



## COVERSHEET

<b>Minister</b>	Hon David Clark	<b>Portfolio</b>	Commerce and Consumer Affairs
<b>Title of Cabinet paper</b>	Disclosure Requirements for New Capital Instruments and Other Matters	<b>Date to be published</b>	9 August 2021

### List of documents that have been proactively released

<b>Date</b>	<b>Title</b>	<b>Author</b>
June 2021	Cabinet paper: Disclosure Requirements for New Capital Instruments and Other Matters	Office of the Minister of Commerce and Consumer Affairs
23 June 2021	Disclosure Requirements for New Capital Instruments and Other Matters DEV-21-MIN-0132 Minute	Cabinet Office

### 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 commercial information has been withheld.

## In Confidence

Office of the Minister of Commerce and Consumer Affairs

Cabinet Economic Development Committee

## Disclosure requirements for new capital instruments and other matters

### Proposal

- 1 I am seeking Cabinet's agreement to change the prescribed disclosure requirements for registered banks under the Financial Markets Conduct Regulations 2014 (FMC Regulations) to include disclosure for upcoming new Reserve Bank of New Zealand (RBNZ) capital instruments. I am also seeking Cabinet's agreement to an exemption for DriveWealth from the Financial Service Providers (Registration and Dispute Resolution) Act 2008, and approval for an Order in Council related to the same Act.

### Relation to government priorities

- 2 In December 2019, RBNZ announced decisions to change banks' capital requirements to reduce the likelihood of a bank failure and support a sound and efficient financial system.
- 3 RBNZ's decisions include changes to the types of capital instruments that will be recognised as regulatory capital, and therefore the instruments that registered banks may offer to investors. Adequate disclosure processes for these products is an important aspect of the Government's focus on consumer protection and reducing harm to consumers.

### Background

- 4 RBNZ requires all registered banks to hold sufficient capital to offset the risks that banking failures may pose to the financial system as a whole.
- 5 In December 2019, RBNZ made decisions to gradually raise bank capital requirements to make banks safer. Increases in the required level of capital will commence from 1 July 2022, and rise gradually until July 2028.
- 6 RBNZ will allow banks to issue new Additional Tier 1 (AT1) capital instruments in order to raise capital to meet the requirements from 1 October 2021. These AT1 instruments will be 'perpetual preference shares' (PPS) which are equity securities.

- 7 While mainly targeted towards institutional investors, the new PPS products may also be available to retail “Mum and Dad” investors, who could experience both benefits and risks from these investments. For example, investors in these products would generally receive distributions before dividends are paid on ordinary shares, but would not enjoy the voting rights that attach to ordinary shares. PPS are also intended to be non-redeemable for the holder, but can be redeemable at the option of the issuer, after a minimum period of 5 years.
- 8 Appropriate disclosure of information about PPS is necessary to ensure that retail investors, if they were to choose to invest in new AT1 instruments, are adequately aware of the risks and benefits of investing in these products.

## Analysis

### *Disclosure requirements need to be prescribed for AT1 instruments*

- 9 Schedule 3 of the FMC Regulations sets out the content of the Product Disclosure Statement (PDS) to be produced in respect of equity securities. Schedule 9 of the FMC Regulations sets out the content of the Limited Disclosure Document (LDD) required to be produced in respect of debt securities issued by registered banks. Neither set of disclosure requirements are fit for purpose for effective disclosure of new PPS AT1 capital instruments. This is because while the PPS AT1 capital instruments are equity securities, they will have several features of debt securities, including fixed coupon payments.
- 10 Therefore, a tailored disclosure regime for AT1 capital instruments is recommended to provide appropriate and meaningful disclosure, and take into account that the products are regulatory capital issued by registered banks.
- 11 If new disclosure requirements are not prescribed, it may lead to inconsistent disclosure across banks where PPS products are offered to retail clients. If disclosure is ineffective, this may lead to consumer harm. Without modifications and additions to the disclosure currently required under Schedule 3, there is a risk that disclosure will not be clear, concise and effective. Tailored disclosure will also ensure a uniform and consistent approach to disclosure across AT1 issuers and achieve the best outcome for investors.
- 12 While elements of both PDS and LDD disclosure requirements may be applicable, these features will be combined and adapted into a new set of prescribed PDS requirements. The content of the requirements will be fine-tuned during the regulations drafting stage having regard to the purpose of the Financial Markets Conduct Act 2013 and the existing disclosure requirements under the FMC Regulations. The disclosure requirements are likely to combine and update relevant parts of existing disclosure for equity and debt securities.

- 13 Features of disclosure will include purpose of offers, key terms, pricing of the product, drivers of return, key risks, financial information, governance-related disclosure and other matters currently required to be disclosed to investors for other financial products.
- 14 Prescribed disclosure requirements leads to consistency across financial institutions and makes it easier to compare financial products. These features will be in line with changes to AT1 terms as per the changes to the RBNZ Banking Supervision Handbook, which will be renamed as *Banking Prudential Requirements*, some of which are pending RBNZ decision, as well as covering non-prudential matters, such as governance-related disclosure.

*Order in Council to bring changes to registration requirements fully into force*

- 15 I am also seeking approval for a separate matter of an Order in Council in relation to the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act).
- 16 The FSP Act requires financial service providers to register on the Financial Service Providers Register (FSPR) and belong to a dispute resolution scheme. The Financial Services Legislation Amendment Act 2019 (Amendment Act) introduced changes so that overseas-based providers are also subject to the FSP Act's registration and dispute resolution requirements. Most of the changes in the Amendment Act came into force on 15 March 2021.
- 17 The Amendment Act gives overseas-based providers that are newly required to register on the FSPR a transitional period after 15 March 2021 to become registered. The end date of that transitional period is to be set by Order in Council and must be at least six months after 15 March 2021.
- 18 I propose setting 16 December 2021 as the end date for that transitional period. This gives affected providers nine months from 15 March 2021 to obtain their registration and almost six months' notice of the deadline. I expect this to give sufficient time to affected providers as the registration process is relatively straightforward, with many applications processed by the Registrar within a few weeks of receiving an application.

*Registration exemption for an overseas provider operating in partnership with local provider*

- 19 I am also seeking approval to make regulations exempting an overseas financial service provider, DriveWealth, from the FSPR and dispute resolution scheme membership requirements referred to at paragraph 16 above.
- 20 DriveWealth is a United States based share broker. DriveWealth and Kiwi Wealth (sister company of KiwiBank) work together to operate an online investment platform "Hatch" which is used by more than 100,000 New Zealanders.

- 21 Because DriveWealth has a number of partnerships worldwide, it expects its local partner to take care of local compliance obligations and is therefore not willing to register on the FSPR or join a New Zealand dispute resolution scheme. I am seeking approval to exempt DriveWealth from those obligations on the condition that Kiwi Wealth effectively steps into DriveWealth's shoes in relation to compliance with the FSP Act, takes responsibility for the resolution of consumer complaints in respect of the Hatch service (including any compensation ordered by a dispute resolution scheme), and notifies consumers of the dispute resolution arrangements. An indication of the details of those conditions is set out in Appendix 1.
- 22 I consider an exemption to be justified in this case. Without the proposed exemption, there is a risk of the Hatch service being withdrawn from the New Zealand market. The proposed exemption enables New Zealanders to continue to have access to an innovative service and maintains competition in the online investment platform market.
- 23 New Zealand consumers would not be disadvantaged with the exemption as they would still have access to the dispute resolution processes of a licensed and reputable New Zealand provider. In fact, it may be beneficial for consumers if there is one provider (Kiwi Wealth) that takes responsibility for consumer complaints in relation to the whole Hatch service.

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I seek Cabinet's authority to make final decisions in relation to the final conditions and scope of the exemption.

### Financial Implications

- 25 There are no financial implications from the recommendations in this paper.

### Legislative Implications

- 26 This paper seeks agreement for the Parliamentary Counsel Office to draft amendments to the FMC Regulations 2014 and the Financial Service Providers (Exemptions) Regulations 2010, and to make an Order in Council in relation to the FSP Act.

## Impact Analysis

### Regulatory Impact Statement

- 27 Treasury's Regulatory Impact Analysis team has determined that the proposal to create tailored disclosure requirements for PPS AT1 capital instruments is exempt from the requirement to provide a Regulatory Impact Statement on the grounds that it has no or only minor impacts on businesses, individuals and not-for-profit entities. A Regulatory Impact Analysis was completed at the time disclosure requirements were created ("Regulatory Impact Statement: Financial Markets Conduct Regulations", CBC Min (13) 4/7 refers); and the Ministry of Business, Innovation and Employment has confirmed that there are no changes to the purpose of disclosure.
- 28 Treasury's Regulatory Impact Analysis team has also determined that the proposal to provide an exemption for DriveWealth in the Financial Service Providers (Exemptions) Regulations 2010 is exempt from the requirement to provide a Regulatory Impact Analysis on the grounds that it has no or only minor impacts on businesses, individuals and not-for-profit entities.

### Population Implications

- 29 There are no direct implications for Māori, women or disabled people. Any benefits from effective disclosure of risks and benefits of investing in the new instruments will apply across the board for all population groups.

### Human Rights

- 30 There are no inconsistencies between the proposals in this paper and the New Zealand Bill of Rights Act 1990 or the Human Rights Act 1993.

### Consultation

- 31 The Financial Markets Authority, Reserve Bank of New Zealand, the Treasury and the Department of Prime Minister and Cabinet have been consulted on this paper.
- 32 Targeted consultation with banks will be undertaken in relation to AT1 disclosure requirements after the regulations have been drafted and prior to Cabinet Legislation Committee consideration.

### Communications

- 33 The Ministry of Business, Innovation and Employment, together with the Financial Markets Authority and the Reserve Bank of New Zealand will communicate these decisions to retail banks and other affected providers as necessary.

## Proactive Release

- 34 The Ministry of Business, Innovation and Employment will publish this paper, subject to redactions, on its website within 30 business days of decisions being confirmed by Cabinet.

## Recommendations

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

### *Disclosure requirement for AT1 instruments*

- 1 **note** that the Reserve Bank of New Zealand will require banks to have higher capital ratios to make banks safer and reduce risks associated with banking failures from 1 July 2022;
- 2 **note** that as part of raising the requisite capital required to be held from 1 July 2022, the Reserve Bank of New Zealand will allow banks to issue Additional Tier 1 instruments known as Perpetual Preference Shares from 1 October 2021;
- 3 **agree** that the disclosure requirements in the Financial Markets Conduct Regulations 2014 be amended to prescribe tailored requirements for the Additional Tier 1 instruments known as Perpetual Preference Shares;
- 4 **note** that the content of the disclosure requirements will be finalised by the Ministry of Business, Innovation and Employment and the Financial Markets Authority, along with the Parliamentary Counsel Office, having regard to the purpose of the Financial Markets Conduct Act 2013 and the existing disclosure requirements in the Financial Markets Conduct Regulations 2014;

### *Order in Council*

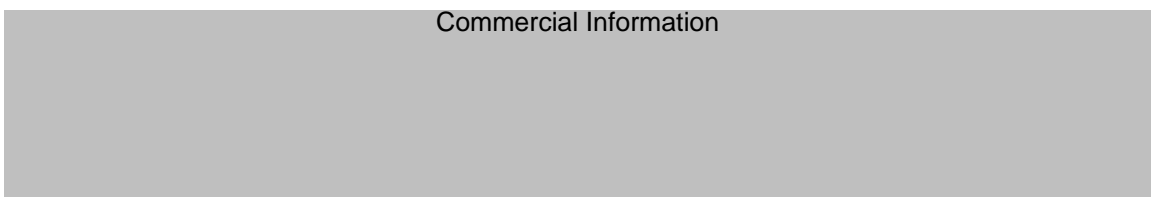
- 5 **agree** that an Order in Council be made for the purpose of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 setting 16 December 2021 as the deadline for registration by overseas-based providers newly subject to that Act;

### *Registration exemption for DriveWealth*

- 6 **agree** that DriveWealth be exempt from the Financial Service Providers (Registration and Dispute Resolution) Act 2008 in relation to the Hatch service provided in partnership with Kiwi Wealth, subject to the conditions as indicated in Appendix 1 which effectively require Kiwi Wealth to step into DriveWealth's shoes in relation to compliance with that Act;

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**IN CONFIDENCE**

- 8 **authorise** the Minister of Commerce and Consumer Affairs to make final decisions in relation to the conditions and scope of the exemption referred to in recommendation 6-7;

*General*

- 9 **invite** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to give effect to recommendations 3-7.
- 10 **agree** to the Ministry of Business, Innovation and Employment undertaking targeted consultation on the draft regulations;
- 11 **authorise** the Minister of Commerce and Consumer Affairs to make decisions consistent with these proposals on any technical issues which may arise during the drafting process.

Authorised for lodgement

Hon Dr David Clark

Minister of Commerce and Consumer Affairs



## Appendix 1: Conditions of proposed exemption for DriveWealth

The following sets out an indication of the conditions for the proposed exemption for DriveWealth:

DriveWealth is exempt from registration on the Financial Service Providers Register (FSFR) and dispute resolution scheme (DRS) requirements in relation to services provided in New Zealand through the Hatch platform (the Services), provided that

- a. Kiwi Wealth or its parent is subject to regulation as a provider of a licensed service.
- b. DriveWealth is subject to US regulations and monitored by a US regulator in relation to the Services.
- c. Kiwi Wealth operates a complaints process and provides access to its DRS in relation to the Services.
- d. Kiwi Wealth would comply with the DRS's findings in relation to the Service, including the parts of the Service provided by DriveWealth. This would include paying any compensation ordered by the DRS.
- e. Kiwi Wealth notifies all consumer clients about the dispute resolution arrangements.
- f. Kiwi Wealth informs the Financial Markets Authority (FMA) and MBIE if any of DriveWealth's directors, senior managers or controlling owners would be disqualified from holding those positions in respect of a registered financial service provider in New Zealand (e.g. because they were an undischarged bankrupt).
- g. Kiwi Wealth informs the FMA and MBIE if there are changes to the services DriveWealth provides in respect of Hatch or changes in ownership in relation to Hatch.
- h. Kiwi Wealth agrees to co-operate with the FMA in relation to monitoring DriveWealth's compliance with relevant laws, including by, for example providing the FMA with an address for notices for DriveWealth.