

# FCA Assesses Whether Fund Managers are Meeting Investor Expectations

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On April 7, 2016, the United Kingdom (UK) Financial Conduct Authority (FCA) published a report (available [here](#)) (Thematic Review TR16/3: Meeting investors' expectations) (Report) containing its conclusions regarding a thematic review announced in its 2015/6 business plan. The review focussed on three main areas of asset managers' activity and investor expectation:

- disclosure of investment strategies and mandates;
- use and content of marketing materials; and
- distribution of funds.

Nineteen UK firms responsible for 23 UK authorised funds and four segregated mandates were reviewed. All funds were undertakings for collective investment in transferable securities (UCITS). Therefore the distribution of the funds in the European Union (EU), the investment policies of the funds and content and use of marketing materials largely would be prescribed by the EU UCITS Directive. It should be noted that a UCITS fund is commonly used as a marketing vehicle to retail investors in the EU. The asset classes and strategies of the funds were diverse and included equities, derivatives, corporate and government bonds. Twenty of the funds were commonly available on third-party platforms. The total value of the funds included in the review was approximately £50 billion.

The conclusion of the FCA was that most firms are taking the correct steps to meet investors' expectations. However, the FCA did identify examples of deficient behaviours by some firms regarding the clarity of product disclosure and governance and oversight.

Most usefully, the Report delivers key messages regarding examples of good and poor practices in three areas:

- clarity of product descriptions;
- adequate governance and oversight; and
- ensuring appropriate distribution.

The examples given by the FCA in the Report can be summarised to include the following.

## **Clarity of product descriptions**

### ***Good practices***

*Giving a detailed explanation of investment strategy* – explaining the specific investment steps the manager would usually go through to choose individual equities for the fund's portfolio in addition to a broad disclosure of the investment objectives and policies.

*Signposting complexity* – in the case of highly complex funds, including a strong recommendation in marketing materials for customers to seek advice. This could help mitigate the risk of inappropriate distribution to investors who did not understand all the important aspects of the fund.

*Being specific about the investments that will be used* – rather than setting out in broad terms the instruments in offering documents that might be used but are in fact unlikely to be used, describing only the instruments that would be used.

### ***Poor practices***

*Unclear product descriptions* – a broad investment mandate, combined with a lack of description of how a fund manager might use the mandate. The specific example given was using a broadly drafted investment policy to invest in companies and mentioning that the fund also may hold government debt securities and cash, when in fact the fund had a flexible investment approach and a significant proportion of the fund has been invested in government bonds and cash for more than a year.

*Undisclosed passive investments (or closet tracking)* – not mentioning in the offering materials of an actively managed fund that, as part of the fund's overall strategy, a fund's assets are passively invested to track an index.

## **Providing adequate oversight and governance**

## **Good practices**

*Ensuring fund management matches communications* – when performing regular monitoring, comparing various aspects of the fund's management against communications. For example, when reviewing the fund's portfolio turnover rate, compare this to the long-term investment approach that has been communicated to investors. This would make sure the fund was managed in line with how it had been presented to investors.

## **Poor practices**

*Inconsistent product review* – the example given by the FCA was that one firm decided to review the annual management charge (AMC) of two funds following negative publicity. The AMC was reduced, in part because a charge for advice that was included in the fee was no longer necessary. The firm consciously restricted the scope of its internal review and did not review other funds with similar advice charges built into the AMC. This included a fund in the FCA's sample that was not actively marketed. Customers in the fund therefore continued to pay a higher AMC, which reduced their return.

## **Ensuring appropriate distribution**

### **Good practices**

*Using indicators to monitor distribution* – using specific indicators to monitor unusual patterns in distribution and obtaining information on the profiles of investors. For example: (a) high levels of cancelled sales and customers selling funds shortly after buying into them are warning signs, and (b) information on how many customers are in different age brackets, provides some insight into whether the fund was being bought by the planned target market.

*Interaction with advisers* – conducting significant due diligence on new financial advisers and providing extensive training to make sure the financial advisers had a good understanding of the investment characteristics and philosophy that was driving the fund's composition. Testing financial advisers about complex funds to assess their understanding of the product.

### **Poor practices**

*Providing inappropriate information* – providing information intended for professional investors to retail investors.

## **Next Steps**

- All fund management firms, including those that sponsor or manage hedge and other private funds, should consider the findings in the Report and review their arrangements accordingly.
- Funds should be described clearly and with enough information about the investment strategy for investors to understand the approach used by the fund manager. Relevant risks should be identified and their consequences made clear.
- Authorized fund managers need to oversee funds effectively, even if the funds are no longer being actively promoted to investors. They also should ensure that funds are appropriately distributed.
- Distributors should consider their responsibilities in light of the FCA's findings and ensure that the appropriate information is provided to investors.
- Senior management and those involved in fund governance should consider whether any of the concerns raised in the Report are reflected within their own firm's operations, and take any action necessary to minimize the risk of poor outcomes to customers.
- The FCA will be writing to all the firms in the thematic sample to provide individual feedback. Where fund management firms did not effectively manage the risks that could lead to poor customer outcomes, the FCA will require them to make improvements to their practices. For the most significant issues, the FCA is already requiring them to be addressed.
- The FCA will follow up on this work through routine supervision.
- The FCA has indicated in its 2016/7 business plan that it will continue its market study into asset management to assess if competition is working effectively and whether investors get value for money when they purchase asset management services. Last year, the FCA published the terms of reference for this market study. Its scope includes both retail and institutional investors. The FCA aims to publish an interim report in summer 2016 and a final report in early 2017.

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