FCA FINANCIAL CONDUCT AUTHORITY

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This letter is historical. See our supervisory correspondence page for more information and current views.

20 January 2020

Dear Chief Executive

Our Asset Management Supervision Strategy

This letter outlines our view of the key risks of harm that Asset Managers[1] pose to their customers or the markets in which they operate. You should consider whether your firm presents these risks and your strategies for mitigating them.

Our view of the key causes of harm

The asset management sector plays a critical role in the UK economy and in overseeing the savings and investments of millions of individuals across the UK and beyond. The sector is growing and changing in significant ways, but its purpose remains unchanged: to protect and grow the capital of its customers and to oversee their investments effectively over the long term. To deliver this, you must act in the best interests of your customers.

We believe that progress is needed for the sector to deliver this purpose effectively. Overall standards of governance, particularly at the level of the regulated entity, generally fall below our expectations. Funds offered to retail investors in the UK do not consistently deliver good value, frequently due to failure to identify and manage conflicts of interest. Inadequate investment in technology and operational resilience has led to deficient systems which could cause harm to market integrity or loss of sensitive data.

Our supervision strategy addresses these key issues, which inform our priorities set out below. Your firm may be asked to take part in one or more pieces of work related to these priorities. We expect you to consider them priorities and take appropriate action.

[1] Our asset management portfolio is comprised of FCA authorised firms that predominantly 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 directly, 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 priorities

Liquidity management

Ensuring effective liquidity management in funds is a central responsibility for any Authorised Fund Manager (AFM) and it remains their responsibility even if they delegate investment management to another person.

Open ended funds can have a liquidity mismatch between the terms at which investors can redeem and timescales needed to liquidate assets. On 30 September 2019, we published a policy statement on illiquid assets and open-ended funds. On 4 November 2019, we also wrote to the boards of AFMs outlining our expectations regarding liquidity management. And on 16 December 2019, the Financial Policy Committee published the initial findings of our and the Bank of England's joint review of liquidity risks in open-ended investment funds.

We expect you to take any necessary or appropriate action following these communications. We will continue our oversight of UK authorised funds. Where we identify potential liquidity issues in funds, including through our regular interaction with depositaries, we will ensure that AFMs take prompt action to mitigate or resolve them.

Firms' governance

Effective governance is critical to the success of your firm in delivering long-term returns for investors.

You should ensure that the boards of your regulated entities engage in robust discussion and challenge around important business decisions, without undue reliance on Group structures. Regulated entities are accountable for their regulatory activities. We also expect you to recognise and take steps to mitigate harm arising from any conflicts of interest between affiliates, most notably between the AFM entity and any delegate investment management entity.

The Senior Managers & Certification Regime (**SMCR**) was extended to this sector on 9 December 2019. We expect you to have refreshed your approach to governance and taken the necessary steps to improve it in line with SMCR requirements. Lines of accountability and responsibility for senior management functions (SMFs) must be clear. The SMCR should not be treated as a discrete compliance project; rather, it is an opportunity to deliver high standards of governance.

We will carry out work in the first half of 2020 to evaluate the effectiveness of governance across the sector, focusing particularly on firms' efforts to implement SMCR.

Asset Management Market Study (AMMS) remedies

Our AMMS **Final Report** was published in June 2017. We subsequently introduced a series of rule changes to address the concerns identified. Those rule changes are now in effect.

The new requirements, among other changes, should prompt you to think differently about your obligations to your end investors by conducting value assessments on firms' authorised funds. They also require governing bodies of AFM entities to have at least one quarter of their members as independent (and have no fewer than two independent directors). Conducting the value assessments on your funds, when done properly, could result in substantial improvements to outcomes for investors. Conversely, and as you may have seen in our recent **press release**, we will continue to take robust action where we identify funds which deliver poor value, including so-called 'closet trackers'.

We will do work in the first half of 2020 to understand how effectively firms have undertaken value assessments. We will seek evidence of meaningful challenge at AFM boards on proposals made by the executive – including on costs, fees and product design.

We expect you to ensure that funds' objectives are clear, fair, not misleading and that they comply with the new rules around objectives disclosure as we assess and authorise investment funds. We plan to publish certain key metrics, such as on long-term underperforming active funds and trends within the sector to provide evidence of whether the reforms are having their desired effect. We do this through our annual **Business Plan**.

Given the breadth and significance of the AMMS reforms, we expect to do more work in the future to evaluate their effectiveness.

Product governance

The introduction of MiFID II in 2018 ushered in a new set of requirements on firms to ensure customer interests remain central throughout the product lifecycle. These new rules set obligations not only at the point of sale, but also at the initial product manufacturing stage and the subsequent ongoing management and distribution of the fund. Asset managers manufacturing UK authorised funds are in scope of these changes.

We wish to see products designed with the best interests of a specified target market in mind. Such products should not include features that are manifestly not in the interests of customers, which could include funds tracking an undisclosed index or where fees exceed target returns. We have begun a review to assess how effectively new product governance provisions have been implemented across the sector. We expect to complete our work in early 2020.

In the UK, AFMs are responsible for ensuring compliance with product governance rules. Sometimes funds are managed by AFMs that are not within the group structure of the delegate investment manager (often known as 'host' ACDs – Authorised Corporate Directors). In these cases, a conflict of interest may arise if the 'host' ACDs cannot oversee the fund properly because, for example, it is concerned to avoid a loss of revenue from the investment manager if it were to offer more assertive challenge. We are concerned that 'host' ACDs may not be undertaking their responsibilities effectively in some cases, leading to poor value products and them failing to ensure risks are properly managed.

In parallel with our product governance review, we are reviewing how effectively 'host' ACDs undertake their responsibilities. We are seeking evidence that these firms can discharge their responsibilities properly, including in the day-to-day management of the fund. We also expect to complete this work in early 2020.

LIBOR transition

Failure to transition away from reliance on the London Interbank Offered Rate (LIBOR) and other unsustainable benchmarks may cause harm to market integrity and poor outcomes for consumers. The FCA has made clear that firms should plan on the basis that LIBOR will cease from the start of 2022. Your firm should recognise its responsibilities to facilitate and contribute to an effective transition to new, more appropriate rates, such as SONIA. The **Dear CEO letter on LIBOR** we published in September 2018 was addressed to dual-regulated firms. But all regulated firms should read it as it may provide some useful indication of our broad expectations. We are currently gathering data from some asset management firms to enhance our understanding of firms' business models, including on their exposure to LIBOR risk. We expect to provide further communications on our specific expectations for LIBOR transition in due course.

Operational resilience

Asset managers are heavily reliant on robust and reliable technology, which underpins the smooth operation of their businesses and the protection of client assets. We expect your firm to ensure it manages its technology and cyber risk appropriately, including through appropriate oversight of third party firms and intra-group service providers. Our **Consultation Paper on Operation Resilience** outlines a proposed approach to strengthen the operational resilience of financial services firms and we will publish our approach in due course.

Asset managers which have a greater risk of causing harm are now subject to proactive technology reviews; we will be in touch with you if your firm is selected to participate. We may choose to involve your firm in ad-hoc reviews, for example to ensure your cyber risk controls are effective. We have also published a **review** of technology resilience in the asset management sector. Where your firm suffers material technological failures or cyber-attacks, we expect you to contact us promptly as part of your responsibilities under **Principle 11**. We expect to undertake further proactive work on this theme in the coming months.

EU withdrawal

The UK government has committed to the UK leaving the EU with a Withdrawal Agreement on 31 January 2020. When that happens, the UK will enter an implementation period during which it will negotiate its future relationship with the EU. The implementation period is due to operate until 31 December 2020. During this time EU law would continue to apply in the UK and passporting would continue. We expect you to consider how the end of the implementation period will affect you and your customers, and what action you may need to take to be ready for 1 January 2021. For information on Brexit, including what the implementation period will mean, visit our **website**. We will update our pages after exit.

Next steps

If you have any queries about this letter, please contact our dedicated Supervision Hub on 0300 500 0597. This is the primary contact for your firm's day-to-day interactions with the FCA.

We recognise there may be occasions when your firm faces urgent issues of strategic importance. In such circumstances, please contact the Head of the Asset Management Department, Nick Miller, on 0207 066 0602 or at nick.miller@fca.org.uk. If Nick is not available please contact Fiona Bisset on 0207 066 5622 or at fiona.bisset@fca.org.uk.

Yours faithfully

Marc Teasdale
Director of Wholesale Supervision
Supervision - Investment, Wholesale & Specialists Division