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Regulatory Institutions and Practices Inquiry
Productivity Commission
PO Box 8036
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Attention: Murray Sherwin

REGULATORY INSTITUTIONS AND PRACTICES DRAFT REPORT – FMA SUBMISSION

1. Thank you for the opportunity to provide comment on the Productivity Commission's draft report on its inquiry into regulatory institutions and practices. FMA welcomes the Commission's recommendations, in particular those aimed at improving the currency and responsiveness of our regulatory regimes and meaningful engagement on the performance of regulators and regulatory regimes. We also welcome the Commission's recommendations aimed at increasing the sharing of experience and practice among regulators, and the provision of guidance on effective regulatory practice. This submission addresses a few specific points in the report that we see as being particularly relevant to financial sector regulation in New Zealand.

Governance, decision rights, and discretion

2. FMA agrees that in general there are advantages in vesting significant regulatory decision-making powers in multi-member bodies, while allowing operational decisions to be vested in individuals. The manner in which these roles are best divided will depend on the legislative and market context in which powers are exercised. In FMA's submission the delegation provisions of the Crown Entities Act provide sufficient flexibility to allow governing Boards to determine the matters within their remit that are best dealt with by the Board, by Board committees or divisions, executive committees, or individuals.

3. In FMA's case the Board operates a regulatory delegations policy that requires matters of strategy and policy setting, as well as matters of significant sensitivity, to be referred to the Board. The policy also sets out specific non-delegated matters such as significant enforcement decisions. This model provides an appropriate balance between Board governance and oversight of significant regulatory matters and agility in operational decision-making.

4. A consequence of FMA's governance model is that we operate a conflicts of interest policy that is more rigorous than might be required in Crown entities with different governance arrangements. Our experience is that once instituted, such a policy is relatively straightforward to maintain. FMA's Board is comparatively large and its membership draws on a range of professional backgrounds and experiences. Given this, and contrary to comments in the draft report, FMA has not found that potential conflicts of interest have left it unable to form a quorum of Board members, even when exercising powers in relation to specific entities.

5. In addition, FMA's governing legislation allows it to appoint divisions of the Board, which operate with full (non-delegated) powers of the Board in relation to matters within their remit. Use of divisions allows FMA to avoid the potential for conflicts of interest that might otherwise arise where matters require consideration at Board level. FMA has never been required to draw upon the "permission" mechanisms provided in the Crown Entities Act to enable participation in such cases.

6. We believe that the non-executive Board model provides real advantages for FMA's connection with market developments and activity and for FMA's credibility with the market. The model is based on that of the Securities Commission, which was chosen after industry expressed concern at the original model for securities markets regulation, which would have vested regulatory authority in officials. The commission-model was adopted in order to provide clear independence from Government as well as respected expertise. It is consistent with the governance model used in financial markets regulators in a number of overseas jurisdictions.

7. In both the opinion of the Board, and my opinion as Chief Executive of FMA, the benefit of this structure to the market in terms of informed regulation and to the executive in terms of access to market and industry experience far outweighs any logistical challenges relating to ensuring conflicts do not present when addressing specific matters. This is all the more so at this time, given the role of FMA in setting policy and implementing new legislation, both of which require extensive examination and discussion of FMA's role as a regulator, its relationship to the market, and its use of its regulatory powers.

Accountability and performance

8. FMA agrees that accountability of regulators is vital to confidence in our regulatory regimes. In our submission this requires meaningful and timely engagement on regulatory strategy, and planning between regulatory Boards, Ministers, and senior officials. The draft report proposes a standardized form of reporting for all regulatory bodies. We agree that more granular reporting by regulators would assist with analysis of performance. However we are concerned that the "effectiveness" information proposed seems to rely heavily on activity measures, with 5 of the seven items being numbers of licences, investigations, enforcement actions, appeals, and complaints. We strongly believe that information designed to measure effectiveness of regulatory operations needs to be more nuanced than counting activities. We also consider that the metrics that are likely to indicate effectiveness of operations will be highly dependent on the role and context of each regulatory body.

9. We suggest that Boards of regulators should have the responsibility to propose measures of effectiveness that are appropriate to their mandate and strategy, and use these as part of an engagement with Ministers and monitoring departments about the harms on which the regulator will focus and the strategies it intends to apply to treat those harms. This engagement should also provide an opportunity for both the regulator and the responsible Minister to discuss and understand their respective risk appetites in relation to failures in the regulated market. It will be important that such an engagement is undertaken in a framework consistent with the Crown Entities Act requirements and does not impinge on the statutory independence of independent Crown entities in relation to their strategic focus and direction and the exercise of their regulatory powers.

10. We also doubt that a focus on licensing activity or other numerical metrics by itself is a helpful measure in the context of financial markets, as a more risk-based approach can reduce the importance given to initial gate-keeping activities and increase the emphasis paid to monitoring the population once licensed. Similarly, reliance on licensing and enforcement activity to tell the story of effectiveness stands the chance of ignoring informal interventions and supportive actions such as guidance.

Rule-making & currency of regimes

11. We share the Commission's concern that regulatory regimes have been allowed to go stale, and struggle to keep pace with industry changes. We have seen this with financial markets regulation in the past. We agree that greater use could be made of tertiary rule-making powers vested in regulators and also that this would require strengthened oversight by the Regulations Review Committee or other control mechanisms to address concerns that regulators could turn too readily to rule-making to address harms in their markets. The Financial Markets Conduct Act 2013 takes a step in this direction by allowing FMA to make designations and combine these with class exemptions to allow tailored regimes to be designed for new products. Such designations and exemptions will be submitted to the Regulations Review Committee.

12. Oversight of the use of these new powers is strengthened by the existence of clear statutory considerations that FMA must take into account in making any designation or exemption and a requirement that FMA publish its reasons when using the power. It is our experience that published reasons for regulatory instruments impose a useful discipline on the regulator, are a positive transparency measure, and are of assistance to the Regulations Review Committee in its scrutiny of these instruments.

Courts and Alternatives

13. One of the questions raised by the draft report is whether there is a need for greater specialization in the judiciary. Given the complexity of financial markets we think there is a case for specialized Courts or a market tribunal to provide services for non-criminal enforcement cases taken by FMA. Probably a more significant issue than specialization is timeliness of enforcement and litigation processes. The consistent feedback FMA receives is that deterrence messages from enforcement action need to be timely to be effective. We do not believe that the general Court system provides for this at present, in contrast to tribunals such as the NZ Markets Disciplinary Tribunal or the Financial Advisers Disciplinary Committee. We think it would be helpful for the Commission's final report to recommend review of the procedural impediments to swift resolution of regulatory enforcement matters.

Submission

14. We trust this submission is useful to the Commission. I should be happy to discuss anything in this submission, or other matters of interest to the Commission in its inquiry.

Yours sincerely

Rob Everett
Chief Executive