NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Ministry of Business, Innovation and Employment

on the

Draft Financial Markets Conduct Regulations (third tranche)

20 June 2014

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Submission by the New Zealand Bankers' Association to the Ministry of Business, Innovation and Employment on the Draft Financial Markets Conduct Regulations (third tranche)

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 fourteen registered banks in New Zealand are members of NZBA:
    - ANZ Bank New Zealand Limited
    - ASB Bank 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 is grateful for the opportunity to submit on the third tranche of draft Regulations (the Regulations).

4. The process around the development of the Financial Markets Conduct Act 2013 (the Act) has been a good example of policy development that has actively involved the industry. NZBA commends the on-going commitment to meaningful consultation and engagement.

5. The following submission makes some brief comments on the draft Regulations.

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

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Debt

7. As discussed at our meeting with the Ministry of Business, Innovation and Employment (MBIE) and the Financial Markets Authority (FMA) on 12 June 2014, NZBA remains concerned about the inclusion of medium term notes (MTNs) in the disclosure regime as proposed by the Regulations, and believes that this needs to be addressed.

8. NZBA's view is based on the fact that MTNs are a very simple product that in many respects operates in the same fashion as a term deposit. MTNs are sold at wholesale and retail levels, with set rates and terms, but with more flexible transferability options than a term deposit. Similar points apply to other vanilla debt products, such as registered certificates of deposit (RCDs), that are not category two products.

9. Clause 21 of Schedule 1 of the FMCA sets out an exemption for debt securities issued by registered banks. NZBA is of the view that this exemption should be available in respect of MTNs and similar products, and should not be subject to the limited disclosure regime proposed in the Commentary document (which may be suitable for other debt products, including subordinated debt). As indicated in that meeting, as an industry we are keen to work with MBIE to produce a suitable taxonomy for bank-issued non-category 2 debt products that distinguishes between levels of complexity for the purpose of determining which debt securities should be subject to limited disclosure under clauses 26 and 27 of the Regulations.

10. We are also concerned that the Regulations do not deal with convertible securities. In our view this complicates the new regime as it will require participants to apply for an exemption immediately to accommodate these products. It would be helpful if the Regulations addressed these products thus avoiding the need for exemption notices. We would welcome the opportunity to work with MBIE to determine the scope of what the regulations should cover in relation to convertible securities.

Managed Funds

11. Part 3 of Schedule 3 of the Regulations requires the fund update for all managed funds to be benchmarked against a hypothetical fund. NZBA considers this problematic because it may be extremely difficult to formulate an appropriate benchmark in order to effectively serve the purpose that clauses 61 and 66 seek to achieve and the benchmarks formulated by different issuers will not be easily comparable. This requirement adds unnecessary complexity to the disclosure regime. Instead, issuers should just be required to disclose the actual performance of the fund. Investors can compare those results against the results of other funds as disclosed in their fund updates. This is a more reliable comparison.

12. In our view, disclosure of material contracts as required under clause 52(1)(a) of Schedule 3 is not necessary in relation to managed funds. This is because typically these contracts are limited to arrangements for the administration of the fund, such as the administration manager contract, and these types of contracts are of little

relevance to investors. They are also unlikely to be drafted with investors in mind and therefore will be complex legal documents, and are likely to contain commercially sensitive information which should not be required to be made publicly available.

13. A key issue in relation to cash and term PIEs relates to transitional arrangements. The industry meeting with MBIE and FMA on 12 June 2014 discussed transitional arrangements being available in relation to these core bank products. In particular, it will be important to confirm the extent to which cash and term PIEs will be exempt from the governance arrangements. This issue needs to be resolved in advance of 1 December 2014 in order to facilitate a smooth transition for these products. NZBA would welcome a meeting with MBIE to work through these issues at MBIE's earliest convenience.

Managed Investment Schemes

14. Throughout the Regulations the provisions do not adequately reflect the structure and nature of unit trusts. For example, clause 15 of Schedule 3 does not contain a prescribed wording option that reflects the fact that units in a unit trust may be redeemable or able to be repurchased by the fund manager.

15. There is unnecessary duplication of the requirement to disclose the risk indicator in the key information summary (KIS) and the body of the product disclosure statement (PDS). The risk indicator is also required in the fund updates. In addition, there is the requirement to include a blank indicator as an example. This seems to be an excessive amount of disclosure of these indicators, particularly in a prescribed length document. NZBA submits that one way to prevent duplication is to require the risk indicator to be disclosed in the fund updates, but not in the PDS. This way, the indicators will reflect current risk and there will be no danger of the indicator in the PDS being out of sync with the fund updates (as it may be, if, as proposed, the PDS does not have to be updated if there is a change of one place on the indicator).

16. If the risk indicator is to remain in the PDS, it should only be disclosed once in that document and once in the annual fund update, reducing the possibility of misalignment between the two documents and providing an appropriate opportunity to update the PDS. Although the suggestion that FMA provide guidance is noted (see paragraph 210 of the Commentary document), it is unlikely that an issuer would be comfortable with there being different risk indicator information in the PDS and a fund update. In addition, there are difficulties associated with the approach discussed in paragraph 210 of the commentary document in relation to risk indicators which require clarification. For example, the risk indicator could move by two places in one quarter due to unexpected volatility but then move back two places the following quarter. This could result in the manager having to update the PDS twice over a period of two quarters. This is contrary to the policy that the PDS contain static information. If the approach in paragraph 210 of the commentary document is adopted, it is crucial that any FMA guidance is issued well before the Regulations take effect, and that there is sufficient detail to ensure that the approach that will be used is clear and unambiguous.

17. NZBA submits that if further specific requirements for KiwiSaver schemes are planned, it is essential that those requirements are included in the Regulations. This will avoid the industry developing one set of documents to meet the Regulations as they stand and needing to develop new ones when the extra requirements follow.

18. Finally, NZBA would also highlight that the length restrictions (that is, the 12 page, 7,200 word limit restrictions) will be problematic at both the KIS and PDS level for both managed funds and derivatives. While the intended outcome is a valuable one, such restrictions may constrain useful combination of products into one disclosure document. One way to avoid such consequences would be to maintain the limits, but make them subject to incremental increases where additional products are being disclosed in a single document. The length of the document will then be dictated by the twin requirements that firstly, products can only be combined whether a reasonable person would consider this would be useful to investors, and secondly, that the PDS is clear, concise and effective.

Derivatives

19. In relation to disclosure of fees, we note in respect of clause 17(3) of Schedule 5 that MBIE's discussion document in October 2013 proposed that fees be disclosed as follows:

> For each type of fee:
> - if the fee is fixed, state the fee
> - if the fee is calculated by some formula, state the formula
> - if the fee is determined on an individual customer basis, state the factors that may be considered in setting the fees and when the fees will be determined
> - state when the fee is payable

20. NZBA submits that this approach to disclosure of fees is appropriate as it reflects current market practice regarding fees that may be set on an individual customer basis, taking a number of factors into account at the time the derivative is entered into.

21. The amendment in clause 17(3) to specifically require a description of "how the fee will be calculated and what procedure is available to an investor to ascertain the amount at the time of, and following, the date on which the derivative is entered into" is a departure from the proposed approach and raises practical difficulties. These difficulties arise because the setting of fees is a complicated process which may take into account a number of factors with changing degrees of materiality at that point in time which cannot adequately be described in the manner contemplated in clause 17(3).

22. No explanation has been given in the third exposure draft for this departure. We submit that clause 17(3) should be amended to revert to the October 2013 discussion document proposal requiring disclosure of the factors that may be considered when setting the fee.

23. In addition, NZBA notes that the confirmation information as proposed in clauses 49, 50 and 51 of the Regulations does not take into account the varied nature of derivatives contracts, and will not in effect provide the anticipated practical disclosure from derivative issuers. Further, the specific confirmation requirements of these clauses are a move away from recognising industry standard (i.e. International Swaps and Derivatives Association) derivative confirmations.

General

Confirmations

24. The timing of confirmations as contemplated by clause 49 of the Regulations does not work for continuous issuers, particularly where investors have to opt-in to electronic disclosure under clause 51(1)(a). It would be highly impractical and investors would end up with vast amounts of paper work that in most instances they will neither need nor want every time a product is issued, transferred or redeemed. NZBA submits that confirmation information, in the absence of an investor opting in to electronic disclosure, would be more practically achieved on an annual basis, as is the case for KiwiSaver, superannuation and workplace saving schemes under clause 49(3).

25. Clause 54 requires KiwiSaver providers to send annual member statements to KiwiSaver scheme members within 20 working days. This will be extremely challenging. Large providers distribute hundreds of thousands of statements under the current regime. In addition to generating the information and appropriate checks on the information in those statements which usually takes several weeks, the physical distribution of information to members is usually staggered over several weeks in order to ameliorate practical issues with the mailhouse and call centres. Although members may opt in to electronic disclosure, this is not expected to be taken up by all investors, particularly in the first year of the new regime. At present the timing of the distribution of the member statements under the KiwiSaver Act is driven by the timing of tax information, which must be sent to members within three months of the end of the financial year. This is also useful for investors because it means members receive one mail out instead of several. The existing timing should be adopted in the Regulations.

Fund Updates

26. Our final point is that fund updates under the Regulations should be treated like the periodic disclosure documents for KiwiSaver and only be used to update existing investors. In our view, a fund update should be a flexible reporting instrument to provide updates to investors, and should not be treated as a ‘quasi-PDS’.