

# Response to submissions on proposed variations to standard conditions of market services licences

## Overview

This document summarises key themes from the 18 written submissions we received following consultation in November and December on our proposals to vary certain standard conditions for market service licences. We would like to thank all submitters for their feedback.

Most submitters supported the changes, or the general direction of the changes. As such many of the varied conditions are substantially the same as the consultation paper which is available [here](#).

However, we have amended the financial resources condition for MIS licensees with supervisors. The change requires MIS licensees with a supervisor to report to their supervisor, rather than to us, if they have negative net tangible assets (NTA). For MIS licensees with supervisors, auditors are only required to perform procedures over year-end calculations based on audited financial statements, and not for the NTA calculations during the period (as this will be monitored by the supervisor). For MIS licensees without a supervisor, the same requirements apply as for other licensees.

We encourage all licensees to review and discuss the new conditions with their advisers.

Other changes include:

- clarifying and simplifying auditors' procedures and the financial resources requirements
- clarifying our timing expectations for certain obligations.

The new conditions will be effective on and from 31 March 2016. This means that varied procedures to be performed by auditors and financial resources requirements will apply to licensees for accounting periods ending on or after 31 March 2016.

A list of submitters is attached as Appendix A.

If you have any queries, call 0800 434 567 or email [questions@fma.govt.nz](mailto:questions@fma.govt.nz)



Document history

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This version was issued in March 2016 and is based on legislation and regulations as at the date of issue.

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<b>Response to submissions on proposed variations to standard conditions of market services licences</b>	<b>1</b>
Overview	1
<b>Section 1: Derivatives issuer licence conditions</b>	<b>4</b>
Key themes from submissions	4
Part A: proposed variations to financial resources requirements	4
Part B: Proposed variations to other standard conditions and Appendix 1	5
<b>Section 2: Other licence types</b>	<b>6</b>
Part A: proposed variations to financial resources requirements	6
NTA requirements	6
The NTA calculation	6
The auditor's procedures	7
Exclusion for small DIMS providers	7
Other changes	8
Part B: Proposed variations to other standard conditions and Appendix 1	9
<b>Appendix 1</b>	<b>10</b>
List of submitters	10

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# Section 1: Derivatives issuer licence conditions

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## Key themes from submissions

### Part A: proposed variations to financial resources requirements

This section of the consultation contained our proposals to simplify and clarify the auditor's engagement requirement, which we expect will also reduce costs to licensees. All submitters agreed changes were needed, and supported either the specific changes or the direction of those changes. The substance of the obligations has not changed from what we proposed. However, we have made a number of changes and commented on certain themes raised in submissions as follows.

**Guidance** – Nearly all submitters who commented on this point agreed that additional guidance would be helpful (for example in relation to clarifying expectations of auditors performing the engagements under the relevant professional standards) and could further reduce compliance costs. The External Reporting Board (XRB) has indicated its willingness to draft this guidance with our help. This would be a separate project. Any guidance would not be available until after the new licence conditions have come into effect.

**Effective date** - One submitter suggested that we should introduce a one-year transition period or acknowledge that the auditors' reports will most likely need to contain a modified opinion due to a limitation of scope over the assurance on controls for the first year after the revised conditions are introduced.

We appreciate that the effective date may mean a licensee will receive a report containing a modified opinion due to the auditor's inability to gain adequate evidence that the controls were in place, and effective throughout the accounting period. This alone will not indicate a breach of the licence conditions. However, regardless of any independent assurance, directors need to be satisfied that they are meeting their licence conditions at all times. On this basis, our view is a transitional period is not necessary.

**Overseas licensees** - Some submitters expressed concern about duplication of regulatory costs especially where the licensee is also licensed overseas. We agree that this is a valid concern in certain circumstances. If we are satisfied, on a case-by-case basis, that a licensee is subject to equivalent or more onerous obligations from an overseas regulator for an equivalent licence, we may allow the licensee to submit reports based on those obligations instead of what's required by Standard Condition 11. As with the reports required by Standard Condition 11, we would need to be an intended user of the report and be able to rely on the report for monitoring or enforcing compliance with the conditions. For example, this approach could be appropriate for certain derivatives issuer licensees that also hold an over-the-counter derivative licence from the Australian Securities and Investments Commission (ASIC).

**Timing of report** – Several submitters asked for additional time to submit the reports to us. We have allowed an additional five working days for submission of the reports.

**Structure** – To minimise potential conflict with professional standards and to allow more flexibility, we have simplified the conditions for the licence and improved the explanatory note.



**Terminology** – We received a number of suggestions to align our proposals with the wording used in the relevant professional standards. We have made a number of changes and XRB staff have reviewed our revised wording.

**Part B: Proposed variations to other standard conditions and Appendix 1**

All who submitted agreed with the proposed changes. Some submitters suggested revising proposals for further clarification. We have included a number of these changes which are marked up in the varied conditions.



## Section 2: Other licence types

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### Part A: proposed variations to financial resources requirements

#### NTA requirements

The financial resources condition includes two different components. The first is the requirement to prepare the net tangible assets (NTA) calculations. The second is the auditor's procedures required for those calculations. Our comments are listed below.

#### The NTA calculation

In addition to the existing obligation to calculate NTA at least monthly, we proposed additional requirements that:

- the NTA calculations are performed on any other date the licensee has 'reason to suspect' that its NTA is negative
- clarify that the licensee has to recalculate the NTA at the balance date based on its audited financial statements
- the negative NTA notification to the FMA must be made as soon as practicable, which we clarified in the explanatory note to ordinarily be within five working days.

One submitter suggested that because it normally receives its revenue quarterly (implying that its NTA is not positive at other times) it should only be required to calculate the NTA quarterly.

As a general principle, we want to know when and why a licensee's NTA is negative. However, we understand that negative NTA, alone, may not be an indicator of financial problems. As such, we would like to reiterate that the condition states that you do not need to notify us (or your supervisor, if applicable) about negative NTA if:

- you have previously made the required notification
- we (or your supervisor, if applicable) have advised you in writing that you do not need to make further notifications
- there has been no material change from your position and circumstances since that notification (these are cumulative tests).

In the situation where we have previously advised that notification is not required, we would not expect the NTA be recalculated solely on the basis the licensee has reason to suspect that it is negative. That is, there would need to be a material change in the licensee's position and circumstances for notification to be required. Therefore, we have not changed this aspect of the condition, and can confirm there is no time limit on this exception.

Some submitters thought that five working days was too short in terms of clarifying the meaning of 'as soon as practicable'. We note that the five working day period is ordinarily what we would expect. However, this is in the explanatory note for guidance purposes.



## The auditor's procedures

In our consultation, we proposed changes that:

- require the auditor to perform some procedures to check the NTA calculation was performed during the period
- require the licensee to send us the auditor's report
- provide additional guidance on the procedures in the explanatory note

Some submitters questioned the value of checking the monthly calculations after the fact, if the auditor's procedures show that during the accounting period there was negative NTA. Our goal with these procedures is to gain some visibility over whether the calculation was performed during the year (regardless of whether the NTA calculation is positive or negative) without imposing significant costs on the licensee. If the auditor is required to perform several separate visits throughout the year, it is likely to be costly and therefore inconsistent with our goal.

In response to certain submissions, we would also like to confirm that the auditor's procedures based on the audited financial statements only apply to the licensees' NTA calculation at their balance date. We expect that licensees will perform other monthly calculations using unaudited financials and other accounting records provided the calculation still complies with Appendix 1.

**MIS licensees** – One submitter drew a distinction between managed investment scheme (MIS) licensees and other licensees. This submitter noted that supervisors already closely monitor the financial resources and position of MIS licensees throughout the year. Therefore, its view is that requiring an auditor to collect information on compliance during the year in addition to the existing reporting to supervisors results in a duplication of oversight, and will raise costs for MIS licensees.

We acknowledge the importance of the supervisors' role in regulating most MIS licensees. Our ongoing dialogue with the supervisors and their obligations to report certain matters to us means that we will have an appropriate level of visibility over MIS licensees' financial position. Therefore, where a MIS licensee has a supervisor, the condition requires the licensee to report the negative NTA to the supervisor. There will be no requirement for the auditor to perform procedures over calculations during the accounting period. However, the auditor will still need to perform procedures over the year-end calculation (based on the audited financial statements). An auditor's report is to be provided to the supervisor rather than the FMA. The MIS licensee must still report any breaches of its license conditions to us.

Where a MIS licensee does not have a supervisor, the condition will be the same as for other licence types.

Several submitters also commented that additional time was needed for licensees to recalculate NTA based on the audited financial statements, for the auditors to perform their procedures, and then for the licensee to submit the report to us. In response, we have allowed an additional five working days.

## Exclusion for small DIMS providers

A number of submitters objected to exempting small DIMS licensees from having to undertake agreed upon procedures (AUP) over their NTA calculations. This is consistent with their submissions on the class exemption – Financial Markets Conduct (Financial Reporting – DIMS Licensees) Exemption Notice 2015. Submitters were particularly concerned with public money being at risk as due to their small size, these DIMS licensees may have less-developed systems and controls. However, submitters acknowledged that the proposed changes are consistent with the class exemption.



Our reasoning for the underlying class exemption, including the requirement for assurance procedures to be performed on an independent custodian, is set out in the [regulatory impact statement for the class exemption](#).

We also note that we have expressly retained the ability to require a DIMS licensee to obtain a report from an auditor if needed, even if the licensee is entitled to rely on the class exemption. On this basis, there are no further changes to this condition from the version published in the consultation paper.

### [Other changes](#)

#### *Exclusion of NZX participants from NTA requirements*

We proposed a general exception for NZX participants from the NTA requirements, subject to certain conditions. Submitters agreed with the proposed changes but one submitter wanted to clarify that we only want final copies of formal reports from NZX to be sent to us, not draft reports or general correspondence with NZX about capital adequacy. We have amended this accordingly.

**Other amendments** – We received a number of comments suggesting we align the terminology with the wording used in the relevant professional standards. We have revised these accordingly in some circumstances.





## Part B: Proposed variations to other standard conditions and Appendix 1

### *Timing for notification of changes to governance and compliance arrangements*

The explanatory note stated that we consider the requirement to notify us 'as soon as practicable' would ordinarily mean within five working days. We have clarified that we only expect notification from the effective date of the material change to the licensee's governance, or compliance arrangements (rather than from when the change was approved). As always, directors will need to ensure they have appropriate governance and compliance arrangements in place at all times.

### *Excluded assets – intangible assets*

All submitters agreed with the proposed changes. One submitter suggested that the terms used should be defined consistently with generally accepted accounting practice. However, our view is the current language is clear, and there is no need to include more complex or detailed definitions. The text of this definition has not been amended from the version included in the consultation paper.

### *Inclusion of subordinated debt in adjusted assets*

Most submitters agreed with the proposed changes. Our response to other points raised on this subject in the submissions is listed below.

- 1) The 'comments and reasons' in the consultation paper inferred that subordinated debt could only be counted as equity if it was from owners (shareholders) of the licensee. However, we would like to clarify that subordinated debt can be from either owners/shareholders or third parties but it must meet the defined requirements for subordination.
- 2) We also confirm that a portion of subordinated debt can only be excluded from liabilities when calculating NTA if, as at the date of the NTA calculation, that portion of the debt cannot be repaid within one year. One submitter suggested there should not be a one-year minimum restriction on repayment. However, we consider that for subordinated debt to be treated as equity (and therefore excluded from liabilities when calculating NTA) it must be considered long term in nature. Therefore, our view is excluding subordinated debt repayable within one year is an appropriate indicator that the debt is long term in nature. This will help promote an orderly and compliant winding-up of the licensee's business should this be necessary.



# Appendix 1

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## List of submitters

ANZ Bank New Zealand Limited  
Crowdarm Limited  
BDO New Zealand Limited  
Chartered Accountants Australia and New Zealand  
CPA Australia Limited  
Ernst & Young  
External Reporting Board  
First NZ Capital  
HiFX Limited  
KPMG  
My Angel Investment Limited  
New Zealand Assets Management Limited  
New Zealand Bankers' Association  
Milford Asset Management  
PwC  
Securities Industry Association  
Trustee Corporations Association of New Zealand Inc  
Trustees Executors Limited

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