

11 November 2011

Revised option for proposed levy to fund the Financial Markets Authority

- 1 The purpose of this document is to seek feedback on a revised option for a proposed levy to fund the Financial Markets Authority (FMA). This document is provided to you as part of targeted consultation to refine the proposed levy. Your feedback would be appreciated by 2 December 2011.
- 2 In June, the Ministry of Economic Development (MED) consulted on proposed fees and levies for the FMA, New Zealand Companies Office (NZCO), the External Reporting Board (XRB), and the Insolvency and Trustee Service (ITS). We proposed reviewing the fees and levies two years after regulations come into force to evaluate whether any adjustments are required to the original design.
- 3 Submitters either supported or made no comment on the proposals for the NZCO, XRB, and ITS. No submitters supported our preferred option for levies to fund the FMA. We concluded that all four of the FMA levy options in the discussion document could cause significant distortions and/or proportionality problems.
- 4 Feedback included that the proposed levies would encourage larger institutions to reduce the number of staff providing financial advice and may drive smaller financial service providers out of the market. This would be contrary to the interests of investors.
- 5 We have tested several alternative approaches and modelled different cost allocation combinations within each approach. We also consider it important to check whether the revised package:
 - Will ensure that each levy amount is consistent with the benefits of financial market regulation obtained by the party paying the levy;
 - Will not discourage some classes of entity from supplying financial products or services; and
 - Is practical, including the costs of collecting the levy, whether the levy can be effectively implemented, is easy to comply with, and avoids large over or under-recoveries.
- 6 The first goal is the most subjective and requires a judgement about the extent of any benefits and where to place the burden of the levy.
- 7 The total average annual amount to be recovered through levies in the five year period from February 2012 to December 2016 is \$16.4 million (excluding GST). The discussion document proposed a structure of multiple distinct levies for different categories of financial market participant, including a Financial Advisers Act levy, an auditor levy, and a more general FMA levy. In addition, it anticipated separate third party funding from trustees and any new licensing regimes arising from the Securities Law Review.

- 8 The revised proposal would recover the entire \$16.4 million through a single type of levy promulgated under section 68 of the Financial Markets Authority Act 2011. This levy would be structured so that different categories of financial markets participant pay different tiered amounts, as follows:

Category	Number	Amount (\$)	GST incl. (\$)	GST excl. (\$)
Category 1				
Banks (Assets >\$50b)	4	350,000	1,400,000	1,217,391
Banks (Assets \$10-50b)	4	80,000	320,000	278,261
Banks (Assets \$2-10b)	7	20,000	140,000	121,739
NBDTs (Assets >\$1b)	3	10,000	30,000	26,087
Total	18		1,890,000	1,643,478
Category 2				
Insurers (GWP >\$250m)	6	175,000	1,050,000	913,043
Insurers (GWP \$50-250m)	26	40,000	1,040,000	904,348
Insurers (GWP \$10-50m)	21	10,000	210,000	182,609
Total	53		2,300,000	2,000,000
Category 3**				
Licensed trustees & statutory supervisors & all other issuers (>\$100m)*	150	35,000	4,500,000	3,913,043
Other managed funds and non-bank deposit takers (>\$10m)*	100	10,000	1,000,000	869,565
All other issuers (including equity and debt)	500	1,000	1,250,000	1,086,957
Total	750		6,750,000	5,869,565
Category 4				
Licensed auditors	100	1,600	160,000	139,130
Category 5				
Share broking firms	50	7,500	375,000	326,087
All other FSPs (not including retirement villages)	9,450	300	2,835,000	2,465,217
Total	9,500		3,210,000	2,791,304
Category 6				
Companies	460,000	10	4,600,000	4,000,000
Total			18,910,000	16,443,478

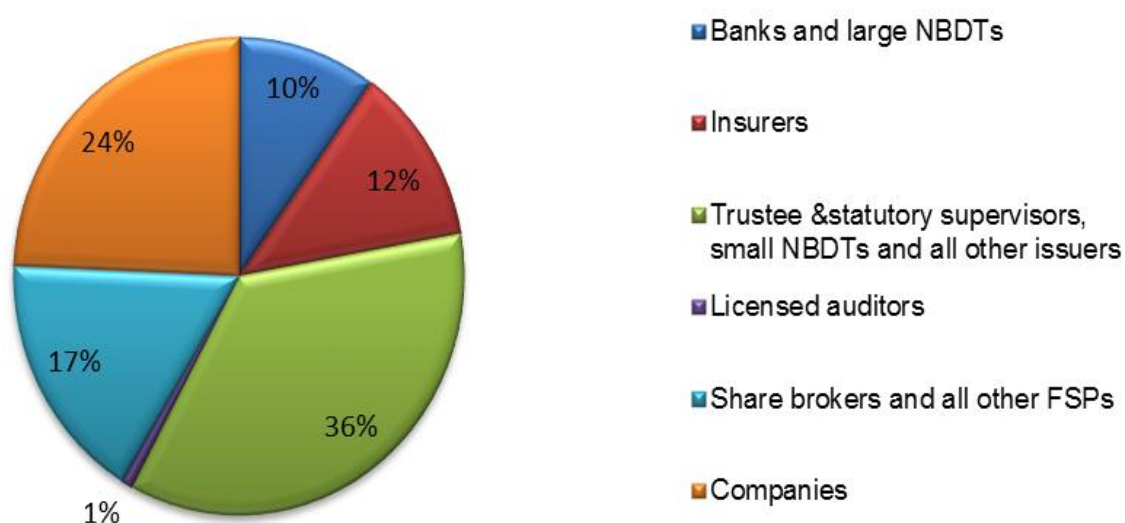
* Funds under supervision for trustee companies. Total assets for other issuers.

** Issuer has the meaning given under the Financial Reporting Act 1993, which includes firms that have made a one-off capital offering. GWP is Gross Written Premium.

Apart from Category 6, if a financial market participant is subject to more than one category or tier, they should pay only the higher or highest amount. However, two or more levies will be payable for groups of companies where individual entities carry out different activities (e.g. a bank that has a subsidiary which provides insurance services).

- 9 The underlying assumption is that financial market participants benefit from the fair, efficient, and transparent investment environment supported by the FMA's activities and should therefore contribute towards the cost of providing that environment.
- 10 We consider that the most direct benefits flow to those who offer financial products and services e.g. brokers. Secondly, benefits flow to the consumers of financial products and services e.g. companies. Finally, the general public receives an indirect benefit from the FMA's activities and contribute to the FMA through taxes. We also assume that a larger organisation benefits more than a smaller organisation in terms of the revenue generated in a sound regulatory environment.
- 11 The following graph shows the proportion that each category will contribute annually to the total of the FMA's third party funding of \$16.4 million.

Breakdown of FMA third party funding contributions by category



- 12 The following table shows the amount of assets/GWP for each \$1 of levy for Categories 1, 2 and 3. For example, the table illustrates that a bank with assets of \$50 billion will pay \$1 of levy for every \$142,857 of assets that it holds.

Ratio of assets/ GWP to each \$1 of levy

Category 1	Assets/\$1 Levy (minimum - based on bottom of tier)
Banks (Assets >\$50b)	\$142,857
Banks (Assets \$10-50b)	\$125,000
Banks (Assets \$2-10b)	\$100,000
NBDTs (Assets >\$1b)	\$100,000
Category 2	GWP/\$1 Levy (minimum - based on bottom of tier)
Insurers (GWP >\$250m)	\$1,429
Insurers (GWP \$50-250m)	\$1,250
Insurers (GWP \$10-50m)	\$1,000
Category 3****	Assets or funds under supervision/\$1 Levy
Licensed trustees & statutory supervisors & all other issuers (>\$100m)***	\$2,857
Other managed funds and non-bank deposit takers (>\$10m total assets)	\$1,000

- 13 Consultation on this revised option will likely delay the FMA levy regulations until 1 April 2012 compared to the 1 February 2012 date in the original discussion document. This has some revenue implications but we believe it is more important to consult on the revised option to ensure it is robust and does not give rise to any unintended consequences. The levy will be collected online through the appropriate New Zealand Companies Office register at registration and annually.
- 14 We would appreciate your feedback on both the proposal and our analysis, summarised in the following table:

Categories	Comment
Category 1: Banks and large NBDTs	Proportionality: Deposit takers tend to be harmed less than other FSPs when investor confidence falls because depositing savings in a bank is relatively low risk. In addition, banking risk tends to be lower the larger the bank because they are better able to spread risk. Thus, deposit takers should be levied proportionately less than other FSPs and proportionately less the larger they are. The levy in each tier has been designed to meet those two objectives. Note also that a banking group that is a qualifying financial entity will not only pay the applicable Category 1 amount as a registered bank but will also be subject to the costs for the Authorised Financial Advisers it employs under Category 5. In the case of a large banking group offering broking or insurance, it may also be subject to levies under other categories too.

	<p>Distortions: We do not expect many distortions because it is unlikely that any entities would change their business models at the proposed levy levels. Indeed, the amounts could probably be higher without creating distortions.</p> <p>Practicality: There is a high degree of certainty that the estimate of the total amount obtained from Category 1 entities is accurate. The tiers are clearly defined and we have reliable information from the Reserve Bank about the number of deposit takers within each tier.</p>
<p>Category 2: Insurers</p>	<p>Proportionality: The dollar amounts within each of the three tiers for insurers are lower than those proposed for banks because insurers tend to be smaller than banks and therefore less able to distribute risk. This makes insurers more vulnerable to events that affect confidence in financial markets and therefore they receive a larger relative benefit from the existence of sound financial market regulation. We consider that the proposed insurer levies are proportionate to the benefits that insurers receive, and the proposed levies for banks.</p> <p>Distortions: We expect that the amounts could probably be higher without creating distortions.</p> <p>Practicality: This is practical for the reasons discussed in relation to Category 1.</p>
<p>Category 3: Licensed trustees and statutory supervisors, and other issuers</p>	<p>Proportionality: We have not been able to identify any proportionality issues either within this category or between this category and the other categories, due to the use of tiers based on a combination of product issued and total assets. In particular, the tier for assets below \$10 million ensures that credit unions and equity-only issues with employee share purchase schemes do not face a disproportionately high levy (the Reserve Bank uses a \$10 million threshold for assessing “small” NBDTs). Compared to large financial institutions like banks and insurers, issuers, licensed trustees, and statutory supervisors are particularly vulnerable to events that affect confidence in financial markets and therefore they receive a larger relative benefit from the existence of sound financial market regulation.</p> <p>Distortions: The levy for each tier has been designed to minimise the risk of directors deciding not to issue to the public due to the amount of the levy. Using total assets as the criterion for distinguishing between the tiers, in combination with the product issued, also minimises those risks. We consider that there will be few if any distortions.</p> <p>Practicality: There is no reliable data about: (a) the total number of issuers; or (b) the size distribution among issuers. Therefore, there is a significant risk that the amount collected from Category 3 entities will be materially different from our estimates. We will be able to collect the missing data during in the first two years of collecting the levy and any significant under or over-recovery can be corrected following the review of levy.</p>

<p>Category 4: Licensed auditors</p>	<p>Proportionality: A levy of \$1,600 on licensed auditors does not seem inconsistent with the benefits to licensed auditors of FMA oversight. We also accept the point made in submissions on the June discussion document that the levy decisions should not be considered in isolation of practice review fees. Registered auditing firms will need to pay about \$40,000 per practice review. Each review must take place no less than four years since the previous review.</p> <p>Distortions: A high levy, such as the \$7,900 proposed in the MED discussion document runs a significant risk of competitive distortions that would favour the Big 4 accountancy firms at the expense of the second tier firms. This is because Big 4 auditors usually spend a much higher proportion of their time on issuer audits than auditors within the second tier firms. This outcome is much less likely with a levy of \$1,600. In addition, it seems likely that most of the auditor levy costs would be passed on to issuers because the demand for issuer audits is highly inelastic.</p> <p>Practicality: Based on discussion with the sector, we expect the number of licensed auditors to be in the range of 80-140 and have used the conservative figure of 100 for our levy modelling.</p>
<p>Category 5: Share brokers and other FSPs</p>	<p>Proportionality: The amount is proportionate for the great majority of “Other FSPs” that are small. However, we have included a higher tier for share broking firms, which tend to be larger than the other entities in this category. We are aiming to target large broking firms where a levy of \$300 would be disproportionately low. We have not been able to identify a clear way of distinguishing between smaller and larger share broking firms and would particularly appreciate feedback on this point. However, because broking firms tend to employ financial advisers, in many cases a broking firm will not only pay \$7,500 for itself, but would also likely pay \$300 for each of the separately registered FSPs it employs. This improves the proportionality of this levy category.</p> <p>Retirement villages are currently included within the definition of FSP in the Financial Markets Authority Act solely because they fall within the definition of “issuer” in the Financial Reporting Act 1993. However, retirement villages are regulated under the Retirement Villages Act 2003 and obtain no direct benefits from the levy-funded FMA activity. Retirement villages offering occupation rights agreements are currently excluded from the scope of the legislation that the FMA oversees. Therefore, we are recommending that retirement villages per se should not be charged as FSPs. However, if a retirement village issues other types of securities such as debt, then they will be treated like any other issuer of those products for the purposes of the levy.</p> <p>Distortions: Distinguishing between advisers that are associated with qualifying financial entities (e.g. banks), and those that are not, could add to the costs of AFA status. It may also drive advisers to qualifying financial entities and reduce investor access and/or add to the costs of obtaining advice. However, at \$300 per FSP, the risks should be relatively low.</p> <p>Practicality: The number of all other FSPs in Category 5 (i.e. 9,450) is based on the number currently registered with an assumption that for those that do very little financial advice work it will make sense to deregister. The risks associated with this estimate are low. Around 3,000 FSPs have registered for activities that include broking services, but this figure is not reliable and creates a risk that the amount collected will be materially different from our estimates. It may be possible to correct this problem after the levy is reviewed using information collected in the first two years of the levy.</p>

Category 6: Companies	<p>Proportionality: We consider that it is consistent with the proportionality criterion to levy all companies a small amount due to the indirect benefits that they obtain from having a stable and well regulated financial sector.</p> <p>Distortions: A \$10 FMA levy will increase the total proposed company annual return charge to \$45, including the \$35 proposed to fund the XRB and the NZCO. The extra \$10 may encourage directors to deregister some inactive or very small companies. However, this should not have a material impact. If \$10 is enough to make a difference, then the loss to New Zealand society associated with company de-registrations will be negligible. In addition, the removal of inactive companies can be regarded as positive from a register user perspective.</p> <p>Practicality: It is estimated that the number of companies on the register will fall from over 500,000 to 460,000 (including new incorporations) due to a combination of changes in tax legislation affecting LAQCs and the proposed new charges. However, estimates of total revenue collected are not overly sensitive to de-registration assumptions.</p>
Categories 1, 2 & 3	<p>Practicality: It may be necessary to reset the tier qualifying criteria from time-to-time due to inflation, where the tiers are defined by dollars.</p>

- 15 There is a trade-off between practicality, proportionality and minimising distortions. The category-plus-tier approach creates some complexities, particularly in relation to collection and revenue assurance. However, it is very difficult to avoid this problem. The wide diversity of FSP and financial adviser business models means that it is necessary to trade-off complexity against the high risk that some will pay highly disproportionate amounts that will distort the market. We consider that the avoidance of significant market distortions should be given a much higher weighting than simplicity.
- 16 Specific questions for your consideration:
- 1) How do the proposed levy categories and tiers perform against the assessment criteria (outlined in paragraph 5)?
 - 2) How could we best differentiate between smaller and larger broking firms?
 - 3) Are there any alternative options we should consider for raising the required \$16.4 million in annual levy funding for the FMA?
 - 4) If you consider that one or more of the categories proposed would pay excessive levies, please provide alternative proposals summing to \$16.4 million without changing the \$10 levy for companies.