

Consultation: Proposed financial reporting exemptions for small and medium-sized DIMS providers

16 March 2015

New restrictions on who can provide Discretionary Investment Management Services (DIMS) came into effect on 1 December 2014. Most DIMS providers now require a licence issued by the Financial Markets Authority (FMA).

DIMS providers who are licensed under Part 6 of the Financial Markets Conduct Act 2013 (FMC Act) are FMC reporting entities. This means they must prepare financial statements that comply with generally accepted accounting practice (GAAP), have them audited by a licensed auditor and lodge them with the Registrar.

Requiring small and medium-sized licensed DIMS providers to produce audited financial statements may result in limited benefit to clients. We are aware the additional cost to do so may greatly outweigh the benefit.

The FMA is considering a class exemption for small and medium-sized licensed DIMS providers from certain financial reporting obligations. Our proposal is to put in place an exemption that will gradually introduce reporting and auditing requirements based on the size of the DIMS provider.

We invite you to review our proposals and share your feedback with us.

Submissions close on Thursday 2nd April 2015 at 5pm. The form at the back provides more details.

What is the issue?

1. DIMS providers licensed under the Financial Markets Conduct Act (FMC Act) are FMC reporting entities.
2. FMC reporting entities must:
 - keep proper accounting records
 - ensure their financial statements are prepared within four months of the balance date
 - ensure their financial statements are compliant with GAAP
 - ensure the financial statements are audited by a qualified auditor (as defined in section 461E of the FMC Act), and
 - lodge financial statements with the Registrar.

3. When the Ministry of Economic Development ((MED) now the Ministry of Business, Innovation and Employment) decided to implement financial reporting requirements for market service licensees it commented in the [Regulatory Impact Statement](#) that:

‘The reason for requiring licensees to lodge audited financial statements is the same as the reason that they will be licensed: they take, manage or supervise public money and should be accountable for the performance of their functions and duties to the public.’

4. The Government’s policy for requiring licensees to report assumes most DIMS providers will be large and the resulting costs will be relatively minor. MED’s Regulatory Impact Statement states:

‘...entities will incur higher financial reporting costs because a separate ledger must be maintained for each required disclosure. However, the total cost is likely to be low because most licensees carry out related activities that would make them FMC reporting entities for other reasons (eg, they are deposit takers or insurers). The costs are relatively minor given the very large amounts of public money that licensees are collectively responsible for managing.’

5. The FMA agrees with the analysis in MED’s Regulatory Impact Statement in relation to large DIMS providers. Large DIMS providers often already have their financial statements audited because they also carry out related activities that require it. This means the incremental cost of complying with financial reporting will be low. In addition, the FMA believes large licensed DIMS providers should be required to have audited financial statements given the impact on clients and the wider financial market if they were to fail.
6. In contrast, audited financial statements produced by small and medium-sized licensed DIMS providers may provide limited benefit but add significantly to the costs for these providers.

7. Clients will not generally rely on DIMS providers' level of financial resources to assess whether they are able to provide the service. That is because small and medium-sized DIMS providers are unlikely to need significant financial resources to run their business. However, larger DIMS providers require sufficient financial resources to ensure appropriate systems, controls and oversight are in place for the nature, and scale, of the business. As such, financial statements, and audits of those statements, become more relevant for larger providers.
8. Investor money and property under DIMS is held either directly by the client or by an independent custodian. Reporting obligations for DIMS custodians holding client funds will not be affected by the exemption. Therefore, requiring DIMS providers to have audited financial statements potentially creates little benefit for monitoring investor money or property.
9. Preparing and having audited financial statements that are compliant with GAAP will add significant extra costs for small to medium-sized DIMS providers because they are unlikely to have previously obtained audits.
10. Please note we seek input and evidence from the industry as to whether the compliance costs will be significant and outweigh any benefit to the client.

How the FMA will provide exemptions

11. The FMA's preferred approach, should any exemption be granted, is to have a class exemption.
12. Our proposal is to exempt small and medium-sized DIMS providers from certain requirements of Part 7 on a graduated basis as set out below.
13. We propose to gradually introduce requirements as the size of the DIMS business grows, and as the reporting and auditing requirements become more material. Use of the graduated approach encourages providers to grow their businesses as the compliance costs increase relative to their business growth.

14. The table below shows the three levels of DIMS providers that will apply for the purposes of the exemptions. Please note the limits in the table are intended as a starting point for discussion. We seek industry feedback on these.

Level One DIMS provider	Level Two DIMS provider	Level Three DIMS provider
At least one of the following applies:	At least one of the following applies:	The following applies:
<ul style="list-style-type: none"> • 20 retail clients or less 	<ul style="list-style-type: none"> • between 21 and 100 retail clients 	
<ul style="list-style-type: none"> • less than \$NZ 4,999,999 retail funds under management 	<ul style="list-style-type: none"> • between \$NZ 5,000,000 and \$NZ 9,999,999 retail funds under management 	<ul style="list-style-type: none"> • between \$NZ 10,000,000 and \$NZ 19,999,999 retail funds under management
<ul style="list-style-type: none"> • licensee is an individual or sole trader 		

15. If a DIMS provider meets the criteria for more than one level, the highest level applies to that DIMS provider.

16. Retail funds under management will be calculated as the combined value of all retail client portfolios the DIMS provider has authority to make decisions over (not the amount of the portfolio the DIMS provider has made decisions over). Funds under management will be calculated at the beginning of the DIMS provider's financial year. Number of clients will also be assessed at the beginning of the DIMS provider's financial year.

17. The exemptions will not apply at all where:

- a. the licensee is an FMC reporting entity for any reason other than being a DIMS licensee, or
- b. the conditions of the DIMS licence prevent the exemption from applying.

18. Situations where conditions may prevent the exemption from applying will be addressed during the licensing process. Matters taken into account will include, but are not limited to, matters of governance structure viewed in light of size, regulatory reach and use of an independent custodian and, in the case of overseas providers, oversight, or lack of oversight by other regulatory bodies for overseas providers.

What the exemptions will do

19. The FMA's preferred approach, for each proposed level of DIMS provider, is that it will:

- a. exempt Level One DIMS providers from:
 - i. being required to keep accounting records that enables the DIMS provider to ensure its financial statements comply with GAAP (section 455(1)(c))
 - ii. being required to keep accounting records that enable their financial statements to be audited (section 455(1)(d))
 - iii. the requirement to keep certain documents in New Zealand to enable preparation of financial statements (section 456(2))
 - iv. being required to prepare financial statements that comply with GAAP(section 460)
 - v. being required to have financial statements audited by a qualified auditor (section 461D), and
 - vi. being required to lodge financial statements (section 461H)

- b. exempt Level Two DIMS providers from:
 - i. being required to keep accounting records that enables the DIMS provider to ensure its financial statements comply with GAAP (section 455(1)(c))
 - ii. being required to keep accounting records that enable its financial statements to be audited (section 455(1)(d))
 - iii. the requirement to keep certain documents in New Zealand to enable preparation of financial statements (section 456(2))
 - iv. being required to prepare financial statements that comply with GAAP (section 460)
 - v. being required to have financial statements audited by a qualified auditor (as defined in the FMC Act)(section 461D), and
 - vi. being required to lodge financial statements (section 461H)

but require Level Two DIMS providers to:

- i. to keep accounting records that enable the DIMS provider to ensure its financial statements can be prepared in accordance with section 460 of the FMC Act in all respects except complying with GAAP

- c. exempt Level Three DIMS providers from:
 - i. being required to have financial statements audited by a qualified auditor (as defined in the FMC Act)(section 461D), and
 - ii. being required to lodge financial statements (section 461H)

but require Level Three providers to:

- i. have the financial statements audited by a chartered accountant who provides auditor services.

What the exemptions won't do

20. The exemption will not exempt DIMS licensees who are FMC reporting entities by virtue of holding another market services licence from their FMC reporting entity obligations.
21. The exemption will not exempt all DIMS licensees from the FMC reporting entity obligations.
22. The exemption will not exempt those DIMS providers relying on the exemption from:
 - a. keeping proper accounting records (section 455(1)(a) and (2))
 - b. keeping the accounting records in the prescribed location (section 456(1))
 - c. keeping the accounting records in English (section 457)
 - d. keeping the accounting records for the prescribed period (section 458), and
 - e. making the accounting records available for inspection (section 459).
23. If we grant exemptions, we may consider further conditions for those DIMS providers relying on the exemption. This will be to ensure proper consideration is given to compliance with the exemption and any assessment they make in assessing which level they fall within.

The FMA's discretion to exempt

24. Under section 556 of the FMC Act, the FMA may, on terms and conditions that it thinks fit, exempt any person or class from compliance with any provision or provisions of Part 2 to 7 of the FMC Act. The FMA must not grant an exemption unless it is satisfied that it is necessary, or desirable, for the purposes of the FMC Act. The extent of the exemption cannot be broader than is reasonably necessary to address the matters that gave rise to the exemption.
25. The purposes of the FMC Act include (among other things):
 - a. promoting confident and informed participation of businesses in the financial markets, and
 - b. avoiding unnecessary compliance costs.

Questions

- Q1 What comments do you have in relation to the FMA's proposed categorisation of small and medium sized DIMS providers as Level One, Level Two and Level Three providers?
- Q2 What comments do you have in relation to the FMA's proposed graduated approach?
- Q3 What comments do you have in relation to the Part 7 financial reporting provisions that the FMA proposes small and medium-sized DIMS providers be exempt from?
- Q4 What comments do you have in relation to costs for GAAP compliant financial statements and audits by licensed auditors? Will these requirements add significant costs? If so, what are the approximate costs?
- Q5 What comments do you have on the thresholds for the categories of small and medium-sized DIMS providers? We are keen to receive feedback on the funds under management limits in those thresholds.
- Q6 What comments do you have in relation to the FMA's proposed conditions for those small and medium-sized DIMS providers relying on the exemption?
- Q7 What comments do you have in relation to preventing the exemption from applying based on governance structure and location of provider?
- Q8 What general comments do you have in relation to the FMA's proposed policy of exempting small and medium-sized DIMS providers from certain financial reporting provisions in Part 7 of the FMC Act?
- Q9 If you disagree with the FMA's proposed policy, what approach do you believe the FMA should take (if any) to exempting DIMS providers from certain financial reporting provisions in Part 7 of the FMC Act?

The next step

How do I make a submission?

Please use the form on the next page – this gives the details of what you need to do. Forms must be submitted electronically in both PDF and word formats and emailed to consultation@fma.govt.nz – please put 'Feedback: Proposed financial reporting exemptions for small and medium-sized DIMS providers' in the subject line.

Submissions close on Thursday 2nd April at 5pm.

Where can I get more information?

You'll find more information about the changes to the regulation of DIMS on our website www.fma.govt.nz.

If you have questions about the consultation process, please get in touch on 0800 434 567.

