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# Crisis Management Powers for Systemically Important Financial Market Infrastructures

Submission to the Reserve Bank of New Zealand

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20 May 2016

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# Crisis Management Powers for Systemically Important Financial Market Infrastructures

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### 1. INTRODUCTION

- 1.1 Payments NZ Limited ("**Payments NZ**") welcomes the opportunity to provide detailed, free and frank, submissions on the proposals in the Reserve Bank of New Zealand ("**RBNZ**") Consultation Document: Crisis Management Powers for Systemically Important Financial Market Infrastructures ("**Consultation Document**").
- 1.2 This submission is made by Payments NZ taking into account what it believes is in the best interests of the payments system as a whole, and the suggestions made in this submission are intended to improve system stability and certainty.
- 1.3 Payments NZ has previously made a submission to the RBNZ on its Consultation Document relating to Oversight of Designated Financial Market Infrastructures ("**Previous Consultation**") in June 2015. Payments NZ reiterates a number of the key themes from that submission. In particular, Payments NZ:
- (a) supports the need for the RBNZ to have crisis management powers – with a particular focus on recovery and resolution over financial market infrastructure ("**FMI**") and an ability to intervene over all payment operators (not just those designated) where there is a significant threat to the system as a whole;
  - (b) proposes that there be a single FMI oversight regime contained in a separate statute that would apply to all FMI (as is being considered in Australia);
  - (c) does not believe a designation process as proposed is either necessary or desirable in respect of either oversight generally or crisis management powers specifically for FMI; and
  - (d) continues to favour a registration regime for those that operate in the payments system (separate from the Financial Services Providers regime). That registration regime would enable the RBNZ to monitor the payment system better and would delineate the full landscape of entities over which crisis management powers could be exercised.
- 1.4 Payments NZ submits that the proposed FMI Act would apply to all payment service providers,<sup>1</sup> however powers could only be exercised where a certain threshold was reached (for example, avoiding disruption that could cause significant damage to the financial system, this being the consideration under section 156K of the Reserve Bank of New Zealand Act 1989). These powers would be subject to appropriate checks and balances, for example a requirement for

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<sup>1</sup> payment service providers would include organisations that provide services such as switching services, messaging services, or data processing services that relate to payment systems.

ministerial consent to exercise them. Payments NZ attaches, at appendix one of this submission, a structure of an FMI Act (which was included in its previous submission).

- 1.5 In short, Payments NZ supports separate crisis management powers for FMI. Our submission is about the scope of those powers and the circumstances in which they can be exercised, including the ability to provide exemptions from certain aspects of the crisis management powers where it makes sense to do so.
- 1.6 Its structure is broken into:
  - (a) general comments on the proposed crisis management framework and its application;
  - (b) comments on the specific crisis management powers; and
  - (c) Payments NZ's response to each of the RBNZ's questions (included at appendix two).
- 1.7 In making this submission, the primary focus for Payments NZ is on how the proposed crisis management powers will affect it and the two systemically important payments systems that it is the "operator" for; namely Settlement before Interchange ("**SBI**") and the High Value Clearing System ("**HVCS**"). This is based on the fact that the RBNZ proposes to include the party responsible for maintaining and administering the rules of an FMI within its definition of operator (i.e. it is not an operator in the usual sense).
- 1.8 Payments NZ also notes the comment in the Consultation Document about risks that networks may "be owned and therefore heavily influenced by the financial institutions that are also their largest participants". While Payments NZ is owned by its eight largest participants, it believes any risks arising as a result are addressed by its governance structure including the requirement to have three independent directors (including an independent chair) and key decisions relating to access being delegated to the independent directors.
- 1.9 Finally, Payments NZ would like to offer to facilitate a broader industry workshop with the RBNZ in relation to the proposed crisis management powers once all submissions have been received. Such a workshop could include Payments NZ's participants and members as well as other stakeholders in the industry such as NZX, ASX, London Clearing House and CLS Bank.

**2. THE PROPOSED FRAMEWORK**

2.1 Payments NZ acknowledges the difficulty of developing a crisis management framework for FMI given the wide range of FMI which need to be covered, including:

- (a) international central counterparties domiciled offshore with little or no actual presence in New Zealand (but which are systemically important);
- (b) international trade repositories;
- (c) domestic central counterparty clearing systems;
- (d) domestic clearing and settlement systems (which do not operate as central counterparties); and
- (e) payments systems which operate through a series of bilateral arrangements with little or no central core infrastructure (which is the New Zealand model for pure payments systems).

2.2 Payments NZ assumes that it is because of this complexity (particularly in respect of issues dealing with systemically important FMI which are operated almost wholly offshore) that the RBNZ is proposing a two tier approach to crisis management being:

- (a) requirements for business continuity plans and recovery and orderly wind down plans for all systemically important FMI; and
- (b) a second tier of powers to give directions, remove directors and appoint statutory managers to FMI which would only apply to systemically important FMI with a significant domestic presence.

2.3 Payments NZ does not believe that business continuity planning should be part of the crisis management powers. Business continuity planning should apply to business as usual operations as part of the standards required of FMI (which appears to be the more usual international approach).

2.4 Payments NZ is also concerned that, on the RBNZ's current thinking in relation to systemically important FMI, the second tier of the framework may only apply to it and NZX and, in these circumstances, it is heavily "over engineered". Payments NZ believes that the better approach is to have the second tier of powers available for exercise against any payment service provider if that payment service provider poses a significant threat to the financial system as a whole.

2.5 Based on Payments NZ's analysis, systemically important FMI would be:

<b>RBNZ</b>	<b>Payments NZ</b>	<b>NZX</b>	<b>International</b>
<ul style="list-style-type: none"> <li>• Exchange settlement account system ("ESAS")</li> <li>• NZ Clear</li> <li>• HVCS (CUG administrator)</li> </ul>	<ul style="list-style-type: none"> <li>• SBI</li> <li>• HVCS</li> </ul>	<ul style="list-style-type: none"> <li>• NZ Clearing and Depository Limited</li> </ul>	<ul style="list-style-type: none"> <li>• CLS Bank</li> <li>• London Clearing House (Swap Clear)</li> <li>• ASX Futures</li> <li>• DTCC</li> </ul>

- 2.6 International FMIs have been largely excluded from the application of the second tier powers, and it is not clear to Payments NZ how the RBNZ would apply powers in respect of itself (especially in relation to ESAS which is a pure payment system and the FMA is not a joint regulator). Therefore, the second tier of crisis management powers realistically may only affect two entities.
- 2.7 In respect of the power to appoint a statutory manager, the RBNZ has expressly stated that it would not be appropriate to exclude designated payment systems from the operations of the Corporations (Investigations and Management) Act 1989 ("**CIMA**"). Presumably, this means that CIMA will also apply to Payments NZ and NZX. Payments NZ is concerned that it could therefore be subject to two competing statutory management frameworks.
- 2.8 In respect of Payments NZ, it is difficult to understand in what circumstances the RBNZ would need powers to:
- (a) give directions;
  - (b) replace directors; or
  - (c) appoint a statutory manager.
- 2.9 This is because Payments NZ's business model is managing and administering rules as opposed to operating or owning infrastructure. In line with our previous submission, Payments NZ believes the better approach is for the FMI oversight regime and, therefore, all of the crisis management powers (other than in relation to business continuity planning) to apply to all FMI and the entities involved in them (not just operators of systemically important FMI).
- 2.10 There is a risk the current approach of focusing only on systemically important FMIs could lead to regulatory blind spots. The better approach to designing the crisis management powers regime is for the RBNZ to:
- (a) ensure the scope of the regime is wide enough by identifying payment service providers, the failure of which could cause disruption to the financial system, and where it is better placed to manage their failure (which could be monitored on an ongoing basis if there was a registration regime for all payment service providers, including all operators, infrastructure providers and participants in FMIs); and
  - (b) identify the sorts of powers and circumstances where it would want to intervene by appointing a statutory manager to protect the financial system.
- 2.11 Attempting to deal with the default of critical service providers through the FMI operator is unlikely to be effective and unlikely to have any utility (if, for example, the operator has no rights or powers over payment switches and card schemes, where failure could cause significant disruption to the financial system). Payments NZ believes it would be better if the RBNZ had direct rights to appoint a statutory manager in the expanded circumstances the RBNZ is suggesting (not just fraudulent or reckless behaviour but where the business is operating in a way prejudicial to the financial system).

### 3. BUSINESS CONTINUITY PLANNING

- 3.1 Payments NZ acknowledges the importance of business continuity planning for payments systems given the risk of failure of key infrastructure to the whole market.
- 3.2 However, Payments NZ does not believe that business continuity planning should be included as a crisis management power. It certainly does not believe that failure to have an adequate business continuity plan should be grounds for the RBNZ giving directions or, in even more extreme circumstances, appointing a statutory manager.
- 3.3 Payments NZ believes that business continuity planning should be included as part of a general 'business as usual' standard.
- 3.4 In practice, Payments NZ believes that market incentives to have good business continuity plans are sufficiently strong that substantial special powers in respect of them are unnecessary. Where participants in a payments system remain in business (i.e. other than in insolvency which is covered by recovery and orderly wind down plans), their incentives are to ensure that customer disruption does not undermine the value of their business. In light of these business incentives, a better approach may be for directors to certify or attest to the adequacy of the business continuity plan (as we see elsewhere in prudential regulation), rather than the RBNZ reviewing such plans and approving them.
- 3.5 Payments NZ has developed an Industry Incident Management Plan ("**IIMP**") for SBI and is currently looking to integrate that plan with one for the HVCS. This work is well advanced.
- 3.6 Payments NZ would be interested in the RBNZ's views on whether the IIMP would comply with the standard which it is proposing (paragraph 62 of the Consultation Document) and, if not, what further work it would see as necessary.
- 3.7 Even if the RBNZ was satisfied with the IIMP, Payments NZ would have some concerns if an obligation was imposed on it to ensure that SBI and HVCS had a business continuity plan that had to meet the minimum standards proposed by the RBNZ.
- 3.8 Payments NZ has only been able to create an IIMP with the cooperation of:
- (a) participant banks;
  - (b) SWIFT; and
  - (c) RBNZ (in relation to ESAS and NZ Clear as the third level contingency providers).
- 3.9 If Payments NZ, as the operator of SBI and HVCS, had the obligation to create and maintain the business continuity plans for those FMI, Payments NZ would need the power (at inception and on an ongoing basis) to:
- (a) obtain information from participants, payment switches and SWIFT to be able to identify essential services, risks, acceptable recovery timeframes and to develop the policies and procedures; and

- (b) compel service providers in SBI and HVCS to invoke contingency arrangements and conduct regular testing.
- 3.10 Payments NZ does not have those powers. While conceivably some of the powers could be included in its Rules, those Rules only apply to participants and not key service providers such as:
  - (a) SWIFT; and
  - (b) RBNZ.
- 3.11 Furthermore, there are a range of other significant risks where Payments NZ's relationship is even more remote, such as, for example:
  - (a) telecommunications infrastructure providers (such as Chorus); and
  - (b) payment switches (such as Paymark).
- 3.12 In short, Payments NZ does not believe that it should be subject to an obligation when it does not have the necessary power or ability to comply with that obligation. Payments NZ accepts the value and importance of business continuity plans, however, it may need the support of the RBNZ to create these if key service providers and others do not cooperate (and the RBNZ would need powers in respect of these entities to enforce cooperation). This is consistent with the Principles of Best Practice Regulation published by the New Zealand Treasury which provide that regulations should be:
  - (a) proportional: the burden of rules and their enforcement should be proportional to the benefits that are expected to result; and
  - (b) certain, predictable: regulated entities have certainty as to their legal obligations, and the regulatory regime provides predictability over time.
- 3.13 While business continuity planning is important for FMI, the position is much more difficult in respect of SBI and HVCS, which are a series of bilateral arrangements between participants, SWIFT, RBNZ and Payments NZ (embedded in Payments NZ's Rules), than it is for those FMI that are either owned or contractually controlled by a single operator (such as, for example, NZ Clear). Payments NZ could undertake a co-ordination role as operator of SBI and HVCS, but with limited ability to compel parties to follow the plan. The nature and scope of any business continuity planning obligation should be appropriate for the applicable FMI, taking into account the number of parties involved and the powers of the operator in respect of that FMI.
- 3.14 Payments NZ believes significant further thought is required on how a business continuity planning power would work in relation to FMI, including whether it should simply be confined to operators of systemically important FMI. Payments NZ believes there is a case for applying this requirement to all payment service providers as part of a registration regime. To ensure that the burden is proportionate to the benefit, there could then be an exemption process for those entities where there would be limited value (from a financial system perspective) in requiring a business continuity plan (or even some elements of a business continuity plan).



3.15 Although the RBNZ did not accept the need for the broader registration regime for payment service providers that Payments NZ suggested in its earlier submission, Payments NZ remains of the view that there is value in establishing such a regime (and it is consistent with what is happening in many other jurisdictions).

#### **4. RECOVERY AND ORDERLY WIND DOWN POWERS**

- 4.1 Payments NZ acknowledges that the CPMI and IOSCO Principles for Financial Market Infrastructures ("**PFMIs**") require FMI to have a set of recovery tools that are comprehensive and effective.
- 4.2 Payments NZ believes this is an example of a power that is focused predominantly on clearing and settlement systems where it is important that there are clear loss "waterfalls" and mechanisms to deal with liquidity shortfalls and is not relevant to payment systems that operate through a series of bilateral arrangements (such as SBI and HVCS which involve a multilateral contract that takes effect as bilateral agreements between participants).
- 4.3 The power is simply not relevant to Payments NZ, which is captured as an operator of a systemically important FMI by virtue of the fact that it maintains and administers the rules of SBI and HVCS.
- 4.4 The governance arrangements for Payments NZ have been carefully developed over a long period of time, in collaboration with the RBNZ, to support the centralised arrangements that have been put in place by the participants. Without these arrangements in place, it would be difficult for the rules to operate effectively as participants would have to revert to individual arrangements which would pose a significant risk to the systems interoperability. A recovery and resolution plan which does not rely on the continued operation of the rules in their current form is therefore unlikely to work in practice. It would certainly be highly disruptive in the change-over.
- 4.5 Accordingly, Payments NZ does not believe that the recovery and orderly wind down plans should be mandatory. Furthermore, Payments NZ believes that, to the extent that recovery and orderly wind down plans are required, it would be more effective to require them in respect of infrastructure providers, such as payment switches and payment gateways, which have the potential to cause significantly more damage to the financial system than a failure of Payments NZ.
- 4.6 While some of these entities could fall within the definition of critical service provider, Payments NZ has no way of imposing these requirements on them because it does not have suitable contractual relations with them, and does not have specific powers to do so.
- 4.7 Ultimately, Payments NZ has concerns about a standard in relation to recovery and orderly wind down plans which is designed on a "one size fits all" basis. If such plans are to be mandatory it is important that the level of detail required in them is proportionate to the risk being managed. For example, these plans may not need to include all of the requirements set out in paragraph 63 of the Consultation Document. Clearly there are a number of elements, such as those relating to loss allocation and liquidity shortfalls that just do not apply to SBI or HVCS, and hence are not relevant to Payments NZ.
- 4.8 Accordingly, Payments NZ believes any legislation should also include an exemption process which enables entities to be exempted from some or all of the requirements of a recovery and

orderly wind down plan. In effect, enabling the regulatory burden to be applied proportionately to any benefit it would create.

## 5. POWERS OF DIRECTION

5.1 Payments NZ notes its comments in its original submission, namely that:

*"Payments NZ agrees that the Reserve Bank should have the power to issue directions to FMI operators subject to the triggering of one of the four crisis management conditions in the Consultation Document and Ministerial approval".*

5.2 Since the Previous Consultation, two further conditions enabling RBNZ to issue directions have been added. Of these, Payments NZ has a concern about the power of the RBNZ to give directions if:

*"the business continuity plans and recovery and orderly wind down plans, for the FMIs the operator is responsible for fail to achieve the required objectives or include the required matters".*

5.3 Payments NZ's concern is that this is a significantly lower threshold for directions than any of the other grounds and hence is potentially a substantial deviation from the RBNZ's core purposes. In other cases, the threshold is fraudulent or reckless behaviour, serious or repeated breaches, insolvency or conducting the FMI in a manner which is prejudicial to the soundness of the FMI, all of which are much more serious.

5.4 Payments NZ does not believe that a direction should be able to be given because the RBNZ believes that either a business continuity plan or recovery and orderly wind down plan fails to achieve "the required objectives" or include "the required matters". Although Payments NZ acknowledges there is some international precedent for directions to be given in respect of recovery and resolution plans, it is not aware of any such precedent for directions to be given for business continuity plans.

5.5 Payments NZ also has some concerns about the matters in respect of which directions can be given and believes that in some instances the content of the direction could be inconsistent with the circumstance triggering the right to give the direction. For example, the joint regulators are entitled to give a direction if the FMI's activities are being conducted in a manner "prejudicial to the soundness of the FMI". However, the RBNZ can give directions requiring the FMI to carry on or cease carrying on functions that relate to the "efficient" operation of the FMI. Similarly, a direction can be given if there is concern about an operator's ability to "effectively carry out the role of operator" whereas the threshold for exercise of the power is the operator acting fraudulently or recklessly.

5.6 Payments NZ believes that directions must be consistent and proportionate with the purpose for which they are given and the risk posed.

5.7 Payments NZ strongly endorses the comment that the directors should be protected from liability following directions. In practice, a direction may be requiring them to take steps they do not believe to be in the best interests of the company and hence directors should be entitled to protection from legal consequences.

5.8 We also note that there is a proposal that a limited power to direct be available against participants but that the RBNZ did not have strong views on this. Payments NZ can see some circumstances where this could be valuable (where Payments NZ, for example, does not have a direct relationship or powers to achieve the objectives required of the FMI).

## 6. DIRECTORS

- 6.1 Payments NZ does not believe that the RBNZ should have the power to remove or appoint its directors.
- 6.2 In practice Payments NZ cannot see how this power could ever be exercised (and could actually work or be useful in practice).
- 6.3 For example, in the case of Payments NZ it has:
- (a) eight bank appointed directors; and
  - (b) three independent directors.
- 6.4 If the RBNZ is to have the power to appoint directors in the case of Payments NZ, it would raise questions such as:
- (a) which director would be replaced and in what circumstances;
  - (b) how would the RBNZ stop a relevant shareholder or shareholders simply then removing that director;
  - (c) what could one director or a few directors realistically achieve (given each only has one vote out of 11); and
  - (d) what moral hazard would the RBNZ be assuming in appointing a director (this could even apply to a lesser extent to removing a director).
- 6.5 In practice, if there is a governance breakdown, then the RBNZ would need to appoint a majority of directors to the board of Payments NZ. At that point other options are likely to be much more effective (e.g. giving directions to participants that are banks and who are under RBNZ's direct supervision).

## 7. STATUTORY MANAGEMENT

- 7.1 Payments NZ believes that a specifically designed statutory management regime for FMI is worth considering.
- 7.2 For the reasons explained earlier, it would appear, based on the proposed application of the second tier of the crisis management framework, that currently the only entities potentially affected are Payments NZ and NZX. In the case of NZX, any circumstances justifying the appointment of a statutory manager may not be limited to its role in relation to clearing and settlement, and therefore its statutory management may well be managed under CIMA.
- 7.3 Payments NZ believes the better approach is to include all entities providing services as part of FMIs within the scope of a statutory management regime. The natural constraint on the invoking of the powers will be the circumstances in which the power arises (e.g. fraudulent or reckless conduct or operating in a manner prejudicial to the soundness of the financial system).
- 7.4 For example, Payments NZ does not believe that the failure of a critical service provider can realistically be dealt with through an FMI's business continuity plan. If the circumstances which give rise to the right to appoint a statutory manager occur (e.g. fraudulent or reckless conduct, or it is acting in a manner prejudicial to the financial system), realistically it is only the regulator that will be able to deal with it.
- 7.5 In short, if a payment switch was to be operated in a manner prejudicial to the payments system, then Payments NZ believes the RBNZ should be the regulator that oversees its statutory management.
- 7.6 In designing a bespoke statutory management regime, Payments NZ believes it is important to be clear on:
- (a) why the circumstances giving rise to the right to appoint a statutory manager need to be extended beyond those included in CIMA; and
  - (b) what additional powers a statutory manager might need that are not included in CIMA (and why).
- 7.7 Given the seriousness of statutory management, Payments NZ does not believe that the circumstances giving rise to the right to appoint a statutory manager should be extended as broadly as suggested. In particular, it does not believe there should be a right to appoint a statutory manager where the FMIs business continuity plans, and recovery and orderly wind down plans, the operator is responsible for, fail to address relevant and material risks the FMI is subject to.
- 7.8 Payments NZ believes the RBNZ should have to meet the threshold of "an FMI being conducted in a manner prejudicial to the soundness of the FMI and the financial system" before a statutory manager is appointed. This should be the threshold and should not be lowered, given the intrusive nature of the regime and the well acknowledged view that statutory management is very much a last resort step.

- 7.9 While Payments NZ notes that insolvency is not a ground for the appointment of a statutory manager under CIMA, it does accept that the circumstances of FMIs and their role in transferring money mean that conventional insolvency processes may not be effective (and wider powers may be needed).
- 7.10 While Payments NZ does not believe there will ever be a need to appoint a statutory manager to it (and therefore no need for a statutory manager to have additional powers), it does note the complexities of clearing and settlement systems (especially central counterparty systems). This may mean specific powers may be required over and above those in CIMA for some FMI (but that these specific powers need to be more clearly designed).
- 7.11 While it is acknowledged in the Consultation Document, Payments NZ believes significant further work will be required to ensure that the powers of a statutory manager do not undermine the legal certainty obtained by those FMI that have had rules designated (i.e. any moratorium powers of a statutory manager must not be able to override designated rules, especially given the status of those rules as legislative instruments). It is important that this is clear given the global trend to require "clean" legal opinions before transacting within FMIs.
- 7.12 For Payments NZ, it is particularly important that any statutory manager appointment will not affect participants' obligations under the Rules. While this is acknowledged in paragraph 101 of the Consultation Document, the wording in the legislation will be critical.
- 7.13 Payments NZ notes that there is a proposal to add an additional power for the regulator to give directions to a statutory manager. This is a power contained in the RBNZ Act but not in CIMA. Payments NZ accepts the rationale for having such a power. However, it will be important to ensure that if a statutory manager is given a direction by the regulator (or even guidelines within which to operate) that it does not absolve the statutory manager from personal liability. In effect, we believe that before any directions or guidelines are issued, it will probably be necessary for the regulator to provide an indemnity from the Crown to the statutory manager. This will be vital for confidence in the ongoing operation of a payment system.
- 7.14 Payments NZ would like more clarity regarding the RBNZ's comments in relation to the interface with CIMA. While the RBNZ has indicated that the RBNZ does not believe that the provisions of CIMA should be applied to FMIs, the RBNZ then goes on to state that the RBNZ does not consider it would be appropriate to exclude the designated payments systems and their operators from CIMA. Payments NZ believes that will only cause confusion in the market, and potentially add a legal complexity, if this is the case.
- 7.15 For the reasons referred to earlier, Payments NZ believes that the RBNZ is the regulator with the necessary expertise and background to manage the failure of a pure payment system, and FMIs covered by the bespoke statutory management regime should be excluded from CIMA.



# Appendix one

## Financial Market Infrastructure Act

<b>Application</b>	The Act would apply to all FMIs and all operators, infrastructure providers and participants in FMIs.
<b>Purpose</b>	<p>The purposes of the powers granted in the Act would be for:</p> <ul style="list-style-type: none"> <li>(a) promoting the maintenance of a sound and efficient financial system; and</li> <li>(b) avoiding significant disruption to FMIs where that disruption could cause significant damage to the financial system.</li> </ul> <p>In effect, the purpose would be similar to the purpose the Reserve Bank has in relation to the supervision of banks.</p>
<b>Powers</b>	<p>The powers in the Act would include:</p> <ul style="list-style-type: none"> <li>(a) the power to obtain information (similar to that already in the Reserve Bank of New Zealand Act 1989);</li> <li>(b) powers of investigation and/or audit (subject to checks and balances if an audit or investigation does not uncover any material concerns);</li> <li>(c) the power to issue directions (similar to the power that the Reserve Bank has in relation to registered banks);</li> <li>(d) the ability to obtain warrants from the court allowing the Reserve Bank to enter premises where the Reserve Bank is concerned about offences being committed; and</li> <li>(e) the power to appoint a statutory manager.</li> </ul>
<b>Grounds for Exercising Powers</b>	Other than the information power, the Reserve Bank would be required to establish that the exercise of the power is reasonably necessary to prevent a material disruption or damage to the financial system as a whole.
<b>Process for Exercising Powers</b>	<p>Other than the information request power, Payments NZ believes that all powers should be subject to a process of independent review before they are exercised. Depending on the nature of the power, this could involve:</p> <ul style="list-style-type: none"> <li>(a) ministerial consent;</li> <li>(b) an Order in Council; or</li> <li>(c) a Court Order.</li> </ul>

	The Reserve Bank would be required to consult before seeking to exercise any power (other than the information request power and the power to appoint a statutory manager).
<b>Statutory Manager</b>	A separate statutory management regime tailored for FMI participants, operators and infrastructure providers would be included in the legislation (which is likely to be a blend of the existing statutory management regimes in the Reserve Bank of New Zealand Act 1989 and the Corporations (Investigation and Management) Act 1989).
<b>Registration</b>	The Act could provide for an obligation for all operators, infrastructure providers and participants of FMIs to register, either with the Reserve Bank or in a separate section of the Financial Service Providers Register.
<b>Offences</b>	The Act could include civil and criminal penalties (based on the equivalent penalties in other legislation supervised by the Reserve Bank).

# Appendix two

## GENERAL APPROACH TO THE CRISIS MANAGEMENT FRAMEWORK

### Question 1:

**Do you agree with our general approach to the design of a crisis management framework for FMIs? Are there other matters which we should be considering?**

Payments NZ does not agree with the proposed general approach to the design of a crisis management framework to the extent that it believes that:

- BCP should not be included as part of crisis management (but as part of the general conditions imposed through standards),
- Crisis management should apply to all payment service providers\* (not just SIFMIs) where the failure of the payment service provider could affect the soundness of the financial system.

\* payment service providers would include organisations that provide services such as switching services, messaging services, or data processing services that relate to payment systems.

## OUTLINE OF THE CRISIS MANAGEMENT FRAMEWORK

### Question 2:

**Do you agree with the proposed objectives of the crisis management framework? Are there other objectives we should be considering?**

Yes, Payments NZ largely agrees with the objectives of the crisis management framework but, as stated, believes that the framework needs to be in respect of all payment service providers, not just SIFMI.

### Question 3:

**Do you agree with the proposed two tier approach to the crisis management framework? If this approach is adopted are there detailed aspects of the framework you would change?**

Payments NZ supports the two tier approach but does not believe that BCP should be part of tier one of the crisis management framework. BCP should be part of BAU imposed through standards.

It is important that the statutory powers which form the second tier enable the recovery and orderly wind down plan to be executed. The powers also need to be proportionate to the risks.

As set out below (and in its submission), Payments NZ believes that there are detailed aspects of the framework which should be changed.

## APPLICATION OF THE CRISIS MANAGEMENT FRAMEWORK

### Question 4:

**If the proposed framework is adopted, do you agree with our description of how it should apply in different crisis situations?**

Payments NZ has concerns with how the proposed framework would apply in different crisis situations. It is noted that it would be particularly difficult to apply the framework effectively in relation to, say, SBI where Payments NZ (as the SIFMI) has no legal power to compel co-operation from various parties who are integral to the operation of SBI – e.g. SWIFT, the Reserve Bank. It is submitted that the framework needs to apply directly to payment service providers if it is to have any utility.

Payments NZ agrees that it is important to have an integrated plan for SBI and HVCS. However, currently it would need Reserve Bank support to ensure that it can deliver this.

#### **Question 5:**

**If the proposed framework is adopted, do you agree with our description of how it should apply to FMIs with these two basic types of legal form?**

Payments NZ understands the proposals in relation to how statutory management will apply to the business of an FMI or the operator of an FMI. However, it is not entirely clear whether the business of the FMI is intended to cover third parties as well. If it is only in respect of the business of the FMI, Payments NZ sees this as sensible (e.g. it may be appropriate to separate the clearing and settlement parts of a business from the wider business being operated by the same entity).

#### **Question 6:**

**If the proposed framework is adopted, do you agree with our description of how it should apply to FMIs with different levels of New Zealand presence?**

Payments NZ has some reservations about this and believes this would be challenging in practice. Whether it will be effective will depend on the content of the recovery and orderly wind down plan – for example, it may be necessary to establish a local entity to provide on-going services (such as clearing) and then appoint the statutory manager in respect of this. However, Payments NZ has no direct experience of international FMIs operating in New Zealand and this is just a general observation.

#### **Question 7:**

**Are there potentially “associated entities” of FMIs that are not operators or critical service providers, but are nonetheless essential to the operation of an FMI and its ability to provide essential services?**

Yes, Payments NZ believes that the framework needs to cover all payment service providers.

## **DESIGN OF SPECIFIC CRISIS MANAGEMENT POWERS**

#### **Question 8:**

**Do you agree with the proposed power to require operators to ensure that their FMIs have business continuity plans, and recovery and orderly wind down plans?**

Payments NZ understands the requirement for BCP but believes these should be largely left to the FMIs to develop, manage and govern. Payments NZ also understands the need for recovery and orderly wind down plans. Provided that in both cases operators have the ability and authority to

deliver on these and there is an exemption regime where the value of such plans does not justify the cost.

**Question 9:**

**Do you agree with our proposed lists of matters that must be included in business continuity plans, and recovery and orderly wind down plans? Are there matters that you would add to, or remove from, these lists?**

In broad terms, the matters are appropriate, although we question the need for a prescriptive list in relation to BCP in particular. Ultimately, the matters which need to be included in plans will depend on the nature/role of the payment operator. Not all matters will be relevant to all SIFMIs.

**Question 10:**

**Do you agree with the proposed role of joint regulators in assessing business continuity plans, and recovery and orderly wind down plans? If not, what role (if any) do you consider joint regulators should have in assessing these plans?**

It is noted that, in respect of pure payments systems, only the Reserve Bank will be the regulator. This is supported by Payments NZ.

For FMIs which are jointly regulated, Payments NZ believes it is reasonable for recovery and orderly wind down plans to be assessed because the regulators will be involved in implementing these. Payments NZ does not support regulators assessing BCPs because it believes that the incentives for businesses are sufficiently strong to ensure that these are effective. There is a concern that this could create a moral hazard for the regulators. A better approach would be to have directors certify that the BCP is adequate.

**Question 11:**

**Do you agree with the proposed direction power and its scope? Are there any changes you consider should be made to this power?**

Payments NZ acknowledges that the regulator should have the power to give a direction when the operator and/or an FMI are being conducted in a manner prejudicial to the soundness of the financial system (being the statutory consideration). This power should cover most of the other grounds listed in paragraph 70 of the consultation document and is the appropriate threshold which must be met before directions are given by the regulator.

Concerns in relation to the efficiency of the financial system should not be a basis on which directions are given. In particular, Payments NZ does not think it would be appropriate for the regulator to give a direction where there is a risk to the efficient operation of the FMI or the payment system (paragraph 72 of the consultation document). Any directions must be linked to the statutory power of the regulator (i.e. soundness of the financial system).

Furthermore, directions should not be given in relation to BCP plans (again because of concerns relating to moral hazard).

**Question 12:**

**Do you agree with the proposed power to appoint or remove directors? Are there any changes you consider should be made to this power?**

Payments NZ does not support the power to appoint or remove a director and sees no practical value in this in relation to itself. The grounds set out in section 151 of the Companies Act 1993 (which disqualify certain persons from being directors), together with moral suasion from the regulator, should be sufficient to ensure that a power to remove or appoint directors is not required.

Payments NZ believes that it would be problematic for the Reserve Bank to exercise this power in relation to it, given the specific powers of individual shareholders to appoint and remove directors.

It is also a power that could create a moral hazard for the Reserve Bank for little benefit to system soundness.

#### **Question 13:**

**Do you think the joint regulators should have a power to direct participants in a limited range of circumstances? If so, do you agree with our description of how this power could be framed, and in what circumstances do you consider it could be used?**

Payments NZ supports the joint regulators having a power to give directions in a limited range of circumstances but believes this power should be in respect of payments service providers (not just participants).

In respect of Payments NZ, the majority of participants are registered banks and the Reserve Bank already has this power. It would be appropriate for similar powers to apply to all its participants as this would ensure a level playing field.

Powers to give directions should only be exercised where there is a risk to the soundness of the financial system.

#### **Question 14:**

**Do you agree with our description of how statutory management could be applied to an FMI or its operator? If not, how do you consider that it could be applied to an FMI and its operator?**

In respect of Payments NZ, the approach does not seem appropriate or sensible. Payments NZ should be able to continue to operate (under a change in management and control, if necessary) rather than vesting those parts associated with running the FMI into a separate company.

#### **Question 15:**

**How practical would it be to sever the FMI business of the operator from the rest of the operator's business? What costs might be involved in pre-positioning the ability to do this?**

For Payments NZ, it would be impractical and unnecessary to sever the FMI business. It would be simpler for Payments NZ to continue under statutory management.

For other entities this could be a very complex undertaking.

#### **Question 16:**

**Do you agree with our proposed trigger for when joint regulators could recommend statutory management? If not, what changes would you make to this trigger?**

As stated above, Payments NZ believes that the threshold for the trigger should be risk to the soundness of the financial system.

**Question 17:**

**Do you agree with the proposed objectives and considerations that would influence the exercise of powers in a statutory management by the joint regulators and the statutory manager? Are there any changes you consider should be made to these objectives and considerations?**

Payments NZ has no concerns with the proposed objectives and considerations that would influence the exercise of powers in a statutory management by the joint regulators and the statutory manager (noting that as the operator of a pure payment system this will only involve the Reserve Bank).

**Question 18:**

**Do you agree with the core powers of the statutory manager that are being proposed? Are there any changes you consider should be made to these powers?**

Payments NZ broadly agrees with the core powers of the statutory manager that are being proposed. However, it is important to carefully consider the statutory manager's powers to ensure that these match the requirements to ensure the on-going soundness of the financial system (and do not compromise the legal certainty of arrangements between participants). In the case of Payments NZ, for example, the statutory manager may need powers which extend beyond the Company itself, to include SWIFT, HP, switches and potentially telcos.

**Question 19:**

**Do you agree with the proposed moratorium and the resolution powers? Are there any changes you consider should be made to these?**

Further careful consideration is required in relation to the role of a moratorium and the design of resolution powers. There is a risk that these could upset the legal certainty which exists in the system today thereby potentially undermining the soundness of the system which they are seeking to protect.

**Question 20:**

**Do you agree with the proposals relating to miscellaneous matters connected to the proposed statutory management regime? Are there any changes you consider should be made to the proposals?**

Payments NZ does not support including payment systems operators within the scope of CIMA, especially where one of the substantive grounds for action under CIMA – operating fraudulently or recklessly – is being imported across to the Reserve Bank of New Zealand Act. There should not be two potential regimes – the Reserve Bank is best placed to exercise crisis management powers in relation to payments system operators under its own legislation.