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Managed fund fees and value for money

Guidance and principles to help managers and supervisors of KiwiSaver schemes and other managed investment schemes to demonstrate how they are meeting their existing obligations, statutory duties, and conduct expectations in respect of fees and value for money.

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

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Introduction

The FMA has an ongoing focus on whether KiwiSaver schemes provide good value for money. Through our own and others' work and research, we have found:

- Where scale exists, its benefits are typically not shared with members.
- There is no systematic relationship between fees charged and returns received.
- There is no systematic relationship between fees charged and degree of active management.
- Active funds typically do not outperform their market index after fees over meaningful periods (i.e. their minimum suggested investment timeframe, and longer). Similarly, passive funds typically do not closely replicate their market index after fees.

Purpose of this guidance

The purpose of this guidance is to help managers and supervisors of KiwiSaver schemes and other managed investment schemes to demonstrate how they are meeting their existing obligations, statutory duties, and conduct expectations in respect of fees and value for money. Boards and senior management should, with assistance from their supervisors, take a disciplined approach to considering and being more transparent about the fees they charge and why, and what value their members receive in return.

Adopting this approach will help some schemes highlight where they need to improve their products' value for money, for instance by reducing fees, enhancing the value provided, or ceasing to offer poor-value products. Ultimately, it will enable schemes to justify and differentiate from other schemes their fees and the value for money they provide.

Greater transparency about fees and value for money will enable scheme members to make more informed decisions about who they invest with. It will enable broader scrutiny and commentary from the media, consumer advocates, political stakeholders, and the public, which will help to inform members' investment decisions.

While we have published information for KiwiSaver members about considering the value they receive for the fees they pay, research repeatedly shows that, in respect of financial products, regulatory effort is far more effective when focused on product providers themselves.

Application of this guidance – KiwiSaver schemes and other managed schemes

The statutory obligation not to charge an unreasonable fee is specific to KiwiSaver schemes, and much of the work informing this guidance has focused on KiwiSaver schemes. However, the overarching statutory duties to act in members' best interests and ensure members are treated equitably, and the FMA's expectations for good conduct, apply to managers and supervisors of all managed schemes.

Accordingly, while specific parts apply only to KiwiSaver schemes, most of this guidance is applicable to all managed schemes, including schemes closed to new members. All managers should, together with their

supervisor, regularly review their fees and what they provide in return, to evaluate whether members receive value for money.

The FMA has the tools to respond to all the issues identified in this guidance. See 'How the FMA can respond' on page 14.

This guidance note should be read alongside the related KiwiSaver performance fees guidance.

The ongoing obligation not to charge an unreasonable fee

The KiwiSaver scheme rules prescribe that the manager of a KiwiSaver scheme (or any other person who charges a fee for services in relation to the scheme[1]) must not charge a fee that is unreasonable. The definition of 'fee' includes all fees charged either directly or indirectly from a member's KiwiSaver account[2].

The obligation is implied into the KiwiSaver scheme's governing documents[3] and is an ongoing obligation in accordance with both the KiwiSaver Act 2006 (KiwiSaver Act) and the Financial Markets Conduct Act 2013 (FMC Act). Obligations imposed by the KiwiSaver Act have been expressly incorporated into the FMC Act[4]. Under the FMC Act, the obligation not to charge an unreasonable fee is within both the definition of an 'issuer obligation' and a 'market services licensee obligation'[5].

While the FMA certifies a fee meets the requirement not to be unreasonable as part of the initial registration requirements[6], this certification does not mean the fee cannot become unreasonable at a later date, even if that fee has not changed. Current KiwiSaver performance fees guidance states that we expect the KiwiSaver scheme supervisors to monitor schemes for compliance with their obligations under their trust arrangements, including the obligation that fees charged are not unreasonable.

Overarching statutory duties and value for money

Conduct is at the core of the FMC Act. The Act applies to all managed funds and their supervisors, with Part 4 imposing overarching statutory duties, requiring managers and supervisors to act in the best interests of members[7].

All managers must ensure ongoing registration requirements are complied with (one of which is the requirement that KiwiSaver fees are not unreasonable), and have a duty to act in accordance with the governing document and all other issuer obligations. Ultimately, managers are accountable to their members and must act with professional care, diligence and skill, put members' interests first, and ensure members are treated equitably. This includes acting in members' best interests from a value for money perspective.

Licensed supervisors, as frontline regulators, must actively supervise the manager's performance of its functions, market services licensee obligations and issuer obligations. Supervisors are also required to act on the members' behalf in relation to the manager, the governing documents, and issuer obligations.

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[1] Includes the supervisor, administration manager and investment manager

[2] KiwiSaver Act 2006 (KS Act), s 4

[3] Financial Markets Conduct Act 2013 (FMC Act), s 135(2)

[4] Annex One sets out the number of ways the FMC Act incorporates the obligation not to charge an unreasonable fee.

[5] FMC Act, s 6

[6] FMC Act, s 128(1)(i)

[7] See Annex One for a list of relevant supervisor and manager duties.

Regular review of scheme fees

Reviewing fees and value for money should be a continuous process. We expect managers and supervisors of all managed schemes to regularly review fees with members' best interests as the overarching consideration. Failure to carry out regular reviews increases the risk that the scheme is poor value and/or its fees are unreasonable, and that the manager is failing to meet its FMC Act obligations – consequently increasing the risk of an FMA response.

The KiwiSaver Regulations list factors the FMA must consider when assessing a KiwiSaver scheme's fees, including the key features of the scheme, the services provided and the costs of the scheme. Under the KiwiSaver Regulations, the FMA has discretion to consider any other matter we consider relevant and to determine the process for any fee assessment of a KiwiSaver scheme[8].

The overarching statutory duties to act in members' best interests and ensure members are treated equitably are particularly relevant when considering fees and value for money. These duties form the basis of our expectations for regular reviews conducted by all managed schemes.

Regular reviews should consist of:

- at least one formal, annual review involving the supervisor, where the manager and supervisor conclude the scheme is providing value for money and is not charging unreasonable fees. If this is not the conclusion, the manager and supervisor should agree on appropriate steps to increase the value of the scheme to its members and/or reduce fees, including considering refunding members who have been overcharged[9]; and
- a review any time the manager updates the Statement of Investment Policies and Objectives (SIPO) or other governing document because of a change that materially affects cost (such as changes of strategy, asset allocation or underlying investment managers). Again, this review should involve the supervisor.

We expect managers and supervisors to provide us with evidence of these reviews, and strongly encourage schemes to report the results of the reviews to their members in an appropriate form.

We note that, if KiwiSaver scheme fees are increased, managers have a statutory duty to notify us of the increase before or as soon as is reasonably practicable after the increase takes effect. Failure to do so constitutes an offence with a fine of up to $50,000[10].

Supervisors' role

Supervisors have the core supervisory and compliance monitoring role for managed schemes. A manager charging an unreasonable fee is in contravention of its issuer obligations, and the supervisor is required to provide a s203 notification of the contravention and the steps they intend to take in response[11]. We expect supervisors to monitor fees and to regularly challenge the manager to ensure fees are not unreasonable or represent poor value for money. This guidance is designed to help supervisors fulfil this important part of their role by framing questions to guide the process and any governance frameworks developed to implement it.

[8] KiwiSaver Regulations 2006 (KS Regulations), regs 10(3), 11 and 12; KS Act 2006, s 118(b); Replicated in Annex One.

[9] Charging unreasonable fees contravenes the manager's issuer obligations. The supervisor is required to advise the FMA of the contravention and the steps they intend to take in response.

[10] KS Act, s 117

[11] FMC Act, s 203

Principles-based reviews

Reviews should be based on four key principles. We will apply these principles when we assess reviews conducted by managers and their supervisors, and if/when we conduct a fee review ourselves.

As context for all reviews, including FMA reviews, this guidance does not equate good value with cheapness and does not prohibit or prescribe any fee structure, size, or type[12]. This guidance also recognises that competent investment management is valuable and managers profiting from it is not inconsistent with acting in their members' best interests.

The key principles

1. **Risk and return are critical**
   The two key indicators of value for money for members are how well the manager's process and capabilities appropriately minimise investment risk that members experience (i.e. through volatility and loss); and members' return after fees.

2. **The financial value of investment management must be shared**
   A member has not obtained the financial value of investment management if it is not shared appropriately between the manager doing the work and the member paying the cost and providing the capital, and therefore taking the risk.

3. **Advice and service is received, not just offered**
   A service or feature provided by a manager contributes to a member's value for money only if it demonstrably helps the member make better investment decisions (such as advice), or demonstrably benefits the member's investment account (such as an investment process that reduces market risk, enhances return, or both).

4. **Review yourself as you review others**
   When evaluating their fees and value for money for members, managers should use the same rigour they would apply to assessing the same of any underlying manager. There may be good reasons for the outcomes to be different – which the manager should explain and substantiate – but there is no justification for the quality of the assessment to be different.

Principle 1: Risk and return are critical

Risk management

Investment risk taken by the member is what is being managed by the investment manager. Return is a by-product.

[12] Other than existing constraints on performance fees set out in Performance Fees and Ethical Fund Fees guidelines and KiwiSaver performance fees guidance.

The simplest indication of whether a manager's investment risk management capabilities provide value for money is whether they consistently exceed the return of their market index if active, or replicate it as closely as possible if passive.

If the manager is unable to do this over meaningful periods (the minimum suggested timeframe for holding the investment as set out in the relevant Product Disclosure Statement, and longer), supervisors should query whether the manager has sufficient investment risk management competence to deliver their chosen strategy. If the fund has been invested for less than its minimum suggested timeframe, performance relative to market index (and comparative funds) is still a useful basis for inquiry.

Note the value to members of their manager beating the market index if active, or closely replicating it if passive, assumes the index properly reflects the investments – and therefore the risk – of the relevant fund. If the investments and risk of the market index are significantly different, the index may not be a reliable indicator of the manager's competence – particularly if the index contains lower-risk investments than the fund (e.g. the fund is predominantly equities but the market index is based on cash).

Note also this performance is before fees and tax. A manager with sufficient investment risk management competence to exceed or deliver a market index return before fees, may fail to do so after fees. This may mean the cost of purchasing the manager's competence outweighs its benefits. That is discussed further below in 'Return after fees' and in 'Principle 2: The financial value of investment management must be shared'.

Risk management – useful questions for managers and supervisors

- How has the fund performed, before fees and tax, relative to its market index over the minimum suggested timeframe for the fund? Is a poor performance trend emerging that is within the minimum suggested timeframe but that nevertheless should be addressed?
- Does the market index properly reflect the investments and risk of the fund? Does it meet the scheme's obligation to have an appropriate market index[13]?
- How have other funds with similar strategies performed relative to their market index over the same period? Do they have the same market index? Is there a more suitable market index used by a comparator fund?
- What does the risk indicator show for funds with similar strategies over the same period? Is the indicated risk level the same? Why is this?
- Are there other risks not reflected in the risk indicator, but which must be managed – e.g. illiquidity risk arising from a strategy focused on small companies or private companies – which can also be contrasted with comparable funds?

Return after fees

Investment risk management is why members use managers, but return after fees (net return) is the 'payoff' to the member. Net return should be reviewed alongside return before fees. Return before fees shows what return was, theoretically, available to the member. Net return shows how much of the return was taken by

[13] FMC Regulations, Schedule 4, Clause 61 states a market index must, among other things, be "appropriate in terms of assessing movements in the market in relation to the returns from the assets in which the specified fund directly or indirectly invests".

the manager in fees – which, unlike return (or, to a substantial extent, tax – see note on tax leakage below) is entirely under the manager's control.

Return after fees – useful questions for managers and supervisors

- What was the net return over the minimum suggested timeframe for the fund? How much of the return available to members was taken by the manager in fees? Is this amount commensurate with the value provided to members?
- How does the value provided to members compare to funds with similar strategies – particularly if they have the same market index? If the fund is active, how does it compare to passive products – index funds or exchange-traded funds – with a similar strategy and market index (as this shows the cost of simply getting exposure to the desired market)?

We discuss this further in 'Principle 2: The financial value of investment management must be shared'.

Tax leakage and transaction costs

Tax also reduces the return for the member but, as it is not charged by the manager, it is substantially not in the manager's control. Some investment approaches do attract more tax (e.g. investing in underlying funds domiciled in other countries). Where a manager's chosen style involves significant 'tax leakage', this should be identified as part of a fee review. The manager should explain to the supervisor why 'leakage' exists and the extent to which it can be mitigated, or why the manager chooses not to mitigate it and why that is in members' best interests. The manager and supervisor should also consider whether this feature should be disclosed – e.g. in the Other Material Information document and website – to ensure members are aware.

Transaction costs are typically not charged directly to members (and are more common in non-KiwiSaver managed schemes). However, they typically impact unit price, which ultimately does affect members. Accordingly, where a manager's chosen style involves high turnover, or other causes of material trading costs, the manager should explain and substantiate how this is in members' best interests. Again, the manager and supervisor should consider whether this feature should be disclosed to ensure members are aware.

Principle 2: The financial value of investment management must be shared

This principle builds on the importance to the member of the net return which, when contrasted with the return before fees, shows how much of the return available to the member is taken by the manager in fees. This is the member's and manager's respective *share* of the financial value created by investment management.

This is important because if the financial value to the member of the manager's investment management capability is materially reduced or even eliminated by its cost, the manager's capability is less relevant to the member, who should go elsewhere.

Accordingly, the member's share of the financial value of investment management must be appropriate for the risk they are taking and the cost they have paid. 'Appropriate' does not mean most or all profits should be allocated to members. What is 'appropriate' will depend on various factors.

Sharing financial value – useful questions for managers and supervisors

Looking at net return relative to return before fees, the member's share of the financial value of investment management may not be appropriate if the manager's operating margins are steadily increasing but fees remain unchanged.

- Is the member receiving the benefits of scale?
- If not, is that because fees are too high? Or is the manager overly focused on rewarding itself (or both)?

Actual costs (and therefore fees) may be unreasonable if there are features of the manager's ongoing cost structure that they are unwilling or unable to avoid. For example, if the manager chooses, or is obliged to use, expensive related-party underlying funds despite the existence of less-expensive alternatives with superior net returns. This may mean the manager has opted for an enduring structural inefficiency which will be a persistent drag on value for money.

- Is the product suitable for its members?
- Is the product sustainable if the inefficiency persists?

Some one-off or ongoing expenses can add value for members despite reducing their share of the financial value. For example, the cost of an order management system that reduces or eliminates the disruption and expense of unit pricing errors.

- What is the value provided, or intended to be provided, to members by the feature or innovation?
- How does the manager substantiate that value has been delivered to members? Or, if the value will become apparent over time, when does the manager expect it to be apparent in a review of fees and value for money?

Performance fees – useful questions for managers and supervisors[14]

- What qualifies as 'performance' to earn the fee? Is it judged relative to a benchmark – and is it the same as the market index chosen for the fund, or different? For example, it is not in members' best interests to pay a fee for outperformance of a cash-based benchmark for an equity-based fund, as the risk of the benchmark and the fund are materially different and the benchmark will, over time, be simple to beat (and so does not represent value added by the manager).

[14] See KiwiSaver performance fees guidance

- Members should not pay twice for the same performance. So, is there an appropriate relationship between how the manager earns its ongoing base fee, and how it earns its performance fee? For example, if a manager outperforms its index by 2%, it is not in members' best interests for the manager to earn a high base fee for all the growth in assets under management arising from that performance *and* a high performance fee for the 2% excess return above the index. A more appropriate structure would be a higher base fee and a lower (or no) performance fee; or a lower base fee and higher performance fee.
- Performance fees for short-term performance can reward managers for periods which are not meaningful to members with longer investment horizons. Additionally, short-term performance focus can come at the expense of long-term performance. So, does the period for a performance fee reward align with members' best interests (i.e. the product's minimum suggested timeframe)? If not, how is the fee in members' best interests?

Membership fees

There is variable maturity and scale in KiwiSaver. Membership fees were intended to cover costs when scale was low. As scale and member balances increase, we see little justification for schemes to charge both a fixed membership fee and a base management fee (which is typically percentage-based). Accordingly, we expect to see KiwiSaver schemes move toward eliminating membership fees from their fee structures. As such, we also expect managers' and supervisors' reviews of fees and value for money to include consideration of whether the existence and size of membership fees is reasonable. This assessment should be evidenced, in accordance with our expectations for fee and value for money reviews in general.

Principle 3: Advice and service is received, not just offered

The value of financial return is quantifiable. Valuing advice and service is subjective, and members will have their own view of what is valuable to them. This guidance recognises the value of advice and service in two ways:

- Advice and any other service or feature that **benefits the member directly**, because it demonstrably assists their decision making; and
- Other services or features that **benefit the member's account**, e.g. a robust investment process demonstrably reducing investment risk or better aligning the scheme with members' values or non-financial expectations.

In all cases, *offering* advice or services of any kind is not evidence of it providing value for money. To claim value for advice or service, particularly if it carries or contributes to a fee paid by the member, managers should evidence that the advice and service is *received* i.e. used or acted upon with positive impact.

Advice

We have long emphasised the importance of New Zealanders getting the help they need to make good investment decisions. Research by the FMA and others has shown that New Zealanders who get this help – from financial advisers but also from other sources – feel better prepared to achieve their financial goals and, importantly, this is reflected in their investment behaviour.

From a value for money perspective, we want to ensure there are as few barriers as possible to New Zealanders getting the help they need to make good investment decisions. However, we want to avoid a situation where fees for advice are embedded within broader fees paid by all members, are not transparent to members, and result in schemes competing to make offers to advisers to 'buy' members from them.

We prefer that fees for advice are charged to the member, not the scheme, or are otherwise structured so members can choose not to pay the fee. We acknowledge, however, that the KiwiSaver market is still maturing – balances tend to be lower than for other managed funds, and even a moderate, optional fee for advice may dissuade KiwiSaver members from using or seeking it.

Consistent with our principles-based approach, we are not prescribing how fees for advice must be charged. We expect, however, that schemes not already charging members directly for advice will move to do so as balances increase, the value of advice is established, and the industry as a whole matures.

We note that schemes contacting members during times of volatility to advise them against switching, redeeming, or other panic-fuelled behaviour, are meeting a basic statutory requirement to act in their members' best interest. This is not advice and cannot constitute justification for an advice fee, however charged.

Advice – useful questions for managers and supervisors (regardless of whether advice fees are charged to the member or embedded within scheme fees paid by all members)

- Is the advice (or other assistance aimed at helping members make better investment decisions, such as digital tools or direct mail campaigns) received, not just offered/sent? Can the scheme show how the advice is engaged with and used? Is there member feedback, customer satisfaction surveys, or similar, to support this?
- Is the advice ongoing, not just given at the on-boarding stage? Is there a demonstrably meaningful interaction, at least annually and at key life events?
- Is the fee reasonable, relative to a reasonable expectation of how much advice will be received and how frequently, over an appropriate term (e.g. at least the minimum suggested timeframe for the product, and longer)? Does the fee reflect the relatively straightforward advice requirements for KiwiSaver? Is the fee optional and if not, why not?
- Is there appropriate disclosure to, and discussion with, members about what fee is charged, who it is paid to, and what the members receive in return?

Other value-adding services

We recognise that services other than advice can provide value for money to members. This guidance regards broader services as valuable if they add value to the member's account – either financially, or by better aligning the scheme with member values or non-financial expectations, and ideally both. Like advice, offering a service does not mean it has value to members.

Other value-adding services – useful questions for managers and supervisors

- If a scheme claims its investment process – such as research or portfolio construction – adds value, can they substantiate it by demonstrating how it benefits investment outcomes? For example, does it reduce risk without reducing return, enhance return without unduly increasing risk, or ideally both?
- If a scheme claims its asset stewardship, including taking account of non-financial factors within an integrated financial product, adds value, can they substantiate it by demonstrating how it fits member values? Or how it benefits investment outcomes? For example, does it reduce risk without reducing return, enhance return, have quantifiable non-financial impacts, or shape company behaviour?
- If a scheme claims features such as 'a big brand' or 'convenience' add value to their members, can they explain and substantiate how?

Principle 4: Review yourself as you review others

Useful general questions for managers and supervisors about fees and value for money

Does the manager have a clear understanding of its cost base and how that is reflected in the fee structure?

- What is the effect on costs (and revenue) of changes in the number of members and value of scheme assets?
- What is the effect on costs of investment style and strategy e.g. active or passive management, buy-and-hold or high turnover, liquid vs. illiquid investments (and of changes to that style or strategy)?
- Is there a clear and credible distinction between fixed costs and ongoing variable costs?
- Can the manager identify costs shared with other funds in the scheme (e.g. investment team remuneration) and explain why that sharing approach has been taken?
- Can the manager identify costs arising from fees paid to related parties?

- Where there are multiple fees charged in different ways – some as fixed sums, some as percentages – can the manager explain why all are necessary and reasonable, and substantiate there are no overlaps and no ‘fees for no service’?
- Where spreads are used, are they for the intended purpose of minimising the impact of members transacting in a fund? If a scheme charges spreads, and entry and exit fees, can the manager explain and substantiate how they fulfil different purposes? If a scheme does not charge spreads, can the manager explain how it is satisfied members are not adversely impacted by member transactions, whether from new, ongoing, or exiting members?

Specific to KiwiSaver schemes

- Can the manager identify the reason for, nature and likely duration of any cross-subsidies? We anticipate cross-subsidies exist to help ensure the impact of fees on members with low balances is not unreasonable. Where they exist for other reasons, we would expect these to be carefully explained and substantiated. We also assume cross-subsidies do not exist in other managed funds, which typically have minimum investments, but where they do exist, the manager should similarly explain them.

Internal and external reference points for fee and value for money reviews

Internal reference points

- What fees does the scheme charge to wholesale investors accessing the same or a similar product? Wholesale investors typically have much larger balances than individual retail investors, which is a good reason why wholesales fees would be lower. However, as a group, retail investors can represent total balances as large or larger than individual wholesale balances. So, the scale benefits of larger invested sums could still be passed on across the retail group.
- What fees are paid to underlying managers? If those fees are reduced, is the saving passed on to members? If not, why not?
- What are the gross and net returns for wholesale investors accessing the same or a similar product over the same measurement period (on the basis substantially lower fees for wholesale investors may reveal a value for money disparity that the manager and supervisor may wish to address)? When answering this question, more focus should be given to longer periods, but the minimum suggested timeframe for the product should also be considered.
- What are the gross and net returns for other products with similar strategies, e.g. workplace savings schemes?
- What advice or other services appear to be adding value in other products or to wholesale investors? What fees are charged for them?

Specific to KiwiSaver schemes

- What fees are charged for the scheme's default funds?
- For schemes without default funds, comparisons to other schemes' default products are still relevant if those products have similar strategies and features.

External reference points

- If a scheme is using 'rebadged' funds another manager, how do the fees charged by the scheme compare with the cost for the member of going direct to that manager, and to other comparable funds?
- What are the industry average fees for comparable funds? We expect this information will become more granular for managers and supervisors as this guidance is implemented.
- For active managers, what fees are charged for passively managed funds with the same strategy? This will hopefully help demonstrate the better return after fees for the active variant.
- What are the gross and net returns for comparable funds?
- For active managers, what are the gross and net returns for passively managed funds with the same or similar strategies?
- What advice or other services appear to be adding value for comparable funds? What fees are charged for them?

How the FMA can respond

We can review the fees and value for money of a registered scheme at any time. The review will be consistent with the key principles identified in this guidance. For KiwiSaver schemes, we will be guided by the process set out in the KiwiSaver Regulations, and will assess whether the fee is significantly higher than fees charged in relation to another scheme that we consider comparable[15] including by applying the principles set out in this guidance.

We will not hesitate to use our statutory powers to investigate commercial arrangements and obtain information to understand scheme costs, including those of sub-managers where member scheme assets are invested.

Enforcement

If we determine a fee is unreasonable, a wide range of enforcement options are available under the FMC Act. Some of these options overlap with those available if a manager (and, in some cases, a supervisor) is in breach of its overarching statutory duties to act in the best interests of members and treat members equitably.

For more information on the enforcement options available to the FMA, please refer to our Regulatory Response Guidelines.

Stop orders

We may issue a stop order on the basis that a KiwiSaver scheme with unreasonable fees is no longer meeting its registration requirements[16]. A stop order can, for example, prevent schemes from advertising, and prevent transfers of new members.

If we consider it is in the public interest to do so, we may issue an interim stop order while we consider the grounds for a stop order. Failure to comply with a stop order is an offence and can result in a conviction and a fine of up to $300,000[17]. Stop orders must be published.

Direction orders

We may also issue a direction order[18]. A direction order may, for example, direct the manager to comply with the requirement to act in its members' best interests[19] from a value for money perspective and/or not to charge an unreasonable fee, or stipulate steps that must be taken for compliance (e.g. making changes to add value to members and/or reducing fees). We have discretion as to whether we publish direction orders. Failure to comply with a direction order is an offence and can result in a fine of up to $300,000.

Direction orders are also available if we are satisfied that a manager or supervisor has contravened, or is likely to contravene, one of their overarching statutory duties, including the duty to act in the best interests of scheme members.

[15] KS Regulations, reg 11; For the full statutory test see Annex One

[16] FMC Act, s 462(1)(e)

[17] FMC Act, s 479(2)

[18] FMC Act, ss 228(4)(e) and (h), 468, 469

[19] FMC Act, ss 143(1)(b), 153(1)(b), 468(1)(c)

Censures, action plans and directions to a licensee

If we are satisfied that a licensee (i.e. a KiwiSaver scheme manager) has or is likely to materially contravene a market services licensee obligation (which includes a contravention of the obligation not to charge an unreasonable fee), we may censure the licensee, require them to submit an action plan, give a direction to the licensee, or suspend or cancel their licence[20].

Court action

The FMC Act specifies a number of provisions that, if contravened, may give rise to civil liability[21], enabling the FMA to apply to the courts for orders, including pecuniary penalty orders (of up to $600,000) or compensatory orders[22]. The following contraventions may give rise to civil liability orders:

- A KiwiSaver manager contravenes the issuer obligation not to charge an unreasonable fee[23].
- A manager contravenes the duty to act in the best interest of members and treat them equitably[24].
- A supervisor contravenes the duty to act in the best interest of members[25].

Civil liability orders can be made not only against the person in contravention, but also against those involved in the contravention. The aim of such orders may be to sanction the issuer, deter behaviour, and/or potentially seek redress for affected parties.

KiwiSaver schemes

In addition to the above, the KiwiSaver Act contains a specific statutory power in relation to unreasonable fees, allowing the FMA (and scheme members) to apply to the High Court for an order annulling or reducing the fee within one year of the fee being debited or imposed[26]. As fees are regularly debited from members' accounts, each and every debit will carry a one-year time limit. The Court may make any order it thinks fit to give effect to the annulment or reduction, which could include ordering excess fees to be paid back to members.

[20] FMC Act, s 414

[21] FMC Act, s 228(4)

[22] Under s 494 of the FMC Act the FMA or any other person may apply for a compensatory order.

[23] FMC Act, ss 143(2), 133(b), 228(4)(e)

[24] FMC Act, ss 143(1)(b), 228(4)(h)

[25] FMC Act, ss 153(1)(b), 228(4)(j)

[26] KS Act, s 119

Annex One

The obligation not to charge an unreasonable fee is an ongoing obligation

Clause 2 of the KiwiSaver rules prescribes that a fee must not be unreasonable:

> **2 Fees must not be unreasonable**
>
> (1) The following persons must not charge a fee that is unreasonable:
>
> (a) the manager of the scheme:
>
> (b) the supervisor or the scheme:
>
> (c) the administration manager of the scheme:
>
> (d) the investment manager of the scheme:
>
> (e) any other person who charges a fee for services in relation to the provision of a KiwiSaver scheme.

The KiwiSaver rules are implied in the trust deed despite anything to the contrary as per section 116 of the KiwiSaver Act:

> The KiwiSaver scheme rules set out in Schedule 1 are implied in every trust deed that establishes a KiwiSaver scheme…
>
> The KiwiSaver scheme rules…apply despite anything to the contrary in the trust deed; and are enforceable by the manager, the supervisor, or any member of the scheme.

The obligation not to charge an unreasonable fee is implied into the governing document under section 135(2) of the FMC Act:

> The governing document is treated as containing any provision that is implied into it by or under this Act or the KiwiSaver Act 2006.

Section 128(1)(i) of the FMC Act prescribes that an "additional and ongoing" registration requirement for KiwiSaver schemes is that a fee charged is not unreasonable:

> **128 Additional initial and ongoing registration requirements for KiwiSaver schemes**
>
> (1) Every KiwiSaver scheme must meet the following registration requirements in addition to those in section 127:
>
> …
>
> (i) The FMA must be satisfied that the fees charged in accordance with any information provided in the application will comply with clause 2 of the KiwiSaver scheme rules under the KiwiSaver Act 2006.

The scheme manager must ensure that the scheme "continues to comply" with the registration requirement that a fee charged is not unreasonable as per section 133(b) of the FMC Act:

> The manager of a registered scheme must ensure that… the scheme … continues to comply with the additional registration requirements for that type of scheme…

The obligation not to charge an unreasonable fee is incorporated into the FMC Act as an issuer obligation and a market services licensee obligation

The manager of a KiwiSaver scheme is an "issuer" as per section 11(1)(b)(iii) of the FMC Act:

> **Issuer** means, in relation to … a managed investment product, the manager of the managed investment scheme to which the product relates.

The obligation not to charge an unreasonable fee is an issuer obligation as per section 6 of the FMC Act:

> **issuer obligation** means an obligation imposed on the issuer of a financial product by or under any of the following:
>
> …
>
> (d) this Act (including, in relation to a managed investment product, all obligations as a manager)
>
> (e) the KiwiSaver Act 2006

The obligation not to charge an unreasonable fee is a "market services licensee obligation" as per section 6 of the FMC Act:

> **market services licensee obligation** means an obligation imposed on a licensee or an authorised body by or under any of the following:
>
> …
>
> (e) in the case of a manager or an independent trustee of a registered scheme, -
>
> (i) a governing document:
>
> (ii) the KiwiSaver Act 2006

Managers' duties that are particularly relevant to the obligation not to charge an unreasonable fee

A manager must:

- Act in the best interests of the scheme participants – s 143(1)(b)(i) FMC Act.
- Treat the scheme participants equitably – s 143(1)(b)(ii) FMC Act.
- Carry out the functions of a manager in accordance with the governing document and all other issuer obligations – s 143(2) FMC Act.
- Ensure that the scheme continues to comply with the additional ongoing registration requirements in section 128, one of which is to comply with clause 2 of the KiwiSaver scheme rules – not to charge unreasonable fees – s 133(b) FMC Act.
- Exercise the care, diligence, and skill that a prudent person engaged in that profession would exercise in the same circumstances - s 144(1) FMC Act.

Supervisors' duties that are particularly relevant to the obligation not to charge an unreasonable fee

A supervisor must:

- Act in the best interests of the scheme participants in exercising its powers and performing its duties as a supervisor – s 153(1)(b) FMC Act. One of the supervisor's functions includes supervising the manager's performance of its functions and issuer obligations – s 152(1)(b)(i) FMC Act.

The unreasonable fees test

Section 118 of the KiwiSaver Act concerns the exercise of functions by the FMA about unreasonable fees and gives us discretion to consider any matter we consider relevant:

In considering whether a fee is unreasonable in relation to the provision of a KiwiSaver scheme or a complying superannuation fund, the FMA –

(a) must have regard to any prescribed matter; and
(b) may have regard to any other matter that the FMA considers relevant; and
(c) may make decisions in accordance with any prescribed process.

Regulations 10-12 of the KiwiSaver Regulations 2006 set out the statutory test:

10 Purpose of regulations on KiwiSaver fees

(1) Regulations 11 and 12 deal with the FMA's functions under the Act and a court's function under the KiwiSaver scheme rules of considering whether a KiwiSaver scheme complies with clause 2 of the KiwiSaver scheme rules (which requires fees not to be unreasonable) (the **fees assessment**).

(2) The purpose of these regulations is to prescribe a process for the FMA's fees assessment and the matters to which the FMA or a court must have regard in carrying out a fees assessment (*see* section 118 of the Act and clause 2 of the KiwiSaver scheme rules).

(3) Neither regulation 11 nor regulation 12 prevents the FMA or the court from considering any other matter that the FMA or the court considers relevant.

11 Process for fees assessment by FMA

The FMA may follow the following process in making a fees assessment:

(a) compare the relevant fee or fees in relation to a scheme (**A fees**) to fees charged in relation to other schemes or classes of schemes (whether or not KiwiSaver schemes) that the FMA considers comparable, having regard to the relevant matter in regulation 12(a); and

(b) determine on that basis that—

  (i) the A fees are not unreasonable; or

  (ii) the A fees may be unreasonable; and

(c) if the FMA determines that the A fees may be unreasonable, further assess the A fees having regard to all the relevant matters in regulation 12; and

(d) determine on that basis whether or not the A fees are unreasonable.

12 Relevant matters for fees assessment by FMA or court

The following matters are relevant to a fee assessment by the FMA or a court:

(a) whether the relevant fee or fees in relation to the scheme are significantly higher than the fees charged in relation to other schemes or classes of schemes (whether or not KiwiSaver schemes) that the FMA or the court considers comparable; and
(b) if the relevant fee or fees are significantly higher, whether or not differences in the following matters mean that it is reasonable for the fee or fees to be higher:
  (i) the cost of the services to which the relevant fee or fees relate; and

  (ii) the structure of the scheme; and

  (iii) the number of members and the number of members actively contributing to the scheme; and

  (iv) the value of the scheme assets at the commencement of the fees assessment and how those scheme assets are invested; and

  (v) the employer contributions in respect of members and employer subsidisation of fees charged in relation to the scheme (if any); and

  (vi) how the relevant fee or fees are charged and the basis on which the relevant fee or fees are calculated; and

(vii) other costs of the scheme; and

(viii) any other matter that the FMA or the court considers relevant.

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