



NBDT Consultation Document:

Remaining NBDT regulatory requirements

Consultation Paper

The Reserve Bank invites submissions on this Consultation Paper by 5 November 2010.

Submissions and enquiries about the consultation should be addressed to:

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

October 2010

NBDT Consultation Document: Remaining non-bank deposit taker regulatory requirements

1 INTRODUCTION

1.1 Background

- 1 On 18 June 2007 Cabinet Economic Development Committee agreed¹ to a new framework for the regulation of non-bank deposit takers (NBDTs), stating that, as the prudential regulator of NBDTs, the Reserve Bank is the agency that:
 - a. licenses and de-licenses NBDTs;
 - b. sets and enforces minimum prudential and governance requirements;
 - c. administers fit and proper requirements;
 - d. administers the rating regime; and,
 - e. has the capacity to intervene in situations of serious NBDT distress or failure where the soundness of the financial system is at risk.

- 2 Public consultation on the full regime took place in 2006.² The regime is being implemented in two stages, to take account of the Ministry of Economic Development's work on registration requirements for financial service providers.

- 3 The first stage (the Reserve Bank of New Zealand Amendment Act 2008) introduced Part 5D into the Reserve Bank of New Zealand Act (the "Act"), and implemented the credit rating and prudential requirements, including those relating to capital, related party lending, liquidity, risk management, and corporate governance. It also introduced associated offences, penalties and enforcement powers for the Reserve Bank.

- 4 The second stage, including licensing and de-licensing, fit and proper requirements, and distress and failure management, remains to be implemented. Although the full regime has been consulted on, we think it is important to consult on these features again for several reasons:
 - there has been a change in government;
 - a reasonably long time has passed;
 - we intend to seek change of ownership powers, which we did not consult on in 2006; and,
 - we intend to recommend a number of refinements to the Act, mainly of a minor and technical nature.

1 EDC Min (07)21/10

2 The discussion document on the Review of Financial Products and Providers: Non-Bank Deposit Takers is available at http://www.med.govt.nz/templates/MultipageDocumentTOC_22185.aspx.

- 5 The regulatory regime has been developed to overcome gaps in the existing regulation of NBDTs, including the absence of minimum entry requirements, and inconsistency in governance and prudential requirements across the sector. These deficiencies have the potential to impede the maintenance of a sound and efficient financial system, undermine competitive neutrality, and contribute to a misallocation of resources and instability in the sector. The new measures proposed in this consultation paper would result in a complete regulatory regime for the NBDT sector.
- 6 These proposals are conventional prudential requirements: they are very similar to the requirements for the other entities supervised and regulated by the Reserve Bank, namely registered banks and insurers, and are typical requirements in international standards. In the Reserve Bank's view, while there will be compliance costs involved in applying for a licence for example, generally speaking the compliance costs imposed by these new requirements are relatively minor.

1.2 Consultation

- 7 This consultation paper proposes the remaining amendments to the Act that the Bank believes are required to fully implement the NBDT regime, as intended by Cabinet in 2007. In summary, these remaining elements are:
- licensing of NBDTs;
 - fit and proper requirements for directors and senior officer holders of NBDTs;
 - controls on changes of ownership;
 - distress and failure management powers for the Reserve Bank; and,
 - refinements to Part 5D of the Act.
- 8 The Reserve Bank welcomes comments and submissions on this consultation paper. The consultation period closes on 5 November 2010. The intention is that the legislation to give effect to these changes will come into force in 2011.

2 PROPOSED LICENSING REQUIREMENTS

2.1 Overview of Licensing Requirements

- 9 Section 157C of the Act defines a “deposit taker” as a person who:
- 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; and,
 - includes credit unions and building societies.
- 10 Currently there are no minimum entry requirements for NBDTs. It is proposed that entities satisfying this definition will be required to hold a licence to operate as an NBDT, unless exempted by the Bank under section 157G. An applicant will have to show that it is or will be in a position to comply with entry as well as ongoing requirements. Licensed NBDTs will be required to meet minimum prudential requirements to operate as a retail deposit taker in addition to the existing requirements applicable to debt issuers, such as Securities Act 1978 requirements.
- 11 The starting point for licensing requirements for NBDTs is the framework for the registration of banks under the Act, adapted for NBDTs. All licensed NBDTs will be subject to similar prudential requirements. It is proposed that the Reserve Bank should have regard to the following matters in licensing NBDTs:
- whether directors and senior office holders meet fit and proper requirements;
 - the applicant’s ownership and organisation;
 - the applicant’s ability to comply with prudential requirements in the Act and regulations;
 - the applicant’s ability to comply with other relevant legislation, such as the Anti-Money Laundering and Countering the Financing of Terrorism Act 2009;
 - any other matters properly the subject of conditions.

2.2 Fit and proper requirements

- 12 Fit and proper requirements attempt to ensure those who run NBDTs have the necessary qualifications and integrity. While shareholders and directors are responsible for ensuring those appointed as directors and senior office holders, respectively, have suitable experience, skills, and qualifications, we are proposing that the Bank has a role in ensuring those who do not meet prescribed criteria are either not appointed, or can be removed by the Bank.

- 13 These requirements will be in addition to the criminal and bankruptcy checks in respect of directors, senior managers, and controlling owners under the Financial Service Providers (Registration and Dispute Resolution) Act 2008.³ They will provide greater flexibility in the assessment of the fitness and propriety of directors and senior office holders, by allowing a wider range of considerations with no time limits and fewer bright lines than the criminal and bankruptcy checks.

Who will have to meet the requirements?

- 14 We are proposing that directors and senior office holders are subject to fit and proper checks.
- 15 “Director” is defined in the Act, and extends to those who act in relation to the entity in a manner that would be considered acting as a director under the Companies Act 1993. Section 157B defines a “senior office holder” as a person occupying a position that allows them to exercise significant influence over the management or administration of the NBDT, such as a chief executive or chief financial officer.
- 16 We believe applying fit and proper requirements to directors and senior office holders will boost investor confidence and increase investor participation in the sector, and should ensure those with a track record of failure are no longer able to participate in management roles.

Question for submission

- 1 Do you agree that directors and senior office holders should be subject to more comprehensive vetting over and above requirements of the Financial Service Providers (Registration and Dispute Resolution) Act?

3 Under section 14(2) of the Financial Service Providers (Registration and Dispute Resolution) Act, the following persons are disqualified from registration as a financial service provider:

- (a) an undischarged bankrupt;
- (b) a person prohibited from being a director or promoter of, or concerned in the management of, an incorporated or unincorporated body under the Companies Act 1993, the Securities Act 1978, the Securities Markets Act 1988, or the Takeovers Act 1993;
- (c) a person subject to a management banning order under the Securities Act 1978, the Securities Markets Act 1988, the Takeovers Act 1993, or subject to an order under section 108 of the Credit Contracts and Consumer Finance Act 2003;
- (d) a person who has been convicted of an offence against section 11, 12, or 41 within the past 5 years;
- (e) a person who has been convicted of an offence under sections 217 to 266 of the Crimes Act 1961 within the past 5 years;
- (f) a person who has been convicted of a money laundering offence or an offence relating to the financing of terrorism;
- (g) a person who is subject to a confiscation order under the Proceeds of Crime Act 1991.

What will the Bank's role be?

- 17 We consider the onus for ensuring that directors and senior management are fit to perform their duties and responsibilities will rest primarily with the NBDT's shareholders and directors, respectively. In particular, the governing body of an NBDT will need to assess senior office holders, and regularly attest to their suitability. Directors will be required to provide self-certification of their suitability.
- 18 It is proposed the Bank will have a secondary role in the process. If a director or senior office holder meets certain "trigger" criteria, the directors will be unable to certify that the person is fit and proper, and must not proceed with the appointment until they have confirmed the Bank does not object.
- 19 The trigger criteria may include such things as:
- bankruptcy;
 - involvement with an entity that has gone into receivership, liquidation, voluntary administration, or been the subject of statutory or judicial management;
 - criminal offending;
 - disciplinary action or adverse findings by a professional or regulatory body for persons engaged in that profession;
 - 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 which would impact on the proper performance of the business.

These would apply whether they take place within New Zealand or overseas. Current (i.e. unresolved) action will also have to be notified, and may be taken into account by the Bank.

- 20 It will be an offence for a director who meets the trigger criteria to self-certify as being fit and proper, or for a senior office holder to mislead the governing body. It will also be an offence for the governing body to certify the fitness and propriety of a senior office holder if the governing body knew, or ought to have known, the person met the criteria, or to appoint such a person without confirming the Bank did not object.
- 21 The Bank will be able to review an appointment where it becomes aware of information affecting a person who has already been appointed, and may withdraw approval or revoke an appointment if they are no longer a fit and proper person for the position. We are also proposing that the Bank should be able to apply to the Court for an order banning a person from participating in non-bank deposit taking business, for a maximum of 5 years.

Questions for submission

- 2 Do you have any comments to make on the proposed approach, namely, placing the onus on the NBDT to evaluate its directors and senior office holders?
- 3 Do you agree with the classes of trigger criteria that are proposed?
- 4 Are there any additional matters that should be included in the trigger criteria?

2.3 Ownership and organisation

- 22 The ownership and organisational structure of NBDTs should be transparent, easily verifiable, and the owners should generally be fully accountable for its business operations. This will help improve the public's understanding of the applicant NBDT, and enable the Bank to identify those persons who control, or exert significant influence over, the applicant. The applicant may be required to provide information on the structure of its governing body, and its share ownership and voting rights.
- 23 We are considering whether the use of a branch structure is appropriate and, if so, what conditions should be placed on the use of such a structure. This is of particular importance where the parent entity does not operate under comparable regulatory standards in the overseas jurisdiction where it is incorporated.

Question for submission

- 5 Do you think that it is appropriate to permit an NBDT to operate in New Zealand as a branch of an overseas entity?

- 24 In some situations, entities may be “deposit takers” without offering debt securities to the public or carrying on the business of providing financial services, for example building societies and credit unions. We wish to avoid the creation of “shell” NBDTs,⁴ and are still considering whether such entities should be granted a licence. For example, a physical presence in New Zealand, such as staff and resources, as well as New Zealand depositors, could be required before an entity is licensed as an NBDT.

Question for submission

- 6 Do you agree that the Bank should not license a deposit taker that does not offer debt securities to the public or carry on the business of providing financial services?

⁴ “Shell” NBDTs are registered in New Zealand, but carry out their activities overseas.

What will the ongoing requirements be?

- 25 Once an NBDT has been licensed, changes in ownership may be undesirable from a soundness and efficiency perspective. Change of ownership controls are standard supervisory practice under international principles, and will help to
- limit concentrations in ownership of NBDTs;
 - limit the risk of contagion from activities conducted by other entities in the NBDT’s wider group;
 - limit the possibility an NBDT is able to be used as a captive source of finance for its owners;
 - support the autonomy and effectiveness of the senior officer holders of an NBDT;
 - prevent corporate structures or arrangements that could hinder the effective supervision of NBDTs; and,
 - respond to other sources of weakness that could arise from the ownership structure.
- 26 Controls will provide a “fit and proper” evaluation of persons who are directly and indirectly involved in the ownership of an NBDT. We are proposing an ongoing regime similar to that applying to registered banks, whereby the Bank’s consent would be required for a transaction that would result in a person acquiring “significant influence” over an NBDT.
- 27 We propose to define “significant influence” as owning, or having the power to control, directly or indirectly, 20% or more of the NBDT’s voting securities, or 25% or more of the NBDT’s governing body. These thresholds are higher than under the banking regime,⁵ but we consider they provide appropriate triggers for prudential purposes for the NBDT sector.

Questions for submission

- 7 Do you agree that it is appropriate to have a threshold above which approval is required for change in ownership?
- 8 Is the proposed definition of “significant influence” appropriate, i.e. owning, or having power to control, directly or indirectly, 20% or more of the NBDT’s voting securities, or 25% or more of the NBDT’s governing body?

⁵ Section 2 Reserve Bank of New Zealand Act 1989 defines “significant influence” in relation to a registered bank as the ability to directly or indirectly appoint 25% or more of the board of directors, or a direct or indirect qualifying interest in 10% or more of the voting securities issued or allotted by the registered bank.

2.4 Ability to comply with prudential requirements

28 Once an applicant is licensed as an NBDT, it must comply with the prudential requirements imposed on NBDTs, such as the capital and liquidity requirements. Therefore, we are proposing that an applicant must demonstrate its ability to comply with applicable prudential requirements, including:

- the prudential requirements specified in Part 5D of the Act and the associated regulations. For example, an applicant must show it has, or has access to, the capital needed to meet the capital ratio requirements specified in regulations, etc;
- having a trust deed registered by the Companies Office;
- having a trustee chosen from a list of trustees authorised by the Securities Commission⁶ for the purpose of supervising their deposit taking activities;
- having an investment statement, and a prospectus that is registered by the Companies Office;
- registration as a financial service provider under the Financial Service Providers (Registration and Dispute Resolution) Act 2008; and,
- the requirements of the Anti-Money Laundering and Countering the Financing of Terrorism Act 2009.

Question for submission

9 Do you agree that these expectations are appropriate?

2.5 Conditions of licence

29 As there will be different circumstances pertaining to each applicant, we intend to propose to Cabinet that the Bank has power to impose specific conditions on the grant of a licence. For example, to alleviate concerns over the creation of “shell” NBDTs, an NBDT may be required to commence deposit taking within a certain period from the grant of the licence. Any conditions of licence may be revised, and further conditions imposed, particularly if the NBDT nears the point of de-licensing. Directors may be required to certify compliance with these conditions on a regular basis.

Questions for submission

10 Do you agree the Bank should have a power to impose conditions of licence?

11 Are there any other matters that ought to be addressed as a condition of licence?

⁶ The Securities Commission is expected to become part of the Financial Markets Authority. All references to the Securities Commission in this document will be applicable to the Financial Markets Authority if it is established as anticipated.

2.6 Other matters: Transition period and exemptions

- 30 To enable existing NBDTs to meet the full licensing criteria, one option is to grant provisional licences for a set period, broadly similar to the licensing of insurers under the Insurance (Prudential Supervision) Act 2010. Entities will have 3 months to apply for a provisional licence that will last for a 12-month period. This will give entities 6 months to apply for a full licence and a further 6 months for the application to be processed and for the entity to come to compliance. We expect this period will be sufficient for licensing, and that the process is likely to be shorter for some entities.
- 31 As some entities are exempt from some or all of the current requirements, such as conduits and payment facility providers,⁷ the licensing regime needs to be sufficiently flexible to deal with these entities. Therefore, we propose that the Bank has powers to exempt NBDTs, or a class of NBDTs, from all or a set of licensing requirements, either temporarily or permanently.

Questions for submission

- 12 Do you agree a provisional licence is an appropriate mechanism to allow existing NBDTs to come to compliance?
- 13 How much time would be sufficient to allow an existing NBDT to come to compliance?

2.7 De-licensing

- 32 An NBDT that has been de-licensed can no longer operate as a deposit taker. We are proposing that de-licensing may be voluntary or mandatory. An NBDT that wishes to discontinue taking new deposits can voluntarily de-licence after repaying existing deposits or transferring them with depositors' consent.
- 33 If an NBDT fails to comply with licensing requirements, we propose that the Bank will be able to de-licence that NBDT. It is envisaged that the Securities Commission and the trustee will be able to recommend de-licensing for breaches of the Securities Act and trust deed provisions, respectively. The Bank will consult with the Securities Commission, the Companies Office and the trustee before initiating the de-licensing of an NBDT.

⁷ For details of exemptions from the NBDT regime, refer to <http://www.rbnz.govt.nz/finstab/nbd/exemptions/3857984.html>

Questions for submission

- 14 Do you agree the Bank should have the ability to de-licence NBDTs for non-compliance with licensing requirements?
- 15 What other circumstances should be considered grounds for de-licensing?

3 PROPOSED DISTRESS AND FAILURE MANAGEMENT POWERS

3.1 Overview of distress and failure management

34 In September 2007, Cabinet agreed that the Bank's distress and failure management powers in relation to registered banks be extended to NBDTs. We acknowledge this, and consider that those powers should be tailored to reflect the threat an NBDT failure would pose to the financial system.

35 We also believe that we should have appropriate powers to respond to early signs of distress, in particular, powers to obtain information and to investigate, and to give directions. At present, the Bank is unable to intervene, even where the failure of an NBDT threatens the soundness or efficiency of the financial system.

36 Trustees will continue to have primary responsibility for responding to a distressed NBDT. General insolvency law provides a number of options, including voluntary administration, receivership, and liquidation. So that the Bank is aware of the status of an NBDT, we are proposing that it be a requirement that the Bank is advised of the appointment of a voluntary administrator, a receiver, or a liquidator to an NBDT. However, we do not believe the Bank needs to have a greater role in these insolvency processes.

3.2 Information-gathering and investigation powers

37 As the regulator of the NBDT sector, the Bank needs access to information to monitor the sector to ensure the level of regulation remains appropriate. The Bank also supervises some aspects of the regime directly, particularly where an NBDT is exempt from the requirement to appoint a trustee, and therefore needs access to information to carry out its ongoing supervisory responsibilities.

38 The Bank already has limited information-gathering and investigation powers under Part 5D, which allow the Bank to request information from an NBDT, or appoint an investigator to an NBDT. These powers are only for the purposes of investigating whether an NBDT is complying with the requirements of, or where the Bank has reasonable cause to believe the NBDT has committed an offence against, Part 5D or the regulations. There is no provision for the routine collection of additional information for monitoring the soundness of the sector or the appropriateness of regulatory settings. The Bank is also unable to obtain information from, or relating to, an associated person of the NBDT, or to require information provided to it to be audited.

Acquiring information from an NBDT

- 39 The restriction on the Bank’s power to request information prevents the Bank from acquiring all the information it needs to fulfil its supervisory and regulatory roles. We are therefore proposing the Bank be given wider powers to obtain information relating to the NBDT, similar to those available in relation to registered banks. This would allow the Bank to obtain information for prudential purposes, for example information about moratorium arrangements and how they impact on investors.

Question for submission

- 16 Do you agree that the Bank should be able to request information from an NBDT for wider regulatory purposes (i.e. rather than simply related to investigations of non-compliance)?

Acquiring information from associated persons

- 40 NBDTs may have associated persons whose conduct and activities have had, or have the potential to have, a negative impact on the NBDT and its creditors. It is therefore likely that the Bank will occasionally need information about associated persons of an NBDT to fully understand the economic risks faced by the NBDT.
- 41 We are proposing that the definition of “associated person” in section 2(2) of the Act be adopted in respect of NBDTs. Section 2(2) defines an “associated person” of a registered bank as a person who:
- directly or indirectly controls the management of the registered bank; or
 - has a direct or indirect qualifying interest in 20% or more of the voting or non-voting securities issued by the registered bank; or
 - the registered bank directly or indirectly controls the management of that person; or
 - the registered bank has a direct or indirect qualifying interest in 20% or more of the voting or non-voting securities issued by that person.
- 42 We propose that the Bank has a power to require information from an NBDT that relates to its associated persons, and that the associated person has an obligation to provide that information to the NBDT. We also intend to recommend that the Bank has the power to investigate associated persons of an NBDT directly. This would allow the Bank to appoint an investigator to obtain a search warrant, and search and seize documents of the associated person, powers the Bank currently has in respect of the NBDT itself.

Questions for submission

- 17 Do you agree that the definition of “associated person” in section 2(2) of the Act is appropriate for the purposes of Part 5D?
- 18 Do you agree that the Reserve Bank should have the ability to obtain information relating to an associated person of an NBDT, to be provided through the NBDT?
- 19 Do you agree that the Reserve Bank should be able to investigate an associated person of an NBDT directly?

Requiring auditing of information

- 43 Under the registered bank regime, the Bank has the option of requiring information it requests to be audited by an auditor it has approved. We are proposing a similar power in relation to NBDTs so that, where necessary, and on an exceptional basis, the Bank can ensure that data provided to it is reliable.

Question for submission

- 20 Do you agree that the Reserve Bank should be able to request the auditing of information provided by NBDTs, associated persons, or trustees?

3.3 Direction powers

- 44 Direction powers are fairly standard prudential tools. At present, the Bank does not have any powers to direct an NBDT or to become involved before an NBDT poses a threat to financial stability. The Bank already has direction powers in relation to registered banks and licensed insurers, and it is proposed that the Bank should also have the power to issue directions to:
- an NBDT;
 - an associated person of an NBDT; or
 - an NBDT’s trustee.
- 45 Directions could include to cease paying dividends, to remove directors, to cease raising funds, or to cease undertaking related party transactions. The scope of directions to the trustee of an NBDT is likely to be more limited and targeted specifically at the trustee; for example, directing them to attend a meeting, to make changes to the trust deed, or to give advice about the merits of a moratorium proposal.

- 46 The Bank would be able to amend, replace, or revoke any directions given. It would be an offence to contravene directions (as is the case for registered banks and licensed insurers). Potentially, it would also be a ground for de-licensing.

Questions for submission

- 21 Do you agree that the Reserve Bank should have the power to issue directions, as proposed?

3.4 Statutory management

- 47 Statutory management places a moratorium on most creditor enforcement measures, and gives the statutory manager wide powers to manage the corporation's affairs.
- 48 There are two statutory management regimes in New Zealand. Firstly, the Bank can recommend statutory management of a registered bank under the Act (and it has a similar power in respect of licensed insurers under the Insurance (Prudential Supervision) Act 2010). This power is to be exercised for the purpose of avoiding the significant damage to the financial system that may be caused by the failure of a registered bank.
- 49 Secondly, the Securities Commission can recommend statutory management of corporations under the Corporations (Investigation and Management) Act 1989 (CIMA). CIMA imposes a different threshold for a recommendation of statutory management, and is to be used where there is no other adequate lawful remedy available.
- 50 We believe the Bank-run regime may be inappropriate for the NBDT sector, and that the existing CIMA statutory management regime is likely to be sufficient. Therefore, we are not proposing that the Bank have the power to recommend statutory management of an NBDT. Instead, we propose that the Securities Commission be required to consult with the Bank before it recommends statutory management of an NBDT under CIMA, and that the Bank be required to inform the Securities Commission when the Bank believes statutory management of an NBDT would be appropriate.

Question for submission

- 22 Do you agree that a distressed NBDT should be managed according to general insolvency law, rather than using a Bank-run procedure like the one available for registered banks under the Act?

4 PROPOSED REFINEMENTS TO PART 5D

4.1 Overview of refinements to Part 5D

- 51 The second Bill provides an opportunity to refine aspects of the existing Part 5D. These changes are generally of a technical nature and simply clarify the Bank's existing policies. However, the following are examples of changes that may have an impact on stakeholders. There will be an opportunity to comment on all changes during the Select Committee process.
- 52 ***Section 157G(3) – exemptions*** – This section enables terms and conditions to be imposed in relation to exemptions. It would be useful to make it clear that terms and conditions can also be imposed in relation to an NBDT's trustee and, where applicable, other members of a borrowing group.
- 53 ***Section 157ZG – information from trustees*** - Currently, the trustee of an NBDT is not obliged to acquire any information which the Bank requests but which the trustee has not already obtained in the course of, or in connection with, the performance of its functions as a trustee. We intend to propose to Cabinet that trustees be required to obtain information from NBDTs when requested to do so by the Bank, provided the information requested relates to areas of trustee responsibility. Trustees would not be required to obtain information about matters directly supervised by the Bank.
- 54 ***Section 157ZT – defence*** - Section 157ZT provides a defence for an NBDT where a contravention was due to acts or omissions of another person, and the NBDT took all reasonable precautions and exercised due diligence to avoid the contravention. Section 157ZT(2) excludes the acts or omissions of directors, employees, or agents of the NBDT from providing a defence. We consider that shareholders, in particular substantial or controlling shareholders, should also be included in subsection (2).
- 55 ***Section 157ZV – liability of directors*** - Section 157ZV is the only provision imposing liability on directors, but liability depends on conviction of the body corporate. This may not always be desirable or possible – we may wish to proceed against the individual only, or the body corporate may successfully plead the defence provided in section 157ZT. This could be resolved with a qualification to section 157ZV that a person may be convicted of an offence even though the body corporate has not been charged with that offence or a similar offence (for example, as in section 246 Fisheries Act 1996).

Question for submission

- 23 Are there any comments you wish to make about these proposed changes to the existing Part 5D?