Providers?

The system will link in to other parts of the financial sector regulatory framework aimed at ensuring that persons managing or controlling some kinds of financial

service providers (e.g. trustees, non-bank deposit-takers) meet “fit and proper” criteria regarding expertise and capability.

When is a registered Financial Service Provider required to update information provided to the Registrar?

Financial service providers will be required to confirm annually that the information they have provided is still correct or to make any necessary changes. Registered financial service providers will be obliged to notify the Registrar within a specified period of changes in the information they have provided with regard to details of their directors and senior management.

What happens to the registration process for Financial Service Providers when there are additional regulatory requirements e.g. for trustees?

Where an entity wishes to provide a service which has additional regulatory requirements, for example that it be licensed or meet specific criteria as to capacity, qualifications or experience, it will not be able to complete the registration process for that service until the relevant regulator (for example the Reserve Bank or the Securities Commission) advises the Registrar that the specific criteria have been met. An example of a service that has additional regulatory requirements is that provided by a trustee who supervises issuers of securities.

What are the penalties for offences?

A maximum penalty of up to 2 years imprisonment or a fine not exceeding \$100,000 for individuals; up to \$300,000 fine for a body corporate for the most serious of the proposed offences, with lower penalties for less serious offending. These penalties are set at a level which is a meaningful punishment and deterrent. These penalties are similar to penalties found in the Companies Act 1993, the Securities Act 1978 and the KiwiSaver Act 2006.

Will there be a charge to access information on the Register of Financial Service Providers?

No there will be no charge. The aim is to provide an easily accessible means for consumers and market participants to find information on financial services providers and products.

CONSUMER DISPUTE RESOLUTION AND REDRESS

Background:

Effective dispute resolution and redress mechanisms are essential to encouraging consumers to participate in financial markets and promoting market discipline for financial providers.

The discussion paper put forward a number of options for improving consumer access to dispute resolution and redress. These options included improved consumer education, enhanced civil remedies and specialist courts/tribunals, and voluntary and/or mandatory industry-based dispute resolution schemes. Submissions on the discussion paper supported the view that there is sufficient evidence of a problem to warrant further government action to improve access to redress in order to promote consumer confidence in financial markets. Submissions were generally in favour of a mandatory industry-based dispute resolution system, however there were also arguments in favour of a voluntary dispute resolution system (status quo), and use of the courts as the appropriate place to resolve disputes.

Submissions were fairly evenly split between the single scheme and multiple schemes approaches, with a slight majority in favour of multiple schemes. The preferred option is the establishment of multiple schemes as submissions were not able to mount a convincing argument that the efficiency and economies of scale of a single scheme would be sufficient to outweigh the flexibility and greater industry involvement of a multiple schemes approach.

Participants in each sector should be free to choose the form of dispute resolution that best suits the particular characteristics of the sector, whether that be a sector-specific dispute resolution scheme or a wider scheme.

Key features include:

- the Minister of Commerce may approve a dispute resolution scheme if the scheme meets criteria of accessibility, independence, fairness, accountability, efficiency and effectiveness.
- Membership of an approved dispute resolution scheme will be mandatory for financial service providers who/that transact with consumers.

It is anticipated that more than one scheme will be approved, and financial service providers will have freedom to choose which scheme they wish to join. In the event of no schemes meeting the approval criteria or if there is not full coverage of the financial industry by those schemes which are approved, reserve powers will allow for a government-established scheme.

What are the objectives of Consumer Dispute Resolution & Redress?

The purpose of the dispute resolution system is to provide a simple, low-cost avenue for consumers to seek redress. The dispute resolution system will be fully funded by industry. Government involvement will be limited to approving schemes (including periodic renewal), receiving periodic reports, and powers of inspection if necessary, rather than involvement in the day-to-day operation of a scheme.

In the context of consumer dispute resolution and redress, three further policy objectives support the overarching aim of a robust and efficient financial sector:

- Promote consumer/investor confidence in financial markets.
- Reinforce market incentives, within a competitive environment, to encourage fair and reasonable behaviour by financial providers towards their customers;
- Maintain resilience and stability of financial markets.

Consumer confidence relies on three elements:

- Consumers' expectations of a transaction are met by suppliers;
- Consumers and suppliers have confidence in market rules and institutions;
- Consumers have effective access to redress.

How will customers be educated about this Act?

Officials will work with the industry to develop public information/ education about the new regime. Further details of such a campaign will be available at a later date.

How will customers know they can complain about a Financial Adviser?

The statutory disclosure obligations of Financial Advisers will require them to disclose to the customer, in writing, prior to advice being given, the nature and procedure of the dispute resolution process available to the consumer.

What changes are proposed?

The new regime will require that all registered financial service providers and financial advisers must join an approved dispute resolution scheme if they transact with consumers.

What will this mean for existing voluntary dispute resolution schemes?

The existing voluntary industry-based dispute resolution schemes, such as the Banking Ombudsman and Insurance & Savings Ombudsman, work very well. These schemes may choose to seek approval. However, voluntary schemes do not currently extend to building societies, credit unions, finance companies, financial

advisers and some superannuation schemes. Establishing schemes to cover these sectors will improve access to redress and promote consumer confidence in financial markets.

How many approved dispute resolution schemes will there be?

The new legislation will not prescribe how many dispute resolution schemes there will be. Existing schemes are already operating efficiently. It would be counter-productive to tamper with them for the sake of creating a unified, cross-industry scheme. As each sector of the financial industry offers a distinct range of products and services, participants in each sector should be free to choose the form of dispute resolution that best suits the particular characteristics of that sector, whether that be a sector-specific dispute resolution scheme or a wider scheme.

Who is required to belong to an approved dispute resolution scheme?

Membership of an approved dispute resolution scheme will be mandatory for registered financial service providers and financial advisers who transact with consumers (see list p9).

What is the definition of “consumer” in the context of Consumer Dispute Resolution & Redress?

The definition of consumer will depend on the particular sector, and will need to be consistent with the other definitions of consumer that flow from the consumer protection and other regulatory requirements in that sector. MED is currently undertaking further work on these definitions. For example, the Securities Act provides consumer protection (through disclosure requirements) for “members of the public”. The Credit Contracts and Consumer Finance Act applies to “consumer credit contracts”, that is, where the debtor is a natural person and enters into the contract primarily for personal, domestic or household purposes.

Who will approve the dispute resolution schemes?

Approval of dispute resolution schemes will be by the Minister of Commerce in consultation with the Minister of Consumer Affairs and Minister of Finance. The legislation will provide for appropriate checks and balances in the approval process, including a requirement for the Minister to be satisfied that the scheme has undertaken appropriate consultation, timeframe for decisions, method of notifying approval, and other matters. There will be principle-based approval criteria and mandatory considerations.

What are the principle-based approval criteria for dispute resolution schemes?

The broad principle-based approval criteria for dispute resolution schemes are accessibility, independence, fairness, accountability, efficiency, and effectiveness.

What are the mandatory considerations for approval of dispute resolution schemes?

- Governance of schemes: independence, accountability, competency, negative assurance checks.
- Periodic reviews: renewal at 10 year intervals; annual reporting; internal or independent periodic reviews.
- Funding of schemes: procedures in place to ensure adequate funding.
- Cost to consumers: free or low cost to consumers to lodge a complaint with the scheme.
- Membership restrictions: the extent to which a scheme's members cover a particular sector or sectors, however, each scheme will be free to set restrictions or qualifications on membership of the scheme to ensure that the scheme operates in an efficient and effective way.
- Jurisdiction of schemes: a minimum jurisdiction covering breach of contract or statutory obligation, and breach of an industry code, as this reflects the jurisdiction available to consumers through the courts; whether a proposed monetary limit is appropriate for the particular sector or type of business carried on by scheme members.
- Evidence and processes: a scheme be based on rules which provide for simplified processes for the resolution of disputes.
- Awareness, promotion and education: the scheme should be promoted to consumers. Member firms will be required to inform their customers of the scheme's existence.
- Reporting to stakeholders: scheme management will be expected to report regularly to their members, the public and other stakeholders.

How will gaps in coverage of the financial industry by dispute resolution schemes be addressed?

The legislation will allow for reserve powers under which the Minister may, by regulation, establish a reserve dispute resolution scheme (the "reserve scheme") if there are no approved schemes, or if there is not full coverage of the financial industry by those schemes which are approved. The reserve scheme would be subject to the same regulatory requirements as an industry-based scheme and would be required to meet the principles of accessibility, independence, fairness, accountability, efficiency, and effectiveness.

Financial providers would be able to satisfy their mandatory membership obligation by joining either the reserve scheme or an approved scheme. The reserve powers will also permit a levy to be imposed on members of the reserve scheme to fund the establishment and operation of the reserve scheme.

What are the funding arrangements for the approved dispute resolution schemes?

It is expected that the dispute resolution system will be fully funded by industry. The Ministry of Economic Development will support the establishment of the schemes through providing guidance and working with scheme owners prior to approval.

What monitoring and supervision arrangements are there for the approved dispute resolution schemes?

Government involvement will be limited to approving schemes (including periodic renewal), receiving periodic reports, and powers of inspection if necessary. Regulations will require an annual report to the approving Minister, setting out basic information about the activities of the scheme (eg number and type of complaints considered, promotional activities undertaken), as well as identifying any issues which may have a wider impact on the financial sector and which the scheme considers require regulatory review by government.

There will also be an obligation for schemes to maintain a list of members and to immediately notify the Registrar of Financial Service Providers if a member is expelled from the scheme.

It is proposed that the Retirement Commissioner retain the power under section 83(e) of the New Zealand Superannuation and Retirement Income Act 2001 to monitor the effectiveness of persons who have been appointed (other than under statutory authority) to consider complaints and disputes about savings and investments.

What happens when a complaint involves firms who are members of more than one approved dispute resolution scheme?

It is expected that schemes will include procedures allowing voluntary cooperation. This could include sharing resources, establishing a single entry point (eg a shared call centre and/or website) for consumers, coordinating cases and learning from each other.

If consumers are dissatisfied with the approved dispute resolution scheme's decision, what can they do?

The proposed industry-based dispute resolution system is intended to operate as a complement to the courts. This means that consumers will still retain their right to take court action if they wish. The scheme's rules will not preclude a consumer from rejecting the approved dispute resolution scheme's decision and taking alternative court action against a financial provider if he or she is dissatisfied with the decision.

What is a member's right to appeal against a scheme's decision?

A member's limited right to appeal from a decision of an approved dispute resolution scheme will be similar to rights available under the Disputes Tribunal Act for appeals against an order of a Disputes Tribunal. That is, an appeal is only allowed on the grounds that the proceedings were carried out in an unfair manner.

REGULATION OF NON-BANK DEPOSIT-TAKERS

Background

Non-Bank Deposit-Takers (**NBDTs**) are entities whose core business involves offering deposits or deposit-like securities to the public and the provision of financial services. The **NBDT** sector comprises a wide range of financial institutions, including finance companies, building societies and credit unions.

The Discussion Document on **NBDTs** noted that the current regulatory arrangements for **NBDTs**, while not fundamentally flawed, had several deficiencies including: inconsistency in regulatory requirements and supervision across different **NBDTs**, the absence of minimum entry requirements for **NBDTs**, and insufficient information to enable depositors to assess and compare the risks of depositing with **NBDTs**.

The Discussion Document proposed some substantive changes to the regulation of **NBDTs** to address these problems, while still seeking to keep regulatory costs low and preserving diversity and flexibility in the **NBDT** sector. The proposals included a requirement for all **NBDTs** to be licensed and to meet minimum prudential, governance and fit and proper requirements, both at licensing and on an ongoing basis. It proposed a new (elective) category of **NBDT**, supervised directly by the Reserve Bank and required to meet a higher level of standards, with other **NBDTs** continuing to be supervised by trustee corporations, but under enhancements to their trust deed requirements.

Submissions on the proposals expressed mixed views. There was widespread agreement on the identified deficiencies with existing arrangements and support for the proposed objectives for reforms. However, most submitters preferred to retain the existing trustee-based supervision arrangements, supplemented with some uniform minimum requirements, and were not supportive of a two-tiered structure. As a result, the changes proposed for **NBDTs** were revised to propose a one-tier regulatory framework, where all **NBDTs** are supervised by trustee corporations, under the (phase two) enhanced trust deed requirements for debt issuers. This is considered a more cost-effective means of achieving the desired regulatory objectives.

The decisions include:

- All **NBDTs** will be required to be licensed by a prudential regulator and to comply with minimum prudential, governance and fit and proper requirements at licensing and on an ongoing basis;
- **NBDTs** will continue to be supervised by trustee corporations under the (phase two) proposed enhancements to trustee-based supervision for debt issuers;
- **NBDTs** will be required to obtain and publicly disclose a credit rating (subject to a Cabinet report back on minimising costs), and to comply with enhanced public reporting requirements;

- The Reserve Bank will be the prudential regulator of **NBDTs**, with the Securities Commission continuing to have responsibility for market conduct supervision and supervision of trustee corporations.

What is a Non-Bank Deposit-Taker (NBDT)?

An **NBDT** is a financial institution whose core business involves borrowing money from the public (mainly in the form of deposits or debentures, whether secured or unsecured) and the lending of money or provision of other financial services.

The definition of an **NBDT** does not include entities that provide financial services, including lending, but which fund solely from non-public sources (eg from wholesale markets, related parties and the like). It also excludes entities that issue debt securities to the public, but whose core business does not include, directly or indirectly, the provision of financial services or lending.

NBDTs can take a number of different legal forms and include finance companies, building societies and credit unions.

What will be the role of the Reserve Bank of New Zealand?

The Reserve Bank will become the single prudential regulator for New Zealand. This would widen the scope of the Reserve Bank's prudential functions to include the prudential regulation of non-bank deposit takers (**NBDTs**) and the regulation and supervision of insurance companies (which is the subject of the Phase 2 report back to Cabinet by 30 November 2007).

What is being proposed?

A one-tier regulatory framework is proposed, where all **NBDTs** continue to be supervised by trustee corporations under the enhanced trust deed requirements for debt issuers, and are subject to some additional requirements:

- All **NBDTs** will be required to be licensed by the Reserve Bank and will be subject to minimum prudential, governance and fit and proper requirements set and enforced by the Reserve Bank in consultation with the Securities Commission.
- **NBDTs** will be subject to enhanced public disclosure requirements under the Securities Act. Proposals on disclosure requirements will be taken to Cabinet under Phase 2 of the **RFPP** reforms, later this year.
- Subject to final Cabinet approval later this year, it is proposed that **NBDTs** will be required to obtain and disclose a credit rating from an approved rating agency.
- The Reserve Bank will be responsible for administering the credit ratings regime and will have the capacity to intervene in situations of **NBDT** distress or failure where the soundness of the financial system is at risk.
- The Securities Commission will authorise and supervise trustee corporations, and will set and enforce public disclosure requirements for **NBDTs**, in consultation with the Reserve Bank.

Why are these reforms being proposed?

The Discussion Document on [NBDTs](#), issued in September 2006, noted that the current regulatory arrangements for [NBDTs](#), while not fundamentally flawed, are inadequate in several respects. The deficiencies highlighted included inconsistency in regulatory requirements and supervision across different [NBDTs](#), the absence of minimum entry requirements for [NBDTs](#), lack of governance requirements and insufficient information to enable depositors to assess and compare the risks of depositing with [NBDTs](#).

The weaknesses in the current regulatory arrangements create a number of risks for depositors and for the soundness and efficiency of the financial system:

- The absence of a licensing requirement for [NBDTs](#), including fit and proper requirements for directors and senior management, creates a risk that an [NBDT](#) could be owned and controlled by entities or persons who may not manage the [NBDT](#) in a manner consistent with the interests of depositors, exposing them to an excessive risk of loss.
- The absence of standardised minimum prudential requirements creates a risk of inadequate supervision of [NBDTs](#).
- Existing disclosure arrangements do not provide a satisfactory basis to enable depositors to identify and compare risks of [NBDTs](#). This impedes the ability of depositors to evaluate the trade-off between risk and return and may lead to depositors taking greater risks with their money than they would take were they aware of the risks.
- There is a potential for contagion within the [NBDT](#) sector, where the failure of some [NBDTs](#) could trigger wider-spread financial distress in the [NBDT](#) sector. The current regulatory arrangements do not adequately address this risk, given that existing disclosure arrangements and the lack of credit ratings do not enable depositors to readily distinguish between the risks of different [NBDTs](#).

Why should [NBDTs](#) be subject to a special form of regulation?

[NBDTs](#) have special features that warrant a form of regulation that goes beyond that required for other debt issuers. These features include the following:

- Many [NBDTs](#) perform bank-like functions, including providing on-call or short-term deposit facilities and the provision of payments services. These functions suggest that [NBDTs](#) should be regulated in a manner similar to that applicable to banks, while still facilitating continued diversity, flexibility and competitiveness in the [NBDT](#) sector.
- Unlike corporate bond and other debt issues, in which the funds are used to finance an issuer's own business, [NBDTs](#) lend to many clients. This makes it difficult for depositors to ascertain the true risk of an [NBDT](#) and provides a justification for additional prudential and disclosure-based regulation.
- [NBDTs](#) are potentially vulnerable to contagion risk, whereby the distress or failure of some [NBDTs](#) could trigger acute distress or failure in others. This suggests the need for enhancements to the standard regulation of debt issuers, such as in

respect of public disclosure requirements, ratings and distress management arrangements.

What impact does this announcement have on the previous in-principle Cabinet decisions made relating to credit unions?

The prudential regulatory regime for non-bank deposit takers will be designed so as to regulate and supervise all **NBDTs** in a similar manner – no matter the legal form. If credit unions are able to meet the prudential requirements for **NBDTs**, some of the protections offered through the Friendly Societies and Credit Unions Act become obsolete. Cabinet has therefore determined that the in-principle decisions regarding credit unions in respect of:

- having the same flexibility to borrow and invest surplus funds and the same ability to hold land as any other **NBDT**, and
- raising capital by issuing securities to their members.

will be confirmed, subject to credit unions falling within the **NBDT** regime. The decisions in respect of granting credit unions

- legal status so that they can have limited liability, own property, have perpetual succession, sue and be sued;
- an ability to utilise a conversion mechanism to allow them to convert to a limited liability company (subject to limitations on reserves and use of the moniker “credit union” and
- explicit requirements regarding the members of the committee of management owing directors’ duties

are also confirmed.

What will happen to credit unions that are unable to meet the base level **NBDT** standards?

It is possible that some smaller credit unions may be unable to meet some of the proposed minimum standards for **NBDTs** (either individually or as a group) – especially in respect of credit ratings. An option that is proposed for these entities, subject to officials reporting back to Cabinet on all of the options that could be used to minimise the cost of credit ratings, would be to impose specific prudential restrictions on these smaller entities, some of which could be based on the current restrictions in place .

What are the objectives of regulating **NBDTs**?

The proposed objectives for prudential regulation of the **NBDT** sector are to promote a sound and efficient financial system by:

- ensuring that **NBDTs** meet a transparent set of prudential requirements designed to promote sound governance and risk management in **NBDTs** and promote depositor confidence;

- providing depositors with a clearer basis for distinguishing between lower-risk and high-risk **NBDTs**; and
- resolving **NBDT** distress or failure in an orderly and timely manner, with minimum disruption to the financial system and depositors.

What do the objectives not include?

The objectives do not include:

- promoting a uniform level of risk across the **NBDT** sector;
- promoting the same level of risk as for registered banks;
- preventing **NBDT** failures; or
- insulating depositors from loss in the event an **NBDT** fails.

What will licensing and minimum regulation of **NBDTs** involve?

Minimum requirements would apply to all **NBDTs** at the time of licensing and on an ongoing basis. It is proposed that the licensing and other requirements will comprise:

- Fit and proper requirements for **NBDT** shareholders with control or significant influence, directors and senior management. These would be designed to ensure that **NBDTs** are controlled and managed by persons with appropriate capability and experience and do not have serious criminal records.
- A requirement that an **NBDT** must demonstrate the capacity to manage its affairs prudently, in line with the nature of business it proposes to undertake.
- A minimum dollar level of capital. The Discussion Document suggested a minimum of up to \$2 million. The minimum amount of capital will be decided by Cabinet later this year.
- A requirement that every **NBDT** must include in its trust deed(s) a minimum capital ratio, determined by the trustee, and that the ratio must be measured on the basis set out in regulation by the prudential regulator.
- Either disclosure of, or a limit on, credit exposures to parties related to an **NBDT**, such as shareholders with control or significant influence, and directors. A decision on this will be made by Cabinet later this year.
- Minimum governance requirements, including a minimum board size and composition, and probably a minimum number of independent directors and a non-executive or independent chairman.

Why require **NBDTs** to be licensed and also registered as financial service providers?

Registration with the Companies Office will be required for all financial service providers, including **NBDTs**. It is intended to be a mechanism for identifying the providers of financial services, determining which regulatory category they should be in, and ensuring that all owners (with control or significant influence), directors and senior management are subject to criminal and other “negative assurance” checks.

Registration is not an equivalent to licensing or authorising of a financial institution; it will not provide any kind of positive assurance assessment of fitness or involve the imposition of minimum regulatory or supervisory requirements. The licensing requirement for **NBDTs** will provide a basic check on fitness for purpose and fitness of owners, directors and senior management, and will involve minimum regulatory requirements.

There will be no duplication of function between financial service registration and licensing of **NBDTs**. Effective coordination arrangements will apply to ensure that the registration and licensing procedures are properly coordinated.

What will be the functions of trustees under the new arrangements?

The trustees will continue to be the front-line supervisors for **NBDTs**, much as they are now. Their functions will include:

- establishing a trust deed for particular offers of securities, in agreement with the **NBDT**;
- prescribing the financial, reporting and other covenants in the trust deed;
- enforcing trust deed covenants and supervising and monitoring **NBDTs**; and
- taking remedial actions to respond to breaches of trust deed requirements or financial distress in an **NBDT**, including advising the Registrar of Companies of any material breaches of trust deed covenants or emerging financial difficulties.

Trustees will be subject to greater oversight by the Securities Commission under the new regulatory arrangements, and there will be a minimum set of requirements for the content of trust deeds.

What will be the functions of the Reserve Bank?

As the prudential regulator of **NBDTs**, the Reserve Bank will be the authority that:

- licenses and (subject to appropriate checks and balances) de-licenses **NBDTs**, in consultation with the Securities Commission;
- prescribes and enforces compliance with the minimum regulatory prudential and governance regulatory requirements for **NBDTs**, in consultation with the Securities Commission;
- applies the fit and proper requirements to **NBDTs**' owners (with control or significant influence), directors and senior managers;
- prescribes the credit rating requirements;
- provides advice and recommendations to the Securities Commission on the performance of trustee corporations in the discharge of their **NBDT** supervisory functions; and
- can intervene to manage the resolution of **NBDT** distress or failure in situations where the **NBDT**'s situation may pose a threat to the soundness of the financial system.

Why will the Reserve Bank be the prudential regulator of NBDTs?

As the Reserve Bank is the prudential supervisor of banks, and will become the prudential supervisor of insurers, there are synergies and efficiencies in the Reserve Bank also becoming the prudential regulator of NBDTs. The Reserve Bank's position as prudential regulator of NBDTs will also facilitate achieving some consistency in prudential regulation between banks and NBDTs, including in respect of capital adequacy measurement, fit and proper requirements, ratings and corporate governance.

Will there be duplication of the functions of the Reserve Bank and trustees?

There will be no duplication of function between trustees and the Reserve Bank. The Reserve Bank's responsibilities are largely limited to the licensing of NBDTs, setting and enforcing minimum standards across the NBDT sector, and administering the credit rating regime.

The Reserve Bank will not be the supervisor of NBDTs. It will not be involved in setting trust deed covenants or monitoring NBDTs on an individual basis. Nor will the Bank be involved in the handling of NBDT distress or failure other than in the rare situation when an NBDT's circumstances may pose a risk to the soundness of the financial system. Rather, the trustees will have these functions – the trustees will be the sole supervisors of NBDTs.

What will be the role of the Securities Commission?

As in the case of other aspects of trustee-based supervision (eg for debt issuers), it is proposed that the Securities Commission would retain responsibility for authorising and supervising trustee corporations. The Commission would also have responsibility for enforcing NBDT disclosure and advertising requirements under the Securities Act 1978, in consultation with the Reserve Bank.

Will there be overlap or duplication in functions between the Reserve Bank and Securities Commission?

The functions of the Reserve Bank and Securities Commission are distinct and will not involve duplications of responsibility. The Reserve Bank's role relates to prudential regulation setting, while the Securities Commission's role relates to market conduct and disclosure. In order to ensure effective coordination between the Securities Commission and Reserve Bank, there will be effective information-sharing and coordination arrangements.

Why is a mandatory credit rating being proposed?

The requirement to obtain and disclose a credit rating from a rating agency approved by the Reserve Bank would bring a number of important benefits, both to depositors and to the financial system as a whole.

Ratings provide a relatively simple summary of the risk of an **NBDT** defaulting on its financial obligations. A rating therefore reduces the need for investors to try to understand more complex and voluminous financial information on **NBDTs**. Ratings would provide the most cost-effective means of enabling depositors to distinguish between higher and lower risk **NBDTs** and thereby make better-informed investment decisions. This is particularly so if ratings are disclosed prominently in public offer documents and advertisements in ways that can be readily understood by non-expert investors, backed by greater initiatives to promote financial literacy among investors.

Ratings would also strengthen market disciplines on **NBDTs** and reduce the need for a more intrusive form of regulation and supervision, both in terms of a reduced need for prudential restrictions on **NBDTs** and less detailed financial public disclosure requirements. In turn, this would reduce the regulatory costs for the **NBDT** sector relative to the situation where there are no required ratings.

Will ratings be understood by non-expert depositors?

Currently, there appears to be quite limited public understanding of credit ratings. However, as more **NBDTs** acquire ratings, and as public awareness of ratings grows, the understanding and use of ratings by ordinary depositors are likely to increase. To facilitate this, a number of initiatives can be taken, both to promote more effective disclosure of ratings and to enhance public understanding of ratings, including:

- clear, prominent and user-friendly disclosure of ratings;
- disclosure of comparisons between the rating scales of different rating agencies;
- promoting public understanding of credit ratings through explanatory information, public education initiatives and by encouraging the financial news media and other bodies to regularly highlight the importance of ratings and provide information on the ratings of **NBDTs**.

Government officials will be considering these and other options as part of the development of the new regulatory arrangements for **NBDTs**.

Will ratings be costly for **NBDTs**?

Requiring **NBDTs** to obtain and disclose a rating will involve costs for **NBDTs** – both in terms of the direct cost of the rating and the indirect cost of management time, systems and controls. However, the costs of mandatory ratings are expected to be modest for most **NBDTs** relative to their revenue, assets and liabilities. The costs could be more significant for very small **NBDTs**.

In the case of **NBDTs** that can only achieve a low rating, a ratings requirement could increase their funding costs. This could lead to consolidation or rationalisation in the

NBDT sector, depending on market reaction to ratings. However, this need not be a negative development; it may be a desirable outcome of better-informed investor decision-making and efficient markets.

There are various options available to reduce the costs of ratings for NBDTs, including the possibility of exemptions for small NBDTs, the application of ratings to groups of entities (eg groups of affiliated credit unions) rather than necessarily requiring ratings to be applied to all individual entities, and the possibility of reduced fees negotiated on a collective basis with the rating agencies. Government officials will explore these options and report back to Cabinet later this year on possible options for minimising the costs of ratings.

When will the new arrangements come into force?

It is intended that legislation to give effect to the new arrangements will be introduced later this year and enacted if possible in 2008. It is proposed that the new regulatory requirements will not come into force until a later date – possibly 2010 – so that all relevant elements in the RFPP package can be brought into force as a cohesive package. It is likely that a transition period will apply after the commencement date to provide existing NBDTs with sufficient time to come into compliance with the new regulatory requirements.

Will stakeholders be consulted on the details of regulatory requirements?

Yes. Stakeholders will be consulted in the development of the proposed regulatory requirements. Consultation with some key stakeholders will occur in the preparation of legislation. Once legislation has been introduced into Parliament, it will be subject to the standard select committee process, therefore enabling any parties to express views on the proposed requirements. Any regulations prepared pursuant to the legislation will be subject to the standard consultation process.

There has already been extensive consultation with stakeholders throughout the RFPP process. The consultation papers elicited a large number of helpful submissions and proposals for the regulation of the NBDT sector have been subject to a number of important changes in the light of these.

What do credit ratings mean?

An indicative example of ratings and a short description of what that rating means and how it fits into the rating agency's scale of ratings, based on Standard & Poor's' rating scale, is set out below.

Rating	Description	Probability of default in next 3 years
AAA	Extremely strong capacity to meet commitments	0.09%
AA	Very strong capacity to meet commitments	0.1%
A	Strong capacity to meet commitments	0.3%
BBB	Adequate capacity to meet commitments	1.2%
BB	Potential for inadequate capacity to meet commitments	5.5%
B	Potential for impaired capacity to meet commitments	15.9%
CCC	Vulnerable to non-payment	40% on average for CCC to C
CC	Highly vulnerable to non-payment	
C	Highly vulnerable to non-payment	

TRUSTEE SUPERVISORY MODEL

Background:

Currently the Securities Act 1978 requires the issuers of debt securities and collective investment schemes offered to the public to engage the services of a trustee corporation for the purposes of frontline supervision of that issuer. The 'Supervision of Issuers' Discussion Document asked: whether trustees should continue as frontline supervisors of issuers of debt securities and collective investment schemes; whether trustees had the necessary powers to carry out this role; and whether there was sufficient transparency and accountability in relation to the supervisory function which is performed by trustees. Submissions on the Discussion Document presented strong support for retaining trustees as frontline supervisors.

The model retains trustees as 'frontline' supervisors of debt securities and collective investment schemes, but has an enhanced role for the Securities Commission, which will approve trustees and monitor them on an ongoing basis. The Securities Commission will have a graduated set of powers to deal with a trustee that appears to be in breach of its obligations.

What is the Trustee Supervisory Model?

The Trustee Supervisory Model retains trustees as 'frontline' supervisors of debt securities and collective investment schemes, but with a new regulatory function for the Securities Commission, who will approve trustees and monitor them on an ongoing basis. Collective investment schemes (CIS) include participatory securities, unit trusts and superannuation schemes. Debt securities include non-bank deposit takers.

What are the objectives of the Trustee Supervisory Model?

The model aims to

- provide a well founded basis for consumers to rely on financial promises being kept;
- encourage sound governance of institutions;
- deter, detect and minimise the risk of unfair or fraudulent conduct; and
- facilitate contestability, competitiveness and innovation.

What will happen to the current automatic right of some statutory trustee corporations to act as trustees for CIS and debt issuers?

There are currently four statutorily approved trustees (Public Trust; Trustees Executors; Guardian Trust; and Perpetual Trust) with this automatic right. This automatic right will be removed. Anyone wishing to be approved to act as a trustee

will have to satisfy the Securities Commission that they meet the approval criteria. It is expected that the current statutory trustee corporations should be able to meet any of the proposed criteria.

What will be the Securities Commission's role in the Trustee Supervisory Model?

The Commission's key role will be to approve trustee licences; to monitor trustees' compliance with the terms and conditions of their licence and to address any non-compliance. The Securities Commission will also:

- have discretion in the application of criteria, and may impose conditions and obligations on a particular trustee. This is because each class or classes of securities differ and require varied forms of capability and expertise. Approval will be subject to an appeals process on the basis of law and merit.
- monitor whether the trustee continues to meet the terms and conditions of its approval.
- be able to receive and act upon complaints which arise from the approval or monitoring of trustees under the trustee supervisory model, and to act on any information it receives, relating to a complaint.
- be provided with a graduated set of powers to deal with a trustee that appears to be in breach, ranging from requesting further information from a trustee to suspension to revoking some or all the trustee's licences.

What are the approval criteria to become licensed as a trustee?

Approval criteria will be flexible in order that they may be tailored to suit the trustees of various single issues of securities, or classes of securities issues.

The Securities Commission will be able to approve trustees to act for a specific issue, for a general class of securities (i.e. debt, or CIS), or on an 'all-securities' basis, as appropriate.

Some approval criteria:

- meeting registration obligations with the Registrar of Financial Service Providers
- independence from issuers and related parties
- appropriate skills, qualifications and experience
- satisfaction of "fit and proper" character requirements
- adequate infrastructure and resources
- appropriate governance standards and procedures
- capital adequacy
- monitoring systems and procedures
- professional indemnity insurance provision
- corporate form to clarify legal and accounting separation of assets
- New Zealand residency

What happens if the Securities Commission declines an application for approval to be a licensed trustee?

If the Securities Commission declines an application, it will be obliged to give the applicant its reasons for doing so. The applicants will be able to bring their case back to the Securities Commission for reconsideration. The Securities Commission will provide an opportunity for the applicant to be heard. Applicants who are still dissatisfied, as well as being able to seek judicial review of the decision, and will have a right of appeal to the High Court, on both law and merits.

What are the penalties for acting as a trustee without a licence?

A person who acts as a trustee for any class or classes of securities issued to the public without a licence will commit an offence and be subject to penalties for that offence. The offence provisions will adopt a similar framework to those already contained in the Securities Act 1978.

What reporting requirements are there by trustees to the Securities Commission?

There will be periodic (annual) reporting and event-based reporting requirements. These are designed so the trustee must demonstrate ongoing compliance with its licence.

What happens if a trustee is suspended or removed and an issuer is unable to appoint a new trustee?

In those cases, the Securities Commission would appoint an 'interim trustee' until the issuer finds a new trustee. This statutory trustee could either continue to supervise the trust, or wind it up in accordance with the trust deed. This statutory trustee will have assured funding, and indemnification from liability for any actions or omissions of the removed trustee and will not be able to profit from the appointment.

What information sharing provisions are there in the Trustee Supervisory Model?

Trustees currently have obligations to the Registrar of Companies under the Corporations (Investigation and Management) Act 1989, including giving notice of their concerns under section 11 in certain dire circumstances. Currently, trustees often consult with the Securities Commission prior to giving the Registrar such notice, and it is proposed that they retain this ability. Submitters supported this, but did not wish such consultation to be an obligation. It is however proposed that when a section 11 notice is given, the Registrar of Companies give a copy of this notice to the Securities Commission for the purposes of the Commission's role as general overseer of trustees.

Who has the power to make regulations prescribing fees and charges?

The Governor-General will have the power to make regulations prescribing fees and charges in connection with the application and approval procedure. There will be consultation on any fees. This power will be equivalent to the current s70A(2) of the Securities Act.

What legislation is impacted by the Trustee Supervisory Model?

The changes will likely require amendments to the Securities Act 1978; the Securities Regulations 1983; the Unit Trusts Act 1960; The Corporations (Investigation and Management) Act 1989; the Trustee Act 1956; The Trustee Companies Act 1967; and the Trustee Companies Management Act 1975.

What confidentiality assurance is there for all data given to the Securities Commission?

All data given to the Securities Commission under the supervisory model will be considered to be given in confidence and kept private, except data that is aggregated with that of other trustees in order to provide an overview of the sector.

All data given in confidence will have protection from the Official Information Act 1982. However, the trustee will be able to agree with the Securities Commission to release a particular piece of information.

INSTITUTIONAL ARRANGEMENTS FOR PRUDENTIAL REGULATION

Background:

In December 2005, Cabinet agreed that prudential supervision for the financial sector be consolidated into a single regulator. Cabinet also agreed in principle that this regulator should be the Reserve Bank, subject to officials reporting back on detailed institutional arrangements for the prudential regulator. Cabinet took decisions in principle to allow time to assess in more detail what additional arrangements would be suitable for the Reserve Bank, given its expanded prudential role, and whether the risk of undermining the independence of its monetary policy activities was sufficiently manageable through governance and accountability arrangements. The Reserve Bank is to be the prudential regulator for non-bank deposit takers and insurers.

The changes will preserve the independence of the Reserve Bank's monetary policy functions and support the extension of the Reserve Bank's prudential regulation functions. The changes include modifications to:

- governance and accountability arrangements associated with the Reserve Bank's financial sector regulation functions;
- policy responsibilities for prudential regulation;
- funding arrangements for prudential regulation functions;
- legislative arrangements for prudential regulation.

Policy responsibilities: the Reserve Bank will be responsible for the provision of policy advice on prudential regulation to the Minister of Finance. [MED](#) and Treasury will continue to provide advice to their respective Ministers on the implications of prudential regulation in their areas of responsibility. They will also provide second opinion advice in relation to the Reserve Bank's policy role.

Funding arrangements: the costs to the Reserve Bank of regulating [NBDTs](#) and insurance companies are to be publicly funded. The Reserve Bank will receive additional funding for these functions through a renegotiation of its Funding Agreement with the Minister of Finance.

Legislation amendments: A Reserve Bank of New Zealand Amendment Bill is to be introduced to give effect to the governance and accountability arrangements outlined above. Changes to legislative will also be required to house the Reserve Bank's new regulatory purposes and functions. Assessment is underway on which existing Acts should be amended and whether new Acts are required.

Who will be regulated by the Reserve Bank?

As the prudential regulator for the financial sector, the Reserve Bank will regulate banks, non-bank deposit takers (such as finance companies, building societies and credit unions) and insurance companies.

Will the prudential regulation of non-bank financial institutions and insurance companies affect the Reserve Bank's monetary policy responsibilities?

There will be a clear legislative separation of the Bank's monetary policy and its new financial sector functions.

What changes are proposed to the Reserve Bank's functions in light of the extension of prudential regulation responsibilities?

The proposed adjustments include:

- changes to some of its governance and accountability arrangements to enhance its transparency and responsiveness to Government while maintaining its regulatory independence;
- responsibility for providing lead policy advice to government on prudential regulation; and
- additional funding to carry out its new functions.

What changes are proposed to the Reserve Bank's governance and accountability arrangements?

Changes include:

- A Ministerial authority to comment on the Reserve Bank's draft Statement of Intent and require it to demonstrate how it has taken these comments into account in the formulation of its objectives for the financial sector;
- A Ministerial authority to direct the Reserve Bank to have regard to a statement of Government policy objectives for the financial sector;
- An amendment to the Reserve Bank Act to reflect the increase in focus on prudential regulation, while recognising that monetary policy remains the Reserve Bank's primary function;
- The Reserve Bank's Statement of Intent (SOI) is to provide more ex ante information about the Bank's intended actions and measures for judging performance;
- The Reserve Bank's Annual Report to contain reporting against the enhanced SOI.
- The Reserve Bank's Financial Stability Report is to provide information on performance of prudential regulation regime and its implications for the financial sector and is to be provided to Parliament;
- The Reserve Bank is to increase transparency around its policy process by publishing assessment of net benefits of its policies; and

- The Reserve Bank Board and Treasury are to increase their monitoring of financial sector regulation.

What changes are proposed to policy responsibilities for prudential regulation?

The Reserve Bank is to become responsible for providing lead policy advice on prudential regulation to the Minister of Finance. While the Ministry of Economic Development will no longer provide lead prudential policy advice on [NBDTs](#) and insurance companies, the Treasury and the Ministry of Economic Development will continue to provide advice to their respective Ministers on the implications of prudential regulation for their areas of responsibility.

How are the Reserve Bank's new regulatory functions going to be funded?

Regulation of non-bank deposit takers and insurance companies is to be funded through a renegotiation of the Reserve Bank's Funding Agreement with the Minister of Finance.

What legislative changes are required to give effect to the changes to the Reserve Bank's prudential regulation responsibilities?

Changes to governance and accountability arrangements are to be given effect to through a Reserve Bank of New Zealand Amendment Bill. Decisions will be taken later in the year on which Acts will be amended and whether new Acts are needed to house the Reserve Bank's new purposes and functions related to the regulation of non-bank deposit-takers, insurance companies and banks.