FINANCIAL SERVICES FEDERATION

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The Chair
Finance and Expenditure Select Committee
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WELLINGTON

Introduction

The Financial Services Federation ("FSF") is New Zealand's largest member based industry organisation for financial institutions. The FSF has thirty six members and associate members providing financing, investment, banking and insurance services to over 750,000 New Zealanders, and our five affiliate members are internationally recognised legal and consulting providers. A list of our members is attached at Appendix A.

FSF Submissions

The FSF supports one key objective of the Bill, namely to move regulation of NBDTs into one statute, separate from the RBNZ Act, but notes that in doing so the Bill continues in many places to assume that the same levels of regulation are required for NBDTs as those required for banks, an assumption that the FSF does not accept. It is also worthwhile for the Committee to note that the compliance burden and cost of regulation is ironically being borne by those NBDT's that *didn't* fail – that is their business models were developed on a sounder and more sustainable footing than failed firms, and yet they bear the ongoing compliance costs for regulation related to improving prudential soundness.

These points are reflected in some of the FSF's principal concerns with the Bill which are:

1. The position of building societies under the Bill is unclear, and requires clarification;
2. The Bill gives the RBNZ some powers in respect of NBDTs that it does not presently have. In some cases, the FSF accepts those powers are appropriate, in others it does not;
3. That applies in particular to the Bill's definition of the "associated persons" of NBDTs in respect of whom the RBNZ is given new powers. The FSF considers that the threshold shareholding of 20% which the Bill sets for those powers is too low;
4. The Bill should make clear that in respect of NBDTs that are presently compliant with regulatory requirements, the default position is that such NBDTs should be granted a licence when the new regime commences;
5. The FSF has no issue with the concept that NBDT directors must not raise "suitability concerns", but is not able usefully to comment on those suitability concerns until such time as regulations make clear what they are. The FSF expects to be consulted in respect of those regulations;
6. The FSF considers that Clause 20(f) of the Bill provides unnecessarily wide regulatory powers with very few limits in relation to the cancellation of an NBDT licence. That clause contains no materiality threshold, nor an obligation for the RBNZ to consult with the Trustee prior to cancellation. We suggest that this provision needs to be amended to include a materiality threshold, and an obligation for the RBNZ to consult with the NBDT's Trustee;
7. The FSF considers that it is not necessary for the Bill to provide for 12 offences with substantial penalties in respect of NBDTs, when there is only one corresponding offence for banks;

8. We have also provided a section including other suggestions relating to additional material which should be included in the Bill.

B. DEFINITIONS OF "NON-BANK DEPOSIT TAKER" AND OF "ASSOCIATED PERSON":

1. Status of Building Societies:

   a) The FSF requests that the Bill make clear whether or not regulations are proposed extending the definition of "debt securities" to include building society shares. Without knowing whether that is intended, building society members of the FSF that fund themselves only by shares cannot be sure of their future status under the Bill.

   b) Based on the Explanatory Notes to the Bill, so far as building societies are concerned the intent of clause 5 seems to be that building societies will be NBDTs only if they issue "debt securities" as presently defined in the Securities Act. At present building society shares are not "debt securities" as thus defined. However, under the draft Financial Markets Conduct Bill recently circulated by the MED, many building society shares will be recategorised as debt securities. This makes it very difficult for the FSF's building society members to know if they will be NBDTs in future. Clarification is needed here, both in terms of the policy intent of this Bill and in terms of co-ordination of policy between this Bill and the draft Financial Markets Conduct Bill. The FSF requests it is consulted in respect of these matters.

2. Definition of "Associated Person":

   a) At present, there are no provisions in Part 5D of the RBNZ Act that relate to an NBDT's "associated persons", and no offences able to be committed by an NBDT's "associated persons". By contrast, the Bill will impose obligations on, and create offences in respect of, "associated persons" of NBDTs. As explained below, the FSF is concerned that in doing so, the Bill defines "associated person" too broadly.

   b) To explain, the Bill's definition of "associated person" closely follows that applicable to banks under the RBNZ Act, meaning that 20% or greater shareholders in NBDTs will be "associated persons". The FSF suggests that is not appropriate, given the significant structural differences between New Zealand banks and NBDTs.

   c) The largest 4 New Zealand banks are all wholly owned by Australian banks. Those New Zealand banks have no shareholders holding less than 100% of their shares. Further, none of their Australian bank parents has a shareholder that holds 20% or more of their shares. In those circumstances, the RBNZ's powers in respect of "associated persons" of banks effectively apply only to those New Zealand banks' holding companies.

   d) By contrast the position with NBDT shareholdings is quite different:

      i. Several FSF members that are NBDTs have shareholders holding between 20% and 50% of the NBDT's shares;

      ii. While a 20% or greater shareholding in a listed bank may well confer significant influence on that shareholder, a shareholding of between 20% and 50% in an unlisted NBDT typically gives no real ability to influence the NBDT;

      iii. Such a shareholder in an NBDT is a minority shareholder in all senses of the word, and it is –

         1. very likely to be pointless to extend the RBNZ's powers to them; and

         2. inappropriate to place such shareholders at risk of criminal sanctions when they have no real ability to influence the affairs of an NBDT;

   e) The FSF accordingly submits that in defining associated persons of NBDTs by reference to 20% shareholdings, the Bill sets the RBNZ's powers at an unrealistically low level, unlikely to achieve

any useful result, and which amongst other things may expose non-controlling shareholders in NBDTs to the risk of criminal liability for events beyond their control.

f) Further, to do so will act as a real disincentive to equity investment in NBDTs. That is inconsistent with the policy objectives of recent NBDT regulation.

g) If the objective is for the NBDT Bill to replicate the position in respect of "associated persons" of banks, then as explained at c) above, the position with New Zealand's main banks is that only their holding company is an "associated person". The same should apply to NBDTs. The FSF submits that should be achieved by replacing references in this definition to shareholdings of 20% or more with references to shareholdings of 50% or more, accordingly.

C. NEW NBDT LICENSING REGIME

1. Transition: The FSF notes that the Bill gives no certainty that an NBDT that is presently compliant with what are in substance the same prudential rules as those in the Bill will be granted a licence by the end of the transitional period: clause 13(1) of the Bill states the RBNZ "must not" grant a licence unless satisfied of the criteria, but does not require the RBNZ to grant a licence where the criteria are being met.

   This leaves FSF NBDT members in a position where they – and their investors – cannot be sure of their future status, even though they are presently compliant with what are for the most part the same prudential rules as contained in the Bill. That uncertainty may even impact on their ability to retain deposits before and during the transitional period, and thus on their liquidity. That is clearly not desirable, and is to some extent at odds with the objectives of the Bill in maintaining a stable NBDT sector.

   The FSF submits that the transitional provisions of the Bill (clause 87) should be revised to make clear that there is a presumption that an NBDT that is compliant with prudential laws at the commencement of the transitional period will be granted a licence, unless the RBNZ is satisfied that the criteria in clause 13 are not met.

2. Licence Conditions: Given that clauses 14 and 15 contain quite a detailed regime regarding suitability notices, and that the "suitability concerns" to which those notices relate are to be addressed in regulations, it is neither necessary nor appropriate for clause 18(1)(b) to allow the RBNZ to be able to effectively alter those regulations itself by adding conditions about "The circumstances in which a director or senior officer may not be appointed or may be required to resign".

   It is also not appropriate for the RBNZ to be able to impose conditions which "modify any of the requirements that would otherwise apply to the NBDT": that may effectively allow the RBNZ itself to amend the Act and the regulations under it, which seems at odds with constitutional principles.

   Further, in allowing the RBNZ to do so in respect of some NBDTs but not others, that may effectively remove the level playing field between NBDTs that would otherwise apply to all NBDTs. That is not consistent with the principles in clauses 8 (a) and (d) of the Bill which emphasise the need for "consistency in the treatment of similar institutions" and "the need to maintain competition within the NBDT sector".

3. Amendment of Licence Conditions: Despite the 7 day period referred to in clause 19 being common to the regimes already applicable to registered banks and to insurers, the FSF submits that the reference to 7 working days' notice in clause 19 should be deleted, as -

   a) it is not long enough for the entire process of amending licence conditions;

   b) it is confusing, as it is not clear if the NBDT's "reasonable opportunity to make submissions" forms part of that 7 working days, or supplements it;

   c) if the intention is the latter, then the 7 working days is the less important period and serves no useful purpose over and above the requirement to give notice, and the clause would function better if the requirement for an NBDT to have a "reasonable opportunity to make submissions" stood alone.

4. Ministerial Decision Desirable: The FSF notes that there is no appeal from a decision of the RBNZ to cancel an NBDT licence. While it can appreciate that the delays of a court appeal may not be desirable in this context, nevertheless the FSF –

    a) Notes that the Bill does give rights of appeal against RBNZ decisions in other situations (such as by a director or senior manager in respect of a suitability decision by the RBNZ, under clause 61) and it seems odd that the more important matter of licence cancellation does not feature comparable rights;

    b) Similar safeguards apply to the cancellation of banking licences, in that it is the Minister that makes the cancellation decision on the advice of the RBNZ, not the RBNZ itself;

    c) Accordingly submits that the process for cancellation of an NBDT licence should, for consistency with the regime applicable to registered banks, also feature the further step of a Ministerial decision before the cancellation process is complete.

5. Cancellation for Trust Deed Breaches: Clause 20(f) of the Bill is one of the most significant provisions within the Bill as it makes ***any*** breach of an NBDT's Trust Deed grounds for licence cancellation, without any materiality threshold and without any trustee involvement. Further, it does not address the possibility that a breach may have been rectified – in which case licence cancellation would be unjustified – and does not require any trustee involvement, despite the fact that supervision of Trust Deed compliance is primarily the role of trustees. The FSF notes that other triggers for cancellation do contain a sensible materiality threshold, e.g. s20(a) false or misleading information in a licence application…in a material respect. The FSF's view is that clause 20(f) provides very significant regulatory powers with very few limitations, and strongly submits that Clause 20 (f) should be amended by adding to it a reasonable materiality threshold as with other provisions which contain triggers for cancellation, and also by adding the words –

    "and –

    (i) That breach has not been remedied by the licence holder; and

    (ii) The Trustee of the licence holder's Trust Deed requests the Bank to cancel the Licence."

D. SUITABILITY NOTICES IN RESPECT OF NBDT DIRECTORS AND SENIOR OFFICERS

1. Suitability Concerns: The FSF has no real issues with the provisions of the Bill around suitability notices and suitability concerns, although it notes that the provisions are presently a framework only, with the substance to be added in future by regulations outlining the suitability concerns. The FSF expects to be consulted about those regulations.

    The FSF does however note that, if the "fit and proper standard" made by the RBNZ under Insurance Prudential Supervision Act is any guide, the suitability concerns may place some emphasis on past associations with insolvent entities or on criminal or similar behaviour. It is relevant to note that such standards would quite likely not have prevented the NBDT failures of recent years: many directors of those failed NBDTs would quite likely not have raised any "suitability concerns" at all.

F. PRUDENTIAL OFFENCES

1. Offences: Clauses 22-40 of the Bill contain 12 offences for non-compliance with prudential obligations. That differs from the position with both registered banks and insurers under the Insurance (Prudential Supervision) Act, where there is only one corresponding offence, namely failure to comply with licence conditions.

    It is accepted that the 12 offences in Clauses 22-40 of the Bill are already offences for NBDTs under section 157ZR of the RBNZ Act, but –

    a. They are now supplemented by a new offence of failing to comply with licence conditions, under clause 17(3) of the Bill; and

b. The reason those 12 offences are separately itemised in section 157ZR of the RBNZ Act was presumably simply that there was no licence regime under Part 5D of the RBNZ Act, and thus no ability to link an offence to licence conditions.

Now that there will be a licensing regime for NBDTs, it is no longer necessary to multiply offences in this way (especially when the nature of some of the offences is almost one of "strict liability"). The FSF submits that all offences in Clauses 22-40 of the Bill should be deleted, leaving the matters to which they relate to be dealt with by the offence in clause 17(3) of the Bill. This would leave NBDTs in the same position as that of banks and insurers, and is more consistent with a level playing field for all financial institutions supervised by the RBNZ.

In addition, the FSF records its support for the Bill's decriminalisation of non-compliance with the governance provisions in clause 24.

G. CHANGES OF CONTROL OF NBDTS, AND OTHER NEW POWERS OF THE RBNZ IN RESPECT OF NBDTS AND THEIR ASSOCIATED PERSONS

1. Changes of Control: The FSF accepts that there may need to be a level at which RBNZ consent is needed to changes in board entitlements or shareholder voting power, as there is with banks.

   However, for essentially the same reasons as already explained in its above submission on the definition of "associated person", the FSF submits that those threshold levels are set too low by the Bill: an ability to appoint 25% of the board may confer no real ability to influence an NBDT's activities, and neither does a 20% shareholding. As with the definition of "associated person", the FSF suggests the threshold for each should be set at 50%, as it is only at that level that real influence arises.

   As a technical submission, the FSF also notes that in terms of clause 42(1)(a)(i) referring to "indirect" ability to appoint 25% of a board, almost any ability to appoint directors may "indirectly" result in the appointor having more than 25% of a board, if other directors resign. The reference to "the ability, directly or indirectly" should be deleted and replaced by "the right".

2. Removal of directors: The FSF submits that it is not necessary for clause 59 to give the RBNZ power to remove and replace directors (except perhaps when there are suitability concerns in respect of a director).

   The FSF is not overlooking that such powers exist now in respect of banks, but that is in a different context from that in which NBDTs operate. Specifically, banks are not subject to trustee (and FMA) supervision, and there is no party able to appoint a receiver of a bank in the way that a trustee can do with an NBDT.

   If an NBDT is insolvent or its directors are engaging in conduct prejudicial to investors, the appropriate response would be action by the NBDT's trustee, such as appointing a receiver. Unlike the position with banks, there is no need for the RBNZ also to be empowered to appoint and remove directors. Indeed the existence of such a power seems broadly inconsistent with the objectives of the recently enacted Securities Trustees and Statutory Supervisors Act 2011, one of which was stated in the Explanatory Notes to that Bill to have been to require trustees to perform their functions more effectively

3. RBNZ powers in respect of associated persons: The FSF notes that so far as the proposed new RBNZ powers relate to associated persons of NBDTs, the FSF considers that they may apply at too low a level, and that is one reason for the FSF's submissions on the definition of "associated person".

OTHER SUGGESTIONS

1. The FSF suggests the addition of a provision into the Bill clearly deeming any RBNZ Exemption notices granted to NBDTs under the RBNZ Act to automatically be carried over to the new NBDT legislation.

2. The FSF would like to see some clarity in the Bill that ensures that if guidelines are to be binding, they are properly characterised as Regulations, otherwise guidelines should be just that – guidelines.

3. There are a number of drafting matters in the Bill that need attendance for example- the definition of "Director", limb (b) of which refers to someone acting "in a similar fashion" to a director, without referring to governance or the purpose of the position, and without incorporating the concept of being a member of the Governing Body (which is better defined in the Bill, although perhaps not broad enough to cover all relevant structures).

Thank you for the opportunity to provide written submissions on this Bill. Of course, the FSF would very much like provide oral submissions to the Committee on the matters above.

Yours sincerely

Kirk Hope
Executive Director

APPENDIX A

FSF Members

- Asset Finance Ltd.
- Avanti Finance Ltd.
- Baycorp (NZ) Ltd.
- BMW Financial Services Ltd.
- Centracorp Finance 2000 Ltd.
- Dorchester
- EC Credit Control Ltd.
- Equico Ltd.
- European Financial Services Ltd.
- Finance Now Ltd.
- Fisher and Paykel Finance Holdings Ltd
- GE Money
- Heartland
- Heretaunga Building Society
- Instant Finance Ltd.
- John Deere Credit Ltd.
- Medical Assurance Society Ltd.
- Mercedes-Benz Financial Services NZ Ltd.
- Motor Trade Finances Ltd.
- Mutual Credit Finance
- Napier Building Society
- Nelson Building Society
- ORIX New Zealand Ltd.
- Oxford Finance Corporation Ltd.
- Prometheus Finance Ltd
- Protecta Insurance NZ Ltd.
- PSIS Ltd.
- QBE Lenders' Mortgage Insurance Ltd.
- Receivables Management (NZ) Ltd.
- RentPlus
- Southsure Assurance Ltd.
- Thorn Rentals NZ Ltd.
- Toyota Finance New Zealand Ltd.
- Veda Advantage Ltd.
- Wairarapa Building Society
- Yamaha Motor Finance NZ Ltd.

Affiliate Members

- Buddle Findlay
- Deloitte
- Ernst & Young
- PriceWaterhouseCoopers New Zealand
- Russell McVeagh