

Regulating New Zealand's financial market infrastructures

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Approximately NZ\$35 billion flows through New Zealand's retail and wholesale payment systems each day. To put this into context, New Zealand's GDP will flow through New Zealand's payment system in just over a week. On an annual basis, approximately NZ\$8 trillion flows through New Zealand payment systems, or about a third of the United States' GDP.

To date, however, there has been very limited regulation of New Zealand's payment and settlement systems. The Reserve Bank of New Zealand (RBNZ) has some limited powers to require operators or participants in payments systems to supply it with information and have that information audited - but very few powers to intervene if things go wrong.

The RBNZ and New Zealand Financial Markets Authority also have the power to designate settlement systems, but only if the operator of the settlement system requests it. Operators of settlement systems only tend to do this if they require legal certainty for their rules, for example, to ensure that payments cannot be unwound, because a participant becomes insolvent.

Notwithstanding, or perhaps because of, the "light touch" regulation, payment systems in New Zealand have operated safely and efficiently and have been amongst the best performing in the world.

However, the regulation of New Zealand payment systems (and other financial market infrastructure (FMI)) is likely to change. The RBNZ has just concluded the second phase of its consultation on *Oversight of Designated Financial Market Infrastructures*. The proposed changes follow a global trend of prudential regulators taking a more active role in payment systems, despite the fact it was acknowledged that the world's FMIs performed well during the global financial crisis (GFC).

Nevertheless, regulators were concerned about what could have happened if payment and settlement systems failed. This led to the publication of *Principles for Financial Market Infrastructures* by the Bank for International Settlements and the International Organisation of Securities Commissions, which has provided some of the basis for reform in New Zealand.

The RBNZ's proposed approach is to introduce a Financial Markets Infrastructure Oversight Act (or amend its own Act) which regulates systemically important payment and settlement systems only. It has identified the following systems as systemically important:

- ESAS, the RBNZ's own exchange settlement account system for inter-bank settlement
- NZClear, the RBNZ's own settlement system for trading securities like government bonds
- High Value Clearing System, New Zealand's wholesale payment system
- Settlement Before Interchange, New Zealand's retail payment system
- NZCDC, NZX's clearing system.

In addition, it potentially also proposes to regulate to varying degrees the following international settlement systems operating in New Zealand:

- CLS Bank, which undertakes cross currency settlements between banks globally (although this is currently described as a domestic system by the RBNZ)
- LCH Clearnet, which clears some swaps for New Zealand banks
- ASX Clear (Futures), the ASX swap clearing business
- DTCC Singapore, which holds information about all derivatives trading in New Zealand.

Each of these entities will be required by the RBNZ to be designated and, by doing this; the RBNZ will then have powers to impose standards on those entities and to oversee their rules, as well as certain powers of investigation and enforcement.

Most of these powers are modelled on powers that the RBNZ currently has in respect of banks and insurers.

In its second phase of consultation, the RBNZ has specifically sought feedback on its crisis management powers. Crisis management has been a particular focus for prudential regulators since the GFC. In this respect, the RBNZ is proposing two tiers of crisis management powers.

The first tier relates to "crisis planning". This will involve a requirement for designated FMIs to have both a business continuity plan and a recovery and orderly wind down plan. A recovery and orderly wind down plan outlines how a failure of the designated FMI would be managed.

The second tier of powers being suggested by the RBNZ are the powers that the RBNZ would seek to use if FMIs were to get into difficulties or to fail. These include the power to give directions, the power to appoint or remove directors and the power to appoint a statutory manager.

Submissions on RBNZ's second round of consultation closed on 20 May 2016. Given new legislation is required to implement the changes; there should be ample time for those affected to plan for the changes.

This article was written by Simon Jensen (partner) for the Australasian Lawyer magazine (Issue 3.3, June 2016). Simon specialises in financial sector regulation, payments and clearing systems. He is the winner of the 2016 Client Choice Award for Banking (New Zealand).

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