RESERVE BANK OF NEW ZEALAND
TE PŪTEA MATUA

Summary of submissions on exposure draft consultation of the Financial Market Infrastructures Bill

Dec 2019

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Introduction: purpose of consultation

1. On 01 August 2019 the Reserve Bank published the "Financial Market Infrastructures Bill: Exposure Draft" for an eight week consultation period closing on 26 September 2019. The main purpose of the consultation was to seek views on the more granular and technical details of the Financial Market Infrastructures (FMIs) Bill (the Bill), given that the overall structure of the Bill reflects decisions that had already been made.

2. We received 16 submissions from a range of stakeholders including, domestic and overseas based FMIs and industry associations (see Table 1 in the Appendix for a complete list of submissions)[1]. Separately on the Reserve Bank website, we have published submissions in full or in part where the submitter has not requested they be withheld.

3. A covering note was published alongside the exposure draft of the Bill that provided some additional context to stakeholders and highlighted a number of matters which we particularly wanted to seek submitters' views on. Submitters provided a range of commentary on these and other topics. This paper summarises the feedback we received along with the Reserve Bank's response, which were developed in consultation with the Financial Markets Authority (who are joint regulators with the Reserve Bank under the FMI Bill).

4. In a number of areas, submitter comments are noted but have not necessarily resulted in changes to the drafting of the Bill. For instance there were numerous comments on the fact that FMIs can differ considerably in their configurations and service offerings and that this requires sufficient scope for the tailoring of regulatory requirements. The Reserve Bank agrees to the need for adequate tailoring but considers that the FMI Bill, as drafted, adequately provides for this – more detail is provided further below in paragraphs 11 - 14.

5. The main areas of feedback were:

    - Links to phase 2 of the Review of the RBNZ Act
    - Scope for tailoring regulatory requirements to different types of FMIs
    - Potential conflict for the Reserve Bank as owner and regulator of FMIs
    - Crisis management provisions
    - FMI rules
    - Offences and penalties
    - Settlement finality
    - Information gathering powers

6. There were also a number of more minor miscellaneous comments that are listed in Table 1.

Part 1: Significant issues raised by submitters

Linkages to phase 2 of the Review of the Reserve Bank of New Zealand Act 1989

7. The cover note to the exposure draft of the FMI Bill noted that the Bill reflects three interim positions that will be reviewed once the detailed conclusions of phase 2 have been

[1] The submission from the NZFMA was received late and therefore is not reflected in this document but will be considered as the Bill progresses through the parliamentary process.

determined. This allows for the FMI Bill to progress but also ensures long term consistency of approach between banking and FMI related legislation where this is appropriate.

8. The three specific areas where the Government have identified the approaches in the Bill as interim are:

    - Ministerial consent being required before the joint regulators may issue a direction to the operator of an FMI;
    - The statutory management model in the Bill; and
    - The statutory manager's power to act contrary to the interests of creditors on financial stability grounds (i.e. clause 105).

Submitter feedback on links with phase 2

9. Some submitters noted their view that there was a narrow timing gap between the FMI Bill and the phase 2 work programme, which meant that delaying the FMI work to better align with phase 2 conclusions would be a more efficient process. Some submitters also supported the retention of Ministerial consent being required before the joint regulators may issue a direction to the operator of an FMI.

Reserve Bank response

10. We note that the timing gap between the two projects remains significant and the timing of the proposed new authorised deposit taker regime has not yet been publicly disclosed.

11. In particular, the timetable for the Bill we are proposing would see it enacted by no later than December 2020, whereas legislation establishing the new deposit takers regime is not expected to be introduced into the House until sometime in the first half of 2021. With this in mind, we recommend retaining the approach previously discussed in the Cabinet paper of December 2018, where the FMI Bill is amended as necessary after it is enacted. This will also allow the FMI Bill to continue to progress as a priority, as suggested by the IMF in their 2017 Financial Sector Assessment Programme review of New Zealand.

Scope for tailoring regulatory requirements to different FMI types

12. Submitters noted that FMIs can that differ considerably in their configurations and service offerings and that this requires sufficient scope for the tailoring of regulatory requirements. More specifically, they also suggested:
    - That the Bill should more clearly distinguish between payment systems and other types of FMIs;
    - That some FMIs do not control any underlying technical infrastructure and are therefore limited in the actions they can take around things like ensuring the continuity of services under contingency plans;
    - That domestic or overseas domiciled FMIs may require different treatment, or that different treatment may be problematic if it damages competitive neutrality.

Reserve Bank response

13. We agree that adequate tailoring is needed but consider that the Bill, as drafted, provides the necessary flexibility for significant tailoring between different types of FMIs and between domestic and overseas domiciled FMIs. For instance, the Bill provides the

regulators with the power to make legally binding standards that can apply to all FMIs, a class of FMIs, or individual FMIs. Standards may only relate to one of the matters set out in the Bill, which themselves are closely aligned to the set of international best practice, such as the CPSS-IOSCO Principles for Financial Market Infrastructures (PFMIs) among others. Also, before issuing a standard the regulators must consult with affected parties, and where the standard will relate to an overseas FMI take into account certain additional matters.

14. The detailed content of the standards will be the subject of a separate project that will be undertaken over longer timeframes but final decisions on the content of the standards will not be made until consultation with stakeholders has been undertaken and the Bill has been enacted.

15. The regulators may also provide guidance to clarify how certain elements of the FMI will be operationalised. This may include for example the approach to supervision, further details around the timing procedures for the approval of rule changes and the use of information gathering powers.

Potential conflict for Reserve Bank as owner and regulator of FMIs

16. Some submitters raised concerns around potential conflicts of interest for the Reserve Bank due to its role as both operator and regulator of certain FMIs (specifically, the Exchange Settlement Account System, and NZClear).

Reserve Bank response

17. In respect to FMIs that are not pure payment systems, the joint Reserve Bank-FMA regulator model is intended to deal with this issue. A strict delineation of roles and reporting lines within the Reserve Bank is also intended to deal with this issue.

18. Supervisory responsibilities for joint regulators will also be detailed in an MOU that will be published.

Crisis management

19. Submitters commented on a few issues regarding the drafting of crisis management provisions in the Bill. These include:

    - That the definition of distressed is too broad because it includes indirect participants and reference to undefined ‘problems’
    - That directions to participants to comply with the rules of an FMI in a crisis situation are unnecessary;
    - That the power to remove directors is unnecessary.

Reserve Bank response

20. The trigger for when crisis management powers can be used hinges in part on when an FMI is “distressed”. The definition of distressed only covers genuine crisis management type situations, but is also purposefully broad in the way that it covers both the failure of

the FMI itself and the FMI's potential role in acting as a conduit for transmitting contagion resulting from the failure of one of its participants.

21. Equally, the term 'problems' is used in a manner that makes it clear that it is referring to any issues that threaten the stability of, or confidence in, the financial system. We do not think that an attempt to define the terms further would add additional clarity.

22. The application of direction powers to participants is considered necessary to support enforcement of an FMI's rules in a crisis situation. Similarly, the ability to remove directors outside of statutory management remains a potentially useful crisis management tool in circumstances where the governance of the FMI has become dysfunctional.

FMI rules

23. Submitters commented on a few issues regarding the regulators powers in respect of a designated FMI's rules. These include:

    - That the definition of rules is unclear;
    - That the various timeframes for procedural aspects around the oversight of rules are too short; and
    - That the requirement to publish all FMI rules may present operational difficulties for the FMI.

Reserve Bank response

24. The definition of rules in the Bill is intentionally broad because flexibility is needed in order to deal with the different ways that FMIs structure their rules (i.e. the rules which determine the operation of the FMI may be spread across several documents). Clarity will be provided in the designation notice for each FMI, as the notice will have to state the specific documents evidencing the FMI's rules.

25. We have amended the Bill to provide additional guidance on certain timeframes for taking steps around rule changes (e.g. the time for an FMI operator to prepare a rule change when requested to do so by the regulators). This has been done in slightly different ways in different clauses (for example, by stating that a step has to be taken in a time set by the regulators which must be not less than 20 working days).

26. We consider that more flexibility around the requirement to publish rules is potentially useful. Specifically, we have amended clause 36 to allow the regulators to consent to some rules of a designated FMI being withheld from publication.

Offences and penalties

27. Submitters provided various comment on the calibration of offences and penalties including:

- That the greater use of pecuniary penalties would be appropriate;
- That director liability for offences is too broad; and
- That there are potential conflicts between the confidentiality treatment of direction powers under the Bill and continuous disclosure requirements for listed FMIs.

Reserve Bank response

28. The Reserve Bank has reviewed the calibration of offences and penalties in light of stakeholder feedback and considers that some minor adjustments are warranted.

29. Existing criminal offences in the Bill have been converted into pecuniary penalties where they relate to compliance with technical regulatory requirements (i.e. requirements that contingency plans must satisfy), or relate to minor procedural requirements without significant impacts (i.e. the requirement to publish the FMIs rules, and failure to notify regulators of changes to the rules of an overseas FMI). All breaches of standards made under the Bill would also continue to only be subject to pecuniary penalties as at present.

30. We consider that the scope of director liability under the Bill is consistent with other Reserve Bank legislation and its effect on directors is not broader than equivalents under FMA legislations (e.g. section 533 of the Financial Markets Conduct Act 2013).

31. For the confidentiality treatment of direction notices, we consider that there are merits in flipping the default position to one where directions are not confidential unless the regulator determines otherwise (as this helps to mitigate some of the potential conflict between the confidentiality of directions and the continuous disclose obligations of an FMI operator that is listed on a stock exchange). This change has been reflected in the Bill.

Settlement finality

32. Submitters noted that the 24 hour protection window for settlement finality (following the default of a participant) was not appropriate in certain circumstances. Central counterparties argued that indefinite settlement finality protections were necessary in order to provide time for them to auction off the option derivative positions of a defaulting participant. Submitters also argued that time limited settlement finality protections are only appropriate where they are triggered by a participant being subject to an insolvency event in New Zealand.

Reserve Bank response

33. We have amended the Bill in order to:

- Narrow the definition of ‘insolvency event’ so that it only applies in relation to insolvency events occurring in New Zealand;
- Remove any time limit for settlement finality protections for central counterparties, and

- Extend the time limit for settlement finality protections to seven days for overseas FMIs that are not central counterparties.

Information gathering powers

34. Some participants argued that information gathering powers should not extent to include indirect participants.

Reserve Bank response

35. We consider that information gathering powers need to reach through to indirect participants, in order to effectively support the monitoring of systemic risk originating from or being transmitted through FMIs.

Part 2: Minor or technical policy issues raised by submitters

36. Submitters also made a variety of minor drafting suggestions, which we have considered and reflected in the Bill where appropriate.

Submission feedback	Response
The interrelationship between the FMI Bill and the Financial Markets (Derivatives Margin and Benchmarking) Reform Amendment Act 2019 needs to be clear.	We have amended the Bill to address this issue.
Split views on whether already designated FMIs should be deemed to be designated under the Bill.	We have concluded that it is preferable to retain the approach of re-designating under the Bill FMIs that are already designated under Part 5C of the RBNZ Act (although in practice we expect to use a streamlined process for re-designation in part making use of analysis undertaken when they were designated under Part 5C).
Unclear whether netting protections apply to the operator when they are also a participant.	We consider that the existing drafting is sufficiently clear that netting protections do apply in this scenario.
Compliance costs a concern by domestic FMIs.	We consider that the regime is sufficiently flexible to ensure regulatory requirements can be appropriately tailored, and note that the Bill requires regulators to have regard to compliance costs when exercising powers under the Bill.
The definition of “rules” in clause 41 includes rules contained in a body’s constitution, which could pose issues in relation to the power to direct rule changes.	We have amended the Bill to clarify how rule changes that are contained in a body’s constitution are to be managed once they are approved by the regulators.

Various comments on how some definitions in clause 5 should be amended.	We have made various changes to definitions in clause 5 to address these points.
A number of submitters thought that the consultation under clause 26 should be extended to participants (in addition to the operator).	We consider that the input of submitters should largely be provided via an operator's own comments on a designation proposal by the regulator. Accordingly, we have included a requirement in the Bill for designation proposals to be published, so participants of an FMI can raise issues with the operator, who may they pass them on to the regulators.
Consistent references to validity and enforceability of FMI rules.	We have made various minor amendments to address these issues
Clause 95 should require the statutory manager to have regard to the principles set out in clause 91 (plus the principle to comply in so far as is practicable with the loss allocation and other recovery related powers in the FMI's operating rules) and consult with regulators in an off shore FMI's home jurisdiction (where applicable).	We have not made any changes in relation to this point, as we feel it would overprescribe how some of these matters would be dealt with in practice.
The power of a statutory manager to disapply the rules of an FMI should only extend to the New Zealand business of the operator.	We have made some amendments to address this issue
There should be no ability to selectively transfer contracts under a new operator scheme or to another person and in particular "all contracts with the same counterparty and subject to the same netting arrangement must be transferred together or left behind and where liabilities under contracts are secured by collateral held by a CCP, the liabilities and the associated collateral must be transferred together or left behind".	We have made an amendment to address this issue

Appendix:

	List of submissions to the exposure draft of the FMI Bill
1	Payments New Zealand (PNZ)
2	New Zealand Bankers Association (NZBA)
3	London Clearing House (LCH) **(confidential)**
4	Visa
5	Bank of New Zealand (BNZ)
6	Bell Gully
7	International Swaps and Derivatives Association (ISDA)
8	RBNZ as FMI operator (of ESAS and NZClear
9	Securities Industry Association (SIA)
10	Mastercard **(confidential)**
11	NZX
12	ASX **(confidential)**
13	Russell McVeagh
14	CLS **(confidential)**
15	Paymark **(confidential in part)**
16	NZFMA (late submission)