FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

Guidance Note

November 2014

Statements of Investment Policy and Objectives under the FMC Act

About this guidance note

This guidance note is for

Managers of managed investment schemes and their supervisors.

It gives guidance on

The expectations the FMA has for your approach to SIPOs under Part 4 of the Financial Markets Conduct Act 2013

About FMA guidance

Our guidance:

- explains when and how we will exercise specific powers under legislation
- explains how we interpret the law
- describes the principles underlying our approach
- gives practical examples about how to meet obligations.

Guidance notes: provide guidance on a topic or topic theme. Typically we will seek industry feedback via a public consultation paper, or more targeted consultation before we release a guidance note.

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

You might also like to check the reports and papers on our website. For example, our monitoring reports describe actual practice we are seeing and our comments on this.

Document history

This version was issued in November 2014 and is based on legislation and regulations as at the date of issue. It incorporates feedback from our August consultation paper: SIPOs and Limit Breaks and our June consultation paper: The new accountability framework – Governance under Part 4 of the FMC Act.

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Overview

This guidance note is for managers of managed investment schemes and their supervisors. It outlines the expectations the Financial Markets Authority (FMA) has for your approach to preparing statements of investment policy and objectives (SIPOs) under Part 4 of the Financial Markets Conduct Act 2013 (FMC Act).

Part 4 of the FMC Act imposes statutory duties of care on managers and supervisors of MIS. It also requires them to act in the best interests of the scheme participants.

These duties, together with the fair dealing duties in Part 2 of the FMC Act, act as overarching duties. They set the scene for how managers and supervisors meet their specific responsibilities and for the relationships and accountabilities they have.

Governing documents and SIPOs play an important part in shaping and ensuring the effectiveness of the overall accountability framework. SIPOs are a mandated document under the FMC Act and in most cases must be lodged with the Registrar. SIPOs should be clear, concise and effective.

The overarching duties require governing documents, SIPOs, and business systems and processes to be 'fit for purpose'. Where a MIS has both a manager and a supervisor, this is a shared responsibility (because both the manager and supervisor have the overarching duties).

Agreeing 'fit for purpose' and effective governing documents and SIPOs, and holding product providers to account through the tools contained in or relating to those documents, is key to achieving the objectives of the FMC Act.

Our Guidance Note: Governance under Part 4 of the FMC Act discusses in more detail the overarching duties managers and supervisors have.

Section 1: The purpose of a SIPO

What is a SIPO?

A statement of investment policy and objectives (SIPO) is a document that sets out the investment governance and management framework, philosophy, strategies and objectives of a managed investment scheme and its investment funds or portfolios.

Under the FMC Act, all managers must ensure there is a SIPO for each MIS they manage. Except in prescribed circumstances, you must also register the SIPO with the Registrar, and must lodge any changes to the SIPO with the Registrar.

Purposes of the SIPO

SIPOs will play an important part in shaping and ensuring the effectiveness of the overall accountability framework for MIS.

The FMA expects SIPOs to be clear, concise and effective in the following contexts:

- Foundation for investment governance framework: A SIPO is the vehicle for clearly articulating the investment objectives and parameters for the scheme.
- Accountability: A SIPO enables a supervisor to ensure a manager is managing investments within established parameters. These should reflect the terms on which the scheme was presented to scheme participants. A SIPO must be effective in delivering clear, specific and measurable risk and return objectives, investment parameters and benchmark asset allocations for the MIS.
- Disclosure: SIPOs enable financial advisers to provide more informed advice and for current and future scheme participants to make better informed investment decisions. Having SIPOs publicly available ensures that all analysts, researchers, advisers and scheme participants have access to the same information. Managers need to be cognisant that the SIPO is a publicly available document accessible to scheme participants. Acting in the best interests of your scheme participants includes a responsibility to provide them with an understanding of the investment objectives of a MIS.

Principles to achieve these purposes

The FMA recognises a prescriptive list of potential content in a SIPO is unlikely to cater to every type of MIS. Instead, this guidance sets out key components that each manager should consider when preparing a SIPO.

You, as manager, should consider the nature and context of your MIS and apply these principles within the overall governance framework. Together this will achieve the key purposes of the SIPO under the FMC Act.

The SIPO should be a complete, standalone picture of the investment policy and objectives of the MIS

It should describe the investment philosophy and strategies at a general level and clearly articulate the investment message for the MIS. It should also deliver an understanding, in a practical way, of how the investment strategy is implemented and monitored.

It should provide only the level of detail required to paint this picture

The FMA expects that generally the SIPO should set out processes and policies for the MIS (for *example*, for managing risks, rebalancing, monitoring investment performance and selecting investment managers). These may be set out in a way that refers to overarching policy principles that are applied to the respective processes – i.e. key things that will be taken into consideration such as parameters and limits, or may provide for more detailed explanation depending on the amount of detail the manager considers is warranted.

Consistency with other MIS materials is important

The SIPO should be consistent with governing documents, the product disclosure statement (PDS) and register entry (where applicable), advertisements and other marketing materials. Terminology, descriptions and the language used must enable readers to logically link information in the SIPO with available disclosure information. The SIPO must accurately reflect on the product offering described in the PDS.

The FMA recognises that some standard industry investment terminology differs from the statutory terminology. Where this occurs we suggest this is clearly identified and explained. The alternative is to use the terminology in the FMC Act and Regulations.

We also recognise there should be minimal overlap between MIS documents where possible. This does not mean that duplication has to be stringently avoided. Ultimately each document should have a clear purpose and be limited to that purpose in order to ensure shorter and more readable information for scheme participants.

There should be a clear link to the governance framework

The investment governance framework should:

- identify the body (for example an investment committee) responsible for ensuring the SIPO is adhered to
- set out the process for changing the SIPO
- detail the processes to ensure compliance with the SIPO
- support the effective selection, management and monitoring of investments, including appropriate monitoring and management of investment risk and compliance with the SIPO.

The supervisor should be involved in developing the SIPO

The supervisor should be involved in developing the SIPO to the extent that it assists them in understanding the MIS from the outset. This will assist both the manager and supervisor to understand the investment context of the MIS, and the SIPO's role in the supervisory monitoring process.

In the case of a restricted scheme, where the FMA acts as the supervisor, the expectation is trustees will work with their advisers to develop the SIPO. The FMA does not expect to be involved in this process.

In the case of existing MISs we do not expect that new SIPOs must be produced, or current SIPOs rewritten, except where it is necessary to ensure the existing SIPO complies with the FMC Act. Where this is the case, or where a SIPO is being amended the FMA would expect that the manager would engage with the supervisor.

The SIPO must deliver on the overarching statutory duty to act in the best interests of scheme participants

In order to do this a SIPO should:

- show scheme participants what you are doing with their money and the mechanics of those processes
- do so in a way that is clear, concise and effective.

Section 2: The key components of a SIPO

FMC Act requirements

Section 164 of the FMC Act requires a SIPO to adequately describe the investment policy and objectives of the scheme, which includes amongst other matters:

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

Where there are no limits on the types of investments or the proportions of each investment type, the FMC Act requires this fact to be clearly disclosed in the SIPO.

Key components will vary according to the MIS type

This section sets out what the FMA considers are the key components of a SIPO. We have grouped like information under certain headings but it is not the intent that a SIPO must follow these headings as we recognise not all the components or information will be relevant in all SIPOs.

Description of key components of a SIPO

Description of the MIS

A SIPO should include a description of the MIS. This should be consistent with the description of the MIS provided in the governing documents and in the PDS.

Investment objectives

The SIPO should describe the investment objectives in terms of both performance and risk/reward trade off. The objectives should make it clear whether or not performance measures include tax, fees and other expenses.

The performance objectives can refer to such matters as:

- desired investment outcome for the MIS
- long-term performance objectives, including expected returns relative to any performance benchmarks
- expected tracking error for performance.

Investment philosophy

Describing your investment philosophy provides a useful background to the investment strategy, and to the resulting risk/reward profile of the MIS. The explanation can also provide the linkage between the investment beliefs and investment strategies of the MIS and/or an explanation of how this links in with the risk profile of the MIS.

The SIPO should set out a high level statement of the investment philosophy to outline the manager's chosen investment management style, structure, and strategy. For *example*:

- Do you believe that markets are efficient and prefer to adopt a passive investment approach, or do you believe there are opportunities in financial markets for active managers to exploit?
- If investment management is outsourced to underlying investment managers, do you prefer to appoint one manager across all asset classes, or sector specialist investment managers within each asset class?

Investment strategy

Outlining investment strategy is the key component of a SIPO. A minimum industry standard is a description of the parameters against which the performance of the MIS will be monitored.

The investment strategy should be presented clearly in a schedule (or schedules), and should include the following information for each fund and each asset class, as applicable:

- benchmark asset allocation
- benchmark asset allocation ranges
- appropriate benchmark index/indices
- any other relevant information that might be useful to explain the investment approach within the asset class (for *example*, appointed investment managers if investment management has been outsourced in that asset class and a summary of that investment manager's investment approach).

Benchmark asset allocation

The benchmark asset allocation is the long-term average expected weighting for each asset class. It should be consistent with the 'target asset allocation' in the PDS and fund update (if relevant).

Your SIPO may reference the fact that the 'target asset allocation' is a term prescribed by regulations for use in the PDS and fund updates, but that in your SIPO you prefer to use the industry term 'benchmark asset allocation' (or whatever term you decide to use e.g. 'strategic asset allocation').

Benchmark asset allocation ranges

Benchmark asset allocation ranges specify the minimum and maximum limits for each asset class. The ranges expressed in your SIPO must broadly reflect your MIS type and must reflect the investment strategy.

Benchmark asset allocation ranges are important because they enable both you and your supervisor to ensure the MIS is managed within the asset allocation ranges in a way that is 'true to label' and reflecting the PDS description.

Include ranges for growth and income assets where relevant

Where a MIS, or a fund in the MIS, invests with a particular label (e.g. conservative, balanced or growth fund) the investment strategy should reflect the label. That is; a conservative fund is expected to be low risk with a low benchmark asset allocation weighting to growth assets and a high weighting to income assets. A growth fund is expected to be higher risk with a high weighting to growth assets and a low weighting to income assets.

Include information on permitted investments

For each asset class there should be a clear explanation of what types of investments the MIS can invest in, with definitions of what each asset type is. Listing permitted investments sets the parameters for all and any investments for a MIS. Any investment manager appointed by the MIS would then be required to comply with these parameters.

The detail of permitted investments may be included in the underlying investment managers' mandates (i.e. where the investment management is outsourced). In these instances the SIPO should still state your overarching policy or principles in terms of permitted investments for that MIS and how this is applied when appointing an underlying investment manager for the MIS.

SIPOs may include a statement to the effect that you may invest in other investments (which are not explicitly stated) that you consider fall within the parameters of permitted investments and that appropriately reflect the risk profile of the MIS and will contribute to the performance objectives of the MIS.

Your SIPO should clearly set out any investments or classes of investment that are expressly prohibited, especially where those prohibitions are material to the overall offer. For *example*, if an ethical fund will not invest in munitions the SIPO should state that, along with other prohibited classes that define it as an ethical fund. However, the FMA does not expect a SIPO to list or set out all of the types of investments that are not expressly permitted (as opposed to those that are expressly prohibited).

Investment policies

Rebalancing policy

Your SIPO should include information about the policy and process for rebalancing MIS investments within the benchmark asset allocations ranges. This would include information such as what would trigger remedial action and what remedial action is required.

The rebalancing policy should also cover details such as:

- the process and timing for monitoring the actual asset allocation in relation to the benchmark asset allocation ranges
- time limits for rebalancing – expected norm, maximum timeframe and any exceptions (e.g. property investments which may be more illiquid might need to have a longer timeframe to rebalance), any limitations and what principles are applied to minimise the risk of loss or negative impact on the MIS.

Hedging policy

The SIPO should outline the overarching policy and principles for hedging including the purpose/objective of hedging investments. It should describe how the hedging exposure strategy is established and implemented by the manager, outline the parameters that must be adhered to in order to manage the overall risk profile of the fund investments, and how the policy is monitored for compliance with the SIPO.

Tactical asset allocation policy

If the manager tries to enhance the MIS investment performance through tactical asset allocation, then the SIPO should include information about the policy. Tactical asset allocation involves varying the actual asset allocation away from the benchmark asset allocation, to take advantage of short term market conditions.

Other relevant policies

You should consider including policies that are directly relevant to achieving the investment objectives and strategies of the MIS and any related operational matters. The FMA expects there will be an explanation of the policies set out in the SIPO. If the policies are available elsewhere then it may be preferable to provide a link to these. If a policy contains confidential or proprietary information the explanation will not have to cover this information.

These could include any of the following:

- liquidity and cash flow management policy – this should include an overarching statement on the appropriate level of liquidity required for the respective fund and an explanation of how this is to be maintained

- conflict of interest(s) policy (e.g. for related party investments, or rules for staff trading on their personal account)
- diversification requirements/limits
- market risk management policy
- credit risk management policy
- settlement risk management policy
- trade allocation and trade execution policies
- voting policies
- derivatives policies
- leverage policies (portfolio gearing)
- socially responsible or ethical investment policies
- crediting rate policy for superannuation schemes and/or non-unitised schemes
- pricing/valuation policies
- taxation policy
- operational risk management policy.

Investment performance monitoring

Investment performance must be monitored. Elements of the performance monitoring process that should be described in the SIPO may include:

- how often performance is monitored - i.e. monthly or quarterly or six-monthly or annually, or any combination of these
- what period(s) performance is monitored over - e.g. quarterly, year to date, annual and rolling three-year, five-year, seven-year and /or ten-year results
- how performance is monitored – i.e. the reporting process and information requirements (for *example,* monthly reports, quarterly and annual reporting)
- what performance is measured:
    - absolute performance
    - performance relative to benchmarks indices
    - performance relative to investment objectives
    - the volatility of returns (and the actual tracking error).

Investment strategy review

Your SIPO should state the approach to conducting an investment strategy review. This should describe:

- the process and timing for reviewing the benchmark asset allocation
- the policy and process for selecting and monitoring the investment managers (if outsourced).

SIPO review

Your SIPO should include a clear policy statement about the process for reviewing the SIPO. This should describe:

- how often the SIPO is formally reviewed and what would trigger an ad hoc review of the SIPO
- the process for the review of the SIPO – what is taken into consideration
- who approves the new SIPO and how the new SIPO is approved.

Once the SIPO has been reviewed, the updated or amended SIPO must contain an effective or commencement date. Each SIPO must also state that the most current version of the SIPO is available on the schemes register (Disclose), together with the relevant website reference.

Section 3: Other MIS and SIPOs

Other MIS must also produce a SIPO

‘Other MIS’ are those MIS that are not a ‘managed fund MIS’ (see ‘Terms used’ below).

Under the Securities Act many participatory securities now fall within the managed investment scheme definition under the FMCA (examples such as forestry partnerships or property syndicates).

The SIPO is predominantly a document produced by a managed fund MIS, and many of the concepts and matters set out in this guidance are relevant mainly to managed funds MIS. However, a registered scheme (being a MIS registered on the register of MIS (Disclose)) is required, under sections 164 and 166, to prepare and lodge a SIPO.

SIPOs may be simpler but should still follow the principles in this guide

FMA recognises that other MIS will not necessarily produce a SIPO that has the level of detail of a managed fund MIS SIPO. However the underlying principles and purposes of a SIPO, outlined in this guidance, should be used to construct a SIPO that is meaningful and relevant.

Managers of other MIS need to consider what is relevant to their MIS, taking into account the factors and matters appropriate in the context of their MIS.

Given that most other MIS are single sector type entities, it is likely the SIPO for an ‘other MIS’ will be a very simple document which describes the investment model adopted. This reflects that the key objective of a SIPO is conveying the relevant and applicable investment philosophy and strategy of the MIS.

The purpose of this guidance is not to provide a document template; the SIPO should ultimately be about articulating the investment message and framework of the MIS. We do not propose to specify or prescribe key components for the many different types of other MIS.

Section 4: Limit breaks in SIPOs – FMC Act and Regulations

The FMC Act and FMC Regulations mandate requirements for SIPOs including:

- changes made to the SIPO
- lodging the SIPO and changes with the Registrar (and when it does not need to be lodged)
- the action that must be taken for limit breaks
- when a report regarding limit breaks must be reported to the supervisor
- quarterly reporting to the supervisor regarding limit breaks
- the content of the reports made to the supervisor.

Managers and supervisors should fully acquaint themselves with these provisions and requirements.

We will publish guidance about material limit breaks in SIPOs. This will operate in conjunction with this guidance and it is important that both are considered and implemented together.

Terms used

FMC Act	Financial Markets Conduct Act 2013
FMC Regulations	Financial Markets Conduct Regulations 2014
FMA	Financial Markets Authority
Governing documents	Trust deed for a managed investment scheme constituted as a trust, and/or such other documents that constitute or govern a managed investment scheme
Managed funds MIS	A managed fund MIS as defined in regulation 5 FMC Regulations 2014
Manager	Manager of a registered managed investment scheme, including in the case of a restricted scheme, the trustees of that scheme
MIS	Managed Investment Scheme The following are managed investment schemes under the FMC Act: • unit trusts • KiwiSaver schemes (see section 128 of the FMC Act) • superannuation schemes (see section 129 of the FMC Act) • workplace saving schemes (see section 130 of the FMC Act) • some participatory securities under the current law • investments declared by the FMA to be managed investment schemes (see section 512 of the FMC Act)
Other MIS	All managed investment schemes that are not managed funds MIS
Part 4	Part 4 of the FMC Act
Restricted scheme	A KiwiSaver, superannuation, or workplace savings scheme that has restricted membership or is closed to new members, and which is registered as a restricted scheme A restricted scheme does not need a licensed manager or a licensed supervisor, but must instead have a licensed independent trustee All restricted schemes are managed investment schemes
SIPO	Statement of investment policy and objectives for a managed investment scheme
Supervisor / Licensed Supervisor	Supervisor of debt securities and/or of managed investment schemes