NEW ZEALAND
BANKERS ASSOCIATION

Submission

to the

Ministry of Business, Innovation and Employment

on the

Financial Markets Conduct (Derivative Issuers) Regulations

8 August 2014

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

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 supplement to the draft Financial Markets Conduct (Derivatives Issuers) Regulations 2014 (the Regulations) made under the Financial Markets Conduct Act 2013 (the Act).

4. The process around the development of the Act has been a good example of policy development that has actively involved the industry. NZBA commends the ongoing commitment to meaningful consultation and engagement and appreciates the invitation to participate in this targeted consultation.

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

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

James Pearson
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Registered bank exemption

It appears that the policy behind the Regulations is to protect investors by providing them with a claim against a registered bank (Regulation 6). Where a registered bank is a derivatives issuer and owes money to an investor or holds property for an investor, the investor already has this protection.

Additionally, in the case of a registered bank that is a derivatives issuer, the 'money' is the debt owed by the registered bank to the investor. This is a liability of the bank (not an asset) and cannot be held on trust for the investor. On this basis, Regulation 6 would require our members to open an account in their name with another bank and deposit the money in it. Opening such accounts is impractical and in our view would not meet the policy intention.

Our members understand that in Australia the Corporations Act purports to 'cure' this anomaly by virtue of Corporations Regulation 7.8.01(1). Due to the nature of the legal relationship created by a bank account we do not believe that inserting an equivalent provision into these Regulations is capable of overcoming this issue.

NZBA submits that a practical solution to these issues is to exempt registered banks that are derivatives issuers from the Regulations. This could be achieved either by amending the definitions of Investor Money and Investor Property or by way of a specific exemption. We would welcome the opportunity to consult further with you on the method of achieving such an exemption.

Tracing / look-through arrangements

NZBA submits that the Regulations should be amended to ensure that any investor money paid to hedge counterparty is not subjected to any trust requirements. NZBA supports the policy intention stated in Jason Le Vaillant's email under the heading "Treatment of investor money for exchange-traded derivatives". However, we submit that amendments to the current draft Regulations are necessary to ensure this outcome is achieved. For example, Regulation 4 appears to apply equally to exchange-traded and all other regulated offer derivatives, which in our view is not consistent with the stated policy intention.

Any intention to keep investor trust interests alive in money used by derivatives issuers to secure their own separate contractual obligations to third parties raises complex issues under insolvency and (constructive) trust laws. As a hedging counterparty, it will not be possible to safely assess the credit risk of, and recourse to, money posted as security by a derivatives issuer. NZBA submits that a provision is required ensuring that hedging counterparties have no obligation to enquire or satisfy themselves as to a derivative issuers' compliance with the Regulations (including Regulations 6, 7, 8 and 9).

NZBA notes that this is a complex area, and our members consider the drafting needs to be carefully considered to avoid any unintended consequences for issuers or third parties.

Drafting and undefined terms

NZBA submits that the link between authorised hedging activity and issuer derivatives with investors is not sufficiently clear.

In general, NZBA also notes that many of the terms are insufficiently defined to interpret the regulations with certainty.

NZBA would be happy to meet with MBIE officials to provide further information on these three points.

Further consultation

These Regulations raise complex issues which impact on banks. In addition, the Financial Markets Conduct Regulations Cabinet paper released on 6 August 2014 proposes a 1 December 2015 transition date. In light of this, NZBA suggests that a further round of consultation is necessary on these Regulations before they are finalised. Our members are available between 12pm and 1pm on Wednesday 13 August 2014 to meet for further discussion in relation to this submission.