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The 2016 New Zealand Financial Sector Assessment Programme (FSAP)

Chris Hunt[1]

This article describes the IMF's Financial Sector Assessment Programme (FSAP) for New Zealand that will be undertaken during 2016. An FSAP is a comprehensive review of a country's financial system, with a particular focus on the quality of financial sector regulation. The 2016 FSAP will examine how New Zealand's financial institutions are prudentially regulated and supervised by the Reserve Bank, and how New Zealand's capital markets and financial market conduct are regulated by the Financial Markets Authority (FMA).

The IMF's assessment will take place across two visits to New Zealand in late August and November. The visits will involve significant engagement with New Zealand authorities, as well as discussions with a wider set of stakeholders including financial sector entities that are subject to regulation and industry groups. The findings and recommendations from the FSAP will be published by the IMF in early 2017. New Zealand authorities will consider the results of the FSAP in the context of both international regulatory norms and local New Zealand conditions.

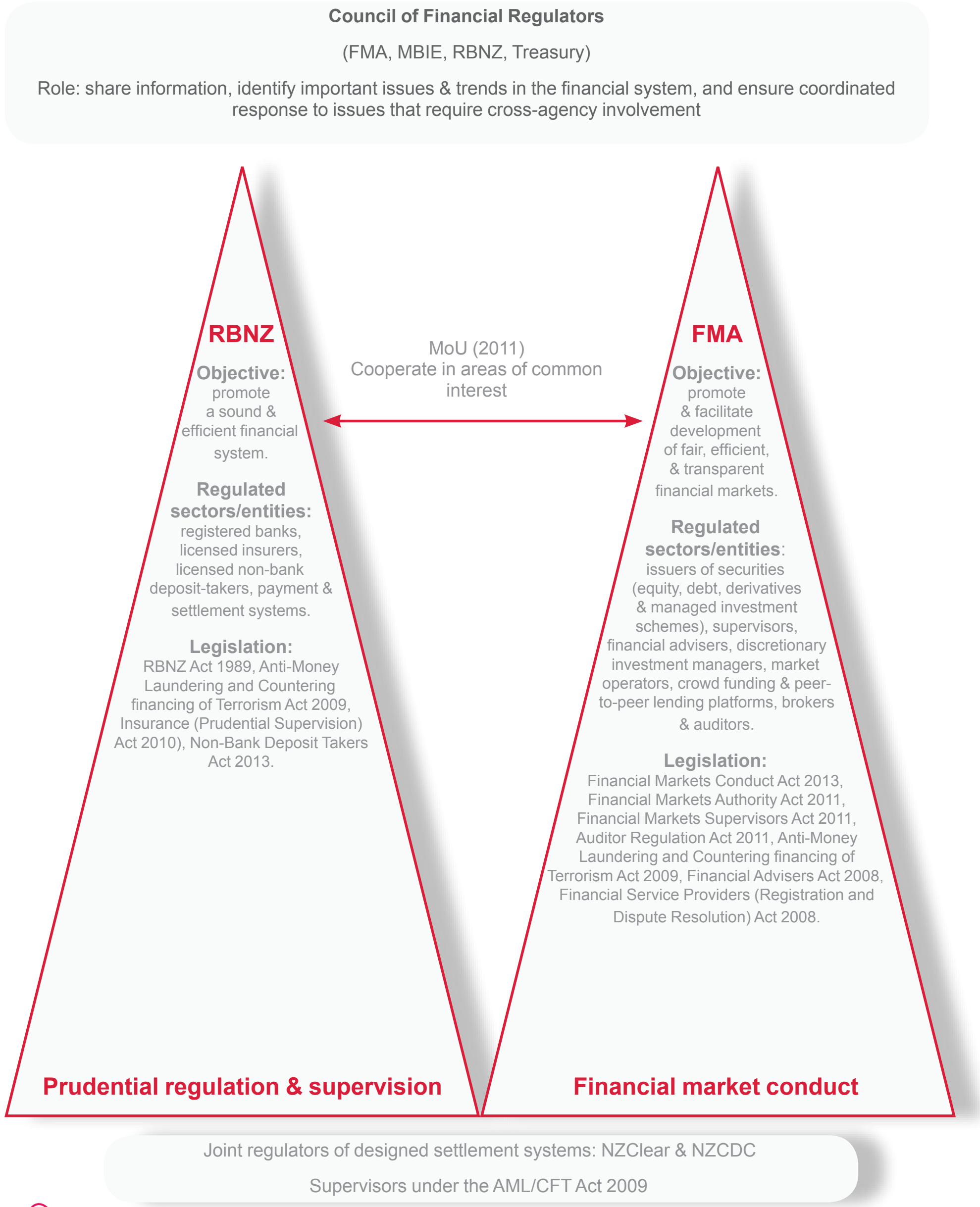
1 Introduction

In the latter half of 2016 the International Monetary Fund (IMF) will be undertaking a comprehensive review of New Zealand's financial system, under the auspices of the Financial Sector Assessment Programme (FSAP). An FSAP is a key part of the IMF's surveillance of individual member countries. FSAPs analyse the resilience of the financial sector, the quality of the regulatory and supervisory framework, and the capacity to manage and resolve financial crises. The last New Zealand FSAP was conducted during 2003-04. The 2016 FSAP is a timely opportunity for New Zealand to be benchmarked against international standards, particularly in light of the significant changes in the regulatory landscape since 2004.

New Zealand has a 'twin peaks' model of financial sector regulation with 'prudential' and 'market conduct' elements (figure 1). The 2016 FSAP will review both dimensions and the way the two regulators – the Reserve Bank and the Financial Markets Authority (FMA) – achieve their respective statutory objectives.

1 FSAP Coordinator, Reserve Bank. This article was written with significant input from the Financial Markets Authority (FMA). The author would like to thank Louise Gibson and Simon Haines in particular.

Figure 1
New Zealand's 'twin peaks' model of financial sector regulation



This assessment will benchmark against various international standards that exist for a number of sectors, including banking, insurance, financial market infrastructure (FMI) and securities. In addition, New Zealand's approach to macro-prudential policy will be evaluated, along with the crisis management and resolution framework for banks. A stress testing exercise for the banking system will also be undertaken in order to assess the resilience of the sector to a number of 'shocks'.

The benefits of an FSAP for New Zealand include identifying any 'gaps' that might exist across New Zealand's regulatory frameworks. This is timely given New Zealand's considerable regulatory reform over the past decade. The IMF's findings and recommendations – which are likely to be made public in the early part of 2017 – will provide an objective evaluation of regulatory developments. This could help to shape the direction of regulatory policy, or could influence changes in the way financial sector supervision is undertaken.

A 'favourable' FSAP is likely to help improve the perception that New Zealand has a well-regulated financial sector. This would underpin investor confidence in the New Zealand financial system (particularly from market participants located offshore), and support further financial market development. More generally, being subject to an FSAP – a decision that is voluntary for New Zealand as a member of the IMF – demonstrates 'good citizenship'. The FSAP is also a mechanism for comparison between countries with similar financial systems.

Engagement with the expert IMF assessors will provide a very positive and useful opportunity for New Zealand authorities to critically reflect on the nature of their regulatory frameworks and the extent to which they are indeed fit for purpose in New Zealand.

The next section describes what an FSAP involves. Section three briefly summarises the outcomes of the last New Zealand FSAP and this is followed by a discussion of key regulatory developments since 2004. The final section five outlines some of the planning that has occurred to-date in preparation for the two missions in August and November.

2 What is an FSAP?

An FSAP is a comprehensive assessment of a country's financial sector.[2] The programme was established by the IMF in the aftermath of the Asian crisis in the late 1990s and has evolved considerably following the global financial crisis (GFC). An FSAP covers three broad areas:

- An analysis of key financial system vulnerabilities and risks, together with an assessment of the resilience of the financial system. This typically includes stress testing of the banking sector (and insurance sectors in some instances), an analysis of 'interconnectedness' among financial institutions and financial markets, and coverage of 'spillovers' from the global economy to the financial system.

- An assessment of the quality of the regulatory framework. This cuts across both prudential and market conduct, and includes an assessment against internationally defined standards in the areas of banking supervision, insurance, securities regulation, and financial market infrastructure (FMI). In addition, the evaluation of macro-prudential policy frameworks has become commonplace in recent years.

- An evaluation of financial safety nets. This reflects a jurisdiction's capacity to manage and resolve a financial crisis. It includes an overview of liquidity management frameworks, lender of last resort policies, deposit protection/insurance schemes, crisis preparedness and bank resolution frameworks. Potential spillovers from the financial sector to a government's fiscal position are also examined.

The IMF will also assess the nature of the responsibilities that have been assigned to various regulatory agencies in order to identify any areas of regulatory and supervisory 'underlap' or 'overlap'. In addition, the IMF will evaluate how authorities cooperate and coordinate policy, and the institutional mechanisms that help foster this cross-agency interaction.

2.1 Changes to the FSAP since 2009

Before the GFC, an FSAP was a voluntary exercise for all of the IMF's 188 member countries. Following a review of the FSAP framework in 2009, however, FSAPs are now mandatory for 29 jurisdictions that are deemed to be 'systemically important' (the 's29'). These members must undertake an FSAP every five years. For New Zealand, which is not one of these 29 countries, an FSAP remains voluntary. This distinction reflects the fact that financial instability in some jurisdictions can have an important impact on other parts of the global economy.

The identification of the s29 countries has introduced a risk-based allocation of IMF resources, albeit at the expense of the frequency of FSAPs for the other 159 members. For the s29, FSAPs are typically more challenging and resource intensive. An FSAP for an s29 country

2 See http://www.imf.org/external/np/exr/facts/fsap.htm

is roughly twice as expensive as one undertaken for a non-systemic country (IMF, 2014). As a consequence the average number of FSAPs undertaken each year by the IMF has declined from 18-20 before 2009, to 14-15 over the past few years.

While the frequency of FSAPs has declined, changes since 2009 have strengthened the analytical focus and coverage for all FSAPs. Some of the key changes have included:

- A greater focus on the third pillar outlined above – financial safety nets – and in particular an assessment of the mechanisms for resolving a failed financial institution.
- The introduction of a risk assessment matrix (RAM) to help provide a sharper focus on key risks facing any given financial system.
- Greater analytical rigour and wider coverage for stress tests, including consideration of a wider set of risks, and the extension of stress tests to sectors outside the banking system (e.g. to the insurance sector).
- An explicit coverage given to macro-prudential policy frameworks. Macro-prudential policy is a relatively new area that emerged in the aftermath of the GFC and reflects a greater focus from prudential regulators on identifying and addressing 'systemic risk' (in contrast to an exclusive focus on the risks and vulnerabilities attached to individual financial institutions).

For non-systemic countries such as New Zealand, the IMF will consider a number of factors when deciding whether to undertake an FSAP. These include the time that has elapsed since the last FSAP; the regional importance of the member country; whether there are any major financial reform programmes that could benefit from a comprehensive external assessment, and; the presence of any obvious financial sector risks and vulnerabilities. In addition, the IMF seeks to create a balance of FSAPs across different regions and between advanced and developing economies.

2.2 Discretionary aspects of an FSAP

While an FSAP will cover the three broad areas identified above, aspects of the assessment are discretionary, and subject to agreement between national authorities and the IMF – irrespective of whether this is part of a mandatory s29 FSAP, or part of an FSAP for a non-systemic jurisdiction.

National authorities can elect to undergo a formal compliance exercise across one or a number of the international standards that pertain to various sectors. These are standards that are not set by the IMF itself, but by international standard setting bodies. These compliance assessments cut across the following sectors:

- banking system (the Basel Committee on Banking Supervision's (BCBS) core principles);
- insurance sector (the International Association of Insurance Supervisors' (IAIS) core principles);
- capital markets and market conduct (the International Organisation of Securities Commissions' (IOSCO) principles);
- financial market infrastructure (the Committee for Payment and Market Infrastructures' (CPMI) principles); and

- Anti-money laundering and countering the financing of terrorism (the Financial Action Taskforce's (FATF) principles).

Formal assessments

Any formal assessment culminates in a *Detailed Assessment Report* (DAR) and a *Report on the Observation of Standards and Codes* (ROSC). These reports contain a formal grading of compliance based on the methodology of the relevant international standard setter. These assessments are often led by an expert from outside the IMF included on the FSAP team. They reveal the extent of a regulatory authority's formal adherence against international norms and can help reveal gaps not previously identified. This exercise may also help to mobilise domestic support for changes that are either planned or under consideration.

However, while this formal assessment can be very useful in identifying gaps in the regulatory architecture, the exercise might understate the extent to which a regulator might achieve some of the key objectives set out by the relevant international standard setting body 'in substance' (i.e., without necessarily meeting some of the formal requirements). Moreover, financial systems can vary considerably in structure, and a generic set of international standards might not necessarily fit neatly for all countries. In other words, there might be sound reasons for a regulator choosing to depart from some of the specific international standards and principles that pertain to any given sector.

Despite significant change since the last FSAP, some aspects of New Zealand's regulatory framework will still not formally comply with the relevant internationally recognised standards when assessed by the IMF. While some of these gaps might need to be addressed in the future, some might exist for a good reason, due to factors specific to the structure of New Zealand's financial system. The FSAP process can provide an opportunity for the regulator to explain the specific approach taken.

Limited assessments

In cases where a full compliance assessment is not necessary or not requested by national authorities, the IMF might undertake a more informal and limited assessment that does not generate a DAR (and accompanying assessment grade). The results of this more limited assessment might be summarised in a *Technical Note* (which itself might still reflect a substantive amount of analysis). In these more limited non-graded assessments there is greater scope for the IMF to comment on proposed changes that are not yet implemented. By contrast, the graded assessments are focussed on the status quo arrangements.

Technical Notes are also produced to summarise any specific analytical work undertaken for the FSAP (e.g. stress testing), or to cover any topic areas where there are no formal international standards per se (e.g. macro-prudential policy).

2.3 Publication of findings and recommendations

There are a number of outputs from the FSAP process. A confidential *Aide Memoire* is presented to national authorities at the end of the mission (the formal visit of the IMF team). Depending on the scope of the FSAP there might be more than one mission. A mission is staffed by the respective experts across the various components of the FSAP, and they might be IMF staff, or external consultants contracted by the IMF for the duration of the mission(s).

3 See http://www.imf.org/external/np/fsap/fssa.aspx

The main findings and recommendations are published in a *Financial System Stability Assessment* (FSSA).[3] This document is discussed by the IMF's Executive Board alongside the annual Article IV mission findings. The findings and recommendations are a distillation of the insights from the DARs and the various *Technical Notes*. Typically, an upfront page details the 'key' recommendations.

Publication of the FSSA on the IMF's website is 'presumed' but not mandatory. Publication of supporting documents such as DARs and *Technical Notes* is subject to agreement from national authorities, but has become more commonplace since 2009.

Publication of the FSSA provides an opportunity for the Government and the relevant regulatory authority to respond to the report, highlighting any particular findings or recommendations, and describing any relevant work that is planned or already under way.

3 The 2004 New Zealand FSAP: findings and recommendations

The IMF visited New Zealand in late 2003 and the FSSA was published in May 2004.[4] New Zealand authorities requested a detailed (graded) assessment against the existing international standards across the banking sector, securities regulation and a set of standards developed by the IMF which assessed transparency in monetary and financial policies.[5]

4 The 2004 FSSA can be found here: http://www.imf.org/external/pubs/ft/scr/2004/cr04126.pdf

5 This latter standard has become a less common part of FSAPs post-GFC.

There were a number of supporting documents that were produced, but not published.

More than 40 New Zealand organisations were involved in some way or another, including various government agencies, financial institutions, industry bodies and other stakeholders (Gordon, 2004). The Reserve Bank was the lead authority and coordinated the FSAP process on behalf of other authorities, which included the Ministry of Economic Development (which later became part of MBIE), the Ministry of Justice, the Securities Commission (later to become the FMA), and the Treasury.

The Reserve Bank published a *Bulletin* article in 2003 alerting its stakeholders to the upcoming FSAP (Mortlock and Woolford, 2003), and produced another article in June 2004 summarising the FSAP findings and detailing the Reserve Bank's response in certain areas (Gordon, 2004).

The broad conclusion of the last FSAP was that New Zealand's profitable and well-functioning financial system, sound and transparent financial policies, together with a favourable macroeconomic outlook, all provided an effective buffer against systemic risk. The regulatory framework was "generally appropriate" for New Zealand circumstances and with some refinements it would continue to provide a basis for maintaining a sound financial system. The key recommendations from the FSSA are listed in appendix 1.

The annexe on the observance of standards that was part of the 2004 FSSA also detailed a response from authorities. In relation to the Reserve Bank's areas of responsibilities the distinctive approach to banking regulation and supervision was defended,[6] while some potential

6 For an overview of the Reserve Bank's approach to regulation see Fiennes and O'Connor-Close (2012).

gaps in the supervisory framework identified by the assessors were acknowledged. The Reserve Bank noted that some work was already under way at the time, or planned, which would help address some of these gaps. This work included crisis management and enhanced cooperation with Australian authorities, measures to bolster the role of bank directors and auditors, and plans to supplement the disclosure information provided by banks with additional reporting to supervisors.

New Zealand's securities regulation performed relatively poorly against many of the international (IOSCO) principles during the last FSAP. This assessment raised questions about the regulator's (the Securities Commission) core capability and effectiveness and resulted in a number of recommendations for change to improve New Zealand's securities regulatory regime (see section 4.3).

4 Developments in financial sector regulation since 2004

The regulatory landscape has changed significantly since the last FSAP. Some of these developments can be traced to the 2004 recommendations, while others are a response to other factors, most notably, the GFC. It is against these changes that the IMF will be evaluating New Zealand's 'twin peaks' regulatory model for the financial sector.

4.1 Key developments in prudential regulation

The perimeter of prudential regulation has expanded since 2004. This partly stems from a recommendation from the 2004 FSAP that New Zealand authorities review the various practices surrounding the regulation and supervision of non-bank financial institutions (NBFIs). In response a working group led by the Ministry of Economic Development (MED) was established in 2005. This working group was tasked with 'reviewing financial products and providers' (RFPP) in order to develop an effective and consistent framework for the regulation of NBFIs, financial intermediaries and financial products in a way that would underpin public confidence in financial markets and result in a sound and efficient financial system. Previously, non-bank providers and products were subject to a myriad of laws, confusing and conflicting objectives and there were gaps in oversight. The work of this group complemented that of another convened to consider the appropriate institutional arrangements governing financial sector regulation.

This 'Domestic Institutional Arrangements' working group was led by the Treasury. The group considered the merits of increasing the Reserve Bank's prudential role to include non-bank deposit-takers (NBDTs) and insurers. In 2007 Cabinet formally considered a package of changes to support the extension of the Reserve Bank's prudential role. These involved up-dated accountability arrangements including a greater statutory focus on the Reserve Bank's financial sector functions. These changes were enshrined in the Reserve Bank of New Zealand Amendment Act 2008 where the Reserve Bank assumed responsibility for the regulation of NBDTs.[7] In 2010 the regulatory perimeter was further extended with the passage of the Insurance (Prudential Supervision) Act (IPSA) 2010.

7 Responsibility for the supervision of NBDTs rests with trustees who are regulated by the FMA.

The development of a bank resolution framework was another key recommendation of the 2004 FSAP. The Reserve Bank began focussing on the practical issues of how to resume the operations of a failed systemic bank in order to avoid significant damage to the financial system. There was a significant trans-Tasman dimension to this work, given the dominance of the Australian-owned banks in the New Zealand system and an associated risk of 'hollowing out' of functions from the New Zealand operation to other group entities. The latter gave rise to policies on local incorporation and outsourcing. Closer cooperation with Australian authorities was enhanced through the formation of the Trans-Tasman Council on Banking Supervision,[8] while legislative changes in 2006 required regulators on both sides of the Tasman to avoid any detrimental impact on financial system outcomes in the other country, to the extent reasonably practicable.

The 2008-09 GFC marked a watershed for regulators globally and set in train a concerted effort to improve the resilience of financial systems to periods of financial stress, while also attempting to reduce the incidence of stress events in the first instance. While the New Zealand financial system weathered the GFC comparatively well – the banking sector did not experience a major deterioration in asset quality, and non-performing loans remained low by international standards – the GFC did expose a long-standing concern for the Reserve Bank tied to the reliance of the banking system on wholesale market funding. In response to the realisation of funding and liquidity risks, the Reserve Bank introduced a new prudential liquidity policy in 2010 designed to ensure that banks do more to self-insure against short-term funding squeezes and put their funding profile on a more stable footing.

The Reserve Bank has adopted the new global solvency standard for banks embodied in Basel III, implementing the new higher minimum capital requirements at the start of 2013. The implementation of Basel III illustrated the more general approach the Reserve Bank has taken to the consideration of international regulatory standards. The Reserve Bank adopts a 'substance over form' approach, adapting international standards to suit specific New Zealand conditions.

The GFC also prompted the accelerated development and implementation of the Reserve Bank's Open Bank Resolution (OBR) policy – which came into effect in 2012. In addition, a *Memorandum of Cooperation on Trans-Tasman Bank Distress Management* was signed in 2010. The Memorandum is designed to assist the participants to reach a coordinated response to financial distress in any bank or banking group that has significant operations in Australia and New Zealand.[9] The Memorandum does not pre-commit to, or rule out, any particular resolution options.

Another important development in the post-GFC regulatory environment has been an explicit focus on identifying and addressing systemic risk across the financial system. This has been associated with the new policy area termed 'macro-prudential'. In the New Zealand context the pursuit of the Reserve Bank's prudential functions has always been guided by a systemic focus. However, what was missing from the Reserve Bank's armoury was a commitment to address the build-up of systemic risk over the financial cycle, explicitly tied to credit and asset price developments – in other words a set of prudential tools that could be varied over the cycle as circumstances demanded. In May 2013 the new policy area was formalised with the signing of a MoU between the Minister of

8 See Terms of Reference available at http://www.rbnz.govt.nz/regulation-and-supervision/banks/relationships/terms-of-reference-for-the-trans-tasman-council-on-banking-supervision

9 Parties to the memorandum are: Reserve Bank of New Zealand, New Zealand Treasury, Reserve Bank of Australia, APRA, Australian Treasury and ASIC. The memorandum is available at http://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/banks/relationships/5181778.pdf?la=en.

Finance and the Governor. The MoU provides clarity around the specific objectives of macro-prudential policy and the operating guidelines for the implementation of any of the four instruments currently in the toolkit. The MoU upholds the Reserve Bank as the primary decision-maker, where the powers to implement macro-prudential policy derive from the existing statutory powers to promote a sound and efficient financial system and to impose conditions of registration for banks relating to a range of matters including ‘carrying on business in a prudent manner’.

One major gap in the regulator’s financial system responsibilities is the absence of a robust regulatory framework governing financial market infrastructure (payment systems, securities settlement systems, central counterparties and trade repositories). The Reserve Bank has recently consulted on a set of proposals designed to address this gap, including more powers to oversee ‘systemically important’ FMIs.

4.2 The Reserve Bank approach to prudential regulation

The developments described in section 4.1 suggest both the scope and nature of prudential regulation and supervisory activities has grown, particularly since the GFC. There has been a greater emphasis placed on what is termed the ‘regulatory pillar’, as a way of helping to ensure the soundness and efficiency of the financial system – as exemplified in the new Basel III capital requirements and the prudential liquidity policy. This regulatory pillar complements the Reserve Bank’s long-standing emphasis on both self-discipline and market discipline (see O’Connor-Close and Austin, 2016). Self-discipline refers to an institution’s own processes and risk frameworks, the responsibility for which rests with an institution’s directors and management. Market discipline refers to the ability of market participants to influence an institution’s behaviour.

That said, “the Reserve Bank still favours a light-handed approach by international standards, but with a rebalancing of regulatory discipline alongside the well-established canons of market and self-discipline, allied with a significantly more active approach to institutional engagement and information provision” (Fiennes and O’Connor-Close 2012, p. 12).

This relatively non-interventionist and governance focussed approach continues to distinguish New Zealand’s approach to prudential regulation and supervision from that seen elsewhere, despite some degree of convergence post-GFC.[10] This approach is illustrated in a number of ways:

- Prudential supervision is conducted in a way that continues to focus on the financial system (or specific sector) as a whole, rather than on individual institutions *per se*.[11] The Reserve Bank’s policy and supervisory resources are not directed at eliminating the risks facing financial institutions (which would generally imply a more heavy handed and intrusive approach). Risk taking (within appropriate prudent parameters) is essential for a dynamic and efficient financial system and this implies a non-zero failure regime. This is buttressed by the absence of any explicit depositor protection objective (or policyholder protection objective in the case of the insurance sector).

- This systemic focus directs the Reserve Bank to allocate its resources in an efficient manner that is outcome focussed and risk based. More resource is directed towards the banking system, while the rules in place for insurers and NBDTs tend to be simpler

10 Note this convergence is mutual with a greater emphasis on the role of financial disclosure and market discipline within Basel III, with respect to the transparency of capital requirements.

11 However, the Reserve Bank can also set regulatory requirements that specifically pertain to an individual regulated entity.

(although not necessarily any less conservative). Moreover, greater supervisory resource is directed towards the larger and systemically important institutions within the banking and insurance sectors respectively.

- Supervision of both banking and the insurance sectors does not rely on on-site inspections, which is an inherently more intrusive and costly form of supervision. As a consequence supervisory resources remain low compared to other jurisdictions.

The Reserve Bank expects that the IMF will assess the substance of New Zealand's prudential regime and the nature of the outcomes it generates, in addition to assessing whether the regulatory regime formally complies with international standards and principles. The Reserve Bank believes that a comparatively lightly resourced regime with an appropriate balance between self, market and regulatory discipline can create the preconditions for a sound and efficient financial system.

That said, the benchmarking by the IMF against the relevant international standards will provide an invaluable opportunity for the Reserve Bank to reflect on various aspects of New Zealand's approach to prudential regulation. Depending on the nature of the IMF's findings and recommendations, the 2016 FSAP might influence the direction of policy development and supervision.

4.3 New Zealand's securities regime and market conduct

As noted in section 3, New Zealand's securities regulation did not receive a favourable assessment during the last FSAP. The key recommendations from the IMF's 2004 review included:

- strengthening the oversight of frontline supervisors (that are now required to oversee regulated debt and regulated managed investment schemes) and auditors;
- allocating resources to enable a risk-based review of issuer disclosure documents (e.g. issuers of regulated debt securities, equities or managed investment schemes);
- providing for greater assessment and regulatory oversight of the New Zealand stock exchange (NZX);
- providing a common regulatory framework, minimum standards and provisioning for the ongoing regulatory oversight of brokers and collective investment scheme operators;
- providing minimum standards and strengthening the oversight of market intermediaries (e.g. brokers) that are not exchange members;
- providing that investment advisers should be subject to ongoing capital and prudential requirements;
- maintaining a crisis management plan for dealing with potential failure of intermediaries; and
- strengthening rules in relation to market manipulation.

The IOSCO principles (and underlying methodology) used for the 2004 FSAP assessment of securities regulation has since been overhauled. In addition, significant changes have been made to New Zealand's securities regime over the same period.

The changes in respect of New Zealand's securities regulation largely stem from the RFPP (2006). Not only did this review lead to the Reserve Bank assuming responsibility for the regulation of NBDTs and insurance sectors (as noted in section 4.2), but also it initiated a review of securities regulation. The result was a fundamental shift in the approach to securities regulation with the establishment of the FMA in 2011 and new standards for market conduct culminating in the introduction of the Financial Markets Conduct Act 2013 (the FMC Act).

The FMA was established in direct response to recommendations from the Capital Market Development Taskforce (2009) to improve New Zealand's financial system. The Taskforce recommended consolidating a range of financial regulatory functions into a single financial markets securities regulator. Owing to the urgency of improving confidence in financial markets following the GFC, the FMA was established prior to the completion of a new regulatory framework designed to complement the new institutional structure – the FMC Act.

The purpose of the FMC Act is to 'promote and facilitate the development of fair, efficient and transparent financial markets', and to promote the confident and informed participation of businesses, investors and consumers. The FMC Act provides a regulatory framework for financial conduct. It governs the way financial products are offered, promoted, issued and sold. This includes the ongoing responsibilities of those who offer, issue, manage, supervise, deal in and trade financial products. The FMC Act also regulates the provision of certain financial services.

The changes introduced by the new legislation aim to play a key role in building confidence in New Zealand's financial markets, by providing better information for investors, as well as setting clearer rules for companies wanting to raise capital. Although the new regime has been in effect since 1 December 2014, most regulated entities have until 1 December 2016 to fully comply. The FMA is focussed on helping the financial services sector through this transition in 2016. This work includes licensing and setting up new systems and processes for ongoing monitoring and oversight.

5 Planning for the 2016 FSAP

As a voluntary undertaking, and given the time since the last FSAP, New Zealand authorities started to canvass the timing of a second FSAP in 2012 with the IMF. At the time however, the FMA had only just been established, while the Reserve Bank was beginning the implementation of Basel III. It was decided to defer a second FSAP until a later date. Moreover, given IMF priorities, there was no urgency on their part to undertake a FSAP.

In March 2014 the Reserve Bank wrote to the IMF on behalf of other Council of Financial Regulators (CoFR) members requesting an FSAP. The IMF agreed and committed to undertake an FSAP at some point during 2016.

FSAPs are a resource intensive undertaking both for the IMF and national authorities. Given the resource implications it was agreed by CoFR in late 2015 that the Reserve Bank would act as lead coordinator across the relevant New Zealand agencies. An inter-agency governance structure has been established, with an inter-agency steering group providing oversight, supported by a secretariat comprising working-level officials. There will also be regular reporting to Ministers during the year.

There will be two separate FSAP missions during 2016. The first will be in late August and a second in November. The IMF FSAP team will meet with both New Zealand authorities and a wider group of stakeholders during the course of their missions. The latter will include regulated entities, industry bodies, audit firms and other private sector stakeholders. In addition, the IMF team will visit Australia and meet with authorities there to discuss trans-Tasman issues – given the interaction between New Zealand and Australian authorities arising from the significant presence of Australian banks in New Zealand.

Table 1 sets out the focus of each mission. As discussed in section 2.2, aspects of the FSAP that are negotiated between national authorities and the IMF – in particular, the nature of the assessments (graded or non-graded) against the relevant international standards. New Zealand authorities have agreed the following mission scope with the IMF:

- A full graded assessment for the banking system against the Basel Core Principles (BCPs);
- A full graded assessment for the insurance sector against the International Association of Insurance Supervisors' (IAIS) Core Principles;
- A 'limited' (non-graded) assessment for securities regulation that will involve a more informal benchmarking against the International Organisation of Securities Commissions' (IOSCO) principles; and
- A 'limited' (non-graded) assessment of FMI against the Committee for Payment and Market Infrastructures' (CPMI) principles.

Table 1
New Zealand FSAP missions

1st mission	'Main' mission
16th August-7th September	1st-17th November
• Banking sector assessment • Crisis management and resolution framework assessment • Insurance sector assessment • Financial market infrastructure assessment	• Securities regulation assessment • Macro-prudential policy framework assessment • Conclusion of bank stress testing exercise

5.1 *Securities regulation assessment*

The decision to undertake a more limited assessment of New Zealand's securities regulatory framework is because the FMA and market participants are still working through the transition to a new regime as laid out in the FMC Act. On this basis, the IMF would find it difficult to adequately evaluate the effectiveness of the framework when many of the market participants have yet to complete the licensing process and there is little practical experience under the new regime. The securities assessment will therefore involve a non-graded assessment and informal benchmarking against the 38 IOSCO principles, and culminate in a *Technical Note*.

The IMF will review New Zealand's securities regulation and the FMA on their second (main) mission in November 2016. The scope and focus of this review has yet to be fully defined and will be the subject of dialogue with the IMF in the first half of 2016. As an example, the IOSCO principles cover a wide range of areas such as:[12]

12 See https://www.iosco.org/

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

The FMA will be talking more to the industry over the coming months, in the lead-up to the IMF's mission to New Zealand, about how the IMF will be reviewing New Zealand's securities regime and how the industry could contribute to demonstrating best practice in New Zealand.

5.2 FMI assessment

The assessment of New Zealand's FMI framework will also involve a *Technical Note* based on an informal benchmarking against the specific international standards. This limited assessment is because the Reserve Bank is currently consulting on a set of proposals designed to improve the regulation and oversight of key FMIs, including crisis management powers for systemically important FMIs.[13] This limited assessment will provide an opportunity for the IMF to review the proposals and evaluate the extent to which they might meet the CPMI's Principles for *Financial Market Infrastructure*.

5.3 Other aspects of the 2016 FSAP

In addition to the graded and non-graded benchmarking across the banking, insurance, securities and FMI sectors, the IMF will evaluate the Reserve Bank's macro-prudential policy framework, as well as New Zealand's approach to managing and resolving distress and failure in the banking system. The latter will include an assessment of New Zealand's bank resolution framework against best practice, including the Financial Stability Board's key attributes. These evaluations will result in *Technical Notes*. A *Technical Note* will also summarise the results of a stress testing exercise directed at the major New Zealand banks.

New Zealand's AML/CFT regime will be formally reviewed in late 2019 by the Financial Action Taskforce (FATF). As a consequence, AML/CFT will not be a specific focus for the 2016 New Zealand FSAP.

The topic areas listed in table 1 will be assessed by the relevant expert assigned to the New Zealand FSAP team. In the case of banking and insurance, there are two experts for each, reflecting the more onerous graded assessments for these sectors. In total, the New Zealand IMF mission team comprises 13 people, including four external consultants.

In preparation for the missions, New Zealand authorities are completing a series of background papers to provide the necessary information to help the IMF mission team understand New Zealand's financial sector regulatory frameworks. In the case of banking and insurance, this work also involves the completion of very detailed 'self-assessments' against the relevant international standards. In August, the banking and insurance expert assessors will be closely evaluating these self-assessments.

13 See http://www.rbnz.govt.nz/regulation-and-supervision/financial-market-infrastructure-oversight/

6 Conclusion

New Zealand's financial sector plays a very important role in supporting economic performance and the improvement in living standards for all New Zealanders. It is crucial that the various functions of the financial system – such as the allocation of funds from savers to borrowers, facilitating an efficient means of transacting, and mitigating economic risk – are equally supported by a robust regulatory framework that is appropriate for New Zealand conditions.

As discussed in this article, the 2016 FSAP will provide a comprehensive external evaluation of the current set of regulatory arrangements across both prudential and market conduct – New Zealand's twin peaks model of financial sector regulation. This review is timely given the significant changes in New Zealand's regulatory landscape since the last FSAP in 2004. New Zealand authorities will consider and respond to the results of the FSAP to help ensure that the current regulatory framework is making the best possible contribution to New Zealand's economic welfare.

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Appendix 1
New Zealand 2004 FSAP – key recommendations

Issue	Recommendation
Disclosure-based regime	Maintain the quality, scope, and timeliness of disclosure to ensure it continues to meet best international practice.
Importance of independent directors	Fit and proper criteria should continue to apply in a comprehensive manner. The RBNZ could offer independent bank directors the possibility of discussing areas of concern without absolving directors of their statutory responsibilities
Surveillance	For banks, monitor more regularly liquidity and large exposure early warning indicators. Consider commissioning 3rd party reports and establish a small specialist team to make focussed on-site visits on particular aspects of credit and operational risk.
Bank resolution and crisis management	Review possible approaches to bank resolution, and the operational and legal consequences that might arise, with a view to establishing internal operational guidelines.
Non-bank supervision	Review practices and resource needs for government agencies involved in oversight, especially the offices of the Registrar and the Government Actuary, with a view towards enhancing public access to timely and comprehensive data.
Securities market regulation	Enhance regulatory framework by including minimum standards of conduct for collective investment scheme operators, improving reporting mechanisms, strengthening standards and penalties relating to market abuse, and strengthening oversight of market intermediaries that are not exchange members.