



COVERSHEET

Minister	Hon Dr David Clark	Portfolio	Commerce and Consumer Affairs
Title of Cabinet paper	Release of discussion document: 2021 Review of Financial Markets Authority funding and levy	Date to be published	Before 15 November 2021

List of documents that have been proactively released

Date	Title	Author
September 2021	Release of discussion document: 2021 Review of Financial Markets Authority funding and levy	<i>Office of the Minister of Commerce and Consumer Affairs</i>
29 September 2021	<i>DEV-21-MIN-0196</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 Economic Development Committee

Release of discussion document: 2021 Review of Financial Markets Authority Funding and Levy

Proposal

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

Relation to government priorities

- 2 The release of a discussion document is a routine process that requires Cabinet approval. The Climate-related Disclosures regime relates to the government's objective to lay the foundations for a better future, in particular tackling climate change as referenced in the speech from the throne.

Executive summary

- 3 The FMA is New Zealand's principal conduct regulator of financial markets. As a result of the three new legislative regimes below, the FMA's monitoring remit will expand significantly and it will be responsible for monitoring and enforcing compliance with these regimes:
 - 3.1. **Conduct of Financial Institutions (CoFI) Regime:** This regime will require all prudentially regulated banks, insurers and non-bank deposit takers (NBDTs) that provide products and services to consumers to obtain a new conduct licence from the FMA. It will also require these institutions to have effective conduct programmes across their businesses to ensure they treat consumers fairly.
 - 3.2. **Insurance Contract Law (ICL) Regime:** This regime will reform insurance contract law so that insurance better meets consumer and insurer expectations. This includes strengthening protections for consumers against unfair terms in insurance contracts and measures to assist consumer understanding of insurance policies.
 - 3.3. **Climate-related Disclosures (CRD) Regime:** This regime will make climate-related disclosures mandatory for large reporting entities under the Financial Markets Conduct Act 2013 (FMC Act). The Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill (CRD Bill) applies to large registered banks, licensed insurers, credit unions, listed issuers of quoted equity securities or quoted debt securities and managers of registered schemes, in each case that meets a certain size requirement, so as to exclude smaller entities. The FMA requires additional funding from 2022/2023 to monitor and enforce compliance with these regimes.

- 4 The Financial Markets Authority Act 2011 (FMA Act) requires the FMA to consult with levy payers about any increase in its appropriation that relate to costs that are intended to be recovered by way of levies. Accordingly, I am now seeking approval to publicly consult and receive feedback on the FMA's additional required funding and levy changes. The discussion document seeks feedback on:
- 4.1. two possible funding options for the FMA for each of the three regimes;
 - 4.2. how any increase in funding could be apportioned between the Crown and financial market levy payers; and
 - 4.3. changes to the levies paid by banks, insurers and NBDTs covered by the CoFI and ICL regimes, and also climate-reporting entities.
- 5 The discussion document also seeks feedback on the implementation of the CoFI regime including the proposed licensing window. This feedback will assist to ensure that both the FMA and financial institutions have enough time to prepare for the regime to take effect.
- 6 Submissions on the discussion document will be open for approximately five weeks during October 2021.

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- 8 I intend to seek approval from the Cabinet Economic Development Committee (DEV) for the corresponding changes needed to the FMA levy model in early 2022.

Background

- 9 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 market participants, providing oversight and monitoring of financial market participants, and carrying out enforcement action where required. It is also responsible for providing information and research to the public.
- 10 The FMA receives a combination of Crown and third-party funding. The latter is recovered in the form of levies on market participants, 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. For example, financial service providers benefit from increased confidence in financial markets, and all New Zealanders benefit from having high-performing and well-regulated financial markets. In 2022/2023, 83 per cent of the FMA's funding will come from industry levies.

2019 FMA baseline funding review

- 11 In 2019, the FMA's baseline funding was reviewed as a result of cost pressures arising from the FMA's expanding remit and the new financial advice regime. Following that review, the FMA's appropriation was increased by \$24.805 million over three years, to a total of \$60.805 million per annum by 2022/2023.
- 12 The 2019 FMA funding review allocated some funding for the FMA to begin preparation for the CoFI regime and to continue the follow-up work from the FMA/Reserve Bank of New Zealand (RBNZ) joint conduct and culture reviews of the

banking and life insurance sectors. However, this funding did not provide for the FMA to implement the CoFI regime.

13 At the time of the 2019 funding review, Pricewaterhouse Coopers (PwC) undertook an independent review of the FMA’s efficiency and effectiveness. PwC found that the FMA is a high-performing organisation with a good alignment between the activities performed by the FMA and its main statutory objective and that there are indicators that point to resources being used effectively.

14 The below table summarises the FMA’s current funding.

Funding	Forecast 2021/22 (\$000)	Forecast 2022/23 (\$000)
Crown funding	\$9,095	\$10,336
Levy funding	\$44,405	\$50,464
Litigation fund*	\$5,000	\$5,000
Fees and other revenue	\$499	\$499

*also provided by the Crown

The three new regulatory regimes

15 As result of three new legislative regimes, the FMA’s remit will expand significantly. The below tables summarise the regimes and the FMA’s expected role in each one.

CoFI regime

Purpose of regime	The CoFI Bill amends the FMC Act to ensure that all registered banks, licensed insurers and licensed NBDTs that provide relevant services and associated products to consumers comply with a principle of fair conduct to treat consumers fairly. The CoFI Bill will require these institutions to obtain a conduct licence from the FMA.
Who is affected	All prudentially registered banks, licensed insurers and licensed NBDTs that provide relevant services and associated products to consumers.
The FMA’s role	The FMA will be responsible for issuing conduct licences to the relevant institutions and for monitoring and enforcing these institutions’ compliance with the requirements of the regime.
Timing	The CoFI Bill is expected to be passed by Parliament mid-2022 with the regime expected to be fully in force from late 2024.

ICL regime

Purpose of regime	The purpose of the ICL Bill is to reform insurance contract law so that insurance better meets consumer and insurer expectations. This includes strengthening protections for consumers against unfair terms in insurance contracts and measures to assist consumer understanding of insurance policies.
Who is affected	Insurers and financial institutions involved in providing insurance policies.

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The FMA's role	The FMA will be responsible for monitoring and enforcing new requirements relating to the presentation of consumer insurance policies and will have shared responsibility with the Commerce Commission for enforcement in relation to unfair contract terms.
Timing	The ICL Bill is expected to be passed at the end of 2022 or early 2023.

CRD regime

Purpose of regime	To broaden non-financial reporting by requiring and supporting the making of climate-related disclosures by certain FMC reporting entities. Mandatory reporting of climate-related disclosures is part of New Zealand's efforts to help its international obligations and achieve its target of zero carbon by 2050. The regime is also intended to enable financial markets to more effectively price in climate change risks and opportunities and help contribute to the efficient operation of the markets.
Who is affected	Large registered banks, licensed insurers, credit unions, building societies, listed issuers of quoted equity securities or quoted debt securities, and managers of registered schemes, as defined in the CRD Bill.
The FMA's role	The FMA will monitor, enforce and report on climate related disclosures to ensure the relevant entities comply with CRD requirements.
Timing	The CRD Bill is expected to be passed by December 2021 with climate reporting to commence January 2023.

- 16 The FMA's funding from 2022/2023 onwards is insufficient to enable it to meet its new legislative mandate under the three new regimes. The FMA has used its internal resources to begin preparatory work for the CoFI regime and its current large work programmes, such as the new financial advice regime, are not anticipated to slow in the next few years.
- 17 Without additional funding for these regimes, the FMA would be required to divert resources from other areas, which would create a risk of regulatory failure and may lead to a loss of stakeholder and public confidence in both the FMA and financial services more generally.
- 18 In 2019, Cabinet noted the FMA would likely require additional funding for the CoFI and ICL regimes, and that the Minister would come back to Cabinet to seek decisions on funding at a later stage once the costs of the new regime were clearer [DEV-19-MIN-0237 refers; Paper accompanying DEV-19-MIN-0311 refers].
- 19 In 2020, Cabinet noted that a Budget bid would be made in 2021 for ongoing funding for both the External Reporting Board (XRB) and the FMA to implement decisions on the CRD regime [DEV-20-MIN-0151 refers]. The XRB received \$17.292 million over four years through Budget 2021 to perform core functions and to deliver climate reporting. The FMA has waited to seek funding for this regime in parallel with CoFI and ICL.
- 20 The Ministry of Business, Innovation and Employment (MBIE) and the FMA have reviewed the FMA's additional funding requirements for these three regimes. As part of this review, MBIE commissioned Deloitte to conduct an independent assessment of the FMA's funding options and underlying costings for each of the three regimes.

The discussion document seeks feedback on which funding option is most appropriate for each regime and feedback on the proposed changes to FMA levies.

- 21 MBIE is interested in hearing stakeholder views on these options before developing a view on a preferred option for any of the regimes.

Requirement to consult with levy payers

- 22 Under section 69 of the FMA Act, the FMA is required to consult with levy payers about any increase in its appropriation that relates to costs that are intended to be recovered by way of levies.

Seeking feedback on funding options

- 23 The attached discussion document sets out two possible funding options for each of the three regimes. These options reflect two different regulatory approaches, both of which would deliver on the legislative intent of the regimes. I consider that it would be unreasonable to expect the FMA to accommodate three new regimes without additional funding.
- 24 Under Option 1 for each regime, the FMA would take a more proactive approach. In particular, this approach would provide the FMA with resource to license entities, detect and enforce misconduct, with more capacity to engage with industry and provide guidance.
- 25 Under Option 2 for each regime, the FMA would take a more reactive approach, and focus its resources on responding to misconduct and enforcement of the regimes with less capacity for proactive engagement with industry and consumers.
- 26 The table below provides a summary of the proposed additional funding over four years for Options 1 and 2 under each of the new regimes. The funding options would provide the FMA with sufficient resources to build and operate each regime, based on the current expected implementation timing.

(\$000)	2022/23	2023/24	2024/25	2025/26 & out years	Four-year Total
CoFI Option 1	\$6,847	\$8,432	\$11,538	\$15,243	\$42,060
CoFI Option 2	\$5,640	\$5,808	\$8,062	\$9,945	\$29,455
ICL Option 1	\$723	\$1,262	\$1,432	\$1,703	\$5,120
ICL Option 2	\$408	\$679	\$865	\$1,141	\$3,093
CRD Option 1	\$1,790	\$2,105	\$1,856	\$1,856	\$7,607
CRD Option 2	\$1,307	\$1,657	\$1,411	\$1,411	\$5,786

Split between Crown and third-party funding

- 27 The discussion document seeks feedback on how any increase in funding could be apportioned between the Crown and financial market levy payers.

Changes to the FMA levy

- 28 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.

- 29 All financial service providers currently pay a FMA levy of \$575 (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 different financial services. Some classes are split into different tiers which reflect the relative size of different providers.
- 30 I am seeking feedback through this discussion document on changes to the FMA levy. These changes:
- 30.1. increase the current levy and create new levy classes for entities who will be targeted by the CoFI and ICL regimes; and
 - 30.2. create a new levy class for those entities subject to the CRD regime.
- 31 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 by levy payers. This approach has been taken in order to consult on the total amount of levies that would be payable under each option in the event that the Crown does not contribute any additional funding towards the FMA.

Timing of any changes to the FMA levy

- 32 It is intended that the FMA receives additional funding and the changes to the levies will come into force from 1 July 2022. The increase in funding will be phased, recognising that it will take time for the FMA to carry out the recruitment necessary to build up its operations, and recognising the FMA's changing focus as the new regimes are developed and then implemented.

Seeking feedback on implementation of the CoFI Bill

- 33 The discussion document also seeks feedback on the approach to implementation of the CoFI regime, including the proposed licensing window. Licensing is a central aspect of the framework of the new regime and the requirement to obtain a licence provides an initial quality control 'gateway' for sector applicants to pass through. MBIE intends to consult on licensing fees for the CoFI regime next year.
- 34 MBIE proposes a period of 18 months (July 2023 – December 2024) for the relevant financial institutions to obtain a conduct licence from the FMA before the regime comes into force. This is intended to allow sufficient time:
- 34.1. for institutions to ensure their business processes will meet the requirements of the new regime, and to ensure incentives arrangements comply with incentives regulations; and
 - 34.2. for the FMA to carry out necessary recruitment, build licensing processes, develop guidance pre-licensing, then assess licence applications during the licensing window.
- 35 This timing also avoids overlap with the licensing period for the new financial advice regime, which many CoFI institutions will also need to comply with. Having overlapping licensing processes may increase regulatory burden for financial institutions and the FMA. Feedback is sought on whether an 18-month licensing window will be adequate. As a comparison, financial advice providers have a two year transitional period to obtain a full licence.

- 36 The CoFI Bill provides flexibility for the regime to be implemented in alternative ways. For example, the licensing obligation could be delayed for certain types of financial institutions, permitting them to obtain a licence at a later date after the main licensing window closes. Feedback is sought on whether an alternative proposal to implementation of the regime would be preferable to the proposed approach.

Next steps

- 37 I intend to return to Cabinet in early 2022 to seek final funding decisions for each of the regimes, and changes to the FMA levy. These final policy proposals will reflect feedback received through consultation and any changes to the Bills as they progress through the parliamentary process.

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Consultation

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

Financial implications

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

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Legislative implications

- 42 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

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

Quality of the impact analysis

- 44 The Regulatory Impact Analysis panel at MBIE has reviewed and confirmed that the discussion document can substitute for an interim Regulatory Impact Statement. It will lead to effective consultation and support the eventual development of a quality Regulatory Impact Statement.

Human rights

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

Gender implications

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

Disability perspective

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

Publicity

48 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.

49 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 more consumers are now also aware of the FMA and the role it plays in ensuring well-regulated financial markets.

50 There may be some adverse reaction to the funding options from the financial markets participants who will see an increase in the levies they pay. The funding options would represent a significant increase in the FMA's appropriation, not long after the FMA received a \$24.805 million increase in 2020.

51 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 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.

Proactive Release

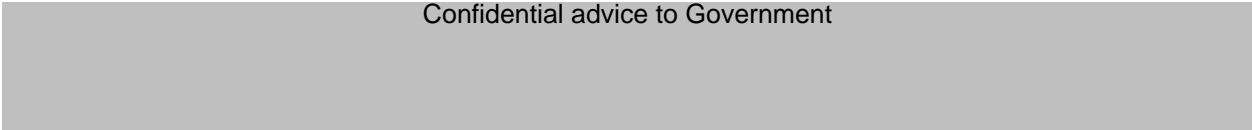
52 This paper will be published on MBIE's website within 30 working days, subject to redactions as appropriate and consistent with the Official Information Act 1982.

Recommendations

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

- 1 **note** that the Financial Markets Authority's remit is expanding and it will be responsible for monitoring and enforcing compliance with three new regulatory regimes, being:
 - 1.1 the conduct of financial institutions under the Financial Markets (Conduct of Institutions) Amendment Bill;
 - 1.2 the reform of insurance contract legislation under the Insurance Contract Law regime;
 - 1.3 a framework for climate-related disclosures under the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill;

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- 2 **note** that the Financial Markets Authority requires additional funding from 2022/2023 to monitor and enforce compliance with the above regimes;
- 3 **note** that the discussion document '2021 Review of Financial Markets Authority Funding and Levy' outlines and seeks feedback on the Financial Market Authority's additional funding requirements, adjustments to the Financial Markets Authority levy and implementation of the Conduct of Financial Institutions regime;
- 4 **agree** to release the discussion document '2021 Review of Financial Markets Authority Funding and Levy' attached to this paper for public consultation;
- 5 **authorise** the Minister of Commerce and Consumer Affairs to make minor and technical changes to the discussion document that may be required;
- 6  Confidential advice to Government
- 7 **invite** the Minister of Commerce and Consumer Affairs to report back to the Cabinet Economic Development Committee in early 2022 to seek approval for proposed policy changes to the FMA levy model.

Authorised for lodgement

Hon Dr David Clark

Minister of Commerce and Consumer Affairs