

**INVESTMENT SAVINGS & INSURANCE ASSOCIATION OF NZ  
INC**

**Submission**

**to**

**Ministry of Economic  
Development**

**on the**

**Periodic Reporting Regulations for  
Retail KiwiSaver Schemes  
Discussion Paper**

11 March 2011



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# **Investment Savings and Insurance Association of NZ Inc.**

## **1.0 Introduction**

- 1.1 The Investment Savings and Insurance Association ("ISI") is the industry association for the companies that issue and manage life insurance, superannuation and managed funds in New Zealand. ISI members are responsible for approximately \$50 billion funds under management. ISI members are also the leading providers of KiwiSaver funds and include the KiwiSaver default providers.

A list of members is attached.

- 1.2 We welcome the opportunity to comment on the Periodic Reporting Regulations for Retail KiwiSaver Schemes discussion paper. Our response is based on consultation with our member companies and work we have done during the year on draft industry standards for:
- Calculation and Disclosure of Fees and Expenses
  - Investment Performance Reporting
  - Disclosure of Portfolio Holdings
- 1.3 We have set out general comments below, followed by answers to specific questions from the discussion paper.

## **2.0 General Comments**

- 2.1 ISI agrees that changes are needed in the regulation of initial and ongoing disclosure for securities in New Zealand. However, we are not convinced that there is justification for regulation of KiwiSaver schemes to proceed ahead of other securities. We made a comprehensive submission last year on the MED Review of Securities Law and, as we said in our submission on the Financial Markets (Regulators and KiwiSaver) Bill, our preference would be for these changes to the regulation of KiwiSaver to be managed as part of the overall Review of Securities Law.
- 2.2 Having said that, ISI agrees with the problem definition set out in the discussion paper and with the need for rationalisation of the various methods of calculating and disclosing essential information for investors in KiwiSaver schemes.
- 2.3 ISI support for improved disclosure is demonstrated by the work we have done over the past year in developing the industry standards noted above. MED officials have been kept advised of work in progress.
- 2.4 One of the key issues to be determined is the extent to which these standards should be regulated rather than being subject to industry self-regulation.
- 2.5 The over-riding objective, however, must be to provide KiwiSavers with clearly defined information that they can understand (albeit possibly with the assistance of advisers and market commentators) and use, rather than all information that may be available but not necessarily helpful to the average investor.

- 2.6 We are concerned that the discussion paper appears to conflate the information needs of retail investors and the regulator. While more detailed information may be useful for the regulator, it is debatable whether that should be supplied as part of the same periodic reporting process. We believe it is essential to tailor the required disclosure to the target audience, or risk incurring compliance costs without meeting that audience's information needs.
- 2.7 Further to point 2.1 above, we have some concerns about the wider securities law implications of some of the proposed disclosure:
- From a legal perspective, the provision of reports via a publicly-available website does not constitute 'receipt', both at common law and under the Securities Act 1978. Therefore, if these regular KiwiSaver reports are required to be 'received' by an investor, then online publication of reports would need to be deemed as 'receipt' for the purposes of these proposed regulations. Alternatively, it may be preferable for providers to be required simply to publish their regular reports on their websites (eventually the Register of Securities) and dispense with the requirement for investors to have 'received' the information, given that the primary point of sale document should remain to be the investment statement (eventually the product disclosure statement).
  - There is a risk that a regular KiwiSaver report under the proposed legislation would constitute an 'advertisement' given that returns in a regular report can potentially induce members to invest in a KiwiSaver scheme.
  - Also, liability under the Securities Act 1978 for any untrue statements in an 'advertisement' is likely to constitute misleading and deceptive conduct under the Fair Trading Act 1986, as well as give rise to potential liability under the Consumer Guarantees Act 1993.
  - We believe that in the absence of a specific exemption for providers from the requirements of the Securities Act and Fair Trading Act with respect to 'advertising' regulation for regular KiwiSaver reports, most providers would adopt a conservative approach and treat regular reports as 'advertisements' which is likely to lead to lengthy qualifications, disclaimers and/or subsequent events notes to any quarterly/annual KiwiSaver reports.
  - In addition, the provider will need to obtain a certificate under regulation 30 of the Securities Regulations 2009 signed by directors, which states that they have reviewed the advertisement and it is not misleading or inconsistent with offering documents. The Securities Regulations 2009 already provide relief from the requirement to obtain Regulation 30 Certificates for issuers of debentures that provide specified variable information from time to time. We believe that the same relief ought to be available for providers that are publishing communications in accordance with standards for calculating fees, returns and other key fund information under the proposed regulations.
- 2.8 We would appreciate the opportunity to comment on any regulatory impact statement relating to the first draft of the regulations.

3.0 Our main submissions are:

### **3.1 Transition**

3.1.1 We recommend there should be a reasonable transition period allowed after the regulations come into force to enable funds to amend systems for periodic reporting and to update offering documents and trust deeds to reflect the new standards.

3.1.2 The regulations should also expressly provide that existing investors should be informed of any changes to trust deeds and/or offering documents through the next available quarterly report.

### **3.2 Fees and Charges**

3.2.1 On 25 November 2010 ISI released a Standard for the Calculation and Disclosure of Fees and Expenses. A copy has been supplied to MED but, for ease of reference, an additional copy is provided with this submission.

3.2.2 We note that MED officials have taken the ISI standard into account while drafting the discussion paper but, in some areas, have proposed more extensive regulation. An example is the proposal that “all costs” should be included in the TER, whereas the ISI standard allows for separate disclosure of certain costs, such as performance fees.

3.2.3 We recommend that the regulations are aligned as closely as possible to the ISI Standard.

### **3.3 Fund Performance and Returns**

3.3.1 ISI is still in the process of drafting and consulting with members on a Standard for Investment Performance Reporting. A copy of the current version is attached.

3.3.2 In discussions with MED officials we have explained the rationale for the approach taken in the ISI Standard and the reason for not adopting the GIPS approach.

3.3.3 Our key recommendation is that fund performance should be reported net of fees and gross of tax.

### **3.4 Asset Allocation and Portfolio Holdings**

3.4.1 ISI is still in the process of drafting a Standard for Disclosure of Portfolio Holdings.

3.4.2 One of the key issues for review is the extent to which separate disclosure should be required for assets in each sector of a multi-sector fund.

3.4.3 We support disclosure of the top 10 assets for a single-sector fund. While there is not unanimous support for the same requirement to apply quarterly to funds invested in other funds, we acknowledge there would be a benefit in consolidated information for those funds being disclosed annually.

### **3.5 Fund Manager Tenure and Conflicts of Interest**

3.5.1 We recommend further consideration of the extent to which these proposals are appropriate for retail funds.

### **3.6 Format and Presentation of Periodic Reports**

3.6.1 We support the standardisation of terminology and forms but have some specific concerns about the proposed formats. We would appreciate the opportunity for further discussion on the format design.

## Responses to Questions

### **1. Do you agree with the Ministry's starting point for periodic disclosure; that any cost deducted from the assets of a fund should be disclosed, and any charge levied on an investor should be disclosed?**

We consider that the Ministry's starting point for periodic disclosure should be the objective of providing sufficient information, in a standard format, to enable investors to compare retail funds. Care should be taken not to overload investors with vast amounts of disclosure that will add to compliance costs and potentially confuse rather than enlighten.

Having said that, with the exception of transaction costs (see below), we agree in principle that all costs and charges should be disclosed, subject to agreement on the standardised format.

### **2. Do you agree with the Ministry's view that regulations should include a prescribed set of terms for each fee type, and standard definitions for each term?**

We agree that fees and charges should be standardised to the maximum extent possible. We also need to make terminology as consistent as possible with offshore jurisdictions as information will need to be sought from offshore managers.

### **3. If yes, should New Zealand prescribe its own set of terms and definitions (based on what is in common use already) or should we adopt an overseas standard, to ensure international portability?**

ISI has already developed a number of standard definitions for terms used in the ISI Standard for Calculation and Disclosure of Fees and Expenses and the draft Standard for Investment Performance Reporting. We recommend this as the starting point for any definitions to be prescribed in the Regulations.

### **4. What do you consider will be the key challenges and costs (not already incurred) in disclosing the different components of transaction costs in periodic disclosure?**

We do not support the disclosure of transaction costs in this manner. As the Discussion Paper notes, transaction costs are typically reflected in the net value of the asset that is bought or sold. As the transaction costs are not presently identified or accounted for separately, quantifying them would be a significant administration cost. The key challenge would be to make the disclosure meaningful for fund members at a fund level as it would be necessary to distinguish costs incurred by individual members (entering, exiting and switching) from those incurred by the fund as a whole (buying and selling to rebalance the fund).

As transaction costs are reflected in the value of scheme assets, they directly affect fund returns. From an effectiveness perspective for retail investors, the overall package of disclosure – fees and returns – needs to be considered. There may be good reasons for higher levels of transaction costs (e.g. new fund, large cash flow, active trading) so high transaction levels would also need to be explained to investors, further complicating disclosure when the after transaction costs returns will be disclosed. We do not consider there is any benefit to investors in having access to this level of detail.

In addition, if the norm offshore is not to disclose, there will be potential difficulties for NZ managers in obtaining this information from offshore managers

**5. What would be the advantages and disadvantages of prescribing a single percentage fee to cover all transaction costs?**

We do not support a proposal to set and disclose a single percentage fee to cover transaction costs. As the Discussion Paper notes, there may be good and unavoidable reasons for relatively high levels of transactions which may breach a predetermined level. (We also question the power under the proposed sections 54C and D of the Securities Act to actually set fee levels.)

In our view disclosure should be limited to the additional fees and expenses incurred by investing in a KiwiSaver scheme that would not be incurred by direct investment in the same assets. We recommend that disclosure in respect of transaction costs should be limited to a description of the costs and information about how and when they are charged.

**6. To what extent is it possible to separate out transaction costs that are generated as a result of cash in and out flows?**

In the New Zealand market, transaction costs are not identified or accounted for separately, but are typically reflected in the net value of assets when they are bought or sold. We therefore consider that it would be very difficult to break down transaction costs to the level proposed and do not believe that the cost would be justified by any benefit to investors.

**7. To what extent is it possible to get accurate transaction cost information when a fund invests in another fund?**

Most NZ funds invest in other funds and, as noted above, it is likely that it will not be possible to get accurate information on the transaction costs of a fund investing in another fund.

**8. To what extent would the disclosure of only the brokerage costs lower compliance costs in extracting information (if at all)? What proportion of all transaction costs are made up of brokerage costs?**

See response to Question 5.

**9. What advantages and disadvantages would arise through the disclosure of a portfolio turnover rate?**

The advantage of disclosing a portfolio turnover rate is that a high rate should give fund members some indication that the fund is likely to have high transaction costs. The disadvantage would arise from providing additional information that will not necessarily be useful or understandable for the average retail investor. As the Discussion Paper notes, there may be good reasons for higher levels of asset turnover and disclosure of a rate would need to be explained, further complicating disclosure and raising issues of accuracy of explanations. Also, this information may be readily available for a standalone fund but will be more difficult to access where the fund is invested in other funds.

**10. Do you agree with the Ministry's view that performance fees should be disclosed? If not, why not?**

We agree that performance fees should be disclosed but we do not agree that they should be included in the Total Expense Ratio ("TER"). While recognising that including performance fees in the TER is part of the IOSCO standard, in other jurisdictions they are excluded from the TER on the grounds that they can have a distorting effect which gives a misleading impression. Inclusion of performance fees in TERs makes it impossible to compare TERs over different periods.

**11. What benefits are there in disclosing a performance fee as a percentage of the net asset value of the fund?**

Presentation as a percentage of average net asset value has the benefit of simplicity of presentation but we also see a benefit in disclosing a performance fee as a function of the fund return.

**12. To what extent would a worked example showing the impact of this fee on returns help investors?**

We agree that it would be helpful for investors to have a worked example.

**13. Do you consider the requirement that trail commissions be deducted at source (i.e. from individual investor accounts) and not fund assets worthy of consideration? If yes, why? If no, why not?**

Trail commissions are not usually deducted from fund assets. They are paid out of the management fee which is separately deducted from all investors in proportion to their funds under management. As such, they are paid by the manager rather than the fund. We agree that investors should receive information on trail commissions but that is part of initial disclosure by the adviser, rather than periodic reporting by the fund. The new Financial Advisers Act will require advisers to disclose to KiwiSaver members, as part of initial disclosure, when and how they receive remuneration for the advice they have given.

Implementing a requirement that any payment to an intermediary should not be deducted directly from the fund would appear to be beyond the scope of new Securities Act sections 54C and D proposed by the Financial Markets (Regulators and KiwiSaver) Bill, which cover disclosure. Such a requirement should be considered under collective investment scheme governance arrangements of the Review of Securities Law presently underway.

**14. Do you consider that all payments made from a fund to financial advisers should be reported quarterly? What are the likely costs and/or benefits?**

As noted above, payments to advisers are made by the manager rather than being paid from the fund. The Government Actuary has not approved KiwiSaver fees that allow for financial advice fees or trail commission. In any event, disclosure of fees paid to financial advisers is covered by the disclosure requirements of the Financial Advisers Act and is appropriately handled under the provisions of that Act.

**15. What do you consider to be the advantages and disadvantages of prescribing a set of cost categories within which all fees must be disclosed?**

We agree that it would be easier for investors to compare funds if costs were disclosed in specific standardised categories. As noted in the Discussion Paper, the ISI Standard for Calculation and Disclosure of Fees and Expenses separates fees and expenses into one of 3 broad categories:

- Choosing an adviser (no fee applicable to KiwiSaver)
- Choosing a provider
- Choosing a fund

**16. Given that providers will be required to charge only those costs that are disclosed in the above, or similar, categories, are there any costs or charges that the Ministry has not identified?**

The Ministry has identified all the relevant costs and charges but we still maintain that there should be no requirement for disclosure of transaction costs.

**17. Do you consider the Ministry's table of three categories appropriate? What should be included and/or excluded? Why? Do you prefer broad categories more closely aligned to the ISI standard, or to the IOSCO standard?**

We recommend that the existing ISI model should be followed. As KiwiSaver fees do not include charges for financial advice, the applicable ISI categories will be those at the KiwiSaver scheme provider level and fees at the individual fund choice level. More detail would increase compliance costs without providing additional benefit for investors.

**18. To what extent should the fees that can fall within the administration and operating expense be prescribed?**

Separate itemisation of fees (prescribed or otherwise) at this level adds an unnecessary level of detail that will require consolidation for meaningful comparison. The regulations could prescribe the fees that fall within the administration and operating expenses but should exclude fees that are paid directly by the investor, otherwise disclosed separately or incurred by the manager but not charged back to the fund. Our preference, however, would be that the regulations focus on disclosure of the total amount of administration and operating expenses as a percentage of total assets. Where one quantified fee covers a number of services that might otherwise be itemised separately, it would help comparison between schemes to allow a description of what the one fee covers while not requiring quantification of the various components.

**19. What do you consider to be the advantages and disadvantages of charging a single fee and does it work against an objective of full transparency?**

A single fee has the advantage of apparent simplicity and ease of comparison for investors, which is the key objective of disclosure. However, a single fee lacks transparency as it does not show the relative costs of services – e.g. investment management and administration. It may also be slightly misleading as it would not include investor-specific fees (such as a switching fee) and therefore would not be totally inclusive. If a fund claims to have a single fee it should not charge other fees in addition.

**20. Do you consider that the IOSCO TER standard currently reflects global best practice in this area? If not, what do you consider to be a better measure and why?**

We believe the TER model does reflect best practice and that is why the ISI Standard has generally followed that model. However, considering mutual recognition of securities offerings between Australia and New Zealand and the prospect of transfer of KiwiSaver and SGC funds between the two countries, alignment of the TER methodology with Australia needs to be a significant consideration.

**21. What difficulties arise from including the monthly or annual dollar based administration fee?**

Dollar-based fees are already easy for investors to understand and to compare across providers. Including dollar-based fees within the TER distorts the ability to establish the actual cost to an individual.

Monthly or annual dollar based fees charged directly against the investor's account should not be included in the TER as that is intended to provide an indication of costs charged against the fund rather than an individual member. The monthly member fee for KiwiSaver is disclosed as a cost of choosing the provider, rather than a cost of choosing the fund.

**22. What other issues will arise if the calculation of a TER is required?**

As many NZ funds are invested into other offshore funds the TER needs to include details of the costs incurred at the wholesale fund level. The ISI Standard sets out the requirements for calculation of a synthetic TER. In some cases there may be difficulties in receiving information from wholesale funds on the costs incurred at that level.

As noted earlier, performance fees should not be included in the TER but should be disclosed separately.

**23. What are the advantages and disadvantages of a synthetic TER?**

As set out in the ISI Standard, a synthetic TER is necessary to incorporate both the costs incurred within the retail fund and the costs incurred by any other investment layers which exist between the investor and the lowest level assets.

The discussion paper notes that New Zealand retail funds (and KiwiSaver funds in particular) are often invested into other collective funds. The calculation of a synthetic TER allows the expense ratio disclosed to investors to be more realistic and comprehensive.

**24. Are there issues of commercial sensitivity relating to disclosure of sub-fund charges? If so, please clarify.**

There are potential issues of commercial sensitivity particularly if the regulations require a detailed breakdown of costs. In normal practice only the expense ratio of the wholesale fund would be disclosed to the retail fund and then incorporated into the synthetic TER.

**25. What will be the challenges, and the costs associated with calculating a synthetic TER?**

The main challenge will be obtaining the necessary and consistent information from wholesale level funds both domestically and offshore in a timely manner, incorporating that information where it may be for a different financial period and explaining the meaning of the TER to investors.

**26. What are the advantages and disadvantages of disclosing a historical TER?**

The advantage of allowing investors to see the trend of TERs over the past five years, and to ask questions if the TER is increasing, needs to be balanced with the extra cost of ensuring the basis of calculation of the TERs is comparable for each period.

**27. For what retrospective period should an annual TER be disclosed and why?**

We consider that the shorter of the fund history and 5 years is sufficient. The ability to calculate historic TERs may be an issue where data has not been collated (e.g. where accounting systems, personnel, or underlying managers have changed). As such, the first TER calculation should be the start of historic data.

The ISI Standard does not require calculation of an historical TER series pre-dating implementation of the Standard as this could potentially incur significant compliance costs in collecting the necessary information from domestic and offshore wholesale funds.

**28. Do you consider there to be any significant impediments to calculating the TER on a quarterly rolling average basis?**

We do not support that proposal and prefer to calculate the TER based on the audited end of year financial statements. We consider that interim calculations would be potentially misleading as well as incurring additional compliance costs. A quarterly rolling average is also an extra concept and complication for retail investors to understand.

**29. What would be the advantages and disadvantages of disclosing a projected TER?**

We do not agree that projections should be made. Future cash flows and returns would have to be projected, contrary to the Securities Act. Projections could easily be misleading and would need to be accompanied by disclosure of the assumptions used in their calculation. This can only complicate investor disclosure for limited benefit. We recommend that the ISI Standard is followed, with the TER calculation based on data from the fund's most recent audited financial statements. That allows for the comparison of TERs from previous years.

**30. What would be the costs and challenges associated with disclosing a projected synthetic TER?**

For the same reasons given in the preceding response, we do not consider there would be any benefit in producing a projected synthetic TER. If there has been a material change in the fund's fees and charges since the previous period that should be disclosed. Otherwise, it is preferable to rely on those audited financial statements.

**31. Do you consider the method of recovering fees from an investor to be material to the investor's return? If so, why? If not, why not?**

We do not consider 'material' to be the appropriate term. We agree that the method of recovering fees from investors is *relevant* to their returns and that is why the ISI Standard requires the method of recovery to be disclosed.

In accordance with our General Comments at the start of this submission, the method of fee payment from funds is also an area that should be considered by fund administration standards under the overall Review of Securities Law.

**32. Should we have regard to GIPS when setting regulations? If so, why? If not, why not?**

We agree that GIPS represent best practice for wholesale fund manager performance but we do not agree that they are appropriate for retail fund performance.

A survey of global best practice commissioned by ISI in 2010 and carried out by PricewaterhouseCoopers concluded that GIPS are the most comprehensive standards and are applied on a voluntary basis by asset managers (generally direct / wholesale) in a number of countries (including Australia and New Zealand). However, their design makes them more applicable for measuring and comparing the performance of wholesale investment managers with a target audience of investing entities such as retail fund managers, pension scheme managers and insurers, rather than retail investors.

GIPS focus on the fund manager performance by looking at "composites" which are an aggregation of performance for a particular asset class measured across the manager's range of funds. This gives a good understanding of how a *fund manager* is performing in relation to certain asset classes, but it is difficult for a retail investor to understand how this relates to their individual *product*. To satisfy the needs of retail investors who are focussed on individual investment products, ISI has prepared a standard (still in draft) which applies the principles of GIPS, adapted to a retail environment, using work already been done by IFSA (now FSC) in developing the equivalent standards in Australia.

**33. What do you regard the role of GIPS to be in a periodic reporting regime?**

We do not consider there is a direct role for GIPS in a periodic reporting regime for retail funds. Rather, the principles should be applied as per the draft ISI Standard for Investment Performance Reporting.

**34. Is there a role for GIPS in other parts of the disclosure regime? If so, where and why?**

We do not consider there is a role for GIPS in disclosure of retail fund performance although we believe that composite fund *manager* performance should comply with GIPS.

**35. Are the performance standards and reporting methodology set by Australia's FSC suitable? If so, why? If not, why not?**

As noted above, ISI has drawn on the existing FSC standard in drafting our Standard for Investment Performance Reporting, with necessary adjustments to fit the different environment in NZ, e.g. the different tax regime.

**36. Do you consider the performance standards set by UCITS to be more appropriate for NZ? If so, why?**

No. The independent review commissioned by ISI in 2010 concluded that UCITS would not be more appropriate for NZ than an amended form of GIPS, based on the Australian model.

**37. In your view is it preferable to use a money-weighted or time-weighted calculation and why?**

A money-weighted calculation of return is sensitive to cash flows beyond the fund manager's control and each individual investor will have a different money-weighted return depending on their contribution history. A time-weighted return therefore gives a better impression of fund performance. The ISI draft Standard for Investment Performance Reporting proposes a time-weighted calculation.

**38. Do you consider that a set time for valuations should be mandated? If so, why?**

Depending on the type of asset, most valuations for unit pricing are done daily. For direct property assets a set time less frequent than daily would be appropriate. Timing of valuations should endeavour to limit the likelihood of sudden large movements in the unit price in order to maintain equity between exiting and ongoing investors.

As KiwiSaver funds are typically unitised collective investments, valuation methodologies need to be consistent with unit pricing standards. While there are presently no mandated New Zealand standards for unit pricing, standards for valuations in determining fund returns need to be considered in the wider context of unit pricing standards. Valuation methodologies are continuing to develop and standards need to recognise this. This is an appropriate area for the wider Review of Securities Law.

**39. Do you think that a standard method for valuing non-tradable assets should be prescribed? If so what should the method be?**

While non-tradable assets are not a large part of the KiwiSaver market, standards need to cover their valuation (considering accounting standards). Standards need to be flexible to cover all situations and allow for trustee or manager discretion to be exercised in unusual market conditions (e.g. very depressed trading activity) or circumstances with a particular asset. As noted above, this is an appropriate area for consideration as part of the Review of Securities Law.

#### **40. What are the costs and benefits of requiring real estate to be valued by an independent valuer?**

Valuation by an independent valuer should be a requirement. The key benefit is the confidence that investors will have from independent valuations and to address any potential conflicts of interest.

#### **41. How often should valuations of real estate and other illiquid assets be carried out?**

Full valuations should be performed annually but this is a matter for the Review of Securities Law rather than for periodic reporting regulations. Standards also need to cover the period between 'hard' valuations using indices or other market movement indicators as well as material events that affect specific asset valuations. Investors need to be aware of the frequency of independent valuations and how often unit pricing is done on the basis of estimates.

#### **42. Do you consider that a standardised method for calculating returns should be adopted for the purposes of periodic reports? Why or why not?**

The ISI draft Standard for Investment Performance Reporting proposes a standardised method for calculating returns. It is not, however, applicable to crediting rate funds or interest-bearing funds. If the credited rate to a credited rate fund is net of all fees, the credited rate should be the quoted return.

#### **43. Should returns be reported as a dollar amount or as a percentage?**

Returns should be reported as a compound percentage per annum.

#### **44. Should funds report return gross and net of fees? Why or why not?**

We agree with the Ministry's preference (paragraph 129) that returns should be reported only net of fees, to the greatest extent practicable and considering ease of understanding for the saver. We consider it would be potentially misleading to investors to report returns gross of fees. This means that returns are net of fees that are included in a unit price or are a percentage of assets. As fixed dollar fees (e.g. a monthly member fee) have a different effect on the overall fund return depending on fund size, they should not be included in the after-fee return but it should be noted that the fee is not included in the return. This is consistent with ISI's recommendation for fee disclosure that includes a dollar member fee as a cost of investing in the scheme.

#### **45. Should funds report return gross or net of tax, or both? Why?**

Returns should be reported gross of tax but we would also like to see returns shown net, using the highest tax rate that can apply to any investor in the fund. This effectively provides a 'worst case scenario'. In a short fund disclosure document it is unrealistic to provide returns at each of the PIRs that could possibly apply to investors. There is the added complication that every time the PIRs change that has to be factored in to any comparison of returns for different periods. In addition, gross returns provide for easier comparison with bank interest rates.

**46. Would a requirement to publish returns both gross and net of tax incur costs for providers? If so, what are these costs likely to be?**

As system tax calculators are designed to calculate tax on actual member account balances, some providers would also need to develop programs to calculate an accurate, after-tax, time-weighted return for each investment fund. This could involve significant development costs. Quarterly tax calculations could also lead to distortions due to changing accrued positions.

**47. Are there any other issues that should be considered in relation to calculation of total return?**

There is an issue for funds that credit returns annually and are unable to price quarterly. They would not be able to provide rolling annual returns on a quarterly basis.

**48. What are the benefits to investors of disclosing past performance? How and should past returns be disclosed and what are the alternatives?**

Past performance may show fluctuations in returns and will illustrate for potential investors that a high return in the previous year will not necessarily continue. We agree that disclosure of annual total returns is the best way to indicate trends over time. Any new requirement to disclose past performance should be introduced with a transition period to ensure that returns do not need to be calculated for periods before the requirement comes into force.

**49. Should funds be required to compare their returns with a portfolio of market indexes previously selected by the fund? Are there any alternative ways of benchmarking performance?**

We do not consider there is any need to require benchmarking of returns. There is no standard use of indices, as funds following different investment strategies will choose the most appropriate benchmark/s to that strategy.

As well as the difficulty of achieving comparability of benchmarks, it is likely to be too complicated for retail investors to understand. Fund benchmarking is an appropriate area for fund commentators and analysts, not for routine investor reporting.

**50. Are there any other issues related to returns that should be considered?**

Returns should be accompanied by the standard disclaimer that they provide no guarantee as to future fund returns.

When disclosing returns in monthly returns (performance) sheets we should be allowed to include the assets under management by Fund (this is currently precluded, other than in relation to audited financial accounts, by the Securities Regulations 2009). AUM provides a valuable insight for investors as a guide to the fund direction trend over time.

While annual returns will be based on audited accounting data, inter-period returns, e.g. rolling annual returns disclosed quarterly, would not be.

**51. What should be disclosed for the purposes of periodic reporting? Should all individual asset holdings be disclosed? Or should the asset mix plus top 10 holdings be disclosed? Please provide reasons for answer.**

We agree that investors should be provided with adequate information to allow them to assess whether their exposure to a particular asset class is appropriate. It is important for investors to understand the investment style of their fund and ISI is in the process of drafting a Standard for Disclosure of Portfolio Holdings. We agree that the percentage of fund assets in each asset class should be disclosed. In addition, for sector specific funds we recommend periodic disclosure of the fund's 10 largest portfolio holdings. For diversified funds we recommend periodic disclosure of the names of the sub funds into which the retail funds are invested, with annual disclosure of the consolidated 10 largest portfolio holdings. However, this could reasonably be limited by only disclosing the 10 largest portfolio holdings which comprise more than 5% of the fund's value.

**52. Do you consider that it would be appropriate to require disclosure of the top 10 portfolio holdings every quarter and the full disclosure of all assets on an annual basis?**

We agree that for sector specific funds it would be appropriate that the top 10 portfolio holdings which comprise more than 5% of the fund's value are disclosed on the web site of the Fund manager and updated each quarter, no later than 3 months after the end of the quarter. That requirement should apply annually to diversified funds.

**53. What are the costs and benefits of requiring disclosure of the underlying assets rather than merely the sub-funds the fund invests in?**

The names of the sub-funds would provide limited disclosure (eg that the fund relates to Asian equities) but would not indicate exactly which assets are held. The cost of compliance would be significantly less if only the names of sub-funds were disclosed as it would limit the amount of consolidation of holdings that would be needed to determine the top 10. However, the investor may find sub-fund information difficult to obtain.

**54. What information in relation to the assets do you consider should be disclosed?**

The information that should be disclosed is the name of the asset and the percentage of the investment fund's total assets represented by that holding.

**55. To what extent should classification categories be prescribed? If so, which categories should be adopted?**

We agree that it would be useful to have standardisation of classification. With regard to classification by industry or by location, we recommend that where a fund invests in sovereign debt the holdings for each country should be amalgamated to determine the top 10 holdings. Otherwise, categorisation should be broad asset class (shares, fixed interest, government debt and property, both overseas and New Zealand) and by industry for an equities fund. Classification categories need only go as far as asset class for diversified funds.

**56. What are the benefits of including credit ratings for debt securities in periodic reports?**

This is a level of detail that would be beyond most retail investors. Investment managers do their own assessments of underlying securities and often securities will be traded based on a manager's view, in direct contrast to that of a rating agency. Underlying securities would generally have ratings by different rating agencies which would compound the difficulty of understanding for investors who are unfamiliar with the interpretation of ratings. We believe that introducing a requirement for credit ratings for underlying securities would significantly increase compliance costs without significantly increasing investors' understanding of what it means for their investments.

**57. Do you consider disclosure of a liquidity ratio should be required? If so, why? If not, why not?**

We do not consider that there is any value in periodic disclosure of a liquidity ratio when funds with lower liquidity (eg property funds) must specifically disclose to potential investors at the point of sale that there may be times when the fund has to delay withdrawals. As long as that initial disclosure is made, periodic disclosure of a liquidity ratio would not provide additional benefit.

**58. What do you consider to be the most appropriate method for reporting fund liabilities and why?**

Initial point-of-sale disclosure should include information about whether the fund can borrow and about the level of gearing. We note that liabilities are disclosed in the financial statements and consider that other periodic disclosure should be limited to information about the level of gearing.

**59. What are the costs and benefits of disclosing the portfolio turnover rate?**

While we do not agree with the reasoning in paragraph 168, we consider that there could be some benefit to investors in disclosure of the portfolio turnover rate as (in the absence of disclosure of transaction costs) it does give an indication of the likely costs incurred by the manager's investment style. However, there may be unavoidable reasons for high turnover (a new fund or one with a high cash flow). High and unproductive turnover that does not enhance returns will be reflected in lowering the after fees return which will be disclosed. Some underlying funds may not be able to provide this information, distorting overall consistency of information.

High turnover is likely to be of limited interest to KiwiSaver investors and the benefit needs to be weighed against the additional compliance cost of calculation and disclosure, including the need for careful explanation and education of investors regarding the significance of the disclosure.

**60. Do you consider it sufficient that funds disclose all soft dollar commissions? If not, then what should be required of funds in this regard?**

As an overall comment, the issues covered in section 5 of the discussion paper should be addressed in the Review of Securities Law as general behaviour requirements of managers of collective investment schemes in their management of investor funds. For example, the

trade and execution policies outlined in paragraphs 177 and 178 should simply not be allowed. A disclosure-based approach is inappropriate and unnecessary at this time, considering the Review is underway.

Soft commissions are inappropriate for managers of retail collective investment vehicles. We consider that disclosure of soft commission arrangements envisaged by paragraphs 172 to 176 is more applicable to wholesale funds than retail funds. Any potential conflict of interest through soft commissions at the retail level would need to be included in the adviser's disclosure at point-of-sale. The scenario described impacts at the institutional level and would not involve any additional costs for investors. It is probably sufficient for disclosure to be made in the prospectus and we recommend that this question should be deferred for consideration as part of the Securities Law Review.

**61. Would mandatory disclosure of trading costs help address this issue? If not, why not? If yes, then why?**

See the previous comments.

**62. Do you consider periodic reporting of trade execution policies necessary? Please explain your answer.**

We do not believe that periodic reporting of trade execution policies is the appropriate way to address the practices described in section 5.1.2 of the discussion paper. Details of the Fund's policies should be disclosed in the Investment Statement and the trade and execution practices outlined should simply not be allowed; disclosure is not the appropriate response – see the previous comments. Other objectionable trade and execution policies would be handled by principles of good collective investment scheme governance.

**63. Do you consider there to be merit in requiring periodic reporting on proxy voting? If so, why? If not, why not?**

This could be reported in the Annual Report, for the information of analysts, but it is generally not relevant for the average retail investor and is likely to represent information-overload.

**64. In your view, do you consider a minimum requirement to periodically report on related party investments or obligations likely to accrue a material benefit to the issuer and/or investment manager necessary? If not, why not?**

We consider disclosure of related party transactions to be absolutely necessary but it is more appropriate as part of annual financial reporting and general principles of management of conflicts of interest. There is already a requirement to report in the prospectus under Schedule 6 Clause 8 of the Securities Regulations 2009.

**65. What, in your view, would constitute 'material'?**

We recommend use of the same definition as applies in the fund's prospectus.

**66. For the purposes of periodic reporting, do you consider disclosure of names and tenures of key personnel to be sufficient? If not, why not?**

We acknowledge that this disclosure is common in other jurisdictions but we consider that it is less relevant for retail schemes in NZ which commonly invest into other funds. Key personnel disclosure requirements need to be sensitive to the investment management structure of the range of KiwiSaver funds. One KiwiSaver scheme may have a number of investment funds managed by separate investment managers. In this case the appropriate personnel are those responsible for the particular investment option they manage. The KiwiSaver scheme provider's function is to select fund managers so extending the tenure disclosure requirement to it as well may simply add complexity.

On the other hand, where the KiwiSaver fund provider actively manages an asset portfolio or a fund of funds, tenure disclosure may be more relevant as they are actively involved in underlying investment manager selection. In that case, disclosure of a considerable amount of underlying fund manager information could be of little value to the KiwiSaver investor.

**67. What are the advantages and disadvantages of adopting a standardised template for periodic reports?**

We support the use of standardised templates and recommend that the ISI model for disclosure of fund fees and expenses should be used as the starting point.

**68. To what extent do you consider that the terminology to be used in periodic reports should be prescribed?**

We consider there to be a significant benefit in having prescribed terminology in periodic reports.

**69. What are the costs and benefits of having a standard table for reporting fees and the Total Expense Ratio?**

The obvious benefit of a standard table is that it is easier for investors to compare their Fund with others. The potential downside is that the contents of the table will need to be very tightly prescribed in order to ensure that the information is, in fact, comparable.

**70. What are the advantages and disadvantages of disclosing return figures in a table? Is there an alternative way in which these figures could be disclosed?**

See previous answer.

**71. What are the advantages and disadvantages of adopting a standardised worked example to illustrate returns after fees and taxes?**

We would support a requirement to provide a standardised worked example. It gives a clearer picture of the effect of fixed and percentage fees and taxes.

However, as mentioned in the answer to question 46, an accurate tax calculation programme on a hypothetical fund would require system development and maintenance.

**72. Do you consider that the worked examples should be calculated using a \$10,000 and a \$50,000 initial investment amount? If not, what amounts should be used?**

We would support worked examples based on the single amount of \$10,000 initial investment. We acknowledge that provision of an additional example using \$50,000 would help to illustrate the variable impact of fixed dollar fees on different fund balances. The wording of the example(s) needs careful consideration to take into account any rebate to investors of the cost of fees payable.

**73. What are the advantages and disadvantages of reporting the top 10 portfolio holdings in a table like that set out in the example template?**

Top 10 asset holdings give valuable information on asset concentration. However, as mentioned previously, top 10 holdings should only be listed if they are over a threshold percentage – we suggest 5%. The majority of KiwiSaver funds are broadly diversified and listing individual assets that comprise less than 5% of a fund has limited retail investor relevance. (Full asset details should be available from an investment manager.) If no individual assets comprise more than 5% of the fund value, a negative statement to that effect should be included.

**74. Do you consider that asset class split should be represented in a pie chart like the one in the example template? If not, why not?**

We agree with representation in the pie chart (as well as the table). However, fund debt should also feature in pie diagram given that unsophisticated investors may not understand fund borrowing and under emphasise it if not also pictorially represented.

**75. Do you consider that fund manager tenure and conflict of interest information should simply be listed? If not, how should this information be presented?**

We do not agree that individual fund manager tenure should be listed. It may be more relevant to list fund management institutions employed. As mentioned previously, conflicts of interest should be managed by good principles of fund governance.

## **List of ISI Members**

### **ISI MEMBERS**

AIA NZ  
AMP Financial Services  
Asteron Life Ltd  
AXA New Zealand  
BNZ Investments and Insurance  
CIGNA Life Insurance NZ Ltd  
Dorchester Life  
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FNZ  
Gen Re LifeHealth  
Hannover Life Re of Australasia Ltd  
Kiwibank Ltd  
Medical Assurance Society NZ Ltd  
Mercer  
Munich Reinsurance Co of Australasia Ltd  
OnePath New Zealand Ltd  
Pinnacle Life  
Public Trust  
RGA Reinsurance Co. of Australia Ltd  
Sovereign Ltd  
Swiss Re Life & Health Australia Ltd  
TOWER New Zealand  
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InvestmentLink (New Zealand) Ltd  
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