

Consultation paper: Proposed class exemption for restricted schemes from certain disclosure and reporting obligations

About this consultation paper

We are considering using our exemption power to exempt restricted schemes from certain disclosure and reporting obligations under the Financial Markets Conduct Regulations 2014 (**FMC Regulations**). The current regulatory settings require some restricted schemes to disclose certain information to members and give certain reports to the Financial Markets Authority (the **FMA**) that, given the nature of these schemes, do not always provide useful information. In addition, these obligations impose high compliance costs relative to the size of the schemes. We are therefore considering whether alternative requirements could be imposed that provide equally useful or improved information and reports at less cost. This would contribute to members' confident and informed participation in the financial markets, and avoid unnecessary compliance costs.

If granted, the exemption would provide relief for certain defined benefit restricted schemes in respect of annual fund updates and confirmation information, and for all restricted schemes in respect of quarterly reporting requirements. We propose including conditions requiring alternate disclosure and reporting.

We welcome your feedback on the exemption proposals discussed in this paper. In addition to your general feedback, we have included specific questions in this paper. Please use the feedback form to provide us with any comments.

If you have any questions, please email questions@fma.govt.nz or call us on 0800 434 566 (or +64 3 962 2698 if calling from outside New Zealand).

Submissions close at 5pm on Wednesday 21 April 2021.

Next steps

After this date, we will consider all submissions, finalise our policy proposals and, if an exemption is granted, work to get it in place.



Contents

FMA's exemption powers	3
About restricted schemes	4
Outline of issues and proposed exemptions	6
Issue 1: Annual fund updates	6
Issue 2: Quarterly reporting	8
Issue 3: Annual confirmation information	10
Questions	12



FMA's exemption powers

To grant an exemption under the Financial Markets Conduct Act 2013 (**FMC Act**), the FMA must be satisfied that the exemption is necessary or desirable in order to promote one or more of the purposes of the FMC Act. The extent of the exemption also cannot be broader than is reasonably necessary to address the matters that gave rise to the exemption.

The purposes of the FMC Act are:¹

- to promote the confident and informed participation of businesses, investors, and consumers in the financial markets
- to promote and facilitate the development of fair, efficient, and transparent financial markets
- to provide for timely, accurate, and understandable information to be provided to persons to assist those persons to make decisions relating to financial products or the provision of financial services
- to ensure that appropriate governance arrangements apply to financial products and certain financial services that allow for effective monitoring and reduce governance risks
- to avoid unnecessary compliance costs; and
- to promote innovation and flexibility in the financial markets.

¹ See sections 3 and 4 of the FMC Act.



About restricted schemes

A restricted scheme is a workplace savings scheme, superannuation scheme or KiwiSaver scheme with restricted membership or that is closed to new members, which is registered as a restricted scheme. All restricted schemes are managed investment schemes (**MIS**). Restricted schemes are legacy schemes created under the Securities Act regime and previously registered under the Superannuation Schemes Act 1989. They are allowed to continue operating under the FMC Act with a variation to the standard requirements for MIS.

Under the FMC Act and the FMC Regulations, restricted schemes have a different governance structure² than MIS, and some different disclosure obligations. This is due to the characteristics listed above and because of the relatively small size of restricted scheme assets when compared to standard MIS.

The vast majority of restricted schemes are considered 'not-for-profit' as they are designed to be run solely for the benefit of members. In developing the different requirements under the FMC regime for restricted MIS, the Ministry of Business, Innovation and Employment was concerned that the compliance costs associated with regulation under the new regime would penalise members of these schemes and lead to scheme closures.³ In the case of legacy schemes where the membership is comparatively lower in numbers than standard MIS, these associated compliance costs were seen to outweigh the benefit members would get from including these schemes as standard MIS under the FMC Act regime.

Given the relatively small size of restricted schemes' assets compared to MIS overall, their limited membership, and the fact that no more restricted schemes can be established, a different and more flexible approach was considered appropriate.

Issues and feedback requested

We have received feedback from industry that the FMC Regulations require some restricted schemes to disclose certain information to members and give certain reports to the FMA that are not always useful, and that these obligations impose high compliance costs relative to the size of these schemes. We have outlined three issues in this paper, and for each have included an explanation of the issue, a proposal for addressing the issue, and the rationale for exempting some restricted schemes from certain requirements. The issues are:

- **Annual fund updates:** Some defined benefit restricted schemes are required to provide annual fund updates under regulation 56 of the FMC Regulations with respect to very few members and for a largely technical reason. Given that fund updates are less relevant for members of a defined benefit restricted scheme, this creates an unnecessary compliance burden.

² A restricted scheme does not have a licensed manager or supervisor, but instead must have a licensed independent trustee. The manager of a restricted scheme is its trustees collectively. Our information sheet on the [governance and accountability framework for restricted schemes and their trustees summarises the duties of trustees](#). Because restricted schemes don't have supervisors, the FMA has a direct oversight role.

³ MBIE Cabinet paper Securities Law Reform para 180.



- **Quarterly reporting:** Regulations 95 and 100 of the FMC Regulations require schemes to provide quarterly reports about limit breaks and related party transaction certificates to the FMA. These requirements impose significant compliance costs on restricted schemes when many of these reports are nil reports.
- **Annual confirmation information:** The annual confirmation information required under regulation 70B for superannuation schemes and workplace savings schemes is based on schemes with a defined contribution and is not relevant information to members of a defined benefit scheme.

We would appreciate any feedback on the issues, and the proposed exemptions to address them.



Outline of issues and proposed exemptions

Issue 1: Annual fund updates

Regulation 56 of the FMC Regulations requires every manager of a registered scheme that is a managed fund to make a fund update available each quarter. If the fund is a restricted scheme the manager only has to provide an annual fund update.⁴ If the scheme is a defined benefit scheme, an annual fund update is only required *if contributions are allocated on a defined basis to any member*.

Description of issue

A defined benefit scheme is a scheme that operates on the principle of unallocated funding.⁵ For some defined benefit restricted schemes, the fund update requirement in regulation 56(2) is triggered with respect to very few members and for a largely technical reason.

The requirement is triggered where members are still employed, receive benefits on leaving service prior to retirement, and where members have voluntary accounts. This means that the entitlement payable is interest-based until retirement, and therefore contributions fall within the definition of being allocated on a defined basis. However, this is not the primary benefit payable by the scheme. The scheme still operates on the principle of unallocated funding (as defined in section 6 of the FMC Act) and the primary benefit applying on retirement is a defined benefit. Members of these schemes have no ability to change anything about the investment earnings they may be eligible for up until retirement. This contrasts with other defined contribution schemes, which provide ‘member choice’ of investment funds.

The number of members still entitled to an interest-based entitlement is typically very low, given that these are restricted schemes established under the Superannuation Schemes Act 1989, are closed to new members or have restricted membership, and will eventually phase out of existence. This means that these schemes are having to produce annual fund updates for a largely technical reason, and the annual fund updates are not useful for scheme members given that the ultimate entitlement they receive is a defined benefit.

Proposed relief and conditions

We are considering relief from preparing and distributing annual fund updates for defined benefit restricted schemes where there are very few remaining members entitled to receive an interest-based withdrawal benefit or payments from a voluntary contribution account.

We understand that some key statistical information included in fund updates (e.g. annual net return and investment strategy outline) is commonly included in annual reports provided to members by defined benefit schemes⁶, and we consider this information to be relevant and important to these members. Accordingly, we propose to require that any defined benefit restricted scheme relying on the exemption includes this additional information in its annual report.

⁴ Regulation 56(2) of the FMC Regulations.

⁵ See section 6 of the FMC Act.

⁶ Annual reports are required for registered schemes under regulation 62 of the FMC Regulations.



Rationale for relief

We consider that defined benefit restricted schemes for which the annual fund update requirement is triggered in respect to very few members should not be required to produce annual fund updates under regulation 56(2) of the FMC Act, given that fund updates are less relevant for members of a defined benefit restricted scheme and the requirement is triggered for a largely technical reason.

Fund updates less relevant for investors in a defined benefit restricted scheme

In the case of defined benefit schemes, fund updates are less relevant because investors do not bear the risk of fund performance. This is also the case for the few remaining members in defined benefit restricted schemes still entitled to receive an interest-based withdrawal benefit or payments from a voluntary contribution account. In the case of a defined benefit, investment earnings are irrelevant once the member leaves service, and the principal entitlement (the defined benefit) applies. This is because most will already have qualified for, or can expect in due course to receive, a salary and pensionable based service benefit (i.e. a defined benefit), when they eventually leave service.

Fund updates provide information about how a fund is performing (e.g. investment earnings), and can help a member compare funds (and schemes). However, these comparators are not relevant in the case of defined benefit schemes, because there is no member choice (unlike in the case of defined contribution schemes). For example, scheme members cannot choose to change the funds they invest in.

In considering the regulatory requirements for defined benefit schemes included in the FMC regime, the Government excluded defined benefit schemes from the requirement to provide fund updates, on the basis that “A fund update is not a useful reporting mechanism for a defined benefit scheme. In this case, investors do not bear the risk of fund performance. Instead they need assurance about the scheme’s financial position and performance, and an understanding of their entitlements to benefits.”⁷ This reasoning remains relevant to defined benefit restricted schemes for whom regulation 56 is only triggered with respect to very few members and for a largely technical reason.

Further, given that restricted schemes are generally smaller than other MIS, the relative compliance costs associated with producing these annual fund updates are higher, with reduced relevance to investors in a scheme where the primary entitlement is a defined benefit paid at retirement.

Related issue

Where the last active member of a restricted scheme with a primary entitlement of a defined benefit leaves employment (or ceases scheme membership) during the last financial year, the scheme still has to produce fund updates under regulation 56(2).

Similar considerations to Issue 1 (above) apply. At year end, there are no contributions allocated on a defined basis to any member, but the fund update requirement is still triggered.

In the case relief from preparing and distributing annual fund updates (as proposed above) is provided to defined benefit restricted schemes where there are very few remaining members entitled to receive an interest-based withdrawal benefit or payments from a voluntary contribution account, this ‘related issue’ will also be addressed.

⁷ Supplementary Financial Markets Conduct Regulations: Commentary and request for submissions May 2015 at paragraph 73.



Issue 2: Quarterly reporting

Regulation 95 of the FMC Regulations requires a manager of a registered scheme to provide quarterly reports about certain limit breaks to the supervisor, or to the FMA in the case of a restricted scheme.

Regulation 100 of the FMC Regulations requires a manager of a registered scheme to provide quarterly reports on related party transaction certificates to the supervisor, or to the FMA in the case of a restricted scheme.

Description of issue

The quarterly reporting obligations set out in sections 95 and 100 of the FMC Act require 'nil' reports to be provided even if there have been no relevant limit breaks or related party transaction certificates given. This ensures that MIS managers turn their mind to whether any limit breaks or related party transactions have occurred each quarter.

In the case of restricted schemes, the majority of quarterly reports provided under both regulation 95 and regulation 100 are nil reports. In view of the size and nature of these schemes, this may impose unnecessary compliance costs when alternative requirements could still ensure useful information is received by the FMA but at a lesser cost.

Proposed relief and conditions

The FMA is considering relief for all restricted schemes from some quarterly reporting, by moving to positive quarterly reporting obligations, as well as an annual reporting obligation. This would mean that quarterly reports are subject to a positive obligation and would only need to be provided if a material limit break had occurred, or a related party transaction certificate had been given. An annual report would also have to be provided, stating whether any material limit breaks, or related party transactions, had occurred during the year. This annual obligation would include any nil reports.

We note that the following provisions will still apply:

- regulation 94 of the FMC Regulations, which requires the manager of a restricted scheme to provide an immediate report to the FMA in the event of an uncorrected limit break; and
- section 173(5) of the FMC Act, which requires the licensed independent trustee's consent to any related party transaction certification.

Rationale for relief

Requiring quarterly reports in respect of limit breaks and related party transaction certificates when these reports would be nil reports imposes an unnecessary compliance cost in respect to restricted schemes. In view of the size and nature of these schemes, we consider it appropriate that they should instead be subject to a positive quarterly reporting obligation in respect of limit breaks and related party transaction certificates, and annual reporting that includes any nil reports.

Restricted schemes generally smaller

Restricted schemes are generally smaller (in asset size) than other MIS, and therefore limit breaks occur less often. Because the schemes are smaller (and have restricted membership or are closed to new members), trustees generally have a higher level of oversight of the scheme, which is tightly controlled and with fewer funds than other MIS. Therefore, we consider the risk associated with excluding nil reporting to the FMA for restricted schemes is low. Further, because these schemes are smaller, compliance costs are comparatively higher than for other MIS.



Different regulatory treatment

Restricted schemes have different governance and reporting requirements under the FMC regime because a number of them are workplace savings schemes and are generally considered 'not-for-profit' given they are designed to be run solely for the benefit of members, and also because they are legacy schemes with decreasing and easily identified membership.

There is a reduced risk of related party transaction harm for restricted schemes compared to other MIS, given the different nature of the related party transactions they enter into. Most restricted schemes' related party transactions relate to the fees payable to the scheme's administration manager or independent trustee, as opposed to investment in a related party of the scheme, as is the case for other MIS (e.g. a subsidiary). The risks are different, and are somewhat mitigated by regulation 176 of the FMC Regulations, which imposes an additional check on these transactions by limiting the in-house asset ratio in relation to any related party or scheme participant of a restricted scheme to less than 5% of the net asset value of the scheme property.

We consider that requiring nil related party transaction reporting in the case of restricted schemes imposes unnecessary compliance costs in light of the alternative reporting option available and the different nature of the related party transactions for these schemes, and the corresponding lower risk to investors.

Timing issues

We understand there are particular characteristics of restricted schemes that may mean providing reports within 10 working days of each quarter-end is especially difficult and increases compliance costs for these schemes. Factors that may lead to these difficulties are:

- delays in obtaining core compliance information given the nature of the outsourcing of investments for restricted schemes; and
- the requirement to obtain all trustees' approval of the reports and get dual sign-off of the documents (the licensed independent trustee and one other trustee).



Issue 3: Annual confirmation information

Regulation 70B requires confirmation information for superannuation schemes and workplace savings schemes to be provided in relation to each accounting period.

Description of issue

The information that must be provided in the annual confirmation under regulation 70B of the FMC Regulations is based on defined contribution schemes (i.e. is transaction-based). Opening and closing balances, and contribution amount concepts are not relevant to the benefit entitlement of members in a defined benefit scheme. The FMC Regulations do not distinguish between defined benefit and defined contribution schemes with respect to annual confirmation information.

Proposed relief and conditions

The FMA is considering relief to allow defined benefit restricted schemes to provide confirmation information that is benefits-based (and focused on current entitlements) rather than transaction-based. In the case of defined benefit restricted schemes, we consider this information to be more meaningful to members.

More appropriate confirmation information for defined benefit scheme members would include:

- current expected pension assuming no salary increase;
- resignation benefit calculation;
- disablement benefit; and
- death benefit calculation.

We have provided 2 examples below of alternative information that could be required as a condition of the exemption. We invite your comments on these examples and any further information you think would be useful to include.

We note that we do not consider it appropriate for this relief to extend to accounts-based master trust plans that have an employer-underwritten minimum preserved defined benefit calculation which is compared to a member's defined contribution accumulation. It remains important these beneficiaries are provided with information about the investment earnings on their account balances, and their entitlement accumulation.



Example 1

PERSONAL DETAILS			
Member No of Birth	«Mem_Num» «DOB»		Date
Superannuation Salary	\$«Salary»	Date Joined Scheme	«Joined»
YOUR BENEFITS			
NORMAL RETIREMENT BENEFIT at «NRD»			
	an annual pension of		\$«NRD_Pen»
	<u>OR</u> a lump sum of		\$«NRD_LS»
DEATH BENEFIT at 1 January 2020 – a minimum lump sum of			\$«Death_Ben»
Normal Retirement and Death Benefit are based on:			
Retirement Benefit Factor of	«NRD_Fac»		
Retirement Benefit Salary of	\$«NRD_Sal»		
DISABLEMENT BENEFIT at 1 January 2020 - an annual pension of			\$«Dis_Ben»
Based on: 75% of Final Average Salary less tax			
LEAVING SERVICE BENEFIT at 1 January 2020		EXISTING BASIS	ALTERNATIVE BASIS
Lump Sum of		\$«Wdl_Ben»	\$«AltWdl_Ben»
This would have converted to an annual pension of:		\$«Wdl_pension»	\$«Alt_Wdl_pension»
Based on:			
Leaving Service Multiple of		«Wdl_Fac»	«AW_Fac»
Average Salary of		\$«Wdl_Sal»	\$«AW_Sal»

Example 2

Resignation Benefit as at 31 March 2019	
Voluntary Contributions	
Opening Balance	«Vol_Open»
Contributions	«Vol_Ytd_Cont»
Interest	«Vol_Ytd_Int»
Closing Balance	«Vol_Closing»
Company Funded Benefit	«Addcomp»
Total Resignation Benefit as at 31 March 2020	«ResigBen»
Death in Service Benefit as at 31 March 2020	
A lump sum of	«Dthben»
Total and Permanent Disablement Benefit as at 31 March 2020	
A pension of	«TPDben» p.a.
Projected Retirement Benefit at age 65 based on current Salary	
Either	A pension of «projRBpen» p.a.
Or	A lump sum (100% Commutation) of «projRBlump»
Or	A combination
Your Current Contributions	
Voluntary Contributions	«VolCont»
Nominated Dependants	
	% Share
«Benefici1_Name»	«Benefici1_»
«Benefici2_Name»	«Benefici2_»
«Benefici3_Name»	«Benefici3_»



Questions

Issue 1: Fund updates

1. Do you think that we should grant a class exemption to managers of restricted schemes with a primary entitlement of a defined benefit that has very few members left receiving a defined contribution entitlement until retirement, from the requirement to provide an annual fund update under regulation 56(2) of the FMC Regulations? Please explain the reasons for your view.
2. If this exemption was granted, do you think a condition should be imposed requiring the scheme to include certain key statistical information (e.g. annual net return and investment strategy outline) in the scheme's annual report? Please explain the reasons for your view.
3. What other information would be useful to include in the annual report?

Related issue

4. Do you agree that the exemption proposed in response to Issue 1 (fund updates) will address the 'related issue'?

Issue 2: Quarterly reporting

5. Do you think that we should grant a class exemption to managers of restricted schemes from the requirement to provide quarterly updates of limit breaks under regulation 95 of the FMC Regulations for quarters in which there were no limit breaks? Please explain the reasons for your view.
6. Do you think this exemption should also be subject to the requirement that an annual limit break report is provided, stating whether there have been any limit breaks in the previous year to which section 167 of the FMC Act applies (including nil reports)? Please explain the reasons for your view.
7. Do you think that we should grant a class exemption to managers of restricted schemes from the requirement to provide quarterly updates on related party transaction certificates under regulation 100 of the FMC Regulations for quarters in which there were no related party certificates given? Please explain the reasons for your view.
8. Do you think this exemption should also be subject to the requirement that an annual report is provided to the FMA on related party transaction certificates, stating whether there have been any certificates given under section 173(4) of the FMC Act in the previous year (including nil reports)? Please explain the reasons for your view.

Issue 3: Annual confirmation information

9. Do you think that we should grant a class exemption to defined benefit restricted schemes from the requirement to provide confirmation information under regulation 70B of the FMC Regulations? Please explain the reasons for your view.
10. Do you think this exemption should be subject to the condition that these schemes provide alternative confirmation information that is more relevant to members of a defined benefit scheme? Please explain the reasons for your view.
11. Do you have any comments on Example 1 and Example 2 provided above of alternative information that could be required?



12. What other information do you consider would be useful to include in the alternative confirmation information?
13. Do you agree that relief from the annual confirmation information requirement should not be extended to account-based master trust plans that have an employer-underwritten minimum preserved defined benefit calculation which is compared to a member's defined contribution accumulation? Please explain the reasons for your view.

General questions

14. Are the proposed conditions appropriate? Should there be any additional conditions? Conversely, are there any conditions you think are unnecessary? Please explain the reasons for your views.
15. If the proposed exemption was granted, would you rely on it? Which parts of the exemption would you rely on?
16. What are the costs to restricted schemes of complying with the disclosure and reporting obligations outlined in this paper? Are these costs likely to increase or decrease over time? Please explain the costs associated with each regulation. How would these costs change if the exemptions are granted?
17. Will restricted scheme members receive relevant and appropriate information if these exemptions are granted? Please give reasons for your view.
18. Do you think that the proposed exemptions will promote the purposes of the FMC Act? If so, how? If not, why not?
19. Do you have any other comments?

Feedback: Proposed exemptions for restricted schemes from certain disclosure and reporting obligations

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Feedback: Proposed exemptions for restricted schemes from certain disclosure and reporting obligations' in the subject line. Thank you. **Submissions close on Wednesday 21 April 2021.**

Date: _____ Number of pages: _____

Name of submitter: _____

Company or entity: _____

Organisation type: _____

Contact name (if different): _____

Contact email and Phone: _____

Question Number	Comment	Recommendation
	<i>You don't need to quote from the consultation document if you use part & paragraph numbers.</i>	
	<i>You may attach extra pages - please label each page with your name & organisation.</i>	

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.