Financial Conduct Authority

Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: Thematic Review 16/3: Meeting Investors' Expectations

Lead regulator: FCA

Date of assessment: 26 September 2016

Commencement date: April 2016

Origin: Domestic

Does this include implementation of a Cutting Red Tape review? No

Which areas of the UK will be affected? Whole of UK – Authorised Fund Managers

Brief outline of proposed new or amended regulatory activity

The Meeting Investors' Expectations thematic review considered whether UK authorised investment funds (Unit Trusts and OEICS) and individual customers' portfolios (segregated mandates) were operated in line with investors' expectations. Fund operators are required to explain to investors how their money will be invested including type and mix of assets, level reference to an index. The mediums in which this is explained include the fund's regulatory documentation, such as its prospectus and the key investor information document (KIID) and marketing literature, including fund fact sheets and websites.

The FCA requested information and conducted on-site visits to 19 firms to assess how well they were implementing existing FCA rules and guidance. These rules provide detailed, and in some areas prescriptive, requirements for the contents of the prospectus and KIIDS as well as requiring marketing material to be clear, fair and not misleading. For example, the KIID regulations requires the KIID to disclose if a fund has a strategy based on an index and whether the investment manager's flexibility to invest differently from that index is limited.

The review also considered how fund operators provided oversight to ensure that a fund is managed in line with the fund objectives as detailed in fund documentation. It also considered how the fund operator understood how its funds were distributed appropriately and whether they followed "The Responsibilities of Product Providers and Distributors for the Fair Treatment of Customers" (RPPD) that is in the FCA's Handbook.

We wrote to each firm telling them if they were meeting the existing rules and noting any areas considered to be weak and where their customer communications should be clearer.

We also published a general report to industry reminding them to adhere to existing rules and describing good and poor practice that we noted across the peer group. The report was directed mainly at firms that provide funds (fund operators) providing them with good and bad practice. It also asked firms that distribute funds (distributor firms) to ensure that they supply up to date fund documentation to retail investors which is required by the rules.

We found that the degree of adherence to the rules was good with most funds in our sample invested in line with their stated strategy and investors were not exposed to any undisclosed investment risks.

However, we did find examples of unclear product descriptions and inadequate governance or oversight, for example funds without clear descriptions of how they were managed, including where investment strategy was constrained by an index. This is in breach of the KIID Rules. We also provided examples of funds that were not being adequately governed resulting in the funds not being managed in accordance with their objectives.

The report explained the conclusions we reached based on the fund operators' responsibilities as product providers when distributing funds through third parties. We found that not all firms were doing this effectively. For example, we identified a few funds that the operator would only sell with advice being available on execution only websites.

The report set out what we had found, including explaining where firms had met the rules as well as examples of where the rules had not been met. To support this, we provided examples of good and bad practice linking to what the rules require and what is not acceptable and does not meet the rules. Examples of good practice included sign posting complexity in a highly complex fund, or how plain English was used to explain a complex investment strategy. The examples of poor practice included where investment objectives were generally drafted leaving an investor unclear of the how the fund was actually managed, or where the approach taken did not comply with the rules such as undisclosed passive investments. The report also provided examples of good and poor practice of governance arrangements we saw. For example the use of end consumer testing to ensure the fund documentation is clear for retail investors.

In the report firms' senior management were asked to consider whether their existing processes were sufficiently robust and take their own decisions as to whether they wished to strengthen one area or another.

The KIID rules require the fund operator to review and revise the KIID as appropriate and as frequently as necessary to ensure that it continues to meet the directive requirements for KIIDs. This means at least once every 12 months or at other points when there is an initiative by a fund operator likely to lead to significant number of new investors in the fund.
There are other requirements in the rules that lead fund operators to keep prospectus and marketing materials up to date.

In practise the KIIDs and other documentation for popular funds are updated many times during a year. For example this would include updating past performance figures, as well as reviewing that the contents (including investment objectives, investment policy and risks of investing in a fund) remain correct so retail investors can easily see whether or not a fund is suitable for their needs. The thematic report included examples for firms to consider on ways in which fund operators can provide clear information to retail investors e.g. the use of tables to enable easy comparison of risks in funds. It also provided examples of where fund operators are not meeting the KIID rules e.g. where funds strategy is to track an index.

The report asked distributor firms to ensure they are providing the correct information to investors (e.g. most up to date KIID), as this is a requirement of the rules there is no additional cost to the industry.

The purpose of the KIID rules is to ensure that retail investors are provided relevant information in an organised and logical way and that the language is appropriate for retail investors. It also specifies the contents on investment objectives and policy. Because of this purpose and the requirement for frequent reviews our thematic report aids the on-going work of firms to understand how they can provide clear and relevant information. Although we recognise that there will be additional costs for fund operators to consider the report and identify whether their fund documentation is clear fair and not misleading as well as considering whether it complies with the rules.

Firms were most interested to know if their practices were as good as or better than their immediate peers and this was addressed in a generalised manner via our private and public feedback.

Which type of business will be affected? How many are estimated to be affected?

Estimated numbers are:

- 200 Fund operators covering 3500 UK domiciled authorised funds.
- 5500-6000 distributor firms and platforms would also need to be familiar with the report but as we point above they already have to provide an up-to-date KIID, which is an existing rule.

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2016	2016	10	-0	0	0

Please set out the impact to business clearly with a breakdown of costs and benefits

1. Capital resource requirements for non-bank depositaries

In the CBA to CP 15/27, we have assessed the impacts of the proposed capital requirements and conclude that it's likely to be negligible. Firms are already subjects to the £4 million minimum own funds requirements that we propose to retain. It could impact incoming EEA depositaries which will have to apply for top-up permission, but we would expect these firms to already hold capital in excess of £4 million.

2. Changes to reporting requirements for AFMs and depositaries

We expect the proposed adoption of a standard Derivative Use Report reporting requirement to have limited impact on firms in terms of costs. We are not proposing to require Authorised Fund Managers of UCITS to gather or report new information, but are introducing a standard tool so they can report the information already required under COLL 6.12.3R (derived from the UCITS Directive).

We have estimated the costs for depositaries to vary between £5,000 and £10,000 per annum, with a total cost for the whole UK depositary industry to vary between £55,000 and £110,000 per annum. These costs take into account only the additional staff time required to fill in and submit the reports, as depositaries will not be asked to produce or collect information that they should not already have. We provide a point estimate to the ongoing costs by rounding this range to £100,000 per annum for the whole industry.

Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.

AFM: Authorised Fund Manager
AIFMD: Alternative Investment Fund Managers Directive
COLL: FCA Handbook on Collective Investment Schemes
EEA: European Economic Area

IPRU (INV): Interim Prudential sourcebook for Investment Businesses
MiFID: Markets in Financial Instruments Directive
UCITS Directive: Undertakings in Collective Investment Schemes Directive