



## COVERSHEET

|                               |                                                                                               |                             |                               |
|-------------------------------|-----------------------------------------------------------------------------------------------|-----------------------------|-------------------------------|
| <b>Minister</b>               | Hon Kris Faafoi                                                                               | <b>Portfolio</b>            | Commerce and Consumer Affairs |
| <b>Title of Cabinet paper</b> | <b>Release of discussion document: Review of Financial Markets Authority Funding and Levy</b> | <b>Date to be published</b> | Before 11 March 2020          |

### List of documents that have been proactively released

| <b>Date</b>     | <b>Title</b>                                                                           | <b>Author</b>                                                  |
|-----------------|----------------------------------------------------------------------------------------|----------------------------------------------------------------|
| 28 January 2020 | Release of discussion document: Review of Financial Markets Authority Funding and Levy | <i>Office of the Minister of Commerce and Consumer Affairs</i> |
| 28 January 2020 | <i>CBC-20-MIN-0001</i>                                                                 | <i>Cabinet Office</i>                                          |

### Information redacted

**YES**

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Some information has been withheld to maintain the constitutional conventions for the time being which protect the confidentiality of advice tendered by Ministers of the Crown and officials.

In Confidence

Office of the Minister of Commerce and Consumer Affairs  
Chair, Cabinet Business Committee

## **Release of discussion document: Review of Financial Markets Authority Funding and Levy**

### **Proposal**

1. This paper seeks agreement to release a discussion document relating to a review of the Financial Markets Authority's (FMA) funding and the FMA levy paid by industry participants.

### **Executive summary**

2. The FMA is New Zealand's principal conduct regulator of financial markets. The operating environment and regulatory remit of the FMA has evolved in recent years as a result of 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.

3. These changes have led to resourcing and cost pressures that mean the FMA's funding is no longer sufficient. As a result, the FMA is forecasting an operating deficit in the current financial year of approximately \$4 million. Confidential advice to Government

An independent review of the FMA's funding needs was carried out and has identified three possible options for increasing the FMA's funding.

4. The FMA is required to consult with levy payers about any increase in its appropriation. Accordingly, the FMA and the Ministry of Business, Innovation and Employment (MBIE) now seek approval to publicly consult and receive feedback on the FMA's funding and levy. The discussion document seeks feedback on:

- 4.1 three possible funding options for the FMA;

- 4.2 how any increase in funding could be apportioned between the Crown and financial markets levy payers (currently 75% of the FMA's funding is levy funded); and

- 4.3 changes to adjust the portion of the levy paid by some classes of financial market participants to better reflect the relative benefits to market participants of well-regulated financial markets, and to ensure the levies does not act as a barrier to entry. For example, proposals to increase the portion of the levy paid by registered banks and non-bank deposit takers, and licensed insurers, and proposals to reduce the portion of the levy paid by financial advice providers, small listed issuers, as well as crowd-funding and peer-to-peer lending services.

5. Submissions on the discussion document will be open for approximately 4 weeks during February 2020. Confidential advice to Government

I will then seek approval from the Cabinet Economic Development Committee (DEV) for the corresponding changes needed to the FMA levy model in early April.

## Background

6. The FMA is an independent Crown entity and is New Zealand's principal conduct regulator of financial markets. Its main statutory objective is to promote and facilitate the development of fair, efficient and transparent financial markets. It is responsible for licensing certain financial markets participants, providing oversight and monitoring of financial markets participants, and carrying out enforcement action where required. It is also responsible for providing information and research to the public.
7. The FMA receives a combination of Crown and third-party funding. The latter is through the FMA levy, and fees for functions such as licensing. This split of Crown and third-party funding is due to the public and private benefits of the FMA's work (e.g. financial service providers benefit from increased confidence in financial markets, and all New Zealanders benefit from having high-performing and well-regulated financial markets).
8. In 2016 the FMA's funding was reviewed in light of work implementing the Financial Markets Conduct Act 2013 (FMC Act). Following this review, the FMA received an additional \$9.816 million annually, taking its total annual appropriation to \$36 million. This increase was met entirely by levy payers and meant that the Crown's split of the FMA's appropriation decreased from around 30% to its current rate of 25%. In addition, the FMA has a separate \$2 million annual Crown funded appropriation to carry out major litigation, which was increased to \$6 million for 2019/20 to reflect increasing caseloads and legal costs.
9. A table summarising the source of the FMA's current funding is set out below.

| <b>Funding source</b>  | <b>Actual<br/>2018/19</b> | <b>Forecast<br/>2019/20</b> |
|------------------------|---------------------------|-----------------------------|
| Crown funding          | \$9 million               | \$9 million                 |
| Levy funding           | \$27 million              | \$27 million                |
| Litigation fund        | \$2 million               | \$6 million <sup>1</sup>    |
| Fees and other revenue | \$1.07 million            | \$1.91 million              |

10. Since the 2016 funding review, the FMA's remit has expanded further, and it is now timely to review the FMA's funding requirements to ensure that it can be an effective and efficient regulator and continue operating at expected service levels. This is vital in order for consumers, investors and businesses to participate in financial markets with confidence.

## Key issues

### *Evolving remit is leading to cost pressures*

11. The Financial Services Legislation Amendment Act 2019 (FSLAA) introduces a new regulatory regime for financial advice. In effect, the FMA will be required to licence and directly regulate more businesses across a broader part of the financial advice sector. For example, many mortgage and insurance brokers are not held to the same standards as investment advisers in the current regime, and the FMA has fewer enforcement tools at its disposal for these individuals. In the new regime, all financial advisers will be held to the same standard and the FMA will be able to use its full range of enforcement tools.
12. Cabinet agreed to the overall design of the new regulatory regime in 2016 [CAB-16-MIN-0336]. At that time, it was noted that the FMA may require additional funding to effectively regulate financial advice in the new regime. To date, The FMA has used accumulated cash reserves to fund the initial implementation and preparation for the new regulatory regime.
13. In addition to the new financial advice regime, the FMA has allocated significant resources to the reviews of the culture and conduct of banks and insurers (run in conjunction with the Reserve Bank of New Zealand (RBNZ)). This is an important ongoing piece of work, particularly in the wake of the Australian Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. As the conduct of banks, insurers and non-bank deposit takers is currently on the edge of the FMA's regulatory perimeter, the conduct and culture reviews and the resulting follow up were not factored into its current funding.
14. The implementation of the FMC Act and continued regulatory reform in other areas, growth and change in financial markets, changing governmental and societal expectations, and a lower than expected state of conduct maturity in financial markets participants, have all led to pressures across the FMA's current resourcing.

Confidential advice to Government

### *Funding review has been completed*

15. In light of these cost pressures faced by the FMA, MBIE commissioned an independent funding, efficiency and effectiveness review. This independent review identified a range of different funding options, taking into account the FMA's expanding remit, and identified some minor opportunities for improvement for the FMA.
16. 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, concluded that the FMA is not right-sized (i.e. its funding does not match its operations or activities) and that as a result the FMA has a number of organisational pressures.
17. Some minor opportunities for further efficiency and effectiveness gains were identified relating to more comprehensive operational reporting and further investment in technology and data analytics. However, the reviewers observed that the FMA is not able to pursue and realise these opportunities with its current resources.

*Seeking feedback on FMA funding levels*

18. Under section 69 of the Financial Markets Authority Act 2011, the FMA must consult those affected by the levy about an increase to its appropriation. The attached discussion document seeks feedback on three possible options for increasing the FMA’s level of funding that were identified during the funding review. These options are summarised in the table below.

| <b>Funding option</b>         | <b>Additional FMA funding</b> | <b>Indicative FMA appropriation</b> |
|-------------------------------|-------------------------------|-------------------------------------|
| Current funding               | -                             | \$36 million                        |
| Option 1: Current expenditure | \$9.215 million               | \$45.215 million                    |
| Option 2: Base case           | \$20.081 million              | \$56.081 million                    |
| Option 3: Enhanced case       | \$24.805 million              | \$60.805 million                    |

19. **Option one** would see the FMA’s funding increase to bring it in line with its current expenditure and provide the bare minimum level of funding necessary to implement the new financial advice regime and conduct and culture follow-up work. It will not address the broader cost pressures faced across the organisation, and may undermine confidence in, and the potential benefits of, the new financial advice regime for the market and consumers.
20. **Option two** would see a large increase in the FMA’s funding. This will allow the FMA to respond to current pressures and increase resources in key frontline areas of supervision, intelligence, enforcement and investigations. It incorporates a medium-to-high level risk-based monitoring approach for the new financial advice regime. It would put the FMA in a better position to respond to growing public expectations of its role, enable follow-up of the conduct and culture reviews, and enable the FMA to respond to technology change and innovation in financial markets.
21. **Option three** represents the largest increase in funding. In addition to the benefits summarised in paragraph 19, this option would allow the FMA to increase its activities across its operations. It would be able to undertake more thematic research and analysis, develop sector expertise and have sufficient resources to adequately respond to significant market events without compromising other work programmes. It would also enable greater supervision and more proactive monitoring under the new financial advice regime, which would facilitate a much faster and better understanding of market risks. It would also mean increased investor and market engagement and guidance. This option would also provide resources for the follow-up to the conduct and culture reviews that would enable the FMA to prepare for the new conduct regime.

The independent review has recommended funding option 3 for the FMA. While these are the three options that have been identified through the independent review, the final funding options that I will submit for consideration will reflect feedback received through public consultation on the discussion document.

### *Split between Crown and third-party funding*

22. Because the FMA's appropriation is sourced from a mixture of Crown funding and third-party levy funding, the discussion document seeks feedback on how any increase in FMA funding could be split. Two potential options will be consulted on, one where the current split between Crown and levy funding is retained (i.e. approximately 25% Crown funded), another where the increase is entirely levy funded.
23. Confidential advice to Government  
As with the funding options, there are a number of potential options for any increase in the Crown's contribution towards the FMA's funding, and public feedback will help inform these decisions.

### *Changes to the FMA levy*

24. The FMA levy is designed to recover a portion of the FMA's funding from those participants who receive a benefit from its activities and from operating in well-regulated financial markets.
25. All financial service providers currently pay a levy of \$460 (ex GST) when registering on the Financial Service Providers Register (FSPR) for the first time, and then pay an annual levy based on the services they provide. The levy model includes a number of classes, which relate to the different financial services. Some classes are split into different tiers which reflect the relative size of different providers.
26. I am seeking feedback through this discussion document on changes to the FMA levy. These changes are intended to:
- 26.1 allow the Crown to recover increases to the FMA's funding;
  - 26.2 introduce new levy classes where market developments have occurred; and
  - 26.3 adjust the portion of the levy paid by certain classes of levy payers to better meet the objectives of the levy.
27. While all classes will see an increase in the dollar levy amount paid under a funding increase, the discussion document proposes changes to adjust the portion of the levy paid by some participants.
28. The discussion document proposes that the portion of levy paid by some classes, including registered banks and non-bank deposit takers, be increased to better reflect the benefits they receive from operating in well-regulated financial markets.
29. On the other hand, it proposes that the portion of the levy paid by crowd-funding and peer-to-peer lending services, small issuers and the financial advice sector be reduced. This is to ensure the levy does not act as a barrier to entry for these entities, and to encourage early-stage capital markets activity.
30. The levies that will be consulted on under each of the funding options have been calculated on the basis that any increase in the FMA's funding will be funded entirely through from levy payers (i.e. there will be no increase in Crown funding). This is to

consult on the amount of levies that would be payable under each option should the Crown choose not to contribute any additional funding towards the FMA.

#### *Timing of any funding changes*

31. It is intended that the changes to the FMA's funding and FMA levies will come into force in July 2020 for the 2020/21 year onwards to coincide with the commencement of the new financial advice regime. This will also allow the FMA to continue the follow up work relating to the conduct and culture reviews.
32. Consideration will also be given to whether any increase in funding should be phased, recognising that it may take some time for the FMA to carry out the recruitment necessary to build up its operations.

#### **Consultation**

33. The FMA, the RBNZ, the Treasury and the Department of the Prime Minister and Cabinet (Policy Advisory Group) have been consulted on this paper.

#### **Financial implications**

34. There are no financial implications arising from releasing the discussion document for public consultation.

35. Confidential advice to Government

36. Confidential advice to Government

approval for the corresponding changes needed to the FMA levy model will be sought in early April through DEV.

37. It should also be noted that in September 2019 the Government agreed to a new regime regulating the conduct of financial institutions [DEV-19-MIN-0237]. As noted at that meeting, any increase to the FMA's funding necessary as a result of this new regime will be considered and consulted on at a later stage once the costs of the new regime are clearer.

#### **Legislative implications**

38. There are no immediate legislative implications arising from this paper. However, the consultation is likely to result in policy recommendations to Cabinet which would require amendments to, or the creation of, regulations made by Order in Council.

#### **Impact analysis**

39. The Regulatory Quality Team at the Treasury has determined that the discussion document will substitute for a regulatory impact assessment on the condition that the discussion document contains the key elements of the impact analysis framework and that this be verified by MBIE's quality assurance panel.

### *Quality of the impact analysis*

40. MBIE's quality assurance panel has reviewed the discussion document and confirms that the key elements of impact analysis have been adequately covered.

### **Human rights**

41. The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

### **Gender implications**

42. There are no gender implications arising from the recommendations in this paper.

### **Disability perspective**

43. There are no disability implications arising from the recommendations in this paper.

### **Publicity**

44. The discussion document will be made publicly available on MBIE's website and key stakeholders will be informed of its release. MBIE and the FMA also intend to hold targeted consultation workshops with key stakeholder groups.
45. I anticipate that feedback and public reception on the proposals will be broadly positive. In light of recent conduct and culture issues identified in financial markets, there has been media coverage regarding the importance of New Zealand having a credible financial regulator and that the FMA is under-resourced for its current responsibilities. More consumers are now also aware of the FMA and the role it plays in ensuring well-regulated financial markets.
46. There is some risk that the release of this discussion document could be interpreted by the public as the Government agreeing on the extent of funding required by the FMA. There is also some risk that it could set an expectation that the Crown will increase its portion of funding. I consider these to be a relatively low risk. The discussion document presents a number of different funding options, and feedback from consultation will inform future Cabinet decisions on what level of funding is appropriate. Further, the levies consulted on are calculated on the basis that the level of Crown funding remains static.
47. There may be some adverse reaction to the funding options from financial markets participants, particularly smaller businesses, who will see an increase in the levies they pay. Two of the funding options would represent a significant increase in the FMA's appropriation, not long after the FMA received a \$9.816 million increase in 2017.
48. There may also be some criticism of the proposed changes to levies paid by the financial advice sector. The Financial Markets Authority (Levies) Amendment Regulations 2019 amended the levies for the financial advice sector under the new regime. As previously signalled to the affected parties, these were intended only to ensure the Crown continued to collect the same amount of funding from the financial advice sector and were not intended to fully cover the cost of the new regime. Nonetheless, these levy payers may be surprised to see new levies being proposed so soon after the adjustment.

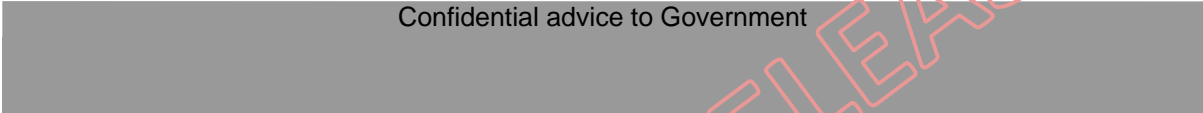


## Proactive Release

49. This paper will be published on MBIE's website, subject to redactions as appropriate and consistent with the Official Information Act 1982.

## Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

1. **note** that on 16 December 2019 Cabinet authorised this Committee to have Power to Act to take decisions on this submission [CAB-19-MIN-0690];
2. **note** that the discussion document outlines and seeks feedback on the Financial Markets Authority's funding requirements and adjustments to the Financial Markets Authority levy;
3. **agree** to the release of the discussion document entitled '*Review of Financial Markets Authority Funding and Levy*' attached to this paper, subject to any minor or technical amendments that may be required;
4. **note** that the discussion document is intended for release on 28 January 2020 for public consultation for approximately 4 weeks;
5.  Confidential advice to Government
6. **invite** the Minister of Commerce and Consumer Affairs to report back to the Cabinet Economic Development Committee in April 2020 to seek approval for proposed policy changes to the Financial Markets Authority levy model.

Authorised for lodgement

Hon Kris Faafoi  
Minister of Commerce and Consumer Affairs