<u>FSF RESPONSE TO RBNZ DOCUMENT NBDT INDUSTRY UPDATE "*REGULATORY STOCKTAKE -STOCKTAKE OBJECTIVES AND SCOPE*" DATED 21 JULY 2015</u>

<u>Page 1 - Objectives</u>:

a. "**The aim of the stocktake is not to alter the fundamental shape of the current prudential requirements for NBDTs"**: The FSF agrees with this approach. The shape of the current prudential regime for NBDTs is after all in part a result of legislation only enacted in 2013, and as the paper notes the regime was also the subject of a review the same year. With some subject-specific exceptions, the FSF's NBDT members would generally not be keen to see further material changes to the regime after such a short time.

b. **"A secondary objective of the stocktake is to consider whether there are areas where we can further improve the quality and effectiveness of our current policy development processes"**. The FSF certainly supports any initiatives that will improve the quality and effectiveness of RBNZ policy development processes, and looks forward to being consulted about them in future.

2013 Review conclusions: "Confirmation of the existing model whereby trustees act as frontline supervisors of NBDTs": As above, the FSF's NBDT members would generally not be keen to see further material changes made to the current model, and changes that materially altered or even removed the current trustee role would be in that category. That said the FSF's NBDT members also recognise that there may be areas of overlap and inefficiencies implicit in a dual supervisor model, and would be keen to participate in any consultation of such matters which the RBNZ might undertake.

There is also significant cost to NBDTs in maintaining their Trustee relationship – to the extent of a 6-figure sum annually. If changes were proposed to the model whereby the RBNZ was to become both the regulator and the supervisor and these were likely to significantly reduce the cost of supervision to NBDTs then clearly they would be very supportive.

<u>In working to develop a more specific workplan with NBDTs for the stocktake, the Bank made contact with three NBDT industry bodies late last year, to identify potential areas of focus</u>.

The FSF would welcome any moves to streamline the suitability assessment process for directors and senior management of NBDTs. In the experience of FSF NBDT members who have been through the current process, they have found it to be very inefficient and a barrier to making an important senior appointment with one NBDT reporting the process as taking three months to complete. This left the business in a situation of working without a senior management position being filled during this period with the consequent pressure that placed on the business and a potential employee in a limbo situation as to their employment position.

The FSF would question whether, as part of the suitability assessment process, some way could be found of linking the checks required to be registered as a Financial Services Provider with this process.

Para 1A on Page 2: "**Credit Rating Exemption: …..The Bank has decided to increase the credit rating exemption threshold from $20 million to $40 million, with a requirement for entities under $20 million to maintain a capital ratio of at least 10%, and entities between $20 million and $40 million to maintain a capital ratio of at least 12%. The Bank will shortly announce the transitional arrangements associated with this change."** The FSF supports the proposed increase in exemption threshold from $20 million to $40 million, and looks forward to the RBNZ's proposals about the transitional arrangements associated with that change.

The FSF does however consider that the associated increases in capital ratios are not a necessary consequence of an increase in the exemption threshold, and may not be desirable in so far as they will to some degree substitute increased costs of capital for the rating-related costs avoided by the exemption. The FSF feels that the proposal to increase capital ratios as a part of this issue might have been better deferred and addressed as a part of the capital review referred to at para 1B on Page 2.

Para 1B on Page 2: "Capital Review: We recently announced in our Financial Stability Report that we will be looking again at the capital requirements for banks under the standardised and internal ratings based approaches. As part of this work we will also be reviewing the capital requirements that apply to NBDTs." The FSF and its NBDT members are certainly keen to be involved in any RBNZ review of the capital requirements that apply to NBDTs.

Para 1B on Page 2: "Liquidity Review: The Bank will review the categorization of credit unions' deposits for liquidity purposes." The FSF is not sure why the RBNZ may think that credit union deposits may need to be treated differently for liquidity purposes from deposits with other NBDTs. The FSF's general approach to NBDT regulation is that there ought to be competitive neutrality between different types of NBDT, achieved by common rules applicable to all NBDTs, and as a result would certainly want to be involved in this review, even though the FSF's members do not include credit unions.

Para 1D on page 2: "Clarification of Risk Management Guidelines." The FSF welcomes the proposal to make risk management guidelines clearer and would be keen to be involved in consultation on any proposed changes.

The FSF's NBDT members report in particular that clarification of when changes to their risk management guidelines and what is considered material and what is not need to be approved by the Trustee would be helpful. The example of the Insurance regime was cited where it is not required that entities seek Trustee approval for changes that strengthen or add to the existing risk management process. This is required only when such changes detract or take away from the existing process.

Para 2A on Page 3: "Clarification of the Bank's "policy-making approach": The FSF welcomes the proposal to integrate this document in the NBDT section of the RBNZ's website.

Para 2A on Page 3: "Improvements to the NBDT section of the RBNZ website": The same applies here – the FSF welcomes in particular the proposed new initiatives page, and the objective of keeping this section of the website updated on a more regular basis.

Para 2C on Page 3: "Creation of an e-mail list serve targeted at the NBDT sector". The FSF also supports this proposal, and expects that its NBDT members are all likely to subscribe to the mailing list. The FSF also notes in this context that RBNZ communications via trustees can sometimes have the effect of increasing trustees' supervisory charges and thus unnecessarily adding cost to the sector, and in that context welcomes the fact that this list may help to avoid such effects.

However an FSF NBDT member who is also a registered insurer, advised that their experience with the insurer email list has been that good information such materiality with regard to risk management programmes can get buried within a regular email and that guidance on such subjects is not always updated at the same time as the email is distributed. They mentioned that it is not easy to search for information after it has been sent.

Related party Exposure Limits: The FSF notes that the RBNZ does not propose any further work on this subject at present, and in broad terms the FSF accepts the view that the limits mentioned "may be still justified to address the kinds of risks that can arise out of related party transactions." However in principle the FSF's NBDT members would favour taking account of any set off rights an NBDT may have when calculating related party exposures.

Page 4 -"Regarding the changes to the composition of the sector, the Bank is aware of the changes in funding models of a number of institutions, and of the overall consolidation of the sector." The FSF has certainly seen consolidation in the NBDT sector and changes in funding models so that lenders no longer fund themselves by raising deposits from the public. The FSF does not believe that this has been in the best interests of the New Zealand public as it has undermined competitiveness in the sector and taken away choice for depositors.

The FSF would certainly be keen to be involved in any consultation about this matter.