Annual Corporate Plan

2018/19

FMA

FINANCIAL MARKETS AUTHORITY

TE MANA TATAI HOKOHOKO - NEW ZEALAND

Contents

Message from the Chief Executive

This is the second year we have published our Annual Corporate Plan. Our intention is to be transparent about where we focus our activity and resources. Indicating our priorities, and the risks we see, helps us influence behaviour within the industry. It gives the regulated population confidence in meeting their regulatory obligations, and ultimately promotes good outcomes for investors and customers.

While this document outlines our planned work, those plans may change during the year as events unfold. Being able to react to evolving market conditions is critical to being an effective regulator. That said, I expect any changes to our work plan to fall within our current strategic priorities, rather than being changes of the priorities themselves.

A good example is the work we are currently doing with the Reserve Bank on the Conduct and Culture Review of banking and insurance firms. This is part of our response to the conduct issues highlighted by the current Australian Royal Commission into financial services*. The work we are doing is consistent with our strategic priorities, and includes planned work we have accelerated.

The plan also highlights the reasonably wide range of administrative and judicial tools at our disposal. One factor in how we apply these will be the amount of time the industry has had to adjust to new expectations.

As the industry came to terms with new regulatory requirements, we have generally taken an educative and facilitative approach. Now, we expect firms to demonstrate results. As key parts of our regime become more embedded, we are becoming less tolerant of a lack of attention by firms or individuals. This applies to areas such as AML/CFT compliance, misuse of the Financial Service Providers Register, misconduct in relation to trading, inadequate or ineffective disclosure, poor work by auditors or failure to engage openly and honestly with us. We recognise that the behavioural changes and improved outcomes we seek may take time. However, we expect firms to be able to demonstrate progress in the areas noted above.

We are conscious that our remit has built up over time. Further reviews are underway, relating to areas including financial advice, insurance, consumer credit, Ponzi schemes and insolvency. How these reviews land, alongside responses to the International Monetary Fund's (IMF) 2017 Financial Sector Assessment Programme and insights from our banking and insurance Conduct and Culture Review, will no doubt further impact our overall remit and resource allocation.

While this plan coincides with something of an attitudinal shift in how we approach our work, it is also coming at a time when society as a whole is reflecting on what it wants and expects from the financial services sector. We see this as an opportunity for firms to look hard at their conduct, the outcomes they are delivering to customers, and where improvements can be made to make lasting change. I believe this will only enhance confidence in, and vibrancy of, New Zealand's financial markets.

Nothing stands still in a dynamic sector such as financial services. Firms, regulators and the regulatory system need to move too. In doing so it is important that neither we, nor industry, lose sight of the fact that first and foremost our goal is to promote fair, efficient and transparent financial markets.

Rob Everett

Chief Executive
Financial Markets Authority

* The full title is the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Introduction

The FMA promotes and facilitates the development of fair, efficient and transparent financial markets. We enforce the Financial Markets Conduct (FMC) Act 2013 and certain securities, financial reporting and company laws as they apply to financial services and securities markets. We regulate securities exchanges, financial advisers and brokers, auditors, trustees and issuers of financial products to retail customers*, including issuers of KiwiSaver and superannuation schemes. We jointly oversee designated settlement systems with the Reserve Bank of New Zealand (RBNZ). We also work to strengthen the capability of investors.

What's in this plan?

This Annual Corporate Plan sets out our priorities for 2018/19. These are based on the strategic risks to our objectives, and the drivers of those risks. The risks, outlined in our Strategic Risk Outlook, represent the major sources of potential harm to customers or the integrity of New Zealand's financial markets.

We have identified eight strategic priorities and associated outcomes we want to see.

Governance and culture

Firms** have an organisational culture that places customer interests at the centre of their business, and reflects high standards of corporate governance.

Sales and advice

Practices are designed and implemented to meet the needs of customers. Providers demonstrate appropriate capability and due skill, care and diligence.

Conflicted conduct

Incentive structures and practices are designed and implemented with a focus on customer outcomes, and conflicts of interest are appropriately identified and mitigated.

Investor decision-making

Investors are capable and confident, and receive clear, concise and effective disclosure.

Capital market growth and integrity

New Zealand has accessible and dynamic capital markets with resilient infrastructure, where participants act with integrity and investors can engage with confidence.

Frontline regulators

Frontline regulators contribute to well-regulated financial markets through effective oversight of relevant markets and participants.

Perimeter conduct

The risk of significant misconduct outside our perimeter is identified, and abuse of the FSPR and unauthorised business is dealt with swiftly.

FMA effectiveness and efficiency

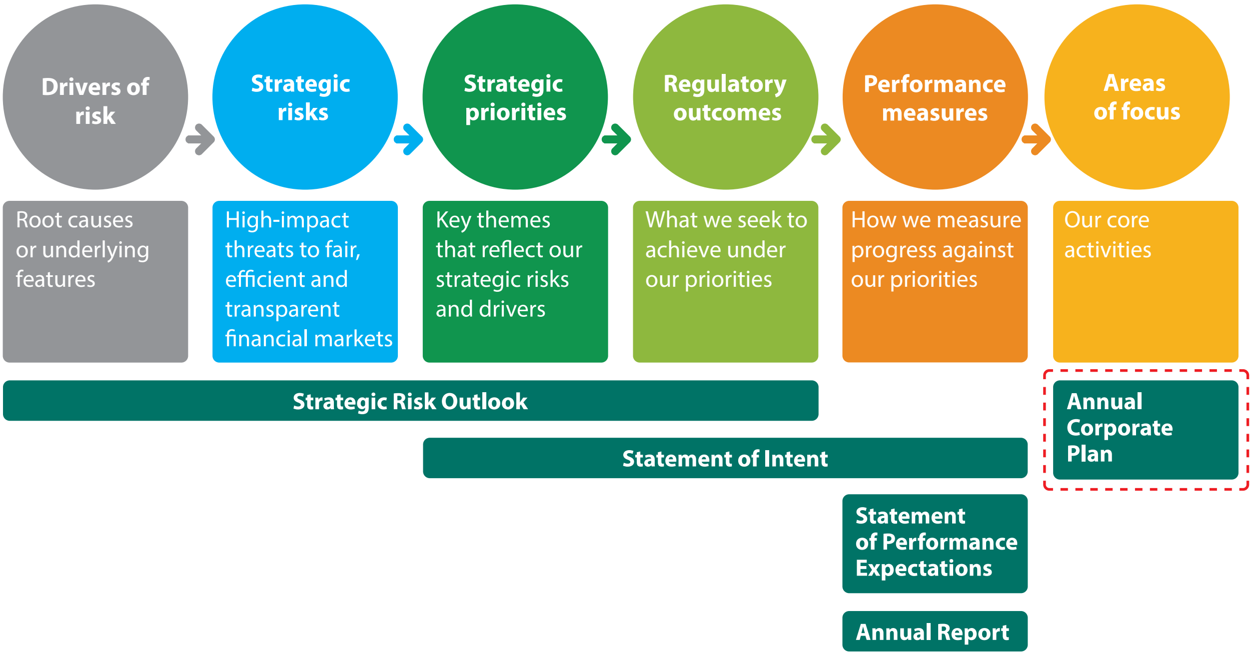
The FMA is an efficient and effective intelligence-led regulator with a focus on continuous improvement.

In this plan we outline each strategic priority, including a discussion of the associated risks. We highlight areas of work in each priority. We also show how our priorities impact the sectors we regulate.

* Customers are the users of products and services, while consumers are the purchasers of products and services
** By 'firm' we mean licensed, registered and other entities that operate in financial markets, including publicly listed companies

How we monitor our performance

The Strategic Risk Outlook and the Annual Corporate Plan set out what we care about, the outcomes we want to achieve and how we will achieve them. Our Statement of Intent and Statement of Performance Expectations outline how we plan to measure our success, and the Annual Report covers progress towards our objectives.



Our approach to regulation

A number of principles underpin our approach to our work.

- **Intelligence-led and harm-based** – We gather and analyse information to identify the greatest risks of harm to customers and New Zealand's financial markets. For example, we undertake ongoing environmental scanning to determine how markets are changing and the impact this may have on our strategic risks. We also use risk assessment tools and frameworks to target our supervision and monitoring activity.
- **Outcome-focused** – We focus our resources where we have the greatest opportunity of achieving desired outcomes. We carefully consider the most appropriate tools and action for each situation. This means recognising the limits of our powers, considering regulatory burden and potential unintended consequences of our actions. We have established a senior review group to monitor and make decisions in relation to our investigation and enforcement activity, to ensure this remains focused on our strategic priorities and outcomes.
- **Consistent and transparent** – We clearly communicate our intentions and expectations to market participants, and explain our actions. An example of this is the publication of our report into our investigations into the trading behaviour of Goldman Sachs in relation the Warrminger market manipulation case. Here we outlined the rationale underpinning our decisions and our expectations of market participants.
- **Flexible and responsive** – We adopt an operating model and ways of working that enable us to quickly adapt and respond to changing market conditions. We seek and act on feedback, and learn from our experiences – for example, initiating the Conduct and Culture Review.

Using our enforcement powers

We have a diverse range of tools and powers, including licensing, monitoring, providing feedback to firms and guidance to industry, issuing public warnings and taking court proceedings.

We prefer to work with industry to improve conduct. However, where misconduct is egregious or persistent, or cooperation is not forthcoming, we take more robust action, including using our formal enforcement powers.

As in 2017/18, this year we expect to see significant investigation and enforcement activity in areas including:

- market conduct (insider trading, market manipulation)
- disclosure in public markets
- anti-money laundering and countering the financing of terrorism (AML/CFT)
- activity on the perimeter (including scams, FSPR abuse)
- any obstruction to the exercising of FMA powers.

Our resource allocation for this work will continue to be a significant component of the FMA's budget and headcount.

Who we regulate

The table below outlines the entities we regulate through direct licensing or authorisation. It notes those who are licensed or registered by other agencies, but may be subject to elements of laws we enforce. We have categorised these entities into broad sectors which are used in the rest of the document to highlight which parts of the market our strategic priorities apply to. As part of our efforts to monitor the perimeter we also take an interest in other products and markets that are not directly in our remit but are linked to financial markets.

Sector	FMA licensed/authorised	Licensed or registered by others[1]
Retail product and service providers	Derivatives Issuers (DI) Managed Investment Scheme (MIS) managers – including KiwiSaver providers	Banks[2,3] Non-bank deposit takers[2,3] Insurers[2,3] Foreign exchange providers[2]
Advisers and discretionary managers	Discretionary Investment Management Service (DIMS) providers Authorised Financial Advisers (AFAs) Qualifying Financial Entities (QFEs)	Registered Financial Advisers (RFAs)[2]
Infrastructure providers	Licensed financial product markets Designated settlement systems	
Alternative capital raising	Peer-to-peer lending providers Crowdfunding providers	Certain other products and markets, eg cryptocurrency exchanges
Frontline regulators	Supervisors Licensed independent trustees NZX (Regulation) Accredited audit bodies	Registered audit firms[4] Licensed auditors[5]
Other market participants	International auditors and audit firms	Brokers[2] Custodians[2] Providers of products and services to wholesale clients[2]
Issuers		Debt and equity offers, and related financial reporting[6]

1. We do not license these market participants but oversee them to some extent.
2. Registered on the Financial Service Providers Register (FSPR)
3. Prudentially registered or licensed by RBNZ
4. Registered on the auditor's register
5. Licensed by accredited audit body
6. Registered on the Disclose register

Strategic priority:

Governance and culture

Risks and harm we want to address

- Poor culture in financial services firms that may result in failures to manage conduct risk, and in some cases may drive conduct risk
- Ineffective governance, accountability or systems and controls that may result in harm to customers and/or market integrity
- Ineffective governance and/or poor culture in publicly listed companies that may result in failures to manage business risks, including disclosure failures

Sectors impacted

All

Outcomes we want to see

- Boards and senior management of regulated firms deliver an organisational culture that places customer interests at the centre of their business
- Corporate governance in New Zealand reflects high standards of practice, balancing the needs of clients and investors

Strong culture and governance is the bedrock on which public trust and confidence in financial services is built. It drives the conduct and behaviour of a firm and its employees, and is critical for managing the myriad of risks faced by firms.

Culture has many facets, such as:

- the tone set from the top
- ethics, professionalism and capability of staff and management
- governance structures
- incentives and remuneration structures.

Local and international investigations into examples of mis-selling, market manipulation and insider trading have highlighted inappropriate culture as a driver of poor outcomes for customers and the market.

Recent problems in New Zealand listed companies have brought corporate governance into sharp focus. We have identified particular concerns with information flows between management and boards, boards providing inadequate oversight and financial disclosure failings.

Examples often highlight that culture and governance must begin and end with the board and senior management. This includes setting appropriate values and behaviours, and ensuring these are exhibited at all levels of the organisation.

As a regulator, we seek to support improvement by setting minimum governance standards and expectations of behaviour for the firms we regulate. We then monitor firms against these.

"...culture and governance must begin and end with the board and senior management. This includes setting appropriate values and behaviours, and ensuring these are exhibited at all levels of the organisation."

Last year we released our Guide to Good Conduct and revised our handbook on corporate governance principles and guidelines. We also released a compliance assurance programme information sheet, which outlines guidance for testing a firm's own compliance programmes. Work in this space will continue throughout 2018/19 as we explore how firms have responded to these and our other stated expectations.

In general, we would like to see firms adopt an approach that goes beyond legal minimums, and sees firms focusing on investors and consumer outcomes.

As both a driver and mitigant of conduct risk, governance and culture is linked closely to our other strategic priorities.

Activities and milestones for 2018/19

- Ongoing proactive and reactive engagement with management and boards of licensed entities to highlight and test expectations around conduct and governance
- Engagement with listed companies, NZX participants and service providers to explain and reinforce expectations around governance obligations
- Thematic work on cyber-resilience and development of our monitoring approach (see page 24)

Conduct and Culture Review

Links between the New Zealand and Australian banking and insurance markets have led to concerns that the issues highlighted by the Australian Royal Commission into financial services misconduct may be present in New Zealand, or undermine confidence in our markets.

To address this risk, we have decided to accelerate and focus monitoring activity on the conduct and culture of New Zealand banks and life insurers through a joint FMA and RBNZ review. This work is also coordinated through the Council of Financial Regulators (CoFR)*.

Objectives

To understand how boards and management of NZ-based banks and life insurers have assured themselves the misconduct highlighted in Australia is not taking place here, and take appropriate action if failings are identified.

Activities

- Review the actions banks and life insurers have taken to promptly identify and address any conduct and culture issues in relation to the Australian Royal Commission and the FMA's Guide to Good Conduct
- Engage individually with firms to test the information provided, including follow-up information requests and on-site monitoring
- Report on our initial findings and next steps in late October

In the longer term this work may identify gaps in the regulatory framework for further consideration.

* CoFR is comprised of RBNZ, FMA, MBIE and Treasury. We also consult with the Commerce Commission as required.

Strategic priority:

Sales and advice

Risks and harm we want to address

- Sales and advice processes and practices that are not aligned to good customer outcomes
- Sales and advice providers not undertaking due care and diligence and/or not possessing appropriate capability

Sectors impacted

- Advisers and discretionary managers
- Retail product and service providers

Outcomes we want to see

- Sales and advice practices are designed to meet the needs of customers
- Providers exhibit appropriate capability and due care, diligence and skill

Factors that may drive poor sales and advice practices include:

- ineffectiveness of processes for assessing suitability
- inadequate disclosure of fees, product risks or conflicts
- inadequate training and/or capability of staff
- inappropriate marketing, misleading advertising and pressure sales tactics
- failure to recognise and promote customer needs and interests
- inappropriate incentives (see Conflicted conduct on page 12).

These factors can be compounded by behavioural bias and lack of capability of customers.

Last year our monitoring and thematic work identified concerns across a range of sales and advice providers, including:

- lack of appreciation of the presence of conflicts of interest
- lack of appropriate disclosure
- insufficient record-keeping
- lack of appropriate communication with clients.

We expect licensed and registered firms to recognise these risks and take action to mitigate them.

First and foremost, we expect advisers to always have customers' interests at the centre of their business activities. This will continue to be a focus of our monitoring and thematic work in 2018/19 across multiple products and sectors.

We also plan to look at how non-statutory disclosure documents such as information sheets are used in the sales and advertising process.

We are working with Government and industry to strengthen the regulatory regime around advice as part of the Financial Services Legislation Amendment Bill (FSLAB) reforms. This will be a major priority for the FMA over the next few years (see opposite).

> "We expect advisers to always have customers' interests at the centre of their business activities."

A key objective of the reforms is improving access to quality financial advice. This is something we also take account of when considering our regulatory activity.

The sales and advice market is changing, driven by changes in technology and business models, and evolving demands from customers. These changes have the potential to improve access, while also helping to mitigate drivers of risk. However, they may in turn give rise to new risks and issues.

For example, in May 2018 the FMA approved the first application to provide digital advice. Digital advice has the potential to provide customers with easily accessible and cost-effective financial advice. However, it raises new issues in terms of control and management of risks associated with algorithms, and the potential for individual errors to impact vast numbers of investors. We are therefore monitoring developments closely to ensure our regulatory response reflects both the benefits and risks of such developments.

This priority is closely linked to our Conflicted conduct and Investor decision-making priorities.

Activities and milestones for 2018/19

- Conduct and Culture Review
- Ongoing proactive and reactive monitoring of the licensed population
- Review of information sheets and other documents used in sales

Financial advice reform

The Government's overarching objective of the reform of financial advice legislation is to improve access to high-quality financial advice for New Zealanders and establish a level playing field of regulation for all financial advice providers. The new regime will include a new Code of Professional Conduct that applies to all financial advisers and is enforceable through the Financial Advisers Disciplinary Committee.

As the licenser and supervisor of financial advisers under the new regime, we have a key role in implementing these reforms.

Outcomes sought

- Smooth transition to the new regime, minimising disruption to the market and to the provision of advice through effective transitional arrangements
- A licensing regime that is both robust in ensuring appropriately capable advisers enter the market, and also efficient so as not to present any unnecessary barriers to entry
- Improved conduct in the advice market through risk-based monitoring against standards set out in the new Code of Professional Conduct

Activities

- Develop and implement transitional licensing arrangements
- Develop and implement a long-term licensing and monitoring strategy
- Develop and deliver clear guidance and expectations to industry on both transitional arrangements and the new licensing and monitoring regime
- Ongoing engagement with industry to ensure issues are identified and dealt with as quickly as possible

Strategic priority:

Conflicted conduct

Risks and harm we want to address

- Inappropriate incentive structures and/or practices that may drive poor conduct
- Firms failing to adequately manage conflicts of interest

Sectors impacted

All

Outcomes we want to see

- Incentive structures and practices are designed with a focus on customer outcomes
- Conflict of interest risks are appropriately identified and actively mitigated by firms

Conflicts of interest are an inherent feature of financial markets and are often at the heart of risks and harm across financial services.

As a primary driver of misconduct, conflicted conduct is reflected in a number of other strategic priorities. However, the importance of firms identifying and managing conflicted conduct makes it a strategic priority in its own right.

Conflicted conduct can be driven by incentives. These can be a monetary bonus, benefits such as promotion prospects and performance management structures, or 'soft' commissions such as complimentary entertainment or international travel.

Conflicts may also arise from vertically or horizontally integrated firms providing different services to the same client, or firms acting for different clients with conflicting interests. They may be present where firms take on differing roles in a market.

Incentives, and vertical and horizontal integration can provide benefits to firms and consumers. However, it is important that firms and employees recognise that incentives, organisational structures and business models can create conflicts of interest. If unmanaged, these conflicts can result in harm to customers.

We expect all licensed firms to be able to identify and manage conflicts, as outlined in our Guide to Good Conduct. This requires adequate systems and controls. Firms should disclose actual and potential conflicts, particularly how staff are incentivised, and be able to explain how incentives are aligned to customer interests.

> "We expect all licensed firms to identify and manage conflicts."

Our monitoring and thematic work last year suggests that some firms have a way to go in identifying and managing conflicts of interest, particularly in relation to incentives.

Our work programme for this year will include following up on the activity noted above. Incentives and conflicted conduct will also be a central element of our Conduct and Culture Review, and our thematic review of bank incentive structures.

Activities and milestones for 2018/19

- Ongoing proactive and reactive monitoring of the licensed population
- Follow up on work in relation to incentives in the insurance and banking sectors through the Conduct and Culture Review
- Continue implementation of the new financial advice regime (see page 11)

Bank incentive structures thematic review

Vertically integrated firms (ie those that create, advise on and sell products) such as large banks present potential conflicts of interest where employees may be incentivised to sell in-house products where clients might be better advised to consider financial products from a different provider.

Objectives

To understand vertically integrated banks' incentives for frontline salespeople and their management line, and how the potential conflicts are managed.

Activities

We will review:

- incentive structures, including bonuses, commissions, competitions, prizes and progression opportunities
- performance management frameworks and practices
- how conflicts of interest related to incentives are managed and reported through the bank, including to senior management and boards.

We plan to report on our findings, and provide guidance on good practice if necessary. This project will inform and be informed by the Conduct and Culture Review.

Strategic priority:

Investor decision-making

Risks and harm we want to address

- Inadequate or incorrect disclosure that may result in investors making poor investment decisions and customers obtaining products they do not understand or need
- Low investor confidence and limited capability that may result in the uptake of unsuitable products or inappropriate investment decisions

Sectors impacted

- Advisers and discretionary managers
- Retail product and service providers
- Issuers
- Infrastructure providers
- Alternative capital raising

Outcomes we want to see

- Capable, confident and well-informed investors
- Investors receive and value clear, concise and effective disclosure

There are many factors that influence an investor's decision-making. This includes the quality of information they receive and their level of capability.

We work with industry and listed companies to improve the quality of information investors receive through pre-registration reviews of product disclosure statements (PDSs) and reviews of financial statements, as well as publishing research and guidance.

"...we have recently encountered situations where cooperation on disclosure has not been as forthcoming as we would expect."

In April 2018 we released findings from research of how investors view PDSs, which identified areas of improvement from previous offer documents as well as areas where we encourage issuers to consider making improvements.

Our publications Improving financial statements and Disclosure of significant accounting estimates were based on reviews that found improvements, but also highlighted challenges in relation to ongoing disclosure. Such challenges have been further highlighted by recent corporate problems in NZX-listed companies.

Our general stocktake of fund updates also found some examples of potential non-compliance or instances where disclosure could be improved. We will continue to look at disclosure of costs and fees, and work with fund managers to improve the prominence and accessibility of this information.

Generally, we have been encouraged by our engagement with industry on disclosure issues. However, we have recently encountered situations where cooperation has not been as forthcoming as we would expect. Where necessary, we are willing to take regulatory action, whether that be public reports, using our statutory powers, or court action.

Investor capability is based on knowledge, skill, experience, understanding and confidence. Decisions can be affected by the level of motivation, trust and other behavioural biases. Certain factors may also make some customers more vulnerable to experiencing negative outcomes from financial decisions.

We are one of a number of agencies involved in building investor capability, and will continue to work collaboratively with the Commission for Financial Capability, and others, on awareness-raising initiatives such as Money Week and World Investor Week.

Our Investor Capability Strategy sets out how we seek to improve investor capability, by influencing how industry communicates with investors, and by speaking to investors directly.

Direct communication with investors includes highlighting issues such as fraud awareness or KiwiSaver fees and returns, and the use of social media, such as our campaign aimed at helping young women to engage more with KiwiSaver and retirement savings.

This year we will also work with academics and industry to build our understanding of behavioural economics and how this can help address some of the risks of harm to customers in financial markets.

Activities and milestones for 2018/19

Disclosure

- Ongoing proactive and reactive engagement with issuers to outline expectations and improve standards of initial and ongoing disclosure
- Ongoing risk-based monitoring of disclosure documents, including non-filing reviews

Investor capability

- Continuing to work with partners to develop tailored information for investors and consumers, covering issues such as identifying scams and frauds, and initial coin offerings (ICOs)
- Awareness-raising activity such as participating in IOSCO* World Investor Week and Money Week
- Refining our approach to social media communications

KiwiSaver

Promoting an effective KiwiSaver market is a critical priority for us. This involves ensuring that providers, including default funds, meet their regulatory and other requirements, and that customers are well-informed and engaged.

In addition to continued monitoring of providers, in 2018/19 we plan to:

- produce targeted information on KiwiSaver, including the KiwiSaver tracker and annual report
- continue to raise awareness of KiwiSaver choices by promoting our consumer material
- build a better understanding of fee competition and practices across the KiwiSaver market
- undertake behavioural insights work on customers' engagement with KiwiSaver.

* International Organization of Securities Commissions

Strategic priority:

Capital market growth and integrity

Risks and harm we want address

- Factors that could undermine market integrity and confidence including:
  - participants failing to act with honesty and integrity, including facilitation of insider trading, market manipulation and money laundering
  - a lack of resilience of market infrastructure providers
  - poor audit quality or lack of auditor independence
- Regulatory settings or market structures that could undermine market growth and integrity

Sectors impacted

All

Outcomes we want to see

- Accessible and dynamic capital markets with resilient infrastructure, where participants act with integrity and investors can engage with confidence

Part of our role as a capital markets regulator is to foster an environment that encourages the growth of New Zealand's capital markets. This includes both traditional public exchanges and more novel approaches to investing and capital raising.

Central to facilitating growth is maintaining the integrity and confidence in capital markets. Confidence and integrity are driven by many factors including:

- the conduct of participants and how they treat clients and counterparties
- market structure, ie how trading occurs
- efficiency and robustness of market infrastructure.

2017 saw the successful completion of New Zealand's first market manipulation case. We also released our report of the findings of our investigation into the related trading activity of Goldman Sachs.

We subsequently engaged directly with market participants to explain our findings. We will continue this engagement to ensure participants are clear about our expectations of trading conduct, governance and controls. This includes working with NZX to enhance its regulatory oversight.

In 2017, we also initiated two insider trading prosecutions, along with a number of investigations into potential market misconduct. We expect these to progress this year.

We are currently preparing for the upcoming Financial Action Task Force evaluation of the effectiveness of New Zealand's AML/CFT framework (see opposite).

> "Central to facilitating growth is maintaining the integrity and confidence in capital markets."

High-quality independent audits are critical to maintaining the integrity of the financial information that investors base decisions on. We will continue our focus on audit quality, including making referrals to the appropriate disciplinary body where necessary.

Our 2017 Audit Quality Monitoring Report found that while quality continued to improve, inconsistencies remain in the quality of individual audits, especially in more judgment-based areas of the audit. We expect audit firms to consider these findings in relation to their own work and address issues where required.

To complement this work we released our director's guide to audit quality, to reaffirm the important responsibilities directors have in the audit process.

In relation to market structure, we will engage with Government and industry to identify and address regulatory or structural barriers to growth. This will include working with NZX on its review of its market rules, as well as seeking views of participants on the effectiveness of the New Zealand capital markets ecosystem and structure.

Additionally, we will progress our work to determine if there is a case for increased regulatory oversight of the custody sector, in response to concerns raised by the IMF. We are also working with MBIE to implement a new regime for financial benchmarks.

We will continue our monitoring of peer-to-peer and crowdfunding platforms, and work on innovative capital-raising mechanisms such as ICOs. Our goal is to encourage development of these sectors in a manner consistent with good customer outcomes.

Growth and integrity is linked to a number of other priorities including Governance and culture, Conflicted conduct and Frontline regulators.

Activities and milestones for 2018/19

- Engagement, monitoring, investigation and enforcement activity in relation to market misconduct
- Monitoring of infrastructure and capital-raising platforms, including the NZX Obligations Review, and introduction of the new financial markets infrastructure regime in conjunction with RBNZ
- Thematic review of custodian sector
- Working with NZX on its review of market rules, and seeking participants' views on the capital markets ecosystem and structure
- Ongoing programme of audit quality reviews and annual Audit Quality Monitoring Report
- Working with MBIE to implement a new financial benchmarks regime

Anti-money laundering/countering the financing of terrorism activity

Detecting and deterring money laundering and the financing of terrorism is critical to maintaining domestic and international confidence in our markets. In 2019-20 New Zealand's anti-money laundering and countering the financing of terrorism (AML/CFT) policies and practices will be evaluated by the Financial Action Task Force. As one of the three New Zealand AML/CFT supervisors, we will need to make a significant contribution to this project.

Activities

Last year we issued more than 40 feedback letters to reporting entities in relation to AML/CFT. This is an area where we expect to see entities demonstrate a clear understanding of their obligations and how these are being met.

We will continue to monitor reporting entities to ensure compliance with the AML/CFT Act and, where necessary, undertake enforcement activity.

In addition, we will continue to:

- assess the level of risk of money laundering and terrorism financing across reporting entities
- provide guidance to reporting entities to help them to comply with the AML/CFT Act and regulations
- work with industry to highlight expectations and promote good practice.

Strategic priority:

Frontline regulators

Risks and harm we want to address

Factors that could undermine effective oversight by frontline regulators including:

- insufficient oversight of regulatory functions
- lack of resource and capability
- failure to manage conflicts of interest
- ineffective engagement and lack of clarity over responsibilities between the FMA and supervisors, including potential duplication and undue burden on licensed entities

Sectors impacted

Frontline regulators

Outcomes we want to see

- Frontline regulators contribute to well-regulated markets through effective oversight of relevant markets and participants

Frontline regulators play a critical role in the oversight of New Zealand markets and participants. Managed Investment Scheme supervisors protect the interests of investors and act on their behalf. NZX monitors trading conduct and compliance with listing and disclosure rules. Accredited audit bodies license, monitor and address misconduct by audit firms.

"Frontline regulators play a critical role in the oversight of New Zealand markets."

The FMA licenses, monitors and reviews the conduct and operations of these frontline regulators. We also set expectations and work with frontline supervisors to raise conduct standards across their respective markets.

Supervisors

Last year during supervisor re-licensing we identified some issues around governance, risk identification maturity and consistency of approach, which we have been working through with the supervisors. We also established regular forums with supervisors to help clarify expectations and build a shared understanding of risks and good practice.

Ongoing engagement with supervisors will be a priority for us in 2018/19, through both the supervisors forum and our ongoing monitoring activity.

NZX

We have been working with NZX on a number of potential trading misconduct cases, as well as the review of its listing rules. We will complete our annual review of NZX against its statutory obligations, including progress on suggested improvements identified in the previous review.

Audit bodies

Our recent reviews of the accredited audit bodies found they were compliant with their responsibilities. We will continue to work with and monitor the activities of the accredited audit bodies with the goal of improving overall audit quality.

This priority is related to a number of other priorities including Governance and culture, and Capital market growth and integrity.

Activities and milestones for 2018/19

Supervisors

- Proactive and reactive monitoring of supervisors
- Ongoing engagement through the supervisors forum

NZX

- Working with NZX on the review of its rules
- 2019 NZX Obligations Review

Audit

- Annual accredited body reports

Strategic priority:

Perimeter conduct

Risks and harm want to address

- Limits of our regulatory remit that may inhibit our ability to promote fair, efficient and transparent financial markets
- Fraudulent offers or scams
- Risks to the reputation of New Zealand's financial markets from abuse of the FSPR
- Unlicensed and/or unregistered firms undertaking activities for which a licence or registration is required

Sectors impacted

- Entities operating on the perimeter of financial services conduct regulation
- Financial services firms not directly licensed or authorised by the FMA

Outcomes we want to see

- Large-scale misconduct outside our perimeter is identified before it becomes systemic
- Investors are better able to spot scams and fraudulent activity, and we are able to provide quick and effective warnings of such activity
- Abuse of the FSPR and unauthorised provision of financial services are identified and dealt with swiftly to ensure confidence in our financial markets is not undermined

Activity outside our regulatory perimeter can significantly affect confidence in and growth of New Zealand's financial markets.

In last year's Annual Corporate Plan we noted the importance of monitoring the perimeter as part of our Capital market growth and integrity priority. Based on the behaviour we have seen on the perimeter, we have made this a priority in its own right. Perimeter risks can manifest themselves in a number of ways.

The IMF noted areas where the FMA does not have direct oversight of conduct, but where risks of harm to customers and confidence may occur, such as in the insurance industry. Core banking products and consumer credit are also not currently subject to regulatory supervision in the same way as financial advice and managed investment schemes.

Technology and innovation may also drive the development of new products and services, where there is ambiguity about whether or not the FMA has oversight. Recent examples include ICOs.

Entities and individuals may actively seek to exploit gaps in the regulatory regime to avoid or reduce regulatory requirements.

Perimeter conduct also relates to entities and firms undertaking activity without required licences, or simply seeking to commit fraud or perpetrate scams for personal gain. All of these have the potential to result in harm to customers and undermine confidence in the market.

We have also seen entities and individuals leveraging New Zealand's reputation by registering on the Financial Service Providers Register (FSPR) even though they are not intending to offer services locally.

Central to mitigating these risks is ongoing monitoring of the perimeter. We do this through reviewing complaints and enquiries, as well as environmental scanning and intelligence-gathering. We also monitor how technology is changing products and services.

Through these activities we seek to identify significant misconduct before it becomes systemic. Where possible we will act directly, eg providing warnings about scams. Where we identify misconduct that is outside our perimeter we will raise this with other agencies to determine an appropriate response, through CoFR or directly with relevant agencies or Ministers.

This priority also links to the Investor-decision making priority and the Regulatory framework developing theme.

Activities and milestones for 2018/19

- Ongoing monitoring of misconduct reporting and environmental scanning to identify conduct perimeter risks, including activity driven by new technology
- Reviewing and issuing guidance on new products and services where required, eg guidance for ICOs
- Raising awareness of scams, including publishing warnings and participating in fraud-awareness activities
- Investigation and enforcement activity

FSPR monitoring and reporting

Some businesses and individuals may try to use FSPR registration to give a misleading impression that their activities are regulated by New Zealand authorities or have a significant connection to New Zealand.

Since 2014, we have dealt with more than 1000 complaints about questionable FSPR registrations. During the three years covered by the 2017 FSPR report, we reviewed the registration or attempted registration of 208 financial service providers.

Of the 115 existing registrations we reviewed, just 15 were not subject to further action. Only 20% of the applicants that were referred to us by the Registrar were allowed to register.

Objective

Abuse of the FSPR is identified and dealt with swiftly to ensure confidence in our financial markets is not undermined.

Activity

We will continue our enforcement-based approach to abuse of the FSPR – especially where we see this being facilitated or encouraged by New Zealand directors and company service providers.

Strategic priority:

FMA effectiveness and efficiency

Risks and harm we want to address

FMA failing to use its resources efficiently to achieve its objectives, or placing potentially unnecessary burden on New Zealand markets through failures in internal governance, processes, capabilities, or systems and controls

Outcomes we want to see

- The FMA is an efficient and effective intelligence-led regulator
- We focus on continual improvement

We continue to focus on building our capability and effectiveness as an organisation. This includes seeking ongoing improvements to our processes, systems and controls, building our people capabilities and fostering a culture based on our values and principles of regulation.

We are currently implementing a new knowledge-management system, and embedding behaviours and processes to ensure we maximise its effectiveness. This will be a core focus of 2018/19.

We have started proof-of-concept testing with analytics tools to ensure we can make the most of the information we collect. We also have a new system to manage our investigations and enforcement discovery and disclosure processes, to enhance our effectiveness in investigating and prosecuting complex cases.

We have introduced a process for ongoing environmental scanning to monitor developments in New Zealand and global markets.

As part of our learning and development programme we have rolled out a capability framework that identifies current and future skill requirements. These form part of our overarching people capability strategy that also covers our approach to recruitment and retention.

A key focus for next year will be reviewing how we engage with stakeholders to gain insights and better understand market developments and their impact. To this end we have refreshed our approach to stakeholder engagement and management, placing greater emphasis on intelligence-gathering.

We have reviewed our approach to the Council of Financial Regulators, with the objective of ensuring a continued focus on forward-looking system risks and increased coordination with participants.

We will continue to work closely with our CoFR partners, RBNZ, MBIE and Treasury, as well as other counterparts including the Commission for Financial Capability, the Serious Fraud Office and other enforcement agencies.

Ensuring an appropriate balance between benefit and burden of regulation will continue to be a key consideration in all of our work.

Activities and milestones for 2018/19

- Accessing external insights through closer engagement with market participants and environmental scanning
- Improving knowledge management and data analytics to enhance our intelligence capabilities
- Further development of our people capability strategy to determine the skills mix for the future, and to grow, attract and retain talent
- Review our project governance and accountability arrangements to identify efficiency opportunities
- Continuing to review and streamline our approach to enforcement and investigations
- Reviewing our Strategic Risk Outlook

Building a regulator for today and the future

Markets, and the environment in which we regulate, are constantly changing. This is driven by changes in technology, regulation, consumer demand, business models, behaviour and societal expectations. We seek to manage the challenges these can present through our approach to regulation, which is being:

- intelligence-led and harm-based
- outcome-focused
- consistent and transparent
- flexible and responsive.

We are focused on building an organisational culture that reflects these principles, as well as the public interest we promote.

We want to ensure we have the right capabilities, in terms of people, processes, systems and governance structures. This includes seeking external insights and expertise where possible.

We are also conscious of the need to continuously review our approaches, legislative powers, tools and decision-making processes, to ensure we can meet the challenges of regulating the financial markets and products of today, while being prepared for those of the future.

Developing themes

These themes are areas we keep on our risk radar. Last year's developing theme of reviewing our perimeter has been recast as a strategic priority to reflect the importance and risk of this to our objectives (see page 20).

Regulating for technology change

Financial technology (fintech) and innovation continues to move at a rapid pace and drive change in our markets. New and innovative offerings provide benefits to customers such as lowering costs, increasing competition, and improving access to products and services.

We have a mandate to promote innovation and flexibility in financial markets, while ensuring appropriate safeguards are in place. Related activity over the past year included:

- issuing guidance for issuers and customers in relation to ICOs
- engaging with ICO issuers to ensure they are aware of their responsibilities and obligations when making public offers
- providing a class exemption to enable firms to offer digital advice
- monitoring developments domestically and globally through our internal ***Innovation Strategy Group*** and environmental scanning activity.

We will continue to monitor developments and work closely with Government and the wider fintech community on relevant initiatives. We encourage market participants to engage with us at the early stages when considering making an offer, introducing new products or services, or providing platforms that offer products and services to the public.

Cyber-resilience approach

The operation of financial service firms and financial markets is increasingly digitised, whether through increased high-frequency trading in equity markets or the use of cloud solutions by financial advisers. The incidence and cost of successful cybercrime-related attacks continues to grow.

Outcomes sought

- Financial service providers and consumers are aware of and prepared for cyber risks
- Providers have proportionate controls to mitigate risks and ensure cyber-resilience
- Strong collaborative dialogue between Government, industry and the FMA

Activities

- Thematic survey on cyber-resilience to better understand preparedness and good practice across our licensed population
- Engagement strategy based on working across Government and with industry to raise cyber-resilience awareness and preparedness
- Development of a risk-based monitoring approach for our licensed population

Helping investor decision-making in changing market conditions

We continue to monitor market conditions to raise awareness of the long-term risks associated with financial products and services through our investor capability work. See Investor decision-making (page 14) for more information.

Retail investor uptake of complex and risky products

In our Strategic Risk Outlook we note the potential risks associated with complex and/or leveraged products. Through our monitoring of international regulatory developments, we have seen an increasingly interventionist approach from a number of regulatory peers, who are acting to ban or restrict the sale of speculative and risky products targeted at retail investors. We have also taken action where we believe significant risk of harm to customers is present. In 2017 we confirmed that selling short-duration derivatives requires a licence under existing law. We will continue to monitor product developments, including those on our perimeter, assess associated risks and take regulatory action where justified.

Review of the regulatory framework

This new developing theme reflects the significant review and reform activity currently underway.

Given the ever-evolving nature of financial markets, it is important that regulatory frameworks, including the scope, powers and objectives of regulators, are kept under review.

The IMF's 2016 review of New Zealand's financial system recognised significant improvements in our financial markets regulation since 2003/4. It also recommended the Government and FMA consider further enhancements in areas such as frontline supervisors, custodians, the wholesale asset management sector and conduct oversight of the insurance industry.

In response to the IMF's findings, we have undertaken work to build our understanding of wholesale asset management and frontline regulators. We have also initiated a project to better understand the operations of custodians. These activities are ongoing and will be progressed further this year. We report regularly to CoFR and Ministers on progress, and engage with MBIE on relevant findings.

We also contribute to work led by other agencies. This year we expect to contribute to the Insurance Contract Law Review, which includes consultation on gaps in New Zealand's regulation of insurers' conduct. We may also be called upon to input to other reviews, including the review of consumer credit regulation and the Reserve Bank Act. In addition, we are working closely with MBIE and others on the passage of the Financial Services Legislation Amendment Bill and implementation of a new benchmarks regime.

Current reviews of New Zealand financial services legislation	
Financial Services Legislation Amendment Bill	To improve access to high-quality financial advice and establish a level playing field of regulation for all financial advice providers
Review of insurance contract regulation	The review will examine a range of issues, including whether there is adequate conduct regulation of insurers and intermediaries
Review of consumer credit regulation	Review of 2014 amendments to the Credit Contracts and Consumer Finance Act, including whether further reforms are required to enhance protection for consumers
Review of the Reserve Bank Act	Review of whether the Reserve Bank's monetary and financial policy frameworks provide the most efficient and effective model

Priorities by sector

This table breaks down our work programme by sector, outlining the areas of focus in the form of questions that we will ask and we suggest firms ask themselves.

Sector	Areas of focus	FMA activities
Cross-sector All regulated firms	• Does a firm's culture put customer interests at the heart of its activities? • How do firms satisfy themselves that they effectively manage conduct risk? How have firms taken account of our Guide to Good Conduct? • How do firms satisfy themselves that their incentive structures and practices are designed with a focus on customer outcomes? • Are conflicts of interest effectively identified and managed? • To what extent are licensed entities aware of and prepared for cyber events, and how resilient are they? • Do firms have sufficient controls to manage money laundering and terrorist financing risks? • Are firms engaging openly and cooperatively with the FMA?	• Conduct and Culture Review of banking and life insurance • Ongoing proactive and reactive engagement with boards and senior management of regulated entities and listed issuers on culture and governance issues • Thematic review of cyber-resilience • Ongoing monitoring and testing of firms' AML/CFT controls
Retail product and service providers	• Do providers provide adequate disclosure of risks, fees, product attributes and strategies? • Are client assets appropriately managed and protected? • Do firms have adequate systems and controls, including in relation to oversight of outsourced activity, valuation, redemption and liquidity risks? • How do providers ensure incentives offered to distributors do not result in poor customer outcomes? • Are firms effectively managing risks of trading misconduct (market manipulation and insider trading)? • Are products designed and marketed in line with customer needs and interests?	• Ongoing work with supervisors • Ongoing monitoring of disclosure • Work on KiwiSaver fees and competition • Thematic review to assess case for licensing and supervision of MIS custodians
Frontline regulators	• Do frontline regulators have appropriate governance, systems and controls for identifying and prioritising risk in supervised populations? • Is there sufficient clarity over the respective responsibilities of the FMA and frontline regulators? • Is there effective engagement between frontline regulators and the FMA? • Are frontline regulators meeting their statutory obligations?	• Proactive and reactive monitoring of supervisors • Ongoing engagement with supervisors through quarterly forums • 2019 NZX Obligations Review • Continued implementation of our Audit Oversight Plan and production of the annual Audit Quality Monitoring Report

Sector	Areas of focus	FMA activities
Advisers and discretionary managers	• How do firms ensure staff recognise and promote customer needs and interests? • Do firms possess and follow effective processes for assessing suitability, including record-keeping? • Is there adequate disclosure of fees, product attributes, product risks and conflicts of interest? • Do advisers and sales staff possess appropriate levels of capability and receive adequate training? • Do advisers and sales staff use inappropriate marketing and pressure sales tactics?	• Implementation of the new financial advice regime • Bank incentive structure thematic review • Ongoing proactive and reactive monitoring • Follow-up work on remuneration and incentive structures through the Conduct and Culture Review
Infrastructure providers	• Do infrastructure providers have effective systems and controls for managing operational risk and ensuring resilience? • Are providers effectively managing trading misconduct risks? • Are there unnecessary structural or regulatory barriers to market growth and development?	• Ongoing monitoring of infrastructure • Investigation and enforcement activity in relation to market misconduct • Review of the Financial Markets Infrastructure regime, with RBNZ • Work with NZX on its review of market rules and participant views on effectiveness of capital markets
Alternative capital raising	• Do peer-to-peer lending and crowdfunding platforms provide appropriate communication, advertising and disclosure to consumers? • Are alternative capital raisers meeting disclosure requirements?	• Monitoring of crowdfunding and peer-to-peer platforms report • Guidance where required, eg ICOs
Other market participants	• To what extent have firms taken account of the findings from recent market manipulation cases and BKBM work? • Are firms effectively managing risks of trading misconduct? • Are client assets appropriately managed and protected?	• Ongoing proactive and reactive engagement with market participants • Investigation and enforcement activity in relation to market misconduct
Issuers	• Do listed issuers provide clear, concise and effective disclosure? • Do financial statements incorporate all material matters?	• Ongoing monitoring of disclosure, and proactive and reactive engagement with issuers
Customers/ consumers	• Are consumers adequately aware of the risk of scams and frauds? • Are consumers adequately engaged with their KiwiSaver products? • How do behavioural biases lead to risks and harm? • How do firms treat vulnerable customers?	• Providing tailored information to investors and consumers about scams and frauds, and other risks • Produce targeted information for KiwiSaver investors • Behavioural insights work
Firms and activities at the perimeter	• Is there activity outside our perimeter that is undermining fair, efficient and transparent financial markets? • Are firms on the FSPR providing legitimate services to New Zealand customers? • Do firms and individuals have the necessary licences or registrations to undertake activities?	• Ongoing reviews of FSPR registration • Ongoing monitoring of misconduct reporting and environmental scanning to identify risks • Raising awareness of scams, including publication of warnings

FMA budget and structure

Our operating budget for 2018/19 is $37.2 million, with average full-time-equivalent (FTE) staff of 187 across the year. The breakdown of FTEs and proportion of the operating budget by functional area is shown below. The divergence in the relationship between operating budget and FTE numbers for the Operations function is explained by this function carrying FMA-wide costs for information technology, occupancy, depreciation, services and supplies. Similarly, the Chief Executive function carries FMA-wide costs for expert fees, corporate memberships, the FMA conference, and overseas travel.

Market Engagement
Director: John Botica

Market outreach

Preparing advisers and industry for financial advice reforms

External Communications & Investor Capability
Acting director: Simone Robbers

Investor capability

Media, publications

Promoting and protecting FMA's reputation

FTE
9.3 (2018: 8.5)

Percent of operating budget
5% (2018: 5%)

Operations
Director: Brad Edley

Finance

Project management

Technology

Operational management

FTE
18.9 (2018: 17.2)

Percent of operating budget
30% (2018: 30%)

General Counsel
Director: Nick Kynoch

Enforcement

Policy and internal governance

Corporate legal services

FTE
38.4 (2018: 36.1)

Percent of operating budget
15% (2018: 14%)

FMA Board & committees

Chief Executive
Rob Everett

FTE: 5.5 (2018: 5.5)

Percent of operating budget:
8% (2018: 9%)

Capital Markets
Director: Garth Stanish

- Conduct in relation to dealings in financial products
- Licensing and supervision of infrastructure providers (market operators and settlement systems) and crowdfunding and peer-to-peer platforms
- Disclosure and financial reporting
- Audit oversight

FTE
28 (2018: 25.9)

Percent of operating budget
10% (2018: 9%)

Regulation
Director: Liam Mason

- Licensing and supervision of MIS managers, discretionary investment managers and advisers, and supervisors
- Data analysis and intelligence-gathering
- Evidence-gathering and investigations
- Complaints
- Anti-money laundering (AML/CFT)

FTE
71.6 (2018: 66.6)

Percent of operating budget
24% (2018: 24%)

People & Capability
Director: Sarah Feehan

- Human resources
- Recruitment
- Organisational development
- Capability and culture

FTE
9.3 (2018: 9.4)

Percent of operating budget
5% (2018: 6%)

Strategy & Risk
Director:
Simone Robbers

- FMA regulatory strategy
- Risk management
- Government and industry relations
- Corporate governance
- Assurance

FTE
6 (2018: 5.5)

Percent of operating budget
3% (2018: 3%)

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