Departmental Disclosure Statement

Financial Markets (Derivatives Margin and Benchmarking) Reform Amendment Bill

The departmental disclosure statement for a government Bill seeks to bring together in one place a range of information to support and enhance the Parliamentary and public scrutiny of that Bill.

It identifies:

- the general policy intent of the Bill and other background policy material;
- some of the key quality assurance products and processes used to develop and test the content of the Bill;
- the presence of certain significant powers or features in the Bill that might be of particular Parliamentary or public interest and warrant an explanation.

This disclosure statement was prepared by the Ministry of Business, Innovation and Employment.

The Ministry of Business, Innovation and Employment certifies that, to the best of its knowledge and understanding, the information provided is complete and accurate at the date of finalisation below.

7 February 2019

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Part One: General Policy Statement

This Bill relates to the linkages between New Zealand's financial markets and international financial markets, in particular through derivatives markets. The purpose of the Bill is to enable New Zealand financial market participants to comply with international rules and therefore to continue to enter into derivatives and certain other types of financial instruments with important overseas financial entities. The Bill is an omnibus Bill, which amends a number of Acts to achieve this single broad purpose. The amendments are made in the context of 2 sets of international reforms. Specifically, the reforms relate to margin requirements for certain types of derivatives and to the administration of financial benchmarks (which are often referenced in derivatives).

The Bill—

- amends a number of Acts to remove impediments to compliance with foreign margin requirements for over-the-counter (OTC) derivatives. This will enable relevant New Zealand entities to continue to enter into certain types of derivatives with international counterparties, in order to, amongst other things, continue to effectively hedge the foreign currency risk associated with overseas funding programmes; and
- establishes a new licensing regime for administrators of financial benchmarks under the Financial Markets Conduct Act 2013. This will enable those benchmarks to be referenced in financial instruments (particularly derivatives) with important international counterparties.

Enabling compliance with foreign margin requirements for OTC derivatives

New rules are being implemented across Group of Twenty (**G20**) countries which require parties to certain types of derivatives to exchange collateral. This collateral is also referred to as "margin". These foreign rules apply to large New Zealand banks and other New Zealand entities, such as the Accident Compensation Corporation (**ACC**) and the New Zealand Superannuation Fund, either directly or by virtue of the rules becoming expected market practice internationally.

Some features of New Zealand law impede the ability of affected entities to comply with these rules, which in the event of default require posted collateral to be immediately available to the non-defaulting counterparty. Inability to comply with these rules may impact affected New Zealand entities' integration with international financial markets and have significant implications for New Zealand's financial system.

Part 1 of the Bill makes a number of amendments to the Reserve Bank of New Zealand Act 1989 (the **RBNZ Act**), the Corporations (Investigations and Management) Act 1989 (**CIMA**), the Companies Act 1993 (**Companies Act**), and the Personal Property Securities Act 1999 (**PPSA**) to enable compliance with these rules.

Key features of *Part 1* of the Bill—

- enable non-defaulting derivative counterparties to access posted collateral immediately (if the defaulting party is in statutory management under CIMA or voluntary administration under Part 15A of the Companies Act), or subject to a short stay of generally no longer than 2 days (if the defaulting party is in statutory management under the RBNZ Act):
- give priority under the Companies Act to the claims of derivative counterparties over those of preferential creditors, including the Commissioner of Inland Revenue and employees, in respect of claims over posted collateral comprised of accounts receivable. This ensures that posted collateral is treated the same regardless of whether the assets making up the collateral are accounts receivable or some other type of asset. Claims on posted collateral comprised of assets other than accounts receivable already have effective priority over preferential claims:
- give priority under the PPSA to the claims of derivatives counterparties over the claims of any other person with a security interest in posted collateral:

- clarify that in certain circumstances the transfer of title in collateral does not create a security interest for the purposes of the PPSA.

Application of the amendments

In order to minimise any impacts on non-derivative creditors, the amendments set out above will only apply in tightly defined circumstances, specifically, where—

- a counterparty to the derivative transaction is a registered bank, the ACC, the New Zealand Superannuation Fund, or another entity prescribed by regulations; and
- the derivative meets certain requirements (such as being subject to a legally robust netting agreement); and
- collateral posted in relation to the derivative meets certain requirements, such as taking the form of a prescribed financial product (such as cash or certain types of investment securities).

Transitional arrangements

The amendments will apply to relevant derivatives entered into after the amendments have come into force.

Introduction of a licensing regime for administrators of financial benchmarks

The Bill also establishes a licensing regime for administrators of financial benchmarks under the Financial Markets Conduct Act 2013 (the **FMC Act**). This regime is being introduced in response to new regulations developed by the European Union (the **EU**) in relation to the generation and operation of financial benchmarks. Other jurisdictions may implement similar regimes. The regulations have effect outside the EU as foreign jurisdictions and benchmark administrators in those jurisdictions must meet requirements in the new regulations in order for the benchmarks they administer to be used in important financial instruments with parties located in the EU.

New Zealand banks and other large private and public sector organisations rely on entering into various derivative instruments with EU counterparties that reference New Zealand benchmarks. These derivatives are critical for hedging, investment, and capital-raising purposes. If New Zealand benchmarks were not accepted in the EU and affected entities were not able to enter into these derivative instruments, this would have significant implications for the affected entities and New Zealand's wider financial system.

The new licensing regime for administrators of financial benchmarks will—

- provide additional assurance around the accuracy, integrity, reliability, and continuity of New Zealand benchmarks:
- ensure continued acceptance of New Zealand benchmarks in EU financial markets:
- avoid significant costs to the New Zealand economy that would arise if our benchmarks were not able to be used in the EU.

Part 2 of the Bill—

- enables the administrator of a financial benchmark to opt-in to obtaining a market services licence under Part 6 of the FMC Act. Supervision and enforcement of licence obligations will be carried out by the Financial Markets Authority (the **FMA**) and detailed licensing requirements will be set in regulations. These requirements will in large part reflect what is required by the EU regulations in order for New Zealand's regulatory regime to achieve formal "equivalence" status:
- provides powers for the FMA to compel administrators of benchmarks to continue to generate, operate, or transfer a benchmark, and contributors to benchmarks to continue to contribute data or information to the benchmark administrator, for a specified period and in accordance with specified requirements. These powers are to be used to ensure the continued availability of financial benchmarks for a period of time in emergency-type situations. This will promote market stability while a smooth transition of a benchmark to

another administrator or an orderly cessation or generation of a benchmark can be arranged. If an administrator or contributor does not comply with a direction from the FMA, the entity may be subject to civil liability, including pecuniary penalties of $200,000 in the case of an individual or $600,000 in any other case.

Commencement

The amendments will come into force on a date or dates specified by 1 or more Orders in Council, but no later than six months after the date of Royal assent.

The Bill is expected to be fully in force by the end of 2019, but the commencement date or dates are to be appointed by Order in Council in order to ensure that the different parts of the Bill can come into force as soon as the related regulations are ready.

Part Two: Background Material and Policy Information

Published reviews or evaluations

2.1. Are there any publicly available inquiry, review or evaluation reports that have informed, or are relevant to, the policy to be given effect by this Bill?	**YES**
Consultation document: A New Zealand response to foreign margin requirements for OTC derivatives, Ministry of Business, Innovation and Employment and Reserve Bank of New Zealand, July 2017: https://www.mbie.govt.nz/dmsdocument/971-consultation-document-a-nz-response-foreign-margin-requirements-for-otc-derivatives-pdf	

Relevant international treaties

2.2. Does this Bill seek to give effect to New Zealand action in relation to an international treaty?	**NO**

Regulatory impact analysis

2.3. Were any regulatory impact statements provided to inform the policy decisions that led to this Bill?	**YES**
'Impact summary: A New Zealand response to foreign derivative margin requirements', Ministry of Business, Innovation and Employment and Reserve Bank of New Zealand, 16 May 2018: https://www.mbie.govt.nz/assets/e3a8c15eb2/regulatory-impact-statement-a-nz-response-foreign-derivative-margin-requirements.pdf 'Impact summary: Introduction of a new regulatory regime for financial benchmark', Ministry of Business, Innovation and Employment, 16 July 2018: https://www.mbie.govt.nz/assets/b7886f254a/impact-summary-introduction-of-a-new-regulatory-regime-for-financial-benchmarks.pdf The Ministry of Business, Innovation and Employment also prepared amendments to the above (second) Regulatory Impact Summary (RIS) in respect of a proposal to include new FMA new compulsion powers in the benchmark licensing regime which came up during the process of drafting the Bill, and for which policy decisions were sought at the same time as approval to introduce the Bill. The amendments to the RIS are now included in the original RIS at the above URL.	

2.3.1. If so, did the RIA Team in the Treasury provide an independent opinion on the quality of any of these regulatory impact statements?	**NO**
The Impact Summaries did not meet the threshold for Treasury RIA Team assessment.	

2.3.2. Are there aspects of the policy to be given effect by this Bill that were not addressed by, or that now vary materially from, the policy options analysed in these regulatory impact statements?	**NO**

Extent of impact analysis available

2.4. Has further impact analysis become available for any aspects of the policy to be given effect by this Bill?	**NO**
2.5. For the policy to be given effect by this Bill, is there analysis available on:	
(a) the size of the potential costs and benefits?	**YES**
(b) the potential for any group of persons to suffer a substantial unavoidable loss of income or wealth?	**NO**
Analysis of the costs and benefits of the policy to be given effect by this Bill is included in the RISs referenced above in question 2.3.	

2.6. For the policy to be given effect by this Bill, are the potential costs or benefits likely to be impacted by:	
(a) the level of effective compliance or non-compliance with applicable obligations or standards?	**YES**
(b) the nature and level of regulator effort put into encouraging or securing compliance?	**YES**
Part 1 of the Bill makes amendments to various Acts to enable compliance with international rules around margin exchange. These amendments do not require industry to comply with any new obligations or standards, and therefore the benefits of the policy do not rely on compliance. Part 2 of the Bill, however, introduces a licensing regime for administrators of financial benchmarks which imposes certain obligations on licensees. One of the purposes of licensing financial benchmark administrators is to promote accuracy, integrity, reliability and continuity of financial benchmarks. In order to achieve the purposes of licences, licensees will need to comply with the licence obligations and the regulator (the FMA) will need to effectively monitor and enforce licence obligations to ensure compliance. Part 6 of the FMC Act, which will apply to licensed financial benchmark administrators, sets out a comprehensive licensing framework for ensuring that licensees comply with their licence obligations and a range of monitoring and enforcement powers for the FMA.	

Part Three: Testing of Legislative Content

Consistency with New Zealand's international obligations

3.1. What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with New Zealand's international obligations?
No separate formal steps have been taken to determine whether the policy to be given effect by this Bill is consistent with New Zealand's international obligations as no policy measures in this Bill have been identified, as part of the normal policy process, as raising any questions of consistency with our international obligations. The amendments relating to derivative margins are intended to ensure compliance with G20 rules for OTC derivatives. EU regulations and International Organization of Securities Commissions Principles (which are driving New Zealand's reforms) were taken into account during policy development of the proposals relating to financial benchmarks.

Consistency with the government's Treaty of Waitangi obligations

3.2. What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with the principles of the Treaty of Waitangi?
The provisions of the Bill apply generally to the New Zealand public as participants in the New Zealand financial markets and do not impact on the principles of the Treaty of Waitangi.

Consistency with the New Zealand Bill of Rights Act 1990

3.3. Has advice been provided to the Attorney-General on whether any provisions of this Bill appear to limit any of the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990?	**YES**
Advice provided to the Attorney-General by the Ministry of Justice is generally expected to be available on the Ministry of Justice's website at: https://www.justice.govt.nz/justice-sector-policy/constitutional-issues-and-human-rights/bill-of-rights-compliance-reports/advice/.	

Offences, penalties and court jurisdictions

3.4. Does this Bill create, amend, or remove:	
(a) offences or penalties (including infringement offences or penalties and civil pecuniary penalty regimes)?	**YES**
(b) the jurisdiction of a court or tribunal (including rights to judicial review or rights of appeal)?	**YES**

Part 2, clause 29 of the Bill amends the civil liability provisions of the FMC Act so that civil liability, including maximum pecuniary penalties of $200,000 in the case of an individual or $600,000 in any other case, may result if a contributor to or administrator of a financial benchmark licence does not comply with a direction or interim direction from the FMA under new section 448C, 448D or 448G of the FMC Act.

Part 2 of the Bill also extends the primary licensing framework of the FMC Act to benchmark administrators (and contributors in limited circumstances). The existing offence of refusing or failing, without reasonable excuse, to comply with a direction order made by the FMA under section 468 of the FMC Act will extend to orders that direct a contributor or administrator of financial benchmarks to comply with a direction or interim direction made under new section 448C, 448D or 448G.

Part 2, clause 28 of the Bill amends the FMC Act (inserting a new section 448J) changes the types of matters that may be heard by the courts. It provides that no civil or criminal proceedings may be brought against a person by reason of the person having provided material, information, or data in good faith and in accordance with a direction or interim direction from the FMA under new section 448C, 448D or 448G.

Part 2, clause 31 of the Bill amends section 532 of the FMC Act to provide for a right of appeal on questions of law only (ie not on questions of fact) against directions and interim directions made by the FMA under new section 448C, 448D and 448G.

3.4.1. Was the Ministry of Justice consulted about these provisions?	**YES**

MBIE consulted with the Offences and Penalties team at the Ministry of Justice on the Bill, including the above-described civil liability and pecuniary penalties that apply for non-compliance with a direction or interim direction from the FMA. The Ministry of Justice considered that in light of the limited scope of the proposed changes, the proposed penalties were justified.

Privacy issues

3.5. Does this Bill create, amend or remove any provisions relating to the collection, storage, access to, correction of, use or disclosure of personal information?	**NO**

External consultation

3.6. Has there been any external consultation on the policy to be given effect by this Bill, or on a draft of this Bill?	YES

In relation to the foreign derivative margin requirements aspects of the Bill, the Ministry of Business, Innovation and Employment (MBIE) and the Reserve Bank conducted a six-week public consultation during July and August 2017. A consultation document was released for discussion during this period: 'A New Zealand response to foreign margin requirements for OTC derivatives'. Six submissions were received. Bilateral discussions were also undertaken with the New Zealand Bankers Association and technical legal experts. Views were also sought from the Council of Trade Unions. No significant concerns were raised (although some stakeholders suggested that broader law reform around derivatives and netting would also be appropriate).

In relation to the new licensing regime for administrators of financial benchmarks, MBIE consulted with the Treasury, Reserve Bank, FMA, and the Department of Prime Minister and Cabinet (Policy Advisory Group) were consulted as part of the development of the policy.

MBIE and the Financial Markets Authority also discussed the policy proposals with the primary financial benchmark administrator to be licensed under the Bill (the New Zealand Financial Markets Association) and relevant industry participants (primarily the banks). That consultation confirmed the need to take prompt action in relation to the EU regulations, and supported the approach to create a new licensing regime under the FMC Act.

Other testing of proposals

3.7. Have the policy details to be given effect by this Bill been otherwise tested or assessed in any way to ensure the Bill's provisions are workable and complete?	NO

Part Four: Significant Legislative Features

Compulsory acquisition of private property

4.1. Does this Bill contain any provisions that could result in the compulsory acquisition of private property?	**NO**

Charges in the nature of a tax

4.2. Does this Bill create or amend a power to impose a fee, levy or charge in the nature of a tax?	**NO**

Retrospective effect

4.3. Does this Bill affect rights, freedoms, or impose obligations, retrospectively?	**NO**

Strict liability or reversal of the usual burden of proof for offences

4.4. Does this Bill:	
(a) create or amend a strict or absolute liability offence?	**NO**
(b) reverse or modify the usual burden of proof for an offence or a civil pecuniary penalty proceeding?	**NO**

Civil or criminal immunity

4.5. Does this Bill create or amend a civil or criminal immunity for any person?	**YES**
Part 2, clause 28 of the Bill (inserting a new section 488J in the FMC Act) provides that no civil or criminal proceedings may be brought against a person by reason of the person having provided material, information, or data in good faith in accordance with a direction or interim direction from the FMA under new section 448C, 448D or 448G of the FMC Act.	

Significant decision-making powers

4.6. Does this Bill create or amend a decision-making power to make a determination about a person's rights, obligations, or interests protected or recognised by law, and that could have a significant impact on those rights, obligations, or interests?	**YES**
Part 2 of the Bill amends section 390 of the FMC Act to give the power to the FMA to issue licences to administrators of financial benchmarks. It is not mandatory for benchmark administrators to be licensed, but they can opt-in to be licensed if they wish.	

Powers to make delegated legislation

4.7. Does this Bill create or amend a power to make delegated legislation that could amend an Act, define the meaning of a term in an Act, or grant an exemption from an Act or delegated legislation?	**YES**

Part 1, clause 6, of the Bill amends section 173 of the Reserve Bank of New Zealand Act 1989 (RBNZ Act) by:

- inserting a new subsection (fb) that allows regulations to be made to prescribe entities and classes of entities included in the definition of "qualifying counterparty" in new section 122A of the Act. This regulation-making power is necessary to allow other entities to be covered by the amendments in Part 1 of the Bill if they become subject to the G20 margin requirements over time.
- inserting a new subsection (fc) that allows regulations to be made to prescribe a period for the purposes of specifying the type of forward transactions covered by the definition of "derivative" in new section 122A of the Act. This regulation-making power is necessary to allow flexibility in the definition of "derivative" within the RBNZ Act, rather than prescribing the relevant period in the Act.

Before such regulations can be made, the Ministers responsible for administering the RBNZ Act and the Companies Act 1993 must have regard to:

- the purposes of the RBNZ Act, the Companies Act 1993, the Corporations (Investigation and Management) Act 1989 and the Personal Property Securities Act 1999
- the effect on the maintenance of a sound and efficient financial system, the creditors of qualifying counterparties, and the integrity of statutory management, corporate insolvency and personal properties securities law.

In Part 2 of the Bill:

- clause 22(3), new section 6(7), and clause 33 allow regulations to be made that exclude certain prices, estimates, rates, indices or values from the definition of "financial benchmark".

4.8. Does this Bill create or amend any other powers to make delegated legislation?	YES

In Part 2 of the Bill:

- clause 32, new section 546(1)(d)(v), amends the FMC Act to allow regulations to be made that impose conditions on licenses for administrators of financial benchmarks to achieve the purposes set out in new section 448B (for example, to ensure the benchmark complies with applicable requirements in overseas jurisdictions). This regulation-making power mirrors the regulation-making powers for imposing conditions on other market services licences.

Further regulations are anticipated to support the basic framework of licensing benchmark administrators in Part 2 of the Bill, including in relation to:

- eligibility criteria for benchmark administrator licences and requirements relating to directors and senior managers of the administrator
- matters that the FMA must have regard to before deciding to issue a benchmark administrator licence, persons or class of persons that must be consulted, and the manner of making a decision
- conditions of benchmark administrator licences.

Eligibility criteria or licence conditions that will apply to benchmark administrators are anticipated to cover areas such as:

- governance and oversight
- conflict of interest management
- benchmark design and methodology eg input data
- procedures around cessation of a benchmark and transition arrangements
- codes of conduct for contributors
- transparency and access to benchmarks
- record-keeping and complaints processes
- reporting to the FMA.

Any other unusual provisions or features

4.9. Does this Bill contain any provisions (other than those noted above) that are unusual or call for special comment?	YES

Part 2, clause 28, new section 448C, of the Bill amends the FMC Act to provide a new power for the FMA to direct contributors to a benchmark (eg banks) to continue to provide information or data to a benchmark administrator for a specified period and in accordance with specified requirements. Contributors are not licensed entities but are subject to civil liability for non-compliance with these directions.

Clause 28, new section 448G, amends the FMC Act to provide a similar power for the FMA to direct benchmark administrators to generate or operate a benchmark, or to transfer a benchmark to another administrator on similar specific bases.

The purpose of these powers is to ensure the continuity and reliability of benchmarks to the market, and avoid instability that might occur if a benchmark were to be disrupted. The powers are also mandatory requirements in order for New Zealand to achieve formal “equivalence” status under the EU regulations that are driving the reforms.