

Proposed exemption from the obligation to prepare scheme financial statements for bundled unit trusts

About this consultation paper

Under the Securities Act 1978 (**SA**) a number of managers of managed investment schemes (**MIS**) operated unit trusts under a 'bundled unit trust' structure. In this structure, a series of unit trusts were formed under a master trust deed. These unit trusts were legally separate and did not have any cross-liabilities. Each unit trust was considered a scheme in its own right, and financial statements had to be prepared for each one.

With a change in definitions between the SA and the Financial Markets Conduct Act (**FMC Act**), these managers now have an additional financial reporting requirement. They must now prepare financial statements for the registered scheme, consolidating the results of all of the constituent unit trusts.

We think this requirement will cause unnecessary costs for fund managers – with no added benefits to investors.

We are proposing an exemption from this obligation (see page 5). Managers will still be required to prepare financial statements for each unit trust.

We are seeking feedback on this proposed exemption so please use the form at the back of this consultation paper.

Submissions close on **Friday 9 June 2017**.

Next steps

After considering all submissions, we will finalise our proposal and aim to have any exemption in force by mid to late July 2017.

If introduced, the exemption would be effective for registered schemes with a balance date of 31 March 2017.

About this consultation paper:

This consultation is for: managers, supervisors, auditors, administration managers, investors.

It aims to: seek feedback on the exemption proposal for bundled unit trusts.

Contents

About this consultation paper	1
Next steps	1
Background	3
Bundled unit trusts under the Securities Act regime	3
Impact on bundled unit trusts after the FMC Act became law	3
Our proposal	5
Issue a class exemption	5
How new structures will be treated	5
How it will affect your 2017 financial statements	6
Questions	7
Feedback form	8

Document history

This version was issued in May 2017 and is based on legislation and regulations as at the date of issue.

FMA document reference code 3409807



Background

Bundled unit trusts under the Securities Act regime

Under the Securities Act 1978 (**SA**) a number of managers operated unit trusts under a 'bundled unit trust' structure. These structures were:

- A series of unit trusts were established under the Unit Trusts Act 1960 (**UT Act**).
- Each unit trust within the series was separately registered on the Unit Trust register.
- The series of unit trusts was governed by a single master trust deed.
- The unit trusts were legally separate and did not have cross-liabilities.

The manager of the unit trust was the 'issuer', and each unit trust was considered to be a 'scheme'.¹ It was typical for each unit trust within the bundled structure to reflect a distinct investment strategy. For example, equities, property and fixed interest funds. The bundled unit trust structure was marketed through a single prospectus.

As an issuer, the manager was also a 'reporting entity' under the Financial Reporting Act 1993 (**FRA 93**).² This required the manager to prepare, audit and lodge financial statements for each scheme they managed (being the distinct unit trusts).

Under the FRA 93, where a scheme had more than one distinct pool of assets (termed 'separate funds') the manager also had to prepare financial statements for those separate funds.³ Because each scheme under a bundled unit trust structure followed a distinct strategy, they did not have separate funds. Therefore, managers only prepared scheme financial statements. Managers typically met their financial reporting obligations for all of the schemes in the bundled trust structure in a single set of financial statements. This was presented in a multi-column format.

Impact on bundled unit trusts after the FMC Act became law

Unit trusts established under the now repealed UT Act, and offered under the SA are now regulated by the FMC Act. The UT Act requirements for a manager, trustee and trust deed correspond to the FMC Act requirements for a manager, supervisor and governing document.

In transitioning bundled unit trust structures to the FMC Act, managers were faced with the choice of either:

- Registering each unit trust as a separate managed investment schemes (**MIS**); or
- Registering the bundled unit trust structure as a single MIS.

¹ Section 2, SA

² Section 2, FRA 93

³ Section 9A, FRA 93



Most managers elected to take the second option.

However, taking this option has created complexities for managers trying to meet their FMC Act financial reporting obligations. Under the FMC Act the comparable concept to the SA/FRA 93 scheme is ‘a managed investment scheme that is registered on the register of managed investment schemes’.⁵

While the FMC Act requires these ‘registered schemes’ and their managers to meet certain disclosure, governance, eligibility and conduct requirements, it does not require registered schemes to be constituted in a particular legal form.

In the case of bundled unit trust structures that have become a single MIS, the registered scheme is a notional entity. Managers must now prepare financial statements for this notional entity.

The financial statements for the registered scheme consolidate the performance of the constituent unit trusts. Further, rather than being considered a scheme for financial reporting purposes, each distinct unit trust is now a separate fund.

See the example below of the change in financial reporting requirements for a hypothetical bundled unit trust structure (ABC Investment Series). ABC Investment Series has three different strategies - equities, property and fixed interest – originally formed as separate unit trusts.

SA / FRA 93 requirement	FMC Act requirement
Scheme financial statements	Registered scheme financial statements
Equities Fund	ABC Investment Series (notional entity registered on Disclose)
Property Fund	
Fixed Interest Fund	
Separate fund financial statements	Separate fund financial statements
None	Equities Fund
	Property Fund
	Fixed Interest Fund

Most managers with bundled unit trust structures transitioned to the FMC Act during 2016. We understand that most have a balance date of 31 March 2017. This means they will need to prepare, audit, and lodge their first set of FMC Act financial statements by 31 July 2017.

In order to meet this new requirement we understand managers would incur set-up costs to put in place new accounting processes. There would also be ongoing costs for preparing the financial statements each year. In preparing these, managers will need to deal with the accounting complexities associated with consolidating a number of separate legal entities. For example, allowance would need to be made for investments and transfers made between the unit trusts.



Our proposal

Issue a class exemption

For bundled unit trusts, where the governing document establishes each unit trust as a separate legal entity, we don't think an additional set of financial statements for the registered scheme is meaningful for investors.

Therefore, we propose a class exemption to remove the obligation to prepare financial statements for the registered scheme. Managers will still be required to prepare financial statements for each separate fund (being each distinct unit trust).

Our reasons for this are:

- Where the unit trusts are separate legal entities and there are no cross-liabilities, investors in each unit trust do not have the ability to call on all the assets on the balance sheet of the registered scheme. There is therefore no purpose for these financial statements and they may confuse investors.
- The financial statements for the registered scheme are irrelevant for tax purposes. Each of the unit trusts is a separate tax entity, individually registered with IRD.

The exemption would apply to bundled unit trust structures where:

- The registered scheme is notional in nature and the assets of the entity are held by a series of separate funds.
- The governing document clearly and effectively creates the separate funds as separate legal entities.
- There are no cross-liabilities between the separate funds. Where there are cross-liabilities, ongoing financial reporting at the level of the registered scheme will remain appropriate.

How new structures will be treated

While the UT Act has been repealed and managers cannot form new unit trusts, we think MISs similar to the bundled unit trust structures discussed in this paper could be established in the future under the FMC Act and the general law of trusts.

We consider the same policy grounds outlined in this paper would apply to those structures. Therefore, we are not proposing to limit the exemption to legacy structures that have transitioned to the FMC Act.



How it will affect your 2017 financial statements

If we decide to proceed, we will aim to get this class exemption in place by the end of July 2017.

This exemption would be effective for registered schemes with a balance date of 31 March 2017. This means that managers of bundled unit trust structures won't need to prepare financial statements for the registered scheme for their 31 March balance date.

If following feedback, we reconsider this proposal, we appreciate managers would not have time to prepare and lodge financial statements by 31 July 2017. In these circumstances, as long as financial statements were lodged for each separate fund, we would not take any enforcement action for failure to lodge financial statements for the registered scheme for the year ending 31 March 2017.

We can confirm the Companies Office won't reject bundled unit trust financial statements lodged for the year ending 31 March 2017 without financial statements for the registered scheme. Managers should let the Companies Office know when they lodge their financial statements that they are relying on this exemption.



Questions

- Q1. What benefits, if any, do you envisage as a result of this exemption proposal? Please provide any quantitative or qualitative details, for example around compliance costs.
- Q2. Do you consider there are any risks that investors will not receive access to relevant information if this proposed exemption is granted?
- Q3. Do you consider our criteria for determining the application of the proposed exemption are appropriate? If not, why not, and what approach would you use? A number of the proposed criteria set out in the table on page 5 relate to the contents of the governing document. Do you see any potential difficulties in framing the exemption in this manner?
- Q4. We do not propose to limit the proposed exemption solely to legacy structures that have transitioned to the FMC Act. Do you agree this is appropriate? Do you see there being any risks around access to relevant information for this element of the exemption proposal? To the extent that there are risks, how could these best be dealt with?
- Q5. Do you have any additional information or comments that are relevant to this exemption proposal?

Feedback form: Proposed exemption from the obligation to prepare scheme financial statements for bundled unit trusts

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Proposed exemption from obligation to prepare scheme financial statements for bundled unit trusts: [your organisation's name]' in the subject line. Thank you.

Submissions close on Friday 9 June 2017.

Date:	Number of pages:
Name of submitter:	
Company or entity:	
Organisation type:	
Contact name (if different):	
Contact email and phone:	

Question or paragraph number	Response
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You don't need to quote from the consultation document if you note the paragraph or question number.

Q1	
Q2	
Q3	
Q4	
Q5	

Feedback summary – if you wish to highlight anything in particular

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.