

New Zealand Law Society

NON-BANK DEPOSIT TAKERS BILL

1. The New Zealand Law Society (Law Society) welcomes the opportunity to make a submission on the Non-Bank Deposit Takers Bill (NBDT Bill).
2. The Law Society notes the primary purpose of the NBDT Bill, being the implementation of a prudential regulation regime for non-bank deposit takers (NBDTs), is the second stage of the two-stage process that commenced with the 2008 amendments to the Reserve Bank of New Zealand Act 1989 (RBNZ Act). Specifically, the NBDT Bill imposes requirements for the licensing of NBDTs, 'fit and proper person' assessments of directors and senior officers, and restrictions on changes in ownership – as well as giving the Reserve Bank increased powers to detect and manage NBDT distress and failure.
3. In this submission, the Law Society makes a series of high-level comments on each of the principal parts of the NBDT Bill.

PART 1: PRELIMINARY PROVISIONS

4. In relation to the definitions in clause 4, the Law Society notes:

Definition	Comments
Associated person	<p>The NBDT Bill contains a definition of 'associated person' that differs from that in a number of other pieces of legislation that impact on the financial services sector. Some of those definitions require a 20% voting threshold in order to establish 'association', and others (including the NBDT Bill) require a 25% voting threshold.</p> <p>The most recent draft legislation on which the Law Society has made submissions is the exposure draft of the Financial Markets Conduct Bill (FMC draft Bill). The FMC draft Bill includes an 'associated person' test that requires a 25% voting threshold, but is also much wider in its coverage by including a more extensive range of relationships and business structures. The increasing use of more complicated business structures as the vehicles for business activities, including (for example) the greater use of limited partnerships, points to the need for further thought about the use and</p>

Definition	Comments
	<p>consistency of threshold requirements as well as the scope for capturing a wider range of business vehicles and relationships in which parties may be said to be ‘associated’.</p> <p>The Law Society recommends that further consideration be given to consistency between definitions of ‘association’ across the legislation affecting the financial services sector.</p>
Debt security	<p>In light of the FMC draft Bill, care needs to be taken to avoid multiple shades of meaning of the term ‘debt security’. The FMC draft Bill includes scope for the Financial Markets Authority (FMA) to declare a financial product to be of a specific category or to change the designation of a financial product. Under the NBDT Bill, the Reserve Bank will also have powers of declaration.</p> <p>This may give rise to confusion or even forms of “gaming” if a financial product is declared to have different treatment by different regulatory bodies. However, clause 75 of the NBDT Bill does include a requirement that the FMA is consulted prior to the Reserve Bank making any recommendations for regulation.</p> <p>The Society has considered whether it would be desirable that a declaration by the FMA under the FMC draft Bill, declaring a financial product to be a ‘debt security’ (or to cease being a ‘debt security’), would trigger a requirement for a corresponding change under the NBDT regime. However, on balance we would expect that the working relationship between the two agencies, together with the requirement for consultation under clause 75, should remove the practical likelihood of confusion and/or gaming opportunities.</p> <p>This may, however, be a matter of consistency which the Committee would wish to consider in more detail.</p>
Guaranteeing subsidiary	<p>The definition of ‘guaranteeing subsidiary’ is narrower than that in the RBNZ Act and only applies to subsidiaries that guarantee all debt securities issued by the NBDT. It is not clear why it has been decided to exclude those guaranteeing subsidiaries that guarantee only some debt securities issued by the NBDT (thereby creating a mismatch with the RBNZ Act).</p> <p>By contrast, the explanatory note to the NBDT Bill explains that the meaning of ‘subsidiary’ has been extended to achieve alignment with the definition used in the Financial Reporting Act 1993 and in securities</p>

Definition	Comments
	<p>legislation.</p> <p>Again, the Law Society recommends that consideration be given to the desirability of consistency between the various definitions of ‘guaranteeing subsidiary’</p>

Contributory mortgage lending by lawyers

5. A traditional activity of a number of law firms is arranging contributory mortgage advances. This activity is fully regulated and is also closely monitored by the Law Society through its inspectorate. The regulatory provisions are to be found in:
 - (a) the Lawyers and Conveyancers Act (Lawyers: Nominee Company) Rules 2008; and
 - (b) the Lawyers and Conveyancers Act (Trust Account) Regulations 2008.

6. As lawyers have their own regulatory regime, they are exempted from the Securities Act (Contributory Mortgage) Regulations 1988 by the Securities Act (Contributory Mortgage) Regulations (Solicitors) Exemption Notice 1996. In accordance with this exemption, lawyers do not register as contributory mortgage brokers. However, they must comply with their own regulatory regime which in various respects is more closely controlled than the contributory mortgage brokers regime.

7. As contributory mortgage brokers are not NBDTs within the meaning of clause 5, the Law Society assumes that lawyers should also be exempt from the provisions of the NBDT Bill insofar as their role in arranging contributory mortgages is concerned. However, for the reasons set out in the Appendix, it may be arguable that the exemption for contributory mortgage brokers does not extend to lawyers under the NBDT Bill as currently drafted.

8. In these circumstances, and the fact that the powers of exemption granted by Part 4 of the NBDT Bill do not enable the Reserve Bank to give an exemption from the requirement to be licensed we submit that an appropriate exemption for lawyers should be included in clause 5(2) of the NBDT Bill. This could be along the following lines:

‘A lawyer in respect of offers to the public of interests in contributory mortgages whilst there are in force rules or regulations under:

- (a) *section 115 Lawyers and Conveyancers Act 2006 regulating the keeping of trust accounts by lawyers; and*

- (b) *section 96 Lawyers and Conveyancers Act 2006 regulating the formation, operation, management, and winding up of lawyers nominee companies for the investment of money in contributory mortgages on behalf of clients.'*

Recommendation

9. That an appropriate exemption for lawyers be included in clause 5(2) of the NBDT Bill.

Financial services

10. In relation to the definition of NBDT in clause 5, the explanatory note states that the definition is broadly the same as the definition of 'deposit taker' in the RBNZ Act. Specifically, the first limb of the definition of 'NBDT' refers to a person that:
- (a) offers debt securities to the public in New Zealand and
 - (b) carries on the business of borrowing and lending money or providing financial services, or both.
11. However, neither the NBDT Bill nor the RBNZ Act contains a definition of 'financial services' – indeed, clause 5(1)(a)(ii) is the only place in the NBDT Bill where the term 'financial services' is used.
12. We have assumed that the term is intended to bear a similar meaning to that of "financial service" in the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act). Indeed, it seems highly likely that the scope of the term in the NBDT Bill was intended to be narrower than that in the FSP Act. It therefore seems unusual that (in the absence of a clear explanation) a person who is not a financial service provider under the wider definition contained in the FSP Act, either as a result of the statutory exceptions in section 7(2) of that Act or as a result of an exemption granted under that Act, could conceivably be a provider of financial services for the purposes of the NBDT Bill, due to the lack of a definition in the NBDT Bill.
13. The Law Society is concerned that the definition of NBDT might be open to interpretation on the basis of whether a person is (or is not) providing 'financial services' (assuming the person is not otherwise caught by carrying on 'the business of borrowing and lending money'). Whilst it is noted that:
- (a) in order to be an NBDT, both limbs must be satisfied (i.e. both offering debt securities to the public in New Zealand and either borrowing and lending money or providing financial services); *and*

- (b) the prudential regulatory regime under the NBDT Bill addresses a narrower range of business activity than the very wide net drawn by the FSP Act,

there is still a need for greater clarity. The Law Society submits that the inclusion of a definition of 'financial services' in the NBDT Bill would enhance clarity. It is suggested that this could be achieved by adding a definition that uses the FSP Act definition as its starting point.

Recommendation

- 14. That a definition of 'financial services' be included in the NBDT Bill.

PART 2: LICENSING AND PRUDENTIAL REGULATION

Subpart 1—Licensing

- 15. The Law Society has paid particular attention to the mechanism, relating to the grant of a licence, dealing with 'suitability concerns'. It is noted that the Reserve Bank is developing experience in relation to prudential supervision and 'fit and proper person' criteria in respect of registered banks and licensed insurers. In the case of NBDTs:

- (a) The identification of what amounts to 'suitability concerns' means matters, circumstances, or conditions that are to be developed in regulations. The Law Society awaits further progress on the development, by the Reserve Bank, of the policy that will underpin those criteria.
- (b) The licensing criteria appear to require compliance (on a prospective basis) with obligations under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009. It is noted that those obligations appear unlikely to be in force at the time when the NBDT Bill should come into force.

Subpart 2—Prudential obligations

- 16. The Law Society notes the carrying forward of the prudential requirements that currently apply to NBDTs under Part 5D of the RBNZ Act relating to governance, risk management, credit ratings, minimum capital requirements, capital ratio requirements, restrictions on related party exposures, and liquidity requirements – with the detailed requirements in existing regulations to also be carried forward. These provisions are, in turn, to be subject to further review in 2013, and are subject to a number of relatively small points of difference which are explained in the explanatory note to the NBDT Bill, including:

- (a) in relation to minimum capital requirements, enabling the Reserve Bank to make regulations to impose minimum capital requirements on NBDTs in relation to borrowing groups as well as on individual licensed NBDTs; and
- (b) in relation to liquidity requirements, broadening the range of matters that regulations can prescribe to include matters relating to liquidity management (rather than just measures to ensure an NBDT maintains prudent cash flows and a level of liquidity sufficient to withstand a range of plausible liquidity shocks),

but without providing further (policy) guidance about the issues that the Reserve Bank may wish to address or perhaps the lessons learned as a result of recent finance company failures that underpin such widened powers.

Recommendation

17. That the Committee note that the aspects of the licensing and prudential obligations regime under the NBDT Bill discussed above depend on regulation or policy development which is not yet completed. Consideration may need to be given to whether that regulation and policy will be promptly available upon the NBDT Bill coming into force, and whether guidance on their development should be given (whether in the Bill itself or otherwise).

Subpart 3—Other obligations

Notifying Bank of suitability concerns

18. The Law Society notes the ‘whistleblower’ provisions in clause 41, imposing a new obligation on directors of licensed NBDTs to notify the Reserve Bank if they are aware that a director or senior officer raises suitability concerns. Clause 41 provides that:
- (a) the Reserve Bank must treat a whistleblower notification as if it were a suitability notice (raising suitability concerns about the person named); and
 - (b) after making inquiries, the Reserve Bank may issue what amounts to a ‘no action letter’ or effectively advise the NBDT that there are suitability concerns and that its licence is at risk.
19. This process has significant implications for NBDTs (if the Reserve Bank declines to issue a ‘no action letter’) and for directors of a licensed NBDT (who commit a tier 2 offence if they fail to act as soon as they become aware, or ought to be aware, that a director or senior officer of the NBDT has become a whistleblower).

Recommendation

20. That the Committee note the need for substantive practical guidance for NBDTs and directors of NBDTs as to the application of the whistleblower regime.

Consent for changes of ownership

21. Clause 42 introduces a new requirement for Reserve Bank consent before giving effect to a transaction that will increase influence over a licensed NBDT through—
 - (a) the ability, directly or indirectly, to appoint 25% or more of the members of the governing body of the NBDT; or
 - (b) a direct or indirect qualifying interest in 20% or more of the voting securities issued or allotted by the NBDT.
22. This provision is modelled on a similar provision in the RBNZ Act that applies to registered banks. However, in light of earlier comments about various threshold requirements in a number of pieces of legislation that will also apply to NBDTs, the Law Society questions the basis on which the thresholds for requiring consent have been determined.
23. This may not have been adequately explained in relation to relevant examples such as ‘associated person’ status (discussed above) or the views of the Takeovers Panel about the threshold at which a change of control may occur.

Recommendation

24. That further consideration be given to the level at which change of control thresholds have been set, in order to ensure consistency with related legislation and the practice of relevant industry regulators.

PART 3: MONITORING AND ENFORCEMENT

25. Clauses 47 and 48 provide new powers for the Reserve Bank, enabling it to require:
 - (a) any associated person of a licensed NBDT to provide certain information, data, or forecasts that relate to the associated person or the NBDT; and
 - (b) a licensed NBDT or an associated person to supply a report, prepared by an approved person, on various matters relating to the NBDT or any associated person.

26. Whilst the RBNZ Act contains powers to require deposit takers to provide information, the Law Society is not aware of comparable powers to require information about those associated with a party subject to a licensing or prudential supervision regime, either from the licensee or the associated person. Although this may be regarded as consistent with the information-gathering powers relating to associated persons as part of the process of licensing, little detail is provided in the NBDT Bill about the circumstances in which these proposed new powers may be used.

Recommendation

27. That consideration be given to defining more closely in the NBDT Bill the circumstances in which information about an associated person may be required, whether from the licensee or the associated person.

PART 4: MISCELLANEOUS PROVISIONS

28. It is noted that, in relation to the powers of exemption provided by clauses 69 and 70, allowing the Reserve Bank to exempt licensed NBDTs, or classes of licensed NBDTs, or trustees, from compliance with particular provisions of the NBDT Act (Bill) or the regulations, that an exemption cannot be given from the requirement to be licensed. For this reason, as noted above, the Law Society submits that the activity of lawyers arranging contributory mortgage advances should be subject to a legislated exemption.

Conclusion

29. The Law Society does not wish to appear but is available to discuss these matters with the Committee or officials if that would be of assistance.



Andrew Gilchrist
Vice President
19 October 2011

Appendix:

Non-Bank Deposit Takers Bill – Application to Lawyers’ Contributory Mortgage Lending

APPENDIX:

Non-Bank Deposit Takers Bill – Application to Lawyers’ Contributory Mortgage Lending

1. The Non-Bank Deposit Takers Bill (NBDT Bill) relates to the prudential regulation of Non-Bank Deposit Takers (NBDTs) including requirements as to credit ratings, governance, risk management, capital, related party exposures, liquidity, licensing, suitability assessments of directors and senior officers, and restrictions on changes in ownership.
2. The issue arises as to whether the NBDT Bill applies to lawyers conducting contributory mortgage lending, whether through a nominee company or not.

3. NBDTs are defined in clause 5 of the Bill as follows:

“5 NBDT defined

(1) In this Act, NBDT means any of the following:

(a) a person that—

(i) offers debt securities to the public in New Zealand;
and

(ii) carries on the business of borrowing and lending money, or providing financial services, or both:

(b) a person, or a member of a class of persons (including any person or class of person identified in subsection (2)(a) to (e)), that is declared by regulations to be an NBDT for the purposes of this Act:

(c) a person that, after this Act comes into force, issues debt securities to the public in New Zealand while being a person described in paragraph (a) or (b), and any of those debt securities remain unpaid:

(d) a person that,—

(i) immediately before 3 August 2011 is a deposit taker as defined in Part 5D of the Reserve Bank of New Zealand Act 1989; and

(ii) before this Act comes into force, issues debt securities (as defined in that Part) to the public in New Zealand while being a deposit taker and, after this Act comes into force, any of these debt securities remain unpaid.

- (2) *However, the following are not NBDTs:*
- (a) *a bank that is a registered bank under the Reserve Bank of New Zealand Act 1989:*
 - (b) *a local authority:*
 - (c) *the Crown (as defined in the Public Finance Act 1989):*
 - (d) *an entity that is in receivership (provided that no debt securities are being offered by, or on behalf of, the entity):*
 - (e) *an entity that is in liquidation (whether under Part 16 of the Companies Act 1993 or under any other enactment):*
 - (f) *a person, or a member of a class of persons, declared by regulations not to be an NBDT for the purposes of this Act.”*

4. To be an NBDT a person must offer debt securities to the public in New Zealand or be a person, or a member of a class of persons, that is declared by regulations to be an NBDT for the purposes of the Act (i.e. the Act which will result from the NBDT Bill being passed into law).

5. A debt security is defined in clause 4(1) of the NBDT Bill as follows:

“debt security means—

- (a) *a debt security within the meaning given in section 2(1) of the Securities Act 1978; or*
- (b) *any other security declared by regulations to be a debt security for the purposes of this Act”*

6. A debt security under the Securities Act 1978 (Securities Act) is defined as follows:

“Debt security means any interest in or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing by, any person ...but does not include—

- (d) *An interest in a contributory mortgage where the interest is offered by a contributory mortgage broker; ...”*

7. A contributory mortgage is defined under section 2(1) of the Securities Act as follows:

“Contributory mortgage” means a mortgage of land that—

- (a) *Secures money owing to 2 or more persons or to a nominee on behalf of 2 or more persons, whether or not the mortgage originally secured money owing to only one person; or*

(b) *Has the same priority in respect of the land as another mortgage or mortgages of that land;—*
and, for the purposes of this definition, money owing to not more than 5 persons as joint tenants shall be deemed to be owed to 1 person.”

8. A contributory mortgage broker is defined under section 2(1) of the Securities Act as follows:

“Contributory mortgage broker means a person (not being a mortgagor under the mortgage or any other person to whom or for whose benefit any money is lent in consideration for the mortgage given by the mortgagor) who—

(a) *Offers an interest in a contributory mortgage to the public for subscription; or*

(b) *Manages interests in a contributory mortgage, being interests that have been offered to the public for subscription, whether or not that person holds beneficially any interest in that mortgage.”*

9. The definition of contributory mortgage broker in the Securities Act could, in general terms, be taken as including lawyers conducting contributory mortgage lending.

10. However, lawyers are exempted from the Contributory Mortgage Regulations by virtue of the Solicitors Exemption Notice 1996. Lawyers have their own regulatory regime in relation to contributory mortgages by virtue of the *Lawyers Nominee Company Rules* and *The Trust Account Regulations*. They do not register as contributory mortgage brokers.

11. Furthermore, the definitions in section 2 of the Securities Act have the usual qualification that they have the meaning set out unless the context otherwise requires.

12. Against this background, there appears to be a more than negligible risk that lawyers could not rely upon the exemption in respect of contributory mortgages arranged by a contributory mortgage broker, in the definition of ‘debt security’ under the Securities Act, in which case lawyers who conduct contributory mortgage lending would be NBDTs.