

## Guidance Note –

# Designations under the Financial Market Infrastructures Act

## 2021

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## 1. Interpretation

- 1.1. This document explains the roles and approach of the Reserve Bank of New Zealand - Te Pūtea Matua (**the Reserve Bank**) and the Financial Markets Authority (**FMA**) when Financial Market Infrastructures (**FMI**s) are designated under Part 3 of the Financial Market Infrastructures Act 2021 (**the Act**).
- 1.2. For the purposes of this document, references to:
  - the **Minister** mean the Minister of Finance and Minister of Commerce and Consumer Affairs together in relation to FMIs other than those that are pure payment systems, where the Minister of Finance acts alone.
  - the **regulator** mean the Reserve Bank and the FMA together acting jointly under the Act in relation to FMIs other than those that are pure payment systems, for which the Reserve Bank is the sole regulator.
  - the **Standards** mean the FMI Standards issued by the regulator in accordance with section 31 of the Act.
- 1.3. All terms defined in the Act have the same meaning in this document.
- 1.4. All statutory references in this document are to the Act unless specified otherwise.
- 1.5. This document may be revised or updated from time to time, as required, or as necessary.
- 1.6. These guidelines are not exhaustive and nothing in this document should be read as to limit the regulator's functions and powers under the Act.
- 1.7. The material in this document is guidance only and does not override the provisions of the Act. It does not constitute legal advice. We encourage FMIs to obtain their own legal advice if they are in any doubt as to their obligations under the law.

## 2. Introduction

2.1. FMIs are multilateral systems that provide trading, clearing, settlement, and reporting services in relation to payments, securities, derivatives, and other financial transactions. FMIs include:

- payment systems;
- central securities depositories;
- securities settlement systems;
- central counterparties; and
- trade repositories;
- or a combination of 2 or more of the above.

2.2. Well-managed and -operated FMIs are essential to a sound and efficient financial system, and the day-to-day operation of the economy. In particular, they provide much of the underlying infrastructure that enables non-cash payments and the settlement of financial market transactions. Given the key role they play, the disruption or failure of important FMIs could have significant negative impacts on the financial system, businesses, and consumers.

2.3. The Act established a framework for the oversight and regulation of FMIs and is designed to avoid significant damage to the New Zealand financial system that could result from problems with an FMI. The purposes of the Act include promoting the maintenance of a sound and efficient financial system and promoting the confident and informed participation of businesses, investors, and consumers in the financial markets, by having a system for designating FMIs and by imposing regulatory requirements on such designated FMIs.

## 3. Designation

3.1. The Minister may, under Part 3 of the Act, declare by notice an FMI to be designated in accordance with a recommendation made by the regulator. The regulator may recommend designation:

- on the regulator's own initiative if the FMI is considered to be systemically important; or
- in response to an application from the operator of the FMI (to have the benefits of designation, including finality of settlements).

3.2. These paths to designation are explained in more detail in part 4 below and depicted in Annex A.

3.3. Section 29 of the Act specifies the content of a designation notice.

### **3A. Effect of designation**

3A.1 The Act provides certain powers to the regulator for the supervision and monitoring of designated FMIs. These include:

- information gathering and investigative powers to enable monitoring of the wider sector;
- issuing Standards and guidance for designated FMIs;
- oversight of FMI rules;
- reviewing FMI contingency plans;
- enforcement powers; and
- crisis management powers.

3A.2 As discussed in further detail in part 4B below, FMIs may apply to the regulator to be designated, even if the FMI is not considered systemically important. FMIs designated in this way will be subject to the same set of regulatory requirements as FMIs whose designation notice specifies they are systemically important, with the exception of crisis management powers under Part 4 of the Act, which only apply to FMIs whose designation notice specifies they are systemically important.

3A.3 The regulator has issued Standards in accordance with the Act, along with Guidance on those Standards, and a Guidance Note for Overseas FMIs that contains an overseas equivalence framework. The Standards apply depending on the class(es) within which the FMI falls. This is explained further in parts 4A and 4B, including for overseas FMIs.

### **3B. Benefits of designation**

3B.1 The Act provides designated FMIs and their participants with legal protections relating to settlement, netting, and the enforceability of the FMI's rules. A designated FMI will

only have such protections if it is specified, in the FMI's designation notice, that subpart 5 of Part 3 of the Act will apply to that FMI.

3B.2 If the designation notice specifies that subpart 5 will apply, then the legal protections apply, and the rules of a designated FMI relating to the following matters will be valid and enforceable despite any enactment, instrument, trust, or other rule of law to the contrary:

- (a) The basis on which settlement instructions are given or received;
- (b) The basis on which settlement obligations are determined and calculated (either on a gross basis or using netting);
- (c) The basis on which settlements are effected (either on a gross basis or using netting);
- (d) The novation of obligations of a participant; and
- (e) Any action to be taken if there is a participant default or an indirect participant default.

3B.3 Where subpart 5 applies, a further benefit of designation is that it also provides legislative enforceability to the finality of settlements effected, netting done, and personal property transferred in accordance with the rules of the FMI.

3B.4 A designation notice may also specify that section 103A of the Personal Property Securities Act 1999 (PPSA) applies to the operator of a designated FMI, meaning it has a priority claim over any personal property held by the operator in order to complete settlement or mitigate possible loss relating to the default of a participant. This is explained further in part 5G below.

## **4. Designation of an FMI**

4.1. As noted above, under the Act, FMIs can be designated in two different ways. We have covered each route to designation in further detail below.

#### **4A. Designation on the regulator's own initiative where the FMI is assessed to be systemically important**

4A.1 The regulator may determine that an FMI is systemically important and recommend that it be designated. An FMI is systemically important if one or both of the following apply to the FMI:

- (a) Disruption to activities of the FMI could cause problems for one or more relevant persons (i.e. a participant or an indirect participant of the FMI) that would threaten the stability of, or confidence in, the whole or a significant part of the financial system.
- (b) Problems with one or more relevant persons could, because of the transactions or other interconnections under the FMI between relevant persons, cause problems for one or more other relevant persons that would threaten the stability of, or confidence in, the whole or a significant part of the financial system.

4A.2 In deciding whether an FMI is systemically important, the regulator must take into account the matters set out in section 24 of the Act. The regulator will consider both quantitative and qualitative factors in the assessment of systemic importance – see [A Framework for Identifying Systemically Important FMIs](#).

4A.3 Where the regulator has a reason to consider that an FMI may be systemically important, the following steps will be taken:

- (a) The regulator will use relevant information collected from the sector, as well as knowledge of FMIs accumulated by the regulator, to identify whether an FMI may be systemically important. Note, if it is determined that the FMI is a pure payment system the remaining steps will be carried out by the Reserve Bank alone.
- (b) The regulator will seek information from the FMI relating to the factors it must consider when determining if an FMI is systemically important. Due to the diverse range of FMIs and varying operating models, the information request will be tailored to suit the specifics of the FMI being assessed.

- (c) The regulator will assess the systemic importance of the FMI in accordance with the Act and the Framework for Identifying Systemically Important FMIs. Further enquiry and engagement may occur at this stage.

4A.4 If the regulator considers that the FMI is systemically important and therefore should be designated under the Act, it will follow the steps in section 26 of the Act, including consulting with the FMI on the determination. Following this, the regulator will proceed to consider the matters outlined in part 5 below, in order to assess the parameters of the FMI's designation.

#### **4B. Designation of an FMI following an application from the operator(s)**

4B.1 An operator of an FMI, or a person who will be an operator of a proposed FMI, can apply for designation on its own accord to access the legal protections around netting and settlement finality. Such applications should be provided to the regulator by email to the following addresses (if the applicant is the operator of a pure payment system, application is to be provided to RBNZ only)

- [FMloversight@rbnz.govt.nz](mailto:FMloversight@rbnz.govt.nz); and
- [FMInotifications@fma.govt.nz](mailto:FMInotifications@fma.govt.nz)

4B.2 An application should include the following information:

- The name of the FMI applying for designation and its legal structure;
- The name(s) of the operator(s) of the FMI;
- The name of any operator of the FMI that is a participant in the FMI;
- The name and contact details of the person to whom questions about the application should be directed;
- A detailed description of the FMI, including details of the types, volume and values of the transactions processed by the FMI, the markets the FMI serves, whether the FMI serves to mitigate risk for participants, and interconnectedness of the FMI with other FMIs;

- A list of the current direct members or participants of the FMI, noting the jurisdiction in which each is established, domiciled, or has its principal office and whether it is supervised for anti-money laundering and countering the financing of terrorism purposes;
- The number and types of indirect participants of the FMI;
- The FMI's rules;
- Details of the concentration of financial risk of the FMI, including market share and the magnitude of any credit or liquidity exposures of the FMI;
- The substitutability of the FMI;
- Whether any operator of the FMI is proposed to be specified as an operator to whom section 103A of the Personal Property Securities Act 1999 (PPSA) applies, and if so, the reasons for such specification;
- Whether the applicant considers the FMI to be a pure payment system; and
- A self-assessment of the FMI against the Principles for Financial Market Infrastructures (PFMI) or a disclosure document in the form required by FMI Standard 23A.

4B.3 Overseas FMIs should also refer to the Guidance Note for Overseas FMIs and provide information that will allow the regulator to assess whether the FMI meets the conditions of an overseas-equivalent FMI, as covered in section 2 and 3 of that guidance. As explained in that guidance, the regulator will, when assessing equivalence, have regard to cooperative regulatory arrangements, any relevant laws and practices in the overseas FMI's home jurisdiction, the overseas FMI's compliance with regulatory requirements in its home jurisdiction, and the rules and practices of the overseas FMI.

4B.4 An operator of an FMI who applies for designation must pay an application fee to the regulator of \$39,130 plus GST.

4B.5 Following receipt of the required information and the payment of the fee, the regulator will undertake an assessment and decide whether to recommend designation. In doing so, the regulator will:



- Assess whether the FMI is a pure payment system. If so, the remaining steps will be carried out by the Reserve Bank alone.
- Consider the matters outlined in section 23 of the Act as discussed below in part 5 of this document.
- Consider whether it is appropriate for subpart 5 of Part 3 to apply to the FMI as outlined in section 22(1)(a).
- Assess whether the FMI applying to be designated is systemically important, using the framework mentioned in part 4A above.

While assessing the application, the regulator may seek additional information from the FMI that will facilitate the assessment, including any third-party verification if required.

## **5. Matters to which the regulator may have regard when recommending designation**

- 5.1. Section 22 of the Act outlines the conditions that must be satisfied for the regulator to make a recommendation to issue a designation notice.
- 5.2. Section 23 of the Act sets out matters to which the regulator may have regard when deciding whether to recommend that an FMI should be designated and deciding the terms of the recommendation. This section sets out the approach that the regulator will take when considering each of these matters. The regulator may request information, and the operator's own analysis where relevant, to assist the regulator to consider these matters.
- 5.3. In all matters covered below, the regulator expects the board of the operator of a designated FMI (or the individual or body with ultimate responsibility for governance of the designated FMI) to have overall responsibility for compliance with the FMI Act and the Standards, and sufficient oversight to ensure the FMI's strategy and purpose, the FMI rules, and underlying policies, procedures and controls, are adequate and appropriate to achieve this compliance.

## **5A. The purpose and scope of the FMI**

5A.1 The Act defines an FMI as a system for the clearing, settling, or recording of payments, transactions involving personal property or other transactions within the financial system. To be designated, an FMI's operations should be consistent with this definition.

5A.2 The scope of the FMI will include the markets it serves or proposes to serve and the basis for membership or participation in the FMI.

## **5B. The FMI's rules**

5B.1 The Act and Standards contain a number of requirements relevant to the rules of designated FMIs. Once designated, an FMI operator(s) will need to ensure compliance with these requirements. The regulator will therefore consider the FMI's rules before recommending that an FMI be designated. The rules may need to be amended to address certain matters before the regulator recommends that an FMI applying for designation is designated or, for a systemically important FMI, after the FMI has been designated.

5B.2 FMIs should have rules setting out (among other things) the following:

- how the FMI is to be constituted (for example, as a set of arrangements between its participants or as a legal person with whom its participants are to interact);
- how activities under the FMI are to be carried out; and
- the rights and obligations under the FMI of its operators and participants.

5B.3 As required by the Standards, the rules of the FMI should:

- be identifiable, clear, comprehensive, up to date, understandable and consistent with relevant laws and regulations;

- clearly, effectively, and unambiguously provide for the matters to which designation gives statutory backing;
- be readily available to all stakeholders and provide sufficient information to enable participants to clearly identify and have an accurate understanding of:
  - their rights and obligations in relation to transactions cleared or settled by the FMI; and
  - risks and costs associated with using the FMI;
- clearly allocate risks to those best placed to manage those risks and otherwise clearly provide for the management of risk;
- contain mechanisms to deal with the insolvency of a participant in a way that will limit the operational and financial impact on the system and its participants;
- contain notification requirements that apply to a participant when it, or a participant whose obligations it settles through the FMI, becomes unable to meet its obligations;
- as applicable, otherwise address matters covered by any relevant international standards;
- be legal, valid, binding, and legally enforceable in the jurisdictions in which the FMI operates; and
- include effective mechanisms for monitoring and enforcing compliance with the rules by the operator of the FMI.

## **5C. Laws or regulatory requirements**

5C.1 FMI Standard 1 requires that the FMI should have a well-founded legal basis under all relevant jurisdictions in which it operates. A designated FMI must comply with all relevant laws and regulations including the Standards that apply to it. The Standards apply depending on the class(es) within which the FMI falls. Part 6 below further explains how the regulator will determine which of the Standards will apply, including in the case of overseas FMIs.

## **5D. The capability and capacity of the FMI and its operator(s)**

- 5D.1 The FMI and its operator(s) must have the capability and capacity to operate the FMI in accordance with the rules and procedures of its system and in a manner that is consistent with the purposes for which the regulator must exercise its powers under the Act. The operator(s) must also be able to operate the FMI so as to comply with the requirements of the Act and the Standards.
- 5D.2 A key consideration for the regulator will be understanding how the operator of an FMI has designed processes and controls to enable compliance with the Act and the Standards, and how that operator monitors such compliance.
- 5D.3 Included within overall compliance with the Standards, the regulator will consider the operator's capacity and capability in relation to the monitoring and management of risk including the framework and methodology adopted for overall risk management and oversight purposes.
- 5D.4 The regulator will consider the operator's existing risk management framework against prevailing best practice, in particular FMI Standard 3, which states that FMIs should have a sound risk management framework for comprehensively managing legal, credit, liquidity, operational risks, and other relevant and material risks.
- 5D.5 Other factors the regulator may consider when assessing the capability and capacity of an FMI include its arrangements with critical service providers, contingency plans, processes for dealing with conflicts of interest, and past performance of the FMI (for example, outages or material incidents).
- 5D.6 Where appropriate, the regulator will also be interested in the honesty, integrity, reputation and individual skills and experience of the directors of the operator, and any senior managers with responsibility for the operation of the system.

## 5E. The financial resources of the operator(s) of the FMI

5E.1 The FMI must have sufficient financial resources to operate in a sound and efficient manner in the context of the markets it serves.

5E.2 This consideration is particularly relevant for systemically important FMIs. The regulator will have a conservative approach to determining such an FMI's capacity to withstand extreme but plausible market conditions.

5E.3 The regulator expects a designated FMI to have a financial resources policy consistent with the Standards applicable to that FMI, particularly FMI Standard 4 (Credit Risk), FMI Standard 5 (Collateral), FMI Standard 6 (Margin), FMI Standard 7 (Liquidity Risk) and FMI Standard 17A (Contingency Plans). The policy should cover **at least** the following matters, taking into account the systemic importance of the FMI:

- The performance of regular stress tests using relevant historical data and meaningful scenarios.
- The determination of sufficient financial resources (including a minimum level of capital) by reference to the results of stress testing and allowing for further unknown contingencies.
- How further capital will be raised or what other arrangements will be put in place or extended if at any time stress testing indicates the FMI's resources are inadequate.
- A policy in relation to the mix of financial resources and other arrangements that the central counterparty has recourse to in order to meet its settlement obligations.
- An investment policy designed to safeguard the FMI's own assets and those of its participants. and
- A policy in relation to eligible collateral.

5E.4 The FMI operator should also have sufficient financial independence to operate, maintain and develop the FMI to the expectations of its participants and other stakeholders.

## **5F. The importance of the FMI to the financial system**

5F.1 The regulator will need to be satisfied that the FMI is important in terms of the purposes for which the regulator must exercise its powers under the Act. In considering the level of compliance with matters that may be considered by the regulator in assessing a designation application, the regulator will consider the importance of the FMI to the financial system.

## **5G. Application of section 103A of the Personal Property Securities Act 1999 (PPSA)**

5G.1 Section 103A of the PPSA gives the operator of a designated FMI a priority claim over any personal property (such as securities or cash) held by the operator to effect a settlement or mitigate a loss relating to the default of a participant. This is intended to provide a high degree of certainty that the designated FMI will have the ability to use the property it holds for these purposes. Such protection under section 103A of the PPSA will apply only if it is specified in the FMI's designation notice. As such, this consideration will not always be relevant.

5G.2 Where this consideration is relevant, the regulator will need to be satisfied that the impact of the priority on other creditors of participants in the FMI is proportionate to the risks being managed and warranted by the system-wide benefits in terms of the purposes for which the regulator must exercise its powers under the Act.

## **6. The regulator's approach to finalising a designation recommendation**

- 6.1. As part of finalising a designation recommendation, the regulator will satisfy itself as to:
- whether designation would be consistent with the purposes and principles of exercising powers under the Act as set out in section 3 and section 13;
  - which legal protections should apply, if any; and

- which class(es) the FMI falls into, including whether overseas equivalence applies. Overseas FMIs may be able to substitute compliance subject to meeting the conditions for overseas equivalence set out in the Guidance Note for Overseas FMIs;

6.2. In addition to the above, where the FMI is being recommended for designation by the regulator, the regulator will consult with the operator of the FMI (and, following the process in section 26 of the Act, its participants and indirect participants) on its designation proposal including, if the assessment is that the FMI is systemically important, the reasons for that assessment; and consider any submissions made by the operator and participants of the FMI and decide whether to proceed with the designation proposal.

6.3. If the regulator is satisfied that the FMI should be designated, the regulator will make a recommendation to the Minister, specifying whether the designated FMI is systemically important or not and which class(es) the FMI falls into. On Ministerial approval, a designation notice will be issued that will contain the information specified by [section 29 of the Act](#) including statements as to whether the FMI is systemically important, and which class(es) it falls into.

6.4. If the regulator is not satisfied that the FMI should be designated, the regulator will notify the operator or the applicant of the decision and the reasons for the decision.

## **7. What to expect after designation**

7.1. Once designated, an FMI will continue to be designated unless the designation is revoked. A designation may be revoked by way of application from an FMI under [section 25 of the Act](#), or by recommendation by the regulator to the Minister under [section 26 of the Act](#).

7.2. The operator of a designated FMI will be required to periodically report information to the regulator, and the regulator will engage with the operator of each designated FMI

regularly. The regulator employs a risk-based approach to supervision and monitoring of each FMI, therefore engagements will be different for each entity, to ensure the regulator can effectively monitor ongoing compliance with the requirements in the Act and the Standards that are applicable to each designated FMI.



## Annex A: The process of designation

