MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

Impact Summary: Regulations to help address misuse of the Financial Service Providers Register

Section 1: General information

Purpose
The Ministry of Business, Innovation and Employment (MBIE) is solely responsible for the analysis and advice set out in this Regulatory Impact Analysis, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final Cabinet decisions to proceed with a policy change.

Key Limitations or Constraints on Analysis
This impact summary relates to regulations to support measures in the Financial Services Legislation Amendment Act 2019 (Amendment Act) to help address misuse of the Financial Service Providers Register (FSPR). The analysis is largely based on impacts identified by submitters. The impacts of the proposals depend on the likelihood of financial service providers finding ways to continue to misuse the FSPR under each proposal, which is difficult to predict. The issue also relates to risks to New Zealand's reputation as a well-regulated jurisdiction, which is difficult to quantify. The analysis therefore includes some evidence relating to the number of affected providers, but quantitative evidence is limited.
Responsible Manager
Authorised by: Sharon Corbett Financial Markets Policy Ministry of Business, Innovation and Employment 04 474 2900 June 2019

Section 2: Problem definition and objectives

2.1 What is the policy problem or opportunity?

In summary, some offshore-controlled firms have been registering on New Zealand's Financial Service Providers Register (FSPR) for unscrupulous purposes. These firms take advantage of the fact that registration on the FSPR currently requires only a place of business in New Zealand (regardless of where services are provided to) and does not require pre-vetting by the regulator for certain financial services. These firms then use registration to imply that they are actively regulated in New Zealand. Some of these firms have been connected to misconduct overseas, which presents a risk to the reputation of New Zealand's financial markets and legitimate financial service providers.

The Amendment Act requires businesses to have New Zealand clients above a minimal level in order to register on the FSPR. This is intended to reduce the ease and net benefit of seeking registration for misuse purposes, and so that the FSPR would show providers that had a real connection with New Zealand in relation to their financial services. This impact summary assesses option for the threshold level of financial services required to register on the FSPR. The rest of this section sets out further background.

BACKGROUND TO CHANGES IN AMENDMENT ACT

Some firms have been registering on the FSPR to take advantage of New Zealand's reputation

Anyone who is in the business of providing a financial service is required to be registered on a Government-administered FSPR, which is accessible by the public. This requirement applies to a range of financial markets participants such as banks, foreign exchange providers, financial advisers and money transfer operators.

All financial service providers who provide services to retail clients (generally everyday consumers) are also required to be members of an approved dispute resolution scheme, which consumers can access for free.

The registration system allows for identification of all those in the business of providing financial services in New Zealand and their financial dispute resolution scheme. It also assists with meeting New Zealand's obligations under the Financial Action Task Force (FATF) Recommendations to register or licence all financial institutions, and with monitoring of anti-money laundering obligations.

However, registration on the FSPR does not necessarily mean a provider is licensed or regulated in New Zealand or elsewhere. Some, but not all, providers on the FSPR are licensed.

As set out in previous RISs,[1] some firms with little or no connection to New Zealand have been registering on the FSPR (for services that do not require a licence) to take advantage of New Zealand's reputation as a well-regulated jurisdiction. These firms use their registration to give the misleading impression that they are licensed or actively regulated in New Zealand, to help influence potential clients (particularly overseas-based clients) to use their services. Some such firms have then been connected to fraudulent activities overseas. This presents a risk to New Zealand's reputation as a well-regulated jurisdiction and to the reputation of legitimate New Zealand registered providers. Evidence of this problem is outlined in previous RISs. For example, for the three financial years from

1 *Regulatory Impact Statement: Amendments to the Financial Service Providers (Registration and Dispute Resolution) Act 2008 and Regulations*, 29 June 2016 https://www.mbie.govt.nz/assets/a1c51b5e7a/regulatory-impact-statement-amendments-to-the-financial-service-providers-registration-and-dispute-resolution-act-2008-and-regulations.pdf and *Regulatory Impact Statement: Further amendments to the Financial Advisers Act and the Financial Service Providers Act,* Part E, 29 October 2016 https://www.mbie.govt.nz/assets/d352d847be/ris-further-amendments.pdf

July 2014 – June 2017, the FMA received complaints about 296 registered providers that had a substantial part or all of their business overseas.[2]

The FSP Act has been amended to address the misuse issue

To help address the misuse issue, the Amendment Act amends the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act) so that providers will be able to (and required to) register only if they:

- will be in the business of providing financial services *to persons in New Zealand* above a minimum threshold*,* regardless of where the financial services are provided from; or
- are required to be licensed or registered by another Act in relation to a specific service,[3] or are a reporting entity under anti-money laundering legislation (AML reporting entity) that provides financial services.

This compares to the current position where anyone that has a place of business in New Zealand is required to register on the FSPR if in the business of providing a financial service, regardless of where the financial services are provided to. Those seeking to misuse the FSPR had been able to do so relatively easily by setting up an office in New Zealand without making any financial services available to New Zealand-based clients. The Financial Markets Authority (FMA) was given the power in 2014 to direct the Registrar to decline a registration application or deregister an entity in certain circumstances.[4] However, using that power has required significant resources from the FMA, including in some instances time responding to appeals against deregistration or declined applications. The misuse issue has also persisted even with the FMA's use of its powers and checks conducted by the Registrar.

Changes were therefore made in the Amendment Act to require providers to have New Zealand clients. This was intended to reduce the ease and net benefit of seeking registration for misuse purposes, and so that the FSPR would show providers that had a real connection with New Zealand in relation to their financial services.

Other changes have also been made to the FSP Act to help address the misuse issue and supporting regulations will set out details. In particular, there will be restrictions on how providers can advertise their status as a registered provider. This means that even if an unscrupulous firm succeeded in passing initial checks to become registered, they would still be restricted from taking advantage of that registration to misrepresent their status. Failure to comply with those restrictions could lead to deregistration. Analysis of those changes have been covered in the previous RISs.

The amendments mean the focus for registration is whether a provider has New Zealand clients

The Amendment Act generally changes the focus of registration on the FSPR from those that provide financial services *from* New Zealand to those that provide financial services *to* persons in New Zealand.

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2 Financial Markets Authority, *The Financial Service Providers Register,* September 2017, http://www.fma.govt.nz/assets/Reports/_versions/9834/170922-FSPR-report.1.pdf.

3 For example, under the Financial Markets Conduct Act 2013 (as amended by the Amendment Act), individual financial advisers will be required to be registered.

4 The FMA was given the power in 2014 to direct the Registrar to decline a registration application or deregister an entity if it considers that registration of that entity is likely to:

- create a false or misleading impression as to the extent to which an entity provides (or will provide) financial services in or from New Zealand, or is regulated in New Zealand; or
- otherwise damage the integrity and reputation of New Zealand's financial markets or regulation of those markets.

The following summarises the changes to the registration scope

Place of business	Clients	Currently can and required to register?	Can and required to register under Amendment Act?
NZ place of business	Providing financial services to persons in New Zealand (retail or wholesale)	Yes	Yes (if above threshold, or is AML reporting entity providing financial services)
	Providing financial services to offshore clients only	Yes	Yes if AML reporting entity providing financial services, otherwise **No**
No NZ place of business	Providing financial services to New Zealand retail clients	No	**Yes** (if above threshold)
	Providing financial service to New Zealand wholesale clients only	No	No
	Providing financial services to offshore clients only	No	No

While the changes to the FSP Act were primarily aimed at addressing misuse, offshore-based financial service providers that have New Zealand retail clients above the threshold will also be required to register, despite not currently being required to do so. This change was made to enable New Zealand retail clients of those entities to have access to free dispute resolution arrangements. Under the FSP Act, only financial service providers subject to the registration requirements, and who provide services to retail clients, are required to belong to a dispute resolution scheme.[5]

THE PROPOSED REGULATIONS

Regulations can specify a threshold level of New Zealand clients required for registration

The ability to prescribe a threshold in regulations was included because even with the changes in the FSP Act, a provider could still seek to misuse the FSPR by for example, undertaking one or two token transactions with New Zealand persons in order to fall within the scope of registration. Prescribing a minimum level of transactions helps to reduce (but will not eliminate) the risk of such misuse.

The FSPR registration system is forward-looking. Providers must be registered in order to be in the business of providing financial services, so registration must occur before commencing services. Therefore at the point of applying for registration, the proposed thresholds would be forward-looking. Applicants would need to be able to demonstrate that they expect to be providing financial services above the prescribed threshold. After the provider has commenced operations, they would need to be able to demonstrate that they continue to meet the thresholds in order to stay registered. References in this document to providers needing to have a threshold level of services should also be read as applicants for registration needing to be able to show they expect to meet the relevant threshold.

Objectives

The primary objective of the proposed regulations is to deter registration by those that intend to

5 Amongst other things, this allows the schemes to rely on checks completed by the Registrar that the provider is not an undischarged bankrupt and meets other minimum requirements. Providers also face the potential ultimate sanction of being deregistered from the FSPR if they fail to engage with the dispute resolution schemes.

New Zealand dispute resolution schemes may not in all cases be able to obtain redress for consumers in relation to providers that do not have a place of business in New Zealand. However on balance, we considered it important that New Zealand consumers have access to dispute resolution when acquiring services from all providers that promoted and provided their services in New Zealand, regardless of where the provider was based.

misuse their registered status.

In considering options for thresholds, we have also kept in mind continuing to facilitate consumer access to the financial dispute resolution system and the purpose of the registration system to identify those in the business of providing financial services in New Zealand.

2.2 Who is affected and how?

As the problem is one that affects the integrity and reputation of New Zealand's financial markets, it affects all those who participate in those markets, including legitimate financial service providers, regulators and New Zealand and overseas clients. Other specific impacts are identified below.

While the problem and proposed regulations relate to which providers are required to register on the FSPR, it also impacts financial dispute resolution arrangements because only providers subject to registration requirements can be required to belong to dispute resolution schemes. Decisions in relation to who is required to register therefore directly impact when New Zealand consumers have access to dispute resolution arrangements.

Specifically, the proposed regulations will therefore affect:

- *financial service providers* in relation to whether they are required and able to register on the FSPR and belong to a dispute resolution scheme
- *clients* of financial service providers, including whether they can continue to access the dispute resolution system in respect of their provider
- *dispute resolution schemes* in relation to the types of providers who will be required to be a member of a scheme
- *government authorities,* including the Registrar of Financial Service Providers (within the Companies Office, which is a part of MBIE) who is responsible for administering the FSPR including processing applications for FSPR registration and deregistrations, and the FMA as the regulator of financial markets.

2.3 Are there any constraints on the scope for decision making?

This impact summary only assesses the level of the threshold for registration. It does not assess measures for addressing the misuse issue generally. The proposed threshold regulations must be within the scope of the regulation-making power in the Amendment Act.

Section 3: Options identification

3.1 What options have been considered?

The options for addressing the problem include the following:

Option 1: Not setting a threshold (not preferred due to higher risk of misuse)

One option is to require and allow providers to register on the FSPR as long as they provide any level of financial services to New Zealand clients. The change in the FSP Act which will require providers to have New Zealand clients in itself will reduce the ease of misuse to some extent. However, this option is not preferred due to the greater risk that a provider sets up one or two token transactions to meet the new requirement for registration.

Option 2: Setting a moderately low threshold (preferred option)

The preferred option, discussed in further detail in section 3.2, is to set a moderately low threshold for registration to balance the objective of deterring misuse whilst continuing to facilitate consumer access to dispute resolution.

Option 3: Setting a relatively high threshold (not preferred due to impact on consumer protections)

Another option is to set a relatively high threshold for registration, e.g. requiring transactions in the hundreds of thousands of dollars each year in order to be registered. This option is not preferred as it could have a material impact on consumer access to dispute resolution.

3.2 Which of these options is the proposed approach?

The preferred option is to set a moderately low threshold for registration

The proposed approach is to set a moderately low threshold whereby to be registered, a provider must in each year ending on the date of its annual confirmation,[6] have at least:

- 10 New Zealand resident clients; and
- $10,000 of transactions in total with New Zealand resident clients.

A provider must in the first six months after registration have achieved half of the threshold above (i.e. 5 New Zealand resident clients and $5,000 of transactions with New Zealand resident clients).

Services provided to relatives and associates would be excluded for the purposes of determining whether the above thresholds have been met.

As noted, the thresholds do not apply to any services requiring a licence, where another Act requires registration, or AML reporting entities that provide financial services. The threshold also will not apply to the consumer lending services (where fit and proper testing is due to commence in 2020).

The ease of misuse will be further reduced

Requiring a minimum level of financial services to persons in New Zealand provides greater comfort that a provider will likely be carrying out genuine financial services transactions with persons in New Zealand, rather than registering for misuse purposes. Providers would need to confirm they were meeting the thresholds at each annual confirmation, and provide supporting documentation to the Registrar if requested by the Registrar. There remains a possibility of providers faking documentation which can never be fully eliminated. However, the requirement to have a threshold level of services

[6] To remain registered as a financial service provider, every year a provider must confirm its registration details.

in New Zealand will make it more difficult for those seeking to misuse to become and stay registered. The preferred option combined with other measures in the Amendment Act (including restrictions on advertising of registered status and greater powers for the Registrar to require information from providers) are expected to deter misuse.

Consumer access to dispute resolution will likely be maintained in most cases

Setting a threshold means that some consumers that would otherwise have had access to dispute resolution (without a threshold being prescribed) may not have access under the proposal if their financial service provider is providing services below the level required for registration.

This is mostly likely to affect consumers of overseas-based providers, or providers that have only administrative or marketing functions in New Zealand. This is because all businesses that have substantive financial service infrastructure in New Zealand will still have to register regardless of whether they meet the threshold or not (because they would likely be AML reporting entities). All consumer credit providers, and others required to be licensed or specifically required to be registered will also still be required to register.

It is difficult to estimate how many overseas providers and providers with a New Zealand administrative presence only would have New Zealand clients below the threshold. Data provided by the FMA and Department of Internal Affairs showed that less than 10% of the AML reporting entities they respectively supervise reported less than 10 clients and less than $10,000 of transactions in 2017/18 annual reports. That data covers both New Zealand and overseas clients, and those particular AML reporting entities would in any case be required to register. However, the data indicates that some (but only a small number of) relevant providers and their clients could be impacted by the proposed threshold.

However, any such affected clients would likely not have access to dispute resolution currently (prior to the Amendment Act coming into force). The current requirement for a place of business in New Zealand has been interpreted to mean that businesses must be providing financial services (not just administrative services) from New Zealand in order to register. It is therefore likely that most genuine providers registered today would still be required to register by virtue of being an AML reporting entity, even with the threshold in place.

So while the proposed threshold means some consumers may not be extended the benefit of increased access to dispute resolution under the Amendment Act, we consider that outcome to be justified given:

- the small number clients or volume of transactions affected
- the relevant consumers are unlikely to have had access to dispute resolution currently
- the benefits of a threshold in increasing deterrence of misuse.

However, MBIE will be working with other agencies to consider communications for consumers about the benefits of using a provider that is a member of a dispute resolution scheme.

There will likely be some complexity in enforcement

Implementing a threshold will add complexity to the registration and any enforcement processes of the Registrar or other regulator (including enforcement actions against providers that are unregistered when they should be) as there will need to be an assessment of the volume of a provider's transaction. However, this complexity is considered to be outweighed by the benefits of further reducing the ease of misuse.

A threshold is not expected to materially impact the purpose of the registration system in identifying

those in the business of providing financial services in New Zealand. As already noted, AML reporting entities will still be required to register. Not identifying overseas providers and providers with a New Zealand administrative presence only where they only have a small number or volume of transactions with New Zealand clients is not expected to materially impact the functions of New Zealand regulators or New Zealand's compliance with FATF Recommendations.

Section 4: Impact Analysis (Proposed approach)

4.1 Summary table of costs and benefits

Affected parties *(identify)*	**Comment**: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*
Additional costs of proposed approach, compared to taking no action		
Financial service providers	As at May 2019, there were over 3,000 entities that were registered only for services that do not require licensing.[7] Those entities and overseas providers newly required to register are likely to be most directly affected by the proposal. Financial service providers will be required to confirm each year in their annual confirmation that they meet the thresholds or are otherwise required to register. Providers may also be required to produce supporting evidence when applying for registration and in response to any requests by the Registrar for further information. Given the proposed thresholds are moderately low, it is expected that many legitimate providers will have this information readily available. The proposed approach is not expected to impose material costs on providers compared to taking no action, as providers would still have needed to confirm they had some New Zealand clients due to the change to the FSP Act itself.	Low (for legitimate financial service providers)
Clients of providers	Compared to taking no action, some consumer clients of financial service providers that provide services below the threshold would not have access to free dispute resolution if their providers were not required or able to be registered. Given the thresholds are moderately low and given AML reporting entities that provide financial services are still required to register, the impact of this is expected to be low. This impact is considered to be justified given the low number or volume of transactions affected, the benefits to deterring misuse, and given relevant consumers likely did not have access to dispute resolution currently before the Amendment Act is in force.	Low

7 This figure does not include individual financial advisers that are not currently required to be licensed, as the Amendment Act will require that all financial advice providers be licensed and all individual financial advisers registered. The figure includes some that provide consumer credit, to which the proposed thresholds will not apply.

Regulators	The Registrar will need to implement processes for checking that applicants expect to meet the threshold level of services and that registered providers are meeting the thresholds, including requesting and reviewing follow up documentation as necessary. However, even in the status quo, the Registrar would still need processes to check that applicants have / expect to have some New Zealand clients. Other regulators considering taking enforcement action against providers for being unregistered when they should be will have a more complex task in proving that the relevant provider did have clients above the threshold. This is expected to impose some costs.	Low
Total Monetised Cost		Unknown
Non-monetised costs		Low

Expected benefits of proposed approach, compared to taking no action		
All participants in financial markets	Overall, the proposal is expected to further reduce the ease of misuse compared to taking no action, which helps to promote confidence in New Zealand's financial markets and financial service providers, for the benefit of all legitimate participants in financial markets. It would be more difficult and costly for firms to misuse the FSPR as they need to have a minimum level of genuine financial services transactions with New Zealand clients.	Medium
Total Monetised Benefit		Unknown
Non-monetised benefits		Medium

4.2 What other impacts is this approach likely to have?
Not applicable.

Section 5: Stakeholder views

5.1 What do stakeholders think about the problem and the proposed solution?

Stakeholders were generally supportive, but concerned with maintaining consumer protection

In April 2018, MBIE consulted on a discussion document relating to the proposed regulations. 14 submissions were received from financial service providers, dispute resolution schemes and the Commerce Commission.

Many submitters were supportive of the proposed regulations. However, the Commerce Commission and dispute resolution schemes emphasised the importance of ensuring that consumer protection and consumer access to dispute resolution were not adversely affected by proposals aimed at addressing misuse by some providers. These comments were taken into account in the final proposals, including by providing that consumer credit providers are not subject to the threshold. The requirement for AML reporting entities that provide financial services to register regardless of whether they meet the threshold was added to the Amendment Act after submissions on proposed regulations – that change should also help to address the above concerns.

Some submitters also disagreed that providers should be required to have any New Zealand clients for registration. They consider that many legitimate businesses that do not have New Zealand clients may wish to register and export their financial services. However, registration on the FSPR is not necessary in order to export financial services and should not be used by either legitimate or other businesses to imply any level of approval or oversight in New Zealand. This is also a matter for the Amendment Act rather than regulations.

Section 6: Implementation and operation

6.1 How will the new arrangements be given effect?

The proposed regulations are planned to be made in 2019, with the regulations and changes in the Amendment Act intended to come into force in mid-2020.

MBIE (in particular, the Companies Office) will be working on processes for assessing applications for registration and deregistration once the changes come into force. We will also work on communicating relevant changes to industry.

Once the changes are in force, the Companies Office will be able to investigate providers which it suspects may not have New Zealand clients and consider deregistration. Providers will also be required to confirm annually that they are still required to be registered, including that applicable thresholds are met (as part of their annual confirmation which providers are already currently required to complete).

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

The impact of the proposals in this RIS will be monitored by MBIE on an ongoing basis as part of MBIE's regulatory stewardship obligations, working together with the Companies Office and the FMA.

Data is already collected by the Registrar and FMA on the number of entities who are registered, deregistered and declined registration. This will continue to be used to assist in monitoring levels of misuse and attempted misuse of the FSPR.

We will work with MBIE's Research and Evaluation team during 2019 to identify monitoring indicators and collect baseline data before the changes are expected to commence in Q2 2020. The monitoring programme will check that the changes are achieving the objective of addressing misuse of the FSPR.

7.2 When and how will the new arrangements be reviewed?

There are no plans for a formal review of the proposed regulations. However, MBIE will continue to work with the Companies Office and FMA and keep in touch with dispute resolution schemes and industry. If concerns arise about the proposed regulations, MBIE will consider whether changes are necessary.