

Consultation paper: Proposed exemption from requirement to name assets

Purpose of this consultation

The Financial Markets Conduct Regulations 2014 (FMC Regulations) require managers of managed funds to disclose certain information, including the 'name of the individual asset', about the fund's assets.

Where funds invest in loans, the 'name of the individual asset' would need to reference the name of the borrower. We have previously granted individual exemptions to managers of funds who have made such investments, so that the name of the borrower does not need to be disclosed, provided other relevant information is disclosed.

We are considering whether to grant a class exemption on the same terms in favour of all managers who make these types of investments.

We seek feedback on this proposal from managers, their advisers, supervisors, investors and other interested parties.

Submissions close on 23 July 2018.

After this date, we will finalise our policy proposals. We aim to have any exemption in force by late 2018.

This consultation is for MIS managers, advisers, supervisors, investors and other interested parties

It seeks feedback on a proposed exemption from the requirement to name assets



Document history

This version was issued in June 2018 and is based on legislation and regulations as at the date of issue.

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Background

Overview

The Financial Markets Conduct Regulations 2014 (FMC Regulations) require managers of managed funds to disclose information about the assets of the fund. Managers must provide:

- a list of the 10 highest-value individual assets of the fund and certain information against that list, including the ‘name of the individual asset’, in both the register entry for the offer¹ and each quarterly fund update²
- a complete list of the individual assets of the fund and certain information against that list, including the ‘name of the asset’, in the register entry for the offer³. This information must also be lodged with the Registrar within 40 working days after 31 March and 30 September in each year⁴.

Policy rationale

The requirement to disclose a managed fund’s portfolio holdings was intended to increase the ability of investors to monitor the investment practices of fund managers⁵. This allows an investor to assess whether the fund’s investments are consistent with the fund’s investment philosophy, and the risk threshold of the investor. It appears that this was aimed primarily at managed funds that invest in the more traditional liquid market assets such as bonds and shares. This was on the basis that it would enable investors who have invested directly into specific bond or share issues to assess their overall level of exposure and adjust their holdings accordingly.

Problems with these disclosure requirements

There is no statutory definition in either the Financial Markets Conduct Act 2013 or the FMC Regulations of the terms ‘name’ or ‘asset’. However, in our view, where funds invest in loans, the ‘name of the individual asset’ must include the name of the borrower. The asset of the fund is the loan made to the borrower, and the income that the fund earns from the asset is the interest payments made by the borrower. In our view, the most understood and accepted way to give a ‘name’ to a financial product would be by reference to the name of the issuer. Accordingly, in the case of a loan, the name of the asset would need to include the name of the borrower (i.e. the issuer of the debt security).

Where borrowers are real persons, their names are personal information. Disclosure of the names of individual borrowers in the register entry or fund update may put the manager in breach of its obligations under the Privacy Act 1993 (Privacy Act). Even if the disclosure does not result in a breach of the Privacy Act, this information is still personal information that individual borrowers are unlikely to want publicised.

¹ Clause 53(1)(c)(viii) of the FMC Regulations

² Clause 70(1)(a)(i) of the FMC Regulations

³ Clause 53(1)(j)(i) of the FMC Regulations

⁴ Clause 54(3)(b) of the FMC Regulations

⁵ Paragraph 15.1 of the Periodic Reporting Regulations for Retail KiwiSaver Schemes: [Discussion Paper, November 2010](#). The resulting KiwiSaver regulations were used as the starting point for the quarterly disclosure requirements for all open-ended managed investment schemes during the drafting of the FMC Regulations (see paragraph 386 of the Financial Markets Conduct Regulations – [Discussion Paper, Chapter 1- Disclosure, December 2012](#))



Disclosure of the name of the borrower also does not necessarily provide meaningful information that would help an investor to assess a loan investment. It is unlikely that an investor would be able to assess the credit risk of a significant number of individual borrowers, or perhaps even corporate borrowers, given that there is likely to be little or no publicly available information on those borrowers.

Proposed solution

Previous exemptions granted

We have previously granted four individual exemptions⁶ to managers of managed funds that invest in loans secured by first-ranking mortgages. This has included an exemption for a manager of a 'fund of funds' where the fund had invested in a related underlying fund. This is because under clause 70(2) of Schedule 4 of the FMC Regulations, if any part of a fund is invested in a related underlying fund, the fund must treat the individual assets of that underlying fund as if they were the individual assets directly held by the fund.

The exemptions that have been granted are in respect of the requirements to name individual loan assets in the FMC Regulations.

Those exemptions were granted on the conditions that, for any loan asset, instead of disclosing the individual borrower's name, the relevant register entry or fund update must contain:

- the registered mortgage number⁷, a description of the principal property secured by the mortgage (either residential, commercial or rural) and the geographical region that the principal secured property is located
- the composition of the fund's assets expressed as a percentage, according to the following asset types:
 - mortgage loans for which the secured property is residential property
 - mortgage loans for which the secured property is commercial property
 - mortgage loans for which the secured property is rural property
 - cash deposits held with registered banks
- the composition of mortgage loans expressed as a percentage according to each geographical region of New Zealand, and within each geographical region, details of the proportion of asset types listed above
- details regarding the value of impaired mortgage loans (if any) and the composition of those impaired mortgage loans expressed as a percentage according to each geographical region and each asset type listed above
- a clear, concise and effective statement by the manager describing the criteria used by the fund for determining which of its mortgage loans fall within each asset type

⁶ Financial Markets Conduct (First Mortgage Trust Group Investment Fund and First Mortgage PIE Trust) Exemption Notice 2015, Financial Markets Conduct (NZ Mortgage Income Trust (No 2 Fund) Group Investment Fund) Exemption Notice 2016, Financial Markets Conduct (Midlands Mortgage Trust Group Investment Fund) Exemption Notice 2016 and Financial Markets Conduct (Capital Mortgage Income Trust Group Investment Fund) Exemption Notice 2018.

⁷ If the loan is secured by more than one property, details of the principal secured property (by value) is provided.



- a table setting out the maximum loan-to-value ratio⁸ for each type of mortgage loan (i.e. residential, commercial or rural) at the date that loan was advanced.

In our view, for each of these funds, this alternative information will provide investors with more meaningful information to help them assess and understand the nature of the fund's investments and the investor's exposure to risk, than disclosing the name of the individual borrower.

Because these disclosure requirements are ongoing obligations, the relevant fund managers may need to reapply for further individual exemptions once their current exemption notices expire. This would be an ongoing cost for fund managers.

Class exemption proposal

Given the number of funds currently affected, and the possibility that further funds will be similarly affected in the future, we are considering granting a class exemption in favour of all managers of managed funds that invest in loans secured by first-ranking mortgages over real property.

This would include managers of a 'fund of funds' who invest in such managed funds (where they are related underlying funds). The exemptions granted would be in respect of clauses 53(1)(c)(viii), 53(1)(j)(i), 54(1)(a)(i), 54(1)(d) and 70(1)(a)(i) of Schedule 4 of the FMC Regulations, to the extent that those clauses require the fund to disclose the name of individual loan assets.

We propose to grant the exemption subject to equivalent conditions listed above. However, we are interested in feedback on whether:

- these conditions remain appropriate
- there are other conditions that we should consider that would be useful to help investors assess and understand the nature of the fund's investments and the investor's exposure to risk
- the disclosure of the registered mortgage number for the mortgage is useful for investors or whether some other description of the mortgage might be more helpful – for example, simply describing it as a first-ranking mortgage.

We are likely to revoke the existing individual exemptions granted on the basis that each affected fund manager would be able to rely on this new class exemption, unless this would cause any particular hardship for those fund managers or their investors.

We are also considering whether to include funds that invest in loans that are secured by second-ranking mortgages, or by other assets, or that are unsecured. We would like to hear from anyone who thinks there is a need to so extend the exemption to such funds, and what conditions are appropriate for such an exemption.

While the conditions of our existing individual exemptions would be relevant to loans that are secured by other assets, different information would be needed for unsecured loans.

Disclosure could include information on:

- whether the loan is secured, or the fact that no security or guarantee had been provided to support the loan
- what priority the security interest has against other security interests in the asset.

⁸ The loan-to-value ratio of a mortgage loan is determined at the time the loan is approved by comparing the principal amount of the loan with the manager's valuation of the secured property.



Unsecured loans may need to include more information about the borrower, such as demographic information, their residential and employment status or credit score.

It may also be necessary to restrict the type of loans that could qualify for the exemption. For example, it might be relevant for investors to know the name of the borrower if the loan is a significant amount or if the loan is made to a large, well-known corporate entity. We would like feedback on whether the size of the loan or the type of borrower (e.g. a listed entity, or of a particular net worth) should be taken into account.



Questions

1. Do you think that we should grant a class exemption to managers of managed funds that invest in loans secured by first-ranking mortgages (in respect of clause 53(1)(c)(viii), clause 53(1)(j) and clause 70(1)(a)(i) of the FMC Regulations)? This includes managers of 'fund of funds' who invest in such managed funds, where they are related underlying funds.
2. Do the conditions attached to the existing individual exemptions remain appropriate? Are there any additional pieces of information that would help investors assess and understand the nature of the fund's investments and the investor's exposure to risk?
3. Conversely, are there any conditions that you think are unnecessary? In particular, is it useful to disclose the registered mortgage number of the mortgage, or is there a better way to describe the mortgage?
4. If the existing individual exemptions were revoked, would this cause any hardship for the affected fund managers or their investors?
5. Should the class exemption include funds who invest in loans secured by assets other than real property or in unsecured loans? If yes, what information should be provided to investors in place of the name of the borrower to help them assess the investment in the loan?
6. Are there any types of loans that should be specifically excluded from this exemption? For example, loans of a particular size or loans made to certain types of borrowers (such as listed entities)?
7. Do you have any additional information or comments that are relevant to this exemption proposal?

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Feedback form: Proposed exemption from requirement to name assets

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 requirement to name assets: [your organisation's name]' in the subject line. Thank you.

Submissions close on 23 July 2018.

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.

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.