MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HIKINA WHAKATUTUKI

Regulatory impact statement

Reviews of the Financial Markets Authority funding and levy, External Reporting Board levy and New Zealand Companies Office fees

October 2016

Agency disclosure statement

This regulatory impact statement (RIS) has been prepared by the Ministry of Business, Innovation and Employment (MBIE).

This RIS provides an analysis of options to fund three entities that perform regulatory functions in New Zealand:

The Financial Markets Authority (FMA) regulates capital markets and financial services in New Zealand.

The External Reporting Board (XRB) is responsible for the development and issuing of accounting and auditing and assurance standards in New Zealand.

The Companies Office is an operating unit within MBIE and supports New Zealand corporate and non-corporate stakeholders to meet their governance and compliance requirements.

The analysis is informed by:

- Extensive consultation with the FMA, XRB and the Companies Office, submissions received in response to a consultation paper in July-August 2016, and data and information from participants in financial markets.
- An effectiveness and efficiency review of FMA's operations by Deloitte.
- A review of Companies Office fee bearing services and funding by Deloitte.

There are some limitations on the analysis undertaken:

- It is not possible to quantify the direct benefit accruing to individual stakeholders from the FMA's activities. The FMA operates a risk-based model, meaning that it focuses on certain types of conduct and activities that may pose the most harm, rather than specific sectors. Its assessment of risks to investors, consumers or the wider economy drives the activities that it undertakes. In order to assess the options relating to the FMA we consider the size and scope of the FMA's proposed activity.
- Where we consider what percentage of FMA's funding should be sourced from the Crown and what percentage should be sourced from a levy on financial service providers we are also bound by the same limitations noted above - we cannot quantify direct benefit to individual stakeholders from FMA's activities. As a result, we are limited in our assessment of this problem and have been unable to identify a preferred option.
- Possible implications from the review of the Financial Advisers Act have not been modelled for FMA's funding or the FMA levy. The FMA requires funding certainty in late 2016 so they can make changes to their operations ahead of their reserves being exhausted by July 2017. It is envisaged that legislation relating to the Financial Advisers Act will not be enacted until later in 2017.
- The attribution of benefit from the XRB's standards setting is based on estimated volumes of financial reporting stakeholders and the XRB's time attributed to each in accordance with their standards setting framework.

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Building, Resources and Markets

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Executive summary

1. This regulatory impact statement considers problems relating to the funding of The Financial Markets Authority (the FMA), the External Reporting Board (XRB) and the Companies Office.

Financial Markets Authority

2. The Financial Markets Authority is New Zealand's main financial markets regulator, replacing the former financial markets regulator, the Securities Commission in 2011. The FMA currently sources 39 percent of its funding from the Crown, 60 percent from a levy on financial markets participants and 1percent from fees and other third party revenue.

3. The FMA's regulatory responsibilities have expanded over recent years, mostly due to the overhaul of New Zealand's securities law and expansion of the financial markets. The Financial Markets Conduct Act (FMC Act) was passed in late 2013 and gives the FMA a broad remit as the conduct regulator for financial services. Developing the FMA was as a key part of the Government response to the global financial crisis. Since 2011 the FMA has been developing its core activities alongside a significant enforcement workload related to the finance company collapses.

4. The FMA's funding is no longer sufficient to meet its obligations. It has been utilising financial reserves accumulated in its start-up phase to fund its operations. The main cost drivers behind the need for this funding increase are the expansion of the FMA's regulatory remit under the FMC Act. The FMC Act represents a significant expansion of the role of (and expectations placed upon) the FMA, compared to the mandate of the Securities Commission.

5. After considering options relating to the total amount of the FMA's funding, we are recommending that the FMA's total appropriation be increased from $26.18 million to $36 million. However, this recommendation is caveated due to inadequacies in our evidence base.

6. We are also recommending that the Crown and levy payers continue to share the costs of the FMA's funding and consider that levy payers should fund a greater percentage than the Crown. We do not however have a view as to what specific percentage either party should pay.

7. In regards to the structure of the FMA levy itself, we are recommending a number of changes should be made to the percentage of the levy that certain populations of financial service providers pay. These changes are intended to more accurately reflect the benefit those financial service providers gain from FMA's regulation.

XRB Levy

8. The External Reporting Board was established in 2011. It oversees the development and issuing of accounting, auditing and assurance standards in New Zealand. XRB receives $4.41 million; original policy decisions estimated that 93 percent of its funding should be gained from third parties and 7 percent from the Crown.

9. We recommend that the relative percentages outlined above should be adjusted to better reflect the number of public benefit entities (such as central and local government, State Owned Enterprises, Crown Entities and Registered Charities) that benefit from XRB's activities.

10. The XRB levy has also been over-recovering over the last four years. We recommend that this over-recovery should be returned via a reduction in the levy over a five year period (or until the levy is re-adjusted).

Companies Office fees

11. The Companies Office's main role is to help businesses meet their governance obligations by operating a portfolio of statutory registers. It is predominantly third-party funded via fees for services undertaken.

12. It operates a memorandum account for its fee collection in order to allow any surplus or deficit created to be balanced over time. Over the last three years it has accumulated a surplus in its memorandum account, recorded as $16.5million at 30 June 2016.

13. We recommend that changes should be made to a number of the fees the Companies Office charges in order to balance the surplus in the memorandum account. Some other fees have also been adjusted in order to better reflect the cost of providing the Companies Office service to which they relate.

1 Introduction

14. This regulatory impact statement provides an analysis of options relating to the funding of two crown entities and a business unit within the Ministry of Business, Innovation and Employment (MBIE) which regulate New Zealand's financial markets and the actors within it.

15. The Financial Market Authority (FMA) regulates capital markets and financial services in New Zealand.

16. The External Reporting Board (XRB) is responsible for the development and issuing of accounting, auditing and assurance standards in New Zealand.

17. The Companies Office supports New Zealand corporate and non-corporate stakeholders to meet their governance and compliance requirements.

18. These regulatory agencies play a vital role in administering financial regulation to ensure that there are minimum standards of operating, and trust and confidence in the financial system is justified. Through their work they also aim to minimise disruptions or shocks to the financial system and, when they occur, address them in an appropriate and timely way.

19. The FMA has a specific function to promote and facilitate the development of fair, efficient and transparent financial market. It works to promote innovation and support the growth of New Zealand's capital base by providing effective regulation of conduct in relation to financial products and services.

20. XRB's overall goal is to help build a productive and competitive economy through setting internationally recognised financial standards. These standards ensure the quality of New Zealand's financial reporting, enhance entities' accountability to stakeholders, and assist the ability to compete internationally.

21. The Companies Office facilitates the ease of doing business in New Zealand by providing easy-to-use registers and readily accessible information.

22. To be able to deliver their regulatory functions effectively, regulators such as the FMA, XRB and the Companies Office need to be adequately resourced. They should also operate efficiently. In this RIS the options to fund each entity relate to their scale, their activity, and the sources of funding for their operations. A common objective for the options presented is that those who contribute to the costs of each entity should do so in terms of the benefits derived from their effective regulation.

23. Determining who should bear the cost of funding is guided by principles set out in the Treasury's *Guidelines for Setting Charges in the Public Sector*[1] and the Controller and Auditor-General's *Charging fees for public sector services*[2].

24. The regulatory impact analysis is set out as follows:

    - In Chapter 2 we discuss funding for the FMA and recovery of funding via the FMA levy.
    - In Chapter 3 we cover funding for the XRB and the portion of funding recovered by XRB levy.

[1] http://www.treasury.govt.nz/publications/guidance/planning/charges/charges-dec02.pdf
[2] http://oag.govt.nz/2008/charging-fees/docs/charging-fees.pdf

- In Chapter 4 we consider funding for the Companies Office through updated fees for service.
- In Chapter 5 we present the implementation plan for the recommended options.
- In Chapter 6 we outline how we will monitor, evaluate and review the proposed options.

2 Funding for the FMA and the FMA levy

Background

25. The FMA is a Crown Entity and was established as a new, consolidated financial markets conduct regulator in May 2011. Its role is to regulate capital markets and financial services in New Zealand.

26. The FMA's approach to market regulation is based on active and extensive engagement with businesses, professionals and investors. The FMA has a range of functions and regulatory tools at its disposal including licensing of firms and professionals, educating and informing investors, monitoring and supervising financial product providers, relieving regulatory burden through exemptions and designations and investigating potential harms to the market and taking appropriate action.

27. The FMA is a risk-based conduct regulator. It focuses on certain types of conduct and practices which present the most risk of harm to investors in markets, rather than specific sectors. This does not necessarily correspond to the sectors with the greatest regulatory obligations. The assessment of the risks of harm to markets and/or investors and consumers then drives the activities it undertakes to address those risks and its prioritization and resourcing of those activities.

28. The FMA and the legislative framework sets specific standards for financial service providers. Financial service providers meeting those standards, and the FMA's role in ensuring that those standards are met, enables fair, efficient and transparent financial markets. With the implementation of the FMC Act the number of businesses, professionals and markets regulated by the FMA has grown substantially since it was established. The transition to the FMC Act regime is now largely complete, with the licensing managers of managed investment schemes the last major piece to come into effect (December 2016).

Status quo

29. FMA's current funding of $28.18 comes from the Crown, including up to $2 million for litigation funding. $17.17 million (approximately 61 percent) is recouped from third-parties via a levy on financial market service providers and an historical transfer from the Companies Office. The FMA also collects a small amount of income from interest and fees for services (such as licensing).

30. The FMA's budget was approved by Cabinet in March 2011. The Crown component of the FMA's funding remained at the same total as the FMA's predecessor, the Securities Commission, and the part of the Ministry of Economic Development that transferred to the FMA. The FMA levy was designed to meet the funding shortfall in the FMA due to the expanded scope of the FMA's regulatory remit over its predecessor entities.

31. Since 2014 the FMA has been using reserves accumulated during its start-up phase to carry out its core initial functions. At current levels of activity, FMA's expenditure will continue to outstrip its funding and these reserve funds will be exhausted by July 2017.

Over-recovery of the FMA levy

32. The levy is currently over-recovering relative to the amount agreed by Cabinet in 2012 which, on average, was expected to be $16.41 million per annum for the first five years. This over-recovery is due to increased market activity, resulting in a larger than projected number of levy-payers. This over-recovery has been retained by the Crown and has not been used to fund FMA's current activities.

Decisions already made

33. From July 2017 the historical transfer of $0.695 million from the Companies Office to the Crown towards FMA's funding will cease. This amount covers the costs of FMA's financial filing and prospectus vetting functions and will be incorporated within the FMA levy.

Legislative requirements

34. Under Section 68(4) of the Financial Markets Authority Act 2011 (FMA Act) the FMA levy covers the portion of the costs of the FMA in performing or exercising its functions, powers, and duties together with the costs of collecting the levy. The portion is determined by the Minister of Commerce and Consumer Affairs.

35. The FMA has consulted on proposed changes to its appropriation and the proportion of funding to be met by levies as required under Section 69(1) of the FMA Act.

Problem definition

Issue 1: The FMA's funding is insufficient to meet its obligations

36. The FMA's funding requirements have increased since its establishment with the growth of its regulatory mandate. FMA's expanding remit is the main cost driver behind its increasing expenditure. Further detail is provided on this below.

37. In the absence of secure long-term funding the FMA has been conservative with its finances and built up a $9 million cash surplus over its first three years of operation. FMA has made its funding 'stretch' until the end of fiscal year 2016/17. However, from July 2017 the surplus of $2.4 million as at 2015/16 will be exhausted and FMA will be constrained in its ability to effectively regulate New Zealand's financial markets and deliver all its statutory requirements.

38. The FMA's revenue and expenditure since it was established is shown in the table below.

	14 months to 30 June 2012 Actual	2012/13 Actual	2013/14 Actual	2014/15 Actual	2015/16 Actual
Total income, comprised of:	**33.56**	**28.90**	**31.19**	**30.20**	**29.90**
Crown revenue	29.85	25.46	27.77	26.18	26.18
Litigation fund	2.43	2.01	1.61	1.68	1.39
Interest and other income	1.28	1.43	1.81	2.33	2.33
Total expenses, comprised of:	**29.85**	**25.36**	**29.41**	**32.68**	**33.92**
Personnel, occupancy & other opex	26.63	22.16	26.56	28.69	29.35
Depreciation/amortisation	0.78	1.04	1.40	2.30	3.18
Litigation fund	2.43	2.16	1.45	1.68	1.39
Net operating surplus (deficit)	**3.72**	**3.70**	**1.62**	**(2.48)**	**(4.02)**
Net litigation fund surplus (deficit)	**-**	**(0.16)**	**0.16**	**-**	**-**
Accumulated surplus	**3.72**	**7.42**	**9.04**	**6.56**	**2.54**

Source: The FMA Annual Reports and Statement of Performance Expectations

Cause: The FMA's full mandate was not known when funding was established in 2011

39. The FMA's funding was set prior to the development and implementation of the FMC Act and other related legislation, meaning that the FMA's full mandate and regulatory responsibilities were not then known.

40. The FMC Act began to come into force in 2014, and represents a complete overhaul of securities law in New Zealand. Securities law governs how financial products are promoted and sold, and the ongoing responsibilities of those who offer, deal and trade them. FMA's regulatory remit has expanded under the FMC Act. It has introduced regulation to new sectors of the financial services population, created opportunities for innovation in financial product offerings, armed the FMA with a suite of new regulatory tools and powers and introduced the new concept of conduct regulation thus bringing New Zealand into line with global regulatory practice. Many of the businesses and professionals the FMA now regulates were previously unregulated or operated under much lighter regulatory arrangements. The FMC Act represents a very significant expansion of the role of (and expectations placed upon) the FMA, compared to the mandate of the Securities Commission.

41. In addition to its regulatory work under the FMC Act, the FMA has also continued the substantial work required to implement the Financial Advisers Act 2008 (FA Act), Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act) and the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act). This legislation introduced new types of activity to regulation and provided new responsibilities and powers for the FMA. This has required significant and ongoing resource commitment from the FMA to ensure that those populations understand the requirements, lift minimum standards of operating where necessary and to consider feedback on the compliance costs associated with these regimes.

Effect of maintaining the status quo

42. Without additional funding from July 2017, the FMA will be constrained in its ability to be a credible and effective regulator of New Zealand's financial markets and be unable to deliver all its statutory obligations. This will have a range of impacts.

43. If there is no change to the FMA' s current funding it will need to reduce its engagement with market participants and its market intelligence and capacity to respond to negative market events will be affected. The FMA is also likely to have to turn to reactive enforcement as its primary mechanism to enforce compliance, rather than a proactive and interventionist approach to emerging risks and driving good conduct.

Issue 2: The FMA levy is over-recovering

44. A further problem is that the FMA levy is currently over-recovering relative to the $16.41 million agreed by Cabinet in 2012. As shown below, for the first four years since the levy was introduced it has recovered approximately $5.1 million more than predicted. This additional collection of the levy has not increased the funding received by the FMA as it is retained by the Crown; as outlined above, the FMA's expenditure in excess of its funding has been covered by financial reserves accumulated during its start-up phase.

FMA levies collected

Fiscal year	Levy revenue ($ million)	Over/(under) recovery ($ million)
2012/13	14.027[3]	(2.383)
2013/14	19.771	3.361
2014/15	18.524	2.114
2015/16	18.397	1.987
2016/17 (forecast)	17.437	1.027

Cause: financial market activity has been higher than expected

45. The FMA levy is payable annually by financial market participants and is related to the activity that each undertakes. The levy model is based on estimated volumes of this activity.

46. Volumes fluctuate naturally depending on market conditions and it is impossible to forecast them with complete accuracy. However, when the levy was established in 2012 there was a lack of robust information about some types of activity. This made it difficult to make good estimates of how much financial participants would pay in terms of the levy and the revenue raised overall. Some of MBIE's estimates at the time were conservative.

Effect of the status quo

47. With respect to the 2012 agreed levy of $16.41 million and based on updated forecasts of market volumes we predict that the levy will continue to over-recover at a rate of approximately $1 million per annum unless it is adjusted.

[3] The levy was introduced on 1 August 2012, so this is not a full year's worth of revenue.

3 Objectives and options analysis

48. This RIS addresses both the overall level of funding that FMA needs to perform its functions as New Zealand's financial markets regulator and who should pay for that funding. These are separate but interrelated questions and options for each have their own assessment criteria. Overlaying these questions are two primary objectives:

- Objective one: the operations of the FMA are the appropriate scale to deliver its regulatory objectives and they are adequately resourced.
- Objective two: those who contribute to the costs of FMA's operations are those whom benefit from its regulation.

49. In order to assess the adequacy of FMA's operations and funding, and who should pay for FMA's funding, we have split our options analysis into three parts.

- Part one: considers how much funding the FMA should receive overall – the total quantum of funding.
- Part two: discusses the problem of the relative proportion of FMA's funding obtained from levy revenue and from the Crown.
- Part three: looks at the structure of the FMA levy and how to split the amount to be recovered from the levy amongst different financial market participants.

50. Part one addresses the objective that the FMA is adequately resourced to deliver its regulatory objectives and be a capable regulator of financial markets. Parts two and three relate to the objective that those who contribute to the costs of the FMA's operations are those whom benefit from its regulation.

Objectives

51. Further detail on the two primary objectives against which options for the FMA's funding are assessed is outlined below.

Objective one: the operations of the FMA are the right scale to deliver its regulatory objectives and it is adequately resourced

52. This objective means that the FMA has sustainable funding to deliver its regulatory responsibilities and fulfil its role as a capable regulator.

53. The FMA Act, which sets out the FMA's regulatory responsibilities, notes that the FMA's purpose is to "promote and facilitate the development of fair, efficient, and transparent markets". The FMA's purpose is echoed in New Zealand's main piece of financial markets legislation, the FMC Act. The FMC Act also has as its other main objective to "promote the confident and informed participation of businesses, investors, and consumers in the financial markets". As New Zealand's primary financial markets regulator, the FMA is responsible for the implementation and administration of the FMC Act.

54. The FMA needs to be funded to allow it to operate at the level of other comparable jurisdictions and achieve the objectives set out by the International Organization of Securities Commissions (IOSCO). IOSCO is an international body that brings together the world's securities regulators and is the global standard setter for the securities sector. IOSCO develops, implements and promotes adherence to internationally recognised standards for

securities regulation. It works intensively with the G20 and the Financial Stability Board on the global regulatory reform agenda.

55. There is a high level of congruence between the standards set by IOSCO and those that the FMA is expected to achieve under the FMC Act and the FMA Act.[4] IOSCO's three primary objectives of securities regulation are:

- protecting investors;
- ensuring that markets are fair, efficient and transparent;
- reducing systemic risk.

56. IOSCO also states in its 'Principles relating to the regulator' that a regulator needs to have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.

Objective two: those who contribute to the costs of the FMA's operations are those whom benefit from its regulation

57. A well-regulated and stable financial market has characteristics of both a public and a private good. Everyone benefits, including consumers, investors and private individuals but some groups and entities benefit more directly. For example, the financial sector benefit as a stable and efficient financial market is a core requirement of their business. Objective two means that those who receive the greatest benefits from a stable and well-regulated financial environment should contribute more towards the FMA's costs.

Part 1 - Overall level of FMA funding

58. As noted in the problem definition section above, the FMA's current funding is insufficient to meet its obligations and it requires a funding increase.

59. To support its proposals for an increase in funding, the FMA commissioned an Effectiveness and Efficiency Review from Deloitte in order to give confidence to stakeholders and the government that it was spending its current appropriation wisely. Deloitte was also asked to provide practical advice to the FMA on how it could enhance the efficiency and effectiveness of its operations over the longer term in order to support the FMA's plans to implement a financially sustainable operating model.

60. Deloitte's findings reinforced that the FMA's existing funding level is not sustainable beyond the end of the 2016/17 fiscal year. Whilst commenting positively on the FMA's market engagement and its discipline over its costs, Deloitte identified some areas for improvement in efficiency in terms of the FMA's organisational structure and accountability systems and made recommendations relating to how the FMA could improve its effectiveness as a regulator.

Deloitte's recommendations for improving efficiency

61. In general Deloitte's recommendations include reducing investment in corporate areas as it enters a more steady state environment, and reviewing the relatively narrow spans of control that some managers have and organisational tiers within the FMA. The FMA has

[4] IOSCO's *Objectives and Principles of Securities Regulation*, June 2010 can be found here: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf

published its response to the recommendations with an indicative timeframe for when the recommendations will be actioned.[5]

62. Several of the recommendations can be implemented across all funding options that have been considered. Of particular note is the FMA's commitment to document core business processes within its annual plan as a focus for 2016-2017 financial year. This is in response to Deloitte's recommendation that the FMA needs to have systems in place to help it understand whether it has the balance between effective regulation and administrative burden on market participants' rights. Continued focus on establishing measureable performance metrics against which to assess its output and impact were also a focus.

63. Other recommendations relate to the use of improved accounting and time-sheeting systems, which the FMA has undertaken to examine once its level of funding is known. Whilst the introduction of improved systems will result in increased initial expenditure, the expectation is that there will be gains in operational efficiency over the long term.

64. We expect the main ongoing tension that the FMA will need to manage over the long term is their intention to recruit staff with the necessary skills in the financial sector against Deloitte's finding that the FMA has higher than average personnel costs when compared with other public sector professionals. The FMA has outlined that this has been driven by its need to compete with the private sector to recruit staff with the right skills and experience, and the required level of seniority.

Assessment of the options for FMA's overall funding

65. Three funding cases have been considered, each showing an increase in FMA's existing funding. These options have been put forward by FMA:

- **the lowest case** of $33.4 million
- **the base case** of $35.6 million
- **the enhanced case** of $38.6 million.

66. These figures incorporate funding sourced from all parties, including the Crown, the levy, fees and other third party revenue and include up to $2 million for litigation funding.

67. The **status quo** for the FMA's funding of $28.7 million is not proposed as a viable option because the FMA's existing expenditure already exceeds its current appropriation. The FMA has advised us that it feels its ability to effectively assess and manage risk is sub-optimal under the status quo. Although Deloitte made recommendations for some areas where efficiencies could be made, we do not consider that those actions would be enough to maintain the current appropriation in the long term.

68. In order to assess the options for the FMA's funding, criteria have been developed in line with the above objectives. We examine how each option would allow the FMA to deliver on core functions and what net benefits each option is likely to deliver for financial markets. The criteria are outlined below.

[5] For Deloitte's recommendations see**:** *https://fma.govt.nz/assets/FMAs-role/160629-Deloitte-summary-letter-for-EE-review-2016.pdf***;** for FMA's response see: https://fma.govt.nz/assets/FMAs-role/160815-FMA-efficiency-and-effectiveness-response.pdf

Criteria one: the FMA is able to fulfil its role as a capable regulator of financial markets

Deliver statutory responsibilities

69. We examine whether the FMA's operational capacity under each funding option enables it to deliver what is expected of them under the FMC Act and other relevant financial markets legislation. We assess whether the relative funding level would allow a minimum level of regulatory activity such that the risk of significant breaches of financial markets legislation would be at an acceptable level.

Supervision and monitoring

70. We assess the FMA's ability to monitor, supervise and influence financial markets participants' behaviour. We examine the internal systems the FMA has in place to perform these functions.

71. The FMA is required to administer the licensing regime for market service providers under the FMC Act and Authorising Financial Advisers under the FA Act. Licensing of key market participants sets clear competency standards for those supplying financial products and services.

72. Similar to the licensing regime, FMA's work in upholding and enforcing compliance with the governance standards required under the FMC Act allows consumers to focus on the decisions they need to make in relation to the products and services rather than having to spend time scrutinising the governance arrangements of the product or service.

Monitoring systemic risk

73. IOSCO expects that financial markets regulators should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate. We examine the FMA's ability to deliver on this expectation under each funding case, in particular how it would be able to operate in relation to the Reserve Bank (the prudential regulator in New Zealand) and other international financial markets regulators, as identification and action on areas of systemic risk will need to be done in conjunction with other regulators.

Minimising harm to investors and prosecuting breaches

74. We examine how each option might impact on the FMA's ability to enforce the requirements of financial markets legislation. In order for consumers and investors to confidently participate in financial markets they need to feel confident that, should there be breaches of law, there is a regulator who can detect those breaches, enforce compliance or assign penalties as appropriate. Although harm to investors can never be completely removed, the FMA's work in responding to actual, or suspected wrong-doing in financial markets can minimise harm to investors so that losses are reduced. In order for the FMA to be effective in this role it needs to have good intelligence and monitoring systems in place to detect suspected breaches of the law. It also needs to be resourced to take action if need be.

75. The FMA's role in educating investors can also help minimise consumer harm. It is difficult to directly correlate the FMA's regulatory activities to improved financial capability and confidence. We are presuming that a greater level of the FMA's activity will translate into public benefit through improved investor literacy. Under its current level of funding the FMA has been focussing on broadening its engagement with the investor population (including KiwiSaver members).

Policy and guidance

76. We assess whether the FMA can liaise with central government in order to continue to develop financial markets policy so that the regime can be upheld, and future proofed to emerging trends in activity.

77. We also assess whether the FMA would be able to assist firms to comply with their obligations, and assist efficiency in financial markets by removing unnecessary obligations where required (for example through exemption powers and guidance or other regulatory relief as appropriate).

Criteria two: net benefits to financial markets of the FMA's increased regulatory activity are maximised

78. We also assess the net benefits to financial markets of the FMA's regulatory activity under each funding option.

79. If the FMA has the funding and operational capacity to deliver on the objectives set by IOSCO and in financial markets legislation we expect benefits will be generated for all financial market participants, both for business and consumers of financial products. There are also benefits for the functioning of financial markets overall in terms of efficiency and potential for economic growth.

80. Although separate, these potential benefits are interconnected. Efficient financial markets can help the flow of capital from investors to businesses, where capital can be used most productively to generate broader economic benefit. This can lead to growth in financial markets overall, support business growth and generate returns for investors. If financial markets function efficiently in this way, it can lead to economic growth.

81. If the FMA is funded to a level that allows it to uphold internationally recognised standards of securities regulation we also expect benefits to be generated from increased flows of international investment. International investment deepens the pool of capital available to New Zealand's firms and generates profit for financial service providers who act as intermediaries.

82. To assess net benefits we take into account the expected benefit that increased regulatory activity from the FMA will have for financial markets against the associated cost of that activity. We assess the actual funding costs and, where possible, the potential compliance costs that increased regulatory interaction with the FMA will have for financial markets participants under each funding option.

83. Our preferred option is one where the costs of the FMA's activities are reasonable given the benefit received by or given to financial markets. Our preferred option will also be one where unnecessary compliance costs are avoided. We aim to find a funding level where net benefits to financial markets and financial markets participants are maximised.

84. It is important to consider the size and scope of the FMA's activity against the cost of providing that activity. Assessing the type of activity as well as the scale of the activity is appropriate given that the FMA is a risk-based regulator. An option that allows the FMA to target its attention to areas of greatest risk in financial markets is preferable against an option that would only allow the FMA to increase its regulatory activity overall.

Evidence base for assessing each option against the criteria

85. Where possible, in our assessment of the FMA's regulatory activities we draw on specific examples of how each option might impact on the FMA's capacity. Our assessment is limited

to what the FMA has told us they can deliver under each funding case, and the information gathered from Deloitte's examination of the FMA's current operations.

86. In our assessment of the options we have utilised current and projected expenditure figures provided by the FMA, the report the FMA commissioned from Deloitte looking into the FMA's current operational capacity, feedback from financial markets participants on the current costs of compliance, and information from the FMA about its own strategic priorities.

Forecast Expenditure Figures

87. The main difference between the three funding cases we are assessing is the level of expenditure on personnel. This expenditure correlates with the FMA's own strategic priorities to recruit and retain staff with the relevant skills and experience necessary to support effective engagement, supervision and monitoring activities. The FMA has advised they are also focussing on making sure there is enough senior staff in those areas so that engagement with industry at the right levels can be maintained.

88. As can be seen in the table below, the FMA's expenditure across all of its other operating areas would be the same for each funding case. The increase in expenditure across the different funding cases is applied to personnel costs. These are the major cost driver for the entity.

Operating Budget Breakdown – BASE CASE	**FY 17/18**
Personnel Costs	$23,036,212
Litigation Fund Expenses	$2,000,000
Occupancy Expenses	$1,910,008
Depreciation and Amortisation	$2,500,000
ICT	$2,214,866
Professional Services	$1,668,200
Services & Supplies	$1,341,167
Travel & Accommodation	$707,432
TOTAL EXPENSES	**$35,377,885**
TOTAL FTE	**167.8**
Operating Budget Breakdown - ENHANCED	**FY 17/18**
Personnel Costs	$26,091,786
Litigation Fund Expenses	$2,000,000
Occupancy Expenses	$1,910,008
Depreciation and Amortisation	$2,500,000
ICT	$2,214,866
Professional Services	$1,668,200
Services & Supplies	$1,341,167
Travel & Accommodation	$707,432
TOTAL EXPENSES	**$38,433,460**
TOTAL FTE	**192.0**
Operating Budget Breakdown - LOWEST	**FY 17/18**
Personnel Costs	$20,886,568
Litigation Fund Expenses	$2,000,000
Occupancy Expenses	$1,910,008
Depreciation and Amortisation	$2,500,000
ICT	$2,214,866
Professional Services	$1,668,200
Services & Supplies	$1,341,167
Travel & Accommodation	$707,432
TOTAL EXPENSES	**$33,228,242**
TOTAL FTE	**148.1**

89. The greatest percentage increase in personnel costs between the base and enhanced cases is in investor capability and engagement with frontline supervisors. Both of these areas would be subject to an increase of 99 per cent between the base and enhanced cases. Proactive supervision and monitoring of individuals and investigations are subject to the next greatest increases of 54 per cent and 33 per cent respectively; these reflect greater financial resource allocation than other areas in line with the FMA's strategic priorities. Entity based relationship management and other market engagement would be subject to a 30 per cent increase. Although it is not possible to determine whether those increases would be a result of increasing FTEs or increasing seniority of staff the percentage increases indicate the areas where the FMA intends to focus its activity between the base and enhanced cases.

90. A full breakdown of the FMA's operating expenditure forecast and personnel costs can be found in Annex 1.

Assessment of options against criteria

91. The table on the following page presents the three funding cases and assesses each case against the criteria. A short description of what can be achieved under each funding case is also provided below. This evidence is supplied by the FMA and forms the basis of our assessment of each option.

Lowest Funding Case (funding of $33.4 million)

92. This funding case represents FMA's current expenditure (made up of its current funding and supplemented by accumulated financial reserves). This funding level has allowed FMA to assist industry to transition to the FMC Act, but it does not allow it to fully deliver on its monitoring and supervision functions due to no investment in intelligence and IT systems. The FMA considers that under current levels of expenditure it is operating under capacity restraints, resulting in trade-offs for some areas of work. The lowest funding case would not allow the FMA to engage sufficiently at its 'regulatory perimeter' or engage proactively with IOSCO and other peer regulators. It would be relying on reactive enforcement to enforce compliance.

93. It would also most likely have to significantly scale back or stop its investor capability functions. The FMA currently works with consumer groups, providers and other government bodies in assisting investors to approach decisions around investment on a well-informed and confident basis. This applies across sectors but in particular securities issuers, fund managers (including KiwiSaver providers) and providers of investment products.

Base Funding Case (funding of $35.6 million)

94. The Base funding case would allow the FMA to deliver on its core statutory activities and invest in new intelligence and data management systems. There would be limited ability for further investment into Entity Based Relationship Monitoring, investor capability and supervision and monitoring frameworks under this funding case.

95. Entity based relationship management (EBRM) – is FMA's direct structured and unstructured engagement with systemically important financial services firms. It is based around a relationship model, with senior FMA staff assigned to each entity. The institutions that are targeted are primarily those that hold multiple FMA-issued licences or those with significant

consumer reach such as banks, KiwiSaver providers, fund managers and NZX participant firms.

96. The FMA's supervision and monitoring frameworks apply to both entities and individuals. Under the base funding case, supervision of newly licensed populations would be conducted in so far as funding enabled, rather than being able to deploy a proactive, future proof model. Depth and frequency of monitoring of high impact firms and supervision of those entities that fall outside or on the perimeter of licensed populations (such as FX traders) would be reduced to a minimum level. Enforcement activity will be largely reactive with little ability for proactive action to lift standards.

97. Minimising regulatory burden and costs to participants whilst meeting obligations under the legislation would remain a key focus, most notably through class exemptions from the legislation. This is technical work requiring legal and accounting expertise and under this funding option the work would be largely reactive and limited by available resource. This will drive sub-optimal response times and will limit the number of issues that the FMA can deal with at any point in time.

Enhanced Funding Case (funding of $38.6 million)

98. This level of funding would enable investment in experienced staff and would increase front-line activities which use risk-based intelligence-led models to identify and prevent harms before they occur.

99. In terms of supervision and monitoring, the FMA would be able to proactively engage with the market on a structured and unstructured basis. It would also fund the implementation of a risk-based and intelligence led programme of supervision for licensees, including increased front-line activities (e.g. site visits, investigations of non-compliance via searches and interviews). This fits with the FMA's aspirations to be a proactive and assertive regulator who influences conduct of financial service providers before issues of misconduct arise rather than after the event.

100. In terms of regulation at its perimeter and monitoring systemic risk. This level of funding will help build the FMA's ability to oversee conduct in the insurance and banking sector, it will also enable the FMA to continue to engage with IOSCO and other international bodies to keep pace with global emerging risks.

101. This funding level allows the FMA to focus on minimising regulatory burden (through the FMA's existing tools) where appropriate, and in a proactive manner, with faster results and greater ability to focus on multiple areas than under the other funding cases. The FMA will also have greater capacity to engage with MBIE and other agencies in regards to ongoing regulatory system enhancement.

102. Under this funding case the FMA's investor capability activities will increase, as it works towards better informed investors who more confidently participate in financial markets.

		Lowest Case of $33.4 million	Base Case of $35.6 million	Enhanced Case of $38.6 million
Criteria One: FMA is able to fulfil its role as a capable regulator of financial markets	**Deliver statutory responsibilities**	FMA has advised that the risk of not meeting statutory obligations to an acceptable standard is high under this option. This option is not supported by the FMA Board. ✘	Core statutory obligations only could be met under this option. ✓✓	FMA believes it will be able to deliver its statutory responsibilities and allocate resource to areas it considers to be a strategic priority based on the evidence it has on market conditions. It will be able to pursue the activities it believes are necessary; and to complete some existing core activities faster. ✓✓
	Supervision and monitoring	There will be very limited investment in intelligence functions and no investment in intelligence or IT systems. This lack of investment in intelligence systems could exacerbate the need to react to events that have already occurred rather than proactively assess and respond to risk based on intelligence received. FMA has advised that there would be no engagement with unlicensed populations under this option and engagement with licensed populations would be largely reactive. ✘	This option incorporates the requirement for operating costs associated with new data management and intelligence systems. Although there will be systems in place, staff capacity constraints mean that monitoring will likely be reactive rather than proactive. FMA could make some investment into entity based monitoring and relationship management (linking senior FMA staff with systemically important financial services firms), investor capability and new supervision frameworks. ✓	As with the base case, this option incorporates the requirement for operating costs associated with new data management and intelligence systems. This level of funding would enable the FMA to allocate sufficient resources to priority risk areas and investment in more experienced front-line staff to proactively assess and mitigate risks and engage with market participants. ✓✓
	Monitoring systemic risk within mandate	FMA's ability to monitor risk at its regulatory perimeter would be reduced. For example, the banking and insurance sector, which, although not licensed by FMA, are represented heavily in terms of how consumers access financial products. Conduct issues in the banking and insurance sectors can sometimes have the potential to have systemic implications because of the size and complexity of those sectors. ✘	There would be limited ability to identify and address perimeter risks under this option. ✓	This option would allow FMA to engage more broadly, including with the Reserve Bank (the prudential regulator in New Zealand) and overseas jurisdictions, on areas of potential systemic risk and in identifying trends within New Zealand and overseas. ✓✓
	Minimising harm to investors and prosecuting breaches	FMA has advised that under this option they will need to rely on reactive enforcement of compliance breaches and will need to reduce the frequency and extent of their monitoring work. While the litigation fund will be the same across all funding cases, it seems likely that FMA will be responding to a greater number of breaches of the law given its more limited ability to detect behaviour that might result in a breach under its supervision and monitoring functions. FMA will likely be investigating following a complaint from a consumer or investor, at which time the harm to consumers is already evident and FMA would be seeking redress rather than preventing harm. ✘	The risks attached to this option for consumers and investors are associated with the capacity constraints resulting in largely reactive supervision and monitoring. Similar to the lowest case we would expect that reactive supervision would result in a greater number of breaches given its more limited ability to detect behaviour that might result in a breach under its supervision and monitoring functions. ✓	We expect that proactive supervision and monitoring of financial services providers – both within and on the edges of FMA's regulatory perimeter – would result in fewer breaches of the law, and thus reduce harm to investors. We would also expect that FMA would have greater capacity under this option to utilise the preventative mechanisms it has available to it, such as issuing warnings for suspected breaches. ✓✓
	Policy and Guidance	FMA's ability to engage on policy issues would be reduced, and its attention would be limited to core issues. Measures to reduce compliance costs (e.g through exemptions and designations) for industry would be limited and would take longer to process than under the other funding cases. ✘	FMA would be able to provide some regulatory relief under this option and this in turn could reduce compliance costs (for example class exemptions from regulatory requirements). However, FMA believes that its ability to perform this function would be limited by resource and this would result in longer processing times which could potentially introduce barriers to efficiency in financial markets. ✓	There are greater opportunities with the enhanced case for FMA to remove unnecessary regulatory burdens on financial markets and behave more proactively in its policy advice to central government. The difference between the enhanced and base case is the speed of processing times due to increased capacity available under this option. ✓✓
Criteria Two: Net Benefits to Financial Markets of FMA's increased regulatory activity are maximised		We consider this option would not maximise net benefits for financial markets. There would be a significant level of funding to FMA under this option but FMA's inability to perform its role as a capable regulator of financial markets in a number of areas would mean there is a risk this funding will not maximise net benefits. Although the upfront costs of FMA's regulatory activity would be the lowest under this option, we would expect that compliance costs for financial service providers may be disproportionate to the benefit received from FMA's regulatory activity. This is because FMA would be limited in its 'risk-based approach' and would therefore be requiring information of a similar nature from all providers it regulates rather than directing its attention to those who present the greatest risk. ✘	We consider that this option could come close to maximising net benefits to financial markets. We consider that as statutory obligations could be met under this option, benefit would be achieved by FMA's regulatory activity. Investment could also be made into some of the areas that would allow FMA to be considered a capable regulator for financial markets. Where the benefits under this option might be reduced are in the areas of capacity, scope of regulatory activity and response to unexpected events. Reactive activity in areas such as entity based relationship management, assessment of systemic risk and supervision may result in less than optimal results over the longer term. ✓	We consider this option is closest to maximising net benefits for financial markets. We consider the main difference between the base and enhanced cases would be FMA's ability to proactively engage with the populations it regulates and with those populations that are at the perimeter of its regulatory sphere of activity. Although we believe the functions of FMA could also be delivered under the base case, the enhanced case should allow FMA to regulate financial markets more effectively and should come closer than the base case to what is expected internationally of a financial markets conduct regulator. ✓✓

Key:	✘ not satisfied	✓ partially satisfied	✓✓ completely satisfied

We consider the enhanced case is likely to result in the greatest net benefits for financial markets

103. Based on the information we have received from FMA, feedback from stakeholders and the obligations we consider a capable financial markets regulator should be able to satisfy, we consider the enhanced funding case is likely to result in the greatest net benefits for financial markets.

104. However, it is possible that the base case could also deliver these net benefits. While we consider that the FMA would be able to perform a role in financial markets across its core regulatory functions under the base case, the likely difference to the enhanced case is in the size and scale of FMA's activities due to capacity relating to staffing levels. This is likely to impact on FMA's effectiveness, but we are not sure to what extent this would impact would be felt, or what affect this would have on financial markets.

105. It is also likely that monitoring the base versus the enhanced case for delivery of net benefits may also be problematic. This is because the main evidence we would be looking for is the effective mitigation of unnecessary risk in financial markets. If FMA is successful in performing this function the risk itself will not eventuate, and so there would be no counterfactual to evaluate FMA's effectiveness against.

106. We are basing our analysis on the fact that what FMA have told us they can deliver under the enhanced case is likely to be the option that most closely reflects the objectives for financial markets regulators, as defined by IOSCO and articulated in the purposes of the FMA and FMC Acts.

Consultation

107. During July-August 2016 feedback was sought on the three proposed funding options for the FMA and whether there were any proposed areas of FMA expenditure that should be expanded or reduced.

108. Forty-one submissions were received as a result of public consultation. Many submitters supported the enhanced funding case in principle, and acknowledged the value of an effective financial markets regulator. Those submitters who did not support the enhanced case generally argued that the amount of regulatory attention they receive from the FMA was appropriate at its current level.

109. A fairly strong theme in submissions was the need for FMA to increase transparency in its reporting to industry about where any increase in funding is spent. In response to this, FMA is working on its internal reporting systems so that it can provide more detail on its expenditure in the future. This is dealt with in more detail in the monitoring and evaluation section of this RIS.

Part 2 – Who should pay for FMA's increased funding?

110. The second part of this options analysis considers what would be an appropriate mix of Crown and levy revenue to meet the FMA's additional funding requirements. The objective is to appropriately source the additional funding required given the benefits received from the FMA's regulatory activities.

111. We consider that parts of the FMA's regulatory activity can be described as a public good. This means there are benefits that are received by New Zealand as a whole from the FMA's activities. These benefits relate to the FMA's positive impact on efficiency and transparency in financial markets. The flow-on effect of improved efficiency and transparency has benefits to the general public through the potential for economic growth that improved financial markets conditions can generate and the lower cost of funding it should deliver to NZ businesses. Given the general public benefit that the FMA's regulatory activity provides it is appropriate the Crown pays part of the FMA's funding.

112. We also consider that there are parts of the FMA's regulatory activity that are directly beneficial to financial service providers. Where benefits can be assigned directly to a particular group it is appropriate that costs are recovered from that particular group via a levy.

113. Given the principles outlined by the Controller and Auditor-General and the Treasury, we are seeking to source the increase in the FMA's funding from those who benefit from the FMA's regulation. Whether we recommend that the increase is wholly funded via the Crown, the levy, or a mixture of both will be determined by where we consider the benefit will accrue – the general public, financial service providers or a mixture of both.

Options for who should pay for FMA's increase in funding

114. We have considered three options for the source of the FMA's additional funding. These options and the implications relative to the enhanced funding case are outlined in the table below. We have modelled the options based on the enhanced case due to our recommendation in Part 1 of this RIS; although this recommendation retains the caveat set-out above that we do not have the evidence to make a firm recommendation.

115. In order to determine who should pay for the increased funding we have assessed the scope and purpose of FMA's regulatory activities, and its strategic plans for the future. FMA's general approach to market regulation is also outlined below, and forms the basis for our assessment of FMA's activities.

116. We have assigned specific regulatory activities to the group we consider derives the majority of benefit from that activity – either taxpayers or financial service providers. This is a guide only, as no activity can be wholly assigned to either public or private benefit

The FMA's regulatory Activity	Majority of benefit received by
Licensing Benefit is to financial service providers	Obtaining a licence from the FMA allows a financial service provider to operate in the regulatory environment overseen by the FMA. A licence is a private good as the benefits of operating in the regulatory environment and the associated profits generated from that operation are retained by the financial service provider. Providers currently pay for licensing via fees (separate to the levy).
Monitoring & supervision Benefit is split between the public and financial service providers depending on the type of monitoring activity	For those populations that it licenses the benefit of the FMA's monitoring and supervision is obtained by financial service providers. Monitoring and supervision of the populations it licences preserves the benefits of holding a licence for licensees. Through monitoring and supervision the FMA maintains the benefit of holding a licence by preserving the licensed population's reputation as a whole.
	The FMA's interaction with other regulators and its work monitoring systemic risk across financial services as a whole generates broader benefit to the public. Monitoring and oversight of this kind helps preserve the health of the financial system.
Investigations & enforcement Majority of benefit is to the public with some benefit generated for financial service providers	There is general benefit to the public through the FMA's activities investigating suspected breaches of the law and prosecuting those it considers to have broken the law. Investigation activities may also help prevent harm to consumers in certain instances.
	Some benefit is also generated for financial service providers in that the FMA's prosecution (or other enforcement measures) removes those who are not complying with the law from the population of financial service providers.
Policy & guidance Majority of benefit to financial service providers	The FMA's action is directed at assisting firms and professionals to comply with the law and so benefit is received directly by financial service providers. The FMA also provides financial service providers relief from regulatory burden through exemptions and designations. The FMA also provides policy advice to central government agencies.
Education & Information Benefit to the public and flow-on benefits for financial service providers	The FMA's activities on improving investor capability are directed at the general population and could help improve the financial wellbeing of consumers as a whole. Confident and better informed investors should lead to increased participation in financial markets – which increases volumes of business for financial service providers and markets.

Option	Portion of the FMA's overall funding (excluding fees and other third party revenue)		Criteria for assessment
	Crown	Levy (including transfer)	
Option one: Increase is 100% Crown funded	$20.9 m 54%	$17.1 m 44%	To make the case for option one, we would need to determine that all of the benefits of the FMA's increased regulatory capacity under the enhanced case would be received generally by the broader public and could not be assigned to a particular group.
Option two (Status Quo funding split between Crown and levy): Increase is 60% levy funded and 40% Crown funded.	$14.91 m 39%	$23 m 60%	To make the case for option two and retain the current funding ratio we need to be satisfied that the benefits of the FMA's regulatory activities will be received by taxpayers and financial service providers in roughly the same manner as they are currently.
Option three: Increase is 100% levy funded.	$11 m 28%	$27 m 70%	To make the case for option three we need to be satisfied that all, or a significant majority of the benefits of the FMA's increased regulatory activities result in benefits for financial service providers.

Assessment of public and private benefit following recent events in financial markets

117. The conditions in financial markets over recent years and the FMA's response to those events are also relevant in determining how the FMA's additional funding should be obtained. The FMA itself has acknowledged that it has shifted its focus from 'disaster recovery' (in terms of post-GFC and the resulting dip in consumer confidence due to finance company collapses) towards facilitating a meaningful shift in the culture and conduct of financial service providers. To deliver on this, the FMA is planning to engage with industry more directly and at a senior level.

118. Following a downturn in consumer confidence over recent years, we consider that the FMA plays an important role in fostering wider public participation in financial markets in a number of ways:

- direct communications to investors regarding investor capability; and
- proactively regulating in order to detect and prevent potential harm to consumers through intelligence gathering; and
- prosecuting breaches of the law; and
- upholding a base standard of compliance within the market such that consumers come to expect, and trust in, a certain level of regulatory oversight.

119. There are also broader public benefits to the FMA's regulatory activity that cannot be assigned to a particular group of beneficiaries. These include the impact that the FMA's work can have on efficiency and transparency in financial markets in providing a regulatory environment that supports increasing investment levels (both domestic and international investment).

We recommend that the majority of the FMA's funding continues to be funded via the levy.

120. As outlined above, there are aspects of the FMA's regulatory work that have both private and public benefits. Our assessment of recent conditions in financial markets leads us more towards assigning greater benefit to financial service providers than to the broader public, or to consumers.

121. It is, however, difficult to establish set percentages for private and public funding sources. This is because it is difficult to make direct correlations between the FMA's activity, and benefit derived by a particular group. Our assessments are limited to more general explanations of public and private benefit.

122. The FMA does not currently collect data in relation to the specific sectors, so whilst we have made a general assessment of how the FMA's regulatory activities benefit the private sector and the public, we do not have data that would allow us to determine a set percentage by industry sector.

123. The FMA is making changes to its internal strategic reporting frameworks. These changes are intended to allow it to report annually and it greater depth, about how its appropriation is spent. This should allow us to make a more accurate assessment of where the FMA's activities are focussed, and will inform any future reviews of the FMA's funding.

124. However, it is worth noting that a levy differs from a fee charged for a particular service in that a levy can factor in benefits that are shared between groups, or benefits that cannot be specifically assigned to a particular group. Therefore, even with more accurate data, a judgment call is still necessary in regards to where benefits accrue.

125. Given our assessment, we recommend that the FMA continues to be funded from both public and private sources but that the majority of FMA's funding continues to be derived from the levy on financial service providers. We do not however have a view as to whether Option Two or Option Three or an alternative would be most appropriate. We do not have an evidence base that would allow us to recommend a particular percentage split.

Consultation

126. Through a consultation paper in July-August 2016, feedback was sought on whether additional funding for the FMA should be wholly funded through the levy or whether the government should cover some of the increase. The consultation paper proposed that the funding increase be wholly funded via an increase in the levy.

127. Almost all submitters argued that the Crown should pay at least some of the increase in the FMA's funding. Most submitters thought that the Crown should meet at least 39 percent of the funding increase (Option Two) in line with the existing funding split between the Crown and financial service providers.

Part 3 – The FMA levy model

128. The third stage of the options analysis involves determining who should pay for the FMA's funding via the levy.

129. The FMA levy was introduced in August 2012 to ensure that industry met third-party funding requirements for the FMA. The levy is payable annually by financial market participants and is prescribed on an activity basis so that participants make a contribution for each class in which they do business.8 For example, a registered bank that is also a derivatives issuer and a KiwiSaver manager will pay a levy for all three activities. The FMA has a discretionary power to waive the levy payable where the circumstances or characteristics of a financial market participant are exceptional when compared with others in the same levy class.

130. Where appropriate, levy amounts are tiered within the levy classes to recognise the variation in size and nature of different financial market participants.

131. Irrespective of the level of funding that the FMA receives, it is important that the levy for each class of market activity:

- aligns with the level of benefit received from a well-regulated financial market; and
- does not discourage the supply of financial products or services.

132. The FMA takes a risk-based approach to regulating the sectors it is responsible for. This means that it focuses on certain types of conduct and practices that pose the most risk or are likely to cause harm to investors, consumers or the wider economy. As the possible consequences of risk change over time and may impact interactions across sectors, products and services, it is not sensible to attribute the levy to individual participants in terms of the FMA's interaction.

133. Through its activities the FMA aims to strengthen confidence in New Zealand's financial markets, promote innovation, and support the growth of New Zealand's capital base. The

level of the levy for financial market participants is intended to be consistent with these benefits and also avoid discouraging the supply of financial products and services.

Why does the levy model require adjusting?

134. Since the introduction of the FMA levy in 2012, there have been changes to the scope of the FMA's regulatory activity, with new types of market participants being licenced. We also have a better understanding of financial market activity and FMA's regulatory role in respect of this.

135. The structure of the levy model requires updating to reflect these changes and, in doing so, the level of benefit received by each stakeholder. Additionally, in some cases, the current levy poses an unduly high barrier to entry to the market.

136. We have considered three options for adjusting the levy model. The options are additive, so, for example, option two includes the changes proposed under option one. The options are:

Option one: updated levy population

Option two: updated levy population**,** updated levy structure in terms of levy classes, tiers and basis for payment of the levy and equity adjustments

Option three: updated levy population**,** updated levy structure in terms of levy classes, tiers, basis for payment of the levy and equity adjustments and return of over-recovery

Assessment of the options for the FMA levy

137. The criteria used for assessing the proposed options reflect the principles of the levy model. The criteria are:

    i. The levy for each stakeholder aligns with the level of benefit.

    ii. The levy does not discourage the supply of financial products or services.

    iii. The levy minimises over or under recovery and is practical to collect.

    The options will be judged on whether they fully, partially or do not satisfy these criteria.

138. In making changes to the levy model to better reflect the model principles there is a trade-off between the principles of equity and simplicity. A model that aims to maximise equity, with many classes and tiers distinguishing different types of market participant, may be overly complex and difficult for stakeholders to navigate and difficult to administer. A model that maximises simplicity (for example, a flat levy) could be regressive and treat some levy payers unfairly. On balance, while the levy model is complex, we think it is necessary to distinguish between types of market activity that are materially different to keep the model in line with the principles outlined above.

139. A problem to be addressed in this RIS is the current over-recovery of the levy, which has been retained by the Crown and is not used to fund the FMA's operations. In accordance with the Treasury's and the Auditor-General's guidelines, levies should be used for the purpose for which they are prescribed in legislation. Over-collection and under-collection should therefore be minimised: over-collection turns a levy into more of a tax and under-collection impacts negatively on the Crown's balance sheet. All the options address future over-recovery by re-setting the FMA levies and updating volumes of levy payers. However, option three proposes to return historical over-recovery to levy payers.

140. The options are assessed against the criteria in the table below.

	Criteria		
Levy model options	For each stakeholder the levy aligns with benefit	The levy does not discourage the supply of financial products or services	The levy minimises over or under recovery and is practical to collect
Status quo: no change to existing levy settings	✓	✘	✘
Option one: updated volumes and new populations	✓	✘	✓✓
Option two: option one + changes to model structure in terms of classes, basis for payment of the levy, tiers and relative proportion of levy paid by stakeholders	✓✓	✓✓	✓✓
Option three: return of over-recovery.	✓✓	✓✓	✓ levy would increase once over-recovery was returned

Key:	✘ not satisfied	✓ partially satisfied	✓✓ completely satisfied

Status Quo

141. Keeping the status quo is not being advanced as a viable option. In its current state the levy model does not capture all levy payers in the appropriate classes due to new populations being licenced. In addition, the model is not equitable and may inadvertently cause barriers to entry.

Option one: updated volumes of levy payers and new populations

142. This option proposes to adjust the model to incorporate newly licenced populations and update volume forecasts to minimise over or under-recovery in the future.

143. With the implementation of the FMC Act additional participants have been required to obtain a licence from the FMA and are now within the population of levy payees. These newly licenced populations include managers of investment schemes, equity crowd-funders, peer-to-peer lenders, derivatives issuers making regulated offers and discretionary

investment management service providers (DIMS). There have also been new requirements for authorised financial advisers (AFAs) that provide DIMS, managed investment schemes (MIS), independent trustees, and custodians.

144. Other categories have changed or will disappear altogether. These include contributory mortgage broking, authorised futures dealers and prospectus filing.

145. The number of levy payers (volumes) is not constant and naturally fluctuates due to changes in the market. When the levy model was established in 2012 forecast volumes were based on the best information available at the time and activity for certain classes was unclear.

146. While volumes can never be completely accurate, more accurate volumes based on up-to-date data will ensure future over or under-collection is minimised and the actual amount recovered aligns more closely with the amount to be recovered by the levy.

Option two: updated volumes of levy payers and new populations, changes to the structure of the levy model and equity adjustments

147. Option two includes option one plus changes to the levy model structure and adjustments to the portion of the levy paid by market participants. These changes encompass some re-categorisation of market participants between the levy classes, changes to the basis for payment of the levy for some financial market participants, and updated or new levy tiers. Changes to the relative levy paid across market participants reflect an updated view of the risk of different types of financial market activity.

148. The levy classes should reflect the principle that each activity should have a levy commensurate with the degree of benefit that stakeholder obtains from well-regulated financial markets. Some activities which are similar in nature but fall into multiple classes need consolidating into one class, and different activities that are grouped together need differentiating. New classes are also needed for newly licenced activities.

149. When the FMA levy was originally set in 2012, the portion paid by each class was based on an approximation of the risk of that class and the benefit they receive from a well-regulated financial market, based on the best information available at the time. For example, banks were determined to pay approximately 11 per cent and insurers approximately 10 per cent.

150. These percentages have changed over time with the number of levy payers in each class and the activity within each class (and therefore, reflect changes in the number of market participants under Option one). Option two incorporates adjustments to the incidence of the levy in terms of proportion of levy paid.

151. The levies for some classes, including managed investment schemes, foreign exchange dealers, derivative issuers, insurers and DIMS providers are not proportionate to their risk profile. A more appropriate cost allocation based on the relative risk of these classes is proposed.

152. A summary of the proposed changes to the structure of the levy model are outlined below.

153. Appendix 2 outlines the reasoning for the structural changes and adjustments to the relative portion of the levy paid by classes of financial market participant.

154. Appendix 3 shows the impact on stakeholders in terms of the levy fully funding the FMA's additional funding under the enhanced funding case.

Stakeholder or activity	Proposed changes to levy class and basis for levy payment	Levy tiers changing?
Accredited bodies	No change	n/a
Authorised financial advisors (AFAs)	Differentiate AFAs that provide DIMS within a separate DIMS category.	n/a
Authorised futures dealers	Repeal as class no longer necessary from 1/12/16.	n/a
Banks and non-bank deposit takers	No change	No
Brokers	Differentiate brokers from those that provide custodial services.	n/a
Building societies, companies, friendly societies, credit unions and limited partnerships	No change	n/a
Contributory mortgage brokers	No change	n/a
Crowd funders and peer-to-peer lenders	New levy class	No
Custodians	Consolidate custodians under the FA Act and the FMC Act into one class.	No
Derivative issuers	No change	n/a
Discretionary investment management scheme (DIMS) providers	Consolidate DIMS under the FA Act and the FMC Act into own levy class.	New tiers
Financial statement filing for FMC reporting entities	New levy class.	No
Financial service providers	No change	n/a
Foreign exchange traders	Split out from DIMS providers under the FMC Act.	n/a
Licensed insurers	No change	Changes to existing tiers
Licensed market operators	No change	n/a
Listed issuers	No change	n/a
Lodging product disclosure statements and prospectuses	As prospectuses are being replaced by Product Disclosure Statements, levy payable on lodgement of prospectus will be repealed.	n/a
Managers or superannuation trustees in respect of securities	No change	Changes to existing tiers
Overseas auditors	No change	n/a
Persons authorised to undertake trading activities on licensed markets	No change	n/a
Supervisors of debt securities and trustees of registered schemes	No change	n/a

Option three: updated volumes of levy payers and new populations, changes to the structure of the levy model, equity adjustments and return of over-recovery over a five year period

155. In addition to Option two, Option three involves returning historic over-recovery of levy revenue, over and above the amount agreed by Cabinet, to levy payers through a levy re-set.

156. Fluctuating volumes will always drive the levy model, resulting in either over or under-collection. Any adjustment for the over-collection within the current levy re-set would need to be reversed when the levy is next reviewed.

157. Currently, the levy has over-recovered $6.1 million since the levy was introduced, and is forecast to over-recover by $1 million until adjusted.

158. Returning over-recovery of the levy is consistent with Treasury and Auditor-General fee setting guidelines. While the levy is not a fee and is more akin to a tax, we consider that returning over-recovery to levy payers is consistent with the principles for revenue collecting within the public sector.

We recommend that option three is selected for the levy model

159. Option three incorporates proposed changes under options two and three. This includes updating the levy model to reflect the players in financial markets and the activity they carry out. It also includes returning over-recovered levies to stakeholders.

160. Financial market participants that carry out similar activities and that pose similar risks are also grouped together and pay the same levy. Levy tiers and the basis for the levy are set to minimise barriers to entry and we have updated the levy model to better reflect the proportion of benefit received by each financial market participant in terms of FMA's activity.

161. A fuller explanation of the rationale behind the changes made to particular classes and the changes that have been made post-consultation are outlined in Appendix Two. A table showing the current levy amounts and the proposed levy amounts across all classes of levy payers is included in Appendix Three.

Consultation

162. Through a consultation paper in July-August 2016, feedback was sought on the above proposed fee levels and the overall impact of current and proposed FMA levy levels on business.

163. Key themes received from submitters included:

- Reduce the burden on small financial service providers.
- Reduce the barriers to entry or growth for new entrants and small financial market participants.
- Have a more appropriate cost allocation for specific classes of levy payer based on the relative risk of financial market participants.
- Simplify the levy model.
- Reduce the differential between tiers where levies are set on a tiered basis.
- Align levy changes with other regulatory initiatives impacting on financial market participants.

164. The levy model has been adjusted in response to these concerns and the impact on different groups of financial market participants is outlined in appendix 2. In summary, changes to the proposals post-consultation involved the creation of a new tier for small NBDTs, new tiers for insurers, maintaining the fixed levy for custodians, increasing the levy on licenced market operators, and changes to the tiers and levies for MIS.

165. A tiered levy for custodians based on New Zealand funds under custody was considered and consulted on. Ultimately it was decided to have a fixed levy due to the administrative difficulty of separating New Zealand funds under custody from overseas funds, and the additional complexity it would add to the levy model.

166. DIMS providers were opposed to the proposed levy changes. They submitted that they would bear an unfair burden under the proposed levies and tiers and this would make their business operations unsustainable, causing firms to exit the market. In addition, submitters believed that levies were not proportionate to the risk posed by DIMS, especially those licenced under the FMC Act. Submitters disagreed with the proposed tiers, saying they did not reflect the variation in size of market participant.

167. The levy for DIMS providers consulted on reflected the idea that DIMS providers licenced under the FMC Act are similar to Managed Investment Schemes (MIS) in terms of their risk profile and the degree of regulatory attention they receive from the FMA. As a result of submissions, the tiers and levies payable for DIMS providers were adjusted to better reflect the large range in size (and ability to pay) between DIMS providers.

168. Insurers outlined many ideas in their submissions on potential changes to the levy on licenced insurers to more accurately reflect the different risk profiles of insurers. These included, reducing the differential between the levy tiers; imposing a different levy on life and health insurance to general property and fire insurance; and including insurance intermediaries in the levy model as they are the source of the majority of complaints rather than insurers themselves. We have adjusted the tiers within the levy model in response to submissions. However we consider that as risk must be priced across all insurance products there is not a strong case for differentiating between types of insurance.

169. A recurring theme from AFAs and their umbrella adviser associations was that, with the Financial Advisers Act (FA Act) review underway, they would like any changes to the FMA levy to be postponed until the impact of these changes on their business is known. Uncertainty around the full impact of compliance costs on their operating model is affecting their ability to make investment decisions and grow. Consequently there was a strong desire for regulatory changes in the financial sector to be coordinated to minimise the impact on business.

170. The FMA levy changes will take effect from 1 July 2017, by which stage the full impact of FA Act changes will not be known. However, the FMA needs additional funding from that date, so aligning the timeframes of the FMA's funding and levies review with the FA Act review is not possible. However, in consideration of the impact on AFAs we are proposing to keep the AFA levy unchanged.

4 Funding for the XRB and the XRB Levy

Background

171. The XRB is an independent Crown Entity responsible for the development and issuing of accounting, auditing and assurance standards in New Zealand. The XRB was established in July 2011 and is the successor to the Accounting Standards Review Board following amendments to the Financial Reporting Act 2011.

172. The standards issued by the XRB establish consistent and best-practice requirements for accounting, auditing and assurance practices, playing an important role in regulating the quality of financial reporting. The standards foster confidence in New Zealand financial reporting, enhance entities' accountability to stakeholders, and assist entities to compete internationally.

Status quo

173. The XRB receives $4.41 million in funding: $4.115 of which is from third parties. The difference of $0.295 million is the Crown's contribution. The XRB also receives a small amount of income from interest.

174. Third party funding is comprised of a XRB levy on financial reporting stakeholders and a historical transfer from the Companies Office of $0.830 million.

175. The levy is currently over-recovering relative to the amount agreed by Cabinet in 2012, which on average was expected to be $3.66 million (excluding GST) per annum for the first five years. This included establishment costs for the XRB of $0.225 million and an operating shortfall.

Decisions already made

176. The XRB is not seeking changes to their funding at this time.

177. The historical transfer from the Companies Office to the Crown towards funding for the XRB will cease in fiscal year 2017/18.

Legislative requirements

178. Under Section 52 of the Financial Reporting Act 2013 the XRB levy covers a part of the costs of the XRB in performing its functions and duties and exercising its powers together with the costs of collecting the levy. The levy amount is determined by the Minister of Commerce and Consumer Affairs.

Problem definition

179. The XRB levy is not currently in line with the objectives underlying it. The levy is:

- over-recovering relative to the amount agreed by Cabinet in 2012
- inequitable in terms of financial reporting stakeholders that pay the levy and those that benefit from the XRB's standards.

Issue 1: over-recovery of the levy

180. The levy is intended to recover \$3.66 million annually. As shown below, for the first four years since the levy was introduced, it has recovered approximately a total of \$3.4 million more than predicted.

XRB levies collected

Fiscal year	Levy revenue (\$ million)	Over/(under) recovery (\$ million)
2012/13	\$3.619[6]	(0.041)
2013/14	\$4.965	1.305
2014/15	\$4.693	1.033
2015/16	\$4.745	1.085
2016/17	4.669	1.009

Cause: activity levels have been higher than expected

181. Companies, limited partnerships, building societies, credit unions and friendly societies pay a fixed \$8.70 (GST exclusive) XRB levy annually at registration or annual return via registers administered by the Companies Office.

182. The levy model is based on forecast numbers of these entities. When the levy was established in 2012 it was assumed that numbers would remain mostly static over a period of five years. Ex-post, activity has been stronger than forecast.

Effect of the status quo

183. With respect to the 2012 agreed levy of \$3.66 million and based on updated forecasts of market activity we predict that the levy will continue to over-recover at a rate of approximately \$1 million per annum unless it is adjusted.

Issue 2: inequity between payment of the levy and users of the XRB's standards

184. When the XRB's funding was established third party funding for the XRB was estimated to be 93 percent and the Crown's net contribution was estimated to be 7 per cent. At the time the XRB levy was set to reflect the range of for-profit private entities benefiting from the XRB's standards-setting activities and who could easily be charged for this benefit. The Crown's contribution represented perceived benefits to the broadest group of beneficiaries, the taxpayer.

[6] The levy was introduced on 1 August 2012, so this is not a full year's worth of revenue.

185. The XRB's standards have public good characteristics. It is not possible to exclude anyone from using them and one party's use of the standards does not detract from their use by another. However, besides taxpayers, financial reporting stakeholders that use the XRB's accounting and audit and assurance standards derive benefits from the standards. These benefits accrue to government and not-for-profit entities as well as private for-profit entities. At present, via the levy, only private for-profit entities pay for the benefits to financial reporting stakeholders.

186. Taxpayers and financial reporting stakeholders benefit from the XRB's standards in the following ways:

- Investors and other market participants are able to compare and make use of quality financial information to make informed economic decisions. There is confidence in New Zealand financial reporting.
- The management of entities are held to account and encouraged to behave in ways that are consistent with the interests of their stakeholders. Examples include companies to their shareholders, issuers to debt security holders, public sector entities to taxpayers and service recipients, not-for-profits to their members, and charities to their donors.
- Through the use of a common financial language, investors can more easily identify risks and opportunities and entities face lower financial reporting and capital raising costs.

Cause: status quo does not reflect use of the XRB's standards

187. The XRB's accounting standards framework is a two-sector structure with different tiers of accounting standards applying within these sectors. Entities are either classed as public benefit entities7 (which include most government entities and many not-for-profit entities) or private for-profit entities.

188. In carrying out annual audits of New Zealand public entities the Auditor-General uses the XRB's audit standards, with some additions. In terms of the private sector, separate pieces of legislation at the entity level determine whether the XRB's audit and assurance standards need to be followed. The membership body, Chartered Accountants Australia and New Zealand (CAANZ) also requires its New Zealand members to carry out all audits, whether regulated or not, in accordance with the XRB's standards.

189. Over 38,000 public benefit entities are required to use the XRB's standards. These include central and local government, SOEs, Crown Entities and, since 1st April 2016, Registered Charities. Attributing the XRB's time to each entity in accordance with their accounting and audit frameworks, it is estimated that the benefit attributing to these entities from the XRB's standards is approximately 55 per cent. On the same basis, the benefit attributing to private for-profit entities is approximately 45 per cent. (Refer Appendix 3 for attribution of benefit calculations).

[7] Public benefit entities are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.

Objectives and criteria

190. The objective is to ensure that the XRB remains sustainably funded while ensuring third parties meet an appropriate proportion of the cost via the levy given the benefits they receive.

191. Associated with this objective are the following criteria:

    i. The levy is simple to administer, low-cost to collect and avoids large over or under-collection.

    ii. Those benefiting from the XRB's functions, or who can create risks that warrant a regulatory response, should bear the costs of these via the levy.

Options analysis

192. Besides the status quo four options have been considered for the XRB levy. These options are outlined in the table below.

Options for the XRB levy

Options		Annual amount to be recovered by the levy	Third-party share of the XRB's funding	Proposed levy (excluding GST)	Estimated annual change to Crown's position[1]	Simple to administer, low-cost to collect, avoids large over/under-recovery	Proportionality/ benefit
Status quo		$3.66 m	93percent (including transfer)	$8.70	n/a	X	X
Option one	Existing third party funding	$4.115 m	93percent	$7.70	$0.017 m	✓✓	X
Option two	Partial benefit model	$2.65 m	60percent	$5.00	($1.432 m)	✓✓	✓
Option three	Full benefit model	$2.00 m	45percent	$3.80	($2.076 m)	✓✓	✓✓
Option four	Return of over-recovery (in conjuction with above options)	-$0.9 m on above options	n/a	-$1.60 on above options for 5 year period	($0.9 m) on above options	✓ but levy would increase once over-recovery has been returned	In line with all options above

1 Based on Crown/levy split and compared to 2012 Cabinet decision

Key

X Not satisfied
✓ Partially satisfied
✓✓ Completely satisfied

Assessment of the proposed options

193. While the options propose different funding mixes for the XRB via the levy and Crown funding, we do not propose to change the types of private for-profit stakeholders that pay the levy nor the method of collecting the levy, which is administratively simple.

194. A number of changes have occurred in the financial reporting system since the levy was established. However, with the exception of Registered Charities being required to use the XRB's accounting standards, changes to financial reporting stakeholders have been immaterial.

Option one: existing third party funding

195. Under option one it is proposed that the annual average levy be re-set to $4.115 million in line with existing third party funding levels for the XRB. While the amount to be recovered by the levy would increase from 2012 estimates, due to higher estimated numbers of contributors the net impact is a $1 decrease in the current levy payable by stakeholders.

196. The new level incorporates the historical funding payment that the Companies Office makes to the Crown for the now defunct Accounting Standards Review Board. When Companies Office fees are re-set in fiscal year 2017/18 this separate third-party funding stream of $0.830 million will cease.

197. Under this option the government would fund approximately 7 per cent of the XRB's revenue and third parties would fund approximately 93 per cent (which is the portion agreed for third parties by Cabinet in 2012). Option one was consulted on and is the Government's preferred option.

Options two and three: partial and full benefit models

198. Options two and three propose a re-adjustment in the portion of the XRB's costs to be met by the levy to better reflect distribution of stakeholder benefit from the XRB's standards setting. At the time that the XRB's funding was established (and under option one), the government's contribution to the XRB's funding was estimated to be 7 per cent. The government's portion represented benefits to the broadest group of beneficiaries, the taxpayer, and did not account for the direct use of the XRB's accounting and audit standards by public entities.

199. Based on estimated volumes of stakeholders that could practically pay the levy and the XRB's time attributed to each in terms of standards setting (refer Appendix 3) these options reflect benefits to financial reporting stakeholders. Both options make adjustments for the Crown as a direct user of the XRB's standards and account for the wider public benefits from not-for-profits using the XRB's standards. (As it would not be appropriate to charge Registered Charities the levy their attribution of benefit is re-allocated to the Crown.)

200. Option two partially adjusts for benefit and increases the Crown's contribution to 40 per cent, with third parties funding 60 per cent via the levy. This portion is higher than the Crown's 26 per cent net investment in the XRB's predecessor, the Accounting Standards Review Board but partially adjusts for the XRB's significantly increased functions.

201. Option three fully adjusts for benefit and increases the Crown's net investment in the XRB to 55 per cent, with third parties funding 45 per cent via the levy.

Option four: return of over-recovery

202. Another option is whether the over-recovery of the levy should be factored into the levy re-set. If the over-recovery was incorporated within the amount of the levy from fiscal year 2017/18 the annual levy to be recovered would reduce by $0.9 million across each option and the levy payable by a further $1.60.

203. Under this option, once over-recovered levies have been returned to stakeholders over the next five years (or until the levy is re-adjusted), the levy would need to be increase.

Recommendations

204. We recommend that options three and four are selected for funding the XRB via the levy

205. Option three reflects public and private benefits from the XRB's standards setting and the split of benefits amongst financial reporting stakeholders. This option is also easy to collect and will address the current over-recovery of the levy.

206. Option four returns the over-recovery of the levy which is estimated to be $4.3 million for the five years to 30 June 2017. Any adjustment for the over-collection within the current levy re-set would need to be reversed when the levy is next reviewed.

Consultation

207. Through a consultation paper in July-August 2016, feedback was sought on option 1 (the Government's preferred option) and option 4 as well as the mix of the XRB's funding.

208. Submitters either were in favour of these options or did not express an opinion due to the levy having minimal impact on their business.

209. After consideration of a range of options, we recommend that options three and four should be adopted. We consider that these options reflect the charging principles established by the Treasury and the Auditor-General.

5 Funding for the Companies Office and Companies Office fees

Background

210. The Companies Office is a business unit within MBIE. Its core role is to operate a portfolio of statutory registers which have diverse characteristics depending upon the objectives and needs each is intended to fulfil.

211. For example, the Financial Service Providers (FSP) Register is a searchable online register of people, businesses, and organisations that offer financial services. The Personal Property Securities Register (PPSR) holds details of security interests over certain personal property including motor vehicles, stock, and plant. The Companies Register is the largest and most complex register and holds company information and documents.

212. In addition to administering public registers, the Companies Office is also the custodian for the New Zealand Business Number (NZBN), manages the business.govt.nz website for small business and is responsible for the Community Housing Regulatory Authority.

213. The functions of the Companies Office contribute to an efficient and transparent New Zealand business environment. Businesses can meet governance obligations online in a simple and cost-effective way. They can also view and search information and documents.

214. The Companies Office aims to minimise the regulatory hurdles involved in starting and operating a business by delivering services digitally, reducing compliance costs and increasing business efficiency.

Status quo

215. The Companies Office is predominantly third-party funded, with some functions being partially or fully Crown funded such as the NZBN, business.govt.nz and the Community Housing Regulatory Authority.

216. For the registry functions the Companies Office charges fees to third parties on a ‘user pays’ basis for the services it provides through the registers. In this way, those that benefit from the registry functions of the Companies Office, and those who need to use the services, contribute to the funding of these functions. Fees are set to levels to recover the long-run cost to the Companies Office of providing these services.

217. The Companies Office operates a ‘memorandum account’ for providing its services. The use of memorandum accounts allows any surplus or deficit in the provision of these services to be recorded and balanced out over time. The Companies Office memorandum account avoids the need to constantly update fees.

218. The Companies Office currently has an accumulating surplus in its memorandum account.

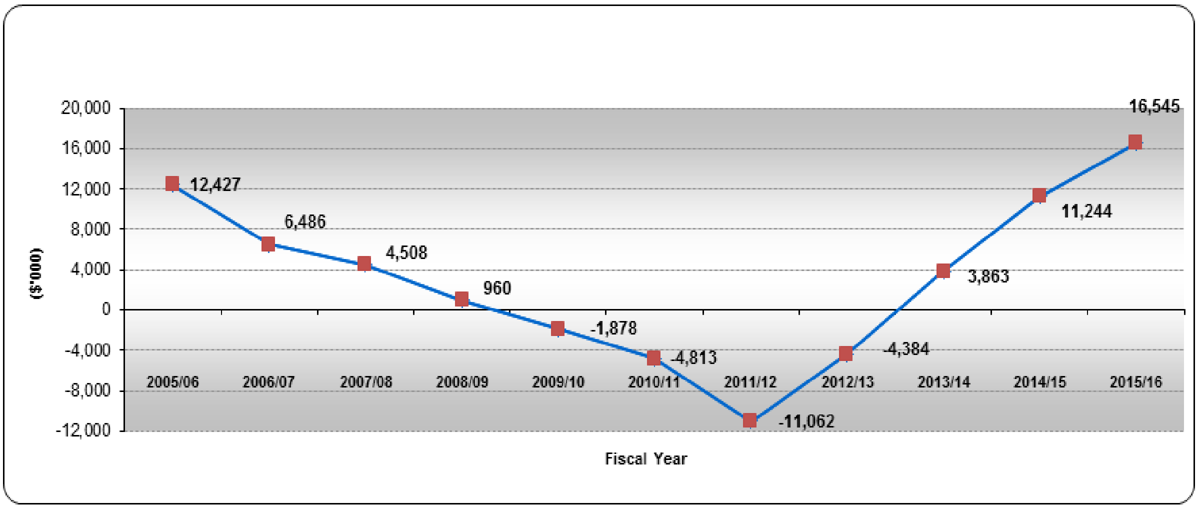
Problem definition

219. Treasury guidelines recommend fees are reviewed every three to five years to manage the balance in the memorandum account and ensure that they fully reflect the cost of providing the relevant service.

220. Companies Office fees were last adjusted in 2012 when the Companies Office's memorandum account was in $11 million deficit. At that time the fee structure was set to recover the deficit and ensure that the Companies Office would have a sustainable level of funding to continue to provide its services.

221. Since 2012, the deficit in the memorandum account has been recovered more quickly than anticipated. As illustrated below, the Companies Office now has an accumulating surplus in its memorandum account, which measured $16.5 million at 30 June 2016.

Companies Office memorandum account, 2005/06 – 2015/16



Cause: more robust activity levels and some fees set above service costs

222. The growth in the Companies Office memorandum account surplus is largely due to higher than expected volumes for some services, coupled with certain fees being set above cost to recover the deficit in the memorandum account.

Effect of the status quo

223. If Companies Office fees are not adjusted they will not accurately reflect current volumes and Companies Office costs incurred in providing services. The memorandum account surplus will continue to grow.

Decisions already made

224. Not all Companies Office fees are being amended because projected volumes and costs for some registry services are uncertain. The Companies Office has opted to split the fee review for the existing registry services into two phases. Phase One changes will be effective from July 2017 (the proposed changes to fees outlined below) and Phase Two will occur at a later date (to be determined). The reason that the fees review has been split is because the fees that need to be considered in Phase Two are for relatively new registers or relate to changes

that need to be made as a result of new legislation such as the FMC Act and the Limited Partnerships Amendment Act 2014. The costs relating to these changes are currently uncertain and so it was determined that it would be preferable to have greater certainty of these costs before proposing new fees.

225. In addition, the changes in fees that are being proposed are for services that are the key drivers of the rising memorandum account surplus. It is therefore appropriate that the memorandum account be reduced through the alteration of these fees.

226. Currently the Companies Office makes payments to the Crown for the FMA and for the defunct Accounting Standards Review Board. These payments will be replaced by the FMA and XRB levies.

227. Funding for the Companies Office will increase by $5.3 million of which $4.3 million is due to a change in MBIE's IT cost allocation model where costs are now more accurately allocated to business units. The remaining $1 million relates to increased compliance and enforcement activity and support of joined up government services such as the NZBN programme as well as replacement costs of legacy shared services systems. The funding increase will be fiscally neutral.

Objective

228. The objective is to adjust Companies Office fees to reflect the cost incurred by the Companies Office in providing particular services, reduce the memorandum account surplus over the next five years and return the memorandum account surplus to stakeholders over the longer term once Phase Two of the fees review has been completed. This is in line with a key purpose of using memorandum accounts to minimise under or over collection from third parties over time.

Option

229. Changes are proposed for fees for services relating to the Companies Register, the FSP Register, the PPSR, and financial statement filing for the next five years.

230. The review of Companies Office fees is based on an external review of costs and funding by Deloitte. The cost allocation process was derived from an analysis of volumes and services. Direct and indirect costs were allocated across fee bearing services to derive a unit cost for each service.

231. Volumes used in the cost allocation model are based on past data (normalised for the effects of the global financial crisis) for the use of Company Office services. These volumes are a key driver in determining a per unit cost of each Companies Office service. A five year average of forecast costs was used to normalise one-off cost pressures and ensure that the costs which are allocated are largely sustainable year-on-year. Built into the costing model is an allocation of MBIE IT support costs and capital charge costs. IT services are essential to maintaining Companies Office registers and these costs are therefore allocated via fees.

232. The Treasury guidance recommends that the memorandum account should balance over the long term. However, as a precaution, the Companies Office is targeting a surplus of $2-3 million over the next five years as a buffer for any future revenue shocks and unforeseen circumstances, particularly in relation to the timing of the review of phase two fees. Without the buffer of $2-3 million the proposed changes to fees outlined here will cause the memorandum account to fall into deficit around 2022. The Companies Office is also aiming

to provide more certainty to the market by avoiding volatile fluctuations of fees.

Proposed Companies Office fees

Fee Type (excluding GST)	Current fee	Unit cost of service	Proposed fee	Change in fee ($)
Company name reservation – online	8.89	12.37	**10.00**	+1.11
Company name reservation – manual	22.22	12.37	**10.00**	-12.22
Company incorporation	113.04	71.66	**90.00**	-33.04
Company annual return - retail	21.74	21.08	**21.00**	-0.74
Company annual return – Government to business	21.74	17.93	**18.00**	-3.74
Company amalgamation	266.67	388.44	**350.00**	+83.33
Company restoration	177.78	149.35	**150.00**	-27.78
Certified copy	22.22	33.87	**0.00**	-22.22
PPSR registration /renewal – Government to business	8.70	7.04	**7.00**	-1.70
PPSR registration /renewal – retail user	17.39	14.30	**14.00**	-3.39
PPSR search – Government to business	1.30	1.21	**1.00**	-0.30
PPSR search – retail user	2.61	2.04	**2.00**	-0.61
FSP Registration	311.11	295.91	**300.00**	-11.11
FSP Renewal	53.33	102.20	**75.00**	+21.67
Financial Statement filing	222.22	174.21	**175.00**	-47.22

Assessment of the proposed fee changes

233. For the Companies Register, a single fee of $10 (excluding GST) is proposed for both online and manual company name reservations.   The proposed $90 (excluding GST) company incorporation fee incorporates increased enforcement activity relating to this activity. A discounted fee is proposed for government-to-business annual return filing once this system is in place later in 2016/17.

234. Under the proposed fee structure, fees for certified copies would be removed. Given the low volumes of certified copies processed by the Companies Office, from an administration perspective, it is recommended that the fee is removed for this service.

235. While small, search fees exist for the PPSR to deter 'keyhole' searching of this register. For example, a person searching the register to see if a neighbour's new car has any money owing on it. We consider that even with the reduction in the PPSR search fee, the charging of a per-search fee would still deter keyhole searching. The deterrence arises through the identification of the casual searcher through payment for the search.

236. In the FSP register it is not proposed to increase the cost of renewal to the level indicated by the costing model. This is because it is possible that costs have risen recently with recent legislative changes and this activity may not continue.

237. The fees are proposed to be set at sustainable levels to provide stability in the memorandum account and minimise the regular accumulation of memorandum account surpluses and deficits. Where fees are set below cost this will return the current memorandum account

surplus. Setting fee levels for a period of five years ensures that they can be maintained for a reasonable period of time and avoids making large corrections to fees in the future.

Recommendations

238. We recommend that the proposed Companies Office fees be adopted.

239. As well as addressing the memorandum account surplus, the proposed adjustments for fees charged for Company Office services that relate to the Companies Register, the FSP register, the PPSR, and financial statement filing more closely align to the cost of providing these services. We therefore recommend that they be adopted.

Consultation

240. Through a consultation paper in July-August 2016, feedback was sought on the above proposed fee levels and the overall impact of current and proposed Companies fee levels on business.

241. Out of 41 submissions, 11 submitters commented specifically on Companies Office fees. Most submitters were content with the net impact of the proposed fee changes and stated that they would have minimal impact on their business.

242. In response to a submission relating to the differential costs between retail and government-to-business filing of annual returns, a discount was proposed for government-to-business filers to reflect the projected costs of providing this service.

243. Some stakeholders believed that FSP Register fees should be higher, given the considerable attention this register is demanding from regulators. Others were of the view that the proposed increase was too high. Costs for the FSP register have been higher than anticipated when the register was established and it is our view that the proposed fee reflects the true cost of providing the service. The Companies Office undertakes behind the scenes work to maintain this register, particularly with regards to integrity and enforcement, and information security.

6 Conclusions and recommendations

The FMA levy

244. After considering options relating to the total amount of the FMA's funding, we are recommending that the FMA's total appropriation be increased from $26.18 million to $36 million – the enhanced case. However, this recommendation is caveated due to inadequacies in our evidence base.

245. We are also recommending that the Crown and levy payers continue to share the costs of the FMA's funding. We consider that the FMA's activities can be deemed to be both a private and public good. It is however difficult to determine what percentage of funding would best represent the share of public and private benefit. We are limited in our assessment to more general explanations of the FMA's activities against what we consider to be mostly public or private benefit.

246. Our assessment of recent conditions in financial markets has led us to recommend that the majority of the FMA's funding continues to be derived from the levy on financial service providers. We do not however have a view as to what set percentage would most accurately represent the benefit received by the public and financial service providers.

247. In regards to the structure of the FMA levy itself, we are recommending a number of changes should be made to the percentage of the levy that certain populations of financial service providers pay. These changes are intended to more accurately reflect the benefit those financial service providers gain from the FMA's regulation.

248. We are also recommending that the over-recovery of the levy should be returned to levy payers via a reduction in the levy across all classes.

The XRB Levy

249. XRB receives $4.41 million; original policy decisions estimated that 93 percent of its funding should be gained from third parties and 7 percent from the Crown. We recommend that the relative percentages outlined above should be adjusted to better reflect the number of public benefit entities that benefit from XRB's activities.

250. The XRB levy has also been over-recovering over the last four years. We recommend that this over-recovery should be returned via a reduction in the levy over a five year period (or until the levy is re-adjusted).

Companies Office fees

251. We recommend that the surplus in the Companies Office memorandum account should be balanced by changing the fees collected for a number of its services. We also recommend that some other fees should be adjusted in order to better reflect the cost of providing the Companies Office service to which they relate.

7 Implementation plan

252. Changes to the amount of FMA's funding, the quantum and split of the FMA levy, the amount of the XRB levy, and Companies Office fees are proposed to take effect from 1 July 2017.

253. The following regulations will require amendment and replacement:

- Financial Markets Authority (Levies) Regulations 2012
- Financial Reporting (Levies) Regulations 2012
- Companies Act 1993 Regulations 2012
- Personal Property Securities Regulations 2001
- Financial Service Providers (Fees) Regulations 2010
- Financial Markets Conduct (Fees) Regulations 2014
- Financial Reporting Regulations 2015

8 Monitoring, evaluation and review

254. All Crown entities are required to report to their responsible Minister and to the general public about their performance. This is done through the entity's Statement of Intent, Statement of Performance Expectations, Annual Report and Long-term Investment Plan (as required). In addition to these existing reporting mechanisms FMA is making changes to its internal strategic reporting frameworks. These changes are intended to allow it to report annually about how its appropriation is spent and should provide levy payers with greater transparency across FMA's activities.

255. We recommend that both the FMA and XRB levies are reviewed in another five years. However, the levies will be annually monitored by MBIE. We also recommend that an interim report on the amount of the levies collected and their breakdown be delivered to the Minister of Commerce and Consumer Affairs in three years' time.

256. In line with the Treasury's guidelines we recommend that options for Companies Office fees proposed in this RIS are next reviewed in five years' time.

Appendix 1: FMA's forecast expenditure by funding case

The following table shows the breakdown of the base, enhanced and lowest funding options across financial years.[8]

Operating Budget Breakdown - BASE	FY 17/18	FY 18/19	FY 19/20	FY 20/21
Personnel Costs	$23,036,212	$23,219,834	$23,219,834	$23,219,834
Litigation Fund Expenses	$2,000,000	$2,000,000	$2,000,000	$2,000,000
Occupancy Expenses	$1,910,008	$1,942,372	$1,975,010	$2,025,926
Depreciation and Amortisation	$2,500,000	$2,500,000	$2,500,000	$2,500,000
ICT	$2,214,866	$2,214,866	$2,214,866	$2,214,866
Professional Services	$1,668,200	$1,668,200	$1,668,200	$1,668,200
Services & Supplies	$1,341,167	$1,341,167	$1,341,167	$1,341,167
Travel & Accommodation	$707,432	$707,432	$707,432	$707,432
TOTAL EXPENSES	**$35,377,885**	**$35,593,872**	**$35,626,510**	**$35,677,425**
TOTAL FTE	**167.8**	**166.8**	**166.8**	**166.8**

Operating Budget Breakdown - ENHANCED	FY 17/18	FY 18/19	FY 19/20	FY 20/21
Personnel Costs	$26,091,786	$26,275,408	$26,275,408	$26,275,408
Litigation Fund Expenses	$2,000,000	$2,000,000	$2,000,000	$2,000,000
Occupancy Expenses	$1,910,008	$1,942,372	$1,975,010	$2,025,926
Depreciation and Amortisation	$2,500,000	$2,500,000	$2,500,000	$2,500,000
ICT	$2,214,866	$2,214,866	$2,214,866	$2,214,866
Professional Services	$1,668,200	$1,668,200	$1,668,200	$1,668,200
Services & Supplies	$1,341,167	$1,341,167	$1,341,167	$1,341,167
Travel & Accommodation	$707,432	$707,432	$707,432	$707,432
TOTAL EXPENSES	**$38,433,460**	**$38,649,446**	**$38,682,085**	**$38,733,000**
TOTAL FTE	**192.0**	**191.0**	**191.0**	**191.0**

Operating Budget Breakdown - LOWEST	FY 17/18	FY 18/19	FY 19/20	FY 20/21
Personnel Costs	$20,886,568	$21,070,190	$21,070,190	$21,070,190
Litigation Fund Expenses	$2,000,000	$2,000,000	$2,000,000	$2,000,000
Occupancy Expenses	$1,910,008	$1,942,372	$1,975,010	$2,025,926
Depreciation and Amortisation	$2,500,000	$2,500,000	$2,500,000	$2,500,000
ICT	$2,214,866	$2,214,866	$2,214,866	$2,214,866
Professional Services	$1,668,200	$1,668,200	$1,668,200	$1,668,200
Services & Supplies	$1,341,167	$1,341,167	$1,341,167	$1,341,167
Travel & Accommodation	$707,432	$707,432	$707,432	$707,432
TOTAL EXPENSES	**$33,228,242**	**$33,444,228**	**$33,476,867**	**$33,527,782**
TOTAL FTE	**148.1**	**147.6**	**147.1**	**147.1**

[8] Total FTE numbers are indicative only. Actual numbers will reflect required skills mix and levels of seniority applied across the activities in each year.

Expenditure across key activities

The tables below show the primary areas where the FMA considers it could vary its resourcing (beyond a de minimis level).

Personnel Costs by Area – BASE	FY 2018/19
1. EBRM and other market engagement	$807,068
2. Proactive supervision and monitoring of entities	$2,533,216
3. Proactive supervision and monitoring of individuals (e.g. AFAs)	$424,466
4. Engagement with Frontline Supervisors	$234,003
5. Surge capacity to rapidly respond to emerging threats or risks	$468,006
6. Risk assessment and intelligence	$1,311,510
7. Investigations	$659,225
8. Investor capability	$297,311
9. Offers and disclosure	$1,683,033
10. Policy capacity	$1,184,294
11. Litigation	$1,299,487
12. Other regulatory and external facing activities	$6,939,723
13. Corporate and support	$5,378,491
TOTAL Personnel Costs	**$23,219,834**

Personnel Costs by Area - ENHANCED	FY 2018/19
1. EBRM and other market engagement	$1,050,922
2. Proactive supervision and monitoring of entities	$3,132,416
3. Proactive supervision and monitoring of individuals (e.g. AFAs)	$655,735
4. Engagement with Frontline Supervisors	$466,063
5. Surge capacity to rapidly respond to emerging threats or risks	$582,579
6. Risk assessment and intelligence	$1,578,882
7. Investigations	$875,316
8. Investor capability	$592,153
9. Offers and disclosure	$1,971,818
10. Policy capacity	$1,453,650
11. Litigation	$1,294,092
12. Other regulatory and external facing activities	$7,243,292
13. Corporate and support	$5,378,491
TOTAL Personnel Costs	**$26,275,408**

Personnel Costs by Area - LOWEST	FY 2018/19
1. EBRM and other market engagement	$800,852
2. Proactive supervision and monitoring of entities	$1,779,306
3. Proactive supervision and monitoring of individuals (e.g. AFAs)	$326,699
4. Engagement with Frontline Supervisors	$232,201
5. Surge capacity to rapidly respond to emerging threats or risks	$232,201
6. Risk assessment and intelligence	$1,165,846
7. Investigations	$654,148
8. Investor capability	$295,022
9. Offers and disclosure	$1,424,473
10. Policy capacity	$1,175,173
11. Litigation	$1,089,730
12. Other regulatory and external facing activities	$6,653,980
13. Corporate and support	$5,240,561
TOTAL Personnel Costs	**$21,070,190**

Appendix 2: Changes to the structure of the FMA levy and relative portion of total levy payable

1. This appendix outlines changes proposed under Option Two to the structure of the FMA levy and adjustments to the portion of the total levy payable by each class of market participant for equity reasons.

Authorised Financial Advisers (AFAs)

2. The levy for AFAs is not proposed to change from its current level owing to the uncertainty around changes to the FA Act and forthcoming implications for AFAs. Consequently, the proportion of the total levy paid by AFAs will decline versus the 2012 model. The impact of the FA Act changes on the FMA's cost of regulating this group of market participants is also unclear at this stage.
3. AFAs that provide DIMS will pay a new DIMS levy in addition to their AFA levy.

Banks and Non-bank deposit takers (NBDTs)

4. The proportion of the levy paid by banks and NBDTs has decreased since the levy was established in 2012 due to new financial market participants being incorporated into the levy model. In keeping with the original model, we propose to adjust the portion of the levy covered by banks and NBDTs back to approximately 12 percent of the total levy. Banks and NBDTs look after approximately 85 per cent of New Zealand's assets and most New Zealanders are customers. They receive a significant benefit from having well-regulated financial markets and changes in market confidence have a large impact on these participants. Consequently it is our assessment that this sector maintains its share of the levy burden.
5. Under FMA's enhanced funding case and assuming industry covers all of the increase in funding, the levy for banks and NBDTs with more than $1 billion assets under management would increase 75-80 per cent. This is balanced by the goal of minimising barriers to entry for new NBDTs and credit unions, and encouraging competition in this market. As a result, new tiers are proposed for NBDTs with less than $1 billion assets under management, reflecting the wide variation in ability to pay amongst these small entities. This would result in a decrease in the levy or a small increase for these market participants.
6. Under the levy regulations a person included in two or more levy classes must pay the levy prescribed for each of those classes. This means, for example, registered banks that issue derivatives or offer managed fund products also pay levies for these activities. In terms of the total amount of the levy paid by banks the relative levy for some other types of financial market activities are also proposed to change.

Brokers and custodians

7. Good conduct by brokers and custodians is critical to retail confidence in financial markets as they are the holders of retail funds. They therefore warrant more regulatory attention and higher levies than are currently paid. The proportion paid by custodians is proposed to increase from approximately 2 per cent to 3 per cent.
8. Brokers, custodians and DIMS providers currently pay different levies depending on whether they are licenced under the FA Act or FMC Act. To streamline the levy model and to better align with the risk profile of these activities, under option two we propose to consolidate

DIMS providers, brokers and custodians into separate classes, regardless of which Act they are licenced under. Brokers that do not provide custodial services will remain in the broker class.

9. The regulatory obligations on brokers are less than that for custodians and they differ in size and ability to pay. This justifies a lower relative levy for brokers compared to custodians. If a broker is also a custodian then in this instance we propose that they just pay the higher custodian levy.

Building societies, companies, credit unions, friendly societies and limited partnerships

10. Building societies, companies, credit unions, friendly societies and limited partnerships currently pay a $8.70 (excluding GST) levy at registration and annual confirmation, reflecting the indirect benefits from having a stable and well-regulated financial sector and access to capital. When the levy was established, this equated to approximately 25 per cent of the total levy funding. This would decrease to approximately 20 per cent under the proposed options, reflecting the indirect nature of the benefit accruing to these participants.

11. This group of financial market participants also pay the XRB levy, which is proposed to decrease.

Crowd funders and peer-to-peer lenders

12. Crowd funders and peer-to-peer lenders are new categories of financial market participants that are licensed by the FMA under the FMC Act. We propose to distinguish these participants within their own levy class. The levy payable has been kept relatively low to minimise barriers to entry.

Derivatives issuers

13. Licensed derivatives issuers are required to comply with money and property handling requirements, but there is no regulatory requirement for their assets to be held by an independent custodian. Derivative issuers are also not required to be supervised by a licensed supervisor. As such, investors take a direct credit risk on the derivatives issuer and its financial stability. To counter this, the regulatory regime (including special conditions covering solvency) for derivatives issuers requires regular reporting and monitoring and oversight by the FMA.

14. It is proposed that the levy payable for derivatives issuers is better aligned to this regulatory benefit and the portion of levy payable by this class increased accordingly. Due to the low numbers of derivative issuers currently this class contributes a small proportion of the overall levy, but this is forecast to increase with new entrants.

Discretionary Investment Management Service (DIMS) providers

15. A DIMS is an investment arrangement where buying and selling decisions about a client's portfolio are made on a client's behalf. DIMS cover a wide range of services and can vary considerably. The FMC Act recognises that because some DIMS can have similar characteristics to a product like a managed investment scheme they are regulated in a similar way. Other DIMS can be entirely personalised to a client's circumstances. In these cases an AFA's business model may involve a personalised DIMS that is based on an individual investment strategy.

16. We propose to treat DIMS providers licenced under the FMC Act and FA Act alike. Under the current levy model DIMS pay one of two fixed levies, according to whether they are licensed under the FMC Act or regulated under the FA Act. As the FMA do not treat DIMS categories differently we propose to consolidate DIMS providers into their own levy class and tier the levy payable according to assets under management.
17. The implication is that the cost of the levy will increase for both types of DIMS providers but more so with those regulated under the FA Act.
18. The levy on DIMS providers will be tiered according to funds under management, reflecting the wide variation in size of market participants offering this kind of service.

Financial statement filing for FMC reporting entities

19. A new class is proposed for FMC statement filing to cover the costs of oversight of issuers by the FMA and compliance with their financial reporting obligations. The advantage of brining this funding stream into the levy is a small reduction in the proportion of the levy paid by other participants.

Foreign exchange dealers

20. Currently traders that exchange foreign currency on behalf of other persons fall within the same levy class as DIMS providers under the FMC Act. As noted above we propose to establish a separate class for DIMS providers. Balancing the objective of not discouraging the supply of financial services and additional focus on foreign exchange traders in terms of the FMA's risk-based monitoring MBIE proposes to increase the levy payable for foreign exchange traders.
21. The new levy for foreign exchange dealers will not affect the levy on foreign exchange operators that provide platforms for investment from small money remitters.

Licensed insurers

22. The portion paid by insurers is proposed to reduce from approximately 12 per cent to 9.5 per cent, due to reduced numbers of licenced insurers. However, it is proposed that insurers still pay a relatively high portion of the levy as their conduct is high on FMA's risk assessment.
23. Insurers supply a large proportion of total financial services in the market and they are a key focus for the FMA. The insurance sector is regulated under part 2 of the FMC Act which covers fair dealing in connection with financial products and services. While insurance intermediaries pay a separate and much smaller FMA levy, the FMA takes a thematic view of risks which includes insurance provider conduct and benefits the wider insurance industry.

Licenced Market Operators

24. Licensed market operators, particularly NZX the largest operator, require considerable supervision resources from the FMA. This is balanced against the goal of not creating barriers for the smaller market operators to grow or for new entrants. The current levy for these market participants is not proportionate to this regulatory attention, so it is proposed that it be increased.

Managed Investment Schemes (MIS)

25. Managed funds have grown significantly in funds under management since the levy was introduced in 2012. The popularity of KiwiSaver has accentuated the importance of maintaining public confidence in this group, and has required significant and increased FMA resources. With more than $34 billion funds under management in KiwiSaver schemes this group of market participants derives significant benefit from sustained public confidence in the management of these schemes. Adding two new tiers at the upper end will align the model better to the growth in funds under management.

26. Proposed changes to the tiers are outlined below:

Total managed assets	
Current tier	Proposed tier
Does not exceed $20 million	Does not exceed $20 million
Exceed $20 million but not $50 million	Exceed $20 million but not $100 million
Exceed $50 million but not $100 million	Exceed $100 million but not $500 million
Exceed $100 million but not $500 million	Exceed $500 million but not $1 billion
Exceed $500 million but not $1 billion	Exceed $1 billion but not $2 billion
Exceed $1 billion but not $2 billion	Exceed $2 billion but not $5 billion
Exceeds $2 billion	Exceed $5 billion but not $10 billion
	Exceeds $10 billion

27. To minimise barriers to entry into the funds management market and assist small fund managers to absorb the cost of the levy we propose to reduce the levy for these financial market participants.

Persons licensed to undertake trading activities on licensed markets

28. Financial market participants in this levy class are members of NZX and benefit from its front-line regulation. Less monitoring is therefore required by the FMA. To address this it is proposed that persons licensed to undertake trading activities on licensed markets pay relatively less levy than currently. This is a levy class where entities also pay levies for other types of financial market activity.

Supervisors

29. The proportion of the levy paid by this class is not proposed to deviate from the original model. While consolidation of supervisors means that there are now no supervisors in the two lower tiers, these tiers will be retained to minimise barriers to entry for new entrants.

Other classes

30. No structural or equity adjustments are proposed for any other classes. Other classes will have an increase in the levy proportionate to the increase in the FMA's funding.

Appendix 3: The FMA levy

1. This table of levies corresponds with the model in which 100 percent of the FMA's additional funding is sought through increased levies on financial market participants and factors in return of the over-recovered levy amount over a five year period. Where the current levy has two or more amounts listed this is a result of consolidation of existing tiers or the introduction of new tiers into the structure of the levy.

Stakeholder or financial market activity	**Basis and tiers for levy calculation**	**Current levy** **Where two amounts are listed it is a result of the introduction or consolidation of existing levy tiers**	**Enhanced funding case with return of over-recovery** **Uplift 100% levy funded**	**Enhanced funding case with return of over-recovery** **Uplift 80% levy funded and 20% Crown funded**	**Approximate % portion of total levy revenue**
Accredited Bodies	Per licensed entity	$1,739	$2,600	$2,400	1.4%
AFAs	Fixed levy	$348	$330	$315	2.8%
Authorised futures dealers	Fixed levy	$1,739	n/a	n/a	n/a
Banks and Non-Bank Deposit Takers	Total assets exceed $50 billion	$304,348	$535,000	$490,000	11.1%
	Total assets exceed $10 billion but not $50 billion	$69,565	$130,000	$120,000	
	Total assets exceed $2 billion but not $10 billion	$21,739	$38,000	$35,000	
	Total assets exceed $1 billion but not $2 billion	$13,043	$22,000	$20,000	
	Total assets exceed $500 million but not $1 billion	$6,522	$10,500	$9,500	
	Total assets exceed $40 million but not $500 million	$6,522	$7,700	$7,100	
	Total assets do not exceed $40 million	Either $1,739 or $6,522	$2,400	$2,200	
Brokers	Fixed levy	$870	$1,800	$1,700	0.7%

Stakeholder or financial market activity	Basis and tiers for levy calculation	Current levy Where two amounts are listed it is a result of the introduction or consolidation of existing levy tiers	Enhanced funding case with return of over-recovery Uplift 100% levy funded	Enhanced funding case with return of over-recovery Uplift 80% levy funded and 20% Crown funded	Approximate % portion of total levy revenue
Building societies, Companies, friendly societies, credit unions and limited partnerships	Fixed levy	$8.70	$9	$8.50	19.1%
Contributory mortgage brokers	Fixed levy	$1,739	$1,800	$1,700	0.1%
Crowd funders and peer-to-peer lenders	Part of other FSP category currently	$304	$2,600	$2,400	0.1%
Custodians	In respect of a registered scheme or DIMS service provided by a DIMS licensee Regulated under FAA	$1,739 $870	$6,300 $6,300	$5,800 $5,800	5.3%
Derivative issuers	Fixed levy	$1,739	$9,600	$8,800	0.5%
DIMS providers	Funds under management exceed $2 billion	Either $304 or $1,739	$36,000	$34,000	1.3%
	Funds under management exceed $500 million but not $2 billion	Either $304 or $1,739	$14,000	$13,000	
	Funds under management exceed $100 million but not $500 million	Either $304 or $1,739	$4,800	$4,500	
	Funds under management exceed $50 million but not $100 million	Either $304 or $1,739	$2,400	$2,200	
	Funds under management do not exceed $50 million	Either $304 or $1,739	$950	$900	
FMC reporting entity filing financial statement	Fixed levy	n/a	$48	$44	0.1%

Stakeholder or financial market activity	Basis and tiers for levy calculation	Current levy Where two amounts are listed it is a result of the introduction or consolidation of existing levy tiers	Enhanced funding case with return of over-recovery Uplift 100% levy funded	Enhanced funding case with return of over-recovery Uplift 80% levy funded and 20% Crown funded	Approximate % portion of total levy revenue
Financial service providers	At registration	$304	$460	$420	4.1%
	Annual confirmation (if not in other levy classes)	$304	$460	$420	13.4%
Foreign exchange traders	Fixed levy	$1,739	$5,300	$4,800	3.3%
Licensed insurers	Annual gross premium revenue (GPR) exceeds $500 million	$130,435	$150,000	$136,000	7.4%
	GPR exceeds $100 million but not $500 million	Either $30,435 or $130,435	$38,000	$36,000	
	GPR exceeds $50 million but not $100 million	$30,435	$24,000	$22,000	
	GPR exceeds $10 million but not $50 million	$8,696	$11,000	$9,700	
	GPR does not exceed $10 million	$1,739	$2,200	$1,900	
Licensed market operators	Fixed levy	$17,391	$29,000	$26,000	0.6%
Lodging product disclosure statements	Per PDS or prospectus (except managed funds)	$1,739	$2,600	$2,400	2.8%
	Per managed fund	$370	$530	$500	
Managers or trustees in respect of securities	Total managed assets exceed $10 billion	$86,957	$380,000	$350,000	21%

Stakeholder or financial market activity	Basis and tiers for levy calculation	Current levy Where two amounts are listed it is a result of the introduction or consolidation of existing levy tiers	Enhanced funding case with return of over-recovery Uplift 100% levy funded	Enhanced funding case with return of over-recovery Uplift 80% levy funded and 20% Crown funded	Approximate % portion of total levy revenue
Managers or trustees in respect of securities	Total managed assets exceed $5 billion but not $10 billion	$86,957	$270,000	$250,000	See above
	Total managed assets exceed $2 billion but not $5 billion	$86,957	$120,000	$110,000	
	Total managed assets exceed $1 billion but not $2 billion	$69,565	$80,000	$75,000	
	Total managed assets exceed $500 million but not $1 billion	$52,174	$45,000	$42,000	
	Total managed assets exceed $100 million but not $500 million	$34,783	$25,000	$24,000	
	Total managed assets exceed $20 million but not $100 million	Either $8,696 or $17,391	$6,400	$5,900	
	Total managed assets do not exceed $20 million	$1,739	$1,400	$1,300	
Listed issuers	Fixed levy	$1,739	$2,600	$2,400	2%
Overseas auditors	Fixed levy	$1,739	$2,600	$2,400	0.2%
Supervisors of debt securities and managed investment products	Total supervised interests exceed $5 billion	$86,957	$138,000	$127,000	2.2%
	Total supervised interests exceed $1 billion but not $5 billion	$52,174	$76,000	$70,000	
	Total supervised interests exceed $100 million but not $1 billion	$17,391	$26,000	$24,000	
	Total supervised interests do not exceed $100 million	$4,348	$6,400	$5,900	
Trading activities on licensed markets	Fixed levy	$6,522	$4,500	$4,200	0.2%

Appendix 4: Attribution of benefit from the XRB's standards

Benefits from the XRB's accounting and audit and assurance standards are widely dispersed across reporting system stakeholders. Those that benefit from high-quality financial accounts include companies, investors, customers, lenders and other creditors, academics, government and government agencies, accountants and auditors, the international community, not-for-profit entities and the public.

For stakeholders that are required to, or choose to, adhere to accounting, audit and assurance standards (for example, large companies and public sector entities) these benefits are felt directly. For others, benefits are more of an indirect nature. However, regardless of whether stakeholders use the standards or not, they benefit from the transparency, accountability and efficiency that the XRB's standards bring to financial markets.

The table below summarises the legal entities that benefit from the XRB's standards, the type and proportion of benefit they receive, and the possibility of them paying for this benefit. Where sensible or when it is difficult to attribute benefit on an individual basis, entities have been grouped together.

Attribution of benefit from the XRB's standards and possibility of funding the XRB

Financial reporting stakeholder	Type of benefit	% of benefit[9]	Possible to pay for benefit?
Public sector entities, eg: Central and local government, SOEs Crown Entities	Direct	40%	Yes – via Crown funding
Private sector for-profit entities, eg: FMC reporting entities Companies – Large - > 10 shareholders - SMEs Large NZ companies subsidiaries of overseas company and large overseas companies that carry on business in NZ Large partnerships and large limited partnerships Retirement village operators	 Direct Direct Direct Indirect Direct Direct Direct	40%	Yes – via XRB levy through the Companies Register, Building Societies Register, Friendly Societies and Credit Unions Register
Registered Charities	Direct and indirect	<18%[10]	Yes - via the Companies Register for charities that are for-profit. No - for other charities as would use funds that would otherwise be used to benefit the community.

[9] Estimates of XRB's time attributed to each entity in accordance with their accounting framework are. tier 1 and 2 for-profit: 40percent, tier 1 and 2 public benefit entity: 50percent, and tier 3 and 4 public benefit entity: 10percent.

[10] The proportion of benefit for Registered Charities does not take into account the fact that they are not required to use the XRB's audit standards. Their total benefit is therefore less than 18percent.

Financial reporting stakeholder	**Type of benefit**	**% of benefit[9]**	**Possible to pay for benefit?**
Other non-profit entities, eg: Those that use the XRB's standards although not obligated to, ie Incorporated Societies, Charitable Trusts. Other specified not-for-profits eg body corporates, Maori incorporations, Agricultural and Pastoral Societies	Indirect Direct and indirect	Unknown	No There are overlaps with other entities such as Registered Charities. There are no charge points.
Other (profit and non-profit) entities: Industrial and Provident Societies Friendly Societies	 Direct Direct	 <1% <1%	 No – no charge point Yes - Friendly Societies and Credit Unions Register

While users of financial statements such as investors and the public benefit from good financial reporting, they have been excluded from the analysis as it is impractical to charge them for this benefit via the levy. Licensed auditors and qualified accountants also benefit from the XRB's standards as they use them to prepare financial statements on behalf of their clients. However, to avoid double counting, these classes of entities have also been excluded.

Attribution of benefit is based on estimated volumes of each entity and the XRB's time attributed to each in accordance with their accounting framework. Using the rationale that similar entities are likely to use the XRB's audit standards, this basis has also been used to attribute their work in this area.