MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HIKINA WHAKATUTUKI

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

Discussion Paper

Review of Financial Markets Authority Funding and Levy

29 January 2020

newzealand.govt.nz

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How to have your say

Submissions process

MBIE and the FMA are seeking written submissions on the proposals and questions raised in this document.

The questions are listed in boxes throughout this document. Your submission does not necessarily need to answer all of these questions.

Your submission may respond to any or all of these proposals. Where possible, please include evidence to support your views, for example references to independent research, facts and figures, or relevant examples.

Please send your written submission on the proposals and questions raised in this document by **5pm 28 February 2020**. Please include your name, or the name of your organisation, as well as contact details.

You can make your submission by attaching it as a Microsoft Word or PDF document and sending to:

FMALevyReview@mbie.govt.nz

Alternatively, you can mail your submission to:

Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140
New Zealand

Please direct any questions that you may have to:

FMALevyReview@mbie.govt.nz

Use of information

The information provided in submissions will be used by MBIE and the FMA to inform the review of FMA's funding and the FMA levy and will be considered in the policy development process.

MBIE may contact submitters directly if clarification on any matters in submissions is required.

Release of information

MBIE intends to upload PDF copies of submissions received to MBIE's website at www.mbie.govt.nz. MBIE will consider you to have consented to uploading by making a submission, unless you clearly specify otherwise in your submission.

If your submission contains any information that is confidential or you otherwise wish us not to publish, please:

- indicate this on the front of the submission, with any confidential information clearly marked within the text
- provide a separate version excluding the relevant information for publication on MBIE's website.

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Private information

The Privacy Act 1993 establishes certain principles with respect to the collection, use and disclosure of information about individuals by various agencies, including MBIE and FMA. Any personal information you supply in the course of making a submission will only be used for the purpose of assisting in the development of policy advice in relation to this review. Please clearly indicate in the cover letter or e-mail accompanying your submission if you do not wish your name, or any other personal information, to be included in any summary of submissions that may be published.

Contents

1 Executive summary

1. The FMA is the principal conduct regulator of financial markets in New Zealand. Since the FMA's funding was last reviewed in 2016, the organisation has expanded and is now experiencing cost pressures. This has been in response to the regulatory remit of the FMA evolving due to financial markets growth and development, the new financial advice regime, the recent reviews into the conduct and culture of New Zealand banks and life insurers, and a lower than expected state of conduct maturity in financial markets. If not addressed, these cost pressures could reduce the FMA's ability to fulfil its statutory functions and undermine market confidence.

2. Accordingly, the FMA and MBIE are reviewing the FMA's operational funding requirements. An independent review of the FMA's efficiency and effectiveness has identified three separate funding options. These are summarised below:

Option one: Current spend	Option two: Base case	Option three: Enhanced case
Increase: **$9.215 million**	Increase: **$20.081 million**	Increase: **$24.805 million**
Total funding: **$45.215 million**	Total funding: **$56.081 million**	Total funding: **$60.805 million**
Addresses some immediate pressures and provides the bare minimum level of funding to implement the new financial advice regime and conduct and culture follow-up work. Does not address the broader cost pressures faced across the organisation and may undermine market and consumer confidence.	Allows the FMA to respond to pressure points and sees a moderate increase in resources for key frontline areas. Incorporates a medium-to-high level intensity risk-based monitoring approach for the new financial advice regime. Provides resource for a tactical follow-up of the conduct and culture reviews, and enables the FMA to respond to technological change and innovation.	Allows the FMA to broaden and deepen activity across regulatory functions, and respond to significant market events. Provides for development of expertise in intelligence and analysis, thematic research and a more systems wide view and engagement on issues. Enables greater focus on customers with new and better capabilities to promote good outcomes, additional resources for more proactive financial advice regime monitoring and guidance, and a more strategic follow-up to the conduct and culture reviews.

3. Feedback is sought on which of these different FMA funding options is the most appropriate.

4. In addition, as the FMA is currently funded through a mixture of Crown and third-party levy funding, two different options are presented for how any increase in the FMA's appropriation should be apportioned between the Crown and levy payers. Option A is where the Crown increases the amount of funding to maintain its current contribution of around 25% of the FMA's

appropriation. Option B is where any increase in the FMA's appropriation is met fully by levy payers and the Crown contribution towards the FMA's appropriation remains the same.

5. MBIE has also reviewed the FMA levy and identified the need for a number of new levy classes to respond to developments in financial markets. Accordingly, feedback is sought on proposals for new levy classes for benchmark administrators, growth market operators, small issuers and self-select schemes.

6. MBIE is also proposing some changes to the portion of levies paid by certain classes to better reflect the objectives of the levy including the benefits from operating in well-regulated financial markets and ensuring that levies do not act as a barrier to entry.

7. A list of the levies payable by each levy class under the different funding options is presented in the Annex. The levies presented in the Annex are based on any funding increase being fully met by levy payers (recovery Option A). If the Crown does increase its contribution towards the FMA's funding, the levies will reduce from the figures presented in this paper to reflect this.

2 Introduction

Purpose of the review and context

8. The FMA is an independent Crown entity and New Zealand's principal conduct regulator of financial markets. Since the FMA's funding was reviewed in 2016, its remit has evolved to encompass activities that are not covered by its current funding. This includes the new regulatory regime for financial advice and the 2018/2019 FMA and Reserve Bank of New Zealand (RBNZ) reviews of the conduct and culture of financial institutions (conduct and culture reviews).

9. It is desirable for the FMA to be a credible conduct regulator that is sufficiently resourced, resilient and able to adopt a proactive, risk-based and systems-wide approach to regulation that includes contributing to wider government policy objectives, where appropriate.

10. MBIE, in conjunction with the FMA, is reviewing the FMA's funding requirements and the FMA levy. In addition, MBIE has commissioned an independent review of the efficiency and effectiveness of the FMA and a review of its baseline funding needs.

11. The objectives of the review are to:

    - review the FMA's funding requirements to ensure that it can continue to meet its statutory functions under the financial markets legislation it administers (including the new financial advice regime) and can operate as a credible and effective financial markets regulator
    - consider the level of Crown and third-party levy funding that is appropriate to reflect the public-private good elements of the FMA's role and operations
    - ensure that the FMA levy settings remain appropriate and proportionate to the benefits received.

What does this discussion paper do?

12. As part of reviewing the FMA's funding and the FMA levy, we are seeking feedback on the funding/levy proposals in this discussion paper. Specifically, this discussion paper:

    - provides an overview of the FMA, its evolving remit and its current funding
    - outlines the FMA's need for additional funding
    - presents the different funding options for the FMA
    - discusses the options for recovering FMA's funding

- outlines proposed changes to the FMA levies paid by financial markets participants[1].

What this discussion paper does not do

13. The Government has recently announced that it will introduce legislation to create an oversight regime for regulating conduct in the banking and insurance sectors (conduct regime). Given these proposals are in the early stages of development, the FMA funding options discussed in this paper do not include funding for this new regime. However, the enhanced funding case does include some organisational capacity to prepare for the extension of its conduct remit. The FMA will require additional funding to credibly implement and regulate this new regime (the quantum of which will depend on the final design and details).

14. In addition, the funding options in this paper do not include any funding for FMA resourcing needs that will arise out of the recently announced changes to New Zealand's insurance contract law. The impact of these changes on the FMA's operations and funding requirements will need to be assessed in the future once more details are known.

Timeline for the review

15. A timeline for this consultation process and review is set out below.

Guidance considered in the review

16. The review takes into account existing guidance on setting charges, including the Treasury's *Guidelines for Setting Charges in the Public Sector*[2]. The principles set out in these guides are reflected in the options for adjusting levies, where relevant.

Using this discussion paper

17. The remainder of this discussion paper is structured into different sections. Suggested questions are included throughout the document and all paragraphs are numbered for ease of reference.

18. Submissions on this discussion paper are due by **5pm 28 February 2020**. Submissions received after this time may not be considered.

[1] This will include changes to the FMA levies that were recently set for the financial advice sector to ensure the Crown continued to recover the same amount of funding from the sector. This is discussed further on page 37.
[2] ***https://treasury.govt.nz/publications/guide/guidelines-setting-charges-public-sector-2017-html***

1	Do you have any feedback on the objectives of the review?

3 Overview of the FMA

What does the FMA do?

19. As New Zealand's principal conduct regulator of financial markets, the FMA is responsible for overseeing and enforcing a range of financial market legislation[3]. The FMA's overarching statutory purpose is to promote and facilitate the development of fair, efficient and transparent financial markets.

20. The FMA sees its role as twofold. Firstly, to seek to promote and facilitate developments which enhance fairness, efficiency and transparency in financial markets by working and engaging with industry, investors and customers. Secondly, to seek to identify and mitigate risks to achieving these conditions. The FMA does this by:

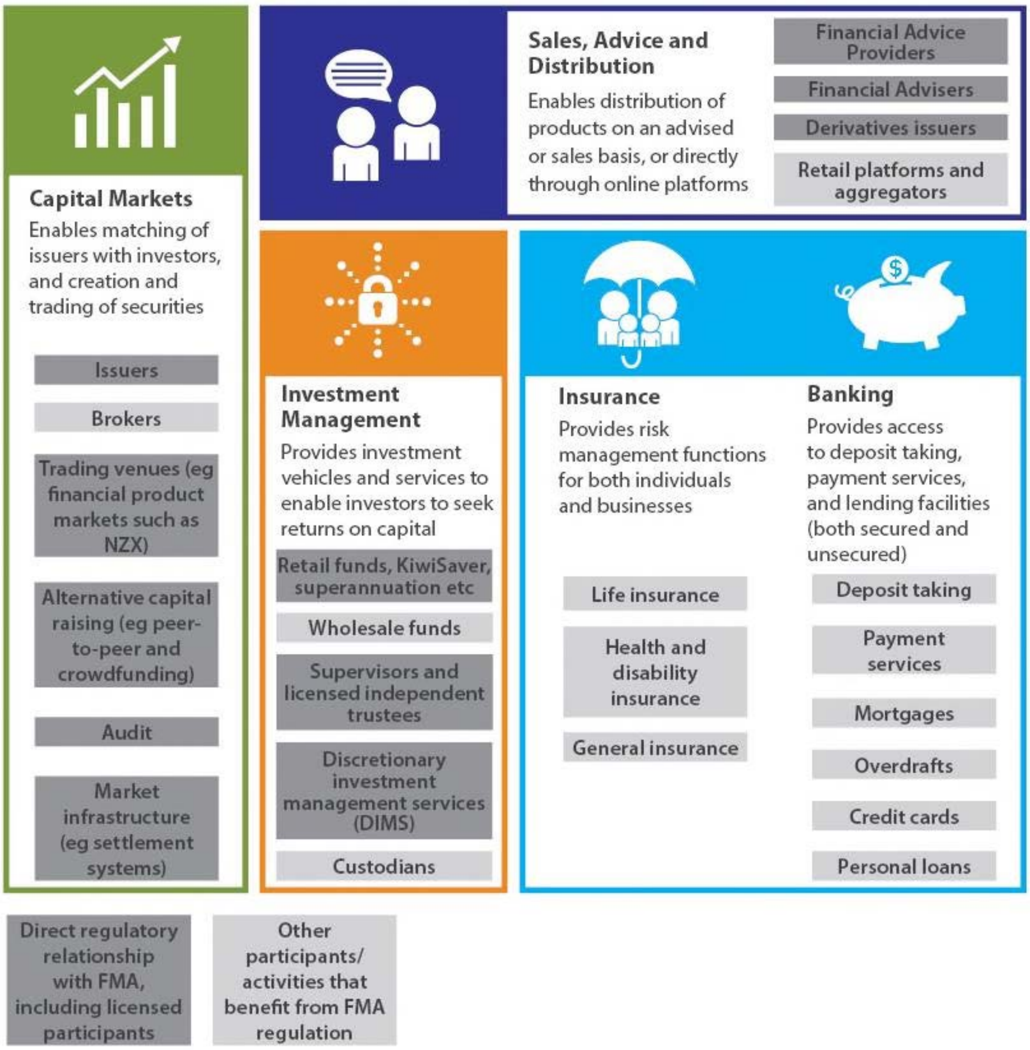
    - setting expectations and influencing industry behaviour
    - monitoring adherence to regulatory and legislative requirements
    - identifying breaches and taking action
    - working to enhance investor and customer engagement and capability.

21. Well-regulated financial markets are vitally important to New Zealand's economy and the financial wellbeing of every New Zealander. Strong financial markets help New Zealanders plan for the future and their retirement, access capital and investment opportunities, manage risk and participate in the economy. Well-regulated financial markets that encourage confident and broad participation drive the efficient allocation of capital which benefits the broader economy.

Who the FMA regulates

22. The FMA oversees a wide range of financial market participants and divides its regulatory landscape into sectors. This ultimately provides the basis for the FMA's assessment of risks. The high-level map below outlines these sectors and describes some of the roles, activities and product types covered.

[3] A list of the relevant legislation is available at ***www.fma.govt.nz/about-us/what-we-do/our-role/legislation/.***



For a full list of those currently levied please refer to the Annex.

How the FMA regulates

23. The extent of the FMA's oversight varies across the above sectors and is prioritised relative to its assessment of the potential risk of harm to retail investors and/or confidence in markets. This reflects the FMA's intelligence-led and harm-based approach to conduct regulation. The other principles underpinning the FMA's regulatory approach and guide its regulatory decisions, as set out in the FMA's Strategic Risk Outlook[4] (SRO), are as follows:

    - outcome-focused: focusing resources on where the FMA has the greatest opportunity of achieving desired outcomes and reducing harm. The FMA considers the most appropriate action for each situation, recognising the limits of its powers, and considering regulatory burden and the potential unintended consequences of its actions

[4] The Strategic Risk Outlook is available at https://www.fma.govt.nz/assets/Reports/2019-Strategic-Risk-Outlook.pdf.

- effective and efficient: the FMA regularly reviews the use of its resources to enhance its effectiveness and efficiency

- consistent and transparent: clearly communicating intentions and expectations to market participants

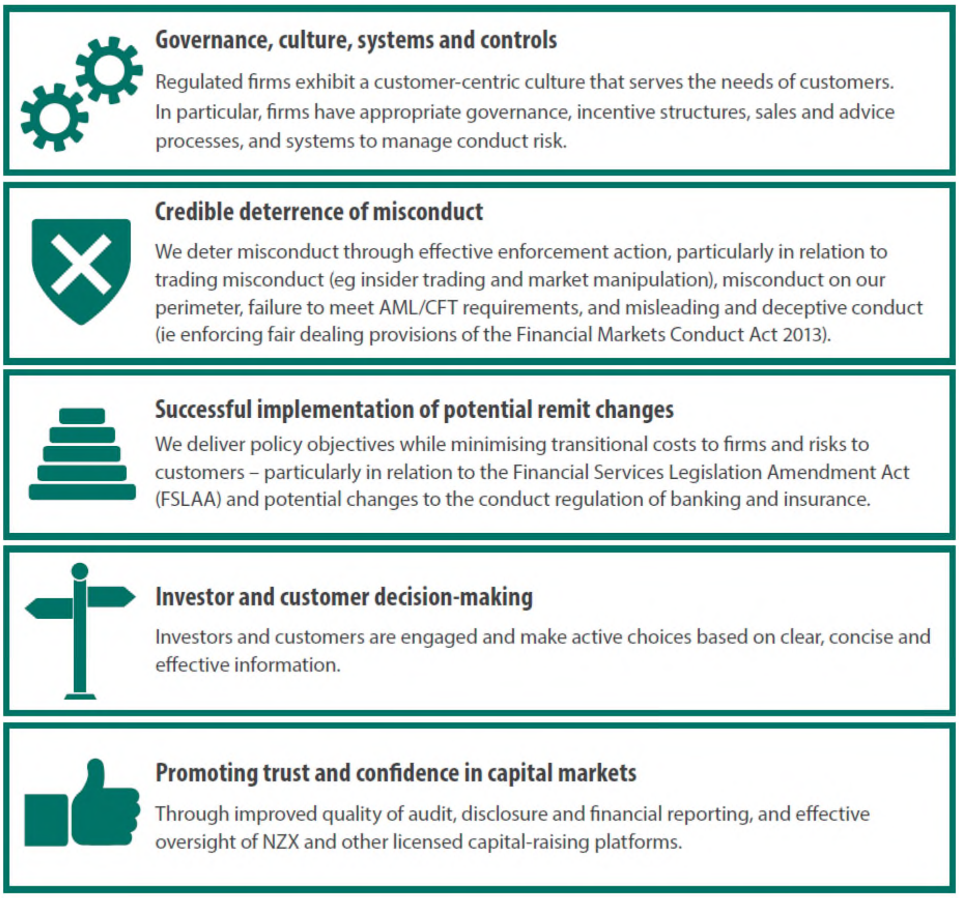
- flexible and responsive: adapting and responding quickly to changing market conditions

- a systems view: the FMA promotes an integrated and coordinated approach to financial markets regulation in New Zealand.

24. The FMA's regulatory approach involves extensive engagement with financial service providers. A good understanding of the business models and conduct 'maturity' of the industry is critical – as is clear understanding on the part of providers as to the FMA's expectations of them. This is a resource intensive model that is designed to identify and reduce risks posed to investors, markets and consumers before they crystallise into harm.

25. This approach relies on being adequately resourced to provide breadth of activity across the markets the FMA regulates and the customers and investors it is charged with protecting, as well as the capability and capacity to undertake detailed investigation of specific issues or entities.

26. The FMA's regulatory approach and its current strategic priorities help it focus activity and allocate resources effectively. The FMA's current strategic priorities are outlined in its SRO and summarised in the below diagram.



How the FMA has performed

27. The FMA reports its performance against published performance measures intended to assess its progress towards achieving its regulatory objectives[5]. A key measure of the FMA's effectiveness is that investors are confident in New Zealand's financial markets and the FMA undertakes an annual investor confidence survey to assist in testing this measure. In 2019, 65% of survey respondents agreed with this statement. This result has been stable for the past two years, and over the longer term has increased from 58% when the FMA started measuring investor confidence in 2013[6].

28. The FMA also carries out an annual 'ease of doing business' survey of stakeholders and market participants. In 2019, 87% of respondents believed that the FMA's actions help raise standards of market conduct and integrity[7]. This suggests that an engaged, well-informed and well-resourced regulator is a positive contributor to New Zealand's financial markets.

[5] More information on the FMA's performance measures is available in its Statement of Performance Expectations: ***https://www.fma.govt.nz/assets/Reports/E.25-FMA-Statement-of-Performance-Expectations-2019-20.pdf***.

[6] See page 40 of the FMA's 2018/2019 Annual Report and pages 40 to 43 for a full analysis of the FMA's performance against its measures: ***https://www.fma.govt.nz/assets/Uploads/FMA-2019-Annual-Report-online3.pdf***.

[7] More information about this survey is available on page 41 of the FMA's 2018/2019 Annual Report: ***https://www.fma.govt.nz/assets/Uploads/FMA-2019-Annual-Report-online3.pdf***.

4 The FMA’s funding

Current funding

29. Since the FMA was established its operating environment and regulatory remit has expanded considerably, particularly under the Financial Markets Conduct Act (FMC Act) (passed in late 2013). In light of this, the FMA’s funding was reviewed in 2016 and its appropriation was increased from around $24 million in 2011/12 to $36 million in 2017/18.

30. The FMA’s annual appropriation is made up of Crown and third-party funding. In addition to the $36 million appropriation, the FMA receives up to $2 million[8] annually from the Crown for litigation funding. The FMA also recovers some of its expenses through fees for services it provides, including licensing fees and auditor quality review fees.

Expenditure currently exceeds revenue

31. The FMA’s revenue and expenditure position is summarised below.

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20 Forecast
Total income comprising:	**26.89m**	**29.58m**	**28.51m**	**28.51m**	**27.94m**	**37.38m**	**37.07m**	**38.19m**
Crown and levy revenue	**25.46m**	**27.77m**	**26.18m**	**26.18m**	**26.18m**	**36.0m**	**36.0m**	**36.0m**
Interest and other income	**1.43m**	**1.81m**	**2.33m**	**2.33m**	**1.76m**	**1.38m**	**1.07m**	**2.19m**
Total expenses comprising:	**23.19m**	**27.96m**	**30.99m**	**32.54m**	**30.70m**	**34.13m**	**36.27m**	**42.44m**
Personnel and other opex	**22.15m**	**26.56m**	**28.69m**	**29.36m**	**27.62m**	**31.32m**	**34.13m**	**39.13m**
Depreciation/amortisation	**1.04m**	**1.40m**	**2.30m**	**3.18m**	**3.08m**	**2.81m**	**2.14m**	**3.31m**
Net operating surplus (deficit)	**3.70m**	**1.62m**	**(2.48m)**	**(4.02m)**	**(2.76m)**	**3.25m**	**0.80m**	**(4.25m)**
Litigation (deficit) funded by operating fund and reserves	**-**	**-**	**-**	**-**	**-**	**-**	**(0.97m)**	**-**
Accumulated surplus (deficit)	**7.42m**	**9.04m**	**6.56m**	**2.54m**	**(0.22m)**	**3.03m**	**2.85m**	**(1.40m)**

[8] The litigation fund was recently increased by $4 million to $6 million for 2019/20.

32. In 2018/19 the FMA incurred a small operating deficit of $172,000. In 2019/20 the FMA is forecast to incur a further deficit of around $4 million, which is to be covered by cash reserves built up over the period to 2017/18. This deficit is driven by a number of factors, including:

- an increase in personnel costs (including employing staff to support the conduct and culture reviews and to help with preparation for the new financial advice regime)
- funding preparation for the new financial advice regime, including significant market engagement, development of transitional and full licensing models and the ICT build for the licensing system
- acceleration of a number of important system upgrades and capital projects which significantly increased depreciation costs, including building the new financial advice regime's licensing system as noted above.

33. Partially offsetting the deficit in financial year 2019/20, the FMA expects approximately $1.2m of licensing fee revenue as part of the licensing of financial advice providers. This income will cover the cost of processing licence applications and the ICT system build for the new licensing system.

FMA efficiency and effectiveness review

34. To support the funding review, MBIE commissioned an independent efficiency and effectiveness review of the FMA. This is intended to give confidence to government and stakeholders that the FMA is spending current funding wisely, is focused on the right outputs and activities and that the outputs effectively support the outcomes (i.e. value for money).

35. The independent review found that the FMA is a high performing organisation with good alignment between its activities and its main statutory objective. It also found strong indicators that the FMA uses its resources effectively and efficiently. However, the review noted that the FMA is not right-sized (i.e. its financial resources are constrained and do not support its operations or activities) and that as a result the FMA has a number of organisational pressure points.

36. The findings from the efficiency and effectiveness review have been incorporated in the funding options set out in section 6 of this paper. The final review report is available on MBIE's website alongside this discussion paper to inform stakeholder consideration of the proposals.

5 The need for additional funding

37. Since the FMA's funding was last reviewed in 2016, the FMA has operated in a constantly evolving environment driven by growth and change in financial markets, the expansion of its regulatory remit, greater stakeholder expectations of its role and activities, and the need for greater monitoring and enforcement as levels of conduct maturity of financial market participants has become apparent.

38. The FMA's own experience as a regulator has also developed, providing it with a better understanding of the requirements and resourcing needed for effective conduct supervision and regulation, which are beyond that which it is currently funded for.

The FMA's evolving environment

39. At the time of the last funding review, the FMC Act was not fully implemented and New Zealand's financial markets were still transitioning. Many market participants had not completed the licensing process and there was little practical experience under the new regime.

40. Shortly after the funding review was completed, the International Monetary Fund (IMF) visited New Zealand to conduct a financial sector assessment of the financial system. The IMF made a number of recommendations, including that further attention be directed at custodians and the wholesale asset management sector.

Growth and change in New Zealand's financial markets

41. There has been significant growth in financial markets, for example, retail funds under management[9]. Innovation has driven the emergence of new products such as binary options and green and socially responsible securities. Technological developments, such as the rise of crypto-assets and digital advice, are also shaping the future of financial markets. The FMA needs to be able to anticipate and appropriately respond to these changes.

Changing expectations

42. Governmental and societal expectations of the FMA's role have increased. This has been driven in part by declining levels of trust in financial services. In particular, the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Australian Royal Commission) highlighted major conduct and customer treatment failures across a broad section of financial services in Australia. These high-profile failings and criticisms of the regulators in

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[9] See page 17 of the FMA's Strategic Risk Outlook 2019 for further information: ***https://www.fma.govt.nz/assets/Reports/2019-Strategic-Risk-Outlook.pdf***.

identifying and responding to them have received significant coverage in New Zealand and magnified concern about both the regulation of financial services in this country and the FMA's ability to respond to misconduct.

43. Increased expectations have also led the FMA to dedicate significant resources to act in areas that are on the perimeter of its mandate and for which it is not currently resourced, such as the conduct and culture reviews.

44. There has also been an increase in the number of identified potential breaches requiring additional resource for enforcement activity.

Greater monitoring and enforcement

45. Findings from the FMA's monitoring work[10] suggest that the maturity of the systems, controls and governance around conduct risks in New Zealand financial services is lower than would be expected given the time that has elapsed since the FMC Act came into force. This indicates the need for more monitoring, investigation and enforcement activity by the FMA than had previously been anticipated.

Expansion of regulatory remit

46. The FMA's mandate has continued to expand and evolve since its establishment. While the FMC regime is now fully implemented and largely embedded, policy and regulatory reform has continued (such as the recent introduction of a new financial advice regime). This has required significant FMA input and greater engagement and coordination with other regulators and government agencies.

The new financial advice regime

47. A new financial advice regime to be given effect by the Financial Services Legislation Amendment Act 2019 (FSLA Act) comes into force on 29 June 2020.

48. The new regime will require the FMA to license a large number of entities (estimated at approximately 2,300) and will increase the number of entities that are subject to the FMA's supervision. Many of those who are expected to operate in the new regime will be subject to licensing and monitoring by the FMA for the first time and thus will require more intensive engagement from the FMA. The FMA's view is that significant work is required of it to assist the sector to understand and meet the requirements of the new regime.

[10] Examples include the FMA's thematic review of Qualifying Financial Entities in relation to insurance replacement business (QFE insurance providers' replacement business practices: ***https://www.fma.govt.nz/assets/Reports/180717-QFE-insurance-providers-replacement-business-practices.pdf***), monitoring of Authorised Financial Advisers, activity of firms on the FSPR and ongoing issues with disclosure and financial reporting of listed companies.

Conduct and culture

49. The 2018 and 2019 high-level conduct and culture reviews of New Zealand based banks and life insurers were undertaken in light of the issues highlighted by the Australian Royal Commission. The reviews highlighted a lack of robustness in (and in some cases attention to) conduct risk management and good customer treatment frameworks. Governance, controls and risk management were not at levels the FMA and RBNZ believed they should be. The reviews recommended all banks and insurers develop detailed plans to address deficiencies found by the FMA and RBNZ. The FMA and RBNZ continue to monitor firms' development and progress in implementing these plans.

50. The conduct and culture reviews noted gaps in the legislation for regulating conduct in these sectors and the Government subsequently published proposals setting out its intention to regulate and license this sector, subject to Parliamentary approval. As set out in paragraph 13, the funding required for this new regime is not within the scope of the funding options discussed in this paper, although the enhanced funding case does include some organisational capacity to prepare for the extension of the FMA's conduct remit. The wider funding implications for the new conduct regime will be considered and consulted upon at a later date.

51. However, preparatory work for the new conduct regime will need to commence before then and without additional funding, resources will need to be redirected from other core activities. This will include considering significant changes to the FMA's structure and operating model, as well as engagement and coordination with other financial markets regulators (such as the RBNZ and the Commerce Commission).

These changes have led to funding pressures

52. Given the FMA's evolving environment and remit, the FMA's operational funding has come under significant pressure. In addition, the conduct and culture reviews highlighted that the FMA does not have the resources to undertake reactive or exceptional thematic work of this scale without significant impact on business as usual functions. Resources were diverted from planned work and projects in a number of areas.

53. To date, the FMA has not received any additional funding to prepare for implementation of the new financial advice regime or the conduct and culture reviews. This has required the FMA to utilise existing cash reserves and divert resources from other areas including, in some cases, reducing or deferring usual monitoring activities of some regulated populations[11].

Counterfactual of no change in funding

54. The FMA's cash reserves will be exhausted during the current financial year. If no new funding is provided, this would effectively represent a decrease in the FMA's financial resources given the

[11] Work that was not completed or progressed as intended in 2018/19 is described on page 17 of the FMA's 2019 Annual Report: ***https://www.fma.govt.nz/assets/Uploads/FMA-2019-Annual-Report-online3.pdf***.

FMA's expanding remit and current expenditure. A major reduction in expenditure would therefore be required. Based on current cost estimates, this would require a headcount reduction (through recruitment holds and redundancies) to an annual average of 160 FTEs over a three-year period from the approximately 200 FTEs currently.

55. Such a reduction would have impacts across all of the FMA's operations. Existing funding pressures would be significantly exacerbated in areas such as supervision, policy and governance, investigations and enforcement. Overall, this would result in a far more reactive regulator with a narrower focus, and one that is slower to respond to events when they do occur.

56. Frontline activity would need to be reduced and limited to the FMA's core mandate, that is, its licensed and authorised population. Sectors where reductions in activity would be likely include banks and insurance (such as the conduct and culture reviews follow-up work), monitoring the regulatory perimeter (such as work in response to potential scams and Financial Service Providers Register (FSPR) monitoring) and responding to emerging issues (e.g. innovation and climate change).

57. There would need to be less engagement with the industry, investors and customers, and reduced cross-government collaboration, potentially increasing costs and leading to system inefficiencies. Slower response times to queries and complaints would be coupled with less and slower enforcement action with reduced resources to devote to investigating and preparing for formal action.

58. Monitoring of the FMA's core licensed population would move to a more reactive approach, including in areas such as derivatives issuers, Discretionary Investment Manager Services (DIMS), crowdfunding and Anti-Money Laundering (AML) and less work in areas such as review of disclosure documents and financial reporting. These are areas in which some work has already been deferred due to the need to allocate resource to the conduct and culture reviews.

59. The need to now implement the new financial advice regime, and maintain a minimum level of conduct and culture reviews follow up work would require reallocation of staff, requiring even further reductions in supervision, monitoring of licensed entities and market engagement in other core areas.

60. As its responsibilities will expand once the new financial advice regime comes into force, if no new funding is provided, the FMA's ability to fulfil its statutory responsibilities going forward would be compromised. This would undermine the FMA's ability to achieve the Government's financial markets policy objectives, and could undermine wider government objectives across a number of areas. These include increasing retirement savings, encouraging home ownership, enhancing investment in business, encouraging innovation and addressing climate change.

6 Funding options

61. The FMA's funding needs to be increased to enable it to effectively fulfil its responsibilities. In the absence of additional funding, the FMA will need to reduce and stop activity in some areas.

62. A number of funding options were developed as part of the independent review of the FMA's efficiency and effectiveness and are set out below.

The options

Funding option	Additional funding	Indicative FMA appropriation (excl. litigation fund and fee revenue)
Status quo: No funding change	-	$36 million
1: Current spend	$9.215 million	$45.215 million
2: Base case	$20.081 million	$56.081 million
3: Enhanced case	$24.805 million	$60.805 million

63. Each option has been assessed against the following criteria:

- alignment with government priorities and expectations
- support for the FMA's strategic direction
- risk (or harm) to investors, consumers, markets and regulators
- resilience and future-proofing
- achievability
- value for money.

64. This assessment is set out in more detail below.

Option 1: Current spend

65. Increasing the FMA's current appropriation by $9.215 million per annum to $45.215 million would allow the FMA to make a bare minimum investment into the implementation of the **new financial advice regime** and retain the staff already employed to undertake the **conduct and culture reviews** limited tactical follow-up work.

66. There would be no scope for additional resource to prepare for the new conduct regime. Limited additional resources under this option mean there would be proportionally less market **engagement**, **monitoring and supervision**, and **enforcement** of the core population as resources would be spread over a wider mandate with greater expectations.

Alignment with government priorities and expectations

67. The limited investment in the implementation of the new financial advice regime under this funding option might undermine the regime's key policy objective of improving access to quality advice in New Zealand, as it would only allow the FMA to carry out limited proactive monitoring and market engagement.

68. This option would allow the conduct and culture reviews follow up work to continue in a largely reactive manner, which may not meet the expectations of government and the public.

69. Engagement with other regulators and agencies across the financial regulatory system would be limited, as would the FMA's contributions to Government financial markets policy objectives and broader issues such as innovation and climate change. This may reduce the speed of achieving wider Government policy objectives and in some cases undermine their delivery.

Support for the FMA's strategic direction

70. Under this funding option, the FMA would need to take a predominantly reactive monitoring approach for financial advisers based on complaints and misconduct reports. Proactive individual monitoring of financial advisers would be minimal and limited to the highest risk entities. It would also mean slow development of the sector risk profile, which would constrain the overall effectiveness of the regime and heighten risks to customers.

71. This option would negatively impact the depth of the FMA's activity and prevent the FMA from increasing the intensity of its monitoring despite increased concerns regarding the lack of conduct maturity across the market (as evidenced by recent thematic work on insurance churn and the conduct and culture reviews. This would reduce the FMA's ability to pursue its broad strategic direction.

72. The option would not deliver what the FMA considers is an optimal level of market engagement, including guidance to proactively provide clarity on the regulator's expectations of market participants. This would subsequently undermine speed and efficiency of achieving the behavioural and structural changes within firms necessary to promote good conduct outcomes.

Risk (or harm) to investors, consumers, markets and regulators

73. The limited investment in the new financial advice regime could reduce consumer confidence and protection in financial advice as full regime monitoring and supervision would take some years. Consumers may expect that the majority of new advisers had been subject to FMA monitoring when in fact the FMA would only have monitoring oversight over a portion of them.

74. The ongoing assessment of compliance and risk under the FMC Act would be constrained, as would the speed with which the FMA could influence behaviour of market participants. Limited regulator capacity to identify and mitigate conduct risk is likely to increase the occurrence of misconduct and therefore harm to customers and investors across financial services.

75. Further, under this option, work identified as priorities for New Zealand by the IMF's 2016 financial sector assessment (e.g. wholesale asset management, custody and client money handling) would be unable to be progressed.

Resilience and future-proofing

76. This funding option leaves no room for taking on any additional work without compromising activity in other areas. Should significant new events arise, planned work would need to be deferred as was the case in undertaking the culture and conduct reviews.

77. Current funding pressures would remain in areas such as supervision, policy and governance, and investigations and enforcement, and are likely to be exacerbated by the need to reallocate resources for the new conduct regime. No resource would be available to address operational risks that may become more acute as the FMA's mandate expands.

78. An overstretched regulator would likely result in higher workloads for staff and potential pressure on salaries making the FMA a less attractive place to work, undermining its ability to attract and retain top talent in a competitive market seeking similar skill sets.

Achievability

79. This funding option has relatively high achievability as it requires only a small increase in resources and FTEs above current levels. Accordingly, it would be relatively simple for the FMA to allocate new resources and staff across the organisation and areas of responsibility. Given the above, the extent of change management required of the organisation is also low and very achievable.

Value for money

80. As this is a relatively modest increase in the FMA's funding, it would have a relatively low impact on the Crown and on financial markets participants. However, it does not fund sufficient regulatory activity to address the current levels of conduct risks in markets and would likely lead to a build-up of system risks.

81. In general, it represents a slower and riskier approach to achieving fair, efficient and transparent financial markets. As such, relative to other funding options, it would adversely impact the FMA's ability to be an effective regulator that could ultimately lead to a loss in market confidence which undermines the whole financial markets regime.

Option 2: Base funding case

82. The base funding option includes an additional $20.081 million of funding per annum, increasing the FMA's total funding to $56.081 million.

83. This level of funding would enable the FMA to moderately increase resources in key frontline areas of supervision, intelligence, enforcement and investigations, and investor/customer engagement. This would enable a move to a more portfolio based supervision[12] approach and toward more proactive engagement and action rather than reactive intervention.

84. The option would allow the FMA to:

- apply additional resources to the **new financial advice regime** and move to targeted risk-based **supervision** of financial advisers in the new regime
- apply a small additional amount of resource to undertake **conduct and culture reviews** follow up work including some **engagement** with entities on their conduct policy, systems and improvements to support better identification of, response to, and rectification of conduct issues
- further develop its **intelligence** function to help understand where risks and harms are greatest and increase its ability to **monitor** and respond to changes in the market driven by technology and innovation (e.g. market assessment of algorithmic trading, engagement and guidance on innovative products and proposals, and exemptions policy work)
- allocate some resources to areas in the **monitoring and supervision** areas subject to delays such as wholesale asset management, custody and client-money handling and that were also identified in the IMF financial sector assessment
- increase **engagement** with market participants and **investor capability** work
- respond to misconduct issues, **investigate** alleged breaches and undertake **enforcement** action in a timely manner.
- address a range of FMA capacity constraints and operational risks as the FMA's mandate expands through greater investment in support functions such as **human resources, operations and corporate governance**.

Alignment with government priorities and expectations

85. Under this funding option, implementation of the new financial advice regime would be faster, enabling the FMA to gain a better understanding of the new population and to facilitate realisation of the new regime's objectives. This option would also involve more proactive monitoring and engagement with financial advisers (including more effective use of the power to refer to the Financial Adviser Disciplinary Committee). The FMA would be able to more readily develop its understanding of sector risks and take swifter action in response to poor conduct or misconduct.

[12] Portfolio based supervision is based around dedicating specific supervisors to individual entities.

86. The FMA's follow-up work to the conduct and culture reviews would be proactive and quicker and include proactive monitoring of action plans and customer remediation activity by banks and insurers. This would increase the speed and comprehensiveness with which these issues are addressed.

87. Greater input into regulatory coordination and government policy would be possible, but not to the level provided under the enhanced funding option.

Support for the FMA's strategic direction

88. The increased resources in key frontline areas such as enforcement and investigations afforded by this funding option would put the FMA in a better position to deliver its strategic priorities, including credible deterrence of misconduct.

Risk (or harm) to investors, consumers, markets and regulators

89. Overall, this funding option would reduce the risks of regulatory failure. It would enable the FMA to improve its understanding of drivers of risk (and opportunities) and appropriately target activity, improving chances for early mitigation, swift response and selection of the right regulatory tool.

Resilience and future-proofing

90. This funding option provides for some capacity to respond to unexpected market events without significantly undermining base level FMA activity.

91. However, while this option enhances capacity within the current remit, and allows for an economist, it does not offer much in terms of capability building in areas such as data analytics, behavioural economics or specialist expertise in specific sectors or areas such as thematic monitoring.

Achievability

92. This option would involve hiring a significant number of new staff, which will give rise to challenges, including the ability to recruit, train and retain high quality people, particularly in an increasingly competitive market place. This will also involve a substantial change management challenge with potential changes to the FMA's operating model, organisational structure and decision-making to reflect a larger organisation with a wider remit. In part, these risks could be addressed through investment in additional business support functions, and phasing any increase in the FMA's appropriation over two years (as shown in the forecast expenditure tables below).

Value for money

93. This funding option represents an increased investment in the FMA and its appropriation, but would provide for a much more adequately resourced and capable regulator, reducing regulatory

risks and providing opportunities to bring about the behavioural changes across the industry to deliver fair, efficient and transparent financial markets.

94. The key downside to this option compared to the enhanced funding option is that this option does not provide for significant improvements above current capability and expertise and does not deliver the same level of capacity to respond to new and emerging market developments.

Option 3: Enhanced funding case (the FMA's preferred option)

95. The enhanced funding option would provide an additional $24.805 million of funding, increasing the FMA's appropriation to $60.805 million.

96. Option 3 is the FMA's preferred option as it considers that it delivers more benefit in several areas over and above the base funding option and also offers better value for money.

97. **In addition to the increased activity of option 2**, this level of funding would enable the FMA to further broaden and deepen activity across the spectrum of regulatory functions and involve a material uplift in the capability and capacity of the FMA.

98. The option would allow the FMA to:

- allocate more resource for the implementation and supervision of the **new financial advice regime**. This would enable the FMA to develop a richer picture of how the financial advice market and sector risks are developing in the new financial advice regime, sooner than under the base funding option. This would also enable guidance to be developed sooner and for more targeted **engagement**
- take a tactical and strategic approach to the **conduct and culture reviews** follow up work with a higher level of momentum. This would also include some organisational capacity to prepare for the extension of the FMA's conduct remit in banking and insurance
- focus further on **organisational capability** development. In particular, building centres of best practice and regulatory expertise in areas such as **intelligence** gathering and analysis, and behavioural economics. This will support a broader focus on customer capability and **supervisory** practice through activities such as thematic reviews
- focus more on **engagement** with customers of financial service providers beyond the FMA's existing focus on investors, including more work on promoting good customer outcomes and employing new capabilities such as behavioural economics to enhance good conduct outcomes
- shift to a much stronger **systems wide view** of market issues and how to tackle them. This would include cross-agency system engagement on common interests and strengthening existing cross-agency initiatives such as the Council of Financial Regulators

- further extend its focus into **new areas and issues** such as the implications of climate change, technological developments, and innovation in financial markets generally.

Alignment with government priorities and expectations

99. This funding option would position the FMA to effectively and comprehensively respond to the growing public and political expectations of its role.

100. As the implementation of the new financial advice regime would be faster and enable a more robust understanding of the market than the base option, this would provide more confidence that the objectives of the new regime would be achieved and mean lower risk of major regulatory problems emerging.

101. The preparatory work that could be undertaken for the new conduct regime would increase the speed and effectiveness with which the regime and its policy objectives can be implemented achieved.

102. Greater financial market system coordination and engagement would be possible. This is essential in preparation for the new conduct regime and with the volume of regulatory change across the system. A key focus would be on engagement with the RBNZ, the Commerce Commission, AML supervisors, other frontline regulators, and dispute resolution schemes.

Support for the FMA's strategic direction

103. The enhanced funding option would represent a significant maturity acceleration for the FMA. It would allow the FMA to undertake more research and analysis to better understand the markets the FMA regulates and the customers they serve. This would also enable better targeting of resources to achieve strategic objectives.

Risk (or harm) to investors, consumers, markets and regulators

104. The speed, breadth, depth and effectiveness of the FMA's regulatory activity would increase across the FMA's regulatory remit, reducing prioritisation pressures and helping reduce risks and harm to customers and investors and the build-up of system risks. It includes focusing on building deep sector expertise of regulated populations.

105. Engagement with financial services providers and sectors would be enhanced, providing for greater expectation setting by the FMA. More proactive work would be possible in defining expectations in relation to serving customer needs and fair treatment. This would provide greater regulatory certainty for providers, customers and investors.

106. Engagement with customers of financial service providers would also be enhanced. This option provides for more direct interaction with customers to better understand where and how financial services can better serve customers. It would also allow the FMA to prepare more investor and customer information and guidance as well as provide more targeted campaigns to meet particular demographic needs, such as vulnerable communities.

107. Work in areas such as behavioural economics would enable the FMA to seek to enhance customer and investor capability as well as the FMA's understanding of their needs and behaviours, enabling better targeting of interventions.

Resilience and future-proofing

108. This funding option provides sufficient capacity to enable the FMA to adequately respond to unexpected market events, including significant enforcement activity, without unduly compromising core activity. It would also see the FMA have the ability to build considerable sector and regulatory expertise.

Achievability

109. As with the base funding option, the biggest challenge associated with this funding option would be the need to recruit a significant number of new employees. This challenge is even greater under this funding option as it requires an additional 74 FTE above the FMA's forecast expenditure for 2020/21. This level of recruitment would likely take a longer time to achieve, but again could be addressed by a phased increase in the FMA's appropriation.

110. This option would provide further resource capacity and capability to support the FMA in the significant organisational change required in bringing on board large numbers of new staff and also the changes required to the FMA's operating model and structure to reflect organisational growth and a broader remit. This would include a detailed recruitment and retention strategy.

Value for money

111. Under this funding option, the FMA's appropriation would increase more than other options, which would impact the Crown and levy payers. However, the risk of regulatory failure would significantly reduce, and there would be associated benefits to confidence in the regulation of New Zealand's financial markets, and therefore the markets themselves.

Summary of assessment

✔= positive impact - = negative impact

	Current spend	Base case	Enhanced case
New FMA appropriation	**$45.215 million**	**$56.081 million**	**$60.805 million**
Description	Increasing appropriation by $9.215 million p/a, in line with current expenditure. Only allows for bare minimum resourcing for implementation of financial advice regime.	Increasing appropriation by $20.081 million p/a allowing for moderate resource increase in frontline areas and medium/high level of resourcing for financial advice regime.	Increasing appropriation by $24.805million p/a allowing the FMA to broaden and deepen activity across the spectrum of regulatory functions, including the financial advice regime.
Alignment with government priorities and expectations	- Would constrain FMA's ability to deliver Government policy objectives including the new financial advice regime and follow-up work on conduct and culture reviews.	✔✔ Enables for a more proactive but risk-based and targeted approach to financial advice implementation and conduct and culture reviews follow-up.	✔✔✔ Puts FMA in a position to effectively respond to growing expectations and allows for greater regulatory coordination and engagement on broader government policy priorities.
Support for the FMA s strategic direction	- Would erode the FMA's ability to deliver its preferred regulatory approach resulting in a more reactive regulator constraining its ability to pursue its strategic direction.	✔✔ Increased frontline activity would put the FMA in a better position to deliver its strategic priorities including credible deterrence of misconduct.	✔✔✔ Represents a significant maturity acceleration for the FMA. Allows for more research and analysis to better understand markets, customers and to target resources accordingly.
Risk (or harm) to investors, customers, markets and regulators	- Constrained FMA capacity is likely to increase the occurrence of misconduct and harm across financial services resulting in a loss of market confidence.	✔✔✔ A more adequately resourced and capable regulator, better able to understand, identify and respond to poor conduct or misconduct, which would reduce regulatory risks.	✔✔✔ Increases speed, breadth and depth of the FMA's activity, reducing levels of risk and harm to customers and investors.
Resilience and future proofing	- Does not address current cost pressures, leaves no capacity for taking on any additional work without compromising activity in core priority areas.	✔✔ Provides a degree of capacity to respond to unexpected market events without undermining levels of core activity.	✔✔✔ Sufficient capacity to enable the FMA to respond to significant market events, and build sector and regulatory expertise.
Achievability	✔✔✔ Relatively low levels of increased resource and change management required.	- Change management challenge of bringing on-board increases in new staff numbers.	- Substantial change management challenge of large new staff numbers. Allows for additional resource capability to support the organisational change required.
Value for money	- Low cost but likely to lead to a build-up of system risks.	✔✔ Increased investment provides opportunities for enhancing fair, efficient and transparent markets.	✔✔✔ Enhanced benefits in several areas over and above the base funding option and offers better value for money.

Forecast expenditure

112. The following tables show the breakdown of the current spend, base and enhanced funding options across future financial years.

Current spend	FY20/21	FY21/22	FY22/23	FY23/24
Operating expenditure	**Forecast**	**Forecast**	**Forecast**	**Forecast**
Personnel costs*	30,469,312	31,040,134	31,729,039	32,559,036
Occupancy expenses	2,494,945	2,862,685	2,864,726	2,866,828
Depreciation and amortisation	3,101,581	3,280,073	3,194,994	3,192,216
ICT costs	3,789,674	3,900,987	4,018,017	4,058,197
Professional services	2,475,798	2,551,339	2,646,630	2,671,621
Services & supplies	1,237,300	1,304,494	1,241,721	1,367,670
Travel & accommodation	1,031,854	1,066,910	1,072,867	1,129,753
Total expenses	44,600,464	46,006,623	46,767,993	47,845,321
Crown appropriation	36,000,000	36,000,000	36,000,000	36,000,000
Other revenue	927,832	1,933,187	747,751	747,751
Deficit – additional funding required	(7,672,631)	(8,073,436)	(10,020,242)	(11,097,569)
4 year average	(9,215,970)			
Total FTEs	211	211	211	211

Base case	FY20/21	FY21/22	FY22/23	FY23/24
Operating expenditure	**Forecast**	**Forecast**	**Forecast**	**Forecast**
Personnel costs*	34,645,364	38,898,937	39,455,145	40,502,565
Occupancy expenses	2,825,782	3,485,410	3,487,451	3,489,553
Depreciation and amortisation	3,144,013	3,347,273	3,262,194	3,251,160
ICT costs	3,884,860	4,101,741	4,224,727	4,266,974
Professional services	3,234,238	3,516,046	3,655,201	3,695,278
Services & supplies	1,312,624	1,393,217	1,333,099	1,473,013
Travel & accommodation	1,359,351	1,571,740	1,592,130	1,669,893
Total expenses	50,406,233	56,314,364	57,009,946	58,348,436
Crown appropriation	36,000,000	36,000,000	36,000,000	36,000,000
Other revenue	927,832	1,933,187	747,751	747,751
Deficit – additional funding required	(13,478,401)	(18,381,177)	(20,262,195)	(21,600,685)
3 year average	(13,478,401)	(20,081,352)		
Total FTEs	238	265	265	265

Enhanced case	FY20/21	FY21/22	FY22/23	FY23/24
Operating expenditure	Forecast	Forecast	Forecast	Forecast
Personnel costs*	36,156,898	43,122,449	43,717,143	44,835,245
Occupancy expenses	2,825,782	3,528,377	3,531,706	3,535,136
Depreciation and amortisation	3,161,679	3,382,604	3,297,525	3,280,602
ICT costs	3,899,282	4,175,951	4,301,229	4,344,242
Professional services	3,250,669	3,600,588	3,742,356	3,778,305
Services & supplies	1,314,188	1,401,266	1,341,396	1,486,559
Travel & accommodation	1,483,515	1,796,074	1,820,306	1,827,516
Total expenses	52,092,013	61,007,308	61,751,662	63,087,605
Crown appropriation	36,000,000	36,000,000	36,000,000	36,000,000
Other revenue	927,832	1,933,187	747,751	747,751
Deficit – additional funding required	(15,164,180)	(23,074,121)	(25,003,910)	(26,339,853)
3 year average	(15,164,180)	(24,805,962)		
Total FTEs	242	285	285	285

** Personnel costs include salaries, contractor costs, recruitment costs, ACC and FMA Board member and committee fees.*

Expenditure by function

113. The following table show the breakdown of personnel costs (using an average of the forecast 3-4 year expenditure for financial years 2021-24) for the three funding options.

Function	Option 1 ($millions)	Option 2 ($millions)	Option 3 ($millions)
Capital Markets	3.9	4.5	4.8
Conduct and Culture	1.3	1.9	2.3
Evidence and Investigations	3.4	4.5	5.1
External Communications and Investor Capability	1.5	1.9	2.3
Financial Advisers	1.8	3.7	4.2
Intelligence and Knowledge Services	1.9	2.4	2.6
Operations	3.3	3.6	4.0
People and Capability	1.3	1.6	1.8
Policy, Governance and Corporate Legal	3.9	4.5	4.9
Strategy and Stakeholder Relations	0.9	1.2	1.4
Supervision	7.2	8.7	9.4
Chief Executive, Risk and Assurance	1.0	1.0	1.1

Total personnel cost	**31.4**	**39.5**	**43.9**

2	Which of the FMA funding options do you consider to be most appropriate and why?
3	Are there any areas of FMA expenditure that you think should be expanded or reduced? Why?

7 FMA funding recovery options

114. The FMA is currently funded through a combination of third-party revenue collected from financial markets participants through the FMA levy (around 75%) and Crown funding sourced from general taxation (around 25%). In addition to their appropriation, the FMA receives a small amount of revenue from fees for services (around $0.6 million in 2018/19).

115. Financial markets participants directly benefit from operating in well-regulated markets and increased consumer confidence and participation in financial services and markets resulting from FMA regulation.

116. In addition, well-regulated financial markets benefit New Zealand by driving down the cost of capital and benefitting the wider economy.

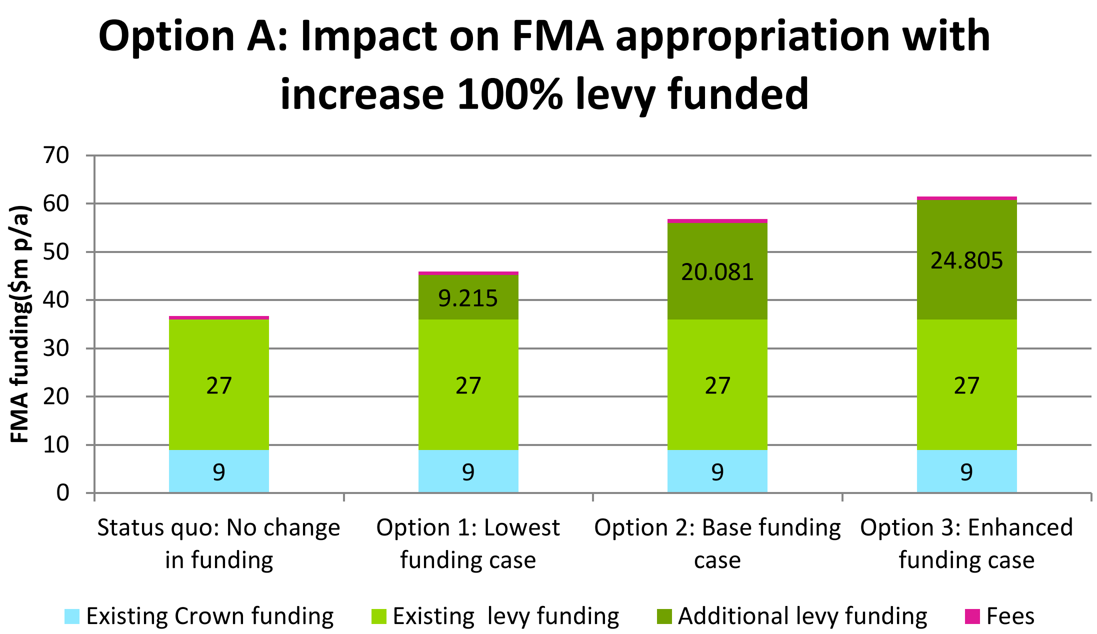
117. The Government is considering what portion of the FMA's funding should be met from the Crown and what portion should be met by the levy. To assist in this, MBIE are seeking feedback on two possible options for how additional FMA funding should be recovered:

- Option A: Increase is 100% levy funded
- Option B: Increase is 25% Crown funded and 75% levy funded (maintaining the current funding split).

Options for recovering an increase in the FMA's appropriation

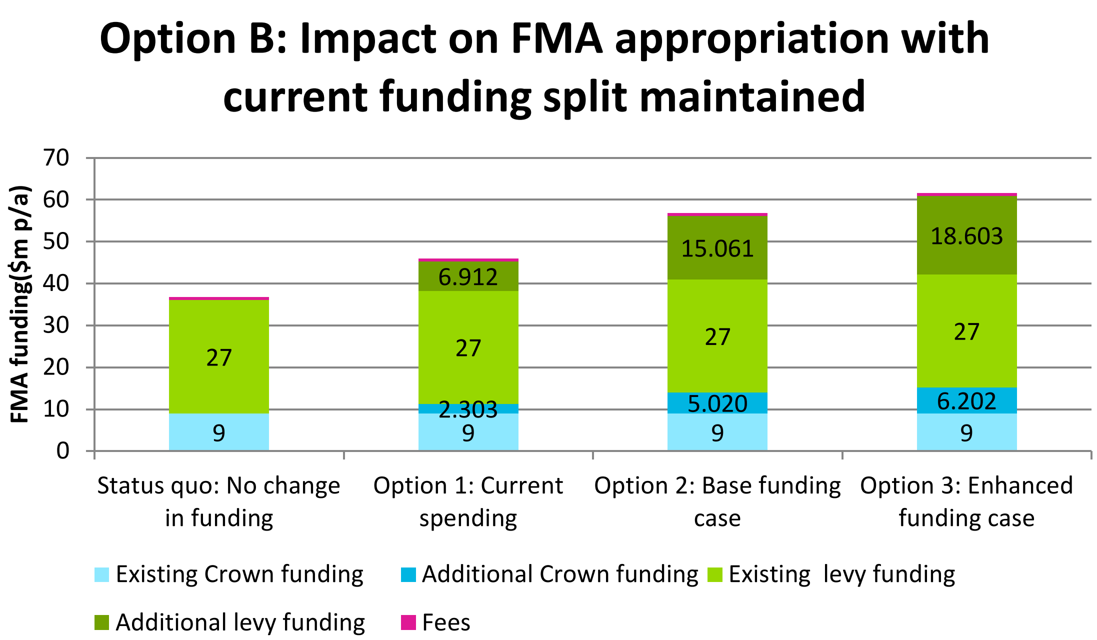
Option A: Increase is fully levy funded

118. Under Option A, the increase in the FMA's appropriation would be met entirely from third-party levy funding. The impact this would have on the sources of the FMA's appropriation across the different funding options is illustrated below.



Option B: Increase is Crown and levy funded

119. Under Option B, the increase in the FMA's appropriation would be met by a combination of Crown and levy funding so that the current split of 25% Crown and 75% levy funding (reflecting the public and private good aspect of the FMA's operations) is maintained. The impact this would have on the sources of the FMA's appropriation across the different funding options is illustrated below.



Criteria for assessing recovery options

120. It is intended that the following criteria will be used to assess which funding recovery option should be recommended:

- proportionality – the proportion of Crown and third-party levy funding reflects the public good element of the FMA's operations as well as the private benefit levy payers receive from well-regulated financial markets
- equity – the relative impacts of the proportion of Crown and third-party funding (e.g. ability to pay) are taken into account
- sustainability – the split of funding is sustainable and viable in the long-term and the Crown operating balance and market activity are not negatively impacted as a result of the levy.

4	Do you think that the proposed additional funding for the FMA should be wholly levy recovered or should the Crown contribute towards the increase? Why?
5	What is the appropriate Crown/levy split of the FMA's appropriation and why?

Impact on the FMA levy

121. As noted above, the Crown currently contributes $9 million annually to the FMA's appropriation, with the remaining $27 million recovered from financial markets participants. Any increase in the FMA's funding will therefore impact the amount to be recovered by the levy and levies payable.

122. The total amount to recover from the levy and the resulting impact on the Crown/levy funding split under the different funding options are shown in the table below. The levies payable for each levy class under the different funding options are provided in the Annex.

123. Funding recovery Option A (where a funding increase is 100% levy funded) has been used to calculate the resulting changes to the levy under the different funding options. If the Crown increases its contribution towards the FMA's funding, the amount to be levy recovered and the levies for each class will reduce from the figures presented in this paper.

Option	Crown contribution	Indicative amount to recover by levy	Indicative FMA appropriation (excl. litigation fund and fee revenue)	Split of FMA Appropriation (levy/Crown)
Status quo: No funding change	$9 million	$27 million	$36 million	75%/25%
1: Current spend	$9 million	$36.215 million	$45.215 million	80%/20%
2: Base case	$9 million	$47.081 million	$56.081 million	84%/16%
3: Enhanced case	$9 million	$51.805 million	$60.805 million	85%/15%

8 The FMA levy

The current FMA levy model

124. The following section outlines the current FMA levy model and seeks feedback on some proposed changes to it.

Background

125. The FMA levy model was introduced in 2012 to enable the cost-recovery of parts of the FMA's operations. The model was then reviewed in 2016 to ensure it remained accurate and appropriate. It has been periodically amended over time to add new market participants or make changes to population forecasts, most recently by the Financial Markets Authority (Levies) Amendment Regulations 2019.

126. The balancing objectives underlying the levy are:

- The cost of the levy for market participants is consistent with the benefits they receive from well-regulated financial markets
- The levy does not discourage entry into the market for, and the supply of, financial products or services
- The levy is practical in respect of its implementation, collection and also avoids large over or under-collections.

127. The levy is payable by financial market participants either on registration or annually or at the time of the prescribed event. The majority of the levy is collected by the Companies Office across the different registers they administer such as the FSPR or Disclose Register. The FMA also collects some levy classes from financial market participants outside of the registers.

128. The levy is prescribed on an activity basis such that financial market participants make a contribution for each class in which they operate[13]. For example, a registered bank that is also a derivatives issuer and manages a KiwiSaver scheme will pay the levy for all three activities.

129. In addition, where appropriate, levy amounts are tiered within classes to recognise variations in size and nature of financial market participants. Accordingly, the amount of levy charged is typically proportionate to the size of the business.

130. However, the FMA has a discretionary power to waive a levy where the circumstances of a financial markets participant are exceptional when compared to others in the same levy class. The

[13] More information is contained within the Financial Markets Authority (Levies) Regulations 2012.

threshold is deliberately high and the waiver power is not intended to be used to revisit settled policy positions.

Key assumptions to the model

131. The levy model is underpinned by forecasts of the number of financial markets participants in each class and in some cases the size of businesses within those classes. MBIE has worked with the FMA and the Companies Office to update the levy forecasts to more accurately reflect market population and activity.

132. There is also a certain element of judgement in setting the tiers within each levy class and the levies payable. Under the levy model objectives, different metrics for the levy classes are used to assess the size of participants within each class (e.g. total assets for registered banks and non-bank deposit takers (NBDTs)). These metrics are rough proxies for economic activity and the perceived benefit each financial market participant receives from well-regulated financial markets.

133. Like many conduct regulators around the world, the FMA takes a risk-based approach to regulating and enforcing the sectors it is responsible for. It focuses on the types of conduct and practices that may pose the most harm, and its assessment of risks drives the activities it undertakes. As risk impact and likelihood of harm change over time and may have interactions across sectors, products and services, it would be impracticable to attribute the levy to individual participants in terms of the FMA's specific interaction with that participant.

Levies collected

134. As the levy model is reviewed every few years, the model assumes that the estimated volume forecasts remain static over time. However, in reality the total population of financial markets participants and the number within each levy class and tier fluctuate from year-to-year in ways that are not predictable. Given this, the levy generally over or under-collects by some amount over time.

135. Between 2012 and 2015 an over-recovery of the levy occurred and was subsequently refunded to levy payers through a temporary reduction in the levy amounts set in 2017. In effect, this reduced the total amount of revenue to be collected via the levy by $1.2 million per year from 2017/18 to 2022/23.

136. From 2017 to 2019 the levy under-recovered approximately $2.8 million (over and above the historic over-recovery which was being refunded). Based on the previous two years, it is expected that the levy will under-recover by a small amount again in 2019/20.

Year	Amount to recover	Levy revenue	Over/(under) recovery
2017/18	$25.780 million	$23.570 million	($2.209 million)
2018/19	$25.780 million	$25.124 million	($0.655 million)

2019 changes to the levy

137. The Financial Markets Authority (Levies) Amendment Regulations 2019 introduce new levies that will apply in the new financial advice regime. These levies were only intended to ensure that the Crown was still able to recover the financial advice sector's proportion of the levy, and were not intended to fully-recover the costs of overseeing the new regulatory regime. As such, they are subject to change should the FMA receive an increase in funding. In addition, these regulations introduced a new levy class for authorised bodies, and confirmed how levies should be calculated when a market services licence covers an authorised body. These changes have been incorporated into the calculations for reviewing the levy.

Future changes to the levy – conduct of financial institutions

138. The Government has also recently announced its plans to introduce legislation to create an oversight regime for regulating conduct in the banking and insurance sectors. As detailed on page 18, this new regime is out of scope of this particular funding and levy review, though the enhanced funding option does include some limited resource to prepare for the new regime.

Changes to the portion of the levy paid by certain levy classes

139. MBIE considers it appropriate to maintain the overall design of the current levy model, with some changes to the portion of the levy paid by certain levy classes to better reflect the objectives of the levy.

140. The levy classes that would experience notable increases in the portion of the levy they pay are set out below. These changes are primarily driven by the degree of benefit that these organisations receive from participating in a well-regulated environment:

- Class 2 (registered banks and NBDTs)
- Class 3 (licensed insurers)
- Class 14 and 15 (registered or incorporated persons).

141. The levy classes that would experience notable decreases in the portion of the levy they pay are set out below. These changes are primarily driven by ensuring that the levy does not discourage entry into the market or discourage innovation:

- Class 1 (new financial service providers)
- Class 6D (crowd funding and peer-to-peer lending services)
- Class 6F and 6G (financial advisers and financial advice providers)
- Class 7 (financial service providers not included in Classes 2-6D).

New levy classes

Benchmark administrators

142. On 30 August 2019 the Financial Markets (Derivatives Margin and Benchmarking) Reform Amendment Act 2019 received Royal assent. This Act will introduce an opt-in licensing regime for administrators of financial benchmarks under the FMC Act.

143. It is necessary to introduce a new 'financial benchmark administrator' levy class, given these providers can apply to be licensed by the FMA and will be registered on the FSPR.

144. At this stage, there is only likely to be one licensed financial benchmark administrator. Having considered the objectives of the levy, and noting that a licensed benchmark administrator will play a significant role in the effective operation of New Zealand's financial markets, both domestically and internationally through ensuring continuation of critical financial contracts with EU parties, MBIE consider that an annual levy of $11,812 is appropriate in the current levy model, increasing to $23,176 in the enhanced funding option.

Growth market operators

145. Under the current levy model, licensed market operators are required to pay an annual levy of $29,000. While licensed market operators benefit significantly from operating in a well regulated environment (whereby investors can confidently invest), MBIE is concerned that the levy could act as a barrier to entry for new market operators. In particular, it has been suggested that this levy may prevent the emergence of a growth market which would allow early stage small-to-medium size growth companies to access capital[14].

146. Accordingly, MBIE is considering whether it is appropriate to create a new levy class for growth market operators and what parameters should be set to clarify which licensed market operators would be caught by this new class (e.g. if a licensed market operator is subject to licensing conditions that restrict the size of issuers that may be listed on it).

147. Currently, MBIE thinks that a levy of $10,000 under the enhanced funding option would be appropriate for this new levy class. This would recognise the reduced benefit that growth market operators would receive, when compared to an established market operator, and should reduce the risk of the levy acting as a barrier to entry.

Small issuers

148. In addition to the proposed new levy class for growth market operators, MBIE is also considering whether a new levy class or tier should be created for small listed issuers. Currently, listed issuers pay an annual levy of $2,600 and feedback has been received that these compliance costs might

[14] The only growth market that has operated to date is the NXT. However, the NZX was not required to pay a levy for this activity as it is already a licensed market operator.

deter smaller companies from listing. Further, smaller listed issuers would receive a lesser benefit, relative to large listed issuers. Weighing up the objectives of the levy, MBIE considers that a levy of $750 would be appropriate for smaller issuers in the current levy model, increasing to $1,471 in the enhanced funding scenario.

149. MBIE currently think that the small listed issuer class could be limited to listed issuers with a market capitalisation below $60 million; however feedback on this would be helpful. Feedback is also welcomed on how to design the threshold used to define the proposed ‘small issuer’ class so that it adequately captures the various forms of listed issuers.

Self-select schemes

150. Self-select schemes are a form of managed fund that allow investors to design their own investment portfolios by choosing from a list of investment options. This differs to other forms of managed funds whereby investors can only chose from a list of pre-selected funds. Self-select schemes typically offer hundreds of possible options.

151. As each individual investment in a self-select scheme is technically considered a separate ‘fund’, the FMA has previously granted waivers of part of the FMA levy to managers who provide self-select schemes. Without this partial waiver, managers would be required to pay $530 for each individual investment option within the self-select scheme. Instead, the waivers specify that managers of self-select schemes are required to pay $2,600 on the lodgement of a Product Disclosure Statement (PDS), which is consistent with the amount payable when a PDS is lodged for a non-managed fund.

152. MBIE propose to amend the regulations to preserve the effect of these waivers so that self-select schemes are required to pay a levy that is consistent with the amount payable when a PDS is lodged for a non-managed fund (Class 9). This would result in a levy of $2,589 payable in the current model, increasing to $5,079 in the enhanced funding scenario.

6	
7	Do you have any comments on the different tiers in the levy model?
8	Do you have any feedback on the impacts of the proposed changes to the levies presented in the Annex?

Annex: Existing and proposed FMA levy (excluding GST)

	Current levy model		Approximate levy under changes to funding (excl. GST)				
Levy class	Type of levy (fixed levy or tiers)	Current $ levy (excl. GST)	Option 1: Current spend	Option 2: Base		Option 3: Enhanced	
			2020/21 & outyears	2020/21	2021/22 & outyears	2020/21	2021/22 & outyears
Class 1 New financial service provider (FSP) registrations	Fixed levy	$460	$416	$467	$546	$487	$602
Class 2	Total assets exceed $50 billion	$535,000	$782,138	$877,349	$1,024,971	$915,009	$1,130,463
Registered FSPs that are registered banks or licensed NBDTs	Total assets exceed $10 billion but not $50 billion	$130,000	$244,965	$274,785	$321,020	$286,580	$354,060
	Total assets exceed $2 billion but not $10 billion	$38,000	$65,482	$73,453	$85,812	$76,606	$94,644
	Total assets exceed $1 billion but not $2 billion	$22,000	$33,669	$37,767	$44,122	$39,388	$48,663
	Total assets exceed $500 million but not $1 billion	$10,500	$17,189	$19,281	$22,525	$20,109	$24,843
	Total assets exceed $40 million but not $500 million	$7,700	$11,171	$12,531	$14,640	$13,069	$16,146
	Total assets do not exceed $40 million	$2,400	$3,412	$3,827	$4,471	$3,992	$4,932

	Current levy model		Approximate levy under changes to funding (excl. GST)				
Levy class	Type of levy (fixed levy or tiers)	Current $ levy (excl. GST)	Option 1: Current spend	Option 2: Base		Option 3: Enhanced	
			2020/21 & outyears	2020/21	2021/22 & outyears	2020/21	2021/22 & outyears
Class 3 Registered FSPs that are licensed insurers	Annual gross premium revenue exceeds $500 million	$150,000	$281,710	$316,003	$369,173	$329,567	$407,169
	Annual gross premium revenue exceeds $100 million but not $500 million	$38,000	$75,628	$84,834	$99,109	$88,476	$109,309
	Annual gross premium revenue exceeds $50 million but not $100 million	$24,000	$45,882	$51,468	$60,128	$53,677	$66,316
	Annual gross premium revenue exceeds $10 million but not $50 million	$11,000	$16,815	$18,862	$22,036	$19,672	$24,304
	Annual gross premium revenue does not exceed $10 million	$2,200	$4,679	$5,249	$6,132	$5,474	$6,763
Class 4 Registered FSPs that are supervisors licensed under the Financial Markets Supervisors Act 2011 in respect of the supervision of debt securities and managed investment products in registered schemes	Total supervised interests exceed $5 billion	$138,000	$187,132	$209,911	$245,231	$218,922	$270,471
	Total supervised interests exceed $1 billion but not $5 billion	$76,000	$103,166	$115,725	$135,196	$120,692	$149,111
	Total supervised interests exceed $100 million but not $1 billion	$26,000	$35,294	$39,590	$46,251	$41,289	$51,012
	Total supervised interests do not exceed $100 million	$6,400	$8,959	$10,050	$11,741	$10,481	$12,949

Levy class	Current levy model: Type of levy (fixed levy or tiers)	Current levy model: Current $ levy (excl. GST)	Approximate levy under changes to funding (excl. GST): Option 1: Current spend 2020/21 & outyears	Option 2: Base 2020/21	Option 2: Base 2021/22 & outyears	Option 3: Enhanced 2020/21	Option 3: Enhanced 2021/22 & outyears
Class 5 Registered FSPs that are managers	Total managed assets exceed $10 billion	$380,000	$452,310	$507,371	$592,741	$529,150	$653,747
	Total managed assets exceed $5 billion but not $10 billion	$270,000	$282,585	$316,984	$370,320	$330,591	$408,434
	Total managed assets exceed $2 billion but not $5 billion	$120,000	$144,612	$162,215	$189,510	$169,178	$209,014
	Total managed assets exceed $1 billion but not $2 billion	$80,000	$100,986	$113,279	$132,339	$118,141	$145,959
	Total managed assets exceed $500 million but not $1 billion	$45,000	$58,895	$66,065	$77,181	$68,901	$85,124
	Total managed assets exceed $100 million but not $500 million	$25,000	$34,518	$38,720	$45,235	$40,382	$49,890
	Total managed assets exceed $20 million but not $100 million	$6,400	$8,359	$9,377	$10,955	$9,779	$12,082
	Total managed assets do not exceed $20 million	$1,400	$1,658	$1,860	$2,173	$1,939	$2,396
Class 6 Registered FSPs where	(a) if the person is authorised to undertake trading activities on licensed markets	$4,500	$6,244	$7,004	$8,183	$7,305	$9,025
One of the following amounts (being whichever applicable	(b) if the person is a contributory mortgage broker	$1,800	$2,613	$2,931	$3,424	$3,057	$3,777

Levy class	Current levy model: Type of levy (fixed levy or tiers)	Current levy model: Current $ levy (excl. GST)	Option 1: Current spend 2020/21 & outyears	Option 2: Base 2020/21	Option 2: Base 2021/22 & outyears	Option 3: Enhanced 2020/21	Option 3: Enhanced 2021/22 & outyears
amount is the greatest):	(c) if the person is registered for the financial service described in section 5(1)(k) of the FSP Act	$5,300	$7,534	$8,451	$9,873	$8,814	$10,889
	(d) if the person is licensed to provide the licensed market service of acting as a derivatives issuer	$9,600	$13,651	$15,313	$17,889	$15,970	$19,730
	(e) if the person is an authorised financial adviser	$330	n/a – Class to be deleted under FSLAA				
Class 6A Registered FSPs that are DIMS retail providers	Funds under management exceed $2 billion	$36,000	$50,226	$56,340	$65,819	$58,758	$72,593
	Funds under management exceed $500 million but not $2 billion	$14,000	$21,238	$23,824	$27,832	$24,846	$30,697
	Funds under management exceed $100 million but not $500 million	$4,800	$7,116	$7,982	$9,325	$8,324	$10,285
	Funds under management exceed $50 million but not $100 million	$2,400	$3,826	$4,292	$5,014	$4,476	$5,530
	Funds under management do not exceed $50 million	$950	$1,806	$2,026	$2,366	$2,113	$2,610
Class 6B Registered FSPs that are brokers other than persons in class 6(a) or 6C	Fixed levy	$1,800	$2,681	$3,007	$3,513	$3,136	$3,875

Levy class	Current levy model: Type of levy (fixed levy or tiers)	Current levy model: Current $ levy (excl. GST)	Approximate levy under changes to funding (excl. GST): Option 1: Current spend 2020/21 & outyears	Option 2: Base 2020/21	Option 2: Base 2021/22 & outyears	Option 3: Enhanced 2020/21	Option 3: Enhanced 2021/22 & outyears
Class 6C Registered FSPs that are custodians and persons providing custodial services	Fixed levy	$6,300	$8,756	$9,821	$11,474	$10,243	$12,655
Class 6D Registered FSPs that provide a crowd funding service or a peer-to-peer lending service	Fixed levy	$2,600	$2,769	$3,106	$3,629	$3,239	$4,002
Class 6E Registered FSPs that are authorised bodies	Fixed levy	$460	$624	$700	$818	$731	$903
Class 6F Registered FSPs that are financial advisers (as defined in section 6(1) of the FMC Act)	Fixed levy	$265	$294	$330	$386	$344	$425
Class 6G	Fixed levy	$225	$249	$279	$326	$291	$360
Registered FSPs that are licensed financial advice providers	Plus every nominated representative engaged by the financial advice provider	$179	$220	$246	$288	$257	$317
	Plus if the financial advice provider gives advice on its own account	$737	$817	$916	$1,070	$956	$1,181

	Current levy model		Approximate levy under changes to funding (excl. GST)				
Levy class	Type of levy (fixed levy or tiers)	Current $ levy (excl. GST)	Option 1: Current spend	Option 2: Base		Option 3: Enhanced	
			2020/21 & outyears	2020/21	2021/22 & outyears	2020/21	2021/22 & outyears
Class 7 Registered FSPs that are not included in any of classes 2 to 6	Fixed levy	$460	$494	$555	$648	$578	$715
Class 8 Listed issuers	Fixed levy	$2,600	$3,699	$4,149	$4,847	$4,327	$5,346
Class 9	All except for PDS of a managed fund	$2,600	$3,514	$3,942	$4,605	$4,111	$5,079
Persons that lodge a PDS	Per managed fund (including self-select schemes)	$530	$747	$837	$978	$873	$1,079
Class 10 Licensed market operators	Fixed levy	$29,000	$47,687	$53,493	$62,493	$55,789	$68,925
Class 11 FMC reporting entity	Fixed levy	$48	$58	$65	$76	$68	$84
Class 12 Accredited bodies	Fixed levy per specified licence	$2,600	$3,835	$4,302	$5,025	$4,486	$5,543
Class 13 Overseas auditors	Fixed levy	$2,600	$3,903	$4,378	$5,114	$4,566	$5,641

Levy class	Current levy model: Type of levy (fixed levy or tiers)	Current levy model: Current $ levy (excl. GST)	Approximate levy under changes to funding (excl. GST): Option 1: Current spend 2020/21 & outyears	Option 2: Base 2020/21	Option 2: Base 2021/22 & outyears	Option 3: Enhanced 2020/21	Option 3: Enhanced 2021/22 & outyears
Class 14	The Building Societies Act 1965	$9	$15	$17	$20	$18	$22
Persons that apply for registration or incorporation	The Companies Act 1993	$9	$15	$17	$20	$18	$22
	The Friendly Societies And Credit Unions Act 1982	$9	$15	$17	$20	$18	$22
	The Limited Partnerships Act 2008	$9	$15	$17	$20	$18	$22
Class 15	The Building Societies Act 1965	$9	$15	$17	$20	$18	$22
Persons that are registered or incorporated, and make an annual return	The Companies Act 1993	$9	$15	$17	$20	$18	$22
	The Friendly Societies And Credit Unions Act 1982	$9	$15	$17	$20	$18	$22
	The Limited Partnerships Act 2008	$9	$15	$17	$20	$18	$22
New levy Growth market operators	Fixed levy	n/a – new class	$6,919	$7,761	$9,067	$8,094	$10,000
New levy Benchmark administrators	Fixed levy	n/a – new class	$16,035	$17,987	$21,013	$18,759	$23,176
New levy Small issuers with a market capitalisation less than $60 million	Fixed levy	n/a – new class	$1,018	$1,142	$1,334	$1,191	$1,471