FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

Reporting SIPO limit breaks

This information sheet outlines the reporting obligations of a Managed Investment Scheme (MIS) manager if there has been a limit break under its Statement of Investment Policy and Objectives (SIPO) under Part 4 of the Financial Markets Conduct Act 2013 (FMC Act)

Overview

The FMC Act requires that where there has been a limit break under a SIPO the manager must report this to the supervisor (or to the FMA if there is no supervisor). In this information sheet we outline these reporting obligations and discuss when they are, or might be, triggered.

This information sheet builds on, and should be read in conjunction with, our:

- Guidance Note: Governance under Part 4 of the FMC Act
- Guidance Note: Statements of Investment Policy and Objectives under the FMC Act

SIPO limits

Section 164 of the FMC Act requires a SIPO to adequately describe the investment policy and objectives of the scheme, which includes:

- the nature or type of investments that can be made, and any limits on those
- any limits on the proportions of each type of asset invested in
- the methodology used for developing and amending the investment strategy, and for measuring performance against the objectives of the scheme.

Where there are no limits on the types of investments or the proportions of each investment type, the FMC Act requires this fact to be clearly disclosed in the SIPO.

Limit breaks

Section 167 of the FMC Act applies to an MIS if, under the SIPO, there is a material breach of any limits set out in the SIPO on either:

- the nature or type of investments that can be made, or
- the proportion of each type of assets that may be invested in.

Where there is a limit break, the manager of the MIS must report it to the supervisor (or to the FMA if there is no supervisor) in the prescribed circumstances and in the prescribed manner.

Limit breaks need to be considered in the context of the MIS (or the relevant fund in the MIS) and the nature of the limit break.

The investment strategy is a key component of any SIPO. As part of that, your stated benchmark asset allocation ranges, and other investment limits, effectively act as the limits of your investment approach. Investments outside of these ranges would constitute a limit break that you may need to report.

Your ranges should be appropriate and relevant for your MIS. Stating wide ranges where they are not needed, or using the provisions of section 164(2) to avoid limits being specified, would be inconsistent with the overarching principles and purposes of a SIPO. A possible exception is a very actively managed fund with wide discretion.

Material breaches of SIPO limits

A limit break is a material breach of limits set out in the SIPO. It can relate to either the nature or type of investments that may be made, or in the proportion of each type of asset that may be invested in (section 167(1) of the FMC Act). As discussed above, your SIPO should have set the limits within the context of your investment approach and investment strategy and this should reflect the context of section 167(1).

Materiality and limit breaks

There is no definitive test of materiality, and we do not consider it necessary at this stage to issue frameworks or methodologies about materiality. However we may review this depending on how limit break determination and reporting develops.

The factors managers should consider when determining whether there has been a limit break include:

- the size of the breach, in relation to the scheme
- any losses caused to scheme participants
- whether the breach involves related-party transactions
- whether the breach is an isolated incident, or part of a recurring pattern of breaches
- if the breach causes the PDS, registry entry, or an advertisement to which the offer relates, to be false or misleading
- how quickly the breach is rectified after the manager became aware of the breach
- how long the breach went on for.

The above list of factors is not intended to be exhaustive. The obligation to determine materiality and report a material limit break remains with the manager.

No single factor is more important; nor does it necessarily require more than one factor for a limit break to occur. Rather, a manager must assess the circumstances, in the context of the MIS, taking into account the factors outlined, to determine whether a breach is material.

Limit break reporting

Section 167(2) of the FMC Act requires the manager of an MIS to report a limit break to the supervisor (or the FMA if there is no supervisor) in the prescribed circumstances and in the prescribed manner. These are set out below.

Immediate limit break reporting

Where there has been a limit break (in accordance with section 167 of the FMC Act), the manager of the MIS must provide a report to the supervisor (or the FMA if there is no supervisor) if that limit break is not corrected within five working days after the date on which the manager becomes aware of the limit break (regulation 94 of the FMC Regulations).

The report must be provided as soon as practicable after the expiry of the five-working-day period.

The report must contain the information specified in regulation 96 of the FMC Regulations.

Quarterly limit break reporting

The manager of an MIS is required to provide a quarterly report to the supervisor (or the FMA if there is no supervisor) about limit breaks. This report may be combined with any other reports the manager is providing to the supervisor. The quarterly report must be provided within 10 working days after the expiry of each quarter of each year (regulation 95 of the FMC Regulations).

The report must state whether there have been any limit breaks in the previous quarter to which section 167 of the FMC Act applies. Under regulation 96(4) of the FMC Regulations, the quarterly report does not have to contain any information previously provided to the supervisor in a report provided under regulation 94 (immediate reporting of an uncorrected limit break). This means limit breaks that occurred in the relevant quarter, which were rectified within the five-working-day period under regulation 94 and did not have to be reported to the supervisor immediately, should still be set out in the quarterly report.

This will allow the supervisor to monitor limit breaks that, while material but rectified by the manager within five working days, could require attention if they are not an isolated or 'one-off' occurrence.

Content of limit break reports

Regulation 96 of the FMC Regulations specifies what is required to be set out in reports under regulations 94 and 95.

The report must disclose:

(a) the date the manager became aware of the limit break

(b) the name of the registered scheme affected and the name of any fund within that scheme to which the limit break relates

(c) the nature and cause of the limit break (the type of limit break)

(d) the net asset value of the scheme property in the registered scheme as a whole and in respect of any fund within that scheme to which the limit break relates (as at the date the limit break first occurred)

(e) the reasons why the limit break is material

(f) the date on which the limit break first occurred and the period for which the limit break continued before it was corrected (or whether the limit break remains uncorrected at the time of the report)

(g) the steps taken, or to be taken, by the manager to correct the limit break

(h) what steps (if any) have been taken, or will be taken, to minimise risk of a recurrence of this type of limit break or to ensure early notification and correction of limit breaks of this type

(i) the timeframe within which the manager intends to take any steps not already taken under paragraph (g) or (h).

Where the information in(d) to (i) above is not reasonably ascertainable as at the date of the report, then the report is not required to contain that information but, it must be provided in a further report as soon as is reasonably practicable after the information becomes reasonably ascertainable.

Where a report has been provided to the supervisor (or the FMA if there is no supervisor) on a limit break under regulation 94, it is not necessary to provide any of the information in (d) to (i) above in the quarterly report, provided the quarterly report states the date of the report in which the information was provided and, as at the date of the quarterly report, the information remains correct.

Planning

We encourage you to plan and be ready to comply with the FMC Act. Plan what you need to do to ensure you comply with your SIPO and report any limit breaks.

Where can I find more information?

For more general information about the FMC Act, visit our website. You can also subscribe to receive FMA updates for the latest news.