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Dear Chief Executive,

Our Asset Management Supervision Strategy

This is our first letter to you since we launched our new integrated regulatory structure across the whole of Supervision, Policy and Competition in the FCA. Asset Management is now supervised by the Buy-Side Directorate of the FCA, and updated contact details are provided at the end of this letter.

This letter outlines the harms to consumers or markets that we think are most likely to arise from 'Asset Managers''[1] business models. It sets out how we intend to supervise the Asset Management portfolio to address these harms and it supersedes our previous strategy letter of January 2020.

The Asset Management portfolio consists of around 1,000 firms managing approximately £11 trillion of assets for UK and global clients, ranging from large institutions to small retail investors. Firms in the sector operate globally. Many UK Asset Managers are part of wider asset management groups serving clients worldwide. The industry provides services that benefit consumers, markets, and global economies. Our supervisory and policy approach is shaped by this context, and by the FCA's overall priorities.

Our review of risks considered a range of information taken from our supervisory work, firm and fund authorisations, external data, and our interaction with asset management associations, and other global regulators.

You should consider whether the risks of harm below are present in your firm and adopt strategies for mitigating them. In any future supervisory engagement with you, we will consider whether your governing bodies, and Senior Managers with accountabilities have taken appropriate action to ensure that consumers and markets are adequately protected from these harms.

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[1] Our asset management portfolio is comprised of FCA authorised firms that directly manage mainstream investment vehicles, or advise on mainstream investments, excluding wealth managers and financial advisers. Our alternatives portfolio is comprised of FCA authorised firms that predominately manage alternative investment vehicles (for example, hedge funds or private equity funds) or alternatives assets or advise on these types of investments or investment vehicles. We recognise that many of the issues within the sector will be common to both types of firms and that business models will often overlap.

Supervisory approach

The risk picture for this portfolio is complex. It is facing changing consumer needs due to the rising cost of living, volatile markets, and a challenging economic environment. This could make it more difficult for firms to deliver good outcomes.

While good governance is always an expectation, it is particularly important during this period of heightened uncertainty. We expect your governing bodies to be composed of members with sufficient expertise, who receive timely and appropriate management information about risk, and who effectively oversee issues within your firm. Your governing body should understand the level of exposure your firm has to the risks in this letter.

We have found ineffective governance to be a root cause of some Asset Managers failing to mitigate material risks or progress towards better outcomes for their customers. In this regulatory cycle, we will focus on assessing the effectiveness of firms' governance in identifying, considering, and mitigating harms. We will focus on those firms with known issues, or where we identify outliers in the risk categories outlined below.

Our supervisory priorities

Product Governance

Our view of the risk:

A key risk for this portfolio is that the quality and value of product offerings, or the quality of communications with customers, do not deliver good outcomes for consumers or meet their needs. This could be for a range of reasons, for example, because the product carries excessive costs and charges, is not designed with the target audience in mind, or is distributed to the wrong type of investor.

In July 2022, the FCA confirmed plans to bring in a New Consumer Duty ('the Duty') which will fundamentally shift how many firms across the financial system serve their customers. It is also more than five years since the FCA's Asset Management Market Study (AMMS). The AMMS was followed by the introduction of several remedies, including enhanced governance and product value assessments. Both AMMS remedies focus on the key risk that products and communications do not meet consumers' needs.

In our previous strategy letter, we set out our expectations for authorised fund managers (AFMs). We emphasised the requirement to act in the best interest of customers. Since the letter, we have conducted several reviews[2] which showed that AFMs had implemented some AMMS remedies, including adding Independent Non-Executive Directors to boards and reductions in some fees. The reviews also identified instances where further effort should be made.

What we expect:

Our expectation is that firms meet the Duty when they determine or have a material influence over retail customer outcomes. Further details of the expectation are set out in the accompanying Consumer Duty letter.

[2] MiFID II: product governance review, Authorised fund managers' assessments of their funds' value

This requires you to consider your responsibilities under the Duty, and to ensure you are appropriately prepared and have made any changes needed to governance and controls to incorporate the requirements of the Duty.

What we will do:

We will follow-up on our 2021 Assessment of Value review findings and seek to identify outlier firms, for example where firms do not apply all the minimum considerations, assess value at fund level rather than unit class, or where fund performance is assessed using measures that don't reflect a fund's investment policy and strategy. We will also consider in this review how firms have built maturity of ESG in value assessment considerations.

The Consumer Duty is core to our proactive supervision. We will conduct a review in 2024, to assess the embeddedness of the Duty, with a focus on Price and Value.

Environmental, Social and Governance (ESG) and Sustainable Investing

Our view of the risk:

Since our last strategy letter, there has been an increase in the prominence of ESG and sustainable investment products in Asset Managers' business strategies. ESG and sustainable investing are broad descriptors encompassing a wide range of factors and investment strategies.

Risks exist that some claims about ESG and sustainable investing are misleading or inaccurate. Inaccurate or misleading information may negatively impact the integrity of the UK financial disclosure regime and is likely to harm consumers' confidence to invest. In addition, it undermines efficient allocation of capital intended for delivery to environmental and social outcomes.

What we expect of you:

In 2021 we published a Dear Chair Letter to AFMs setting out our expectations on the design, delivery and disclosure of ESG and sustainable investment funds. We will shortly publish results of a review of some firms' ESG oversight practices. Asset Managers should consider the findings of the review to benchmark their own practices.

In the first half of 2023 (in scope) Asset Managers will make their first TCFD-aligned disclosures under the rules in the ESG sourcebook, published in PS21/24 Enhancing climate-related disclosures by asset managers, life insurers and FCA-regulated pension providers. Also, the FCA are aiming to publish our final decision on the proposals in CP22/20 (Sustainability Disclosure Requirements (SDR) and investment labels) setting out our rules for product disclosure and labelling. We will employ these new sources of information and applicable rules when considering firms' conduct in relation to ESG products.

As outlined in PS21/24, we support the Government's Net Zero commitments and encourage firms to outline an assessment of the extent to which net zero commitments have been considered in transition planning.

What we will do:

Our supervisory activities will focus on the governance structures that oversee ESG and stewardship considerations, and we will test whether firms deliver on the claims made in their communications with investors. We will particularly focus our supervisory activities on outlier firms that have been identified in previous supervisory activities or other ongoing surveillance.

We will seek to ensure that governance bodies are appropriately structured to oversee and review management information about product development, ESG and sustainability integration in investment processes, third-party and proprietary ESG information providers, and other ESG and sustainability claims made by the firm.

Product Liquidity Management

Our view of the risk:

Open ended funds can have a liquidity mismatch between the terms at which investors can redeem and the time needed to liquidate fund assets to meet the redemption request.

Since our previous strategy letter, different market and pricing shocks have caused liquidity issues for Liability Driven Investment portfolios, property funds, and money market funds. In a more volatile market environment, liquidity risks are relevant across a broader set of products.

What we expect of you:

Firms have tools available to improve the quality of their liquidity risk management, but we have concerns that they may not always oversee them correctly or use them consistently.

When AFMs set a liquidity strategy to meet redemptions, they must meet regulatory requirements. Asset Managers should ensure exiting and remaining investors are treated fairly when considering the costs of redemption, and the mix of assets which may be employed to meet redemption requests.

Asset Managers should work with stakeholders to ensure that operational systems and processes are fit for purpose, can be executed at pace, and can be scaled to handle additional demand when needed.

What we will do:

We will continue to focus our work on elements of the system that have shown liquidity vulnerability to market stress. We are working with the Bank of England, and other regulators internationally, to strengthen resilience of money market funds, funds with significant liquidity mismatches, and transmission of risk from the non-bank financial sector to the wider market.

We are in the process of completing a liquidity management multi-firm review. We will work with identified outliers to improve practices, and expect firms to consider their own governance, oversight, and controls in reference to the review’s findings.

Investment in Operations and Resilience

Our view of the risk:

Underinvestment in operations can lead to service disruption or failure, with consequential loss to investors and detriment to markets. Increased market volatility or stress may heighten the impact of disruption on consumer outcomes and market integrity.

Poor investment in operations can hamper innovation, reduce efficiency and increase cost, and can result in service decline for investors. It may also result in business disruptions, or lead to vulnerabilities that can be exploited to control systems or inappropriately transfer information.

What we expect of you:

You should have appropriate measures to understand the operational health of your business, and to be able to respond in a timely manner. If you rely on (intra-group or external) third parties for services, you should ensure that you have sufficient information, skills, and knowledge to make sure that third parties will continually deliver a service which allows you to meet your regulatory obligations.

The current level of incident reporting across the sector is variable. You should review your policies and procedures to ensure you are meeting your reporting obligations. If your firm suffers material operational failures or cyber-attacks, we expect you to contact us promptly as required under Principle 11. SUP 15.3 contains additional rules and guidance which specify the circumstances in which firms must immediately notify the FCA of certain matters.

Policy Statement 21/3 Building Operational Resilience sets out the requirement for (in scope) Asset Managers to have identified their important business services and to have set impact tolerances by 31 March 2022; and to remain within these tolerances by 31 March 2025.

What we will do:

Over the cycle we will complete a range of proactive programmes to monitor and test Asset Managers' ability to meet these regulatory requirements. We may select firms for further review, including through utilising our cyber and operational resilience assessment tools and our intelligence-led penetration testing scheme (CBEST).

Financial Resilience

Our view of the risks:

Since the previous letter, we have increased monitoring of Asset Managers' prudential health, and implemented the Investment Firms Prudential Regime (IFPR) for in-scope firms.

Over the cycle we have seen few asset management firms fail. However, disorderly firm failure has the potential to cause significant material detriment to consumers and markets.

What we expect of you:

Given the impact of potential economic headwinds, you should ensure that you have sufficient capital and liquidity to operate, and that your governance processes allow for prudential health to be regularly and adequately assessed. You should aim to identify prudential concerns early and to take appropriate actions.

You should seek to reduce the chances of a disorderly failure, and should review your wind-down procedures in reference to the Wind Down Planning Guide and our Observations on wind-down planning: liquidity, triggers & intragroup dependencies. Under the rules in SUP 15.3, you must notify the FCA immediately if you become aware of or have information which reasonably suggests that the firm is failing to satisfy the threshold conditions (or may in the foreseeable future), for example, in relation to the 'appropriate resources' threshold condition.

Where you hold or control client money or safe custody assets as part of your business, you must follow rules set out in the Client Assets Sourcebook. This is essential to ensure that clients' safe custody assets and money are protected and capable of being transferred promptly if a firm fails. Compliance enhances market integrity by giving participants confidence that their money and assets are protected in case of a firm failure.

What we will do:

We will continue to assess firms' prudential health using internal and external data sources and (where necessary) will conduct targeted monitoring visits. Where firms are failing, or are likely to fail, we will take appropriate actions to minimise the harm from failure. In the first half of the year, the FCA aims to publish initial observations on firms' implementation of the IFPR requirements, which you should consider when reviewing and strengthening your processes.

Next steps

As CEO, you are responsible for ensuring that your firm meets FCA requirements, including the obligations and expectations set out above. You should take all necessary actions to ensure these are met and reinforce accountabilities with your Senior Managers for these risks.

This letter covers our supervisory strategy, but the FCA's focus on positive change also means we may seek other forms of engagement with you and your team to obtain input about our Future Regulatory Framework. We will conduct a policy discussion about whether our regulatory regime provides an effective and proportionate way of achieving good outcomes and can facilitate innovation, taking account of developments in technology and global standards of financial regulation.

Contacts

Should you have any queries please contact your usual FCA supervisor, or use the channels on our contact page if you do not have a named supervisor. For those of you with dedicated supervisors, this letter is an addition to your Firm Evaluation letter.

In the event your firm faces urgent issues of strategic importance, please contact Christopher Davis, the Head of Department for Market Interventions – Asset Management & Funds at Christopher.Davis@fca.org.uk

Yours sincerely,

Camille Blackburn
Director – Wholesale Buy-Side