NEW ZEALAND
BANKERS ASSOCIATION

Submission

to the

Financial Markets Authority

on the

Consultation Paper: Draft Guidance on Risk Indicators and Descriptions of Managed Funds

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Submission by the New Zealand Bankers' Association to the Financial Markets Authority on the Consultation Paper: Draft Guidance on Risk Indicators and Descriptions of Managed Funds

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 fifteen registered banks in New Zealand are members of NZBA:
   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) 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 NZBA is grateful for the opportunity to submit to the Financial Markets Authority (FMA) on the Consultation Paper: Draft guidance on risk indicators and descriptions of managed funds (the Guidance) in relation to the Financial Markets Conduct Act 2013 and the Financial Markets Conduct Regulations 2014 (the FMC Act regime).

4. The process around the development of the FMC Act regime has been a good example of policy development that has actively involved the industry. NZBA commends the ongoing commitment to meaningful consultation and engagement and appreciates the invitation to participate in this targeted consultation.

5. The following submission provides responses to the questions posed in the Guidance.

6. If you would like to discuss any aspect of the submission further, please contact:

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Executive summary

7. NZBA does not support the proposed Descriptions of volatility (Descriptions) as currently drafted. For example, the Descriptions for risk categories 6 and 7 should be differentiated. Our members will expand on this and make further suggestions about the Descriptions generally in their own submissions.

8. NZBA submits that the fund update events described in paragraph 25 of the Guidance should be amended to provide greater clarity and ensure that each update event is accompanied by a reasonable timeframe.

9. NZBA does not support the proposed naming conventions for funds and considers that they stifle innovation and are inconsistent with the purposes of the FMC Act regime. However, should the FMA consider naming conventions to be essential NZBA submits that the proposed naming conventions should be amended to ensure they are consistent with market and international practice. NZBA also submits that the definitions for the proposed naming conventions should specify that the percentage of value in growth assets relates to the fund's benchmark asset allocation (as opposed to the fund's benchmark asset allocation range).

Question 1: Do you think the suggested Descriptions of volatility accurately reflect the Risk category numbers?

10. NZBA acknowledges that the proposed Descriptions will determine how banks and other fund managers refer to fund volatility in any documentation with a view to assisting investor understanding and enhancing ease of comparability between funds.

11. NZBA does not support the Descriptions as currently drafted. This submission is developed further in our response to question two below.

12. More generally, NZBA submits that investor education would be useful in this area to assist investors to understand the risk categories for funds, specifically how and why these are allocated and how they can be used to inform investment decisions.

Question 2: If your answer to Question 1 is no, please explain why and describe the alternative risk descriptions that you would consider would be more appropriate.

13. As outlined above, NZBA does not support the Descriptions as currently drafted. All of our members recommend that risk categories 6 and 7 should have different Descriptions. It is somewhat confusing (and potentially misleading) that risk categories 6 and 7 are both described as "very high" in their corresponding Descriptions.

14. We understand that our members will be expanding on this and will also be making further suggestions about the Descriptions generally in their own submissions.

Question 3: Do you agree that a PDS needs to be updated in the above circumstances? If not, when do you think a PDS should be updated to reflect a change in risk category, and why?

15. NZBA submits that the update event described in paragraph 25(a) could be improved by the following additions (italicised):

    > the risk category has moved by two or more *consecutive* categories *in one direction*, for example from risk category 3 to risk category 5.

16. NZBA also submits that the update event described in paragraph 25(a) should be accompanied by a reasonable timeframe in which the risk category movement must take place. For example, the risk indicator could move by two places in one quarter due to unexpected volatility and then move back one or two places the following quarter. Without a timeframe this could result in the fund manager having to update the PDS twice over a period of two quarters. The relevant Fund Update will always contain the most current risk indicator in any event.

17. NZBA submits that the update event described in paragraph 25(d) could be improved by removing the words "….fund's investment policy or strategy direction" and replacing them with the words "fund's statement of investment policy and objectives" or "fund's SIPO".

18. NZBA submits that the update events described in paragraph 25 should also take into account that certain movements in risk categories may be more significant than others. For example, a move from risk category 1 to risk category 3 is potentially much more significant than a move from risk category 5 to risk category 7. For example, if a cash fund had category 1 risk, then a move to risk category 3 risk would be quite significant. However for a growth fund, a move by two risk categories is arguably not so significant.

Question 4: Do you agree with our approach to the naming conventions for funds? If not, why, and what approach would you suggest?

19. NZBA does not support the proposed naming conventions for funds and submits that they should not apply. NZBA considers that such naming conventions stifle innovation and are inconsistent with the purposes of the FMC Act regime.

20. Specifically, section 4(d) of the FMC Act provides that one of the FMC Act's additional purposes is to promote innovation and flexibility in the financial markets. NZBA submits that, by setting naming conventions, FMA would limit the innovation of banks and other fund managers, and stifle flexibility to offer solutions which are considered to be non-standard.

21. However, should FMA consider naming conventions essential, NZBA makes the following submissions about the proposed naming conventions:

Consistency with market practice

22. In our view the proposed naming conventions do not reflect market practice.

23. For example, we do not consider it to be market practice to label a fund holding 35% in growth assets as a 'Balanced' fund, and there is no 'Moderate' fund proposed in the Guidance.

24. Furthermore, we note that the proposed range for a 'Conservative' fund in the Guidance differs from that required for KiwiSaver default funds, which is 15%-25% in growth assets.

25. NZBA submits that the proposed naming conventions should reflect and correspond with market practice. This will help to ensure that investors are not confused by potentially inconsistent naming conventions, and ensure consistency across products (including international comparisons).

26. To this end, market practice could be ascertained by reference to the bands and category naming conventions used by leading investment research houses.

Benchmarks as opposed to ranges

27. The definitions for the proposed naming conventions are unclear in that they do not specify whether percentage of value in growth assets relates to the fund's benchmark asset allocation or its benchmark asset allocation ranges.

28. NZBA submits that the percentage of value in growth assets in the naming convention definitions should relate to a fund's benchmark asset allocation (as opposed to a fund's benchmark asset allocation range), and explicitly specify this.

29. This should provide greater certainty for banks and other fund managers when naming their funds and reduce, but not eliminate the requirement for name changes

(which may come at a substantial cost, as discussed in our response to question five below).

Other jurisdictions

30. NZBA submits that the naming conventions should align with international practice and similar international guidance. This, for example, may assist to ensure that trans-Tasman portability is not affected.

31. NZBA understands that Australia does not have regulated naming conventions which relate to asset classes, and that standard industry practice guides the names ascribed to funds. This is consistent with NZBA's position outlined above that the proposed naming conventions should not apply.

Question 5: Would this guidance cause you to change the names of any of your funds when you make a transition to the FMC Act regime? If so, what are the costs associated with this?

32. We submit that any changes required to comply with the proposed naming conventions would incur significant costs and inconvenience for our member banks, including costs associated with amendments to collateral, communications and marketing, and staff training.

General comments

33. NZBA encourages FMA to consider whether it may also be helpful for the Guidance to reference FMA's 'Statements of Investment Policy and Objectives Under the FMC Act' Guidance Note to help ensure consistency.