FINANCIAL MARKETS AUTHORITY

TE MANA TATAI HOKOHOKO - NEW ZEALAND

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Regulatory impact statement – Methodology for calculating fees in KiwiSaver annual statements

This document is for

KiwiSaver providers.

It discusses the methodology that must be used to calculate the total sum of fees paid by KiwiSaver investors in annual statements.

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Executive summary

This regulatory impact statement (RIS) is about a notice setting out the methodology KiwiSaver scheme providers must use when they calculate the fees paid by KiwiSaver investors in annual statements. It summarises the problem we are trying to address, our objectives, the options and their associated impacts, and the consultation feedback we considered before deciding on the methodology.

It is important for KiwiSaver investors to be informed about the fees they are paying and receive accurate information. We want to give KiwiSaver scheme providers certainty about the legal requirements and, as far as possible, ensure they are calculating fees in a consistent manner. We are also trying to avoid burdening KiwiSaver scheme providers with unnecessary costs, and give them enough time to comply.

After considering regulatory and non-regulatory impacts, we decided to issue a methodology notice requiring KiwiSaver scheme providers to allocate fees charged at the fund level to investors using either:

- the investor's average balance (total annual fund charges calculation or TAFC methodology); or
- the investor's balance as at the date the units of the fund are valued (cents per unit calculation or CPU methodology).

Our preference is for KiwiSaver scheme providers to use the CPU methodology, as we believe this will lead to a more accurate figure for investors. We will review our methodology notice within the next five years and decide whether (in future) all KiwiSaver scheme providers should only use the CPU methodology.

Introduction

Background

By law, KiwiSaver scheme providers must give their investors an annual statement at the end of each accounting period. This statement contains useful information about the investor's retirement savings for that year.

The required content of these annual statements is set out in section 100 of the Financial Markets Conduct Act 2013 (FMC Act) and regulations 69-71 of the Financial Markets Conduct Regulations 2014 (FMC Regulations). The FMC Regulations were amended in April 2017, changing the requirements for these annual statements (new regulations).

One of the key changes is that the statements must now show the approximate total fees, in dollar value, that an investor was charged for that year. The new regulations do not specify how total fees should be calculated. Instead, they provide that total fees must be calculated in accordance with any framework or methodology specified in a notice issued by the FMA.

The frameworks, or methodologies, issued by us are about detailed or technical matters. They help market participants understand the requirements of the FMC Act. Frameworks or methodologies are subordinate legislation. Our power to issue either of them does not have the same restrictions as the power to issue exemptions. To issue a framework or methodology there is no requirement that we are satisfied that it is necessary or desirable to promote the purposes of the FMC Act. We just need to ensure the methodology is not inconsistent with the FMC Act or any regulations. We also must consult with those substantially affected by the proposed methodology.

Statement of the Problem

The new regulations do not prescribe how personalised total fees should be calculated.

This leads to consistency issues for:

- how fees should be calculated, including how accurate and up to date they need to be; and
- how fees, including underlying fees which are indirect in nature, should be allocated back to individual investors.

There are different methods to resolve this, with varying degrees of accuracy. Without a prescribed methodology, providers would be free to use any calculation method they think fit.

We want to ensure that KiwiSaver scheme providers use the most accurate method reasonably available to them to calculate fees. We must also take into account that KiwiSaver scheme providers don't have much time to build systems needed to make these calculations, as fee information must be included in the next set of annual statements.

Objectives

One of the objectives of the new regulations was to ensure investors are given key information about their investment in a clear, concise and easy to understand way[1]. For fees, this was to be achieved by disclosing fees in personalised

[1] This was objective one for the new regulations, as described on page 12 of the Ministry of Business, Innovation & Employment's Regulatory impact statement – Changes to annual statement information for KiwiSaver investors (December 2016) http://www.mbie.govt.nz/publications-research/publications/business-law/ris-kiwisaver.pdf/view

dollar values. We want to make sure KiwiSaver investors receive accurate information about the fees they have been charged. Providers also want certainty that they are using an appropriate method to calculate total fees, and ideally all providers would use the same method for consistency in approach.

Another objective was to ensure the costs to KiwiSaver scheme providers do not outweigh the net benefits to KiwiSaver investors[2]. KiwiSaver scheme providers must start disclosing personalised dollar value fees in their 2018 annual statements. As this accounting period has already commenced, they have limited time to build any systems they may need to make these calculations. Feedback tells us that these systems can be expensive to build and implement. We want to provide KiwiSaver scheme providers as much time as possible to build systems that comply with our prescribed methodology, without unnecessary costs.

We issued a methodology notice requiring KiwiSaver scheme providers to allocate fees charged at the fund level to investors using either the TAFC methodology or the CPU methodology. To avoid the methodology being potentially retrospective in its application, it only applies to accounting periods of a KiwiSaver scheme commencing on and after the commencement date of the notice. That means KiwiSaver scheme providers will not need to comply with the methodology notice when producing their 2018 annual statements. However in practice we expect providers will still comply with the methodology, to avoid the cost of changing systems when producing their 2019 annual statements.

Before deciding to issue a methodology notice, we measured the four options outlined in this RIS against the objectives discussed above.

As part of our policy process we worked and consulted with KiwiSaver scheme providers and their administrators and registry service providers.

[2] This was objective four of the new regulations, also described on page 12 of the Regulatory impact statement referred to above.

Options and impact analysis

Options

Based on the submissions received, we considered four options:

Option 1: Issue a methodology notice requiring all providers to use the TAFC methodology when calculating fees.

Option 2: Issue a methodology notice requiring all providers to use the CPU methodology when calculating fees.

Option 3: Issue a methodology notice requiring all providers to use either the TAFC methodology or CPU methodology when calculating fees (our preferred option).

Option 4: Status Quo – do nothing.

Option 1: Require all providers to use the TAFC methodology when calculating fees

Description

Option 1 would require all KiwiSaver scheme providers to use the TAFC methodology when calculating total fees. The TAFC methodology requires a provider to derive the total fund charges by applying the most recently completed year's total fund charges as a percentage of the average net asset value of the fund, to the investor's average annual balance. The TAFC methodology is largely based on the existing requirements for fee disclosure in the product disclosure statement (PDS) and fund update. This means it would not require an issuer to do additional work to derive the fund's total fund charges.

Impact analysis

This methodology is not as accurate as the CPU methodology, as the investor's average balance rather than actual balance is used. That balance is recorded on a monthly, weekly or daily basis and then averaged. Therefore, the attribution of fees is an approximation of the fees paid by the investor. This will be affected if large infrequent withdrawals or contributions are made by an investor throughout the year. However assuming KiwiSaver balances are relatively stable, and are a long-term investment (up to 40+ years), this should generally not be an issue.

This methodology is less computationally intensive than the system required for the CPU methodology, as only one calculation would be made at the end of the year. All submitters confirmed they could implement such a system in time to deliver the 2018 statements, provided our methodology was released promptly.

Providers offered a wide range of cost estimates for implementing a system using the TAFC methodology. Some providers are already using this method so the cost has already been incurred. For providers who have built a system using the CPU methodology already, there would be additional cost on top of those already incurred to build that system.

While this method is not the most accurate, it is consistent with our objectives, as it is achievable within the timeframe and includes underlying fund charges for the most recent period.

We think providers should be able to use this methodology. We do not want to prescribe this as the only methodology, as this would prevent providers already able to use the more accurate CPU methodology (and who may have already built the necessary systems) from using it.

Option 2: Require all providers to use the CPU methodology when calculating fees

Description

Option 2 would require all KiwiSaver scheme providers to use the CPU methodology when calculating total fees. The CPU (cents per unit) methodology is based on the PIE tax calculations under the Income Tax Act, and is largely similar to the TAFC methodology. The main difference is that fees would be attributed to investors at every fund valuation period, using the investor's actual balance at the time the fund is valued.

Impact analysis

This methodology is more accurate than the TAFC methodology, as calculations are carried out at every fund valuation period (usually on a daily basis) using the investor's corresponding actual balance. It takes withdrawals and contributions made throughout the year fully into account.

Some submitters said it would be impossible to build the necessary systems in time to deliver the 2018 statements. We received a range of cost estimates to implement a system using the CPU methodology. Some providers are already using the TAFC methodology and will incur further costs to change their systems. Others, who have built a system using the CPU methodology, said it was relatively low cost to build.

This will offer the most accurate results, so we think it is the best method of calculation. But it will largely produce the same or similar result as the TAFC methodology if no large infrequent withdrawals or voluntary contributions are made by an investor, or if the fund charges are relatively constant. Also, some submitters believe it will be more expensive to implement than the TAFC methodology, and that they will be unable to implement this system in the timeframe.

Based on this information, we did not think we should prescribe only this methodology. If we did, we expect some providers would ask for exemptions requesting more time for implementation. If granted, this would mean investors in affected schemes would not receive personalised fee disclosure for at least another year. We would not want providers to implement the TAFC methodology on a transitional basis, as that would mean they would need to pay for building two different systems in a short period of time.

Option 3: Require all providers to use either the TAFC or the CPU methodology when calculating fees

Description

Option 3 would require all KiwiSaver scheme providers to use either the TAFC methodology or the CPU methodology when calculating total fees.

Impact analysis

Giving providers a choice gives comfort that a minimum standard has been imposed, while enabling each provider to choose to implement the system that best suits them in the time available. Providers who already have a system that meets those standards would not need to incur the additional cost of switching to a new system.

We initially thought the best option would be for all providers to use the same methodology to ensure consistency and comparability amongst providers. However this does not seem possible given the accounting period for the 2018 annual statements has already commenced.

There is still consistency, in that providers are using one of two methods. Should KiwiSaver investors wish to compare the fees of different providers, they can use the PDS or fund updates of those providers.

Option 4: Status Quo – Do nothing

Description

Providers would be free to calculate total fees however they thought best. We would not issue a methodology notice.

Impact analysis

This option does not achieve the objectives discussed in this RIS. The accuracy of calculations would depend on the particular method selected by the provider. There would be no consistency between providers.

Without a methodology, providers would also not be certain they are complying with the requirements of the new regulations. Guidance could be issued to support providers. However guidance alone seems inappropriate when we are asking providers to incur costs to build systems implementing our preferred methodology – as compliance with a methodology notice is mandatory. Our ability to enforce minimum reporting requirements is also limited if only guidance is issued.

Summary of options against objectives

	Option 1: TAFC methodology	Option 2: CPU methodology	Option 3: Either TAFC or CPU	Option 4: Status quo
Accurate information provided	Not always as accurate as the CPU methodology, but parameters imposed to ensure a minimum standard ✔ Stops providers using the more accurate CPU methodology ✖	Most accurate methodology ✔✔	A minimum standard is imposed, but providers who are capable of using the more accurate CPU methodology can do so ✔	Providers are free to use whatever methodology they wish which may or may not be accurate ✖
Promotes transparency	Provides consistency ✔✔	Provides consistency ✔✔	Provides consistency in that providers will be using one of two options ✔	No consistency ✖
Avoids unnecessary compliance costs	Not as costly as the CPU methodology ✔ Some providers have already built a system using the CPU methodology so will incur extra cost switching to TAFC ✖	Most expensive option ✖ Some providers are already using the TAFC methodology so will incur extra cost switching to CPU ✖	Providers can choose the least expensive option for them ✔	Some cost still involved, as providers need to build a system, but likely not as costly as the CPU methodology ✔

Providers have certainty that they are in compliance with the regulations	Provides certainty ✓✓	Provides certainty ✓✓	Provides certainty ✓✓	Lacks certainty ✗
Providers have enough time to comply	All providers can comply in time ✓✓	Some providers will not have enough time to comply ✗	All providers can comply in time ✓✓	All providers can comply in time ✓✓

Key

✓✓ Meets the policy objectives
✓ Partially meets the policy objectives
✗ Does not meet the policy objectives

Consultation

Consultation process

In January and February 2017, we attended meetings organised by MBIE with a number of KiwiSaver scheme providers to gather feedback on the new regulations. At those meetings, providers gave us their views on both the TAFC and CPU methodologies. The new regulations then came into force in April 2017.

We published a consultation paper seeking feedback on a proposal to issue a methodology notice in April 2017. We received 14 submissions from KiwiSaver scheme providers, their administrators, and registry service providers. As part of the consultation, we asked submitters for their views on both the TAFC and CPU methodologies, noting that at that time we favoured the TAFC methodology, as we were concerned providers would not be able to build any necessary systems for the CPU methodology, in time.

We also consulted extensively with submitters as we settled the methodology notice.

Submissions received

We received written submissions from:

- Trustees Executors Limited
- Fisher Funds Management Limited
- MMC Limited
- ANZ New Zealand Investments Limited
- NZX Limited
- Mercer (NZ) Limited
- Craigs Investment Partners
- Bank of New Zealand
- Financial Services Council and Workplace Savings NZ Incorporated (joint submission)
- Milford Funds Limited
- ASB Bank Limited
- AMP Wealth Management New Zealand Limited
- BT Funds Management (New Zealand) Limited
- Link Market Services

Summary of submissions

Most submitters agreed that we should prescribe the method of calculation for total fees. They thought this would provide certainty and create a consistent approach amongst providers.

We were interested to see that most submitters wanted to use the CPU methodology rather than the TAFC methodology, believing it to produce a more accurate result. However other submitters said they would be unable to build the systems for the CPU methodology in time for 2018 annual statements, and it would be expensive for them to do so. Those submitters were able to build a system using the TAFC methodology, provided our methodology notice was released as soon as possible.

Submitters also tested our objective of seeking a single consistent approach among providers. Good arguments were raised against the need for all providers to use the same methodology to ensure comparability. They thought investors would not be able to easily compare the fees charged with others, as they would need to find someone with the same balance and same investments. Instead, investors would be able to compare fees using the fee information in the PDS and fund updates for the relevant funds.

One submitter noted that all their fees (including underlying fund charges) were charged directly to the investor, rather than at the fund level. On that basis, they would not need to use the methodology proposed.

For the TAFC methodology, we asked whether the investor's average balance should be calculated using the investor's daily or monthly balance. Most submitters preferred the daily balance, but there was also support for use of the monthly balance. This has been reflected in the methodology notice issued.

We also asked KiwiSaver scheme providers to let us know if there were any other methodologies we should consider. Some proposed a few slight variations to the CPU methodology, but we are unable to expand on these as they appeared to be quite specific to the particular computer systems used.

Some submitters wanted more guidance on the use of estimates when calculating fees. We have updated our existing guidance note for managed funds on fee disclosure in response to this request. The guidance note now includes specific guidance for KiwiSaver annual statements, but the same rules that relate to PDSs and fund updates will generally apply.

We did not think it was appropriate to provide a materiality threshold or rule relating to estimates. The new regulations are clear that you must use a best estimate of the fees if actual figures are not known. The guidance note also states that we encourage, but do not require, KiwiSaver scheme providers to exchange ISI files. Although some providers asked for more specific guidance on the content of those files, we do not think that this is appropriate as we are not requiring the use of ISI files. We understand that the systems that generate ISI files all have different levels of functionality specific to the relevant administrators and managers, so we think industry is better positioned to agree a common approach for how they are exchanged. We may reconsider this in the future.

In response to the consultation feedback, we developed option 3 which included:

- allowing KiwiSaver scheme providers to choose between the TAFC methodology and CPU methodology
- confirming that our methodology does not apply if KiwiSaver scheme providers can calculate the actual fees charged to each investor.

Based on the submissions received, we think option 3 will best achieve the objectives outlined in this RIS.

Conclusion and preferred option

Overall, we think option 3 - issuing a methodology notice that would require all providers to use either the TAFC or the CPU methodology when calculating fees - will best meet the objectives outlined in this RIS. This option will require KiwiSaver scheme providers to calculate fees paid by investors in the prescribed manner, ensuring transparency for investors. It prescribes a minimum standard of accuracy that KiwiSaver scheme providers must comply with. Providers can also choose the method that best suits their existing processes, so it avoids unnecessary compliance costs. While we have given KiwiSaver scheme providers the choice between the two methodologies, we would prefer they use the CPU methodology, where possible. We believe this method provides a more accurate and meaningful fees figure for investors.

We will review the methodology notice within the next five years to decide whether or not all KiwiSaver scheme providers should only use the CPU methodology in future.