IMF 2016 review of New Zealand

Summary of the International Monetary Fund's 2016 Financial Sector Assessment Program (FSAP) review of New Zealand

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In 2016 the International Monetary Fund (IMF) visited New Zealand to conduct a Financial Sector Assessment Program (FSAP) of this country's financial system. New Zealand's last assessment by the IMF was completed over a decade ago in 2003/2004.

This was a great opportunity for us to be benchmarked against international principles to show how much progress we have made since the last mission, and to receive some recommendations and feedback from the IMF.

We have now received the IMF's review of and report on our securities regulation (MIS) and financial market infrastructure and insurance conduct.

The IMF has published their Financial System Stability Assessment (FSSA) for New Zealand and technical notes.

Background

The FSAP is a comprehensive assessment of the country's financial sector and was coordinated by the Reserve Bank of New Zealand (RBNZ) on behalf of the members of New Zealand's Council of Financial Regulators, which includes the FMA, the Treasury and MBIE.

New Zealand's prudential and securities regulation was tested against international principles and practices.

Taking part in the IMF assessment programme is an important way for New Zealand to show we want to be recognised as an international destination for investor capital. Seeing how our system stacks up against international best practice means investors both here and abroad can have confidence in the regulatory framework we have been building over the last decade.

The regulations covering our financial system, and in particular our securities markets, have been transformed since the IMF's last FSAP review. And not only as a result of the shortcomings reported in the last FSAP. The impacts of the Global Financial Crisis and the recommendations from the Capital Markets Development Taskforce have also contributed to a huge overhaul of our regulatory framework.

New Zealand now has a twin peaks oversight model for the financial system, with RBNZ taking on prudential supervision of the banks and non-bank deposit takers (NBDTs), and the establishment of the FMA to supervise securities and financial markets conduct.

The IMF's 2016 FSAP review was a joint effort between the RBNZ, the FMA, Treasury and the Ministry of Business, Innovation and Employment (MBIE).

While the FMA's part in the overall FSAP review (which is focused on assessing New Zealand's financial stability) was secondary to RBNZ's, was still a major piece of work for the FMA.

The IMF conducted two missions to New Zealand – the first in mid-August 2016, (focussed on reviewing the banking and insurance sectors, and financial market infrastructure) and the second in the first three weeks of November, when they reviewed securities regulation.

As the new regulatory regime for securities under the Financial Markets Conduct Act wasn't fully implemented until the end of 2016, the IMF's review recognised that the FMA and New Zealand's financial markets were still in transition.

The IMF has acknowledged they could not conduct a full detailed assessment of the effectiveness of our new regime, when many market participants hadn't yet completed the licensing process and there was little practical experience under the new regime.

The FMA agreed with the IMF that instead of a full detailed assessment with a rating, the IMF would conduct a review of New Zealand securities regulation and provide 'technical notes' on its findings. These notes assess how our regime measures up against best practice and international principles.

What is a Financial Sector Assessment Program?

A Financial Sector Assessment Program (FSAP) is a comprehensive assessment of a country's financial sector by the International Monetary Fund (IMF). The goal of FSAP assessments is to gauge the stability of the country's financial sector, to identify any potential sources of systemic risk and to assess its potential contribution to growth and development.

The IMF will be undertaking a review of the New Zealand financial system in 2016 as part of their FSAP. The last FSAP for New Zealand was conducted nearly 13 years ago (in late 2003), with publication of findings and recommendations in May 2004.

An FSAP covers three broad areas:

- an analysis of key financial system vulnerabilities and risks, together with an assessment of the resilience of the financial system
- an assessment (using internationally defined standards) of the quality of the regulatory framework for banking supervision, insurance, securities regulation and financial markets infrastructure
- an evaluation of financial safety nets, which reflect a jurisdiction's capacity to manage and resolve a financial crisis.

FSAPs are mandatory for 29 'systemically important' jurisdictions. New Zealand is not one of these 29 countries, so our FSAPs are voluntary.

You can find out more about FSAP assessments and view examples on the FSAP page of the IMF website.

What did the 2016 New Zealand FSAP cover?

- A full detailed (graded) assessment for the banking system against the Basel Core Principles (BCPs);
- A full detailed (graded) assessment for the insurance sector against the IAIS' principles;
- A limited (non-graded) assessment for securities regulation that will involve a more informal benchmarking against the IOSCO principles; and,
- A more limited (non-graded) assessment of financial market infrastructure (FMI) that will involve a more informal benchmarking against the CPMI principles.

The full graded assessments for the banking and insurance sectors resulted in a Detailed Assessment Report (DAR) for each sector, while the assessments for securities regulation and FMI resulted in Technical Notes.

Anti-money laundering and countering financing of terrorism (AML/CFT) was excluded from the 2016 assessment but the IMF did hold meetings on correspondent banking relationships (CBRs) and the interface between New Zealand's AML/CFT regime and money remittances.

AML/CFT is scheduled to be reviewed in 2019 by the Financial Action Taskforce (FATF).

Managed investment schemes a focus

The International Monetary Fund (IMF) and FMA agreed the scope of the IMF's review of New Zealand's securities regime.

The review included a deep dive into managed investment scheme (MIS) regulation, and the reforms and improvements made to regulatory framework since New Zealand's last assessment in 2004.

The MIS regulation review tested many aspects of the new FMC Act regime in the managed investment scheme context. It examined both the new legislative framework put in place through the FMC Act and also the FMA's plans and activity in areas such as licensing, supervision and enforcement.

We provided a detailed background piece for the IMF. This included narrative about the reforms and improvements to the regulatory framework since New Zealand's last FSAP in 2004, which resulted in a relatively poor assessment of our securities market regulation.

IMF feedback

Feedback from the IMF indicates the FMA has managed the FMC Act transition effectively, has a good range of enforcement tools and makes good use of them. This reflects progress made since the last mission, when New Zealand's securities regulation performed relatively poorly against many of the IOSCO principles.

Overall the IMF's reports are favourable, providing a very positive assessment with helpful commentary and constructive recommendations. The IMF thinks the reform of securities market regulation (including establishment of the FMA , introduction of the FMC Act and the FMA's engagement and enforcement activities) have "significantly improved" the New Zealand framework. These reforms have included licensing providers of certain products, including managers of retail funds.

There are no real surprises in the IMF's report and, as expected, there are some areas where the IMF recommends we direct further attention. The areas relevant to the FMA are supervisors, custodians, wholesale asset management, insurance conduct and financial markets infrastructure.

The following table provides a brief summary of the IMF's feedback, as provided through their Financial System Stability Assessment and technical notes.

Brief summary of the IMF's feedback

Area	Context	Feedback
Fund Management: Regulation, supervision and systemic risk monitoring	The FMA is the conduct regulator of the financial sector. The FMA's role includes licensing and supervising fund management businesses. This includes requirements they must meet for governance, capability, controls, systems and processes, and financial resources.	• Supervision of the asset management industry has recently started and is still developing. The FMA completed initial licensing of MIS managers under the new regulatory regime in December 2016 and is now in the process of refining the risk-based approach to supervise these entities. The licensing process has allowed staff to gain insight into the sector and is assisting in the identification of the major risks to be monitored through the subsequent ongoing supervision. • The overall regulatory framework for asset management is well developed, but would benefit from some enhancements to prevent the build-up of risks. The regulatory perimeter could be reviewed to include wholesale asset managers and custodians, whose activities will become more relevant as the asset management industry matures, bringing potential new risks. • Private entities called Financial Markets Supervisors are now licensed and expected to play a role in the monitoring of MIS managers. The FMA should define its supervisory approach to asset management activities giving significant consideration to the expectations set on Supervisors. There are challenges and benefits from leveraging off the work of Supervisors and the FMA should keep the risks and appropriate responses under constant review. • The FMA has a comprehensive and flexible set of tools to influence financial conduct, and has a significant track record of enforcement action.
Insurance		• There is a need for more focus on the regulation of insurance intermediaries and insurance conduct, which is likely to require increased resources. The government and the FMA have been moving in this direction under recent legislation and in the FMA's supervisory initiatives, including on high life insurance commissions. • The current approach takes account of the relatively limited conduct risks in insurance, given the product range, while self-regulation by industry bodies is developing and there is a well-established system for disputes resolution.

		• However there is a need, which the government is addressing, to enhance the deliberately low intensity regime currently applying to most independent insurance advisers and brokers. The current regime does not include even basic competence and disclosure requirements. • There is a need to extend the range of conduct of business requirements specific to insurance beyond the current focus on advice, and to ensure that the appropriate requirements apply to all insurance activity, including sales without advice and ancillary sales. • The FMA functions with clear objectives within a generally sound framework of powers and processes and its responsibilities relative to those of government are clearly differentiated. The FMA would benefit from enhanced enforcement powers and would need to add insurance-specific expertise and maybe greater overall resources.
Regulation and Oversight of Financial Market Infrastructures (FMIs)	FMIs provide the central infrastructure (comprising institutions, rules, procedures, risk management frameworks, and technical platforms) to clear and settle payments, securities, and derivatives transactions. Together with the Reserve Bank of New Zealand (RBNZ), the FMA jointly oversees FMIs in New Zealand.	• Domestic cooperation between the RBNZ and the FMA is effective for day to day oversight and supervision of the designated settlement systems. The regulators bring different perspectives to issues given the different statutory objectives, with the FMA primarily responsible for conduct and the RBNZ for financial stability. Inconsistencies and gaps in the supervisory approach are avoided through frequent and constructive communication and consultation. • FMIs in New Zealand seem compliant with the different requirements in the CPSS IOSCO Principles for Financial Market Infrastructures (PFMI principles) to a large extent. But further work is needed to ensure full compliance, in particular with the 'newer' requirements. • The RBNZ and FMA currently lack sufficient legal powers to identify and address risks building up in FMIs, partly because the regime is voluntary and the authorities do not have the appropriate toolkit to pursue their oversight objectives. • Recognising the shortcomings of the current regime, the RBNZ and FMA are proposing to develop a new regime. These proposed reforms will bring New Zealand broadly on par with international standards.

Why do an FSAP?

The benefits of an FSAP include:

- early identification of financial system risks and vulnerabilities and/or gaps in the regulatory framework
- a 'positive' FSAP can support the financial system as a whole, improve the perception that the country has a well-regulated financial sector, facilitate market development, and underpin investor confidence
- participation in the assessment process provides a sense of international citizenship and a mechanism for comparison with countries with similar financial systems
- where there are gaps in international standards that reflect the specific financial structure of a given jurisdiction, an FSAP provides an opportunity for the local authority to clearly articulate why they have chosen to depart from international norms
- international lenders and investors may take the results of FSAP assessments into account when considering the risks and benefits of investing in a jurisdiction, and the level of return that they will expect.

The FMA's role in the 2016 New Zealand FSAP

The IMF's 2016 FSAP review will involve a joint effort between the Reserve Bank of New Zealand (RBNZ), the FMA, Treasury and the Ministry of Business, Innovation and Employment (MBIE).

While the FMA's part in the overall FSAP review (which is focused on assessing New Zealand's financial stability) is secondary to RBNZ's it still represents a major piece of work for the FMA.

The FMA will contribute to the voluntary (non-graded) components of the FSAP.

The methodology and IOSCO principles used for the IMF's FSAP assessment of securities regulation has been overhauled since New Zealand's last FSAP review in 2004. In addition, significant changes have been made to New Zealand's securities regime over the same period (see below for detail). In light of this, it is important and useful to undertake a fresh assessment against the new international standards.

The FMA has agreed with the IMF that a limited assessment 'technical note review' of New Zealand's securities regulation is more appropriate for this FSAP review, bearing in mind the FMA and the New Zealand securities market are still working through the transition to the new FMC Act regime.

The IMF has acknowledged they could not conduct a full detailed assessment of the effectiveness of our new regime, when many market participants haven't completed the licensing process yet and there is little practical experience under the new regime.

This technical note review will involve a non-graded assessment and informal benchmarking against the relevant principles from the 38 IOSCO Objectives and Principles of Securities Regulation.

The scope and focus of the IMF's review of New Zealand's securities regulation has yet to be fully defined and will be the subject of dialogue with the IMF in the first half of 2016 – with the review of NZ's securities regulation and the FMA occurring on the IMF's second or main mission in November 2016.

However, by way of example of the breadth of the IOSCO principles, they cover a wide range of areas such as:

- the effectiveness of the regulator – both in terms of its enforcement powers and monitoring and supervision tools
- how effective the licensing process is, the robustness of the assessment criteria and whether there are clear rules for market participants to follow
- how the regulator intends to deal with and monitor market participants, and manage and mitigate market and systemic risks.

The IMF's technical note report on New Zealand's securities regulation will include their findings and recommendations for areas where they think improvements are needed. This report will be considered by the FMA and Government and we will be given the opportunity to respond. Any publication of the final findings and recommendations will be made in early 2017.

What does an FSAP involve?

The IMF's 2016 FSAP review of New Zealand involves two separate 'missions' (visits by the IMF). The IMF's first mission to New Zealand will be in mid-August 2016 with the main mission following in November.

The authorities (RBNZ, Treasury, MBIE and the FMA) are required to provide an extensive amount of information to the IMF mission team of expert assessors in preparation for a series of meetings across the two missions. This involves responding to background questionnaires and data requests, together with comprehensive self-assessments against the relevant international standards and completing tailored questionnaires for the technical note reviews.

The missions themselves will involve a number of meetings with the authorities, and other stakeholders including industry. In addition, the IMF 2016 mission team intend to visit Australia and solicit the views of Australian authorities on trans-Tasman related issues.

About the 2004 New Zealand FSAP

The IMF conducted our last FSAP in late 2003, and published their findings and recommendations in May 2004.

The broad conclusion was that New Zealand had a profitable and well-functioning financial system, sound and transparent financial policies, and a favourable macroeconomic outlook - all of which provided an effective buffer against systemic risk.

The IMF assessed our regulatory framework as “generally appropriate” for New Zealand circumstances and indicated that (with some refinements) it would continue to provide a basis for maintaining a sound financial system.

The main recommendations made in the 2004 New Zealand FSAP are included in the RBNZ’s 2016 New Zealand FSAP Bulletin, published in late April.

However, New Zealand’s securities regulation performed relatively poorly against many of the international (IOSCO) principles. This assessment raised questions over the regulator’s core capability and effectiveness and resulted in a number of recommendations for change to improve deficiencies in New Zealand’s securities regulatory regime.

The key recommendations from the IMF’s 2004 review of securities regulation included:

- strengthening oversight of frontline supervisors and auditors
- allocating resources to enable a risk based review of issuer disclosure documents
- providing for greater assessment and regulatory oversight of the NZX
- providing a common regulatory framework, minimum standards and provisioning for the ongoing regulatory oversight of brokers and CIS (our managed investment scheme) operators
- providing minimum standards and strengthening oversight of market intermediaries that are not exchange members
- providing that investment advisers should be subject to ongoing capital and prudential requirements
- maintaining a crisis management plan for dealing with potential failure of intermediaries
- strengthening market manipulation rules.

Changes to New Zealand's regulatory environment since 2004

There have been significant changes to New Zealand's regulatory landscape since our last FSAP in 2004. These changes were initiated (in part) in response to IMF recommendations from the 2004 FSAP review, as well as recommendation from the Capital Markets Development Taskforce and external developments such as the Global Financial Crisis (GFC).

The changes to New Zealand's securities regulation include:

- the Review of Financial Products and Providers (2006). This subsequently led to the RBNZ assuming responsibility for the regulation of the non-bank deposit taker (NBDT) and insurance sectors
- the RFPP review also initiated the review of securities regulation. It resulted in a fundamental shift in the approach to securities regulation, with the establishment of the FMA and new standards for market conduct. This work led to the introduction of the Financial Markets Conduct Act 2013 (FMC Act).
- the introduction of the AML/CFT Act (2009).

The FMA was established in 2011 in response to the Capital Market Development Taskforce recommendations to improve New Zealand's financial system. The concept was to consolidate a range of different financial regulatory functions into a single financial markets securities regulator.

The FMA was also established to administer a new regulatory framework, which consolidated the regulation of securities into a single regime. This was a recommendation of the Capital Markets Development Taskforce and an implication of IMF recommendations in their 2004 FSAP review of New Zealand.

Because of the increased urgency of improving confidence in financial markets as a result of the GFC, the FMA was in fact established prior to the completion of the new regulatory framework – the FMC Act.

The purpose of the FMC Act is to promote and facilitate the development of fair, efficient and transparent financial markets, and to promote the confident and informed participation of businesses, investors and consumers.

The FMC Act works to reform the regulation of financial conduct. It governs the way financial products are offered, promoted, issued and sold. This includes the on-going responsibilities of those who offer, issue, manage, supervise, deal in and trade financial products. The FMC Act also regulates the provision of certain financial services.

The changes introduced by the new legislation play a key role in building confidence in our markets, by providing better information for investors, as well as setting clearer rules for companies wanting to raise capital.

The transition to the FMC Act was the last major step of this reform, with the final phase of the transition taking place from 1 December 2014.

Although the new regime has been in effect since 1 December 2014, most regulated businesses and individuals have until 1 December 2016 to transition across from the old regime.

The FMA is focused on helping the financial services sector through this transition in 2016. This work includes licensing and setting up new systems and processes for ongoing monitoring and oversight.

The methodology the IMF use for their FSAP assessments has also been overhauled since the last New Zealand FSAP in 2004, so it is both necessary and useful to undertake a fresh assessment against the new international standards.

Other broader changes and those specific to the banking sector are covered off in the RBNZ's 2016 New Zealand FSAP Bulletin. In short they include:

- implementation of a prudential liquidity policy for the banking system (2010)
- implementation of the new Basel III capital standards for the banking system
- the development of a new bank resolution framework
- the pivot towards a somewhat more intensive approach to banking supervision post-GFC
- the development of a new macro-prudential policy framework (2013) and subsequent deployment of loan to value ratio (LVR) restrictions.

IMF documents

Financial System Stability Assessment (FSSA) for New Zealand

All FSAP technical notes for New Zealand