NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Financial Markets Authority

on the

Targeted Consultation: Annual declaration of compliance for Financial Markets Conduct Act 2013 licensees – revised standard condition and certification wording

17 June 2016

About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes which contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following fifteen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) Limited
   - Bank of New Zealand
   - Bank of Tokyo-Mitsubishi, UFJ
   - Citibank, N.A.
   - The Co-operative Bank Limited
   - Heartland Bank Limited
   - The Hongkong and Shanghai Banking Corporation Limited
   - JPMorgan Chase Bank, N.A.
   - Kiwibank Limited
   - Rabobank New Zealand Limited
   - SBS Bank
   - TSB Bank Limited
   - Westpac New Zealand Limited.

Background

3. NZBA welcomes the opportunity to provide further feedback to the Financial Markets Authority (**FMA**) on the Targeted Consultation: Annual declaration of compliance for Financial Markets Conduct Act 2013 licensees – revised standard condition and certification wording (**Targeted Consultation**). NZBA also wishes to thank the FMA for attending a teleconference on 3 June 2016 with NZBA representatives to discuss the Targeted Consultation (**Teleconference**).

4. The process around the development of the Financial Markets Conduct Act 2013 and the Financial Markets Conduct Regulations 2014 (**the FMC Act regime**) has been a good example of policy development that has actively involved the industry. NZBA commends this ongoing commitment to meaningful consultation and engagement.

5. The following submission provides feedback on the Targeted Consultation and the questions posed in Olivia Murphy's email dated 16 May 2016.

6. If you would like to discuss any aspect of the submission further, please contact:

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Executive summary

7. NZBA wishes to reiterate its submissions made in December 2015 in response to the Consultation Paper: Proposal for annual declaration of compliance for Financial Market Conduct Act 2013 licensees (**December 2015 Submission**).

8. NZBA makes the following key submissions in response to the Targeted Consultation:

    a. NZBA does not support the proposed annual declaration of compliance standard condition (**Declaration**) in either its original or revised form, as it will impose a significant compliance burden and costs without any corresponding benefit(s), and is entirely unnecessary (**Primary Submission**).

    b. If the FMA does not accept NZBA's Primary Submission, NZBA submits that the Declaration should be:

        i. Deferred for consideration until a later point at which it is clear how the Financial Market Conduct Act 2013 (**FMCA**) licence regime is working; and

        ii. Amended:

            1. So that it can be executed by the relevant oversight body (e.g. management team); and

            2. To allow FMCA licensees to adopt a date to provide their Declaration by notifying that date to the FMA.

    c. Due to the significant compliance burden and costs that will result, and the lack of any obvious corresponding benefit(s) to the FMA, FMCA licensees or consumers/investors, NZBA strongly submits that the FMA should produce and publish a Regulatory Impact Statement before considering implementing the Declaration.

9. NZBA's responses to the FMA's specific questions posed in Olivia Murphy's email dated 16 May 2016 are set out in Appendix 1. The key submissions contained in our responses are:

    a. Limb (a) of the Declaration should be more closely aligned to that of the compliance standard condition.

    b. Limb (b) of the Declaration should be amended to include a materiality threshold, be more closely aligned to that of the compliance standard condition/accepted practice for assurance assignments, and to ensure it is consistently applied by FMCA licensees.

c. Limb (c) of the Declaration should be removed as it is not relevant or necessary.

d. The Declaration will result in a significant increase in our members' compliance burden and costs.

Primary Submission: NZBA and its members do not support the Declaration

The Declaration will impose a significant compliance burden and costs without any corresponding benefit(s)

10. NZBA submits that the compliance burden and costs associated with producing the Declaration (discussed further below) are significant, unjustified, and far outweigh any perceived corresponding benefit(s) (of which NZBA submits there are none).

The Declaration is unnecessary

11. There are already strong continuous disclosure obligations on FMCA licensees, and the Declaration merely duplicates obligations already imposed under the FMCA. As such, the Declaration will offer no additional protection to consumers/investors, nor will it offer any additional information, assurance or comfort to the FMA.

Section 412

12. Material breaches of standard conditions must already be notified to the FMA under section 412 of the FMCA. Under that section an FMCA licensee must:

    a. Have in place effective methods for monitoring compliance with its market services licensee obligations and identifying **material** changes in circumstances; and

    b. Provide a report to the FMA if it believes it has contravened, may have contravened, or is likely to contravene a market services licensee obligation in a **material** respect.

13. Under section 6 of the FMCA, a market services licensee obligation includes an obligation imposed by a licence condition. Thus the FMCA already ensures that the FMA receives accurate information on a regular basis about licensees' compliance with their conditions.

14. Section 412 means that FMCA licensees should be focused on continuous compliance and monitoring, rather than an 'annual check' as proposed by the Declaration. As there is already a positive obligation on FMCA licensees to continually update the FMA as to the status of their compliance with their licence, the Declaration is completely unnecessary.

15. Further, entities must have met the FMA's minimum standards to have obtained a market services licence. This includes a requirement "to maintain effective methods

for identifying and reporting to the FMA any material change of circumstance or breach of your market services licence obligations". The FMA should therefore have gained assurance through the licensing application process that FMCA licensees have effective processes and procedures in place to comply with their continuous monitoring obligations under section 412.

16. In the absence of evidence that FMCA licensees are in practice failing to comply with their obligations under section 412, it is difficult to identify what additional benefit the Declaration will provide.

Regulatory Return

17. The Declaration will also duplicate information that will be required to be reported to the FMA in future as part of the Regulatory Return standard condition.

18. This standard condition has not been brought into force because the relevant Framework and Methodology has not been published. However, the explanatory note that accompanies the Regulatory Return standard condition states that it is "likely to require reporting of… the numbers and types of breaches, and complaints information". This indicates that the Declaration will duplicate information that will be eventually included in the Regulatory Return.

19. We strongly submit that the appropriate way forward would be for the FMA to publish the Regulatory Return first, and to then consider at a later point whether there is a policy case to introduce the Declaration, following an assessment of the value of the information obtained via the Regulatory Return and based on data to support the compliance history of FMCA licensees. We do not expect that such a case would be made out.

Duplication of liability

20. As the Declaration will duplicate FMCA licensees' existing statutory obligations, in the situation where a licensee fails to report a material breach to the FMA, it is likely that it will have contravened both section 412 (discussed at paragraphs 12-15 above) and the new standard condition. One mistake could result in two contraventions. NZBA considers this is a policy position that leads to duplication of liability and should be a matter for Government to consider and determine.

21. Additionally, as noted in the Declaration itself, section 512 of the FMCA, which makes it an offence to make false or misleading statements, will apply to the Declaration.

The Declaration should be deferred for consideration until it is clear how the FMCA licence regime is working

22. If the FMA does not accept NZBA's Primary Submission above, NZBA submits that the Declaration should be deferred for consideration until a later point at which it is clear how the FMCA licence regime is working.

23. During the Teleconference, the possibility of delaying the introduction of the Declaration to allow further consideration of how the FMCA regime is operating was discussed. NZBA strongly supports this suggestion.

24. The FMCA is still subject to a transitional period. It would be in both the FMA's and FMCA licensees' best interests to defer consideration of implementation of the Declaration and its relevance again a year after the FMCA becomes fully operational and all transitional licences have come into effect (i.e. December 2017), when both FMCA licensees and the FMA have had time to embed the FMC Act regime in its totality. This will also allow the FMA time to assess how FMCA licensees engage with the new regime, including the section 412 reporting requirements.

25. By this time the FMA will have actual data available that may be relevant to determining whether the Declaration is warranted to enhance required behaviours. This approach may also enable the FMA to form a considered view on whether the Declaration would operate more effectively if it was imposed as a special condition on certain FMCA licensees as a tool to address risks the FMA sees arising in the FMC regime.

26. Further, we note that regardless of the commencement date, the requirement to provide the Declaration should not be retrospectively applied. Appropriate systems and processes will need to be put in place in order to confidently attest to compliance, and FMCA licensees will need to have a clear understanding of the finalised scope of the attestation before these can be developed. NZBA does not support pushing out the implementation date but with retrospective effect, as is proposed in the Targeted Consultation.

The Declaration should be amended

27. If the FMA does not accept NZBA's Primary Submission above, NZBA submits that the Declaration should be amended:

    a. So that it can be executed by the relevant oversight body (e.g. management team); and

    b. To allow FMCA licensees to adopt a date to provide their Declaration by notifying that date to the FMA.

28. Please also see our response to Question 1 in Appendix 1 below for further recommended amendments to the revised Declaration wording.

Sign off level

29. As previously submitted, if introduced, the Declaration should not be required to be signed personally by directors. The Declaration should be amended so that it can be provided by the relevant oversight body (e.g. management team), or appropriate members of that body.

30. The obligations in section 412 to which the Declaration refers are entity level obligations (i.e. the obligations apply to the entity rather than its directors). As noted in our December 2015 Submission, because the Declaration is to be made by the FMCA licensee, it should therefore be capable of being executed in any manner permitted by the licensee's governance structure.

31. Where the FMCA licensee is a large organisation, the appropriate people to sign such a Declaration on its behalf are the senior managers who have day-to-day operational influence over the licensed business. As the Commerce Select Committee observed in its report on the Financial Markets Conduct Bill directors "*should be able to focus mainly on business strategy and management, rather than on compliance and liability*".

32. Obtaining the signature of two directors (as currently proposed) requires that the Board fully consider the Declaration and all relevant material. This requires preparation of Board reports and supporting materials, which adds additional compliance burden/cost. This step would be entirely additional to the 'oversight body', which has been empowered and is acting under Board delegation, in accordance with the licensee's decision as to appropriate governance. Furthermore, directors' availability to sign documents can also be problematic outside regular Board meetings, particularly where the licensee is incorporated overseas.

33. The proposed approach also seems at odds with the more flexible approach in licensing materials regarding 'governing bodies', which enables firms to choose bodies with appropriate levels of seniority and involvement for the size of the firm. This recognises the strategic nature of the Board's role in larger organisations as contemplated by the Commerce Select Committee. To require director attestation runs counter to the delegation of oversight that the FMA has previously permitted be implemented through the licensing process.

Timing of the Declaration

34. NZBA submits that FMCA licensees should be able to adopt a date to provide their Declaration by notifying that date to the FMA, rather than having to meet an arbitrary and restrictive date (proposed in the Targeted Consultation as being within three months of the FMCA licensee's balance date).

35. This approach would allow FMCA licensees to:

    a. leverage existing attestation processes for other reporting requirements;

    b. time the provision of the Declaration to minimise disruption to their businesses;

    c. integrate the Declaration with a more holistic consideration of compliance risk management in the licensed area; and

d. avoid times when governance bodies are often occupied with matters relating to disclosure of results and supporting processes.

36. A process by which FMCA licensees nominate their own dates and communicate these to the FMA could be managed through the Disclose register.

Appendix 1 - Targeted Consultation Questions

1) Do you have any comments on the scope of the revised standard condition wording?

37. NZBA supports the removal of the due diligence and confirmation of compliance with the specific market service licence conditions. Attesting to the existence of processes rather than the fact of compliance is a significantly more manageable standard.

38. NZBA also supports the removal of the requirement to confirm reporting of all breaches of licence conditions and listing those breaches.

39. Despite paragraphs 37-38 above, NZBA does not consider that the revised wording does anything to allay the industry's concerns, nor alleviate the Declaration's redundancy.

40. In addition to the recommended amendments discussed at paragraphs 27-36 above, NZBA makes the following submissions on the revised wording of the Declaration.

Limb (a)

41. NZBA submits that the wording of the Declaration, specifically limb (a), should be more closely aligned to that of the compliance standard condition. The Compliance standard condition provides that FMCA licensees must have "at all times, adequate and effective systems, policies, processes and controls that *are likely to ensure* licensees will meet their market services licensee obligations in an effective manner". In particular, the Declaration should be amended to refer to processes that are "likely to ensure" compliance with the licensee's market services licensee obligations.

Limb (b)

42. During the Teleconference the FMA expressed concern about the situation where an FMCA licensee has written policies, but they do not reflect its true practices. We understand the FMA wishes to address this concern via the Declaration, however we do not believe that the Declaration's current wording will achieve this objective. NZBA submits that limb (b) should be reworded, as:

    a. It is not clear how the phrase "properly applied" should be interpreted. If one individual employee makes a mistake resulting in non-compliance, can it still be said that processes have been properly applied?

    b. The requirement to certify that "the Processes were properly applied" does not have a materiality threshold. This is inconsistent with section 412, which requires FMCA licensees to report material contraventions to the FMA, and is also inconsistent with our understanding of the FMA's intention in its amendments to

the Declaration (as outlined in the Comparison table in Olivia Murphy's email dated 16 May 2016, which indicates that the revised Declaration will no longer require the reporting of **all** breaches of licence conditions of the licensee and the listing of those breaches). As currently worded, this requirement could lead to a significant burden on firms, or inconsistent application across firms.

43. Based on our discussion with the FMA, we believe that it was not the intention to require all instances where processes had not been complied with to be disclosed (including where these instances do not result in any breach or issue of a regulatory nature).

44. Whilst, as discussed during the Teleconference, we accept that this wording is used in banks' Reserve Bank (**RBNZ**) Disclosure Statements without disclosure of a significant list of issues, this phrase is used in the context of:

    a. Systems for risk management, (which are accepted as applying materiality, through consideration of the size and likelihood of the risk and any subsequent issues), rather than in the context of legislative requirements.

    b. A regime which has been in place for some time, with a common understanding across banks of the expected standard.

45. This proposed wording will not be well understood outside that context or by non-bank entities. Furthermore, the RBNZ disclosure regime has also been in place for some time and does not necessarily reflect current terminology and the desire for commonality across legislation or regulatory regimes.

46. The wording is also inconsistent with the existing compliance standard condition, which requires, "at all times, *adequate* and *effective* systems, policies, processes and controls that are likely to ensure licensees will meet their market services licensee obligations in an effective manner'. This wording reflects accepted practice for assurance assignments (for example under XRB standards or internal audit assignments), where 'adequate' relates to the design of the systems (and is used in limb (a)) and 'effective' relates to whether those systems operate in practice, with an understanding that this includes an assessment of materiality. For example, see clause 10(1) of the Financial Advisers (Custodians of FMCA Financial Products) Regulations 2014:

Requirements of assurance engagement and report

(1) An assurance report must state whether, in the auditor's opinion,—

(a) the custodian's processes, procedures, and controls were suitably designed to meet the control objectives in subclause (2) throughout the most recently completed relevant period; and

(b) the custodian's processes, procedures, and controls operated effectively throughout that relevant period.

47. NZBA submits that the wording in limb (b) should be amended to refer to processes which "operated effectively". Using this wording would have the advantage that there are already people within licensed entities who have an understanding of the approach taken in commissioning, reading or providing such opinions. It would also simplify matters for directors and senior managers as they can become familiar with a common set of terms with a common meaning. The FMA's policy team may wish to discuss this proposal with their own internal audit team and external audit supervision teams.

48. Whilst we strongly support changes to the wording of limb (b), as outlined above, if this wording is retained, we submit that the FMA should issue guidance on its intention regarding materiality.

Limb (c)

49. As discussed at paragraphs 12-15 above, NZBA does not consider that the component of the Declaration relating to section 412 is relevant or necessary. We therefore submit that limb (c) should be removed.

50. The confirmation required by limbs (a) and (b) of the Declaration have the effect of an FMCA licensee complying with (c), because a material breach of a market services licence obligation is reportable (under section 412). Additionally, FMCA licensees are required to comply with section 412 of the FMCA at all times. If a 'no' answer was submitted, an FMCA licensee would effectively be declaring they had breached the FMCA. In this respect the Declaration is a specific duplication of existing obligations. Please also see paragraphs 21-20 above which relate to the duplication of liability imposed by the Declaration via section 512 of the FMCA.

51. If the reference to section 412 is not removed, NZBA urges the FMA to release guidance about what factors constitute 'materiality' for the purposes of section 412. In NZBA's view, introducing this part of the Declaration may result in an over-reporting of incidents to the FMA in order for licensees to ensure that the they do not inadvertently fail to report an incident that it is later determined that section 412 applies to. For this reason, FMA guidance about what it considers 'materiality' to mean in the context of section 412 would provide FMCA licensees with greater ability to make determinations relevant to their specific circumstances as to how section 412 applies and ensure that their consideration was made in line with the expected general criteria.

52. NZBA further submits that the same protections that apply to a section 412 report should apply when a FMCA licensee reports an incidence of non-compliance via the Declaration. Section 413 of the FMCA provides that a report provided by a licensee under section 412 is not admissible as evidence in a criminal proceeding against the licensee, except in a criminal proceeding that concerns the falsity of the report.

2) Do you think the requirement to complete an annual declaration (as revised) will result in a significant increase of your compliance costs?

53. Based on feedback from our members, and as noted in our December 2015 Submission, the Declaration (in both its original and revised form) will result in a significant increase to compliance costs.

54. NZBA members will provide estimates of the increase in compliance costs required to prepare and provide the Declaration in their own individual submissions.

3) If yes to question 2, please detail what the process of sign-off of the annual certification would involve and what the associated costs would be? To what extent would this process be in addition to the level of reporting and assurance that you would provide to your board/governing body in order to enable them to meet their FMC Act compliance obligations and responsibilities in any event?

55. As proposed, the Declaration will ultimately require the FMCA licensees' directors to consider the Declaration and authorise the execution of it by the directors at a Board meeting. There is also a very real risk that the proposed timing of the provision of the Declaration may require a special board meeting just to consider it (at a significant cost).

56. As discussed at paragraphs 29-36 above, the combination of the proposed attestation by two directors and the inflexibility as to when the Declaration can be provided will add unnecessary compliance costs without any corresponding benefit.

57. Based on feedback from our members, the process of sign-off of the Declaration and the associated costs are likely to be similar to the process and costs for the ABS provided to the FMA on an annual basis. This process is time-consuming and labour intensive, requiring input from both operational and compliance staff. For example, in a larger organisation it may involve multiple managers and papers for several committees, and a lead time of several months. Time may be absorbed in completion of attestations and management of process, rather than on value-adding with respect to compliance.

58. NZBA stresses that because the Declaration confirms information that the FMA should have in any event, the compliance costs involved are not justified. Since the most that can be expected as a result of the Declaration is that the FMA receives a series of disclosures about non-material matters (noting that material matters should already have been reported), NZBA considers that the costs associated with the Declaration are disproportionate to any perceived benefits.

59. NZBA members will outline the process of sign-off required for the Declaration for their own businesses in their individual submissions.