

# Submission

to the

# Financial Markets Authority

on the

# Consultation on the content of regulatory returns for licensed DI, MIS managers and DIMS providers

16 April 2018

## 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 that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.
2. The following seventeen 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
  - China Construction Bank
  - Citibank, N.A.
  - The Co-operative Bank Limited
  - Heartland Bank Limited
  - The Hongkong and Shanghai Banking Corporation Limited
  - Industrial and Commercial Bank of China (New Zealand) 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 feedback to the Financial Market Authority (**FMA**) on its consultation on the content of regulatory returns for licensed derivative issuers (**DI**), managers of managed investment schemes (**MIS managers**) and providers of discretionary investment management services (**DIMS providers**) (**Consultation**) and commends the work that has gone into developing the Consultation.
4. If you would like to discuss any aspect of the submission further, please contact:

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## Question one

5. NZBA considers that all licensees should have a longer window for the preparation of regulatory returns (around three months as for AFAs), and that MIS managers' regulatory returns should be allowed to be completed at a different time of the year.
6. As the Consultation stands, MIS managers' returns will need to be prepared within two months of the end of the financial reporting year for the manager (as opposed to the relevant MIS). In some cases the MIS managers' financial year will be the same as the MIS' financial year. That will put significant pressure on the MIS managers, particularly given that the end of the financial year triggers a number of other regulatory obligations, including the preparation of annual financial statements and annual reporting to investors. Relatedly, where a MIS does not have the same financial year end as the MIS manager, the proposed date for the first returns will give rise to issues in terms of mismatch with the timing of audited financial statements and availability of other data. An appropriate degree of flexibility with respect to the respective reporting dates of managers and their MIS should therefore be facilitated.
7. We also seek clarification as to why the reporting period for DI and DIMS providers differs from the reporting period for MIS managers.

## Question two

8. NZBA broadly considers that the information requested is appropriate and clear. Specific comments on the requested information are set out at paragraph 15 and following. However, we note the following:
  - (a) **DI returns:** not all of the information requested is appropriate for the derivatives business of a registered bank. Some of the information that the FMA is proposing to request appears to be coming from an 'investor' mindset, and doesn't take account of those derivatives businesses that are predominantly wholesale in nature, and where the service focus is on providing risk hedging facilities to customers for their businesses (rather than 'investment'). The FMA appears to be taking a one size fits all approach that ignores the significant difference in DI types and the purposes of derivative instruments.
  - (b) **DIMS providers returns:** NZBA notes that the guidance section in respect of questions 11 and 12 could be clarified so that the reference to 'percentages' explicitly refers to the information set out in the questions listed. Additionally, further clarity is requested with respect to the concept of 'overall group'.
  - (c) **MIS managers returns:** Not all of the information requested is appropriate or well defined. We also note that the reference to 'adviser' is unclear in question 16 and could be better defined.
9. NZBA also wishes to ensure that the commercially sensitive information provided to the FMA by way of regulatory returns is protected. In particular, the FMA should commit to resisting disclosure of information provided where that is requested under the Official Information Act 1982 on the basis that it is commercially sensitive.

## Question six

10. NZBA considers that this requirement should be clarified to make it clear that providing information for 2018 is voluntary, but if a provider intends to provide information for 2018, then it must be done on a 'best efforts' basis.

## Question seven

11. NZBA considers that the requirement to provide information by 2019 is reasonable assuming that our specific comments on the content of the returns are taken into account, and subject to systems changes that may be needed in order to produce the information.

## Question eight

12. NZBA supports this approach but notes that it is unlikely to have a significant effect on how banks respond to the returns.

## Question nine

13. NZBA generally considers the intent of questions 21-23 is clear. However further guidance may be appropriate to:
  - (a) clarify the definition of 'Unique Investor';
  - (b) clarify the definition of 'Wholesale Fund'; and
  - (c) clarify the appropriate treatment in relation to funds under management (**FUM**) that are invested at both the retail and wholesale level (ie should this FUM be double-counted).
14. Finally, FMA should ensure consistency in the use of terminology, in particular: 'pools', 'funds' and 'schemes'.

## Comments on the DI information return

15. We have the following specific comments on the DI information return:
  - (a) **Question five:** We query the need for such granular information and recommend that some materiality criteria should be considered.

It is not clear what value some of this information adds, for example the number of complaints directed straight to the dispute resolution scheme (**DRS**), and complaints resolved during the year/currently open.

Additionally, instead of using the terminology of 'resolved' or 'declined' by the DRS we think the number of complaints upheld, partially upheld or held against (from the DI's point of view) would be more relevant.

We also seek clarification as to whether the FMA is only interested in complaints from retail customers, or also those holding regulated products.
  - (b) **Question six:** Licencees are subject to a standard condition attaching to their licence (Derivatives Issuer Standard Condition 6) which requires that

they notify the FMA of any material changes to their outsourcing arrangements within five working days. The FMA should, therefore, already have this information through licencing and through the application of the Standard Condition 6. This also applies in respect of the DIMS information return where Standard Condition 7 requires this reporting.

- (c) **Question seven:** We question whether percentage of staff turnover is a transparent or meaningful metric. There are numerous reasons why staff leave a role or organisation. Accordingly, we are not sure this metric provides any insight without additional context.

Additionally, for banks who are derivatives issuers, it would be difficult to answer this question in a meaningful way. Banks are unlikely to be able to provide a definitive full time equivalent allocation to the regulated products within their markets businesses, given there is no separation between staff involved in providing the regulated products and other markets business activity.

- (d) **Question eight:** We query why this question asks for information over the previous three years, as opposed to the other questions which are seeking information over the previous 12 months? We also note that this question is likely to be inapplicable to registered banks which receive money on their own account rather than receiving investor money.

- (e) **Question nine:** We query whether this question is applicable to banks who are derivatives issuers given that they are prudentially regulated by the Reserve Bank of New Zealand. We also note that banks will generally hedge on an aggregated basis rather than an individual basis, so it may be difficult to extract this information in a meaningful way.

Additionally, we are concerned that providing only the names of hedging counterparties does not give an accurate representation of concentration risk; it does not provide the FMA with information regarding the volume traded through hedging counterparties. For example, 90% of trading could be done through two hedging counterparties.

- (f) **Question ten:** We query whether this question is applicable to banks who are derivatives issuers. Banks will generally not take 'margin', but rather set credit limits with regard to internal credit assessment of the relevant client.

Additionally, we request that the FMA clarify the definition of 'margin calls'.

- (g) **Question eleven:** We query whether this question is being asked on an individual client or portfolio basis? Additionally, we request that the FMA clarify the definition of 'house account' in the context of this question.

- (h) **Question twelve:** We seek clarification as to the following:

- (i) The definition of revenue – is the FMA referring to customer sales revenue only or a broader definition of revenue?
- (ii) Whether hedging trades are to be included in the response to this question?

- (i) **Question thirteen:** We query whether this level of detail is required.
- (j) **Question fourteen:** We do not consider that this is appropriate for the derivatives business of a registered bank. The information is not easily obtainable and complicated by the number of hedge counterparties that a bank has as principal.

Additionally, we seek clarification as to whether this question is also intended to cover interbank trading and international trading?

Finally, we note that this question asks for data on wholesale customers that fall outside the licenced business and query why the FMA requires this wholesale information.

- (k) **Question fifteen:** We seek to clarify whether this question relates to the quality of advice or whether a bank is meeting its obligations.
- (l) **Question eighteen:** We suggest that this question could be rephrased as follows:

*What checks and balances do you have in place to ensure that your customers make informed decisions about the products they acquire? How does your senior management and board provide oversight in relation to this obligation?*

The rationale for this question is stated as being to understand the checks and balances DI licensees have in place to ensure they meet conduct obligations. However, if the question is left as currently worded, the FMA will not receive a true view of the checks and balances in place, as the question presupposes only one particular form of such arrangements.

Additionally, the use of the term 'investments' does not align with the nature of the products sold under the licenced business, which are not investment products but products sold for an express business need (such as interest rate and foreign exchange risk management).

## Comments on the DIMS information return

16. We have the following specific comments on the DIMS information return:

- (a) **Question eleven:** We assume 'groups business' refers simply to the licensed entity only and is not inclusive of related parties. If the financial half-year or full-year of the licensed entity does not align with the reporting period, we assume that the most recent half-year/full-year will be a suitable proxy.
- (b) **Question twelve:** We suggest:
  - (i) Defining 'management fees'. If 'management fees' are reflective of both advice fees and product management fees earned by the licensed entity then we would recommend this is separated and defined.

- (ii) That the 'Brokerage' category is broken down further into Primary Market and Secondary Market. We believe the ways these may be used within a DIMS business warrants separation.
- (c) **Question fourteen:** We suggest defining management fees. We assume this is only in the context of on-going advice, administration, product management and monitoring fees charged by the licensed entity; not product management fees charged by a related or third party.

## Comments on the MIS manager information return

17. For MIS manager information returns earlier concerns regarding the specificity of information also applies, and overall we consider:
- (a) A significant proportion of the information requested is already being provided to the FMA and/or a MIS manager's supervisor as part of ongoing compliance reporting required under the MIS licence (although, in some cases, the newly requested information has more granularity). What this means in terms of the intended role of the "front line" supervisor is unclear. Additionally, we question how the current and proposed reporting regimes are intended to work alongside each other.
  - (b) As mentioned above, there are both similarities and differences between the information currently reported to supervisors and the FMA, and that proposed. We are concerned that the proposed additional reporting would create an unnecessary compliance burden (ie at considerable cost and systems-build) given the differences in information requested and the reporting period differences. The reasons for gathering the additional information, and the how it is intended to be used, are unclear. Therefore, it is difficult to determine whether the benefit gained (either from a supervisory or consumer protection perspective) outweighs the additional compliance cost.
  - (c) The regulatory reporting questions appear more akin to a qualitative research review performed by an external ratings agency or research house (ie Morningstar, S&P), or within an RFP, rather than a regulatory report.
  - (d) NZBA reiterates in relation to MIS managers (as well as DIs and DIMS providers') returns that the information requested on complaints seems too granular and detailed. Also, that guidance will be needed, particularly around materiality.