

## Financial Markets Conduct (FNZ Group) Exemption Notice 2018

Pursuant to section 556 of the Financial Markets Conduct Act 2013, the Financial Markets Authority, being satisfied of the matters set out in section 557 of that Act, gives the following notice.

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### Notice

#### 1 Title

This notice is the Financial Markets Conduct (FNZ Group) Exemption Notice 2018.

#### 2 Commencement

This notice comes into force on 28 August 2018.

#### 3 Revocation

This notice is revoked on the close of 30 November 2020.

#### 4 Interpretation

(1) In this notice, unless the context otherwise requires,—

**Act** means the Financial Markets Conduct Act 2013

**buffer** means firm money belonging to an FNZ group member that is deposited into the FNZ client money trust account and retained in that account for the purpose of reducing the risk of a shortfall arising in the scheme property held in respect of a scheme participant in the FNZ client money trust account

**business day** means a day on which banks are open for trading in Auckland and Wellington

**FAA custodian assurance report** has the meaning set out in (a) below (required assurance reports)

**financial product transaction** means in relation to scheme participants' interests in scheme property, a transaction involving the acquisition or disposal, or the variation of the terms of an acquisition or disposal, of a financial product or other dealing in relation to a financial product which is within investment options approved by the manager for a self-select scheme

**financial product transaction business** means the business of facilitating or arranging the settlement of financial product transactions on behalf of, or for the benefit of, scheme participants in a self-select scheme

**firm money** means money held by or for a FNZ group member on its own account

**FNZ client money trust account** means the account that a FNZ group member operates as a custodian and that is required by section 157(1) of the Act

**FNZ group member** means any of FNZ Limited and FNZ Custodians Limited

**gap analysis** means a document that maps the controls in place for the FAA custodian assurance report, against the controls set out in regulation 88 of the Regulations

**good custodial practice** means exercising the care, diligence, and skill that a reasonable custodian would exercise in the conduct of custodial business in the same circumstances

**qualified auditor** has the meaning given to it in section 461E of the Act

**Regulations** means the Financial Markets Conduct Regulations 2014

**registered bank** has the same meaning as in section 6 of the Act

**relevant date**, in relation to a FNZ group member means either of the following:

- (a) the FNZ group member's balance date; or
- (b) an alternative date in each calendar year determined by the FNZ group member and notified to the FMA in writing to be its relevant date for the purposes of this notice (but that first relevant date need not be in a particular calendar year)

**relevant period**, in relation to a FNZ group member, means a 12-month period ending on the relevant date of that FNZ group member, or if there is a change of the relevant date of that FNZ group member, such that the period ending on that date is longer or shorter than 12 months, that longer or shorter period is a relevant period.

**relevant persons** has the meaning given to it in clause 87(4) of the Regulations

**required assurance reports** means:

- (a) an assurance report obtained under regulations 9 and 10 of the Financial Advisers (Custodians of FMCA Financial Products) Regulations 2014 in respect of client money and client property held by a FNZ group member under the Financial Advisers Act 2008 for each relevant period
- (b) a type 2 assurance report that is obtained by a FNZ group member under International Standard on Assurance Engagements (New Zealand) 3402 *Assurance Reports on Controls at a Service Organisation* (ISAE (NZ) 3402), issued in New Zealand with reference to Guidance Statement GS007 *Audit Implications of the Use of Service Organisations for Investment Management Services* (GS007) issued by the Australian Auditing and Assurance Standards Board in respect of client money and client property held by a FNZ group member for each relevant period

**self-select scheme** means a managed investment scheme under which a scheme participant can select the assets to be acquired and held by the scheme for that scheme participant's benefit.

- (2) For the purposes of this notice, a practice or an action of a FNZ group member that involves scheme property being held together with firm money is **reasonably necessary** if—

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- (a) the FNZ group member has taken reasonable steps to investigate alternatives that would overcome or reduce the extent to which scheme property is held together with firm money; and
  - (b) the FNZ group member is satisfied on reasonable grounds either that, in the circumstances, there are no alternatives available or that any such alternatives—
    - (i) would pose an undue risk to the prudent and orderly conduct of its financial product transaction business; or
    - (ii) are not able to be accessed or implemented without exposing the FNZ group member or a self-select scheme or its scheme participants to an unreasonable level of cost or delay or risk; or
    - (iii) would be contrary to the best interests of a self-select scheme or its scheme participants being able to undertake financial product transactions in a timely and prudent manner.
- (3) Any term or expression that is defined in the Act and the Regulations and used, but not defined, in this notice has the same meaning as in the Act and the Regulations.

**5 Exemption from obligation to hold scheme property separately in order to reduce risk of scheme property shortfalls**

Each FNZ group member is exempt from section 157(2)(a) of the Act in respect of the scheme property of a self-select scheme to the extent:

- (a) that it is reasonably necessary for firm money to be held together with scheme property in the FNZ client money trust account to reduce the risk of a shortfall arising in the scheme property held for the benefit of a scheme participant in a self-select scheme in that account; or
- (b) that a FNZ group member places firm money in the FNZ client money trust account in its capacity as a broker under the Financial Advisers Act 2008.

**6 Conditions of exemption in clause 5**

- (1) The exemption in clause 5 is subject to the conditions that—
- (a) firm money must be held together with scheme property only to the extent that is reasonably necessary for the purposes of the FNZ group member conducting its financial product transaction business in a prudent and orderly fashion; and
  - (b) the FNZ group member must not place firm money into the FNZ client money trust account for any purpose other than:
    - (i) facilitating or arranging the settlement of 1 or more financial product transactions for a self-select scheme for the benefit of a scheme participant; or
    - (ii) reducing the risk of a shortfall arising in the scheme property of a self-select scheme held for the benefit of a scheme participant in that account; and
  - (c) the FNZ group member must take reasonable steps to ensure that the amount of firm money in the FNZ client money trust account is no more than the amount that is reasonably necessary to facilitate or arrange the settlement of 1 or more financial product transactions for a self-select scheme for the benefit of a scheme participant and to cover the risk of a shortfall arising in the scheme property held for the benefit of a scheme participant at any time; and

- (d) the FNZ group member must take all reasonable steps to ensure that scheme property remains separately identifiable from firm money; and
  - (e) the FNZ group member must document, implement, and monitor processes that are consistent with good custodian practice and that are appropriate to manage the risks to any self-select scheme and its scheme participants associated with not separating firm money from scheme property, in reliance on the exemption in clause 5, in the context of the FNZ group member's financial product transaction business.
- (2) Notwithstanding subclause (1), a FNZ group member may hold scheme property together with client money or client property held in its capacity as a broker under the Financial Advisers Act 2008 in the FNZ client money trust account.

**7 Further conditions of exemption in clause 5**

- (1) The exemption in clause 5 is subject to the further conditions that—
- (a) the FNZ group member must maintain at least 1 FNZ client money trust account at a registered bank in each currency in which it accepts scheme property of a self-select scheme; and
  - (b) the FNZ group member must provide the manager and supervisor of any self-select scheme with the following information in writing before the FNZ group member holds any scheme property for that self-select scheme:
    - (i) a statement that all scheme property received by the FNZ group member will be held on trust for that self-select scheme for the benefit of a scheme participant and deposited in the FNZ client money trust account; and
    - (ii) a summary of the terms of that trust; and
    - (iii) a statement to the effect that an amount of money held by or for the FNZ group member on its own account may be deposited by the FNZ group member in the FNZ client money trust account to the extent that is reasonably necessary to reduce the risk of a shortfall arising in the scheme property held for the benefit of a scheme participant in that account and otherwise on the terms and condition of this notice; and
    - (iv) a description of any risks to scheme participants that the FNZ group member is aware of that exist or are likely to arise as a result of scheme property not being held separate from firm money in reliance on the exemption in clause 5; and
  - (c) the FNZ group member must, in relation to each FNZ client money trust account,—
    - (i) have obtained from the bank holding that FNZ client money trust account a written acknowledgement of the trust status of that account; and
    - (ii) ensure that the words "client funds account", "trust account", "client funds a/c", or "trust a/c" appear in the name of that FNZ client money trust account; and
    - (iii) if the name, account number, or status of that FNZ client money trust account changes, obtain from the bank holding that FNZ client money trust account a new written acknowledgement of the trust status of that account as soon as practicable after the date of the change; and
  - (d) the FNZ group member must, on each business day, take adequate steps to reconcile the records for each FNZ client money trust account with the records of the bank holding the FNZ client money trust account for the purpose of identifying whether there is any

- shortfall in the scheme property held for the benefit of a scheme participant in the FNZ client money trust account or any risk that a shortfall may occur; and
- (e) if, on any business day, the FNZ group member identifies that there is a shortfall or a risk that a shortfall may occur, the FNZ group member must take reasonable steps to rectify the shortfall or prevent that shortfall occurring by paying into the account, before the end of that business day, by way of, or on account of, a buffer of an amount of firm money that is not less than the amount of the shortfall or anticipated shortfall; and
  - (f) the FNZ group member must retain written records of the operation of each FNZ client money trust account that include the following information, and make those records available to the supervisor as soon as practicable after the supervisor makes any request:
    - (i) details of any shortfalls that occurred in the scheme property held for the benefit of a scheme participant of a self-select scheme in the FNZ client money trust account; and
    - (ii) details of any risks that a shortfall might arise in the scheme property held for the benefit of a scheme participant in a self-select scheme in the FNZ client money trust account identified by the FNZ group member; and
    - (iii) details of any payments of firm money into the FNZ client money trust account by way of, or on account of, a buffer; and
  - (g) the FNZ group member must obtain, within 4 months after each relevant date, a report from a qualified auditor regarding the FNZ group member's compliance with the conditions in this notice during the relevant period and provide a copy of that report to the supervisor and the manager of the relevant self-select scheme within 20 working days after it has been obtained; and
  - (h) the FNZ group member must ensure that the qualified auditor provides to the supervisor of the relevant self-select scheme, any information that the supervisor may request from the qualified auditor regarding the FNZ group member's compliance with the conditions in this notice during the relevant period as soon as practicable after the supervisor makes any request; and
  - (i) the FNZ group member must provide the qualified auditor with all necessary access to its systems and records, and otherwise co-operate fully with the qualified auditor, to enable the qualified auditor—
    - (i) to assess ongoing compliance by the FNZ group member with the conditions in this notice; and
    - (ii) to provide the reports and other information required by this notice; and
  - (j) the FNZ group member must provide the supervisor of the relevant self-select scheme and the qualified auditor with a written consent authorising the qualified auditor to provide the supervisor and the manager of the relevant self-select scheme with the information required by this notice; and
  - (k) the report obtained from the qualified auditor under paragraph (g) in respect of the FNZ group member's compliance with the conditions in this notice must be prepared in accordance with the applicable auditing and assurance standards issued by the External Reporting Board under section 12 of the Financial Reporting Act 2013 (for example, the Standard on Assurance Engagements 3100 Compliance Engagements (SAE 3100)).

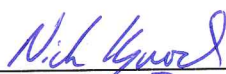
## 8 Exemption from obligation to obtain assurance engagement

Each FNZ group member is exempted from regulation 87(1) and (2) of the Regulations in relation to a relevant date for the FNZ group member that occurs on or after the commencement date of this notice, and thereafter the relevant period ending on that date.

## 9 Conditions of exemption in clause 8

- (1) The exemption in clause 8 is subject to the conditions that:
  - (a) the FNZ group member obtains the required assurance reports from a qualified auditor; and
  - (b) the FNZ group member provides copies of the required assurance reports to the relevant persons within 20 working days after obtaining the required assurance reports; and
- (2) the required assurance reports must include an assessment by the qualified auditor as to whether in the auditor's opinion there is reasonable assurance that the custodian's processes, procedures and controls, in respect of scheme property of any self-select scheme held in the FNZ client money trust account were suitably designed to meet the relevant control objectives; and
- (3) the FAA custodian assurance report is accompanied by a gap analysis and where there are any gaps, include a detailed explanation of the gap and any remedial action to be undertaken or why no action is required to be taken. The gap analysis will be provided to the supervisor and the manager of the self-select scheme; and
- (4) Subclauses (1)(a) and (2) must be complied with within 4 months after the end of each relevant date; and
- (5) Subclause (3) must be complied with within 20 working days after obtaining the required assurance reports.

Dated at Auckland this 27<sup>th</sup> day of August 2018.



Nick Kynoch  
General Counsel  
Financial Markets Authority

## Statement of reasons

This notice comes into force on 28 August 2018 and is revoked on the close of 30 November 2020, exempts FNZ Limited and FNZ Custodians Limited (each a **FNZ group member**), on conditions, from the following provisions of the Financial Markets Conduct Act 2013 (**the Act**) and the Financial Markets Conduct Regulations 2014 (**the Regulations**):

- (a) section 157(2)(a) of the Act; and
- (b) regulation 87(1) and (2) of the Regulations.

Section 157(2)(a) is the requirement that a custodian for a registered managed investment scheme ensures that scheme property is held separate from property held by the custodian on its own account (**the segregation requirement**).

The exemption will permit the co-mingling of scheme property of a self-select scheme with money of the FNZ group member (**firm money**), acting as custodian of a self-select scheme to the extent that is reasonably necessary to reduce the risk of a shortfall arising in the scheme property held in the custodian's client money trust account.

A practice or an action will be regarded as reasonably necessary if –  
the FNZ group member

- has taken reasonable steps to investigate alternatives that would overcome or reduce the extent to which scheme property is held together with firm money; or
- is satisfied on reasonable grounds either that, in the circumstances, there are no alternatives available or that any such alternatives—
  - would pose an undue risk to the prudent and orderly conduct of its financial product transaction; or
  - is not able to be accessed or implemented without exposing the FNZ group member or a self-select scheme or any scheme participant to an unreasonable level of cost or delay or risk; or
  - would be contrary to the best interests of a self-select scheme or any scheme participant being able to undertake financial product transactions in a timely and prudent manner.

Regulation 87(1) and (2) is the requirement that a custodian for a managed investment scheme must obtain an assurance engagement that covers the assurance engagement matters specified in regulation 88 of the Regulations.

The exemption relieves the FNZ group member from the requirement to obtain an assurance engagement in relation to custody of scheme property of self-select schemes.

The Financial Markets Authority (FMA), after satisfying itself as to the matters set out in section 557 of the Act, considers it appropriate to grant these exemptions because—

- Co-mingling will arise upon the scheme property of a self-select scheme being transferred into the custodian's client money trust account, as firm money is permitted in the account under the Financial Advisers (Non-NZX Brokers – Client Money) Exemption Notice 2017;
- shortfalls in a custodian's client money trust account may occur for a variety of reasons, including bank reversals, timing issues (eg, for offshore trades), changes in foreign exchange rates, processing errors, tax or fee payment obligations, payments being dishonoured or reversed, failures by clients to lodge funds, and internal errors;
- these shortfalls, unless addressed, may result in insufficient funds being available to settle financial product transactions on behalf of scheme participants in self-select schemes;
- upgrading or changing existing systems and processes to mitigate the risks of a shortfall arising without use of a buffer is likely to result in significant compliance costs and business disruption for FNZ. The exemptions will reduce compliance costs for a FNZ group member by relieving it of certain obligations;
- conditions will only allow the use of buffers where they are reasonably necessary in order to facilitate the settlement of financial product transactions for scheme participants in a self-select scheme or reduce the risk of a shortfall arising, and a FNZ group member will be required to take all reasonable steps to ensure that scheme property remains separately identifiable and that the amount of firm money held in the FNZ client money trust account is no more than is reasonably necessary to cover the risk of a shortfall arising;

- requirements in relation to the establishment and operation of the FNZ client money trust account and for a declaration of trust, will ensure that a trust is established to protect scheme property held by the FNZ group member in the FNZ client money trust account. Additionally, conditions will also require the FNZ group member to keep records on compliance with the requirements under this notice and make them available on request. Independent verification regarding compliance will be provided through an assurance engagement and reports obtained from a qualified auditor; and
- adequate custodial assurance reporting is provided by the FNZ group member on the FNZ client money trust account under existing custodial assurance reporting obligations, and conditions requiring a gap analysis will ensure there is adequate custodial assurance reporting of self-select scheme property.

Therefore, the FMA is satisfied that -

- granting the exemptions is necessary or desirable in order to promote the purposes of the Act, specifically, the exemptions will avoid unnecessary compliance costs; and
- the exemptions are not broader than is reasonably necessary to address the matters that gave rise to the exemptions because the exemptions are restricted to the custodian in respect of the scheme property of a self-select scheme.