Finalised guidance

Distributor-influenced funds

Points for Authorised Corporate Directors, fund managers and platform providers to consider

February 2012

Contents

This factsheet is for:

- **firms that run or help to run, distributor-influenced funds for distributors;**
- **product providers and platforms that include fund links to distributor-influenced funds; and**
- **firms that are considering any of these activities.**

It may also be of interest to distributors with their own range of distributor-influenced funds or that are planning to introduce one.

It explains:

- what we mean when we refer to distributor-influenced funds; and
- what to consider when using distributor-influenced funds.

The factsheet reflects our current rules and has been updated to explain our expectations as a result of rule changes in the Retail Distribution Review.

There are no rules which relate specifically to distributor-influenced funds: the factsheet provides guidance on rules which have a more general application. Some of the observations we make in this factsheet will therefore also be relevant to other investments.

What are distributor-influenced funds?

Distributor-influenced funds are created for the clients of a particular distributor, typically an adviser firm or network. They could be designed on a bespoke basis for the distributor or they could be set up using an existing fund that is tailored for the distributor. Fund administration and management is outsourced to other firms but the distributor may have a degree of influence over the fund (short of day-to-day asset selection). It may be, for example, that the distributor is able to:

- influence the hiring (or removal) of the Authorised Corporate Director (ACD) or the delegated investment manager; or
- create accountability of the investment adviser by attending investment committees.

They are commonly arranged as OEICs (where they may be known as broker OEICs, distributor funds or distributor-owned funds) but may also take other structures (like unit trusts or insurance funds). We have chosen to refer to them as ‘distributor-influenced funds’ in this factsheet, as this term covers the full range of possible structures.

In this factsheet, distributor-influenced funds are distinct from the operations of fund managers, collective investment scheme operators and private client investment managers for whom investment management is central to the business proposition. They are arranged by firms that have chosen to outsource to professionals as their preferred route, potentially without permission to manage investments or operate a fund.

Our key concerns

If you are to use these funds, they should not simply increase complexity and costs without providing new services and good value for money for clients. Although the distributor has most responsibility for the way the product is sold to the end-customer, all parties involved in the product have a share in the responsibility to treat those customers fairly. If you run the funds or make them available through other products you should consider how your actions help distributors to act fairly for the end client. More information on the respective responsibilities of providers and distributors is available in the Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD)[1].

You should take into account that many distributors entering this market may not have practical experience in it and that the product presents different risks to those to which the distributor and its customers are ordinarily exposed.

Issues to consider

You may want to review your business processes to help distributors manage the challenges of offering these funds. It remains your responsibility to identify the issues that will be relevant but the following are some areas that you will want to consider.

- **Marketing the proposal to distributors**: promotional material to distributors should present a balanced view of the product, including the risks of the product and its disadvantages, to help advisers assess suitability for their clients. The fund prospectus, for which the ACD is responsible, should set out the relationship between the various parties, the extent of the distributor's decision-making powers, and the charging arrangements if payments are made out of scheme property.
- **Assessing commercial viability**: before launching a new fund, you should assess whether it will be commercially viable based on realistic assumptions and without compromising the adviser's obligation to provide suitable advice to each client (a contingency plan is needed in case funds do not achieve commercial viability).
- **Due diligence**: a related matter is your assessment of whether to work with a particular distributor at the outset and regularly reviewing this decision (considering, for example, areas such as their training and competence, conflicts of interest procedures and TCF programme).

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[1] http://fsahandbook.info/FSA/html/handbook/RPPD

- **The appropriate level of distributor influence**: it is important to decide the appropriate level of influence that you will accept from the distributor and to keep a clear distinction between the regulated activities each party is expected to perform. This is especially important if you are the fund's ACD because you have the ultimate regulatory responsibility for operating it compliantly, regardless of your commercial relationship with the distributor.

- **Product design and market research**: where relevant, you should consider work done to identify the target market and its needs, and whether the fund's charges are appropriate for expected returns (particularly for lower risk strategies where lower, more stable returns are targeted and higher charges would have a greater impact). There may be a reduction in yield (for products) or total expense ratio (for funds) above which you no longer expect this product to be suitable.

- **Communications with clients**: it may be that you are better placed to produce standardised product disclosure material than distributors who are not normally required to produce this information.

- **Non-advised sales**: given the complexity and potentially high costs of these funds, it is unlikely to be fair to allow non-advised sales methods of distributor-influenced funds. Where relevant, if you wish to allow non-advised sales methods, you need to consider how this could be done in an acceptable manner.

- **Default funds**: for similar reasons, it is unlikely to be fair to allow distributor-influenced funds to be sold as default funds. Where relevant, if you wish to allow them to be used as default funds, you need to consider how this could be done in an acceptable manner.

We note that many advisers are involved in choosing the default fund from an existing range for group personal pension plans. We do not regard this as falling within the scope of this factsheet.

Questions to consider

1. How will you promote distributor-influenced funds to distributors?
2. What due diligence will you conduct?
3. How will you assess how the design of the product meets the needs of the end client?
4. Will you allow non-advised sales or the funds to be used as the default option on a product?
5. What will happen if the fund does not reach commercial viability within an acceptable period?
6. How will you monitor funds to assess whether changes are necessary or whether different parties are performing the regulated activities for which they are responsible?
7. How will you assess whether the impact of higher charges on expected returns is acceptable?

Changes as a result of the Retail Distribution Review

From 31 December 2012, firms advising on distributor-influenced funds will not be able to receive a share of product charges as remuneration. This means that you cannot pay a share of the annual management charge to them for their role on a fund governance committee.