

Regulatory Impact Statement

Financial Service Provider Registration Amendments

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the Ministry of Business, Innovation and Employment.

It provides an analysis of options to minimise misuse of the Financial Service Providers Register by overseas based financial service providers in order to ensure that New Zealand remains a trusted place to do business. The status quo is not considered to sufficiently enable the Registrar of Financial Service Providers and the Financial Markets Authority to prevent the registration of financial service providers with no substantive link to New Zealand.

The analysis is based on information collected by the Registrar and on incidents of misuse reported to the Registrar and the Financial Markets Authority. There is some uncertainty as to the size of the problem identified, as the Registrar may not have identified all incidents of misuse. This analysis does not take into account incidents of misuse that the Registrar may not have identified.

None of the policy options identified are likely to have effects that the government has said will require a particularly strong base before regulation is considered.

The Ministry has undertaken targeted consultation with government agencies and a range of financial sector industry bodies on the proposed reforms.

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Status quo and problem definition

- 1 The Financial Service Providers (Registration and Dispute Resolution Act) 2008 (the FSPA), was a part of financial sector reforms in 2008 that aimed to promote confidence in financial markets. The FSPA established a public register for all financial service providers (FSPs). The purposes of the registration system are to prevent certain people from providing financial services in New Zealand; assist regulators with the regulation of the financial sector; and to ensure that consumers have access to free dispute resolution services. The FSPA applies to FSPs that are ordinarily resident in New Zealand or have a place of business in New Zealand, regardless of where the financial service is provided.
- 2 Since the registration regime came into effect in 2010 a significant number of offshore based FSPs have sought to register in New Zealand, in order to take advantage of New Zealand's reputation as a well regulated jurisdiction. These FSPs seek to register for services that are not licensed in New Zealand, such as foreign exchange services.
- 3 This may enable such operations to enjoy a lesser degree of scrutiny than might otherwise be applied when conducting their affairs around the globe. The customers of these FSPs may incorrectly assume that they are New Zealand based, or licensed in New Zealand, or both. While this may not impact on New Zealand businesses or consumers in a direct way, it does present a risk to both New Zealand's reputation as a well regulated jurisdiction and to the reputation of legitimate New Zealand-based financial service providers.
- 4 There have already been examples of FSPs registering in order to facilitate allegedly criminal activities. IB Capital FX (NZ) LLP, a United Kingdom limited partnership was registered from December 2011 until July 2012, until it was de-registered on the basis that it did not have a genuine place of business in New Zealand. IB Capital had allegedly been involved in fraud of around US\$53 million.

Withheld under s9(2)(g)(i) of the Official Information Act 1982

The Registrar and the FMA are assisting overseas authorities with the case.

5 Withheld under s9(2)(g)(i) of the Official Information Act 1982

These applicants are asked to provide further details to ensure they meet the qualifications for registration. The Registrar also consults the Financial Markets Authority (FMA), as the regulator with responsibility for financial markets. The Registrar is declining to register FSPs if it does not consider the applicant to have a legitimate New Zealand place of business.

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Withheld under s9(2)(g)(i) of the Official Information Act 1982

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- 8 In addition, while a person with a criminal conviction for theft, fraud or money laundering within the past five years in New Zealand is currently disqualified from registration, a person with an equivalent conviction in another country is not. There is nothing to prevent known overseas criminals from being registered, further damaging the reputation of New Zealand's regulatory regime.
- 9 If the status quo is maintained, there is a high risk that misuse of the FSPR will continue and cause damage to the both New Zealand's reputation as a well regulated jurisdiction and to the reputation of legitimate New Zealand-based financial service providers

Related Reforms

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Withheld under s18(d) and s9(2)(b)(ii) of the Official Information Act 1982

- 11 The Anti-Money Laundering and Countering Financing of Terrorism Act 2009, which comes into force on 30 June 2013, will impose a number of reporting requirements on New Zealand financial institutions. This will limit the potential for New Zealand-based FSPs to be used for money laundering and similar offences and impose some compliance costs on these FSPs. While this may dissuade some offshore based FSPs from registering in New Zealand for purely reputational reasons, it will not resolve the problem, as FSPs will only be required to report in relation to their New Zealand operations.
- 12 The government has already moved to address misuse of other registers. The Companies and Limited Partnerships Amendment Bill, currently awaiting its second reading, includes a number of measures to address the registration of shell companies and limited partnerships in New Zealand. While these measures should reduce the number of shell entities that are established in New Zealand, it will not resolve misuse of the Financial Service Providers Register as there is no requirement for an FSP to be incorporated in New Zealand.⁴

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Withheld under s18(d) and s9(2)(b)(ii) of the Official Information Act 1982

⁴ Like in other industries, overseas corporate entities are able to carry on a financial service business in New Zealand by registering on the Companies Office Overseas Companies Register. Also, financial service providers are often natural persons or types of unincorporated entities.

Objectives

- To promote confidence in New Zealand's regulatory regime for financial service providers.
- Any measures should be effective in reducing misuse of the financial service provider registration regime.
- The costs of legitimate businesses should be minimal unless the benefits can be clearly demonstrated to outweigh those costs.
- Any measures should not provide a means by which New Zealand financial service providers could avoid registration and any associated requirements.

Withheld under s18(d) and s9(2)(b)(ii) of the Official Information Act 1982

Regulatory impact analysis

Option 1: Changes to Scope and Registration Criteria

The territorial scope of the FSPA and the qualifications for registration could be amended to clearly exclude either FSPs that do not offer a financial service from New Zealand or FSPs that do not have a substantive presence in New Zealand. Changes to the territorial scope of the Act and/or the registration criteria could provide both the Registrar and applicants with clear criteria regarding which FSPs are not able to register in New Zealand. This would provide for an efficient registration process and would minimise the impact of this problem on the Registrar and FMA's resources.

However, any relatively minor changes to the territorial scope and/or the registration criteria are unlikely to be effective in preventing misuse of the register, as offshore-based FSPs are likely to adjust their operations to meet the amended requirements. On the other hand, significant changes to these criteria run the risk of having significant unintended consequences. Adopting a narrower definition of "place of business", for example, could allow some actual New Zealand-based FSPs to avoid registration by ensuring that they do not have a "place of business" that meets that requirement. We consider that it is important that the FSPA remains comprehensive in its coverage of New Zealand-based FSPs.

Option 2: Licensing of Services

The offshore-based FSPs that are of concern are attempting to register for financial services which do not require licencing in New Zealand. A number of other jurisdictions licence all financial services. In Australia, for example, all entities that provide financial services are required to obtain an Australian Financial Service Licence, which involves demonstrate to the regulator that they are competent and sufficiently resourced to carry on the proposed business. The licensing process allows the regulator to impose a range of requirements on applicants and ensures that all Australian FSPs, including those that are based offshore, are appropriately regulated.

However, it would be disproportionate to license all New Zealand FSPs purely to address the identified problem with offshore-based FSPs. We are of the view that that for a number of classes of financial services the costs on providers would outweigh the benefits of a licensing system. The costs associated with even a relatively light 'fit and proper' licensing

system for all FSPs would be significant and would only be justified if there were a broader public benefit in imposing further requirements. These costs would include an expansion of the FMA's licensing processes and systems and both direct and indirect costs on FSPs associated with the licencing process and ongoing regulatory requirements.

Option 3: Changes to Registrar's powers and disqualification criteria (Preferred option)

13 We recommend introducing three measures to directly target the identified problems, without significantly impacting on the wider group of legitimate FSPs.

Allowing the FMA to decline registration or de-register FSPs

14 This amendment would give the FMA the power to direct the Registrar to decline a registration (in the case of new applications), or to de-register an FSP (in the case of registered FSPs) where the FMA is not satisfied that registration is necessary or desirable in light of the purpose of the FSPA.

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16 The proposed power would allow the Registrar to refer clearly suspicious applications, and existing FSPs about which it has concerns, to the FMA for further consideration. The FMA is well placed to make determinations on this matter due to its role as the supervisor of financial market participants. FMA would consider a number of matters in deciding whether to decline registration or de-register an existing FSP, in light of the purposes of the Act. We anticipate that this will include assessing whether the FSP actually offers or intends to offer services from New Zealand or to New Zealanders. The purposes of the registration part of the FSPA include enabling the Registrar and other regulators to regulate financial service providers and to conform with New Zealand's obligations under the Financial Action Task Force Recommendations

17 The power would allow the FMA to look at the substance, rather than the form, of an FSP's operations. If, after examining the details of an FSP's operations, the FMA is confident that it is not desirable or necessary for the FSP to be registered, it will direct the FMA to decline registration or de-register the FSP. If it is not clear that a new application is genuine, the applicant will likely be registered, although their operations may be monitored to see whether they qualify for continued registration.

18 The FMA's decision to decline registration or to de-register an FSP could be appealed to the High Court under the FSPA's existing appeal provisions. The decisions will also be subject to judicial review.

- 19 The primary benefit of this approach is that it empowers the Registrar and the FMA to deal with misuse of the register in a flexible and proactive manner, without the costs and unintended consequences of the other options. In time, this measure is expected to reduce the volume of suspect applications as prospective applicants become aware of the higher standards being applied. Making it more difficult for offshore-based FSPs to use registration to incorrectly represent themselves as being licensed or regulated in New Zealand should promote consumer confidence in dealing with legitimate New Zealand FSPs.
- 20 There will be costs associated with this measure for any applicants that are subject to this consideration. They would likely be required to provide further information to the FMA, although for genuine FSPs the cost of obtaining this information should be low. In addition, for new applicants there would be some delay in their registration, which could delay an FSP from starting their operations. While there may be opportunity costs associated with any such delay, we expect that the number of genuine FSPs subject to this kind of extensive due diligence by the FMA at the application stage will be very low.

Extending the Registrar's inspection powers

- 21 The proposal would allow the Registrar to seek any information necessary to determine whether an FSP should be registered or whether an application should be referred to the FMA for a determination under the proposed power detailed above.
- 22 The Registrar's current inspection powers allow it to require information for the purpose of ascertaining whether an FSP is qualified to be registered or whether an FSP is in breach of the FSPA. Failure to comply with this power results in registration and potentially in a criminal conviction.

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- 23 In addition, there would be value in allowing the Registrar to insert a note of warning in the register, notifying that such a request has been made. The Registrar would decide whether to insert such a warning based on the circumstances of the request. The note of warning would alert members of the public dealing with an FSP that the Registrar has concerns about the FSP's registration status. A similar provision for companies and limited partnerships is included in the Companies and Limited Partnerships Amendment Bill.
- 24 The costs of providing further information to the Registrar are not expected to have a significant impact of genuine New Zealand FSPs. For genuine providers this information should be readily available, although if the registration is managed by a professional agent, such as an accountant, a fee based on the agent's hourly rate would be incurred. FSPs may also incur an indirect cost due to loss of business opportunities if the Registrar chooses to insert a note of warning on the register due to a loss of consumer confidence in the FSP.

25 The costs of the increased functions of the Registrar would be absorbed from within existing baseline funding.

Disqualifying persons convicted of certain offences other countries

26 The proposal would disqualify persons with overseas criminal convictions within the past five years that are equivalent to New Zealand offences involving dishonesty, theft and money laundering (as under Sections 217 to 266 of the Crimes Act) from registration as an FSP (and from the management and direction of an FSP).

27 This amendment will ensure that the same standards apply, regardless of where the conviction was received. However, it will not be feasible for the Registrar to undertake overseas criminal history checks on every FSP, and applicants will be required to self-certify that they do not have such a conviction. As a false certification could result in a criminal conviction, this may deter some persons with overseas convictions from making such a certification in order to gain registration.

28 In situations where the Registrar or the FMA suspects an applicant has made a false certification, they could require a criminal history check from any other jurisdiction considered relevant. Similarly if the Registrar becomes aware that a person with such a conviction is registered it will be grounds for immediate removal from the register. There will be a right of appeal to the High Court regarding any decisions to decline registration or remove an FSP from the register on this basis.

Consultation

29 The Ministry has undertaken targeted consultation with a range of financial sector industry bodies on the proposed reforms. These bodies expressed support for measures to strengthen the registration regime and emphasized the importance of maintaining the reputation of New Zealand financial markets.

30 The following government agencies have been consulted on these proposals: Treasury; Ministry of Justice; Department of Internal Affairs; Reserve Bank; FMA; and Department of Prime Minister and Cabinet.

Implementation

31 The implementation of the preferred measures is outlined above. We do not anticipate any transitional arrangements being necessary and we expect that the Registrar and the FMA will be in a position to implement these measures when the legislation comes into force.

32 As noted, the preferred measures are not expected to involve any significant process changes for the Registrar, as it will simply strengthen its existing register integrity work. There will need to be some changes to the Financial Service Providers Register website and forms to reflect the inclusion of certain overseas criminal convictions in the disqualification provisions.

33 The FMA will need to allocate resources to undertake its new role in assessing whether registration should be declined or an FSP de-registered. As the FMA already devotes significant resources to assisting the Registrar with suspect FSP registrations and to dealing with complaints about offshore-based FSPs, its initial assessment is that these costs should be able to be absorbed within current baseline funding.

34 When undertaking these assessments the FMA will be able to utilise the inspection powers delegated by the Registrar under the FSPA along with its power to require information under the Financial Markets Authority Act 2011.

Monitoring, evaluation and review

35 The Registrar will continue its monitoring of new FSP registrations to determine whether the proposed measures are effective in reducing misuse. The FMA, in its role as the regulator of financial markets, takes primary responsibility for monitoring registered FSPs, although there is ongoing information sharing and dialogue with the Registrar.

36 A statutory review of the FSPA is required to be submitted to Parliament by August 2015. The effectiveness of these measures and the necessity for any further changes will be considered as part of this review.