

---

# Enforcement Principles and Criteria – Payments NZ submission to Reserve Bank

---

November 2021

## Introduction

1. This submission is made by Payments NZ Limited (Payments NZ). It is made in response to the Reserve Bank's consultation paper on Enforcement Principles and Criteria dated 13 October 2021.
2. The principles are described as a set of high-level ideals that will guide the direction of the Reserve Bank's enforcement strategy and inform the approach to applying its enforcement discretion. The criteria are the specific considerations which will be worked through and weighed against the available evidence when deciding on the appropriate enforcement response.
3. It is intended that this framework will operate for the purposes of the legislation administered by the Reserve Bank. The legislation will include the Financial Market Infrastructures Act 2021 (the FMI Act) which is presently being implemented. The Reserve Bank has indicated that the High Value Clearing System and Settlement Before Interchange governed by Payments NZ are likely to be designated as systemically important financial market infrastructures for the purposes of this legislation and Payments NZ would be designated as the operator of these systems.
4. This submission takes the form of general commentary (as envisaged in section 12 of the consultation paper) and answers to the specific questions that are raised in the consultation paper are attached as an appendix.

## Payments NZ

5. The Reserve Bank is a prudential regulator of banks, non-bank deposit takers and insurers. As a prudential regulator, it has different and considerably more sanctions at its disposal, compared to those which it has pursuant to the FMI Act. Therefore, Payments NZ will be in a different position to other entities regulated by the Reserve Bank.
6. The sanctions under the FMI Act are limited to criminal offences and pecuniary penalties. The criminal offences are set in section 127(4) and range from level 1 to level 5 (which are the most serious)<sup>1</sup>. The grounds for pecuniary penalties are set out in section 130(1). They arise in the case of specified matters, including a contravention of a standard issued under section 31.
7. It is self-evident that there must be a clear and sound basis for the taking of any enforcement action and this is especially so when it involves action in the Courts, whether to prosecute an offence or to obtain a pecuniary penalty order.
8. In the case of a prosecution, this is governed by the Solicitor-General's Prosecution Guidelines of 2013. These state that prosecutions should only be initiated or continued where the prosecutor is satisfied that the Test for Prosecution is met. This entails two underlying tests, namely, an evidential test and a public interest test. There must be a

---

<sup>1</sup> An example of a level 5 offence is wrongly holding out that a system is a designated FMI. This carries a maximum fine of \$2 million in the case of a body corporate. It carries a term of imprisonment up to 18 months and a maximum fine of \$200,000 (or both) in the case of an individual.

reasonable prospect of conviction for the first test to be satisfied and the prosecution must be required in the public interest for the purposes of the second test.

9. It is the second test that has particular importance in the context of FMI regulation given the nature of some of the offences that are created under the legislation. The dealings and background between the parties must always be important for determining whether the public interest is being served. The relationship between the Reserve Bank and Payments NZ has, in fact, always been an extremely cooperative and constructive one, and this has been the case ever since Payments NZ was established in 2010.
10. The public interest test has not been canvassed in the consultation paper, in tandem with the evidential test (on page 9). We think it needs greater prominence, consistent with the Solicitor-General's Prosecution Guidelines.
11. A clear and sound basis for taking action becomes even more pertinent in the case of pecuniary penalties, if they are to be based on a contravention of standards. The Reserve Bank has indicated that the standards will take the form of the Principles for financial market infrastructures as published by the Committee on Payments and Market Infrastructures and the International Organisation of Securities Commissions (the PFMI). As such, the standards will recite the principle in each case followed by the key considerations (in the style and format of the PFMI).
12. Regard needs to be had to the way the PFMI are framed. In the absence of clearly defined requirements, there is likely to be some uncertainty as to their application and uncertainty about the liability that arises for a pecuniary penalty based on a breach of the PFMI.
13. We think a strong case will need to be made out for a pecuniary penalty if some of the other grounds are to be relied on e.g. as contemplated by section 130(1)(c) or (d) – for not publishing a designation proposal or not publishing rules. As with any pecuniary penalty, it is a serious course of action involving proceedings in the High Court. Invariably there has to be conduct which is deserving of a punitive response.

## Enforcement principles

14. In broad terms, the consultation paper appears to cover a number of the routine matters that are expected to arise when exercising enforcement action. We support the enforcement principles outlined: risk-based, proportionate, and transparent; and the four enforcement criteria: seriousness of conduct, responsiveness, public trust and confidence, and efficacy. However, it is important that these principles and criteria are aligned with any matters which the Court must have regard to. For example, section 132 of the FMI Act sets out the matters which the Court must consider, including whether the conduct undermines the purposes of the FMI Act, whether there has been any loss, whether steps were taken to mitigate loss, whether the conduct was intentional or reckless, and whether similar conduct has previously been engaged in.
15. Additionally, we take the opportunity to mention the following matters for consideration in the context of enforcement more generally:

- The Council of Financial Regulators comprises the Reserve Bank, the Financial Markets Authority, the Commerce Commission, MBIE, and The Treasury. The function of the Council is to facilitate co-operation and co-ordination between members to support effective and responsive regulation of the financial system in New Zealand. It appears to us that there is an opportunity here to have a common approach to enforcement across the various regulatory agencies and that this can be readily facilitated by virtue of the Council of Financial Regulators platform. We would encourage such an initiative to ensure consistency of approach in New Zealand. We would add that consistency of action is especially important when it comes to twin-peak regulators such as the Reserve Bank and the Financial Markets Authority;
- Not every breach should be amenable to enforcement. A no-action response needs to be recognised and facilitated. The Financial Markets Authority says it will not enforce every breach, in particular, where it would not be justified in the public interest, where it was unlikely to further statutory and strategic objectives or where there were opportunities for more effective intervention. On this basis, the Financial Markets Authority is less likely to pursue matters that are one-off, isolated, or constituting minor events relating to a technical error or something similar, unless there are other compelling reasons to do so. It is more likely to respond to such matters in a low-level and proportionate manner, and to keep the matter and/or financial market participant under review. We consider this should be explicitly provided for in any enforcement policy. Articulation of such a policy, or similar types of policy, is reasonably widespread among regulatory agencies around the world. It seems even more desirable in the case of the Reserve Bank given the approach of its twin-regulator;
- There needs to be explicit recognition of the right to be heard, in particular, the opportunity for the affected party to explain their conduct and to put forward their version of events. Legal representation should be permitted and legal privileges respected (such as the privilege against self-incrimination and legal professional privilege);
- We agree that compliance history is relevant. However, it is important that the matter under immediate consideration is determined first before moving on to look at compliance history;
- Enforcement also needs to promote future compliance on the part of the regulated entity concerned. As such, deterrence needs to be balanced with this consideration in mind;
- There needs to be the opportunity to review or appeal the enforcement decision that is made at first instance, instead of having to rely on the relatively narrow confines of judicial review. This would be consistent with the 2021 Legislation Guidelines of the Legislation Design and Advisory Committee. These state that the ability to review or appeal a decision helps to ensure that the decision is in

accordance with the law. It is also stated that the prospect of scrutiny encourages first-instance decision makers to produce decisions of the highest possible quality. These are worthwhile objectives. It is useful recording also that internal review is not a substitute for appeal – per the Legislation Guidelines;

- Establishing a dedicated committee, perhaps within the Reserve Bank (with independent representation), might well be appropriate in this regard. And the case for this is even more compelling given the very wide catchment of regulatory responsibilities that the Reserve Bank has (covering banks, non-bank deposit takers, insurers, not to mention its AML/CFT responsibilities);
- Publication of an enforcement action should not be automatic. It may not always be appropriate, where it is against the public interest to do so – for example: to protect the legal rights of a person, where it may jeopardise the stability and effectiveness of the regulatory arrangements, in the interests of maintaining an orderly market. There should be conferral with the affected party in any event if it is under consideration, as publication can be a very damaging outcome;
- A sound legal basis for acting needs to be combined with obligations on the regulator to act fairly, impartially, objectively and expeditiously. All these matters are fundamental, however, we believe they need to be emphasised in an enforcement policy, in particular, to provide assurance to the entities that are regulated;
- The Reserve Bank owns and operates the Exchange Settlement Account System and the NZClear Settlement System. These two systems were designated under Part 5C of the Reserve Bank of New Zealand Act 1989 and are being brought across to the FMI Act. The Reserve Bank needs to explain how enforcement will work when it is the owner and operator of the system itself. We think this is important in terms of transparency;
- We understand that an Enforcement Committee has been established at the Reserve Bank. We had been under the impression that it would largely be dealing with repeated and serious breaches of regulatory requirements. However, the latest Financial Stability Report appears to contemplate all enforcement actions being referred to that committee. It would be helpful to know exactly its role, who will be on it, and how it will work - again for the sake of transparency.

16. Payments NZ is grateful for the opportunity to make this submission in response to the consultation on Enforcement Principles and Criteria.



Steve Wiggins  
Chief Executive  
Payments NZ Limited

# Enforcement Principles and Criteria Consultation

## Summary of questions

Table 3: Summary of questions	
<b>Q1:</b>	Do you have any comments on the high-level descriptions of the three principles?
	We are broadly in agreement with the high-level descriptions of the three principles when looking at enforcement generally.
<b>Q2:</b>	Do the descriptions provide clarity on how we apply the three principles? If not, what further information would better help you understand the application of the three principles?
	The descriptions are helpful but probably have limited application when considering the position of Payments NZ, which will not be prudentially regulated by the Reserve Bank, unlike banks, non-bank deposit takers and insurers. We also note the challenges, as set out in our submission, of applying the principles when there is a contravention of a standard (based on the PFMI) when there may be some uncertainty in relation to the application of the PFMI itself.
<b>Q3:</b>	Are there any additional principles that you think should be included? Please explain how any additional suggested principles would improve our decision-making process.
	Having a sound legal basis for acting is a vitally important consideration. This needs to be combined with the need to act fairly, impartially, objectively and expeditiously. These are fundamental when exercising an enforcement discretion. Consideration should also be given to the matters which the Court must have regard to (e.g. in section 132 of the FMI Act).
<b>Q4:</b>	Do you have any additional comments on the principles?
	We do not have any additional comments.
<b>Q5:</b>	Do you have any comments on the high-level descriptions of the criteria?
	We are broadly in agreement with the high-level descriptions of the criteria when looking at enforcement generally.
<b>Q6:</b>	Do the descriptions provide clarity on how we apply the criteria and factors when making enforcement decisions? If not, what further information would better help you understand how the criteria and factors are applied?
	The descriptions are helpful to an extent but, as noted above, there will still be challenges in applying the criteria, particularly where there is a contravention of a standard (based on the PFMI) when there may be some uncertainty in relation to the application of the PFMI itself. Compliance history should only become relevant once the matter has been

---

determined. Deterrence needs to be balanced with encouraging compliance on the part of the regulated entity. Any decision to prosecute must also satisfy the public interest test as provided for in the Solicitor-General's Prosecution Guidelines (in addition to the evidential test).

---

**Q7:** Are there any additional criteria and/or factors that you think should be included? Please explain how any additional suggested criteria and/or factors would improve our decision making process.

Please refer to our response to the previous question. Reflection or recognition of these matters will improve the quality of decision-making.

---

**Q8:** Do you have any additional comments on the criteria and factors?

There are a number of matters that are mentioned in our submission that we think would be useful to consider:

- a common approach across the regulatory agencies,
- articulation of a no-action policy,
- recognition of the right to be heard together with legal representation and legal privileges,
- the need for review or appeal and establishment of a dedicated committee for this purpose,
- articulation of how the Reserve Bank will deal with ESAS and NZClear,
- explaining the workings of the Enforcement Committee.

---

**Q9:** Do the examples illustrate the link between the criteria and principles, and how they are applied? If not, what further information or examples would better help you understand this link and application?

The examples are helpful. But we do think that the emphasis on deterrence may be overstated. As mentioned, enforcement should also encourage compliance, in particular, on the part of the entity concerned. We also do not think that publication of enforcement action should be automatic. It may not always be appropriate. It should be subject to consultation with the affected party in any event.

---

**Q10:** Do you have any comments on how the principles and criteria link to our strategic priorities?

We have no comment to make on this.

---

**Q11:** Is there any additional guidance that we could develop that would help you understand our enforcement function?

Nothing to add.

---

---

**Q12:** Are there any final comments you have on this consultation paper?

---

Nothing to add.

---