NEW ZEALAND
BANKERS ASSOCIATION

Submission

to the

Ministry of Economic Development

on the

Proposed fee and levy changes for the Financial Markets Authority, External Reporting Board, New Zealand Companies Office, and Insolvency and Trustee Service discussion document

8 July 2011

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Introduction

1. This paper is a preliminary submission on the Proposed fee and levy changes for the Financial Markets Authority, External Reporting Board, New Zealand Companies Office, and Insolvency and Trustee Service discussion document (discussion document) from the New Zealand Bankers' Association ("NZBA"). As agreed with officials, NZBA will submit a more detailed supplementary submission to the Ministry of Economic Development ("MED") around July 15, 2011 and welcomes the opportunity to engage with officials beyond this date.

About NZBA

2. 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 safe and successful banking system that benefits New Zealanders and the New Zealand economy.

3. The following twelve registered banks in New Zealand are members of NZBA:
    - ANZ National Bank Limited
    - ASB Bank Limited
    - Bank of New Zealand
    - Bank of Tokyo-Mitsubishi, UFJ
    - Citibank, N.A.
    - 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.

Submission

Proposal

4. In responding to the discussion document, member banks recognise that they will need to pay a reasonable share of the levies funding the Financial Markets Authority ("FMA"). NZBA proposes applying a variant of Option 3 (a combined levy apportioned according to the benefits derived). This type of levy applied to different categories of registered market participants is likely to be more principled than an FAA levy based on numbers of advisers, and will also allow better identification of market participants. This proposal is also likely to produce fewer distortions as it is based on the nature of the financial services which market participants are registered to provide. It will provide more stable funding because it is based on a matter that is subject to registration and on which there is centrally available stable data (rather than QFE adviser numbers which can change at any time)... It also spreads the levy across market partipcants, decreasing the bill owed by each and accounting for the wide range of beneficiaries of financial market regulation. Given that this is a new

jurisdiction whose benefits are still to be realised it will be advantageous to spread the levy burden widely.

5. If, upon more detailed assessment, this approach turns out to be too complex, NZBA submits that the most feasible alternative is Option 4.

Critique of Option 1

6. Option 1 will not be workable in practice due to the huge cost that will be imposed on many QFEs, which we understand was unintended. In the case of banks this outcome is due to their branch and call centre structure, which leads them to have thousands of category 2 QFE advisers; well above the predictions in the discussion document. To illustrate, larger member banks have calculated that they will face total levies of up to $800,000. Even small member banks face bills of several tens of thousands of dollars.

7. We understand that this pattern is repeated in other industries dominated by QFEs. Therefore, in practice there is likely to be significant over collection.

8. Furthermore, the likely over collection caused by reliance on numbers of QFE advisers highlights the unavoidable difficulty involved in calculating numbers of QFE advisers across the whole market. There is likely to be significant variation in numbers of QFE advisers over time, meaning total levies collected under such a model will be likely to vary greatly from year to year. This will lead to an uncertain revenue stream for the FMA. The levy model needs to be based on figures that are steadier and more readily obtainable.

Compliance costs and distortions

9. A primary reason for the original proposal for QFEs under the Financial Advisers Act 2008 was to avoid the administrative costs to financial service providers and the Crown should large numbers of staff of financial service providers been required to register individually as financial service providers on the Register of Financial Service Providers (the Register) when they were only providing advice in relation to their employers' category 2 products. Setting the levy based on the numbers of QFE advisers thus undermines one of the basic rationales for a large financial service provider obtaining QFE status. The fact that QFE advisers are simply employees or nominees of the QFE makes QFE adviser numbers an inherently unstable measure on which to base a levy compared to matters that are the subject of registration.

10. In addition to the cost of paying levies, QFEs have also needed to build significant compliance frameworks to comply with their QFE obligations under the FAA. These costs vary between institutions but are typically several hundreds of thousands of dollars each for larger member banks. There are also significant ongoing costs associated with a QFE assuming frontline compliance responsibility for its QFE advisers and being accountable to the FMA in that capacity, as required by the legislation. The purpose of the QFE model was to streamline compliance monitoring and supervision for both QFEs and for the regulator by making QFEs directly accountable to the regulator, as opposed to the regulator needing to individually supervise advisers.

11. Although many independent AFAs will have accrued large bills to pay for their education ahead of authorisation, much of QFEs’ system builds and ongoing activity

as front-line supervisors have been to supervise category 2 advisers, who have no specific education or supervision-related requirements when they are independently registered.

12. Therefore, Option 1 will create a significant distortionary incentive for large institutions to minimise financial advice or even to move to an “information only” model. The removal of basic advice about call accounts and term deposits (in the case of banks) will be to the detriment of investors and savers looking for the right account. Furthermore, this incentive to avoid giving advice will eventually erode the funding base of the levy system, as advice is phased out. NZBA understands that this happened to the Real Estate Agents Authority, which initially levied on a per agent basis.

Rationales for levy models

13. Paragraph 15 of the discussion document indicates that that the rationale behind Option 1 is that the levy should be largely proportional to the amount of risk introduced into the market by the person being levied.

14. In the sections on the FMA levy the rationale for the proposals is that the levy should be applied in proportion to the benefits derived from regulation.

15. NZBA considers that both of these rationales are sound and consistent with the Treasury Guidelines on Setting Charges in the Public Sector. However, we suggest that Option 1 does not set up a system that correctly measures risk introduced into the market or benefits accrued from regulation.

16. In contrast to the discussion document, NZBA argues that each QFE adviser introduces less risk into the market than does an independent adviser working with the same category of financial product. This is because the advice task is simpler, requiring only that the adviser choose the product that best suits the customer from the range produced by the QFE (which is exactly the service expected by the customer). As issuers of the products advised on, QFEs must also stand behind their products to a much greater extent than do independent advisers. This position as issuer also means QFEs have intimate knowledge of their own products so providing advice is a simpler task (and more predictable for the consumer) than choosing between myriad product providers of different types and paying different levels of commission, as occurs in the independent market.

17. Although the discussion document notes that independent advisers’ firms are also expected to have compliance systems, an assessment of compliance arrangements is not a factor in the authorisation, registration, or ongoing supervision of individual AFAs or RFAs. In contrast, an assessment of compliance arrangements is a key factor in determining an entity’s eligibility for QFE status and in the ongoing supervision of QFEs. This must surely mean that the level of risk that a QFE adviser introduces into the market is lower than for a comparable independent. The cost of QFEs’ supervision of their advisers is the system build costs already incurred and the ongoing costs of performing the frontline supervision role expected by the legislation and the FMA.

18. Finally, in the case of banks’ category 2 QFE advisers, it is important to recognise that they are not first and foremost financial advisers. Their main roles are providing

banking and transactional services and many may seldom give advice in practice (and when they do it will be in relation to basic accounts, term deposits and cash PIEs). This further lowers the level of risk they pose to the market.

19. Option 1 also draws no distinction between wholesale-only QFE advisers and retail client QFE advisers despite this being an important distinction in the independent adviser market.

20. With regards to the rationale of benefits derived from regulation, NZBA agrees with MED's general proposition that the benefits of regulation accrue mainly to the centre of the market. However, NZBA considers that banks primarily draw benefit from the prudential regulation of the Reserve Bank, rather than from market conduct regulation such as the FAA. This is particularly true in the case of bank deposit products, being the only products advised on by the vast majority of banks' QFE advisers, as recognised by the comprehensive exemptions from the Securities Act 1978 for these products.

21. It is also worth noting that the benefits of regulation do not accrue to QFEs proportionately to numbers of QFE advisers employed, given the very different types of service they can provide, as outlined above. A QFE with few advisers but high funds under management, for example, will still derive a lot of benefit from greater public confidence in its products and distribution network.

22. Furthermore, the benefits of the FAA and other market conduct regulation accrue at least as much to institutions that might not necessarily be covered by Option 1's FAA levy as they do to banks and other QFEs. In particular:

- Trustees and auditors will experience increased business from confidence in financial markets and financial products.
- Registered exchanges and authorised futures exchanges benefit significantly from the licensing and supervision of the FMA, as well as from market conduct regulation generally, including the FAA.
- Similarly, designated settlement systems and approved electronic securities transfer systems benefit from their approved and supervised status and from general market conduct regulation.
- Authorised futures dealers, while excluded from the application of the FAA, benefit from their approved and supervised status and from general market conduct regulation.
- Various types of issuers including non-bank deposit takers, insurers, fund managers, and all issuers of listed securities. These institutions might or might not engage their own financial advisers but benefit in any case from the increased public confidence in their products and distribution networks produced by the FAA and by other market conduct regulation.

Towards an improved levies model

23. As noted above, NZBA intends to lodge a supplementary submission around 15 July. This second submission will contain more detail as to NZBA's suggested levy model.

In the mean time NZBA can make a number of general points, most of which have been alluded to in the analysis above.

24. First, NZBA notes that there could be calls for the levy to be based on ability to pay. NZBA strongly disagrees with this proposition and considers that a reasonable levy framework must be based on the level of risk introduced into the market, the level of benefit derived from regulation or a mix of the two measures.

25. In NZBA's opinion, the best levy model would be a variant of Option 3 – a combined levy apportioned according to the benefits derived. Such a model would need to recognise the benefits of market conduct regulation enjoyed by the full spectrum of core market participants, particularly issuers of listed securities, fund managers, insurers, non-bank deposit takers, authorised futures dealers, securities and futures exchanges, and settlement systems.

26. Under this model, different categories of market participant would pay a different levy, according to the benefits they receive from regulation.

27. NZBA suggests that, with few exceptions, the types of financial service on the Register of Financial Service Providers ("Register") would correctly identify the necessary participants. NZBA notes MED's concern in the discussion document that the Register allows providers to register as multiple types of provider at once, limiting the usefulness of the Register as a tool. NZBA submits that this can be easily dealt with by creating a rule that a provider must pay the highest levy of the various levies he/she/it qualifies for.

28. The Register will also provide an efficient means of collecting the levy.

29. NZBA notes, however that consideration will need to be given to how the various categories of provider should be subdivided to ensure that small insurers, for example, are not levied disproportionately to large insurers.

30. If, however, MED decides that the levy model should be at least in part based on the level of risk introduced into the market, NZBA submits that the points made above about the level of risk posed by QFE advisers – and particularly banks' QFE advisers – need to be carefully considered.

Spreading the net widely

31. Finally, NZBA considers that if uncertainty over the numbers and nature of market participants is deemed too great, the best solution would be to apply a low levy to all companies, mutuals and other relevant businesses along the lines of Option 4. Such a model recognises that all businesses receive benefits from quality financial market regulation in the form of improved overall economic performance and reduced cost of capital.

32. This model would provide stable and sustainable funding without significant market distortions until a more complete analysis of market participant numbers can be completed. NZBA notes that this will become significantly easier once the securities law review is completed, as most significant market participants will need to be licensed under current proposals, making them easily identifiable.

Future steps

33. NZBA recommends that the review of the levy model that is signalled in the discussion document should include consultation on the outputs of the FMA. This should be in the form of a work plan, such as is produced by the Commerce Commission and other regulatory authorities as a part of their budget-setting process. Being able to view such a plan would make more detailed analysis of the levy model much more possible.

34. The review should also attempt to more systematically quantify the amount of benefit enjoyed, and the level of risk created, by different classes of market participant.

35. NZBA looks forward to discussing these matters further with officials over the coming months.

36. Please free to contact me if you have any queries.

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Appendix - Answers to Questions Posed by MED

37. NZBA advises that this is its preliminary submission. Further detail will be provided in its supplementary submission, to be delivered around 15 July, and through ongoing conversations with officials.

1 – Which is your preferred option?

38. NZBA prefers a variant of Option 3, under which a combined levy is applied at different levels to different types of market participant, in proportion to the benefits they accrue from the FMA's market conduct regulation. If a single entity falls into multiple categories, a hierarchy of levies should exist so the entity only pays once, for example it should have to pay only the highest of its potential levies.

39. If this submission is not accepted, NZBA suggests that Option 4 is the most feasible alternative.

2 – Is there an alternative you would prefer?

40. See answer to question 1.

3 – Why have you chosen your preferred answer?

41. NZBA proposes its variant of Option 3 because it is the most effective way of imposing levies in proportion to the benefits received from market conduct regulation. It recognises that a wide range of intermediaries and product providers benefit from having a sound regulatory framework but do not necessarily benefit by the same amount.

42. It should also be practical, as the Register should provide a suitable mechanism for collecting the levy.

43. NZBA's second preference is Option 4. Option 4 is desirable because it is simple and workable in the face of uncertainty about adviser and market participant numbers. It also recognises the fact that the benefits of regulation extend across all businesses in the form of improved all round economic growth and easier access to capital Option 4 also minimises market distortions and incentives to arbitrage the system by imposing the same low levy on all players.

44. Finally, under Option 4 levies will be easy to collect.

4 – Which types of entities should be required to pay the Financial Markets Authority levy?

45. All financial service providers should be required to pay the FMA levy to some degree, as all receive benefits from regulation to one degree or another.

46. As noted above, the levy could also be reasonably imposed on all companies, mutuals, etc.

5 – Is it desirable to vary the amount of the FMA levy applied to different groups?

47. Yes, this is desirable. Differentiating between different groups is important, as it recognises that different providers benefit to varying degrees from market conduct regulation.

48. If this is not deemed practical, Option 4 is the most feasible alternative.

6 – How could this be achieved, given the limited information available for structuring such tiers?

49. Benefits of regulation are not necessarily proportional to the number of advisers working for an institution, for the reasons outlined in this paper, so this is not the best way to construct tiers.

50. NZBA will provide more detail on this matter in its supplementary submission. However, as a general indication, most of the largest market participants (who are seen to accrue most of the benefits of regulation) can be identified in one way or another:

- Insurance companies are required to register as such on the Register and must be licensed by the Reserve Bank.
- Banks must be registered as such and are licensed by the Reserve Bank.
- Non-bank deposit takers are required to register as such and are licensed by the Reserve Bank.
- Financial advisers of all kinds and their employers are required to register in respect of their type of financial adviser service and QFEs and AFAs must be licensed by the FMA.
- Statutory supervisors must register as such and are licensed by the FMA.
- Registered securities exchanges, authorised futures exchanges, designated settlement systems, and approved electronic securities transfer systems are all readily identifiable as a result of becoming registered, authorised, designated or approved as the case may be.
- Authorised futures dealers must be licensed by the FMA.
- Issuers of listed securities can be identified from registered exchanges.
- Fund managers are identifiable in a range of ways:
- Managers of participatory securities must register as such on the Register.
- Contributory mortgage brokers must be registered as such on the Register.
- Names of managers of KiwiSaver schemes are recorded on the KiwiSaver schemes register maintained by the FMA.
- Managers of superannuation schemes and unit trusts will have to register but might not be readily identifiable as such at this time.

7 – Are the Financial Advisers Act 2008 (FAA) levy tiers appropriate?

51. No, the tiers are not appropriate. As outlined above, a levy based on number advisers will be highly distortionary, does not account for the lower level of risk posed by each QFE adviser and does not accurately reflect the benefit each QFE receives from market conduct regulation. This model is also unlikely to provide stable funding, as QFE adviser numbers are likely to be highly variable.

8 – Should any other financial service providers pay the FAA levy e.g. brokers?

52. Yes. The benefits of financial adviser regulation accrue not just to financial adviser businesses but also to product providers (i.e. issuers, credit providers and insurers) and to other intermediaries like clearing and settlement systems, brokers and the stock exchange. Such businesses should be levied in proportion to the benefits they receive from the FAA.

53. Furthermore, all financial service providers benefit to some degree from market conduct regulation so the levy should apply at a low level across all FSPs.

54. If MED decides that this approach is not practical, NZBA submits that Option 4 is the only feasible alternative at this time.