

29 June 2016

Rob Everett
CEO
Financial Markets Authority
Level 2, 1 Grey Street
WELLINGTON

Dear Rob,

Effectiveness & Efficiency Review (E&E Review) Summary

As you know, FMA commissioned us to conduct the E&E Review earlier this year, and we have now completed our work and recommendations. The purpose of this letter is to summarise the scope and conclusions of the review and thereby to close out that piece of work.

Purpose and approach

The purpose of the E&E Review was to:

- Provide you with analysis and insights which you can use to give your external stakeholders, particularly the Ministry of Business, Innovation and Employment (MBIE) and the Treasury, confidence that the FMA is spending money wisely, so that they can in turn support your funding proposals.
- Provide you with practical advice on how to enhance efficiency and effectiveness and hence to support the long run implementation of a financially sustainable operating model.

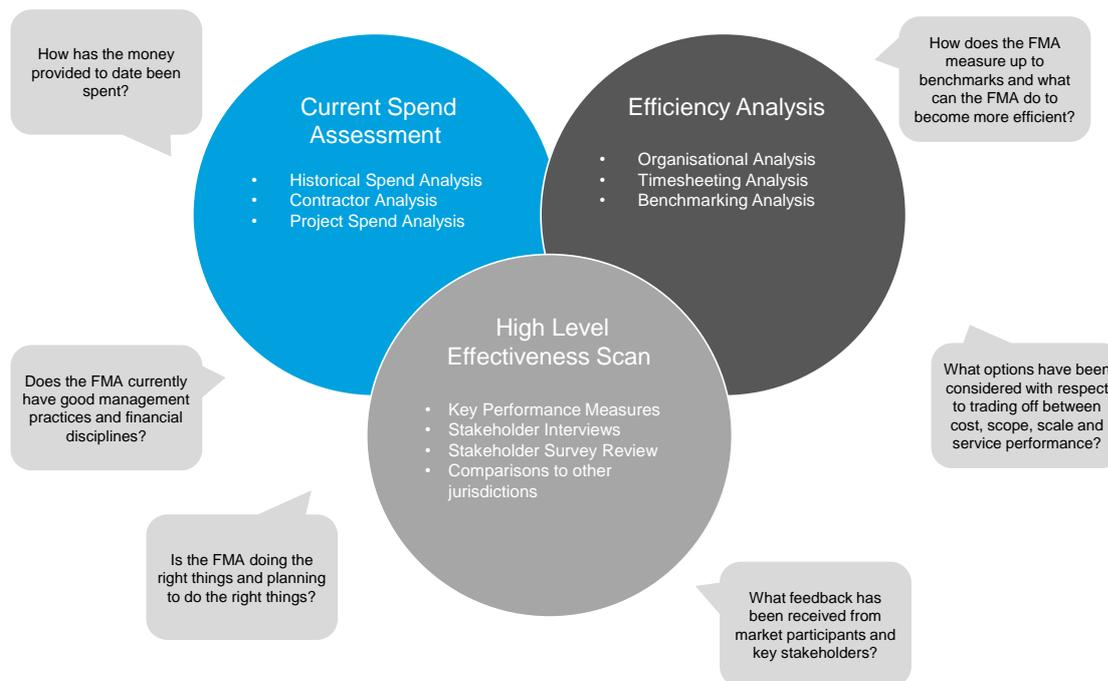
Accordingly, our approach was to focus on constructive criticism and helpful advice to you and the broader FMA leadership team as our core customer.

Our scope and analysis

We planned our work to address questions we would expect you and your stakeholders to consider important – in order to give confidence that the FMA is doing the right things and well-managed.

Our work included analysis and evaluation of information you were able to provide internally, extensive engagement with FMA leadership and management, as well as a number of stakeholder interviews.

The diagram below summarises our scope and analysis.



After completing our interviews and analysis, we facilitated a workshop with your leadership team to test that our findings were correct, and to assist you and your team to develop a high-level roadmap for you to address our recommendations. Our observation from that workshop was that the entire leadership team was very engaged in the process, including the preliminary findings that were presented at that workshop, and came prepared to present constructive input into the roadmap development.

Findings

The following provides a brief summary of the findings from our work, categorised across the three areas illustrated above.

Current Spend Assessment

The FMA faces challenges maintaining financial sustainability beyond FY 15

Over the period up to FY 14 the FMA built up a cash surplus, which has allowed it to run deficit budgets since. This is not a sustainable position, and while we note that FMA has implemented short-term fiscal measures to ensure it can operate under existing funding arrangements until the end of FY 17, it is important that it seeks a new, sustainable level of funding from the start of FY 18.

The FMA has employed significant contractor resource, but that trend has reversed

As part of its "start-up" phase, the FMA required a range of specialist services and resources, which is to be expected. A significant proportion of contractors worked on projects that have established the ICT systems and infrastructure for the FMA. Expenditure on contractors peaked in FY 15 and has declined markedly since.

Pressures from finance company failures and market events have impacted on resourcing

One of the early priorities for the FMA's investigations and enforcement areas was finance company failures, but there have also been other high-profile market events that have required a response. Caseloads are difficult to forecast, and the FMA has had to pull in specialists from across the organisation on several complex cases.

While this demonstrates a good degree of resource flexibility, it has also reduced capacity to manage other business areas. In particular, the emphasis on responding to external market pressures, has meant that relatively less senior level resource has been devoted to internal corporate governance matters. Management has recognised that this needs to be addressed.

Efficiency Analysis

There are structural opportunities to increase efficiency by reviewing spans of control and organisational tiers

The FMA has around 170 staff across its seven Directorates. A majority of Managers have relatively narrow spans of control, reflecting the specialist nature of the FMA's range of activities.

The FMA has higher than average personnel costs, compared with other public sector professionals

With offices in both Auckland and Wellington, the FMA has largely recruited from the private sector to ensure staff have sound experience in financial markets. It has had to compete for talent with large banks and law firms in New Zealand's most expensive markets. The relatively high average personnel costs also reflect a high weighting towards senior roles where significant experience is required.

The FMA has relatively high corporate services costs, compared with public sector benchmarks and similar-sized agencies

There are several reasons for relatively high corporate costs. In particular, as part of establishing itself, the FMA has maintained a strong focus on external communications and stakeholder engagement. The FMA is also investing significantly in people, responding to relatively high staff churn, the need for ongoing recruitment, and the need to train and develop staff.

The proportion of time frontline staff spend on regulatory work is relatively high

Timesheet analysis shows that staff "utilisation" on core work activities, at over 70%, is higher than our experience of many other public sector agencies. We note there are some teams where utilisation is less even due to administration workloads.

High Level Effectiveness Scan

While the majority of external stakeholders we talked with were complimentary, there are opportunities to strengthen engagement with the market

Trends in stakeholder feedback are generally positive, but show there is significant appetite to continue and further improve engagement with the market. Spending more time in the market will enable the FMA to better understand market dynamics and changing risk profiles.

There are internal perceptions the FMA workforce is quite homogenous

Many of FMA's people have professional legal and / or accounting qualifications, often with private sector experience. Some internal stakeholders expressed the view that a more diverse workforce with broader skillsets and backgrounds might be of benefit.

The FMA's activities and performance measures have evolved as the organisation has matured

The FMA developed and published its Strategic Risk Outlook in 2015, and has used this work to refine its SOI, with seven new measures reflecting the seven strategic priorities in the 2015-2019 SOI. More work is underway to establish stronger linkages and performance measures between FMA strategy and business unit plans.

Analytics and intelligence management are not yet at a mature level

While the FMA has made a lot of effort to establish risk-based prioritisation approaches for regulatory activities, these are not consistent. Information is not always structured, and the FMA lacks sophisticated analytics capabilities.

Our conclusions and recommendations

We developed our recommendations across five themes, which are described below. We have been conscious that the FMA is currently going through a funding bid process to seek a new, sustainable level of funding from FY 18, and until then is constrained in its ability to take on new initiatives or make new ICT investment decisions.

Performance management and strategic alignment

The FMA has made considerable efforts to develop and communicate its strategic objectives, linked to the drivers of risk, as per the Strategic Risk Outlook (SRO) and Statement of Intent (SOI). Business Planning is now being used to more effectively determine the allocation of resources. While this is driving decisions around where to focus activity and effort at an organisational level, there is less clarity around how the broader objectives link to individuals and how they can make a difference. The steps being taken to develop an organisational plan are positive and will set out business-wide priorities. What is still lacking, however, is a performance management framework to enable a more robust culture of tracking and managing to performance targets and outcomes at the functional and individual levels.

The types of measures the FMA uses across its three core functions (enforcement, compliance and monitoring, education) are similar to the measures used by regulators in other jurisdictions. However, comparisons to other regulators suggest the FMA should consider how it can remain relevant and effective in the context of broader strategic challenges, such as innovation-driven product complexity, digital disruption, and globalisation.

Market Engagement

The external stakeholders we talked with are almost universally complimentary of the FMA's level of engagement and strong leadership. At an operational level, good levels of collaboration and responsiveness to feedback have been recognised. Strong relationships exist with FMA's key stakeholders through MoUs, formal committee structures, and informal engagement. Its impact as a regulator has been characterised by being responsive and willing to take action. However, stakeholder feedback also includes a theme of relatively weak understanding of FMA's role in the broadest sense, as opposed to the narrower interactions the FMA might have with any particular stakeholder.

Feedback from external stakeholders suggests that spending even more time engaging with the market will provide a greater depth of understanding of the market dynamics and changing risk profile. Building on intelligence in turn, will allow better decisions to be made around reallocating resources for education and monitoring activities. Creating organisational flexibility to facilitate this learning, such as secondments into the market, could help to accelerate progress, as would focusing on the market sectors that will deliver the greatest knowledge returns.

Efficiency

Comparison of the FMA with BASS benchmarks indicates some corporate areas are higher cost than comparable agencies. The FMA also has relatively narrow spans of control for most of its managers. We believe efficiency savings are achievable over time through:

- Reviewing spans of control and organisational tiers across FMA;
- Reducing investment in corporate areas.

We believe it is impractical for the FMA to achieve significant savings in the short term, given the costs of change and potential disruption within the context of full transition to the new regulatory regime completing December 2016. We also note the FMA has already planned for \$1 million in savings across FY 16 and FY 17 as part of ensuring it has sufficient funds until its new funding at the start of FY 18 is available.

Creating the right balance between effective regulation and administrative burden on market participants is an ongoing challenge. Often the requirements are driven by legislation, but the FMA also has a role to test and challenge where appropriate, and provide feedback to Government where there are opportunities to improve processes. Additionally, assessing the cost to the market and embedding a continual improvement culture which systemises the feedback loop and focuses on improving processes will lead to greater levels of efficiency and effectiveness.

FMA's budgeting processes are still relatively immature, although we note there has recently been increased focus on budget and cost management. While timesheet information is captured, it is not used for management or operational reporting. The FMA should consider using budget and timesheet information to more proactively manage the utilisation and productivity of its staff.

Organisation and capability

Ensuring the right mix of experience and capability of the workforce is a key challenge for most organisations. The role of the FMA has meant it has demanded high levels of experience for its front line regulatory operations. This has resulted in challenges in competing for and recruiting good talent, and relatively high levels of turnover in some parts of this business. We note the FMA has recently refreshed its Employee Value Proposition to help address talent challenges. We believe there are opportunities for FMA to:

- Strengthen the appeal of working at the FMA, outside remuneration, for example through work/life balance, secondment opportunities and career growth paths
- Broaden the experience base by recruiting more staff from public sector backgrounds and more general markets experience outside legal and accounting

Knowledge management and intelligence

Ongoing risk assessment and intelligence gathering is critical to being a risk-based regulator. Staff make important decisions in their roles, and need to rely on having all relevant information available to guide their judgement. The current systems constrain effective and consistent sharing of structured and unstructured information, and sophisticated analytics are not available. We note the FMA has completed internal business cases to address Enterprise Content Management and Data Analytics, but the investments have not progressed due to uncertainty regarding available funding. We believe these investments should be a priority, once funding becomes available.

Next steps

We facilitated a workshop with the FMA's leadership team to commence FMA's development of a roadmap to address the opportunities and recommendations identified through the E&E Review.

This roadmap should be confirmed and set out in more detail as part of business planning for FY 17.

Acknowledgments

We have had the full cooperation and assistance of the FMA's staff and leadership team throughout this review. We appreciate that they have given their time to provide us with their insights, and to understand our findings.

We would also like to acknowledge the time provided by FMA's external stakeholders, who provided valuable perspectives for this review.

If you have any questions about this letter, please contact me on 021 773 873. We appreciate the opportunity to have conducted this review.

Yours sincerely

DELOITTE



Linda Meade

Partner

for Deloitte Limited (as trustee for the Deloitte Trading Trust)

cc. Murray Jack, FMA Board Chair