

Submission

to the

Ministry of Business,
Innovation and Employment

on the

Draft Financial Markets
Conduct Regulations -
supplement to third
exposure draft

24 July 2014

Submission by the New Zealand Bankers' Association to the Ministry of Business, Innovation and Employment on the Draft Financial Markets Conduct Regulations (supplement to third exposure draft – discretionary investment management services)

About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes which contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.
2. The following fourteen registered banks in New Zealand are members of NZBA:
 - ANZ Bank New Zealand Limited
 - ASB Bank Limited
 - Bank of New Zealand
 - Bank of Tokyo-Mitsubishi, UFJ
 - Citibank, N.A.
 - The Co-operative Bank Limited
 - Heartland Bank Limited
 - The Hongkong and Shanghai Banking Corporation Limited
 - JPMorgan Chase Bank, N.A.
 - Kiwibank Limited
 - Rabobank New Zealand Limited
 - SBS Bank
 - TSB Bank Limited
 - Westpac New Zealand Limited.

Background

3. NZBA is grateful for the opportunity to submit on the supplement to the third tranche of draft Regulations (the Regulations) made under the Financial Markets Conduct Act 2013 (the Act).
4. The process around the development of the Act has been a good example of policy development that has actively involved the industry. NZBA commends the on-going commitment to meaningful consultation and engagement.
5. However, NZBA notes that a two-week consultation window on the discretionary investment management services (DIMS) discussion document has not allowed enough time for meaningful discussion and assessment of this material. On this

basis, we would welcome the opportunity to continue to engage with officials on these issues after the allocated consultation period ends.

6. The following submission makes some brief comments on the Regulations.
7. If you would like to discuss any aspect of the submission further, please contact:

James Pearson
Associate Director – Policy
04 802 3353/ 021 242 0603
james.pearson@nzba.org.nz

Transition Period

8. NZBA's members appreciate the creation of the transition regime proposed in clause 1, Schedule 1 of the Regulations. However, as currently drafted the transition regime creates a scenario where DIMS providers will have applied for a licence but may in fact be unlicensed for DIMS for the period between 1 June 2015 and 30 November 2015. During this period, we understand that DIMS providers are expected to begin transitioning their existing clients to the new regime, and will also begin adopting the new regime in respect of new clients (to avoid having further clients to transition from the old regime to the new regime on 1 December 2015). This appears to raise a small issue as it is unclear whether use of client agreements, investment proposals service disclosure statements (SDSs) and other documentation could create a false impression that a DIMS provider is licensed when in fact they are not. NZBA would like clarification of how DIMS providers should manage the use of documents for existing customers during this period.

Disclosure Documents

9. The draft regulations provide flexibility to combine the SDS with the Investment Proposal, or the Investment Proposal with the Investment Authority, but do not allow all three to be combined into one document. NZBA submits that regulation 207 should allow the SDS, the Investment Proposal and the Investment Authority to be combined into one document.

Quarterly Reporting

10. The reporting requirements as currently drafted do not accurately reflect how time consuming the reporting process is. Quarterly reporting would place an undue burden on DIMS providers with little added benefit. NZBA submits that a six-monthly reporting requirement would be more appropriate. This also aligns with the timing of reporting by FMC custodians.
11. In addition, requiring reports to be issued within 20 working days of a reporting date is too short a timeframe. The impact of this might be ameliorated if electronic disclosure was available on an opt-out basis, as fewer customers would require

periodic disclosure. Regardless, the timeframe should be extended to 30 working days.

Investment Proposal

12. The requirement in clause 27(3) of Schedule 31 that the investment proposal includes a comparison to a model portfolio is impractical given the significant degree of variation that may exist between portfolios under DIMS. A warning to investors should be included so that it is clear to investors that the target asset mix of the model portfolio and that of their own portfolio is likely to differ.
13. In addition, the asset classes permitted to be used by clause 1(2) are too narrow. The list omits funds that are not diversified, which are frequently an asset available to DIMS providers. It is unclear why this approach has been taken, but if it is to create a "look-through" approach to asset disclosure, it should be amended. Managed funds are themselves financial products, regardless of whether they are diversified.
14. In respect of clause 30, information about historic performance has the potential to mislead customers and should be omitted from the investment proposal. It is the nature of DIMS that investors' portfolios will differ depending on their particular assets, cashflow, and other parameters. Accordingly, historical information about the performance of a composite portfolio will bear little relation to the returns that a client receives. Furthermore, by requiring a weighted composite of historical returns, the information will be skewed based on the coincidental outcome of which portfolios have been selected to be included in the model portfolio. This would be the case even where outliers were removed in accordance with clause 30(4)(a), due to the cumulative effect of minor differences in portfolios.
15. NZBA submits that the more appropriate way to present this information would be to require a benchmark return, and include a disclaimer that there may be differences between the model portfolio and an individual portfolio.

Existing Clients

16. NZBA would appreciate clarification in relation to what documentation will need to be provided to existing customers in the transition to the new regime. In particular, NZBA submits that existing customers should be provided with a copy of the SDS and the Investment Authority, but not the Investment Proposal. Existing clients will be aware of the historic performance and fees of the DIMS service, and fees will already be covered in the Client Agreement. This will avoid unnecessary duplication of information already known to customers, and will avoid confusion.

Contingency DIMS exemptions

17. NZBA fully supports the objective of avoiding unnecessary cost in obtaining a full DIMS license for what can appropriately be considered an "ancillary" service, but is concerned that the timing for contingency exemptions for AFAs as currently allowed for by regulation 183 is too generous.

18. NZBA submits that rather than allowing six months in any 12 month period, the contingency exemption should be available for six months in a year, and that any management beyond that six month period should require a DIMS license.