



Consultation Document:

Regulations under the Non-bank Deposit Takers Bill 2011

Consultation Document

The Reserve Bank invites submission on this Consultation Document by 27 April 2012.

Submissions and enquiries about the consultation should be addressed to:

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

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SECTION 1: INTRODUCTION

- 1 The bulk of the requirements for the prudential regulation of non-bank deposit takers (NBDTs) were put in place by virtue of Part 5D of the Reserve Bank of New Zealand Act 1989 (the Act) and regulations made under that legislation. The requirements cover credit ratings, governance, risk management, capital, related party exposures, and liquidity. All of these requirements have been in force since 1 December 2010.
- 2 The remaining elements of the prudential regime are expected to be put in place by the Non-bank Deposit Takers Bill (the Bill) that is currently before the Finance and Expenditure Select Committee. The Bill introduces the need for NBDTs to be licensed and, with that, a role for the Reserve Bank relating to the suitability of NBDT directors and senior officers. Where a director or senior officer or proposed director or senior officer raises one or more of the suitability concerns prescribed in regulations, the Reserve Bank will decide whether or not to allow the appointment to continue or proceed, as applicable. The Bill will also introduce change of ownership controls, and powers for the Reserve Bank to issue directions, as well as bolster the Reserve Bank's information gathering powers and its ability to act against directors (both of an NBDT and its associated persons).
- 3 The Bill will constitute a stand-alone framework for the prudential regulation of NBDTs, bringing across the existing provisions found in Part 5D of the Act (with some minor amendments) along with the new elements mentioned in the preceding paragraph.
- 4 The Bill was the subject of public consultation in the latter part of 2010. This consultation is on two sets of regulations proposed to be promulgated under the Bill, in particular:
 - to declare the shares of building societies that are in-substance the same as debt securities to be debt securities for the purposes of the NBDT regime; and
 - to prescribe suitability concerns for the purposes of the new legislation (traversed in the 2010 consultation.)
- 5 The Reserve Bank welcomes comments or submissions on this consultation paper. The intention is that the two sets of regulations will come into force at the same time as the Bill, expected to be in the second half of 2012.

SECTION 2: REGULATIONS DECLARING BUILDING SOCIETY SHARES TO BE DEBT SECURITIES

- 6 The core definition of ‘NBDT’ under the Bill (and the definition of ‘deposit taker’ under existing Part 5D of the Act) is a person that:
- offers debt securities to the public in New Zealand; and
 - carries on the business of borrowing and lending money, or providing financial services, or both.
- 7 A difference arises between Part 5D and the Bill in relation to building societies. Part 5D explicitly includes building societies in the definition of NBDT if they are incorporated under the Building Societies Act 1965. This is not the case under the Bill, as there is no longer any explicit inclusion of building societies in the definition. Consequently a building society will no longer automatically be treated as an NBDT under the Bill and it will need to satisfy the core definition set out in the preceding paragraph.
- 8 Clause 72(1)(d) of the Bill authorises the making of regulations for the purposes of “*declaring certain securities to be debt securities for the purpose of this Act*”.
- 9 The Reserve Bank proposes now to make regulations under this provision to declare the shares of building societies to be debt securities for the purposes of the new law, in particular, those shares of building societies which are debt-like participatory securities. This is proposed on the basis that this is the same approach taken by the (former) Securities Commission, now the Financial Markets Authority, under the Securities Act (Building Societies) Exemption Notice 2002.
- 10 The exemption was given because most building society shares have the characteristics of debt securities even though they are technically participatory securities for the purposes of securities law. Building societies that issue debt-like securities are exempted from sections 33(3) and 53 to 53F of the Securities Act and regulations 3(3), 7A(1) and 14 of the Securities Regulations. The exemption is subject to conditions that a trustee is appointed for the securities and:
- the building society and trustee sign a trust deed for the securities as if they were debt securities;
 - the trust deed complies with the law and is in full force when the securities are allotted;
 - the building society complies with the said sections 53 to 53F as if the “*specified participatory securities*” were debt securities;
 - the prospectus and investment statement for the securities comply with the Second Schedule and Schedule 3D (respectively) of the Securities Regulations as if the securities were debt securities; and

- if applicable, advertisements for the securities state either that the securities are unsecured or the nature and ranking of the security of the securities.
- 11 Designated building societies are exempted in respect of “*specified participatory securities*”, which is a defined term under the exemption. The definition is stated to mean a building society share exclusive of a share that:
- carries the right to payment of a dividend from the annual surplus or accumulated reserves of the building society;
 - is irredeemable or redeemable only at the option of the building society; and
 - entitles the holder to participate in the assets of the building society on liquidation after the payment of all its other liabilities.
- 12 The exemption effectively substitutes the participatory securities regime with a debt securities regime based on an in-substance view of the securities involved.
- 13 In light of the approach that has been taken under the exemption, the Reserve Bank now intends to promulgate regulations under clause 72(1)(d) to declare debt-like participatory securities of building societies to be debt securities, and hence to bring them within the scope of the new law.
- 14 This proposal essentially maintains the *status quo* in terms of the treatment of building societies for the purposes of prudential regulation i.e. they are captured under Part 5D and they will continue to be captured under the Bill (by virtue of the proposed regulations) in respect of most of their shares. Some shares will not be captured because they are equity-like participatory securities but, as we understand, these are very much in the minority. The overwhelming bulk of building society participatory shares are debt-like in nature.

Question:

- 1 Do you have any comment to make on the proposal to declare debt-like participatory securities of building societies to be debt securities for the purposes of the Non-bank Deposit Takers Bill?

SECTION 3: REGULATIONS PRESCRIBING SUITABILITY CONCERNS

- 15 Suitability concerns are an important element of the new law under the Bill, in particular, in relation to determining the suitability of directors and senior officers of NBDTs. Suitability concerns are defined in clause 4(1) of the Bill as meaning:

“the matters, circumstances, or conditions, identified in regulations, that must be drawn to the attention of the (Reserve) Bank if any 1 or more of them apply to a director or senior officer, or proposed director or senior officer, of an NBDT or proposed NBDT.”

- 16 Clause 72(1)(e) authorises the making of regulations prescribing the suitability concerns.
- 17 Definitions of ‘director’ and ‘senior officer’ are in clause 4(1) of the Bill. The latter will include a person occupying a position that allows the person to exercise significant influence over the management or administration of the NBDT e.g. a chief executive or chief financial officer.
- 18 The primary responsibility for ensuring that NBDT directors and senior officers have suitable skills, experience and integrity should lie with the NBDT owners and its governing body. In line with this, an NBDT’s governing body will have to certify whether any senior officer raises suitability concerns and directors will be required to self-certify whether they do the same. The Reserve Bank has to be notified of the outcome in either case, per a “suitability notice”. A wrongful certification may give rise to criminal liability.
- 19 If a suitability notice states that a person does not raise any suitability concerns, the Reserve Bank is entitled to rely on that for determining whether the person is unsuitable, and may grant a licence to the NBDT without giving a notice of non-objection.
- 20 If a suitability notice states that the person raises a suitability concern, the Reserve Bank must not grant a licence to the NBDT until it gives a notice of non-objection in respect of that person. In that event, it must make inquiries to determine whether a non-objection notice ought to be given. If the Reserve Bank is satisfied that the person is not unsuitable to be a director or senior officer of the NBDT, it may give a notice of non-objection. Conversely, if it is satisfied that the person is unsuitable it may refuse to issue a notice of non-objection in which case a licence will not be granted or may be withdrawn if the appointment proceeds or is not terminated, as applicable.
- 21 The preceding requirements are found in clauses 14 and 15 of the Bill. In addition, clause 59 sets out grounds for the removal of an NBDT director. The Reserve Bank can act to remove a director if a suitability notice was false or misleading in a material respect. It can also do this if a suitability concern arises since the grant of an NBDT licence, or since the appointment of a director.

- 22 The Reserve Bank now proposes to prescribe the following matters as suitability concerns for these purposes (and as provided for under clause 72(1)(e) of the Bill):
- a judgement debt, recourse to the No Asset Procedure or bankruptcy;
 - involvement in an entity that has gone into moratorium, receivership, liquidation, voluntary administration, or has been the subject of judicial or statutory management;
 - criminal offending;
 - disciplinary action or adverse findings by a professional or regulatory body for persons engaged in that profession or activity;
 - adverse findings or action taken by any other regulatory authority, market operator, or government agency (whether taken directly or indirectly through a court or tribunal);
 - conflicts of interest that could impact on the proper performance of the business.
- 23 These would apply whether they have taken place within New Zealand or overseas. Current (i.e. unresolved) action will also require notification as a suitability concern.
- 24 The triggering of these suitability concerns does not mean that the Reserve Bank will not ultimately give a notice of non-objection in respect of the director or senior officer concerned. Each case will be considered by the Reserve Bank in accordance with its own facts and circumstances and whether, in the Reserve Bank's judgement, the suitability concern(s) raised render the person unsuitable to be a director or senior officer of the NBDT. When deciding what action it should take (i.e. whether or not to give a notice of non-objection) factors the Reserve Bank are likely to take into account are the nature of the involvement of the person in the matter giving rise to concern, the nature of the concern itself and its gravity, and any extenuating circumstances. The Reserve Bank expects to confirm this discretionary approach in subsequent guidance.
- 25 The Bill provides a right of appeal to the High Court against any decision of the Reserve Bank concerning a person's suitability to be a director or senior officer. There is a further right of appeal to the Court of Appeal on a question of law, and with leave.

Questions:

- 2 Do you have any comment to make on the proposal to make regulations prescribing the matters that are suitability concerns for the purposes of the Bill, in particular, on the range or scope of the matters that have been articulated in paragraph 22 and how they will operate?

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| 3 | Are there any additional matters that should be included? |
| 4 | Are there any matters that should be deleted from the list of suitability concerns? |