FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

MARCH 2023

Consultation: Renewal of class exemption for MIS managers where assets do not have an appropriate market index

About this consultation

The Financial Markets Authority - Te Mana Tātai Hokohoko (FMA) is reviewing whether to renew an existing class exemption notice for managed investment scheme (MIS) managers for a further five years. This exemption provides relief to MIS managers with funds that invest, in whole or in part, in assets that do not have an appropriate market index and instead allows managers to take alternative approaches. We are also considering enabling the use of additional alternative indices in respect of particular types of relevant assets, to help improve the market index returns information available to investors.

We invite your feedback to support our review of this exemption notice. Please use the feedback form provided.

Submissions close at 5pm on 14 April 2023.

Next steps

After considering submissions, we will finalise our policy proposals and aim to have any exemption in place prior to the expiry of the existing notice.

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

This consultation is for managed investment scheme managers. It is also for relevant industry groups and advisers, and investors in those entities.	It asks for feedback on whether the current exemption notice should be renewed and, if it were, what changes (if any) should be made.

Contents

Review timing and process

The *Financial Markets Conduct (Market Index) Exemption Notice 2018* (the **current notice**) is due to expire on 16 July 2023. We have decided to renew the current notice for an interim period of one year on the same terms. The interim notice is intended to allow sufficient time to consult on a more fulsome renewal for a further 5 years, and also to consider potential amendments to any renewed notice. The interim notice is expected to come into force in July 2023, so that the terms of the exemption continue to apply seamlessly for a further year.

We plan to complete a fulsome review of the current notice and have any replacement notice in place before the interim notice expires in approximately July 2024.

If the outcome of this review supports the granting of the notice without substantive amendment for a further period, this will allow market participants to seamlessly continue to rely on the notice.

If we decide that these exemptions are no longer warranted, or that substantive amendments are required, we will provide notice of this and, if needed, provide a transitional period to give entities that rely on the exemptions an opportunity to make any necessary changes to business systems and processes.

Our process and timeline will vary depending on the significance of issues under consideration. The indicative timetable is noted below and is subject to change.

Date	Step
14 April 2023	Consultation period closes, consideration of feedback begins.
July 2023	Current notice expires on 16 July; interim notice with the same terms comes into force for 1 year before current notice expires.
Approximately September 2023	Decision whether to extend relief under the interim exemption notice for a further 5 years and on what terms.
October 2023 onwards	If the decision is made to extend relief, during this period we will draft a replacement notice to give effect to the policy decision.
Before July 2024	Replacement notice (if granted) comes into effect in advance of the expiry of the interim notice.

FMA’s power to grant class exemptions

We have powers to exempt persons or transactions from compliance with requirements in the Financial Markets Conduct Act 2013 (FMC Act) and associated regulations.

Before we do so, we must be satisfied that the exemption is not broader than is reasonably necessary to address the matters that gave rise to it. We must also be satisfied that the exemption is necessary or desirable to promote one or more of the following purposes of the FMC Act regime:

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

We can only renew exemptions where we are satisfied that the statutory requirements are met. We need information from you to support our decision-making, so we encourage you to provide feedback.

Overview of class exemption

Background

The Financial Markets Conduct Regulations 2014 (the **FMC Regulations**) require MIS managers to disclose information on the past performance of their funds. This information must be made available in quarterly fund updates under the heading *'How has the fund performed?'*[1]

The performance of an appropriate market index must be included alongside that information (referred to as the **market index requirement**). To be appropriate, the market index must meet certain criteria, set out in the FMC Regulations. Specifically, the market index must be a "broad-based securities index" that:[2]

- is either widely recognised and widely used in the financial markets, or is administered by a person other than the MIS manager or their associated persons; and
- is "*appropriate in terms of assessing the movements in the market in relation to the returns from the assets in which the specified fund directly or indirectly invests*".

The purpose of requiring the performance of an appropriate market index is to provide a benchmark that is independent and representative of the assets and markets the fund invests in, so investors can evaluate the performance of the fund against movements in the market for assets in which the fund invests.

If there is no appropriate market index for a fund or a portion of its assets, a manager cannot in practice comply with these requirements. The Financial Markets Conduct (Market Index) Exemption Notice 2018 (the **current notice**) seeks to address this.

Reliance on notice	
Q1	Are you the manager of a managed investment scheme? If so, do you rely on the current notice? How many funds do you have under management that rely on the current notice?

[1] See clause 59 of Schedule 4 to the Financial Markets Conduct Regulations 2014.

[2] See clause 61(3) of Schedule 4 to the Financial Markets Conduct Regulations 2014.

Existing exemption notice – key effects and reasons

The current notice applies to managers of funds that invest, in whole or in part, in assets that do not have an appropriate market index (**relevant assets**). These funds are referred to as "exempt funds" in the current notice.

The current notice requires the manager of an exempt fund to use reasonable endeavours to identify a peer group index for each of the relevant assets of the fund.[3] A peer group index is required where one is available and is:

- based on the performance of a group of funds that invest in a particular sector(s); and
- either or both:
  - widely recognised and widely used in the financial markets;
  - recognised as being sufficiently objective or independent; and
- likely to be useful to investors when assessing the performance of the relevant assets and the exempt fund as a whole.

An exempt fund may comprise numerous different types of relevant assets that each use different peer group indices. An exempt fund could also comprise both relevant assets and assets for which there is an appropriate market index. In both cases, the manager may create a composite index based on the different indices and use the return on that composite index in the fund update.[4] Composite indices should be weighted according to the fund's asset allocation.

The alternative approaches under the current notice include:

Where a fund has…	The manager may…
Relevant assets with different peer group indices	Use a composite index that reflects the different peer group indices
Both relevant assets and assets that do have an appropriate market index	Use a composite index that reflects both the peer group index (or indices) and the appropriate market index (or indices)[5]
Assets that do have an appropriate market index and no relevant assets with a peer group index	Use the appropriate market index (or indices) if it is likely to be useful to investors when assessing the performance of the fund as a whole

If there is no peer group index that is likely to be useful to investors when assessing the performance of the relevant assets and the fund as a whole, then a complete exemption from the market index requirement is available in respect of those assets.[6]

We consider that, where appropriately and carefully selected, the use of peer group indices and composite indices is consistent with the underlying policy rationale of the current market index requirement, which is to

[3] Clauses 6 and 4(1) (definition of peer group index) of the Financial Conduct (Market Index) Exemption Notice 2018.

[4] Refer to clause 7(3)(e)(ii) and (iii) of the Financial Conduct (Market Index) Exemption Notice 2018.

[5] Under the FMC Regulations, managers are able to disclose the return on a composite index composed of more than one 'appropriate market index' (refer to cl 61(3), Schedule 4 which defines an appropriate market index and refers to "index *or indices*").

[6] Clause 9 of the Financial Conduct (Market Index) Exemption Notice 2018.

provide investors with a benchmark that is independent, and representative of the investment strategy of the fund.

The policy reasons for granting the exemptions available under the current notice can be summarised as follows:

- Without the exemptions, managers of exempt funds (being funds investing in assets, in whole or in part, with no appropriate market index) cannot comply with the market index requirement. They might publish the returns of an index or indices that do not reflect the assets the fund invests in, and are therefore not relevant to investors when assessing the performance of the fund. This may be confusing for investors. The conditions to the exemptions are appropriate because managers are required to use suitable and independently administered or widely recognised and used alternative indices if they are available, and provide information about the index used.
- The exemptions improve the disclosure made to investors in respect of exempt funds, and will also improve comparability across funds over time. Reducing the difficulties in comparing the performance of different funds should improve market efficiency. It is a practical way of fulfilling the aim of the market index requirement when it cannot practically be complied with in accordance with its original terms.

Granting the exemption therefore promotes the confident and informed participation of businesses, investors and consumers in the financial markets and avoids unnecessary compliance costs.

We seek your feedback on whether the policy reasons for granting the exemption remain relevant and valid.

Support for renewal	
Q2	Do you support the renewal of the current notice or not? What are the reasons for your view?
Q3	Do you think the original policy reasons for granting the exemption remain relevant and valid? Are you aware of anything that has changed during the period since the notice was granted that would affect or alter these reasons? Are there any additional policy reasons that would support granting, or not granting, the exemption?
Q4	If you are a manager of a MIS that relies on the current notice, what impact would *non-renewal* of the notice have on you?
Q5	What impact would renewal of the notice have on scheme participants and members, compared to non-renewal? Please include any benefit or detriment to the level of information available to members and their ability to easily access this.
Note: If we cannot obtain evidence and data that supports the continued need for the exemption and confirms that the statutory test for granting the exemption is met, then we may not be able to renew the notice. Your feedback is appreciated.	

Exemption conditions

The existing exemption is subject to a number of conditions as set out in the current notice. These include conditions requiring the manager to provide additional disclosure, including information on the register entry and in fund updates. There are also conditions ensuring 'risk indicators' are still provided, as well as statements about performance-based fees.

If the decision is made to renew the notice, our initial view is that these conditions remain appropriate. We seek your feedback on this.

Amendments needed	
Q6	Do you think any amendments will be needed to the notice if it is renewed? If so, please specify the amendments you propose, the reasons for these, and the impact of the amendments on the schemes, participants, or investors.
Q7	Please tell us if the notice has not effectively minimised the unnecessary compliance costs it aims to address, causes unintended unnecessary compliance costs through its conditions, or could go further to address unnecessary compliance costs not identified when the notice was made. Please quantify the costs with as much detail as you are able to. Please tell us how the notice could be amended to address these issues.
Q8	If you rely on the current notice to use a peer group index (or indices), have you encountered any issues with aligning the reporting period of the peer group index (or indices) to the reporting period of the fund update the data appears in? If so, please provide details about the issue(s) and what steps you have taken in response.

If the decision is made to renew the notice, we may seek further feedback at that time on any technical drafting issues that arise when we prepare the replacement notice.

Proposal to allow exempt funds investing in ‘single assets’ to use alternative indices

Single assets are generally exempt from the market index requirement under the current notice

Currently, managers of funds that invest, in whole or in part, in ‘single assets’ will most likely need to rely on the exemption in respect of those assets.

When we refer to single assets, we are referring to one particular asset the fund holds, for which there is generally a market price available but not a broad-based index that would satisfy the definition of an appropriate market index. Under the current notice, single assets would be considered ‘relevant assets’. Examples include cryptocurrencies (e.g. Bitcoin) and commodities (e.g. gold).

We understand that an index that would be appropriate as a benchmark for comparison for a single asset will not be broad based because of the nature of tracking the market movements in the price of a singular asset (or even handful of assets).

Furthermore, we understand peer group indices may not be available for single assets because of the difficulty in identifying a group of enough funds invested in the same or similar enough asset allocations or investment strategies such that the peer group index is likely to be useful to investors.

Therefore, managers of funds invested in single assets often need to rely on the full exemption from the market index requirement that the current notice affords.

Single asset indices could provide some comparison information, rather than none

Investors in exempt funds that invest, in whole or in part, in single assets may benefit from managers being able to use an alternative index or indices in respect of those assets. Currently, where a fund invests solely in a single asset and relies on the full exemption for the market index requirement, investors receive no benchmark information at all.

For example, a fund that invests solely in a cryptocurrency (whether directly or through an underlying fund) and has no appropriate market index or peer group index does not currently disclose any relevant benchmark at all. This is despite there being clear return and asset price information against which the performance of the fund could be compared (albeit not in the form of a currently accepted index). We consider that in this situation, the use of an alternative, relevant index would be preferable to no index at all.

Single asset indices could form part of a composite of indices

As is the approach in the current notice, we propose that a single asset index or indices would be able to be used as part of a composite index.

In the case of a fund with a portion of its assets being single assets, investors may receive more limited benchmark information which does not take into account the market movements in those single assets. We consider that allowing managers to create a composite index which includes a single asset index would provide investors with more accurate and useful comparison information.

For example, 95% of a fund’s assets are non-relevant assets for which an appropriate market index is available. The remaining 5% of the fund’s assets are single assets invested in wheat, a commodity for which no appropriate market index or peer group index is currently available. The manager determines that the appropriate market index is still appropriate in terms of assessing the movements in the market in relation to the returns from the assets in which the fund invests, despite it only covering 95% of the fund's assets. Adding an alternative, single asset index which is appropriate for the 5% single assets to create a composite index would improve the overall relevance and accuracy of the composite index, and thereby improve investors' ability to compare the fund's returns against market returns for the assets invested in.

A fund made up of both relevant and non-relevant assets which produces a composite index of appropriate market indices and peer group indices could also add a single asset index to its composite index in relation to any single assets it invests in. This would also improve the overall relevance and accuracy of the composite index.

Single asset indices would need to meet certain requirements to be eligible

A single asset index could include indices that are based on one single asset or a small number of one type of asset. For example, it could be a cryptocurrency index that tracks Bitcoin, or a commodity index that tracks types of grains (for example, corn, wheat and soybeans).

We propose that an eligible "single asset index" would need to be:

- widely recognised and widely used in the financial markets; and
- administered by a person who is not any of the persons specified in clause 61(4) of Schedule 4 of the FMC Regulations; and
- appropriate in terms of assessing movements in the market in relation to the returns from the relevant assets (being single assets) in which the exempt fund directly or indirectly invests.

In other words, the single asset index would be an index that would otherwise be an appropriate market index, but for the 'broad-based' requirement.

We also propose that a single asset index would need to be adjusted to take account of the following assumptions (to the extent that it does not already do so):

- that all income is reinvested;
- that there are no charges; and
- any other reasonable assumptions that reflect the operation of the exempt fund.

We are not proposing to allow the use of absolute return indices as part of this proposal. This is consistent with the approach in the current notice and the position we expressed in the 2018 guidance note accompanying the current notice.[7]

If a single asset index is available, it could be used in place of a peer group index even if one is also available

Our preliminary view is that if a single asset index is available in respect of single assets that are relevant assets, it must be used. Because they track the underlying asset, single asset indices are more accurate and relevant for comparison purposes than peer group indices. Increased accuracy and relevance support the policy intent of enabling comparison of the fund's performance against the market. Requiring single asset indices to be used in respect of single assets, even if a peer group index is available, could improve the overall comparison value of the index.

[7] Guidance on the exemption from the market index requirement (July 2018), pages 11-12 and 17.

We invite your feedback (see the questions below) on whether single asset indices should be used in respect of single assets even though a peer group index may also be available, or whether they should only be allowed to be used if there is no peer group index available. As described above, we understand it would be quite unlikely that a peer group index would be available in respect of a single asset, but it is not necessarily impossible.

The introduction of a single asset index would not be intended to circumvent the broad-based (and other) requirements of the appropriate market index. If a manager can identify an appropriate market index in respect of some or all of the fund's assets, it will still be required under the FMC Regulations to use that first, and it will not be entitled to rely on the exemptions available in respect of those assets (because they will not be considered 'relevant assets').

The introduction of a single asset index also would not be intended to change the requirements for a peer group index to be used (if one is available) in respect of relevant assets that are not single assets.

Some funds may still need to rely on the complete exemption from the market index requirement

If there is:

- no eligible single asset index that is appropriate in terms of assessing movements in the market in relation to the returns from the relevant assets in which the specified fund directly or indirectly invests; *and*
- no peer group index that is likely to be useful to investors when assessing the performance of the relevant assets and the fund as a whole

then there would still be a complete exemption from the market index requirement in respect of those relevant assets.

Policy rationale for considering this proposal

At the time the current notice was issued, the inability to comply with the market index requirement was most acute for managers of funds investing in alternative assets (such as real estate, infrastructure and hedge funds) or funds that followed an alternative investment strategy. The introduction of an alternative peer group index (or composite index) under the current notice was designed to address that problem.[8]

However, alternative funds have continued to evolve and innovate. Funds investing in other alternative assets such as cryptocurrencies and commodities appear to be more popular now. These developments support consideration of this proposal to amend the terms of the exemption.

We consider that this proposal is consistent with the underlying policy rationale of the current market index requirement: to provide a benchmark that is independent of the manager and representative of the assets and markets the fund invests in, so investors can evaluate the performance of the fund against those assets and markets.

This proposal acknowledges that single assets generally cannot meet the definition of an appropriate market index nor a peer group index, and seeks to provide an alternative, independent and representative benchmark to enable investors to compare performance against the market where they would otherwise have no comparison at all. We also consider that this proposal would improve the disclosure made to

[8] Guidance on the exemption from the market index requirement (July 2018), page 11.

investors in respect of exempt funds investing in single assets. This would also improve comparability across similar funds over time, which should improve market efficiency.

Proposal to allow funds investing in single assets to use alternative indices	
Q9	Are you the manager of a MIS that has funds investing in single assets? If yes, list the type(s) of single asset(s) and identify whether an appropriate market index (as defined in cl 61(3) of Schedule 4 of the FMC Regulations) or a peer group index (as defined in the current notice) is currently used in respect of each single asset. If no index is currently used in respect of a type of single asset, is there an alternative index currently available that would be considered “widely recognised and widely used in the financial markets”? If yes, please provide details about the alternative index, including why it would be appropriate in terms of assessing movements in the market.
Q10	Do you think it is worthwhile or necessary to allow managers to use single asset indices?
Q11	Is the proposed definition of “single asset index” appropriate? Are there any changes you would suggest? Please explain.
Q12	Do you think single asset indices should be required to be used in respect of single assets even though a peer group may also be available, or should the peer group index take precedence?
Q13	Are there any unforeseen consequences that may occur as a result of implementing this proposal?

Absolute return indices are not permitted

Consistent with the underlying policy of the market index requirement, the current exemption does not allow managers to use the return on absolute or total return indices in their fund updates.

These types of indices typically do not provide contextual information about the performance of the assets or markets the fund invests in; an absolute return benchmark does not reflect movements in the markets or assets the fund invests in. Absolute return indices also have a discretionary element set by the manager and are therefore not independent.

We are therefore not considering a change of approach in terms of absolute return indices.

Other	
Q14	Do you have any other comments?

Feedback form

Consultation: Renewal of class exemption for MIS managers where assets do not have an appropriate market index

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Consultation - Renewal of class exemption for MIS managers where assets do not have an appropriate market index: [your organisation's name]' in the subject line. Thank you. **Submissions close at 5pm on 14 April 2023.**

Date: Number of pages:

Name of submitter:

Company or entity:

Organisation type:

Contact name (if different):

Contact email and phone:

Question number	**Response**

Feedback summary – *if you wish to highlight anything in particular*

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

The information we gather from this consultation will be utilised primarily for the purpose of considering whether the exemption noted should be granted for a further period and it may be used for other regulatory purposes as noted in the Transparency Statement on our website www.fma.govt.nz.

Personal information gathered in this consultation will be handled in accordance with our Privacy Statement on our website www.fma.govt.nz.

Thank you for your feedback – we appreciate your time and input.