

**FOR  
INFORMATION**

SM/17/106

May 3, 2017

To: Members of the Executive Board

From: The Secretary

Subject: **New Zealand—Publication of Financial Sector Assessment Program Documentation—Technical Note on Fund Management—Regulation, Supervision, and Systemic Risk Monitoring**

Board Action: Executive Directors' **information**

Additional Information: Completed in connection with the Financial Sector Assessment Program

Publication: Yes, after Wednesday, May 10, 2017

Questions: Mr. Lopez Mejia, MCM (ext. 34334)





INTERNATIONAL MONETARY FUND

# NEW ZEALAND

FINANCIAL SECTOR ASSESSMENT PROGRAM

May 2017

## TECHNICAL NOTE

FUND MANAGEMENT: REGULATION, SUPERVISION, AND  
SYSTEMIC RISK MONITORING

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**Monetary and Capital Markets  
Department**

This Technical Note was prepared by Cristina Cuervo in the context of the Financial Sector Assessment Program in New Zealand. It contains technical analysis and detailed information underpinning the FSAP's findings and recommendations. Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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## Glossary

AUM	Assets under Management
CIS	Collective Investment Schemes
COFR	Council of Financial Regulators
FMA	Financial Markets Authority
FMC Act	Financial Markets Conduct Act 2013
FMC Regulations	Financial Markets Conduct Regulations 2014
FSPR	Financial Service Providers Register
IOSCO	International Organization of Securities Commissions
KIS	Key Information Summary
MBIE	Ministry of Business, Innovation and Employment
MIP	Managed Investment Product
MIS	Managed Investment Schemes
MMF	Money Market Funds
MoU	Memorandum of Understanding
NAV	Net Asset Value
NZX	New Zealand Stock Exchange
PDS	Product Disclosure Statement
RBNZ	Reserve Bank of New Zealand
REM	Risk Estimate Model
SIPO	Statement of Investment Policy and Objectives
SRC	Strategic Risk Committee
SRO	Strategic Risk Outlook

## EXECUTIVE SUMMARY

**The capital market regulatory framework in New Zealand has gone through a major overhaul since the last FSAP in 2004.** Many capital market players were not licensed or supervised at the time, including asset managers. A major regulatory reform established the FMA as the conduct regulator of the financial sector and determined a licensing regime for managers of Managed Investment Schemes (MIS) – known more commonly as collective investment schemes (CIS) elsewhere. Retail offers of MIS are also regulated now and subject to governance, disclosure and eligibility requirements.

**Supervision of the asset management industry has recently started and is still developing.** The FMA completed initial licensing of MIS managers under the new regulatory regime in December 2016 and is now in the process of refining the risk-based approach to supervise these entities. The licensing process has allowed staff to gain insight into the sector and is assisting in the identification of the major risks to be monitored through the subsequent ongoing supervision.

**Private entities called Financial Markets Supervisors are now licensed and expected to play a role in the monitoring of MIS managers.** Under the old regime, trustees were appointed to act on behalf of the unit holders of investment funds. Under the new regulatory framework, MIS offered to retail investors are required to appoint a Financial Markets Supervisor (Supervisor). These are private companies licensed by the FMA to carry out certain statutory supervisory activities, including primary oversight of significant features of the MIS framework such as monitoring the adequacy and use of asset valuation policies, custody, leverage and liquidity risk management.

**The overall regulatory framework for asset management is well developed, but would benefit from some enhancements to prevent the build-up of risks.** The provision of custody services does not require a license in New Zealand and, therefore custodians fall outside the direct supervision of the FMA. They are neither subject to prudential requirements nor to ongoing supervision by any other authority. Given that custodians perform key functions regarding safeguarding investors' assets, the government should require that these entities be licensed and subject to ongoing supervision by the FMA. Also, because the regulatory regime for asset management rests on the concept of the funds being offered publicly to retail investors, wholesale asset management activities are not covered by the regulatory and supervisory framework of the Financial Markets Conduct Act (FMC Act). While there is an indication that this sector is not significantly larger than the retail sector, the limited data available hampers a true assessment of any risks arising from that area.

**The FMA should define its supervisory approach to asset management activities giving significant consideration to the expectations set on Supervisors.** There are challenges and benefits from leveraging off the work of Supervisors and the FMA should keep the risks and appropriate responses under constant review. Consideration needs to be given to the importance of ensuring that the FMA continues to have direct oversight of areas relevant to the stability of the sector and where more technical expertise and a macro perspective is required. Also, monitoring of

Supervisors should ensure that they achieve excellent quality standards of work and are able to carry a consistent view of the expectations under the regulatory framework.

**The FMA is engaged in relevant work to identify and monitor potential systemic risk related to securities markets, including in asset management activities.** Through its Strategic Risk Committee, it aims to determine key strategic risks for the FMA to monitor and mitigate. This work is complemented by the work in several domestic and international cooperation forums, including the Council of Financial Regulators and the Trans-Tasman Emerging Risk Committee. The FMA is currently undertaking a study on New Zealand's wholesale markets to be able to define its role in regulation and supervision of these markets, particularly in the wholesale asset management area. This is a welcome development and work should continue on that front.

<b>Table 1. New Zealand: Main Recommendations on Regulation and Supervision of Managed Investment Schemes</b>	
<b>Recommendation</b>	<b>Priority<sup>1</sup></b>
Develop a framework for minimum requirements for valuation methodologies and pricing practices, including restricting the use of historic net asset value (NAV) and constant NAV.	Short-Term
Define Money Market Funds within regulation of MIS.	Short-Term
Ensure that MIS' use of leverage is monitored to be able to determine its actual size and growth.	Short-Term
Require that the provision of custody services be subject to licensing and supervision.	Short-Term
Continue the pre-lodgment review of MIS offer documents and introduce the review of SIPOs and governing documents of MIS at the time of registration.	Immediate
Ensure that the supervisory approach to MIS managers places an emphasis on direct monitoring by the FMA (as opposed to exclusively through Financial Markets Supervisors) of aspects most relevant to financial stability.	Immediate
Continue to engage with Supervisors to ensure that they take a consistent approach to their supervision of MIS managers and that this is aligned with FMA priorities.	Immediate
Ensure an appropriate supervision of delegated functions and consider whether more stringent requirements for eligibility of delegates (including for cross-border delegation) are needed going forward.	Immediate
Continue to refine the coverage and format of data reporting in the MIS sector to ensure appropriate monitoring of the risks and an efficient analysis of the information.	Immediate
Consider the need to expand the perimeter of regulation to ensure an appropriate oversight of the wholesale asset management sector.	Short-Term
<sup>1</sup> Immediate= Within one year; Short term = 1–3 years.	

## INTRODUCTION<sup>1</sup>

**1. This note reviews the functioning and effectiveness of the regulation, supervision and systemic risk monitoring of collective investment schemes (CIS), using as benchmarks the relevant International Organization of Securities Commissions (IOSCO) Principles and Standards.<sup>2</sup>** CIS are more commonly known in New Zealand as managed investment schemes (MIS) and will be referred to as such in this Technical Note. Emphasis is placed on requirements with most direct relevance for financial stability, namely valuation, segregation and safekeeping of fund assets, and redemption of fund units. The note also reviews how the FMA applies the regulatory framework and supervises compliance with it, and how the authorities analyze the systemic risk arising from fund management activities.

**2. The note also provides a summary of the major reforms to the regulatory and supervisory framework for securities markets since the last FSAP.** New Zealand has undergone a major regulatory reform in the securities markets since 2004, when the previous FSAP took place. While the mission focused on reviewing the regulatory and supervisory regime for CIS, it also obtained detailed information on the overhaul of securities markets regulation in New Zealand in recent years.

**3. This note is structured around two main sections: Background and Regulation and Supervision of Managed Investment Schemes.** The Background section summarizes the previous regime, main aspects of the regulatory reform and the current regulatory model. The section on MIS is structured as follows: subsection A describes the market structure, subsection B reviews the regulatory framework for MIS, subsection C outlines the licensing process for asset management related activities, subsection D describes the supervisory and enforcement approach and subsection E covers the FMA's monitoring of systemic risk.

**4. The FMA is the authority responsible for supervising financial market participants' operations.** Its primary objective is to promote and facilitate the development of fair, efficient and transparent financial markets. The FMA is an Independent Crown Entity, monitored by the Ministry of Business, Innovation and Employment (MBIE) on behalf of the Minister of Commerce.

<sup>1</sup> The on-site work supporting the findings and conclusions of this Technical Note was conducted during November 2016. The information in this note is current as of December 2016.

<sup>2</sup> The relevant IOSCO documents used are: Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation, August 2011, Principles of Suspensions of Redemptions in Collective Investment Schemes (CIS), January 2012, Policy Recommendations for Money Market Funds, October 2012, Principles of Liquidity Risk Management for CIS, March 2013, Principles for the Valuation of CIS Assets, May 2013 and Standards for the Custody of CIS Assets, November 2015.

## BACKGROUND: NEW ZEALAND'S REGULATORY REFORM OF THE SECURITIES MARKETS

### A. Previous Regime

**5. At the time of the previous FSAP the overall regulatory framework for New Zealand securities markets was light handed.** Most market participants were not subject to eligibility, governance and conduct requirements and regulation focused on ensuring that market participants complied with disclosure requirements. Where issues were identified outside of disclosure, investors were largely required to seek self-help remedies.

**6. The regulation for securities markets was dated and had not been reviewed to reflect changing international standards.** The main acts were the Securities Act 1978 and the Securities Markets Act 1988, which regulated primary and secondary markets, respectively. Aspects of securities law regulation were also contained in other legislation like the Financial Reporting Act, the Companies Act, the Reserve Bank of New Zealand Act, the Unit Trust Act and the Superannuation Schemes Act.

**7. While the New Zealand market relied heavily on self-regulatory organizations and independent trustees, the regime did not provide any substantive regulation for these.** The New Zealand Stock Exchange (NZX) was the frontline regulator for listed issuers and independent trustees were contracted to supervise the trust deeds for debt securities and CIS. The regulation did not provide an adequate regime for the operation of these businesses or for their supervision.

**8. Regulatory responsibility was divided up amongst several regulators.** The Securities Commission was the general regulator for offers of securities to retail investors. However, a number of aspects of securities regulation, such as review of offer documents or taking of enforcement action, rested with other regulators. The Registrar of Companies had responsibility for reviewing prospectuses and considering whether to take enforcement action. The National Enforcement Unit had enforcement powers to prosecute contraventions of securities laws. The Government Actuary and the Insurance and Superannuation Unit were responsible for the registration and monitoring of superannuation schemes. The Commerce Commission had a general mandate to pursue remedies in respect of false or misleading statements in the course of trade. And the Takeovers Panel was responsible for regulation of takeover activity and processes.

**9. The 2004 FSAP identified several material deficiencies, which related primarily to the capacity of the regulator, CIS and market intermediaries.**<sup>3</sup> The FSAP made a number of recommendations including to provide: (i) a common regulatory framework, minimum standards and ongoing regulatory oversight of brokers and operators of CIS and (ii) minimum standards and increased oversight of market intermediaries which were not exchange members and to strengthen

<sup>3</sup> Known as CIS at the time of the last FSAP, they were later renamed Managed Investment Schemes under the new regime, as explained in more detail below.

the oversight of frontline regulators. While at the time of the FSAP several reforms were already underway, the New Zealand government embarked on a comprehensive review of the securities laws after the release of the FSAP documents.

## B. Regulatory Reform

**10. A series of regulatory reforms which were already underway at the time of the FSAP were approved in 2006.** These provided greater enforcement powers for the then existing Securities Commission, including the power to freeze assets and to seek civil remedies for certain breaches of disclosure provisions. Also, the reform approved new insider trading and market manipulation laws and introduced a new investment adviser and broker disclosure regime.

**11. The KiwiSaver Act was also enacted in 2006 and introduced a new voluntary national work-based retirement savings initiative meant to create incentives for New Zealanders to save for their retirement.** Prior to KiwiSaver there were no specific incentives to save for retirement and there was a tax disincentive to investing in CIS compared to direct real estate investment. KiwiSaver schemes are managed by private sector companies called KiwiSaver providers and subject to special rules to encourage participation and give effect to the retirement savings purpose of the policy. Members can choose which KiwiSaver scheme to invest their money with and which underlying investment fund they want their contributions invested in.<sup>4</sup> If the member does not choose a provider, they will be allocated to one of nine government appointed Default Providers and their funds will be invested in a default (conservative) investment fund. Subject to permitted withdrawals, scheme participants are prohibited to withdraw their savings until retirement age.<sup>5</sup> The initiative seems to have had an effect in encouraging people to make changes to their approach to investing and KiwiSaver schemes now make up a significant portion of the New Zealand fund market with over \$37 billion in assets.<sup>6</sup>

**12. Several government initiatives to review the capital market regulatory framework resulted in a significant number of reforms.** A Review of Financial Products and Providers in 2006 and a Capital Market Development Taskforce in 2008 were drivers of a key legislative reform that resulted in substantial changes to New Zealand's securities regulatory landscape. The main reforms were implemented by the following pieces of legislation:

- The Financial Services Providers Act 2008 established a new regulatory regime for financial services providers.
- The Securities (Disclosure) Amendment Act 2009 created simplified procedures for certain forms of capital raising, while aiming to ensure timely disclosure of relevant information to prospective investors.

<sup>4</sup> In many instances, KiwiSaver schemes take the form of umbrella schemes, with several different investment fund options within one scheme.

<sup>5</sup> Early withdrawals are permitted in limited circumstances, such as experiencing significant financial hardship, having moved overseas permanently or to assist with the purchase of a first home.

<sup>6</sup> All references to dollar amounts (\$) in this note will be to New Zealand dollars.

- The Securities Trustees and Statutory Supervisors Act 2011 (later renamed Financial Markets Supervisors Act 2011) set out a licensing regime for what were previously independent trustees and were renamed Supervisors under the new regime.
- The Financial Markets Authority Act 2011 (FMA Act) established the FMA as the consolidated market conduct regulator for the financial sector.
- The Securities Act 1978, the Securities Markets Act 1988 and other financial markets legislation were reviewed resulting in the passing of the Financial Markets Conduct Act 2013 (FMC Act) and Financial Markets Conduct Regulations 2014 (FMC Regulations).

**13. The FMA finished transitioning to the full implementation of these reforms in December 2016.** The FMC Act now provides a regulatory framework for the conduct of market participants. It governs the way financial products are offered, promoted, issued and sold and it also regulates the provision of certain financial services and introduces a licensing requirement for providers of certain products (including Managed Investment Schemes or MIS). While parts of the FMC Act have been in force since April 2014, most regulated businesses and individuals had until 1 December 2016 to transition into the new regime.

### C. Current Regulatory Model

**14. As a consequence of the FMA Act reforms, New Zealand now operates a “twin peaks” model of regulation.** The FMA is a conduct regulator for the financial sector, consolidating functions previously undertaken by the Securities Commission, the Government Actuary, the National Enforcement Unit and the Registrar of Companies. The FMA’s role includes licensing and supervision of entities, which encompasses requirements relating to their governance, capability, controls, systems and processes and financial resources. The Reserve Bank of New Zealand (RBNZ) has responsibility for the prudential supervision of banks, insurers and regulation of nonbank deposit takers.

**15. The FMA’s main objective is to promote and facilitate the development of fair, efficient and transparent financial markets.** It was established in 2011 as an independent Crown entity that is not required to have regard to government policy. It is governed by a Board, whose members are appointed by the Governor-General on the recommendation of the FMA’s responsible Minister. It is funded by a mix of industry levies and government contribution.<sup>7</sup>

**16. FMA strategic priorities set in its Strategic Risk Outlook aim to assist in prioritizing its resources on conduct that poses the most significant risk to its objective of fair, efficient and transparent financial markets.** The FMA has identified seven strategic priorities and specific areas

<sup>7</sup> The FMA’s responsible Minister announced on November 3, 2016 the government’s approval to a funding increase for the FMA of approximately 20 percent of its budget, to come from changes in levies of financial services providers. The funding increase was considered necessary to account for the growth in the FMA’s responsibilities created by the implementation of the FMC Act and the progressive implementation of the Financial Advisers Act and the AML/CFT Act.

of focus within those, where the FMA can presumably most effectively minimize conduct risks, improve behavior within the market, benefit participants and investors and help strengthen New Zealand's economy. These strategic priorities are: (i) governance and culture; (ii) conflicted conduct; (iii) capital market growth and integrity; (iv) sales and advice; (v) investor decision making; (vi) effective frontline regulators; and (vii) FMA effectiveness and efficiency. FMA's management is responsible for ensuring that these priorities permeate throughout the organization and assist to make decisions and prioritize action within disclosure, licensing, supervision and enforcement.

**17. The FMA has a comprehensive and flexible set of tools to influence financial conduct.**

The FMC Act and the FMA Act gave the FMA significant regulatory, supervisory and enforcement powers, including information gathering and search and seizure powers, the ability to make stop orders and direction orders, seek relief and injunctions from the courts and bring civil and criminal actions. The FMA also has the power under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 to deregister financial service providers. In addition, the FMA has the ability to calibrate the scope of the FMC Act through the granting of exemptions from the ordinary operation of the FMC Act and designations of products into the appropriate category, therefore triggering the application of the FMC Act to them. It can also prescribe more detailed requirements through the specification of frameworks or methodologies.

**18. The FMC Act regime is designed around the concept of Regulated Offers.** The starting point of the FMC Act is that an offer of financial products requires prescribed disclosure to be made to all investors that have received an offer, except to those offers detailed in Schedule 1 of the FMC Act (Schedule 1 Exclusions).<sup>8</sup> Where at least one investor able to accept the offer is not covered by Schedule 1 Exclusions, then the offer is considered a Regulated Offer. This determination triggers the primary disclosure, governance and financial reporting requirements of the FMC Act (the Regulated Offer Regime):

- **Disclosure.** The FMC Act requires all investors not covered by a Schedule 1 Exclusion to be provided with a Product Disclosure Statement (PDS). This is an offer document that contains the relevant information for a "prudent but not expert" investor to make an informed decision. Each PDS must include a Key Information Summary (KIS) containing the issuer's assessment of the most significant aspects of the offer relevant to investors. In addition, the issuer must prepare a Register Entry, containing all material information in relation to the Regulated Offer that is not contained in the PDS. It must be lodged on the Disclose Register.
- **Governance.** Offers of debt must have a trust deed and a Supervisor before they can be made. For offers of MIS, a governing document, a manager, a statement of investment policy and objectives (SIPO) and a Supervisor are required.

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<sup>8</sup> The exclusion regime in Schedule 1 covers buy-side exclusions like offers made to wholesale investors and sell-side exclusions that relate to the characteristics of the issuer (e.g., offers by the Crown or offers of debt and related products by registered banks). It also covers exclusions based on the relationship between the issuer or the investor (e.g., close business associates and relatives).

- **Eligibility.** The FMC Act requires that the following activities associated with Regulated Offers are licensed: managers of certain MIS, Supervisors and derivatives issuers.

**19. Financial Markets Supervisors are a particular feature of the New Zealand regulatory framework.** Regulated under the Financial Markets Supervisors Act 2011, the main function of a Supervisor is to protect the interests of the investors and act on their behalf in respect of the relevant MIS manager or debt issuer. They also supervise performance by the issuer or manager in relation to their legal obligations and their financial position and monitor that investments are made in accordance with the PDS, SIPO, and governing document. They have a range of powers and duties to enable them to carry out these functions, like the power to require managers or issuers to provide any information, engage experts, approve the auditors of the scheme or of the issuer, or in certain cases, even appoint a receiver to the scheme and request its winding up. They receive regular reporting from MIS managers and debt issuers to assist them in their functions.

**20. There are four types of financial products defined under the FMC Act:** equity securities, debt securities, Managed Investment Products (MIPs, which are MIS units), and derivatives. Each type of financial product has its own Regulated Offers Regime, with specific disclosure, governance and eligibility requirements tailored to the relevant product.

**21. In addition to the Regulated Offers Regime, the FMC Act sets out a wider framework for conduct regulation.** This framework provides a set of minimum compliance standards through the Fair Dealing Obligations and a regime for regulating market abuse and breaches of continuous disclosure obligations.<sup>9</sup> It also establishes a licensing regime for entities other than those involved in Regulated Offers like market operators, operators of peer-to-peer lending and crowd funding platforms and providers of discretionary investment management services. The FMC Act also prescribes a variety of requirements relating to financial reporting, auditors and marketing and distribution of financial products. The provision of financial advice is regulated by the Financial Advisers Act, which is also overseen by the FMA.

**22. The Disclose Register and the Financial Service Providers Register (FSPR) were established.** The Disclose Register is an online register for offers of financial products and MIS under the FMC Act. At the end of the transition period it will replace some Companies Office and FMA registers. The FSPR is a searchable online register of the people, businesses and organizations that offer financial services in New Zealand. Registration as a financial service provider is not an official approval of an individual, business or organization and does not necessarily indicate that the provider is licensed or regulated in New Zealand or any other country.<sup>10</sup> Both Registers are under the control of the Companies Office (part of MBIE). The FMA receives immediate notification of

<sup>9</sup> The FMC Act provides for fair dealing in relation to financial products and services by prohibiting misleading or deceptive conduct, false or misleading representations, unsubstantiated representations and offers of financial products in the course of unsolicited meetings. The fair dealing provisions of the FMC Act apply to all recipients of financial products or services regardless of whether they are a retail or a wholesale client (Fair Dealing Obligations).

<sup>10</sup> A reform of the FSPR is currently under discussion to re-design its features in a manner that the registration of an entity does not create a misleading appearance as to the entity providing financial services in New Zealand or being regulated by New Zealand law.

updates or changes to the Registers related to any firm or product under its supervision, as well as of any new entries. The FMA and the Companies Office meet regularly to discuss coordination issues.

## REGULATION AND SUPERVISION OF MANAGED INVESTMENT SCHEMES

### A. Market Structure

**23. The investment fund industry in New Zealand has grown significantly since the introduction of KiwiSaver.** KiwiSaver schemes are MIS, regulated by the FMA as such, and managed by private sector companies called KiwiSaver providers (licensed as MIS managers under the FMC Act). As at 30 September 2016, there were 2.67 million New Zealanders who were members of KiwiSaver with funds invested in 30 KiwiSaver schemes of about \$37.7 billion. As a result, these funds have become New Zealand's most important MIS product. In addition, licensed MIS managers manage approximately \$32.6 billion invested in retail unit trusts, about \$22.5 billion invested in other registered superannuation schemes and about \$9.2 billion in cash management trusts, which are money market products.<sup>11</sup>

**24. All Registered MIS are managed by New Zealand based MIS managers licensed by the FMA.** At December 1, 2016, there were 377 Registered MIS and 66 licensed MIS managers. The total AUM of MIS managers were approximately \$129 billion (as at September 30, 2016).<sup>12</sup> About 50 percent of assets invested in MIS are managed by the top three New Zealand MIS managers. The top ten MIS managers are managing about eighty percent of assets invested in New Zealand MIS. There is currently no complete data on the amount of AUM outsourced to foreign investment managers.

**25. Foreign MIS can be offered in New Zealand under specific mutual recognition regimes.** Currently, there is one mutual recognition regime with Australia, which allows offers of MIS by Australian managers to New Zealand investors provided they remain subject to and compliant with Australian law.<sup>13</sup> There are currently 480 Australian MIS offers open through this mutual recognition

<sup>11</sup> As explained in further detail below, offers of funds to wholesale investors are not covered by the FMC Act regime and therefore, wholesale funds and wholesale fund managers are not supervised by the FMA, which means no official data is available on the size of this sector.

<sup>12</sup> While data for the number of licensed managers and registered MIS is as of December 1, 2016 (post transition into the new regime), the data on AUM are as at September 30, since MIS managers are only required to report AUM data quarterly.

<sup>13</sup> For MIS this includes being registered as an Australian scheme and preparing an Australian offer document. In addition to compliance with Australian law, the regime requires that suitable warning statements are provided to investors to put them on notice to the effect that the offer is an Australian offer and may be subject to additional risks. In addition to the FMA's bilateral MoU with ASIC for investigation and enforcement issues, the Companies Office and the FMA have established protocols for cooperation between the authorities administering the mutual recognition regime.

regime. Additionally, New Zealand, Australia, Japan, Korea and Thailand are in the process of developing a partial mutual recognition regime for MIS called the “Asia Region Funds Passport.”

**26. Some MIS take the form of umbrella schemes, with a number of funds offered within the scheme.** Each of those funds meets the definition of MIS but is not registered independently. The MIS manager is responsible for complying with the requirements of the FMC Act regime for all the underlying funds. Some of those funds can be, in turn, invested in funds managed by a third party investment manager. This investment manager does not necessarily need to be licensed in New Zealand.

## B. Regulation

**27. The definition of Managed Investment Scheme (MIS) focuses on the economic substance of the product, not its legal form.** A scheme is considered to be a MIS where three requirements are met: (i) the purpose of the scheme is to enable its participants to contribute money to it, as consideration to acquire interests in the scheme; (ii) those interests are rights to participate in, or receive, financial benefits produced principally by the efforts of another person under the scheme; and (iii) the holders of those interests do not have day-to-day control over the operation of the scheme. The regime permits a wide variety of legal structures, including trusts, limited or special partnerships and syndicates or schemes based on contractual participation. Existing MIS in New Zealand most commonly take the form of unit trusts.

**28. The typology of MIS in New Zealand is dependent on whether funds are publicly offered or registered.** As described in the Background section, the FMC Act is oriented around the concept of Regulated Offers and this also impacts the MIS regime. Where there is a Regulated Offer of the interests in a MIS (Managed Investment Products, or MIPs), or where the MIS is voluntarily registered, it is considered a Registered MIS and it is subject to the standard Regulated Offer Regime for MIS, which is explained in more detail below. The FMC Act also provides an alternative governance framework that diverges from the standard regime for certain legacy schemes with restricted membership (Restricted MIS). MIS where the units are not offered publicly under the FMC Act Regulated Offers regime are considered Wholesale MIS and are exempt from the FMC Act MIS framework, however subject to fair dealing requirements for the entities that market/distribute them.<sup>14</sup>

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<sup>14</sup> Wholesale MIS may also choose to voluntarily register.

### Box 1. Main Investment Fund Types

**The broad set of regulatory requirements for MIS in New Zealand applies where there has been a Regulated Offer or the MIS manager has voluntarily elected to register the MIS (Registered MIS).**

Wholesale MIS do not need to be registered and are not subject to the Regulated Offers regime. Restricted MIS are a category of legacy schemes from the former regime, to which a variation of the standard requirements applies. No Restricted MIS can be created after December 1, 2016. Most KiwiSaver schemes fall within the regime of Registered MIS, while a small number of them are Restricted MIS.<sup>1</sup> In terms of legal form, most MIS in New Zealand are set up as trusts.

**For the purposes of disclosure, a distinction is made in the FMC Act regime between Managed Funds and Other MIS.** Managed Funds are Registered MIS where the MIPs are: (i) offered on the basis that they will be continuously offered and redeemed on a basis calculated mainly on the value of the scheme property (open-ended); (ii) offered on the basis that the scheme will invest at least 80 per cent of its assets in certain eligible securities that are deemed liquid; or (iii) a KiwiSaver scheme, superannuation scheme or workplace savings scheme. All Registered MIS that are not Managed Funds are labeled Other MIS, and these are typically schemes that invest in more illiquid assets like forestry or real estate.

Type of MIS	Frontline Supervisor	Manager	Custody of Scheme's assets	Disclosure	Nature of investment <sup>2</sup>
Registered <sup>1</sup>	Licensed Supervisor.	Licensed MIS manager.	Licensed Supervisor.	PDS.	<b>Managed Funds</b> (open-ended/liquid).
			OR External custodian (non-licensed), under Supervisor's responsibility.	Governing Document.  SIPO.  Register Entry.	
Wholesale	NO.	No license requirement.	No requirements.	No requirements.	
Restricted	NO.	Trustees, where at least one is a Licensed Independent Trustee (LIT).	Corporate body (non-licensed).  OR External trustee (non-licensed).	Governing Document.  SIPO.  (PDS and Register Entry for offers open to new members).	

<sup>1</sup> The majority of KiwiSaver schemes are Registered MIS. Also, all KiwiSaver schemes established after December 1, 2014 are Registered MIS.

<sup>2</sup> For disclosure purposes, Registered MIS are either considered Managed Funds if they are open-ended or invest in liquid assets, or Other MIS. This distinction is not used for non-Registered MIS.

**Table 2. New Zealand: Assets under Management in KiwiSaver Schemes**  
September 30, 2016<sup>1</sup>

Asset Class	Assets under management (\$M)	Percent of assets
Australasian equities	\$4,904.20	13.24
Cash	\$7,352.31	19.86
International equities	\$9,703.62	26.20
International fixed income	\$7,207.64	19.46
Listed property	\$1,688.38	4.56
NZ Fixed interest	\$5,489.89	14.83
Other	\$494.47	1.34
Unknown	\$0	0
Unlisted property	\$189.16	0.51
Total	\$37,029.67	100

Source: FMA.

<sup>1</sup> Data for AUM of the 25 KiwiSaver schemes that are Registered MIS. It excludes the 5 Restricted KiwiSaver schemes (with AUM of \$675 million) which are not required to submit quarterly portfolio holding reports.

**Table 3. Assets under Management by New Zealand MIS Managers**

Type of fund	MIS domiciled in NZ	
	Number of MIS (December 2016)	AUM (\$M) (September 30 2016)
Registered MIS	377	88,115
Wholesale MIS <sup>1</sup>	No complete data	27,222
Restricted MIS	109	13,868
<b>Total</b>	<b>486</b>	<b>129,205</b>

Source: FMA.

<sup>1</sup> Wholesale MIS are not required to register and the FMA does not currently have data on the number of wholesale MIS in New Zealand. The wholesale AUM figure is taken from the RBNZ Managed Fund Survey and may include some funds managed on behalf of Registered MIS.

## 29. Registered MIS must comply with a core set of requirements relating to eligibility and operational conduct, governance, custody and disclosure:

### • Eligibility and operational conduct:

- MIS managers of Registered MIS must be licensed by the FMA under the FMC Act, therefore satisfying minimum eligibility conditions to operate a Registered MIS. MIS managers must comply with the Overarching Duties of Managers of honesty and fair treatment of participants and meet a professional standard of care.<sup>15</sup> They must also comply with their Licensee Obligations as set out by the FMC Act, the terms of the license, the governing document and, where applicable, the KiwiSaver Act.
- A Registered MIS must engage a Supervisor.

<sup>15</sup> Further to the FMC Act, the MIS Manager is required to: act honestly in its role as MIS Manager, act in the best interest of the scheme participants and treat such participants equitably when exercising any of its powers or duties as MIS Managers, and not make use of information acquired through its role as MIS Manager to gain an improper advantage for itself or any other person, or cause detriment to scheme participants (Overarching Duties of Managers).

- **Governance:** The MIS must set out investor rights and establish an accountability framework through two key documents:
  - The governing document must set out the rules of the MIS, in compliance with the FMC Act and cover at least: transferability of the MIPs, subscription and redemption of MIPs, methodology for calculation of NAV and unit price, fees, appointment and removal of Supervisor and the MIS manager and winding up of the scheme.
  - The Statement of Investment Policies and Objectives (SIPO) is the foundation for the investment governance framework and provides accountability, ensuring the manager is managing investments within established parameters. It also intends to provide disclosure and transparency to scheme participants, as it is required to be made publicly available. The FMA expects SIPOs to describe the investment strategy and objectives in terms of performance and risk as well as the parameters against which the performance of the MIS will be monitored and all policies that are directly relevant to achieving the investment objectives and strategies (e.g., hedging, tactical asset allocations, liquidity and cash flow management, leverage and diversification requirements).

The Supervisor monitors compliance against the SIPO and the governing document. The Supervisor must be given prior notice of any changes to the SIPO. Changes to the governing document must be approved by scheme participants or in some instances by the Supervisor if the Supervisor is satisfied that the amendment does not have a material adverse effect on the participants and appropriate disclosure is made.

- **Custody:** Scheme property must be held independently of the MIS, either by the Supervisor or by an external custodian.
- **Disclosure:** Before making a Regulated Offer of a Registered MIS the manager must prepare a PDS, intended to provide investors with the information they need to make an informed decision about whether to invest in a MIS. The content of the PDS is heavily prescribed and differs depending on whether the MIS qualifies as a Managed Fund (those MIS that are either open-ended or liquid) or as Other MIS.

**30. MIS managers are permitted to delegate some or all of their functions while retaining liability for the performance of those functions.** In outsourcing management functions, the MIS manager must take all reasonable steps to ensure that those functions are performed in the same manner and subject to the same duties and restrictions, as if the MIS manager were performing them directly. The manager is also expected to monitor the performance of those functions. Delegated functions will be disclosed as part of the PDS information. Where there are changes in the delegation of functions, the MIS manager will need to make prescribed disclosures in the Quarterly Fund Update and/or annual report as well as consider the ongoing compliance of their PDS with the requirements of the FMC Act.

**31. Regulatory requirements on the eligibility of delegated entities are fairly light while the focus of the regime is on managers' oversight of the performance of delegated functions.**

The fact that the manager has to be able to ensure the discharge of the delegated function is performed in accordance with the FMC Act regime should ensure certain implicit eligibility standards for the delegated entity. Also, the fact that MIS managers remain responsible for meeting the eligibility criteria and minimum standards for any outsourced function should prevent managers from being mere letterbox entities. As explained in Section D below, any risks deriving from this light approach to regulation should be contained through ensuring appropriate supervision of delegated functions. Going forward, the FMA should also consider whether more stringent requirements for eligibility of delegates (including any requirements for cross-border delegation) are needed.

**32. Certain variations to the standard framework described above apply to Restricted MIS and to KiwiSaver schemes.**

- Restricted MIS are a legacy scheme from the period before the introduction of the FMC Act.** They were superannuation schemes and workplace savings schemes that are allowed to continue operating under a variation of the standard requirements for Registered MIS. They have to comply with standard FMC Act requirements for a governing document and SIPO, but Restricted MIS are not required to have a MIS manager or a Supervisor.<sup>16</sup> Instead, a Restricted MIS (which must be constituted as a trust) is managed by the trustees, of which at least one must be either (i) a Licensed Independent Trustee (LIT)<sup>17</sup> or (ii) a sole corporate trustee, with at least one director who is a LIT. Scheme property must be held independently of the MIS by a corporate body that is either the corporate trustee or has as its directors only persons who are trustees, or an external custodian authorized by the governing document. Due to their legacy status, Restricted MIS are subject to more flexible operational conduct requirements and the license conditions for LITs are less prescriptive. This seems a reasonable approach, given the relatively small size of Restricted MIS' assets compared to the MIS universe and the fact that no more entities will be created under this regime. As mentioned below, an intense supervisory approach could supplement the less stringent regulatory regime.
- KiwiSaver schemes have certain additional requirements:** fees must not be unreasonable and investment in a KiwiSaver scheme must be readily transferable.

**33. Offers of MIS made only to wholesale investors are not subject to the Registered MIS regime.** These schemes do not have to comply with the above requirements for eligibility, governance, custody and disclosure and are not subject to reporting to or supervision from the FMA. However, investment managers and distributors of Wholesale MIS are subject to the Fair Dealing Obligations of the FMC Act and therefore subject to prohibitions on misleading conduct, false or misleading representations and making unsolicited offers.

<sup>16</sup> Restricted MIS are required to report to the FMA in a manner similar to the way in which Registered MIS must report to the Supervisor.

<sup>17</sup> LITs must satisfy the eligibility criteria in the FMC Act and the minimum standards defined by the FMA in its licensing guidelines for LITs that cover the following categories: general legal requirements, fit and proper, capability, operational infrastructure, financial resources and governance.

## Box 2. MIS Supervisors, a New Zealand Feature

**Under the FMC Act, there is a requirement for a Regulated Offer of MIS to have a Supervisor, licensed by the FMA.** As of November 2016 there were 5 Supervisors in New Zealand that were licensed in respect of Registered MIS.

**The fundamental function of Supervisors is to protect the interests of investors and to act on their behalf.** For MIS this involves: (i) acting on behalf of the scheme participants in relation to the MIS manager; (ii) acting in relation to matters connected with the governing documents or the terms of any Regulated Offer; (iii) acting in relation to any breaches of Issuer Obligations under the FMC Act;<sup>1</sup> and (iv) supervising: the MIS managers' performance of its functions and Issuer Obligations, the financial position of the MIS manager and the schemes it manages.

**In carrying out their functions, Supervisors have general duties to act honestly and in the best interest of participants and meeting professional standards of care.** According to the FMC Act this means they have to exercise the care, due diligence and skill that a prudent person engaged in the business of acting as a licensed Supervisor would exercise in the same circumstances. The FMA also expects Supervisors to make a determination of what systems and processes need to be in place to ensure they can meet their overarching and specific duties in relation to each MIS manager that engages them.

**The process for replacing a Supervisor is primarily determined by the governing document.** In addition, the FMC Act determines that the Supervisor can be removed by a special resolution of the members of the MIS, by a decision of the High Court on application by the manager or by decision of the FMA in accordance with the Financial Markets Supervisors Act. The governing documents for some MIS may not give the MIS manager the ability to remove the Supervisor at their discretion, which may make the process more complex.

**Supervisors of MIS managers are responsible for the primary oversight of significant features of MIS framework.** Among other tasks, Supervisors are responsible for reviewing and monitoring the adequacy and use of asset valuation policies, ensuring the MIS manager implements its investment strategy in accordance with the SIPO (including monitoring the use of leverage, compliance with investment limits and use of liquidity risk management policies) and provides accurate disclosure to investors on the above.

**Supervisors have a range of powers and duties that enable them to carry out their functions.** They can require MIS managers to provide any information at any point in time, engage experts where they consider it necessary to assess specific aspects of MIS managers' functions, call meetings of scheme participants or apply to the court for a variety of directions relating to the MIS. In the normal course of their business, Supervisors will receive regular reporting from the MIS managers and any external custodians to carry out their functions.

**Supervisors also are the primary responsible entities for holding MIS property on behalf of scheme participants.** If custody is contracted out, the Supervisor must appoint and monitor the performance of the external custodian. Aside from custody of scheme property, the Supervisor cannot delegate any of its functions.

**The FMA has a duty to monitor the conduct of Supervisors and their ability to meet their statutory functions.** For this, the FMA receives regular reports from each of the Supervisors on their oversight of their MIS managers. In these reports, the Supervisors are expected to describe their interactions with their appointments and provide a summary of how any issues were resolved.

<sup>1</sup> Issuer Obligations are the obligations imposed on the MIS manager by or under any of the following: The governing document, the terms of any Regulated Offer of the MIPs, the FMC Act, the KiwiSaver Act, and the Nonbank Deposit Takers Act.

**34. The discussion below focuses on the elements of the regulatory framework that are considered most relevant for financial stability.** The discussion points out areas where the regulatory framework is not compliant with the relevant IOSCO Principles or Standards, or where enhancements are otherwise recommended. The manner in which the FMA addresses compliance

with the regulatory framework when authorizing and supervising firms and funds and monitoring the sector risks is discussed in sections C and D.

## Valuation of assets

**35. There is no specific regulatory requirement relating to the frequency of publication of subscription or redemption prices for Registered MIS.** The FMA considers that the appropriate timing for valuation of scheme property depends on the structure of the MIS, the nature of the assets and the investment strategy of the MIS, as reflected in its SIPO. However, for Managed Funds, the FMC Act requires that the MIS manager must calculate and disclose the NAV of each fund at least quarterly (in the Quarterly Fund Update that is lodged with the Disclose Register). In practice, many of these funds calculate and disclose their NAV on a daily basis.

**36. MIS managers must ensure that all valuations are made in accordance with the relevant valuation methodology specified in the governing document.** MIS managers must ensure that they have documented methodologies to value each type of asset, that they apply methodologies consistently across similar asset classes and review them periodically, that assets are valued regularly and independently by staff with the right skills and that any conflict of interest is addressed. The MIS manager minimum standards require that the asset valuation function will be carried out independently of the investment management function. They also expect that if there are particular risk factors (e.g., conflicts of interest), these should be considered and addressed in the asset valuation methodology. The methodology and the rules applying to the valuation of assets for each Registered MIS and the pricing of its units must be detailed in its governing document, which can also be accessed at the Disclose Register. Where any asset type is not covered by any specific valuation methodology, it is to be valued according to New Zealand GAAP (which is equivalent to IFRS, see below).

**37. While there is no prescribed requirement to use forward pricing, MIS managers are expected to do this in compliance with their Overarching Duties as Managers.**<sup>18</sup>As noted above, MIS managers would reflect pricing methodologies in the SIPO and governing document. They are required to ensure that in implementing these they act in the best interest of the scheme participants and treat such participants equitably when exercising any of their powers or duties as MIS managers. The licensing minimum standards for MIS managers include a requirement that the MIS manager has policies and processes in place to prevent arbitrage. The FMA understands this would prevent them from calculating the price for effecting purchases and redemptions of MIPs at historic NAV. Supervisors should also be expected to raise this as an issue if any of the MIS managers they monitor use this method for calculating unit prices. In practice, the FMA is not aware of any MIS manager using historic NAV.

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<sup>18</sup> Forward pricing is understood to be the practice of effecting purchases and redemptions of CIS interests at the next computed NAV after the receipt of the order. Therefore, investors will not know the NAV per unit at the time of placing the order within the relevant cut-off time and all investor orders will be treated the same. IOSCO Principles for the Valuation of Collective Investment Schemes provide that the purchase and redemption of CIS interests should not be made at historic NAV.

**38. MIS managers are allowed to use an external valuer and many outsource this function.**

Where the MIS engages an external valuer to carry out this function, it must ensure that the engagement is conducted in accordance with the requirements of the FMC Act and the minimum standards for MIS managers' licensing. The MIS manager must monitor the performance of the external valuer and retains ultimate responsibility for the performance of those functions.

**39. There are no specific regulatory provisions for the valuation of Money Market Funds (MMFs).**

The regulatory regime does not provide for a definition of MMF or for any provisions on the valuation of these types of funds.<sup>19</sup> There seems to be a very limited number of MIS invested in debt securities and seeking to provide daily liquidity that are offered with the aim of maintaining a constant NAV.<sup>20</sup> It appears that market practice would be to provide certain additional liquidity safeguards for these funds like a relatively longer notice period for redemptions and the ability to set limits or delay redemptions in specific circumstances.

***Role of Supervisors and auditors***

**40. Supervisors have an obligation to review and be satisfied that a MIS asset valuation policy is appropriate and is being correctly applied.** Supervisors have a duty to supervise a MIS manager's performance of its functions, including valuation of the MIS' assets. The Supervisor is expected to review and be satisfied that the asset valuation policy is appropriate and is being correctly applied. In discharging this function, the Supervisor can engage a valuation expert where it requires assistance to determine the financial position of the scheme.

**41. Auditors review the valuation of the MIS assets as part of their review of the MIS annual accounts.** MIS managers must prepare financial statements for any Registered MIS they manage and these must be audited by a qualified independent auditor. The auditor will be required, under applicable auditing and assurance standards to assess whether the measurement and disclosures in relation to the scheme's assets are in accordance with applicable accounting standards.<sup>21</sup> Financial statements must be prepared in accordance with New Zealand GAAP. NZ GAAP involves using equivalents to International Financial Reporting Standards as issued by the International Accounting Standard's Board for Registered MIS, Restricted MIS, and MIS managers.<sup>22</sup>

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<sup>19</sup> IOSCO defines MMFs as investment funds that seek to preserve capital and provide daily liquidity, while offering returns in line with money market rates. Policy Recommendations for Money Market Funds, IOSCO, October 2012.

<sup>20</sup> There are other cash MIS that invest fully in New Zealand bank deposits. These typically offer a variable rate of return that is allocated to investors in the form of units and are offered as an alternative to bank deposits due to the MIS having better tax treatment. They would be subject to the same credit risk as a deposit with a credit institution.

<sup>21</sup> Before appointing or reappointing an auditor for a Registered MIS, the MIS Manager must consult with the Supervisor, ensure that the comments of the Supervisor on the appointment are taken into account and enable the Supervisor to be a party to an engagement for the Supervisor to obtain assurance of matters relevant to the exercise or performance of the powers or duties of the Supervisor.

<sup>22</sup> In the context of this mission it has not been possible to conduct a detailed comparison of the accounting requirements.

***Treatment of pricing errors***

**42. The FMC Act provides guidance on the reporting and correction of pricing errors and non-compliance with pricing methodologies.** Where a material pricing error or non-compliance with pricing methodologies occurs, MIS managers are required to correct the error, notify the Supervisor and ensure any disadvantaged investor is reimbursed or compensated appropriately. There is no regulatory definition of materiality, but every MIS manager must have an explicit policy to determine when an error or non-compliance with pricing methodology is material. In practice, the thresholds of materiality set by managers seem reasonable for an appropriate protection of unit holders. The fact that the monitoring of pricing errors is one of the main focus of Supervisors' oversight probably also has an impact on this.

**43. Supervisors have a duty to monitor and assess pricing errors.** MIS managers must report material pricing errors to the Supervisor, who must also have processes in place to identify and assess any material notifications. In turn, under the FMC Act the Supervisor must also report any material pricing error, along with details of a remedial plan, to the FMA. Since the implementation of this notification regime, every reported MIS pricing error has been fully reimbursed by either the MIS manager or the administration manager, depending on the cause of the error.

**44. The FMC Act regime contains a comprehensive framework for the valuation of assets of MIS.** The regime covers most relevant aspects of the IOSCO Principles and Standards that relate to the valuation of CIS assets. The FMA may consider, however, developing a framework for MIS managers and Supervisors on certain minimum requirements that valuation methodologies should encompass. Such guidance could ensure that practices like historic NAV pricing and use of constant NAV are clearly discouraged, in line with Principle 9 of the IOSCO Principles for the Valuation of CIS Assets and Recommendation 10 of IOSCO Policy Recommendations for MMFs.<sup>23</sup> Money Market Funds should also be defined through regulation, in line with Recommendation 1 of the Policy Recommendations for MMFs.<sup>24</sup>

**Management of redemption risk*****Liquidity risk management***

**45. The FMC Act does not have an explicit definition of liquidity but MIS managers are required to manage liquidity risk appropriately.** All MIS have the flexibility to set their investment strategy, provided they meet the governance and disclosure requirements of the FMC Act. MIS managers, however, are expected to have robust processes and controls in place to manage the liquidity risks associated with the investment strategy of the MIS they manage. These processes must be documented in the governing document of each MIS.

<sup>23</sup> Recommendation 10: "MMFs that offer a stable NAV should be subject to measures designed to reduce the specific risks associated with their stable NAV feature and to internalize the costs arising from these risks. Regulators should require, where workable, a conversion to floating/variable NAV. Alternatively, safeguards should be introduced to reinforce stable NAV MMFs resilience and ability to face significant redemptions."

<sup>24</sup> Recommendation 1: "MMFs should be explicitly defined in CIS regulation."

**46. While the FMC Act does not prescribe any specific liquidity, diversification or concentration limits, the MIS liquidity risk management policies should be detailed in the SIPO.** The SIPO should contain any policies that are relevant to achieving the investment objectives and strategies of the MIS. This would include any liquidity and cash flow management policies, tactical asset allocation policies, rebalancing, hedging and any diversification requirements or limits. As mentioned above, monitoring compliance with the prescriptions of the SIPO is one of the Supervisors' major duties with respect to MIS.

**47. As part of the licensing process, the FMA assesses whether the liquidity risk management functions of MIS managers are appropriately implemented, monitored and reviewed.** The FMA's expectation is that, for a MIS manager to be capable of effectively managing the investments of the MIS, it has to consider the liquidity risk of the underlying investment products in forming the investment strategy. It must also have adequate and effective processes to select and allocate assets to comply with the SIPO and taking into account the liquidity for different types of assets and the impact of investment techniques and strategies. MIS managers are also expected to stress test their investment strategies as appropriate for the particular investment strategy or scheme assets.

**48. A MIS manager can use any tool incorporated in the governing document of the MIS to manage the scheme's liquidity.** This would enable MIS to use redemption notices, lock-in periods, liquidity buffers, gates, suspension of redemptions, redemptions in kind, side pockets, separate liquidity facilities, swing pricing, etc. if these were incorporated into the governing document. Changes to the governing document to introduce or remove liquidity management tools will typically require the approval of scheme participants or of the Supervisor, if it is satisfied that the amendment does not have a material adverse effect on the participants.

### ***Suspension and deferral of redemptions***

**49. A MIS can suspend or defer redemptions as long as this is provided for in its governing document.** In exercising their discretion to suspend or defer redemptions (for example in the occurrence of a liquidity event), MIS managers will need to comply with their Overarching Duties as Managers to act in compliance with a professional standard of care. The Supervisor will also monitor the MIS manager and MIS in these situations and report to the FMA the steps to be taken to address a liquidity event.

**50. The power to suspend redemptions can be exceptionally obtained by a MIS manager if it is not included in the governing document.** Should a MIS governing document not contemplate suspension of redemptions, but a situation arises that the MIS manager cannot value or redeem MIS assets (e.g., in case of market disruption), MIS managers can either (i) seek a change to the governing document (a process that could be dealt with expediently by obtaining permission of the Supervisor if the change does not have a material adverse effect on participants) or (ii) apply to the court for an additional power to suspend redemptions, which the court will grant if it considers this to be in the best interest of participants. The FMA would also be able to intervene and give a direction to suspend redemptions, when it considers that a MIS manager or Supervisor is not

adequately managing a valuation, pricing or redemption matter not contemplated by the governing document.

**51. The FMA has done a high level sample review of liquidity risk management tools described in SIPOs and governing documents of MIS throughout the MIS manager licensing process.**<sup>25</sup> Further to anecdotal evidence obtained through the licensing process, most MIS managers incorporate the ability to suspend redemptions in the governing documents, while other tools like side pockets and notice periods are seen less often. Swing pricing appears to be rarely used.

**52. While the liquidity risk management regime is lightly prescribed, it is flexible enough to permit use of any liquidity management tools appropriate to the MIS under management, including suspending redemptions.** In general terms, prescribed disclosure ensures that any risks are appropriately signaled to investors through the PDS. At the same time, any limits or controls to the investment strategy of each MIS, as well as the ability of the MIS manager to use any exceptional liquidity management tools, are set out in the SIPO and governing document and therefore monitored by the Supervisor. As discussed in the following section, an adequate supervisory approach by the FMA should mitigate any potential risks arising from the lightly prescribed regime.

### Use of leverage

**53. There are no regulatory restrictions or limits on the use of leverage by a Registered MIS.** MIS managers are able to use leverage provided that this is (i) provided for in the governing document of the MIS and SIPO; (ii) disclosed to investors in the PDS/Register Entry; and (iii) undertaken in accordance with the Overarching Duties of Managers to act in compliance with a professional standard of care. Also, where leverage is permitted, the FMA considers that it is generally appropriate to provide limits on its usage. These limits would also be established in the SIPO and governing document.

**54. Supervisors monitor the use of leverage by Registered MIS managers.** Supervisors must ensure that the MIS manager is complying with the MIS' governing document and SIPO and that it is providing accurate disclosure on the use of leverage to investors. For these purposes, Supervisors receive regular reporting from managers and custodians and these reports are reviewed against the SIPO to ensure all investments are permitted and do not break restrictions. The Supervisors are also expected to undertake ongoing monitoring of the policies, processes and controls the MIS manager has in place to ensure compliance with the SIPO and that any leverage is appropriately disclosed to investors.

**55. There is a general perception that leverage is minimally used by New Zealand MIS managers, but available data is limited.** Many governing documents contain the possibility of using leverage, both through borrowing—which would be permitted on a short term basis only, to

<sup>25</sup> While review of MIS managers' liquidity risk management systems is done on a systematic basis at the time of licensing, the FMA has so far only done sample reviews of some of the governing documents and SIPOs for the MIS they manage (i.e., no exhaustive review of all Registered MIS' SIPOs and governing documents has been carried out).

effect redemptions on the fund—or through the use of derivatives. However, for those MIS that can use leverage, self-imposed limits tend to be very conservative (generally up to 20 percent of the NAV). Through the information obtained during the licensing process, the FMA’s perception is that the actual use of derivatives by MIS managers is very limited (other than for hedging purposes) and limited to a few funds. Under the FMC Act MIS managers must report their derivatives positions as part of their portfolio composition every six months, which will give the FMA an initial sense of the actual use of synthetic leverage by New Zealand Registered MIS.

**56. Even in the absence of prescribed limits, the use of leverage by New Zealand MIS managers seems quite conservative.** The self-imposed limits on leverage are primarily monitored by the Supervisors through their initial review of the SIPO and the ongoing monitoring of the manager’s compliance with their investment strategies. The FMA should assess the data on holdings that will be reported by the MIS managers of Registered MIS and the Supervisors’ review of MIS’ use of leverage to have a better perspective on the extent to which leverage is used within the MIS population and be able to monitor any significant increase.

### **Safekeeping and segregation of fund assets**

**57. The FMC Act requires that the assets of MIS are segregated from those of the MIS manager.** The property of a Registered MIS must be held by the Supervisor, who can in turn delegate custody to an external custodian if permitted by the MIS governing document. Assets must be held separate from the assets of the Supervisor or custodian and are protected from the insolvency of any of those entities. When delegating the provision of custody services, the Supervisor must ensure that the function is performed in the same manner as if the Supervisor was performing it directly and monitor such performance. Where the holding of scheme property is contracted out to an external custodian, the Supervisor remains jointly liable for the performance of the custody function.

**58. External custodians that provide services in relation to MIS do not need to be licensed entities and are not subject to any prudential requirements.** To be eligible to be appointed as an external custodian of a Registered MIS, a firm must (i) be a legal entity that the Supervisor believes to be appropriate to hold and safeguard MIS assets and (ii) be functionally independent of the MIS manager. In practice, a number of New Zealand custodians are subsidiaries of Supervisors. They are permitted to use omnibus accounts to register assets of each fund on behalf of investors. Detailed account of the units held by each individual investor will be kept by the MIS manager or the fund administrator.

**59. The FMA has no direct oversight of the activities of custodians.** Whether custody services are provided by a licensed Supervisor or an external custodian, these operations do not need to be separately licensed. Therefore, the FMA cannot directly oversee the custody functions carried out by Supervisors or third party entities. The FMA has some indirect insight into these activities through monitoring of the Supervisors. In particular, it can get a sense of the governance and culture within those Supervisors that also provide custody services and that share reporting lines. It will also monitor the Supervisor’s processes, approach and criteria applied when approving

and monitoring the performance of custodians, which indirectly may provide certain information on the operations of the latter.

**60. Given the fact that custodians perform key functions regarding safeguarding investors' assets, consideration should be given to reviewing the perimeter of regulation to require them to be licensed.** Aside from an indirect oversight through the monitoring of Supervisors, the FMA has no visibility of custody activities for MIS. Custodians are not prudentially supervised by any other authority in New Zealand. IOSCO's Standards for the Custody of CIS' assets recognize the fact that most regulatory regimes require CIS custodians to be licensed, authorized or approved and be subject to some form of ongoing regulatory oversight.

### C. Authorization

**61. The FMA has a structured and documented process to assess and verify license applications.** The process includes the undertaking of a risk evaluation of the application to determine the level of assessment required. Each applicant is assessed through a risk estimate model using qualitative risk factors (e.g., complaints, alerts or warnings) and quantitative data to assign a risk estimate for the license application. The risk rating will determine the intensity of assessment of the license application. Depending on the level of risk determined, the review and assessment of applications can entail desk-based reviews, requests for further information, interviews with the applicant, on-site reviews and/or engagement with the applicant's Supervisor.

**62. The FMA has a core licensing team which works with the broader supervision team to process all license applications.** The licensing team receives all MIS manager license applications and reviews them for completeness as well as undertakes any fit and proper checks before handing the applications over to the supervision team to assess against the eligibility criteria. Staff in the supervision team have been involved fully in the licensing process, considering the authorization of MIS managers is the first stage of the supervisory cycle. Staff are not necessarily assigned to specific types of applicants, but the flexible structure of the team permits it to leverage on the expertise of its members on certain types of entities as needed. Throughout the transition to the FMC Act regime, the FMA licensed 66 MIS managers.

#### MIS managers

**63. MIS managers are subject to comprehensive licensing requirements.** Any person acting as the MIS manager of a Registered MIS must be licensed by the FMA. In order to issue a license, the FMA must be satisfied that the MIS manager has met all of the relevant requirements in the FMC Act and Regulations (Eligibility Criteria). The FMA has also published a Licensing Application Guide which sets out a series of minimum standards for MIS managers covering legal requirements, fit and proper, capability, operational infrastructure, financial resources and governance. The FMA expects all applicants to explain how their approach is appropriate to meet the minimum standards and Eligibility Criteria for the size and nature of their business.

**64. The FMA also has the ability to impose additional license conditions on a MIS manager.** If the applicant is issued a MIS manager license, it must continue to meet eligibility criteria on an ongoing basis. It will also be subject to standard license conditions for the provision of its services. The FMA may also set additional specific conditions for individual managers on a case-by-case basis. Some are imposed on a transitional basis and reflect the significant step up that is made by applicants to transition into the new regime. These conditions will be reviewed as part of follow up monitoring.

**65. MIS managers also need to meet applicable licensing requirements for outsourced functions.** MIS managers can outsource some of their functions, like investment management and/or administration, while remaining responsible for discharging those functions, as there is no separate requirement for the external provider to be licensed.<sup>26</sup> Where a function has been outsourced the MIS manager will remain responsible for meeting any relevant Eligibility Criteria and minimum standards. The FMA assesses any delegation arrangements as part of the licensing process for the MIS manager, verifying that the manager has: appropriate processes to ensure that the external provider is capable of effectively performing the outsourced function to an acceptable level, legal arrangements to enable effective monitoring and to ensure records will be available for inspection by the FMA on request, and a performance program to monitor the provider's performance. MIS managers are required to report any material changes to outsourcing arrangements to the FMA, which will allow the FMA to continue to monitor the manager's ability to satisfy its statutory duties and licensee obligations.

**66. To be able to assess managers' ability to perform their functions at the licensing stage, the FMA has done a high-level sample review of governing documents for some MIS.** As part of the review of a MIS managers' processes and capabilities, licensing staff looked through a sample of SIPOs and governing documents for MIS managed by each manager. This has provided the FMA staff with an overview of some of the types of funds each manager would offer and how the manager's resources and expertise match the complexity of the products offered. It has also provided an indication of whether the processes of the managers are fit for purpose for the investment strategies offered, (e.g., for the management of liquidity risk, use of leverage and valuation of assets).

**67. The FMA considers licensing a confirmation of compliance with minimum entry-level standards.** By issuing a license to a MIS manager, the FMA recognizes that the processes, procedures and operational conduct of the MIS manager meet the entry-level expectations, while the aim of the FMA is to raise standards over time, through its supervisory/monitoring process and industry engagement.

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<sup>26</sup> Note that entities performing delegated investment management functions in New Zealand for MIS are not required to be licensed by the FMA. The provision of portfolio investment management services to retail clients (where entities make buy-sell decisions for retail clients without needing to consult them), is called Discretionary Investment Management Services (DIMS) in New Zealand, and is licensed by the FMA.

## Supervisors of MIS managers

**68. To license a Supervisor, the FMA must be satisfied that the applicant is capable of effectively performing its functions.** The FMA's assessment covers fit and properness, capacity, resources, controls and processes, governance, and independence. A significant part of the review focuses on the applicant's compliance monitoring and how the applicant will ensure that the MIS managers it oversees will comply with their obligations. Additionally, the FMA must be convinced about the Supervisor's independence from the MIS manager. It considers any relationship that the Supervisor or its directors and senior managers may have with the MIS manager or any other businesses or relationships of the Supervisor or its associated persons that may compromise its independence.

**69. The licensing regime for Supervisors has been in place for five years.** Over this time, the FMA has engaged with Supervisors regularly, through industry meetings and ongoing monitoring, which has resulted in a progressive improvement of standards.

## MIS

**70. MIS are not subject to licensing, but are registered on the Disclose Register.** Before being able to make a Regulated Offer, the MIS manager must register the MIS on the Disclose Register. For these purposes the MIS manager must prepare a PDS and supply the Registrar with all the information that the register entry for the MIS is required to contain – such as any governing documents and the SIPO.

**71. While compliance with the registration requirements of the FMC Act is assessed by the Registrar, the FMA carries out pre and post lodgement reviews of offer documents.** The pre-lodgement review process is not a legal requirement. The process is aimed at ensuring that offer documents are likely to meet FMA's expectations and to assist with meeting the new requirements of the FMC Act. Once an offer is lodged on the Disclose Register, the FMA rates it and reviews it in accordance with its risk estimate model described above. Where the FMA finds that an offer document is potentially non-compliant with regulations, it will contact the MIS manager and seek to have the query resolved or documents withdrawn or amended.

**72. The review of MIS offer documents has provided valuable market information to the FMA on the industry's approach to and disclosure of risk.** In the period from the introduction of the FMC Act until 1 December 2016, the FMA has reviewed the PDS of 109 MIS that have registered on the Disclose Register. As this is the first time MIS have had to be registered, the FMA has taken the opportunity to engage with the industry on the expected standards of offer documents for MIS. As part of the process of reviewing the PDS for MIS, FMA staff have met with the MIS managers where needed to discuss the quality of the content and, in particular, the approach to risk under the new regime and the expectations for MIS managers when disclosing those risks to investors. This review has also provided FMA staff with a better understanding of the MIS offered by MIS managers and will likely assist in the supervisory process going forward.

**73. The FMA has comprehensive and well documented processes for the licensing of MIS managers and Supervisors and is appropriately resourced to carry out that function.**

**74. The FMA should continue the pre-lodgment review of MIS offer documents.** The FMA has made a significant effort undertaking the pre-lodgment review of MIS offer documents and we understand this review will be continued. This review will assist the FMA in ensuring that MIS offer documents are in line with the FMC Act, being able to address any issue before lodgment. Also, as mentioned, the sample review of governing documents and SIPOs for newly registered MIS has proven to provide very relevant information to the FMA. Going forward, the FMA should consider reviewing SIPOs and governing documents for new MIS. While this is still a primary responsibility of Supervisors, it would be important for the FMA to take a more hands-on approach as these documents govern many relevant topics. Presumably, the FMA can approach the review from the point of view of systemic risk implications while Supervisors will tend to focus more on issues relevant to the protection of unit holders.

## D. Supervision

### Organization and resources

**75. The supervision team is responsible for the monitoring of fund management related activities.** This team currently has 24.9 full-time employees (FTEs) responsible for the ongoing monitoring of all entities under the supervision of the FMA, including MIS managers, Supervisors and LITs. As mentioned above, the staff of the supervision team has also been involved in licensing of MIS managers to gain a better understanding of the asset management industry.

### Supervisory approach

**76. The FMA applies a risk-based approach to supervision, aiming to focus on those participants that pose the greatest risk of adversely impacting fair, efficient, and transparent financial markets.** The FMA's monitoring priorities are guided by top-down and bottom-up considerations:

- Through reviewing its Strategic Risk Outlook (SRO), the FMA takes a top down approach to identifying market risks and assessing potential harms.
- Within each sector, the FMA reviews the information gathered from licensing, monitoring, reporting, complaints and thematic reviews and interaction with market participants and uses this information to estimate the level of risk associated with market participants, assisted by the use of risk estimate models (REMs).

**77. The inputs into the REMs include quantitative data and qualitative assessments.** Inputs are collected from different sources, including all of the reports and notifications that the FMA receives from market participants. The REMs also include qualitative assessments from monitoring work and thematic reviews conducted by the FMA. The risk factors are scored and weighted to give

a result for consequence and likelihood (of failure to meet licensing and/or regulatory obligations), and a final risk score. The REMs and their processes are continuously refined and are being influenced by the experience gained by the FMA through the recent licensing of firms under the FMC Act. The FMA is currently finalizing the REMs for MIS managers (post licensing) and expects to be able to start using those to assist in the determination of the future supervisory cycle of the new licensees.

**78. Supervisory activities of MIS encompass four broad areas:**

- **Monitoring provided by Supervisors.** Supervisors provide the frontline monitoring of MIS managers, and are expected to identify and assess risks posed by them, understand and monitor how these risks are mitigated and act to require the MIS managers to take additional steps where needed. The obligation on Supervisors to oversee MIS managers does not prevent the FMA from also monitoring the same MIS managers where the FMA considers that appropriate. Additionally, the FMA has an ongoing oversight role relating to Supervisors, which it carries out through assessment of periodic and ad hoc reporting, on-site visits and assessment of market trends.
- **Periodic monitoring and inspections.** In the near term, the FMA's planned monitoring will be undertaken on the basis of the priorities identified during the licensing process. This monitoring can entail a mix of on-site visits, desk-based reviews and telephone interviews.
- **Thematic reviews.** Thematic reviews use a combination of FMA's resources, including data gathering and analytics, desk based research and on-site activity. They typically result in a Board paper, report to the market and possible market guidance. The FMA's target is to complete at least five thematic reviews per year. Recent areas of coverage include sales and advice by financial service providers (including KiwiSaver providers) and corporate governance disclosure.
- **Reactive monitoring and inspections.** The FMA can also undertake reactive supervision in response to feedback from the market, complaints from investors, reporting from Supervisors or referrals from co-regulators or overseas regulators.

**79. As explained in Section B above, several relevant aspects of fund management activities are subject to direct ongoing oversight by the Supervisors.** The approach to liquidity risk management (including stress testing, suspension of redemptions, etc.), valuation of MIS assets and segregation and custody of assets are issues that are particularly relevant to the stability of the financial sector and where significant risks could arise. Under the FMC Act regime, these are to be monitored directly by the Supervisors through their oversight of compliance with the SIPO and governing documents. However, the FMA retains supervisory capacity over all aspects of MIS management, irrespective of whether these are to be primarily overseen by Supervisors.

**80. The supervisory strategic priorities for the next fiscal year will focus on newly licensed MIS managers.** Leveraging on recently acquired visibility of the MIS manager population through the licensing process, the FMA will focus on undertaking follow-up monitoring of any MIS manager

identified as high risk. The FMA will monitor those MIS managers with short dated or prerequisite conditions, as well as those that have been required to comply with additional specific conditions in the licensing process. Monitoring work to assess compliance with these conditions will also be undertaken under a risk-based approach.

**81. The FMA has a broad range of investigation and enforcement powers.** The investigation powers range from the ability to obtain information, documents and evidence to the power of entry and search under a search warrant granted by the court and also includes broad powers to share intelligence and information with domestic and foreign counterparts. The FMA also has overarching powers to take remedial action in case of breaches of securities regulation, including the ability to impose remedies on supervised entities in relation to contravention of licensee obligations, the power to make stop orders or direction orders, issue warnings and to bring both civil and criminal proceedings against any person under a variety of acts.

**82. Investigations can result from information provided by a number of sources, which the FMA is in the process of systematizing.** Investigation activity can arise from information provided by FMA operational teams, frontline supervisors (Supervisors and the NZX), complaints and other government agencies. The FMA is currently developing a new framework to process the collection, handling, analysis and response to all the information received or generated across the FMA. The system, called the Information and Contacts Management Framework, is intended to facilitate the assessment of information to determine the need for further action.

### **Use of supervisory and enforcement tools**

**83. Due to the novelty of the FMC Act regime, supervisory record for MIS activities is still limited.** The transition period for the FMC Act expired on December 1, 2016 and the majority of MIS managers have only recently entered the FMC Act regime. Nevertheless, the FMA has undertaken some reactive monitoring reviews of MIS managers where issues have come to its attention.

**84. The FMA has a relatively longer track record of monitoring Supervisors.** Since the licensing regime for Supervisors came into effect in 2011, the FMA has proactively inspected each licensed Supervisor to follow up on the matters of specific concern and relevance identified in their initial licensing process. After this initial round of on-site inspections in 2013–2014, the FMA has adopted a more risk-based approach to Supervisors and while it carries out regular reviews of their approaches and responses received through reporting requirements, on-site inspections of Supervisors have been pared back to an average of inspecting 2 Supervisors per year. Priority is given to areas where there have been previously identified concerns or where new issues may have been identified through licensing of MIS managers.

**85. Given the significance of Supervisors for the FMC Act regime and the novelty of regulations, the FMA has intensely monitored their activities during the first years under the new regime.** Under the old regime, Supervisors were trustees for different types of issuers, and carried out a role which was based on review of documentation and compliance with governing documents. The transition to the new regime under the Financial Markets Supervisors Act 2011 and,

further, the introduction of the MIS regulatory framework, has changed the role of the Supervisor. As a result, Supervisors are now expected to identify and assess the risks posed by the entities they supervise, as well as to monitor the steps taken to mitigate those risks. The FMA will continue to monitor and engage closely with Supervisors and has signaled to them that it expects their standards to continue to improve.

**86. The FMA has a significant track record of enforcement action.** FMA's investigation and enforcement activities since its establishment largely focused on dealing with the failure of many finance companies during the Global Financial Crisis. With this legacy enforcement action now almost complete, the FMA's future workload has begun to reflect its transition to a risk-based conduct regulator.<sup>27</sup> Since the FMC Act came into force, the FMA has been able to use the wider range of investigation and enforcement tools the new regime provided, already presenting a comprehensive use of the toolkit.<sup>28</sup> The FMA has been using the regulatory powers in a manner that is proportionate to the harm, the alleged conduct and other public interest factors.<sup>29</sup>

**87. When defining its supervisory approach to MIS managers, the FMA should consider retaining direct monitoring of those aspects that are most relevant to financial stability, while leveraging on the oversight provided by Supervisors.** To maximize the value added by the role of the Supervisors, it is important that the FMA determines what its expectations are in relation to the oversight provided by them and periodically reviews compliance with these expectations as Supervisors and the MIS industry continue to mature. In setting those expectations, the FMA should ensure that there is appropriate oversight of MIS managers' activities that are most relevant to financial stability. This could be done by conducting thematic reviews of specific issues or by making sure that on-site inspections dedicate enough attention to the review of these topics. The supervisory approach should leverage on the Supervisors' knowledge of the business of MIS managers to ensure that any potential risks are monitored. In addition, the FMA should ensure it maintains a level of oversight of Restricted MIS that is appropriate to the relatively less stringent regulatory framework for these entities.

**88. The FMA should continue to engage with Supervisors to ensure that they take a consistent approach to their supervision of MIS and that this is aligned with FMA priorities.** Supervisors should approach monitoring of MIS managers in a way that is appropriate to the MIS managers' business models and the risks they may pose, but also with a certain level of consistency across the industry. Going forward in the supervisory cycle, the FMA should make sure that it continues to engage with Supervisors to discuss policy positions and supervisory priorities.

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<sup>27</sup> Since 2011, the FMA brought proceedings in relation to 19 finance companies, resulting in more than \$82 million returned to investors, \$18 million imposed as fines, 37 directors being convicted and banned and 11 people agreeing to be subject to certain restrictions on their ability to be involved in the management of entities.

<sup>28</sup> Enforcement action has been taken in a number of areas and using a variety of enforcement tools. Notable enforcement activities have related to governance and culture.

<sup>29</sup> Due to the novelty of the MIS regime, it was not possible for this mission to evaluate any meaningful information on sanctions or enforcement actions affecting MIS managers.

**89. In particular, appropriate supervision of functions delegated by MIS managers should be ensured.** The FMA has indicated that the review of outsourcing is likely to be an early theme of monitoring after the FMC Act transition period, which we would strongly encourage. The FMA should particularly assess the extent of delegation and the qualifications of the entities performing delegated functions. Attention should also be given to existing cross-border outsourcing of investment management functions as this would be relevant for the development of any needed supervisory cooperation arrangements going forward.

## Reporting

**90. New Zealand MIS managers are subject to comprehensive periodic reporting requirements.** The majority of reporting obligations require that MIS managers report to the Supervisor, including changes to the SIPO, pricing errors, serious financial problems, or related party transactions. More significant changes to the MIS or the MIS manager, like probability of an insolvency event or resigning of an auditor, may also trigger a report to the FMA. For Managed Funds, the MIS manager must provide quarterly fund updates, including information on the risk profile of the fund and the actual portfolio composition at the end of the quarter, its target investment mix and the top 10 investments and their relativity to the net asset value of the fund.

**91. The Supervisors can also prescribe the type of information they require MIS managers and custodians to provide, in order to monitor their activities.** This typically involves monthly reports from MIS managers and custodians to the Supervisor on portfolio composition, transactions, use of leverage, value of assets, etc.

**92. Deviations from the terms of the mandate of MIS managers must be reported to the Supervisor as a limit break.** The governing document and SIPO must set the investment approach for a MIS, including in most cases benchmark asset allocation ranges and investment limits. A limit break would occur if there was a material breach of either: (i) the nature or type of investments that may be made or (ii) the proportion of each type of assets that may be invested in. Any limit break not corrected within five working days must be reported to the Supervisor and the MIS manager must also provide the Supervisor with a quarterly report on all material limit breaks occurred in the period. Where a limit break reflects a material issue with the operational conduct of a MIS manager, it has to be reported to the FMA.

**93. The FMA can require MIS managers and Supervisors to provide additional information or more frequent reporting.** This is typically done through the use of license conditions, imposed by the FMA to require additional periodic or ad hoc reporting from the MIS manager, either as a standard condition or on an individual basis where the FMA considers that the manager requires higher levels of scrutiny in light of the nature of the business and ongoing compliance and governance structures.

**94. In addition to license conditions, the FMA can request the provision of specific information in the form of a regulatory return.** This tool is currently being developed by the FMA and it will aim to gather information that will enable the FMA to update and improve its risk

assessment of licensed entities, as well as to monitor risk in areas where regulation is relatively light and where the FMA has decided to monitor market activity before imposing additional regulatory requirements. To determine the content of regulatory returns, the FMA is mapping the information that it already receives or has available under the new regime, the information collected through the licensing process or from other sources and identifying any relevant gaps that would need to be filled by periodic returns. It expects to finalize this process in the following months and submit the draft returns for industry consultation.

**95. KiwiSaver schemes are subject to additional reporting requirements.** These requirements include producing an annual return including prescribed statistical information on top of the general reporting requirements for Registered MIS described above, as well as providing a notification to the FMA of any fee increase in relation to any fees for services of a KiwiSaver scheme.

**96. Supervisors also have certain reporting requirements related to their own conduct.** Aside from reporting on MIS managers' operations as required, the Supervisors have to deliver regular operational reports of their own conduct to the FMA at least every six months. These reports provide a summary of the Supervisor's compliance with the terms of its license and of its interactions with the MIS managers it supervises as well as any relevant change in the Supervisor's circumstances. Supervisors must also certify that they continue to have sufficient financial resources and independence to support their operations and hold adequate professional indemnity insurance.

**97. The reporting regime is quite comprehensive and includes significant reporting to the Supervisor.** While data at the time of this mission was relatively limited due to the novelty of the licensing regime, information to be received from MIS managers under the reporting requirements of the new regime will provide the FMA with a more accurate picture of the industry. When developing the content of additional regulatory returns, the FMA should also consider what information is already being reported to the Supervisor to avoid duplications. It may also be worth considering whether the information reported to Supervisors and FMA should be provided on a compatible format to permit better analysis of the information.

## E. Systemic Risk Monitoring

**98. The FMA has a broad responsibility to contribute to the identification, monitoring and appropriate management of systemic risk in the New Zealand financial markets.** To assist in meeting this responsibility, the FMA has established the Strategic Risk Committee (SRC), composed of senior staff from different areas of the organization who meet monthly to discuss emerging risks and review the status of previously agreed strategic risks. Strategic risks discussed by the SRC are recorded in a Risk Register and assessed against the FMA's overarching risk assessment and prioritization framework to understand their potential likelihood and consequences.

**99. A Strategy and Risk team is responsible for the overall management of the FMA's strategic and operational risk framework.** The team has 4.8 FTEs and, among other duties, is responsible for drafting a monthly Emerging Risk Report, identifying risks that are either growing in size or importance, or are new to the FMA's regulatory perimeter. Information collected from

different sources available to the FMA (including submissions and papers prepared by staff in operational teams) is assessed to determine key strategic risks for the FMA to monitor and mitigate. This monthly report feeds into SRC discussions.

**100. Systemic risk monitoring and assessment is also done through interagency cooperation.** The most significant interagency cooperation forum is the Council of Financial Regulators (COFR), made up of the RBNZ, the FMA, the Treasury and MBIE. It meets on a quarterly basis and its chair rotates between the RBNZ and the FMA. COFR's main objectives are to share information on strategic priorities of the agencies, identify important issues and trends in the financial system that may have an impact on achievement of the agencies' objectives and ensure coordinated action. COFR maintains a risk register where the major risks identified by the different work streams are reflected and updated. The FMA also engages in the Trans-Tasman Emerging Risks Committee with the Australian Securities and Investments Commission (ASIC) on priorities and emerging risks of joint interest. It also participates in the Trans-Tasman Council on Banking Supervision which aims to increase coordination and harmonization of trans-Tasman issues relating to financial stability.

**101. The FMA regularly reviews its perimeter of regulation as part of its systemic risk monitoring work.** The FMA is currently developing work on the role it should play in relation to wholesale markets. This includes undertaking a scoping study of market composition, business models and potential risks of the wholesale markets, clarifying the FMA's expectations around wholesale market conduct and reviewing FMA's access to data on market composition and trends. In particular, the FMA is looking into the size and profile of the wholesale managed fund sector.

**102. The scoping work on the composition and size of the wholesale asset management sector should be promoted.** The FMA should continue to explore the profile and importance of the wholesale asset management sector to determine the need to expand its perimeter of regulation to encompass these activities. As the asset management industry continues to grow and mature, it should be expected that risks also continue to develop and expand to the wholesale sector. If this happens, restricting the application of certain areas of the FMC Act to retail fund management activities will be too limited. In the near term, the FMA should at least aim to obtain reliable data on the sector to be able to assess its size.