Information sheet – April 2015

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

DIMS limit breaks under the FMC Act

This information sheet outlines the obligations of Discretionary Investment Management Services (DIMS) providers under the Financial Markets Conduct Act 2013 (FMC Act) relating to investment authority limits and reporting breaches of those limits.

Overview

Under the FMC Act, a material breach of the limits set out in the investment authority agreed between a DIMS licensee and investor (limit break) must be reported to the FMA. This information sheet outlines these reporting obligations and discusses when they are, or might be, triggered. In particular, we discuss factors DIMS licensees might consider in determining whether a breach of a limit is material. We also include some examples of material breaches.

Investment authority limits

Section 437 of the FMC Act requires a DIMS licensee to ensure there is a written investment authority granted by the investor for that service. The DIMS licensee must further ensure the investment authority provides adequately for the investment objectives and the scope of the investment authority, including the following matters:

- the nature or type of investments that can be made and any limits on those
- any limits on the proportions of each type of asset invested in, and
- the methodology used for developing and amending the investment strategy, and for measuring performance against the investment objectives.

Where there are no limits stated in the investment authority on a matter set out in the first two points above, or if the matter is capable of changing without the prior written consent of the investor, this must be clearly disclosed in the investment authority.

Limit breaks

DIMS licensees need to report to the FMA if there is a material breach of any limits under the investment authority referred to in section 437 on either of the following (limit break):

- the nature or type of investments that can be made, or
- the proportion of each type of asset invested in.

A DIMS licensee must report limit breaks to the FMA in the prescribed circumstances and in the prescribed manner, as discussed below.

Material breaches of investment authority limits

A limit break is a material breach of limits set out in the investment authority. In particular, a limit break is a material breach of limits in either the nature or type of investments that may be made, or in the proportion of each type of asset that may be invested in (section 437(2) of the FMC Act).

Materiality and limit breaks

There is no definitive test of materiality. We do not consider it necessary at this stage to issue frameworks or methodologies about materiality. However, we may review this depending on how limit break determination and reporting develops.

The factors DIMS licensees should consider when determining whether there has been a limit break include:

- the nature of the breach
- the size of the breach, in relation to the client(s) affected
- whether the breach involves related-party transactions
- whether the breach is an isolated incident, or part of a recurring pattern of breaches in relation to either an individual client or across the business as a whole
- if the breach causes any investment authorities, or an advertisement to which the DIMS relates, to be false or misleading
- how quickly the breach is rectified after the licensee became aware of the breach, and
- how long the breach went on for.

The above list of factors is not exhaustive. The obligation to determine materiality and report a limit break remains with the DIMS licensee.

No single factor is more important, nor does it necessarily require more than one factor for a limit break to occur. Rather, the DIMS provider must assess the circumstances in the context of the service provided, taking into account the factors outlined, to determine whether a breach is material.

Examples of material breaches

You need to consider all the surrounding circumstances to decide if a breach is material. If there is any doubt, we suggest you treat it as material.

The following are examples of breaches we consider to be material:

- any purchase of an investment of a type or nature expressly prohibited under the investment authority
- if a time period has been clearly set out in the investment authority for undertaking any action under the DIMS and this action is not completed within the specified period.

Limit break reporting

Section 438(2) of the FMC Act requires the DIMS licensee to report a limit break to the FMA in the prescribed circumstances and in the prescribed manner. These are set out below.

Immediate limit break reporting

A DIMS licensee must provide a report to the FMA where there has been a limit break (in accordance with section 438 of the FMC Act); if that limit break is not corrected within five working days after the date the DIMS licensee becomes aware of the limit break (regulation 230 of the FMC Regulations).

The FMA expects the report, required under regulation 230 of the FMC Regulations, to be provided to the FMA no later than 10 working days of the DIMS licensee becoming aware of the limit break. Note; the obligation to report is only triggered if the limit break has not been corrected within five working days, and the obligation in regulation 230 is to provide the report as soon as practicable after the expiry of that five working day period.

The report must contain the information specified in regulation 232 of the FMC Regulations as set out below.

Quarterly limit break reporting

The DIMS licensee is also required to provide a quarterly report to the FMA about limit breaks (regulation 231 of the FMC Regulations).

The quarterly report must be provided within 10 working days after the expiry of every quarter of each year.

The report must state whether there have been any limit breaks in the previous quarter to which section 438 of the FMC Act applies and include the following information.

Content of limit break reports

Regulation 232 of the FMC Regulations specifies what is needed to be set out in reports required under regulations 230 and 231 of the FMC Regulations.

The report must disclose:

(a) the date the DIMS licensee became aware of the limit break

(b) a description of the service affected

(c) the nature and cause of the limit break (the type of limit break)

(d) the net asset value of the assets held under the service to which the limit break relates (as at the date the limit break first occurred)

(e) the reasons why the limit break is material

(f) the date on which the limit break first occurred and how long the limit break continued before it was corrected (or whether the limit break remains uncorrected at the time of the report)

(g) the steps taken, or to be taken, by the DIMS licensee to correct the limit break

(h) what steps (if any) have been taken, or will be taken, to minimise the risk of a recurrence of this type of limit break, or to ensure early notification and correction of limit breaks of this type, and

(i) the timeframe within which the DIMS licensee intends to take any steps not already taken under paragraph (g) or (h).

If the information in points (d) to (i) is not reasonably ascertainable at the date of the report, the report is not required to contain that information. However, the information must be provided in a further report as soon as is reasonably practicable after the information becomes reasonably ascertainable. The FMA has not specified timeframes for these requirements because they are dependent on individual and factual circumstances.

Where a limit break report has been provided to the FMA under regulation 230, and if the information provided in that report remains correct at the date of the quarterly report, it is not necessary to provide any of the information in points (d) to (i) in the quarterly report in respect of the limit break already reported under regulation 230.

How to report

Reports can be submitted to the FMA by email to compliance@fma.govt.nz.

Please include in the subject line "DIMS limit breaks quarterly report" or "DIMS limit break regulation 230 report".

Planning

We encourage you to plan and be ready to comply with the FMC Act. Plan what you need to do to ensure you comply with your investment authorities and report any limit breaks.

Where can I find more information?

For more general information about the FMC Act, visit our website. You can also subscribe to receive FMA updates for the latest news.