Feedback: SIPOs and Limit Breaks

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Feedback – SIPOs and Limit Breaks' in the subject line. Thank you.
Submissions close on 26 September 2014.

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Responses to specific questions

Section#	**Question #**	**Response**
You don't need to quote from the consultation document if you use section and question numbers. You may attach extra pages - please label each page with your name and organisation.		
3	*1*	*Yes. The SIPO should state:* *1. Expected volatility (tracking error and standard deviation, including the appropriate measurement period and **why** that is an appropriate period)* *2. Basis for that expectation of volatility and the level of confidence in the expectation* *3. Impact on return at different time periods (i.e. make clear that the impact is money weighted, with scenarios to illustrate e.g. what would happen as a consequence of a 3% dip one year in to the investment, relative to five years in, given the return assumptions)*
3	*2 and 3*	*Investment beliefs should provide a very clear underpinning of a managers' investment approach; and will assist participants to understand the risk profile, provided the beliefs are well articulated.* *We note that we are aware that some managers will be in different positions: i.e. some manage their own portfolios of assets while others are effectively managing a portfolio of managers. Regardless, we cannot over-emphasise the importance, for any type of manager, of getting their investment beliefs right.* *For managers making decisions about a portfolio of assets, this would be articulating the beliefs relevant to those decisions. For managers making decisions about appointing (or terminating) managers; and what size of investment to make with those managers, this would be articulating the beliefs relevant to how they choose (and then change) managers for their portfolio.*

3	*4*	*There also needs to be a clear articulation of the linkages – the cause and effect – from risk profile to investment types. At relevant parts of the SIPO, the text should articulate:* *1. Why does the MIS have this risk profile* *2. Given the risk profile, why is this asset allocation (benchmark and ranges) appropriate?* *3. Given this asset allocation, why is this the appropriate benchmark?* *4. Given all of the above, why is this the appropriate manager (where one has been used) and/or investment type*
3	*5*	*The conflict of interest/personal trading policies should be included within a broader Code of Conduct which governs other behaviours relevant to participants e.g. use of confidential information, acting in the interests of clients, fraud and corruption, etc.*
4	*1*	*The key factors are:* *1. Does this materially alter the risk/return equation I have accepted for this MIS?* *2. Does this represent a significant departure from the investment approach I have bought into with this MIS?* *3. Does this cost me an unexpected and unacceptable amount of money?*
4	*2*	*While this is a reporting matter rather than one which would be accommodated in the SIPO, we would expect the manager to understand the difference between isolated incidents, and patterns of incidents.*
4	*3*	*No – essentially by definition. If it is important enough to be included in a SIPO, a departure from it is material. It may be that the* ***consequence*** *of the breach is not material, but the* ***fact*** *of it is always material (particularly if it is part of a pattern of departures, which suggests process shortcomings or, worse, conscious departures)*
5	*1*	*It is sufficient provided the key points about articulacy are made to all MIS types; and each is able to articulate the linkages and justifications we have discussed throughout our responses to this document.* *What the guidance and SIPO is ultimately attempting to drive is not a document template; it is an articulacy and disclosure* ***discipline****. Per our response in 'General Comments' to section 1 (pars 7 and 8), the disclosure output will be different for each, but the participant comprehension outcome should be the same (i.e. the participant should feel in a position to make an informed investment decision, which would include an informed decision NOT to invest).*
General comments		
Section#	**Para #**	**Comment**
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1	*Entire section*	*This description of the purpose of the SIPO is silent on cost, which is integral to the return of the MIS for which the SIPO is relevant. In particular, articulation by the MIS as to the relationship between the risk-adjusted return expected and the cost charged. This is important for two reasons:* • *Participants should be able to make a judgement on whether the cost is appropriate relative to the complexity of the MIS investment strategy ("**should** this be expensive?")* • *Participants should be able to make a judgement as to the likely impact of cost on the risk-adjusted return ("what is the impact on my return of this being expensive?")*
1	*7 and 8*	*Articulacy is crucial. Disclosure is just an output, comprehension is the actual outcome. If an MIS cannot quickly and simply summarise the essence of their investment proposition, that should be a warning sign for scheme participants, regulators and supervisors alike. The 'nuts and bolts' understanding should be a key differentiator between offers.* *Where a manager is appointing managers rather than directly investing assets, this should focus on their ability to select, and size allocations to, investment managers. It should also focus on how and why the manager would change allocations, or change managers.* *In fact we believe the MIS should state the level of investment sophistication they believe is necessary to 'get to grips' with the investment which is the subject of the SIPO. A 1-7 rating for this would be as useful, if not more, than the 1-7 grading currently applied to risk. <u>And very useful when combined.</u>*
3	*5*	*The SIPO must also articulate:* 1. *What is the level of the MIS' confidence in the returns they expect, what is the source of that confidence, and what would have to change for that confidence to decline (or increase)?* 2. *What are the characteristics/competencies/skills of the MIS that make it an appropriate manager of the proposed investment strategy (or a competent evaluator, selector and manager of investment managers)? What are the people, process, philosophy and discipline factors which should give participants confidence that the MIS is able to **persistently** produce the expected return and manage the expected risk. Where the MIS is allocating to investment managers, the same information should be supplied **for each manager** as it supports the MIS' contention that they are competent evaluators and selector of investment managers.* 3. *The appropriateness of the linkage between expected risk and expected return. By this we mean, how a participant gets confidence that the expected return adequately compensates them for the risk being taken. How much return is reasonable to expect for level 2 risk, or level 7 risk? Why?*

3	*27*	*Where the MIS is responsible for hedging, the SIPO should explain why it is has chosen a particular approach. Whoever is responsible for it, the SIPO should discuss the likely cost implications of the chosen hedging approach as it affects returns.*
3	*29*	*Performance should be reported on a net basis (or a net and gross basis) so the impact of fees and costs are clear.* *We believe performance should also be reported relative to comparable MIS (whether active or passive). Participants should be able to identify not only whether an active strategy was the correct choice (how it performs, net of fees and charges, relative to the benchmark); but whether their selected MIS was the correct choice from among its competitors.* *Volatility should be tracking error and standard deviation (with a clear explanation of the significance of each).*
4	*13*	*We would expect that the departure of key people is a limit break as it alters the investment proposition for a participant, particularly if a 'star fund manager' is a factor. We appreciate that this may impose cost, and that it is a slightly different proposition for a manager who is appointing investment managers, rather than investing assets directly.* *However, to the extent that a manager markets the capabilities of a team, or of an individual (including one charged with appointing managers); and that is therefore part of their commercial proposition; the departure of that team or individual is material and should be communicated to investors.*

Feedback summary – *We have attempted to reflect that there are two types of managers, and that SIPO requirements will necessarily be different in the content (if not the intent) of each. Specifically, that managers directly investing assets should discuss different topics in a SIPO than managers selecting portfolios of investment managers. We have also been conscious that ongoing disclosure carries a cost; but our main focus remains on what managers must disclose to ensure well-informed investment decision making.*

We would welcome an opportunity to further discuss our submission in person.