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Ministry of Business, Innovation & Employment
Financial Markets Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment
PO Box 1473
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By email only: FMALevyReview@mbie.govt.nz

NZX Submission – Review of Financial Markets Authority Funding and Levy

1. NZX Limited (**NZX**) is pleased to submit this response to the Ministry of Business, Innovation & Employment's (**Ministry**) '*Review of Financial Markets Authority Funding and Levy*' (**Consultation Document**). We thank the Ministry for the opportunity to make this submission, and to contribute to the Government's discussion on choosing the best funding option for the Financial Market Authority (**FMA**).

2. NZX maintains a close working relationship with the FMA, as our interests are aligned in promoting confidence in New Zealand's markets. NZX is subject to the FMA's regulatory oversight as both a licensed market operator, and as the operator of a designated settlement system. In addition, the FMA regulates NZX's wholly-owned subsidiary, Smartshares Limited, as a licensed managed investment scheme manager.

3. The FMA's continued ability to effectively regulate New Zealand's financial markets is pivotal in ensuring market confidence is not undermined. We consider that the increased remit of the FMA's role due to the recent changes in market conduct and the legislative environment, justifies an increase to the FMA's funding. This will ensure that the FMA can continue to promote confident and informed participation in New Zealand's financial markets, preserving New Zealand's international competitiveness.

6. We support an increase to the FMA's funding by $24.805 million (Option 3). This increase would acknowledge the FMA's role as a key conduct regulator, and provide the FMA with the platform from which to promote strategic initiatives that enable innovation in New Zealand's capital markets.

Response to consultation questions

7. In this section of our submission, we provide our response to the specific questions raised in the Consultation Document.

Introduction

Q1. Do you have any feedback on the objectives of the review?

No

We agree with the objectives set out in the Consultation Document, and support the manner in which the review has been conducted, noting the work undertaken by PwC to provide the report '*Financial Markets Authority – efficiency, effectiveness and baseline review*' (**PwC Report**).

FMA funding

Q2. Which of the FMA funding options do you consider to be most appropriate and why?

Funding Option 3: Enhanced Case

We consider that Option 3 is the most suitable funding option for the FMA.

The FMA requires additional funding as it is currently operating with a significant budget deficit of over NZD $4 million. We agree that additional funding is needed to maintain and grow the scope of the FMA's oversight and regulatory functions, given the increases to their remit (in particular as a result of the introduction of the new financial advice regime and conduct and culture work).

We believe that Option 3 allows the FMA a suitable budget to address the recent increases in its responsibilities, while allowing enough surplus to enable it to respond to evolving market trends and engage on more innovative projects. In particular, this funding increase would enable the FMA to engage on the recommendations of the Capital Markets 2029 Steering Group, that are designed to enable capital to flow more efficiently to New Zealand enterprises[1]. As noted in our introductory comments, it is important for the health and international competitiveness of New Zealand's capital markets, that the FMA is appropriately resourced to perform its functions. We note this option was also recommended by PwC through its independent assessment of the FMA's effectiveness and efficiency review.

NZX has direct experience of the importance of New Zealand's regulatory regime being comparable with those of other leading international economies. NZX is accredited as a designated off-shore market with the SEC, and a foreign board of trade by the CFTC. These accreditations have been granted to NZX on the basis that it operates in a suitably regulated regime. We consider that the FMA must receive sufficient funding to enable New Zealand to be well regarded on the world-stage.

We note that the PwC Report, concluded that the FMA was using its resources responsibly. In addition, the FMA has a track record of reserving surplus funding, and is currently

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[11] Capital Markets 2029, *Growing New Zealand's Capital Markets 2029*, available here.

operating using its cash reserves from previous years. This demonstrates that the FMA is equipped to responsibly manage additionally allocated funds.

We consider that the FMA may require another budget review in the near future, and/or be unable to perform its functions appropriately, if either: Option 1 (Current spend) or, Option 2 (Base case), are chosen.

Q3. Are there any areas of FMA expenditure that you think should be expanded or reduced? Why?

No specific preference

We believe that the FMA is best equipped to determine the manner in which its funding is apportioned. We note that the funding increase recommended by PwC and set out in the Consultation Document, does not take account of the resources that may be required in respect of the oversight regime for conduct in the banking and insurance sectors, or the proposed changes to New Zealand's insurance law.

Funding recovery options

Q4. Do you think that the proposed additional funding for the FMA should be wholly levy recovered or should the Crown contribute towards the increase? Why?

The Crown should contribute towards the increase

The FMA provides national benefits and private sector benefits through its regulatory oversight function. Therefore, we believe that the most equitable option is for the FMA to be funded by both the Crown and directly regulated entities. This will be best achieved through an increase in levy funding as well as a proportionate increase in Crown funding.

We believe that partial Crown funding is appropriate, as the FMA provides broader benefits to the New Zealand economy and all New Zealanders by preserving the integrity of New Zealand's capital markets, and maintaining New Zealand's international standing. New Zealand currently holds the no. 1 position in the World Bank's Ease of Doing Business 2020 rankings[2], which is in part directly attributable to the FMA's ongoing regulatory work.

The inability for the FMA to perform its functions to an appropriate standard could have an adverse effect on international perceptions of New Zealand, as a place to do business and its economic performance. In addition, we note that the 2017 International Monetary Fund Financial Sector Assessment Program (FSAP) assessment of New Zealand recommended increased supervisory resources for all financial sectors[3].

[2] World Bank, *Doing Business 2020*, October 2019, available here.

[3] International Monetary Fund, *Financial System Stability Assessment, New Zealand*, May 2017, available here.

Q5. What is the appropriate Crown/levy split of the FMA's appropriation and why?

Increase Crown funding.

Currently the Crown funds 25% of the FMA's budget, with the remainder being monies acquired through levy funding. We support the retention of Crown funding.

We also support an increase to the proportion of the Crown's contribution, as we consider that the conduct of the FMA lowers the cost of capital for New Zealand businesses, providing benefits to the New Zealand economy and all New Zealanders. We also note that the FMA's remit has broadened since the original contribution settings were designed. It is therefore proportionate and equitable for the Crown to fund a significant proportion of the FMA's appropriations.

Changes to the FMA levy

Q6. Do you have any comments on the proposed new levy classes/tiers? Should further classes be considered?

Yes: growth market operators should not be differentiated; the self-select category should be included and broadened to include 'fund of fund' of the same MIS manager.

<u>Growth market operators</u>

The Consultation Document proposes that a new levy class should be added for 'growth market operators'. It is proposed that a licensed market operator, whose licence conditions restrict its activities (such as the size of the issuers that may be listed on that operator's market), would fall within this category.

We consider that it is inappropriate to differentiate market operators based on the nature of the activities permitted on their markets. As all licensed market operators act as the front-line regulator of the markets they operate, we expect that the core obligations to which a licensed or 'growth' market operator are subject, will be the same. We would expect all licensed market operators to have appropriate arrangements to maintain fair, orderly and transparent markets.

We agree that it is important for the health of New Zealand's capital markets that the FMA has sufficient resources to provide effective conduct oversight of compliance with these obligations. However, it is inequitable for 'growth market operators' to be differentiated as a levy class (for the purpose of paying reduced levies), when the resource requirements required for their regulation are the same, or greater.

In addition, such an approach does not align with the FMA's risk-based approach to conduct regulation, which requires consideration of activities that could cause the most harm to New Zealand's capital markets. We expect that in the near-term, 'growth market operators' may pose more risk than established market operators, given the reduced regulatory requirements to which their markets may be subject, and the nature of the entities that wish to list on such markets.

Fund of Fund with same MIS manager

We support the creation of 'self-select schemes' as a different levy class. We agree that it is inappropriate for these products to be levied as separate funds, because this would not accurately reflect the level of regulatory resources required by the FMA to oversee these products.

We also support the introduction of a new category, where a licensed MIS manager operates a fund that solely invests into another fund managed by the same manager, where the economic substance of these funds, and the arrangements by which they are managed are virtually identical. We consider that these structures should be levied in the same manner as self-select schemes, because the most significant regulatory resources will be required to ensure that the manager's conduct is appropriate, and charging a levy at each tier in the structure results in an inequitable outcome.

Q7. Do you have any comments on the different tiers in the levy model?

Yes

As noted above, we do not support the creation of a 'growth fund operator' category.

In the event that the Ministry determines to proceed with the creation of this category, we object to the levy for a 'growth market operator' being set at $10,000, while the levy for a licensed market operator is proposed to be set at $68,925 (under Option 3, as set out in the Annex). Such an approach is inequitable, creating an unfair competitive advantage for 'growth market operators', for the reasons noted above.

We note the proposed significant increases in the levies for certain sectors (such as the insurance and fund management industries[4]). We are concerned that a significant increase in these levies could cause certain participants to exit the industry, reducing the range of providers available to consumers.

In recognition of these effects on market innovation, we consider that it may be appropriate for the FMA to be provided with the discretion to offer some new entrant operators a levy discount over the first few years of operation. This would mitigate the effect of levies acting as a barrier to entry. We would support this approach extending to 'growth market operators', if, despite our earlier submission, they are differentiated under the new regime.

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[4] For example, under the Option 3 funding scenario: (1) a class 3 licensed insurer's fees will approximately triple (causing a mid-sized insurer's fees will change from $24,000 to $66,000); and (2) a class 3 manager's fees will increase by approximately 50% (causing a mid-sized manager's fees to increase from $45,000 to $85,000).

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Q8. Do you have any feedback on the impacts of the proposed changes to the levies presented in the Annex?

No

However, we wish to confirm that in the event the Crown continues to fund the FMA for 25% of the FMA's budget, that this will this result in a 25% reduction of the levies set out in the Annexure.

Closing comments

8. We thank the Ministry for this opportunity to submit on this proposal and we are happy to provide further information or clarification of any matters contained in our submission. We welcome the opportunity to meet with officials to discuss any aspect of this submission.

Yours faithfully,

Kristin Brandon
Head of Policy and Regulatory Affairs