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## **Consultation Document: Crisis Management Powers for Systemically Important Financial Market Infrastructures**

The Reserve Bank invites submissions on this consultation document by 5pm on 20 May 2016

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Please note that a summary of the submissions may be published. If you consider that any part of your submissions should properly be withheld on the grounds of commercial sensitivity or for any other reason, you should indicate this clearly.

**March 2016**

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## Executive Summary

Financial market infrastructures (FMIs), such as payment and settlement systems, are the channels through which financial institutions, governments, businesses and individuals transmit money and financial instruments. They are generally sophisticated systems that centralise certain activities, handling significant transaction volumes and sizeable monetary values.

Because of the services they provide, the volume of transactions they can handle, and their interconnections with the rest of the financial system, some FMIs are systemically important. This is because a disruption in the services they provide would have an adverse impact on the soundness and efficiency of the financial system as a whole.

In December 2015 we published our final policy proposals for an enhanced legislative framework for the oversight of systemically important FMIs (SIFMIs), including a preliminary list of FMIs that might be of systemic importance<sup>1</sup>. The key features of the proposals are that:

- Joint regulators (the Reserve Bank and the Financial Markets Authority (FMA)) have enhanced oversight powers in respect of SIFMIs, including investigative and enforcement, standard-setting, rule setting and crisis management powers, via a revised Designation Regime;
- FMIs that meet the criterion of systemic importance would be required to be designated under the new Designation Regime; and
- Designated FMIs that are payment and settlement systems can continue to seek legal protection for netting and settlement as per the focus of the existing Designation Regime. Other non-systemically important payment and settlement systems are also able to opt in for designation.

One key part of the proposals is a crisis management regime for SIFMIs. However, the proposals published in December did not go into significant detail on the design of this crisis management regime.

The purpose of this consultation paper is to set out the detailed design of the proposed crisis management regime, and how it would apply in the different circumstances in which SIFMIs may operate. It should be noted that the proposed regime would only apply in relation to SIFMIs, like most of the powers in the rest of the proposed oversight framework. Where the remainder of this executive summary refers to an operator, this should be taken to include all of its operators when it has more than one.

This consultation paper proposes a two tier approach to crisis management. The first tier of this framework would be a requirement for operators of SIFMIs to prepare:

- Business continuity plans to achieve rapid recovery and timely resumption of essential services or to facilitate the replacement of the SIFMI's operator; and
- Recovery and orderly wind-down plans to respond to financial threats to the continued provision of essential services.

This first tier recognises that a SIFMI that has put in place preventative measures and appropriate recovery plans is more likely to address problems without public intervention.

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<sup>1</sup> [http://rbnz.govt.nz/regulation\\_and\\_supervision/financial-market-infrastructure-oversight/regulatory-developments/summary-of-submissions-and-final-policy-proposals-FMI-oversight-dec-2015.pdf](http://rbnz.govt.nz/regulation_and_supervision/financial-market-infrastructure-oversight/regulatory-developments/summary-of-submissions-and-final-policy-proposals-FMI-oversight-dec-2015.pdf)

This approach also has the merit of leveraging off the existing rules and plans that will already be in place for many SIFMIs, and allowing for certain matters (such as loss allocation) to be agreed in advance between participants and operators. It is proposed that the joint regulators would be able to set out certain objectives these plans must achieve and/or matters they must address, and that the regulators would have the power to direct operators to amend these plans.

The second tier of the framework would be a set of statutory powers that could be used by joint regulators when the SIFMI's business continuity plan, and/or recovery and resolution plan, is:

- Not applicable to the situation giving rise to the direction; or
- Not adequate to deal with the situation giving rise to the direction; or
- Are not being effectively implemented to deal with the situation giving rise to the direction; or
- Have failed to resolve the situation giving rise to the direction

In summary, these statutory powers are:

- A power for joint regulators to issue directions to the operator of a SIFMI with the consent of joint Ministers;
- A power for joint regulators to appoint, replace or remove the directors of an operator with the consent of joint Ministers; and
- A power for joint regulators to recommend that a SIFMI be placed into a specially designed statutory management regime.

Given the diverse ways in which FMIs can be structured, the application of this two tier framework may be influenced by the nature of the crisis event, legal form of the FMI, and the level of New Zealand presence that the FMI has. The consultation document discusses how the framework would be applied in these different circumstances.

In general, we propose that the first tier of the framework (the requirement for having a business continuity plan, recovery and wind down plan) would apply to all SIFMIs, regardless of their structure and level of New Zealand presence. These plans would cover all relevant types of crisis scenarios, including a failure of an operator, failure of its infrastructure, a participant defaulting on its obligations, and failure of a critical infrastructure provider.

How the second tier of the framework would apply would vary depending upon the circumstances. For example:

- The proposed statutory powers would apply in respect of the failure of a SIFMI or its operator, but not in respect of a participant (unless that also triggered the failure of the SIFMI or its operator);
- Where the SIFMI and its operator are a single legal entity all of the statutory powers would apply, whereas when the SIFMI is a set of arrangements between participating institutions:
  - The power to issue directions, and the power to appoint, replace or remove directors, would apply to the operator; and

- Statutory management would apply to the FMI business of the operator where it could be severed from the rest of their business, and the operator themselves where it could not;
- Where the SIFMI and its operator are based in New Zealand, all of the statutory powers would apply, when they are based in New Zealand and another jurisdiction, the powers would apply in more limited circumstances, and where they are based entirely outside of New Zealand the powers would (with some exceptions) not apply at all.

Appendix 2 sets out in more detail the application of these statutory powers in different circumstances.

## Introduction

### ***Background***

1. A number of financial market infrastructures (FMIs) play a key role in facilitating financial transactions in New Zealand and are crucial to the smooth functioning of the New Zealand financial system. These FMIs are often characterised by significant externalities which might impact on their sound and efficient functioning (in particular, the costs of an FMI failing can heavily impact on a wide range of market participants, and not just the operator of the FMI). They can also operate in highly concentrated markets and sometimes have the characteristics of natural monopolies. The Reserve Bank therefore considers that the oversight of such FMIs should be strengthened to reflect the importance of these infrastructures and the risks they can raise.
2. The Reserve Bank consulted on the oversight of systemically important financial market infrastructures (SIFMIs)<sup>2</sup> in April 2015, proposing to revise the current Designation Regime to provide the Reserve Bank and the Financial Markets Authority (FMA) – the joint regulators – with a range of powers for the oversight of SIFMIs. The proposed powers include the power to set regulatory requirements by via standards, new enforcement and investigative powers, and crisis management powers.
3. The consultation paper released in April 2015 also discussed crisis management situations that could result from either the failure of a SIFMI or a participant. It proposed that the following crisis management powers be provided for:
  - The power to issue directions;
  - The power remove, replace or appoint a director of an operator; and
  - Statutory management.
4. While a large majority of the submitters were supportive of the proposal to provide for crisis management powers, a number of them sought more detail on the proposed crisis management framework, and clarification on how it would apply to FMIs that were structured in different ways. Some also questioned how the proposed framework compares to overseas regimes.

### ***Purpose and structure of this paper***

5. The purpose of this consultation document is to set out our detailed proposals on the design of a crisis management framework for SIFMIs. It is divided into five parts. Specifically:
  - Part 1: Why crisis management powers are necessary;
  - Part 2: Our general approach to thinking about the structure and purpose of crisis management powers for SIFMIs;
  - Part 3: An outline of the basic framework of crisis management powers we are proposing;
  - Part 4: A description of how that framework would apply to SIFMIs in different types of failure situation, and to SIFMIs with different legal structures and levels of presence in New Zealand; and

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<sup>2</sup> [http://rbnz.govt.nz/regulation\\_and\\_supervision/financial-market-infrastructure-oversight/Oversight-of-Designated-Financial-Market-Infrastructures.pdf](http://rbnz.govt.nz/regulation_and_supervision/financial-market-infrastructure-oversight/Oversight-of-Designated-Financial-Market-Infrastructures.pdf)

- Part 5: A detailed description of the design of the specific crisis management powers that we are proposing.

***A note on definitions***

6. A number of terms (such as “joint regulators”, “FMI” and “operator”) are used widely throughout this consultation document. These terms should be taken to have the following meanings:
- “Joint regulators” means the Reserve Bank and the FMA (except in relation to payment systems where it means the Reserve Bank alone);
  - “Joint ministers” means the Ministers of Finance and Commerce (except in relation to payment systems where it means the Minister of Finance alone);
  - “FMI” means a multilateral system among participating institutions, including the operator of the system, used for the purposes of clearing, settling, or recording payments, securities, derivatives or other financial transactions. An FMI includes a payment system, securities settlement system, central securities depository, central counterparty, and trade repository. A multilateral system could be organised as a set of arrangements between participating institutions (as in the case of some payment systems) or as a legal entity (or group of related entities) that participants interact with (as in the case of central counterparties and trade repositories);
  - “Designated FMI” means an FMI that is designated as systemically important under the proposed oversight regime;
  - “Operator” means any person who is legally responsible for carrying out or managing the services provided by the FMI, or maintaining and administering the rules of the FMI. The operator of a systemically important FMI will be named in the Order in Council designating that FMI. An FMI may have more than one operator. Powers that may be exercised in respect of operators may be exercised against all or some of the operators when there are more than one. References to an “operator” in this consultation document should be taken to include all of the operators of an FMI if there are more than one;
  - “Essential services” in relation to an FMI means any services provided by the FMI which if they ceased being provided, would have adverse impacts on the financial system as a whole. Essential services generally relate to the clearing, processing, settlement and reporting of payments, securities and derivatives. They are often described as the plumbing, or wiring, of the financial system. They are essential because if they did not take place, or took place inefficiently, transactions between buyers and sellers may not take place. At worst transactions could freeze or stall before being completed, or become unable to be completed. These failures may have major downstream effect on other financial system participants (for example leading to a chain of defaulted transactions) and become a cause of transaction defaults, unnecessary losses and contagion across the financial system and economy;
  - “Critical service provider” means a provider of services to the FMI that are essential to its ability to provide essential services.

## Why crisis management powers are necessary

7. For FMIs, market forces alone may not always be effective in promoting the maintenance of a sound and efficient financial system.<sup>3</sup> In particular, FMIs are networks that may 1) display high levels of market concentration; 2) produce spillover effects and may create significant negative externalities given their pervasive role in the economy; 3) be owned and therefore heavily influenced by the financial institutions that are also their largest participants; and 4) be prone to coordination issues amongst their operators and participants.
8. Crisis situations (such as the breakdown of a SIFMI) are very rare. However, it is in a crisis situation that negative externalities and spillover effects are likely to be most strongly felt. In particular, the significant externalities that could arise out of the failure of a SIFMI could have impacts across the financial system as a whole, exposing market participants to solvency or liquidity issues, and resulting in a breakdown of day to day transactions that could impose significant costs across the economy.
9. The scale of these impacts makes it important that crisis management powers are in place to deal with these events, and minimise the costs and disruption to the financial system and broader economy.

## General approach to the crisis management framework

10. The current crisis management regimes applying to banks and insurers in New Zealand are in large part based upon three key tools: the power to issue directions to a bank or insurer, the power to appoint or remove directors of a bank or insurer, and the power to place a bank or insurer into statutory management. These powers can only be exercised where certain thresholds are met. Broadly speaking these thresholds are indications of when a crisis situation may be developing, or has already developed.
11. This framework (including statutory management) is mostly compliant with key aspects of the Financial Stability Board's Key Attributes of Effective Resolution Regimes for Financial Institutions ("*Key Attributes*").<sup>4</sup>
12. The application of the *Key Attributes* to FMIs, and the development of tailored resolution regimes for FMIs, are relatively new developments, which have been reflected, amongst other things, by:
  - The FSB reissuing the *Key Attributes* incorporating Guidance on the implementation of the *Key Attributes* for non-bank financial institutions<sup>5</sup>, including an Annex for resolution of FMIs (the Annex on FMI resolution together with the report on FMI recovery published on the same day by CPMI and IOSCO<sup>6</sup> provide a comprehensive set of guidance on recovery and resolution for different kinds of systemically important FMIs); and
  - Various jurisdictions consulting recently on resolution frameworks for FMIs (a summary of the proposed approaches by Hong Kong, Singapore, UK and Australia is provided in the Appendix 1, along with the proposed approach for New Zealand discussed later in this paper).

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<sup>3</sup> See Section 68, Reserve Bank of New Zealand Act 1989.

<sup>4</sup> [http://www.financialstabilityboard.org/wp-content/uploads/r\\_111104cc.pdf?page\\_moved=1htm](http://www.financialstabilityboard.org/wp-content/uploads/r_111104cc.pdf?page_moved=1htm)

<sup>5</sup> [http://www.financialstabilityboard.org/press/pr\\_141015.htm](http://www.financialstabilityboard.org/press/pr_141015.htm)

<sup>6</sup> <http://www.bis.org/cpmi/publ/d121.pdf>

13. Given this context, our starting point is that the crisis management powers for FMIs should, at a high level, be based on the same types of crisis management powers that we currently have for banks and insurers in New Zealand. In particular, we consider that this conclusion is justified by the lack of well-established approaches to FMI resolution frameworks internationally, and the high level consistency between our existing crisis management powers for banks and insurers and the *Key Attributes*.
14. However, we are also conscious of the fact that crisis management for FMIs differs in some very significant ways from crisis management for banks and insurers. Amongst other things:
- FMIs are multilateral systems that may take the form of a set of arrangements between participating institutions, or a separate legal entity that participants interact with. Where the FMI is a set of arrangements between participating institutions, this can create potential legal uncertainty around precisely what the scope of the FMI is;
  - Contractual arrangements between FMIs and participants will set out in detail participants' rights, obligations and remedies, and often address default or failure situations in detail; Respecting these arrangements in a crisis management situation is essential to retaining confidence in the system; and
  - For most FMIs a crisis management situation is as much (or more) likely to be caused by a governance or infrastructure failure than the insolvency of an FMI or its operator. Indeed, many types of FMI do not take on credit risk as principal (for example NZClear, or a trade repository), although others, such as a CCP, do. The greater likelihood of a crisis situation arising out of a governance or infrastructure failure than insolvency changes the degree of importance that may be placed on specific statutory powers in a resolution.
15. These differences mean that the crisis management powers used for banks and insurers cannot be simply transposed to FMIs without significant adaptation.

Q1. Do you agree with our general approach to the design of a crisis management framework for FMIs? Are there other matters we should be considering?

## Outline of the crisis management framework

### *Objectives of the framework*

16. We consider that the ultimate purpose of the crisis management framework should be to ensure the continuity of essential services provided by a SIFMI:
- Until participants can shift to alternative providers; or
  - If there are no alternative providers, on an ongoing basis.
17. The framework should also ensure any failure of a SIFMI is resolved in an orderly manner and does not significantly disrupt the functioning of the financial system. It should not be designed to resolve the affairs of the operator itself, except where this is necessary to ensure the continued provision of essential services by the SIFMI.
18. This broadly aligns with the recommended objectives of a resolution regime for FMIs in the *Key Attributes*.

Q2. Do you agree with the proposed objectives of the crisis management framework? Are

there other objectives we should be considering?

***Two tier approach to the framework***

19. We are proposing a two tier approach to the crisis management framework. The first tier would be comprised of a requirement for operators to have the following plans in place for their SIFMIs:
  - Business continuity plans (to achieve rapid recovery and timely resumption of essential services or the replacement of an operator) ; and
  - Recovery and orderly wind down plans (to respond to financial threats to the continued provision of essential services) including, where relevant, rules that allocate losses caused by a default or failure situation.
20. This has the merit of leveraging off the existing rules and plans that will already be in place for many SIFMIs, and allowing for certain matters (such as loss allocation) to be agreed in advance between participating institutions and operators. It aims to make it less likely that a SIFMI should ever reach the point where it needs to be resolved by resort to statutory crisis management powers.
21. The second tier of the framework would comprise various statutory powers. Specifically:
  - The power to issue directions to the operators of SIFMIs (and possibly participants);
  - The power to appoint and remove directors of an operator of a SIFMI; and
  - Statutory management of an SIFMI.
22. The purpose of the general direction power and the power to appoint or remove directors of the operator is to ensure operators take certain measures to address threats to the soundness and efficiency of their FMIs, and the ability of these FMIs to continue to provide essential services. These threats may arise out of financial risks to the FMI, risks to the infrastructure supporting the FMI, or risks to the management of the FMI.
23. Statutory management is the most intrusive of the proposed powers and would only be exercised when all other practical options had been exhausted. The purpose of the statutory management regime in this context would be to take control of the FMI in order to allow a new operator to run it, or to manage its resolution directly.
24. Where the FMI could be severed from its operator, it would involve shifting the FMI to a separate company established by the statutory manager and placing that company into statutory management. Where the FMI could not be severed from the operator it would involve placing the operator into statutory management until the difficulties faced by the FMI were resolved.
25. With some exceptions, the threshold for using the proposed statutory powers would be that the FMIs' business continuity plan, and recovery and orderly wind down plan, are:
  - Not applicable to the situation; or
  - Not adequate to deal with the situation; or
  - Not being effectively implemented to deal with the situation; or
  - Have failed to resolve the situation.

26. As discussed below, the differing ways that FMIs could be structured, and their differing levels of connection to New Zealand, also mean that not all of these statutory powers would apply to all operators and FMIs.

Q3. Do you agree with the proposed two tier approach to the crisis management framework? If this approach is adopted are there detailed aspects of the framework you would change?

## **Application of the crisis management framework**

27. How the proposed crisis management framework would apply would vary depending upon various factors, including:
- The nature of the crisis situation and the FMIs rules;
  - The structure of the FMI and its operator;
  - The level of presence the FMI and its operator have in New Zealand.
28. How the framework would apply in light of these factors is discussed in more detail below, and is outlined in Appendix 2.

### ***The nature of the crisis situation and the FMIs rules***

29. In theory, a crisis situation could arise out of a number of quite different events. Specifically:
- The failure of an operator or FMI, or the failure of its infrastructure;
  - A participant defaulting on its obligations under the rules of the FMI; or
  - The failure of a critical service provider.

### ***The failure of an operator or FMI***

30. The failure of an operator would arise when an operator was no longer able to fulfil its role as operator (for example, as a result of it becoming insolvent), or was operating the FMI in a manner that was prejudicial to the soundness of the FMI and financial system (for example, was being operated fraudulently).
31. The failure of an FMI would arise if a problem with its infrastructure meant that it could not provide its essential services. Where the FMI was structured as a legal entity it could also arise from the insolvency of the FMI.
32. In all of these cases, the requirements for the FMI to have a business continuity plan, and recovery and orderly wind down plan, would apply to the operator of the FMI. The power to issue directions would also apply to the operator of the FMI, as would the power to appoint or remove directors if the operator is incorporated in New Zealand.
33. Where the FMI is a separate legal entity, statutory management would apply to the FMI (rather than the operator). Where the FMI is a set of arrangements between participating institutions, statutory management would apply to:
- The FMI business that could be separated from its operator and vested in a separate entity at the point it was placed into statutory management; or
  - The operator, where the business of the FMI could not be separated from the operator.

*Participant default*

34. The default of a participant would be dealt with in the first instance under the rules of the FMI (for example, through rules governing the allocation of losses and the suspension of a participant's access to the FMI). Joint regulators' powers in respect of the oversight of rules (which are outside the scope of this consultation document) would be used in part to ensure that the rules were adequate for this purpose.
35. If the failure of a participant were to threaten the ability of the FMI to provide essential services despite the rules that are in place, it would be treated as an FMI failure.

*Critical service provide (CSP) failure*

36. The failure of a CSP would be dealt with in the first instance through the requirement for operators to be satisfied on reasonable grounds that the CSPs of their FMIs comply with the principles based requirements in Annex F of the Principles for Financial Market Infrastructures<sup>7</sup> (in substance, these include a requirement for CSPs to have effective business continuity plans in place to deal with any outage). Where this fails, the FMIs own business continuity plan would be expected to deal with the issue.
37. Where the failure of a CSP threatens the ability of the FMI to provide essential services despite these measures, the event would be treated as an FMI failure.

Q4. If the proposed framework is adopted, do you agree with our description of how it should apply in different crisis situations?

***The legal form of the FMI***

38. In addition to the different events that could result in a crisis situation arising, the crisis management powers also need to be able to deal with FMIs that take two different types of legal form. Specifically:
  - A legal entity or group of related entities (e.g. central counterparties, trade repositories); or
  - A set of arrangements between participating institutions (e.g. many forms of payment system).
39. In both cases, the requirements for the FMI to have a business continuity plan, and recovery and orderly wind down plan, would apply to the operator of the FMI (indeed, the plans may provide for the replacement of the operator). The power to issue directions would also apply to the operator of the FMI, as would the power to appoint or remove directors if the operator was incorporated in New Zealand.
40. Where the FMI is a separate legal entity, statutory management would apply to the FMI (rather than the operator) and possibly related legal entities (for example, any subsidiaries critical to the functioning of the FMI, and any custodians) which together are responsible for the FMI.
41. Where the FMI is a set of arrangements between participating institutions, statutory management would apply to:

<sup>7</sup> <http://www.bis.org/cpmi/publ/d101.htm>

- The business of the FMI when that could be separated from its operator and vested in a separate company at the point it was placed into statutory management; or
- The operator, where the business of the FMI cannot be separated from the operator or where dealing with the operator is sufficient to resolve the difficulties of the FMI.

Q5. If the proposed framework is adopted, do you agree with our description of how it should apply to FMIs with these two basic types of legal form?

***The level of presence the FMI has in New Zealand***

42. Finally, crisis management powers need to be able to deal with FMIs that have different levels of presence in New Zealand. Specifically, an FMI and its operator could be:
- Based in New Zealand;
  - Have a presence in New Zealand and one or more other jurisdictions; or
  - Have no New Zealand presence.

*Where an FMI and its operator are based in New Zealand*

43. All of the proposed crisis management framework would apply to the FMI and its operator (as applicable).

*Where an FMI and its operator have a presence in New Zealand and one or more other jurisdictions*

44. Where the operator has a corporate presence in New Zealand (e.g. company registration, physical infrastructure, assets and staff), the requirements around the FMI having to have a business continuity plan, and recovery and orderly wind down plan, would apply to the operator. The power to issue directions would also apply to the operator of the FMI (as would the power to appoint or remove directors if the New Zealand presence of the operator was incorporated here). However, in these cases the power would be exercised only after consideration of how the operator is regulated in the other jurisdictions that it operates in.
45. Statutory management of the FMI could only apply to the New Zealand based FMI business of the operator when:
- That was a separate legal entity, or the FMI could be separated from the operator and vested in a separate company which could be placed into statutory management; and
  - That would enable the continuation of essential functions in New Zealand.

*Where the FMI and its operator have no New Zealand presence*

46. The requirement to have a business continuity plan, and recovery and orderly wind down plan, would continue to apply to the operator in these circumstances. We would anticipate that the required contents of these plans would closely align with the approach taken in the FMI's home jurisdiction. However, the other proposed crisis management powers would generally not apply in this situation.

47. Crisis management in respect of these FMIs would largely mean supporting the resolution of the FMI by the home country and/or at an international level. In practise, this requires the power to gather information from New Zealand based participants of a designated FMI (which is included in our proposed oversight regime but is outside the scope of this consultation document) and the power to share information with overseas regulators.
48. In respect of payment systems, the power to share information with overseas regulators is provided for at present under section 156G of the Reserve Bank of New Zealand Act 1989 (RBNZ Act), and in respect of settlement systems it is provided in sections 156ZN of the RBNZ Act. More specifically, these sections state that information obtained under the relevant parts of the RBNZ Act must not be published or disclosed to a third party except in specified circumstances. One of these circumstances is when:
- “The publication or disclosure of the information or data is to any central bank, authority, or body in any other country that performs functions and duties that correspond with, or are similar to, those conferred on the [Reserve Bank or joint regulators] under [Part 5B or Part 5C], and the [Reserve Bank or joint regulators] are satisfied that the information or data will be used by that central bank, authority, or body for the purpose of performing those functions or duties”
49. These provisions also state that information or data may only be disclosed or published under these sections where the Reserve Bank (under section 156G) or joint regulators (under section 156ZN) are satisfied that satisfactory provision exists to protect the confidentiality of that information or data.
50. We propose to simply carry these rules across to the new legislation rather than design separate information sharing powers for these purposes.
51. We note that in addition to the power to gather information and share it with overseas regulators in this situation, there might occasionally be a need for joint regulators to have the power to direct participants of an FMI in order to support the resolution of the FMI by the home country and/or at an international level. The possibility of a power to direct participants is discussed in paragraphs 81-84.

Q6. If the proposed framework is adopted, do you agree with our description of how it should apply to FMIs with different levels of New Zealand presence?

***Should the framework apply to “associated entities” of FMIs?***

52. We are interested in submitters’ views on whether the structure of some FMIs may mean that there could be entities related to an FMI that were not critical service providers, and would not come within the definition of “FMI” or “operator”, but which were nonetheless essential to the operation of an FMI and its ability to provide essential services.
53. If such entities might exist, we would also welcome views on whether they should be subject to the general direction powers and statutory management regime being proposed.

Q7. Are there potentially “associated entities” of FMIs that are not operators or critical service providers, but are nonetheless essential to the operation of an FMI and its ability to

provide essential services?

## Design of specific crisis management powers

### ***Business continuity, recovery and resolution plans***

*What are business continuity plans, and recovery and orderly wind down plans?*

54. In summary, we see the purposes of business continuity plans as being to set out how the FMI will address non-financial matters that may threaten its ongoing provision of essential services. In particular, how it will achieve the rapid recovery and timely resumption of those services or, if necessary, the replacement of an operator.
55. By contrast, the purpose of recovery and orderly wind down plans would be to set out how the FMI will address threats to its financial ability to continue to provide essential services and the process of winding down the operation of the FMI should it be unable to continue for any reason. As stated by IOSCO:<sup>8</sup>

*An FMI should have a set of recovery tools that is comprehensive and effective in allowing the FMI to, where relevant, allocate any uncovered losses and cover liquidity shortfalls. The set of tools should also include plausible means of addressing unbalanced positions and replenishing financial resources, including the FMI's own capital, in order to continue to provide critical services. Each tool should be effective in the sense of being timely, reliable and having a strong legal basis. The tools should be transparent and designed to allow those who would bear losses and liquidity shortfalls to measure manage and control their potential exposure. The tools should create appropriate incentives for the FMI's owners, participants and other relevant stakeholders to control the amount of risk that they bring to or incur in the system, monitor the FMI's risk-taking and risk-management activities, and assist in the FMI's default management process. The tools should also be designed to minimise the negative impact on direct and indirect participants and the financial system more broadly.*

56. We would expect that these plans would be standalone documents, but that they would be operationalised in a variety of ways, including through specific provisions in the rules of the FMI in appropriate cases. For example, to the extent that the FMI failure creates losses, the rules of the FMI should provide for the allocation of losses to members. Example of such rules are the payment waterfalls featured in the rules of CCPs and rules for the pro-rating of losses across security account holders that are typically a feature of central securities depositories (allocating losses in the rules provides ex ante certainty for participants and regulators, limiting the need for such matters to be resolved judicially).

*How the power to require FMIs to have these plans would work*

57. Our proposed oversight regime includes the power for joint regulators to prescribe minimum requirements for designated FMIs via standards. We propose that this power be expanded so that standards may require designated FMIs to have business continuity plans, and recovery and orderly wind down plans, in place for the FMIs that they are responsible for.

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<sup>8</sup> <http://www.bis.org/cpmi/publ/d121.htm>

58. As we have discussed previously,<sup>9</sup> the standard setting power would be subject to a number of procedural safeguards. Specifically:
- Before making, amending or revoking a standard, joint regulators would be required to consult with affected entities, and take into account submissions received;
  - Standards would be legislative instruments for the purposes of the Legislation Act 2012, which means that they would be subject to scrutiny by the Regulations Review Committee and could be disallowed by Parliament;
  - Joint regulators would be required to notify standards in the Gazette, make standards publicly available, and make standards available for purchase at a reasonable price on request; and
  - Joint regulators would be required to assess the regulatory impacts associated with applying particular standards to newly designated FMIs, making new standards, or amending standards that are already in place (unless the amendment to the standard was of a minor or technical nature).
59. Failure to comply with a standards could trigger various sanctions (including offences and/or pecuniary penalties), or result in the exercise of other powers under the regime (such as the power to issue directions).

Q8. Do you agree with the proposed power to require operators to ensure that their FMIs have business continuity plans, and recovery and orderly wind down plans?

*Proposed requirements for the content of these plans*

60. We do not propose that the required content of business continuity plans, and recovery and orderly wind down plans, be prescribed in a high level of detail. This is not likely to be practicable given the diverse functions of FMIs and ways they are structured.
61. Instead we think it would be appropriate to use the standard setting power we are proposing as a broader part of the oversight regime to set out certain objectives that these plans must achieve and/or matters that they must address.
62. For example, the standard could require that business continuity plans:
- Identify the FMI's essential services (especially if the operator performs other functions as well);
  - Identify events that pose a significant risk of disrupting the FMI's operations including events that could cause widespread or major disruption (such as natural disasters);
  - Include objectives - what constitutes an acceptable degree of recovery and within what timeframe;
  - Include policies and procedures designed to respond to the identified risk events;
  - Include clearly defined event management procedures covering the invocation of contingency arrangements and the return to normal operations; and

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<sup>9</sup> See page 10 of the consultation document Oversight of Designated Financial Market Infrastructures at: <http://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/financial-market-infrastructure-oversight/oversight-of-designated-financial-market-infrastructures.pdf?la=en>

- Include arrangements for the regular testing and review/update of the plan.
63. A similar approach could be taken to recovery and orderly wind down plans, which could be required to:
- Include a set of recovery tools that is comprehensive and effective (in terms of reliability, timeliness and legal rigour). The tools should be transparent and allow those who would bear losses and liquidity shortfalls to measure, manage and control their potential exposure. The set of tools should also create appropriate incentives and be designed to minimise negative impacts. Where appropriate they should also allocate uncovered losses and liquidity shortfalls and, to the extent practicable, ensure other recovery tools are established ex ante and are enforceable;
  - Identify the FMI's essential services;
  - Identify stress scenarios that may prevent the FMI continuing to provide those services as a going concern (those scenarios would include credit losses or liquidity shortfalls caused by such things as participant default, general business losses, the realisation of investment losses, the failure of a third party (such as a liquidity provider) to perform a critical function, the failure of related entities or failures in linked FMIs);
  - Include clearly defined event management procedures (who is responsible for doing what and when);
  - Include procedures to allow for a change of operator;
  - Include actions that could be taken to achieve an orderly wind down of the business should it become apparent that the recovery tools are not going to allow the FMI to continue operating and replacing the operator is not viable;
  - Include mechanisms for allocating/recovering the costs of resolving the FMI from participants; and
  - Include arrangements for the regular testing and review/update of the plan.
64. If this approach is adopted we would consult further on the precise content of any standard setting out these matters.

Q9. Do you agree with our proposed lists of matters that must be included in business continuity plans, and recovery and orderly wind down plans? Are there matters that you would add to, or remove from, these lists?

*The role of joint regulators in assessing these plans*

65. We do not propose that joint regulators formally approve FMI's business continuity plans, and recovery and orderly wind down plans.<sup>10</sup> However, we consider that joint regulators can play an important role in respect of these plans by:
- Monitoring whether plans contain all of the basic content required; and
  - Monitoring requirements for regular testing and reviews of these plans (and the steps taken as a result).

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<sup>10</sup> In particular, we do not consider that a model where joint regulators formally approve these plans would be consistent with the requirements discussed below for joint regulators to only exercise certain statutory powers where they consider that these plans are not adequate to deal with situation.

66. To this end, we would expect that joint regulators would require operators to provide them with the most up to date versions of these plans for their FMIs.
67. We also consider that joint regulators should have the power to direct changes to these plans in cases where they are clearly inadequate. This power would be reflected in the broader direction powers available to joint regulators.

Q10. Do you agree with the proposed role of joint regulators in assessing business continuity plans, and recovery and orderly wind down plans? If not, what role (if any) do you consider joint regulators should have in assessing these plans?

### ***Direction powers***

#### *General direction powers*

68. This power would apply to operators based in New Zealand or with a New Zealand presence, and to activities occurring in New Zealand.
69. These directions would be issued by joint regulators with the consent of joint Ministers. The principle design issues here are the circumstances in which a direction could be given and the action that a direction could require an operator to take.
70. We propose that a direction could be given when the joint regulators have reasonable grounds to believe that:
- The operator is insolvent, likely to become insolvent, or otherwise unable to perform its role as operator; or
  - The business of the operator and/or FMI are being conducted in a manner prejudicial to the soundness of the FMI and the financial system; or
  - The operator has acted, or is acting, fraudulently or recklessly; or
  - The business continuity plans, and recovery and orderly wind down plans, for the FMIs the operator is responsible for fail to achieve the required objectives or include the required matters; or
  - The operator has been involved in serious or repeated breaches of obligations imposed by, or under, the Act; or
  - It is necessary to issue the direction to facilitate the resolution in its home jurisdiction of an FMI that is based in a foreign jurisdiction but has a corporate presence in New Zealand.
71. Before issuing a direction under the first two of these grounds (actual or potential insolvency, or business being carried on in a manner that is prejudicial to the soundness of the financial system), joint regulators must also have reasonable grounds to believe that the FMIs business continuity, recovery and resolution plans are:
- Not applicable to the situation giving rise to the direction; or
  - Not adequate to deal with the situation giving rise to the direction; or
  - Are not being effectively implemented to deal with the situation giving rise to the direction; or
  - Have failed to resolve the situation giving rise to the direction.

72. Directions could be given that require the operator to:
- Consult with joint regulators immediately and/or from time to time, about the circumstances of the operator and the methods of resolving any difficulties facing the operator or the FMI;<sup>11</sup> or
  - In accordance with the direction, carry on, or cease to carry on, any functions or business that creates a risk to the sound and efficient operation of the FMI; or
  - Take the action that is specified in the direction to address a breach of any obligation that has been imposed; or
  - Take the action that is specified in the direction to address any circumstances that create a risk to the sound and efficient functioning of the FMI, or the operator's ability to effectively carry out the role of operator; or
  - Ensure that any officer or employee of the operator ceases to take part in the management or operation of the FMI except with the permission of the joint regulators and so far as that permission extends; or
  - Amend in a specified manner the business continuity plan, or recovery and orderly wind down plan, of an FMI the operator is responsible for; or
  - Remove, replace or appoint a director of an operator; or
  - Prevent a person from being involved in the management of the operator and/or FMI.
73. We consider it is important that the proposed direction power can only be used in potential "failure" or "crisis" type situations given its potentially intrusive nature. Where problems arise in other circumstances, it is intended that these be addressed through "business as usual" type oversight powers (such as the power for joint regulators to issue standards).
74. We note that directions that require that the operator to ensure that any officer or employee cease to take part in the management or conduct of the operator and/or FMI will have to be subject to a provision like in section 113B(5) of the RBNZ Act (which provides that the direction power applies regardless of any rule of law to the contrary).
75. Directors should also be protected from liability under any other enactment or rule of law where they comply, in good faith, with the terms of the direction. The requirement to act in good faith is important here in that it stops directors from taking improper advantage of having to comply with any direction.
76. Failure to comply with a direction would be an offence and/or result in a pecuniary penalty, and be a ground for recommending the statutory management of the FMI or the operator (as the case may be).

Q11. Do you agree with the proposed direction power and its scope? Are there any changes you consider should be made to this power?

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<sup>11</sup> We note that a requirement to consult with joint regulators is different from an obligation to provide information to joint regulators (i.e. the first means notifying joint regulators of an issue and discussing it with them before taking an action to address that issue, whereas the second means simply providing joint regulators with information). It is for this reason that we propose to keep the two requirements separate, and include a requirement for Ministerial consent for the issuing of a direction requiring consultation with joint regulators.

*Power to appoint or remove directors*

77. This power would only apply to operators that are incorporated in New Zealand. The purpose of this power is to enable regulators to deal with a situation where the FMI's or operator's management is the source of problems with the FMI or creating impediments to the recovery or resolution of the FMI.
78. Where the threshold in paragraphs 70 and 71 are met, and joint regulators have reasonable grounds to believe that it is necessary to remove, replace, or appoint a director of the operator, joint regulators may (with the consent of joint ministers):
- Remove or replace a director;
  - Appoint any person as a director
79. This power should be exercised by joint regulators giving notice in writing to the person concerned, the relevant operator (and where applicable) the Registrar of Companies.
80. The power would need to be subject to a provision like in section 113B(5) of the RBNZ Act (which provides that the power applies regardless of any rule of law to the contrary).

Q12. Do you agree with the proposed power to appoint or remove directors? Are there any changes you consider should be made to this power?

*A power to direct participants?*

81. It has been suggested that the regime should also include a limited power to direct participants in order to facilitate the resolution of an FMI. We do not have strong views on this at present, but are considering a very tightly constrained power to direct participants for this purpose. Such a power could be used where:
- The FMI is a legal entity and has become insolvent; or
  - A failure of the infrastructure of the FMI has resulted in it ceasing to provide essential services; or
  - The operator of the FMI is no longer able to effectively carry out their functions as operator.
82. If this approach were adopted, a direction to participants could require them to:
- Comply with their obligations under the rules of the FMI; or
  - Where the rules of the FMI do not address the situation in question, take any action that is reasonable and necessary to facilitate the continued provision of essential services by the FMI.
83. As with ordinary directions, these directions to participants could only be issued with the consent of joint Ministers.
84. We are interested in submitters views on whether a power to direct participants should be provided for, and if so, the types of circumstances in which it could be used.

Q13. Do you think joint regulators should have a power to direct participants in a limited range of circumstances? If so, do you agree with our description of how this power could be

framed, and in what circumstances do you consider it could be used?

## ***Statutory management***

### *Introduction*

85. The basic purpose of the statutory management regime would be to ensure the continuity of the essential services provided by the FMI by providing the power to:
- Appoint a person to take over the operation of the FMI where the current operator is unwilling or unable to do so to the required level; and
  - Having that person resolve the FMI business by transferring it in whole or in part to a new operator, and by carrying out the orderly wind down of those parts of the FMI business for which no new operator can be found.
86. As discussed below, it would apply only where business continuity, recovery, and resolution plans are not implemented, fail or otherwise are inadequate.

### *Application of statutory management to FMIs and their operators*

87. Statutory management could apply to three different types of entity or arrangement:
- An FMI that is a separate legal entity;
  - An FMI is an unincorporated set of arrangements;
  - An FMI that is a part of the same legal entity as its operator
  - An operator that has been placed into statutory management as it cannot be separated from its FMI.
88. To operationalise the second and third of these scenarios, we consider that it would be necessary to vest those parts of the operator's business associated with running the FMI into a separate company which would then be managed by a statutory manager for the purposes of operating or resolving the FMI.
89. In practice, this would require that the relevant FMI business of the operator that will be placed in statutory management be pre-positioned in such a way that it is severable from the rest of their business. Operator's would be encouraged to provide some structural separation of their FMI operations from any other lines of business (indeed, the potential for other business to impact on an FMI business is a matter regulators would be concerned with). However, it is not clear that this would be sufficient to provide the necessary severability.
90. We would welcome views on how practical it would be to sever the FMI business from its operator in this situation, and the likely level of cost involved in pre-positioning this severability where it is not already in place.

Q14. Do you agree with our description of how statutory management could be applied to an FMI or its operator? If not, how do you consider that it could be applied to an FMI and its operator?

Q15. How practical would it be to sever the FMI business of the operator from the rest of the operators business? What costs might be involved in pre-positioning the ability to do this?

### *Trigger for statutory management*

91. An FMI or its operator would be placed into statutory management via an Order in Council made on the advice of joint Ministers given in accordance with joint regulators.
92. Joint regulators could only recommend that such an Order in Council be made where joint regulators have reasonable grounds to believe that:
- The operator is insolvent, likely to become insolvent, or otherwise unable to perform its role as operator; or
  - The business of the operator and/or FMI are being conducted in a manner prejudicial to the soundness of the FMI and the financial system; or
  - The operator has acted, or is acting, fraudulently or recklessly; or
  - The operator has failed to comply with a direction; or
  - The business continuity plans, and recovery and orderly wind down plans, for the FMIs the operator is responsible for fail to address relevant and material risks that the FMI is subject to;
  - The operator has been involved in serious or repeated breaches of obligations imposed by, or under, the Act; or
  - It is necessary to recommend that the New Zealand based component of the FMI be placed into statutory management in order to facilitate its resolution in its home jurisdiction.
93. Before recommending statutory management under the first two of these grounds (actual or potential insolvency, or business being carried on in a manner that is prejudicial to the soundness of the financial system), joint regulators must also have reasonable grounds to believe that the FMIs business continuity, recovery and resolution plans are:
- Not applicable to the situation giving rise to the recommendation; or
  - Not adequate to deal with the situation giving rise to the recommendation; or
  - Are not being effectively implemented to deal with the situation giving rise to the recommendation; or
  - Have failed to resolve the situation giving rise to the recommendation.
94. The relevant operator must be notified of the decision to trigger statutory management and the grounds for that decision.

Q16. Do you agree with our proposed trigger for when joint regulators could recommend statutory management? If not, what changes would you make to this trigger?

*Objective of the statutory management, considerations the SM must have regard to when exercising their powers*

95. We are proposing that the Act establishing the broader oversight regime will also provide that:
- The Reserve Bank must use its powers under the Act for the purposes of:
    - Promoting the maintenance of a sound and efficient financial system; or
    - Avoiding significant damage to the financial system that could result from the failure of a financial market infrastructure or the failure of a participant in a financial market infrastructure; and

- The Financial Markets Authority must use its powers under the Act for the purposes of:
  - Promoting the integrity and effectiveness of financial market infrastructures and related markets in New Zealand; and
  - Enhancing the confidence of investors and other market participants in financial market infrastructures and related markets in New Zealand.

96. These purposes also set out, at a high level, the roles of joint regulators in a statutory management.<sup>12</sup> This approach also broadly reflects how the Reserve Bank's objectives in the resolution of a failed bank are formulated.<sup>13</sup> For this reason we are not currently proposing to specify more specific resolution objectives in legislation.

97. In respect of the statutory manager themselves, both the RBNZ Act and the Corporations (Investigations and Management) Act (CIMA) provide for a list of matters that the statutory manager must have regard to when exercising their powers. In guiding the statutory manager in how to carry out their role, we propose to adopt this approach here rather than setting out specific objectives for the statutory manager. More specifically, we propose that in exercising their powers in legislation, the statutory manager must have regard to the following matters:

- a) The need to maintain public confidence in the financial system;
- b) The need to avoid significant damage to the financial system;
- c) The need to ensure the continuity of essential services provided by the FMI;
- d) To the extent not inconsistent with a), b), and c) the need to resolve as quickly as possible the difficulties of the designated FMI;
- e) To the extent not inconsistent with a), b), c) and d) respecting the rules of the FMI, and preserving the position of creditors and maintaining the ranking of creditors;<sup>14</sup>
- f) The advice of joint regulators.

Q17. Do you agree with the proposed objectives and considerations that would influence the exercise of powers in a statutory management by the joint regulators and the statutory manager? Are there any changes you consider should be made to these objectives and considerations?

#### *Core powers of the statutory manager*

98. The core legislative provisions establishing the statutory manager's capacity and powers would be based upon sections 128-130 of the RBNZ Act, and would provide that:

- Management of the entity in statutory management vests in the statutory manager;

<sup>12</sup> Particularly the Reserve Bank's objective of avoiding significant damage to the financial system that could result from the failure of a financial market infrastructure or a participant in a financial market infrastructure, and the FMA's objectives of enhancing the confidence of investors and other market participants in Financial Market Infrastructures and related markets.

<sup>13</sup> Under the statutory management regime for banks in the Reserve Bank of New Zealand Act 1989, the Reserve Bank must exercise its powers for the purposes of promoting the maintenance of a sound and efficient financial system or avoiding significant damage to the financial system that could result from the failure of a registered bank (see section 68, Reserve Bank of New Zealand Act 1989)

<sup>14</sup> We note that creditors in this context includes any participants of the FMI that may also be creditors of the FMI under its rules.

- The statutory manager has, and may exercise:
  - Rights the entity has under any contracts;
  - The powers of shareholders in an AGM; and
  - The powers of the board of directors;
- The statutory manager is empowered to carry on the entity in statutory management.

99. The purpose of these powers would be to ensure the statutory manager has the ability to carry out the function of operator, exercise powers assigned to the operator under the rules, and (if the operator is placed into statutory management as it cannot be severed from the FMI) take any action on behalf of the operator to resolve its difficulties as they affect the functioning of the FMI.

Q18. Do you agree with the core powers of the statutory manager that are being proposed? Are there any changes you consider should be made to these powers?

*The role of a moratorium and the design of resolution powers*

100. In considering the role of any moratorium, and the appropriate resolution powers for the statutory manager, it is important to reiterate that the entity in statutory management could be:
- An FMI that is a separate legal entity;
  - An FMI that is an unincorporated set of arrangements, or part of the same legal entity as its operator, but which has been vested in a separate company established to hold that FMI business; or
  - An operator that has been placed into statutory management as it cannot be separated from its FMI.
101. The moratorium which would apply to debts and obligations of the entity in statutory management, except those which are owed to participants of the FMI acting in their role as participants (a moratorium in that case would defeat the purpose of ensuring the continuity of essential services, as it may stop transactions taking place using the FMI).
102. Only in the third of those cases would the non-FMI business of the operator be included in the statutory management. In every other case liabilities are unlikely to be owed to any parties except participants and providers of essential services to the FMI.
103. However, in this third case, the moratorium would provide the statutory manager with “breathing space” to allow it to focus on continuing the business of the operator for a sufficient time to resolve the difficulties of the FMI.
104. As a consequence of this moratorium, the statutory manager would also have the power to:
- Suspend payment of money owing (as in section 127, RBNZ Act);

- Pay creditors and compromise claims (as in section 131, RBNZ Act)<sup>15</sup>
105. The additional powers that we consider the statutory manager needs to resolve the FMI in these three scenarios are:
- The ability to sell or transfer the FMI business in whole or in part to a new operator; and
  - The power to conduct the orderly wind down of the FMI business where no replacement operator can be found.
106. We propose that these powers be given effect by a general provision which enables the statutory manager to sell or otherwise transfer to a third party the whole or part of the business of the entity in statutory management. The one exception to this power would be that when the operator is the entity in statutory management (because it cannot be severed from the FMI) it could only be used in respect of those parts of the operators business that are necessary to operate the FMI. It would also be subject to the constraint that where the sale or transfer was of the whole or a substantial part of the business of the entity in statutory management it requires the consent of joint regulators given with the approval of joint Ministers.
107. We are not proposing specific statutory powers for unilaterally writing down claims, varying margins, or exercising similar powers. The expectation is that such actions could only be taken under the rules of the FMI.
108. We also note that when the resolution is complete, the entity in statutory management may simply be a shell with little or no assets or liabilities. In these cases the statutory manager may exercise the rights of shareholders in an AGM and apply to place the entity into liquidation or deregister it. It is not expected the statutory manager will carry out the liquidation.
109. In circumstances where the operator is the entity in statutory management (because it cannot be severed from the FMI), the entity will have non-FMI related assets and liabilities after the FMI has been resolved. In these cases the statutory management will be lifted and control of the operator will revert to its original owners and management, or the operator will be placed into liquidation or some other form of resolution arrangement.

Q19. Do you agree with the proposed moratorium and the resolution powers? Are there any changes you consider should be made to these?

### *Miscellaneous matters*

#### i Direction power

110. We consider that joint regulators should have the power to direct the statutory manager. This power would be based upon section 120 of the RBNZ Act. As a result it

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<sup>15</sup> We note that, in conjunction with the hierarchy of matters that we propose that the statutory manager must have regard to in exercising their powers, this may theoretically provide a legal basis for the statutory manager to alter the position of creditors on financial stability grounds. However, we consider that it is extremely unlikely that this would ever be done. Partly this is because it is fundamental to the model that we are proposing that the loss allocation rules of the FMI be respected, and partly because unless it is unavoidable, the intention is that only the FMI business of the operator would be placed into statutory management (i.e. that any non-FMI business of the operator would be outside the scope of the statutory management).

would not restrict the nature and scope of potential directions that may be issued. This is an important power for joint regulators to have in overseeing the conduct of the statutory management, in that it allows joint regulators to intervene directly on systemic issues and place limitations on the statutory manager's discretion.

111. To provide additional flexibility in the statutory management model, joint regulators would also have the power to issue guidelines to the statutory manager on their conduct of the statutory management. While statutory provisions are not necessary to provide joint regulators with the power to issues guidelines, making this power explicit in the legislation would reinforce that the fact that joint regulators may have an active role in overseeing the Statutory Manager and setting parameters around their conduct of the statutory management.

ii Requirement on the statutory manager to consult with joint regulators

112. We consider that the statutory manager will be required to consult with joint regulators in relation to any matters set out by joint regulators and on any frequency specified by joint regulators

iii. Committee structures

113. It is not proposed that any intra-government committee structures be provided for in the legislation at this stage, although they may be established without legislative backing if circumstances make it appropriate.

iv. Retirement or removal of the statutory manager

114. The statutory manager may be removed by joint Ministers acting on the recommendation of joint regulators where the statutory manager is unable to perform the functions of the office, is bankrupt, or otherwise has failed to perform their duties satisfactorily (which with minor modifications reflects the grounds for removing a statutory manager under the RBNZ Act.

v. Statutory manager's power to apply to the High Court for directions

115. The statutory manager would have the power to apply to the Court for directions on any matters relating to the administration of statutory management. It is intended that this would be a power used to either provide legal certainty about particular matters and would be used following the statutory manager giving notice to, and consulting with, joint regulators.

vi. Interface with the Corporations (Investigations and Management) Act 1989

116. Given the FMA's joint powers with the Reserve Bank in respect of all designated FMIs (except payment systems) and their operators, we do not consider that that the statutory management regime and other powers in the Corporations (Investigations and Management) Act 1989 (CIMA) should apply to these FMIs.

117. However, given that the Reserve Bank would be the single regulator of payment systems under this framework, we do not consider that it would be appropriate to exclude designated payment systems and their operators from the scope of CIMA.

118. Instead, we propose that the FMA be required to consult with the Reserve Bank before exercising any powers under CIMA in relation to a designated payment system or its operator. This is consistent with:

- The approach taken to banks and insurers; and
- The view that in a crisis management event, sector specific crisis management powers are usually expected to take precedence over the generic powers in CIMA.

Q20. Do you agree with our proposals relating to miscellaneous matters connected to the proposed statutory management regime? Are there any changes you consider should be made to these proposals?

## Conclusion

119. The purpose of this consultation document has been to set out the detailed of the proposed crisis management regime for SIFMIs, which is the final component of our proposals for an enhanced oversight regime for these Infrastructures..
120. In designing these crisis management powers, we have drawn from the existing crisis management powers in place for banks and insurers, and international standards and guidelines. We consider that the two tier approach we are proposing is an appropriate model, and has significant benefits in leveraging off the bespoke rules adopted by individual FMIs, especially in respect of the allocation of losses amongst operators and participants in a failure situation. At the same time, the proposed statutory powers would enable joint regulators to step in to manage systemic risks and ensure the continuity of essential services in cases where SIFMI's business continuity plans, and recovery and orderly wind down plans, are insufficient.
121. We remain conscious of the fact that how the proposed crisis management framework is applied would, in some cases, be heavily dependent upon the specific circumstances of the SIFMI (which adds considerable complexity to the design of the framework). Crisis management frameworks for FMIs are also rapidly evolving internationally, without many well established models being in place in other jurisdictions. Given this context, submitters' views on the proposed framework will be especially valuable, and we would encourage submitters to provide detailed, free and frank, submissions on the proposals in this consultation document.

## Appendix 1: Summary of proposed international approaches, and comparison with the Key Attributes and FMI Annex

|   | Key Attributes  | FMI Annex                                  | HK  | Singapore   | UK   | Australia   | NZ   |
|---|---|--|---|---|--|---|--|
| 1 | Scope   | Scope                                      | Cross-sector; Authorised institutions, licensed corporations, insurers, FMIs, recognised exchange companies | Financial institution incl. banks, insurers, FMIs, approved exchanges   | CCPs   | Clearing + Settlement (CS) facilities; TRs  | Designated FMIs  |
| 2 | Resolution Authority  | Resolution Authority                       | Various...plus a lead resolution authority  | Monetary Authority of Singapore   | BOE - CCPs   | RBA – CS facilities<br>ASIC – TRs   | RB - Designated PS<br>RBNZ + FMA - all others  |
| 3 | Resolution Powers   | Resolution Powers                          | 1) Bail in<br>2) bridge institution<br>3) directions  | Transfer to bridge;<br><br>No bail in proposed yet for FMIs   | BEO can resolve a failing CCP through the transfer of property to either a private sector purchaser or a bridge CCP owned by the Bank, or to transfer ownership of a CCP to any person | Statutory management;<br>Issue directions<br>Moratorium on payments to general creditors;<br>Transfer of operation to a 3rd-party bridge institution; | Statutory management incl. transfer to 3 <sup>rd</sup> party;<br>Issue directions;<br>Moratorium on payments to general creditors;<br>Remove and appoint directors |
| 4 | Set-off, netting, collateralisation, segregation of client assets | Temporary Stay on early termination rights | Temporary stay on early termination rights; protecting set-off, netting                                     | Temporary stay on early termination rights of financial contracts up to 2 business days, also can be longer;<br>Suspend termination rights of non-financial contracts |  | Temporary Stay on early termination rights (up to 48 hours)   | No proposal at present   |
| 5 | Safeguards  | safeguards                                 | No creditor worse off   | Safe guards for temporary stay;<br>Respect hierarchy of claims in liquidation, equal treatment of creditors of same class; creditor                                   |  | Respect of creditor hierarchy but can depart;<br>No creditor worse off (NCWOL) applied<br>Ex-post compensation  | No new proposal at present (in line with our other crisis management regimes)  |

|   | Key Attributes  | FMI Annex                 | HK  | Singapore  | UK | Australia  | NZ  |
|---|---|---------------------------|---|--|----|--|---|
|   |   |                           |   | compensation framework   |    | mechanism<br>Explicit safeguards to ensure the integrity of netting and collateral arrangements would be preserved in the event of any transfer  |   |
| 6 | Funding of firms in resolution                          | Funding of FMI resolution | Arrangements to recover excess costs of resolution on an ex post basis  | Ex post recovery mechanism for funding of resolution measures (levies through direct and indirect participants)                                    |    | Appropriate measures to provide temporary funding to facilitate/implement resolution plans; the funding can be recovered<br>For CCPs, RBA can allocate a residual loss in a manner consistent with the allocation of losses in insolvency  | To be dealt with in the rules of FMIs where appropriate.  |
| 7 | Legal framework conditions for cross-border cooperation | Cross-border cooperation  | Statutory recognition framework enabling resolution authority to recognise all or part of a foreign resolution action | Monetary Authority of Singapore can already take supportive measures to implement / support resolution measures taken by a foreign home authority. |    | No substantial change is proposed as current legal framework doesn't trigger automatic action, discriminate creditors on basis of nationality or location; resolution authority has powers to support resolution by foreign authority.<br>Might need to provide Australia authority the right to prevent an application from being made to the court | This will be implemented via our supervisory approach to the sector rather than in legislation. |
| 8 | Crisis  | Cooperation               |   |  |    | No specific actions  | No specific proposal  |

|    | Key Attributes   | FMI Annex  | HK  | Singapore   | UK  | Australia   | NZ   |
|----|--|--|---|---|---|---|--|
|    | management Group   | coordination, information sharing                |   |   |   | proposed;<br>Not fully developed in most jurisdictions yet; might not need change to legislation  |  |
| 9  | Institution-specific cross-border cooperation agreements | Cooperation coordination and information sharing | Legislation will establish info sharing gateways  | No specific proposal  |   | Power for resolution authorities to direct how Australian-based assets, liabilities and operations of an overseas CS facility licenses in the event that overseas authority has no regard to Australian interests                 | Info gathering power and info sharing power are proposed, and possibly the power to direct NZ participants |
| 10 | Resolvability assessments                                | Resolvability assessment                         | Further conditions required which may vary across sectors – likely Code of practice             | RRPs would be compulsory for SMGs, and contravention is an offence  |   | No specific proposals made; detailed requirements to support resolvability assessments will be set following implementation of FMI resolution framework   | No specific proposals at this stage  |
| 11 | Recovery and resolution planning                         | Recovery and resolution planning for FMI         | Further considerations – a proportionate approach will be adopted – likely via Code of Practice | Require formulation and development of RRPs by the board; a failure to discharge would constitute an offence. Technical details on this would be set out in supporting regulation | All supervised FMIs in UK now maintain recovery plans | RBA already requires CS facilities to organise their operations to support potential resolution actions. RBA will review this annually and detailed requirements will be set following implementation of FMI resolution framework | FMI operators would be required to prepare recovery plans  |
| 12 | Access to info   | Access to  | Legislation to empower  | No specific proposal  |   | No action required to   | Carry over the info  |

|  | Key Attributes   | FMI Annex             | HK                       | Singapore | UK | Australia   | NZ                                  |
|--|------------------|-----------------------|--------------------------|-----------|----|---|-------------------------------------|
|  | and info sharing | info and info sharing | broad info request power |           |    | change ASIC or RBA's ability to share information with foreign authorities<br>Proposed that a material adverse change in cooperation or info-sharing arrangements with home regulator be a ground for license suspension  | sharing clauses in current RBNZ Act |
|  | Other            |                       |                          |           |    | Enhance direction powers:<br>RBA can issue directions;<br>ASIC/RBA can issue recovery and resolution directions, incl. removal of directors/senior management<br>Direction power extend to related entities that provide critical services or funding to an FMI<br>Strengthen sanctions for non-compliance with a direction |                                     |

- Hong Kong – Completed a second consultation April 2015, published responses, intend to submit a Bill by end of 2015 – covering cross-sector
- Australia – Consultation was February 2015, response published November 2015. Draft legislation would be consulted.
- UK – Consulted in 2012; UK recognised payment systems and securities settlement systems have now put in place recovery plans which aim to ensure the ongoing provision of critical services should their operating companies suffer financial distress.

Secondary legislation to extend the UK's Specialist Resolution Regime to cover UK CCPs came into effect on 1 August 2014, which gives powers to the Bank of England to resolve a failing CCP through the transfer of property to either a private sector purchaser or a bridge CCP owned by the Bank, or to transfer ownership of a CCP to any person.

A Special Administration Regime for recognised payment systems, operators of SSS and firms which have been designated as their CSPs was also established by the Financial Services (banking Reform) Act 2013. The secondary legislation required to bring this regime into force has yet to be made

- European Union – Consulted in 2012. The Bank Recovery and Resolution Directive is now in place and Initiative for CCP resolution regime will start soon (based on a April 2015 roadmap)

Currently some CCPs have varying contractual recovery arrangements in place, but no Member States have yet developed a comprehensive statutory framework to carry out effective resolution.

- Singapore – Consultation out in June 2015, covering financial institutions incl. designated payment systems, approved exchanges, recognised clearing houses; the proposed policy changes will be effected primarily through amendments to the MAS Act and MAS will consult on legislative amendments after considering the feedback on the policy proposals in this consultation.

## Appendix 2: Outline of how the proposed crisis management framework would apply in different circumstances

| Crisis scenarios  | Types of FMIs   | Applicable powers  | Examples   |
|---|---|--|--|
| <i>FMIs that are based in New Zealand</i>                                     |   |  |  |
| <b>Failure of an operator/FMI (e.g. insolvency or operating fraudulently)</b> | If FMI is a system and has an operator or operators, or if the FMI is part of the same legal entity as the operator | <ul style="list-style-type: none"> <li>Requirement for operator to have a BCP and a Recovery and Wind Down Plan (RWP) for its FMI;</li> <li>Power to issue directions to operator;</li> <li>Power to appoint or remove directors of operator;</li> <li>Statutory management of either:               <ul style="list-style-type: none"> <li>The FMI business that could be separated from its operator and vested in a separate entity; or</li> <li>The operator where the business of the FMI cannot be separated from the operator.</li> </ul> </li> </ul> | Settlement Before Interchange (SBI) and High Value Clearing System (HVCS), with Payments NZ as operator for both |
|   | If FMI is separate legal entity   | <ul style="list-style-type: none"> <li>Requirement for operator to have a BCP and a RWP for its FMI;</li> <li>Power to issue directions to operator;</li> <li>Power to appoint or remove directors of the operator;</li> <li>Statutory management of the FMI.</li> </ul>   | NZCDC Settlement System  |
| <b>Participant default</b>  |   | <ul style="list-style-type: none"> <li>Rules of the FMI (e.g. rules that govern the allocation of losses and the suspension of a participant's access to the FMI);</li> <li>If participant's failure threatens the ability of FMI to provide essential services despite the rules that are in place, participant default is treated the same as failure of an FMI.</li> </ul>  |  |
| <b>Critical infrastructure provider failure</b>                               |   | <ul style="list-style-type: none"> <li>Requirements in Annex F of the PFMI, including that the critical infrastructure provider has effective BCPs in place to deal with any outage;</li> <li>FMI's own BCP;</li> <li>Where the failure of a critical infrastructure provider threatens</li> </ul>   |  |

| Crisis scenarios   | Types of FMIs  | Applicable powers   | Examples |
|--|--|---|----------|
|  |  | the ability of the FMI to provide essential services despite these measures, the event would be treated as an FMI failure.  |          |
| <i>Where the FMI and its operator have a presence in New Zealand and one or more other jurisdictions</i> |  |   |          |
| <b>Failure of an operator/FMI (e.g. insolvency or operating fraudulently)</b>                            | If FMI is a system and has an operator or operators, or the FMI is part of the same legal entity as the operator | <ul style="list-style-type: none"> <li>• Requirement for the operator to have a BCP and a RWP for its FMI;</li> <li>• Power to issue directions to the operator;</li> <li>• Power to remove or appoint director of the operator (if the NZ presence of the operator was incorporated in NZ);</li> <li>• Possible power to direct New Zealand participants to support the resolution of the FMI by the home country;</li> <li>• Statutory management of the NZ-based FMI business of the operator when: <ul style="list-style-type: none"> <li>- That was a separate legal entity, or the FMI could be separated from the operator and vested in a separate company which could be placed into statutory management; and</li> <li>- That would enable the continuation of essential functions in New Zealand.</li> </ul> </li> </ul> |          |
|  | If FMI is a legal entity   | <ul style="list-style-type: none"> <li>• Requirement for the operator to have a BCP and a RCP for its FMI;</li> <li>• Power to issue directions to the operator;</li> <li>• Power to appoint or remove directors of the operator (if the NZ presence of the operator was incorporated in New Zealand);</li> <li>• Possible power to direct New Zealand participants to support the resolution of the FMI by the home country;</li> <li>• Statutory management of the NZ-based FMI business of the operator when: <ul style="list-style-type: none"> <li>- That was a separate legal entity, or the FMI could be separated from the operator and vested in a separate</li> </ul> </li> </ul>   |          |

| Crisis scenarios  | Types of FMIs  | Applicable powers  | Examples  |
|---|--|--|---|
|   |  | <p>company which could be placed into statutory management; and</p> <ul style="list-style-type: none"> <li>- That would enable the continuation of essential functions in New Zealand.</li> </ul>  |   |
| <b>Participant default</b>  |  | If participant's failure threatens the ability of the FMI to provide essential services despite the rules that are in place, participant default is treated the same as failure of an FMI.   |   |
| <b>Critical infrastructure provider failure</b>                               |  | Where the failure of a critical infrastructure provider threatens the ability of the FMI to provide essential services despite the FMI's BCP, the event would be treated as an FMI failure.  |   |
| <b><i>Where the FMI and its operator have no New Zealand presence</i></b>     |  |  |   |
| <b>Failure of an operator/FMI (e.g. insolvency or operating fraudulently)</b> | If FMI is a system and has an operator or operators, or is part of the same legal entity as its operator | <ul style="list-style-type: none"> <li>• Requirement for an operator to have a BCP and a RWP for its FMI;</li> <li>• Possible power to direct New Zealand participants to support the resolution of the FMI by the home country;</li> <li>• Power to share information with home country regulator.</li> </ul>             |   |
|   | If FMI is a legal entity   | <ul style="list-style-type: none"> <li>• Requirement for an operator to have a BCP and a RWP requirement for its FMI;</li> <li>• Possible power to direct New Zealand participants to support the resolution of the FMI by the home country;</li> <li>• Power to share information with home country regulator.</li> </ul> | CLS System<br>LCH Clearnet<br>ASX Clear (Futures)<br>DTCC Singapore |
| <b>Participant default</b>  |  | If participant's failure threatens the ability of FMI to provide essential services despite the rules that are in place, participant default is treated the same as failure of an FMI.   |   |
| <b>Critical infrastructure provider failure</b>                               |  | Where the failure of a critical infrastructure provider threatens the ability of the FMI to provide essential services despite the FMI's BCP, the event would be treated as an FMI failure.  |   |

### Appendix 3: Consolidated questions

- Q1. Do you agree with our general approach to the design of a crisis management framework for FMIs? Are there other matters we should be considering?
- Q2. Do you agree with the proposed objectives of the crisis management framework? Are there other objectives we should be considering?
- Q3. Do you agree with the proposed two tier approach to the crisis management framework? If this approach is adopted are there detailed aspects of the framework you would change?
- Q4. If the proposed framework is adopted, do you agree with our description of how it should apply in different crisis situations?
- Q5. If the proposed framework is adopted, do you agree with our description of how it should apply to FMIs with these two basic types of legal form?
- Q6. If the proposed framework is adopted, do you agree with our description of how it should apply to FMIs with different levels of New Zealand presence?
- Q7. Are there potentially “associated entities” of FMIs that are not operators or critical service providers, but are nonetheless essential to the operation of an FMI and its ability to provide essential services?
- Q8. Do you agree with the proposed power to require operators to ensure that their FMIs have business continuity plans, and recovery and orderly wind down plans?
- Q9. Do you agree with our proposed lists of matters that must be included in business continuity plans, and recovery and orderly wind down plans? Are there matters that you would add to, or remove from, these lists?
- Q10. Do you agree with the proposed role of joint regulators in assessing business continuity plans, and recovery and orderly wind down plans? If not, what role (if any) do you consider joint regulators should have in assessing these plans?
- Q11. Do you agree with the proposed direction power and its scope? Are there any changes you consider should be made to this power?
- Q12. Do you agree with the proposed power to appoint or remove directors? Are there any changes you consider should be made to this power?
- Q13. Do you think joint regulators should have a power to direct participants in a limited range of circumstances? If so, do you agree with our description of how this power could be framed, and in what circumstances do you consider it could be used?
- Q14. Do you agree with our description of how statutory management could be applied to an FMI or its operator? If not, how do you consider that it could be applied to an FMI and its operator?
- Q15. How practical would it be to sever the FMI business of the operator from the rest of the operators business? What costs might be involved in pre-positioning the ability to do this?
- Q16. Do you agree with our proposed trigger for when joint regulators could recommend statutory management? If not, what changes would you make to this trigger?

Q17. Do you agree with the proposed objectives and considerations that would influence the exercise of powers in a statutory management by the statutory manager and joint regulators? Are there any changes you consider should be made to these objectives and considerations?

Q18. Do you agree with the core powers of the statutory manager that are being proposed? Are there any changes you consider should be made to these powers?

Q19. Do you agree with the proposed moratorium and the resolution powers? Are there any changes you consider should be made to these?

Q20. Do you agree with our proposals relating to miscellaneous matters connected to the proposed statutory management regime? Are there any changes you consider should be made to these proposals?