

FINANCIAL MARKETS AUTHORITY

**STRATEGIC RISK**

**OUTLOOK**

.....  
**2015**



FINANCIAL MARKETS AUTHORITY

TE MANA TATAI HOKOHOKO - NEW ZEALAND

## ABOUT THE FMA

The FMA is an independent Crown entity with a mandate to promote and facilitate the development of fair, efficient and transparent financial markets. We work with financial markets participants to raise standards of good conduct, ethics and integrity, and to achieve best standards of practice and compliance.

[www.fma.govt.nz](http://www.fma.govt.nz)

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FMA Strategic Risk Outlook 2015

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# INTRODUCTION

In three years of operation, the Financial Markets Authority (FMA) has established itself as an agency with a critical role in regulating capital markets and financial services in New Zealand.

Our main objective is to promote and facilitate the development of fair, efficient and transparent financial markets. As a risk-based conduct regulator, we focus our resources on conduct that we think poses the most significant risk to achieving this objective.

This strategic risk outlook describes what we believe are the current and main drivers of risk to fair, efficient and transparent financial markets. Based on these drivers of risk, we have identified seven strategic priorities that will guide our operations over the next three years. By sharing our thinking we hope to encourage market participants to consider both the drivers of risk and our priorities, and the implications they may have for their own business activities.

It is important to note that this risk outlook does not describe every aspect of our work; rather it outlines the areas where we see the most potential for harm. Like any risk-based regulator, we have had to make choices about where to focus our efforts and, consequently,

where not to. These choices are reflected in our areas of focus, where we believe we can have the biggest impact on minimising harms, lifting standards of conduct, and improving trust and confidence in our markets.

As part of our regulatory role, we act to minimise harms where we find them. The greater vision we are working to deliver is increased trust and confidence in our financial markets. This trust and confidence, we believe, will deliver better outcomes for investors, businesses and our economy as a whole.



Rob Everett,  
Chief Executive

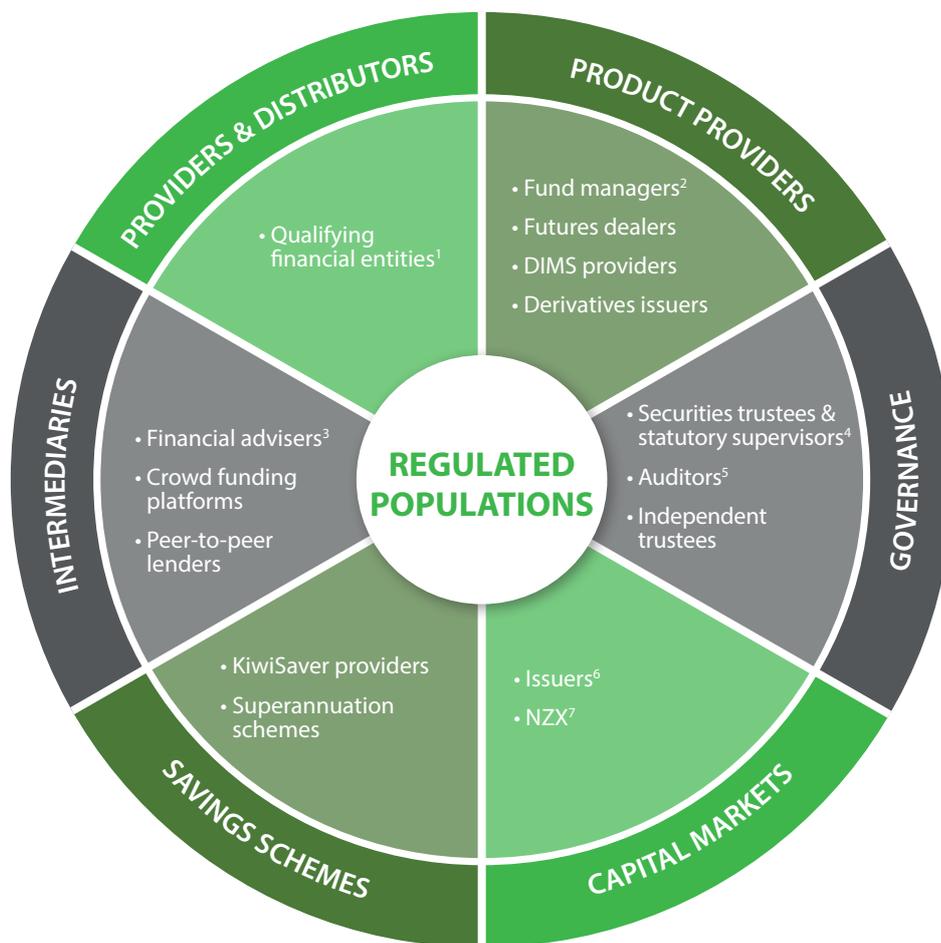


Fair, efficient and transparent financial markets.

## WHO WE REGULATE

### Businesses, professionals and markets regulated by the FMA

The number of businesses, professionals and markets regulated by the FMA has grown under the FMC Act. Our regulated populations are detailed below.



1. QFEs are firms or groups providing financial advice on their own account and they take responsibility for financial advice provided by their employees and contractors. See [www.fma.govt.nz](http://www.fma.govt.nz) for the full list of QFEs.

2. Recognised in the FMC Act as managers of registered schemes.

3. Including authorised financial advisers (AFAs); registered financial advisers (RFAs); and advisers in qualifying financial entities (QFEs).

4. Including debt securities trustees; trustees of unit trusts; KiwiSaver Trustees; and supervisors of other investment schemes.

5. Including accredited bodies; licensed New Zealand auditors; registered audit firms; and licensed overseas auditors. FMA's auditor regulation applies only to audits of issuers.

6. Including equity securities; debt securities; investment life insurance; managed funds; superannuation; and contributory mortgage brokers. Includes financial reporting requirements to which issuers are subject under Part 7 of the FMC Act.

7. NZX (registered exchange), including: NZSX (main board); NZAX (alternative market); NZDX (debt market); FSM (Fonterra shareholders' market); and NZCX (derivatives market).

## DRIVERS OF RISK

Our intention is to prioritise our resources on conduct that poses the most significant risk to our objective of fair, efficient and transparent financial markets.

We also work to ensure our regulatory response is appropriate and proportionate at all times. To help us do this, we look across our markets and economic environment to identify the root causes of risk and understand what these may mean for investors, consumers and market participants. We call these the drivers of risk.

Drivers of risk can arise from a range of sources. They may reflect market structures, behaviours and economic developments, or they may be embedded features of our markets such as investor biases and information asymmetries (described further in this document). Some of the drivers identified in this document are specific to New Zealand, while others are common to most financial markets.

We are highlighting our view of the current drivers of risk to provide a level of transparency to market participants about various market structures, developments and behaviours that we think could create or exacerbate the potential for harm. We encourage participants to consider how these drivers might impact their business, including product design and delivery.



### Governance

Boards of directors are responsible for setting the strategy, values and culture of an organisation. It is then up to senior management to pursue these objectives. Having the right tone-at-the-top will help embed good organisational practices and is crucial to achieving good outcomes for a business and its customers. Significant risks may arise where boards fail to lead from the top, or where they simply apply a 'set-and-forget' approach. Instead, boards have a responsibility to continuously assess culture and conduct against both organisation and customer outcomes.



### Culture and conduct

The culture of an organisation is reflected in how employees behave and the way business is conducted. For financial services firms, embedding a strong culture that puts customer interests at the heart of the business is crucial to ensuring conduct that benefits both the business and consumers. An organisation's incentive arrangements should also be aligned to its business strategy and culture. Poor culture and poor or misaligned incentive arrangements can drive a range of risks, including financial product mis-selling and the design and sale of products that disadvantage investors and consumers.



## Investor understanding

Investor understanding is a key component of well-functioning financial markets. Comparisons with international data suggest that New Zealanders score relatively well on understanding basic financial knowledge concepts<sup>1</sup>. However, research undertaken on behalf of the FMA has found that investors continue to misunderstand investment risk. For example, 52 percent of New Zealanders surveyed in September 2014 believed that term deposits come with a guarantee, while 42 percent believed that KiwiSaver is guaranteed<sup>2</sup>.

Investor exposure to a growing and complex product range means financial decisions, now and in the future, are likely to require higher levels of financial knowledge and skill. Low financial literacy and knowledge gaps are a significant driver of risk. Investor education is essential to ensure improvements in this area. Timely, clear and concise disclosure of the risks of financial products, and sales and advice practices that consider the best interests of investors, can help to reduce the impact of this driver of risk.



## Investor behaviour

Investors and consumers in the financial markets, as in other sectors, are affected by behavioural biases when making decisions. Instances of behavioural biases include placing too much emphasis on short-term outcomes; being overconfident about financial decision-making and future wealth creation; and chasing past trends. An understanding of investor behaviour can assist market participants to better tailor their products and services to the needs of investors. However, poor outcomes can result when financial service providers take advantage of these biases. For example, poor outcomes are likely to result in instances where information is framed to highlight some features of a product or service, while downplaying others. Decisions that are based on instinct or irrational exuberance are also likely to result in poor outcomes for investors.



## Information asymmetries

Information asymmetries are common to all financial markets, with investors usually having inferior information to the financial service providers who offer the product or service. Unequal access to information can prevent investors from making well-informed decisions. For instance, it can mean that investors are not able to fully understand or compare financial products, which may limit their ability to make investment and switching decisions. Information asymmetries can also occur between investors who have differing levels of market information. They can also manifest in wholesale markets where participants along the distribution chain have differing levels of information and use that to their advantage.

<sup>1</sup> <http://www.cflri.org.nz/sites/default/files/docs/FL-FinKnowBehavSurvey-Summary-Jun-2013.pdf>

<sup>2</sup> <http://www.fma.govt.nz/keep-updated/newsroom/media-releases/2014/new-zealanders-underestimate-investment-risk-and-prefer-lower-risk-investment-options>



## Conflicts of interest

Conflicts of interest can arise in both retail and wholesale markets. They can be embedded in certain business models and are easily intensified in smaller markets like New Zealand. If they are not properly identified and managed, conflicts of interest can undermine market integrity and result in poor investor outcomes. When conflicts of interest are combined with information asymmetries, it can be difficult for investors to know whether a market participant is acting in their best interests. Remuneration and incentive arrangements can also reinforce conflicts of interest, particularly when sales staff are remunerated on a volume basis or through certain bonus structures.



## Newly regulated market participants

Comprehensive financial markets regulation is new to the majority of New Zealand market participants. Legislation such as the *Financial Advisers Act 2008* (FA Act), *Financial Markets Conduct Act 2011* (FMC Act) and the *Securities Trustees and Statutory Supervisors Act 2011*, bring the majority of financial service providers into a supervisory relationship with the FMA. It is to be expected that some newly regulated participants will be unsure of their obligations, particularly where those obligations are also new and untested. Similarly, market participants may be unsure of our expectations and regulatory approach. In such an environment, standards of conduct and compliance within some market sectors may be low, putting market integrity at risk.



## Legislative, policy and regulatory settings

Our legislative and policy settings aim to balance harm mitigation with business innovation and market growth. As business practices and market structures change, we need to consider whether our legislative and policy settings are appropriately targeted to address risks in the market, or whether the settings could be driving risk or resulting in unintended consequences. At the same time, we need to be mindful of excessive regulation, where regulatory settings or the application of those settings raise costs without necessarily providing compensating benefits. This could stifle economic activity and capital growth.

Regulatory settings, including the operations of regulators, can also be a driver of risk. Inadequate financial or human resources, including capability gaps, could drive risks in terms of our ability to identify, assess and address the most significant harms to our markets. Poor targeting of regulatory resources could disproportionately increase costs for market participants, while sub-optimal systems and processes could also reduce regulatory efficiency and effectiveness. In addition, New Zealand's regulatory structure is fairly complex, involving a number of regulatory players. Poor coordination and communication amongst regulators could have significant effects on our broader regulatory objectives.



## The role of frontline regulators

Frontline regulators such as trustees and statutory supervisors, accredited bodies and NZX, play a crucial role in New Zealand's financial markets. Our regulatory settings place a great deal of responsibility on these private sector bodies to oversee the conduct of a range of market participants including fund managers, KiwiSaver providers, listed issuers and auditors.

Ineffective oversight by frontline regulators would pose a significant threat to the integrity of New Zealand's financial markets. It is therefore essential that frontline regulators have robust monitoring arrangements in place and that they understand the businesses they oversee. They must also allocate sufficient resources to their regulatory role and apply the right level of professional inquiry and scepticism when overseeing market participants.



## Small, concentrated market

New Zealand's financial markets are small, concentrated and highly connected. Registered banks account for around 80 percent of total New Zealand financial system assets<sup>3</sup> and, through KiwiSaver providers, are responsible for around 61 percent (or \$13.7 billion) of KiwiSaver assets under management<sup>4</sup>. At the same time, a 2012 study indicates that company director influence in New Zealand is relatively concentrated in a small group of interconnected directors<sup>5</sup>. While some degree of interconnectedness is vital to the efficient functioning of our financial system, it can also serve to amplify existing market frictions, conflicts of interest, information asymmetries, and other structural and behavioural factors. As a small, open market we are also susceptible to regulatory and legislative settings overseas that may impact financial service provider conduct in New Zealand.



## Economic activity

New Zealand's economy suffered during the Global Financial Crisis (GFC) but has recently started experiencing some growth and increased investor confidence. During 2014, growth in the economy has been faster than the domestic trend. Strong construction sector activity, high net immigration, and interest rates, which remain low by historic standards, continue to support this expansion. The NZX50 index has also increased 60 percent in value over the same period. Organisation for Economic Co-operation and Development (OECD) economic forecasts for 2015<sup>6</sup> expect New Zealand's Gross Domestic Product (GDP) growth rate to be higher than the OECD average (3.3 percent vs. 2.8 percent).

Economic developments such as these can drive risks in our market by influencing the types of financial services and products participants are willing to offer, the behaviour of market participants, and the needs and behaviour of investors. For instance, our recent low interest rate environment could drive more risk-taking behaviour on the part of investors, which when combined with other drivers or risk, such as information asymmetries, can result in poor investor outcomes. Significant global economic developments, resulting in large capital inflows or outflows, could also drive risks to the integrity of a small, open market such as New Zealand.

<sup>3</sup> Appendix 3: New Zealand financial system assets and liabilities, Financial Stability Report (2014). Does not include general insurance companies.

<sup>4</sup> <https://www.fma.govt.nz/help-me-invest/kiwisaver/compare-kiwisaver-information/> Calculated as at 30 June 2014.

<sup>5</sup> <https://zen.nzherald.co.nz/media/webcontent/document/pdf/201238/gov.pdf>

<sup>6</sup> OECD Economic Outlook (May 2014)



## Increasing percentage of retirees

Like most developed economies, New Zealand is experiencing a significant change in the structure of its population. The number of people aged 65 and over has doubled since 1980, and is likely to double again by 2036<sup>7</sup>. From the late 2030s, people aged 65 and over will make up over one quarter of our total population<sup>8</sup>. This change in age structure, together with a global trend towards shifting the risk and responsibility for funding retirement from governments to individuals, could drive risks to fair, efficient and transparent financial markets. For example, retirees may be more susceptible to promises of high yields (and higher risks), and less able to recover from a significant loss of capital.



## New business models

Business innovation supports capital market growth. As with technological advances, market innovations are likely to move faster than regulatory controls. Where those innovations do not allow for the protection of investor interests, new and possibly greater risks to our financial markets may arise. Conversely, where regulation is not sufficiently adaptable it can act as a brake on innovation.



## Technological advances

New technologies can bring significant advantages for businesses and investors, including providing more efficient means of transacting; lowering business and investment costs; improving product comparability; simplifying disclosure; improving access to products and services; and increasing market liquidity. However, risks can increase as businesses and investors increasingly rely on technology-driven products and solutions. Technology-based distribution methods, including platforms, increase retail investor exposure to complex products (such as derivatives) and can hinder investors' understanding of the complexity of these products and the risks associated with them. Other technological developments, including algorithmic and high frequency trading, could, if abused, also impact the integrity of our financial markets. Our increased reliance on technology raises market and investor vulnerability to cyber-attacks, for example, theft, fraud, viruses and scams.

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<sup>7</sup> [http://www.stats.govt.nz/browse\\_for\\_stats/population/estimates\\_and\\_projections/ageing-population-property-market.aspx](http://www.stats.govt.nz/browse_for_stats/population/estimates_and_projections/ageing-population-property-market.aspx)

<sup>8</sup> [http://www.stats.govt.nz/browse\\_for\\_stats/people\\_and\\_communities/older\\_people/demographic-aspects-nz-ageing-population.aspx](http://www.stats.govt.nz/browse_for_stats/people_and_communities/older_people/demographic-aspects-nz-ageing-population.aspx)

## OUR STRATEGIC PRIORITIES

We have looked across our markets, regulatory and economic environment to identify the most significant risks to the fair, efficient and transparent operation of our financial markets.

We have identified seven strategic priorities that reflect these risks and the drivers of risk. These priorities will guide our operations over the next three years.

Within each of our priorities, we have identified specific areas of focus where we think we can most effectively minimise conduct risks, improve behaviour within our

markets, benefit participants and investors, and help strengthen New Zealand's economy.

In choosing these areas of focus, we have taken into account our role and resources. We have also made a conscious decision not to focus our regulatory resources on some other areas.



## Governance and culture

**Aim:** Boards and directors lead their organisation's strategy, culture and values.

Drivers of risk that underpin this priority:



- governance
- culture and conduct
- newly regulated market participants.

Good governance plays a critical role in contributing to markets that are fair, efficient and transparent. It also contributes to better outcomes for investors, shareholders and the economy as a whole.

There has been an increased focus on good governance in recent years, particularly in light of the finance company collapses in New Zealand and the contribution governance failures made to those collapses. While the fundamental expectations of directors have not changed, directors are seeking clarification of their responsibilities and the FMA's expectations of boards and directors. In the financial services sector, we see many organisations that are new to conduct regulation and a regulatory relationship with the FMA. We expect boards and directors of financial service providers, both big and small, to set a strong tone-at-the-top, and to ensure that customer interests are central to organisational strategy, culture and conduct. This includes:

- paying attention to the outcomes delivered to customers and ensuring those outcomes match the board's aspirations and claims
- acting in a way that is designed to protect and serve shareholders and customers
- driving corporate culture and setting the tone-at-the-top, through good leadership and by demonstrating the values and goals the board cares about.

### Specific areas of focus

#### Reinforce expectations of boards and directors

We will publish our revised 'Corporate Governance

in New Zealand, Principles and Guidelines' handbook to clearly outline our expectations of directors, executives and advisers. We will also produce specific guidance to assist market participants to understand our expectations under the FMC Act, and to help companies ahead of an initial public offering (IPO).

Where conduct falls short of our expectations, we will seek to engage with boards and senior management to collaboratively address the issue.

#### Use of management information by the board

It is the responsibility of boards to set the strategy of an organisation and to lead through culture and values. However, it is not enough to set and forget. Boards must continue to test the right culture is embedded within the organisation. Through our entity-based monitoring we will be asking boards of financial service providers how they know the organisation is focused on investor outcomes. We will test whether this work is reflected in organisational culture and conduct. We will also ask if boards review regular information on customer outcomes such as complaints data, sales incentive structures, and criteria for promotions and rewards.

#### Review conflicts of interest

Conflicts of interest occur where directors put their personal interests and relationships before the interests of the company, its shareholders, employees and customers. We expect directors to have arrangements in place to manage any conflicts of interest that may arise. We will consider these elements as part of our offer document disclosure reviews.

#### Review governance structures and processes

Governance is only effective when proper structures, systems and processes are established, practised and reviewed. Through our entity-based monitoring we will be looking at structures that aid effective governance. We will look at the use of boards and relevant committees to determine how these groups support the scrutiny of management information and ensure effective decision making. We will check that firms have internal processes in place, including risk management processes, to ensure critical information is delivered to the right levels in a timely way.

## Conflicted conduct

**Aim:** Market participants effectively manage conflicts of interest.

Drivers of risk that underpin this priority:



- culture and conduct
- conflicts of interest
- small, concentrated market.

Conflicts of interest are at the core of many conduct-related risks. They can be embedded in certain business structures and can be exacerbated by poor culture. Conflicts of interest can be more prevalent in small markets like New Zealand, where there is a high degree of concentration and connectedness amongst market participants and across sectors. Proactive and effective management of conflicts, in both retail and wholesale markets, is crucial to ensuring our markets are fair, efficient and transparent.

### Specific areas of focus

#### Distribution models that embed conflicts of interest

Vertically integrated distribution models, where a market participant is the provider, manager and distributor of a product, can exacerbate conflicts of interest and result in poor investor outcomes. This is particularly the case when the profit-making interests of the market participant are put ahead of the interests of investors. Remuneration and incentive arrangements can fuel this risk further, resulting in unfair investor outcomes and undermining confidence in our markets and financial service providers.

Through our entity based monitoring, we will focus on distribution models that exacerbate conflicts of interest. In particular, we will look at remuneration arrangements that can lead to conflicted advice or sales, and whether firms have in place appropriate safeguards to prevent mis-selling. These remuneration arrangements may include certain volume-based incentives, up-front commissions and trail commissions. Within the managed funds sector, we will also focus on fee-driven behaviour that is likely to result in unfair investor or market outcomes.

#### Custody of client money and property

Investors need to be confident that their assets are being held safely; that systems and controls for custody are appropriate; and that any conflict risks, such as fraud or misappropriation, are minimised. In early 2014 we issued guidance on custody of client money and client property, and the key obligation of brokers to hold client money and client property on trust. Through our entity-based monitoring we will look at whether brokers and custodians are meeting the expectations set out in our guidance. We will also consider custody arrangements as part of our licensing process for managers of managed investment schemes, and for discretionary investment management services (DIMS) providers.

## Capital market growth and integrity

**Aim:** Regulatory activities facilitate capital market growth and support market integrity.

Drivers of risk that underpin this priority:



- culture and conduct
- investor understanding
- legislative, policy and regulatory settings
- economic activity
- new business models.

An important part of our mandate is to promote the development of our capital markets. Capital growth depends upon investors having confidence in the markets. A growing and vibrant market, with confident investors and participants, is a sign of success for our regulatory regime. While we are seeing increased confidence in our markets with new innovative business models emerging, we also know from past experience that this confidence can be fragile. We will focus on timely and visible action against misconduct in order to protect the integrity and reputation of our markets.

### Specific areas of focus

#### Secondary markets conduct

Our work with NZX seeks to achieve effective and timely responses to possible market misconduct, such as allegations of market manipulation and insider trading. We will prioritise enforcement responses to these cases so that our licensed markets are seen as fair and transparent places to do business, for both onshore and offshore participants.

#### Tailor regulation and reduce regulatory burden

The FMC Act provides us with a much broader range of regulatory tools. We will focus on using this extended range of tools, including exemptions and designations, to tailor regulation, alleviate compliance costs and reduce unnecessary regulatory burdens.

#### Streamline capital raising

We will leverage new avenues under the FMC Act to allow smaller providers the opportunity to raise funds to grow their business. New avenues for raising capital include crowd funding, peer to peer lending, stepping stone markets and various exempt activities set out in the legislation. Our intention, where appropriate, is to support businesses to raise capital without incurring high regulatory costs. We will also provide guidance, where appropriate, to help businesses understand the new opportunities and explain our approach to the capital raising mechanisms in the legislation.

#### Address perimeter threats

We will focus on maintaining confidence in our regulatory settings, and in the reputation of our markets, by monitoring complaints and other information about activity on the perimeter of our regulatory regime. Where necessary, we will use the designation tool to 'call-in' products or services if we see these unregulated activities posing unacceptable risks to our markets. We will use other tools such as warnings, fair dealing powers, and de-registration orders, to act against conduct that threatens the integrity or reputation of our regulatory system, including in wholesale and offshore markets and through abuse of financial service provider registration.

## Sales and advice

**Aim:** Sales processes and advisory services reflect the best interests of investors and consumers.

Drivers of risk that underpin this priority:



- conflicts of interest
- culture and conduct
- investor understanding
- investor behaviour
- information asymmetries.

When investors and consumers buy financial products, whether on an advised or non-advised basis, they expect to be treated fairly. Several drivers of risk could undermine the quality and integrity of sales and advice services. Competence of advisers, conflicts of interest, poor culture and conduct, information asymmetries and gaps in investor understanding can all lead to unacceptable sales and advice services and poor investor outcomes. We expect market participants to take account of these risk drivers and put investor interests at the heart of their sales processes and advisory services.

### Specific areas of focus

#### Address the mis-selling of financial products

With total KiwiSaver assets up 29 percent in the year to 31 March 2014<sup>9</sup>, KiwiSaver is becoming an increasingly important part of the national economy. While KiwiSaver balances continue to grow and the number of new KiwiSaver members slows, competition for KiwiSaver business is expected to intensify. From a regulatory perspective, we are concerned that

members receive appropriate advice and support when they transfer their KiwiSaver. Some of the sales practices we have discovered through our monitoring activity do not reflect the best interests of customers. With this in mind, KiwiSaver mis-selling and particularly KiwiSaver switching sales processes and advice will be key monitoring themes for our team.

Mis-selling of insurance products, including selling products that do not meet the customer's needs, or churning of customers (rapid turnover of insurance business that is not in the customer's interest), is also an area of concern. We have received an increasing number of complaints regarding insurance sales and will undertake work to more accurately size the problem. Insurance mis-selling will be included as a key monitoring theme for our team.

#### Registered Financial Adviser conduct

Registered Financial Advisers (RFAs) represent a large and important segment of the financial advice sector, with a significant retail investor client base. We will prioritise reports of RFA misconduct, particularly in relation to insurance mis-selling. We will also look to provide clear guidance on our expectations around the duties of care that RFAs have under the FA Act, and we will enforce these expectations.

#### Review of the Financial Advisers Act

A strong and respected advice sector is important to the efficient functioning of New Zealand's financial markets. The FA Act was introduced in 2012 with the aim of improving the quality of investment advice available to New Zealanders. This legislation is to be reviewed in 2015–16, in particular to test whether it is meeting its objectives and also whether the regulatory obligations imposed on the provision of different types of advice are proportionate to the potential harms identified.

<sup>9</sup> Total KiwiSaver assets invested as at 31 March 2014 exceeded \$21.40 billion. <https://fma.govt.nz/assets/Report-and-Papers/FMA-KiwiSaver-Report-2014-for-the-year-ended-30-June.pdf>

## Investor decision-making

**Aim:** Investors have access to resources that help them make informed financial decisions.

Drivers of risk that underpin this priority:



- investor understanding
- investor behaviour
- information asymmetries
- increasing percentage of retirees
- technological advances.

Investor confidence in New Zealand's financial markets has improved since the GFC. While we are historically a nation focused on residential property investment, retail investor exposure to financial markets is increasing and will continue to increase, in part thanks to growing KiwiSaver balances. In our current economic environment, we see some investors searching for higher yielding assets without necessarily understanding the risks associated with those products. In the future, we expect greater retail investor exposure to more complex financial products and technology-based financial services. While market participants need to be mindful of the challenges faced by investors, investors also need to take responsibility for their own financial decisions. These trends highlight the importance of good financial decision-making and ensuring investors have access to resources that can help them make informed financial decisions.

### Specific areas of focus

#### Partnerships to support investor resources

We will work with other regulators, government agencies and market participants to develop useful investor resources. Our intention is to improve access to resources that will assist investor decision-making and enable investors, financial advisers and analysts to compare financial services and products.

#### Timely, clear, concise and effective disclosure

Timely, clear, concise and effective disclosure can help to engage investors and assist them to make better informed financial decisions. The FMC Act brings into effect new layered disclosure arrangements that will ensure key documents are shorter, more accessible and easier to navigate, while also allowing for comparability of products such as managed funds. We will refresh our effective disclosure guidance and provide support for early adopters for the new product disclosure statement (PDS) regime.

Documents are only effective if they are being read and used by investors. We will undertake risk-based disclosure reviews with a focus on offers that pose the greatest challenges to investors, including IPOs and complex products. We will continue to promote timely, clear, concise and effective financial information and encourage financial statements that are more meaningful and accessible to investors and market analysts. We will also undertake financial reporting reviews including assessments of going concern and audit and non-audit fee disclosures.

**Advice for retirees**

Our aging population highlights the importance of saving for retirement. It also suggests that an increasing number of New Zealanders may need or seek financial advice at the point of retirement – a point where many New Zealanders will be entitled to withdraw a significant sum from their KiwiSaver schemes. We will look at the quality of financial advice to this demographic. We will also work with other regulators, government agencies and market participants to consider the challenges and opportunities available to improve access to advice at the point of retirement.

**Reliable and comparable KiwiSaver information**

The purpose of the KiwiSaver quarterly and annual disclosure statements is to ensure consistent and comparable information about KiwiSaver funds is publicly available on a regular basis. We will work to improve the comparability of data provided in the quarterly disclosure statements and will test the consistent use of figures by KiwiSaver providers. Testing will cover both provider websites and offer documents, to ensure investors are able to base their decisions on reliable and comparable information.

**Issue warnings**

We have seen an increase in the number of complaints about firms or people making cold-calls and offering suspicious 'big win' products or services. These offers include investment schemes and forex trading services. We will continue to issue warnings to alert the public where we see trends in conduct that may harm investors.

## Effective frontline regulators

**Aim:** Frontline regulators are effective in their role.

Drivers of risk that underpin this priority:



- governance
- culture and conduct
- newly regulated market participants
- legislative, policy and regulatory settings
- the role of frontline regulators.

Frontline regulators play a crucial role in New Zealand's financial markets. They are responsible for overseeing the conduct of a range of market participants including: fund managers; KiwiSaver providers; listed issuers; and auditors. Strong financial markets depend on effective frontline regulators who consider not only the policies, processes and procedures that a market participant has in place; but also the participant's culture, conduct and activities, and how these reflect the best interests of their customers.

### Specific areas of focus

#### Quality of frontline supervision

We expect frontline regulators to ensure they have the appropriate capability and resources available to undertake their regulatory role effectively. This means understanding both the businesses they regulate, as well as the obligations of those businesses as financial market participants. This expectation also means applying a level of professional inquiry and scepticism when monitoring or reviewing the conduct of supervised interests, rather than a 'tick-box' approach

to those reviews. We will continue to closely monitor frontline regulators to test the effectiveness of their supervisory approach, with more frequent monitoring directed towards those requiring most improvement. We will use our direction powers where necessary improvements have not been made.

#### Management of conflicts of interest by NZX

Given the dual role of NZX as both market operator and frontline regulator, it is important for NZX to effectively manage any conflicts of interest that might arise between its commercial and supervisory roles. In our 2014 report – NZX General Obligations Review – we noted a growing public perception that NZX's regulatory decision-making may be vulnerable to undue influence from conflicts of interest. While we are satisfied that NZX's conflict management framework is adequate, NZX has agreed to take a number of actions to strengthen the current arrangements and deepen confidence in the operation of its regulatory function. We will review these actions as part of our next NZX general obligations review.

#### Implement the FMC Act governance regime

Part 4 of the FMC Act resets the accountability framework for managed investment schemes and debt securities from 1 December 2014. It imposes statutory duties of care on licensed supervisors and on managers of managed investment schemes. Managers of managed investment schemes must also act in the best interests of investors. Ensuring that managers and supervisors have a clear understanding of their respective roles and holding them to account is central to building investor trust. We will provide guidance on the new standards that apply and our expectations of managers and supervisors in this area.

## FMA effectiveness and efficiency

**Aim:** The FMA is an effective and efficient conduct regulator.

Drivers of risk that underpin this priority:



- newly regulated market participants
- legislative, policy and regulatory settings
- technological advances.

As a regulator, we need to maintain our own effectiveness to ensure our actions support highly functioning, respected capital markets that attract investment and contribute to a more productive New Zealand economy. As a relatively new regulator, we are focused on clarifying our regulatory approach and ensuring we have the right systems, processes and capability to regulate conduct within New Zealand's financial markets. At the same time, it is essential that there is effective coordination between all financial market regulators to avoid issues falling between regulators or being inadequately addressed because more than one regulator is involved.

### Specific areas of focus

#### Establish our regulatory strategy

We are developing and implementing our regulatory strategy over the near term, which includes the delivery of this strategic risk outlook report. Our intention is to provide clarity on our strategic priorities and to ensure a consistent, proportionate and reliable regulatory approach. Internally, our strategic priorities will be linked to personal accountability and performance plans.

#### Support regulatory cooperation and coordination

New Zealand's financial markets regulatory structure is highly interconnected. This means that cooperation among market regulators is essential. We will continue to work closely with other agencies to ensure market participants are effectively regulated and not over-burdened by multiple regulatory obligations. These agencies include:

- Reserve Bank of New Zealand
- Ministry of Business Innovation and Employment
- Serious Fraud Office
- Commerce Commission
- Department of Internal Affairs
- The Takeovers Panel
- The Commission for Financial Literacy and Retirement Income
- Council of Financial Regulators

#### Information and communication systems

Over the next few years we will continue to build our internal systems and business processes to ensure we are an effective markets regulator. We will increase our ability to gather, access, interpret and analyse market information to support informed and well-targeted regulatory action. Where those systems interact with market participants or investors, for instance through the collection of regulatory data or complaints, they need to be robust, simple and cost-effective.

#### Ensure regulatory capability

Ensuring we have the right regulatory capability is crucial if we are to be an effective regulator. We will continue to invest in our people so they are well equipped to regulate New Zealand's financial markets and are respected by the market and our stakeholders. We will also focus on ensuring the FMA is an attractive place to work so we can attract high calibre staff in a competitive environment.

## ONGOING REVIEW

The strategic priorities outlined in this report will guide our work over the coming three years. While the overarching priorities will remain the same for this period, our specific areas of focus will continue to evolve and adapt to new market developments.

Through our on-going research, use of intelligence, and monitoring and policy work, we will continue to assess our operating environment and respond to risks emerging within the changing landscape. We will also remain engaged with market participants and other stakeholders to capture their feedback both on market risks and our strategic response to those risks.

This strategic risk outlook report represents our current view of the strategic risks facing our financial markets. We will continuously improve our risk assessment processes and capability to ensure our activities are well-targeted and proportionate.

We look forward to working with all parties to support fair, efficient and transparent financial markets in New Zealand.

## GLOSSARY

<b>AFA</b>	Authorised Financial Advisers	A financial adviser who is authorised in accordance with the <i>Financial Advisers Act 2008</i> .
<b>DIMS</b>	Discretionary Investment Management Services	An investment arrangement under which a person is authorised to make buy-sell decisions for the owner (client) in respect of a portfolio of investments (investment portfolio), often without referring to the client for every transaction or investment decision.
<b>Director</b>	Industry term	An appointed member of a Board who jointly oversees the activities and direction of an organisation and represents the interests of shareholders.
<b>Financial markets participant</b>	Industry term	A person who is, or is required to be, registered, licensed, appointed or authorised under any financial markets legislation.
<b>FA Act</b>	Financial Advisers Act 2008	The <i>Financial Advisers Act 2008</i> regulates the provision of financial adviser and broking services to clients in New Zealand.
<b>FMA</b>	Financial Markets Authority	New Zealand's Government agency tasked with upholding high standards of conduct within New Zealand's financial markets.
<b>FMC Act</b>	<i>Financial Markets Conduct Act 2013</i>	The <i>Financial Markets Conduct Act 2013</i> aims to promote and facilitate the development of fair, efficient, and transparent financial markets and to support the confident and informed participation of businesses, investors and consumers in the financial markets.
<b>Frontline regulator</b>	Industry term	A financial markets participant who has statutory obligations to ensure regulatory and professional standards of practice are met by other market participants.
<b>GDP</b>	Gross Domestic Product	The monetary value of all the finished goods and services produced within a country's borders in a specific time period.
<b>GFC</b>	Global Financial Crises	A worldwide period of economic difficulty experienced by markets and consumers.
<b>IPO</b>	Initial Public Offering	A type of public offering where shares of stock in a company are sold to the general public, on a securities exchange, for the first time.
<b>NZX</b>	New Zealand Exchange	Information, markets and infrastructure company that operates securities, derivatives and wholesale energy markets in New Zealand.
<b>OECD</b>	Organisation for Economic Co-operation and Development	An international economic organisation of 34 countries founded to stimulate economic progress and world trade.
<b>QFE</b>	Qualifying Financial Entity	Qualifying Financial Entities are companies or organisations that are registered on the Financial Service Providers Register (FSPR) and have been granted QFE status.
<b>RFA</b>	Registered Financial Advisers	Registered advisers can provide advice on category two investments such as bank deposits and insurance products, provided there is no investment component.

## DIRECTORY

<b>Nature of business</b>	The Financial Markets Authority (FMA) is an independent Crown entity and New Zealand's financial conduct regulator.
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<b>Auditors</b>	Audit New Zealand – Mana Arotake Aotearoa
<b>Glossary</b>	A full glossary is available at <a href="http://www.fma.govt.nz">www.fma.govt.nz</a>
<b>The FMA complaints line</b>	For all complaints, reports of misconduct or tip-offs, contact: 0800 434 566 (+64 3 962 2698 for overseas callers)
<b>The FMA general enquiries line</b>	For all enquiries and questions, contact: 0800 434 567
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