

Legal update on banking and commercial - June 2014

12 June 2014

Productivity Commission's draft report on the design and operation of New Zealand's regulatory system

The Productivity Commission (the Commission) released its [draft report](#) on regulatory institutions and practices on 13 March 2014 and is due to release its final report at the end of this month. The Report covers all regulatory agencies ranging from the New Zealand Walking Access Commission to the Reserve Bank - responding to the government's July 2013 request for advice on how New Zealand regulatory functions could be improved. As a consequence, the Report, at 466 pages, provides a long and general review of New Zealand regulatory regimes. It makes 130 system-wide findings and 43 recommendations on how to improve both the design of new regulatory regimes and operation of existing regulatory regimes. It does not, nor is it intended to, review individual regulators, specific regulations or regulatory objectives. The overall conclusion is that the system is not broken but there are system-wide deficiencies.

The Commission carried out three case studies, including one of the financial sector to which Buddle Findlay contributed (along with banks and some industry bodies), which formed the basis for a number of recommendations.

This article looks at how three issues identified by the Report - overlaps in regulatory function, variance of governance and merits review - apply to the financial sector.

Overlaps in regulatory function

Submitters identified duplicated compliance requirements as an issue in New Zealand. Financial markets were specifically identified as an area of concern in this respect. The Report notes several examples of overlap in regulation, such as the overlap (and potential conflict) between the New Zealand Stock Exchange (NZX) and the Financial Markets Authority (FMA) in regulating brokers under the NZX Participant Rules and the Financial Advisers Act 2008, and concurrent investigations by the Serious Fraud Office and the FMA.

The Report provides the following findings on managing regulatory overlaps:

- F 4.7: Cooperative arrangements like Memoranda of Understanding play an important role in managing regulatory overlaps. To be most effective, they should be reviewed regularly, be publicly available, provide clear guidance to regulated firms and individuals, and be empowered by legislation.
- F 4.8: Regulatory exemptions can help manage overlaps between regimes, and allow regimes to adapt to changing business practice and circumstances. Principles or criteria guiding the use of exemptions should be included in legislation and regulators should publish their reasons for granting exemptions.

No recommendations specifically aimed at reducing overlaps in regulation are made - nor was this appropriate given the purpose of the Report. Instead, the Report states (page 87):

- The best way to reduce regulatory overlaps is to review the relevant legislative frameworks, as these are the direct cause of conflict. New Zealand regulatory systems can struggle to keep current and coherent, due to a weak review and evaluation culture and difficulties in gaining access to time at Parliament in the absence of a crisis. A more strategic approach is needed to revisiting regulatory regimes, and the Commission sees a case for periodic, systemic and independent reviews of regulation.

We agree that this is a sensible approach. Overlaps in regulatory function cause practical difficulties in the management of regulatory compliance. In particular, we note that the overlap between the Department of Internal Affairs, FMA and Reserve Bank of New Zealand (RBNZ) in anti-money laundering regulation has created unnecessary duplication and inconsistencies in regulatory approach.

Variance of governance

The Report notes the variety of internal governance arrangements and allocation of decision-making rights in regulators. The Commission found that this variety appears to be ad hoc rather than based on sound governance principles. The Report cites regulation in the financial sector by the RBNZ, FMA and the Commerce Commission as an example of this:

- The RBNZ's regulatory powers are vested in a single decision maker - the Governor of the RBNZ. In particular, its board has no powers over its regulatory functions.
- The FMA's regulatory powers are vested in a large board of non-executive board members, who often have conflicts of interest.
- The Commerce Commission's regulatory powers are vested in a small board of executive commissioners.

In our view, a principled-based approach to governance is desirable, with any inconsistencies being justifiable. A review of the RBNZ and FMA's governance, including whether the extent of differences between them are justified would be sensible, given they operate as the twin peaks of financial regulation in New Zealand. The Report does not make any general recommendations to this effect. However, it does make more specific findings and a recommendation relating to the different models of governance:

- F 6.7: In designing new regulatory regimes, it is most appropriate to vest significant regulatory decision-making powers in multi-member bodies, unless there are good reasons not to. But a range of day-to-day administrative decisions are more appropriately vested in individuals.
- F 6.8: Designers of new regulatory regimes need to consider providing for the internal review of day-to-day administrative decisions which are taken by individuals.
- R 6.1: The effectiveness of a part-time board comprised of participants in the regulated sector (as in the FMA) should be reviewed by the State Services Commission before its wider application to other sectors of regulation.

In the related discussion on regulatory independence, the Report makes a finding that (page 104):

- There is inconsistent allocation of legislative provisions between primary legislation and types of secondary legislation in regulatory regimes. There is evidence that existing mechanisms to promote greater consistency are ineffective.

The variation between the regulatory requirements of the FMA and the RBNZ is as cited as an example of this - the FMA's main regulatory requirements are provided by government regulation made by the Governor-General in Council, while the RBNZ is responsible for setting most of the regulatory requirements without the need for them to be approved by the Executive Council. Two recommendations are advanced to address this:

- R 5.2: The Minister for Regulatory Reform should coordinate a principle-based review of regulatory legislation to ensure greater consistency in allocation of legislation material between primary legislation and types of secondary legislation.
- R 5.3: The Minister for Regulatory Reform should consider stronger mechanisms to ensure greater consistency in the allocating material between primary legislation and types of secondary legislation, either by elaborating departments' Disclosure requirements for government legislation, empowering Parliamentary Counsel to provide stronger guidance, or some other mechanism.

We would support such a review as a basis of improving the checks and balances over regulatory powers.

Merits review

The Commission found that in general, legislation establishing regulatory regimes does provide access to merits review of regulatory decisions. However, in areas of complex or highly technical regulation, access to merits review or the scope of appeal provided is often limited. This seems to be the case in the financial sector. Of the 94 statutes identified, 57 provided for full merits review. Of the 37 that didn't, ten belong to the financial sector with:

- The Anti-Money Laundering and Countering Financing of Terrorism Act 2009, Securities Transfer Act 1991, Financial Reporting Act 1993, Overseas Investment Act 2005 and the Reserve Bank of New Zealand Act 1989 providing no access to appeals
- The Commerce Act 2003, Financial Advisers Act 2008, Financial Markets Authority Act 2011, Securities Act 1978 and Financial Markets Conduct Act 2013 limiting appeals to questions of law.

The Commission did not make a finding or recommendation on whether merits review should be provided in specific regulatory regimes, although it appears to agree with the current position that merits review is not suitable for complex decisions. In general, the Commission saw judicial review as an effective mechanism for reviewing decisions:

- F 10.9: The Commission has found no evidence to suggest that judicial review is an ineffective method of challenging regulators' decisions, and ensuring they act in proper, lawful, and reasonable ways.
- F 10.11: Merits review does not offer additional safeguards to ensure decision makers followed good processes, beyond those offered by judicial review.
- F 10.12: The broad scope of judicial review in New Zealand means that the availability of merits review would not provide significantly stronger incentives on regulators to make correct decisions than is provided by access to judicial review alone.
- F 10.13: Providing access to merits review may not always promote the objectives of a regulatory regime.

We will provide an update on key features of the Commission's final report when released.

Amendments to CCCFA - Commerce Select Committee puts Bill through its paces

In March this year the Commerce Select Committee (the Committee) reported back on amendments to the Credit Contracts and Financial Services Law Reform Bill (the Bill) (this has now been separated to form the Credit Contracts and Consumer Finance Amendment Bill). The Bill is intended to amend the Credit Contracts and Consumer Finance Act 2003 (CCCFA). (It also contains changes to the Financial Service Providers (Registration and Dispute Resolution) Act 2008, but we have commented on these separately).

The CCCFA has been the subject of a review process since 2008, leading up to the Bill's introduction to Parliament in April 2013. Because of concerns that some lenders were engaging in irresponsible lending practices and some consumers were making poor choices, the Bill contained a number of amendments intended to ensure more responsible lending practices and better disclosure.

In our [November 2013 banking and commercial law legal update](#) we expressed concern at the underlying approach of the legislation, arguing that an increased emphasis on enforcement would be a better approach than increasing overall compliance costs for the industry and increasing uncertainty. We made a submission to the Select Committee on the Bill setting out our concerns and recommendations, which can be accessed online [here](#).

The Committee received a large number of submissions (more than 70) from a range of concerned parties, and made a number of changes to the Bill. The Committee's report can be accessed [here](#).

The most important of these, which we consider an important win for lenders, is the staggering of the commencement dates for the amendments, so that the responsible lending provisions only come into force once the 'Responsible Lending Code' (the Code) has been prepared. The Code will be drafted to set out expectations and guidelines for how lenders should discharge their new obligations, and provide safe harbours for lenders who comply with its provisions. As we noted in our article referred to above, the Bill as introduced to Parliament provided for the new obligations to come into force prior to the Code – thus potentially leaving lenders stumbling in the dark on how best to comply with their new obligations. The amendment at Committee stage avoids this problem.

A particular area of concern that still remains is fees - the extent to which lenders can validly recover costs, and the ability of borrowers to validly compare lenders, with some lenders loading into the interest rate matters that other lenders incorporate into fees. With the *Sportzone* decision still subject to appeal, and the Bill still leaving major uncertainties with regard to fees, this remains an area for further work.

The Bill has now had its Third Reading, and is due to receive the Royal Assent. We will keep our clients updated on the development of the Code and the timing and implementation of the changes.

Fair dealing - co-operation between the Commerce Commission and the FMA

On 1 April 2014, certain parts of the Financial Markets Conduct Act 2013 came into force, including provisions making the Financial Markets Authority (the FMA) the primary regulator of misleading and deceptive conduct in relation to financial services, a role previously held by the Commerce Commission. The Commerce Commission retains its role as the regulator in respect of the Fair Trading Act 1986, including in relation to consumer credit, but must obtain the FMA's consent before enforcing the Fair Trading Act in relation to the financial services.

The Commerce Commission and the FMA have entered into a Memorandum of Understanding (MOU) to assist them in managing the potentially overlapping roles of the two regulators. In summary the MOU:

- Reiterates that the FMA is the primary regulator of misleading and deceptive conduct in relation to financial services
- Sets out some very high level provisions around the process for the Commerce Commission obtaining the FMA's consent to bring proceeding
- Sets out some co-operation principles that both regulators agree to comply with, most of which relate to communication between the regulators.

Given the high-level nature of the MOU, it will be interesting to see how the split regulation is managed in the future.

Incorporated societies law reform: the government responds

It is generally recognised by those involved with or who act for incorporate societies that the Incorporated Societies Act 1908 is out of date and incomplete. As we have mentioned in our Business Law Reform articles, in August 2013 the Law Commission presented parliament with its final report "*A New Act for Incorporated Societies*", which, as the title suggests, recommended replacing the Incorporated Societies Act 1908 with a new Act for incorporated societies. It recommended that the basic principles for incorporated societies remain the same, being that:

- Incorporated societies are run by their members
- Incorporated societies should not distribute profits or financial benefits directly to members
- Incorporated societies are private bodies that should be self-governing

but that a wide range of other provisions around the establishment, governance, operation and dissolution of incorporated societies be set out in the new Act.

On 28 February 2014, the government responded to the Law Commission's final report. The government in principle accepted all but one of the Law Commission's recommendations. The one recommendation that the government did not accept was around the relationship between the new Act and agricultural and pastoral societies, which the government intends to respond to at a later time. The government proposes to prepare and release an exposure draft of the new Act and a draft model constitution for consultation in 2015.

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