OLIVER WYMAN

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

FMA PROGRESS REVIEW
STAKEHOLDER FEEDBACK REPORT

July 2013

MARSH & McLENNAN COMPANIES

Executive summary

- This report is the result of a review conducted by Oliver Wyman focusing on stakeholder perspectives on achievements, short-comings and future priorities for New Zealand's Financial Markets Authority
- The FMA has received wide recognition as a capable, credible, and professional regulator after establishing a significantly stronger and improved regulatory framework including efficient authorisation of market participants and the delivery of an increased level of conduct and disclosure clarity
- Stakeholders also praised the efficient and highly successful execution of legacy litigation activities and the establishment of the Strategic Intelligence Unit - perceived as a positive and innovative function with good potential and having already made some valuable initial contributions to the Council of Financial Regulators
- Stakeholders were highly satisfied with the FMA's achievement of a significant cultural turn-around from the Securities Commission through its collaborative, engaged and proactive working style and a significant increase in staff capabilities including the extensive re-vamping of staff, attraction of good talent and strong leadership and market presence
- There was broad recognition that the FMA's achievements were made against the backdrop of being a fresh organisation and under difficult circumstances including a large mandate with very limited timeframes
- There was general consensus that a lack of action on investor education was the FMA's largest shortcoming and a significant amount feedback was provided on ways in which the FMA could increase its activities in this area
- Additional areas for potential improvement highlighted included:
  - Some lack of clarity over guidance, particularly disclosure guidance and also the consistency of the FMA's advice and application of its own guidance when advising market participants
  - Stakeholders believed that the level of conduct guidance may be insufficient, particularly for some classes of advisers
  - Some concerns over the tone of some of the FMA's communications with market participants
  - Mixed views with regards to the relative level of supervisory activity across various sectors (some stakeholders feeling that the FMA was not allocating enough attention to smaller firms at the "fringes" of the market vs. larger firms and vice-versa)
- There were also mixed views – particularly between public and private sector stakeholders - on the FMA's role in and level of public communication on policy reforms – particularly with regards to input on policy reforms made in public

Contents

Section 1 | Introduction

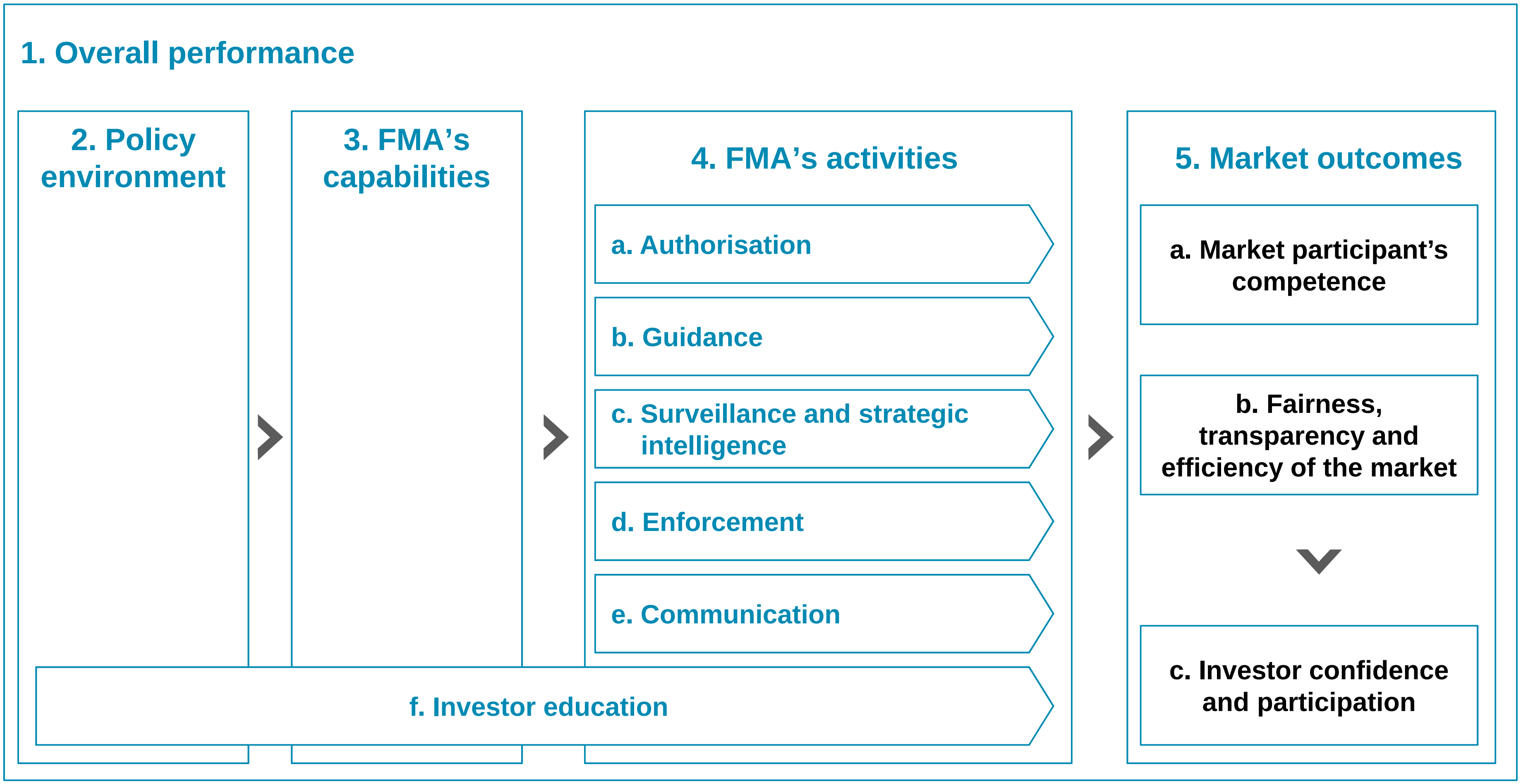
Context and background

- The New Zealand Financial Markets Authority (FMA) was established as New Zealand's consolidated financial markets regulator, commencing operations on May 1st 2011 as a Crown Entity assuming the functions of the Securities Commission, some functions from other agencies plus a range of new responsibilities
- As the FMA completes its second year of operation, the Board and management have decided to undertake a review of the FMA's progress to date, based on the views of key stakeholders from across the public, private and community sectors to assist it in shaping its priorities going forward
- The review sought to gather and synthesis stakeholder views on the following topics:
  - Key achievements and shortcomings of the FMA's work to date
  - Gaps in the FMA's activities or mandate
  - Organisational capabilities of the FMA
  - Prioritisation of key shortcomings and gaps to be addressed
  - Priorities for the FMA going forward
- Oliver Wyman was commissioned to conduct an assignment to address these goals and produce a report presenting its findings
- The report builds upon and further develops previous work including "Capital Markets Matter – Report of the Capital Market Development Taskforce" of 2009, which provided recommendations that contributed to the establishment of the FMA, as well as Oliver Wyman's 2011 report "Roadmap for Markets Regulation" which proposed an initial set of strategic goals for the newly formed FMA

Section 2 | Summary of stakeholder feedback

Our diagnostic framework assessed the FMA’s performance within the context of its broader policy environment and end market outcomes

Diagnostic framework



Diagnostic framework: details of categories of assessment

Categories of assessment

Categories	Components / activities
1. Overall assessment	• Overall stakeholder assessment of the FMA's achievements and shortcomings
2. Policy framework	• Markets' policy, legislative and broader regulatory environment
3. FMA's capabilities	• FMA's capabilities and resources
4. FMA's activities	
a. Authorisation	• Approving regulated entities
b. Guidance	• Guidance activities related to disclosure and conduct
d. Surveillance and strategic intelligence	• Identification of entity specific and economy-wide risks and issues
e. Enforcement	• Litigation and enforcement activities
f. Communication	• Communication with market participants and the public
f. Investor education	• Investor education activities
5. Market outcomes	• Impact on market participant's competence and market activity, efficiency, transparency and fairness • Impact on investor confidence and participation

Summary of stakeholder input (1 of 4)

Alignment of stakeholder views[1]: High Med Low

Categories			Key stakeholder feedback	Alignment
1	**Overall performance**	Achievements	• Wide recognition as a capable, credible, and professional regulator	
			• Successful implementation of a strong regulatory framework and delivery of an increased level of conduct and disclosure clarity	
		Shortcomings	• Key shortcoming: lack of action on investor education	
			• Other shortcomings: Guidance clarity and consistency of advice, low profile in the investor community, appropriateness of tone of communications and level of seriousness/urgency of information requests	
			• Mixed views on FMA's level of public communication on policy reform	
2	**Policy framework**	Achievements	• Praise for establishment of FMA and increased powers of FMA vs. Securities Comm.	
		Shortcomings	• Advisors: licensing regime largely does not consider qualifications and quality and creates an non-level playing field resulting in inefficient outcomes	
			• Custodians: custodians responsible for large share of managed fund assets and KiwiSaver but not directly supervised, licenced or required to have independent directors and have holdings audited	
			• KiwiSaver funds: lack of transparency and standardised reporting	
			• FMC: bill progressing slowly through parliament and reforms urgently needed	
3	**FMA capabilities**	Achievements	• Rapid cultural transition, extensive re-vamping of staff / attraction of good talent	
			• Opening and staffing of the Auckland office	
			• High degree of market praise for the public profile of the FMA CEO	
		Shortcomings	• Level of 'market related' skills and knowledge at the working level of the FMA	

1. Alignment refers to the level which stakeholders who expressed shared similar views on each point

Summary of stakeholder input (2 of 4)

Alignment of stakeholder views: High Med Low

Categories			Key stakeholder feedback	Alignment
4a	**Authorisation**	Achievements	• Licensing duties executed very efficiently and with a high degree of competence, professionalism and integrity and appreciative of working style • Recognition of high volume of licensing work conducted within short period	
		Shortcomings	• Concerns raised around additional compliance burdens being placed on directors	
4b	**Guidance**	Achievements	• Recognition of having done a good job, significantly improving disclosure standards while also maintaining fairness and praise for "consultative" working style	
		Shortcomings	• Lack of disclosure guidance clarity persists, leading to confusion and also, combined with the more serious threat of prosecution, an increase in risk-aversion activity resulting in longer prospectuses rather than "clear and concise" ones • Some experiences of inconsistent advice between the FMA and different firms • View by some that guidance stepped beyond a "reasonable interpretation of the Law" • Suggestions that there was insufficient conduct guidance (esp. for QFEs)	
4c	**Surveillance and strategic intelligence**	Achievements	• Strategic Intelligence Unit perceived as a positive and innovative function with good potential – recognition of already having produced some valuable initial contributions to the Council of Financial Regulators (e.g. retirement villages, property syndicates and shell companies) • Limited views and familiarity with surveillance work, although a very few participants suggested that efforts were robust and covered market participants well – particularly with regards to financial advisers (although some disagreed with this view)	
		Shortcomings	• Lack of clarity over the focus areas and purpose of the Strategic Intelligence Unit • Lack of focus on identifying risks at the "smaller end of town" • Lack of surveillance and detection of insider trading activity • Lack of actionable insight on the actions required to mitigate/monitor risks raised	

Summary of stakeholder input (3 of 4)

Alignment of stakeholder views: High Med Low

Categories			Key stakeholder feedback	Alignment
4d	Litigation activity / enforcement	Achievements	• Financial company litigation was well executed and the FMA have established a sense of increased the regulatory threat • Stakeholders appreciated the FMA's transparency over its enforcement framework	
		Shortcomings	• Section 34 of the FMA Act under-utilised • Prosecution activity has dragged on too long	
4e	Communication	Achievements	• General satisfaction with the level of engagement and communication and the FMA's ability and willingness to consult with market participants and provide guidance • Opening of Auckland office • Most stakeholders very satisfied with FMA's high public presence	
		Shortcomings	• Tone in communication with market participants was often harsher and critical than required and sometimes exaggerated sense of urgency/seriousness • Instances of lack of response from the FMA or significant delays in responses following submission of information requested by the FMA from market participants • Under-investment in public engagements with the investor community • Strong and divergent views with regards to the FMA's public communications on policy reform (most public sector stakeholders felt that the FMA should reserve comments on policy to internal discussions, while private sector stakeholders supported the FMA's public commentary on policy reform)	
4f	Investor education	Achievements	• None mentioned	
		Shortcomings	• The majority of stakeholders felt that the FMA should play an active role in investor education although there was a large variety in views on what their role should be • A smaller number of stakeholders felt that the FMA should not have a role in investor education	

Summary of stakeholder input (3 of 4)

Alignment of stakeholder views: High Med Low

Categories			Key stakeholder feedback	Alignment
5a	Market participant’s competence	Achievements	• Overall, too early to make an accurate judgement of progress although view that licencing, compliance and litigation activities had resulted in a significant positive “cultural shift” and behavioural change across market participants	
		Shortcomings	• Key gaps surround financial adviser, trustee and custodian competence	
5b & 5c	Fairness, transparency and efficiency of the market / investor confidence and participation	Achievements	• Stakeholders suggested that it was difficult to provide firm views on the FMA’s impact on market efficiency, fairness and transparency, given its short period of operation and due to a lack of clear evidence given the numerous factors impacting the market • Litigation efforts and establishment of “regulatory threat” resulting in increased fairness • Disclosure guidance and conduct activities contributing towards improved transparency and efficiency • FMA’s public litigation work to keep directors accountable and increased presence have proved it to be a capable and credible regulator and have improved investor confidence	
		Shortcomings	• No major shortcomings raised	

Detailed inputs from stakeholder interviews
1: Overall assessment (1 of 2)

Key achievements

- Near full consensus among stakeholders of a **highly successful first two years**
- Won appreciation and **wide recognition as a credible, competent, professional regulator**
- **Implemented a strong regulatory framework and established market presence**
  - Implementation of licensing across a large population of market participants
  - More guidance issued in 2 years than during the Securities Commission's duration with the quality of guidance being "very useful" and improved regulatory clarity
  - Litigation activities executed with a high degree of efficiency
  - Achieving behavioural change within market – for example directors who are "starting to take their obligations seriously and thinking about the risks"
  - High regard for CEO and leadership team
  - Increased compliance contributing towards a return of confidence and an attitude of "respect and fear" from market participants
- Wide recognition across stakeholders that the **FMA's achievements were made in the context of a demanding mandate**, and that they had to effectively "start from scratch"
  - High expectations for a significant break in "reactive" and non-engaging operating style, "gun-shy" regulatory attitude and effectiveness from the Securities Commission
  - Significant recruitment, training and re-training of staff needed plus cultural change
  - Worked within challenging legislative frameworks (e.g. for advisors)
- While shortcomings and opportunities for improvement were identified, stakeholders were broadly very impressed with the FMA's performance over its first two years, and some suggested it was difficult to be critical given the large mandate of work executed successfully

"They did an incredible amount of work in a short time. I admire what they've been able to do. Their responses have been very mature as a regulator"

– Industry body stakeholder

"They've struck the right balance between supervision, enforcement, guidance"

– Private sector stakeholder

"They've come across as firm but fair"

– Private sector stakeholder

" Rather than just waving a big stick, they've been good at trying to resolve things in a fair manner collaboratively"

–Industry body stakeholder

"The Securities commission had a legal mindset while the FMA has a market mindset"

– Public sector stakeholder

"Their view is that they don't want to be the ambulance at the bottom of the cliff – is the right one"

– Industry body stakeholder

" The regulator has teeth and is willing to use them – Sean has made it clear that the FMA is not to be messed with"

–Industry body stakeholder

Detailed inputs from stakeholder interviews
1: Overall assessment (2 of 2)

Operating style and work attitude

- Near unanimous agreement that the **FMA's operating style**, which represents a **significant departure from the Securities Commission's**, is **highly effective and appreciated**
  - Proactive approach to regulation and enforcement, often "stepping in early"
  - "Productive", "engaging" working style, culture of "openness" and willingness to have private dialogues with market participants and guide them to solutions
  - Tough but fair attitude when dealing with misalignments between market participants' and FMA positions on various issues such as disclosure
  - Good commitment to deadlines

"They are very pragmatic to deal with and good to engage with"

– Private sector stakeholder

" All our experiences have been characterised by them being professional, reasonable and measured"

– Private sector stakeholder

" They were accommodating of our time frames and met deadlines"

– Private sector stakeholder

Shortcomings

- Overall, largest shortcoming mentioned by stakeholders regarded a **lack of investor education activity and leadership**
- A number of stakeholders also felt that there was more room for improvement in the FMA's **disclosure guidance clarity**, and also in terms of the **consistency of feedback** from the FMA in advising market participants on disclosure guidance
- Significant concerns were raised around the **financial adviser licensing regime**, although stakeholders acknowledged that these were dependent on legislative change and that the FMA may only be able to **contribute through increased conduct guidance for now**
- There were some calls for more **clarity on the role and focus of the strategic intelligence unit** and also for the division to better **articulate the implications** of the risks it identifies
- Stakeholders recognised a need to **continue to foster management talent development** to ensure the strong leadership of the organisation could be sustained
- There were a few strong views around **moderating the tone of FMA communications and ensuring a greater level of consistency** in application of regulations
- **Strong but mixed views on the level of public commentary** the FMA should engage in with regards to **policy reform**

" The FMA's single biggest shortcoming is investor education"

– Industry body stakeholder

" They've sometimes taken guidance a little further than they should have and almost created new laws, but that's part of the learning curve"

– Private sector stakeholder

" They do behave like a regulator. There's the image of the sheriff on a horse coming to town to clean up. This is a good starting point, but being more forward looking would be good"

– Private sector stakeholder

Detailed inputs from stakeholder interviews
2: Policy environment (1 of 4)

Positive comments on policy environment

- Stakeholders highly supportive of policy to establish the FMA and the increased powers and mandate granted to the FMA in comparison to the Securities Commission
- Furthermore, stakeholders found the oversight of financial advisers to be a positive first step for the industry
- Many stakeholders view the FMC bill as vital part of the financial markets reform process and believe it will address a number of longstanding issues

"While its not perfect the Financial Advisors Act is a big step forward

– Private sector stakeholder

Inputs on specific areas of policy

a. KiwiSaver disclosure

- Several stakeholders suggested that a **lack of standardised/comparable, accurate, transparent and regular reporting of fees and performance** in KiwiSaver funds were **generating significant inefficiencies** in the market and must be addressed immediately
  - Stakeholders reported many problematic practices including the use of self-created benchmarks for performance comparisons and varying fee calculation metrics
- More broadly, across KiwiSaver and other managed funds, some stakeholders suggested that **full and regular disclosure of underlying holdings** of funds was required to improve transparency and assist the market in understanding risks
- Some consensus that a **consolidated repository for KiwiSaver fee, performance and holdings data** would be beneficial to market transparency, confidence, efficiency and potentially even participation, with a potential role for the FMA in overseeing and/or hosting it and also making calculation methodologies widely available

"KiwiSaver has a 'halo' brand and a lot of people think that its government guaranteed and safe – if anything goes wrong, it could cause a lot of damage"

– Private sector stakeholder

"We need a service like 'What's My Number' [1] to improve KiwiSaver transparency"

– FMA stakeholder

1. New Zealand Electricity Authority - http://www.whatsmynumber.org.nz/

Detailed inputs from stakeholder interviews
2: Policy environment (2 of 4)

b. Advisor regulation

- Broad **concerns that adviser licensing requirements are not strong enough**
  - **Wide concerns that the qualification requirements for AFAs were not strong enough** driven by a perception that there were many insufficiently qualified advisers operating
    - Some stakeholders suggested that a lack of professional qualification requirements resulted in lower incentives to invest in such qualifications
  - This concern which was echoed more strongly for RFAs, with some stakeholders suggesting that the **RFA regime was meaningless given the low entry requirements**
  - Some stakeholders suggested that RFAs, despite being limited to category 2 products, still have a large influence on personal financial outcomes and arrange significant financial solutions without qualifications to advise their clients
  - Some concerns that the **public interpreted the AFA and RFA designations as representing qualifications, quality and capability**
    - Concerns that the RFA and AFA brands had become stronger than qualifications such as the CFP and that there was a need to educate the public as to what they really mean
- While most stakeholders felt that adviser licensing requirements should be strengthened, one stakeholder cautioned that this could result in many advisers exiting the market and a resulting under-supply of advisers
- A number of stakeholders highlighted that they felt **QFE's were under-regulated with limited conduct guidance and supervision**, especially when considering their wide product coverage
  - A few stakeholders suggested that there was potential for mis-selling practices to occur
- Overall, a number of participants expressed that the **legislations were resulting in "double-standards" between AFAs, RFAs and QFEs, creating a non-level playing field**

"There is a public expectation that the government should do something (on advisors and investment schemes) and inevitably, the FMA may take some of the blame for this"

– Industry body stakeholder

"The framework for advisors is flawed and doing disservice"

– Private sector stakeholder

"It's a surprise that the debate on adviser legislation has not been given priority"

– Industry body stakeholder

"There are too many under-advised people out there and its too hard for advisers to make a buck – its not worth dealing with people with <$500k for them. Further tightening of licensing could result in even fewer advisers in an already under-advised market"

– Private sector stakeholder

"There is a perception that the FMA is biased in their attention towards the AFAs only, and do not spend much time on QFEs/QFE agents"

– Private sector stakeholder

"The process was too simple, that's why Ross got through"

– Industry body stakeholder

Detailed inputs from stakeholder interviews
2: Policy environment (3 of 4)

c. Custodian regulation

- A number of stakeholders expressed that they felt that a number of **gaps existed with regards to legislation and regulation surrounding custodians for managed funds**
- Stakeholders expressed that these **gaps were significant given the size of assets held under custodians (including KiwiSaver funds)** and the **potential for systemic risk** if a problem were to emerge
- Key gaps identified included:
  - **No requirement to be licensed**
  - **No requirement for independent directors** on custodian boards and no limitations to related entities acting as custodians
  - **No requirements for auditing of underlying assets**
  - **Trustees are given full responsibility to monitor custodians,** rather than any external regulator and there are capability problems prevalent in trustees
- Ross Asset Management was commonly brought up as an example citing the key role that a lack of custodian independence played in enabling his practices

"The underlying assets should be held in a place that is audited and trusted"

– Private sector stakeholder

"Custodian independence is very important"

– Private sector stakeholder

"Custodians are the biggest area of risk"

– Private sector stakeholder

Detailed inputs from stakeholder interviews
2: Policy environment (4 of 4)

d. Other issues raised

- **Financial Markets Conduct (FMC) Bill:** A number of stakeholders expressed concerns that the FMC bill was progressing too slowly and may be passed to late to also meet timelines proposed for compliance with the Bill
- **Category 2 product regulations:** A few stakeholders suggested that there were significant gaps in the overall level of regulation and oversight of category 2 products and their sales practices, and that there may be potential risks here in the future
  - High degree of product churning of insurance policies mentioned as an example
- **Upfront fees:** In relation to the high levels of product churn, a few stakeholders suggested that rules around upfront fees should be tightened to reduce the incentives to churn product

"The real issue is for the Government to get on and pass the FMC Act"

– Private sector stakeholder

"Potentially too much focus on category 1 products – there are a lot of potential issues in category 2 products – a potential accident waiting to happen, although this is also a legislative issue"

– Industry body stakeholder

"There are distributor groups who are blatantly churning clients predominantly around category 2 products"

– Private sector stakeholder

Detailed inputs from stakeholder interviews
3: FMA Capabilities (1 of 2)

Key achievements

- Wide recognition and commendation from stakeholders on a **rapid cultural transition** and **extensive re-vamping of the staff** of the FMA together with its **efficiency in opening and staffing the Auckland office**
- Further wide recognition that the FMA have been **able to attract good talent** and that **staff capabilities have generally risen** when compared to the Securities Commission and that **capabilities are continuing to improve**
- Stakeholders generally indicated that they had found the FMA's staff to be very **capable and have a good understanding of the subject matters** being discussed
- A key aspect mentioned almost unanimously across stakeholder groups was **significant public profile of the FMA's CEO** and his personal influence in shaping the industry and leading as the face of the FMA
- Positive feedback with regards to the FMA's secondment program with law firms and other public sector bodies as a way of building mutual understanding

"The FMA have attracted some great talent"
–Private sector stakeholder

"They've invested in the right capabilities"
–Private sector stakeholder

"The CEO's got market credibility"
–Private sector stakeholder

Detailed inputs from stakeholder interviews
3: FMA Capabilities (2 of 2)

Development opportunities

- Overall, **only a few capability orientated issues were pointed out** with regard to existing staff with the key points being:
  - The extensive nature of the FMAs mandate and the rigour to which they have applied themselves has seen some **level 2 and 3 managers appear to be stretched and stressed**
  - A need to **train staff** across the board to **handle a scaling up of operations** – particularly with regard to methods to strategically prioritise monitoring and surveillance activity
  - Recruiting more "markets orientated" people (i.e. former stock analysts, brokers etc), who may be better able to communicate investment and market risks to the public
- Wide recognition that the **FMA may be under-staffed/under-resourced to scale up**, particularly once the Financial Market's Conduct Bill is introduced and that continuing to source talented people will be difficult
  - The FMC Bill's introduction will result in the requirement to re-train FMA staff and to re-issue guidance notes which will represent a significant investment
  - Furthermore, some stakeholders believe there will be a significant increase in the FMA's 'inbound' workload under the bill
- Internal recognition that **they could do more, if they were resourced to do so**

"The FMA's staff need to build industry networks and win the trust of the industry"

–Industry body stakeholder

"The FMA's staff came from a broad range of backgrounds and many did not really know the industry well initially. They went in without an appreciation of the market, but things have improved a lot lately"

–Industry body stakeholder

"There is still a bit of a 'Jekyll & Hyde' situation between the old Securities Commission culture and the new FMA culture"

–Public sector stakeholder

Detailed inputs from stakeholder interviews
4a: Authorisation

Key achievements

- General consensus across stakeholders that the FMA had **executed its licensing duties highly efficiently** and with a high degree of **competence, professionalism and integrity**
  - Wide appreciation of the **complexity of licensing a large population** of market participants within limited timeframes and a **"challenging legislative framework"**
  - Consensus that **guidance provided for licencing was of a high standard** and "very useful" and representing a significant increase in standards from the previous regime
- Market participants overall were **highly appreciative of the FMA's working style describing them as "approachable", "willing to listen", "engaging"** and their culture as promoting "openness" enabling participants to understand requirements
- General commendation for **establishment of market presence** which is conducive to broadly improving confidence
- However, especially internally, there was recognition that there was more to do, to improve the current licencing regime, although limitations are largely a result of legislation

Shortcomings

- Stakeholders generally recognised that it is **difficult to be critical of the FMA's compliance and conduct work given the amount of work it had completed in in a short time**
- One stakeholder suggested that the **FMA placed greater emphasis on form over substance and detailed industry knowledge** and that his experience of the licensing process was a negative one
- Most short-comings raised in relation to authorisation were focused on the policy framework and are thus addressed elsewhere in this document

"The FMA's efforts in carrying out the authorisation exercise in the timelines they did were very impressive"

– Private sector stakeholder

"They've done a very good job to work within the financial adviser framework"

– Private sector stakeholder

"From a regulatory perspective, they operate in a best practice way"

– Industry body stakeholder

"These guys are not slackers, they are tough"

–Private sector stakeholder

"They've established a market presence – everyone knows that there's a regulator there"

– Private sector stakeholder

Detailed inputs from stakeholder interviews
4b: Guidance (1 of 4)

Key achievements

- Overall stakeholder **recognition of having done a good job, significantly improving disclosure standards while also maintaining fairness**
- Recognition that **assisted compliance activities including discussions around conduct guidance** had also been **proactive and engaging**
- Strong commendation with regards to the **FMA's "consultative" working style and willingness to work together with market participants** and guide them through to achieving appropriate disclosure standards, rather than only review outputs at the end
  - An often quoted example included was the FMA's responsiveness and willingness to listen to the industry, acknowledge an error and re-issue a disclosure guidance note with a perception that the process was professionally managed
- A key acknowledgement mentioned by some stakeholders was that the **FMA was perceived to know its boundaries well with regards to what aspects of disclosure they should oversee**
  - The FMA's decision to not get involved with marketing imagery and style in the Moa Beer prospectus and focus only on investment related disclosure was cited as a positive example by a few stakeholders
- Some stakeholders however mentioned that the real test will come when the FMC Bill is passed

"Their guidance activity has been good and they have shown that they are willing to listen and it may be too early to judge any shortcomings"
–Private sector stakeholder

"Prescriptive but helpful"
–Private sector stakeholder

"Their approach has been first class – we couldn't have expected more"
–Private sector stakeholder

"All of our experiences have been characterised by them being professional, measured and reasonable"
–Private sector stakeholder

"They are tough, demanding (with regards to standards), and good to work with"
–Private sector stakeholder

Detailed inputs from stakeholder interviews
4b: Guidance (2 of 4)

Shortcomings – disclosure guidance

- A **lack of guidance note clarity** was **leading to some confusion** and also, combined with the more serious threat of prosecution, **an increase in risk-aversion activity resulting in longer prospectuses rather than "clear and concise" ones**
  - A **lack of clarity on the definition of "clear and concise"**
  - Some lack of clarity between the **level of disclosure required in the investment proposal vs. the prospectus -** although largely driven by legislation
  - Some views of **inconsistent application of guidance** into comments on issuer documentation between different issuances and lack of clarity in verbal guidance
  - Element of increase in risk aversion recognised as an **industry-wide "wake up call"**
- **Similar risk-aversion and long disclosure practices were also observed in the financial advice industry**
- Some stakeholders felt that the **FMA had stepped beyond a "reasonable interpretation of the Law"** with regards to disclosure guidance leading to further **confusion and risk-aversive behaviour**
- Concerns were also raised around **additional compliance burdens being placed on directors**, and compliance discussions accounting for a larger share of Board meetings, although some viewed this as catching up to international practice and not necessarily unhealthy

" The FMA may be making it worse by not making guidance clear enough"

– Private sector stakeholder

" I don't know how helpful it is for investors to get a 250 page prospectus"

– Private sector stakeholder

"Their focus should be on thinking of the economics of what happens rather than a strict adherence to laws"

–Private sector stakeholder

" They may have stepped beyond the reasonable interpretation of the law in one or two cases"

– Public sector stakeholder

" There's a disconnect between what their guidance says and the law - if their expectations are not realistic, they will have issues"

–Industry body stakeholder

" Sometimes the FMA were unclear whether they wanted us to change aspects of our disclosure documents"

– Private sector stakeholder

Detailed inputs from stakeholder interviews
4b: Guidance (3 of 4)

Shortcomings – conduct guidance

- The following views were each expressed by smaller sub-groups of stakeholders:
  - **Some perceptions of inconsistent advice** between FMA written guidance, verbal communications, and the specifics of legislation, and the interpretations of legal advisors ; or between guidance provide on the same issues to different firms
  - **Strong desire for clearer conduct guidance from some AFAs and QFE advisors** in order reduce compliance risk and simplify training
- In light of these issues, there was **appetite (including across the private sector) for further guidance, particularly on advisor conduct** to ensure that private sector practices were developed in line with regulatory expectations and to avoid future regulatory surprises requiring vast changes

"What would be more helpful is more code of conduct guidance as we are going along doing it our own way for now"

– Private sector stakeholder

" We'd be happy to see more codified guidance – the industry is very hungry for guidance and we're not resisting. However, we don't want surprises"

– Private sector stakeholder

Shortcomings - other

- Many stakeholders suggested that **lawyers were effectively intermediating** between the FMA and Directors in efforts to interpret FMA guidance, with **instances of advice erring on excessive risk-aversion common,** adding to prospectus length
- One stakeholder felt that the FMA was focused more on "systemically important floats" and could **increase attention on other, smaller issuances**

" The legal profession may be becoming an intermediary between the FMA and the market"

– Public sector stakeholder

Detailed inputs from stakeholder interviews
4b: Guidance (4 of 4)

Suggestions from stakeholders

- A number of stakeholders expressed an **appetite for further guidance to increase the level of clarity**, and **engage in some broader industry-wide informational sessions** to **clearly communicate their expectations** outlined in the guidance notes
  - Suggestions for **further engagement with legal community and boards** to clarify guidance – potentially after the FMA bill is passed
- A number of stakeholders believed that the FMA should **consider introducing a "lighter" or less onerous disclosure and compliance regime for smaller growth orientated companies** to enable them to **improve access to capital markets**
  - Some participants believed that smaller companies find the current disclosure and compliance regime too expensive and onerous to justify accessing capital markets, while others believe they simply have less interest in capital markets financing
  - "Light" disclosure regime would focus on the most essential aspects requiring disclosure and be subject to regulatory review
  - Internal discussions suggested that such action would be within the FMA's powers

" Either force a high level of disclosure on them [small/growth companies seeking to list] raising their costs, or light disclosure and focus on what matters"

–Private sector stakeholder

" The FMA has got to be seen to be out there educating the market about their disclosure expectations"

–Private sector stakeholder

" [Small companies] are nervous about the thought of being in the market and being regulated"

–Private sector stakeholder

Detailed inputs from stakeholder interviews
4c: Surveillance and strategic intelligence (1 of 3)

Surveillance - achievements

- There were **limited views** received with regards to the surveillance efforts of the FMA, partly due to a **lack of familiarity** with the FMA's broader surveillance efforts
- A few participants suggested that the FMA's surveillance efforts were robust and covered market participants well – particularly with regards to financial adviser auditing

"There is a perception that they have a cop on every corner"

–Private sector stakeholder

Surveillance - shortcomings

- A **lack of surveillance and identification of insider trading cases** was indicated as a key gap by a few stakeholders
  - Stakeholders suggested that there was a general perception of insider trading activity occurring and not being detected and addressed yet
  - Internal interviews indicated that the FMA was beginning to review its approach to identifying and addressing potential insider trading cases
- Some recognition that the **FMA may be under-resourced to effectively perform surveillance activities** across the wide population of licenced entities they cover, particularly the thousands of advisers
- A few stakeholders suggested that the FMA consider how it could further incorporate improved data mining and technology to further enhance its surveillance capabilities

"I don't think they are doing anything about insider trading"

–Private sector stakeholder

Detailed inputs from stakeholder interviews
4c: Surveillance and strategic intelligence (2 of 3)

Surveillance - potential areas of future focus

- Some stakeholders suggested that the FMA should **increase its surveillance focus on participants at the "smaller end of town"** (e.g. advisers, brokers and smaller issuers) while others suggested they need to **increase surveillance of larger participants** (e.g. banks, trusts, KiwiSaver):
  - **Increased focus on smaller market participants**
    - Historically where problems have occurred – "there will be more Ross's out there"
    - Some stakeholders indicated that **Ross Asset Management's practices where known** to many people in the advising industry and that if the FMA were networked at this level, they would have been informed informally, while **others disputed this**
    - Need for increased focus supported by perception of **public expectation that the FMA actively conducts surveillance on advisors**
    - Need for a channel for FMA staff and for wider industry participants to efficiently escalate potential risks and problematic practices suspected among smaller market participants to the FMA – although efforts are currently being considered here
    - Potentially consider mystery shopping
  - **Increased focus on the "big end of town"**
    - **Growth and significance of KiwiSaver warrants increased focus (examples included the governance and supervision framework for KiwiSaver** and related institutions including **custodians and trustees**)
    - Recognition that any problem with KiwiSaver could cause a significant drop in investor confidence
  - Currently the FMA is perceived to be well networked "at the big end of town"

"There were investment managers around town who lost clients to Ross Asset Management– they knew and should have raised a flag. The industry is relationships driven and having relationships within this community could have served to alert the FMA of Ross Asset Management"

–Industry body stakeholder

"The more active they get in fringe markets (the investor side and IFAs) the more they will be supporting market activities"

– Industry body stakeholder

"They don't have the capacity to do basic checks on financial advisers"

–Private sector stakeholder

"There are bigger fish to fry – there may be more Ross Asset Managements out there"

–Private sector stakeholder

Detailed inputs from stakeholder interviews
4c: Surveillance and strategic intelligence (3 of 3)

Strategic intelligence - key achievements

- Stakeholders who were familiar with the FMA's relatively new strategic intelligence unit described it as a **positive and innovative function with good potential**
  - Recognition of **good initial work in setting up analytical frameworks**
  - Recognition that **approach of "following the money" was sensible**
- Public sector stakeholders identified that the unit had **already produced some good initial work** and had made **valuable contributions to the Council of Financial Regulators**
  - Ensuring the council are aware of **key emergent systemic risks**
  - **Identification of potential sector specific risks** including retirement villages, property syndicates and shell companies

" The FMA bring valuable intelligence to the Financial Regulator's Council and their analytical rigour is fine"

– Public sector stakeholder

" Setting up the strategic intelligence division has been a good move to address the big picture issues and give some guidance and warnings to the market for example of a property bubble"

– Industry body stakeholder

" If the FMA had not brought some of these risk discussions to the table, the risks may not have been identified"

– Public sector stakeholder

Strategic intelligence - shortcomings

- Overall, stakeholders (both external and some internal) expressed a **lack of clarity over what the focus areas and purpose of the strategic intelligence unit were and should be** – partly attributable to the fact that the unit was a recent addition
- Some perceptions that the FMA was still reactive, although these were in the minority
- Stakeholders suggested that once potential risks/issues were identified by the FMA, they were **unclear on the actions required to mitigate/monitor those risks or implications**
- **Internal recognition that the team is often utilised for other purposes** such as research for exemptions **diverting attention from intelligence related work**
- A few stakeholders suggested that the **FMA should consider closer monitoring of Solicitors Nominee Accounts** and **FX brokers** for potential risks

Detailed inputs from stakeholder interviews
4d: Enforcement (1 of 2)

Key achievements

- **General consensus across stakeholders that the FMA's litigation activities were very successful and well executed** in terms of speed, efficiency and professionalism
  - 100% win rate on cases undertaken and several high profile cases fought
  - Perception of having done what they can with limited resources
  - Rapid mobilisation from initial alert (for example with Ross Asset Management)
  - Stakeholders appreciated the FMA's transparency over its enforcement framework
- Consensus across stakeholders that the **FMA has increased the regulatory threat** and **delivered a firm message that they are there to defend the rights of the public** and that white collar criminal prosecution is possible
- Overall message has been positive for investors

"They've done a very good job, considering what they inherited and the GFC fallout, the recruitment efforts and expanded mandate"

–Private sector stakeholder

" All of us were happy with the heavy-handed approach taken with the financial companies"

–Private sector stakeholder

" There is a view of them as the Sheriff on the horse coming into town to clean it up – this is a good starting point"

–Private sector stakeholder

Detailed inputs from stakeholder interviews
4d: Enforcement (2 of 2)

Key shortcomings

- While only raised by a few stakeholders, a potentially large issue was that **no insider trading cases have been pursued** despite what stakeholders suggest as being strong evidence of insider trading activities
- One stakeholder suggested that **the FMA has not engaged in any activity regarding Section 34 of the FMA Act regarding public interest action**
- Finally, few stakeholders suggested that the continued **litigation activity was continuing to remind the public of negative news** and possibly dent their trust and confidence, and that communications should be focused on more positive aspects of the industry
- Similar to the above issue, some stakeholders suggested that some of the **prosecution activity has dragged on too long** and should be wrapped up soon
- A number of stakeholders suggested that the FMA's prosecution activity has had a "chilling effect" on behaviours and discouraged some people from considering Board positions although others felt that there would still be a sufficient supply of Board candidates

" They can't be held responsible for the old financial company collapses and the legislative issues in the industry"

–Industry body stakeholder

" The longer things drag, the more uncertainty they create"

–Industry body stakeholder

" People are saying, 'why would you consider getting involved with something like a Board position with the risk/return payoff'"

–Private sector stakeholder

Detailed inputs from stakeholder interviews
4e: Communication (1 of 2)

Private stakeholder communication – key achievements

- Stakeholders indicated that they were **very impressed with FMA's level of engagement and communication**, particularly their **ability and willingness to consult with market participants** and **provide guidance and transparency** on requirements
- Stakeholders felt that the FMA was **receptive to feedback**
- Stakeholders highly appreciated the FMA's **decision to open an office in Auckland**
- **Inter-agency (i.e. within public sector) communication was also highlighted as being positive**, particularly through regular meetings and through their contributions to the Council of Financial Regulators and other internal policy discussions

"They are still the big, scary regulator, but much different to the Securities Commission – their communications approach has allowed people to go on a journey with them and understand what they are doing"

– Private sector stakeholder

"We had a good hearing, we had easy access to their staff, they were open to talk through the issues, had people who understood the issues and were easy to deal with"

– Private sector stakeholder

Private stakeholder communication – shortcomings

- Some stakeholders commented that **FMA's tone in communication with market participants was often harsher and critical than required** and can have the effect of unnecessarily panicking regulated firms
- **Sense of urgency and seriousness of some issues raised in FMA communications may be exaggerated**
- Instances of lack of response or **significant delays in responses** from the FMA following submission of information by a market participant which was urgently requested by the FMA

"They need to tone down the aggressiveness of their tone. Our clients have taken their tone very seriously and been very worried, unnecessarily"

– Private sector stakeholder

Detailed inputs from stakeholder interviews
4e: Communication (2 of 2)

Public communication – key achievements

- **Stakeholders very satisfied with FMA's high public presence** through over 100 presentations, especially when compared to the Securities Commission's much lower profile
- Mixed views with regards to the FMA's **public communications on policy reform**
  - Some suggested a **good level of policy advocacy commentary** (balancing interests of market participants and government) while others suggesting that level of **policy commentary is beyond FMA's boundaries**
  - Many public sector stakeholders suggested that the FMA should **reserve comments for internal discussions** while most private sector stakeholders **encouraged more reform orientated public commentary**

"The CEO says a lot of good things in public"
– Private sector stakeholder

"There is a healthy tension in the FMA's communications with us and other public sector organisations on policy issues"
– Public sector stakeholder

"In the public's mind, its our job to be dealing with policy in this area [with regard to financial advisers], even though its not"
– FMA stakeholder

Public communication – shortcomings

- The largest issue raised by stakeholders regarded an **under-investment in public engagements with the investor community** to whom the FMA brand is still unfamiliar
- Furthermore, it was widely acknowledged that the **public's expectations of the FMA's role was inaccurate** (financial adviser licensing being a common example) and this carries the risk of further trust problems in the event of a problem – stakeholders suggested that the FMA invest in building a stronger profile within the investor community
- A few stakeholders suggested that the **FMA focus more on the positive aspects of the industry and regulatory framework** to build confidence rather than further negative litigation cases which has formed the bulk of "visible work" and can be perceived to be harming public confidence

" The FMA could focus on promoting the positive aspects of the industry"
– Private sector stakeholder

"They need to focus on guiding the media more – people believe what they read in the papers and the FMA has had some trouble – what's in the paper may not be what they intended"
– Private sector stakeholder

"They should clearly communicate to the public what the financial advisor acronyms mean"
– Industry body stakeholder

"They are invisible to the general public"
–Public sector stakeholder

Detailed inputs from stakeholder interviews
4f: Investor education (1 of 5)

The role of investor education

- Most stakeholders held the view that **investor education is important for New Zealand** citing two main reasons:
  - **Preventing poor investment decisions which have led to people losing significant wealth** and also mis-managing their investments
    - Many stakeholders suggested that investors often did not know how to assess the appropriateness of financial advice given to them, and would make investment decisions based on trust of their advisor only
    - A lack of understanding of basic concepts such as risk and return and diversification common in people who lost significant wealth through investments in risky financial companies
    - Sub-optimal management of personal investments – for example investment strategies which are not matched to current stage of life
  - **Encouraging increased investment market participation and engagement** – a number of stakeholders also suggested that an increased understanding of investment and the markets would empower people to better engage and participate in capital markets, leading to increased market efficiency
- **A few stakeholders were however sceptical on the benefits of investor education** programs and whether further efforts were needed in New Zealand – in particular, they cited that there was **little consensus in research** on the effectiveness of investor education
- However, despite a general acceptance of the difficulty to measure the effectiveness of investor education, there was a g**eneral understanding that something needed to be done to prevent further investment mistakes** and **empower the population to better understand investment and address their personal investment objectives**
- **One stakeholder described investor education as a "back-stop to the system"** – effectively empowering investors to be able to be informed enough to avoid scams and inappropriate investments – especially where they may escape the eyes of the regulator
- A few stakeholders suggested that there should be more focus on financial literacy first, as investor education would not be helpful while basic financial literacy problems were prevalent citing an example of many people not understanding compound interest

"Everyone agrees that financial literacy and investor education are highly desirable things"
–Public sector stakeholder

"Helping investors understanding risks and investment is part of the efficient flow of capital and thus they have a lever they can push"
–Industry body stakeholder

"People need to be properly equipped if they are to have some responsibility for their own welfare when they get older – this is an important area"
–FMA stakeholder

"If investors don't understand, they are not going to invest, and that's going to hurt the economy"
–Industry body stakeholder

"Creating a culture where participation and engagement in markets is in FMA's interest and mandate"
–Industry body stakeholder

"It may be good to do, but would fall on deaf ears – there's not much you can do"
–Private sector stakeholder

"Its hard to understand if NZ has a problem with the level of financial understanding"
–Private sector stakeholder

Detailed inputs from stakeholder interviews
4f: Investor education (2 of 5)

Current investor education efforts

- Many stakeholders identified a **lack of investor education action as the FMA's most significant shortcoming** during its first two years of operation
- Stakeholders recognised that beyond the introductory investor education information provided on the FMA's website currently, there was **no large scale effort to address investor education**, and that there was likely to be **low awareness of the FMA's site**
- However, stakeholders widely held the view that a **lack of political leadership and emphasis on investor education may be the real problem**, and the reason why no agency has made larger efforts to date:
  - Common perception that there is no clear political ownership for action on investor education, and no clarity on what was needed
  - General view that there was no agency mandated to take leadership, although a few public sector stakeholders held the view that the Commission for Financial Literacy and Retirement Income's (CFLRI) held the mandate for delivering investor education programs with the FMA's support
  - One public sector stakeholder expressed that NZ's light regulatory framework assumed people would make good decisions if the information was available, and thus did not emphasise aspects like investor education, and that this thinking may need to change now
- Internally, **FMA stakeholders indicated three key reasons as to why further efforts had not been taken on investor education**:
  - A lack of a clear understanding of what the FMA's role should be
  - A lack of understanding on if the outcomes of any investor education efforts could be effectively monitored and tracked to assess effectiveness
  - A lack of resourcing and also the relative prioritisation of the significant amount of work required in other areas during the FMA's establishment (e.g. licensing)
- Stakeholders who were familiar with the **National Financial Literacy Strategy** suggested that it contained **insufficient actionable guidance** for implementation purposes
- A number of stakeholders felt that the **CFLRI efforts on financial literacy, particularly Sorted, were very good**
- At least one stakeholder questioned whether NZ's actions on investor education to date were any different from other nations, and whether NZ was any more disadvantaged under the current level of investor education activity than any other nation

"Who is responsible is completely unclear. There should be a decision centrally on who does what"

–Public sector stakeholder

"There has to be political will and that's where the problem is "

–Industry body stakeholder

"Without a political mandate, its hard to do more than what is currently happening – there needs to be a clear leadership mandate"

–FMA stakeholder

"Successive governments at a whole have not wanted to take an active role"

–Public sector stakeholder

"Unfortunately there is not one agency which has been tasked with dealing with this area, and thus this is the reason for a lack of progress"

–FMA stakeholder

"Everyone's running for cover and this issue is so important for achieving outcomes of market'"

–Industry body stakeholder

"The National Strategy for Financial Literacy is not really a strategy, it only says 'here's what's desirable and happening"

–Industry body stakeholder

Detailed inputs from stakeholder interviews
4f: Investor education (3 of 5)

Investor education efforts required

- ***Investor education framework and coordination:***
  - **Need for a national strategy** with clear actions, timeframes and accountabilities
  - **Multi-stakeholder approach** incorporating the public and private sectors to leverage the strengths of each to ensure necessary program scale can be attained
  - **An agency must take leadership and play a coordination role** across all organisations involved in investor education
- ***Suggestions of investor education initiatives:***
  - **KiwiSaver comparison:** a website or registry with clear, comparable/standardised KiwiSaver performance, fees and holding information
  - **Financial adviser quality:** enabling investors to understand how to use financial advice, what questions to ask their adviser (e.g. to validate appropriateness of advice, assess risks), how to find an appropriately qualified adviser and understanding the actual meaning of AFA and what it is not (i.e. difference between AFA designation and CFP type qualifications)
  - **Investment concepts:** public awareness campaigns and more detailed information sources for learning fundamental concepts such as risk vs. return, diversification and the impact of fees
  - **Product labelling:** some stakeholders suggested that adding labels onto products should be evaluated – for example suggesting that a certain product should be reconsidered if the investor had a mortgage outstanding as paying off a mortgage may be better for them
  - **Schools programs** were also suggested by a few stakeholders, although it was recognised that these may bridge more into financial literacy than investor education, and that there may be challenges in adding further elements to the curriculum
- Stakeholders suggested that it was **vital to go beyond conventional forms of program delivery** as well, and that options for **app development and more interactive delivery methods** such as games should also be considered
- Nevertheless, there was still **reasonably strong support for conventional means such as public awareness campaigns** similar to those run by Sorted
- One stakeholder also suggested that public campaign design should **consider similar approaches to successful public health and road safety campaign designs**

"There should be a website which says 'here's what you should expect from your advisor' and then ensure they check their advisor has an independent custodian"

–Private sector stakeholder

"Websites are not enough today, the FMA should consider launching apps to assist people making investment decisions"

–Industry body stakeholder

"We believe that there is a high degree of buy-in from the industry on the need to improve investor education, but they are not sure what is the most effective way to approach it. Many of our members would be interested to participate if they saw a comprehensive strategy"

–Industry body stakeholder

"Any strategy should have an enablement focus"

–Industry body stakeholder

"If the FMA and politicians got the top CEOs together and proposed a joint initiative, no one would say no to getting involved"

–Private sector stakeholder

"There needs to be a lead agency"

–Industry body stakeholder

Detailed inputs from stakeholder interviews
4f: Investor education (4 of 5)

FMA role in delivery of investor education

- The **majority of stakeholders** interviewed felt that the **FMA had a role in delivering investor education** while a few stakeholders believed that the FMA should not be involved in any investor education initiatives and should focus purely on regulating the supply side of the market
- A few stakeholders also suggested that the FMA should more broadly also contribute to financial literacy efforts
- Several stakeholders suggested that the **FMA should take leadership in investor education** while the **CFLRI focused on more broader financial literacy**
  - Stakeholders suggested that if the FMA didn't take leadership, there may be further delays in enacting investor education programs and a continued lack of action given no agency currently taking leadership
  - A few stakeholders articulated this view as seeing the FMA as "the conductor of the orchestra for investor education" with the FMA coordinating broad industry efforts which were owned by industry players
- **A few public sector stakeholders felt that the CFLRI should take leadership for investor education**, drawing heavily on FMA input, for both overall strategy and detailed content for program design
- Regardless of the option for delivery and leadership taken, many stakeholders felt that a **multi-stakeholder model was necessary including the private sector** to leverage the strengths of all involved including resources
  - Stakeholders suggested that other organisations with related roles such as the Ministry of Consumer Affairs and the Federation of Family Budgeting should also be involved
- The **FMA's funding was recognised as a constraint** for further investor education program development and some stakeholders raised this as a key reason for CFLRI leadership and for involving the private sector
- Some stakeholders called for the FMA to aim to obtain increased political ownership in the process and to "think big" in developing nation-wide solutions

"FMA are like a police force and they should work to get citizens to be responsible"

–Industry body stakeholder

"Need to help empower investors to understand their investment decisions"

–Private sector stakeholder

"The FMA could act as the conductor of the orchestra for financial literacy/investor education"

–Industry body stakeholder

"FMA needs to be playing the role of ensuring that people understand how to interpret prospectuses and products"

–Private sector stakeholder

"The role of FMA is to push government to include it into the curriculum"

–Industry body stakeholder

"The FMA can't give out advice, but they can say 'here are the questions to ask your advisor'"

–Public sector stakeholder

"They are not resourced to do it, but they should be"

–Industry body stakeholder

Detailed inputs from stakeholder interviews
4f: Investor education (5 of 5)

Who to target

- Stakeholders expressed a number of views on who investor education efforts should be targeted at:
  - **All investor groups**, whether small, big, inactive or active – the key point being that the target group had investible funds
  - **KiwiSaver investors** – recognising that KiwiSaver investors could also benefit from an improved understanding of investment concepts and potentially apply this to managing their KiwiSaver funds
  - **Investors who make direct investments**, or have the capability and interest to do so, even if only occasionally – a few stakeholders suggested that registrations of interest in recent floats could be used as a proxy for this segment of the population
  - A few stakeholders also mentioned the **importance of including future potential investors** (such as young professionals) who may not currently have investible funds and those from more vulnerable and lower socio-economic groups

"The focus should be on vulnerable groups"
– Public sector stakeholder

"We need to concentrate on the active investors who most need the information"
– FMA stakeholder

Connection to financial literacy

- Stakeholders suggested that **investor education efforts should be coordinated with the national approach to financial literacy** as well
- Most stakeholders acknowledged that **financial literacy was clearly the role of the Commission for Financial Literacy and Retirement Income**, and not the FMA
- Broad stakeholder recognition that **financial literacy covered a broader range of concepts, including savings and consumer credit while investor education was focused on people who had investible assets, particularly those who were actively investing**

"We need to be clear on the boundaries between Investor Education and Financial Literacy, which is not our space"
– FMA stakeholder

Detailed inputs from stakeholder interviews
5a: Market participant's competence (1 of 2)

Overall views

- Stakeholder views in terms of the **overall change in the competence of market participants were varied** and many felt that it may be **too early to make an accurate judgement** of progress
- However, stakeholders believed that the FMA's licencing, compliance and litigation activities had resulted in a **significant positive "cultural shift" and behavioural change across market participants**
  - Recognition that the **regulator is "serious" about enforcing** compliance
  - **Company directors taking their responsibilities more seriously** due to the "wake-up call" threat of criminal liability
  - Business processes being reviewed to meet compliance and licencing requirements
  - Increase in compliance related discussions as a proportion of board meeting time

"The financial company prosecution activities have been a wake up call to all directors"

– Industry body stakeholder

"There is a sense that the industry is getting better - possibly 50% attributed to the FMA"

– Private sector stakeholder

"There has been a chilling effect on market behaviour"

– Private sector stakeholder

Financial advisors

- **Varying views** with some saying that there has been an improvement in the overall quality of advice and professionalism, but most suggesting that there has not been a change
  - Stakeholders suggested that where the biggest differences have been made are in terms of adviser compliance, but that **compliance does not mean the quality** of advice has improved
  - A number of stakeholders suggested that **some of the bad players had been 'weeded out'** through the licensing process, but that many still remain
- A **key concern** raised by a few stakeholders was that the **public were now more aware of the AFA/RFA brand than quality/competence based qualifications** such as a CFP
  - Result of FMA's effective job in promoting the AFA/RFA licenses for advisers
  - Need to ensure public understand how to assess advisor quality (e.g. from checking for qualifications such as a CFP)

"Their approach and work has definitely seen an improvement in overall quality of financial advice"

– Industry body stakeholder

"There is a fundamental problem in the quality of advisers"

– Private sector stakeholder

"FMA should say that not all AFAs are equal'"

–Industry body stakeholder

Detailed inputs from stakeholder interviews
5a: Market participant's competence (2 of 2)

Trustees

- **Stakeholders felt that while some of the weaker players left, some still remain**, and that the overall level of competence is relatively low - some stakeholders suggested that this was **one of the largest areas of risk in NZ's financial markets**
  - Trustees recognised as having a **key role in the supervision of the funds industry** including KiwiSaver
  - **Significant gaps in internal processes, and overall competence** highlighted by stakeholders and that the only practical solution may be an increase in compliance standards, supervision and even training
  - Recognition that the FMA was highly resource constrained in order to do further in terms of licensing and guidance issuance for trustees

"Custodians and trustees are an important area and need further attention"
– Private sector stakeholder

"The industry is scathing about them (trustees), but they don't want to pay more either"
– Public sector stakeholder

Custodians

- A number of stakeholders expressed that they felt that a number of **gaps existed with regards to legislation and regulation surrounding custodians**
- Stakeholders expressed that these **gaps were significant given the size of assets held under custodians** and the **potential for systemic risk** if a problem were to emerge
- Key gaps identified included:
  - **Requirement for independent directors** on custodian boards
  - **Requirement for auditing**
- Ross Asset Management was commonly quoted as an example given the role of a lack of custodian independence in enabling his scheme to operate for so long

"The underlying assets should be held in a place that is audited and trusted"
– Private sector stakeholder

"Custodian independence is very important"
– Private sector stakeholder

"Custodians are the biggest area of risk"
– Private sector stakeholder

Detailed inputs from stakeholder interviews
5b&c: Market-impact (efficiency, fairness and transparency)

Key points

- Stakeholders **struggled to provide firm views on the FMA's impact on market efficiency, fairness and transparency**, given its short period of operation and also the numerous other influencing factors
- Key market level impacts suggested by stakeholders included:
  - Litigation efforts and establishment of "regulatory threat" resulting in **increased fairness**
  - Furthermore, some stakeholders suggested that the F**MA's activities including public litigation work to keep directors accountable** and increased presence have also proved it to be capable and credible and have **improved investor confidence** although it is difficult to measure
  - Disclosure guidance and conduct activities contributing towards **improved transparency and efficiency**

"They've done a lot to prevent future occurrences (of financial company collapses)"

– Public sector stakeholder

"It may be too early to give a grounded view of their overall performance with legislation and the markets changing"

– Private sector stakeholder

Detailed inputs from stakeholder interviews
Other issues

FMA funding model

- Management projections indicate potential for deficit in operating cashflows from 2015
- Some stakeholder views concerning the fairness of the FMA's current levies model i.e.
  - Implication of fixed levy regardless of business size perceived to be unfair by smaller organisations
  - Some stakeholders perceived unfairness in the fact that Australian entities operating in NZ are not charged FMA levies
- One stakeholder suggested that the FMA may be able to considerably increase revenues while implementing a fairer funding model through charging a constant proportional levy e.g. based on AUM for fund managers
- Some stakeholders expressed concern on the sustainability and dependability of the FMA's crown funding

Regulatory architecture

- Some lack of clarity on delineation of roles (e.g. SFO and FMA with regards to fraud) for some stakeholders
- Some questions of the efficiency of having separate organisations when a combination of some organisations (e.g. SFO/FMA, or Companies Office and FMA) may enable better intelligence and experience sharing
- FMA staff suggested that the current level of data sharing between the FMA and other public sector bodies was productive and that they did not experience any serious problems
- MBIE acknowledged good working relationships between their staff and the FMA's staff

Other

- One stakeholder suggested the FMA should explore opportunities for increasing engagement and mutual collaboration with foreign regulators

Detailed inputs from stakeholder interviews
Internal vs. external stakeholder views

- Overall there was a reasonably high level of alignment between the views of internal stakeholders (i.e. FMA management and Board) and external stakeholders (i.e. market participants, industry bodies, and other private sector) – including most key areas of shortcomings raised
- Internal stakeholders were more aware of the challenges and limits (resourcing and legislative) faced by the FMA and as a result, their views reflected an appreciation for these challenges and were more positive in their appraisal of the FMA's performance in the context of these limitations

Appendix 1 | Methodology

Methodology

Inputs into this study

Desktop review of existing assessments and strategic plans

- FMA internal reports including SOIs, Minister's letter of expectations and strategic documents
- FMA 2012 stakeholder survey
- OW 2011 stakeholder study
- NZ industry reports

Stakeholder interviews

- Public sector representatives
- Private sector representatives
- Industry bodies
- FMA Board and management

Foreign best case practices and experiences

- OW global experience
- Case studies of other markets

Assessment of achievements, shortcomings of the FMA's activities and gaps in their mandate

Oliver Wyman interviewed a selected group from a wide range of stakeholders to gain their perspectives on FMA's activities

Private sector / market participants

AMP	Jack Regan
Bell Gully	David Flacks
Capital Market's Development Taskforce (former)	Rob Cameron (Cameron Partners) Nigel Williams (ANZ)
Chen Palmer	Mai Chen
Fonterra TAF	Mike Cronin Alex Duncan
NZX	Tim Bennett
Tower	Sam Stubbs

Industry bodies

New Zealand Banker's Association	Kirk Hope
Institute of Directors	Ralph Chivers
Institute of Financial Advisers	Stuart Auld (Morningstar) Tony Vidler (Strictly Business)
Financial Services Council	Peter Neilson The Rt. Hon Dame Jenny Shipley
Shareholder's Association	Gayatri Jaduram John Hawkins Grant Diggle

Public sector

Australian Securities and Investments Commission	Robert Drake
Commission for Financial Literacy and Retirement Income	Diane Maxwell
Ministry of Business, Innovation and Employment	Gaye Searancke David Smol
New Zealand Government	The Minister for Commerce, Hon. Craig Foss
Reserve Bank of New Zealand	Toby Fiennes
The Treasury	Girol Karacaoglu

FMA

Board of Directors	Simon Allen Mark Verbiest Murray Jack Bruce Sheppard James Miller
CEO	Sean Hughes
Head of the Strategic Intelligence Unit	Adam Hunt

Note: A few of the FMA directors interviewed also presented market based views from their directorships of listed companies

Appendix 2 | New Zealand capital markets benchmarking

Executive summary

Introduction

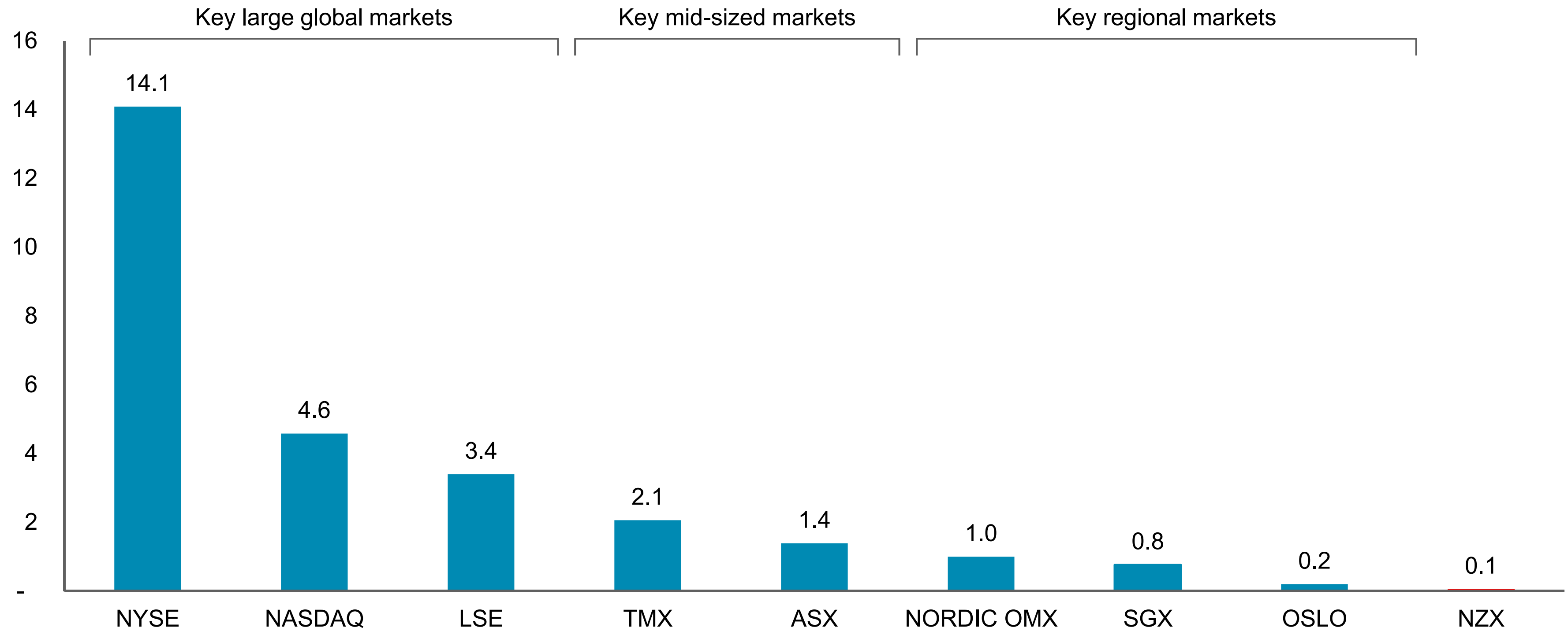
- This report forms an appendix to Oliver Wyman's review of the FMA's performance during its first two years
- The purpose of this report is to provide high-level background context on the current state of New Zealand's capital markets and its recent evolution in comparison to key OECD and comparable markets – primarily focusing on equity markets due to constraints in comparable data

Overview

- NZ's equity market is very small when compared internationally in terms of size (both relative and absolute)
- While efficiency indicators place New Zealand lower than key OECD markets, they are not too dissimilar to other smaller markets, and in some areas, potentially better (e.g. transaction costs vs. ASX and concentration of market cap vs. Oslo)
- Growth in equity market capital relative to GDP has been high, but below all the other markets considered
- Limited range of investment opportunities for investors with only ~170 listed companies
- A large share of NZ's economic activity occurs within cooperatives and similar to other smaller nations, State Owned Enterprises (SOEs) also account for a high portion of economic activity, although in New Zealand these have been largely unlisted until now
- New Zealand is a nation of small businesses and mid-sized businesses. The majority of larger businesses are listed and only few mid-sized businesses are listed
- Small to Medium Enterprises in NZ broadly appear to be able to satisfy their financing needs, although access declined during the GFC
- There are a few alternative options for financing although these are relatively small such as venture capital and angel funds
- NZ's savings rate has been steadily rising since 2005 and became positive again in 2010, although still below most of our comparison countries
- New Zealanders have very high proportion of their financial assets placed in bank deposits, and this share has consistently grown over the past 10 years
- New Zealanders also have a high amount of mortgage debt, although similar as a % of GDP to Australia and the UK

We have chosen 8 OECD markets of varying sizes as comparisons for this benchmarking exercise of which New Zealand's equity market is the smallest

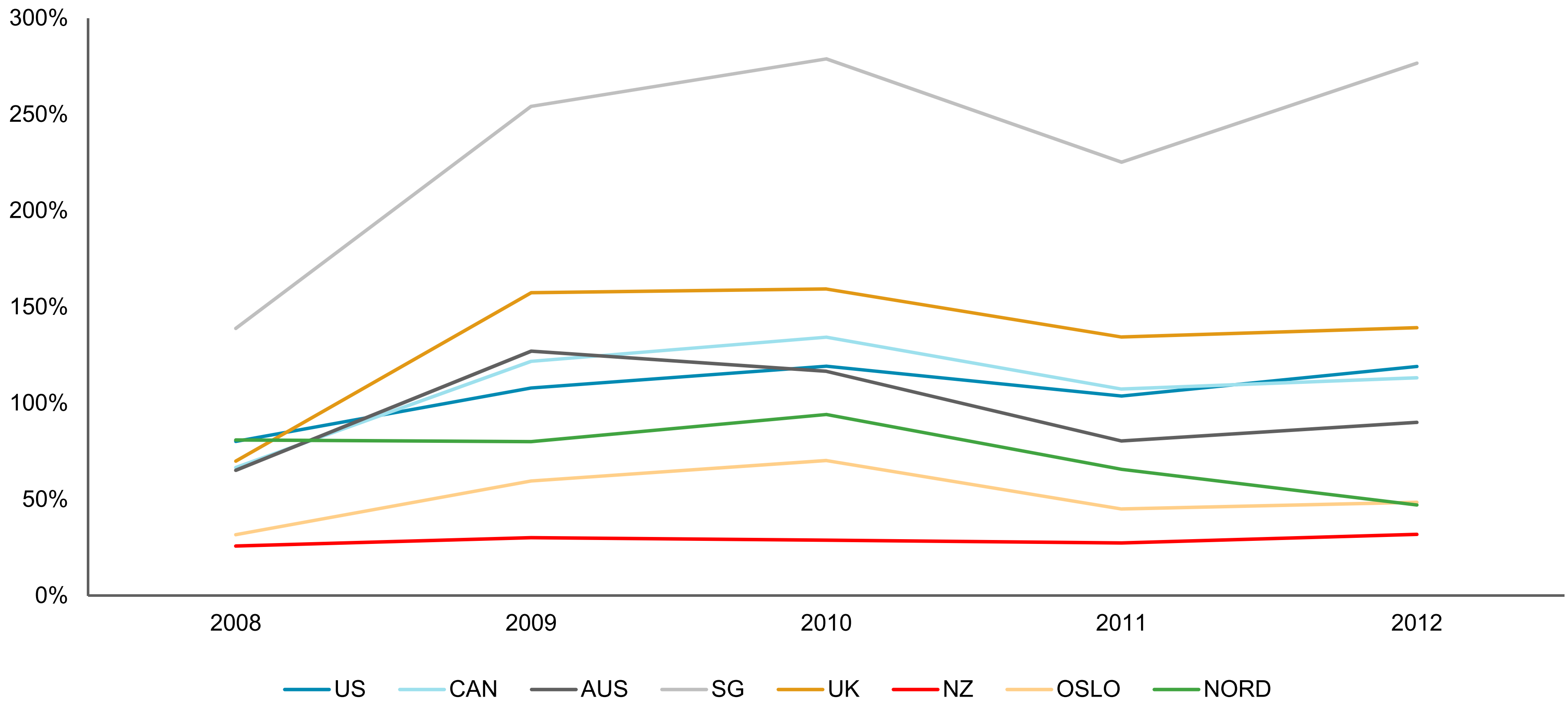
Market capital
US$ TN, 2012



Source: WFE, NZX
Note: NZX market cap converted to US$ using average annual exchange rates

Even in relative terms of market capital to GDP, NZ's market is the smallest in the comparison group, although similar to the Nordic exchanges

Market capital/GDP



Source: WFE, NZX, Oxford Economics

There were 167 companies listed on the NZX as at December 2012, with the overall number of listed firms remaining relatively stable over 5 years

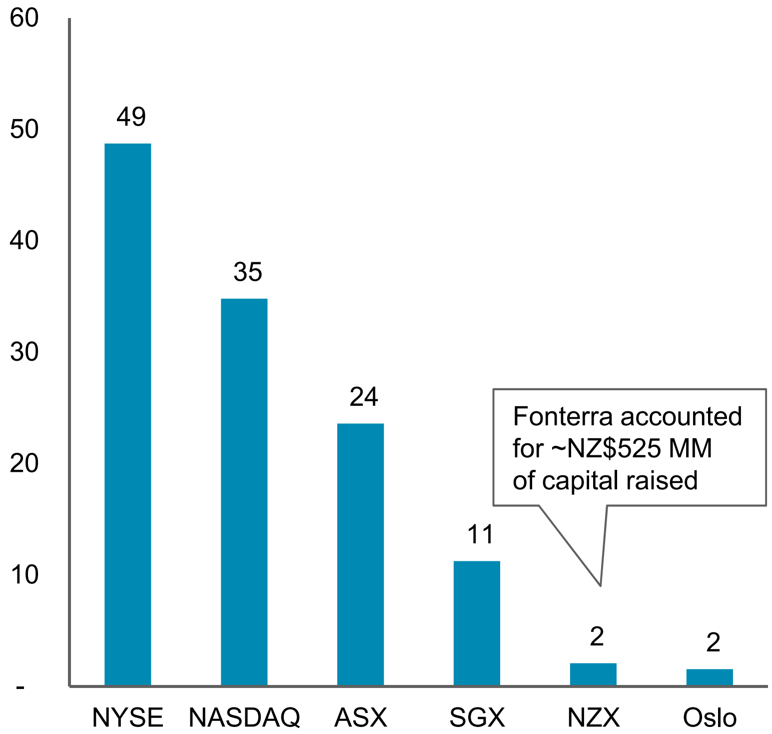
Number of listed companies
As at Dec 2012

	TMX	LSE	NASD	NYSE	ASX	SGX	NORD	OSLO	NZX
IPOs 2008–12	+1,042	362	273	295	343	133	162	-	11
Change in number of listed firms 2008–12	+129	-329	-446	+376	+47	+9	-73	-31	-5

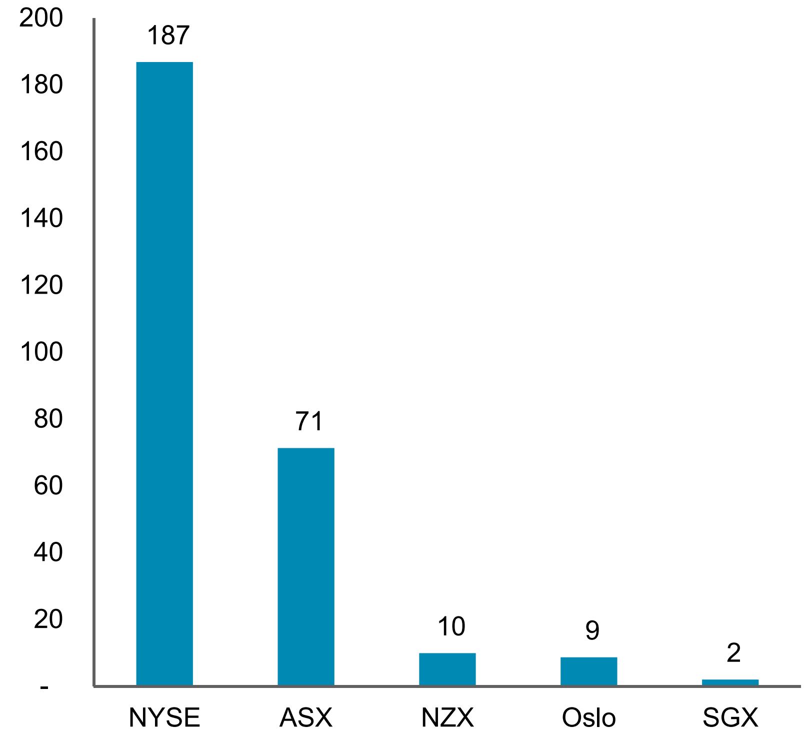
Source: WFE, NZX, press

New capital raised in New Zealand's primary markets was comparable to the Oslo and Singapore markets in 2011 and 2012

IPO capital raised
US$ BN, 2011–12



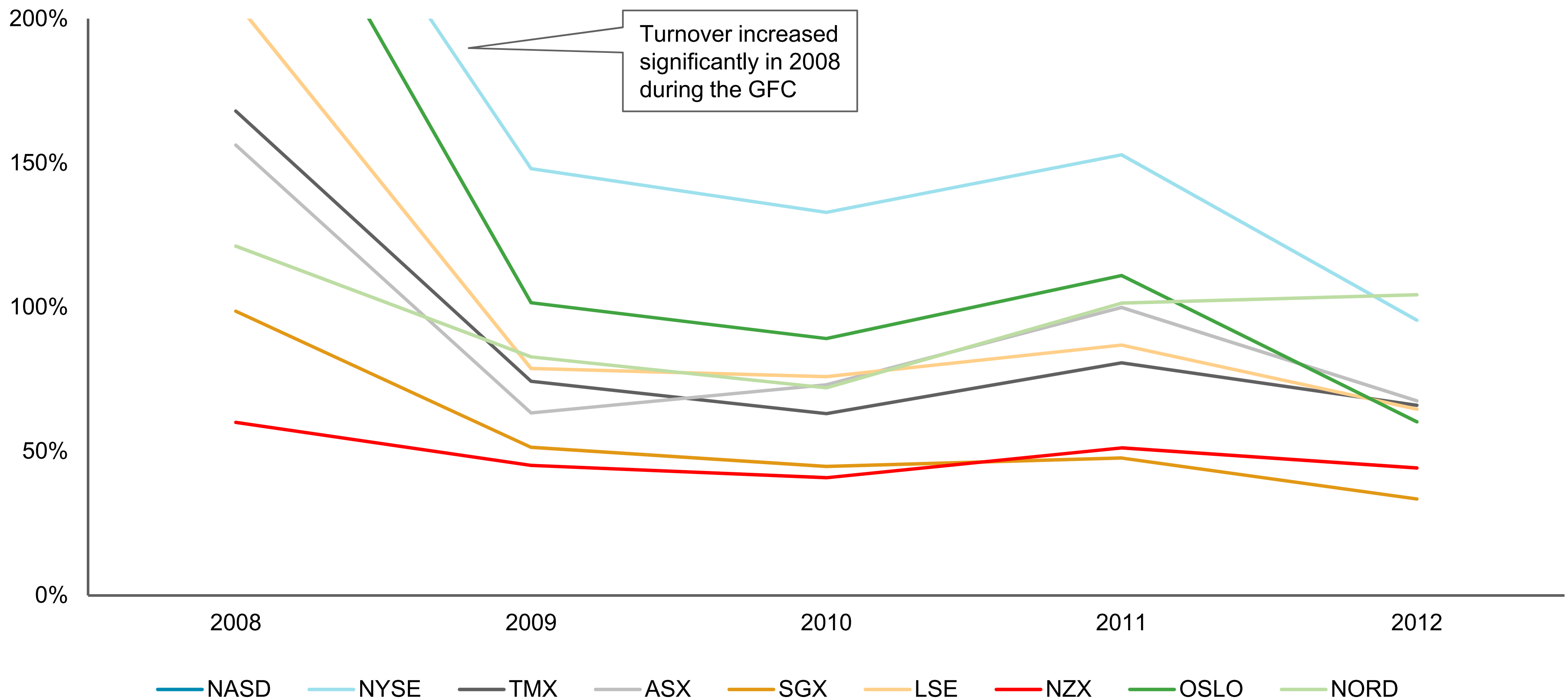
Non-IPO new capital raised
US$ BN, 2011–12



Source: WFE, NZX

When considering efficiency metrics, New Zealand compares similarly to other smaller markets in terms of securities turnover…

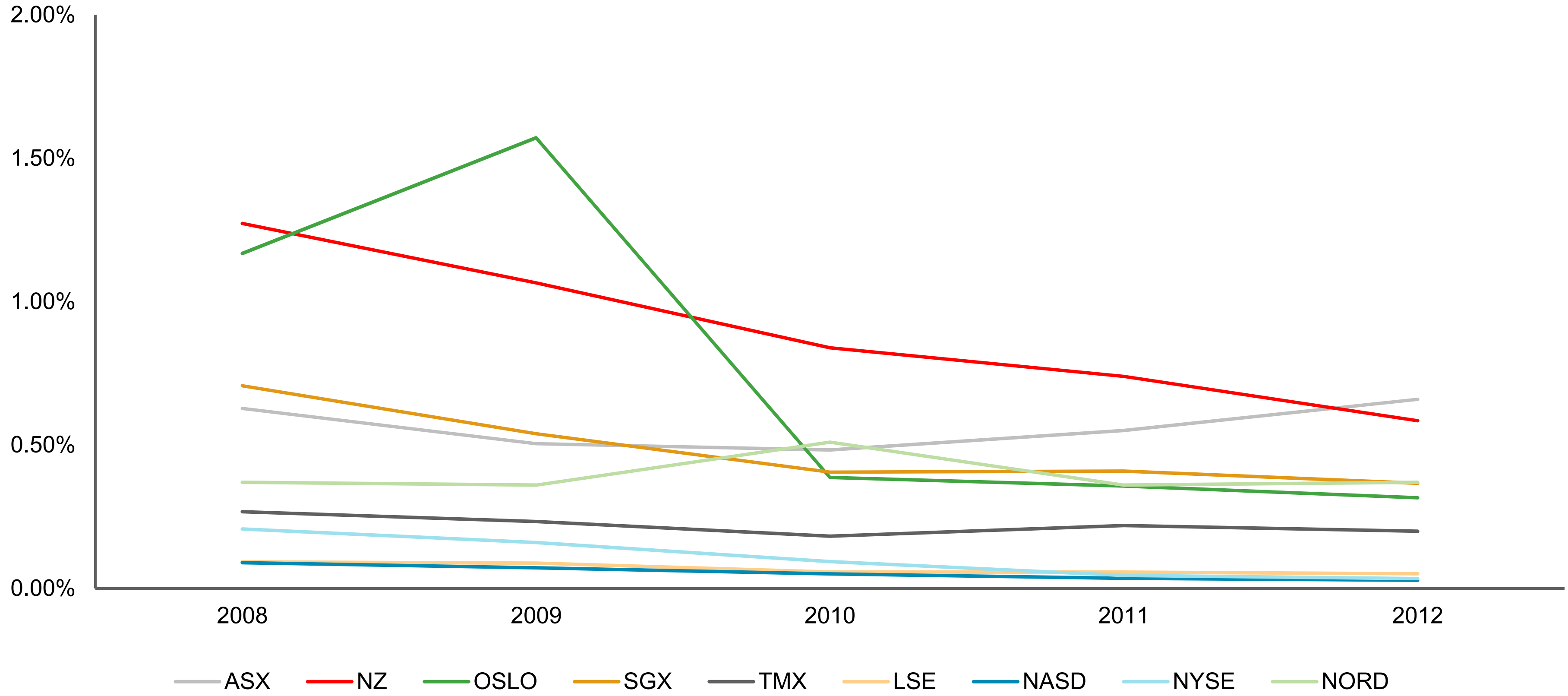
Annual securities turnover ratio
Value of securities traded/Market cap



Source: WFE, NZX

…and estimates of transaction costs where it has shown steady progress in improving efficiency over the past few years

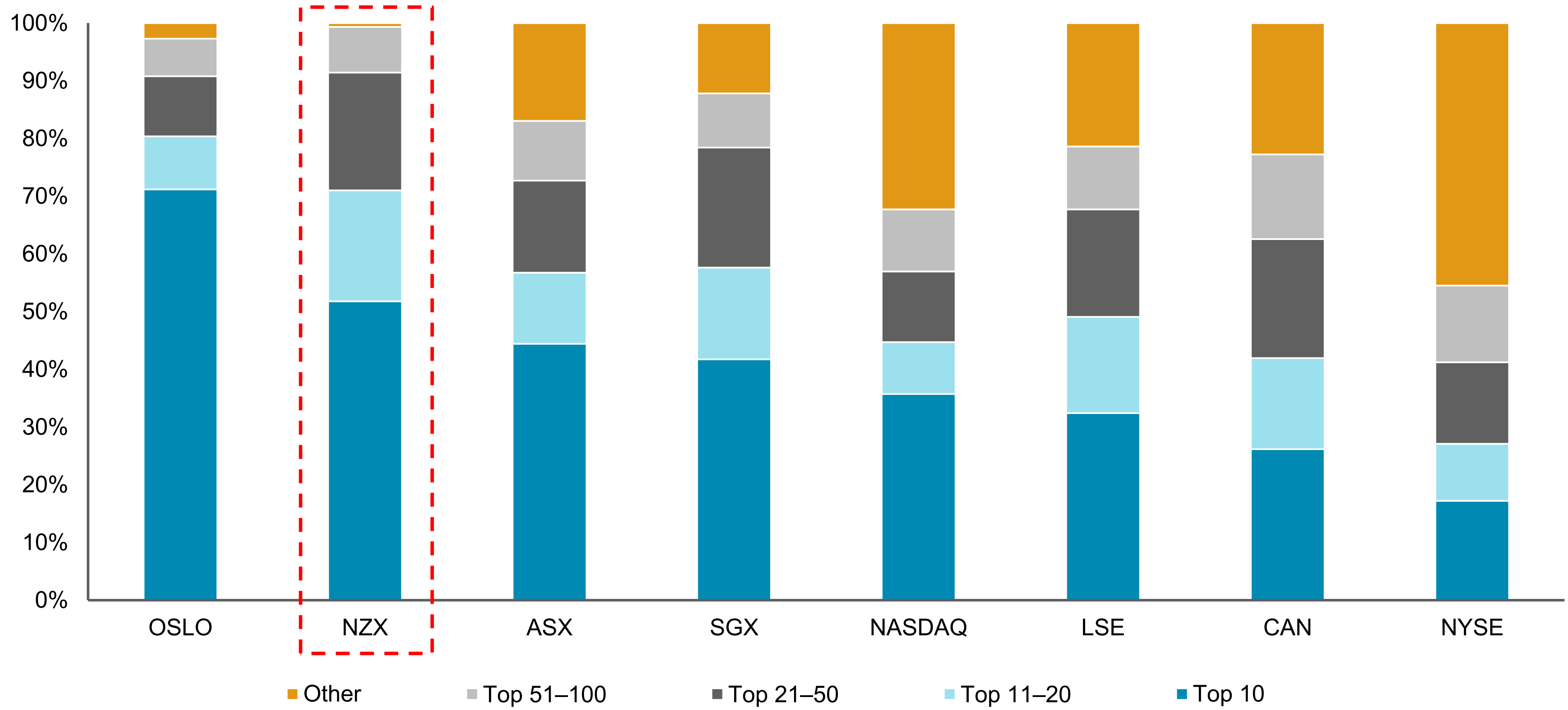
Approximate average bid/Ask spreads of top 20 listed companies
Average ask price/Big price as a % of average share price, annual averages



Source: Datastream

NZX's market capital is highly concentrated among the largest 20 companies, however, this is not atypical for small to middle sized markets

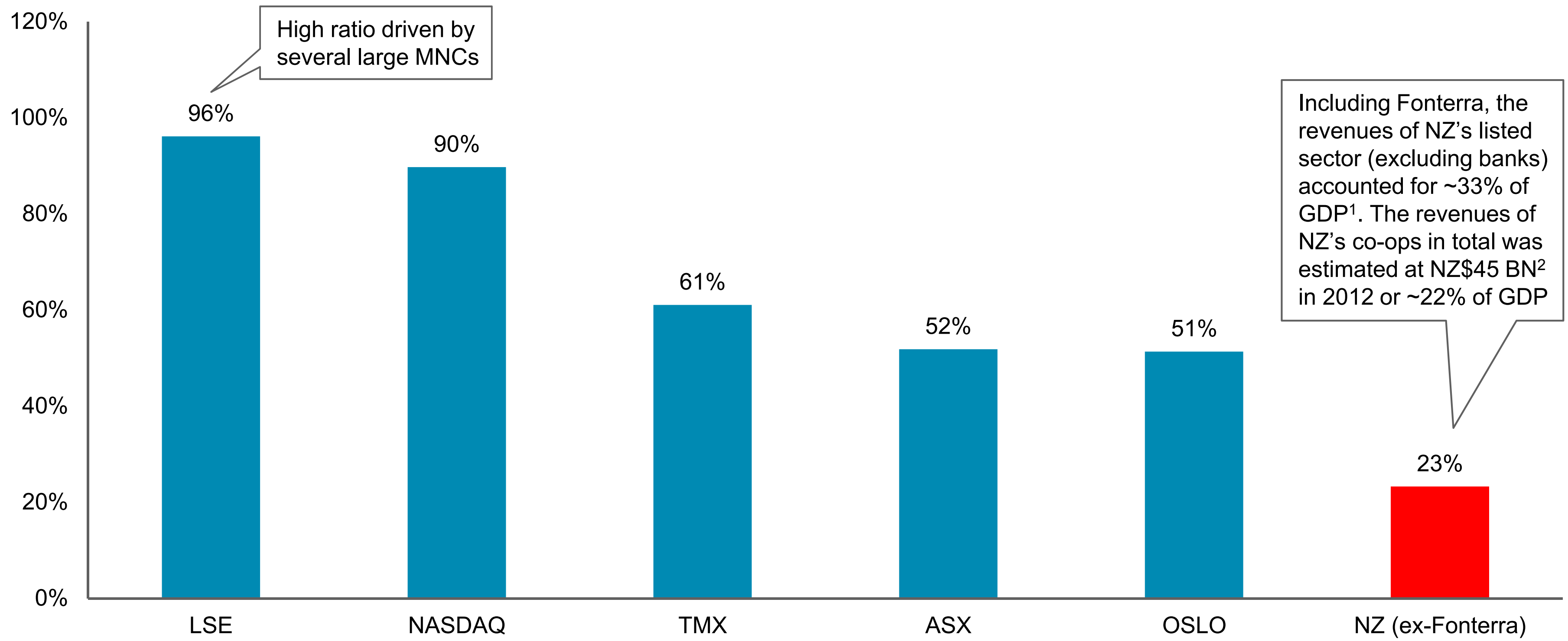
Market capital concentration by largest securities
% of market cap, average 2010–12



Source: Thomson

A large share of NZ's economic activity occurs within cooperatives…
The revenues of NZ's non-bank listed companies account for 23% of GDP, although if cooperatives were included, this number would rise to ~55%

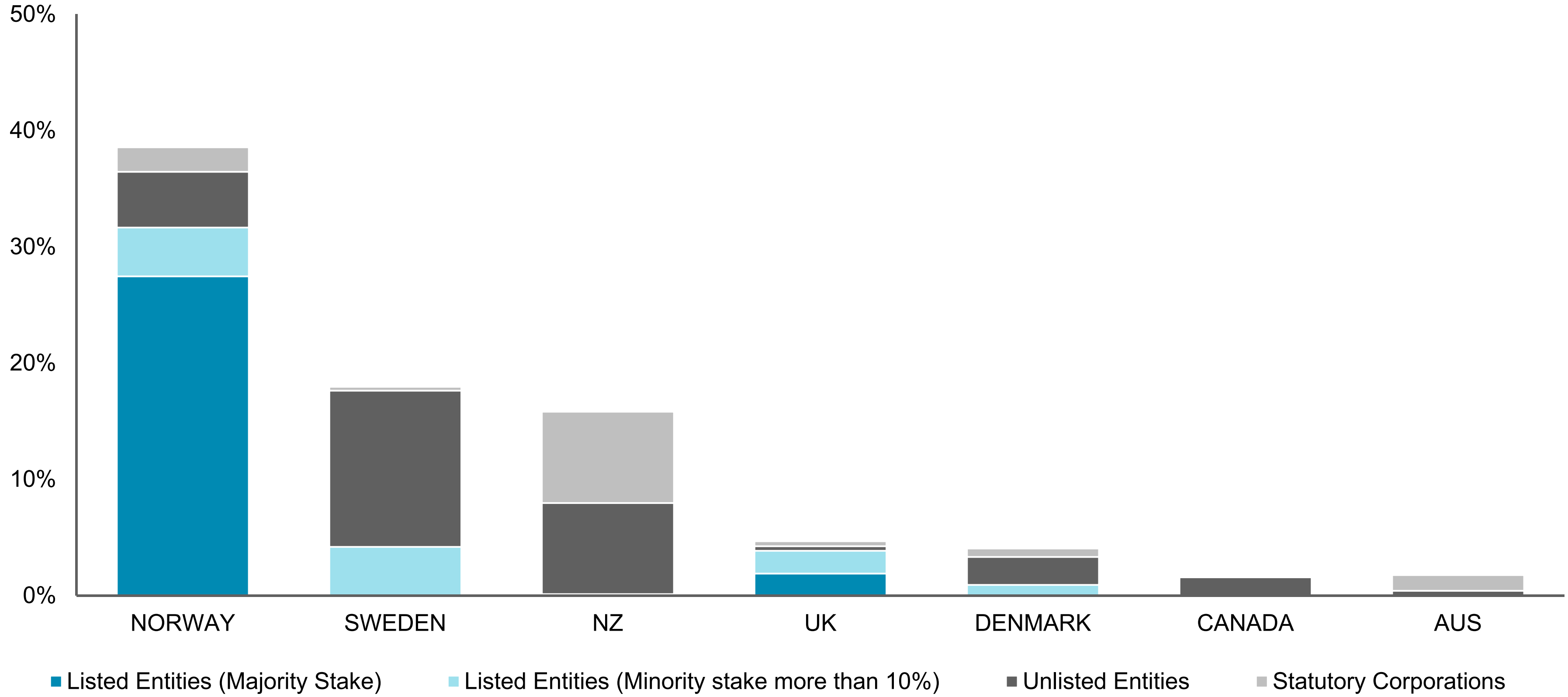
Listed companies revenues (ex-banks) as a % of GDP
Average 2010–2012



1. Thomson
2. "NZ Co-operatives: Structures Risks and Governance", 2012 – FMA Co-operatives Analysis
Source: Thomson, Oxford Economics

…and State Owned Enterprises (SOEs) also account for a high portion of economic activity in New Zealand and these have been largely unlisted until now

Value of listed SOEs, unlisted SOEs and statutory corporations as a % of GDP[1]
2008/2009



1. Information presented is based on countries' questionnaire responses. Listed SOEs are valued at market values, unlisted SOEs are valued at a combination of market and book equity values depending on the country

Source: Christiansen, H. (2011), "The Size and Composition of the SOE Sector in OECD Countries", OECD Corporate Governance Working Papers, No. 5, OECD Publishing; Oxford Economics

New Zealand is a nation of small businesses and mid-sized businesses. The majority of larger businesses are listed and only few mid-sized businesses are listed

Structure and ownership of NZ companies[1]

Revenue	Number of private, NZ controlled firms	Number of NZX firms	Number of NZAX firms	"Unlisted" trading facility
Over $150 MM	~10–20	50	0	1 (temporary quotation)
$10–150 MM	3,500	35	16	11
$5–10 MM	10,000–20,000	4	2	2
Under $5 MM	Hundreds of thousands	18	12	4

Number of enterprises by employee size[2]

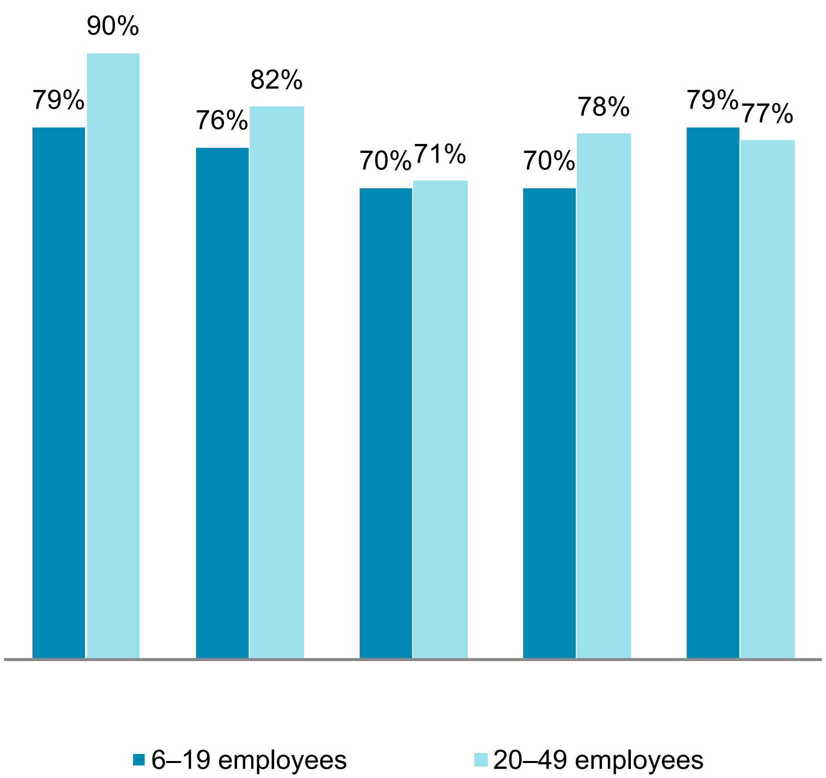
Employee size group	Number of enterprises	Percentage of all enterprises	Cumulative percentage
0	323,935	68.9%	68.9%
1–5	97,888	20.8%	89.7%
6–9	19,571	4.2%	93.8%
10–19	15,980	3.4%	97.2%
20–49	8,420	1.8%	99.0%
50–99	2,489	0.5%	99.6%
100–499	1,739	0.4%	99.9%
500+	324	0.1%	100.0%
Total	470,346	100%	-

1. Reproduced from Table 2, "Capital Markets Matter – Report of the Capital Markets Development Taskforce", CMD Taskforce, 2009
2. Reproduced from Table 1, "SMEs in New Zealand: Structure and Dynamics", Ministry of Economic Development, 2011

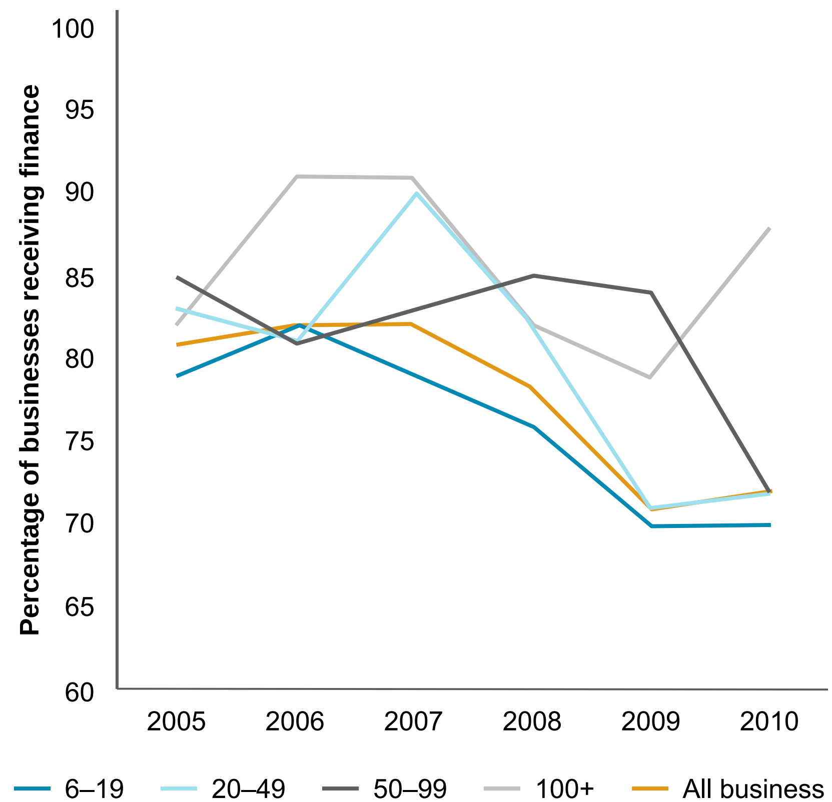
Small to Medium Enterprises in NZ broadly appear to be able to satisfy their financing needs, although access declined during the GFC (1 of 2)

Equity finance

Availability of Equity Finance Sought on Acceptable Terms, by Employee Size Group[1]



BOS Data – Finance Available on Acceptable Terms – Equity (August 2005–2010)[2]



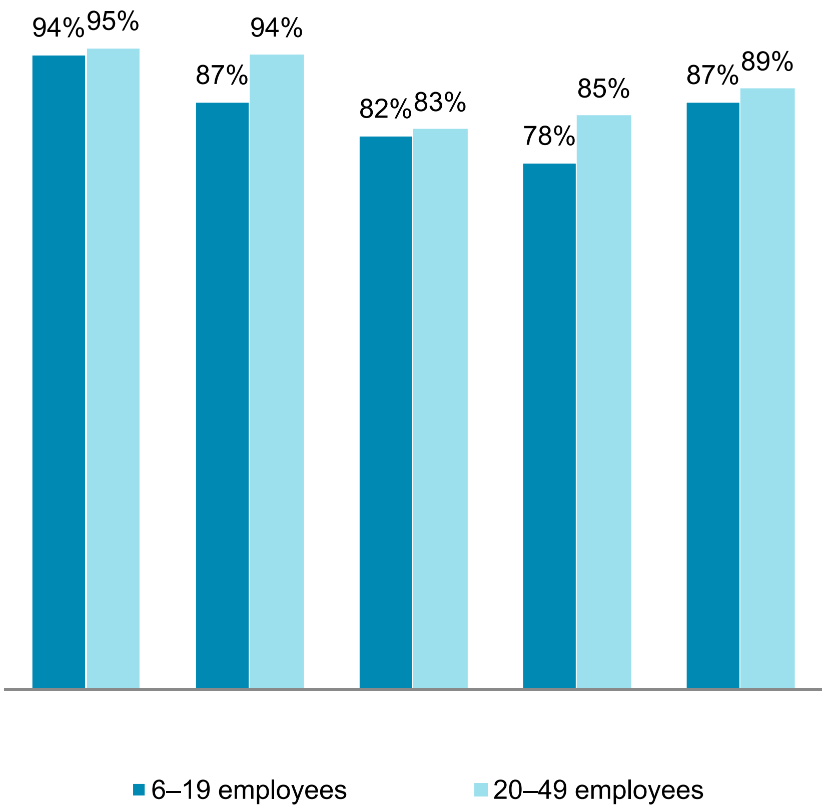
1. Reproduced from Chart 17, "Small Businesses in New Zealand", Ministry of Business, Innovation & Employment, March 2013;
2. Reproduced from Figure 56, "SMEs in New Zealand: Structure and Dynamics", Ministry of Economic Development, 2011

Note: Both images are based on the Business Operations Survey which captures the proportion of firms seeking and obtaining debt and equity finance on acceptable terms

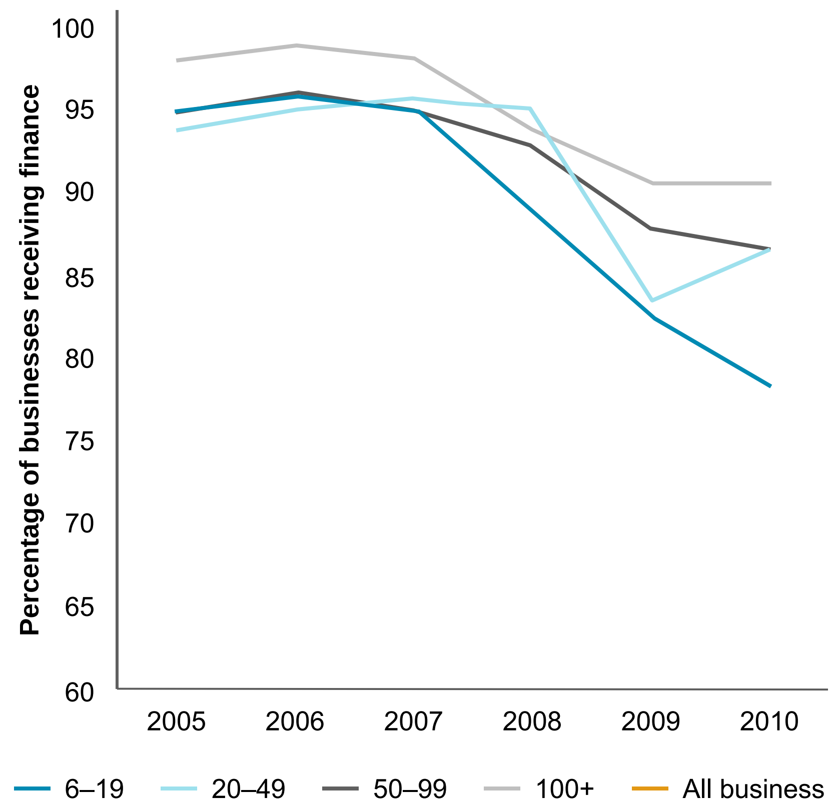
Small to Medium Enterprises in NZ broadly appear to be able to satisfy their financing needs, although access declined during the GFC (2 of 2)

Debt finance

Availability of Debt Finance Sought on Acceptable Terms, by Employee Size Group[1]



BOS Data – Finance Available on Acceptable Terms – Debt (August 2005–2010)[2]



1. Reproduced from Chart 18, "Small Businesses in New Zealand", Ministry of Business, Innovation & Employment, March 2013;
2. Reproduced from Figure 55, "SMEs in New Zealand: Structure and Dynamics", Ministry of Economic Development, 2011

Note: Both images are based on the Business Operations Survey which captures the proportion of firms seeking and obtaining debt and equity finance on acceptable terms

There are a few alternative options for financing although these are relatively small

New Zealand Venture Investment Fund (NZVIF)

- NZVIF is the "Crown's lead investment agency addressing the capital market gap for emerging high growth New Zealand companies that require new risk capital (equity and quasi equity) for growth"
- Consists of two funds
  1. $160 MM private sector VC fund: partners with institutional and individual investors to invest in VC funds
     - As of May 2013, the fund has invested in 57 businesses and committed $136 MM in total
     - Focuses on high growth technology businesses
  2. $40 MM Seed Co-investment Fund (SCIF): established in 2005 as a passive investor alongside accredited angel investors and networks
     – As of May 2013, it has funded 94 companies and allocated $40 MM in total
     – Focuses on very early stage SMEs with strong potential for high growth

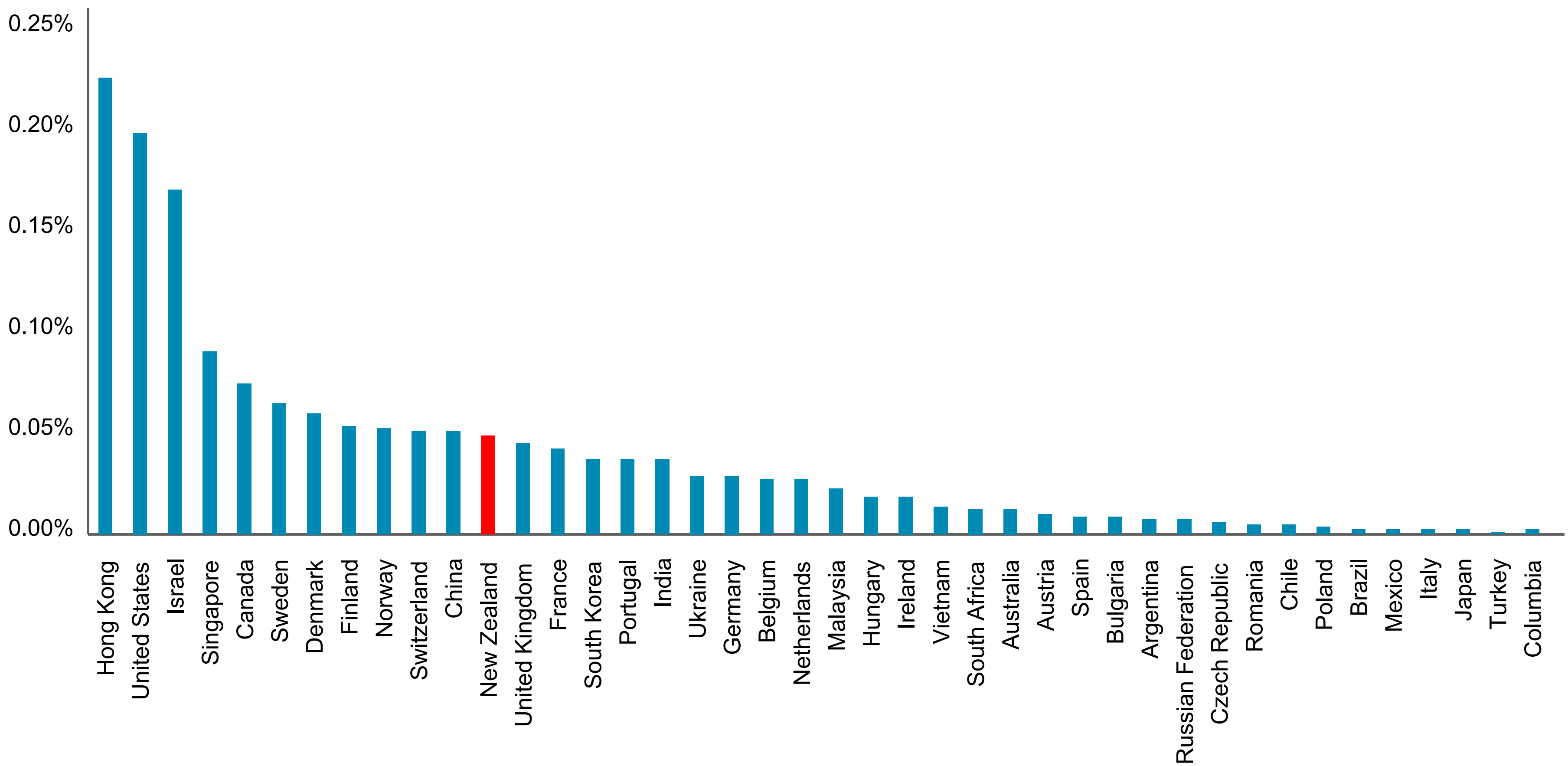
Angel investor activity

- Relatively young community with 15 established angel network groups alongside informal networks
- Angel Association of New Zealand: aims to promote the growth of domestic and foreign angel investment and educate investors to create a bigger capital pool for innovative start-ups
- Average of around 100 deals a year involving $30 MM of investment by NZ Angel Investment community
- Angels invested $27.6 MM across 95 deals in 2012 compared to $34.5 MM across 100 deals in 2011

Source: NZVIF, Angel Association of New Zealand, Young Company Finance
Note: Angel industry data is very "SCIF focused" and there is inadequate visibility on non SCIF deal and venturing

Globally, New Zealand ranks favourably in terms of venture capital investment activity

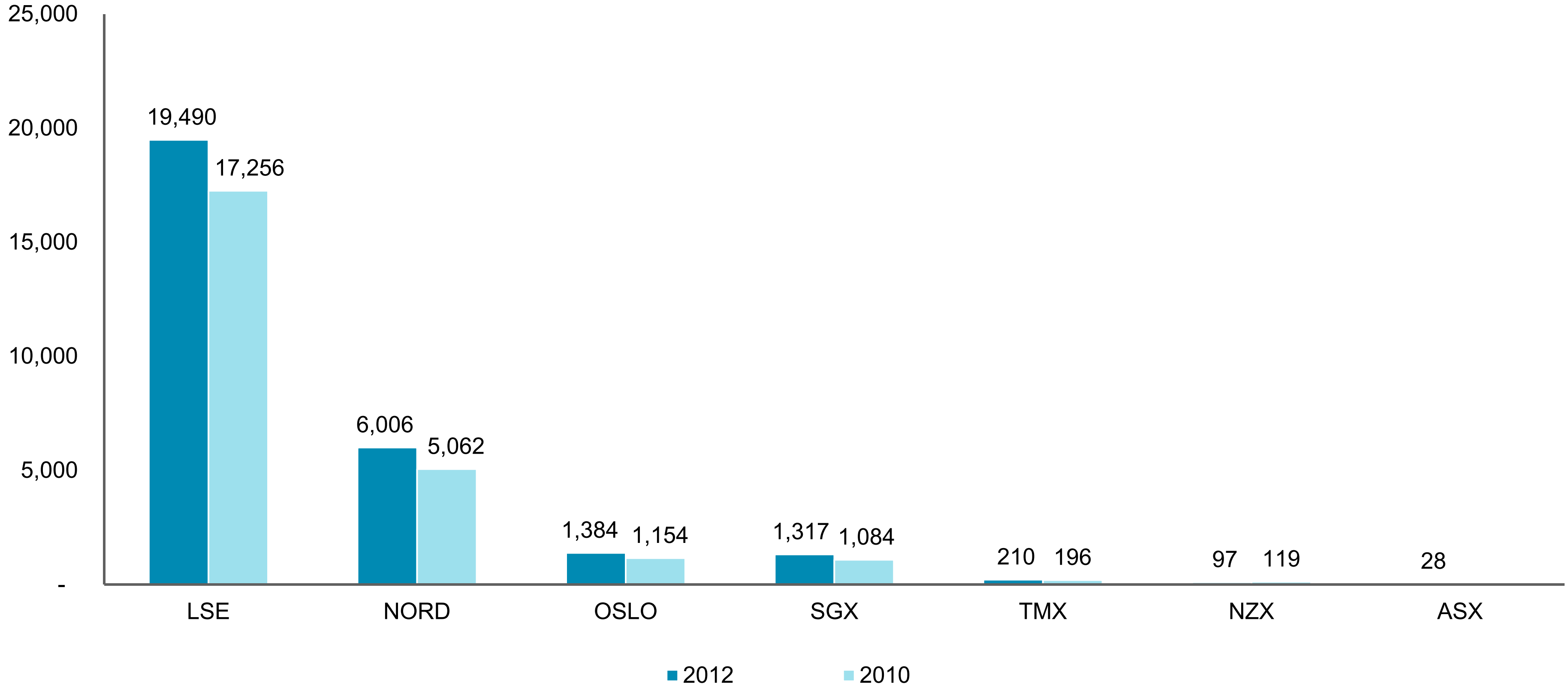
Venture capital investing as a % of GDP[1]
2010



Source: Reproduced from Figure 1, "Statement of Intent 2012–2017", NZVIF, 2012

In terms of listed bonds, New Zealand has a reasonable number of securities when compared to Canada, and many more than Australia

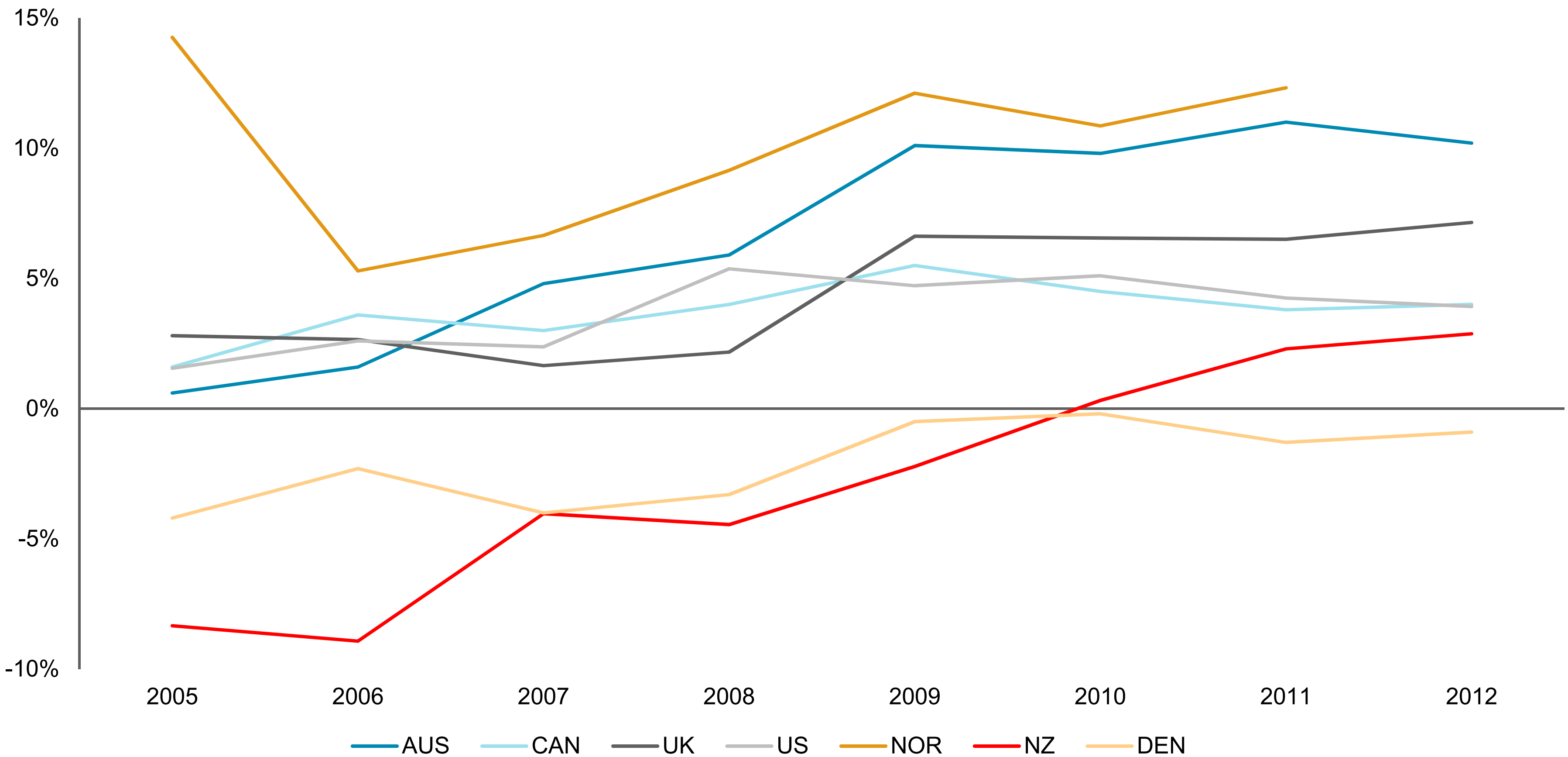
Number of bonds listed on national exchange



Source: WFE, NZX, ASX

NZ's savings rate has been steadily rising since 2005 and became positive again in 2010, although still below most of our comparison countries

Household savings rate

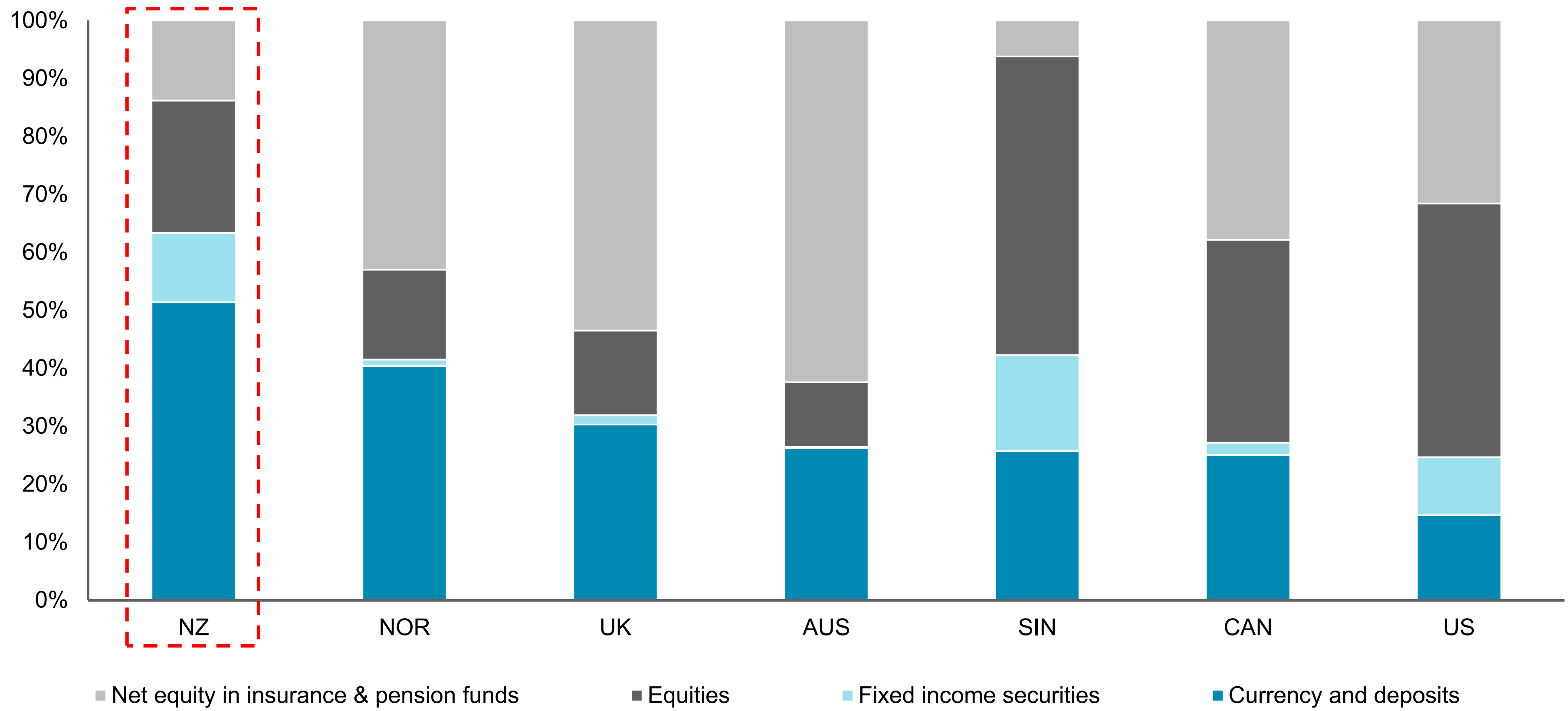


Source: Datastream

New Zealanders have very high proportion of their financial assets placed in bank deposits

Composition of house-hold financial assets (excludes housing)

% of household financial assets, 2012



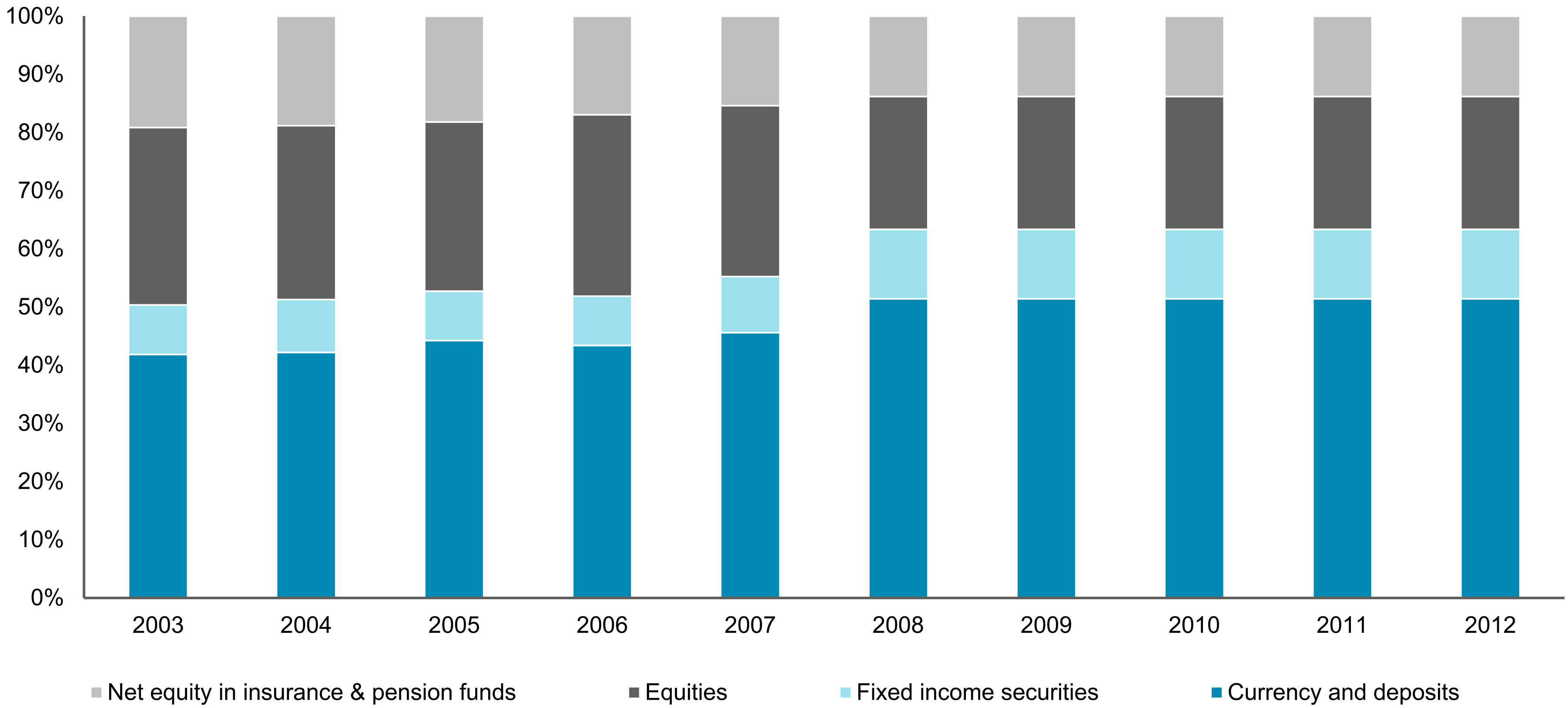
Source: EIU

Note: While the share of NZ's households financial assets in equities appears to be higher than some other nations, these statistics do not separately show the value of equities included within "net equity in insurance and pension funds" and thus the true share may be unclear

The proportion of financial assets in bank deposits has risen over the past 10 years

Composition of house-hold financial assets (excludes housing)

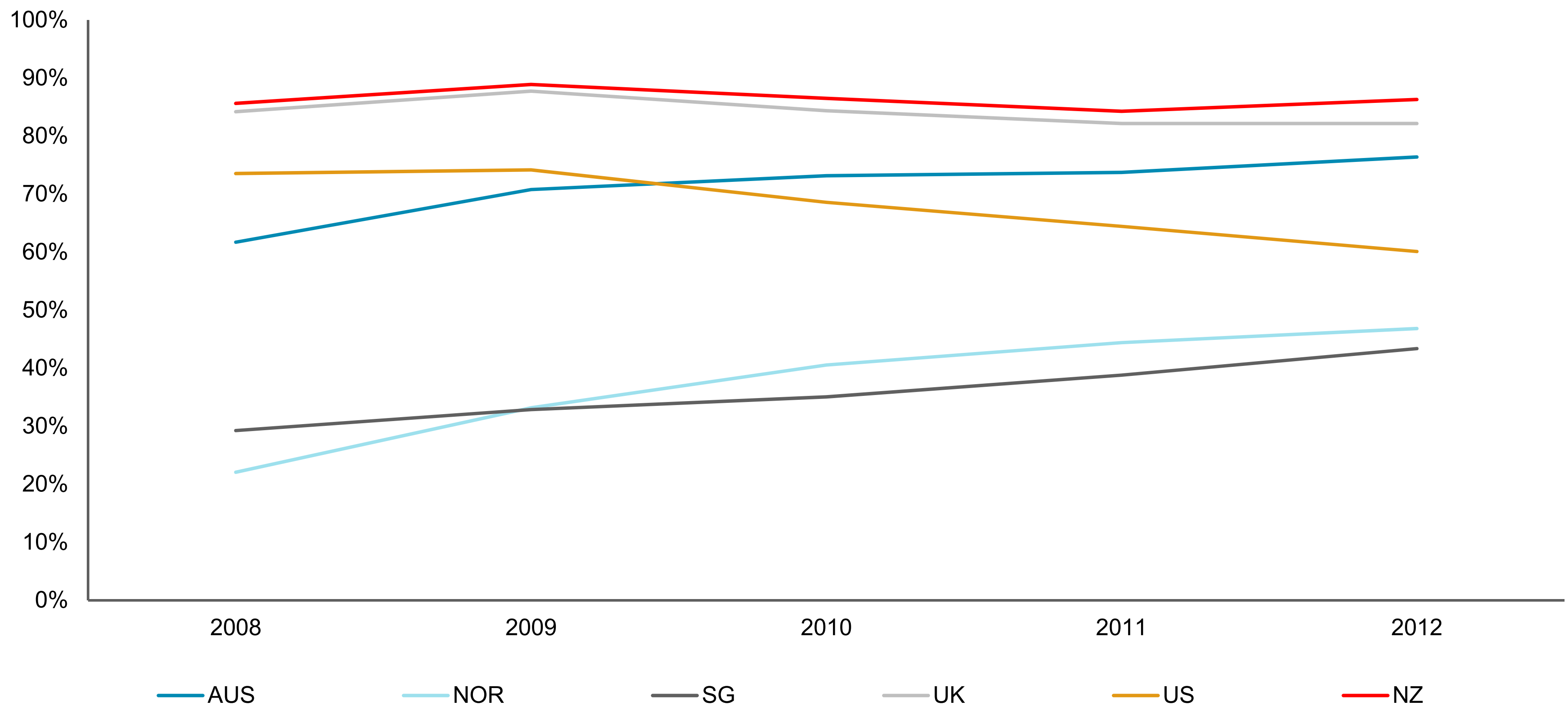
% of household financial assets



Source: EIU

New Zealanders also have a high amount of mortgage debt, although similar as a % of GDP to Australia and the UK

Mortgages as a % of GDP



Source: Oxford Economics, RBNZ, RBA,

QUALIFICATIONS, ASSUMPTIONS AND LIMITING CONDITIONS

This report is for the exclusive use of the client named herein. This report is not intended for general circulation or publication, nor is it to be reproduced, quoted or distributed for any purpose without the prior written permission of . There are no third party beneficiaries with respect to this report, and does not accept any liability to any third party.

Information furnished by others, upon which all or portions of this report are based, is believed to be reliable but has not been independently verified, unless otherwise expressly indicated. Public information and industry and statistical data are from sources we deem to be reliable; however, we make no representation as to the accuracy or completeness of such information. The findings contained in this report may contain predictions based on current data and historical trends. Any such predictions are subject to inherent risks and uncertainties. accepts no responsibility for actual results or future events.

The opinions expressed in this report are valid only for the purpose stated herein and as of the date of this report. No obligation is assumed to revise this report to reflect changes, events or conditions, which occur subsequent to the date hereof.

All decisions in connection with the implementation or use of advice or recommendations contained in this report are the sole responsibility of the client. This report does not represent investment advice nor does it provide an opinion regarding the fairness of any transaction to any and all parties.