REVIEW OF FINANCIAL PRODUCTS AND PROVIDERS:

OVERVIEW OF THE REVIEW AND REGISTRATION OF FINANCIAL INSTITUTIONS

Discussion Document

September 2006

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Regulatory and Competition Policy Branch
Ministry of Economic Development
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http://www.med.govt.nz

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2. INFORMATION FOR SUBMITTERS

The Ministry of Economic Development has prepared these discussion documents in conjunction with other government officials and agencies, and in consultation with stakeholder advisory groups. Written submissions on the issues raised in these documents are invited from all interested parties.

How to Make a Submission

Please send your submissions to **Review of Financial Products and Providers** at the contact details provided below. The Ministry asks that submissions sent in hard copy also be provided in electronic form (Adobe Acrobat, Microsoft Word 2000 or compatible format).

Please note that the questions in the discussion documents are only intended to provide a suggested focus of the issues. Some of the questions have elements that overlap with other questions and other documents. Submitters should also feel free to provide broader comments where desired if issues are not subject to specific questions. However, submitters should provide reasons for their answers or in support of their position. There is no need to address all the issues or questions, and submitters should feel free to provide submissions only on the issues of direct concern.

The closing date for submissions is: **1 December 2006.**

After receiving submissions, the Ministry will evaluate them and seek further comments where necessary before developing recommendations for Ministers and then Cabinet to consider.

Copies of the Discussion Document

Hard copies of the discussion documents are available on request from the contact details provided below. The document is also available electronically on the Ministry of Economic Development website www.med.govt.nz

Contact for Queries and Submissions

Please direct all submissions and any queries to:

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Attention: Financial Sector Team
Regulatory and Competition Policy Branch

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Access to Current Statutes, Regulations and Bills

Current statutes and regulations may be accessed through the government's interim Public Access to Legislation website at www.legislation.govt.nz.

Acknowledgment

The Ministry would like to acknowledge our partners, the other government agencies that have assisted us in the drafting of these discussion documents and with the policy development process. These include: The Reserve Bank, the Treasury, the Securities Commission, the Ministry of Justice and the Ministry of Consumer Affairs.

We would also like to thank the members of the advisory groups who have helped us in developing the options for the discussion documents. Their assistance has been

invaluable in providing: guidance on how to narrow down options in some areas; a clearer idea of the costs and benefits for business of different proposals; and also a better understanding generally about how the financial sector operates.

3. PART A: OVERVIEW OF THE REVIEW

3.1 BACKGROUND

1. The key objective for the Review of Financial Products and Providers ("RFPP") is to develop an effective and consistent framework for the regulation of non-bank financial institutions and financial products that promotes confidence and participation in financial markets by investors and institutions, and results in a sound and efficient financial sector.

2. The RFPP considers the regulation of insurance (health, life and general), superannuation, collective investment schemes, platforms and portfolio management services, non-bank financial institutions (friendly societies, credit unions, building societies, finance companies, industrial and provident societies) the offering of securities and consumer dispute resolution and redress in the financial sector.

3. The RFPP does not cover registered banks, securities trading law (as this has been the subject of a number of previous reviews) and consumer credit law (as the Credit Contracts and Consumer Finance Act 2003 took effect from 1 April 2005).

4. The RFPP provides a response to the Law Commission review of the Life Insurance Act 1908, the Ratings and Deposits Review and includes the Phase 2 changes to the Friendly Societies and Credit Unions Act 1982 and the fourth part of the securities law reform programme – a review of the Securities Act 1978.

5. The Ministry of Economic Development ("MED") is leading the RFPP, with the support of an inter-departmental working group made up of the Treasury, Securities Commission, Reserve Bank, Ministry of Justice and the Ministry of Consumer Affairs. These agencies have contributed to the drafting of these discussion documents.

3.2 THE PROCESS FOR THE REVIEW

3.2.1 Stage One: Problem Identification

6. The review began in March 2005 with Stage One: Problem Identification. Stage One included:

   - The development of a framework for the RFPP which included: the outcomes the Government wanted to obtain from the non-bank financial sector, the reasons for government intervention in the sector and the objectives of any regulatory regime;

   - An assessment of the current regulatory regime for the non-bank financial sector against the framework for the RFPP, including identifying any problems; and

   - Some general directions for reform of the non-bank financial sector.

7. In reviewing the current regulatory regime for the non-bank financial sector against the framework for the RFPP, officials utilised: information the Government had gathered through previous consultation in the non-bank financial sector (for example, the review of the Life Insurance Act 1908, the various securities law reviews, the ratings and

deposits review); international assessments of New Zealand's regulatory regime (for example, the Financial Sector Assessment Programme ("FSAP") and New Zealand's compliance with the Financial Action Task Force Recommendations); analysis undertaken by officials; and additional input from key stakeholders.

8. Consultation on the problem identification was undertaken with: the Insurance Ombudsman, the New Zealand Association of Credit Unions, Manchester Unity, Investment, Savings and Insurance Association of New Zealand, the Insurance Council, the Insurance Brokers Association of New Zealand, the Association of Superannuation Funds of New Zealand, the Financial Services Federation, the New Zealand Society of Actuaries, New Zealand Exchange Limited ("NZX"), the Trustee Companies Association (and individual trustee corporations), Institute of Finance Professionals of New Zealand, the Institute of Directors, the New Zealand Bankers' Association, the Retirement Commission, the Shareholders Association, Health Funds, the Consumers Institute, KPMG, and various law firms, merchant banks, friendly societies and building societies.

9. A paper outlining the conclusions of Stage One of the review was presented to Ministers in July 2005, and can be found on the MED website at: http://www.med.govt.nz/templates/MultipageDocumentTOC____14105.aspx

3.2.2 Stage Two: Options Development

10. The Second Stage of the Review was the development of options for reform. These options for reform were developed in conjunction with advisory groups made up of people from key industry organisations, industry participants, professional organisations and government bodies. The advisory groups provided industry expertise and knowledge to inform options development, the costs and benefits of various proposals and implementation. We have, where possible, reflected the advisory groups' views in the discussion documents. While there was consensus on many issues, not all members of the advisory groups agreed with the proposals in these discussion documents. For further information on the participants in the advisory groups and the advisory group process please see : http://www.med.govt.nz/templates/Page____14641.aspx

3.2.3 Stage Three: Release of Discussion Documents

11. The release of these discussion documents represents the third stage of the review. The discussion documents bring together the work streams and put forward proposals for feedback. While we have utilised the advisory group process, which has provided us with invaluable business insights and options for addressing issues, we would also like to test many of these ideas with a wider audience. This is because we recognise that the impacts of this review are far-reaching and we would like to give all interested parties an opportunity to contribute to the review.

12. While the discussion documents are out for consultation officials also intend holding some focus group discussions on the documents with stakeholders.

3.2.4 Stage Four: Development of Policy Proposals

13. Once we have received feedback on the discussion documents, policy proposals will be developed for Ministerial and Cabinet consideration by April 2007. Drafting of legislation and supporting legislation through the legislative process will then take until

2008. A more detailed timeline for implementation will be made public towards the end of 2006.

3.3 THE NEED FOR THE REVIEW AND THE DISCUSSION DOCUMENTS

14. The financial system, which includes financial products and providers and financial markets, is central to economic growth. Financial institutions, financial intermediaries and markets are at the centre of the processes that provide liquidity and mechanisms that allow firms to make payments, grow and innovate. These processes also mobilise and allocate savings to their best use, enabling long-term investment projects to be undertaken.

15. A robust and efficient financial sector, where consumers are confident, well-informed and provided with choices, can assist in increasing the number of people saving/investing and the rate of saving. This can enable people to accumulate assets, achieve higher living standards in retirement and provide consumers with some buffer against adverse circumstances. There may be broader benefits, for example, stronger economic growth, the economy being less vulnerable to economic shocks and direct employment and investment by the financial sector.

16. Financial markets, different financial institutions and financial intermediaries contribute to this outcome in different ways.

17. One of the key factors in business growth, and investment in innovation is access to capital (both the cost and supply of funds). For many businesses, capital is accessed through issuing securities to the public, especially if the financial markets are deep and liquid. Equity securities are particularly important for businesses in higher-risk sectors of the economy, where debt financing may not be a realistic option, while issuing debt securities can provide access to long-term debt at lower cost than borrowing from institutional investors or banks.

18. Public securities markets allow households to diversify their investments and risks, in a cost-efficient way, by investing in a range of businesses, sectors and countries, either directly or via collective investment vehicles. Financial markets also provide an important maturity transformation role, enabling short-term funding to be converted into longer-term capital.

19. Financial systems facilitate economic development by efficiently allocating limited capital to its best use (allocative efficiency). Markets price the information acquired and analysed by analysts and large players, which influences how capital and funds are allocated. Financial systems also provide dynamic efficiency (i.e. there are strong incentives to develop new products and market structures) and productive efficiency (product and market providers have strong incentives to minimise transaction costs and risks).

20. Insurance and superannuation savings play important roles, by enabling people and businesses to manage, pool and mitigate financial risks efficiently, such as in the event of death, property loss/damage, or poor health, and by providing vehicles for savings and investment, including to increase living standards, particularly in retirement. In addition, insurance can facilitate commerce and trade.

21. Collective investment vehicles play a range of roles, including providing some equity, some risk pooling and savings vehicles.

22. Non-bank financial institutions, such as building societies, finance companies and credit unions, may potentially fill gaps in the financial services offered in a bank-based financial system, such as through specialising in the provision of services to particular sectors, groups or regions. These institutions may also increase competition, add to financial depth/liquidity and provide a wider choice for consumers/investors.

23. For all of these reasons a robust and efficient financial sector, where the financial system is resilient to economic shocks and the public have a strong basis for being confident in the sector, is an essential prerequisite for a strong and dynamic economy. The outcomes the Government would like from a well-functioning non-bank financial sector are:

    - A financial system that is resilient in the face of economic and financial shocks;
    - Investment which encourages growth and innovation;
    - An environment that facilitates wealth accumulation;
    - Facilitation of effective risk management (i.e. the ability to mitigate and pool risk);
    - Confidence in the sector that encourages participation by consumers, firms and providers; and
    - Efficient functioning of day-to-day transactions and payments.

24. There are a number of reasons why the financial sector cannot achieve these outcomes without some government intervention. The reasons for the need for government intervention in the financial sector are addressed in each of the individual discussion documents. There is also a need for Government to address these reasons for intervention by providing well-targeted regulation which meets specified objectives. These objectives vary depending on what area of the financial sector is being discussed and are outlined in each of the discussion documents.

25. The Stage One Problem Identification part of the review concluded that the objectives behind regulation of the non-bank financial sector in many areas were fundamentally sound. However, there is a range of areas where the regulation could be improved in order to meet the objectives of the review. The general drivers for the review follow.

    - There are a myriad of pieces of legislation in the non-bank financial sector that have been developed in different decades and sometimes different centuries, with confusing or conflicting objectives. This has led to gaps in coverage of the regulation, inconsistencies in the regulatory treatment of similar financial products and consequent regulatory arbitrage.
    - Some unnecessary compliance costs are being imposed on business and inefficiencies or inflexibility in the regulation has the potential to impede business innovation. In particular, some of the legislation is very out-dated (in the case of insurance around 100 years old), resulting not only in costs but also regimes which are not appropriate for current New Zealand conditions.

- In some areas there are concerns about inadequate consumer protections and the overall effectiveness of the regulation in achieving its objectives (e.g. in some areas governance, accountability or supervision could be enhanced). In some cases the objectives of the regulation are not clearly specified.

- In many areas New Zealand does not comply with international principles (e.g. those relating to securities regulation or insurance supervision), or international obligations we have signed up to (e.g. the Financial Action Task Force Recommendations on Anti-Money Laundering and Countering the Financing of Terrorism). This has the potential to damage confidence in, and the reputation of, our market.

26. The discussion documents also outline more specific problems with each of the areas of the financial sector. Many of these problems have been identified by market participants themselves and in many areas there is a high level of consensus around both the need for change and the issues that need to be addressed.

27. The discussion documents are:

- Review of Financial Products and Providers: Overview of the Review and Registration of Financial Institutions;

- Review of Financial Products and Providers: Securities Offerings

- Review of Financial Products and Providers: Supervision of Issuers;

- Review of Financial Products and Providers: Collective Investment Schemes

- Review of Financial Products and Providers: Non-Bank Deposit-Takers;

- Review of Financial Products and Providers: Insurance;

- Review of Financial Products and Providers: Mutuals' Governance

- Review of Financial Products and Providers: Consumer Dispute Resolution and Redress

- Review of Financial Products and Providers: Platforms and Portfolio Management Services

28. Outlined below is a brief summary of each of the discussion documents.

3.3.1 Overview of the Review and Registration of Financial Institutions

29. This discussion document contains an overview section for the release of the discussion documents which provides submitters with: the background for the review; the process and how to make a submission; how the RFPP links to other government reviews; and an overview of all of the discussion papers and any relationships between the documents so that submitters understand which documents may be relevant to them.

30. It also contains a section on the registration of financial institutions.

31. Currently, there is no comprehensive way of identifying or monitoring providers of financial services. There are registration requirements for some providers and for particular financial products under specific legislation. These registration systems have been put in place for a range of purposes and do not provide complete coverage of financial service providers and the services they provide. As the information available does not identify the nature of the financial services an entity provides, it is difficult to build up a complete picture of a provider's details and activities.

32. All of this makes it difficult for regulators to collect data in order to monitor and identify risks in the sector or people who are not complying with the law. It also makes it difficult for market participants (i.e. business analysts, intermediaries and consumers) to access information on a financial services provider. New Zealand is a signatory to the Financial Action Task Force's Recommendations on Anti-Money Laundering and Countering the Financing of Terrorism (FATF Recommendations) and does not comply with the requirements in the Recommendations that there be clear identification of all financial institutions.

33. Finally, the current framework does not provide assurance that financial service providers have not been convicted of financial crimes or other misconduct or that they are fit to run financial institutions. This increases the risk of unfair, fraudulent or negligent misconduct in relation to financial institutions and also means that New Zealand is not compliant with Recommendation 23 of the FATF Recommendations.

34. This document proposes that the Companies Office register those "financial institutions", as defined by the FATF Recommendations, that are not otherwise subject to a registration regime suitable for the purposes of Recommendation 23. This means that, in general, the Companies Office would register core financial institutions. Other groups, such as lawyers and accountants which are only captured by the FATF financial institutions definition when they provide specified services, would continue to be registered by their professional associations. The Ministry of Justice's third FATF discussion document considers the issues around registration of those institutions defined by under FATF as "designated non-financial business providers".

35. The registration requirements for the Companies Office would include collecting some base level information about the entity and undertaking negative assurance checks, which could involve checking to make sure that directors, senior management and significant shareholders:

    - Do not have director or management bans;
    - Have not undertaken relevant criminal activity (this check would be undertaken in conjunction with the Police); and
    - Have not been bankrupt within a specified period.

36. It is proposed that any qualitative checks (i.e. whether people have the experience, capability and capacity to run a particular financial institution) would be undertaken by the applicable regulator (e.g. the Reserve Bank or the Securities Commission) who would notify the Registrar if a person met the necessary requirements. Good information sharing between the regulators will be important. The proposed fit and proper requirements that financial institutions should comply with are outlined in the other discussion documents, or in the case of banks, already exist under the Reserve Bank of New Zealand Act 1989.

37. The register would be electronic and easily searchable for market participants and would contain information about an entity in one easily accessible place (i.e. financial statements, offering documents, other disclosures and key information).

38. This regime would address the issues identified above as it would identify financial institutions, allow more effective monitoring and evaluation, provide easy access to information about institutions, give some assurance about the integrity and capability of people running financial institutions and meet New Zealand's obligations under the FATF Recommendations.

39. This option presents the least cost for government and business. The Companies Office already registers nearly all financial institutions either under their corporate form (companies, credit unions, building societies, etc.) or for offering document purposes (i.e. prospectuses). The proposed regime would make the necessary links and leverage off the other registration regimes and therefore any additional cost on business would be small.

40. As all financial institutions will be subject to the new regime it is important that this part of the discussion document is read by all participants in the financial sector.

3.3.2 Securities Offerings

41. Government has been undertaking a four-stage securities law reform programme since 2000. The review of the Securities Act (which regulates offers of securities to the public) is the fourth, and final, part of this reform programme.

42. The objectives behind the Securities Act 1978 and the Securities Regulations 1983 are sound, however, the Act and regulations have been around for a while now and industry has identified a number of areas where the regulatory regime could be improved by reducing costs for business. For example: ensuring that the disclosure regime applies only to offers of securities to those investors who need that protection; and by addressing problems with duplication, ill-targeted disclosure requirements, and removing areas which lack sufficient flexibility, certainty or impose a lot of administrative costs.

43. Consumer groups too would like some changes to the regime so that disclosure about financial products is better targeted and more accessible for consumers.

44. The discussion document contains a number of detailed proposals that have been worked through with industry to enhance the regime for securities offerings, including:

- Making the exemptions from the Securities Act clearer and more comprehensive so that offers to those people not needing the protections of disclosure (for example experienced investors) do not need to comply with the requirements of the Act. This is aimed at making access to capital simpler for business as they can target particular investors and do not have to go through the expense of creating public disclosure documents;

- For those wanting to seek capital from the public, there are a number of enhancements proposed to the disclosure regime to make disclosure better targeted for particular products and consumers and to reduce some of the cost on business of complying with the regime (for example, removing

overlaps/repetition, requirements for unnecessary information and allowing for more information to be provided on websites). These are that:

- Each offer document must have a Part A which is prescriptive, product-specific and concise (there may be requirements as to length). This is targeted at retail investors and should give them the key information they need on the product in a short digestible way;

- Each offer document must have a Part B which contains the fuller information and also refers people to where other information relevant to the offer is available on websites;

- Educational material also be distributed with the offer document, either included in Part A or a separate one pager which contains key information and pointers to enable people to better understand financial concepts and what to look for; and

- A number of amendments are made in relation to ongoing disclosure. For example, whether there should be better ongoing disclosure of material changes; whether there should be additional ongoing disclosure requirements for securities which are not listed on a registered securities exchange and have an established market; and whether there should be some exemptions from the Securities Act for people who are listed on a securities exchange and make a new offer of securities (as many of these issuers have had to disclose information already under the continuous disclosure regime).

45. The discussion document also recognises that there are limits to what disclosure can achieve, and that there are other areas where work is going on to encourage participation and understanding of financial markets. Examples of this are the work the Government is undertaking on financial education and the review of Financial Intermediaries.

46. The disclosure obligations will apply to all financial institutions offering to the public, except product disclosure obligations for insurance which are discussed in the insurance discussion document. Those institutions that come under prudential regulatory regimes will have to make some institutional disclosure under the proposed prudential regimes and therefore would have some exemptions from the disclosure regime, but it is likely that they will still have to comply with many of the specific product disclosure requirements.

3.3.3 Supervision of Issuers

47. When the Financial Sector Assessment Programme (undertaken by the International Monetary Fund) assessed New Zealand in 2003, one of the emergent issues was a heavy reliance on private supervisors (i.e. trustees) but there were insufficient checks and balances and accountability in how these people were performing their role.

48. Other issues have also been raised in relation to trustees as supervisors. These include: whether there are sufficient entry requirements for trustees (we are also non-compliant with the FATF Recommendations in this regard); that inconsistent trust deed requirements or a lack of consistent minimum protections in trust deeds makes it difficult for people to compare products or may mean that consumers may be lacking important

protections; that trustees may need more powers in some areas to effectively carry out their role and that there is currently no effective way for Government to gather whole-of-sector data and monitor the sector.

49. In relation to superannuation the fact that trustees are also the issuers of securities in superannuation schemes raises concerns, particularly where the trustee is a subsidiary of the provider of the scheme (i.e. this occurs in some retail schemes and employer master trusts). In these cases the trustee can have competing incentives and there is the potential for conflicts of interest, which makes it difficult for them to be an independent supervisor.

50. There are a number of benefits of retaining trustees. Many trustees are close to the market and therefore have the ability to apply standards in a flexible way commensurate with the level of risk of the scheme (which minimises costs for the scheme); they have good knowledge of the areas they are in, good working relationships with issuers and regulators, demonstrated capacity and a long and favourable track record, all of which cannot easily be replicated in a regulator.

51. For these reasons, the discussion document proposes that trustees be retained for debt issuers and collective investment schemes (including superannuation) but that they meet entry and ongoing requirements, and are supervised by the Securities Commission. It also suggests that in some areas trustees be given greater powers to carry out their role and that the issuer and trustee functions in superannuation be separated. However, it is not proposed that the issuer and trustee functions be separated for existing employer stand-alone superannuation schemes (both defined contribution and defined benefit schemes). As these schemes have already been winding up or moving to employer master trusts, and any major changes may result in further wind-up of these schemes, it is proposed that only minor rather than wholesale changes be made so as not to accelerate this unnecessarily.

52. The paper also proposes that there be some additional minimal protections and consistent disclosure requirements contained in debt trust deeds.

53. There has been general industry support for the trustee supervision model, and the Trustee Corporations have expressed a willingness to work within the model. There has also been some support for consistent requirements in debt trust deeds. There has been a mixed response in the market to the idea of separating out the trustee and issuer roles in superannuation with some in the industry supporting the changes and others, notably employer master trusts, raising some concerns about whether there is a need for change and the cost of paying someone independent to carry out the trustee role. The discussion document recognises the arguments for and against separation that have come from industry, and as part of this, recognises that paying for someone external rather than internal to carry out a similar role should mean that any additional costs should not be significant. The proposals are consistent with the proposals for KiwiSaver schemes, where concerns about the potential for trustee conflicts of interest have been addressed in part by requiring KiwiSaver default funds to have a trustee corporation and all other funds to have an independent trustee.

54. This discussion document also suggests some improvements to the Securities Commission powers in relation to disclosure enforcement under the Securities Act and in relation to debt trust deeds.

55. Everyone operating in public securities markets should read this discussion document.

3.3.4 Collective Investment Schemes

56. While the current regulation of collective investment schemes (i.e. unit trusts, superannuation schemes, participatory securities) is fundamentally sound, a number of problems have been identified with the current regime. In particular:

    - The various pieces of regulation applying to different Collective Investment Schemes ("CISs") create inconsistent and complex obligations for CISs which are difficult for investors to differentiate and understand. This creates both inefficiencies and costs for providers and the potential for regulatory arbitrage;

    - There are inconsistent regulatory controls and trust deed requirements across CISs, resulting in inconsistent, and in some areas insufficient, investor protections;

    - The governance arrangements for different CISs are inconsistent and do not adequately meet the objectives for regulation of CISs. There are no entry requirements on the competency or capacity of issuers of CIS products; and

    - A number of minor issues have arisen with the current regulatory requirements.

57. The discussion document proposes one regulatory framework for collective investment schemes and most superannuation schemes since the consumers in these schemes have similar characteristics and require similar protections. This includes: entry and ongoing requirements for issuers of schemes; consistent and improved trust deed requirements; and clearer and more effective functions and powers for the issuer, trustees and the Securities Commission.

58. It is also proposed that existing employer stand-alone schemes (including all existing defined benefit schemes) have a transitional structure so as to minimise scheme wind-up. When schemes wind-up money is generally released from savings and spent, which is contrary to the Government's current policies in relation to savings and the objectives of the review. The structure would be similar to the current structure under the Superannuation Schemes Act though there will be additional powers for the Regulator in relation to monitoring and enforcement. Some additional improvements are also suggested for existing defined benefit schemes to ensure that investors have adequate protections.

59. All unit trusts, superannuation schemes, participatory securities and Group Investment Funds, advisors, trustees/statutory supervisors and consumers should read this discussion document.

3.3.5 Non-Bank Deposit Takers

60. This discussion document puts forward the proposition that there is a separate category of financial institution (Non-Bank Deposit Takers - "NBDTs"), which are in the business of borrowing money from the public to lend to others, and hence different from other debt issuers, and whose consumers need more protections. This category would include entities like finance companies, credit unions, and building societies.

61. The particular characteristics of deposit-takers that require a higher level of supervision are outlined below.

- Deposit-takers hold assets across a wide range of borrowers, whereas other debt issuers generally invest within the same company or a group of related companies. It is therefore more difficult for depositors to understand the level of risk associated with their deposits than in the case of investing funds with a debt issuer that lends only to itself or a group of related companies.

- Deposit-takers generally issue relatively short-term deposits that investors are more inclined to rely on for transaction or near-term purposes than in the case of other debt securities.

- Deposit-takers tend to be highly geared relative to most other forms of debt issuers.

- There is a potentially substantial level of contagion risk with deposit-takers, both because of their funding nature and because they tend to be viewed as like entities.

62. The discussion document proposes that there be two tiers of NBDTs.

- **Tier One (Opt-In): Authorised Deposit Takers ("ADTs")**. Any deposit-taker could elect to become an ADT provided that they meet the licensing and ongoing supervisory requirements imposed by the prudential supervisor – a Cabinet in-principle decision is that the prudential supervisor be the Reserve Bank (the current supervisor of registered banks). These requirements would include a minimum level of capital, a minimum capital adequacy ratio, a minimum credit rating, a limit on related party exposures, and some governance and disclosure requirements.

- **Tier Two Deposit Takers ("Enhanced Trustee Model")**. These entities would come under the improvements above for other issuers (i.e. enhanced disclosure, trustee/Securities Commission supervision model, enhanced trust deeds) and would be regulated by the Securities Commission and trustees. It is proposed that they also meet other requirements proposed in the discussion document (i.e. a minimum capital requirement, possibly a mandatory credit rating, enhanced disclosure, capital adequacy measurement framework, more fit and proper person requirements). They would be required to disclose prominently that they are not an ADT.

63. It is proposed that credit unions and building societies would also be regulated by the prudential regulator as a special class of financial institution. This reflects a view that it would be more efficient for credit unions and building societies to be regulated by the prudential regulator in order to ensure consistency of regulatory approach and because, for reasons of scale, it may not be commercially viable for trustees to supervise these entities if some become ADTs. Consistent with agreement with industry, credit unions would still be given the option of keeping restrictions/remaining small or having their restrictions removed and transitioning to the ADT category.

64. The purpose of the two-tier regime is to provide a clear means of distinguishing between risks of institutions, without imposing unnecessary impediments to raising capital. It is intended that the proposed approach will assist in creating a clear differentiation between ADTs, that are all required to meet the same minimum standards and are supervised on a consistent basis, from other deposit takers. Given that ADTs would be required to meet a uniform set of requirements similar to those for

banks, and to be supervised on a fully consistent basis, the paper indicates that this can most effectively be done through one government agency, the prudential regulator (there is a Cabinet in-principle agreement that this will be the Reserve Bank). This would facilitate a consistent approach and enable economies of scale and scope to be derived in the supervision process. It would also facilitate more effective management of distress in the ADT sector.

65. Credit unions, building societies, finance companies and other entities offering debt securities to the public are in the business of lending on these funds, and consumers, will need to read this discussion document.

3.3.6 Insurance

66. The regulation of the insurance sector in New Zealand is very light-handed. However, possibly because of strong industry self-regulation and the effects of parent supervision in many cases, there have been very few problems with the insurance market.

67. A number of issues that have arisen with the current legislation (which has been in place for decades and in some cases centuries) are outlined below.

- Regulation is out of date/inflexible, and allows for regulatory arbitrage;
- While most of the industry complies with solvency standards, these are not legislatively backed and there are a few fringe players who do not comply;
- A lack of monitoring and supervision tools for the regulator means there are risks for policyholders and Government if an insurer fails;
- The light-handed regulatory approach leads to issues with the reputation of the New Zealand market (it is not compliant with International Association of Insurance Supervisors Principles);
- There are inconsistent standards of product disclosure and a lack of understanding by consumers of their obligations in forming insurance contracts; and
- There are ineffective entry requirements for insurers to operate in the New Zealand market.

68. The discussion document acknowledges this is not an industry in crisis and attempts to leverage off industry self-regulation where possible. It proposes that there be: a licensing regime which includes entry criteria to ensure an entity has the appropriate capacity and capability to run an insurance company (including fit and proper person requirements for individuals and the board, a solvency support plan and a flexible minimum capital requirement at start-up); legislative backing of enhanced solvency standards which are set by the industry and approved by the regulator; plus requirements that insurers have a risk management plan and financial condition report.

69. The discussion document proposes a monitoring regime which focuses on disclosure and director attestation, but with more monitoring and enforcement powers for the prudential regulator to use if needed. It proposes that the regulator have the discretion, based on transparent criteria, to determine whether a) an entity can run classes of insurance business (i.e. general, health and life) with only accounting separation or

through subsidiaries; and b) an entity with a foreign parent can offer insurance through a branch structure with accounting separation or through a subsidiary structure. Conditions for both would be able to be imposed by the regulator.

70. The document also raises for discussion the option of mandatory ratings for all or some insurers (with recognition that if there are mandatory ratings there will need to be exemptions for smaller insurers because of the costs involved).

71. In relation to the market conduct aspects of insurance, the discussion document seeks information on: a new product disclosure regime; refinements to the law relating to insurance contracts to further clarify the obligations, rights and remedies of the parties in forming contracts; clarification of intermediaries' responsibilities for an insurer's product disclosure when the product is offered/sold by them directly to the consumer; and improvements which will reduce the cost and processes applying to registration of assignments and mortgages of life policies.

72. All insurers, those involved in the sale of insurance products, and consumers, should read this discussion document.

3.3.7 Mutuals' Governance

73. Currently different mutuals (i.e. friendly societies, insurance mutuals, credit unions, industrial and provident societies and building societies) have different corporate governance requirements, which can lead to confusion for investors. In addition, many of the corporate governance requirements give insufficient protections for consumers, particularly since many are investing money in these organisations. Finally, the requirements do not provide appropriate incentives in some areas for organisations to be soundly managed and governed.

74. The discussion document proposes that there be one statute that contains base level corporate governance requirements for mutuals. It also provides other options for discussion, since the contents of this discussion document have not been the subject of consultation with advisory groups. The intention is that the proposals recognise the special features of mutuals, but also that there needs to be some minimal adequate protections for consumers. In some cases (like mutual insurers) many of the requirements are already being met, while in others (like credit unions) there will need to be a transition to any new regime.

75. All credit unions, building societies, friendly societies, industrial and provident societies and mutual insurers should read this discussion document.

3.3.8 Consumer Dispute Resolution and Redress

76. The current coverage of consumer redress in the financial sector is patchy, with the Banking Ombudsman (BO) and Insurance Savings Ombudsman (ISO) providing effective redress for consumers in relation to many of these entities but other areas (i.e. financial intermediaries, finance companies, some superannuation, credit unions and building societies) having no ombudsman schemes. This means consumers are only able to seek redress from the individual institutions or the courts.

77. There is some evidence (from surveys undertaken by the Ministry of Consumer Affairs and the Financial Intermediaries Task Force) of problems with consumers' knowledge

of, and ability to access, redress mechanisms. However, there has not been extensive consultation on this issue, and there was no advisory group for this area of the review.

78. For this reason the discussion document tests the magnitude of the problem and proposes some options for reform. Essentially it proposes that as a condition of registration a financial institution must belong to an industry-based consumer dispute resolution scheme. There are three options for this:

- One financial sector ombudsman funded by industry, possibly with different specialist divisions. This would ensure coverage of the entire industry and have scale and efficiency advantages. However, there are some concerns that some of the industry buy-in to sector-specific schemes that currently exists for the ISO and BO may be lost;

- Multiple dispute resolution schemes; financial providers would be able to join any dispute resolution scheme - this would raise some concerns that the schemes would not cover all parts of the sector; whether there would be barriers to entry and whether the small New Zealand market can sustain a number of separate schemes;

- Several dispute resolution schemes with some shared infrastructure (e.g. administrative resources and systems). This would have some efficiencies, but there would be similar concerns as in the previous bullet point in relation to coverage of all parts of the sector and barriers to entry.

79. All those participating in the financial sector should read this discussion document.

3.3.9 Platforms and Portfolio Management Services

80. This is a small technical discussion document. It deals with platforms, which are computerised administration services designed to hold, trade and report on investments. There are three separate functions that can be bundled together in the offer of a platform: a financial adviser, an administrator and a custodian. The discussion document also covers portfolio management services, which provide similar services to platforms. The main difference being that portfolio management services have two functions, namely manager/broker/financial adviser and custodian.

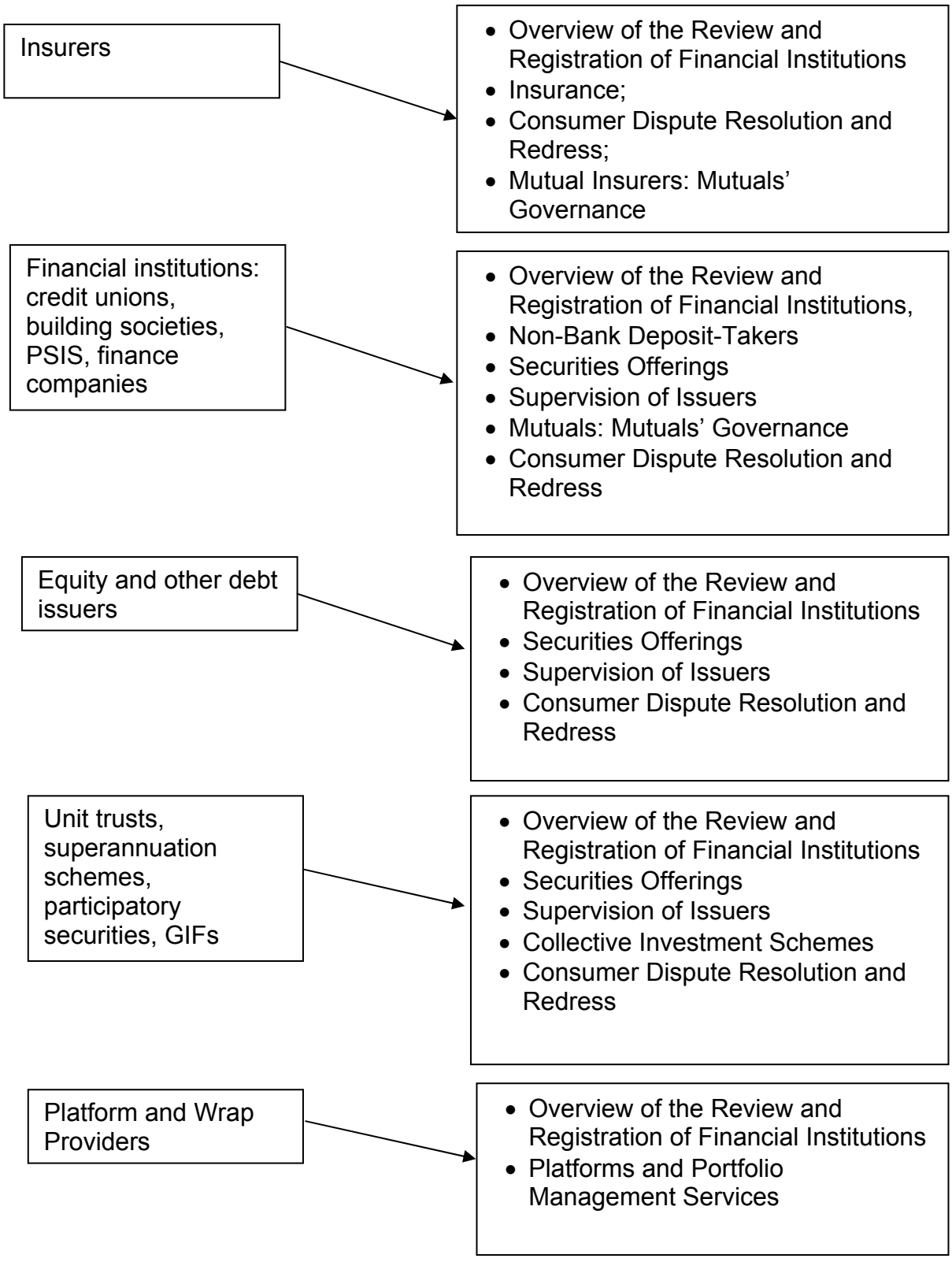
81. Platforms are generally offered through financial advisers, although some platforms can be offered directly to investors. Platforms do not fit within the Securities Act and while they perform similar administration functions to issuers of CISs and custodians perform similar custodial functions to CIS trustees, it is recognised that platforms and portfolio management services have unique features that require a slightly different regime. Currently, there are few regulatory protections for consumers using platforms and portfolio management services and many consumers may not know their investments are being channelled through platforms or that they are being charged platform fees.

82. The discussion document contains proposals to place minimum protections on platforms and custodians. These include: entry requirements to ensure that platforms and custodians have the capacity and capability to perform their role; minimum duties to investors; and some disclosure requirements. In relation to portfolio management services we are proposing similar requirements for custodians and disclosure

requirements (financial advice will be dealt with under the Review of Financial Intermediaries).

83. All platform providers, custodians and those using these services should read this discussion document.

3.4 DISCUSSION DOCUMENT MAP FOR FINANCIAL INSTITUTIONS



3.5 PRINCIPLES FOR THE REVIEW

84. Under the Review of Regulatory Frameworks, the Government is focusing on the removal of unnecessary regulatory constraints on economic growth as well as the continuous quality improvement of regulatory frameworks and processes. An important component of this is ensuring quality process in regulatory design. The RFPP intends to meet all of these objectives. In some areas of the RFPP we will be removing unnecessary costs on business and making the regulatory regime more flexible. In others, while some costs will be imposed, it is intended that the regulatory regime be made more effective. We are hoping that the consultation to date and feedback from the discussion documents will assist us in ensuring that any regulatory design is responsive, based on sound analysis, and actually achieves our objective of encouraging investment in New Zealand's financial markets by promoting a sound and efficient financial system in which the public and industry can have confidence.

85. In undertaking this review and in analysing any submissions received, consistent with the Review of Regulatory Frameworks and the principles of good quality regulatory design, we will be taking into account the following principles.

- **Reinforce market disciplines**. Regulation must reinforce and not undermine market disciplines on financial institutions and inherent incentives for sound institutional governance and risk management practices.

- **Efficient and effective**. Regulation should be targeted to well-defined objectives and go no further than meeting those objectives (i.e. it must be commensurate with the problem, impact and risks). In particular, regulation should aim to minimise compliance or transaction costs and careful identification should be undertaken as to who bears the costs and the impact of those costs. Care should be taken to ensure that any regulation does not adversely affect productive, dynamic and allocative efficiency. All non-regulatory measures (market solutions and self-regulation) and their effectiveness should be considered before any decision to regulate. For example, we are aiming to use a range of regulatory measures to address issues, which will include leveraging off industry standards and practice and private supervisors where possible. See the proposed supervisory model for trustees and the option of basing standards for insurance on existing industry standards where possible.

- **Transparency**. Regulation should be clearly understood and any regulation, codes and standards readily available so that risks can be considered and well-informed decisions can be made. Transparent regulation also reduces uncertainty and costs for providers.

- **Clarity**. Regulatory processes and requirements should be as understandable and accessible as practical.

- **Equity**. Any regulatory regime developed should not create incentives for providers to structure products or investments solely to take advantage of favourable regulatory treatment (i.e. regulatory arbitrage). Regulation should be fair and treat those affected equitably.

- **Flexibility**. The design of any regulatory regime should be sufficiently flexible to let firms, markets and products innovate and move with technological change and should not put up excessive barriers to entry.

- **Effective enforcement and supervision**. Any regulatory regime needs to: have appropriate and flexible redress mechanisms; make use, where appropriate, of industry self-regulation or private supervisors; have regulators with the necessary functions and powers to effectively monitor and enforce the rules; and have effective penalties that deter. Any supervision and enforcement by regulators should be risk-based, not one size fits all, and recognise that the different components of the regulated sector exhibit different behaviours and pose different risks to agreed policy outcomes.

- **Compliance with international principles**. In order to have a financial sector that attracts investment and participation, any regulation developed will aim to be consistent with international standards and codes, unless there is a good reason for New Zealand to take a different approach. For example, many of the proposals within the discussion documents will bring us closer into line with international principles. In particular, these include the International Organisation of Securities Commissions Principles, the International Association of Insurance Supervisors Principles; and the Financial Action Task Force Anti-Money Laundering and Countering the Financing of Terrorism Recommendations.

- **Enhance coordination with Australia**. Any regulatory regime developed will be considered within the framework for the Memorandum of Understanding on Business Law Coordination between New Zealand and Australia. This means there will be a presumption in favour of coordination (in order to reduce transaction costs and so that firms ideally only have to comply with one set of laws, where possible). However, this presumption will be overturned where there are good reasons for the laws to be different between the two countries. For example, in some areas of the review trans-Tasman coordination will be less relevant (i.e. where institutions are not offering product trans-Tasman or globally), and we may achieve similar outcomes by using slightly different regulatory frameworks and considering such things as mutual recognition. In others, we may need to pay close attention to coordination, for example, where there are a number of Australian branches and subsidiaries operating in New Zealand.

86. When answering any of the questions outlined in the discussion documents we would welcome any comments that focus on what options best achieve the above principles.

3.6 INTER-RELATIONSHIPS WITH OTHER REVIEWS IN THE FINANCIAL SECTOR

87. The Government appreciates there are currently a number of different reviews being undertaken in the financial sector. Where possible, officials are ensuring these reviews are being coordinated, inter-linkages are being made, any outcomes are consistent and impacts or implementation issues are aligned in order to impose the least cost on the sector.

88. In particular the following reviews are connected to the RFPP:

- Review of Domestic Institutional Arrangements (this review is being led by Treasury);

- Anti-Money Laundering and Countering the Financing of Terrorism: New Zealand's Compliance with FATF Recommendations: Third Discussion Document AML/CFT Supervisory Regime (this review is being led by the Ministry of Justice); and

- Review of Financial Intermediaries (this review is being led by MED).

89. Other current reviews which may have connections include: KiwiSaver, the Portfolio Investment Entity tax changes and the Securities Legislation Bill.

3.6.1 Review of Domestic Institutional Arrangements

90. In order for any regulatory regime developed to be effective it needs to be adequately monitored and enforced. A review of Domestic Institutional Arrangements is being undertaken at the same time as the RFPP with the aim of ensuring that any regulatory framework developed will have skilled regulators with the appropriate powers, checks and balances to effectively implement, monitor and enforce the regime.

91. To date the review has considered the current regulators in the New Zealand market and whether there should be any changes to the current structure. In particular, it looked at different models for regulatory supervision. For example, whether there should be one "mega regulator" supervising the market or a dual regulator model like that used in Australia (i.e. a market conduct regulator and a prudential regulator). At the end of last year Cabinet agreed that currently there are no significant coordination problems in the New Zealand market and that the costs of making large changes to the regulatory structures would outweigh any perceived benefits. It also agreed that there should be one prudential regulator, and agreed in principle that this should be the Reserve Bank.

92. Depending on the outcomes of the RFPP it is likely that the supervision of some financial institutions will come under the prudential regulator.

93. Supervision of the other financial institutions, for example, equity/debt issuers, trustees and collective investment schemes will come under the Securities Commission as the market conduct regulator.

94. This market supervision structure of a market conduct regulator and prudential regulator is similar to the ASIC/APRA model in Australia. However, the Registrar of Companies will retain its current role in relation to companies, financial reporting, insolvency, personal property securities and the National Enforcement Unit. Depending on the outcome of the work on registration it may also perform the role of central register for all financial institutions operating in the New Zealand market.

95. The RFPP will design the regulatory framework that will then be monitored and enforced by the supervisors. At this stage the proposed allocation of supervisory responsibilities is shown in the following table.

Securities Commission	Reserve Bank	Registrar of Companies
Product disclosure for all financial products, including insurance Conduct regulation and enforcement Supervision of Trustees (debt, NBDTs who do not opt in and CIS/Super) Supervision of Intermediaries Securities trading law and securities exchanges AML supervision for entities it supervises	Systemic Issues (payment system, macro policy etc) Prudential regulation of Banks and also potentially NBDTs that opt in, Credit Unions, Building Societies and insurers AML supervision for entities it supervises	Registration of all financial institutions Approval and enforcement of the regulation of corporate forms and some securities offences (including powers under CIMA) Insolvency Financial Reporting

3.6.2 Anti-Money Laundering and Countering the Financing of Terrorism: New Zealand's Compliance with FATF Recommendations: Third Discussion Document AML/CFT Supervisory Regime

96. The Ministry of Justice's third discussion document on the FATF Recommendations, which focuses on the supervisor/s and the supervision regime for anti-money laundering and countering the financing of terrorism ("AML/CFT") has close links with both the RFPP and the Review of Domestic Institutional Arrangements and is being released at around the same time as these discussion documents. Two previous discussion documents - the first on how the Financial Transactions Reporting Act 1996 could be amended so that New Zealand meets its international obligations in relation to the FATF Recommendations, and the second outlining preliminary proposals and seeking views on their workability are available on the Ministry of Justice website[1].

97. Recognising that AML/CFT supervision will impose some costs on business, Government is keen to explore supervisory options which are aligned with the supervisory options under the regulatory regime for the financial sector, to get some efficiencies and reduce costs for business.

98. For this reason, the discussion document explores AML/CFT supervisory options which could leverage off any processes and procedures that may be designed through the RFPP, and are supervised by the same regulator for RFPP and AML/CFT purposes. This would mean businesses have to deal with only one regulator and one set of processes, where possible.

[1] http://www.justice.govt.nz/fatf/index.html

99. The RFPP is exploring through the discussion documents how the regulatory regime should meet some of the FATF recommendations. For example, in each discussion document we consider what “fit and proper” requirements should be imposed on different financial institutions both for FATF purposes and in order to ensure that the institution has the skill and capacity to carry out the particular financial service. The registration regime proposed in this discussion document will meet the FATF recommendations for identification of financial institutions and will also provide wider benefits for the regulation of the financial sector. The RFPP also considers in this discussion document how to progress compliance with FATF recommendations 33 and 34.

3.6.3 Review of Financial Intermediaries

100. The Review of Financial Intermediaries has many links with the RFPP. However, this work is currently further advanced due to the efforts of the Financial Intermediaries Task Force.

101. Officials will, however, ensure that any links are made between the reviews, for example, between disclosure of financial intermediaries and disclosure in relation to financial products.

4. PART B: REGISTRATION OF FINANCIAL INSTITUTIONS

4.1 EXECUTIVE SUMMARY

102. This discussion document discusses a proposal to require financial institutions to be registered. Currently, there is no comprehensive way of identifying or monitoring providers of financial services. There are registration requirements for some providers and for particular financial products under specific legislation. These registration systems have been put in place for a range of purposes and do not provide complete coverage of financial service providers and the services they provide. As the information available does not identify the nature of the financial services an entity provides, it is difficult to build up a complete picture of a provider's details and activities.

103. All of this makes it difficult for regulators to collect data to monitor and identify risks in the sector or people who are not complying with the law. It also makes it difficult for market participants (i.e. business analysts, intermediaries and consumers) to access information on a financial services provider. New Zealand is a signatory to the Financial Action Task Force ("FATF") Recommendations on Anti-Money Laundering and Countering the Financing of Terrorism and does not comply with the requirements in the recommendations that all financial institutions be clearly identified for supervision purposes.

104. Finally, the current framework does not provide assurance that financial service providers have not been convicted of financial crimes or other misconduct, or that they are fit to run financial institutions. This increases the risk of unfair, fraudulent or negligent conduct in relation to financial institutions and also means that New Zealand is not currently in compliance with Recommendation 23 of the FATF Recommendations.

105. The document proposes that the Companies Office register those "financial institutions" as defined by the FATF Recommendations that are not otherwise subject to a registration regime suitable for the purposes of Recommendation 23. This means that, in general, the Companies Office would register core financial institutions. The registration requirements for the Companies Office would include collecting some base level information about the entity and undertaking negative assurance checks, which could involve checking to make sure that directors, senior management and significant shareholders:

- do not have director or management bans
- have not undertaken relevant criminal activity (this check would be undertaken in conjunction with the police)
- have not been bankrupt within a specified period.

106. It is proposed that any qualitative checks (i.e. whether people have the experience, capability and capacity to run a particular financial institution) would be undertaken by the appropriate regulator (e.g. the Reserve Bank or the Securities Commission) who would notify the registrar if a person met the necessary requirements. Good information sharing between the regulators will be important. The proposed fit and proper requirements that financial institutions should comply with are discussed in the other discussion papers, or, in the case of banks, already exist under the Reserve Bank Act.

107. The register would be electronic and easily searchable for market participants and would contain information about an entity in one easily accessible place (i.e. financial statements, offering documents, other disclosures and key information).

108. This regime would address the issues identified above as it would identify financial institutions, allow more effective monitoring and evaluation, provide easy access to information about institutions, give some assurance about the integrity and capability of people running financial institutions and meet New Zealand's obligations under the FATF Recommendations.

109. The preferred option has the least costs for Government and business. The Companies Office already registers nearly all financial institutions either under their corporate form (companies, credit unions, building societies etc) or for offering document purposes (i.e. prospectuses). The proposed regime would make the necessary links and leverage off the other registration regimes and therefore any additional costs on business would be small.

110. The paper also discusses proposals to improve New Zealand's compliance with the FATF Recommendations aimed at ensuring transparency of information on the people behind corporates or trusts so that these cannot be used for money laundering. An example is a requirement that shareholders disclose whether or not they hold shares beneficially.

4.2 INTRODUCTION

111. This section of the discussion document discusses a proposal to require financial services providers to be registered. Currently, there is no comprehensive way of identifying or monitoring providers of financial services and no reliable means of determining whether regulatory requirements are being met.

112. The types of financial products and services being considered under the RFPP are varied – insurance, superannuation, collective investment schemes, non-bank deposit taking, futures and derivatives and offerings of securities. As discussed under the various areas, there are at present a number of regulatory regimes that apply to particular types of products or providers. To successfully implement an effective and consistent regulatory framework for the non-bank financial sector, it is necessary that regulators and investors/consumers are able to identify which persons and entities are providing financial services, and what categories of financial services they offer.

113. One way to provide for such identification would be to require registration of service providers and the recording of the providers and products they offer on a comprehensive database. Such a database of financial services providers would contribute to the main objective of the RFPP – that is, to promote a sound and efficient financial system. It would achieve this through promoting well-informed investors/consumers, reducing the risk of fraudulent conduct, and enabling the appropriate authorities to ensure providers are meeting the relevant regulatory requirements and are owned and managed by persons with appropriate expertise and integrity. It would also facilitate the collection of data on the financial sector for monitoring purposes.

114. An additional factor is New Zealand's obligation to comply with the FATF Recommendations on Anti-Money Laundering and Countering the Financing of Terrorism. A number of these recommendations relate to the regulatory and

supervisory arrangements for the financial sector. To streamline and avoid duplication of regulation and reporting requirements, Cabinet agreed that the RFPP should include consideration of compliance with FATF Recommendations in relation to specific areas within the terms of reference of the review.

115. The relevant recommendations are those that relate to supervision and transparency of financial institutions. Identifying providers of financial services is a prerequisite of a supervision regime, to ensure that they are implementing anti-money laundering/countering the financing of terrorism ("AML/CFT") systems and processes. In conjunction with this, we are looking at how to meet the requirement that regulatory authorities be able to access information on the beneficial owners of companies and the information relating to the beneficial owners of legal arrangements, such as trusts. This is aimed at ensuring that companies and trusts are not used for money laundering or terrorist financing.

4.3 OUTCOME SOUGHT

116. A comprehensive registration system which will contribute to the outcome of promoting confidence in the financial sector that encourages participation by consumers, firms and providers.

4.4 WHY REGULATORY INTERVENTION IS NEEDED

117. The reasons for intervening in this area are the presence of information asymmetries, expectations and confidence and the potential for unfair or fraudulent conduct. As noted above, the intervention is also intended to assist in addressing New Zealand's obligations under the FATF Recommendations.

118. Investors and consumers are reliant on providers being of good standing and acting with integrity. The lack of a framework to provide assurance that financial services providers have not been convicted of financial crime or been the subject of a director/management ban or adjudged bankrupt increases the risk of unfair or criminal conduct. It is difficult, if not impossible, for consumers and investors to search this information.

119. Ultimately, no financial system can be sound and efficient, and support a vibrant economy, without public confidence in that financial system. Compliance with international standards and codes assists in attracting international investment and participation in New Zealand markets, and promoting confidence in them.

120. An additional advantage of a register is that it will improve overall information on financial providers and products to assist decision-making. At present it is costly for investors to gather information on the various products provided by an institution. There is no easily accessible place to search for and obtain all information on the financial activities they undertake, and other relevant documents. This may have impacts on the financial sector as consumers and markets will not be as well informed as they could be, and may make inefficient choices about where to place their funds or investment.

4.5 GOVERNMENT OBJECTIVES

121. The objectives of having a registration and approval system follow.

- To identify the entities providing defined financial services in the New Zealand market. This would include the identification of directors, senior management and significant shareholders of the entities. It would enable the relevant regulatory authorities to assess what regulatory requirements are applicable to the entity (for example, prudential or market conduct regulatory requirements and AML/CFT monitoring requirements), make it easier to monitor and enforce the law and enable sectoral data to be collected.

- To provide an easily accessible means for investors/potential investors, intermediaries, analysts and other market participants to find information on financial services providers and the range of services they provide, to enable informed investment decisions and to provide analysis of the market. This would include the information under the previous objective, as well as financial statements and any disclosure documents such as investment statements and prospectuses.

- To ensure that the directors and management of financial services providers meet "negative assurance criteria"; that is, they have no record of criminal activities or adverse regulatory judgments such as having been bankrupt, or the subject of a director/management ban. The system will also link in to the part of the regulatory framework aimed at ensuring that, where appropriate, persons managing or controlling financial services providers meet "fit and proper" criteria regarding expertise and capability.

- To ensure effective coordination and information-sharing between financial sector regulatory authorities so that the requirements on firms are streamlined.

- To comply with the relevant international principles and standards.

4.6 ASSESSMENT OF THE CURRENT REGIME AGAINST THE OBJECTIVES

4.6.1 Current Registration Requirements

122. Some types of financial institution are subject to registration requirements under specific legislation. Examples are the Reserve Bank of New Zealand Act 1989, Building Societies Act 1965 and Friendly Societies and Credit Unions Act 1982.

123. Other providers of financial services register under regimes not related to the financial sector, for example, under their various corporate forms (for instance, under the Companies Act or the Co-operatives Act).

124. The existing regulatory regime for insurance differentiates between life and general insurance. Of the insurance providers operating in New Zealand, a number are non-corporate insurers such as friendly societies, which register under the Friendly Societies and Credit Unions Act. Life insurance products with an investment element are subject to the disclosure obligations under the Securities Act 1978, which are principally the investment statement and prospectus regime.

125. On the other hand, some entities providing financial services will be registered by the Companies Office as a company, under the Companies Act, but will not be able to be identified as financial sector participants. Under current regulatory arrangements, a

person can set up a finance company by registering a company with the Companies Office. However, there is no register of finance companies so information about this part of the financial sector is not readily available. Finance companies do, however, have to comply with registration processes when undertaking certain activities (for example, when they offer securities to the public they must register a prospectus with the Companies Office).

126. This also applies to collective investment schemes and other offerings of securities. Hence, the product is registered but not the entity, making it difficult for investors to find information on other activities the entity is undertaking.

127. These registration systems have been put in place for a range of purposes and do not provide complete coverage of financial services providers and the services they provide. The information available, even where an entity is registered, does not identify the nature of the financial services it provides so it would be difficult to build up a comprehensive picture of a provider's details and activities.

128. Without an identification process, regulators may have difficulty finding out who may be operating in breach of the statutory requirements, and carrying out their functions. They are also less able to adequately monitor risks to financial stability, particularly in the non-bank sector.

129. For current and potential consumers and investors (retail and institutional) in financial products, and commentators on these products (such as business analysts, or financial intermediaries), there is at present no easily accessible place to search for information on a provider and obtain all information on the financial activities they undertake, and other relevant information.

4.6.2 Current Controls on Directors and Management

130. The primary regulatory measure in New Zealand that would prevent unqualified persons or criminals controlling or acquiring financial institutions is the power of the Registrar of Companies (under the Companies Act 1993) to ban or apply to the court to ban specific persons from managing or being a director of a company. This ban is usually applied following a history of fraud or wrongdoing in commercial operations by the specific individual. The Securities Commission, Takeovers Panel and Registrar of Companies will also have the power to go to court to seek bans for a number of breaches of securities law when the Securities Legislation Bill is passed.

131. In relation to public offerings of securities and disclosure requirements for investment advisers and brokers, directors and managers are obliged to disclose relevant information such as criminal convictions, bankruptcy, or banning orders.

132. Hence, while there are general measures aimed at preventing criminals controlling or acquiring companies in New Zealand, there are no specific measures to ensure compliance by the non-bank financial sector. There are also no measures requiring directors and managers of non-bank financial services providers to meet specific eligibility criteria in relation to their expertise or qualifications. This is discussed further below in terms of New Zealand's assessment against international principles and agreements.

4.6.3 Issues relating to International Principles and Agreements

4.6.3.1 Financial Sector Assessment Programme ("FSAP")

133. In 2003, New Zealand's financial system was assessed by the International Monetary Fund and World Bank, under the FSAP. FSAP is designed to assess the potential vulnerabilities in a country's financial system and to evaluate the adequacy of financial sector regulation and supervision, using international standards and codes as benchmarks, as well as a number of other analytical tools. A key component of the FSAP is the assessment of a country's regulatory framework as it relates to the financial sector, focusing – where relevant – on banking supervision, securities market regulation, supervision of insurance companies and pension funds, payment systems, anti-money laundering frameworks, and the transparency arrangements applicable to monetary policy and financial sector regulation.

134. One of the principal recommendations of the FSAP assessment of New Zealand was that in relation to the non-bank sector, New Zealand should review the oversight of this sector with a view towards enhancing public access to timely and comprehensive data. The FSAP Financial Sector Stability Assessment commented:

135. "Efforts to coordinate and strengthen data collection and disclosure would help regulators, market participants, and depositors to have a more accurate and timely picture of developments in the sector."

136. In relation to FSAP New Zealand also failed to comply with some of the International Organisation of Securities Commission (IOSCO) principles, as it did not impose entry level "fit and proper person" requirements for people participating in financial markets. Managers of collective investment schemes, operators of securities exchanges, and financial intermediaries were examples of some of the people specifically mentioned.

4.6.3.2 Financial Action Task Force Recommendations ("FATF")

137. In October 2003, New Zealand underwent an assessment of its compliance with the FATF Recommendations, as part of the FSAP assessment. Further information on FATF can be found on the Ministry of Justice website.[2]

138. The evaluators commented that New Zealand's criminal justice legislative measures for combating money laundering and terrorist financing are generally sound, and in several areas the effectiveness of those measures has been improved over time. The evaluators suggested that some changes would enhance the system. A number of these changes have already been made and others are being considered by the Government.

139. The Ministry of Justice ("MOJ") is responsible for policy development relating to compliance with the FATF recommendations. MOJ is releasing a series of three discussion documents on the legislative reforms required to improve New Zealand's compliance with the FATF Recommendations.

140. However, the Government recognises that regulation of the financial sector for FATF purposes needs to be consistent with the overall regulation of the sector, and that

[2] www.justice.govt.nz/fatf/chapter-4.html

minimising compliance costs for business is important. Accordingly, Cabinet agreed that the RFPP should include consideration of compliance with FATF recommendations in relation to specific areas within the terms of reference of the review.

141. Cabinet has also agreed that financial institutions should be subject to monitoring for AML/CFT compliance in accordance with FATF Recommendations. To enable this monitoring to occur, it is necessary to identify the entities which must be monitored. Therefore, it is appropriate that this aspect of FATF compliance should be considered as part of the RFPP.

142. New Zealand's 2003 FATF evaluation report noted that "supervision by competent authorities plays a limited role in the New Zealand framework and this creates an obstacle to ensuring the effective application of the AML/CFT requirements by financial institutions." The report went on to recommend that "an effective system needs to be introduced to supervise and/or monitor the compliance by relevant financial and other institutions with their AML/CFT obligations."[3]

143. In terms of FATF Recommendation 23, New Zealand is required to have a comprehensive supervisory framework for financial institutions. To have such a framework we need to be able to identify the institutions, as defined by FATF. The FATF definition is broad and includes deposit-taking and the taking of other repayable funds from the public, lending, the transfer of money or value, financial services relating to securities issues, managing funds or money on behalf of other persons. Currently some of the financial institutions defined by FATF do not have to be registered or may have to register prospectuses only.

144. FATF also requires the implementation of "fit and proper person" entry requirements for significant shareholders and managers of some financial institutions. While New Zealand currently requires disclosure by directors and management of any information that may be relevant for consumers/investors when choosing certain financial products (for example, whether they or the entity they are running have been convicted of relevant offences, or they have been bankrupt, or have been banned or prohibited from taking part in the management of a business), and there are banning orders for directors and management who breach companies or financial sector regulation, this was not deemed to be sufficient for FATF purposes.

145. The registration regime implemented will therefore need to ensure that it covers the range of financial institutions subject to the FATF recommendations, including those which are not part of the regulatory regime within the RFPP. So, while banking regulation is not part of the RFPP, banks will need to be monitored for AML/CFT purposes, and should, therefore come within the same registration system as other financial institutions. This will not alter the Reserve Bank's supervision functions in relation to banks under the Reserve Bank of New Zealand Act 1989.

146. The third MOJ discussion document includes proposals for AML/CFT supervisory regimes for financial services providers.

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[3] The FATF/APG *Report on Observance of Standards and Codes FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism*, published August 2005 is available on the Ministry of Justice's web site at: www.justice.govt.nz/fatf/nz-report.html

147. FATF Recommendations 33 and 34 (reproduced in Appendix I) require New Zealand to:

> 33 ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities.
>
> 34 ensure that there is adequate, accurate and timely information on express trusts,[4] including information on the settlor, trustee and beneficiaries, which can be obtained or accessed in a timely fashion by competent authorities.

148. Recommendations 33 and 34 differ from the other FATF recommendations in that they are not specific to the institutions in the financial sector or to law enforcement or supervision of the financial sector, but relate to the laws specifying information that has to be provided by all types of corporate forms and by legal arrangements such as trusts.

149. These recommendations are aimed at ensuring transparency of information on the people behind corporates or trusts so these cannot be used for money laundering.

Recommendation 33

150. A number of existing Acts establish reporting obligations, record keeping requirements and registers that provide information on the ownership and control of certain legal persons. These can be accessed by the authorities and by the public. The Companies Act 1993, the Financial Reporting Act 1993, the Incorporated Societies Act 1908 and the Partnerships Act 1908[5] are examples that incorporate such provisions to differing degrees.

151. The Companies Office maintains a register that allows searching of details relating to incorporated companies.[6] Every company has certain basic elements (which can be obtained by a search) being a name; at least one share, one shareholder and one director; and contact details. This Act also imposes the obligation to keep and maintain certain records (company records,[7] a share register and accounting records)[8] and to keep these at the company's nominated registered office. These records must be made available for inspection by anyone.

152. The Companies Office also maintains registers for a wide range of other types of bodies. These are set out in paragraph 177 below.

Preventing misuse of bearer shares

153. The ability to issue bearer shares in New Zealand is generally precluded by sections relating to shares and their issue in the Companies Act 1993 (especially Part 6) and the

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[4] An express trust refers to a trust clearly created by the settlor, usually in the form of a document (for example, a written deed of trust). Express trusts are to be contrasted with trusts which come into being through the operation of law and which do not result from the clear intent or decision of a settlor to create a trust or similar legal arrangements (for example, a constructive trust).

[5] Applying only to limited partnerships.

[6] Including online searching facilities.

[7] Such as a Company's Certificate of Incorporation, Minutes of Meetings, Resolutions and documents creating enforceable obligations on the Company.

[8] Sections 189, 87 and 194 of the Companies Act 1993 apply.

Securities Act 1978 (particularly section 51). However, shares may be issued to nominees.

Investigative powers of competent authorities

154. The Registrar of Companies has a range of statutory powers of investigation in relation to corporate activities. The Registrar may authorise the National Enforcement Unit (a unit within the Ministry of Economic Development) to investigate and prosecute offences under a number of statutes and regulations including the Insolvency Act 1967, Companies Act 1993, Securities Act 1978, Financial Reporting Act 1993 and the Unit may also prosecute offences under the Crimes Act 1961.

155. The Police (including the Financial Intelligence Unit), the Serious Fraud Office and the Inland Revenue, have broad investigative powers - including powers to compel production of financial records, trace property ownership, search premises for evidential material and summons a person to give evidence under oath.

156. These measures enable broad compliance with recommendation 33.

Recommendation 34

Timely access to adequate, accurate and up-to-date legal arrangements details

157. New Zealand is a common law jurisdiction that permits the establishment and operation of trusts.

158. There are some central systems of registration relating to legal arrangements. These include incorporated charitable trusts;[9] unit trusts[10] and superannuation schemes,[11] all of which are accessible via the Companies Office website.[12]

159. The only place where any form of registration occurs for many types of trusts in New Zealand is with the Inland Revenue Department. This occurs where a trust intends trading or anticipates having an income source. From recent figures available, Inland Revenue had 255,123 trusts listed. When applying to the Inland Revenue, there is a requirement to supply a copy of the relevant trust deed which would provide details of the settlor(s), trustee(s) and beneficiary(ies).

160. There are legislative provisions which require that the names of the trustees of a trust appear on any register and not the name of the trust. One example of such a provision is section 128 of the Land Transfer Act 1952 which means that title to land will be shown in the names of the trustees. An exception is the Personal Property Securities Register, on which the name of a trust can be shown as a debtor.

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[9] The register of charitable trusts is maintained by the Companies Office. This is likely to continue for the foreseeable future despite the establishment of the Charities Commission and its associated functions under the Charities Act 2005. Charitable trusts and incorporated societies will continue to gain their "legal entity status" by incorporating through the Companies Office, while registration as a charity with the Charities Commission will provide additional advantages for charitable trusts, for example tax-exempt status.

[10] The Registrar of Companies administers the Unit Trusts register.

[11] The Government Actuary administers the register relating to superannuation schemes.

[12] Charitable trusts have ongoing obligations which include filing changes to the trust deed and changes to the trust's contact details with the Registrar. In addition to the mandatory information that is required, a trust can provide a brief description of what the trust does; alternate addresses; and the names of the trustees and their contact details.

161. Structures, including trusts, under Te Ture Whenua Māori Act 1993, are usually constituted and dealt with by way of the Maori Land Court leading to the details being documented by this court as a result.

Information on settlor(s), trustee(s) and beneficiary(ies)

162. The key requirements for trusts can be found in the Trustee Act 1956.[13] A trust's written deed of trust will include some information on the settlor(s), trustee(s) and the beneficiary(ies).

163. There are no specific requirements in law to disclose, obtain, verify, or retain information on the beneficial ownership and control of trusts.

Investigative powers of competent authorities

164. The details under the same heading for Recommendation 33 are relevant for this Recommendation too.

Measures to assist compliance with Recommendation 5

165. The current registers facilitate access to differing levels of ownership and control information of certain legal arrangements which would assist financial institutions in meeting the customer due diligence requirements set out in Recommendation 5 (refer to Appendix I).

166. In terms of the legislative measures in place, however, there are some areas where the current legislation does not comply with FATF recommendation 34:

Timely access to adequate, accurate and up-to-date legal arrangements details

- There is no existing or proposed system of central registration for trusts (excepting those for incorporated charitable and unit trusts).
- There is no requirement on any of the Registrars to verify the information they receive.
- Incorporated societies and charitable trusts supply information in their rules (which form part of the register). They may also supply, on an optional basis, information such as the names of officers or trustees and their contact details and alternate addresses.
- Some beneficial ownership and control details relating to legal arrangements are presently only held by Inland Revenue.

Information on settlor(s), trustee(s) and beneficiary(ies)

- No specific requirements exist to disclose, obtain, verify, or retain information on the beneficial ownership and control of trusts.

[13] If the trustee of a trust is a corporate entity, it must comply also with the registration and reporting requirements for an incorporated company.

Investigative powers of competent authorities

- Even though the investigative powers available are sufficient for the purposes of complying with this Recommendation, the information-sharing capacity between agencies may need to be enhanced.

Measures to assist compliance with Recommendation 5

- There is a lack of registers for legal arrangements (particularly certain types of trusts) and/or not enough information contained on existing registers to assist compliance with Recommendation 5 (refer to Appendix I).

4.6.4 Data Collection Issues

167. The inability to identify the providers of financial services and what they do means that authorities are not easily able to collect adequate data about providers and products to monitor the performance of New Zealand's financial markets. This was the subject of comment in New Zealand's FSAP assessment. Without a comprehensive database, regulatory authorities are not able to identify sectoral problems or risks in order to address them. Data-gathering authorities find it difficult to collect sectoral data and policy makers find it difficult to evaluate the impact of regulatory reforms on the financial sector.

168. Without an identification process, regulators have difficulty carrying out their functions to monitor conduct in the financial sector and discover and act against breaches of the law. They are also less able to adequately monitor risks to financial stability.

4.6.5 Definition of Financial Services

169. The financial services for which registration is required will include those that are performed by the financial institutions falling under the FATF definition[14], except where they are subject to a separate registration regime that is adequate for the purposes of FATF Recommendation 23. This is appropriate as one of the uses of the register will be to identify the financial sector entities that are required to be supervised for their compliance with AML/CFT requirements. However, there are some services which will require registration under the financial sector registration regime, such as the provision of general insurance services, which are not specified in the list of FATF financial institutions.

170. The institutional and functional basis for determining coverage by the AML/CFT regime is discussed in the Ministry of Justice's second discussion document "Anti-Money Laundering and Countering the Financing of Terrorism: New Zealand's Compliance with FATF Recommendations" released in June 2006. Submissions on this discussion document closed on 31 July 2006.

171. The specific categories of financial services will need to be finalised along with the proposals for the various work streams under the RFPP, as the registration regime will also be used to classify which type of services are supervised under which regulatory

[14] The Definition can be found in the glossary of the FATF recommendations at the link: www.fatf-gafi.org/glossary/0,2586,en_32250379_32236889_35433764_1_1_1_1,00.html#34289432

regime. For example, it is proposed that there are different regulatory requirements for different types of insurance and different types of deposit-taking institutions.

Question for Submission

1. What are the appropriate categories of financial services that should be able to be searched on the register?

4.7 OPTIONS

172. Keeping in mind the principles for the review as a whole, the criteria against which we have assessed options to meet the objectives are:

- Effectiveness in meeting the objectives
- Level of compliance costs for business
- Avoidance of duplication
- Fit with existing or proposed regulatory function
- Efficiency of use for regulatory authorities
- Efficiency of use for investors/public.

173. Two possible options were identified and dismissed. These are outlined below.

4.7.1 Status Quo

174. For the reasons identified above, the current regulatory regime does not enable government or the public to identify all financial sector providers or their services, does not comply with the FATF recommendations and does not meet the objectives. The information available on the financial services provided is not easily accessible to investors and does not provide all the relevant information. The system has led to negative comments on New Zealand's level of compliance with international standards. Therefore, it is not appropriate to maintain the status quo.

4.7.2 Different Agencies with Regulatory Responsibilities Perform the Registration Function for Different Financial Services Providers

175. A further option considered involved the various financial sector regulators each maintaining a register for the entities they supervise. For example, the Reserve Bank would perform a registration function for banks and other entities for which it has prudential responsibilities and the Securities Commission would register entities such as collective investment scheme operators and trustees, and the Companies Office would potentially register other issuers. This option would mean that there would remain a significant number of financial services providers that need to be registered but do not come within the responsibility of the Reserve Bank or Securities Commission. Hence there would need to be a registration system for the remaining entities. In addition, some entities which carry out a range of services would be supervised by and

registered with both the Reserve Bank and Securities Commission, as well as with the Companies Office, resulting in duplication and increased compliance costs. The cost for Government would also be greater as different registers would need to be created and maintained. In addition, this option would not provide a comprehensive, easily accessible source of information for investors and the public.

176. This option would meet the objective of identifying some entities but would not cover all the entities falling under the FATF definition. It would mean duplication of registers, low level of fit with the existing regulatory functions of the Reserve Bank and Securities Commission, greater compliance costs and inability to meet the objective of an easily accessible source of information for investors and market participants.

4.8 PREFERRED OPTION

177. The preferred option is that the Companies Office performs the registration function. This option meets the objectives, is a good fit with the functions of the Companies Office, involves a low level of compliance costs for business, results in one comprehensive public database of information, and avoids duplication. A more detailed assessment against the criteria is set out below.

4.8.1 Companies Office

178. The Companies Office currently administers a range of registers covering:

- Limited liability companies
- Cooperative companies
- Overseas companies
- Superannuation funds
- Building societies
- Charitable trusts
- Unit trusts
- Friendly societies
- Credit unions
- Contributory mortgage brokers
- Industrial and provident societies
- Incorporated societies
- Forestry investment partnerships.

179. The Office also registers corporate documents such as prospectuses and financial statements of issuers, and in future will register retirement villages and limited partnerships. It maintains a register of persons prohibited from taking part in the

management of a company by both the Registrar of Companies and the court at the request of the Official Assignee. The Insolvency and Trustee Service which administers the bankruptcy procedure is within the same branch of MED as the Companies Office, so the Office has access to bankruptcy information.

180. The registration work involves four aspects: new registrations, maintenance of information, removing defunct records and ensuring compliance with statutory disclosure obligations. The Companies Office provides online services to allow people to register a company, file annual returns, file financial statements for incorporated societies and search the registers. The Office also has compliance, prosecution and enforcement functions under the Companies Act 1993, Securities Act 1978, Corporations (Investigation and Management) Act 1989, Financial Reporting Act 1993 and the Friendly Societies and Credit Unions Act 1982. These functions are performed by the Ministry's National Enforcement Unit ("NEU").

181. There are currently over 450,000 entities on the various Companies Office registers. In the last financial year there were more than 6.5 million searches of information on the registers.

4.8.2 The Proposed Registration Function

182. The register will show the name and contact details of the financial service provider, grouped into broad categories based on the nature of the financial services they provide or propose to provide, so that they can be brought under whatever regulatory regime applies. If the financial institution later offers other financial products (e.g. through issuing securities) or undertakes activities such as a takeover, any registered documents or relevant information would then be added to this information. The database will be capable of linking information on different subsidiaries and associated entities.

183. The register will also show the details of the directors, management and others in control or who can significantly influence the financial service provider. Again, this information would be kept with information required under other Acts (e.g. the Companies Act); there would not be a duplication of information and compliance costs would be reduced. These people would be subject to a "negative assurance" check. This would include undertaking a criminal check, a bankruptcy check and any checking for any director/management bans, and any other requirements that may be specified under legislation. As discussed above, the Companies Office is best placed to undertake bankruptcy checks and checking of director/management bans.

184. The registration function will be separate from any other merit licensing or qualitative "fit and proper" tests that the relevant financial sector regulator will carry out, but all information on the financial services provider will be kept on the registration system, making it a comprehensive database of information on a provider. Some financial institutions would therefore have a two-step process when they register for the first time, with the initial registration step carried out by the Companies Office and the "qualitative step" carried out by another regulator.

185. There will be effective information-sharing powers between the Companies Office and other financial sector regulatory authorities including the FIU, Securities Commission and Reserve Bank, so that information gained through registration or licensing is available to all regulatory authorities.

186. The proposed registration function will not impact on corporate body registration, but will avoid duplication for financial sector entities which currently file information and documents with the Companies Office. For example, where information has been provided or a document has been filed to meet requirements under the Companies Act or Financial Reporting Act, the entity will not need to re-file the document or re-key information. This option enables the various existing sources of information on an entity to be brought together and relevant documents and information on the different financial products/services offered by a provider to be added.

187. As the register will be an online service, an entity will be able to access the link to the Companies Office page containing the registration form from any of the relevant authorities' websites. It is proposed that the Companies Office verify that the required information has been provided and, if the entity is also subject to a supervisory regime, it will pass the form to the relevant regulator. The regulator will then be able to contact the provider directly to discuss the qualitative assessment. The registrar and regulator will work together to ensure that information from each step of the process is added to the online register at the appropriate time. In practice, a provider may approach the regulator first to discuss the "fit and proper" criteria, but effective coordination and information sharing will ensure that both parts of the approval process are completed expeditiously.

188. As well as the initial registration of financial services providers, the registration system will require the details to be kept up to date, so changes to the types of services provided, or changes of directors, managers or major shareholders would need to be provided. New personnel would also need to pass the "fit and proper person" requirements.

189. The system will be designed so entities are able to provide updating details online. The Companies Office and the regulator concerned will liaise on the necessary changes to the register, and each will confirm its approval before the register is updated. For example, where an institution that is already registered and that is subject to a supervisory regime wishes to advise of a change in directors, it may need to discuss this with the regulator before submitting the updated details.

190. In future, there is the potential for the Companies Office system to be used to assist entities to provide statistical information to the Statistics Department, further reducing compliance costs for business.

191. There may be other ongoing information provided to the registrar and kept on the registration system, for example financial reports. Such requirements may arise from the RFPP or work on FATF, or may be disclosures required in order to collect data for the purposes of monitoring the financial system. Any such additional disclosures would be subject to a materiality threshold, depend on the nature of the financial service in question and not impose unnecessary compliance costs.

192. There will need to be legislative provisions setting out penalties for offering financial products or services without being registered (these may vary from institution to institution). The National Enforcement Unit ("NEU") of the Companies Office could undertake enforcement action for breaches of this requirement with the authorisation of the Registrar of Companies. The Registrar has a wide range of inspection and information-gathering powers, which could be used by the NEU to verify information provided.

193. Where providers are required to undergo a qualitative "fit and proper" assessment, consideration will also be given to whether it is appropriate to have an appeal process for refusal to approve on the basis of the "fit and proper" criteria. For example, in relation to securities offerings, a party can appeal to the Securities Commission if the Registrar of Companies refuses to register a prospectus. This process would relate only to the qualitative aspects of the process (not the registration itself), as the negative assurance aspect involves purely a factual checking procedure. The need for an appeal process will be considered in relation to the relevant parts of the regulatory framework.

194. The registration system will also be able to keep some information private. The qualitative information on individual directors and management would be part of the registration database, but would be available only to the regulatory agencies. In addition, the system would be capable of indicating where a provider has not filed a document or is under investigation, and access to such information could be restricted.

195. A summary of how the registration system would work for entities under the three supervisory models proposed in the RFPP is set out below.

- An equity or debt issuer would apply to the Companies Office to register a prospectus. If the issuer is not already registered, this would trigger the Companies Office to seek information on the issuer (through the registration form), and carry out negative assurance checks. If the checks are passed, the Companies Office will register the issuer under the relevant category of financial services provider.

- A Collective Investment Scheme ("CIS") issuer, superannuation scheme issuer or non-bank financial institution (the "issuer") would apply to register an offer document. If the issuer is not already registered, this would trigger the Companies Office to seek the necessary information on the issuer, and carry out negative assurance checks. Once these checks are completed, the Companies Office would refer the information to the Securities Commission to carry out "fit and proper" person checks. The Commission would seek a recommendation from the trustee selected by the issuer as to whether the issuer meets the "fit and proper" requirements. The Commission would advise the Companies Office when the "fit and proper" person criteria had been met and the Companies Office would register the issuer under the relevant category of financial services provider. To retain flexibility in the regime, the issuer may wish to approach the trustee and the Commission first for pre-approval of the "fit and proper person" criteria to give it certainty before it applies to register the offer document.

- A bank or other entity prudentially supervised by the Reserve Bank (potentially authorised deposit takers and insurers) would apply to the Companies Office to register as a financial services provider. The Companies Office would carry out the negative assurance checks and refer the information to the Reserve Bank to carry out "fit and proper" person checks. The Reserve Bank would advise the Companies Office when the "fit and proper" person criteria had been met and the Companies Office would register the entity under the relevant category of financial services provider. There would be the flexibility, however, for the bank to approach the Reserve Bank initially on matters relating to bank licensing or "fit and proper" criteria, in which case the Reserve Bank would provide the

relevant information to the Companies Office, rather than the entity having to provide information to both agencies.

Question for Submission

2. Is there any other information that should be available on the registration system?

4.8.3 Costs and Benefits

4.8.3.1 Costs

196. The introduction of a financial services registration system will impose negligible additional cost on businesses, through being required to provide some additional information. These costs will be minimised through the Companies Office performing the registration function.

197. There may be a few entities that do not currently have to register with the Companies Office. This option would thus impose a small amount of additional costs on the Companies Office (and on the few entities concerned). However, the additional systems costs are likely to be least under this option and some of these costs could be recovered from the entities who register.

198. There would be a separation between the registry function and the regulatory or supervisory function. This could lead to some inefficiencies and costs. For example, for the Reserve Bank, it separates registration from prudential and AML/CFT supervision, and for the Securities Commission, it separates registration from market conduct and AML/CFT supervision. However, these costs could be minimised under the model by ensuring good information sharing and processes to ensure registration and qualitative assessment work effectively, as well as by undertaking work to raise public awareness of where to find information about financial services firms, and of the respective roles of the Companies Office and regulators.

Question for Submission

3. Is there any more cost-effective way to implement the registration system?

4.8.3.2 Benefits

199. This option will have the advantage of reducing the time needed for an entity to become familiar with the financial services registration processes, as they will already be familiar with Companies Office registration and filing processes.

200. As described above, a core function of the Companies Office is the maintenance of a registry for all corporate bodies within New Zealand. In addition, the Companies Office registers superannuation schemes, and prospectuses for securities offerings as well as maintaining a wide range of other registers. For example, the Personal Property Securities Register and the Motor Vehicle Traders Register. The Companies Office administers the Financial Reporting Act 1993, therefore, receives documents such as financial reports which entities are required to file.

201. It would be relatively easy to add additional fields of data to existing registries to meet the requirements of the financial sector registration system discussed above. No other agency currently has the equivalent existing systems, technology and skills able to be so easily adapted for a new registration system for financial service providers. This option would therefore involve the lowest costs for Government, as it could build on existing systems rather than creating a new registration system.

202. The Companies Office rates very well for customer service and has been judged "the most helpful government agency" for three years running (in the Business New Zealand-KPMG Compliance Cost Survey 2003-05). The existing Companies Office system provides for two distinct groups of customers: companies who register; and people searching for information on the registers it maintains. This dual focus would assist in meeting the objectives of the financial sector registration proposal.

203. The Companies Office is currently undertaking a major review of its registration systems. The first stage is now complete, ensuring that all documents are electronically available. The second stage will involve further enhancing the system to make its search functions more effective and to enable any new registers to be added easily.

204. MED estimates that virtually all financial institutions are companies or entities that are already required to register with, and provide information to, the Companies Office. Giving the Companies Office the registration function would mean efficiencies could be gained and compliance costs minimised for businesses, as they would have to deal with only one registration body, and there would not be a duplication of requirements to provide registration information. The interface between the provision of information for registration purposes and data collection for monitoring or statistical purposes will be coordinated among the regulatory agencies, to avoid duplication of requests, and minimise compliance burdens.

205. For consumers, it will mean that there is one easily accessible point for information on a financial institution. For example, a consumer could find information about a financial institution, such as its constitution, trust deeds, prospectuses and other disclosure documents, details of senior management, financial reports, all in one place. This option would most effectively meet the objective of informing consumers, business analysts and intermediaries. There may, however, be a small cost to consumers for accessing information, for example, while there is no charge to view a company file, there is currently a charge of $1 to view any PDF documents relating to that company.

206. The information available will also be accessible to overseas financial institutions who are required under the FATF recommendations to exercise due diligence on New Zealand's financial institutions. It will facilitate dealings between New Zealand and overseas institutions that are subject to similar AML/CFT requirements.

207. The Companies Office is easily accessible to financial services providers and to the public. The Companies Office has enforcement resources and expertise available through the NEU. The range of existing enforcement powers would allow it to requisition information, carry out inspections, analyse and verify that information meets the registration requirements, and to take action against people who are operating without being a registered financial institution.

208. The Companies Office has systems in place for information sharing with agencies such as the Police[14] and with other regulators, for example, the Securities Commission. These relationships will be useful for the purposes of registration.

209. Finally, the Companies Office has procedures for carrying out negative assurance checks. As part of its current registration and enforcement processes in relation to the Motor Vehicle Traders Register, it carries out criminal checks using Police checking processes and has established relationships with the Police and Ministry of Justice. As stated above, the Companies Office has access to information on bankruptcies and on persons banned from being involved in the management of a company.

210. The Companies Office option will enable New Zealand to meet international regulatory principles and standards. It facilitates consistency between the regulatory framework for the financial sector, and the registration and transparency measures (which apply more broadly than just to the financial sector) needed to meet FATF Recommendations 33 and 34.

211. To comply with FATF special recommendation VI, New Zealand is required to register or licence persons who provide money or value transfer services. Including these types of services in the financial services registration system under the Companies Office will mean that New Zealand will be able to ensure full coverage of the entities required to be registered for FATF purposes.

Question for Submission

4. What are your views on how the registration system could be designed to be most useful to consumers, business analysts, and intermediaries?

[14] The NEU and Companies Office have a number of enforcement responsibilities and also play a role in relation to proceeds of crime.

4.9 OPTIONS FOR COMPLYING WITH RECOMMENDATIONS 33 AND 34

4.9.1 Recommendation 33

212. In general, ownership and control information for legal persons is available on registers and kept up to date. However, the information will not indicate any underlying arrangement (in terms of beneficial ownership). A minimal additional requirement could be included in the legislation to require an indication of whether a shareholder holds the shares beneficially. This information could be provided to the Companies Office in the application for registration and updated in the annual return. Along with the details provided to companies by shareholders, companies would obtain a yes or no answer to the question on whether the shares are held beneficially. This would not be an onerous requirement, but would ensure that authorities are alerted to the fact there is an underlying arrangement as to the ownership of the shares.

213. The Companies Office could consider whether further information on control of bodies other than companies can be included as part of their registration and annual returns.

214. As part of the registration proposal for the financial sector, it is proposed that there will be effective information-sharing powers between the Companies Office and other financial sector regulatory authorities. These powers will be able to be used in relation to AML/CFT matters; hence, information obtained using the Companies Office's investigative powers will be available to the AML/CFT supervisory authorities.

Questions for Submission

5. What are your views on the proposal to require shareholders, as part of share registration requirements, to provide an indication of whether they hold the shares beneficially?

6. For bodies other than companies, what information on control should be provided as part of registration requirements?

4.9.2 Recommendation 34

215. As noted above there are hundreds of thousands of trusts in New Zealand. Where these trusts undertake financial transactions, financial institutions are required to report any suspicious transactions to the FIU. It is proposed that trusts providing financial services will be registered by the Companies Office and details of their ownership and control will be available. To register all trusts would result in a high level of administrative costs and compliance costs with only a small potential reduction in the risk of money laundering. This approach is consistent with the risk-based approach in the Ministry of Justice discussion documents.

216. To facilitate transparency concerning the beneficial ownership and control of trusts, an option is to include a provision in the Trustee Act 1956 requiring trustees to provide full details relating to the trust – including the settlor(s), trustee(s), beneficiary(ies) and

deed of trust – if requested by an AML/CFT supervisor, the FIU or other law enforcement agency.

217. A further initiative could be to consider adding a mandatory requirement to supply certain information as part of existing registration requirements for trusts. For example, adding to section 11(1)(a) of the Charitable Trusts Act 1957 the requirement to provide a brief description of what the charitable trust does, alternate addresses (like a website) for the society and the names of the trustees and their contact details.

4.9.3 Costs and Benefits

218. These proposals would result in a small increase in compliance costs for bodies and trusts in providing additional information. The benefit would be that New Zealand's compliance with the FATF Recommendations would be improved.

Questions for Submission

7. Do you agree with the proposal that trustees be required to provide details of a trust to regulatory agencies on request? If not, why not?

8. Do you agree with the proposal that trusts with existing registration requirements be required to provide further information to enhance transparency? If not, why not?

9. Would this proposal result in a significant increase in compliance costs for trusts?

APPENDIX I

FATF Recommendation 33

Countries should take measures to prevent the unlawful use of legal persons by money launderers. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. In particular, countries that have legal persons that are able to issue bearer shares should take appropriate measures to ensure they are not misused for money laundering and be able to demonstrate the adequacy of those measures. Countries could consider measures to facilitate access to beneficial ownership and control information to financial institutions undertaking the requirements set out in Recommendation 5.

FATF Recommendation 34

Countries should take measures to prevent the unlawful use of legal arrangements by money launderers. In particular, countries should ensure there is adequate, accurate and timely information on express trusts, including information on the settlor, trustee and beneficiaries, that can be obtained or accessed in a timely fashion by competent authorities. Countries could consider measures to facilitate access to beneficial ownership and control information to financial institutions undertaking the requirements set out in Recommendation 5.

FATF Recommendation 5

Financial institutions should not keep anonymous accounts or accounts in obviously fictitious names.

Financial institutions should undertake customer due diligence measures, including identifying and verifying the identity of their customers, when:

- Establishing business relations;
- Carrying out occasional transactions: (i) above the applicable designated threshold; or (ii) that are wire transfers in the circumstances covered by the Interpretative Note to Special Recommendation VII;
- There is a suspicion of money laundering or terrorist financing; or
- The financial institution has doubts about the veracity or adequacy of previously obtained customer identification data.

The customer due diligence (“CDD”) measures to be taken are as follows:

- Identifying the customer and verifying that customer’s identity using reliable, independent source documents, data or information.
- Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner such that the financial institution is satisfied it knows who the beneficial owner is. For legal persons and arrangements this

should include financial institutions taking reasonable measures to understand the ownership and control structure of the customer.

- Obtaining information on the purpose and intended nature of the business relationship.

- Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds.

Financial institutions should apply each of the CDD measures under (a) to (d) above, but may determine the extent of such measures on a risk sensitive basis depending on the type of customer, business relationship or transaction. The measures that are taken should be consistent with any guidelines issued by competent authorities. For higher risk categories, financial institutions should perform enhanced due diligence. In certain circumstances, where there are low risks, countries may decide that financial institutions can apply reduced or simplified measures.

Financial institutions should verify the identity of the customer and beneficial owner before or during the course of establishing a business relationship or conducting transactions for occasional customers. Countries may permit financial institutions to complete the verification as soon as reasonably practicable following the establishment of the relationship, where the money laundering risks are effectively managed and where this is essential not to interrupt the normal conduct of business.

Where the financial institution is unable to comply with paragraphs (a) to (c) above, it should not open the account, commence business relations or perform the transaction; or should terminate the business relationship; and should consider making a suspicious transactions report in relation to the customer.

These requirements should apply to all new customers, though financial institutions should also apply this Recommendation to existing customers on the basis of materiality and risk, and should conduct due diligence on such existing relationships at appropriate times.

APPENDIX 2: SUMMARY OF QUESTIONS FOR SUBMISSION

1. What are the appropriate categories of financial services that should be able to be searched on the register?

2. Is there any other information that should be available on the registration system?

3. Is there any more cost effective way to implement the registration system?

4. What are your views on how the registration system could be designed to be most useful to consumers, business analysts, and intermediaries?

5. What are your views on the proposal to require shareholders, as part of share registration requirements, to provide an indication of whether they hold the shares beneficially?

6. For bodies other than companies, what information on control should be provided as part of registration requirements?

7. Do you agree with the proposal that trustees be required to provide details of a trust to regulatory agencies on request? If not, why not?

8. Do you agree with the proposal that trusts with existing registration requirements be required to provide further information to enhance transparency? If not, why not?

9. Would this proposal result in a significant increase in compliance costs for trusts?