

New Zealand Council of Financial Regulators

Regulatory Charter

Financial markets regulatory system

Context: regulatory charters

Why have a Regulatory Charter?

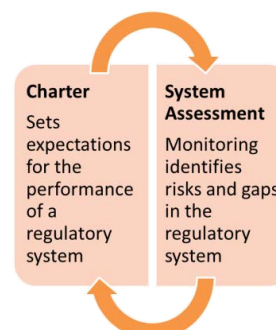
Promoting good regulatory stewardship is a key element of the Government's regulatory approach, with government entities monitoring the performance and maintaining the quality of the regulatory systems they oversee.

What is in a Regulatory Charter?

This Regulatory Charter:

- sets clear expectations for what the regulatory system is intended to achieve;
- outlines the key principles underlying the design of the regulatory system; and
- describes the respective roles and functions of agencies in various parts of the regulatory system.

Figure 1 Charters and System Assessments complement each other



Objective of the Financial Markets Regulatory Charter

The objective of the Financial Markets Regulatory Charter is to promote active management of the financial markets regulatory system. The Charter is a management tool that is designed to support a living regulatory system¹, by recording how the system is intended to perform, reinforcing shared ownership for the system among those core government entities with policy and regulatory functions, and assisting them to quickly identify and address risks and gaps in a timely and appropriate manner.

Core agencies are committed to working collaboratively and collectively across their respective roles and functions, including at the most senior level through the Council of Financial Regulators, to support continuous monitoring and improvement and to ensure that the financial system continues to support higher living standards for New Zealanders.

Charter ownership

This Charter has been developed jointly between the core agencies in the financial markets regulatory system (the Ministry of Business, Innovation and Employment (MBIE), the Financial Markets Authority (FMA), the Reserve Bank of New Zealand (RBNZ) and the Treasury). Ownership for the Charter sits with the Council of Financial Regulators, which represents these core agencies.

Other agencies have roles and functions in the system but these agencies are not parties to the Charter or owners of it.

Charter review and management

Responsibility for maintaining and reviewing this Charter document sits with MBIE.

Review of this document should occur at least every five years. A Charter review should include assessments of:

- Whether system objectives, policy or context have changed over time
- Whether the Charter document should be updated to reflect these changes
- Whether, as a result of system assessments, progress has been made in addressing identified risks and closing gaps.

¹ A living system is one which is continuously monitored and improved, rather than set and forgotten. A living system incorporates mechanisms to enable the regulators in the system to identify, assess and evaluate the system and make adjustments where appropriate to meet evolving opportunities and risks. In a living system, the system's owners have shared expectations of how the system is supposed to perform and can assess how that system is performing against those expectations.

Table of contents

1. Background: regulating the financial system	4
1.1 <i>The financial system</i>	4
1.2 <i>Why is the financial system important?</i>	4
1.3 <i>Why regulate the financial system?</i>	5
2. Scope and objectives of the financial markets regulatory system	6
2.1 <i>Scope of the system</i>	6
2.2 <i>The objective of the system</i>	6
3. Approach to New Zealand’s regulation of financial markets	7
3.1 <i>Twin peaks model: separate prudential and conduct regulators</i>	7
3.2 <i>Core agencies working together</i>	7
3.3 <i>Financial markets legislation</i>	9
3.4 <i>Principles</i>	11
4. Agency roles and responsibilities	16

1. Background: regulating the financial system

1.1 The financial system

The financial system comprises the institutions and markets involved in the transmission of financial assets (including money and financial products) between economic agents. In New Zealand, among others, the sector includes:

- banks and non-bank deposit takers
- insurers and reinsurers
- fund managers and managed investment schemes
- financial advisers
- entities involved in the creation of financial instruments (e.g. investment banks)
- frontline supervisors (such as trustees and supervisors) and custodians
- payments and settlement systems
- capital markets (debt and equity)
- foreign exchange markets
- money markets, and
- derivative markets.

1.2 Why is the financial system important?

Collectively the system participants listed above facilitate a number of valuable services in the economy, including:

- Intermediation between market participants.
- The transfer of capital to productive uses in the real economy.
- The management of wealth, including by providing financial assets and facilitating changes of ownership of financial assets.
- The management and diversification of risk, including through insurance and derivative markets.
- The management and transmission of liquidity, from retail payments through to large scale treasury operations.

These functions play an important role in supporting the performance of the New Zealand economy. For households, the financial system provides efficient ways to make transactions, invest wealth, manage financial risks, and borrow to make purchases that can be funded through future income (such as housing). For businesses, the financial system provides efficient ways to access capital to invest, manage cash flows, measure performance, and manage financial risks.

The financial system also provides similar valuable functions for government. Furthermore, the financial system plays a crucial role in linking New Zealand to international capital markets, facilitating trade and investment flows with the rest of the world. Collectively, this helps support increased economic growth and wealth accumulation, reduced financial risk in the economy, and ultimately higher living standards for New Zealanders.

1.3 Why regulate the financial system?

There are imperfections in the financial system that mean that, left alone, the system will not result in socially optimal outcomes. Three key imperfections that the regulation of financial markets aims to overcome are **externalities**, **asymmetric information** and **agency problems**.

The actions of financial system participants can have significant costs and benefits that are felt much more widely than those directly involved in the system. These costs and benefits are known as **externalities**. For example:

- Risk-taking in the financial system can result in material costs that are felt by other parties (well beyond the parties who are taking risks). For example, it can impact on household wealth, the cost and availability of capital for business, and the taxpayer (either through supporting individual institutions or dealing with the wider economic fallout of a failure). The fact that individual financial institutions do not bear all of these costs can mean they lack the incentives to manage the risk of them occurring.
- A stable and efficient financial system brings significant benefits to all New Zealanders beyond those directly participating in the system. As a result, certain services may not be provided in unregulated markets to the extent that would be socially optimal. This kind of externality is known as a 'public good'.

Aspects of the financial system are also prone to **information asymmetries**. The providers of financial services or products often have superior information to individual customers and investors. If left unregulated, such information asymmetries could allow providers to extract excessive profits and detract from the efficiency, stability, and trust in certain markets. Relevant and understandable information gives consumers the opportunity to assess risk and return. In extreme situations, lack of information can also have an adverse effect on the willingness of market participants to transact with each other, and market liquidity more broadly. As such, there is also an important role for regulation in reducing information asymmetries.

The complexity of the financial system and of relationships in the system also creates problems of motivating one party (the agent) to act in a way that is the best interests of the other party (the principal). This is known as an **agency problem** and occurs when incentives between two parties are not aligned and the agent inappropriately prioritises their own interests over those of the principal. For example, a financial adviser could suggest that a client invest in a product where the adviser earns a commission rather than a product that most suits that client's circumstances.

The degree of regulatory influence varies across the system. However, to some degree, regulation affects all parts of the system, either directly or indirectly.

2. Scope and objectives of the financial markets regulatory system

2.1 Scope of the system

The **financial markets regulatory system** consists of any legislation, entity, activity or policy objective² that is used to prescribe rules or influence conduct, calibrate incentives or change preferences³ in relation to financial products, financial market conduct or financial services, or the soundness and efficiency of the financial system.⁴

The financial markets system incorporates numerous regulations and activities. The boundary with other regulatory systems is not always clear. To clarify some particular boundary uncertainties, for the purposes of this Charter, the regulatory system:

- **includes** legislation, entities, activities and policies for the registration or licensing and prudential regulation of banks, non-bank deposit-takers⁵ and insurers. It also includes macroprudential policy, payment and settlement systems and policies to prevent money laundering and terrorism finance (AML/CFT) as they relate to financial market participants.
- **excludes** regulation for the control of money, credit contracts and any aspects of regulation for taxation, banking, insurance and that are not related to financial market conduct, financial market services or other prudential matters. It also excludes financial reporting regulation for entities other than Financial Markets Conduct Act reporting entities.

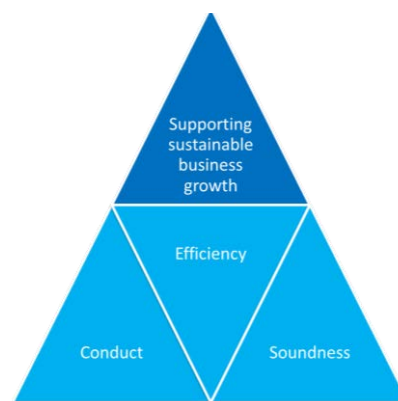
2.2 The objective of the system

The Government aims to have well-functioning financial markets which support sustainable business growth and job creation.

To this end, our financial markets regulatory system focuses on these three elements:

- **conduct:** financial markets are fair, efficient and transparent, and businesses, investors and consumers are confident and informed participants.
- **soundness:** individual financial institutions and the financial system as a whole are resilient, so as to minimise any disruption to economic activity.
- **efficiency:** effective and reliable services (including those provided by regulators and policy makers) are provided to participants in financial markets in way that allocates resources to productive activities, minimises compliance costs and encourages positive innovation.

Figure 2: Objectives for the financial markets regulatory system



² The Treasury, Best Practice Regulation: Principles and Assessments (February 2015). (Online) <http://www.treasury.govt.nz/regulation/bpr>

³ Orbach, B. (2012) What Is Regulation? 30 Yale Journal on Regulation Online 1.

⁴ AML is included because external parties who comply with the regulatory requirements would see AML rules as being part of the financial system rather than (say) part of criminal law enforcement or overseas investment regimes.

⁵ A non-bank deposit taker is defined as a person, other than a registered bank, that makes a regulated offer of debt securities within the meaning of the FMC Act, and is in the business of borrowing and lending money, or providing financial services, or both. The NBDT sector comprises finance companies and savings institutions (which include building societies and credit unions).

3. Approach to New Zealand’s regulation of financial markets

3.1 Twin peaks model: separate prudential and conduct regulators

The financial markets regulatory regime is based on the twin peaks model of financial regulation. Under this model, market conduct and prudential regulation are administered by independent bodies.

The Government decided that a two agency structure reflects the different functions, skills, tasks and infrastructure required for each institution, and ensures a clear mandate for both areas of regulation.

Market conduct regulation is about ensuring consumers are adequately informed and that market participants act with integrity, with a focus on product disclosure and the behaviour of financial services providers. By contrast, **prudential regulation** is about institutional soundness, and promoting the maintenance of a sound and efficient financial system.

Both are aimed at being preventative and respectively providing appropriate incentives for institutions to manage market conduct and prudential risks. These are also backed up by investigation and enforcement powers and functions.

The market conduct regulator of capital markets and financial services is the FMA (along with frontline supervisors). Establishment of this model is largely a result of substantial reform of New Zealand’s financial markets laws from 2011 to 2014, which resulted in a simpler system with more streamlined legislation (including the Financial Markets Conduct Act 2013 (“FMC Act”)) and greater clarity around regulatory entities, activities and outcomes.⁶ Information on the development of the Financial Markets Conduct Act can be found at <http://www.mbie.govt.nz/info-services/business/business-law/financial-markets-conduct-act>.

A central principle of the conduct pillar is ensuring on-going high standards of professional conduct and boardroom governance (in contrast with a system that relies only on periodic disclosure and enforcement for breaches of the law).

RBNZ is the prudential regulator of the banking, insurance and non-bank deposit taker sectors, sets prudential standards and oversees compliance with these standards.⁷ The mandate of RBNZ is found in the Reserve Bank of New Zealand Act 1989, the Insurance (Prudential Supervision) Act 2010, and the Non-bank Deposit Takers Act 2013. It involves the regulation of banks, insurers, NBDTs, payment systems and (jointly with the FMA) settlement systems with the aim of ensuring they are operated in a prudent manner which promotes the maintenance of a sound and efficient financial system.

3.2 Core agencies working together

The Council of Financial Regulators (CoFR) fosters high-level cooperation and information-sharing between the FMA, RBNZ, the Treasury and MBIE. It is a forum to consider and address any financial markets regulatory issues, risks or gaps that arise or are being monitored. This ensures a whole of government approach to manage regulatory risks.⁸ CoFR’s risk register also helps CoFR and core agencies to prioritise and monitor action on prudential, conduct and regulatory framework risks.

⁶ Before the introduction of the FMC Act in 2013 New Zealand’s securities law was mostly contained in the Securities Act 1978 (which regulated primary markets where new securities were issued to investors) and Securities Markets Act 1988 (which regulated secondary markets where existing securities were traded, and also derivatives). A number of other pieces of legislation also regulated financial products and market participants resulting in a confusing array of rules and requirements.

⁷ Although in the case of NBDTs the frontline supervision of compliance with prudential standards is carried out by trustees.

⁸ See the terms of reference for the Council of Financial Regulators at

http://www.rbnz.govt.nz/regulation_and_supervision/banks/relationships/4525791.html

Below CoFR, each core agency has day-to-day responsibility for the system (see chapter four), which involves:

- monitoring and undertaking reviews of parts of the regulatory system the individual agency has responsibility for;
- working collaboratively and collectively with other core agencies; and
- providing updates to CoFR on issues, risks or gaps.

The financial markets system currently includes the following processes for review:

Process	Comment
Programmed legislative reviews and evaluations	<p>Discrete pieces of legislation within the financial markets regulatory system are subject to reviews and evaluations. For example:</p> <ul style="list-style-type: none"> • Following the passing of the FMC Act, MBIE began a five year evaluation of its effectiveness. The purpose of the evaluation is to assess whether a number of short and medium term policy outcomes of the FMC Act have been achieved. • MBIE must report on the operation of the Financial Advisers Act 2008, and any recommendations for change, within five years of its commencement (by July 2016). • The Non-bank Deposit Takers regime was reviewed in 2013, 5 years after the passing of the legislation establishing this regime. • The Insurance (Prudential Supervision) Act 2010 is due to be reviewed within 5 years of it coming into force.
Monitoring performance against Statements of Intent	<p>The FMA and the RBNZ are required to prepare Statements of Intent (under the Crown Entities Act 2003 and Reserve Bank of New Zealand Act 1989, respectively). The purpose of a Statement of Intent is to promote transparent accountability. A Statement of Intent has to include the specific impacts, outcomes, or objectives that the entity seeks to achieve or contribute to and, if the entity is directed have regard to government policies, how this has been achieved.</p>
Annual Reports and Statements of Performance Expectations	<p>As a Crown entity, the FMA is required to report (in an Annual Report) on its performance against expectations (set out in the Statement of Performance Expectations).</p> <p>The RBNZ is required to prepare an annual report containing, amongst other things, a report on the operation of the Bank during the financial year, and an assessment against the intentions, measures and standards set out in the statement of intent prepared at the beginning of the financial year.</p>
Financial Sector Assessment Program (carried out by IMF)	<p>This programme was established in 1999 and is a comprehensive and in-depth analysis of a country's financial sector. New Zealand will undergo the FSAP review in 2016. More information about the indicators used in an FSAP review can be found at www.data.imf.org</p>
Financial Stability report and Reserve Bank Bulletin	<p>The RBNZ must prepare, at least twice yearly, a financial stability report. This report must be presented to the Minister of Finance, tabled in Parliament, and published on the RBNZ's website. It must contain a report on the soundness and efficiency of the financial system, and contain information necessary for making an assessment of the RBNZ's activities to achieve its prudential purposes. The RBNZ also publishes an online bulletin of articles relating to central bank issues (including prudential regulation).</p>

In addition to monitoring risks and gaps, good regulatory stewardship involves reviewing the Financial Markets regulatory system from time-to-time to ensure that it is meeting the objectives of the system, and if different objectives are needed.

3.3 Financial markets legislation

This section outlines the legislative framework applying to New Zealand’s financial markets system. Figure 3 below sets out each of the Acts in the financial markets regulatory system (rows), and illustrates the different types of rules/requirements (columns) in each Act.

Figure 3 Legislation in the Financial Markets Regulatory System

	Fair dealing of financial products and services	Dealing in financial products on markets	Financial reporting for FMC reporting entities	Disclosure*	Providing market services	Registration of market participants	Licensing of market services, banks, NBDTs and insurers	Governance and supervision of financial products or market participants	Enforcement, liability and redress	Prudential regulation of banks, NBDTs and insurers (including macroprudential policy)	Payment and settlement systems
Financial Markets Conduct Act 2013											
Reserve Bank Act 1989, Part 5 and 5C Non-bank Deposit Takers Act 2013 Insurance (Prudential Supervision) Act 2010											
KiwiSaver Act 2006											
Financial Markets Supervisors Act 2011											
Financial Advisers Act 2008											
Financial Markets Authority Act 2011											
Financial Service Providers (Registration and Dispute Resolution) Act 2008											
Takeovers Act 1993											
Anti-Money Laundering and Countering Financing of Terrorism Act 2009											
Financial Reporting Act 2013											
Other rules that influence the system but are outside the scope of this Charter	Tax rules, financial reporting rules for non-FMC reporting entities; OCR rules; rules for bank payment systems; settlement system rules; Crimes Act; Commerce Act (Part 2); Companies Act; Overseas Investment rules; Contract Law; Industry-specific investment rules (such as cooperative rules); Rules and policies underpinning the Government as market participant (issuing bonds, Kiwisaver, student loans, large entity borrowing, acting as guarantor); Rules setting out requirements for approval of ratings agencies.										

Primary source

Secondary source

*this includes disclosure for offers of financial products, and bank or insurer disclosure for prudential purposes.

The table below provides a high-level overview of each of the different requirements as set out in Figure 3 above.

Key areas of regulation	Purpose
Fair dealing of financial products and financial services	The FMC Act provides for minimum standards of behaviour in relation to financial products and financial services. It prohibits misleading or deceptive conduct, the making of false, misleading or unsubstantiated representations, and making offers of financial products at unsolicited meetings. These fair dealing obligations extend to all parties dealing in financial products or providing financial services (including banks, non-bank deposit takers, and both wholesale and retail markets, but excluding providers of credit contracts).
Dealing in financial products on markets	The FMC Act provides rules for the fair, orderly and transparent dealing of financial products on markets. It also provides for diverse financial product markets that take into account the different needs and objectives of issuers and investors, with the ability for market-specific rules to be proportional to the nature, size, and risks of the market.

Key areas of regulation	Purpose
Financial reporting requirements for FMC reporting entities	Providers of regulated financial products and services, and prudentially regulated entities (collectively known as FMC reporting entities) must keep proper accounting records, prepare financial statements that comply with generally accepted accounting practice, and have them audited by a licensed auditor. The collation and publication of standardised accounting records help investors and others in the market understand the financial fundamentals of the entity and impose discipline on those in governance of the entity to monitor its performance.
Disclosure requirements	Disclosure seeks to mitigate against the fact that firms looking to issue financial products, and prudentially regulated firms, have much more information about the firm's financial position and prospects than potential investors. Disclosure requirements aim to ensure information is investor focused to allow consumers to make informed and confident judgements about the risks and returns from investment decisions, and to incentivise the prudent management of prudentially regulated firms.
Registration of market participants	Those who are in the business of providing a financial service are required to be registered on the Financial Service Providers Register. There are also registration requirements for markets and settlement systems. Registration enables the public to access information about financial service providers, prevent certain people from providing financial services in New Zealand, and assists regulators with the regulation of the financial system. Registration is not equivalent to licensing, and does not in and of itself impose supervisory regulation. ⁹
Licensing of market services, financial advisers, banks, NBDTs and insurers	Licensing is used as a means to: 1) ensure market participants have the capability and capacity to provide the services they seek to provide and/or carry on business in a prudent manner; and 2) form the basis of the regulator's ongoing supervisory relationship with these firms.
Governance and supervision of financial products or market participants	Financial product governance and supervision aim to mitigate the harm of financial loss to investors caused by product provider mismanagement, inadequate supervisor oversight, or inadequate processes and tools for holding providers and supervisors to account.

⁹ While banks are formally registered rather than licensed under the Reserve Bank of New Zealand Act 1989, it results in banks being subject to regulatory and supervisory requirements as though they are being licensed. We accordingly treat the registration regime for banks as a licensing regime for the purposes of this document.

Key areas of regulation	Purpose
Enforcement, liability and redress	Specific civil and/or criminal liabilities apply beyond the remedies available in general law. Enforcement action aims to hold to account those who breach their legal obligations and deter others from doing the same. All financial service providers who provide services to retail customers must also belong to a dispute resolution scheme, with the aim of promoting confidence in financial markets through improving consumers' access to redress from providers.
Prudential regulation of banks, non-bank deposit-takers and insurers	Prudential regulation aims to promote the maintenance of a sound and efficient financial system (or insurance sector) ¹⁰ by ensuring that systemically important entities (or entities in systemically important sectors) are financially sound and carry on their business in a prudent manner.
Payment and settlement systems	Payment and settlement systems are overseen with the objective of promoting the maintenance of a sound and efficient financial system. Settlement systems are also overseen (jointly with the FMA) for the purposes of ensuring they met the standards necessary for settlement finality protections to apply to transactions settled on those systems.
Macroprudential policy	Macroprudential policy aims to promote greater financial system stability through the financial cycle by: 1) building additional resilience in the financial system during periods of rapid credit growth and rising leverage or abundant liquidity; and 2) dampening excessive growth in credit and asset prices.

3.4 Principles

This section describes the high level principles that underpin the design and operation of the financial markets regulatory system.

In the table on the next page, the left hand column below describes the general intent of each principle.¹¹ The right hand column explains how each of these principles has been given effect to in the financial markets regulatory system, with some illustrative examples where relevant.

¹⁰ The meaning of "sound" in the phrase "a sound and efficient financial system" used in the Reserve Bank of New Zealand Act is about promoting resilience in individual financial institutions and in the financial system at large, so as to minimise any disruption to economic activity. See C. Bloor and C. Hunt, 'Understanding financial system efficiency in New Zealand', Reserve Bank of New Zealand: Bulletin, Vol. 74, No.2, June 2011.

¹¹ These principles are taken from the Treasury's principles for best practice regulation.

Principles	Description of the design or operational approach
<p>Growth compatible: economic objectives are given an appropriate weighting relative to other specified objectives, including other factors contributing to higher living standards</p>	<p>The financial markets system has, at its core, economic growth objectives. In particular, well-functioning financial markets directly contribute to economic growth and higher living standards. Trade-offs have been made in the design of the conduct and prudential pillars to ensure that promoting economic growth is given appropriate weighting vis a vis other factors (such as impact on consumers and investors, and soundness/sustainability).</p> <p>Examples of growth compatible regulatory features:</p> <ul style="list-style-type: none"> • The FMC Act introduced a new framework to allow easier forms of capital raising, where possible, based on characteristics of the issuer, investor or activity (such as crowdfunding, peer-to-peer lending, same-class exclusion, wholesale exclusion, etc.) • The objectives of the various prudential regimes relate to the soundness and efficiency of the financial system¹² (or in the case of insurance, insurance sector). A sound and efficient financial system is a fundamental underpinning of economic growth.
<p>Proportional: the burden of rules and their enforcement should be proportional to the benefits that are expected to result</p>	<p>The financial markets regulatory regime takes a graduated approach that the regulatory requirements are not overly burdensome relative to the problem identified. This recognises that the regulatory requirements on participants (such as prudential requirements, disclosure, governance, financial reporting, and licensing) can impose significant costs and stifle innovation. The FMA and RBNZ also focus their monitoring and enforcement activities with a view to ensuring that the costs of regulation are proportional to expected benefits to the regulator and participants.</p> <p>For example:</p> <ul style="list-style-type: none"> • The FMA and RBNZ use a risk-based monitoring and enforcement approach. In the FMA's case this means focusing its resources on participants or practices that present the greatest risk to well-functioning financial markets (e.g. by looking at the numbers and types of customers at risk and the size of potential losses). In the RBNZ's case this means focusing resources on those entities that are most likely to be systemic (i.e. whose failure would have the most significant impact on the financial system). • The FMC Act reduces compliance costs for capital raisers in areas where less investor protection is needed, such as for wholesale activities or investors which have fewer information asymmetries. • In some cases prudential requirements will only apply to entities with a certain level of systemic importance (for example, local incorporation and outsourcing requirements for banks). In other cases prudential requirements will not apply to certain entities due to the costs outweighing the benefits (for example, NBDTs under certain size thresholds are not required to have a credit rating). • To ensure regulatory responses are proportional, prudential and conduct regimes use a variety of tools to set or vary regulatory requirements. These include conditions of licence, exemptions and standards.

¹² The financial market system includes the insurance sector for the purposes of this document as per chapter 2.1.

Principles	Description of the design or operational approach
<p>Certain and predictable: regulated entities have certainty as to their legal obligations, and the regulatory regime provides predictability over time</p>	<p>The financial markets system sets clear rules/obligations in legislation and clear processes for complying with the rules. It uses a mixture of principles-based and prescriptive rules as appropriate. Regulators also have a range of powers and tools to clarify legal obligations.</p> <p>For example:</p> <ul style="list-style-type: none"> • FMA and RBNZ release commentary or guidance material designed to provide clarity and certainty about how principles based or prescriptive rules will be applied. • Guidance material is provided on the requirement for a NBDT to have a quantitative liquidity requirement that is, amongst other things, “appropriate to its business”. <p>Providing for increased certainty and predictability can run counter to the principle of flexibility and durability (see below). In order to strike an appropriate balance between the two principles, the regulatory system should set clear principles and processes that the regulators must follow in exercising their powers, tools or discretion.</p>
<p>Flexible and durable: regulated entities have scope to adopt least cost and innovative approaches to meeting legal obligations. The regulatory system has the capacity to evolve in response to changing circumstances</p>	<p>The financial markets regulatory regime has been specifically designed with a view to allowing the regime to adapt to unique situations or innovations that may emerge – such as new products or new ways of raising capital.</p> <p>For example:</p> <ul style="list-style-type: none"> • MBIE can develop regulations and the FMA can develop exemptions or designations that modify, reduce or impose obligations. • The RBNZ can recommend that regulations be made declaring entities in or out of the insurance and NBDT regimes, and prudential requirements can be tailored to the circumstances of particular entities through conditions of registration/licence, exemptions or standards.

Principles	Description of the design or operational approach
<p>Transparent and accountable: rules development, implementation and enforcement should be transparent</p>	<p>Legislation sets out processes and requirements that must be met in the development and enforcement of rules. For example:</p> <ul style="list-style-type: none"> • It is FMA’s and MBIE’s usual practice is to consult before any delegated legislation is made. Consultation requirements are contained in the legislation in relation to certain instruments while general principals of good regulatory practice apply to other instruments. FMA must publish a statement of reasons and before regulations are made, MBIE must publish any supporting regulatory impact statement. • The RBNZ must consult before making conditions of registration or licence, or making standards, or (in some circumstances) recommending that regulations be made. • The RBNZ is also required to assess the regulatory impacts of proposals (except those of a minor or technical nature) and publish these assessments. • FMA publicises its enforcement actions when required by law and in other cases where appropriate as good regulatory practice. • The RBNZ and FMA also publish guidance on aspects of their approach to registration/licensing and supervision. <p>As a matter of good practice, the FMA and RBNZ also strive to clearly communicate their goals and focus to industry participants, for example through speeches and ongoing dialogue. The aim is a no-surprises approach, whereby participants understand what the regulators expect from them on an ongoing basis.</p>
<p>Capable regulators: the regulator has the people and systems necessary to operate an efficient and effective regulatory regime</p>	<p>The FMA and RBNZ are subject to regular processes to ensure they have appropriate resources, capability and skills to achieve the objective of well-functioning financial markets. For example, through the Performance Improvement Framework reviews.</p> <p>On an ongoing basis, the regulators assess whether they have the right tools to deal with emerging issues.</p> <p>Aspects of compliance monitoring have been devolved to frontline supervisors (such as trustees). This recognises that those who are closer to the management of a business are sometimes best able to identify undesirable conduct and correct it.</p>

Principles	Description of the design or operational approach
<p>Understanding behavioural responses: regulatory requirements are designed with the likely behavioural responses of market participants in mind</p>	<p>Various requirements and regulatory settings in the financial markets system have been designed with the likely response of market participants in mind, to more effectively achieve the objectives of the regulatory system</p> <p>For example:</p> <ul style="list-style-type: none"> • Product disclosure statements under the FMC Act are designed to be useful for retail investors to compare products and for investors to understand the choices available. Disclosure focuses on essential information and risks for an informed investment decision, and for readily comparison of investments. Presentation or wording also needs to be “clear, concise and effective”. This recognises that investors cannot make informed decisions when information is excessively long and involves complex legal terminology. • The KiwiSaver regime aims to overcome consumer inertia by ‘nudging’ employees into a default KiwiSaver scheme (which they can then opt out of). <p>The prudential framework is designed in part to address the risk of moral hazard and any implication of an implied Crown guarantee. One of several ways it does this is through the Open Bank Resolution policy. The prudential framework also places significant weight on incentivising firms to operate in a prudent manner through market discipline (via the Disclosure Statement regime for registered banks) and self-discipline (for example, through director attestation requirements).</p>

4. Agency roles and responsibilities

Figure 4 below illustrates the key functions in the financial markets regulatory system. The arrows illustrate that it is a 'living' system.

There are numerous regulatory entities and activities involved in each function of the financial markets regime. The table (on the next page) depicts the regulatory system responsibilities (colour coded) of core agencies and key participants. No one agency has single ownership of the financial markets regulatory system. Rather, it is co-owned with agencies taking a lead role in parts of the regulatory system.

The system enables the core agencies to evaluate the regime and make adjustments where appropriate in response to opportunities and risks.

The Council of Financial Regulators is the key forum for agencies to co-ordinate the discussion of emerging issues and monitor known issues.

Figure 4: Regulatory system life-cycle



System strategy and policy	The Council of Financial Regulators ...	... provides a forum to review industry trends and issues and ensure coordination between the member agencies (RBNZ, FMA, MBIE and The Treasury). ¹³	RBNZ and FMA (jointly) ...	... set operational policies in relation to the designation of settlement systems.	Compliance and enforcement	FMA ...	... has primary responsibility for supervision of financial advisers, derivatives issuers, managers of MIS, crowd funding and peer-to-peer lending platforms, DIMS, independent trustees and supervisors, issuers of financial products with a view to promoting good conduct and taking remedial action where conduct is poor (this includes AML matters relating to brokers and custodians). The FMA has a range of regulatory tools it can use to address non-compliance. May refer breaches of the Code of Professional Conduct for Financial Advisers to the Financial Adviser Disciplinary Committee.	
	MBIE ...	... has policy functions in relation to financial markets legislation, excluding the functions held by Treasury, IRD and the RBNZ.		NZX and other licensed markets or platforms ...		... set operational policies in relation to market listing, the format of certain disclosures etc.	RBNZ ...	... has responsibility for monitoring compliance, with and enforcement of, prudential matters relating to banks, insurers and NBDTs ¹⁴ (and AML matters in relation to these entities), payment systems and (jointly with the FMA) prudential matters relating to settlement systems.
	The Treasury/ IRD ...	... have policy functions in relation to KiwiSaver (together with MBIE).		Designated settlement systems...		... sets operational policy for participants wishing to access and use each system.	NZX / other licensed markets, auditors ...	... are frontline compliance monitors, who operate under the conditions of their licence or rules and refer breaches of the rules to the NZ Markets Disciplinary Tribunal or the FMA.
	RBNZ ...	... has policy functions in relation to prudential regulation of banks, NBDTs, insurers, payment systems and (jointly with MBIE) settlement systems. Also has responsibility for macroprudential policy.	Advice, education and information	Commission for Financial Capability ...		... provides education about investing to members of the public, and has oversight of the Investor Capability Strategy, which is a multi-agency strategy for upskilling investors.	Supervisors and Trustees...	... monitor and promote conduct of market participants in compliance with regulatory requirements. Acts as frontline monitor of NBDTs' compliance with prudential requirements.
	Ministry of Justice...	... is the lead policy agency for AML matters.		FMA ...		... produces guidance and information for market participants, regulated entities and investors, and gathers market intelligence about local and global developments that may affect financial markets.	Commerce Commission, Serious Fraud Office/NZ Police, Takeovers Panel ...	... each play defined roles in compliance or enforcement, per statute, MOU or licensed market rules.
	Others ...	... (especially those with regulatory functions) are consulted during policy-making. This includes Trans-Tasman counterparts (ASIC and APRA) and international counterparts (IOSCO, Basel Committee and the Financial Stability Board).		RBNZ ...		... produces guidance for regulated entities about (amongst other things) how to apply for licenses (or registration in the case of banks) and how to comply with certain prudential requirements. Gathers market intelligence. Publishes the six monthly Financial Stability Report, and the Reserve Bank Bulletin.	Council of Financial Regulators ...	... ensures cross-agency awareness of financial system risks, prudential risks, conduct risks and regulatory framework risks to New Zealand financial markets. It maintains a risk register to identify risks, prioritise them and monitor actions taken on those risks.
	FMA sets licensing conditions, approves market rules, issues frameworks and methodologies, and grants exemptions and designations.		Delivery of services		MBIE (Companies Office) operates the Disclose register, the Companies register, the Financial Service Providers Register and other entity registers.	MBIE, the Treasury ...	... monitors and evaluates policy settings (with the Treasury also providing advice on policy settings monitored by RBNZ and MBIE). ...monitors FMA's performance in accordance with the Crown Entities Act.
RBNZ ...	... sets prudential and (where appropriate) macroprudential requirements for banks via conditions of registration, and sets certain prudential requirements for insurers (solvency requirements, fit and proper requirements) via standards.	FMA ...	... licenses and authorises market participants (excluding those registered (licensed) by RBNZ). ... grants exemptions and designates products to be subject (or not) to regulation.		RBNZ ...	... collects detailed statistical data on the financial system, and monitors and reports on the soundness and efficiency of the financial system as a whole. ... monitors and evaluates operational settings in relation to prudential oversight of banks, non-bank deposit takers, insurers, and jointly with the FMA) payment and settlement systems.		
NZX and other licensed markets or platforms ...	... set the rules for the markets or platforms they operate and for market participants.	RBNZ ...	... registers (licenses) banks, and licenses NBDTs and insurers for prudential purposes. ...grants exemptions for NBDTs and in limited circumstances insurers. ... operates NZ Clear and the Exchange Settlement Account System.		FMA ...	...to keep under review the law and practices relating to financial markets, financial markets participants, and other persons engaged in conduct in financial markets.		
External Reporting Board ...	... sets accounting and auditing & assurance standards.	NZX and other licensed markets or platforms ...	... operate markets and platforms for the transfer of financial products.		All crown entities ...	... have monitoring obligations imposed on them by the Government (on behalf of taxpayers) in respect of their own performance against objectives.		
Code Committee (Financial Advisers) ...	.. prepare, review and recommend changes to the Code of Professional Conduct for Authorised Financial Advisers for FMA approval.	Financial service providers ...	... provide advice and services in relation to consumers of financial market products.					
Designated settlement systems...	.... sets standards for participants wishing to access and use each system.	Payment systems and designated settlement systems...	... operates payment systems and designated settlement systems for executing payments and settling transactions.					
Operational policy	FMA ...	... sets risk-based regulatory strategy for how the FMA will regulate which is set out in its Strategic Risk Outlook. ... sets operational policy in relation to licensing of MIS managers, derivative issuers, independent trustees and supervisors, crowd funding and peer-to-peer lending platforms, DIMS, market operators, auditors and Authorised Financial Advisers and Qualifying Financial Entities. ... grants exemptions and designations. ... issues frameworks and methodologies. ... provides conduct guidance.	Disputes resolution	Dispute resolution schemes...	... investigate and resolve complaints made by consumers against financial service providers. They operate in accordance with their rules and the requirements of the FSPR Act (the schemes are the Banking Ombudsman Scheme (BOS), the Financial Dispute Resolution Scheme (FDRS), Financial Services Complaints Limited (FSCL) or Insurance Savings Ombudsman (ISO)).			
	RBNZ ...	... sets operational policies in relation to the registration/licensing of banks, NBDTs and insurers. ...issues exemptions, and guidance.						

¹³ A terms of reference for COFR can be accessed at: www.rbnz.govt.nz

¹⁴ The RBNZ's compliance monitoring role in respect of NBDTs is more limited than for banks and insurers, as trustees act as the frontline supervisors of NBDTs.